

## EQUITIES PERSPECTIVE

June 19, 2009

DJIA: 8,556

The Banks, the Banks, the Banks . . . the Banks. The S&P dropped below its recent little trading range, not exactly our favorite thing. As it happens, though, these tight little trading ranges usually get resolved to the upside, even when the first move is to the downside. Maybe this breakdown won't prove a fake out, but without serious problems going into all this, we find it hard to envision too much downside. The trading range break that more concerns us is that of the Banks. Stocks like J.P. Morgan (33), PNC (39) and Wells Fargo (24) had been in their own trading ranges, going nowhere but holding. Now they're teetering, and that's being kind. Meanwhile, the Regionals have really started to give it up. These managed a sharp rally from the March low, soldout like many beaten-up stocks. While the focus and the worries always seem to surround the Citi's (3) and Bank of America's (13), these regionals are generally under-reserved and own lots of residential mortgages. When it comes to banking problems, size doesn't matter.

We have no expectations that Banks in any way will be a part of the market's leadership. Aside from becoming serial diluters to keep the capital wolf from the door, sectors that lead in one bull market just don't lead in the next – Cisco (19), for example, is yet to make it back to its 2000 peak of 84, and Cisco has done a lot better than Nortel or Lucent. That said, the Banks and other Financials are an important part of the economy and the market. There are so many of the stocks, for one thing, they can have an important impact on market breadth. So if not go up, we at least would like to see them hold up. They were at the root of the problem we've just been through. So if those problems are indeed behind us we wouldn't expect to see some big new downtrends here. At that, however, it seems important to keep in mind the Regionals are much weaker than the JP Morgans.

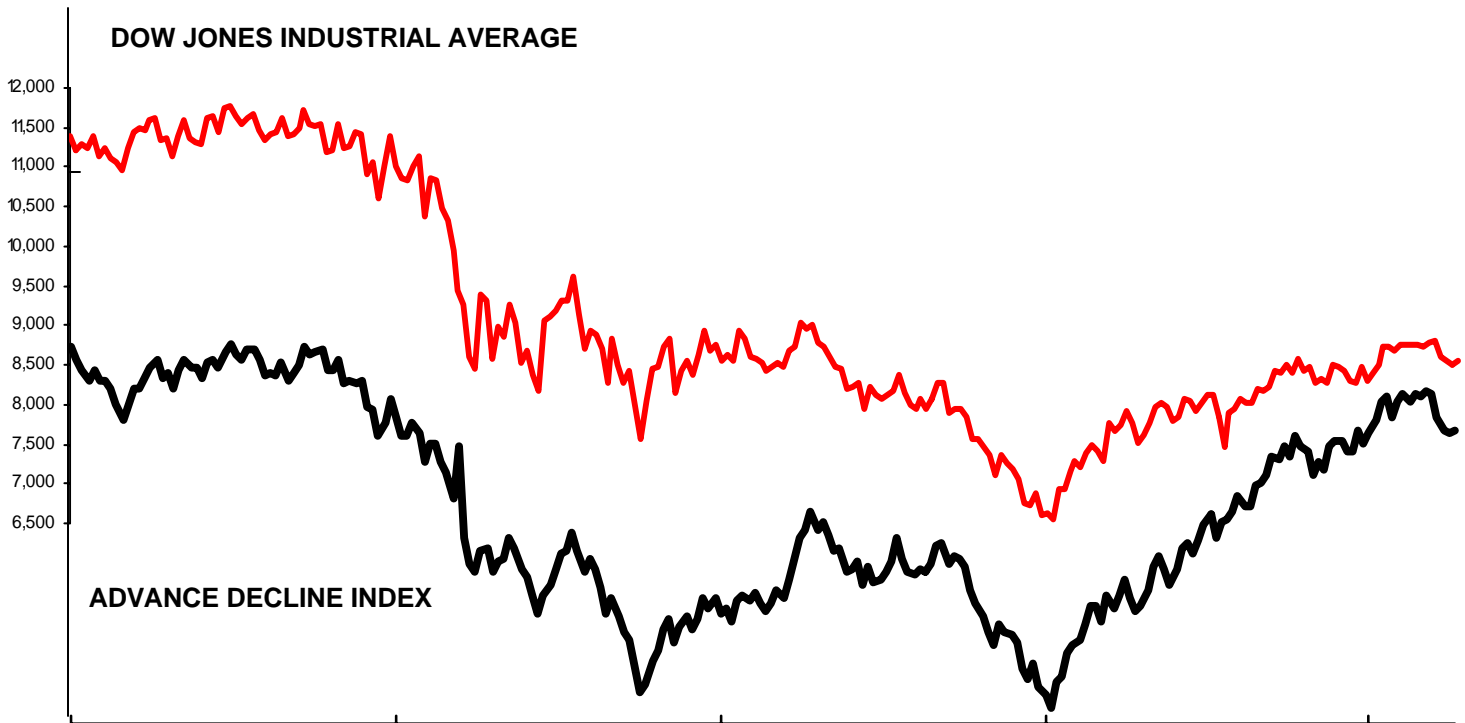
Another area to lag recently has been the Transports. In so doing the Dow Transports failed to confirm the new high in the Industrials, a Dow Theory no-no. We don't place a great deal of emphasis on the Transports per se, but it's always nice to have the market in sync at the highs, market breadth being most important. What is of some concern, however, is the pictures of Fedex (52) and UPS (48). You would think that more than most, these companies have their finger on the pulse of the economy. If so, that finger wouldn't seem to be coming up with many green shoots. Of course Fedex did miss, as did Best Buy – or did they? A month ago the same numbers may not have been viewed so harshly. In good markets most news is taken well regardless, in weak markets stocks struggle even with good news. Obviously this is more than a little subjective, but there does seem to be a change.

Before Thursday's bounce, breadth had been negative for four consecutive days, the first such stretch since the rally began. That's not terminal, but it's a change. Through Thursday the Dow is down about 250 points, this in the normally bullish expiration week. S&P stocks above their 10-day moving average are down to 20%, a level from which we rallied in May. Similarly, Put-Call Ratios have improved – show more caution – to the level that produced the May rally. In March the market became overbought but wouldn't go down, the buyers stepped up. Now the market is oversold but so far can't put together a decent rally – Thursday's rally saw mediocre breadth and pretty much awful volume. The market has been set up to rally. The witches of the deep have been summoned, but so far they're not responding. We've often noticed that when the market doesn't do what it should do, it's best to pay attention.

At the recent peak in the market averages, which marked the highest level in the rally, market breadth also reached its highest level in the rally, and so too did the percent of stocks above their 200 day moving average. Against that background it would be unusual for the market to get into trouble or, at least, big trouble. We've suggested it's often rallies rather than declines that you have to worry about, in this case any rally that follows the recent weakness. Were breadth not to keep pace with the averages, or if volume is poor, that's the time to worry. That said, the recent action has been far less than stellar. We've taken out the lower end of the trading range, and have not quickly reversed. The big Banks have done nothing since late April, and now appear to be breaking, the Regionals are toast. News seemingly not all that bad took down Fedex (32) and Best Buy (34), and in the latter's case most of Retail as well. And, though seemingly temporary and normal, the commodity stocks are in sharp corrections. These are changes not for the better. On the plus side, how about that Abbott Labs (47)! Rotation is a good thing, and Pharma and Biotech wouldn't be the worst leadership for a while.

Frank D. Gretz

# STOCK AVERAGE VS. AVERAGE STOCK



Jul-01-08

Dec-22-08

Jun-17-09

