

# KAY INVESTMENTS

S E C R E G I S T E R E D I N V E S T M E N T A D V I S O R

June 30, 2010

*Based on evidence that has always and only been observed during or immediately prior to U.S. recessions, the U.S. economy appears headed into a second leg of an unusually challenging downturn - John Hussman, Hussman Funds, [www.hussmanfunds.com](http://www.hussmanfunds.com), June 28, 2010.*

Much has been written recently about whether we may move into a double dip recession in 2011 and whether the bull market will last. My first reaction to all the goings on is that we are in uncharted waters. Normally, coming out of a recession, we witness robust economic growth and a healthy bull market. Further, it is often said that every bull market climbs a wall of worry. However, there are elements of this recovery that make things seem different, that call into question the usual assumptions about impending events.

It is undeniable that low interest rates, easy money and government spending SHOULD create a favorable environment for the economy and for the stock market. Easy money usually leads to business growth. This favorable environment is the single most cited reason defending the durability of the bull market. Additionally, corporations are considered to be in relatively strong shape financially (although smaller businesses are having difficulty borrowing). It is the non-corporate entities, i.e. people and governments, that are having difficulty.

The other side of the argument cites the following factors as ominous tipping points:

- The recession that just ended last year was not the common “overheated economy” recession. It was driven by so-called asset bubbles. Asset bubbles unwind in different ways and can require more time. Cheap, easy, printed money was a key ingredient in creating these asset bubbles and the U.S. government is currently attempting to employ the same strategy as a cure.
- Government debt is exploding, creating fears of “Greece” like scenarios. Along similar lines, several states are looking at possible bankruptcy scenarios. This only compounds the problem. See graphics below (courtesy Hedgeye Risk Management).
- Debt liquidation is contracting the economy. Specifically, when people and businesses pay down (or default) on debt, they are not buying goods and services. Private debt is being replaced with government debt. Unfortunately, exploding government sectors cannot effectively replace contracting private sectors.
- The oil spill can eventually create damage in the hundreds of billions of dollars. It has the potential by itself, depending on severity, to provide a tipping point.
- Tax increases are set to take place at the end of the year. Some parties are speculating that increased tax receipts in 2010 are not signs of growth but signs that people and businesses are just accelerating gains from 2011 into 2010.

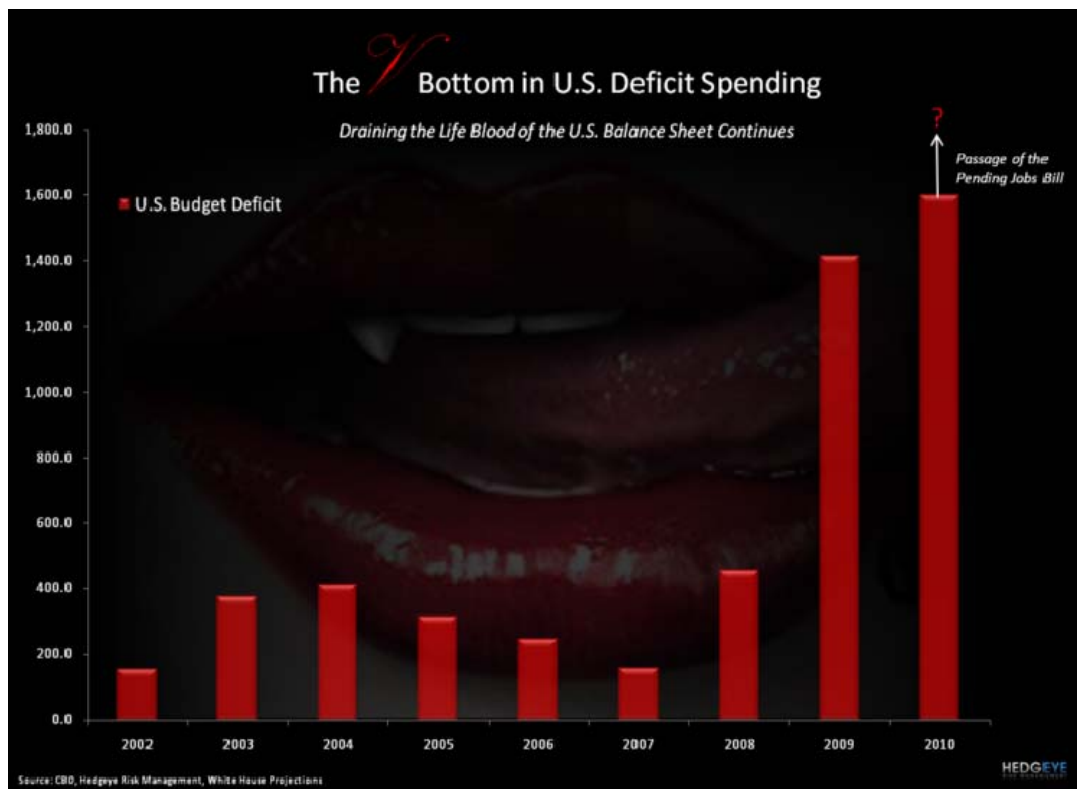
- Many countries (not the U.S.) are implementing fiscal austerity measures. This is contractive. Economic illness can be catchy.
- Consumer confidence, a key ingredient to economic growth, is tumbling (Wall St Journal, 6/29/2010, “Consumer Confidence Tumbles”). Consumer spending was a huge ingredient in the last recovery – especially in real estate.
- Home prices are not recovering nationally yet.

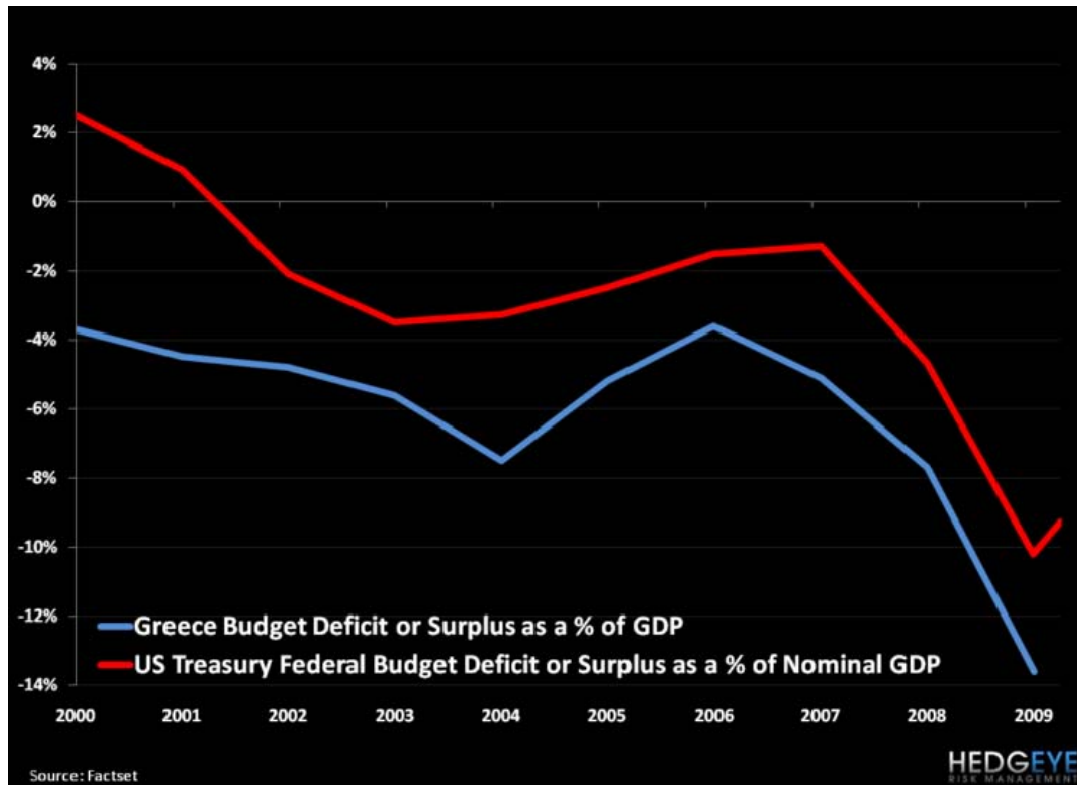
From everything that I can see and everything I have been able to read, I feel that the chances of a double dip recession in 2011 are likely about 50-50. This may sound wishy-washy but it may also depend on factors that have yet to play out. In other words, the possibility is very real but just not knowable yet. Recessions are generally unkind to the stock market. Also, the markets typically move in advance of economic events.

Finally, even if the recessionary scenarios do not materialize, the stock market upside may be limited. Solid, substantial gains in the market eventually require solid, substantial economic growth. It has to be more than companies making themselves more cost efficient.

### Changes in the Works

I have been working hard in pursuit of a strategy/strategies that I feel may be able to make money in both up and down markets. I recently licensed technology that will enable me to pursue such strategies and portfolios. If you are interested in discussing and exploring this program, which is quite different from “buy and hold”, please contact me.





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