

Monday, April 6, 2009

Ah, procrastination...

A major reason why I chose to write daily letters instead of weekly or monthly reports was because I have a problem with procrastination. When I started this service a few months ago I knew that if I tried to write big reports with set publication deadlines I would never get anything done. So my solution was to send out small, daily missives. So far this has worked out fairly well. I send out a little something for you to read each business day. This has been a win-win set-up for both of us, I think.

But then last week I promised a Quarterly Review of my work and its relation to current market conditions. This has turned into an embarrassment for me, as an entire week has elapsed and I haven't got any 'Quarterly Review' for you to read yet.

Then to make matters worse, yesterday afternoon when I was supposed to be starting work on this morning's issue I decided that I felt a little 'tired' so I laid down for a nap. Amazingly I didn't wake up until 3:30 am, the time I'm usually mailing out the morning letter.

So not only do I have no Quarterly Review, but I've made it difficult for myself to even write an adequate regular issue for you this morning. So it goes, I guess. I hope you will bear with me as I try to put the service back on the right track.

My thought now is to try and integrate something of a review into this week's regular mailings. The problem is how to go about this. In the last three months I have published at least 65 daily letters. Frankly, reading through all that material and making a review of it is too large a task for me, so I'm just going to pick out a few things from past issues and try to make fresh appraisals of them.

Defensive Stocks versus 'Cheap Pieces of Shit'

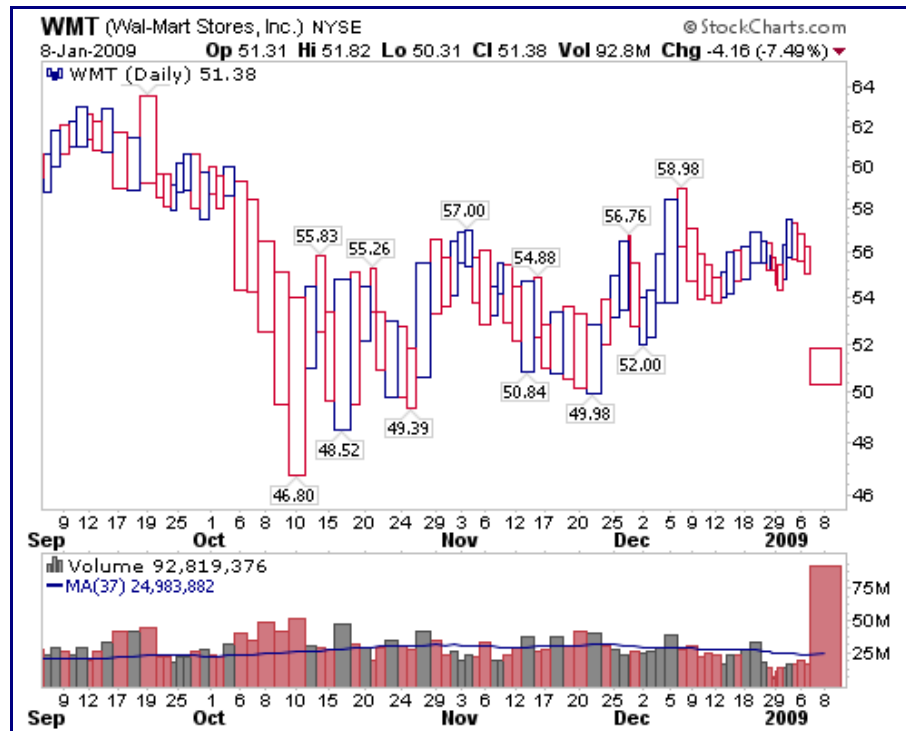
When I started the newsletter the first week of January, my initial outlook for the Stock Market was moderately bullish, at least for the short-term. I had it in my mind that the rally that began in later November had somewhat more to go before equities rolled over once more into the next phase of the bear market. This was a major mistake on my part. In fact I would say this was my biggest error of the last few months. Sure, I never recommended going all-in with equities, as I was clear that whatever rally we saw would be a countertrend. And sure I corrected my outlook before the Stock Market dropped too precipitously. But the reality is that I was wrong, even if the error was temporary. But as I was working my way out of this error (I didn't change my outlook on a dime) I happened upon an interesting scenario. Below is an excerpt of the Jan 9th issue where I first made mention of my idea. I'll return with current commentary at the bottom.

WMT, SLX:XLP Ratio

We just noticed this headline from the Wall Street Journal:

Wal-Mart's Stumble Isn't Likely to Last

It is nice to know that folks at the WSJ retain such confidence in Mr Big Box. But the big gap down on massive volume yesterday should give WMT bulls at least some cause for concern.



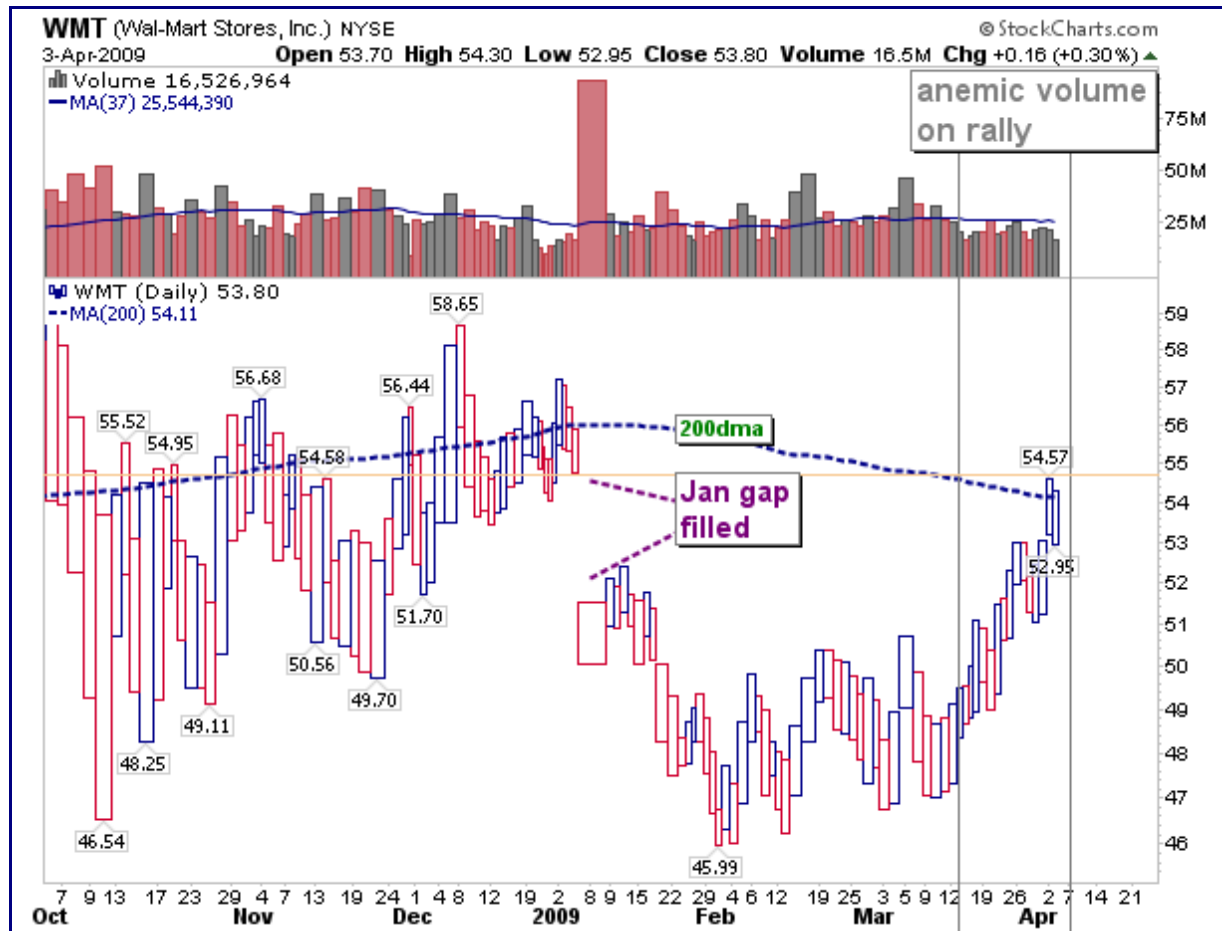
Even after the drop, Wal*Mart's trailing P/E is still close to 15. The short story is that investors are cycling out of expensive, so called 'defensive' stocks and moving into cheap stuff. Sears, Supervalu and Whole Foods go up big on the same day that WMT dumps, is that a coincidence? This trend may even have further to go. Supervalu (SVU), for example, has a P/E of about 6.5, well under half of WMT's valuation. While we are not expecting SVU to become as highly valued as WMT, it does seem likely that this valuation gap will continue to narrow for a while. That could mean SVU goes up in price, or WMT comes down, or a combination of the two, as we've seen recently.

This is just one example of what we are talking about. Pick a defensive stock right now and short it. At the same time, pick a cheap piece of shit and buy it. Over the weekend we shall see if we can find any of this type of opportunity, but at the moment the ratio of SLX (Steel ETF) versus XLP (Consumer Staples ETF) shows this trend we hope to capitalise on in the clearest possible manner:



[End Excerpt]

First of all, I just noticed that WMT has finally filled that January gap with a rally back up to the 200 day moving average:



The upswing in the share price over the last month has been accompanied by lackluster volume. Meanwhile Wal*Mart's P/E is back up to nearly 16, which accordingly to my valuational framework is pushing the limits of reason.

The SLX-XLP ratio that I introduced in January is up close to 7 percent since I first mentioned it, but as you can see from the chart, a real trend one way or the other has yet to develop. The pattern that has developed since October may be interpreted as a potential inverse head and shoulders. A fulfillment of that pattern would likely target the 200 day moving average



(currently at 1.90) but I admit not to having a strong feeling about the matter just now.

After becoming bearish on Defensive stocks back in January, there were three symbols that I explicitly suggested shorting: MCD, ABT and CLX.

CLX ended up being a short-term play (short rec at 51.85 on Jan 14th, take profit rec at 48.38 on Jan 26th) but I haven't yet recommended closing out the position in MCD and ABT. So let's take a fresh look at these two.



The share price of MCD has climbed back to where it lost support a couple months ago, which happens to be where some of the important moving averages are clustered. If the broader market stays buoyant in the short-term, then I suppose the share price could pop up another couple points, but I doubt it would hold. The PE is 15 now. That valuation will put a cap on further appreciation. Furthermore, McDonald's still carries a debt load of 10 billion dolaritos. The company is priced for perfection in an environment where a lot of shit could go wrong.



Once this starts to decline again my initial downside target is 45 or 46, though my full target is 40

or lower.

ABT has not participated in the broader market festivities of the past few weeks at all. In fact the share price just hit a new 52 week low on Friday.



Months ago I came to the conclusion that this company was run by a bunch of arrogant, over-confident assholes. I determined that there was a bull clique propping up the share price. But now that the longer-term price supports have given way, we should also wonder whether these

dudes have been inflating company earnings as well. The amount of insider selling in the 50 to 60 range was just incredible. You should go take a look for yourself ([click here](#)) but I'll include the summary table from yahoo:

NET SHARE PURCHASE ACTIVITY

Insider Purchases - Last 6 Months

	Shares	Trans
Purchases	6,000	2
Sales	856,978	42
Net Shares Purchased (Sold)	(850,978)	44
Total Insider Shares Held	2.29M	N/A
% Net Shares Purchased (Sold)	(27.1%)	N/A

My gut tells me that there will be more pain for share holders before this is over. However, I would encourage each of you (if you have any interest in this symbol at all...) to evaluate the situation yourself and come to your own conclusions. If earnings have been legitimate, then the downside from here is fairly limited. My continued bearishness is predicated on the hunch that that fishy smell is coming from a real fish.

There's a long-term chart of ABT on the next page.

ABT (Abbott Laboratories) NYSE

3-Apr-2009

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Open 46.69 High 48.80 Low 43.77 Close 44.12 Volume 68.2M Chg -2.48 (-5.32%)

- ABT (Weekly) 44.12
- MA(65) 53.30
- MA(1) 44.12



I'll review more of my analysis of the past few months in the coming days. Contact me with questions or suggestions about what you would like me to review.

Warm Regards,

Kyle Ledbetter Lucas

Equal-Weight Currency Indexes

USD: 101.86

JPY: 90.64

EUR: 98.89

GBP: 105.46

CHF: 95.83

CAD: 100.56

AUD: 104.88

XAU: 101.87

XAG: 110.91