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"Markets are never wrong, only opinions are."

Jesse Livermore

Jesse Livermore is not exactly a household name today and he has, in fact, been dead for over 70 years. He is, however, considered one of the greatest stock traders of all time and the above quote is my favourite from him and one of my favourite stock market axioms. For all our technological advancements and for all the knowledge we have acquired since Jesse died, the above quote still holds true. Everyone, including me, has an opinion on the market. As I've said many times: My clients don't care if I'm right or if I'm wrong - they care whether they made money or not!

If you're thinking that this is my way of weaseling out of making any hard and fast predictions for 2011, you are absolutely correct! But gosh darn it, I love to give my opinion and so I don't mind sharing with you what my feelings are about the market for the rest of 2011. As the title in the subject line suggests, I have a feeling that there is potential for a great "tug-of-war" between the bulls and the bears this year. I can tell you, though, that I have not had as good a feeling about the stock market since at least 2007. Two years of good returns can do that to you not to mention that the economic news coming out of the US, while not awe inspiring, continues to get better and better.

Here's what worries me: everyone else is feeling good about the stock market, too. It feels like every analyst and strategist that I follow is predicting that stocks will be up this year and will outperform bonds and cash. So who am I to disagree? Even the most pessimistic ones seem to be jumping on the bandwagon. What concerns me is it feels like investors are becoming complacent and ignoring the real risk that still exists out there. To top it off, I have had several clients ask me recently if we should be taking more risk given that the market seems so strong. This is a big red flag to me and what we call a "contrarian indicator". What that basically means is if the crowd is going one way, you should give serious consideration to going the opposite way.

Being contrarian is not a fool proof strategy, though. In fact, there is no such thing as a fool proof investment strategy that always makes money. If there were one, believe me, I would have found it by now. It is just one of many, many factors that I take into consideration when I make my day-to-day investment decisions. Market psychology or the "mood of the market" is very near the top of my list of things I consider everyday. And the mood is as good as I've seen since before the financial crisis. Here are some other issues that I consider relevant to today's market:

1. The US economy looks to be on track and going in the right direction. Of course, their unemployment is still high and their economy is growing slower than you would expect coming out of a recession but both of these metrics are going in the right direction.

2. The European debt crisis seems to be somewhat under control…for now. We could find out in as soon as a few weeks how the situation really looks in Spain which is a major source of concern for the markets. Spain's economy is much larger than Greece or Ireland so if they run into trouble refinancing their debt, it will be much more troublesome than Ireland and Greece put together. The reason for all the concern, by the way, is very simple. If any of these countries were allowed to default on their debt, it would be very bad for European banks because they are holding much of this debt. This would cause potentially great losses for these financial institutions which, if you recall what happened to Lehman Brothers, would not be good for the financial system as a whole.

3. Japan's debt is now 200% of it's GDP and had their debt downgraded recently by Standard and Poors to AA-. The debt to GDP ratio is used as a measure of the general health of a country's economy. So the more debt you have compared to the size of your economy (GDP or gross domestic product), the worse off you are. I don't even know where to begin here but this is

a serious situation. To give you an idea, the US debt to GDP ratio is "only" about 95%. Canada is less than 80%. It's OK if your GDP is growing faster than your debt but this is not the case in Japan. They've been fighting deflationary pressures for 20 years and their aging population is not helping. Their demographics are horrible and so it seems unlikely they can grow their way out of this problem.

4. It appears that the Federal Reserve will not raise US rates in 2011. In fact, Ben Bernanke has said that making stocks go up is one of his goals. This will provide important support to both the stock and bond markets for as long as it lasts. The Bank of Canada has basically telegraphed that they will raise rates in Canada this year but if the US stays put, it will be risky to raise them too much. The market consensus seems to be a total of 1% in hikes for 2011. I see this as aggressive because this will likely cause our dollar to strengthen which is already over $1.00 compared to the US$. The higher our dollar goes, the more pressure this will put on our exporters and that could act as a drag on our economy.

5. The fact that US companies have approximately $2 trillion in cash on their balance sheets will tend to be supportive of the markets. This is a lot of cash and because it is earning so little right now because of low rates, companies will become more and more anxious to spend it. The way they spend it will depend on the company but you would think that acquisitions, dividend increases and stock buybacks would be the most likely avenues to increase shareholder value. All of these are good for the stock market.

Assuming that nothing unexpected happens, I think that stocks have a good chance of outperforming bonds and cash in 2011. The farther the market goes up, however, the more concerned I will become that expecations of investors will continue to be met. I won't mind a little volatility, though, because when markets get volatile, investors tend to make emotional decisions which can cause dislocations. It's my job to look for these and make money for my clients.

As always, feel free to contact me if you have any questions.

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