CLEARVIEW
INVESTMENT PARTNERS

250 Newport Center Dr. Newport Beach, CA 92660 (877) 762-6208 www.cviewip.com September 22, 2010

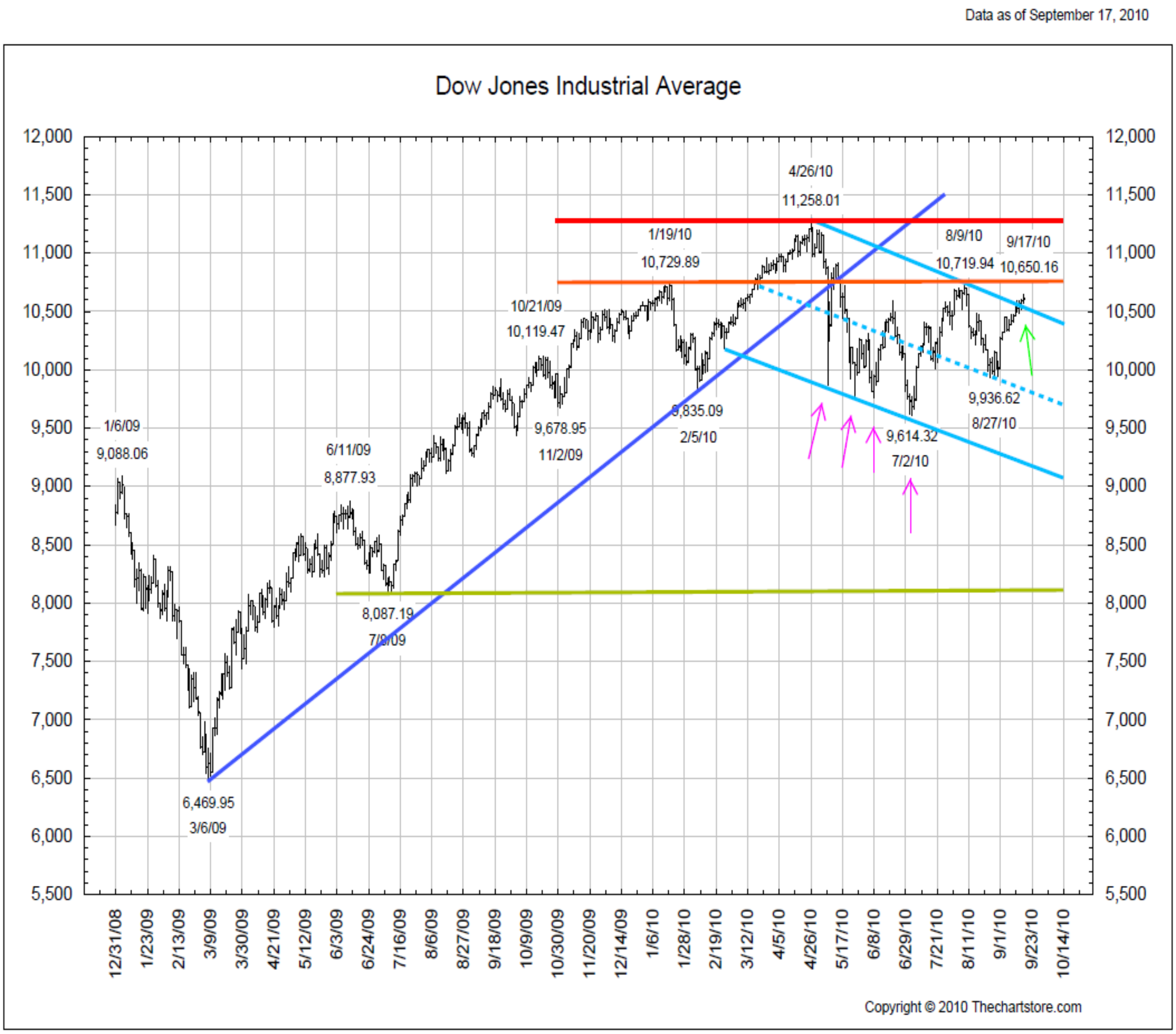
Tech Spotlight

John Maynard Keynes, a well-known British economist (1883-1946), once said that “The markets can stay irrational longer than you can stay solvent.” There are times when I think the word “patient” can be substituted for the word “solvent” in this quote. With proper risk management, and I don’t mean implementing a simple “buy and hold” strategy, we can use asset allocation, diversification and hedging strategies to help protect us from market fluctuations that can tear into a simple “buy and hold” strategy. The markets, though, do seem to try the limits of our patience when it comes to confirming a trend or a change in trend. The current environment is such a time for our patience to be tested. There are some indicators (a small few) and a number of talking heads in the media that would seem to indicate/say that the economy and the markets are on the mend and better times are in front of us (even the National Board of Economic Research came out Sunday afternoon and officially confirmed the “Great Recession” ended in May 2009). And then there are a number of indicators that would seem to say that, at best, we are going to muddle through for the next few years before better times are here again.

This month we’ll take another look at charts of the Dow Jones 30 (DJIA) and S&P 500 (SPX) stock market indices, the 10-Year U.S. Treasury Bond Yield and charts of several economic statistics to see what they may be saying about the economy and the future trends in the various markets.

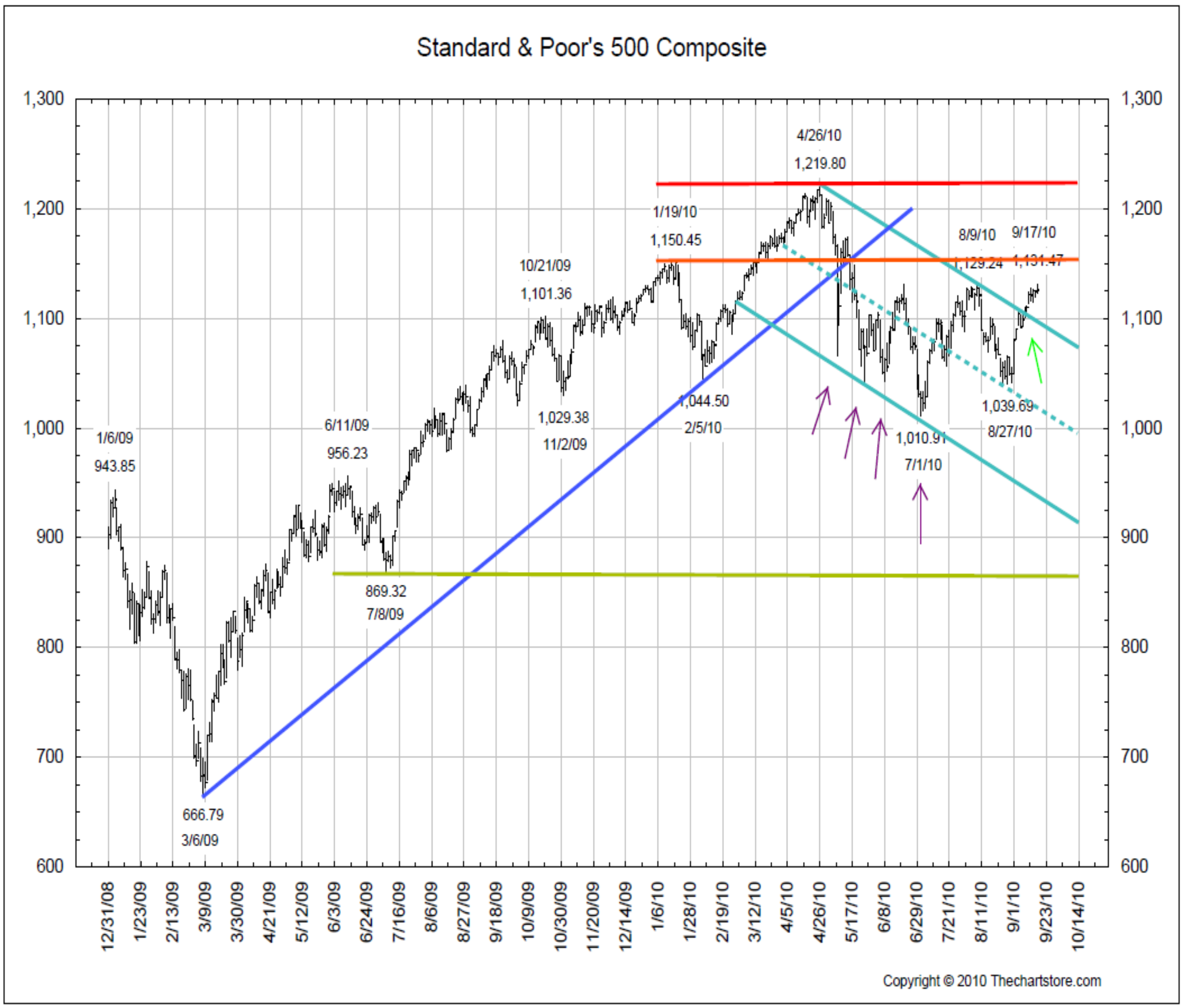
When it comes to the DJIA, as well as the SPX, we are seeing the same “pattern” that we have been watching for the past seven months. Four months ago, coincident with the May “flash crash”, both indices broke uptrend lines that began at the March 2009 market bottom (dark blue lines in the following two charts). Since then, each has rallied three times with each rally being accompanied by lower volume than the one before it. As mentioned in last month’s Tech Spotlight, sell-offs on higher volume and rallies on low volume are a classic bearish sign. So, it would appear that the overall market rally since March 2009 is running out of steam. But it may have a bit to go, as both the DJIA and SPX indices (as well as a number of other market indices) have just now broken above their short-term downtrend lines drawn from their April 2010 market peaks (upper light blue downtrend line on the following two charts).

DJIA and SPX – Intermediate-Term Charts



While I still believe that April 26th was at least an intermediate-term market top for most all stock market indices, the markets continue, for the fourth time since the year began, to slowly grind their way upward. With the break of the downtrend line shown above at the green arrow (and below for the SPX) we now must ask how far the indices may rise before really running out of steam, if they do. In the case of the DJIA and SPX, we could see these indices rise to 10730 for the DJIA and 1150 for the SPX (the horizontal orange resistance lines). If the markets continue their upward march, then the old April 26th highs (Dow 11258 and SPX 1220 – the red resistance lines) come into play. And if these levels are broken, then there should be some very heavy follow through on the upside. If these two resistance levels hold, however, then we are once again looking at a test of the July 2009 intermediate-term market bottoms (horizontal olive green lines).

Data as of September 17, 2010

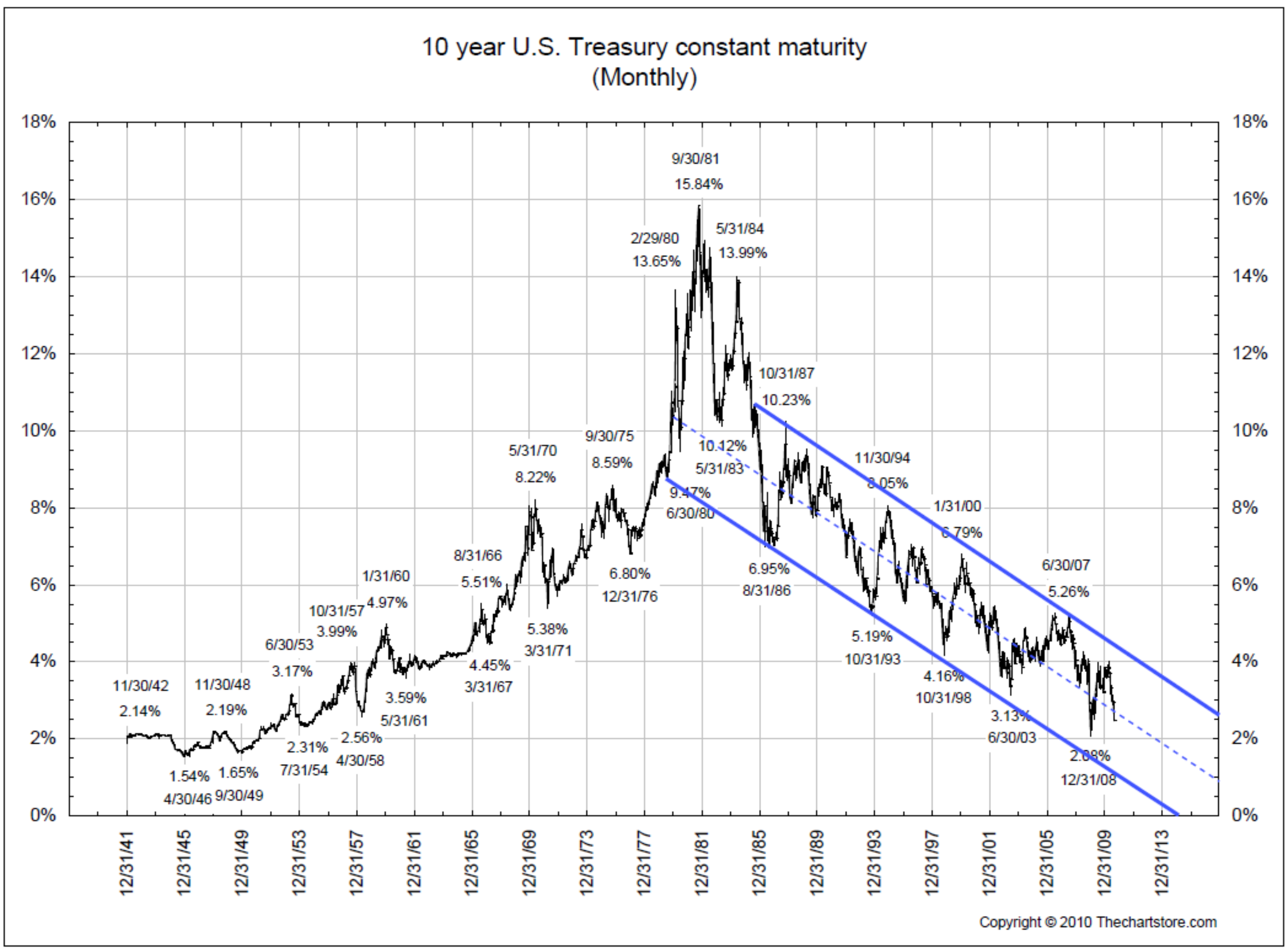


CLEARVIEW INVESTMENT PARTNERS

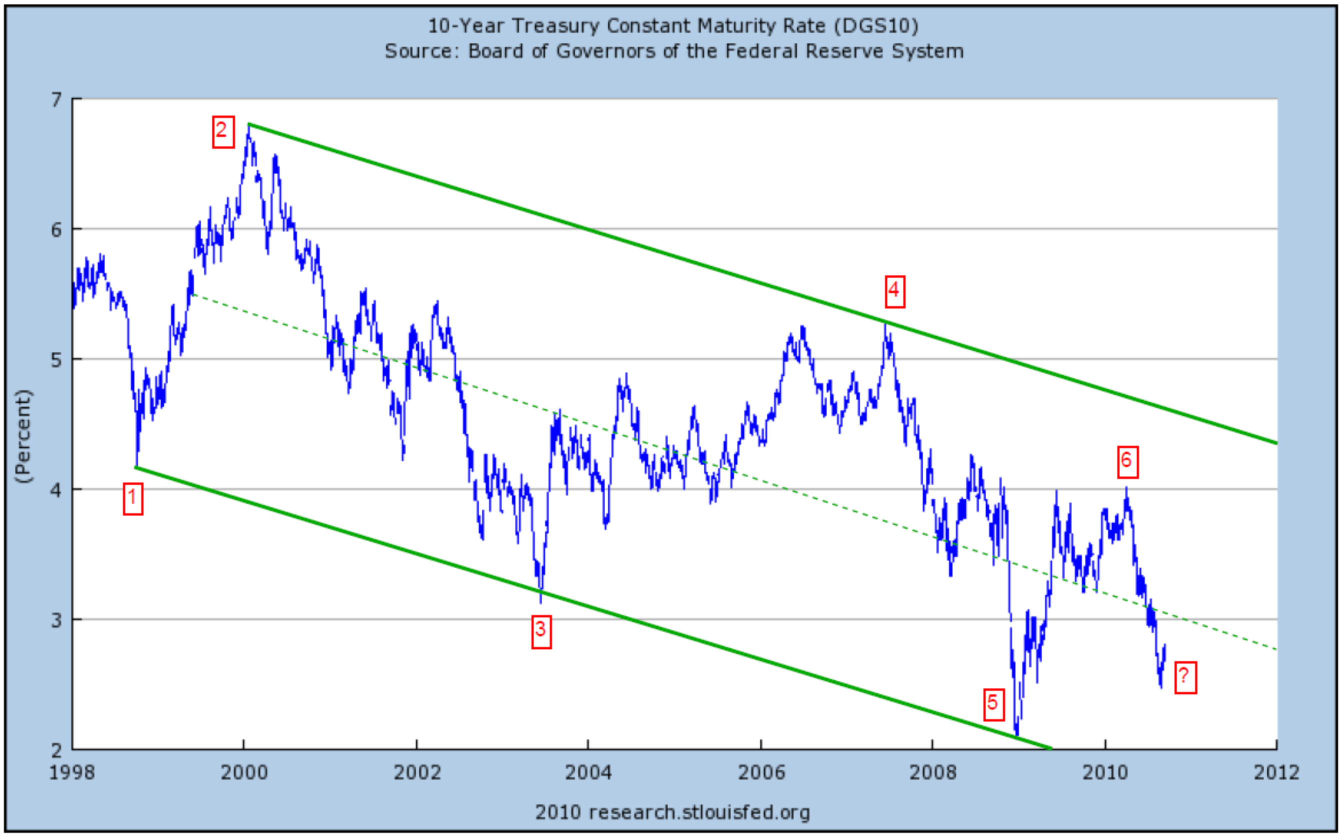
10-Year U.S. Treasury Bond Yield Long-Term and Intermediate –Term Charts

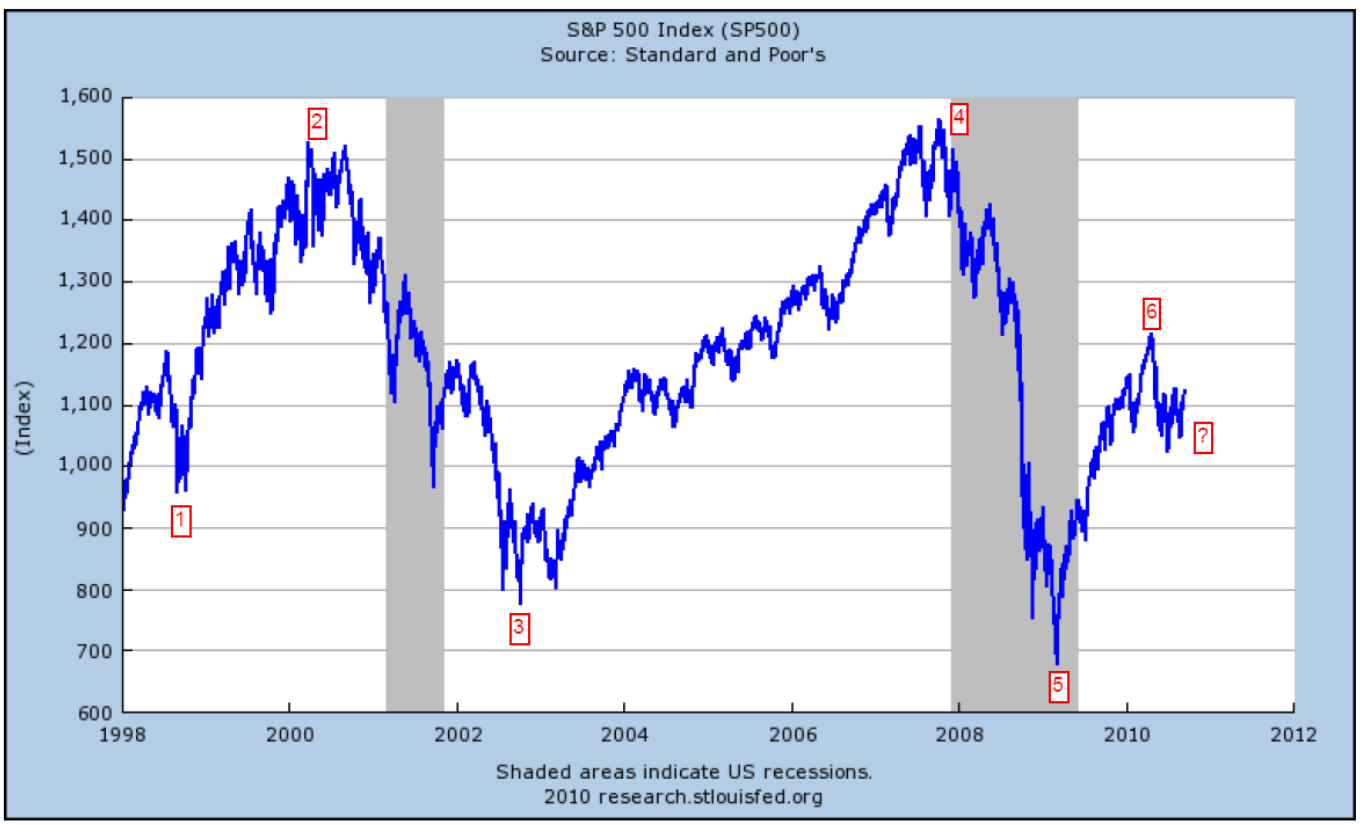
Below is a long-term chart of the 10-Year U.S. Treasury Bond (T-Bond) Yield. I have shown this a few times already this year, and its story has not changed. If the long-term trend in rates continues (the two solid dark blue lines in the chart below) we would expect to see rates slowly but surely make their way on down to the 1-2% range, rates which this country has not seen since the 1940's and early 1950's. The direction of this trend, if it continues, is a cause for concern. Generally speaking, in rising stock markets, we have seen money leave the T-Bond market in search of a higher return on invested monies in the stock or other kinds of bond markets. Likewise, when the stock market declines, we see money flowing out of the stock market and into the T-Bond market (thinking safety of principal) which causes a rise in the price of bonds resulting in lower bond yields (just take whatever dollar amount in interest that a bond pays and divide it by the now higher bond price that you paid for the bond).

Data as of August 2010



Now, consider the following intermediate-term charts of the 10-Year U.S. T- Bond Yield and the SPX …


10-Year Treasury Constant Maturity Rate (DGS10)
Source: Board of Governors of the Federal Reserve System
(Percent)
7
6
5
4
3
2
1998
2000
2002
2004
2006
2008
2010
2012
1
2
3
4
5
6
?
2010 research.stlouisfed.org


S&P 500 Index (SP500)
Source: Standard and Poor's
(Index)
1,600
1,500
1,400
1,300
1,200
1,100
1,000
900
800
700
600
1998
2000
2002
2004
2006
2008
2010
2012
1
2
3
4
5
6
?
Shaded areas indicate US recessions.
2010 research.stlouisfed.org

The correlation between these two indices has been very close over the past 12 years in particular. Please don't focus on the magnitude of the index changes, but on the change in trend directions. Also understand that the following is somewhat of a simplification of what you see in the above two charts. While it appears that changes in trends take place at the same time, in actuality, the yields in U.S T-Bonds slightly lead the change in direction of stock prices.

From September 1998 into the first part of 2000, money left T-Bonds (and so yields rose) and flowed into the higher returning stock market (anyone forget the dot com bubble?). This is represented in the charts as the period showing from box 1 to box 2. As the stock market began its 2-3 year decline, money flowed out of the stock market and into U.S. T-Bonds for their perceived safety, driving up bond prices and in turn lowering yield percentages (boxes 2 to 3). Once the stock market bottomed in October 2002 and survived a serious test in March 2003, money flows changed direction and reverted from U.S. T-Bonds back into stocks (boxes 3 to 4 in the above two charts). Once the market peaked in October 2007 and began its one and a half year decline, money flowed out of stocks and back into U.S. T-Bonds (boxes 4 to 5). See how repetitive this technical analysis stuff can become? So, as we monotonously continue on, once the stock market bottomed in March of 2009, money reversed flow again and began leaving U.S. T-Bonds and headed back into stocks (boxes 5 to 6 in your 'program').

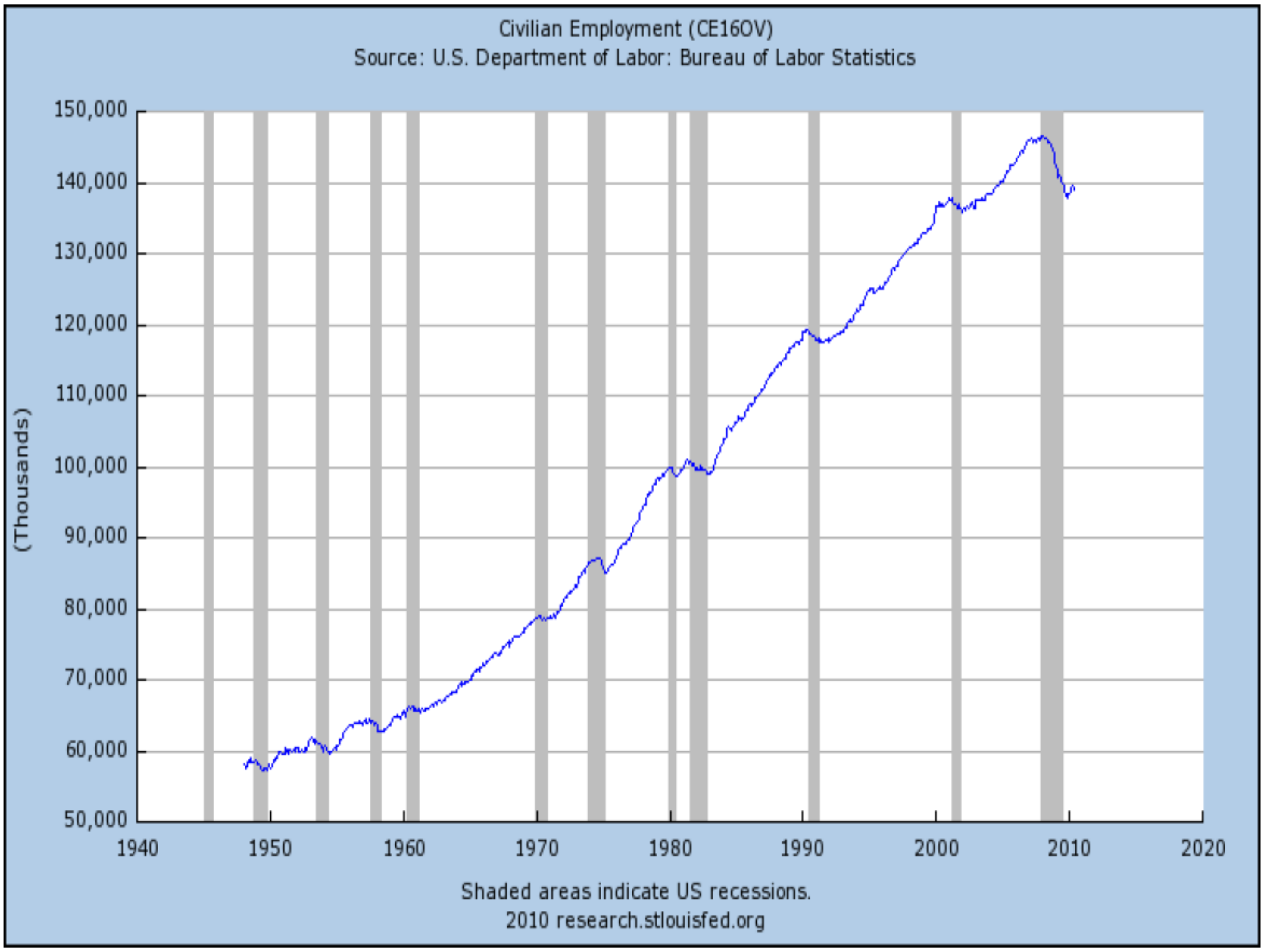
Now, after appearing to top out in April 2010, just ten days before the May 6 flash crash, money started to leave stocks and flow back into U.S. Treasury bonds (boxes 6 to ?). It would sure be nice if past patterns would continue without change, but, at about the time everyone thinks they have figured out the pattern, it can change (see John Maynard Keynes' quote at the beginning of this piece). In this case, it doesn't mean that the correlation has to change, but it could also mean that the duration of a trend or its volatility could change. It would appear, based on the continuing decline in U.S. T-Bond yields, that there is significant money still moving into U.S. Treasury Bonds, which is now in contrast to the upward movement in stock market prices as evidenced by the recent action in the SPX. Short-term fluctuations or divergences in the correlation between the SPX and the 10-Year U.S. T- Bond Yield do happen from time to time. But history shows that they often come back into a high correlation. The question now is, will yields in the 10-Year Treasury Bond reverse course and turn up to follow the stock market to higher levels or will the SPX turn lower and follow 10-Year T-Bond yields lower? Time will tell, and it shouldn't be too far off.

We are watching this relationship very closely to see how it resolves itself which in turn will determine the markets' movement in the months ahead.

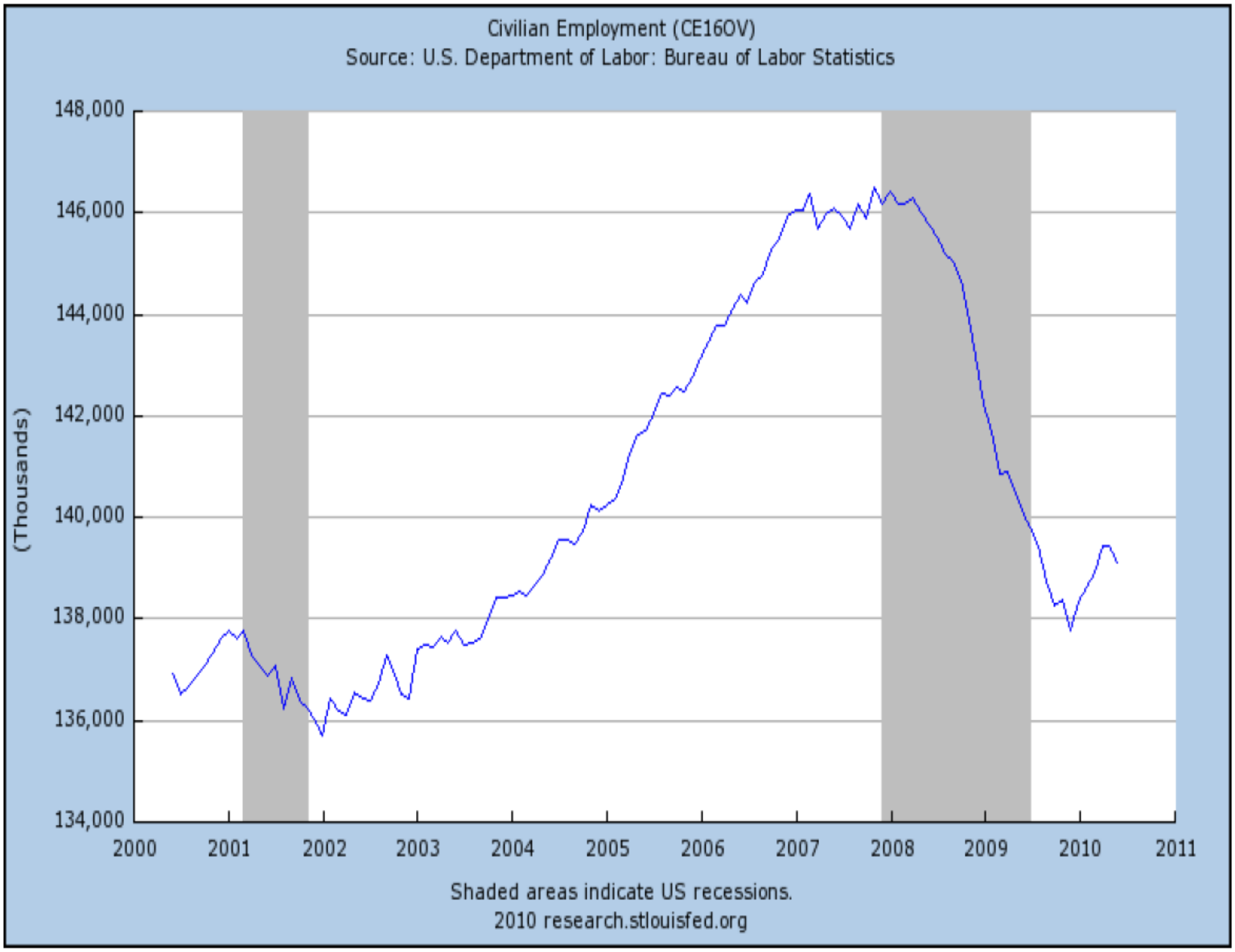
As mentioned in the first page, members of the National Bureau of Economic Research (NBER) got together over the weekend and concluded on Sunday that the "Great Recession" formally ended in June 2009. There are a number of statistics that they look at as part of a "black box" formula to determine when a recession begins and when it ends. Now, though the recession has been officially labeled as over, the stock market and bond markets are not acting as if that is the case and better times are upon us. So what indicators can we look at to help us see what is fundamentally happening in the economy? It would logically seem that a self-sustaining recovery would sustain itself through job growth, consumer credit growth and business investment (there are other factors, but these three are perhaps enough to look at for today's piece).

A higher than "normal" number of people remain unemployed based on the reports we receive from the Federal Government via the Bureau of Labor Statistics (BLS). The most recent report shows an official unemployment rate of 9.6% of the total labor force. But, did you know that the BLS has another unemployment number, referred to as U-6, that adds in two other important groups not included in the above-mentioned "official" unemployment rate? (Whose technical name is U-3.) These two groups include a) Marginally Attached Workers who are people that are not actively looking for work but who have indicated that they want a job and have looked for work (without success) sometime in the last 12 months but not in the last 30 days; and, b) those people who are looking for full-time work but have to settle on a part-time job due to economic reasons, which means they want full-time work but can't find it. These two groups are not counted as being part of the total labor force for purposes of calculating the U-3 unemployment rate by the BLS. This is why it can seem that more people are unemployed or underemployed than before yet the official unemployment rate does not rise. The U-6 unemployment rate for the month of August 2010 is 16.5%, which contrasts sharply with the official unemployment rate of 9.6%.

I won't even begin to get into the facts that the unemployment numbers are seasonally adjusted and that firm birth/death assumptions are used in the calculation of U-3, both of which can lead to an interpretive debate on what is really happening in the labor force. Better, I think, that we look at just the plain number of people who are working. This number is not as open to as much interpretation as the unemployment numbers. Consequently, please consider the chart below on U.S. civilian population employment:



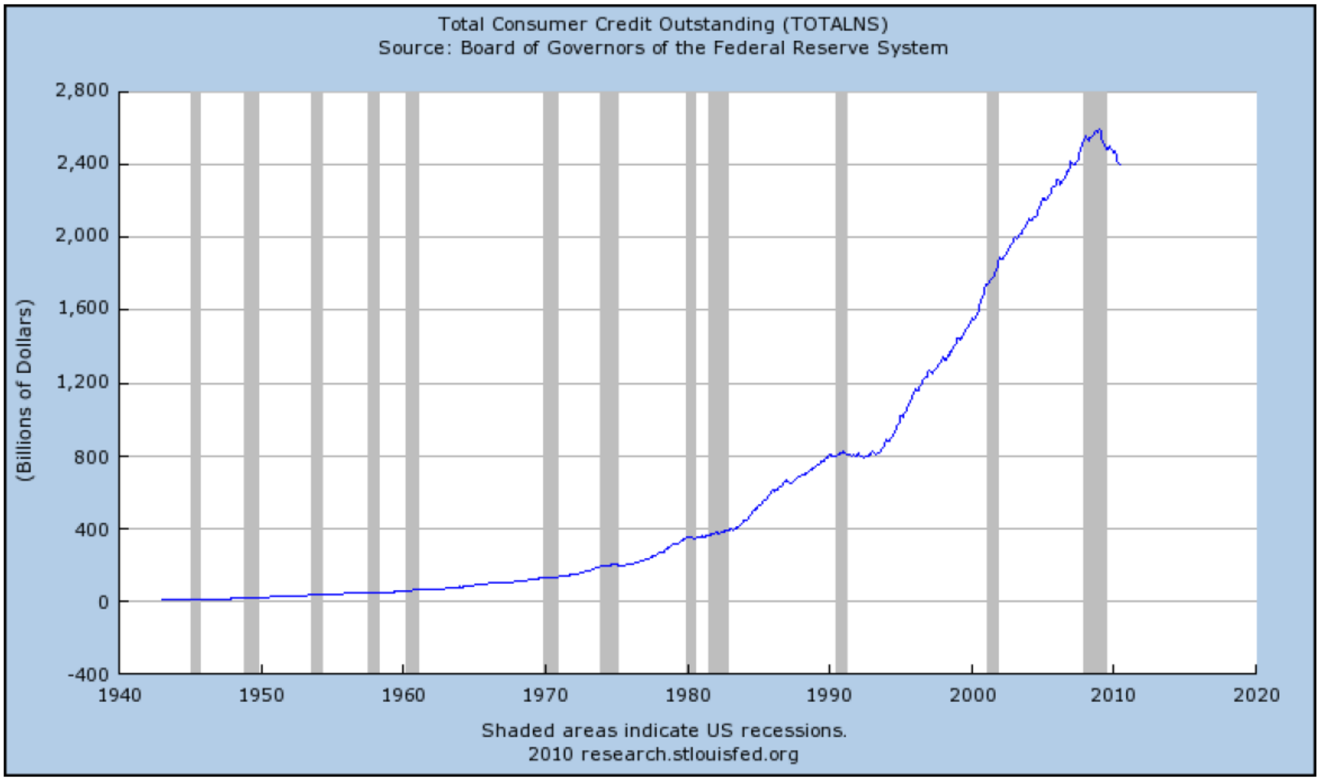
As you can see, there has been a fairly consistent rise in the number of people employed since 1948 when the BLS began to record these numbers. You will notice small pullbacks in the number of folks employed in 1974/75, in the early 1980's, 1990/91 and then the early 2000's. The biggest fall, numerically and percentage-wise, has come since the Great Recession began in December 2007. Even though the NBER has officially declared this recession over (see the gray areas above for a time line on officially declared recession dates) it is still possible for the number of employed persons to decrease. See the chart below for a closer look at the last ten years and how the employment numbers have changed. Even in the case of the 2001 recession, employment continued to drop after the recession was considered "over". The obvious clue for us will be to see a rise in the employment numbers to give us a better feel on the direction of the economy.

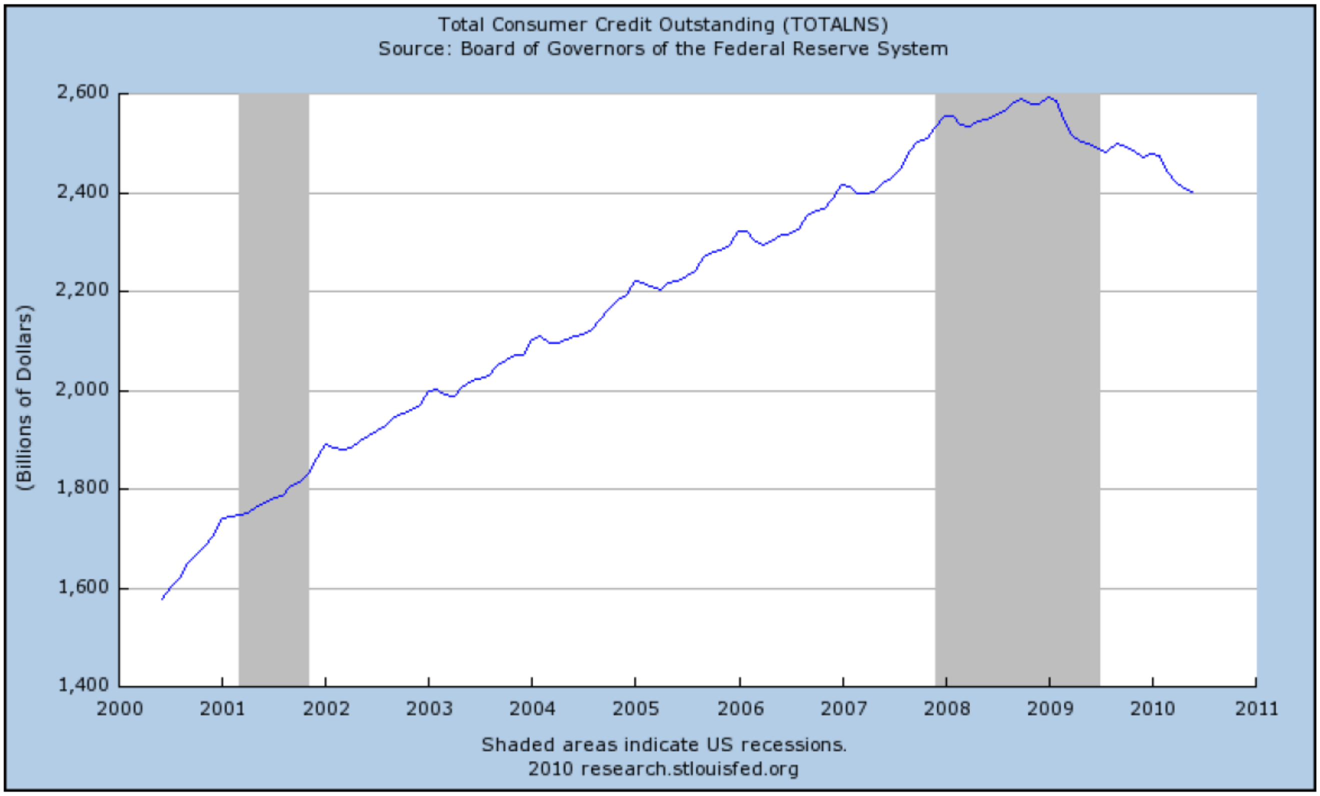


You can see that while the employment numbers have risen since late 2009, they have again begun to decrease. To feel more comfortable about the economy and the various asset markets, we would like to see this number turn back up and maintain itself in an uptrend.

The following two charts look at Total Outstanding Consumer Credit on a long-term basis since 1948 with the second chart looking over the past ten years in particular.

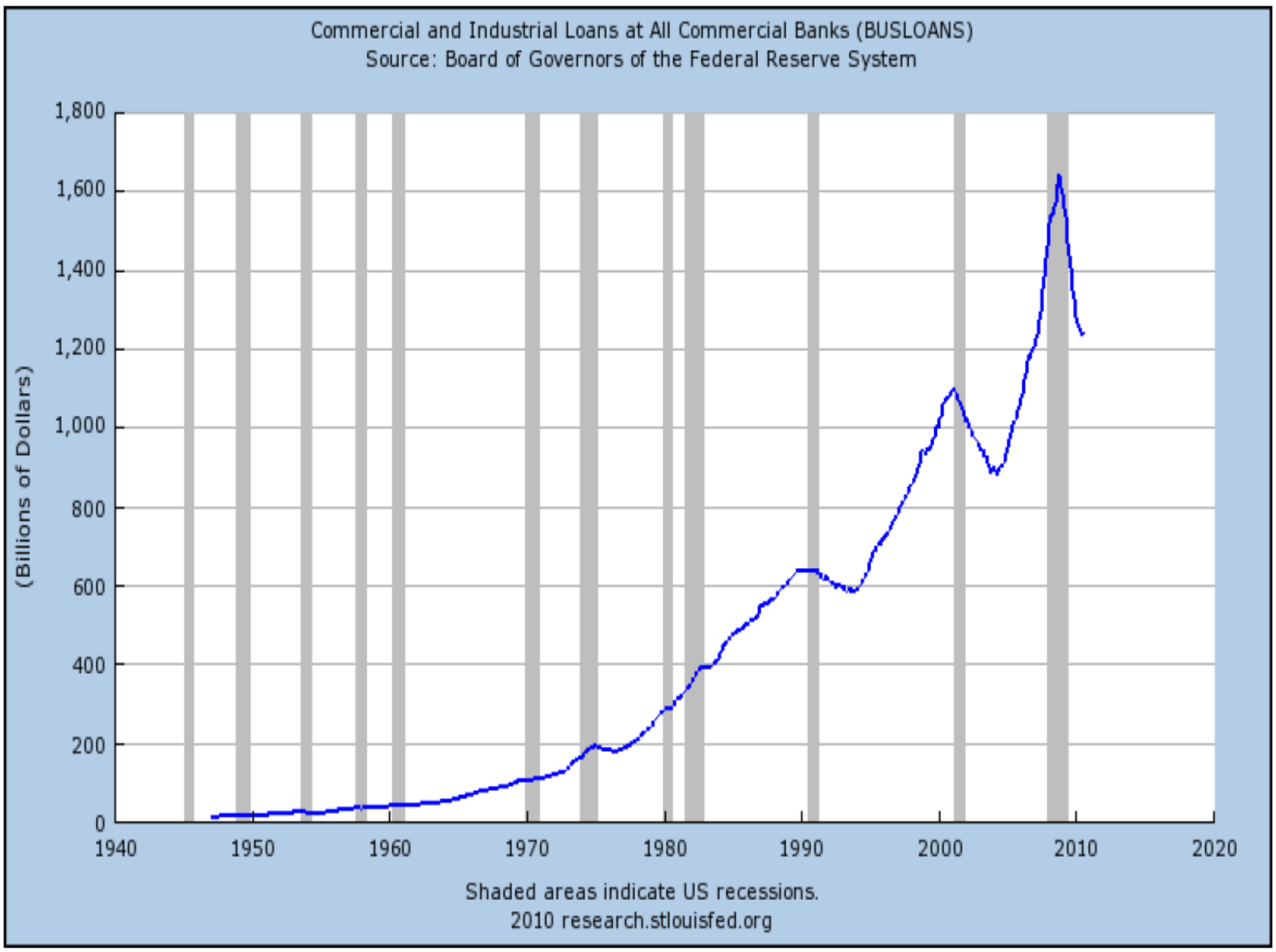
As was the case with the employment numbers, Outstanding Consumer Credit has had its biggest decrease on both a numerical as well as percentage basis since the mid 1940's. Of course, this is why the most recent recession has been referred to as the "Great Recession". The recent contraction in consumer credit is another sign of the consumer hunkering down for what they perceive to be difficult times ahead. This is confirmed by increases in personal savings rates and the paying off of debt (or the walking away from debt).


Total Consumer Credit Outstanding (TOTALNS)
Source: Board of Governors of the Federal Reserve System
2,800
2,400
2,000
1,600
1,200
800
400
0
-400
(Billions of Dollars)
1940
1950
1960
1970
1980
1990
2000
2010
2020
Shaded areas indicate US recessions.
2010 research.stlouisfed.org

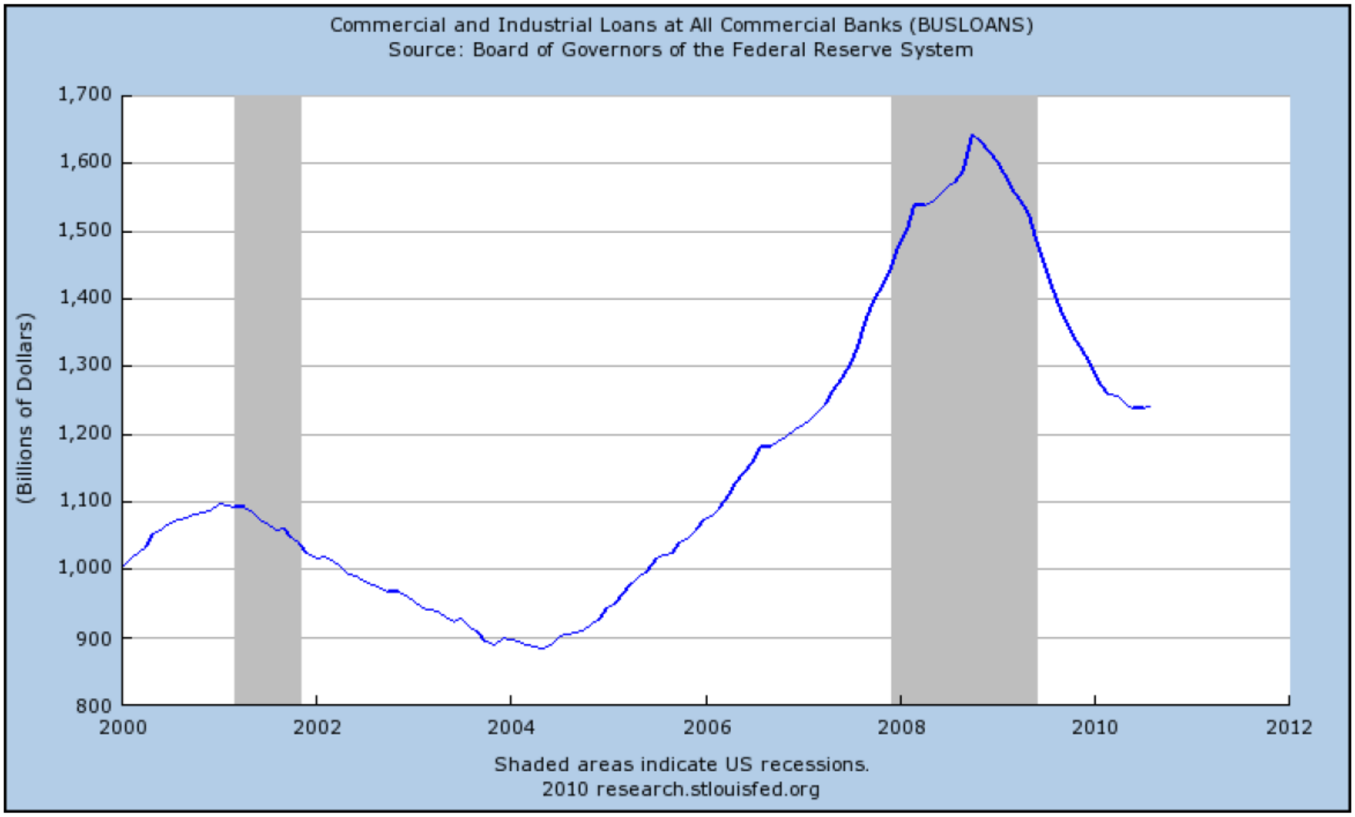

Total Consumer Credit Outstanding (TOTALNS)
Source: Board of Governors of the Federal Reserve System
2,600
2,400
2,200
2,000
1,800
1,600
1,400
(Billions of Dollars)
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
Shaded areas indicate US recessions.
2010 research.stlouisfed.org

Since consumer spending represents 70% of GDP, the appearance of the consumer hunkering down to take care of and/or repair his/her personal balance sheet, while a good thing, is not necessarily good for the economy and job creation. How bad would you like to be in the Fed's shoes right now? The choices that Chairman Bernanke and the rest of the folks on the Federal Reserve Board are currently faced with are not easy ones.

Now consider the following chart for representing outstanding commercial and industrial loans to businesses:



This chart, as well, shows the biggest decline in terms of pure dollars and as a percentage decrease going back to the 1940's. The chart on the next page shows just the last 10 years:



Again, to feel better about the direction of the recovering economy, we'd sure like to see these numbers turn up. They currently appear to be bottoming. Better to see an upward trend begin to take place.

A lot to look at this month, a lot to try and interpret. It would appear the markets are facing a very challenging environment with considerably more downside risk than upside potential. And, yet, the stock markets continue to slowly grind upward. A seeming contradiction based on most of the evidence at hand. The stock markets soared in 1999 and in very early 2000 in the face of company fundamentals that did not come anywhere near matching investor optimism and "expert" analyst expectations. In the long term, investors, both individual and institutional, wake up to the true underlying fundamentals and the markets go to where they should. In between, investor emotions can cause markets to take an extraordinarily divergent path from the fundamentals. What we cannot yet tell from the economic charts above is whether the economy is bottoming out and really turning upward or is there more retrenching to come?

Kenneth G. Hobbs III, Managing Partner

CLEARVIEW
INVESTMENT PARTNERS

TECHNICAL ANALYSIS

Seeks to define the trend of various markets, be it short-term, intermediate-term or long-term.

Remember, markets never move straight up or straight down, they move more like the ocean tides, surging (trending) up or surging (trending) down until the tide changes direction. We use various chart time horizons to give us an idea of how far a wave will move within a tide. Our intent is to keep clients apprised of changes in the various markets' movements in the months and years ahead.

Technical Analysis operates under three Basic Premises:

1. Market Action discounts everything. Or …

   Supply Versus Demand governs market action.

2. Prices move in trends. And …

   Trends stay intact until broken.

3. History often (but not always) repeats itself. Or …

   At the very least, it sure seems to rhyme.

The study of charts is based on the evaluation of past events to determine future probability. We seek a stock, or other asset or financial instrument, forming a particular pattern. We note that this pattern resembles that which typically precedes an asset's upward or downward move. In this way we are able to use our knowledge of the way a particular asset has acted in the past to estimate this particular asset's most probable future move. There will be a rational, logical and fundamental explanation for a particular chart formation usually following a given move in price.