

Markets

May 5, 2009

It's been a while since I made any remarks about the market because there hasn't been much to discuss. A few weeks ago, I mentioned that the 8200 level was fairly significant and represented a pivotal point in the market. Since then, the market has rallied to this level and has stuck around.

From that level, I felt the market would make a large move; either up or down. A few weeks ago I was inclined to believe that the market would make a downward move. However, the longer such a move is held off, the longer the economy would have to respond to the trillions of dollars being pumped into the economy, ridiculously low interest rates, changes to mark-to-market accounting and other short-term remedies that will only create bigger problems down the road. It is also likely that the recent swine flu media mania has served to distract from the realities of the economy.

Yesterday, the market delivered surprising gains based on the growing misplaced optimism of a "recovery" in the financial and real estate sectors, which is thought to be the key to a recovering economy. This could be no less true. If you have been following my emails, you know that a real recovery will not materialize.

However, that does not mean that the market won't respond to these illusions because it most likely will. **Knowing the realities of the economy is only partially useful. You must also understand sentiment because it drives short-term market performance.** Knowing the realities of the economy is what helps me manage downside risk.

As I have stated previously, you should expect a surge in the market (along with misleading economic data) due to the trillions of taxpayer dollars pumped into the economy. But such "progress" will represent an illusion and will be short-lived. Monday's gains have increased the chances that this surge could be forming now. Much of the previous gains made since the market lows several weeks ago were a normal compensatory response due to the massive sell-off. Now the slate is clean and we will monitor further positive gains in the market with more scrutiny.

Over the past several days, the market has largely ignored bad news and this is always seen as a sign of elevated investor sentiment. But this short-term trend, if it holds, should not be confused with a reversal in the downward market trend.

The longer the market can hold these levels, the greater chances for further positive movement. Yesterday's performance was key, as it signals what I believe to be some important signs that the rebound from market lows could extend up to the 9000-9200 range over the next few weeks. I am not saying that it will; only that

this probability is considerably higher with Monday's gains combined with positive market sentiment over the past 1 to 2 weeks.

It is still too soon to tell whether this short-term trend will hold. But if the Dow can hold above 8000 through this week, that would strengthen my impression. Further gains this week would be even more compelling. The key thing to focus on over the next several days is to note what kind of news is hitting the wires, how much optimism, and how much the market reacts. Understand that overreaction to news events is linked to short-term overvaluation. In contrast, overvaluation is not linked to market timing. For this we must read market sentiment.

All of the semantics aside, I would only recommend we take advantage of such a move by implementing short-term trading strategies. That means we must be skilled in short-term trading. This is NOT the time to practice your trading skills. Otherwise, I would sit this one out and wait for a correction in this ~ 30% moves since the bottom was reached.

I still believe we will retest the 6600 bottom and ultimately break down to new lows most likely below 6000. This could happen in a couple of months or by the end of this year. But the intermediate-long term trend for the market is still down.

Everything changes with time and new developments. This is especially true with the stock market. However, based upon what I have seen over the past few months up through today, I still hold these views.

In my view, it is still best to focus on caution rather than opportunity, even if that means we miss out on some gains

Of course no one has a crystal ball. That is why it is critical that I follow things closely and factor in new developments into our investment strategy and forecasts.

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