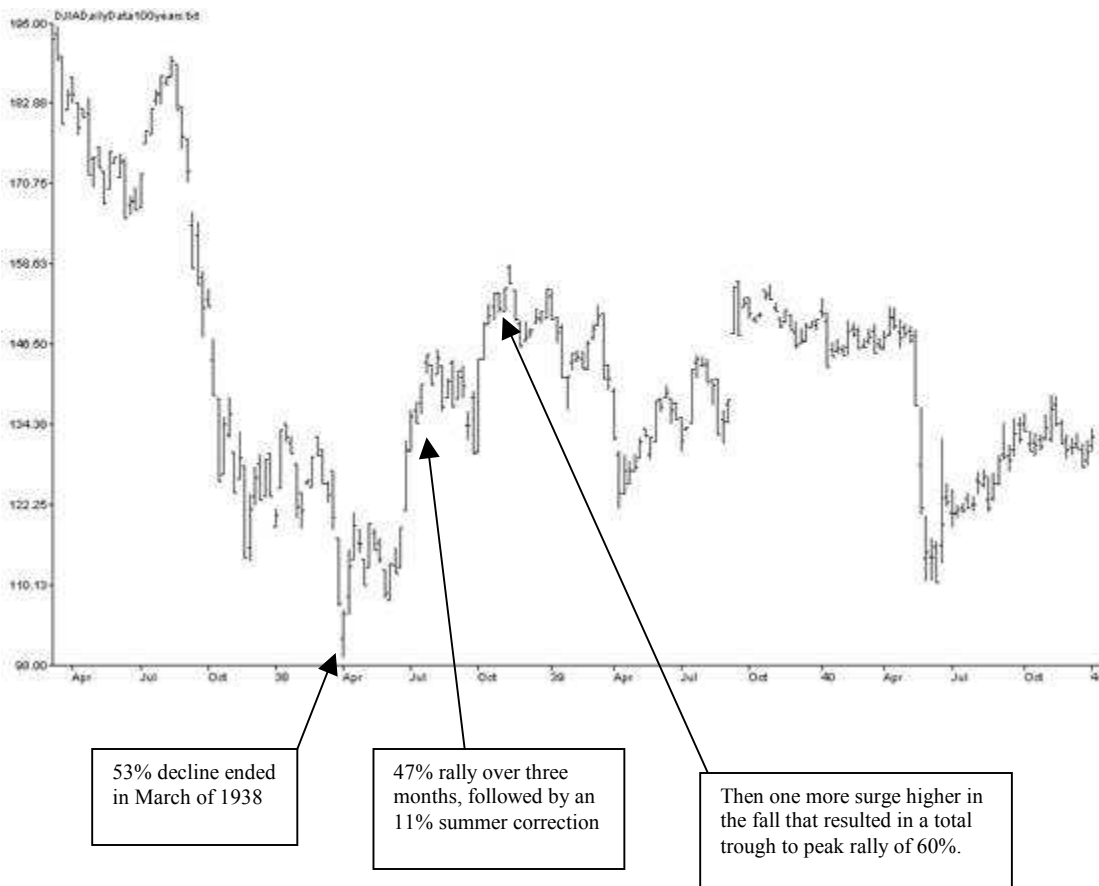


The Starboard Side Report

The week ending June 26, 2009

The markets continue to correct in a somewhat orderly fashion. Since the S&P 500 first entered its current trading range in early May, buyers have stepped-up on three separate occasions at the 880 level; the most recent support at this level occurred this week. There has been no change to our thesis that we are in the midst of a normal correction process that may run through a good part of the summer. Once this consolidation plays itself out, the market should be able to muster one more leg higher later this year into early next year. Should the above mentioned 880 mark not hold, we see the next downside support coming in the 830 range. That would be about a 13% correction and follow a pattern similar to the 1938 and 1975 post crash rallies (please see our June 5th report for more on this discussion). Below we have posted a chart from Frank Barbera of FinancialSense.com. This covers the Dow Jones Industrial Average from April 1937 through December 1940. As you can see, both the crash phase and the recovery to-date look very similar to 2009.



Last week we discussed the big picture relationship of commodities versus stocks. The chart that we presented showing commodities in a long-term relative strength advantage versus US stocks is also very important due to what it means for the various sectors of the market. We can analyze this by breaking down the S&P 500 sector weightings through the decades. The main sectors that benefited from fund flows during the great stock bull market between 1982 and 2000 were technology and financials. This was mainly at the expense of the commodity related sectors (energy and materials). Technology stocks peaked at 40.6% of the S&P 500 in 2000 while financials were almost 22% in May of 2007. Back in 1975, financials only made up 0.6% of the stock market. Therefore, their weighting grew by 35 times over a thirty year period! This market capitalization weighting for finance stocks doesn't even paint the true magnitude of the bubble because at its peak, over 45% of the S&P 500 earnings were derived from financial companies.

The table below illustrates the sector weightings through the years. This is a great companion to the chart that we showed last week. You can clearly see that since the S&P 500 peaked in 2000, the commodity sectors have steadily gained ground as a percent of the Index. That being said, we still believe that they have a long way to go until this trend runs its course. At the top of the last commodity cycle in 1980, the energy and materials sectors were 37.9% of the market or 20.4 percentage points larger than the technology and financial groups combined. Even after the bursting of both the technology and credit bubbles, the commodity sectors are a combined 19.5 percentage points smaller. This can be observed in the bottom row that we have titled Spread. When all is said and done for this long-term commodities bull market versus the US stock bear market, we expect that the weighting spread will once again be meaningfully positive for the energy and materials sector. Institutional portfolios that are loaded down with prior bull market legacy positions in technology and finance still have a long way to go to before they are properly positioned for the new asset class cycle dynamic that is upon us.

Sector Weightings as a Percent of the S&P 500 (commodities vs. technology and financials)

<u>Sector</u>	<u>Top of</u>				<u>Top of</u>							
	<u>Present</u>	<u>Credit Bubble</u>	<u>2005</u>	<u>2000</u>	<u>Tech Bubble</u>	<u>1995</u>	<u>1990</u>	<u>1985</u>	<u>1980</u>	<u>1975</u>	<u>1970</u>	
Energy/Materials (commodities)	15.7	13.5	12.3	8.9	8.0	15.2	20.2	18.7	37.9	29.6	25.7	
Finance & Technology (equity bubble sectors)	35.2	40.3	39.4	44.0	52.5	31.1	18.0	23.6	17.5	17.0	18.2	
Spread	(19.5)	(26.8)	(27.1)	(35.2)	(44.5)	(15.9)	2.2	(4.9)	20.4	12.6	7.5	

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Still a lot of bubble excesses to unwind in financials and tech with the spread at negative 19.5. We believe that this will revert back to a positive figure like we saw in 1980 sometime in the next decade.

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At the peak of the last commodities cycle, the energy and materials sectors were 20.4 percentage points larger than finance and technology.