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INTELLECTUAL AMMUNITION

Excuses, Excuses

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The "don't fight the Fed" and "super-V superbull" crowds are capitulating -- and that's an opportunity for the rest of us.

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We've been bearish on stocks and bullish on bonds for so long that we've been able to sniff with relative equanimity the stench of panic that is now wafting through Wall Street, reclining in a restful position on our laurels. We've gotten it right in terms of equity valuations, interest rates, and the slow pace of economic recovery. So it's been painless for us to have recently established the small beginnings of a position in equities now that they've finally become fairly valued, or even slightly undervalued (see "Normal Valuation: Where Do We Go from Here?" June 11, 2002).

But it hasn't been painless for the pundits who've made the wrong macro calls over the last year (and for the investors who were beguiled by them). For those who got bullish when **the Fed** started easing in early 2001, or when super-V recovery mania took hold in late 2001, it's a world of hurt. Based on what they're saying *now*, they're finally capitulating -- and at just the wrong time. The very things they mistakenly bet on too early (and for the wrong reasons) are now coming approximately true (but for entirely different reasons).

The pundits feeling the most pain are the "don't fight the Fed" crowd, who bought the top in May 2001 after the first several rate cuts. They're now wearing a loss of more than 30% in the S&P 500 since they started not fighting the Fed a year ago.

We, on the other hand have argued all along that low interest rates alone wouldn't be enough to revive an economy throttled by **Alan Greenspan's** 1999 and 2000 deflationary *jihad* against irrational exuberance. We argued that only the expansion of liquidity could end Greenspan's deflationary epoch -- and we've only seen such a liquidity expansion in the last couple of months. The evidence is gold's sustained move to the 320-to-330 range, and the retreat of the dollar back to its pre-deflation levels.

Those are *good* things. They mean that Greenspan is finally getting it -- however belatedly -- or at least that he's doing the right thing by accident. But this good news is greeted with horror by the same pundits who said "don't fight the Fed" in the first place. They fear that Greenspan is now "too easy" -- that he is risking an outbreak of inflation and a crash of the US dollar (see "Trade Deficit Hokum" June 21, 2002). You'd never guess it from long Treasury rates, which are about as low as they've been all year. But I suppose when you've been so wrong for so long you have to say something to explain your losses with a modicum of dignity.

The “super-V superbull” crowd who bought the top last December and January are hurting, too. Hoping for a resurgence of American unity and energy rising from the ashes of September 11, they told themselves that some combination of war fever and **President George W. Bush's** second-rate tax cuts and the policies of his third-rate economics team would stimulate the economy into a super-V recovery only months after recession was formally declared. And they told themselves it was worth paying near-historic valuations for stocks. After all (they told themselves) those valuations were signaling the super-V recovery!

But we, on the other hand, predicted that recovery would be slow and painful (see "The Risk Aversion Hurdle" January 15, 2002). And we argued that it's circular reasoning to buy stocks because you expect a super-V recovery, when the way you know there will be a super-V recovery in the first place is that stocks have gone up -- that's nothing more than saying stocks *will* go up because they *have* gone up. And we showed that even the most wildly optimistic super-V recovery scenario didn't justify the valuations that the bulls were happily paying (see "Vay Out of Vack -- Even for a 'V'" December 10, 2001).

We had argued even before September 11 that Bush's tax cuts were too small, too deferred, and too focused on "putting money in people's pockets" -- as White House economic advisor **Larry Lindsey** repeatedly said to justify them -- rather than focused on supply-side incentives to take risks and make investments. And after September 11, we despaired that President Bush was wasting his political capital with economic stimulus initiatives that were equally misguided (see "A Stimulus to Folly" October 10, 2001).

It's been no surprise to us to see Bush turn out to be a bust on the economics front. Bush may be a Republican, but he's no more a **Ronald Reagan** than his father was -- and no one who listened attentively to his presidential campaign can say he wasn't warned. Bush ran as a "compassionate conservative" and nothing more than that. Pro-growth voters endorsed him because he was "an electable Republican," and he turned out to be barely even that -- electable, I mean.

Bush has always been just… well, Bush. Yet the super-V superbull crowd is now acting shocked -- *shocked!* -- that Bush has slapped tariffs on imported steel, continued **Bill Clinton's** interventionist antitrust policies, and has done nothing to restore confidence in securities regulation. Six months ago they were saluting the Commander in Chief with both hands. But now the super-V superbull crowd needs an excuse for their 13% loss in the S&P 500 since the end of last year when their super-V mania first took hold.

There's no super-V, but there is a real recovery. What we've got is a garden variety recovery, taking root in the least growth-sensitive parts of the economy -- the parts that were least damaged by Greenspan's deflationary siege and will benefit the most readily now that the siege is lifted. And for almost the first time in 5-1/2 years the mass of stocks is fairly valued -- actually just slightly undervalued -- thanks to the capitulation of the "don't fight the Fed" and super-V superbull crowds. For investors who have no illusions, who have no pain, and who need to make no excuses, it's the beginning of an opportunity.