

## EQUITIES PERSPECTIVE

April 24, 2009  
DJIA: 7,957

Hurray, hurray for the 24<sup>th</sup> of May . . . stress testing ends that day. But while the suspense will end that day, just how the market will evaluate the results is anything but clear. Banks are well capitalized under the current accounting and regulatory rules, but the so-called “stress tests” of the 19 largest Banks is designed to generate capital to deal with expected losses over the next two years. It’s hard to believe some bank won’t fail provided, of course, the testing is on the up-and-up. A reasonable outcome would seem that the stress tests will require a fair amount of capital raising by those banks with sizeable troubled asset positions. Citi (3.15) is mentioned most often as a candidate for more help, but certainly there could be others. While all this may be well intentioned and necessary, it seems fraught with possible unintended consequences. Put another way, it’s easy to imagine that nothing good will come from it. That, coupled with the market’s 30% advance, seems likely behind the recent sloppy action.

Whether it’s stressing about the testing or just plain tired, the market is correcting. It’s not one of those down a lot corrections, it’s one of those nice sideways corrections, at least so far. In the S&P the problem seems to be the 875 level, the area the market peaked in both January and February. Another problem is a little more short term complacency, that evidenced by a drop in the CBOE Put-Call Ratio. However, in the bigger picture sentiment-wise, the VIX dropped to 34 last week, the lowest level since last fall and below its recent range. And the market seemed to be back to its old way of dealing with news, that is, ignoring the bad – Caterpillar (33) being a prime example. In good markets most news is good, even when it’s not. Given the overall decline, it’s not surprising that 12 month new highs are few, but new lows have disappeared. And stock patterns are simply better. NYSE stocks above their 200 day moving average are back to 26-27%, versus the low-to-mid teens at the start of the month. What you want to see here is not so much a certain level but, rather, improvement.

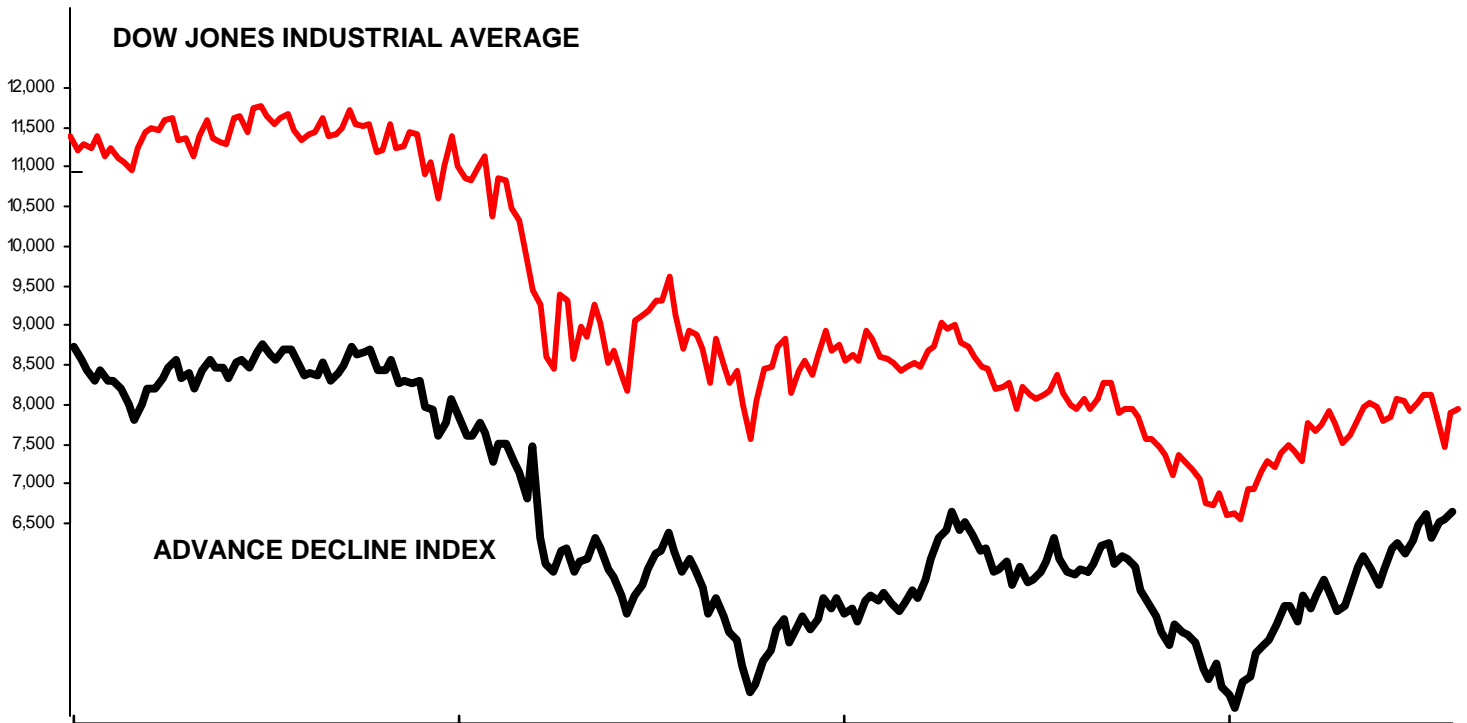
In a turnaround that’s almost biblical, two of last year’s first have become this year’s last. Those would be Wal Mart (41) and McDonald’s (54). WMT started the year with a significant downside gap and, after stabilizing in February-March, seemed to be on the mend. Another downside gap a couple of weeks ago, however, negated that improvement. Meanwhile, as the year began few charts looked better than MCD. The sharp January break negated that, and the recovery from its March low hasn’t been impressive. Things change, and for WMT and MCD they did so in a hurry. Ironically, both are part of two of the market’s strongest groups, retail and restaurants. Family Dollar (40) is up about 35% this year, most of that from the March low. Ross Stores (40) is up about the same. Meanwhile, restaurants are ranked 3 among IBD’s 197 groups, up some 22%. But that hardly tells the story. Cracker Barrel (34) is up 65%, Buffalo Wild Wings (42) 62%, and Darden (40) 43%. Pretty Yummy (32), up 34% from the March low.

The switch in this relative performance could have an explanation other than the stocks per se. Off of market lows small is better, and this low has proven no exception. From March 9 through April 20 the Russell 2000 is up 32% versus 24% for the Russell 3000, which represents 98% of the investable equities market. The low-price and volatile rule off of a market low. Similarly, down the most rallies the most, it’s just a matter of compression. In this case, those would be the Banks and other Financials, many of which have become mid or even small-caps. An analysis by Goldman found that as of April 17, stocks above \$30 had risen 75%, but stocks below \$5 have risen more than 250%. Again, the latter is where the compression was and, hence, the vacuum of sorts on the upside. Obviously, though, in most cases this has nothing to do with fundamentals, its technical – supply and demand. So while this action has to be viewed as more or less normal off of a low, it seems reasonable to eventually expect less distinction between hamburgers, so to speak.

The week has been more than a little confusing. After Monday’s drubbing, Tuesday’s strength was almost a surprise. Monday’s weakness as well as Tuesday’s strength were both attributed to something Geithner said, so go figure. More likely Monday’s weakness was a reaction to Friday’s expiration, Tuesday a reaction to Monday. There were two good closes and two poor closes, volume that wasn’t special. Ironically, Wednesday was one of the more interesting days, as the downside reversal took the Dow down 80 points but breadth remained positive. Breadth, the number of stocks up versus down, always is where the focus should be. Markets get in trouble when the average stock stops participating with the stock averages. So far, breadth is actually outperforming. When the market does move up again, the other important thing is volume, especially in a move above that 875 level. Rallies without volume, whether in the market or individual stocks, are always suspect.

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# STOCK AVERAGE VS. AVERAGE STOCK



Jul-01-08

Nov-24-08

Apr-23-09

