

"Rough Riders"

"It is not the critic who counts; not the man who points out how the strong man stumbles, or where the doer of deeds could have done them better. The credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood; who strives valiantly; who errs, who comes short again and again, because there is no effort without error and shortcoming; but who does actually strive to do the deeds; who knows great enthusiasms, the great devotions; who spends himself in a worthy cause; who at the best knows in the end the triumph of high achievement, and who at the worst, if he fails, at least fails while daring greatly, so that his place shall never be with those cold and timid souls who neither know victory nor defeat."

. . . Teddy Roosevelt; Colonel of the Rough Riders at San Juan Hill

Clearly it has been a "rough ride" for the equity markets since their parabolic peak of April 26th, which saw the S&P 500 (SPX/1135.68) tag an intra-day high of nearly 1220 and then experience an eye-popping eight-session, 12.6% decline into its May 6th intra-day "crashette low" of ~1066. While I turned too soon'ly cautious at the end of March, participants should still have been prepared for the cantankerous correction and subsequently positioned their accounts accordingly. Comes the May 6th mauling, I recommended "lifting" most of the downside portfolio hedges, as well as my "bets" on increased volatility (as recommended in these reports), since that Thursday tumble sure looks like a "selling climax" to me. Subsequently, the equity markets have behaved much as forecast.

Market observers should recall that after a selling climax what typically happens is a one- to three-session throwback rally followed by a downside retest attempt of those "lows." Sometimes said "lows" are marginally broken, but most of the time they are not. As Jason Goepfert, of the brilliant website "SentimenTrader.com," notes (as paraphrased by me):

On Friday (May 7th) the ratio-adjusted McClellan Oscillator dipped to an historic reading of -120, the second-most oversold in more than 20 years. Let's go back to 1940 and look for any other time the Oscillator hit this level of oversold while in a bull market (defined as a rising 200-day moving average on the S&P 500) and see how the S&P performed going forward.

Jason then presents a table of the other five instances (since 1940) when the Oscillator has registered such oversold readings. One week later the S&P was, on average, 1.9% lower; one month later it was only 0.5% lower. Three months later, however, it was, on average, 4.2% higher; six months later its average gain was 6.9%. Additionally, Jason shows that the bottoming process took anywhere from 13 sessions to a maximum of 40 sessions, with the average being 24 sessions. If that sounds familiar, it should, for while I don't have the empirical data Jason does, that is pretty much the sequence I laid out following the recent crashette. And almost on cue, the equity markets have "danced" to that "tune." Verily, after the previous Friday's stabilization, last Monday saw the perfunctory throwback rally (DJIA +405), which didn't really extend as late week participants' anxieties drove stocks lower on the rumor *du jour*.

As usual, my phone lit up with media-centric questions as to which rumors were responsible for Friday's Fade. The first rumor suggested France's sovereign debt rating was going to be downgraded over the weekend. Why anyone would think the analyst purporting that view had any insight into the situation is beyond me, so I deemed that one to be fallacious. The second rumor also didn't ring true in that I seriously doubt if Germany, which is clearly upset by France's prodding to backstop the Grecian bailout, was actually going to renounce the euro and switch back to the D-mark. The third rumor was even more preposterous. To wit, as scribed in the *EU Times*:

"A grim report circulating in the Kremlin today written by Russia's Northern Fleet is reporting that the United States has ordered a complete media blackout over North Korea's torpedoing of the giant Deepwater Horizon oil platform owned by the World's largest offshore drilling contractor Transocean that was built and financed by South Korea's Hyundai Heavy Industries Co. Ltd., that has caused great loss of life, untold billions in economic damage to the South Korean economy, and an environmental catastrophe to the United States. Most important to understand about this latest attack by North Korea against its South Korean enemy is that under the existing 'laws of war' it was a permissible action as they remain in a state of war against each other due to South Korea's refusal to sign the 1953 Armistice ending the Korean War."

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Obviously, I didn't believe any of those rumors, preferring to think all the "noise" was/is simply part of the bottoming process that began with the May 6th mini-crash. This is why I have been advising participants to ready their "buy lists" and look to accumulate favored stocks/funds during the market's convalescing period, which (as stated) could take anywhere from two to eight weeks. To that point, in last Friday's verbal strategy comments I suggested a number of investment vehicles for your consideration. On that list was everything from my favorite international mutual fund, MFS International Diversification Fund (MDIDX/\$11.21), to the recent addition to our Focus List, namely 7%-yielding Enterprise Partners (EPD/\$34.15/Strong Buy). I also mentioned a number of favored countries, such as Japan and Vietnam, along with investment vehicles that play to those countries. One country I failed to address, however, was my longstanding "love affair" with Brazil.

While it is true I have been somewhat cautious this year on emerging and frontier countries in the short-term, my longer-term favorable investment stance on them has not wavered since embracing the theme in 4Q01. Moreover, Brazil is unique. As well-known British investor Jim Slater says, "Brazil is insulated against the world's main shortages – fresh water, agricultural commodities, and energy." This is not an unimportant point given my views on water, agriculture, and energy over the next 20 years. Additionally, Brazil has been dubbed "the Saudi Arabia of ethanol" since it can produce vast amounts of alcohol fuel from sugarcane at prices competitive with petrol. Finally, Brazil's government has implemented policies that have fostered a flourishing middle class, which should have extremely positive ramifications for Brazil's infrastructure business (agribusiness, energy, steel, transportation, utilities, etc.). While there are a number of "static funds" for investing in Brazil, most of those funds have VERY large weightings in just two Brazil-centric companies. Another, more actively managed way to invest in Brazil's future (for your consideration), is the newly created Dreyfus Brazil Equity Fund (DBZAX/\$12.44), managed by BNY Mellon. And for more stock-specific investors, I suggest reading our Latin American analyst's (Ricardo Cavanagh) recent report on 7%-yielding CPFL Energia (CPL/\$61.33/Outperform), which is Brazil's largest utility company.

The call for this week: Last week the S&P 500 snapped a two-week losing streak, yet failed to travel above its 50-day moving average (at 1175). That was in keeping with my sense the throwback rally would not exceed 1185 and the convalescing period would take weeks, not days. Indeed, market historians should recall that after a selling climax what typically happens is a one- to three-session throwback rally followed by a downside retest attempt of those "lows." Sometimes the "lows" are marginally broken, but most of the time they are not. I continue to invest accordingly.

P.S. – "The things that will destroy America are prosperity-at-any-price, peace-at-any-price, safety-first instead of duty-first, the love of soft living, and the get-rich-quick theory of life" . . . Teddy Roosevelt.

Additional public companies mentioned in this document.

Company Name	Ticker	Exchange	Recent Closing Price	RJ Rating (if Applicable)	RJ Rating Organization
Transocean	RIG	NYSE	66.32	1	RJ & Associates

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