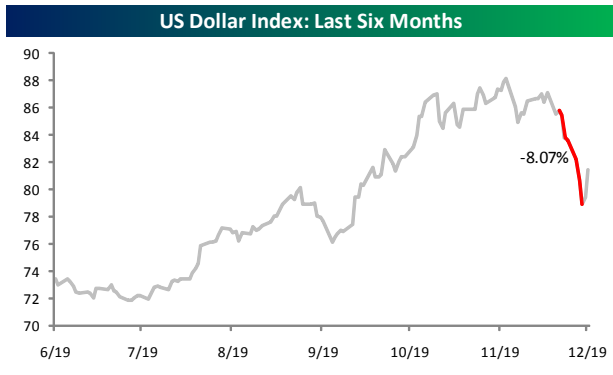
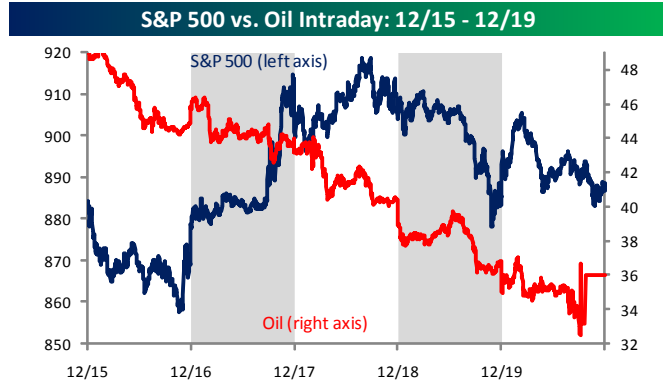


This Week In Review: Calming Down

Is the storm subsiding or are we just in the eye of the hurricane? That's the question we now face as the S&P 500 traded in its narrowest range (7.1%) since September when the credit crisis hit full throttle. Needless to say, a seven percent range from the week's highs and lows is still extreme by most measures, but compared to what we've experienced over the last three months, it is enough to put a trader to sleep.

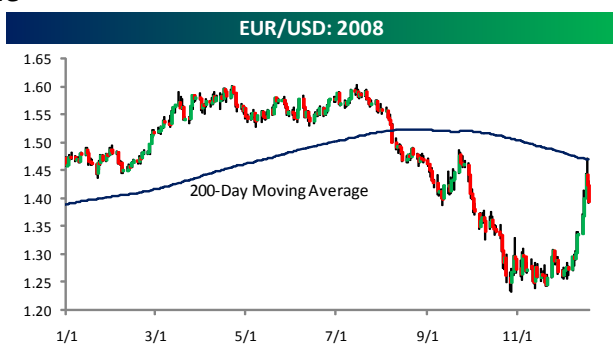
While the stock market appears to be settling down, other assets remain chaotic. In the currency markets, volatility is actually picking up, but unfortunately for the dollar, it has been biased to the downside. As shown in the chart to the right, through Wednesday, the US Dollar index declined by 8.1% over a six-day period. Even for the stock market, an 8% move over such a short period is unusual, but in the currency market, it is unheard of. As far back as daily data is available (1971), the six-day move was the largest in the index's history.

The move in the Euro was even more pronounced. At one point on Thursday, the Euro had rallied by more than 12% in the span of a week, which was its biggest move ever versus the Dollar. However, that rally came to an abrupt halt yesterday, and the Euro has since corrected by more than 5%. The main explanation for the Euro's two-day decline is that the ECB said it would enact measures to spur more lending between banks. However, the chart to the right shows that the currency ran into key resistance right at its 200-day moving average. While technical analysis is often criticized as a method for 'lazy' traders who don't want to do in-depth research, charts like this show that even if you are a strict fundamental investor, you should always be aware of the major trends other traders are following.



Worst Six Day Periods for US Dollar Index

Week Ending	Price	Percent Change (%)
12/17/2008	78.91	-8.07
9/26/1985	131.55	-7.48
2/14/1973	101.62	-6.74
9/21/1981	103.84	-5.24
7/6/1973	90.54	-5.07



Like the movements in the currency market, commodities have been just as volatile. Given the overall weakness in the Dollar and the 2 million barrel per day cut in output by OPEC, one would expect to see oil doing well. However, that couldn't be further from the truth. As the intraday chart on page one illustrates, oil has been in a complete freefall this week without even a feeble attempt to rally. When asset prices go down in a straight line, it's a clear sign that liquidation is occurring. What a difference a few months makes.

We all remember back in May when Goldman Sachs (GS) issued a report predicting that oil's "super spike" would likely send the commodity to \$200 "over the next 6-24 months."

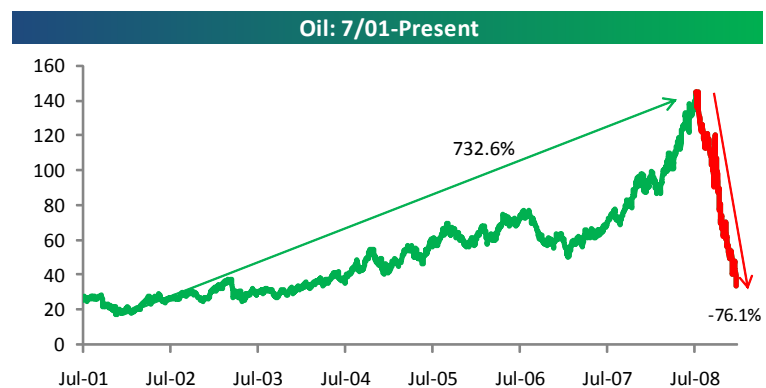
Analyst warns of \$200 crude oil

On Monday (six months later) Goldman advised clients that "oil prices will fall to \$30 a barrel in the next three months."

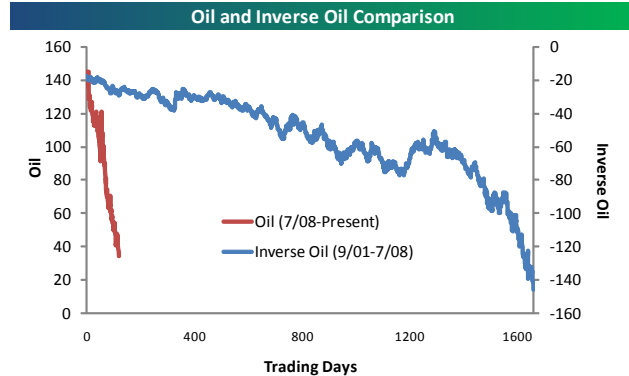
Goldman predicts oil to hit \$30 a barrel

While we almost got there this week, we would note that if the call for \$30 oil is as accurate as Goldman's call for \$200 oil, investors may want to fill up their gas tanks and lock in their heating oil prices ASAP. *Just as analysts were front running each other to have the highest target on oil during the Summer, when they start doing the same thing on the downside, it will be a signal that the commodity is bottoming.*

The trends we have witnessed in the oil market highlight the adage that the bigger the bubble, the louder the pop. After rallying 732.6% from its low of \$17.45 in 2001 to its high of \$145.29 this July, oil is now down an astounding 76.1% from its peak. In the past, we've compared the oil bubble with the Nasdaq and homebuilder bubbles. *At its current price of \$34 and change, oil only needs to fall another \$2 to see the same declines that the Nasdaq saw during the bursting of its bubble.* The only difference is that it took years for the Nasdaq to reach its lows, while oil has declined by almost as much in just a few months. Back in September, we highlighted our bubble comparison and suggested that oil in the \$30s wouldn't happen until 2011 if it took the same track as prior bubbles. *At -76.1% in 5 months, oil's fall, like the drop in the Baltic Dry Index, is one of the fastest and most extreme bubble bursts in history.*

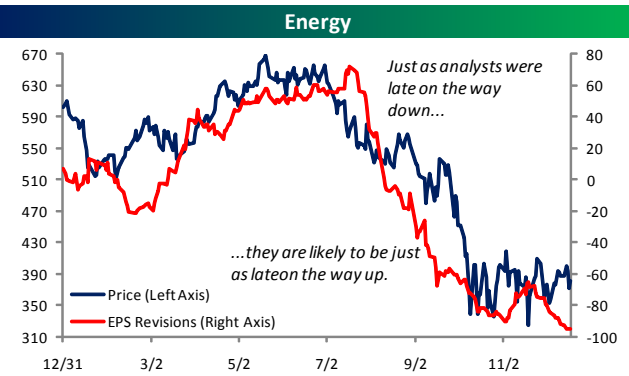


If there is one thing the recent bubble bursts have taught us, it is that *bubbles burst a lot faster than they inflate*, and the oil example is a perfect one. At right we compare the inverse of oil during its run-up from 9/01 to 7/08 with the regular price of oil from 7/08 to present. Our goal here is to show how much quicker assets usually decline than they go up. It took more than 1,600 trading days for oil to reach its highs and just a little more than 100 to move back down close to its lows.

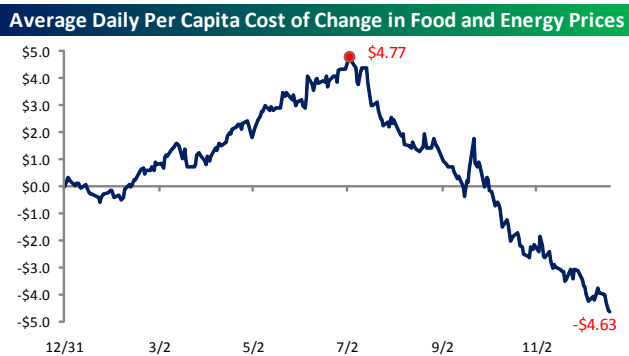


At the risk of stating the obvious, energy stocks are feeling the pain of lower energy prices, and given the \$100+ decline in a barrel of oil, analysts haven't been able to cut their earnings forecasts fast enough.

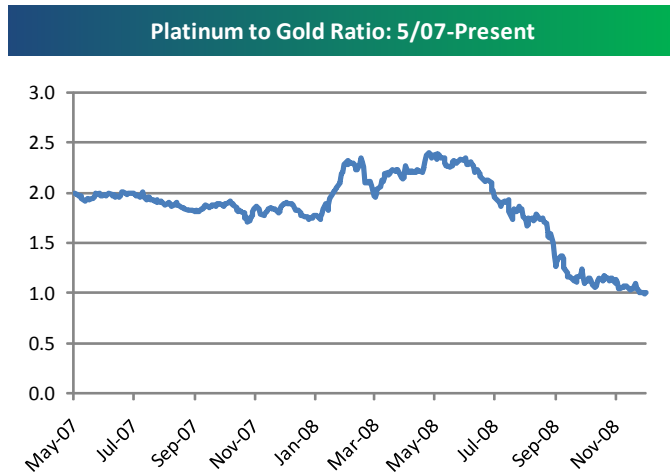
In the chart to the right, we show the net pace of earnings revisions over rolling four week periods throughout 2008. *Currently, only three (BRS, INT, and OSG) of the 89 stocks in the S&P 1500 energy sector have not seen their earnings estimates cut over the last month.* Before getting too bearish on energy stocks, however, we would note that when oil was at its peak, analysts could not raise estimates fast enough. By the time they started cutting estimates, oil was already well below its peak. Just as analysts were behind the curve in forecasting the peak, we expect that they will be just as late when oil makes the turn higher.



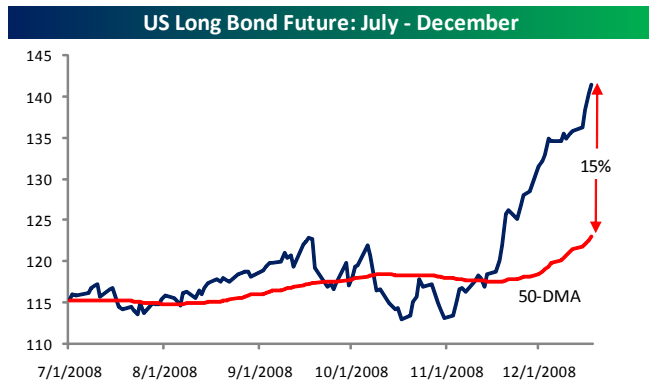
While energy companies have been getting clobbered by the selloff in oil and other energy related commodities, the consumer is enjoying quite the windfall. As shown in our chart of the average daily per capita cost (or benefit) of the YTD change in commodity prices, the average American is now saving \$4.63 per day in 2008 versus 2007. That works out to nearly \$1,700 extra in each of our wallets per year. So as bad as the impact of rising commodities was in July, the impact of declining prices has been a boon for consumers.



While we are on the subject of commodities, we would note that the recent swings in the market have created some interesting anomalies. As one example, we would cite the recent trading in gold and platinum. Investors have been flocking to gold in recent weeks on currency concerns, and after this rally, the yellow metal is now trading at the same price as platinum, which is 30 times as rare as gold. On Thursday, platinum closed at \$865.20, while gold closed at \$867.50. As shown in the chart below, the ratio of platinum to gold traded close to 2 to 1 up until the middle of this year when it began to decline as platinum fell faster than gold. Yesterday, the ratio turned negative for the first time in years. Given this disparity, investors looking to buy gold may want to take a look at platinum instead.



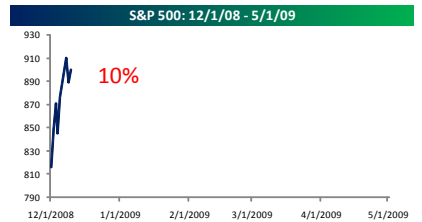
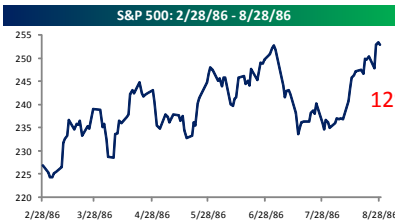
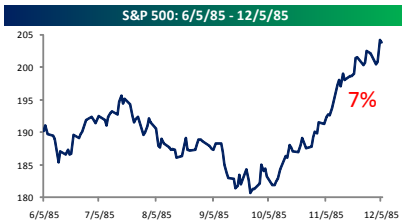
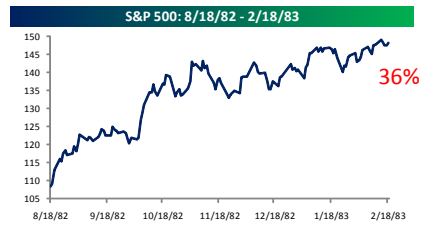
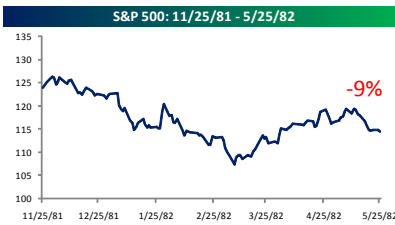
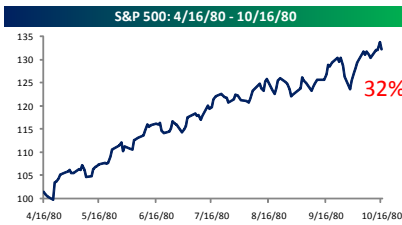
The bond market has been just as volatile as the currency and commodity markets. In the case of the Treasury market, however, the direction has been practically straight up. As of Thursday, the US long bond future has risen 17% in the last twenty trading days, arguably making the current rally the strongest in at least thirty years. As a result of this move, the long bond is currently trading 15% above its 50-day moving average (DMA), which is an extremely uncommon occurrence. In fact, since 1977 there have only been five other periods where the long bond future even traded more than 10% above its 50-DMA.



So following big rallies in the Treasury market, where should bond investors who have made a killing put their gains? Stocks? Or back into Treasuries? In the table below, we calculated the performance of the long bond future and the S&P 500 following the first day in each period when the long bond traded more than 10% above its 50-DMA (in the current period that day was 12/01). Based on prior trends, equity bulls will be encouraged by the apparent outperformance of stocks. In the five prior periods, the S&P 500 was up four times for an average gain of 14.6% over the next six months (table and charts below). The long bond future, on the other hand, had more muted returns of 2.65% over the next six months, with gains in three out of five periods.

Bond & Stock Performance After Long Bond Future Trades 10% Above 50-Day Average

First Day More Than 10% Above 50-DMA	Long Bond Performance (%)			S&P 500 Performance (%)		
	One Month	Three Months	Six Months	One Month	Three Months	Six Months
4/16/1980	6.69	6.48	-1.86	5.23	17.82	31.67
11/25/1981	-7.73	-5.50	-3.42	-1.40	-8.53	-8.82
8/18/1982	0.27	12.61	8.59	14.52	27.09	35.84
6/5/1985	-3.32	-2.66	1.92	0.68	-1.47	7.40
2/28/1986	5.93	-0.99	8.01	5.31	9.00	11.46
12/1/2008	7.50 thru 12/18			10.19 thru 12/18		
Average	1.56	1.99	2.65	5.75	9.02	14.62



One of the most puzzling aspects of the rally in Treasuries has been that it is occurring in an environment where government outlays are set to increase at nearly an exponential level. Given the flood of issuance that's on the horizon, what is driving investors into Treasuries? The safety factor is the most oft-cited reason. Given the declines we have seen in equities and non-US government fixed income, investors have become increasingly risk averse, opting instead for Treasuries. While this started the rally, Tuesday's Fed statement kicked it into a higher gear.

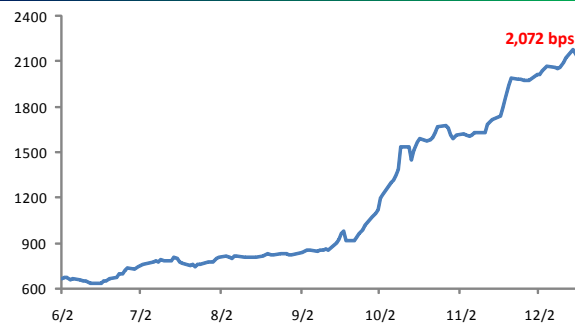
In its statement, the Fed outlined its plans going forward now that the Fed Fund Rate is practically at zero. The key part of the statement was:

The focus of the Committee's policy going forward will be to support the functioning of financial markets and stimulate the economy through open market operations and other measures that sustain the size of the Federal Reserve's balance sheet at a high level. As previously announced, over the next few quarters the Federal Reserve will purchase large quantities of agency debt and mortgage-backed securities to provide support to the mortgage and housing markets, and it stands ready to expand its purchases of agency debt and mortgage-backed securities as conditions warrant. The Committee is also evaluating the potential benefits of purchasing longer-term Treasury securities.

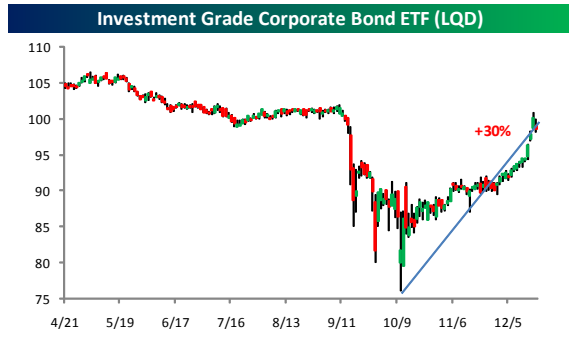
As Bill Gross has mentioned, the easiest way for fixed income investors to make money has been to go where the Fed is going. So when the Fed said it was evaluating the purchase of Treasuries, they created a stampede into that market without even actually doing anything.

While the Fed's statement was good for the Treasury market, it will be useless if we don't see any thaw in the non-Treasury fixed income market. Based on data from the Merrill Lynch High Yield Master index, the spread between high yield bonds and comparable Treasuries has increased from around 600 bps all the way up to over 2,072 basis points since June. With the 10-Year Treasury currently yielding a little more than 2%, companies falling into the high yield category are facing interest charges of around 23% to borrow. This is not a healthy environment to conduct business. While high yield spreads have narrowed slightly since the Fed's announcement, we still have a long way to go before we reach any level of normalcy.

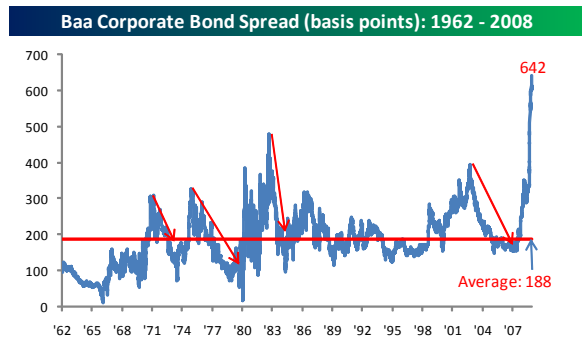
Merrill Lynch High Yield Spreads (bps): June - Present



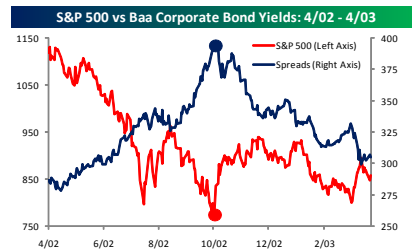
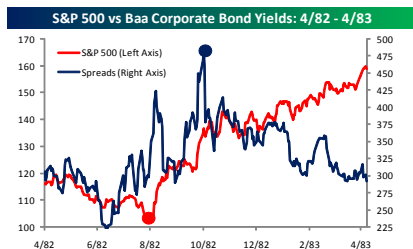
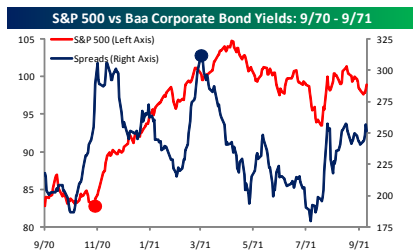
While the high yield market is still frozen, recent moves in the investment grade sector of the market are encouraging. Using an ETF (LQD) for the sector as an example, we have seen a 30% rally in investment grade corporate bonds since the October 10th low. If we can begin to see this type of improvement in the high yield market as well, it will be an incredibly encouraging signal that we are near the end of the storm rather than just in its eye.



Investors are in mutual agreement that the economy will not be able to get on track until the credit markets show some improvement. Where investors disagree, however, concerns the relationship between corporate spreads and the stock market. Most investors would argue that corporate spreads lead stocks, and therefore stocks will not bottom until spreads come in meaningfully. In practice, though, this argument doesn't hold water.



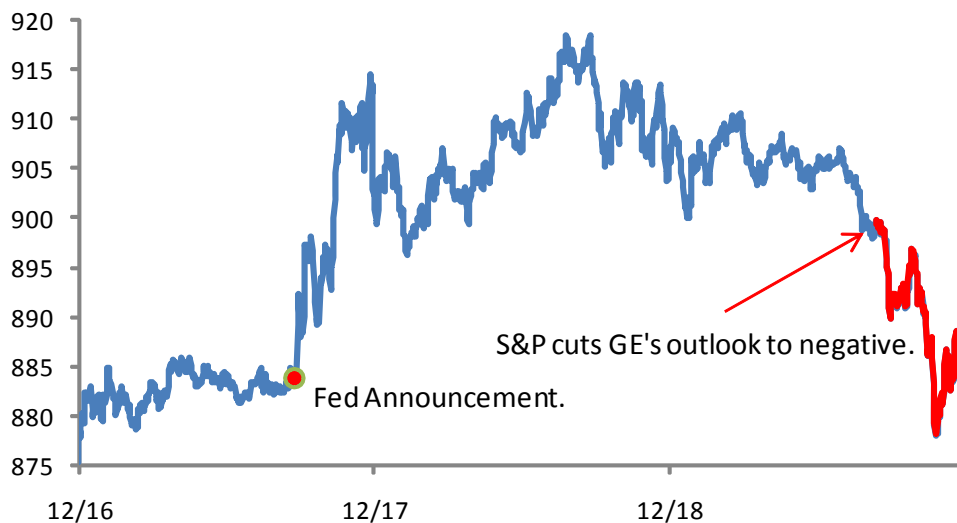
In the four charts below, we compare the performance of the S&P 500 and corporate spreads six months before and after the peak of the four spikes highlighted above. As shown, in three of the four periods, the S&P 500 bottomed well before spreads peaked. In the fourth (2002), spreads peaked at the same time that the S&P 500 made its low. Based on these periods, stock investors waiting for a signal that spreads have definitely peaked will likely be left behind.



Following the Fed's rate cut and statement on Tuesday, the S&P 500 responded with a rally of 5.1%, which was the 7th best day of the bear market, and the best 'Fed Day' for the S&P 500 since they began announcing their policy decisions in real time (prior to 2/94, the Fed announced rate decisions 6 weeks after the meeting). But as quickly as the Fed gave us a rally, the ratings agencies took it away. On Wednesday, the market digested its gains from Tuesday, but on Thursday we drifted lower and then picked up steam to the downside in the afternoon.

The primary catalyst for the sell-off was a cut in the outlook for General Electric (GE) by Standard & Poor's (S&P), where they said there is at least a 33% chance that GE will have its AAA rating cut in the next two years. While many argued that the statement from S&P was old news and just a rehash of Jeff Immelt's comments from December 16th, it certainly impacted the market. The amazing aspect of the S&P call, however, is that the ratings agencies have any credibility at all, especially after the events of the last several months. (Remember the emails that were released where S&P analysts joked that they would rate a deal structured by cows?)

S&P 500 Intraday: 12/16 - 12/18



On the economic front, it wasn't a pretty week. Once again, we had more reports come in below estimates (6) than above estimates (4), and even the better than expected reports were extremely weak. Additionally, there were also four reports that showed their worst readings ever. Not surprisingly, three of those four were related to the housing sector.

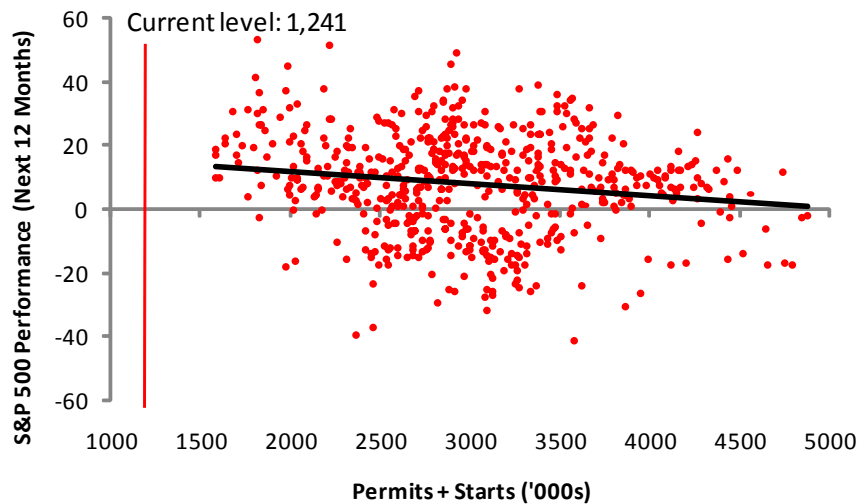
Now, we all know that the market will turn well before the economy, so besides providing good material for the headline writers, these reports are really of little value. To highlight this point once again, we cite housing starts and building permits. Going back to 1960, we added the monthly number of housing starts and building permits and then compared those readings to how the stock market did over the next twelve months.

As the chart illustrates, there is an inverse relationship between the monthly reading and the performance of the S&P 500 over the next year. When the combined number of units is high, stocks have struggled, and when the combined reading was abnormally low, stocks rallied. In fact, of the 11 months where the combined reading was less than 1,750K units, the S&P 500 was higher one year later every single time for an average gain of 18.6%. At a current level of 1,241K units, November's combined reading was the lowest ever. But based on future market performance, not all the bad news is necessarily that bad.

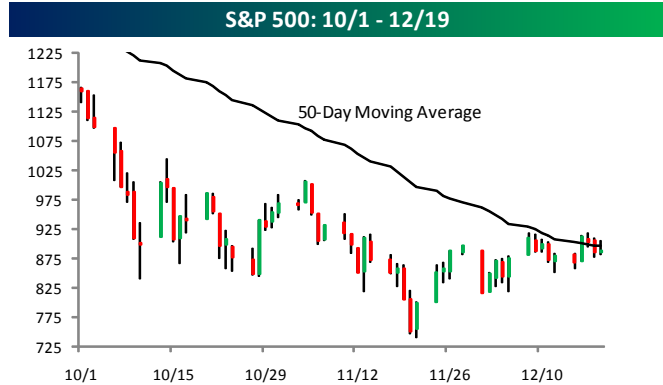
Economic Scorecard: Week of 12/19				
Date	Indicator	Actual	Consensus	Difference
12/15	NY Empire State Index	-25.8	-27	1.2
12/15	NAHB Housing Index	9	10	-1
12/15	Capacity Utilization (%)	75.4	75.6	-0.2
12/15	Industrial Production (%)	-0.6	-0.8	0.2
12/16	Core CPI (%)	0.0	0.1	-0.1
12/16	CPI (%)	-1.7	-1.3	-0.4
12/16	Building Permits	616K	700K	-84K
12/16	Housing Starts	625K	730K	-105K
12/18	Initial Claims	554K	554K	0
12/18	Continuing Claims	4384K	4390K	-6K
12/18	Leading Indicators (%)	-0.4	-0.4	0.0
12/18	Philadelphia Fed	-32.9	-40.5	7.6

■ Weakest level ever

Housing Starts+Building Permits vs. S&P 500 Performance



One of the most notable events of the last week was that the S&P 500 closed above its 50-day moving average. Normally, this wouldn't be an event worth highlighting, but when it hasn't happened in 72 trading days, it is worth talking about. However, the fun didn't last long as the S&P closed out the week back below its 50-DMA.

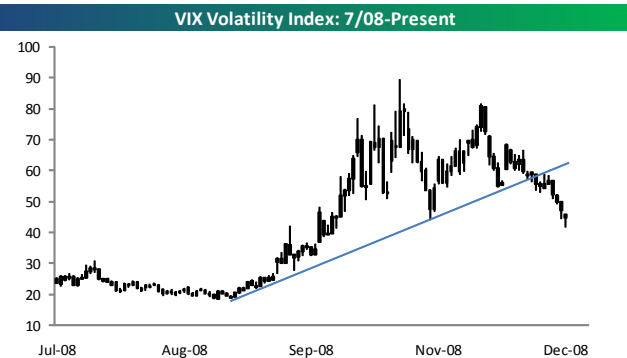


While the failure of the S&P 500 to show a meaningful rally following the trade above its 50-day was disappointing, it wasn't out of the ordinary. In the table below, we calculated the performance of the S&P 500 after it traded above its 50-DMA following other streaks where it traded below that level for 72 days or more. While the average overall returns are positive, they are not overwhelmingly skewed to the upside.

S&P 500 Longest Streaks Below 50-Day Moving Average

Date	Days Below 50-Day Average	S&P 500 Performance After Crossing 50-DMA (%)			
		One Week	One Month	Three Months	Six Months
1/7/31	75	-1.62	1.49	2.55	-10.69
7/19/32	89	12.97	60.67	49.16	48.12
7/2/37	75	3.95	6.82	-12.61	-32.80
1/5/38	90	8.42	-1.65	-15.11	11.17
1/14/42	75	-2.33	-4.66	-13.41	-2.11
11/1/46	97	-1.46	-2.59	3.92	-1.86
7/6/53	72	-0.86	1.89	-3.69	2.34
11/26/57	82	3.19	-1.42	1.30	9.23
7/26/62	82	2.13	5.16	-3.66	15.82
10/11/74	82	1.60	5.30	2.07	18.33
11/9/77	75	2.66	-0.22	-2.31	3.16
11/2/90	74	0.61	3.33	10.00	22.11
10/24/01	89	-2.34	4.78	3.96	0.73
8/16/02	86	1.30	-4.19	-2.04	-10.11
12/16/08	72	-	-	-	-
Average		2.02	5.34	1.44	5.25
Percent of Time Positive		64.3	57.1	50.0	64.3

One stat that we're encouraged by is the continued drop in the VIX. Recent action in the VIX index as well as the narrower intraday market ranges that we have been seeing make us increasingly confident that the volatility bubble is winding down. Late last week the VIX broke below its uptrend line, but this week when it tried to rebound back above that level, it reversed hard, even on days when the market was down.



As we wind down 2008, the frequency of outlooks for 2009 is increasing. To that end, we thought it would be a good time to see what Wall Street's strategists are looking for. With the caveat that making a one-year forecast is difficult enough in normal times, it is often useful to compare what you are expecting versus the consensus expectation.

Using a recent *Bloomberg* survey of market strategists for their 2009 S&P 500 price targets as a proxy, we found that Wall Street strategists are collectively looking for a gain of 21.8% from the index's current level. Additionally, none of them are anticipating a decline for 2009. As shown below, UBS is the most bullish of the group with a year-end 2009 price target of 1,300 (UBS was the most bullish last year also with a target of 1,700). Goldman and Strategas are the second most bullish this year with price targets of 1,100. Credit Suisse has a target of 1,050 (for mid-year '09), Citi and HSBC are at 1,000, and Merrill Lynch is at 975. Merrill is the least bullish strategist of those surveyed, but they're still looking for a gain of 10.4% from current levels.

For those looking for direction from these strategists, their 2008 projections should be noted. All were looking for gains this year, and their targets at the start of the year are far above where the S&P 500 is currently trading.

Strategist		2008 Price Target (1/2/07)	% From Current S&P 500 Price	2009 Price Target	Expected % Chg From Current S&P 500 Price
UBS	David Bianco	1,700	-48.1	1,300	47.2
Goldman Sachs	David Kostin	1,675	-47.3	1,100	24.6
Strategas	Jason Trennert	1,640	-46.2	1,100	24.6
Credit Suisse*	Andrew Garthwaite	1,650	-46.5	1,050	18.9
Citi	by Committee	1,675	-47.3	1,000	13.3
HSBC	Kevin Gardiner	1,700	-48.1	1,000	13.3
Merrill Lynch	Richard Bernstein	1,525	-42.1	975	10.4
Average		1,652	-46.5	1,075	21.8

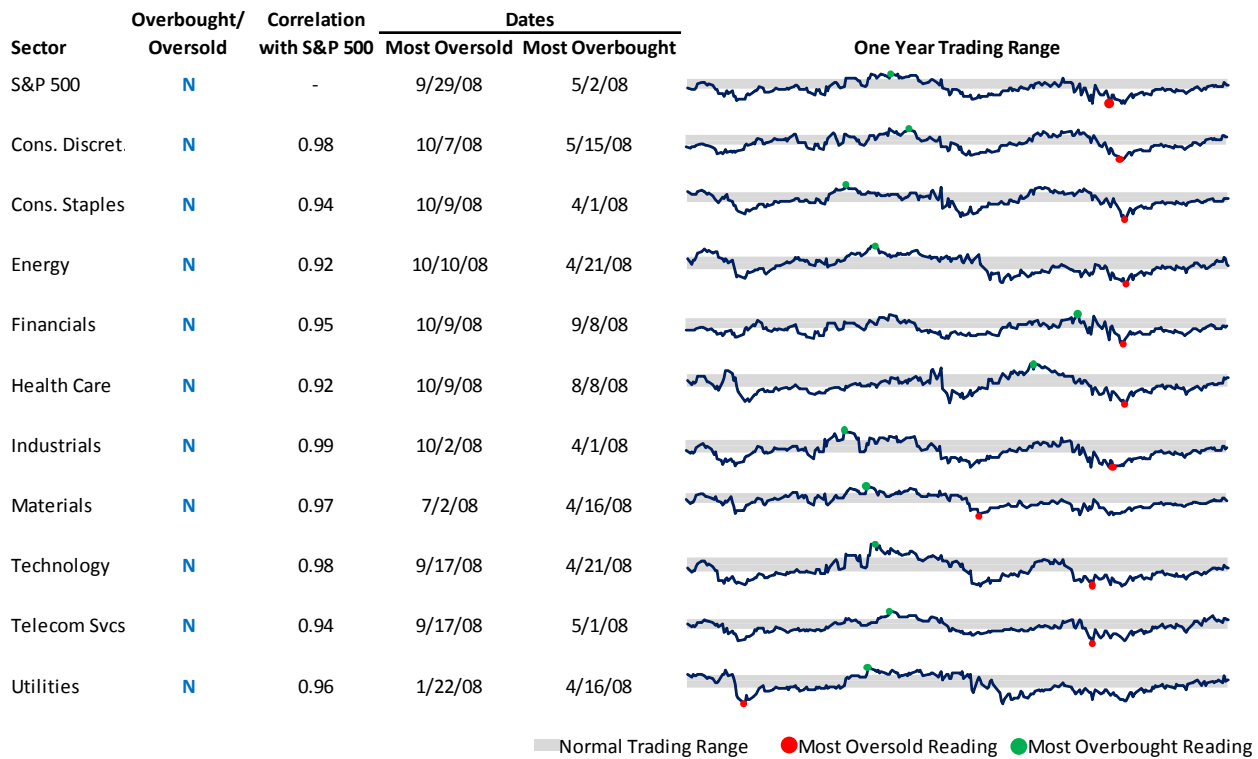
*Mid-Year '09 Forecast

For the third week in a row, the S&P 500 and each of its sectors are all trading within their normal trading ranges. So while last week was only the sixth time in the last five years that we had the luxury of going home on a Friday when neither the market or any of its sectors were overbought or oversold, this week we get to do it once again. The fact that the S&P 500 has remained within its normal trading range for three weeks now also helps to explain why the VIX has cratered.

Barring any major market moves, we will not be publishing a weekly review for the next two weeks as we finish up our Annual Report for 2009.

Have a great weekend!

S&P 500 Sector Trading Ranges: 12/19/08



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Interpretation

If any provision of this Agreement is found invalid or unenforceable, that provision will be enforced to the maximum extent permissible, and the other provisions of the Agreement will remain in force. This Agreement states the entire agreement between you and us relating to use of the Site or the Service. This Agreement may not be amended except as provided above.

Contact

If you have any questions, concerns or comments, please email info@bespokeinvest.com.