BILLS ASSET MANAGEMENT

BAM MARKET NOTE

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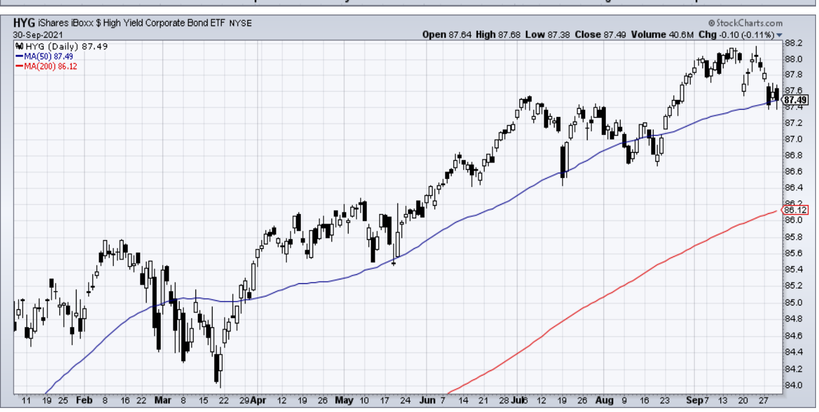
Well, that escalated quickly. The bounce from last week gave way to renewed selling this week. September's bad reputation added another chapter this year as the S&P fell nearly 5% for the month. Importantly, the index retested the recent lows of last week. This is an important line in the sand for the bulls. Further weakness here would lead to a test of the next support level almost 2% below Thursday's close. The increased selling at yesterday's close gives little comfort that the re-test will hold. While a 5% pullback is not particularly worrisome or unusual in a typical market, the current environment is anything but typical. It has been some time since a loss of this magnitude has happened – in fact almost a year as last October saw a 7.5% decline. It's not a time to sell everything but it is a time to tread cautiously. Every steep sell off starts just like the current one. Tighten your stops and reduce risk in your portfolio to adjust to your level of comfort.



For most asset classes, moving averages don't work particularly well for buy and sell decisions. However, high yield bonds are one asset class that responds well to using moving averages for investment guidance. This is due in large part to their tendency to trend and their relative low volatility. As stated before, they are also a very good read on the state of the economy. High yields began to roll over in early September, rebounded a bit and have now rolled over again. They currently sit right on the 50-day moving average. Further weakness would pierce this support and would be further cause for concern.

Our Point

There is no way to sugar coat it – the markets have had a horrible September. This week saw the Fed admit (though many consumers already knew it) that inflation is a little bit more than transitory and may last longer than the Fed previously predicted – perhaps much longer. We are also seeing the slow unraveling of both the "small" infrastructure bill and the "much larger" one. While Wall Street had some reservations about the $3.5 trillion bill being passed, few expected that the smaller $1.5 trillion bill would be held up. That is where we stand now. The Republicans want to limit the bills cost and scope while the Democrats are split between the progressive wing and the more moderate one. The progressive wing has drawn a firm line that they will only approve both bills while some of the more moderate members are balking at the price tag of the larger bill. It is a mess and both bills are currently in peril as nobody is looking to compromise. One can argue the wisdom of passing one or both of the bills and we have in these pages over the last few months, but Wall Street wants to see money flow and the lack of either bill could spell trouble for the markets. That said, the Fed continues to print money (despite the inflation concerns) and the spigots remain open. Should more market weakness come, the Fed is likely to only refill the punch bowl providing some relief to a market that has become dangerously accustomed to easy money. Tapering is certainly off the table with weak markets. At some point, the Fed backstop will no longer work. Are we at that point? We don't think so and the markets remain in a bull market. Even another 5-10% correction would not change our views. However, that does not mean that an informed investor should do nothing. In all honesty, nobody knows where the market is headed next so one should just respond to what the market is actually doing rather than what one might think it will do. We have done just that and lightened up on our equity exposure this week. We will take more action next week should conditions warrant. Be careful and be cautious. Have a wonderful weekend.