

## I Should Have!

"Oscar Wilde said he could resist anything but temptation. But doing something you know you shouldn't is easier if you can convince yourself that this will be the last time you indulge, that you won't do it again. So we convince ourselves that since we'll be strong in the future, we can still indulge today. Whether it's smoking, eating too much or going to the pub instead of the gym, we delude ourselves into thinking that we will take the more difficult path *next time*. A few years ago, two economists actually looked at the issue using gym membership data. They found that in a club in which non-members could pay a no-strings fee of \$10 per visit, people preferred to pay the \$70 per month for unlimited access. And since members only attended 4.3 times a month on average, they ended up paying an average \$17 per visit. The authors concluded this to be clear evidence of 'overconfidence about future self control.' Investors understand the affliction all too well: a stock trades at \$10 and we tell ourselves that we're buyers at \$8. But how many of us buy when it gets to \$8? Some of us do, but most of us don't. Most of us (I can't be the only one!) convince ourselves that it's going lower still: 'I'll buy at \$7' becomes 'I'll buy at \$6' and by the time it's back at \$8 we're 'waiting for a pullback.' Each investor has their own way of circumventing this problem. But at root, such poor decision-making is a consequence of our fundamental underestimation today of the discipline and even courage we will require in the future."

... Dylan Grice, *Société Générale*

"I should have bought Walter Energy (WLT/\$79.70/Outperform) at \$67, or North American Energy Partners (NOA/\$10.03/Strong Buy) at \$8, or (insert the stock of your choice), a week or so ago" . . . was the cry on the Street of Dreams last week as the "selling stampede" seems to have bottomed in the typical 17- to 25-session timeframe. Indeed, the climatic action of February 4th and 5th, whereby the DJIA lost 268 points on the 4th followed by another Dow Dive early the next day that reversed to upside leaving the senior index up 10 points, appears to have been the "low" we have been anticipating. That sense was reinforced last Tuesday when the NYSE experienced a 90% Upside Day, meaning that over 90% of the volume came on the upside with an attendant 170-point Dow Wow. It was the first 90% Upside Day since November 9, 2009 and was accompanied by a breadth reading of 5 advancing stocks for every 1 declining issue. The result elicited a strong expansion in Lowry's "Buying Power Index" (read: demand) with an even more pronounced contraction in their "Selling Pressure Indicator" (read: supply). Moreover, the DJIA has now strung together more than three consecutive sessions on the upside, which also suggests that the "selling stampede" is over. Recall that stampedes tend to last 17 to 25 sessions, with only one- to three-session counter-trend attempts before exhausting themselves, and Tuesday was session 19 in the downside skein. Accordingly, the four-day positive "pop" should be viewed as a reversal of the nearly four-week "wilt."

Setting the stage for the stock market's reversal has been relatively constructive economic data implying that the first revisions of 4Q09 GDP (due 2/26) are unlikely to be major, a Greek Gotcha that appears to be on simmer, a Chinese New Year that has closed their financial markets, also putting on simmer near-term worries of further monetary tightening, and a host of other Street-friendly figures. Meanwhile, momentum traders, speculators, and model-driven players have been buying U.S. dollars, which suggests another change in the trend since stocks rallied right in the face of a stronger dollar. Even more surprising was crude oil's spurt, as well as gold's weekly climb, given the "buck's bounce." Indeed, counter intuitive as it seems given the greenback's strength, the strongest sector last week was Basic Materials, which gained an eye-popping 5.02%.

Also of interest, at least to us since we are "long," is that Japan's economy expanded at a faster than expected 1.1% in 4Q09. Despite all of the negative nabobs, we continue to like Japan for a multiplicity of reasons. Apparently, so does Byron Wien, vice chairman of Blackrock Advisory Services and former chief market strategist of Pequot Capital and Morgan Stanley. According to Byron, "Japanese stocks will be the best investment among the world's biggest markets." He goes on to note, "Everybody who could sell Japan has sold Japan. Everyone is on one side of the boat. My view is that we have a pretty good chance of having this one be the best of the major industrial markets. It's not a boom, but things are getting better." Obviously we agree and have been recommending tranching into the Japan Equity Fund (JEQ/\$5.33) and Japan Smaller Capitalization Fund (JOF/\$7.78). As the savvy folks at the GaveKal organization opine, if China can change its business model from one of "labor productivity" to one of "capital

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productivity" (to gain more efficiencies on capital), it is hugely bullish for Japan because Japan does more business with China than it does with the United States.

Since world currencies, and sovereign defaults, worries are swirling around the world's financial markets, we thought we would conclude this morning's missive with an excerpt from John Mauldin's always insightful market strategy letter, especial since he and Kerri spent the weekend with us. The excerpt begins with an exchange between two other market mavens, namely David Kotok and Dennis Gartman. To wit:

*Dennis,*

*Most of the time you and I are simpatico in view. But this time we are on totally opposite sides. You predict the EUR is toast. I think it emerges from this stronger than ever and that the weaker system is now the deficit-ridden US. I have organized and chaired conferences and seminars in Europe for the last decade as program chair of the GIC. The next one is in June in Paris and Prague, to which I am inviting you with this email. In the course of this decade those meetings have ranged in location from south (Italy) to Baltic (Estonia) to west (Ireland). All of these meetings were multinational. None of them had language or cultural barriers. All of these various hosts were gracious and hospitable and welcoming. All of them had goodwill among nationals of the various European countries. None of them had internal antagonism. Come with me in June and see this with your own eyes. Europe wants a hard currency and better economics and knows how to get it. The Greeks will end up better off and the politics will force it. I am a euro bull. All the best. By the way, I still want you to come fishing with me.*

*David [Kotok]*

Dennis answered:

*David,*

*I'm writing from Calgary this morning. Nice town, and not all that cold. Nice people out here in Canada's west. I always feel better about the world when I get to the Canadian west. We do indeed disagree on the EUR, David, and I hope you are right, but I fear you are wrong. These cultural differences are simply too great to be overcome. I have always been a EUR skeptic, and have been surprised that the whole experiment has lasted this long, but the Germans are not going to allow any of their money to be shipped to Athens to defend Greeks who have no pride in their own country [and are] tax-paying scofflaws. The Germans felt put-upon by the rest of Europe when they paid for the cost of reunification entirely, and they have no intention of now paying for Greeks who thumb their noses at law and fiscal responsibility. Right now, the market's sayin' I'm right, and for now I'm going to press the issue until the market tells me I'm wrong, David. It's all I know to do. Expecting Papandreaou to change his fiscal spots is simply not wise. He has been a profligate all his life; so too his father. It is genetic and it ain't gonna change. Be well, my friend. We can disagree and still be impressed by one another's work. I know I am.*

*Dennis Gartman*

John Mauldin concludes:

"Who's right? In an odd way, both of them. Let's look at what I think is the difference between my two friends. If you read European papers and briefings by serious economists and euro politicians, the idea of the euro zone breaking up is simply unthinkable to them. So much time and effort was put into creating the euro to begin with that there is a lot of vested interest in keeping it. (And by the way, let me be clear that the world is better off with a viable euro.) When David goes to Europe, as he often does, he meets with the top tier of business, investment banking, and central banking circles. And they assure him they will figure this out. These are the thought leaders who brought the euro together in the first place. Dennis listens to the trading floors and people in the streets. He was a man born in the trading pits. He rightly looks at the politics of Greece and Germany and says that is a "dog that won't hunt." In the short term, a Greek default will put significant pressure on the European banking system and through that the euro. But it is not the end of the world for the euro. Ultimately, in the grand scheme of things, the value of the euro, within limits, is not significant. If it falls to dollar parity there are winners and losers, of course. European exporters will be delighted. So will be their farmers. If you are a consumer buying goods outside the euro zone, you will not be as happy. But the valuation of the euro is not in and of itself a reason for the euro to disappear. At one time it was \$0.82. Then over \$1.60. All currencies fluctuate, some more than others. What destroys them is political malfeasance. What would put the euro at risk of a bad political decision? A Greek bailout without serious conditions would be the one thing that could be

a very bad start to a downward spiral. If Greece is bailed out, then why not Portugal or Spain or Ireland? What about the emergency room crisis that is Austrian banks?

The line has to be drawn, and it has to be a hard line. And basically, what David is saying is that the serious leaders with whom he is in contact get it. But it is not certain how things will play out. Will Greek politicians and unions blink when faced with reality? Polls show that a majority of Greeks now favor making serious budget cuts. And the reality is that they will lose access to the credit markets if they do not make major spending cuts and get some kind of pan-European guarantee for their new debt. Losing access to the credit markets will mean even more (and immediate!) drastic cuts. The real choice for the Greeks is whether to stay in the monetary union. Of course, leaving and defaulting on their debt also cuts them off from the credit markets. It is a sad reality they face."

Well said John!

**The call for this week:** John Mauldin and I discussed the "state of the state" as we cruised around the Gulf of Mexico in my boat yesterday while wearing our Minyanville hats. John is more worried about deflation, while I remain worried about inflation. This morning, however, the equity markets don't seem to be worried about either as gold, and crude oil, are relatively flat and the pre-opening S&P 500 futures are better by some 4 points. We think the trading lows are "in" and have tilted accounts accordingly.

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