

Stocks have endured a bumpy last few weeks. After peaking intra-day at 1422 on the S&P 500 on April 2, which was the first trading day of the second quarter, stocks (SPY) have been on the fade. Overall, stocks have declined by as much as -4.6% in the days since its recent peak. But this decline is modest when considered in context of the swift rally that preceded it over the last several months and was long overdue from a technical perspective.

What is driving the pullback? Is this just a pullback or is it a new trend down? Of course I don't have a crystal ball, but the best way I know how to answer these questions is to evaluate the fundamental and technical factors.

Fundamental Perspective: (Time horizon is 6 months or longer.) Better than expected US economic news caught the market by surprise during the later part of the 4th qtr and much of the 1st qtr. There was, still is, true signs of improvement across small businesses and housing- two key pillars to economic stability and growth. This improvement is confirmed in the expansion of bank credit and improvement in bank earnings (JP Morgan and Citi). Additionally, we saw a steady decline in unemployment claims indicating people are finding jobs; corporate earnings have reached an all time high; company balance sheets are very healthy. Topping all this off, is a very, very friendly Fed who is continuing to flood the market place with liquidity which in turn has held interest rates hostage at exceptionally low levels. Purchasing Treasury bonds now insures a negative real return (Gross rate - inflation). Bernanke has basically said it is indeed the Fed's intention to inflate the prices of financial assets at expense of savers. Consensus growth for the US in 2012 is firmly in the 2-3% range.

Turning attention outside the US, the fundamentals are neutral to negative. China, which had been the engine of world growth is at a stall speed for now- only growing at 8%! This is still OK, but not a game changer. Meanwhile, Europe is continually haunted by unresolved debt burdens. Although a 3yr liquidity facility has been put in place to avoid a credit melt down, the issue of genuine growth and servicing debt has yet to be addressed.

Net, the fundamental picture is at best, solidly neutral.

Technical perspective: (Time horizon is 1- 3month and considers price momentum, supply/demand and long/short positions.) The simplest way to understand technicals is to picture a life boat packed with people. As wave conditions change (fundamentals) everyone starts to move to one side of the boat causing the boat to tip, sometimes quite dramatically. The market is much like this. Last November, everyone was on the 'bearish' side of the boat. Then the waters changed (the economic news started to improve) and everyone moved to the 'bullish' side of the boat. This change took about 4 months and a +20% price change in the markets. Now the waters are changing again, that is, the economic news is less positive, more neutral, and hence trading positions, once again, are adjusted to more neutral posture.

So, what does that mean for price levels? My best guess is for now the market has topped out, and is in the process of establishing a trading range in the order of 7-9%. This means the market could trade down another 3-5% from here, or not. But if this occurs, it would be over fears of an on-coming recession. Odds are high that this type of price correction would prompt the Fed to come to the rescue once again with yet another quantitative easing package.

Investment Strategy: Steady as she goes mate! Strategies are constructed to ride through the rough seas through holding a wide diversity of risk classes and income producing assets. Bonds, large cap value and dividend paying stocks give stability and income to the portfolios.