

Chapin Hill Advisors, Inc. Market Comment
May 25, 2007

No More Bears!

That's it....all the bears have retreated and everyone's a bull. The Wall Street Journal had an article this week quoting a number of respected economists and technicians, including Louise Yamada, stating that we are at the very beginning of a long bull market. Ms Yamada is predicting Dow 16,000! They gave us a number of reasons for continued growth including continued low interest rates, growing corporate profits, reasonable PE's and strong global demand.

The few bears quoted in the article reminded us of Yale economist Irving Fisher's quote in 1929 just before the infamous bear market where Mr. Fisher said, "Stock prices have reached what looks like a permanent plateau". Will these current bulls be just as wrong?

The last week has brought us new highs on the S&P 500 as well as the Dow. The Nasdaq hit a "six year high". While the media is pounding this message out, what most investors are missing is that had you bought and held an S&P index fund in 2000, you just broke even **after 7 years**. Had you bought the Nasdaq in early 2000, you are **still down 50%** from its 5048.62 high to the current level of just about 2550.

The market has been responding to the continued merger frenzy. Many Fridays bring rallies in anticipation of new deals being announced over the weekend. So far this year, 12% of the S&P has been taken private. If a company merges with another listed company, investors generally get new stock. However, if a company is taken private, investors get cash.

If a portfolio manager receives cash and has a mandate to be fully invested or benchmarks closely to an index, they must re-deploy this capital. This new money fuels prices and drives stocks up. However, there are fewer stocks making new highs and light volume on a number of days the market has rallied. Combined with generally heavy volume on the few sell-offs, it is a cause for some concern. Light volume is generally a sign that institutions are not stepping up to the table when the markets are rising. We pay attention to institutions as they are generally savvy investors.

Sentiment readings on individual investors are a concern as many are somewhat bearish. This is important as the average investor is generally wrong. They are what we call a "contrary indicator". However, the readings taken do reflect the individuals' reaction to the economy. With slumping housing prices, housing demand falling off a cliff, rising interest rates, tighter lending standards, rising oil and gas prices and the Iraq war continuing to drag on, there's a lot to worry about. So the readings on investors' sentiment may be colored more by the slowing economy than the stock markets action. Will the market climb this wall of worry?

Thursday brought good news in rising new homes sales and a small uptick in durable good purchases for April and an upward revision in March's number. This was initially interpreted as good news despite the fact that the sales in homes were driven by a 10.9% decrease in prices – the largest drop since December 1970! The rise brought the glut of unsold homes down from an 8 month inventory to a 6.1 month level.

After an initial positive reaction across all indices the markets reversed as fears of rate increases returned. There is inflation in the economy. Gasoline is now over \$3.20 a gallon on a national level. Driving season begins this weekend. We are spending \$1.2 billion a day on gasoline - up from \$800 million this past February.

Existing home sales were released on Friday morning and they declined by 2.6% - the lowest level since June 2003. Unsold homes increased to 10.4% or an 8.4 month supply, the most since 1992.

More deals were announced as the Nasdaq is buying the Nordic Bourse to expand their overseas presence. Coke is buying vitamin water. Earlier this week, GE sold a division to a Saudi company and there were mergers in the health care arena.

Inflation numbers have been running higher than the Fed's comfort range however if the economy is slowing, rates cannot rise. The Wall Street Journal reported that steak prices are up 5.5% from a year ago and whole chickens are up 7.7%. As corn prices rise with demand increasing for ethanol, feeding pigs, cows, cattle and chickens becomes more expensive translating into higher prices for consumers on meat, dairy and eggs. Combined this with rising gasoline to fuel their cars, higher electric, oil and gas prices to cool homes and lots of "for sale" signs in the neighborhood and the consumer has lots of reasons to feel pessimistic.

China's market has risen 52% this year. Greenspan shook things up this week as he called for the bubble to pop. China's 9% drop in February triggered a global sell-off. A crack in China can quickly become a domino effect across the globe. China announced they are investing \$3 billion in Blackstone's coming IPO. Is this similar to the Japanese paying top dollar for trophy property Rockefeller Center in 1989/90 at peak prices, only to sell it in the mid 90's a huge loss? Or is it simply the beginning of a trend as China starts to diversify their \$1.2 trillion surplus. If global demand slows for Chinese products, a glut will quickly build.

You can't fight the tape and we have been positioned defensively which has been painful over the last few months. Traditionally, May-October returns are much lower than November-April. Will the "Sell in May and go away" adage apply? Only time will tell.

Earnings season is just about over. The last few retailers have been reporting with sales at Home Depot and Lowes declining as the housing market creates a drag on chains that cater to the homeowner. Toll Brother's profit declined 79% as new homes sales declined, prices declined, inventory increased and some potential buyers chose to forgo their deposits. Aeropostale, Ann Taylor and the Gap were all positive about future prospects. Brokerage firms are coming to the end of their quarters and we'll look to see if the slowing mortgage markets will drag on their earnings.

Be cautious on new money being invested at these levels. Investors have been increasing their allocations to international markets as overseas markets generally outperform domestic averages. But the "rear view mirror" is generally not a good predictor of future returns.

Assess the risk in your portfolio. This is hard to do and most investors forget about the downside when they see the returns being touted in the news. Review your asset

allocation and be sure you have some defensive positions and do not get carried away on riskier investments.

As always, please call us or email with questions and comments.

Who is Chapin Hill?

Chapin Hill Advisors, Inc. is a boutique financial planning and investment advisory firm, providing our services to high net worth individuals or business owners. We use the full range of investment products and employ a core and satellite strategy to better facilitate the implementation of specific strategies.

We pride ourselves on the delivery of great service. Our delivery of service is customized to the clients needs and includes quarterly reviews as well as regular communication based on what you desire.

The Chapin Hill Advantage

A unique, process-driven approach to financial advice that combines expert financial knowledge with high-touch service, resulting in a personal investment strategy that leaves clients feeling confident and having “peace-of-mind”. We take the time to understand you prior to making any recommendations. Our planning process covers *The Seven Tenets of Planning*: retirement, education funding, risk management, cash flow/debt management, taxation, estate planning and investment management. Our process can determine your probabilities of success based on the most appealing scenario of your choice.

The Chapin Hill Advantage was created by our founder Kathy Boyle. She has over 15 years’ experience within national and regional investment banking and brokerage firms prior to founding Chapin Hill in 2000. Kathy is a regular commentator and guest on national television shows such as **CNBC’s Power Lunch**, **NBC’s Nightly Business News**, **ABC’s Businessweek TV**, **Fox’s Your World with Cavuto** and **Bloomberg** radio and personal-finance shows.

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