



# The Starboard Side Report

The week ending July 09, 2010

The market was able to find some stability this week once the S&P 500 approached the key psychological level of 1,000 on Monday. We would like to see some follow through on the buy-side next week in order to be more convinced that selling pressure is finally starting to dry up. As we see in the graphic below, the second quarter of 2010 that just ended on 6/30 was the twelfth worst on record for the S&P 500 (going back to 1950). The key to what happens from here appears to be related to whether this is a growth scare (as we believe) or a double dip recession (as the consensus has started to believe).

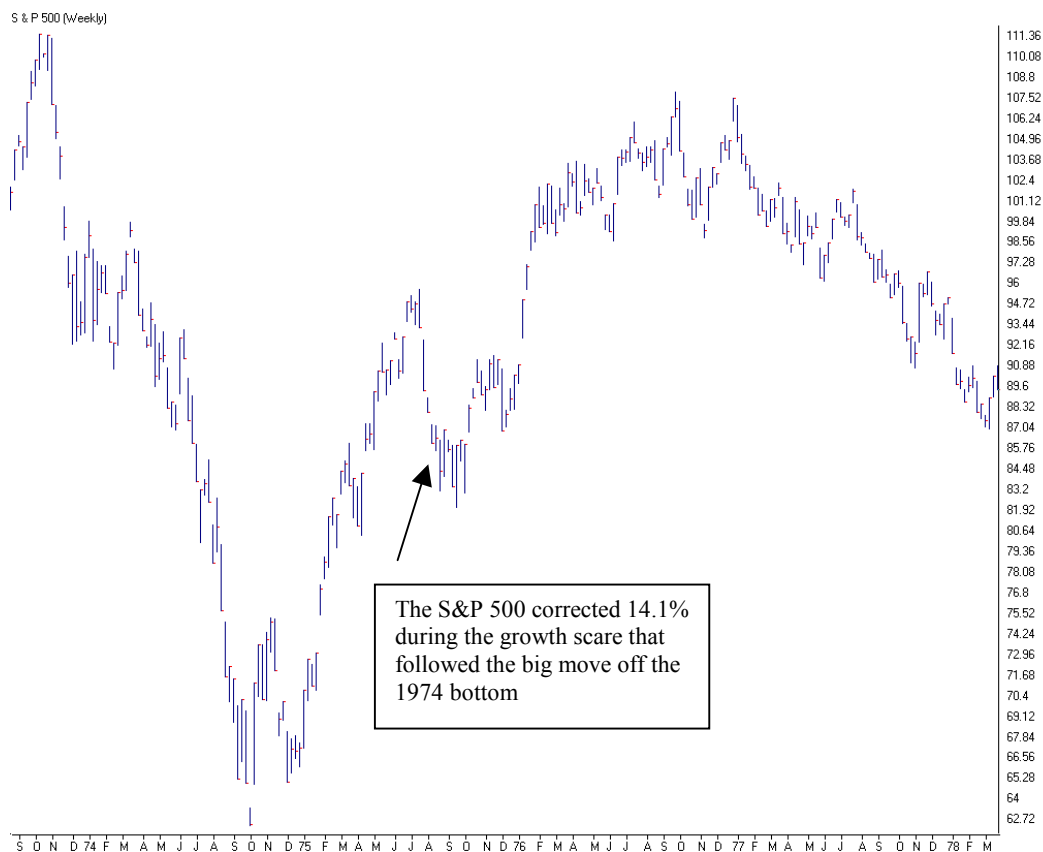
## Worst S&P 500 Quarterly Performance since 1950

#	<u>Quarter ending</u>	<u>% Decline</u>	<u>6 months later</u>	<u>1 year later</u>	<u>Recession</u>	<u>Growth Score</u>	<u>NYSE BP Low</u>
1	9/30/1974	-26.12%	31.19%	32.00%	Y		8
2	12/31/1987	-23.23%	10.69%	12.40%	N	N	6
3	12/31/2008	-22.56%	1.78%	23.45%	Y		4
4	6/29/1962	-21.28%	15.25%	26.70%		Y	6
5	6/30/1970	-18.87%	26.72%	35.73%	Y		6
6	9/30/2002	-17.63%	4.03%	22.16%		Y	24
7	9/28/2001	-14.97%	10.23%	-21.68%	Y		28
8	9/28/1990	-14.52%	22.60%	26.73%	Y		18
9	6/28/2002	-13.73%	-11.11%	-1.55%		Y	24
10	3/30/2001	-12.13%	-10.29%	-1.12%	Y		42
11	9/30/1975	-11.89%	22.53%	25.48%		Y	48
12	6/30/2010	-11.86%	?	?	?	?	38
13	3/31/2009	-11.67%	32.59%	46.57%	Y		14
14	9/30/1981	-11.45%	-3.63%	3.65%	Y		20
15	9/30/1957	-10.45%	-0.75%	18.01%	Y		8
		Avg	10.85%	17.75%			18

Data Source: Dorsey Wright & Associates

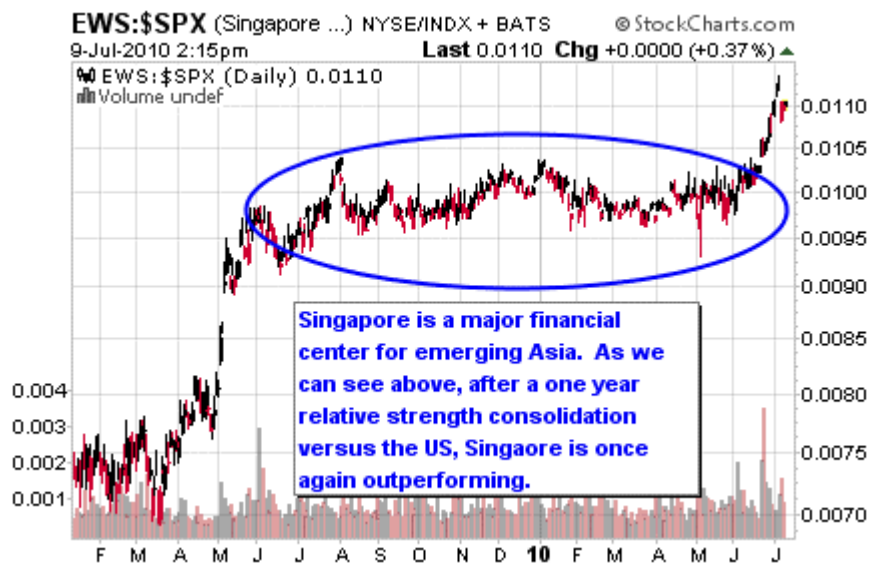
There are a few interesting nuggets in the data above. First, over the past 60 years, the odds of losing money in the market over a six month and one year time frame go down considerably once a very bad quarter is out of the way. However, it is necessary to look beyond the very short-term to see the big picture. We know that can be difficult at times, especially with the market swirling in a cloud of negativity, but buying the S&P 500 on the first day after a terrible quarter has resulted in an average S&P 500 gain of 10.85% over six months and 17.75% over one year. There are a few outliers like 1981 and 2001, but the majority of evidence in this study lends credence to a contrarian investing strategy that buys stocks during extreme weakness when sentiment is at its worst.

The next interesting point focuses on the NYSE Bullish Percent Index level associated with the weak quarters. Historically, bad quarters have led to washouts in the NYSE Bullish Percent Index. By washout we mean a move below 30%. There have been only two instances (other than this current one) when this index did not fall below 30% due to a bad quarter. The two in question tell a very different tale about where we may be heading. We draw your attention to lines ten (3/30/2001) & eleven (9/30/1975) in blue on the chart above. These are the outliers in which we *did not* have an unusually large drop in the bullish percent being that it stayed above 40% in both instances. The current quarter just ended has so far bottomed at 38%, so again, by historical standards, this has been a rather routine correction. In hindsight, we now know that the correction in the first quarter of 2001 was associated with a recession, whereas the third quarter of 1975 was part of a growth scare. The conclusion we can draw is should the double dip recession crowd be correct, then we will likely see more downside in the months ahead and a washout in the NYSE Bullish Percent Index below 30%. A brief rally in April 2001 was followed by much more pain throughout the rest of the year as the recession took hold. However, should this just be a normal growth scare (ala August 1975) then we could be in store for some very nice gains over the next year and the bottom may be close at hand. The S&P 500 gained 25% in the 12 months following the 1975 growth scare as the chart below shows.



We have been trying to point out over the past few weeks that all is not as dire as the headlines would make it seem in some parts of the global economy. There are a few pockets of strength that have held up very well since late May/early June. Most of these areas are confined to the emerging world, but the relative strength is starting to come through very clearly in the charts. Major market bottoms in 2006 and 2008 were telegraphed by the beginning of key divergences on the part of certain emerging markets. We are starting to see that once again in recent trading. Below are some charts of Singapore that fit together with those we included last week. We have long felt that the city-state of Singapore was one of the best ways to gain exposure to global financial sector since 50% of their market consists of financial stocks. As the US tightens the regulatory noose around the neck of its banking sector, Singapore is attracting more attention and capital flows. This is a natural transition from the developed world banking hubs of New York and London since Singapore is culturally and geographically closer to Asian growth centers like China, Vietnam and Indonesia.

### Relative Strength of Singapore versus the US



### Singapore iShare ETF



After about a one year pause, we believe that key divergences by the emerging markets may be a sign that they are beginning to take back the relative strength baton from the US. The three charts we showed last week of Latin America, Central Europe and Emerging Asia, in conjunction with these charts of Singapore, are telling us to dig below the surface of negative US news flow. Lo and behold, we see things like this recent headline on the Dow Jones Newswire- *"Sales of German Luxury Cars Soar, Driven by China."* Another from The Financial Times- *"Caterpillar expands in emerging markets; plants to be built in China and Brazil."* These are just some of the positive headlines that are getting crowded out. One final quote from the Business Insider about Australia, a foreign country that is not emerging, but has a lot of its growth tied to the resources boom in China. This also gives a bit of a different perspective on the problems in Europe and the US:

"Australia's job creation has been explosive, beating estimates by 200% yesterday. Unemployment is plummeting, already sitting at a level where most economists consider an economy 'fully employed'. Yet Australian job creation could soon hit the brakes, not for lack of jobs, but for lack of workers. A new joint report from the Australian Industry Group and Deloitte explains that one of Australian CEOs largest concerns is that a shortage of available workers will crimp their companies' growth prospects."

So much for the jobless recovery that we are hearing so much about these days. There are clearly other parts of the world that are experiencing a normal economic recovery.