

April 04, 2008  
DJIA: 12,626

Love 'em then hate 'em . . . then love 'em again. Back on March 17, with Bear Stearns selling for 2, Lehman Brothers (44) was toxic. On that memorable day LEH sold as low as 20.25, down some 19 points. Woulda coulda shoulda, it was quite the buy back then, though at the time the financial world as we know it seemed to be unraveling. So, it seems a bit ironic that Lehman, of all things, played the role it did in Tuesday's big rally. The company, dogged by rumors that it lacked liquidity, sold \$4 billion of convertible stock Tuesday, a billion more than planned when the offering apparently was 3-to-1 oversubscribed. They hate it, they love it – you can't make this stuff up. "The significant oversubscription for this deal demonstrates the confidence that investors have in Lehman Bros.," CFO Erin Callan said in a statement. A confidence, obviously, that was sorely lacking back on March 17. UBS (33) wrote down another \$19 billion in mortgage assets Tuesday, and the stock rallied 15%. Meanwhile, Wednesday's headline read, "Bank Write-Downs Trigger Big Rally In Stocks." When bad news is good news, that's not bad.

Of course, that action in Lehman wouldn't be the only confounding thing going on. Just look at the Homebuilders. For Homebuilding, the news just doesn't get better. Not only is the news bad, it seems likely to stay bad, maybe forever. But there is the fundamental lore, that even technicians know, that you buy the stocks at 1x book and sell at 2x book. These poor guys were selling at something like 0.6x price-to-book at the end of last year, probably a record low valuation. And they're selling there, of course, because they're down a lot, something like 70-80% from 2005-2008. That, by the way, matched other noteworthy bubble declines, like that of the NASDAQ from 2000-2002. What seems most important, however, is that despite a bad market, the stocks stopped going down in early January. Given home sales, inventories, the financial crisis and so on, the 50%+ rally in these stocks is almost hard to believe. Then, too, the market does this discounting thing where good news and bad news gets priced-in. You have to remember that these stocks peaked in January 2006, long before anyone understood there was a housing bubble. It's not that farfetched that the stocks could bottom long before anyone understands that the bust is over.

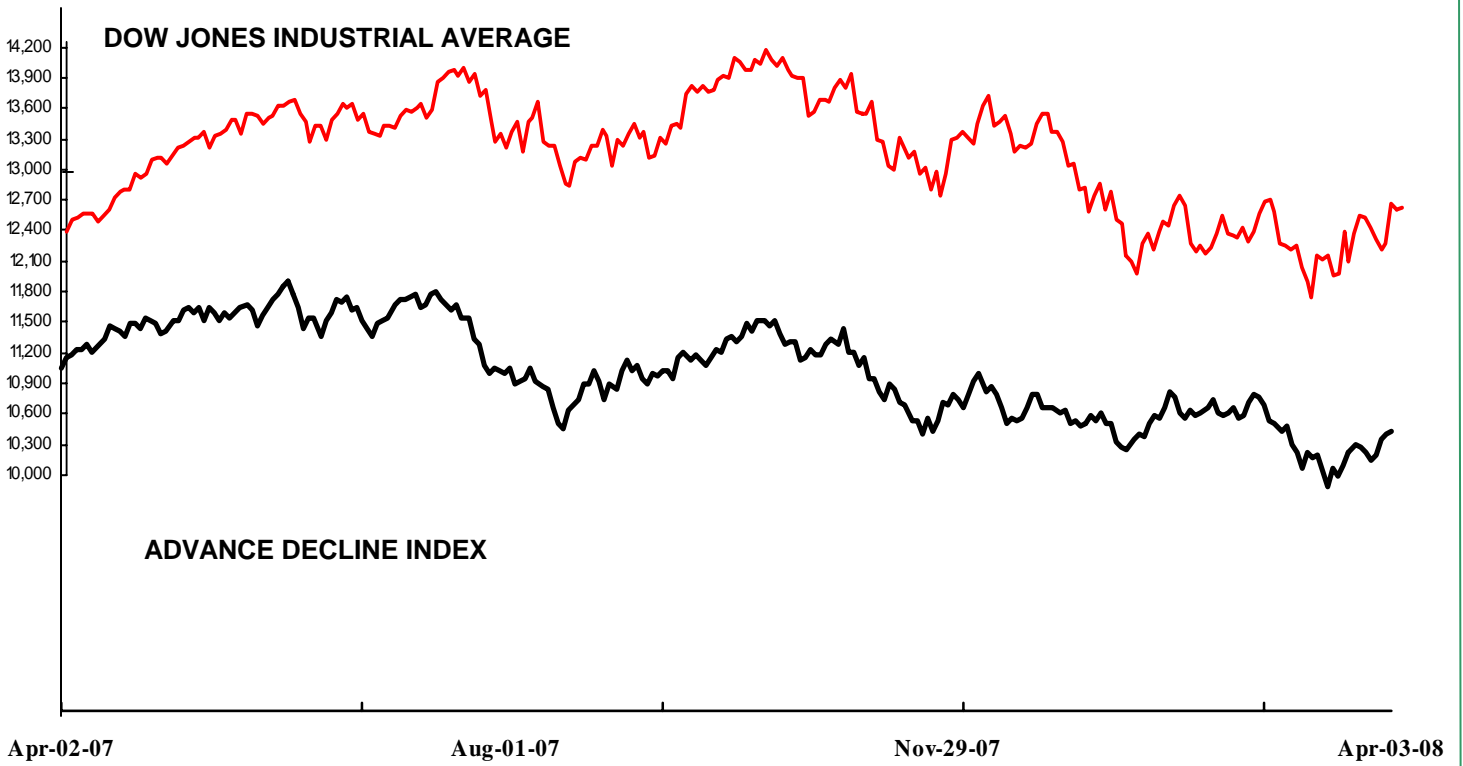
The idea that the Homebuilders have stopped going down seems an important positive. The whole financial crisis boils down to the idea that everyone's house isn't worth as much as it used to be, so there's that. But the more basic idea that these and other stocks have been holding, they had stopped going down, is important. Back at the low on January 22 more than 2000 stocks made a 12-month New Low. At the recent low March 17 less than 1100 stocks made New Lows. And that was a day where the market actually reversed to close higher in the Dow, so you have to imagine that a lot of stocks that day touched New Lows but didn't close at New Lows. Of all things even the Regional Bank Index (RKH) seems a good example here, in that the March 17 low didn't take out the January 22 low, and the Index closed higher on the day. So we've seen a bit of a reversal of the pattern at the high, when the averages were acting better than the average stock. Now the average stock has done a good job of holding, in some cases better than the averages, a positive divergence. And "the market" usually follows the direction of the average stock.

Back on March 17 they threw everything at the market – Bear Stearns, Lehman, "the worst financial crisis since the 30's" – and it didn't break. There's always something, but it's a bit hard to imagine what's left out there that could prove the market's undoing. After holding that Monday, the next day we saw a 400+ point, 9-to-1 up day, followed by another one this week. We've seen plenty of 9-to-1 days on the downside, but on the upside they're a bit more rare. And, typically, they mean the market is soldout, therefore the ease of upside movement. Just how good this rally may prove to be of course is difficult to say. But the good rallies stay good longer than you might think. The good rallies don't give you that good chance to buy. But even if not that, we at least seem likely to hold, and buying any weakness should work.

Meanwhile, have you noticed that China has quietly been in its own bear market. That market is down almost 50%, for goodness sake. It's pretty astounding that that, too, hasn't exerted more of a negative influence on our market. Then, too, maybe that weakness has something to do with the recent break in commodity prices, though the jury still seems out on just how serious, if at all, that break will prove to be. In the event, we can all pretty much agree that stock prices often can be a reflection of the economic environment. Not every bear market means recession, but we can't think of many recessions without weakness in stock prices. It certainly seems possible that the near 50% correction in Chinese stock prices is forecasting the unthinkable – China is slowing. And if they are, and if they are the driver of virtually every commodity these days, that too might make one a bit wary of the commodity play.

Frank D. Gretz

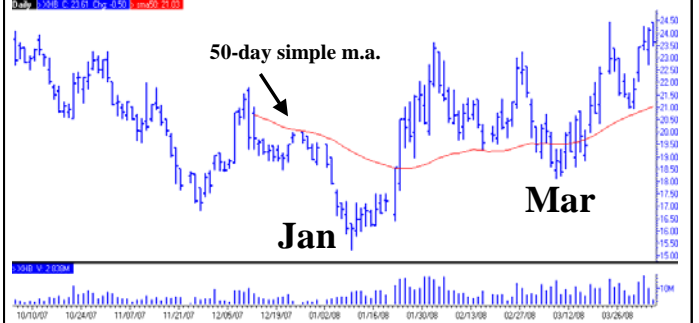
# STOCK AVERAGE VS. AVERAGE STOCK



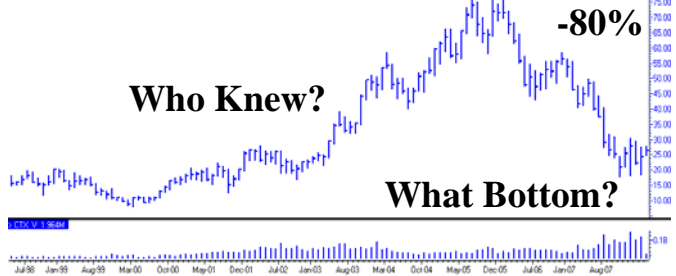
**LEHMAN BROS (LEH - 43) – DAILY**



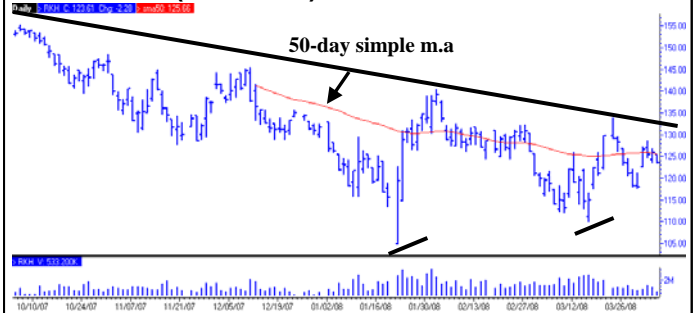
**HOMEBUILDERS (XHB - 24) – DAILY**



**CENTEX CORP (CTX - 27) - MONTHLY**  
**What Bubble?**



**REG BANKS (RKH - 126) - DAILY**



**CHINA (FXI - 148) - WEEKLY**



**METALS (DBB - 25) - WEEKLY**

