

EQUITIES PERSPECTIVE

February 8, 2008
DJIA: 12,247

Bad . . . but not that bad. The NAZ, that's bad. The NASDAQ has taken out the late January low, at least on a closing basis. The real market, the market not so influenced by three or four stocks, that's not so bad. In terms of the Dow or S&P, the market has retraced only something like 50% of the rally. The big difference of course is simply the difference between the Techs and the rest. The Financials, the Banks and even the Homebuilders, have given up relatively little. This doesn't mean there's a whole new leadership out there, hardly. But it does mean that what got us into this mess, the Financials, at least are holding. That's not such a bad thing. Thanks to those Financials, of which there are many, the Advance Decline Index or market breadth has retraced less than 50% of its advance. Again, that's not a bad thing. Daily New Lows are running around 100 versus the more than 2000 of two weeks ago. Most stocks are holding. Most stocks, that is, except Tech and therefore the weakness in the NASDAQ.

After the low of a couple of weeks ago, no one said it would be easy. No one could even say it was a low of any duration let alone "the" low. But we got our 10% rally off that low and now we get to find out just what kind of low it was. And when it comes to that the market averages are of little importance. One thing that matters is volume, that is, is the selling out of the way. There the news isn't so good given the volume expansion into much of the recent weakness, particularly Tuesday's 370 point rout. The other important thing seems market breadth, and there the news is much better. From a technical standpoint all this started with breadth divergences, the idea of weakness in the average stock while the stock averages held up. Now that's reversed. As measured by market breadth the average stock is acting better than the stock averages. Granted much of that is the oversold rally in the Financials, but it is what it is. With breadth holding up better than the averages, it would be most unusual for the market to get into big trouble.

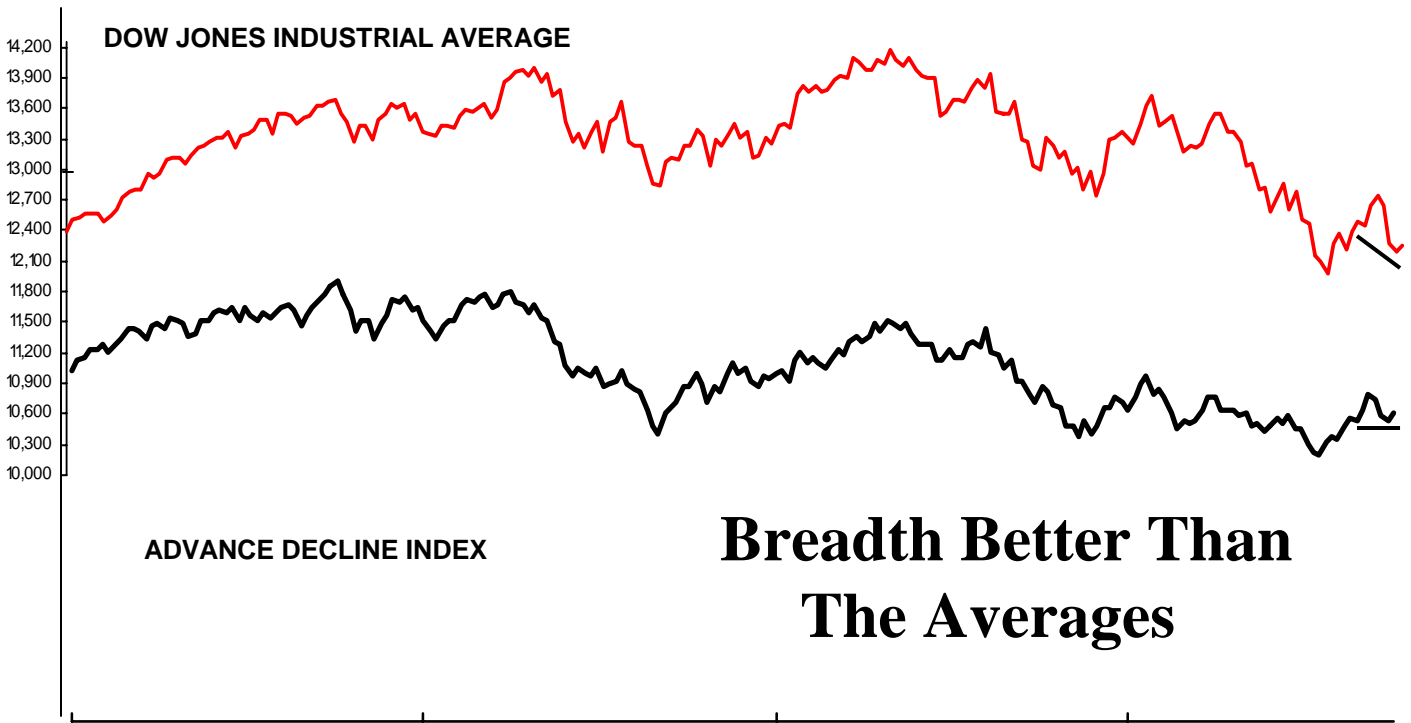
In this rally-test sequence the question of course is how much more testing or weakness are we likely to see. For all its volatility, Thursday's action didn't help. Tech could have come unglued but didn't, the market could have closed on its high but didn't. However, there was more good than bad, and some things seemed impressive. Breadth was good and volume expanded. But the best part doesn't show up in the numbers. That would be the action in stocks like Cisco (23) and WalMart (50) and, for that matter, the fact that the market was able to reverse to the upside. The downside start to the day began with a poor outlook from Cisco and poor sales out of WalMart. Yet both closed higher. While Cisco isn't Apple (121), Tech in general has become the new weak link. If the weak no longer are weak, that seems good. The same for the beaten-up Retailers. If bad news isn't bad news, it's discounted, that too seems good. So, not a bad day but if so, some follow-through should soon be on the way.

The idea that January saw a decent low, a tradable low though unlikely "the" low, still seems viable. But, in the event, any easy part seems over. We had our 10% rally and now we get to see just what kind of low January was. The averages don't really matter. For the NASDAQ and Techs like the Semi's, the latter at four year lows, it was no low at all. For most stocks, the "average stock," the lows are still very much intact and that's what's important. If the Retailers, Financials and Homebuilders can hold, let alone rally in the face of ongoing bad news, that's not a bad sign. We doubt this will prove much more than a trading range of sorts, but it is whatever it is. What you don't want to see is expanding volume into any further weakness. What you really don't want to see is strength without volume and/or good breadth, that is, more divergences.

Someone once said that second marriages are a triumph of hope over experience. Much the same seems true of the rally in the Homebuilders, up as much as 50% from their early January lows. Meanwhile, pending home sales just came in down 24% versus a year ago. Toll Bros (21), the largest U.S. luxury home builder, said it expects Q1 home building revenue to drop 22% and warned that it's "not yet seeing much light at the end of the tunnel." What's worse, these housing cycles aren't short, they take years to turn around. If you're looking over this valley what you're seeing is more valley. Any bottom here likely will resemble the letter "L." And that's why you gotta love this business. The stock market is a place where ordinary logic doesn't apply. It's a place where supply and demand rules. When stocks get sold out, no matter how bad the news they rally. Even the Homebuilders, at least for now.

Frank D. Gretz

STOCK AVERAGE VS. AVERAGE STOCK



Breadth Better Than The Averages

Apr-02-07

Jul-13-07

Oct-23-07

Feb-06-08

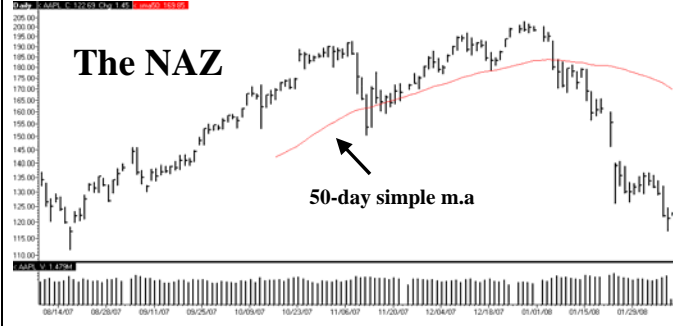
NASDAQ 100 (QQQQ - 43) - DAILY



FINANCIAL INDEX (XLF - 28) - DAILY



APPLE (AAPL - 121) - DAILY



RETAIL (RTH - 92) - DAILY



SEMICONDUCTORS (SOX - 347) - DAILY



HOMEBUILDERS (XHB - 21) - DAILY

