

## **Chapin Hill Advisors, Inc Market Comment 9-25-07**

### **Will the Fed Easing Rescue the Market?**

Last week, Ben Bernanke and the rest of the Federal Reserve met and decided to lower interest rates a 1/2 percent rather than the 1/4 point that most of Wall Street expected. This set off a massive rally with the Dow rising 335 points and the Nasdaq up 70 for the day.

Since the consensus was for a 1/4, many traders were taken by surprise and short positions were covered quickly, adding fuel to the rally. The Dow finished the week up 2.8% - its best weekly gain since March 2003. The S&P rose 2.8% as well – its best performance since March of this year. The Nasdaq climbed 2.7% and has rallied 4 out of the past 5 weeks. The Russell 2000, which had been the lagging index, rallied 3.8%.

Lehman Brothers posted a better than expected third quarter, quelling fears that their lack of diversification left them over-exposed to the credit/mortgage problems unraveling over the past few months. Bear Stearns' earnings plunged 61% affected by their big hedge-fund losses and declines in fixed-income trading – the latter being their mainstay. However, Goldman was savvy enough to hedge their mortgage exposure and surprised the Street with a 79% surge in net income.

Tech stocks continued to lead the market while the defensive stocks lagged the market. Oracle reported a 25% jump in earnings on a 26% rise in revenues. The bulls were in control again and momentum continued until some profit taking on Friday, which was also the day options expired.

All of this may seem like cause for celebration. However, in this week's Barrons, Charlie Minter and Marty Weiner of Comstock Partners pointed out that when the Fed lowered rates on January 3, 2001, the markets exploded in upside. In that single session, the S&P 500 ran up 5% and Nasdaq a full 14% bringing cheers across Wall Street. Unfortunately, the run-up was short-lived and over the next 21 months, the S&P lost 43% while the Nasdaq fell 57%.

The Fed may be too late to save the beleaguered home owners as their adjustable rate mortgages reset. The value of the foreclosures expected in the sub-prime area alone is \$164 billion dollars. Foreclosures in August increased 36% from July and 115% year over year. In September almost \$32 billion of sub-prime adjustable rate mortgages reset. The average increase in monthly payments is \$350 per household. This can be a lot of money for the average person to find in their budget.

So while ARM's are resetting and oil continues to climb, winter on its way with heating oil costs rising, the continued spending of the indefatigable consumer may very well begin to decline. Target reported much slower traffic and Lowes warned that year end numbers will have to be adjusted lower.

On Tuesday, September 25, Consumer Confidence was reported to have dropped to the lowest level in 2 years and was well-below estimates. Existing home sales dropped to the lowest level in 5 years and prices declined to 16 year lows.

Homebuilder Lennar surprised on the downside with a \$513 million dollar loss, \$3.25 a share versus \$1.30 in profit for the same quarter in 2006. Wall Street anticipated a \$0.55 loss so the stock dropped another 4%. The stock is now trading at about \$23 down from over \$55 earlier this year.

Later this week, new home sales will be reported and KB Homes posts their fiscal third quarter. GDP (gross domestic product) and personal income may give us further insight into the strength of the economy as well as the strength of consumer spending.

While there is a good chance this market will continue to rise to hit the high's reached in July, it is also overbought on a short term measure. Techs seem to be the new darling of the Street and any pullback could be a good entry point. Not all stocks are rising as 40% of the S&P is negative year to date while the index is up just about 7%.

Emerging markets continue to be strong but the more developed countries are showing signs of weakening. If the industrialized countries pull back it may indeed spill over to the faster growing emerging markets as their economies are export driven and rely on the more developed nations to consumer their goods.

Be careful not to get complacent. Oil and gold are rallying and our dollar is weakening against almost all other currencies. The Canadian dollar (or loonie) reached parity with the US dollar last week – a first in 3 decades. Once again, this makes our exports more attractive, investments in our Treasuries less attractive and imports more expensive. With higher cost for food, heating their homes and driving, Americans may begin to cut back. Consumer spending prevented us from tripping into a full blown recession in 2000-2002 but even lower rates from the Fed may not be enough to prevent a recession this time around.

As always, feel free to call us for questions or comments. Feel free to pass this comment on to friends and colleagues.

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