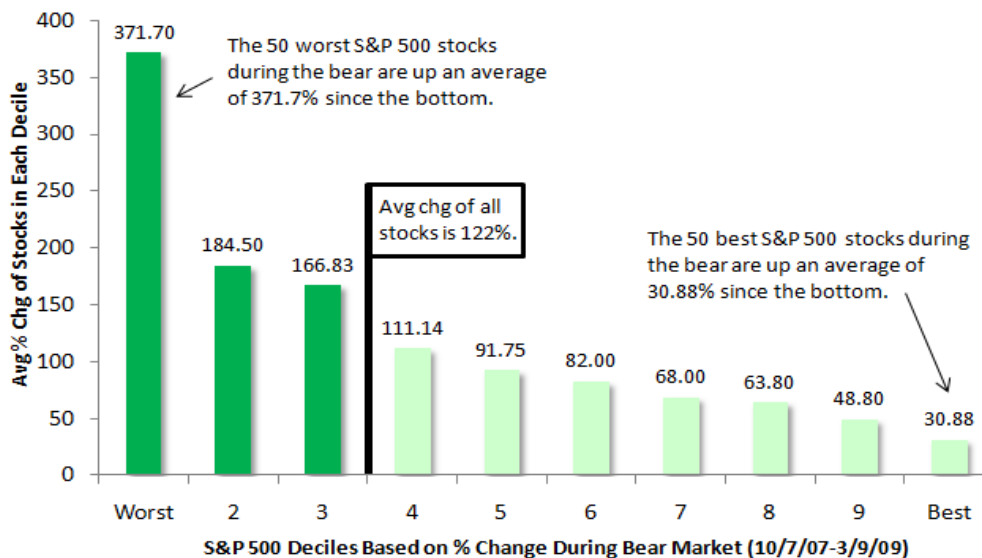


The Starboard Side Report

The week ending March 12, 2010

The rally phase that the market began in early February continues to play out to the upside. As we have discussed a lot of late, we feel that it will be very difficult for the market indices to sustain a major move back above the January highs in the near-term (1150 level on the S&P 500). This view is based on studying many years of market history. A long-term analysis shows that whenever the market has had gains of 60-70% within a year of a major bottom, it needs to undergo a lengthy consolidation process before making another leg higher (see our 2/19 report for more in-depth analysis) This is not to say that we can't have a short burst above that January ceiling in the next few weeks, but we do not believe that any such move will be long lived. It is most likely that rising oil prices and/or long-term interest rates will snuff out the party before it gets started. Surprisingly, the US sectors that are acting the best right now are financials and consumer stocks. Each of these sectors has already broken above their January peaks We feel these groups are especially vulnerable to higher oil prices and interest rates, so it is a bit surprising to see leadership from them. Below is an interesting chart from Bespoke investment group that illustrates the stocks that were hit the hardest in the bear market have performed the best over the past year. This action we are seeing in the financial and consumer companies may be the last vestiges of the inertia bounce that followed the massive sell-off in 2008. Once this plays itself out we expect to see high quality, low-debt companies and those with better long-term fundamentals start to take the baton from riskier securities leverage to US consumption.

S&P 500 Decile Performance Since 3/9/09 Based on Change During Bear



We believe last year provided a good window to be a buy and hold investor, but we feel this year it will be prudent to take a more tactical approach. This means only aggressively adding to positions when we get sharp pullbacks and focusing more on strong relative strength groups and countries. Chasing rallies will likely prove to be a bad idea when all is said and done.

One area that we have not discussed lately is the agriculture sector. Long-term, we feel that crop prices are going to head higher due to increasingly volatile weather patterns, the addition of millions of middle class families in the emerging world and higher energy prices. We recently read an article that stated agricultural commodity prices such as wheat, corn and soybeans are in a permanent downtrend due to improvements in technology and the resulting productive gains by farms. We agree with this to an extent because there is no denying that technology advancements in the areas of genetic seed modification have tremendously boosted yield per acre. However, at some point in the future higher energy prices and advancing prosperity in emerging markets such as China will more than offset these productivity gains. The globalization of the food industry was carried out on the back of abundantly cheap fossil fuels. As that changes in the years ahead the entire global supply chain model of the food industry may come into question.

Farm cooperative CHS Corp estimates that by 2020 over 950 million Chinese will be living in cities. This would amount to a 70% increase over 560 million in 2005. This means roughly 20 million people are moving to the urban areas each year with the hopes of climbing the class ladder towards middle class status. The average income for a rural worker in China is \$697 versus \$2,310 for an urban resident. This may not seem like much to us, but it will start to make a big dent in global agricultural resources as a middle class lifestyle and diet is attained. This diet consists of eating more protein such as pork, poultry and fish that will increasingly require more soy-based feeds. Corn will also benefit from these developments as more and more corn-fed beef and poultry are raised to meet the demands of this growing middle class. Between 1996 and 2009, total Chinese meat consumption grew by almost 70%. There appears to be a direct correlation between the 20 million people that are heading into the cities each year and the growth in meat consumption. These growth trends are not only being observed in China, but also throughout the entire emerging world.

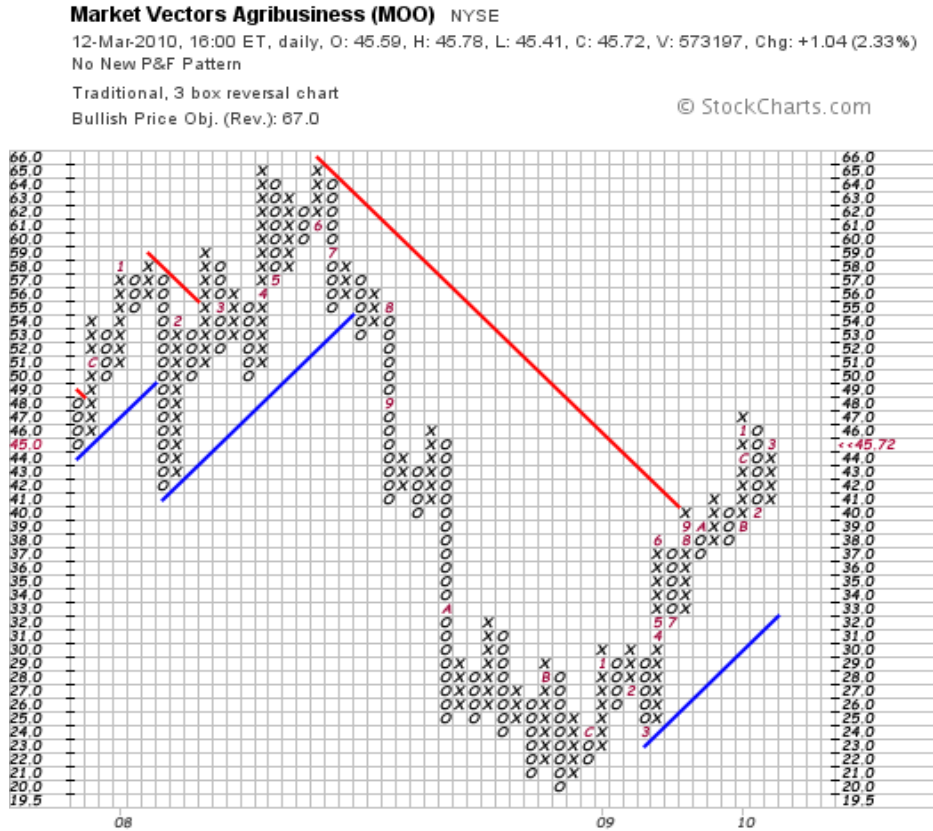
One of the best ways to gauge the price of an asset class is to look at its long-term inflation adjusted price cycles. This can tell us a lot about long wave up and down trends. It is pretty standard operating procedure for an asset class bull market to end only after it has exceeded the inflation adjusted price peak of the prior cycle (see Dow chart on page 5 below). As we can see below, soybeans broke a 25 year bear market downtrend in the decade just past. However, they still have an extremely long way to go to get back to the prior cycle price high.....over 430% to be exact.

Soybean Futures (adjusted for inflation)



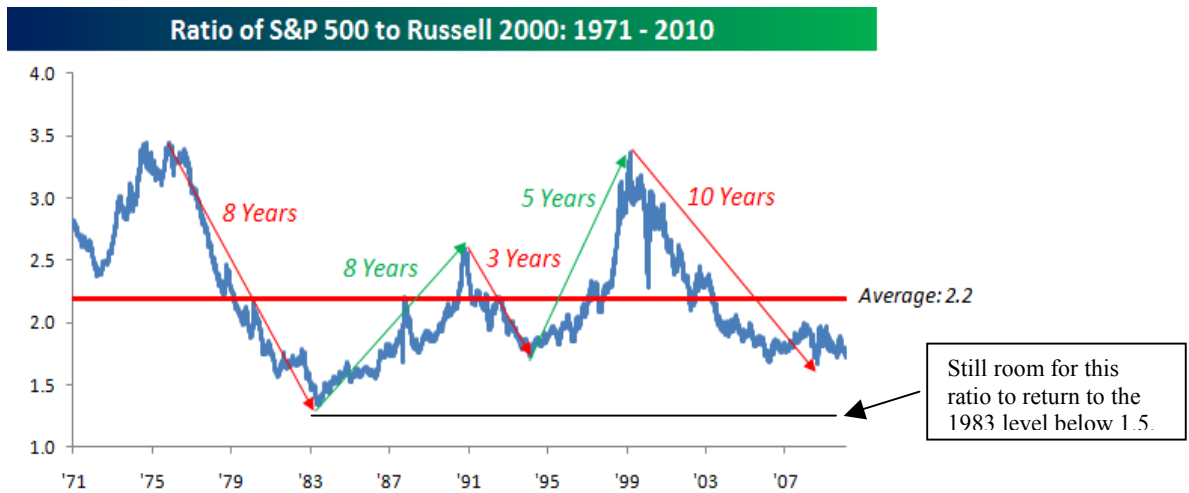
1970's inflation adjusted high was followed by a 27 year downtrend.

It is this type of analysis that provides a good framework for those assets with the most *potential* upside in the years ahead. It's not just soybean and corn futures that will benefit, but the entire agribusiness complex should do well. More crop money in the farmers pocket means more spending on farm equipment upgrades, fertilizer, seeds etc. This is one area that we expect to accumulate a larger exposure to as the year goes on as buying opportunities present themselves. Below is a point and figure chart of the Market Vectors Agribusiness ETF. This is a very healthy technical picture that backs the positive fundamental story we have just been discussing.



Another area that has been strong since the early February low is small capitalization stocks. Small caps are in the midst of a ten year bull market versus large caps and that appears poised to continue. Below are two charts that illustrate what we mean.

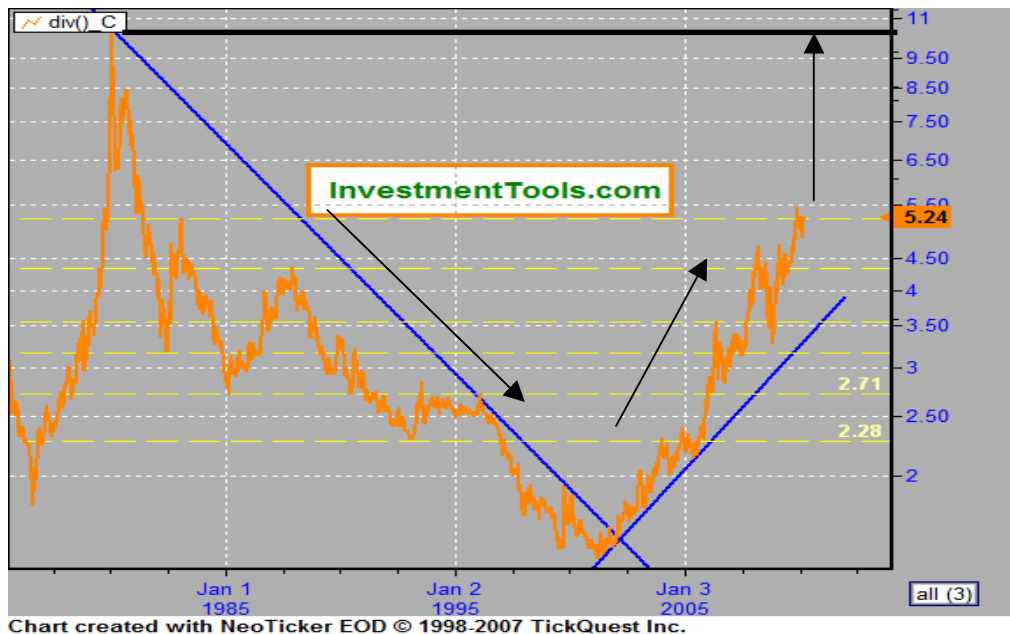




Source: Bespoke Investment Group

It has been 10 years of underperformance for large cap stocks over their small cap peers. This is longer than the great small-cap bull market in the late 1970's. However, based on a historical relative strength price analysis, it appears as if this ratio shown above still has more room to run. Eventually, when this relationship starts to shift back in favor of large caps, it should present a great opportunity to buy high quality multi-national US companies for the long-term.

In the agriculture piece above, we touched on inflation adjusted returns and the importance of these bull and bear asset class cycles. Below is a long-term look at the inflation adjusted price of gold and also the Dow Jones Industrial Average. As you can see with gold, we are still not back to the prior cycle high hit back in 1980. However it is very clear gold is in the midst of a long-term bull market up trend. Therefore, we believe that all the recent talk of gold being an asset bubble is very premature.



Gold is not as cheap as agricultural commodities on an inflation adjusted basis, but it is still well below its prior cyclical peak thirty years later. Using the Dow as a template we should see this happen in the next few years.

Chart created with NeoTicker EOD © 1998-2007 TickQuest Inc.

Finally, we see the Dow Jones Industrial Average in inflation adjusted (also known as real) terms. We included this to illustrate how long-term bull market cycles set new highs in real terms before the cycle is over. Of course, unlike many commodities and gold, the Dow appears to be in a bear market down cycle at present.

Source: <http://homepage.mac.com/ttsmyf/>



The Dow peaked in 2000 in real terms and is now in a long-term bear market downtrend.

It took thirty years, but the Dow finally exceeded its 1929 real peak in 1959. The bull market lasted another seven years in real terms.

Once again, it took 30 years for the Dow to finally surpass its 1966 prior inflation adjusted cyclical peak in 1995. The bull market then lasted another five years.