

### **Too much Cash...not enough Confidence...**

The last several quarters have been frustrating for most investors. The major market indexes have done little to create any enthusiasm. Sector rotation has been the dominant theme. While we have seen big gains made in several sectors, pity those that stayed too long in any one sector. Be it the retail companies, homebuilders, or energy stocks- they all took turns leading the market- all were subject to severe downdrafts.

There is another severe problem that seems to be stepping into the forefront- real estate seems to be topping and rolling over. All of the signposts are showing up. Tricky mortgage plays are beginning to unwind leading to more inventory on the market that is moving more slowly. We have also seen the signs of many home building stocks rolling over. Who knows, an unwinding of the housing market run up could end up being a benefit to the stock market. There are those who feel real estate money will come back into the equity markets. More likely, a downturn in the housing market will represent more problems for the economy as cash-out refinancing comes to a halt leading to a further drop in consumer confidence.

Now, with all of these negative headlines providing a perfect smoke screen, all of the catalysts are also in place to launch a new bull market in 2006. Thinking about it, it is hard to believe with all the shocks to the system that the stock market has been as resilient as it has been. In fact, while everyone remains focused on the S&P 500 and the Dow Jones 30- the S&P 600 and the S&P 400 and the NYSE equally weighted composite have each hit all-time highs last month. Corporate earnings are strong and corporate cash levels as a percentage of their market capitalization are at 26-year highs. This is why mergers and acquisitions are at new record levels.

The enormous distrust towards Wall Street has lead to an enormous cash buildup of money on the sidelines. The closely watched Institutional Brokers' Estimate System (IBES) Valuation Model shows the stock market as undervalued relative to the bond market by 39% the highest level ever recorded! The international markets have been stronger then ours all year. The US dollar has begun to regain strength making our market more attractive to foreign investors. Long-term trends are in place that will lead to millions of new consumers for agile companies selling into new markets. The only missing ingredient to ignite a powerful bull market move remains investor confidence.

What will turn around the investment climate and bring the sideline money back into the stock market? Liquidity! It drives the stock market. While the Federal Reserve Board has raised the Fed funds rates and received a lot of media doing so- it also has increased the money supply by the fastest rate seen in several years. The new Fed Chairman will start lowering interest rates by the middle of next year. Oil and gas prices will ease providing relief to consumers. Japan's economy, the world's second largest, continues to

improve. Any positive news out of Iraq or the war on terrorism would obviously be a huge and welcome benefit. As soon as a couple of these events unfold and consumer and investor confidence returns, the stock market should begin a new advance that will again take most investors, and “experts”, by surprise.

Despite my positive expectations, I am not always bullish on the stock market, nor am I bullish on all stocks. I have and continue to stress careful stock selection. We use our proprietary Magnet Stock Selection Process to isolate companies that are showing rapid revenue growth, rapid profit margin acceleration, and are producing strong cash flow. When we can find companies like this that trade at a discount to their growth rate and are under accumulation it is easy to tune out the noise. The good news is- we see plenty of ideas right now!

Remember the stock market is an auction market. During pessimistic times like these, if you are in your accumulation phase, you need to be a buyer. The old Wall Street expression says, “You pay a dear price for a rosy scenario... “. Times like these only come around once in a while. Take advantage of looking around the corner while the foolish will not dare!