Catalysts among the Chaos

As of July 28, 2006

Driven by the strong earning reports and a larger-than-expected increase from durable goods (rose 3.1% according to the U.S. census Bureau), the Dow rose 1.07%, its best week in 19 months, the S&P 500 was up 1.22%, and the Nasdaq gained 1.93%. The 10-year Treasury bond rose 12/32 in price to yield 4.99%. Despite so many negative stories, the markets rallied and put together a strong week.

According to the Commerce Department, GDP, a key piece of economic data dropped to 2.5% in the second quarter less than the expectation of 3% growth. It is largely due to the deceleration in consumer spending. In addition, business investment turned down even further, decreasing 1.0 percent this quarter, following a 15.6% increase from the previous quarter. While business spending eased, new and existing home sales declined and inventory of available homes rose in most major metropolitan areas nationwide. On top of these market cooling factors, the continuous concerns on geopolitics and surging energy price have created an even more chaotic market for investors.

During this period of time, it is better to avoid consumer related sectors such as retail and restaurants. As for the manufacturing sector, substantial sales gains were reported for makers especially from semiconductors. It would be better to trade through ETF than mutual fund since it allows investors to get in anytime and it trades the whole sector (e.g. SMH, Semiconductor Holders). Taiwan Semiconductor Manufacturing Company posted a solid earning report with its gross profits jumping 75% for the year. Despite a 2% fall on the Dow Transportation Index, stocks on railroad or freight transportation, which is traditionally considered as a cyclical stock, are actually growing due to the continuous commodity demands from China and India.

Although the market sentiment is still bearish, the stock market is unlikely to have a big fall since the P/E ratio has only been around 14 to 15 (normally is around 16). What investors can do among all these mixed signals is to hold on to the quality stocks. For money managers, active trading is the key and has to be quick. As we witnessed from last Wednesday's spike due to the belief in the end of the interest rate hikes, the markets rallied again thanks to strong earning reports from the blue chips and the big increase in durable goods. When the right catalysts come together, the markets benefit. Take this opportunity to clear out the smoke and seek out quality trades.

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