

## EQUITIES PERSPECTIVE

January 29, 2010  
DJIA: 10,120

Get those Banks . . . both here and China. The idea that Chinese Bank lending might be restricted was bad for stocks, in China and everywhere. And the novel idea that Banks here should be, well, Banks, also wasn't so good. The irony, of course, is that while Chinese Banks lend too much, Banks here don't lend enough. True the problem has worsened, but going back to the interest rate crisis of 1980, Banks have consistently under-lent to business, the area that can make money and pay them back. Instead the lending went to homes, cars and so on, in other words, consumers. Be that as it may, Bank bashing is all the populace rage. With 10% unemployment for the foreseeable future, it's not hard to see that a little trade with China could be next. In labor negotiations with the auto companies Walter Reuther once asked, who do they think buys this stuff? Much the same might be asked of our never ending debt issuance. But this is just part of the background to the market's surprisingly sharp correction, one which could bring into question the overall uptrend.

The banking concerns both here and in China have taken their toll on the markets. But to go back a couple weeks the perception was that good earnings would drive markets higher. Intel (20), IBM (124), GOOG (535), you name it, good earnings haven't done the trick. It's not even clear that those Apple (200) earnings, and the "hype-pad," will survive the "sell on the news" pattern. As the sentiment numbers had suggested, the good news was priced-in, the buying had been done, and that set the stage for what we're seeing. The resulting selling has been severe – three 1% down days last week, two of the three with expanding volume, the other with above average volume. Monday was up, as usual, and volume was down, as usual. Tuesday looked flat, but breadth was down, Wednesday looked up (DJ + 42), but breadth was flat, Thursday was down all around. After several tries at it, S&P 1085 has held, that's the good news. The bad news, a break there would call the intermediate term uptrend into question, to put it politely.

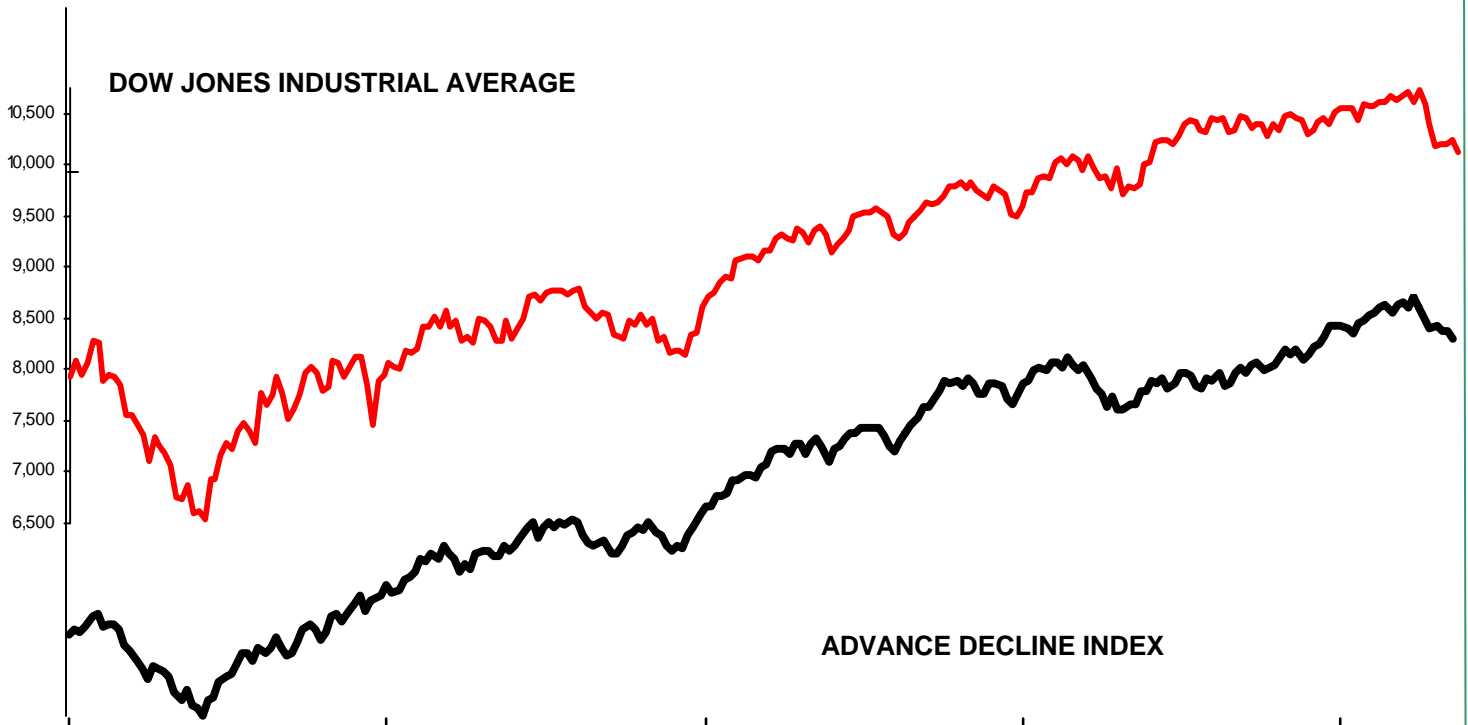
Bull markets invariably last longer than just 10-11 months. And so, it's argued, the bull market can't possibly be over. All too true, provided of course that this is a new bull market. From that same duration argument, a case can be made this isn't a bull market at all. Secular or long term bull markets, like the one from 1982 to 2007, end with a major bear market, not one lasting a year and a half. The S&P broke its long term uptrend in 2002, co-incident with the end of the Tech bubble. It then rallied to a new high but subsequently broke below the 2002 low, coincident with the housing bubble. Given these two asset bubbles, it's hard to believe that 2009 marked the end of a secular correction in terms of time. The coincident stock market and real estate bubbles in Japan back in 1990 makes it clear that putting things back together takes time. Unlike now, bull markets evolve from a deflated credit structure, high savings and pent-up demand, not a government induced economic recovery.

If the recovery has been too brief to see the end of a new bull market, it's not too brief to see the end of a bear market rally. The 48% rally that began in November 1929 ended the following May. The 60% rally in 1939 extended from April to November. Getting back to Japan, they've had four bear market rallies since their bear market began back in 1980. One of those, the 62% rally that began in late 1999, lasted more than a year, and began not long after the low in 1992 was decisively broken, a pattern similar to the S&P's break of the 2002 low. Around that time Japan also had major stimulus programs, and their industrial production index actually rebounded about 11% from December 1998-2000. Their ongoing debt problems, however, proved the rally's undoing, problems we have a few of as well. We've rallied 50-60% and retraced 50% of the bear market, not at all out of the ordinary for a bear market rally. Yet everyone speaks of "the bull market." It's human nature, opinions follow price.

When the market bottomed in March, measures showed panic-like sentiment, while downside momentum had waned – less volume and fewer 12 month New Lows. The background was there for a good rally – a new bull market, a bear market rally, it didn't much matter. If we do begin a decline here does it really matter what you call it? In the bull market that began in 1982, the advancing phase lasted a year and the market then corrected for ten months. Whether you call this a bull market or a bear market, and who really knows, a 10-to-15% decline isn't a lot of fun. And if we do take out that S&P 1085 level, you have to accept that such a decline is a real possibility. Stocks have come a long way since last March, and so too has the level of investor comfort.

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# STOCK AVERAGE VS. AVERAGE STOCK



Feb-02-09

Jun-01-09

Sep-25-09

Jan-26-10

