

Has a New Cyclical Bull Market Begun?
&
Longer Term Outlook for the Economy

\$SPX (S&P 500 Large Cap Index) INDX

1-May-2009

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Open 872.74 High 880.48 Low 866.10 Close 877.52 Volume 4.2B Chg +4.71 (+0.54%) ▲





\$SPX (Weekly) 877.52
 MA(89) 1199.19

Mar 10th: Primary wave A is in. Now expect a primary wave B that could last for months and retrace 38% - 50% of Primary wave A

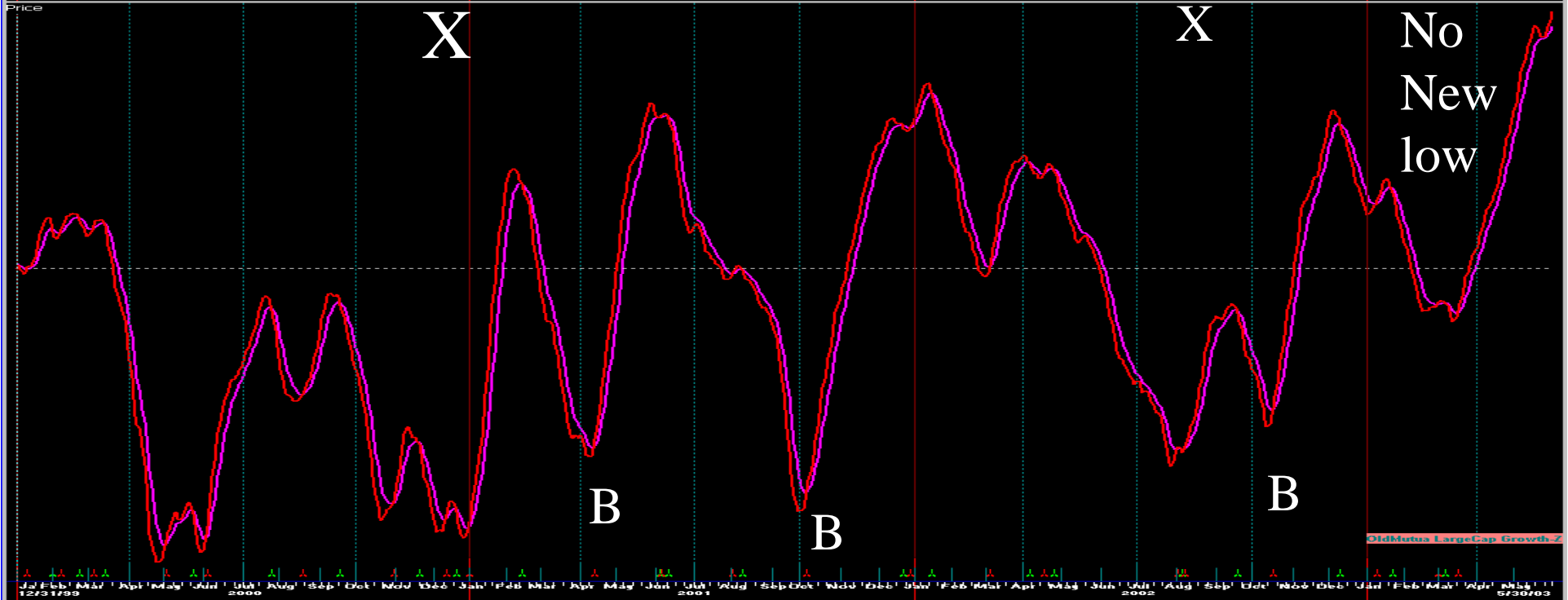
Wave B could retest the 89 week MA or 38% - 50% Fibs

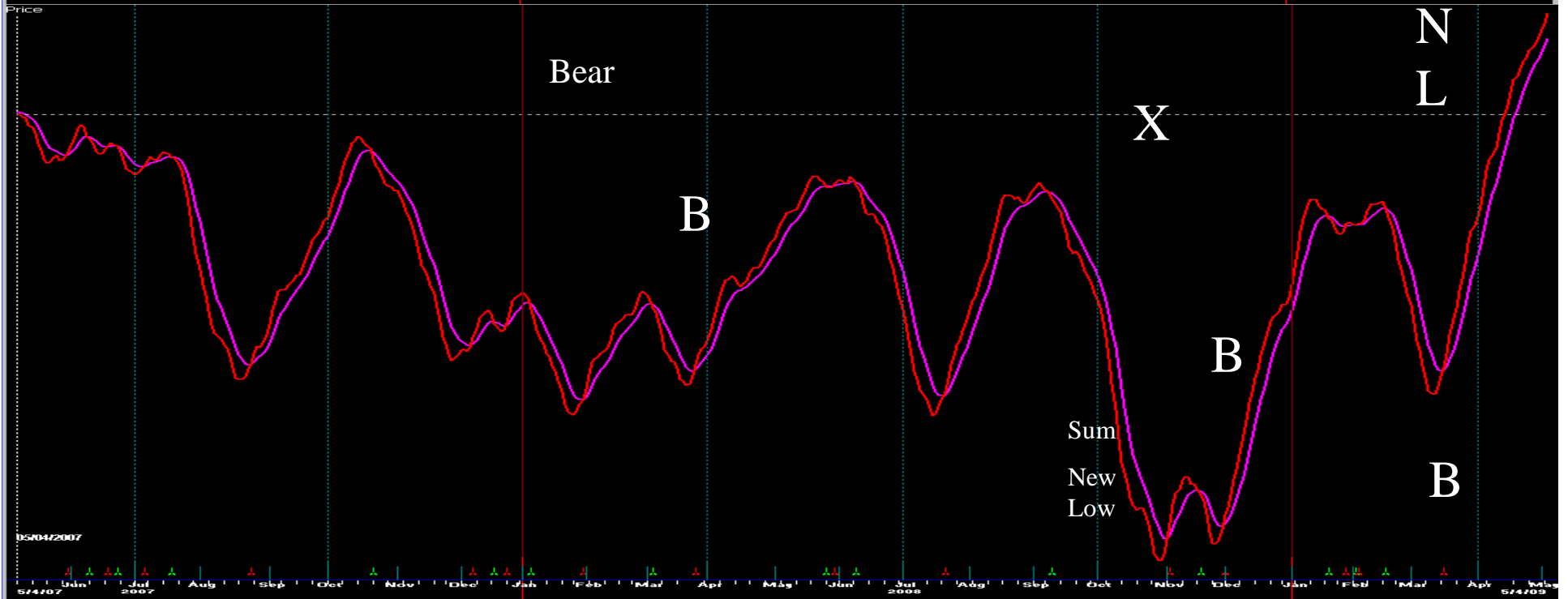
Mar 5th: Finally we are nearing the later stage of the primary wave A downtrend that began in Oct 2007. We are now in the final wave 5 of the pattern. When Primary wave A is put in, the bear market will not be over. A multi week/month counter trend primary wave B rally should unfold, and then finally devastating wave C move to scare all of us would occur, and when the C wave is over, the bear market will finally be over.

Volume 23.65B, EMA(60) 22.24B

Jan 13th: Scenario #1: Bearish Case
 Major wave A is not in yet and this is still a wave 4 bounce with a wave 5 decline to new lows coming very soon that would finally put in major wave A, then a major wave B oversold rally would occur, then finally a devastating major wave C decline to new lows again that would finally end the bear market

Positive Divergence





Volume 5 - Issue 28
May 4, 2009



John Mauldin's
"Outside The Box"

***The Financial
Commentator
on the Economy***
by Jim Welsh

As noted last month, there is a good chance that GDP will post a positive print in the fourth quarter of this year, and maybe in the third quarter. Most of the 'gain' will be statistical nonsense, but that won't deter most economists from getting excited. In the last 2 years, the 80% plunge in housing starts has subtracted about .9% from GDP each quarter. If housing starts stabilize near February's level in coming months, the .9% hit to GDP will become 0%. If inventories are brought down by the fourth quarter and are in line with sales, the decline of 1% to 2% to GDP from production cuts in the first and second quarter could also improve to 0%. In the fourth quarter last year, personal consumption fell an extraordinary -2.99%, as consumers turned into Grinches.

But consumer spending improved in the first quarter, as government income transfers of \$127 billion offset the decline in wages and salaries of \$89 billion. In the second quarter, social security recipients will receive a onetime \$250 payment in May. Tax refunds are up 11% from last year, and the decline in gasoline prices is also providing a boost to incomes. Consumers will use the extra disposable income to pay down debt, and increase savings and spending. All of these factors should help swing personal consumption to a positive for GDP in coming quarters. In the second quarter of 2008, GDP grew 2.8%, which is a respectable number. Despite this growth, job losses continued each month, and a *self sustaining* economic expansion failed to take hold. ***The most important issue in the next 12 to 15 months is whether the rebound in the second half of 2009 and first half of 2010 will gain enough traction to launch a self sustaining economic recovery.*** There are many reasons why I remain skeptical.

The *American Bankers Association* reported that 3.22% of consumer loans were delinquent at the end of 2008. That is the highest level since the ABA began tracking overall loan delinquency rates in the mid 1970's. ***And that was before 2 million jobs were lost in the first quarter.*** The surge in job losses are working their way up the income ladder, with an increasing number of middle income and upper middle income workers being affected. This is pushing many of those who previously were considered prime credit risks over the edge. Two-thirds of mortgages in the U.S. are held by the best credit risk, ***prime borrowers***. According to the *American Bankers Association*, 5.06% of prime borrowers have missed at least one mortgage payment. Since prime borrowers are such a large group, this represents 1.8 million mortgages. Although the delinquency rate for sub prime mortgages is up to 21.9%, it only accounts for 1.2 million mortgages

The *International Monetary Fund* (IMF) now estimates the U.S., European, and Japanese financial sectors face losses of \$4.1 trillion. Banks are confronting losses of \$2.5 trillion, insurers \$300 billion, and other financial institutions \$1.3 trillion. To date, the banking sector has written down \$1 trillion of expected losses. ***The IMF estimates that U.S. and European banks need to raise \$875 billion in equity by next year to return to pre-crisis levels.***

STRESS TEST ? What are the parameters? No Body Knows!!

Over the last week a number of banks have reported first quarter *earnings*, which was a pleasant surprise. Citigroup said it made \$1.6 billion. One of the ways Citigroup achieved this gain was booking a profit of \$2.7 billion on the decline in Citi's own debt. Say what? Under accounting rules, Citi was allowed to book a one-time gain equivalent to the decline in its bonds because, in theory, it *could* buy back its debt cheaply and save \$2.7 billion over time. Of course, Citi didn't actually do that. Even though more consumer loans went bad in the first quarter, Citi reduced its loan loss reserve from \$3.4 billion in the fourth quarter to \$2.1 billion in the first quarter, thereby picking up another \$1.3 billion of 'earnings'. And the recent change in mark to market accounting enabled Citi to book an additional \$413 million in 'profit' on impaired assets. Without these one-time adjustments, Citi's \$1.6 billion in first quarter profit becomes a \$2.8 billion loss.

The amount of excess capacity that has been created by the depth of this economic contraction is unprecedented. What most inflation bugs and investors fail to understand is how long it will take to work off the current over hang of excess capacity. If the output gap grows from the current 7% to 10% next year, Goldman Sachs estimates it could be 2015 before all the excess capacity is used up, *and that's if GDP grows 4.75% per year!* Ironically, one of the reasons the economy is not likely to grow that fast is that business investment will be weaker than in prior business cycles. With so much excess capacity, businesses won't need to materially increase business investment for the next 2 or 3 years.

Outlook for Stock Market:

Do not underestimate what can happen over shorter term when the Government and Fed throw billions into the economy.

Buyer were finally exhausted so prices rallied. At some point in time we will begin to get more in balance. Taking out the January 2009 high is important. Until we can do that there is possibility of a large triangle sideways setting in with one more test of lows late this year or by mid year 2010.