

Weekly Commentary August 24, 2009

The Markets

An extremely weak real estate market helped lead us into this financial crisis. Could a strong real estate market help lead us out? Some say possibly.

Existing home sales rose a stunning 7.2% in July and July marked the first time in five years that existing home sales rose for four consecutive months, according to the National Association of Realtors. An influx of first-time homebuyers taking advantage of the government's housing tax credit coupled with improved housing affordability – due to lower home prices – helped drive demand.

While the top line sales number looked good, there were some significant chinks under the armor. Approximately 31% of the sales in July were considered “distressed” sales. And, in what could be a sign of more trouble down the road, MarketWatch reported that the Mortgage Bankers Association released a survey showing the percentage of residential mortgages either in foreclosure or with at least one payment past due rose to 13.16% in the second quarter – a record high percentage.

Despite the mixed real estate news, the market viewed it as positive and a strong rally last Friday sent the S&P 500 index to a new 2009 high. If the real estate market continues to improve and home prices start to rise, that could help support a healthier stock market down the road.

In my opinion, what's happening is the “run up”. At the beginning of a big inflation, it feels good to everyone. Everything starts going up – stocks, real estate, agriculture, metals, etc. People then will begin to believe the government's inflation was the correct answer to all of the problems. Their thought is “Just print more money – that way nothing bad has to happen”.

Of course, the good times don't last. The purchasing power of the currency goes down, potentially even collapsing. But at the beginning... everything soars. I think there is significant probability that we are in the start of that period now. The “run up” will feel great. But purchasing power has a significant risk of falling dramatically over the next two to three years. Favor investments that are backed by hard assets (good inflation hedges), provide steady income, and/or that are linked to the positive growth of the stock market, but include some mechanism to protect you from the downside.

Data as of 8/21/09	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	2.2%	13.6%	-20.6%	-7.5%	-1.3%	-2.8%
DJ Global ex US (Foreign Stocks)	0.5	27.3	-15.8	-5.6	5.0	1.3
10-year Treasury Note (Yield Only)	3.6	N/A	3.8	4.8	4.3	5.9
Gold (per ounce)	-0.1	9.5	14.3	15.1	18.3	14.0
DJ-UBS Commodity Index	0.1	8.8	-35.7	-9.4	-2.9	3.8
DJ Equity All REIT TR Index	1.3	9.1	-30.4	-13.1	0.6	8.5

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not available.

HERE'S A TRIVIA QUESTION FOR YOU: How many bull markets has the United States experienced since 1927? We define a bull market as a rally of at least 20% that was preceded by a decline of at least 20%.

The answer is 26, according to Bespoke Investment Group. Interestingly, 10 of those bull markets occurred during the decade of the 1930s. Overall, the stock market was horrible during the 1930s as the S&P 500 index had a total return of 0.0% for that depressing 10-year stretch, according to Vanguard. Doesn't it seem a bit odd that a decade could have 10 bull markets yet still end the period with absolutely zero return?

The reason for this oddity is that some of the best bull markets happen within the context of a long secular bear market. These "snapback" rallies may be powerful and alluring. They may lull unsuspecting investors into thinking that all is well. But, just when the majority is breathing a sigh of relief, the market may do what it does best – drop anew and confuse all but the sharpest investors.

Could the current rally simply be one of those snapback rallies that ensnare unsuspecting investors?

Bears point out that between the September 1929 bull market high and the mid-1932 bear market low, there were four bull markets – one of which was a 46% rally that lasted 148 days. Yet, during that nearly three-year period, the stock market still lost more than 80% of its value. The bears say the current rally is a snapback rally that will give way to further declines down the road.

Bulls, by contrast, say the current rally, which has driven the S&P 500 up 52% since its March 9 low, is so strong that it heralds a new bull market as opposed to just being a bear market rally. Supporting their claim is recent data that suggests the economy is finally starting to stabilize.

So, who's right? The bulls or the bears?

Ironically, they both could be right. By definition, we're clearly in a bull market. However, that does not preclude another drop of 20%, which would signal a new bear market. This 20% drop could happen in the next 90 days or it might not happen for two or three years. Like all investors, we have no way of knowing with precision when the next 20% drop will happen. Instead, we take the news as it happens and do our best to adjust accordingly to help meet your goals and objectives.

Weekly Focus – Think About It

“Learn every day, but especially from the experiences of others. It's cheaper!”
-- John Bogle

Best regards,

Tony Hartman

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this e-mail with their e-mail address and we will ask for their permission to be added.

- * The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.
- * The DJ Global ex US is an unmanaged group of non-U.S. securities designed to reflect the performance of the global equity securities that have readily available prices.
- * The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.
- * Gold represents the London afternoon gold price fix as reported by the London Bullion Market Association.
- * The DJ Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998.
- * The DJ Equity All REIT TR Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.
- * Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
- * Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.
- * Past performance does not guarantee future results.
- * You cannot invest directly in an index.
- * Consult your financial professional before making any investment decision.
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