Chapin Hill Advisors, Inc.
Market Comment 1-15-09

Will we see a January Effect?

The market made a low on November 21 and proceeded to rally almost 19% through the end of the year. The quiet week between Christmas and New Year's brought substantial gains but the volume was very light. This generally means that the institutions are not participating so most savvy investors will not trust a rally with little volume.

The market rallied the first 2 days of the New Year and then proceeded to plummet. The S&P managed to hit 942 – up from the 750 level hit on November 20th. The S&P had not traded near 942 since early November. From Tuesday, January 6th through Wednesday, January 14th, the S&P fell back to 840 – a drop of 10.8% in a week!

What a way to start the New Year!

The bad news continues to hit the papers. Everything you read is bad and there doesn't seem to be good news anywhere on the horizon.

Citibank reported a 4th quarter loss of more than $1 Billion. They are spinning off Smith Barney to Morgan Stanley to create a new huge wire house as firms move further away from trading. Investment banking seems to be dead in the water.

Citi also announced the sale of a number of units which will unravel the empire Sandy Weill built during his reign. Jamie Dimon seems to be maintaining his top dog status as JP Morgan reported actual earnings on Thursday morning.

US retailers reported really dismal sales for December and bankruptcies threaten a number of them. Although many are denying the rumors, the list of who may be in trouble is lengthy and covers a variety of retailers. GE and Wachovia – two of the largest lenders in this sector – have pulled back on their lending.

Circuit City is in the process of liquidation and closing stores as is Goody's, Bon Ton, Claires Stores, Duane Reade, Loehmans and Finlay's which operates Bailey Banks & Biddle. Macy's reported store closings in 9 states. Others are sure to follow as the consumer continues to scale back spending.

Two years ago we had a negative personal savings rate. We are now turning into a nation of savers. Estimates range from 3-5% for personal savings and Goldman Sachs thinks we could hit 6%. While this is a good thing for the individual as they de-leverage and increase their savings, the bad news is this comes off of spending. Remember – consumer spending is 70% of our GDP. In addition, the

U. S. comprises a very large percentage of global GDP – bad news for foreign markets.

South Korea reported a huge drop in industrial production last week. The UK government is creating a plan to assist companies with unloading bad debt. Dubai is increasing government spending in an effort to boost the economy. The list of countries creating some type of bailout plan goes on and on.

President-elect Obama has been meeting with his team of advisors, urging Bush to release the rest of the TARP money. Obama's economic plan is to create jobs by building infrastructure. This will also help him bail out the local governor's who are moaning about their falling tax revenue and budget crisis. Revenue from the infrastructure projects such as bridges and new highway tolls can help offset some of the decline in tax revenues. Obama is also considering a tax reduction to help fuel spending.

The Federal deficit continues to rise as it hit $1.2 trillion last week. At some point, we have to pay the piper for all the money that has been lent out. While many are concerned about falling prices and deflation, we are concerned that we will be in an inflationary environment in the near future due to the massive flood of liquidity.

Treasury money markets experienced 100% growth last year and we feel Treasury prices are the next bubble which will burst. If interest rates on Treasuries go back to the yield on November 13, 2008, the price of the 30 year Treasury will fall 25%. So be very careful about rushing out to invest your money in "safe" Treasuries. The longer the maturity, the more volatile the price! There are strategies which allow you to capitalize on a falling Treasury price – call us for more info.

The fallout from stores closing or entering bankruptcy proceedings means that retail malls are at risk. REITs and real estate companies are likely to be the next sector subject to massive declines and failing balance sheets. Former AA or AAA tenants are now facing their own shrinking balance sheets.

Apartment buildings were supposed to be considered "safer" venues in the REIT world because people "have to live somewhere". My concern is that folks who are being squeezed are going to consider alternatives such as moving in with relatives or sharing apartments and houses. The inventory of vacant apartments is increasing in many locales.

The residential housing market continues to fall. Last week's Wall Street Journal had an article about the housing markets in NYC, Boston and Charlotte, all of which have not yet fallen very much from their peaks. The article took the position that they may fall faster and further as they are the last to get hit. All three cities have a major concentration of jobs financial services – an area where layoffs continue, bonuses are shrinking, and stock option plans are worth much less than they were a year ago.

Unemployment continues to climb hitting 7.2% last week. Many economists feel we are not accurately stating the actual number of people out of work. Estimates continue to get raised and we may see 10% unemployment in the near future.

This week's Barrons reported research from Merrill's Bernstein on the January Effect. The January which follows the 4th quarter underperformance of C and D rated companies versus A+ rates companies has a greater chance of a positive return.

We are still in the camp of anticipating a short term rally. We are anticipating the S&P to rally, possibly as much as 20-25% over the next few weeks. However, we are anticipating this to be followed by another severe decline. We believe that we could see October lows hit again in late February to March.

The markets are oversold and they can remain oversold for a period. However, since we are contrarians, we feel that the massive amount of bad news, the lack of belief in the short rally, and the light volume on most of the sell-off is leading us into a rally in the next few days.

If you take a look at charts of past secular bear markets you will see that you needed to be nimble in your decision-making. We do not believe you can "buy and hold" this market. The 78 million baby boomers who are marching towards retirement will continue to affect the current markets.

As always, feel free to call us or email us with questions and comments.