

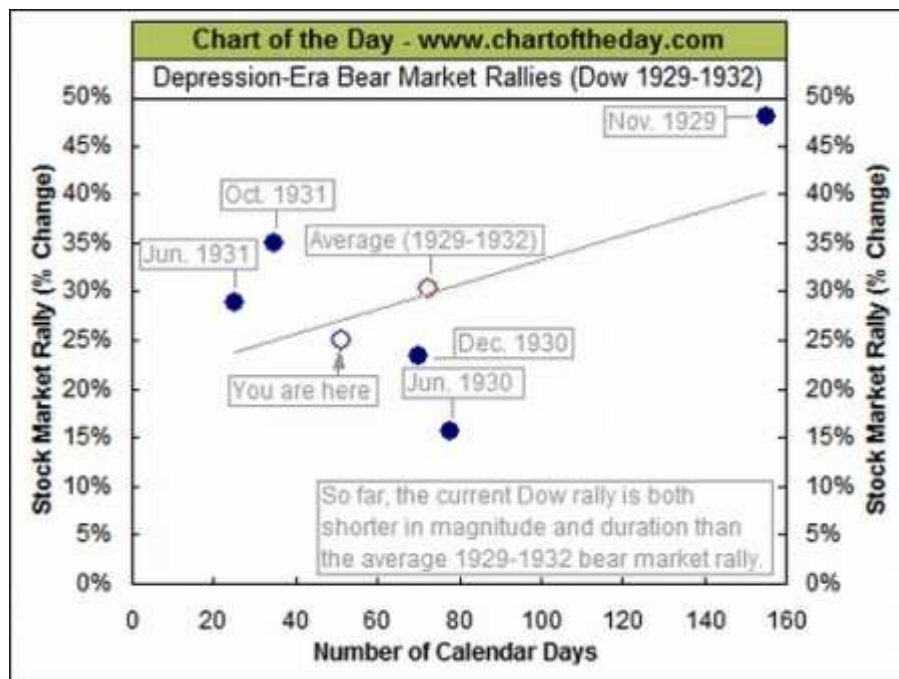
CITY SECURITIES WEALTH ADVISORS

Your Life. Your Goals. Your Advisors.

May 4, 2009

The last six weeks have provided us with a very pleasant 25% rise in equity markets, thanks to a string of bad news that was better than the expected bad news. First quarter earnings for the S&P 500 companies reporting so far are down 32.3% from the previous year, but that is better than estimates. 30 days ago, only 33% of reporting companies were beating their earnings estimates, now 62% are beating their earnings estimates. So earnings are bad, but not as bad as we feared. Then, the headlines announced that the economy contracted by 6%, but consumer spending rose (sort of) and the markets rallied. As I said in my March 30th letter, investor psychology is a powerful thing, and right now investors are feeling pretty good about better bad news.

This “better bad news” rally prompted my curiosity about how long and how high these can run historically. The following chart plots the 5 bear market rallies that occurred from 1929 to 1932, compared with the current rally marked “you are here” on the chart. At this point, the rally is just below average both in terms of duration and magnitude.



Of course averages really don't tell us much, and this rally will run as long as investor psychology will let it regardless of the averages. This weekend, John Mauldin wrote that he sees “lots of opportunity for disappointments and missed targets. And bear market rallies are killed by disappointments and missed expectations.” Another prominent writer, Richard Russell, recently observed that many “are saying that this is a market that won't go down. Believe me, all markets go up - and all markets go down.” (source: *Dr. Prieur du Plessis*)

I don't find these observations depressing at all. On the contrary, rallies and corrections are what our markets need to be doing right now as we travel a path toward restoring health to our markets,

economy and financial systems. I share them with you so that you are not surprised when the news turns negative again, markets post declines, and the pundits who are currently claiming a new bull market continue to fill the limelight with newfound pessimism. We will emerge from this process, and disciplined diversified investors will benefit. While we wait, expect the good news and bad news cycle to continue.

The real story behind the “better bad news” is simply that the rate of economic decline has slowed - and that is indeed better news. If you read or hear anyone mention the “second derivative of growth” turning positive, this is what they mean. The slowdown has slowed down. In a Washington Post interview last week, Nouriel Roubini, nicknamed “Dr. Doom” for his infamous economic pessimism, said as much when he stated that “Six months ago I was more worried about an L-shaped near-depression. Today...we are, instead, in the middle of a U.”

How long this bottoming process will last is unknown - views range from the end of this year to the middle of next year. But it will take time to correct problems that were years in the making - so it is time to wait. While waiting, the stock market will produce some periods of great performance along with its share of declines, additional opportunities are being created in other markets, and fixed income securities are providing yields of 5, 6, and even 13% in some sectors - effectively paying investors while they wait. Diversification, reinvesting income, systematic savings, and asset rebalancing are the techniques that will produce long-term success for investors both during this bottoming process and in the coming uphill climb of restoring economic growth amid high levels of unemployment and debt.

On a final note, today I had lunch with my closest friend and mentor who was laid-off this morning. His Indianapolis-based company provides parts and services to Chrysler and its suppliers. Last week I had a few conversations with clients who are also beginning to see the recession have a noticeable impact on their local community. A recession isn't just an academic and economic exercise to be studied and strategized. A recession is personal, and it is affecting people near us. It is important to understand this so that our “time to wait” is also effectively used to serve others.

All the best,



Kenneth R. Klabunde, MS, CFP®
Vice President