

EQUITIES PERSPECTIVE

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DJIA: 10,393

A 50% retracement . . . but 5-to-1 after 10-to-1. The recovery since last March has retraced 50% of its bear market loss. That's not unusual for a bear market rally but, then too, even less unusual for a new bull market. For now, however, we're more concerned with this 50% retracement of the Jan-Feb decline. The recovery has carried the averages back into overhead resistance, and at or just above their 50 day moving averages, often another area of resistance. And in the process, the rally has unwound the market's oversold position, that is, it's no longer stretched to the downside. Indeed, arguably it's now stretched to the upside. So the market is, you might say, at a logical place where the rally should stop but, we've noticed, it hasn't. And, unlike early January, the news background hasn't always been hospitable. The extent of the recovery seems unexpected, and often there's a message in the unexpected. A little more strength and this will look like more than an oversold bounce.

The reversal-day back on Feb 5th didn't seem all that impressive. However, it did follow a day where declines outnumbered advances by an unusual 10-to-1. That kind of number suggests a "washout," but you only know a washout by what follows – they have to go up. Back in the good old days, that is, the days when all this stuff worked, a 10-to-1 down day followed by a 5-to-1 up day signaled a washout – it's hard to get 5-to-1 up unless all the selling is out of the way. Tuesday's breadth was 4.9-to-1 up. Market breadth has been positive for seven days in a row and over that period has averaged 2.6-to-1 up. Even 12 month New Highs have come back reasonably well. The rally has been so strong that 90% of all stocks are above their 10 day moving average, and that's the highest level since last November. The missing ingredient, of course, is volume. It's hard to have a "washout" without volume. Volume this week has been particularly anemic, including Tuesday's 5-to-1 up day.

Another flaw in the "washout" idea is sentiment. While in early January everyone was euphoric at the prospect of good earnings driving the market higher, a couple of weeks ago they weren't exactly in a panic and throwing stocks overboard. About the best that can be said about sentiment is that it's less euphoric. And, as we suggested last time, there has been some damage. While stocks above their 10 day average have moved sharply higher in the rally, like the averages only about half of all stocks are above their 50 day moving average. From 90% as the year started, and after falling to 67% on Feb 5th, stocks above their 200 day moving average now are 79%. While there's no magic to these moving averages, as it happens the 50 day often acts as a resistance area, or a support area, for stocks as well as the averages. The 200 day moving average is a bit different, it's more medium term. All that medium term momentum built up last year, 95% at the peak, is beginning to unwind. And like the momentum itself, the unwind isn't easily reversed.

We doubt the correction is over, we even harbor doubts the bear market is over. Nonetheless, we've come to respect rallies, or declines, that surprise us. Volume, or the market's ability to rally without it, continues a mystery. But so too in its way is market breadth, seemingly either 2-to-1 up or 2-to-1 down, with the middle ground rare. In part that reflects decimalization, but markets have changed. The unregulated growth of esoteric, computer-dominated strategies such as flash trades, co-location and "dark pools" – commonly lumped together under the term "high frequency trading" – don't reflect fundamentals or emotion, and yet are thought responsible for 50-70% of daily volume. Still, if you look at volume in this decline-rally period we have been through, clearly the greater volume was in the weakness. The not so surprising and pretty much meaningless discount rate hike could provide an excuse for some weakness. If so, volume into any weakness should offer some insight.

Problems in commercial real estate are anything but secret. For goodness sake even the government knows. A report recently released by the Congressional Oversight Panel forecast losses up to \$300 billion over the next several years. Despite last year's better second half and some positive signs for the first part of 2010, the outlook for commercial real estate has not materially improved. Florida based Guardian Solutions, a debt restructuring firm, expects commercial real estate vacancy rates to hit 19% this year, the highest since 1986. Lending standards remain exceptionally tight, and there has been little progress clearing up the onslaught of properties with maturing loans in the next few years, many of which are underwater. That same Congressional report also pointed to the likely increase in bank failures, with banks in the \$1 billion-to-\$10 billion asset range, that is, Regionals, with the highest real estate exposure. Yet, to look at the stocks you wouldn't know it. Regions Financial's real estate holdings are one of the highest at 27%, and the chart is one of the best, for now. Like the housing bubble, the commercial real estate overbuild won't matter until it matters. Meanwhile it's the investment banks like Goldman (156) that don't act well.

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