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## Is this really the Rally?

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Over the past month, we've seen some signs of light at the end of the tunnel in the markets. However, a level of skepticism remains about the current equity market rally. There is a sense of disbelief that this is real, and many investors are waiting for more signs of recovery.

**“This market is more about investor sentiment than economics. However, it's a good time for intelligent investors to take a balanced view of what is driving the rally.”**

There is no denying the recent rally has been noteworthy. Last month we saw a 10-day upswing in the global markets that was the strongest since 1938.

Frankly, the jury is still out, and no one knows for sure how far this rally may go. But our money managers tell us that indicators continue to flash, buy on many companies.

So should we be getting excited about the next big movement in the market? Truth is, we've experienced a market like this only a few times before, which makes it hard to predict. As we've stated previously, this market is more about investor sentiment than economics. However, it's a good time for intelligent investors to take a balanced view of what is driving the rally:

### Reasons for Optimism

- Economic data is improving, and the high inventory levels of '08 seem to be decreasing. Housing prices are stabilizing, and housing transactions are rising
- Infrastructure spending is being provided and will have an impact. This is a global phenomenon as countries around the world, including China, continue to spend money internally on all over infrastructure projects
- World economies are full of healthy companies at depressed valuations where the markets have overshot on the downside and are now making these companies exceedingly cheap
- The equities earnings yield gap—the difference in dividends and earnings based on bonds—now supports equities, which should cause investors to gravitate to higher yields at some point
- So much cash is on the sidelines earning less than .50% that some of it should soon be deployed back into the market
- Globally, government policies are extremely supportive of risky assets and will continue to be until asset prices recover (eg TARP, TALF, PPIP)
- Legacy loans are actually being reduced
- Markets, always a leading indicator, should start to turn a good 12 months before the real economy recovers

- The market panic is over; smart investors are recovering from their initial alarm and are looking to deploy capital in a prudent matter
- Inflation will be positive in diminishing the real value of debt and should start to encourage consumption

### Reasons to be pessimistic

- Government bailouts such as TARP, TALF, PPIP, etc. may not work as well as intended. These plans all seem to be short on details and long on promises and principles. The process may take longer than anyone thought
- Due to the recent credit fright, even though credit markets may function, the demand may also continue to diminish. The propensity to consume and jump back into leverage by consumers could slow recovery time
- The crisis of unemployment may take longer to resolve. It is occurring not just in North America, but also globally

The foundation of this rally is squarely in the hands of the US government. The government has a vested interest in ensuring the stock market stays up. This time it made a highly coordinated attack on the markets. Just look at what has happened over the past month.

### Recent events

First, 60 Minutes was allowed to go behind the scenes with the FDIC as they took over a small bank. They showed how the FDIC works and how, if your bank is taken over, you shouldn't be worried about getting your money. The FDIC is good at what it does.

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Two days later, word leaks about the reinstatement of the “uptick rule” which prevents short-sellers from driving a stock artificially low. At the same time we hear that the US Congress is investigating the impact of relaxing the “mark to market” accounting rules on bank balance sheets.

Then, 60 Minutes airs a rare interview (*first one in 20 years*) with Fed Chairman Bernanke. Two days after that, Bernanke announces the Fed action to pump over a trillion into the economy and push long-term interest rates significantly lower.

The next move was a weeklong PR campaign from President Obama to try to instill confidence in his economic team (*they've clearly learned their lesson when it comes to Secretary Geithner speaking to the general public*) right before the latest version of the Treasury's rescue plan is detailed.

Throughout, the government was feeding the markets more information about its plans. And when we reached the point where any news is good news, the markets recovered strongly.

### Step back

In short, our analysts are saying that we're going from a panic sell off that lasted from Sept '08 until Mar '09 to a rally from that panic sell off.

For long-term investors with horizons of 3, 5, 10 years (*in our opinion, should be the only investor*

*dealing in equities*), it is a good time to step back and consider the bigger picture and not get caught up in overanalyzing where the bottom of the market may lie.

The main thing is that stocks, by just about every valuation measure, are undervalued from where they were only a year ago. Yes, valuations fooled most investors a year or two ago, when massive leverage had propped up earnings, making P/E ratios and other metrics artificially low. But now that we've been in a recessionary climate for more than 15 months, credit is moving slow, and the most conservative valuation measures are indicating stocks are cheap.

If asked for advice, most professional investors will continue to put money into their sound intellectual framework. And, just as it has tended to do throughout more than two centuries of stock market history, they would expect such a practice to yield strong returns over the long haul, regardless of what happens today, tomorrow, or next week.

## Keys to Success

The short-term movements of the market are anyone's guess. All the technical indicators are up and there are still trillions of dollars on the sidelines, not yet in the market.

The latest version of the bank bailout plan was greeted with open arms, but significant questions linger which may prevent a sustainable rally beyond another 20%-30% from now.

Now the markets are weighing the good, bad, and not-as-bad-as-we-thought, and the not-as-bad-as-we-thought is winning.

We continue to advise people to stick to a defined plan and not get caught up in the day-to-day ups and downs of the markets. Always keep the herd in the back of your mind when looking for both the top and bottom of the market.



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