Why to Consider Increasing Stock Market Exposure

Davidson Wealth Management
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"When the facts change, I change my mind. And what do you do, sir?"
British economist, Maynard Keynes.

The facts have been changing. Below are four areas of comment:

1. **Market measures: 2 Thumbs Up!**
   Two key measures have returned to their pre-September 2008 levels, the TED spread and the VIX. The TED spread is, by definition, the difference between the three-month US T-bill and the three-month LIBOR rate. This is the inner-bank lending rate, the rate at which banks lend to each other. The Fed's return to "quantitative easing" has helped return this measure to the pre-credit crisis levels. The VIX (the CBOE Volatility Index) is currently near 30, also below the pre-September/Lehman Brothers "run on the bank". This index is supposed to measure fear.

   Just eight months ago "biology trumped mathematics" when the fall of Lehman Brothers caused a withdrawal of $87B from $3.4T in money markets. Many believe this modern day run on the bank began the credit seizure, which lead to talk of depression and bank nationalization. Talk of bank nationalization, in February 2009, was just three months ago.

   Other market measures seek to record the flow of funds back into equities from money market funds due in part to the low rates being paid for cash and the rebalancing from bonds back to stocks by pensions and endowments.

2. **Economic data: Some More Good News.**
   On May 5, 2009, Federal Reserve chair, Ben Bernanke stated, "We now see early signs of stability" referring to the economy. Between May 10th and 20th, banks, who are anxious to pay off TARP debt, were successful in coming to market selling stocks and bonds without government guarantees. On May 20th, the Conference Board's leading economic indicators jumped. Business inventories are generally being restocked.

3. **Hope & Reason for Economic Recovery:**
    - There has been unprecedented global stimulus.
    - The US Federal Reserve balance sheet has expanded from $500B to $3.2T. This is the result of printing money to stimulate the economy.
    - I believe investors' sentiment has shifted from focusing on the credit seizure of September 2008 and focusing on possible economic depression to that of a mere severe recession.
    - More companies are now offering earnings guidance for 2009. It was just four months ago that they were not offering guidance.
    - I believe the mainstream media focus has shifted from gloom and doom to one reflecting hope and optimism.
4. **Our concerns going forward relate to slower corporate earnings growth due to:**
    - Ongoing consumer deleveraging which can mean muted spending.
    - Continued housing troubles.
    - Increased government regulation in the financial and automotive markets.
    - De-globalization and reduced commerce.

It is important to note that the fear levels appear to have subsided to below pre-credit crisis levels and that we are entering familiar territory, that of a recession. While this recession, like the flu, is severe just like the swine flu, it is still familiar territory. As a result, we think investors should bear in mind the potential opportunity in equities over the next five years from these current prices.

For instance, if 18 months ago we had told you that you would have a chance to buy the S&P 500 below 900 with an outlook of economic recovery, we believe that many of us would think it to be an opportunity of a lifetime. At Davidson Wealth Management, in our discretionary accounts, we are increasing stock market exposure. We believe that it is time to start pulling money out from under the mattress. Borrowing from the music of the 1960s (*Give Peace a Chance, John Lennon*), let's give capitalism a chance. Remember, Bob Dylan once said the facts (*times*), they are a changing.

Sincerely,

Chris

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