Mines Along the Dow's Way

Beyondbond

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Throughout last week, investors and traders were bombarded by the Dow's frenzy that resulted in an all-time high (11,722.98). Nevertheless, after several very close attempts, the Dow did not rewrite history on Friday. For the week, the **Dow** gained 1.6%, finishing the quarter at 11,679, the **S&P 500** was up 1.6% to 1,336, and the **Nasdaq** increased 1.8% at 2,258. While many people thought this was it for the Dow, it kept up the good spirit and continued to rally this week. On Tuesday, the Dow's all-time high record, which had stood for more than 6-1/2 years, was finally retired with a close at 11,727.34. With many thanks to the bearish performance in the Energy sector, the markets had the best third-quarter in nine years. A calm hurricane season, a temporary peaceful geopolitical environment, and high inventory, lowered crude futures to $58.68 a barrel, a 20% drop since its peak at above $78 per barrel back in August.

Whereas this is a September to remember and a busy month for the editors at Stock Trader's Almanac, the bond market also has had a very unusual performance. The yield on the 10-year Treasury note continues with little changes at around 4.6%. As much as we applauded for the stock market bulls, an inverted yield curve (more than 60 basis points below 5.25% fed fund rate), which usually harbors a slowdown and recession in the economy, expressed a not so optimistic investors' sentiment toward the economy. Floods of investors were willing to lock in lower long yields with the expectations of the cut on short-term interest rate in the near future. This raised a red flag to Wall Street's current rally. Investors need to examine more closely the money that is pouring into the markets. Is it dumb money or smart money? The markets are surrounded by a "feel good to own the high flying stocks" atmosphere. Individual investors, who do not want to be left behind, are heating up this short term buying momentum instead of the smart money coming from the bond market. Magical highs from the Dow were encouraging yet dumb money would neither lead nor sustain a positive trend in the markets.

Besides the "it" news about the Dow, another hot topic among investors was whether the relief from the Energy sector would off set the slump in the housing market. Let's take one step back and ask which sector has a bigger impact on the overall markets and economy. Despite the fact that existing-home-sales number for August had only shrunk 0.5% from the previous month, the average sales prices dropped 1.7%. This represented the first year-over-year decline in 11 years and inventory has piled up 60% compared to a year ago. Consumer spending is likely to take a hit as mortgage-equity attributes 1.5% of household disposable income. According to an article, "Housing's Hidden Headache", written by Jacqueline Doherty from *Barron's*, home builders today heavily use options and off-balance-sheet joint ventures to buy land to avoid bulking up their debt. If the gloomy clouds on housing prices turn into a storm, home builders will be forced

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to write off these investments that cannot meet the return requirement after the deposits and face a serve impact on their earnings. **NVR Inc.** (NVR) has option deposits, which account for 64% of its book value. The wave of walking away from these option and joint venture investments will trigger a chain effect among all the players in the housing market and then extend to the economy. Examples would be the increase in unemployment rate since the housing market has contributed a large chuck of job growth in the past several years. Investors probably shouldn't get too comfortable on the bearish energy sector, especially when it is a hand grenade with many triggers attached.

As congressional elections zoom in closer and closer, any news whether good or bad coming from either party will give investors and traders a second thought betting on party-oriented sectors. Last week, the sex scandal involving Mr. Foley, a Florida Republican and a former page crumbled the used-to-be-firmly Republican state. As the snowball continues to roll with more witness and details unveiled, the Democrats will only need 15 seats (instead of 16) to take over the senate. If that happens in the midterm election, Fannie Mae and Freddie Mac, renewable/alternative fuel, liquid natural gas companies, healthcare services, genetic drug manufactures, life insurers, e-commerce, and internet gambling will likely to be the winners in the markets. For the last four or five years, Fannie Mae and Freddie Mac have been on the Republicans' chopping block because of the adding scandals. However, these two big government-sponsored mortgage associations will be able to catch a breath if the Democrats win since they leaned toward the preference of having government control over the monopolizing business. Also leaning toward a more environmental concern, renewable/alternative fuel and liquid natural gas companies will finally see some relief from energy slump. The losers from the result of the election will probably be Bell operating company, integrated oil companies, exploration and production companies.