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DJIA: 10,144

A bailout for Greece . . . and the line forms on the right. Sounds a lot like the “Greenspan Put” and “too big to fail.” You wouldn’t think of Greece as too big to fail, but a default likely would mean bad things for the banks there, resulting in financial crisis part 2. And while it’s tempting to think it’s not our crisis, one thing subprime taught us is that markets are interlinked. A Greek solution of course won’t be easy - Germans paying Greek pensions and Greek workers unhappy anyway. The bigger worry is that Greece is just the start. The Europeans have pretty much made the Asians in ’97 look like fiscal conservatives. Not surprisingly, problems, even problems you didn’t know were problems, always seem to evolve when the technical background isn’t at its best – in all of January, for example, only once did the market rally with expanding volume. But following last Friday’s dubious reversal, the market at least has stabilized, and Tuesday was a good day and Thursday wasn’t bad. It should, however, get harder from here.

In a sense worries of the Greece default aren’t such a bad thing. Coming into the year expectations that good earnings would drive prices higher had pushed sentiment measures to extremes. The decline has caused the near-euphoria to unwind, but a corresponding move toward fear is yet to evolve. Perhaps fear is too strong a word, but it does seem likely we will lose this “just a normal connection” commentary before the decline finally ends, and measures don’t show that as yet. And the weakness, after all, has done some damage. Breaking that support level of S&P 1085 was our line in the sand, of sorts, and reaching the 7% decline level often works as a good stop-loss point. While those are more tactical matters, other measures show the damage to most stocks. As recently as the start of the year NYSE stocks above their 200 day moving average were at the 90% level, but had dropped to 67% a few days ago. If you consider the 200 day moving average as a good proxy for the medium term trend, that means this is more than your ho-hum pullback. Something like a third of all stocks now are in medium term downtrends, and that’s a change of some significance.

This particular measure, the number of stocks above their 200 day moving average, had reached an unusually high level of 95%. In turn, that indicates an unusually high level of upside momentum, a level of momentum that takes considerable time to unwind and, indeed, it has. Even if that momentum is now beginning to unwind, as seems likely, the good news is that it doesn’t happen in a straight line – this measure doesn’t go from 95% to 20%. And other momentum measures offer similar comfort. For example, at the start of the year 26% of the issues on the NYSE made new highs, the peak for the recovery. Since 1967 no important market peak has occurred with more than 25% of stocks making new highs, and the median was more like 11%. Moreover, the lead time in the peak in new highs versus the peak in prices is considerable – momentum peaks before price, the momentum unwind takes time. We will recover from this decline, it then just depends what that recovery looks like.

China, thankfully, has been driving global growth. China exports have risen 20% y/y, but imports have surged 85%. Growth there, of course, isn’t exactly balanced, with some contending soon there will be an office for every person in China. In the event, news of China’s tightening measures proved unsettling. What strikes us as even more unsettling, however, is the stock market there. You may argue that their growth is bubble-like, but there’s little denying the growth is there. Yet the stock market there has gone nowhere for some 8 months. Growth here is tentative at best, but our markets made a new high in early January. Is the China market discounting slower growth and our market discounting stronger growth? The real point is that everyone thinks it’s growth that drives markets – the angst that’s poured into every detail of every economic report. Yet China proves that there are times when that’s just not the case. Even with strong growth, sometimes markets just need a rest and, at a minimum, that likely seems true for us.

One nice thing about all the fuss over Greece is that we don’t have to worry about our own runaway spending and jobless recovery, at least this week. And while everyone has their own idea of “oversold,” it’s true the market had become a bit stretched to the downside, particularly by last Friday. Though up from that intra-day low around 1045, what we’ve seen so far is more stabilization than rally, with considerable volatility – six of the last nine days have seen the Dow close up or down 100+ points. It seems unlikely that we’ve seen an important low and this S&P 1085 area, the former support level, should provide a test of the rally’s strength. Also, some of the compression effect of the oversold condition now has been undone. Breadth has never really been the issue with this market, but volume has. It’s hard to see too much good happening without some evidence of increasing volume/buying.

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