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As the Market Hits New Highs, Most Investors are Still Cautious

By Louis Navellier

The S&P 500 gained another 1.2% last week, reaching a new all-time high of 1633.70. The Dow and Russell 2000 also hit record highs. With over 87% of S&P 500 companies reporting first quarter results, two-thirds (67%) exceeded analysts’ earnings estimates, but only 47% beat sales estimates. After this somewhat disappointing result, Wall Street will now begin to look forward to a hopefully more robust second-quarter sales and earnings season, resulting from improving economic growth this quarter.

The Fed is Trying to Find Ways to Wind Down its “QE4-Ever” Policies

On Friday, *The Wall Street Journal* reported that the Fed is mapping a strategy for winding down its epic and unprecedented five-year run of quantitative easing. First off, Fed officials say that they plan to reduce the amount of bonds they buy in careful, deliberate steps, as their confidence about the job market and inflation improves. However, the timing of these moves is still being debated, so the Fed’s \$85 billion (in actuality, closer to \$90 billion) per month in money pumping remains in force for the time being.

Interestingly, only the hawks – who represent a minority at the Fed, led by Dallas Fed President Richard Fisher and Philadelphia Fed President Charles Plosser, are commenting on the Fed’s new strategy. So far, Fed Chairman Ben Bernanke and his fellow doves have been conspicuously silent on the subject.

Another outspoken hawk is Harvard Economics Professor Martin Feldstein, former Chairman of the Council of Economic Advisors under Ronald Reagan, who wrote an editorial in *The Wall Street Journal* last Thursday that was critical of the Fed’s bond buying and accumulation of more than \$2 trillion in long-term assets. Essentially, Professor Feldstein said the Fed’s bond buying spree has done little to boost GDP growth. Furthermore, Feldstein said the Fed’s bond buying is helping boost housing and stock prices, implying that asset bubbles are forming and the seeds of future inflation are being sown.

Meanwhile, the rest of the world is following Japan’s lead and easing “with a vengeance.” Last week, the Reserve Bank of Australia cut its key benchmark lending rate 0.25% to 2.75%. Previous to that cut, the Australian dollar was near a 30-year high, constricting Australia’s exports and hindering competitiveness, while hurting retail sales and tourism. Before September’s elections, more Australian rate cuts are likely.

In addition, Poland and South Korea cut rates last week, bringing the total of global central bank acts of “easing” to over 510 since mid-2007, according to Kopin Tan in Saturday’s *Barron’s*. Central banks are staging a global “race to the bottom” with their currencies, so we’ll see if the Fed can afford to cut QE. For the time being, the stock bull market remains intact as long as the Fed continues its easing policies.

Stat of the Week: China’s Exports Rose 14.7% in April

The economic news in America was unusually light last week, so our Stat of the Week comes from China.

For years, China has enjoyed a trade surplus, but that trend was arrested in March with a surprising \$884 million trade deficit. But China returned to “normal” in April with a huge trade surplus of \$18.3 billion. Exports rose 14.7% in April, after rising only 10% in March, so it appears China’s export-driven economy is reviving. That, in turn, speaks well of global demand for its products. Analysts were looking for only an 8.6% rise in exports, so 14.7% is a solid indicator of rapidly rising global growth.

Any sign of double-digit economic growth rates in China always arouses inflation fears, but inflation is still under control in China. Last Thursday, the National Bureau of Statistics announced that China's consumer prices rose at a 2.4% annual rate in April, up from 2.1% in March. A 4% rise in food prices was the primary culprit for the April surge. But despite this food inflation, China's consumer inflation continues to run below the government's 3% forecasted rate. Also on the positive side, wholesale prices actually declined 2.6% in April, based on China's Producer Price Index, after declining 1.9% in March.

Investors and Advisors Still Suffer from "Fear of Another 2008"

This bull market has climbed a major "wall of worry" for more than four years. After the traumatic crisis of 2008, most private investors and investment advisors still seem battle-scarred. According to Gallup's latest figures, only 52% of Americans now say they own stock, outright or in mutual funds or retirement accounts, the lowest figure since at least 1998 and well below the 65% level back in 2007.

Last week, a study published in the *Journal of Financial Therapy* said that 93% of financial advisors have suffered from a form of post-traumatic stress disorder (PTSD) after the market bloodbath of 2008. Brad Klontz, an associate professor at Kansas State University and co-author of the study, said, "a lot of these financial planners I worked with couldn't sleep at night." Another survey by Curian Capital Asset Management found that after 2008, 63% of over 1,000 independent financial advisers began switching to tactical asset-allocation strategies in an attempt to avoid another market crisis.

Essentially, I view 2008 as a "Black Swan" event in which most institutions seemed to be on one side of the same highly-leveraged trade. In the final four months of 2008, it was estimated that at least \$1 trillion in municipal and corporate debt was forced to be sold as this leveraged debt came unwound. Naturally, fixed income traders then adopted wide bid/ask spreads and picked off everybody that was forced to sell. When the Credit Default Swap (CDS) market collapsed, the Fed had to step in and rescue the commercial paper market, the mortgage backed security market, and big banks that were deemed too big to fail. In the end, leveraged debt blew up in 2008 and the bond market essentially took out the stock market.

With so many investors still so cautious, the good news is that there is no general "euphoria" around the recent new record highs in the S&P, Dow, and Russell indexes. That means there is a good chance that the market can keep rising as more battle-scarred investors finally dip their toes back into the rising market.

Marketmail gets updated on Fridays and whenever the DOW closes up or down 300 points or more.

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