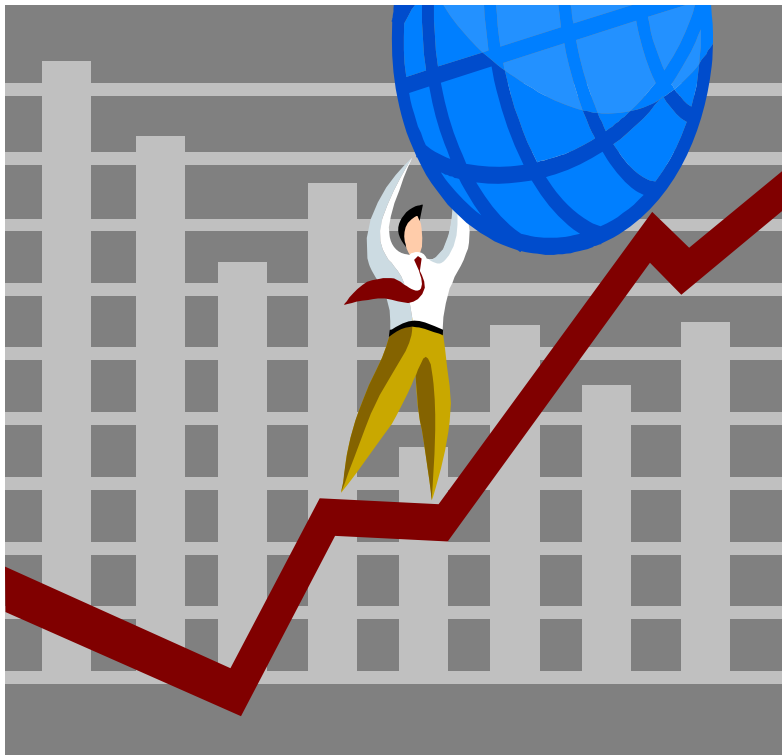


Island in a Stormy Sea

2009 Q1 Quarterly Commentary



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Island in a Stormy Sea

The bleak, end-of-the-world disaster movie which was our reality just weeks ago has faded to black.

Instead of doomsday scenarios, we hear about “green shoots” of recovery.

The market is almost flat for the year and we feel almost giddy with relief.

Crazy world.

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The whole Weyland crew had lunch out on our deck a week ago Friday. It was the first really nice Spring day in Portsmouth, and being in Northern New England, you gotta take ‘em, when you can get ‘em.

At lunch, the inevitable question came up: is this rally the first leg of the next bull market or are we just in the midst of one giant bear market rally. Frankly, we don’t know.

But I did compare our current market environment to being on an island - think Hawaii - on a sailing journey across the Pacific. We may not be at our final destination (the next bull market), but at least we’re much closer to it than when we began our journey.

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But what do we know?

Among the most important economic data pointing to a stabilizing of the economy is the Manufacturing ISM Index. This index from the Institute of Supply Management measures the opinion of manufacturing purchasing managers on various business factors like inventory levels, pricing levels, production levels and most importantly new order levels.

While manufacturing is not as important to America’s economy as it has been in decades past, change in manufacturing output still has a very large impact on the economy and on the markets. This fact makes the ISM index one of the few, true leading indicators of the economy as most economic indicators are either coincident or lagging, both of which are less useful for investors.

The hopeful news is that the ISM may have hit bottom for this business cycle in December when it plummeted to 32.9, a level at which was last seen in mid 1980 and has only been breached three times since 1948 (although it came close in 1958). Since December it has risen to 36.3 (March) and is expected to possibly hit 40 when released this week.

This would indicate that the ferocious weakness in the economy is waning and that the economy is stabilizing. It's a tautology, but one that bears repeating: economies can't start going up until they stop going down. And the economy appears to be going down less.

As investors, we ask ourselves what is the relationship between the ISM and future stock market returns?

If we assume that December was the low in this cycle (and a reading of 40 this week would be pretty good evidence) here are the twelve month returns of the S&P 500 following a low in the ISM below the level of 35:

Month of ISM Low	Next 12 Month S&P 500 Total Return
February 1949	28.2%
January 1958	38.6%
January 1975	35.4%
May 1980	26.8%
Average:	32.3%

If we average these four instances we get a total return of 32%. As the S&P 500 remains down for the year this would imply a gain of about 35% from our current levels. This is not a prediction, and you certainly can't "take it to the bank".

But it is definitely not implausible and does give credence to the notion that the worst may very well be behind us.

Further, certain coincident indicators (or indicators that coincide with market bottoms) have recently shown strength: a couple of housing indicators seem to have bottomed out while analysts' estimates of S&P 500 forward earnings turned up in the past week - finally.

Maybe there is something to these green shoots. Happy Spring!

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