

Ambac \$96 . . . Ambac \$6. No misprint, both prices are right or, at least, right within the context of the last eight months. Back in mid-May ABK peaked at \$96, it closed Thursday at \$6.24, touching a low of \$4.5. You hear about the problems at Citigroup (26) and at Merrill (52), and a myriad of other financial guys, but few have been harder hit than poor Ambac. The company Wednesday wrote off something like \$32/share, cut its dividend, and said it sees a Q4 loss of up to \$5.80/share. But that's not the bad news. The real problem is that now, let's say that again, now, the rating agencies may lower the company's AAA rating. For these companies, the bond insurers, you don't got no AAA rating, you don't got no business. And, if you have any doubt that subprime isn't the gift that keeps on taking, there's more. If the ratings of these companies are downgraded, count on all the bonds that they insure being downgraded as well. Remember when they tried to tell us that subprime was contained.

Clearly the subprime problem is yet to be contained. For investors, however, the real question is whether the impact of the subprime problem is contained. In other words, is the bad news discounted? While Ambac is the extreme, Citigroup (20) and Merrill (51) seem less so, but even there the action isn't promising. Everyone knew the numbers from Citigroup would be bad, that's why the stock is down 50% from its peak in mid-May. But the stock went down anyway because the market was disappointed that the write-downs weren't bigger. We get the idea that getting all the bad news out is good. Still, you have to sort of laugh at the idea that losing even more would have been better. And if so, what about Merrill? There the bad news was too bad? The real point is simply this – bad news is still bad news. At a low stocks stop going down on bad news. The bad news gets discounted, the sellers have sold.

For all that, most financial stocks are trying to hold their lows of a week or so ago. Even the Homebuilders are holding recent lows, and actually were a little higher Thursday. That despite the lowest housing permits since '93, and a Fed Governor's comment that the housing market is in "freefall." Of course, they hold until they don't, but most stocks have become quite stretched to the downside. A week or so ago there were 1350 daily New Lows, and that's a lot. It surpassed the 1275 of last August, meaning together with the averages many stocks have taken out their lows. Then, too, that peak in New Lows last August happened a day before the market bottomed. The catch, of course, is that who can say the peak this time won't eventually be much greater. What may be more telling is the number of New Highs. Perversely it used to be that important lows weren't made until there were almost no daily New Highs. In other words, good lows aren't made until they get to everything.

That process of getting to everything may very well be underway. Energy and most commodity stocks have turned weak. They'll tell you that's because a recession/worldwide slowdown will lower demand for everything. While that's certainly true, it's also true that in markets with divergences like this one, eventually they get to everything. Even the red-hot agri-stocks have come in – see for example the ETF with our favorite symbol, "MOO." But it's the Apple (160), Google (610) and RIMM (88) trio that we still think will have their problems. Again, they'll tell you Apple didn't exactly wow them at MacWorld and traffic at Google in December was below forecasts, but there's always something. These stocks have been looking tired for a while now and it seems a matter of time before they succumb to a more serious break. It's one thing for a weak stock like Intel (19) to collapse even further, and that tells you something about the economy. But from a market standpoint we just don't think it will be over until they get to the Apple's.

While subprime again seems the feature of the day, and just won't seem to go away or, more importantly, get discounted, it's not the only problem out there. The Chinese seem intent on slowing their economy, and that could prove a real problem for a bubble stock market which already seems to have peaked. Then there's that yen for the carry-trade, which could yet prove an unpleasant unwind. Perversely, it almost seems the market needs some sort of jolt. Whether it's because of a misguided faith in the Fed or the simple fact the leaders are just starting down, there's more complacency than fear. Despite the bad news and weakness, for example, Thursday afternoon was the first time there was any pickup in the VIX, the Volatility Index, which still remains below the levels of last August or November. Another missing element is volume. Light volume in weakness is good in an uptrend, but in downtrends it takes volume to wash things out. Markets bottom out of panic and fear, they bottom when the sellers are out of the way. We're not there yet.

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# STOCK AVERAGE VS. AVERAGE STOCK

