



# DAVID R. KERN

**ASSET MANAGEMENT**  
*Dynamic Asset Allocation Strategies*

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## 3rd Quarter 2006 Newsletter

### The Economic Landscape

Wall Street finds a reason to party after the Dow Jones 30 Industrial Average flirted with record territory even as the broader based S&P 500 Index and the much broader NASDAQ market index are still below their historic highs made in the spring of the year 2000.

While recent surveys show that Wall Street optimism is on the rise, investors are still no more confident today than they were in the middle of the bear market in the summer of 2002. It could be that the Dow has taken nearly seven years to re-coup its losses from the bear market, even though it normally takes bull markets only about three years to return to record territory following a major down move. The S&P 500 Index is still 13% below its record high set in March of 2000, and the NASDAQ index including over 3000 stocks is still down 55% from its high in the spring of 2000.

Many professional market strategists and money managers are not convinced that we are in a new long term bull market. With the Standard and Poor Index still below its peak over 6 ½ years ago, David Rosenberg, the North American economist for Merrill Lynch, wrote to clients as the Dow Jones broke its old record, "Call us when the S&P 500 manages to break through its old high like the Dow".

There is another big reason investors are wary. While stocks often move in anticipation of economic trends, they are by no means a perfect prognosticator. Just 14 months after the Dow set its previous record high in January of 2000, the U.S. economy slipped into recession that lasted

from March 2001 to November 2001. Given the age of both the economy's recovery in this bull market which celebrates its fourth birthday on October 10<sup>th</sup>, many on Wall Street are already beginning to anticipate a recession. The bond market is all but forecasting a major economic slowdown and that can't be good for stocks. While the Dow has been partying, ten year Treasury Note yields have sunk from as high as 5.24% in June to as low as 4.56% last week. Bond investors seem to be bracing for a hard landing as the economy slows. The Federal funds rate, which banks charge one another on overnight loans, is at 5.25%, significantly higher than the yield on ten year Treasuries. Historically, whenever the Federal funds rate has been a full percentage point higher than the ten year Treasury yield, we are faced with negative year over year job growth and a recession.

One major reason for the market's recent rise from the lows in May has to do with oil prices. Crude oil is more than 25% off the historic high price of over \$76.00 per barrel set earlier this year, and now trades below \$60.00 a barrel. If this big decline in oil prices has helped fuel the stock market, along with a Federal Reserve, whose unsure on the direction of inflation, what will happen if crude oil start rising again? The Federal Reserve may be forced to start raising interest rates again, and that can't be good for the stock market.

Please contact David R. Kern Asset Management if there are any changes in your financial situation or investment objectives, or if you wish to impose, add or modify any reasonable restrictions to the management of your account. Our current disclosure statement is set forth on Part II of Form ADV and is available for your review upon request.

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**David R. Kern, Registered Principal**