April 20, 2009

First Quarter Market Summary – Dr. Ray Hofshi

During the first quarter of 2009, the US stock market made a major reversal. The market decline intensified during January and February, removing roughly an additional 30 percentage points of value from the major indices. Then it came roaring back in March, recouping about 20 percentage points of the previous losses. The end result was an 11 percent decline for the entire first quarter as measured by the S&P 500 index with dividends, but it is no longer clear that the market trend is down.

The major move upward in March was a reasonable response to a grossly oversold market: but I think that it may have been more than that. First of all, a general consensus seems to have developed that the likelihood of a depression is extremely low. Secondly, there are numerous scattered signs that the worst part of the economic decline appears behind us. While this recession is by no means over, the rates of decline in various economic measures appear to be slowing. One very important economic measure, housing sales, has actually improved over the last couple of months. It should be noted, however, that housing prices are still declining.

The Obama administration has moved rapidly, and I think competently, to re-liquefy the financial markets and hopefully restructure the US auto industry. Very large amounts of money have been committed to making the US government the spender of last resort. This spending, much of which may have yet to be reflected in the economy, should help to moderate the severity of this recession. Of course, in future years, we will have to pay for this spending spree by having tighter budgets and/or higher taxes. But for now, we first need to climb out of this negative spiral.

Our strategy during this market decline has been to preserve/enhance our cash position. In the first quarter, additional cash was raised by selling some covered calls. The time is near when we must gradually invest this cash into equities with significant long term potential. Our average cash position at the end of the first quarter increased to 17 percent.

TIMING MODEL

The Timing Model continued to improve in the first quarter. It moved to a slightly bullish reading of 55%. Thus, it predicts a 55% chance of market appreciation and a 45% chance of a market decline over the next 3 – 6 months.

ECONOMIC OUTLOOK

As I have written in recent quarterly reports, I believe the foundation for a recovery has already been put in place. Those things that are self correcting, in a capitalistic economy, have apparently corrected. The prices of essentially all commodities, especially oil, have declined appreciably, and now appear conducive to growth.

Those areas in our economy that are not self correcting have had very large government intervention. Short term interest rates have been brought close to zero, and thirty year mortgages have been forced below five percent. Large infusions of funds have been provided to the major banks, so that they can continue to "grease the economy". The new federal budget includes very large expenditures (with very large deficits) in order to minimize job losses.

The last ingredient for an economic recovery is time. It takes time for the economy to heal, and reverse its course. As I mentioned earlier, there are scattered indications that the worst part of the decline is behind us. Some economic measures such as housing sales, car sales, durable goods orders, and retail sales, have begun to improve on a month over month basis. Investor psychology is beginning to become more positive. We will soon be in investment mode again.

Sincerely yours,

Ray Hofshi

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