

# DO THE FUNDAMENTALS COUNT ANYMORE?

12/13/06

All of the following economic reports of last week were negative for the economy:

1. Durable Goods Orders
2. Confidence–Conference Board Report
3. New Home Sales
4. Continuing Claims–Unemployment
5. Initial Jobless Claims
6. Chicago Purchasing Managers Index
7. Construction Spending
8. ISM Manufacturing Index

Aside from the above, it was a great week. One of the most interesting reports is the second report regarding the third quarter GDP. It was raised from +1.6% to +2.2%. It, of course, was greeted with much applause from Wall Street, BUT most of the revision upward was due to inventory building that will negatively affect future economic activity. If the truth were known, this report is also negative.

We continue to watch retail sales as the future real gauge of the financial markets. Actually, it's a coincident indicator, but Wall Street absolutely pays no attention to the leading indicators that have been flashing red for months. On that score, Wal-Mart's November sales were -0.1%, Penny's +1.4% and Nordstrom's +5.4%. These three represent by in large the three classes of consumers, low end to high end. All are down from the previous reporting period. It's trickle up, baby.

It's always been our opinion that levitation was an optical illusion, but the hedge funds have proved us wrong. There is not a doubt in our mind but that it's been these market scalpers that are levitating the stock market. Many others might say the bond market also

has received a dose of levitation and they are right with regard to lesser than government quality securities. We now, however, are beginning to see the spreads widen between lower and higher quality bonds, as one would expect as the economy slows. This spread change is of major importance this time around. Both individuals and pension funds are “loaded” with less than pristine assets. Wall Street and bankers have managed to hand off most of the risk of ownership to others. If you think about it, investment bankers and commercial bankers have had their bird nests on the ground for the last 10 years or so. Huge fee income has been obtained with no risk as they hand off the risk-laden securities to willing investors seeking more income in this income drought environment. A match made in heaven for the financial firms!

From time to time we have mentioned Dick Wisner, who we believe to be one of the finest stock market technicians in the country. The following are his concerns pertaining to recent stock market action. We find nothing to argue with.

- The yield curve is seriously inverted and getting worse.
- S&P projects lower real earnings in the 2<sup>nd</sup> half of 2007.
- The market has not had a 10% correction in over 930 days.
- The transports have failed to confirm either of the last two DJIA highs.
- I don't think the Fed is going to lower rates until inflation gets down to 2%.
- I think the rally in the August-October period front-ran the November-January strength. Read hedge and mutual funds.
- Congressional takeovers are followed by sell-offs.
- The S&P is currently trading at 18.3 times record earnings (on record profit margins).
- Yes, I think the consumer will pull back in reaction to the crack in housing.

**- Taken from Dick Wisner's Nothing Has Changed**