

EQUITIES PERSPECTIVE

January 2, 2009
DJIA: 8,776

The two great trades of '08 ... buy oil, sell oil. It seemed a year where everything tanked. And while by the end that was basically true, there was money to be made in commodities like oil, provided you sold in July. At the end of 2007 with tight supplies and rising demand from emerging markets, crude had followed a steady ascent to around \$90 a barrel. As often is the case, the dot-com bubble of 2000 a good example, speculation often exaggerates a move. Hence came \$146/barrel crude in July, on its way to \$200 they told us. At the time, of course, it was easy to ignore one of the obvious signs that the demand for commodities was beginning to slow – the Chinese stock market had peaked 7 months earlier. Money was made in commodities, but it was anything but a “one-decision” trade. The Dow Jones AIG Commodity Index, a basket of 19 commodities, is down about 40% year to date, including a near 60% drop in crude.

We suspect the undoing of many hedge funds was overstaying the long commodity trade. But in its equal opportunity way, there were chances as well to lose money on the short side. When you think weak, you think Financials. However, a stock like US Bancorp (24) moved to a new high in September, double its July low. Even Bank of America (13), down some 70% from late '07, doubled from its summer low. As someone once said, when you're short, sitting through a 50% rally is worth a year in business school. Meanwhile, with the possible exception of some of the Regional Banks, Financials have had poor recoveries, but they're at least holding. That seems important for the overall market recovery, though ultimately their performance should remain poor. Think what happened to Techs, the ones that survived, when their leadership ended in 2000. The Commodity stocks are a little more tricky. Certainly they could have sharp rebounds, but the extent of the corrections calls into question the overall uptrends.

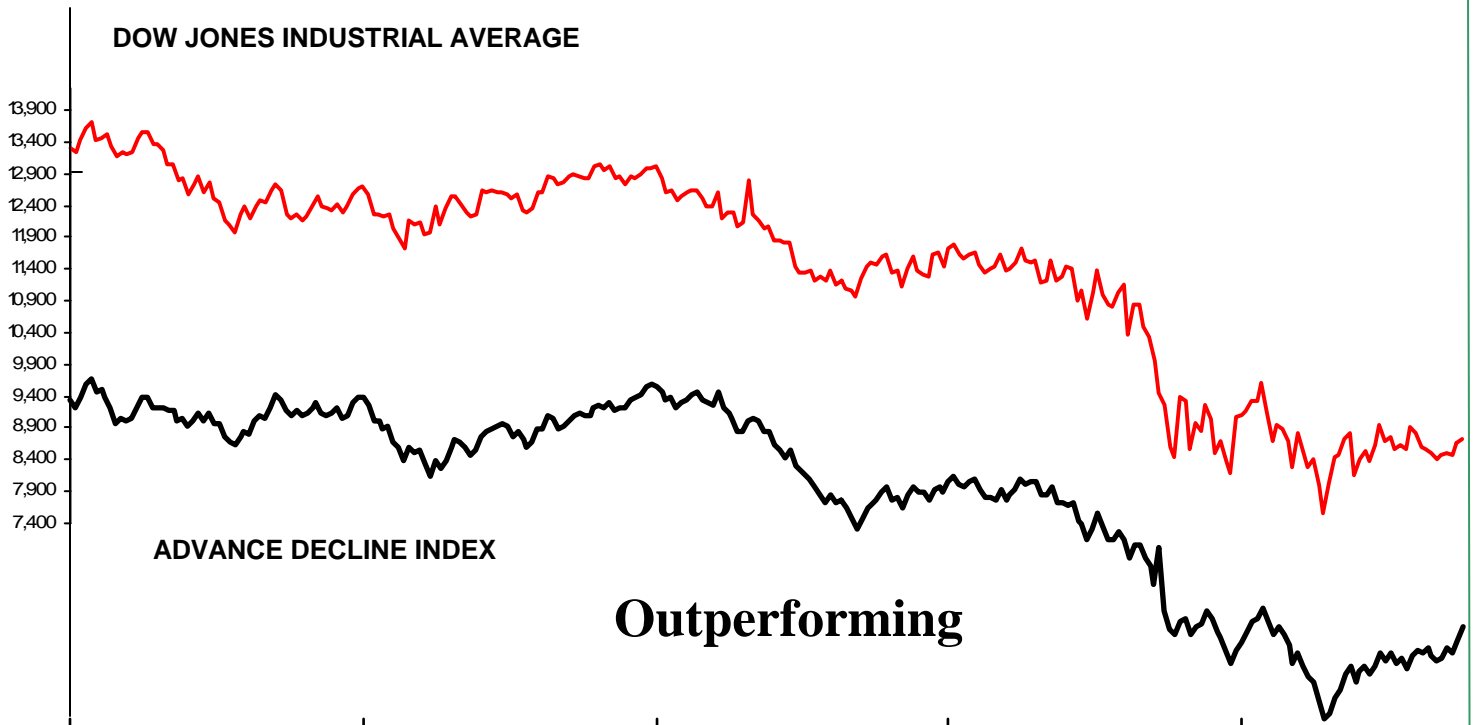
In retrospect, the place to be in '08 was kind of obvious – where most shop, and where most eat – WalMart (54) and McDonald's (61). And there's nothing to suggest that is about to change as we enter '09. But since the commodity peak in July, leadership has been lacking. There are few new highs and even fewer whose names you would recognize. As a group, education stocks like Apollo Group (77) look promising, as do assorted healthcare issues like LHC Group (34) and, of all things, water-related stocks. After its 40% correction from the March peak, gold again looks promising. In a way, however, it's not terribly productive fretting over what might lead in a recovery. If the markets get going here, breaking above their recent trading ranges, leadership will become clear enough. In a good rally, the leaders are the first ones out.

Meanwhile, if not dynamic, the market acts well enough. If volume is a measure of buying, since the November 20 low, volume has been consistent in expanding into strength and contracting into weakness. Market breadth, a measure of the “average stock,” has been almost surprisingly positive, even outperforming the market averages recently. At the October 10 low, 92% of NYSE stocks made a 12-month low, only 1% were above their 200 day moving average. That's a washout! Lower lows in the averages in November saw most stocks hold, that in the face of horrific economic news – declining employment, deflating house prices, the never-ending bailouts. The background seems in place for a continuation of the recovery; all that's needed is a kick-up in buying. That wouldn't be unusual in January.

There's little question but that things still look bleak. The Consumer Confidence Index is at the lowest level since its inception in 1969. If not one thing, it's another, and there's a panic to fix everything from banks to insurers to the auto industry. Then, too, not that long ago the worry was whether the Fed was about to raise rates. Silly as that may seem, it's not at all unusual that what worries you now will look silly six months from now. A year ago anyone would have jumped at the chance to buy the market down 40% – but not now. The Federal Reserve has dropped rates to zero and mortgage rates make is almost tempting to buy a house. Suppose this stuff starts to work, suppose things loosen up? Suppose an Obama stimulus package works, suppose he restores confidence? The Dow was up 80% after FDR's first 100 days. There's so much bad news already priced-in the market, it's almost susceptible to good news. Whether it's houses, companies or equities, we could start to figure out there are a lot of bargains around. All this may be wishful thinking, but a good January would make it look a lot less so.

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STOCK AVERAGE VS. AVERAGE STOCK



Dec-03-07

Apr-15-08

Aug-21-08

Dec-30-08

