Economic Update

Broadleaf Partners, LLC

Wow, Bear Markets, and the Craziness of Datapoint Trading

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In bear markets -- and I'm willing to call this a bear market given that many indices are close to 20% from their highs -- the swings in stock prices become emotionally charged. Yesterday, the Broadleaf holding of Chicago Mercantile Exchange (CME) had a massive downdraft of about 18%. The downdraft had nothing to do with the company's earnings results the prior day...which like many earnings reports was good...but a Justice Department document release which suggested that exchange regulations should be altered to allow for increased competition. Namely, the author of the report suggested that the industry should be restructured by disallowing exchanges to own both trading and clearing functions under one roof.

Jeff and I talked about this issue a great deal yesterday morning, believing that the Justice Department release was so random and that the stock was falling so precipitously that one would think that the entire structure of the industry had already been changed with the mere stroke of a regulator's pen. Never mind the fact that it took years of legal anti-trust wrangling with Microsoft to reach a no-change verdict and that the argument here had little to do with issues of monopoly power and just the thought that the current structure, having been in place for a hundred years, might be more competitive if altered. Perhaps these regulators should consider testing their theories in new virtual worlds like Second Life before issuing edicts that only serve to unsettle an already psychologically fragile marketplace in the real world. CME did have a conference call yesterday afternoon, but the selling only became worse. Thankfully, some rationality came to the rescue with a few good reports from analysts this morning and a rebuke of the Justice Department's edict by the CFTC, the current regulating body for the exchange industry. If you subscribe to the Wall Street Journal, you can read the article here. The stock is recovering somewhat nicely today, up about 9%.

Cisco, like many great growth companies this quarter, posted good numbers last night, but also reduced guidance going forward due to weaker order momentum during the month of January, both in the U.S. and around the globe, including Europe. To us, this shows how economic fears can become self fulfilling prophecies in the short run. What's different since January? Well, the Fed finally seems to be on our side and is not only aware of the economy's fragile state but is more willing to take action to combat it. The ECB will hopefully follow suit shortly. As an aside, while we don't own Cisco's shares, it is trading at just 14.5x revised earnings estimates! The company is managed superbly, having bought back a record $4 billion in shares this quarter, which on an annualized basis, is about 10% of the company and is a discipline they've been engaged in for years now. One additional bright spot was a 21% quarter to quarter improvement in their sales to financial institutions, an area that had weakened significantly for the company in the prior quarter. While the data point seems a bit hard to believe, taken at

the surface, it suggests that psychology can swing in both directions and that the economy's goods haven't been damaged beyond a shorter term crisis state.

So, make no mistake about it. In bear markets, stocks can move to extremes, less on fundamentals, but more on the reciprocal momentum of greed, which is the snowballing downside born of fear. I really believe in my heart of hearts that we're setting ourselves up for a strong bull run for growth stocks once the dust settles and calmer nerves prevail. Once we're through earnings season and absent any waffling by the Fed, I suspect that we'll start to feel the shift.

Until then, never go to bed angry and sleep tight.

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