Walter Deemer's

MARKET STRATEGIES AND INSIGHTS

...for Sophisticated Institutional Investors

December 14, 2012

WELL, THIS IS EMBARRASSING...

As you know, I have a great deal of respect for the Four-Year Cycle and not much at all for the so-called Presidential Cycle. The combination worked out rather well from 2008 to 2011:

In the election year of 2008, the Presidential Cycle said the market would be up while the Four-Cycle warned that due to the 2006-2007 bull market extension the market would be down a lot. The S&P fell 38.5% in 2008. Win: Four-Year Cycle.

In the post-election year of 2009, the Presidential Cycle said the market would be down while the Four-Year Cycle said it should stage a good advance during what was Year One of the new cycle. The S&P rose 23.5% in 2009. Win: Four-Year Cycle.

In 2010, the Presidential Cycle said the market would be down while the Four-Year Cycle said it would be up. The S&P rose 12.8% in 2010. Win: Four-Year Cycle.

And in 2011, the Presidential Cycle said that the market would be up while the Four-Year Cycle said that it should be in some sort of topping process. The S&P was unchanged in 2011. Win: Four-Year Cycle -- now four for four.

Which brings us to 2012, which was a Presidential election year (when the Presidential Cycle said the market would be up) and Year Four of the Four-Year Cycle, when the market was at maximum risk. The market ended up thumbing its nose at my beloved Four-Year Cycle in 2012, however, and just as the so-called Presidential Cycle said it would, staged what looks like will be a double-digit advance.

This is, to say the least, most embarrassing; we had two clear-cut but opposing choices, and the market ended up following the (I think) mythological Presidential Cycle rather than the statistically-sound Four-Year Cycle. (Well, it did follow the latter in that it appears to be staging the fourth bull market extension since 1945, but since

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that outcome had only a 23% probability of occurring at the beginning of the year I treated it accordingly.)

I would like to blame this embarrassing outcome on the Fed's printing presses, but market analysts live and die on the actual moves in the stock market -- no matter why they occur. I therefore go into the 2012 Holiday Season with egg on my face – and, unfortunately, it didn't come from eggnog.

And next year? Well, the Presidential Cycle (which is now batting .200 for the past five years) says the market will be down. The Four-Year Cycle, meanwhile, says we are in a bull market extension which will lead to a much-bigger-than-average decline when it ends -- but doesn't say when that will be. There have been three bull market extensions prior to this one; in 1961, the market topped the month the Four-Year Cycle was scheduled to bottom. In 1987, it topped 12 months after the Four-Year Cycle was supposed to bottom, and in 2007 it topped seven months after the scheduled Four-Year Cycle low. Since the Four-Year Cycle low is/was projected for March, 2013, this sets up the possibility that the S&P could – could -- make a new bull market high sometime between March 2013 and March 2014. This, however, is a very low-confidence prognostication (three prior cases are hardly statistically significant), and the highest-confidence conclusion I can offer is that the market remains in an environment where risks are unusually high. (Lest you think that I'm just a cranky old bear, though, I might add that the holdings in our Fidelity switching program, immediately below, are – and have been all along -- an excellent source of buy ideas.)

Fidelity Sector Funds. 67% positive vs. 69% a week ago. Switching program holdings: #1 Construction & Housing, #4 Multimedia and #9 Consumer Finance.

Question Of The Week. Which will we see first – an unemployment rate of 6.5% or an inflation rate of 2.5%?

Think about it…

-- Walter Deemer