



# MUCH ADO ABOUT NOTHING

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I believe we were overdue for a market correction. Up until today, stock market volatility was extremely low. Looking at the chart below of the S&P 500 stock price index, you can see only very small changes around the trend over the last four years.

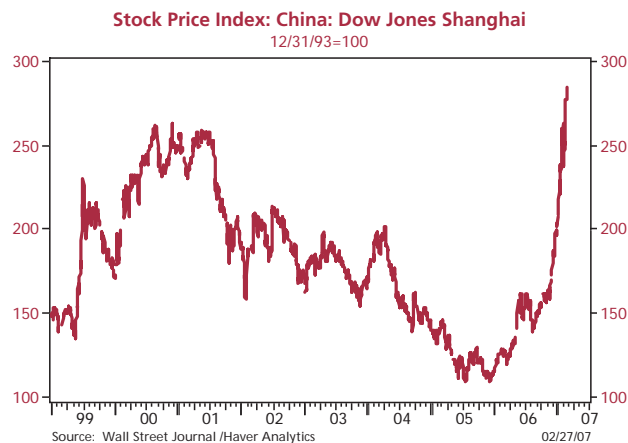


So, a big one-day correction when some bad news comes in is not surprising. The key question is whether this day is the first of a bunch of down days or just a short-term correction that is not supported by the fundamentals. I think it is the latter.

The bad news that piled in yesterday came from three main stories: 1) a 9% drop in the Chinese stock market overnight, 2) newspaper headlines purporting that Alan Greenspan thought a U.S. recession likely this year and 3) a relatively large 7.8% drop in new orders for durable goods in January.

All three news items are not particularly important. Let us start with China. Yes, they are tightening up on the economy a bit, and a pro-market economy minister may be on the way out, but a 9% drop in this red-hot market is, in my opinion, a drop in the bucket. Look at the chart showing the Shanghai index. It has been a moon shot over the last year, rising 124%. When it shoots up this way, investors get very skittish and are ready to sell at the first sign of market risk.

Next, there are the now infamous headlines purporting that Alan Greenspan thinks a U.S. recession is likely this year. In fact, nothing could be further from the truth.



Greenspan supposedly said (according to source):

“Greenspan: Recession In U.S. 'Possible' In Late 2007.”

Greenspan actually said:

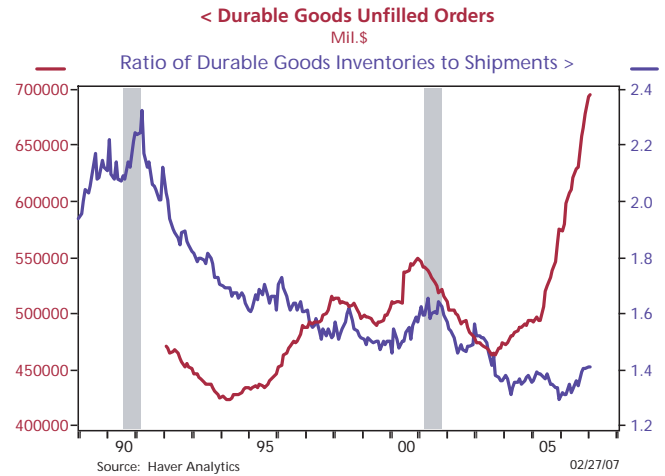
“While, yes, it is possible we can get a recession in the latter months of 2007, most forecasters are not making that judgment and indeed are projecting (growth) forward into 2008 ...with some slowdown.”

In his remarks, Greenspan called the global economy “benign and stable.” In a broad-ranging discussion, Greenspan said the U.S. and global economies are far more resilient now than before to economic and financial shocks.

Greenspan knows the meaning of the word ‘while’, but apparently reporters do not. He also knows that ‘possible’ does not mean ‘probable’.

Finally, there was the Durable Goods Advance Report for Manufacturing. This report shows a 7.8% drop in new orders in January (the blue line in the chart below). We have swings in new orders of similar magnitude fairly often which, in my opinion, have not been at all important. Also, shipments (the red line) actually rose 0.3%.

big as new orders, so I consider a 7.8% drop in new orders to be pretty piddling with such a huge order backlog. Also, the ratio of inventories to sales (the blue line), while up a bit recently, is bouncing off of an all-time record low. I see no serious inventory accumulation that might trigger significant production cuts.



This same report shows other data that I view as more important at present – the backlog of unfilled orders and the ratio of inventories. As you can see in the next chart, the backlog of unfilled orders has surged to, by far record high levels (the red line). Unfilled orders are 3.4 times as

My reading of the economy, and Greenspan's, is that a recession is unlikely this year. I think that overall the U.S. equity market is in good shape. That said, I do think we are in the midst of performance rotation, and I recommend reducing exposure to some of the flying asset classes and sectors.

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Investing in emerging markets can be riskier than investing in well-established foreign markets. Foreign investments are subject to risks not ordinarily associated with domestic investments, such as currency, economic and political risks and different accounting standards.