ASPERA BULLETIN

Intelligent, Independent Investment Management

Buckle Up: Turning Short-Term Bullish

919-622-2076
Cary, North Carolina
ken@asperafinancial.com

It sure feels like we're due for either a circuit-breaker triggering meltdown in the market or an incredibly powerful bear market rally. How's that for input? The market may go down a lot or up a lot.

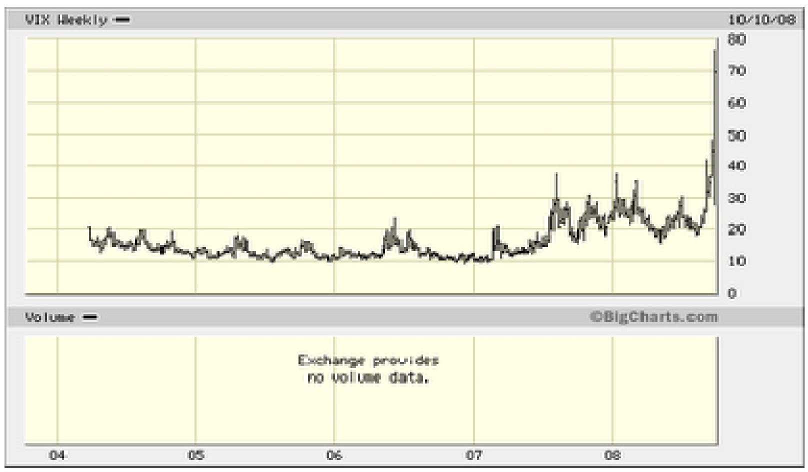
My sense is that we'll see the latter, and in keeping with that, virtually all remaining short positions were covered at the close of the market yesterday. Furthermore, with the Dow down another 400 points today, I added two new market long positions to the portfolio, a double long S&P 500 ETF (SSO) and a double long QQQ ETF (QLD). I anticipate building these long positions on further sell-offs near-term if I prove to be a little early on this call.

This move is significant to me because many years have passed since I've made any type of overall bullish call on the U.S. stock market. Although this isn't a market bottom call per se, it feels good to finally be getting more constructive on the U.S. market, even if my bullishness is likely to be short-lived.

Of course, these types of shorter-term calls can be challenging and humbling. I imagine a number of people made a similar bet last Friday with the Dow at 10,325. They would have lost 18% in only five trading days.

Why the change and why now? For one, the market has just fallen nearly 20% in a mere week. To the best of my knowledge this ranks as the second worst week ever for the U.S. stock market. Keep in mind that a 20% decline is often the threshold for bear markets, and we've fallen almost that far in just the last five trading days. I've been looking for some sign of capitulation, and the second worst week in history seems like a pretty good candidate.

In addition, sentiment is simply atrocious. The VIX index spiked from 45 to 70 this past week (30 has often been viewed as an oversold level), and the VXN index has also experienced a huge spike in the last couple of weeks. Both of these indices are measures of volatility, both are illustrating the pervasive sense of fear in the market, and both have proven effective contrary indicators in the past. (Of course, if you went long when the VIX first crossed 30 this time, you'd be sitting on a sizable short-term loss.) These two indices could always climb higher, but with both at or near record levels (since they've been tracked), I believe fear and capitulation are likely to be close to a near-term peak.



Also, anecdotally, it seems as though everything I'm reading is focused on the potential for another Great Depression and a complete financial system meltdown. It's all over the newspapers, the television, the internet, and the Presidential debates. Few experts/pundits are pounding the table to buy stocks right now. Being bearish is popular. The focus seems to be more on how much further this market may fall rather than whether we're due for a bounce. This strikes me as yet another good contrary signal.

What gives me further comfort with this call is that market valuation is now far more reasonable. I've remarked to clients and peers on a number of occasions in the past few months how surprised I was that the market was holding up as well as it was given the fundamentals and the deteriorating earnings outlook. This recent rapid sell-off has helped to catch valuation up with the fundamentals. Although the market typically overshoots averages during manias and undershoots during bear markets, we're now at a very reasonable normalized market P/E multiple (in the low to mid-teens range depending on the earnings measure and time frame used).

This near-term bullish call is predicated on the assumption that the global financial market, though very strained, is not going to completely implode. If that holds true, there could be any number of catalysts to ignite a rally. The beauty, however, is that we don't even necessarily need good news to get a powerful rally given how negative sentiment is. Just a decrease in the amount or severity of the bad news (second derivative) could propel a near-term 1000-point Dow rally (not necessarily all in one day).

The strategy, therefore, is to build this position further if I'm early, barring any significant further deterioration in the fundamentals. If we do get the rally, I won't be shy about closing out these positions as this is not some grand market bottom call. In fact, the more powerful the rally, the more likely I'll be to rebuild the short side of the portfolio.

Oftentimes, investors should be doing that which is least comfortable. The least comfortable action right now is putting money into the market. Hence, that's exactly what we're doing. Buckle up.

Best,

Ken Bell, CFA, CFP
President
Aspera Financial, LLC

10/10/08