

EQUITIES PERSPECTIVE

July 17, 2009

DJIA: 8,712

That's not a top . . . that's a bottom. We don't place a great deal of emphasis on chart "patterns," a bit embarrassing since we've lectured on "Chart Recognition" at Fordham for the MTA. Apparently, however, most people do, in this case the enigmatic "head-and-shoulders." We don't recall a time when a chart pattern was so recognized by so many which, of course, pretty much doomed it to failure from the get-go. But that was not the only flaw. Integral to any price pattern is the volume pattern that goes with it. In the case of the head-and-shoulders top, volume declines as the pattern progresses, indicating diminished buying particularly in the right shoulder or weakest rally. You could argue volume was light at the end of June, the right shoulder, or was that because of the holiday? Patterns in the averages are difficult because volume isn't always clear and, again, when it comes to chart patterns volume is every bit as important as price. In the event, a little longer perspective of the S&P now shows an inverse head and shoulders, that is, a bottom pattern.

When it comes to the charts our taste runs more to trend analysis rather than pattern analysis. In keeping with our belief that nothing is easy but it doesn't have to be complicated, higher highs and higher lows works for us as a definition of an uptrend, and vice versa. With that in mind we have been in a 5 week downtrend – the early July peak, the right shoulder if you like, was below the mid-June peak, and the recent low below the June low. But now that we've rallied above that July 1 peak it's hard to argue we're still in a downtrend, let alone on the edge of some important decline. And, after giving it a try several times, S&P 880 basically held. The market had its chance to go down but did not, that despite the seeming disappearance of a few green shoots. Markets don't go straight up or straight down. Even strong markets need a rest, a chance to consolidate or digest their gains. You can argue that since the May high that's all we've done, and we're now ready for another leg up. A move through the early June highs around 950 would make it hard to argue otherwise.

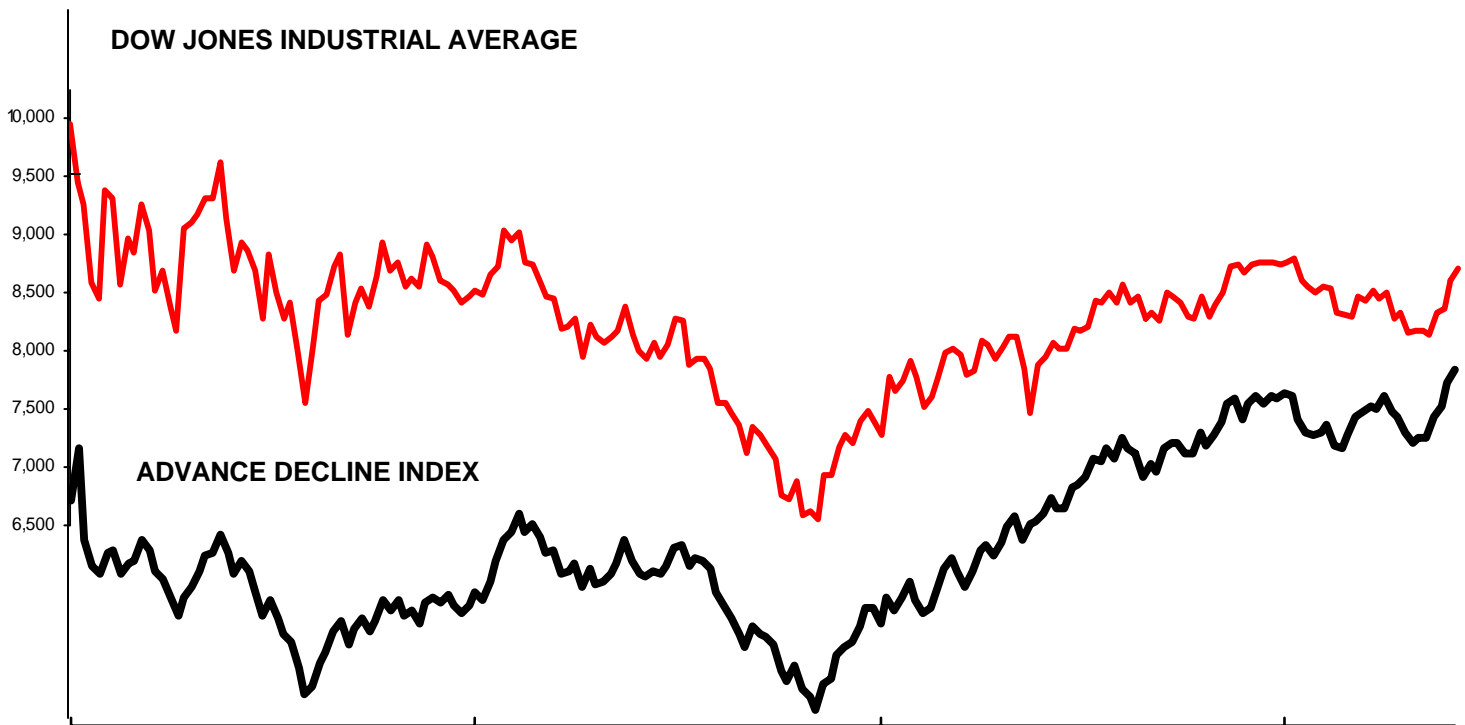
Of course there's a lot more to the recent action than just holding and rallying. It's the way the market has rallied that's impressive – 4 straight positive days including days of 5-to-1 and 9-to-1 breadth. And on both of the big up days, volume expanded relative to the prior day. The Advance-Decline Index is at a new high and NYSE stocks above their 200 day moving average also is at a new high. We've often noted that the market gets into trouble when there are divergences, most importantly when the average stock lags the stock averages. That wasn't the case at the recent high and, indeed, the market didn't get into big trouble. Now the average stock, the A/D Index and stocks above their 200 day, are acting better than the market. That argues for another leg up in the averages. On the back of a strong Tech sector the NASDAQ Composite already has made a new high. And it's not just Tech. Consumer Staples act well and after teetering seemingly forever, even the big Banks may yet get it together.

In keeping with our belief that opinions follow price recently, there hasn't been much to cheer about on the economic front. While that's pretty much still the case, earnings news has turned better – Goldman, Intel – or, was the market just ready to rally? After all, what could have been construed as very good news from JP Morgan was basically ignored. And think back to March where this all began. Was the Citi/Bankamerica news back then all that special, or was the market just ready to go with any excuse to rally. Back then instead of looking at Citi's earnings, the market could have looked at Citi's rot, and the market could have treated Goldman and Intel as, so far, it has treated JPM. Earnings count, you heard here first. That's what the charts/the market gets, well before the funnymentalists. Then, too, it's the market that's behind how news/earnings are treated. On that basis, our idea of a green shoot is Fedex (62).

Not forgetting that observing is better than predicting, the odds do favor higher prices. And those odds are only enhanced by the seeming fascination with the "head-and-shoulders top pattern," that is, an eagerness to embrace the downside. While we have our doubts that green shoots will ever be more than that, and suspect this bull market is just part of an overall downtrend, sufficient unto the day is the evil thereof, and all that. The trend is up and the market deserves the benefit of the doubt. Market tops take time, and they're not defined by chart patterns. Stocks might bottom together, as they did in October and again in March, but they don't peak together. Markets gradually lose participation, the average stock, stocks above the 200 day, New Highs, fall behind the market averages, until finally the averages themselves give it up. That's not the picture at present.

Frank D. Gretz

STOCK AVERAGE VS. AVERAGE STOCK



Oct-06-08

Feb-25-09

Jul-15-09

