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JULY 26, 2010

7/23/2010	Value	YTD %
Dow Jones Industrial Avg	10322.3	-1.0%
Vanguard 500 Index	100.8	-.9%
Vanguard Total Bond Index	10.7	5.9%



### TIME FOR A BASIC REVIEW

Ok, let's take a deep breath and review what we know.

Recently, Fed chairman Ben Bernanke wisely said to Congressional interrogators that he doesn't know what will happen in the economy. He said the outlook is "unusually uncertain." He's right; nobody knows what will happen. Data is very mixed. We could go into another recession or continue a fitful, slow recovery.

He also wisely said that he wouldn't direct the Fed to intervene aggressively if there was another economic slowdown. Top-down economic stimulus can take years to work, and he is appropriately concerned about the rebound effects of overdoing it. Good for him.

The newest employment data suggests a current slowdown. The job market was the recipient of artificial government intervention in 2009 and early 2010. Hundreds of thousands of short term jobs were created for the 2010 census. Those jobs are now ending, and as a result, unemployment is rising. No surprises here; the removal of short-term market forces often results in rebounds.

In addition, the ongoing discovery of literally thousands of new hidden taxes and administrative requirements for small businesses in Obamacare and other reform legislation has caused small businesses, which create over 60% of new jobs in the US, to huddle down in uncertainty and refrain from new hiring.

We can also see this effect in the deeply declining income of the self-employed. Uncertain entrepreneurs are choosing to sit on their hands instead of work, figuratively speaking. Meanwhile, the official statistics do not represent the millions of unemployed Americans who are taking the summer off from job hunting and have, at least for now, given up. There are many uncounted unemployed or underemployed citizens out there.

Housing is hung-over from the expiration of a home-buyer's tax credit. New mortgage applications have reached record lows. We've got an 8.3 month supply of homes for sale, and as we've seen, net income is declining. So the outlook for home sales in the near-term is bleak. That's bad news economically in the short run. To me it also indicates that the longer-term is likely to be positive: less debt, fewer marginally-capable home buyers, punished speculators, and greater supply. 2010/2011 will probably be an historically superb time to buy a new home to live in, if not for investment.

Now for the silver lining: the last few days have given us earnings reports which clearly indicate a healing economy. Caterpillar, the tractor maker, turned in 90% growth in 2<sup>nd</sup> quarter profits. UPS reported a 71% improvement. Conglomerate 3M enjoyed an 18% upturn, and earnings for AT&T are up 13%. These numbers are telling us that work-related equipment which was purchased prior to the Financial Panic of 2008 is beginning to wear out or become obsolete. At some point, computers, cars, tractors, and airplanes will have to be replaced regardless of our depressed national mood and fears about the future. The American economy will heal itself to some degree regardless of government.

Finally, we can take comfort from investors themselves. We are now watching a fascinating exercise in investor psychology. Charles Biderman at the market research firm Trim Tabs has noticed an interesting trend: flows in and out of exchange-traded funds are almost perfectly negatively correlated to actual market moves. In other words, day traders and hedge funds are getting it exactly wrong. When ETF's experience a net sales period, the market rises in the following weeks. When ETF's have a time of inflows, the market punishes them with a session of declines. What are ETF's doing now? Net outflows.

The bottom line here is that Ben Bernanke is right: the future is remarkably opaque. The data seems to be suggesting that we continue to experience a slow, fitful, multi-year recovery. If we are about to experience a double-dip recession, there is nothing yet to indicate that it will be horrendous. Instead we see the signs of a grinding, uneven, wearing slow recovery that will continue to hold optimism at bay. As we struggle through our national emotional malaise, earnings appear to suggest that economically, good days are somewhere ahead.

Meanwhile, long-term investors seem to be holding their own. Very diversified portfolios continue to outperform cash over any multi-year horizon, while short-term traders seem to be bleeding a lot. As you can see, even the Vanguard S&P 500 Index fund has done better than one to three year Treasury bonds, which themselves have done better than cash. Since we are diversified into other investments which have done better than the Vanguard S&P 500 Index fund, our portfolios have certainly done better than cash in the bank. Stay with the long-term plan. Stay the course. ■

