ANDRESEN & ASSOCIATES

P.O. Box 1434 Salinas, CA 93902-1434
Phone: (831) 758-1575 or 1-800-345-9644
Fax: (831) 758-1576
PETE@ANDRESENASSOC.COM
WWW.ANDRESENASSOC.COM

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01/31/2011	Value	YTD %
Dow	11823	2.10%
Van 500 Index	117.65	1.58%
Van Total Bond Index	10.6	0%

EURO-LESSONS

In keeping with tradition, enclosed is a small red envelope of money to wish you good fortune in 2011. February 3, 2011 marks Chinese New Year, Year of the Rabbit. Gung Hay Fat Choy! Inside that packet you will find a Euro coin.

Surely the story of the Euro is one of the greatest stories of 2010, and certainly one of the most ironic.

When it was introduced in 1999, the creation of a pan-European currency was considered the initial step in the creation of a unified European state. Much paper and ink was sacrificed to announce that the US dollar's days as the global currency were numbered. A newer, more chic, and certainly more colorful currency was about to be the global standard.

During a trip to Switzerland in 2000, I witnessed the political bludgeoning that the stodgy Swiss endured when they chose to remain with the Swiss Franc. Likewise, in 2006, during a trip to Great Britain, I watched the Brits endure European criticism that by remaining with their British Pound currency, they were revealing themselves as hopelessly antiquated.

In the first few years, the Euro *did* rise a bit. However, after 9/11, the Euro dropped as safety became paramount. Then of course we experienced the Financial Panic of 2008. In fact, based on historical measures, the Financial Panic of 2008 isn't finished yet. But in the initial phases of the crisis, the US appeared at risk. The flood of dollars unleashed upon the world to inject liquidity into the global financial system caused dollars to cheapen versus almost all other currencies.

At that point, I was receiving phone calls from clients worried about the security of their bank deposits and asking for savings accounts in Euros. The entire world appeared to embrace the idea that the dollar was devalued to dust and the Euro was triumphant.

This was shortly followed by failure of the central banks of several peripheral Euro participants. Greece, Ireland, and Portugal were the most famous. And the Euro began its recent sawtooth decline as investors sought safety elsewhere.

One place they went was to the Swiss Franc, which had so recently been regarded as a 19th Century geezer currency. 2010's Swiss Franc appreciation is a profound vindication for a separate financial system.

Another place for skittish investors to go during this tumultuous decade was gold, and to some degree other precious metals. If the dollar is declining in the face of rumors of imminent demise, and the Euro is vulnerable, where else can a third-world investor go? So the investors' herd went trundling off to the traditional lifeboat of the gold markets. My take is that they aren't safe there either. It smells like a bubble, but who's listening?

The irony of this is so extreme that sometimes I wonder if it isn't fiction. But it's worth studying: the ENTIRE episode has been based on perceptions and hot air. The US did NOT fail…so far, anyway. The Euro was NOT the currency of salvation and grace. The Swiss Franc was NOT useless and outmoded after all.

In the next few years, Europe may become genuinely more united. Alternatively, the Euro may shed some member nations and become the "Euro-light." At this point, we don't know what will happen. But it certainly won't be what people predicted when the Euro was launched in 1999.

So that little coin in your red envelope tells us quite a story. What we think will happen, may not. And all that glitters is not gold.

That leads us back to our domestic stock markets. I'm a bit concerned. What I am seeing is that the markets are fairly valued, as the statistics such as the VLMAP suggest.

Ø The Median of Estimated PRICE-EARNINGS RATIOS of all stocks with earnings:
16.7

Ø The Median of ESTIMATED YIELDS (next 12 months) of all dividends paying stocks under review:
1.9%

Ø The Estimated Median APPRECIATION POTENTIAL of all 1700 stocks in the hypothesized economic environment 3 to 5 years hence:
45%

(That's a telling change...down from 60% in March 2010)

I am also seeing a great deal of complacency and positive feeling. Last week, stock mutual funds took in a net $6.54 billion.

We know that investors are rotten timers. Positive sentiment is a negative indicator. So what that's saying to me is that a mild correction is probably overdue.

Adding to my sense of mild unease is the length of our current upturn: the Standard and Poor's 500 index hasn't gone up for seven straight weeks since 2007. That means people are thinking that the hard times are behind us, that a double-dip recession is impossible, and that bad news is discounted.

Thus it may come as a shock when the inevitable bad news hits. I am guessing that a 5% to 10% stock market correction would be historically appropriate in the coming weeks. Of course I may be wrong. I can only fall back on past market behavior as my guide.

This correction, should it occur, would pass in a few months if it follows historical norms.

Economic numbers ARE NOT currently suggesting that a major meltdown is imminent. So the likelihood of a 2008-style collapse is reduced, although not altogether absent. We appear to be most vulnerable in the housing sector, which will be damaged if interest rates surge.

With all that in mind, I am investing our portfolios with a little bit of extra caution, by selecting less risky mutual funds and by holding an extra dollop of cash. Holding cash right now is a grueling experience, since it yields almost nothing. But I've got my eyes on the prize: a 10% discount for later purchases. And if I'm wrong, we will lag by only a bit.

ANDRESEN & ASSOCIATES SEMINAR

The Financial Markets in 2011

Thursday, February 10, 2011
5:30-7:30 pm

158 W. Gabilan St., Salinas

We will celebrate Asian New Year with a light Asian meal before Pete's presentation.
Please call Laurie or Renee at the office if you will be attending.

(831) 758-1575 or email laurie@andresenassoc.com