



CALDWELL & ORKIN®

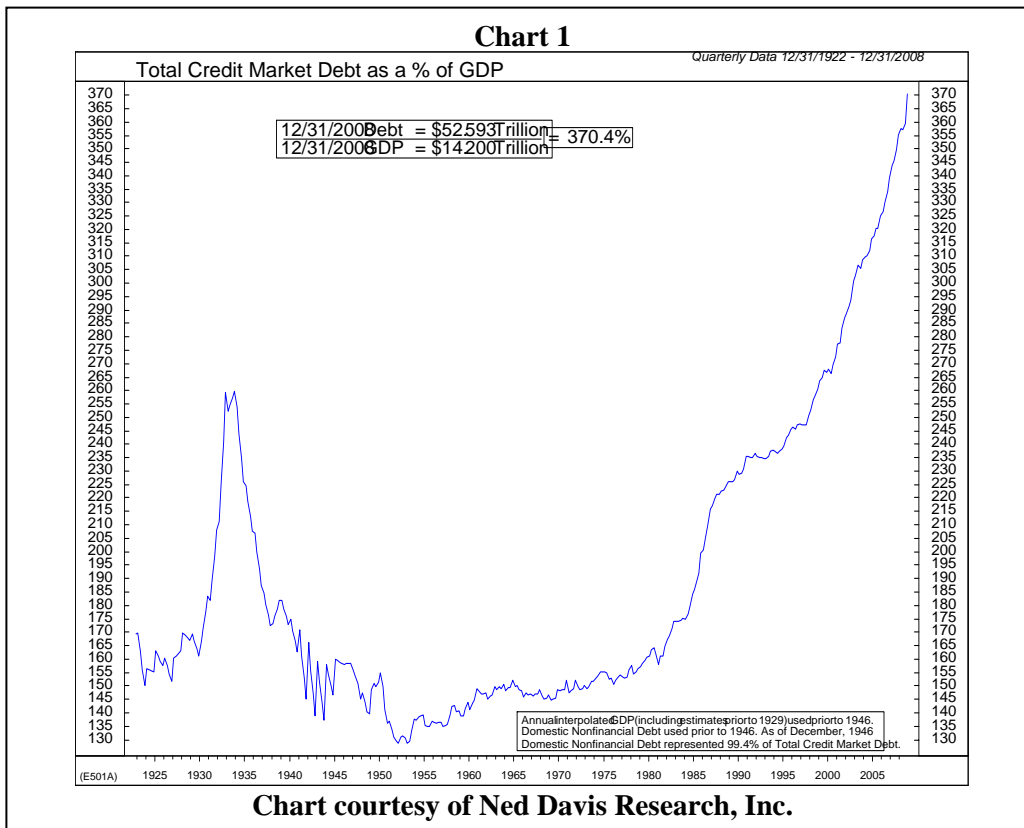
# UPDATE

March 2009

“Conviction is not a badge of honor, it’s an anchor around the neck.”

-Jeff deGraaf, Technical Analyst, ISI Group, Inc.

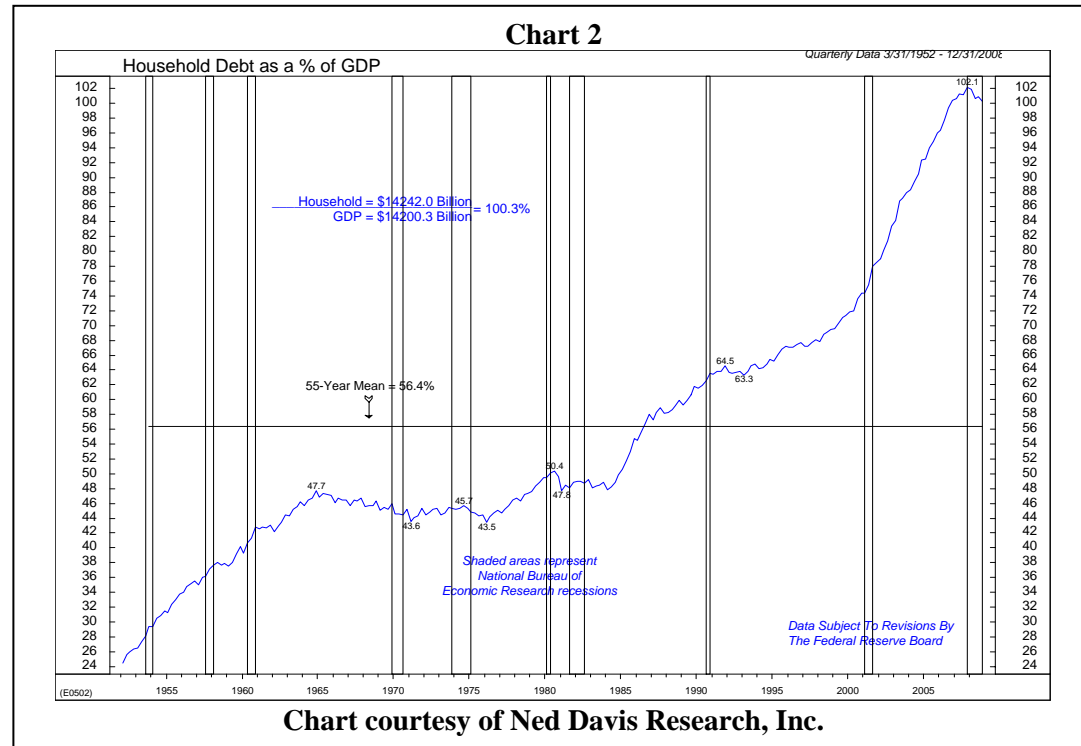
## Anchors Aweigh



In our October 2005 *Update* we compared the U.S. consumer to Icarus, (the character in Greek mythology whose wings were burned when he flew too close to the sun) suggesting the consumer was flying too high on debt-financed consumption and was at risk for a dramatic, painful fall. In that *Update*, we led with the Ned Davis chart seen in Chart 1, Total Credit Market Debt as a Percent of GDP. Back then (and for a long time afterwards) few neither listened nor cared. The

times have changed. Today this chart is being highlighted by many market strategists and portfolio managers as a symbol of the problems we face as a nation now in a deep recession. We love this chart now just as much we loved it then, but with everyone so in tune with the leverage issue, so focused on our cumulative over-indebtedness, we wonder if the time isn't ripe for a swift, significant *bear market rally*.

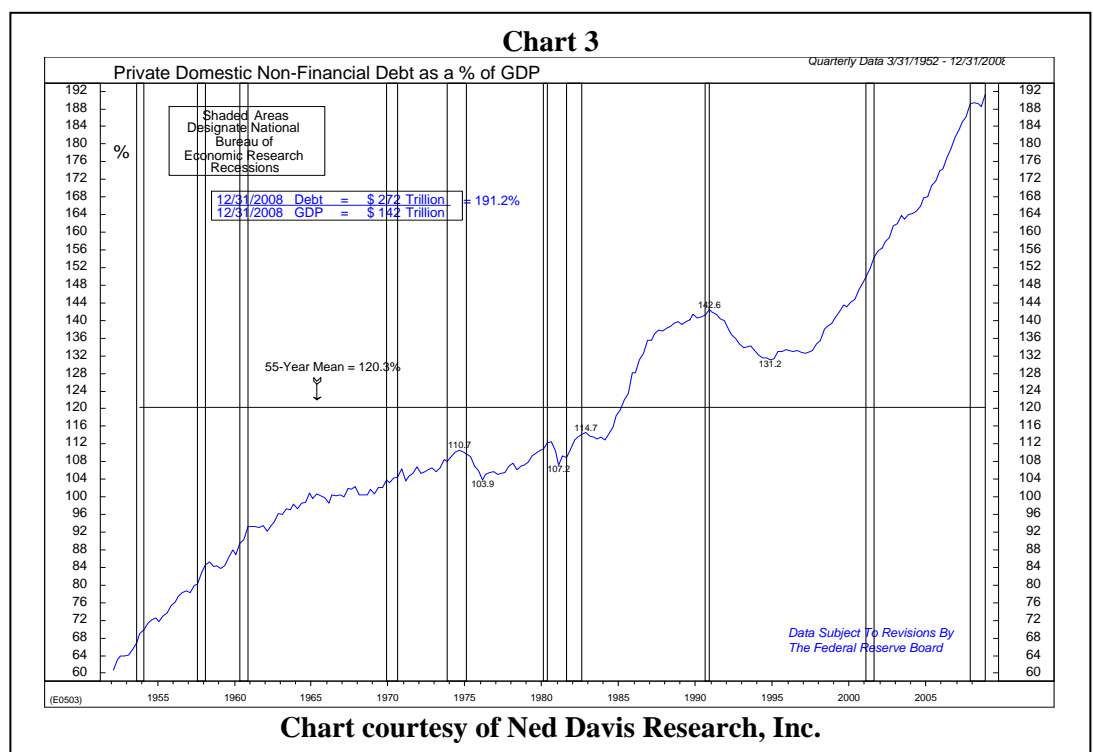
To be clear, we believe our debt issue is secular. That is, we believe that leveraged consumers, corporations and government (See Charts 2, 3 and 4) alike will mute future economic growth and dampen future equity market returns on a long-term basis. But we also realize that this view has now become consensus thought. The macro view of the world we've held for years is now discussed on national news programs and joked about on American Idol. Pollyannas like Jim Cramer are now being dragged onto [The Daily Show](#) kangaroo court so the masses can exact their pound of flesh

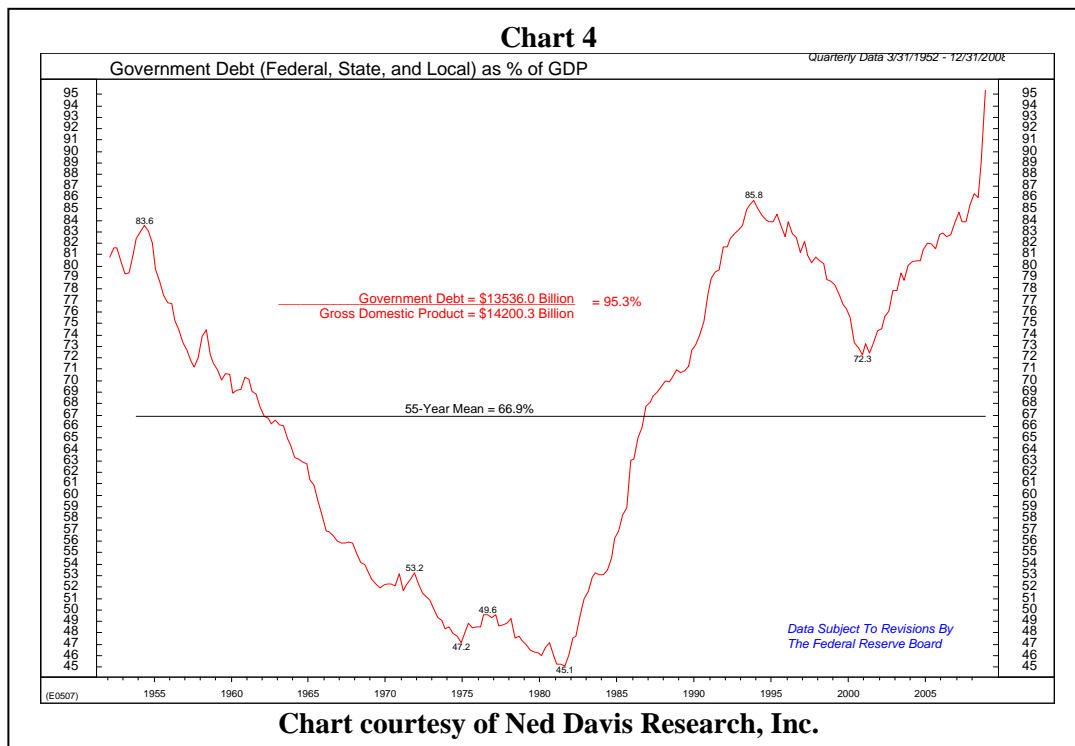


prices have begun to decline at an accelerated pace, and along with the equity market declines led to an erosion of -18.0% or -\$11.1 trillion in consumer net worth (CNW) in 2008. According to data from the Federal Reserve, in the fourth quarter of 2008 alone CNW fell -9.0% or \$5.1 trillion, the largest quarterly decline in the 57 years the Fed has kept such records. “With stock prices and house prices both continuing to fall, CNW is declining more than we expected in the first quarter,” wrote Hyman. “We are lowering our third quarter GDP forecast from 0.0% to -1.0%. With this change...the 2009 Great Recession will be more severe than the 1974 Great Recession.” Consumer confidence is at all-time lows, companies are shedding jobs, and sales of homes and

(<http://www.thedailyshow.com/video/index.jhtml?videoId=221516&title=jim-cramer-unedited-interview>).

Without question the economic picture is NOT getting brighter. In fact, if anything the economic data from February 2009 showed a marked decline from Q4 2008’s destruction. According to Ed Hyman at ISI Group, Inc., house





autos are virtually non-existent. It seems that this is the worst economic disaster in generations.

It's easy to understand why nobody wants to own stocks. As the market made new lows during the week of March 2, 2009, the American Association of Individual Investors (AAII) reported that 70% of investors were bearish on the

equity markets, the highest bearish percentage in over twenty years. "Now that major market averages have fallen to new lows, many investors seem to have lost all hope," wrote Paul Desmond of *Lowry's*. "Gloom and doom has become pervasive. The financial press is filled with articles projecting a deepening and protracted decline in equities... In brief, investor psychology appears to be approaching a level of despair. But, as our founder, L.M. Lowry used to say, 'It begins to get light from the very darkest hour of night.'"

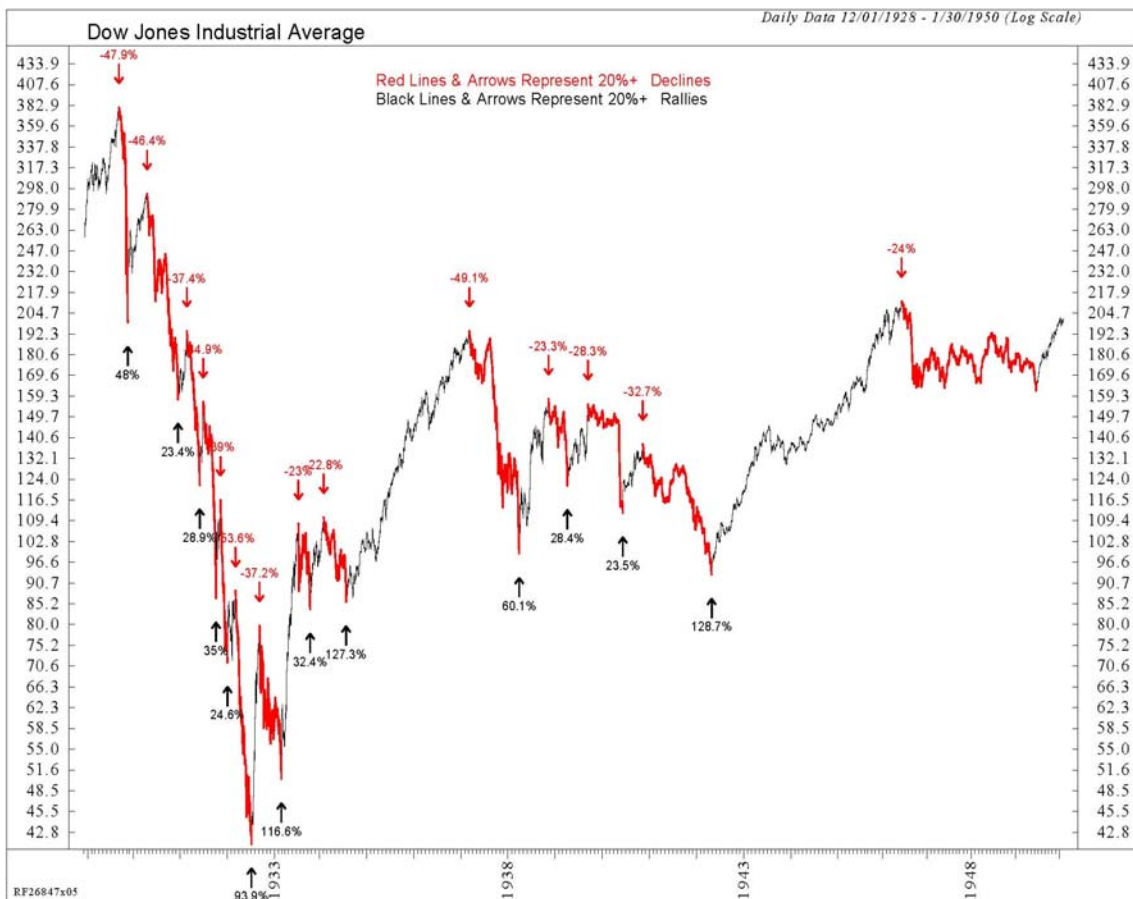
To be sure, significant rallies in bear markets are the norm, not the exception. From its first quarter peak to its fourth quarter trough the Dow Jones Industrial Average plummeted -88% in 1932, a dramatic, historic destruction of wealth. However, within this decline there were five separate rallies of greater than 20% and towards this bear's end there were two rallies of greater than 90%. (See Chart 5) Now that's stomach churning volatility! "Bear market rallies are usually meaningful and painful to those with a directional bias," wrote Jeff deGraaf of ISI on March 11, 2009. "We believe there is still a substantial bounce to be had which will force the chronic shorts to rethink or adjust their attitude down the road... Average bear market rallies are 19% in magnitude... Given the conditions prior to today's rally... we are prepared for an above average bear market bounce."

And we are too.

But we do not expect to maintain this posture for long. As sentiment turns more positive, and pundits begin speculating about the new bull market for equities, the secular bear market interruption will likely come to a close and previous market lows, at the very least, are likely to be tested. Given historic bear market volatility, we must stay nimble. While our conviction in our fundamental macro outlook remains, to Mr. deGraaf's point, we do not wish to be anchored against an ill-tide.

In anticipation of this *bear market rally*, Anchors Aweigh!

**Chart 5**



© Copyright 2008 Ned Davis Research, Inc. Further distribution prohibited without prior permission. All Rights Reserved.  
See NDR Disclaimer at [www.ndr.com/copyright.html](http://www.ndr.com/copyright.html). For data vendor disclaimers refer to [www.ndr.com/vendorinfo/](http://www.ndr.com/vendorinfo/).

**Chart courtesy of Ned Davis Research, Inc.**

*Michael B. Orkin, CFA, J. Patrick Fleming, CFA & William C. Horne*

**Portfolio Management Team:**

*Michael B. Orkin, CFA, J. Patrick Fleming, CFA & David R. Bockel, Jr.*

*Caldwell & Orkin, Inc., 5185 Peachtree Parkway, Suite 370, Norcross, GA 30092-6542  
(800) 237-7073 or (678) 533-7850 / E-mail: [Update@CaldwellOrkin.com](mailto:Update@CaldwellOrkin.com)*