

Investor Sentiment - between Greed and Fear

by IMCZ Member John Henry Smith

How efficient is the Stock Market?

If the above graph is in any way accurate, how can the equities market be considered efficient, since over-reactions, at the extremes of which are market bubbles and crashes, would never occur? The theories of an efficient market requires that any over- or undershooting of prices would rapidly stabilize to a new price equilibrium based on changed future expectations of return that new announcements cause, instead of stock prices being in a constant state of disequilibrium as argued by George Soros¹. Theoretically, in such a market, price trends would be less volatile since investment decisions would be based on the purely rational incentives postulated by academia², instead of the amoral dynamics of the free market that search for 'abnormal' opportunities.

A stock's present price is a reflection of the market's expectations of future capital values; values that in essence are uncertain but have some degree of probability. However, as waves of news flood the marketplace, the best-efforts rationality of market players is expressed in shades of either fear or greed, causing prices to be in a constant state of disequilibrium. Irrespective of whether certainty or uncertainty grip investor sentiment, prices 'walk randomly' in the direction of the dominant emotion until appositional forces swing prices into a new direction.

The Fuels of Disequilibrium

The plethora of announcements and forecasts about the economy and corporate performance is the very fuel that drives the stock market and from which prices are derived. Of the two sources, the former, being principally factual in nature, is significantly more reliable than the latter source, notwithstanding that ordinary news, backward looking as it is, may also be peppered with ambiguities and other anomalies. However in direct contrast, forecasting faces a veritable mine field in its attempts to provide useful information on future economic direction. Consequently, the track record of accuracy is very poor even if they are issued by neutral and respected sources, such as the U.S. government. These inherent difficulties are shown in the range of variances of key economic factors for September 2008:

Event	Forecast	Actual	Variance
Building permits	930,000	854,000	-76'000
Consumer confidence	59.0	55.0	4.0
Consumer credit	\$9.0B	\$4.6B	-4.4B
CPI (inflation)	-0.2%	-0.1%	+01%
Durable orders	-1.5%	-4.5%	-3.0%
GDP	3.4%	2.8%	-0.6%
Hourly earnings	0.3%	0.4%	+0.1%
Industrial production	-0.3%	-1.1%	-0.8%
Initial claims (unemployment)	415,000	444'000	-29,000
Non-farm payrolls (job creation)	-70,000	-84'000	-14,000
Purchasing Power Index	-0.5%	-0.9%	-0.4%
Retail sales	+0.7%	-0.3%	-1.0%
Trade balance	-\$56.0B	-\$62.0B	-\$6.0B
Treasury budget	N/A	-\$111.9B	-\$111.9B
Unemployment rate	5.7%	6.1%	-0.4%

This is not the only hurdle investors face in their search for good guidance, on which to base their strategies; no, not by far! When we can't make head or tail of the market's behavior, it's nice to take the advice of market experts. Or is it? In a study, www.cxoadvisory.com assessed the top 50 U.S. market soothsayers, the findings of which are summarized below:

Total measurable forecasts	Forecasts Essentially Right	Forecasts Essentially Wrong	Top Rating	Bottom Rating	Average Accuracy
4210	2008	2202	68%	15%	47.8%

Only 16 of these experts were in the 52% to 68% range, with only 3 having been 50% accurate, while the other 31 experts were in the range of 49% to 15%. Most notable were *SP Outlook of Business Week* with 49% and *Jim Cramer* of CNBC fame with a rating of 46%. The average probability of 47.8% 'to invest or not to invest' is of no help to the ordinary investor, since he can do just as well himself. The question is that if these 'gurus' are not consistently right, how reliable are our own financial advisors?

Yet another worrisome phenomenon of the market is the validity of the buy, hold and sell recommendations issued by research firms, as the following table on Apple, Inc. (AAPL) shows:

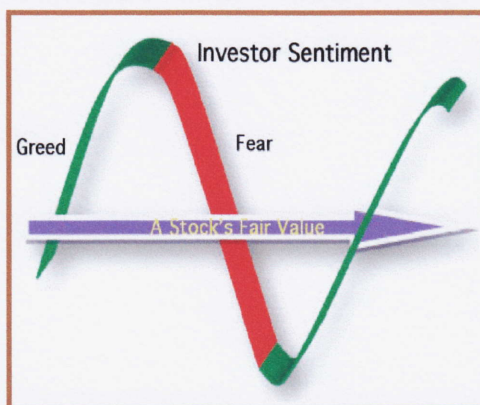
Date	Research Firm	Action	From	To	Price on date recommended	Price on Oct 20, 08	Percent age Loss
Aug 8, 08	Credit Suisse	Initiated		Outperform	\$169.55	\$97.40	-44.5%
Aug 5, 08	UBS	Initiated		Buy	\$160.64	\$97.40	-39.4%
May 22, 08	Oppenheimer	Initiated		Outperform	\$177.05	\$97.40	-45.0%
May 5, 08	Am Tech Res.	Upgrade	Neutral	Buy	\$184.73	\$97.40	-47.3%

Source: finance.yahoo.com/q/ao?s=AAPL

According to the Yahoo's website these recommendations still remain in place at the time of writing and as of today are perhaps valid, perhaps! But for the trusting investors, who bought the stock at the time these

recommendations were made and still hold the stock, such heavy losses must be very sour to bear! And it must be said that this is no isolated example, so investors beware!

In a vibrant economy, earnings estimates are continually being updated by corporations and research



firms, which have the affect of fuelling prices, even though such projections are certainly uncertain. Investors assume that earnings

drive stock prices, whereby the most potent force is earnings surprises, which is another way of saying that the market analysts got it wrong again! Here is the result of an analysis of 50 corporate earnings results for the 2nd quarter of 2008.

Missed Earnings Expectations	Meets Earnings Expectations	Beats Earnings Expectations
17%	10%	56%

With only 10% of analyst earnings forecasts accurate and 90% inaccurate, investors' confidence in the quality of the research being performed must be poor. All the more so, when one looks at the extent of the inaccuracies. For example, Peabody Energy (BTU) earnings were expected to be 56

cents, but the company reported 89 cents, exceeding consensus expectations by +33 cent or 59%. Terex Corp's (TEX) expected earnings were \$2.01, but they reported \$2.32, a surprise of +31 cents or 15% and on the other side of the buck, Martin Marietta Material's (MLM) earn-

ings surprise was that it missed forecasted estimates by 47 cents or 25%! Instead of announcing \$1.86 it reported only \$1.39!

The Rebirth of the Financial Phoenix

As the market moves from one discrete piece of information to another, with the massive flow of failed, ambiguous, contradictory and bogus information entering the market, is it any wonder that in times like these the market has become more volatile in its search for direction; that investors are at a loss at what to do with their funds, suffering from the consequences of the mortgaged-back securities fiasco, toppling financial institutions and the imprecision of market analysts?

How else can the recent gyrations of the SP500 over the last twelve days be explained?



Date	SP500	Points	Percentage
Oct 9, 2008	909.92	-75.02	-7.6%
Oct 10, 2008	899.22	-10.70	-1.2%
Oct 13, 2008	1003.35	+104.13	+11.6%
Oct 14, 2008	998.01	-5.34	-0.5%
Oct 15, 2008	907.84	-90.17	-9.0%
Oct 16, 2008	946.34	+38.59	+4.3%
Oct 17, 2008	940.55	-5.88	-0.6%
Oct 20, 2008	985.40	+44.85	+4.8%
Oct 21, 2008	955.05	-30.35	-3.1%
Oct 22, 2008	896.78	-58.27	-6.1%
Oct 23, 2008	908.11	+11.33	+1.3%
Oct 24, 2008	876.77	-31.34	-3.5%

Intentionally or otherwise, lack of clarity creates uncertainty and uncertainty greater volatility, a volatility that traders exploit in the swings from greed to fear and back again, wiping away trillions of dollars and draining the market of its most important participants; the investors. While a free capital market is the foundation of our economic growth and wealth, the imprecision of the prevailing system and the abuses of Wall Street should not undermine the well-being of the global economy. Ronald Reagan's and Maggie Thatcher's ideology of market fundamentalism and non-regulation has produced extreme greed of the most destructive kind, bringing financial systems perilously close to the brink of a dark and deep abyss. And just as the stock market will create a selling climate out of despair, from which a new phoenix will arise from the ashes in the form of a key reversal, so too do world leaders learn and acknowledge that the prevailing financial system needs to be overhauled in the best interests of global economic stability. In this context I feel that George Soros³ was visionary when he wrote in 2002:

"Market fundamentalism promotes the free movement of capital and entrepreneurship by the removal of regulation. This misapprehends the way financial markets work. It assumes that markets tend towards equilibrium and that equilibrium assumes the optimal allocation of resources. By equating private interests with public interest, market fundamentalism endows the pursuit of self-interest with a moral purpose."

Let us hope that whatever evolves from all this the pursuit of profits are frameworked by ethical, professional, and social principles to keep our financial markets stable in the best interests of prosperity for everyone.

¹A billionaire investor, George Soros's writings focus on the concept of reflexivity, whereby the biases of individuals enter into market transactions, potentially changing the fundamentals of the economy and who has popularized the concept of disequilibrium.

²Such examples as the Discounted Cash Flow (DFC) of Dividend Streams or Earnings; the Capital Asset Pricing Model (CAPM); the Price to Earnings ratio (P/E).

³George Soros: "Why the Markets can't fix themselves" www.geocities.com/ecocorner/intelarea/gs21.html.

Investment Corner

by IMCZ Member John Henry Smith

As there are several categories of investment styles, each month a stock will be analysed by a different category, i.e. Momentum Investor, Value Investor, etc.

Assessments and Analysis based on Nov 3, 2008 closing price: \$50.28

Analysis of:	MOSTLY FAMILY, INC. (AFAM)
Industry:	Home Health Care
Strategy:	Momentum Investor
YTD Performance:	+159%
SP 500 YTD Performance	-34%

Almost Family, Inc. (Almost Family), along with its subsidiaries, is a provider of home health services. The Company has service locations in Florida, Kentucky, Ohio, Connecticut, Massachusetts, Alabama, Indiana, Illinois and Missouri. The Company has two segments: Visiting Nurse (VN) and Personal Care (PC). The Company's VN segment, which it operates primarily under the trade names Caretenders and Mederi-Caretenders, provides a range of Medicare-certified home health nursing services to patients in need of recuperative care. Its PC segment, which it operates under the trade name Almost Family, provides services in patients' homes on an as-needed, hourly, or live-in basis. On October 26, 2007 it acquired the assets of all the Medicare-certified home health agencies owned and operated by Quality of Life Holdings, Inc. In August 2008, the Company completed the acquisition of Patient Care, Inc.

CATEGORY	CRITERIA OF A MOMENTUM INVESTOR	SCORE	REPORT CARD
Current quarter vs. same quarter last year:	Current EPS growth 18% better than the same quarter last year	42.9%	PASS
Annual earnings growth:	Annual earnings growth above 18%	41.6%	PASS
Earnings consistency:	Year on year earnings growth higher than the previous, allowing for one dip only.	Before extraordinary items: 0.20, 0.33, 0.58, 0.81, 1.14	PASS
Current price level:	Within 15% of its 52-week high	Current stock price (\$39.93) is within 15% of 52 week high (\$46.45)	PASS
4 month S&P relative strength line:	A general upward trend in the stock's weekly relative strength compared to the SP500.	AFAM's relative strength trend has been increasing over the last 4 months	PASS
Price performance compared to all other stocks:	A stock's price performance, or weighted relative strength, compared to the SP500 over the past year should be no less than 80.	AFAM's relative strength is 98	PASS
Confirm at least one other leading stock in the industry:	Confirm the industry's attractiveness by citing at least one stock that has a relative strength of at least 80.	In AFAM's industry (Healthcare Facilities) there are 28	PASS
Look for leading industries:	The number of companies in the industry with a weighted relative strength above 80, or look for industries with the most stocks making new 52-week highs.	AFAM's industry is currently one of the top performing industries	PASS
Decreasing long-term debt/equity	A debt/equity ratio less than 2, or the company has consistently cut debt over the last 3 years.	AFAM has a Debt/Equity ratio of 0.04	PASS
Return on equity:	A ROE of at least 17%.	AFAM's ROE is 18.6%	PASS
Shares outstanding:	Shares outstanding less than 30 million.	AFAM has 8 million shares outstanding	PASS
Insider ownership:	15% or more.	Insiders own 13.9%	FAIL
Institutional ownership:	Some institutional ownership is preferred.	Institutions own 50.4% of AFAM stock	PASS

DISCLAIMER: The above financial data is for informational purposes only, and is explicitly not a recommendation made by IMCZ, which cannot be held liable for its accuracy and that any purchase and/or sale of securities in whatever form based on this information is entirely at the reader's own risk.