

Stock Market Needs Lubrication (and a reality check)



As the rally trudges on, the engine driving it appears to be showing signs of strain as it huffs and puffs up the hill.

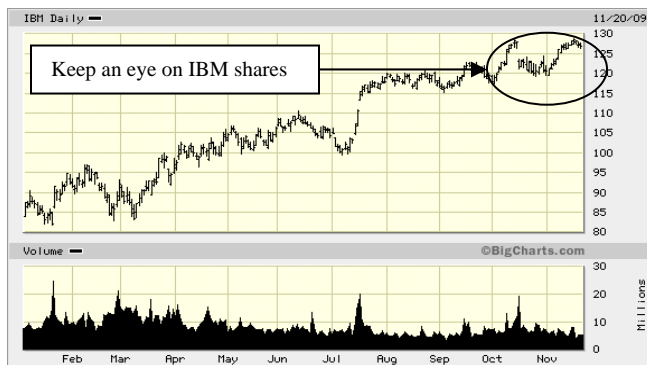
Admittedly, this rally has been quite impressive. That is of course if you ignore the

fundamentals. But, it's the fundamentals or relative lack of that has us concerned.

Another catalyst in this rally has been a resurgence of the “whisper” number. It's provided pundits and fund managers plenty of yodeling room thanks in no small part to analyst estimates being ratcheted down **too** much. Keep in mind it was less than one year ago that analysts estimates were **too** high. So, like any sensible analyst who wants to remain gainfully employed, its better to low-ball than get your head ripped off.

However, when it comes to value and earnings quality, these two vital pieces of the puzzle remain MIA. Until we see evidence of top-line growth (more paying customers), this rally is based on not much more than cost-cutting to bolster the bottom-line.

That said, it is understandable that fund managers have been chasing performance, especially after the pummeling they received this past two years. Then what?



Forget about high beta stocks for a moment and their moment-ous run. A stock like Apple (AAPL) for example is no proxy to a rational market.

But, when an institutional bell-weather such as IBM (at left) starts to break down, then investors may want to proceed cautiously.

What other threats lurk about? There's plenty, but 10 plus percent unemployment isn't exactly a consumer confidence builder. Lagging indicator or not, the market is pricing in too much optimism regarding payrolls. In addition, all the bank and lender bailouts (TARP, TALP...HELP!) assumed we would not exceed 10%.

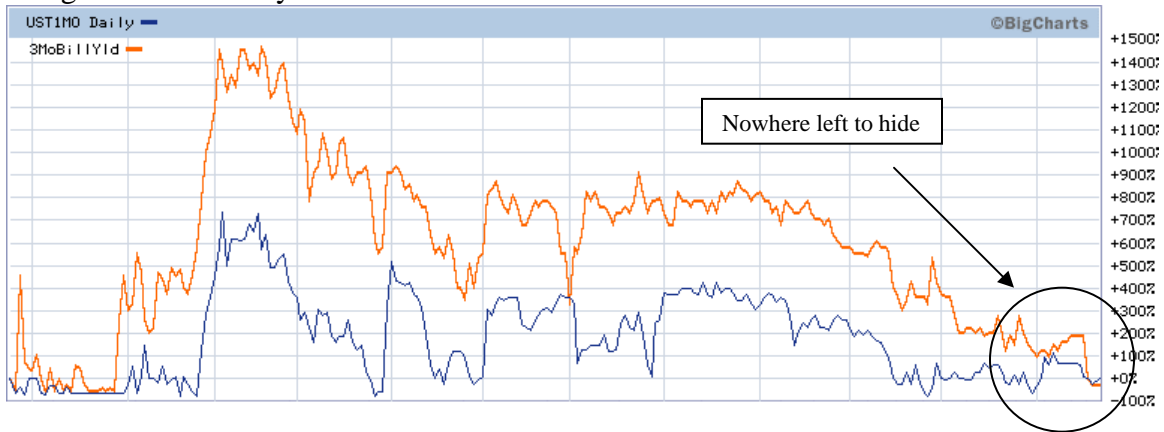
Gold and the Dollar: Gold fever is alive and well these days, thanks to supposedly limited “above-ground” inventory, central bank demand and a healthy dose of speculation. Gold has historically been a hedge against inflation.



Yet, we are not seeing demand driven inflation per se, which suggests perhaps more of an allocation shift away from a debased currency (i.e. the dollar).

While we believe the dollar is likely due for a technical bounce, it's hard to make a case that it's undervalued. We're printing too much of the stuff for that to happen.

Treasury Bills: When one and three month T-Bill rates (below) go to zero %, or negative, you can figure that at some time in the not too distant future, there is a good chance of being smoked out of your hole.



If you want a flight to safety, why not consider inflation linked securities. One CEF we own is the Western / Claymore Inflation Linked Securities (WIA). It's a closed-end fund, with about 85% of portfolio in TIPS. The fund is leveraged (22.04%), but average credit quality is AA+. Expense ratio is about 1.21%, but it currently trades at a 5% discount to NAV and distribution rate is presently 3.69%. Another plus: it pays monthly.