

Stock analyst fears bonds like the bogeyman

STOCK ANSWERS
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Picture a poor child lying awake in a blackened bedroom when the utter fear becomes so overwhelming that he is driven under his bed to avoid the bogeyman in his closet.

It is only then, as he lies trembling on the cold floor beneath his Sealy Posturepedic that he realizes the monster as been lying in wait under his bed all along.

That's how James Demmert thinks of the bond market these days as fearful investors flee stocks to buy bonds in the hope of finding a safer haven for their money.

"The bogeyman that everybody is afraid of is probably not in the stock market anymore," said Demmert, managing partner of the Sausalito investment and wealth management firm Main Street Research. "It's probably in the bond market."

Investors flooded bond funds with new investment and Demmert said he hears many investors asking if they shouldn't be moving out of stocks and into bonds to protect their investment capital.

"Investors are jumping from one fire into a bigger fire. Their emotions are causing them to go from one direction to the other at precisely the wrong time," said Demmert. "We've been through one of the more difficult bear markets in stocks. At the same time, we've been through one of the biggest bull markets in bonds, which is likely to come to an end simply because when economies do recover, which this one obviously is beginning to do, interest rates do have upward pressure."

Demmert said people plunging into the bond market tend to chase the biggest yields. The biggest yields generally have the longest maturities and the weakest credit quality and are going to be the most susceptible to pressure from rising interest rates.

At the same time, Demmert draws comparisons to the current economic climate and the recovery of 1958. It was the one time when the Federal Reserve moved to raise interest rates within a year of a recession. Typically, he said, the Fed likes to keep its foot off interest rates in the first couple of years of a recovery.

"It had a number of impacts. It pushed rates up considerably and forced bond prices down. It also created one of the shortest economic expansions in the history books," he said.

Though that creates concern that the current recovery may be short-lived, Demmert believes there's a strong case to be made for stocks right now. In 1958, stock prices fully recovered within about 12 months even though the Fed's action shortened the recovery. He expects a strong rally, but thinks the Fed could bring it to an abrupt halt if they move on interest rates too fast.

"There are so many great values being created, particularly in the last few months," he said. "I do believe the experience investors are going through right now, which is a nerve-rattling one, will likely unfold as the beginning of a new bull market."


Demmert likes stocks across a wide range of sectors. Along the theme of recovery, he thinks investors should buy biotechnology stocks. In particular, he likes the biotech giant Amgen Inc. (AMGN). "Biotechnology is an important theme over the next three to five years. They do particularly well in a recovery as investors' appetites for risk start to get reinvigorated," said Demmert.

He also thinks all investors should own financial stocks and said he'd buy Citigroup Inc. (C). "Financial stocks do exceedingly well in recoveries," said Demmert.

Another favorite, which is not a recovery bet, is the defense

contractor General Dynamics Corp. (GD). Demmert considers this a good way to play the defense build-up because General Dynamics' entire business is defense contracting.

WHAT DEMMERT LIKES



| Company | 52-week high | 52-week low | Current price |
|-----------------------|--------------|-------------|---------------|
| Amgen (AMGN) | \$70 | \$47 | \$48 |
| Citigroup (C) | 53 | 34 | 44 |
| General Dynamics (GD) | 99 | 72 | 99 |
| Intel Corp. (INTC) | 36 | 19 | 26 |
| Home Depot (HD) | 53 | 30 | 45 |
| Target Corp. (TGT) | 46 | 26 | 45 |

As for technology stocks, Demmert said a lot of investors are scared of the sector right now, but thinks this is the time to put money into technology. He thinks there's plenty to choose from here, but zeroed in on Intel Corp. (INTC). He said semiconductor companies tend to lead technology rallies.

Last, he thinks investors should take on some retail sector exposure. Two names he likes here are Home Depot Inc. (HD) and Target Corp. (TGT). "There's equally great management at both of those companies," he said.

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