UPDATE

OPPENHEIMER

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Market Strategy

Wall Street Upstages Pamploma

Market Overview.

The stampede of the bulls into equities continued last week. Augmenting their allure as the asset class uniquely possessing upward momentum, equities enjoyed a boost from a broadening consensus – led by spokesmen from the Federal Reserve Board and from its former chairman – that the slowdown in housing does not constitute a threat to the economy. Indeed, it is considered salutary in that it will bring growth back to a sustainable pace. Indeed, the Fed's maunderings stressed that participants should not become complacent that the current pause would be followed by a rate cut, and emphasized that all options were open in case the economy reaccelerated enough to exacerbate inflationary pressures. Needless to say, the view here is that it is premature to dismiss the housing issue as a non-event.

Commodities are again vying for center stage. The new focus is on soaring grain prices, as wheat reached the highest level in a decade. While fundamentals – low carryover stocks and disappointing current crops, particularly in Australia – suggest higher prices, the rise may well overreach and parallel the parabolic moves seen earlier this year in energy and metals skyrocketing in response to speculators stampeding into the pits. The ramifications could be ominous in the real world where consumers deal with food prices several times a day, much more often than gasoline prices. The experience could present a challenge to their so far unflappable optimism.

In metals and energy, the view here is that the emetic phase of liquidation by trend following speculators has been largely completed and prices now are more likely to reflect supply-demand forces from real life users. Indeed, if all is right with the economies of the world, as equity markets suggest, then the recent decline should be considered a mere piercing of a bubble, rather than the more profound signal of an end to the cycle. Conditions suggest that the consolidation trend will accelerate, particularly in the oil sector. Russia's uningratiating attitude toward foreign developers may serve to highlight the appeal of owning reserves in politically safe areas, as well as raising the possibility, and concern, that Russia, rather than OPEC, may evolve as a key player in supporting prices through supply cutbacks.

For the deliberate investor, tactics at this stage present a quandary. The dynamics of the equity market remain favorable. Stocks as an asset class do not face serious competition from bonds that provide returns drastically below historical norms nor from real estate with nose bleed capitalization rates. The recent dramatic and compressed move has been exaggerated by an apparent change in asset allocation by hedge funds – commanding unprecedented aggregations of capital that dwarf mutual funds and individual investors, and under enormous pressure to perform near term. As Lord Keynes famously observed, the secret of successful speculation is an accurate gauge of psychology. At this juncture, the outlook for the equity markets is believed to be almost entirely a matter of psychology.

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