

CAPITAL INVESTMENT MANAGEMENT

Registered Investment Advisor

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February 2010 Economic Update

The Economy

- Economic progress continues but market action indicates some caution as we look toward potential developments for the rest of the year.
- Earnings have been coming in better than expected, and U.S. GDP gained 5.7% for the fourth quarter, but the market has been more focused on risks; recently experiencing a long-awaited correction.
- Economic growth continues to be stronger than expected, but the Federal Reserve is beginning its exit strategy and liquidity measures are being reduced.
- Substantial economic slack and low labor costs should keep U.S. inflation in check in 2010 and beyond, although industrial commodity prices may benefit from inventory replenishment and a strong recovery in global trade.
- Dollar bearishness has been widespread; however, the U.S. trade position has improved significantly as Europe and Japan endure a significant loss of competitiveness. Concerns over the sovereign debt of certain euro-zone members could result in a more substantial flight-to-quality trade.

Summary

- We have a cautious view toward equities as we've entered the new year. In the latter part of the year, the poor fiscal position countries may face, and the global economy's questionable staying power in 2011, will likely create volatility.
- Economic challenges are building as the year looks forward. Increasing tax burdens and the winding down of the Obama stimulus program could hamper the expansion. Higher costs, stemming from increased industry regulation and financial reform, also have the potential of impeding economic growth.
- In light of the recent correction, we have moved our portfolios to a defensive position by decreasing overall market exposure.
- Our seasonal trade, mentioned before in this update, has done well this year. For an interesting look into more seasonal theory, feel free to read the additional Super Bowl commentary.

The Super Bowl Indicator

Market movements can be predicted by who wins a football game according to popular wisdom. The Super Bowl indicator is based on the idea that if a team from the old American Football League (now the AFC division) wins the Super Bowl, the market will decline over the next year. Conversely, a win for a team from the old NFL (now the NFC division) means the stock market will be up for the year.

The first question to address is whether or not the popular wisdom withstands the scrutiny of testing. Actually, the indicator is surprisingly successful. A team from the AFC has won twenty of the 43 games. In years when these teams won, the market was up 60% of the time, and showed an average gain of only 1.9%, well below the average return of 10% a year the market delivers over the long term. Wins by NFC teams were followed by an average gain of 13.2% and the market was up in 86% of the years after an NFC win.

Trading system developers would certainly be happy with results like this, but would be hard pressed to explain the logic underlying the system. One possible explanation as to why this indicator might work is found in looking at the overall economy. Old NFL teams, such as the Chicago Bears and Cleveland Browns, are Rust Belt cities with economies dependent upon manufacturing. The upstart AFL, when it began playing football in the 1960s, placed franchises in booming cities dependent upon the new economy – oil in Houston, technology in Oakland – or whose owners had new money fortunes like the Hess family which owned the New York Jets.

When the old economy does well, fans in those cities have good jobs and feel good about their prospects. They fill the stadiums of the home team, and fill the coffers of their teams with cash needed to sign great players to win the Super Bowl. As the new economy does better, we see their teams dominate the NFL, and the manufacturing companies that dominate the Dow Jones Industrial Average do worse, resulting in a bad year for stocks.

So the Super Bowl indicator works, and is supported by logic. It is everything an indicator is meant to be. For 2010, it's bullish no matter who wins since both teams playing in the big game have their roots in the old NFL.