



>: All hail the "king" of Wall Street!

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For all the talk about "measured" increases in short-term interest rates, the Federal Reserve, citing more evidence of inflationary pressure, has sounded a heck of a lot more hawkish than at any time in the recent past.

Perhaps most disturbing, from the investors I've talked with, is that after 17 consecutive interest rate hikes, the Fed's recent comments make it sound like it's still at the beginning of a tightening cycle (as opposed to the end of one).

It's this uncertainty that sent stock prices tumbling during the past couple of months and it's this uncertainty that will likely keep them muddling around in the immediate future.

Investors have a right to be concerned: interest rates reflect the "price-of-money." If it costs more to borrow money, fewer individuals and organizations will be able to do so.

If fewer people can afford to borrow money, they'll make fewer investments; fewer investments mean an economic slowdown.

In my view, what's been particularly interesting during the past two months hasn't been the fact that the economy is slowing, and the stock market has sold off.

What's been most interesting is the fact that many investors "professionals included" seem to have been caught flat-footed by all of it. In other words, it's almost as if the stock market's decline has caught them completely by surprise.

Today I'd like to explain why the recent sell-off in the stock market has not only been completely natural but is, in fact, a very good thing.

Why the market's recent sell-off has really been a "good" thing

To understand why the stock market's recent decline has been a good thing, it's important to "pull the camera back" far enough to understand why it's actually happening.

But before I get into the specifics of "why" I want to introduce an investing rule that just doesn't get mentioned often enough: The only thing an investor should ever be concerned about is the unexpected.

How does that rule apply to this conversation? Well, as I mentioned above, the most surprising aspect to the market sell-off was just how unexpected it was by some of the world's most famous investors. From April 15th to May 15th, there must have been ten strong bullish calls from the usual suspects on Wall Street predicting that there seemed to be nothing stopping the markets from moving higher.

On May 1st, Barron's matched the bullish rhetoric inside the paper with the bold prediction of "Dow 12,000!" splashed across the front page. The paper claims to have simply been reflecting the bullishness of the "top" money-managers they asked for opinions.

Later that week, I remember watching both CNBC's Jim Cramer & Larry Kudlow; regardless of the opinions of the guests each had on, their professional opinion was that the markets were headed higher. A reasonable person could assume that each commentator was as bullish as he could possibly be.

I could give you 5 more examples in the mainstream press and 10 more in the newsletter industry (our competitors) but the point is that, based on the wild optimism of the "mainstream" financial press, many investors would be forgiven for being surprised at the 1,000 point sell-off that occurred immediately after these bullish calls were proclaimed.

The market call of a lifetime?

But members of our *Fallen Angel Stocks*

family weren't surprised when the market collapsed at all. That's because you were armed with our April issue (Volume III, Issue IV) where I let them know just how bearish I was when I "boldly" predicted that in the near future the market had "no place to go but down."

Many of my dearest friends said I was nuts for being so bearish in what was so obviously a strong economy. Even a few members of Fallen Angel Stocks emailed me to question my sanity; one even went to great lengths to prove that he called in and asked Jim Cramer his opinion on my thinking and that Cramer "slammed" my premise.

Hollywood couldn't have written my script any better: as if acting on my cue, within weeks of my bearish call the market collapsed well over 1,000 points from where I said it would and seemed to be headed much lower. But more importantly, the famous "paradigm-shift" I discussed was actually taking place right before my very eyes: almost overnight, every diehard bull miraculously turned into a diehard bear.

On Wall Street, a professional "call" like this is a really big deal. Careers have been made by such contrary calls: witness Elaine Gazerilli's famous 1987 bear call that sent her career at Lehman Brothers into the stratosphere; or Abbey Joseph Cohen's sudden partnership offer from Goldman Sachs after she was right on her famous 1998 prediction that the markets were headed higher.

That's why I wasn't surprised when, during a one-week period alone, several professional friends called me and congratulated me on the "single best market call they've ever seen."

You might think that I'm the ungrateful type, but you're about to see why the surprise expressed by many professional investors to my market call reflects far more about their ignorance than it does about my market savvy.

Dumb and dumber?

As much as I'd like to take credit for being a brilliant market timer, to do so would be moronic. For starters, I've explained at length in these pages why I place no faith in market predictions: regardless of whether the stock market is overvalued or not, in the short-term, it will always trade according to the collective fear or greed of the people trading it. If investors are generally happy, the market will trade higher; if they are scared, the markets will trade lower.

Thus, the fact that the market dropped immediately after I suggested it should does no more to excite me than if the market had gone up by 1,000 points. The reality was that the market was overvalued; the fact that it happened to correct sooner rather than later is nothing more than plain old-fashioned luck. Giving me credit for that would be as asinine as giving me credit for having dark hair, an act that required no special insight on my part.

You may be wondering why I'm going out of my way to discredit myself. The Freudians among us may think that I have a problem accepting compliments or have a generally low opinion of myself. Nothing could be further from the truth.

The reason I'm taking the time to do this (and invite you into the process) is because, as investors, it's important that you have the information necessary to make sound investment decisions yourself. That doesn't mean that you should fire your brokers, quit your job and start day trading. I just want to make sure that I do my very best to help you gain the knowledge to do business with the right people, or not get overly excited or overly nervous when the market moves downward.

In short, I'm going to show you why the market's recent decline was a) completely natural, b) fairly predictable and c) actually a good thing.

The nature of economic cycles ?

In the beginning of any recovery, the goal is to spur economic expansion. After some time (usually in Years 3 & 4,) the Fed's primary goal shifts from economic growth to protecting the currency from inflation. Much of the Fed's actions at this point of a recovery are akin to walking an expansion/inflation tightrope.

In fact, every single economic recovery throughout U.S. history has forced the Fed to walk the expansion/inflation tightrope at one point.

When the Fed is able to walk this tightrope successfully, the economy is often called a "Goldilocks" economy: growth isn't too fast to bring about inflation, nor is it too slow to slow the economy. That's essentially where we've been for the past 18 months.