From the Desk of John Colley...

REFLECTION POINTS

I would not call it panic selling but the recent selloffs are reminiscent of last spring's pullback. That pullback was more than indigestion as the Euro zone troubles really dominated the economic news, feeding on itself day after day.

Again, we are seeing a general weakening in Euro currency, which causes US Treasury yields to go lower while the US dollar minutely strengthens as a result. The 2-year Treasury is yielding .25%.

The higher VIX (volatility gauge) implies more risk sensitivity than the stock markets experienced in the recent first quarter. The triple-witching (on Friday) was a set-up factor.

What do we see...

Some so-so earning and some strong earnings have so far been reported. The biggest disappointment has been the banking and housing sectors.

Our markets probably got ahead of itself in the first quarter and this current pause is a corrective phase... often referred to as a **Risk Flattening Mode**.

With the first quarter a zoom, the current pullback is a testing of the waters. The fundamentals, on an improve plane, have not been consistently strong enough, and allows the worrying to creep in... thus casting some doubts and bearish worries.

Observations:

- The quality of earnings from Corporate America is tied for the best since 2007 (not inflation-adjusted either). Stay large cap and US-based seems to be the consensus opinion. Small cap and specific niche situations exist.

- The believability of earnings is very credible. The analysts are slightly bullish and do not like pulling down the estimates (i.e. financials). But it is a check and balance and the markets will remain emotional, fickle, and irrational. Apple's forward P/E is 7 times, a ridiculously low valuation.

- The reliability of earnings is a signal of regularity and so far we have witnessed about 85% of Corporate America come in on target. Over the last 2 quarters there have been more positive surprises than negative.
- Volume of trading seems to shrink (dry up) on sell off days and there have been very few “flush outs” over the past 12 months.
- GDP numbers are due to be released this Thursday for the first quarter growth.
- $1.7 trillion sitting on sidelines (down from $1.9 trillion at year-end) is being put to work.

JC
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