



### **GREEN SHOOTS OR BROWN SHOOTS?**

While it hasn't been surprising to us; the first six months of 2009 have been extremely volatile. The good news is that this volatility continues to create extraordinary opportunity. During the first quarter we witnessed the DJIA drop to the mid 6000's along with a decrease of 24% for the S&P 500 driven by legitimate concerns we could be headed into an economic depression. The only thing we have been a little surprised by is the recent 40% rally off the March lows, considering we thought the market had it right in March.

Investor sentiment has improved significantly as investors seem to be sending an "all clear" signal. The volatility index (VIX) has dropped considerably, trading at "pre-Lehman" levels and the government continues to spend money on anything and everything.

We are still extremely concerned about the state of the economy and the domestic equity markets. This recent 40% rally has been dominated by second and third tier companies that have rallied significantly more than the underlying indices. This is not a bad thing because it has created some very exciting opportunities to short companies that appear to be vulnerable.

Small business owners are still having difficulty raising capital, major concerns exist within the credit card industry, and the commercial real estate market is clearly struggling and possibly headed for disaster. There is still a massive housing inventory overhang that continues to loom out there. As we have said in the past "this crisis started with housing and needs to end with a housing recovery."

The public is beginning to realize that the government cannot control long term interest rates, as mortgage rates have risen by almost a full percent over the previous two months. We are also concerned that the government is gradually running out of ammunition in the face of the worst economic recession since the great depression. Other factors that cannot be ignored are the fact that unemployment continues to escalate at an alarming rate. In short, we are very concerned about the future of our economy.

As we documented in the May issue of the "Rady Review", we view the government's "stimulus" as a giant shell game. On one hand, the treasury is aggressively buying everything under the sun while at the same time issuing significantly more debt than they are buying and therefore flooding the market with supply. Not to mention there has been a significant increase in the credit risk profile of the treasury's balance sheet. With the \$350 billion purchase of Treasuries and expansion of the TALF program and government agency purchases; the balance sheet is likely to expand beyond \$3 trillion. This represents almost quadruple an already levered 2007 Treasury balance sheet. At some point in the relatively near future, we simply don't see any place for interest rates to go but up, up, up!

We have been accused of being too doom and gloom but we do see significant opportunity in certain sectors. We firmly believe that healthcare is an attractive place to invest as baby boomers will continue to grow old and get sick. These opportunities exist irrespective of the health of the economy. We also don't think the Obama health care proposals will be as bad as people anticipate for certain companies. We see some very attractive asymmetric risk/reward opportunities, as a number of stocks in this sector are trading at historical low valuations. We are also interested in energy. As North American rig counts have declined by over 50% we continue to focus on domestic natural gas exploration and production companies.

These volatile markets and uncertain economic environment make stock price inefficiency greater and more prevalent. In other words, as the economy deteriorates we will see more and more opportunity to generate Alpha. This concept can be difficult for most investors to stomach from an emotional perspective.