Aspera Bulletin

Intelligent, Independent Investment Management

An Overdue Rally

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Every client portfolio is separately managed.

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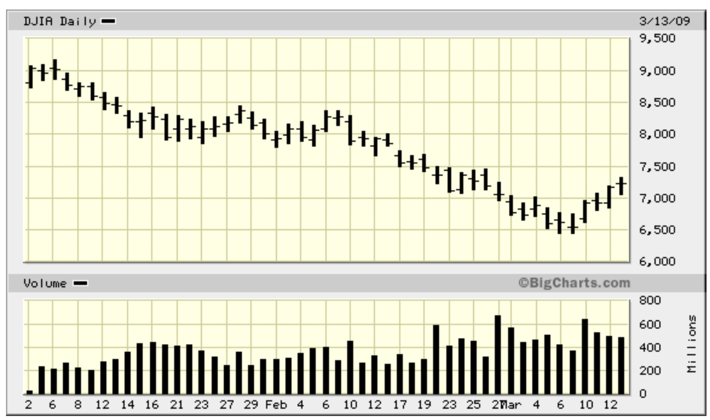
You can almost hear the collective sigh and the sound of feet shuffling back from the ledge. After a relentless 25% slide since the beginning of the year, the market finally staged its first significant bounce since November of last year. In just 4 short days, the market has managed to rally 10%. Last week was a nice reprieve from a vicious bear that still has the market down over 50% from its highs.



As I've repeatedly warned, bear markets don't go straight down. The job of a bear market is to crush hope. They're notorious for their periodic rallies that inspire relief and renewed confidence before again heading lower and snuffing out any new-found optimism. This latest rally arrived just about on time. In a Bulletin from February 23rd, I wrote the following:

"It's so ugly out there, it's hard not to be a little bullish. My contrarian sympathies have certainly been helpful in avoiding complete disasters over the years and have been instrumental in all of my most profitable investments. But everything has a cost. The curse of the contrarian is often being early in your calls, sometimes quite a bit early. That has always struck me as a very fair trade.

With the global economy now in tatters, stock markets hitting fresh multi-year lows, and journalists jockeying to see who can use the word "depression" most often in their articles, the contrarian in me is starting to feel a little frisky. Perhaps the stars are aligning for a nice rally.

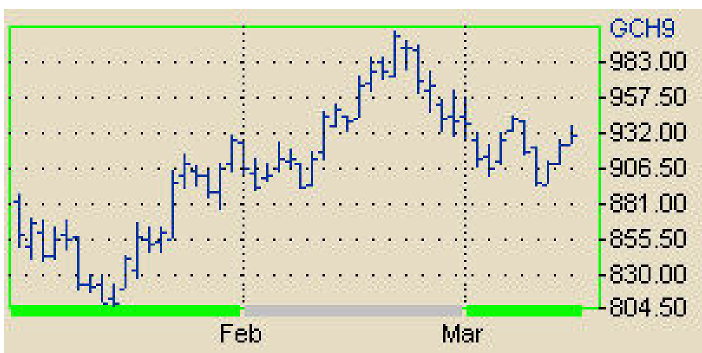
In recent days, I've added a little more market exposure, reduced our already small short position, and reduced our gold position (still one of our larger holdings). Gold is due for a healthy pullback after its recent rise, and I suspect a rally in the market may result in a decline in gold as safe haven buying temporarily wanes. Should this occur, I'll be rebuilding the gold position again."

The market did continue to sell off for a couple of weeks following those comments, but that was just fine as it gave me a little more time to increase our market exposure. [A couple of weeks for a contrarian is basically instantaneous.] Going into last week's strong 10% rally, most accounts were at their highest equity exposure since they've been under management at Aspera. Considering that I've been generally bearish on the U.S. stock market for most of the past 10 years, that's not insignificant.

Most of my recent buying has been focused on metals/mining, energy, commodities, currencies, gold, China, and India. Most of the recent additions offer terrific long-term value and are core positions, but a few shorter-term opportunistic positions were added as well.

Gold vs. Gold Stocks

My modest reduction in gold a few weeks back turned out to be well-timed. Gold failed to break through its prior cycle high of just over $1,000 per ounce. Traders took that as a signal of weakness and started unloading the metal. Gold quickly gave up 10%. Back near the $900 level, I again began adding to gold exposure. Gold is likely in the process of consolidating in stronger hands before eventually attempting another assault on the $1,000 mark. The fact that gold actually rose during the market rally this past week strikes me as a fairly bullish sign for gold.



The relative attractiveness of owning gold itself versus gold mining stocks changes over time. Although gold isn't far from it's recent highs, most of the gold mining stocks are well below their 52-week highs. Despite strong gold prices, these stocks weren't spared from the equity market sell-off. In addition, concerns about liquidity and access to capital weighed on the group, particularly the junior (smaller) gold mining firms.

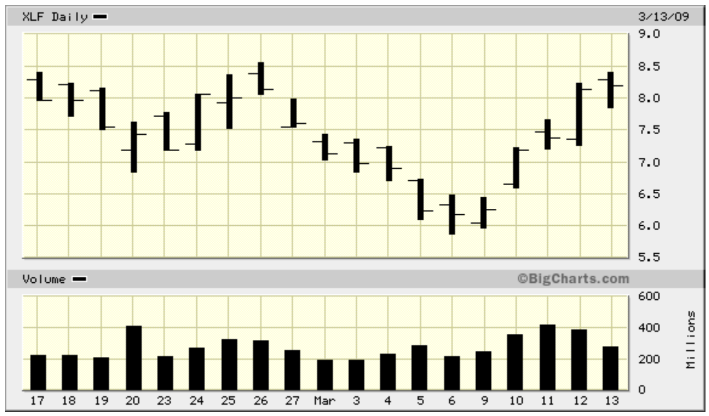
As a result of this, I believe the best way to own gold right now (and silver) is through the stocks as opposed to the metal. The smaller and mid-tier players in particular look very attractive, and this is where my attention has recently been focused. These stocks are very volatile, but if I'm correct in my view that a gold mania may still lie ahead, these names will eventually soar. I'll be looking to shift some gold exposure from the metal itself (GLD and DGP) into stocks (GDX and the juniors) opportunistically - particularly on days when the mining stocks are significantly underperforming the metal.

Energy

One new area of focus has been energy. We've been very underweight energy throughout this bear market, and I've been very patiently biding my time with this sector as it has been collapsing. During the past couple of weeks, I've finally begun to increase our energy exposure. Some of the best long-term values in the market right now are in the energy space. My next bulletin will focus more on the opportunity here as well as highlight a few of the names we've been buying.

Financials

The financials staged a vicious sell-off and then a powerful rally in the last two weeks. We have been and remain extraordinarily underweight this sector. In fact, for much of the bear market many accounts have had a net short exposure to this group. I don't foresee this changing any time soon. The return on assets and equity that these firms once enjoyed are gone. Their strong performance in the years prior to the collapse is owed to poor risk management, liberal use of leverage, and inadequate reserving for losses. Much of the earnings that they generated were never real. Furthermore, these firms have owed much of their growth and success over the years to constantly pumping out new products for consumers and the investment community. In the current environment, I have a hard time seeing how this game can continue.



There will eventually be some huge winners in the financial space, but there will also be many more failures. However, the lack of financial statement transparency and the uncertainty as to the government's future regulatory actions make it near impossible to separate the winners from the losers. As a result, we'll be largely sitting it out with this sector. In fact, should this sector continue its current rally, we may well be shorting it again soon.

Is The Rally Real?

Is this latest move in the market the real deal or yet another bear market rally? No one really knows, but the odds favor the latter. The market had finally fallen to levels at which valuation was supportive, and I've been finding more great long-term buys than at any time in the past 20 years. However, bull and bear markets tend to get carried to extremes as emotion overpowers thoughtful analysis and objectivity. Today's great buys may be tomorrow's incredible buys.

Either way, a move to the upside was due, and I’ve been busy recently getting positioned for it. Whether we’ve seen the bottom or not, I fully expect to be doing some selling should this market climb much further. The first securities to go will be those purchased as shorter-term opportunistic trades. Next, to the degree that any of our core positions experience outsized short-term gains, I will be taking some of that off of the table. Finally, you should expect to see a rebuilding of short positions if the rally gets carried away.

As always, the plan is to remain patient and take advantage of the long-term and short-term opportunities provided by the market rather than worrying about if and when the market may have bottomed. At the margin, we'll continue to sell into strength and buy into weakness.

Best,

Ken Bell, CFA, CFP
President
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