

EQUITIES PERSPECTIVE

July 18, 2008
DJIA: 11,447

Look at that . . . Wells Far Go! Virtually single-handedly Wells Fargo (27) appears to have saved the entire Financial sector. The company's earnings fell 21% but, hey, that beat views by a whopping 3 cents. Perhaps most importantly, while many rivals are slashing their payouts, the company hiked its dividend by 10%. And they say dividends don't matter. The stock jumped 33% Wednesday and the Financial ETF jumped 13%. Of course, that follows a decline of almost 6% in the ETF the prior two days and some 40% just since the start of May. You might say the rally was due, but in just two days it has been nothing short of spectacular. While one might wonder just what the Wells Fargo dividend hike means to some bank in Okefenokee, no one ever said that in the short run the market is all that rational, in its exuberance or otherwise. In the event, these stocks look to be through going down, at least for a while. For sure though, wherever the low, it's gonna be a long way back.

In a real role reversal, while Financials have rallied Commodity stocks have tumbled. The Oil market was surprised to learn that supplies rose last week, defying views for a decline. Gas futures also sank on weak demand, the economy is slowing, China is slowing, the war is over, whatever. Sentiment has been one-sidedly bullish here while most of the stocks have been teetering for a couple of weeks now. In reality, Commodities sank for pretty much the same reason that Financials rallied – they were both overdue. Oil remains in an uptrend and Financials in a downtrend, but these countertrend rallies can last a while. Meanwhile, most won't understand the recent sharp weakness in the stocks – if crude goes to \$80/barrel the companies will still make a gazillion dollars, they'll tell you. And indeed, maybe it will take some bad news, the world's biggest oil discovery or something, to diminish the giddiness. But just as Gold, which started its correction back in late March and now seems to be coming out of it, for the Energy sector this too will pass.

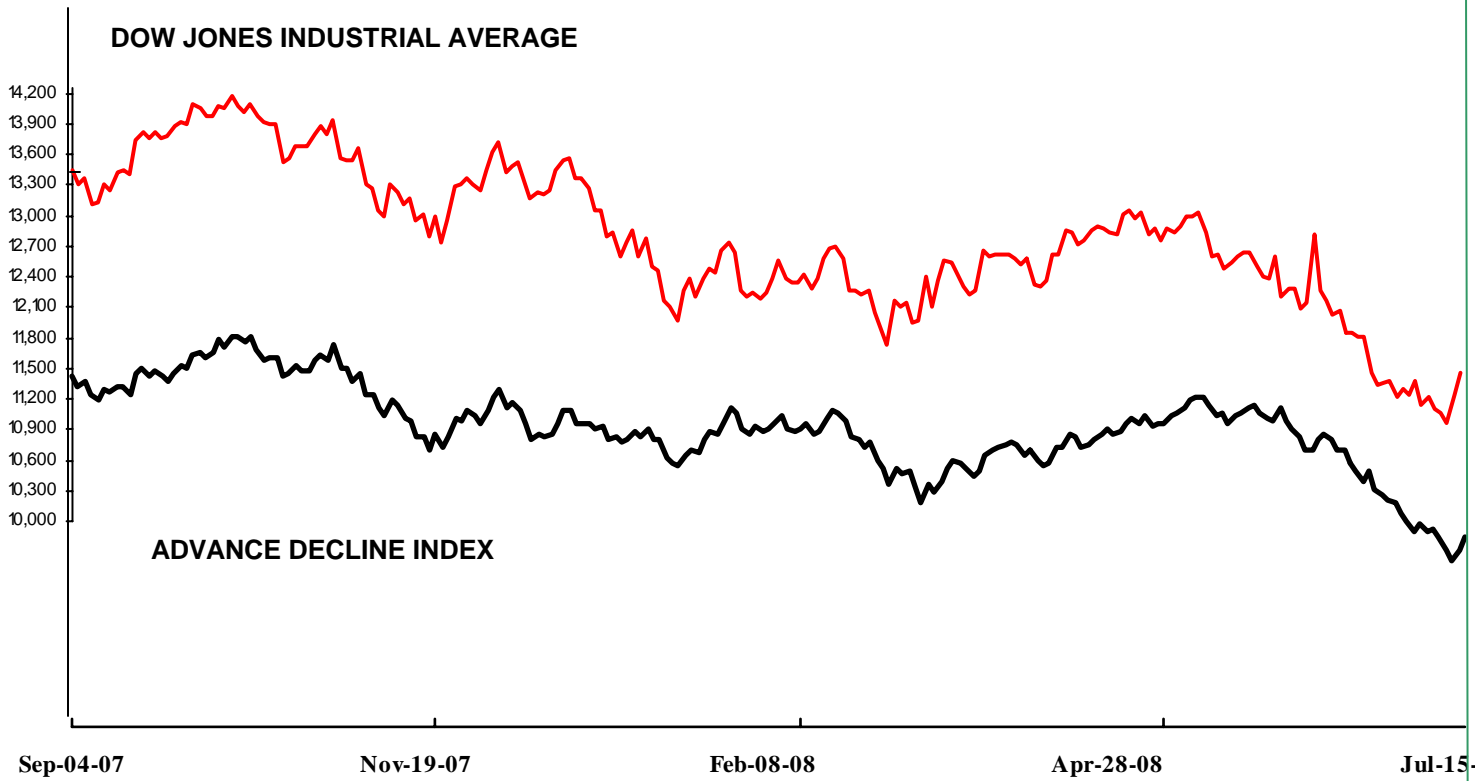
This hasn't exactly been your textbook washout low, but it has its points. We were thinking more along the lines of a reversal out of a 300+ decline Tuesday, but the market never really got that weak, and closed pretty much mid-range. But, there was volatility and there was volume – the second highest ever. That fits with a washout even if the price action wasn't quite what we had in mind. And the news – the Fannie (11) and Freddie (8) bailout – raised the panic level. The VIX or Volatility Index briefly crossed above 30 and while not the upper 30's of January and March, it has come a long way from the 17 level of mid-May. Moreover, the two day drop to 25 is positive rather than the negative it might seem. You don't know a peak until, as in this case, there's a move back down. But the real key to any low is the rally that comes after. Two days isn't a lot to go on, but they have been two great days – close to 3-to-1 breadth both days, good volume Wednesday and great volume Thursday. There would be nothing wrong with some pullback here, but if the market holds up in the face of Thursday night's bad news from Google (492) and Microsoft (28), that would be particularly impressive.

There are some other potential positives. We've often mentioned this idea that in bear markets eventually they get to everything. When they do that, like getting to the Commodity stocks recently and maybe Google and Apple, that's another part of the bottoming process to fall in place. And, the market is oversold on a medium term basis. NYSE stocks above their 200 day moving average range between 20% and 80%, levels not all that common. In both January and again in March we reached 15%, a downside extreme. The recent low however was 20%, not as oversold, but perhaps a level suggesting less selling pressure this time around. That may not sound like much, and we may yet go lower. However, when this bull market got started in 2003 the low in this measure was only 19% and that was October 2002. The next low was in January and that was 27%, once again less selling pressure. Similarly, Tuesday's peak of 1360 daily New Lows was well short of the more than the 2000 in January – less selling pressure. Something to think about.

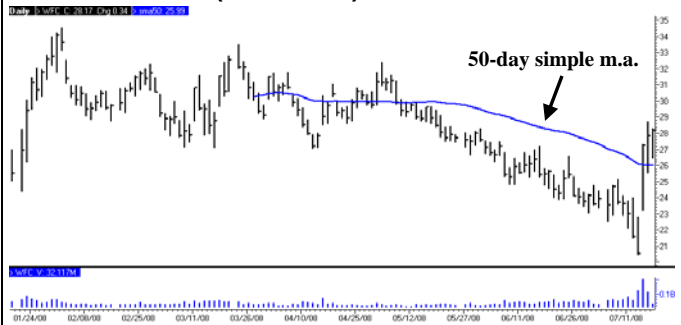
Pity the poor short seller. For a short seller the last couple of years has been the kind of market a skunk couldn't make a cent. Then, finally, a bear market. Even stocks that never go down, like Fannie Mae and Freddie, now can't get out of their way. And, short sellers now are bad guys. When they mindlessly run up stocks like Apple or Google every day that's fine. But when these leveraged Financials come unglued it's all the fault of the short sellers, like it was the short sellers that put all the toxic mortgages on their books. Meanwhile, when you see these 200 point rallies in a matter of minutes a lot of that is short covering, and no one complains then about the short sellers. It works both ways and probably all the more so in a rally. Hence the term, squeezing the shorts. Being short the Financials the last couple of days is probably comparable to a year in business school. Though it's not yet completely clear, now they somehow want to change the rules, or maybe just enforce them. You don't have to borrow stock to buy and, indeed, there's plenty of buying on margin. We don't quite see that the issue of borrowing stocks is the cause of the bear market.

Frank D. Gretz

STOCK AVERAGE VS. AVERAGE STOCK



WELLS FARGO (WFC - \$28) – DAILY



OIL (XLE - \$76) – DAILY



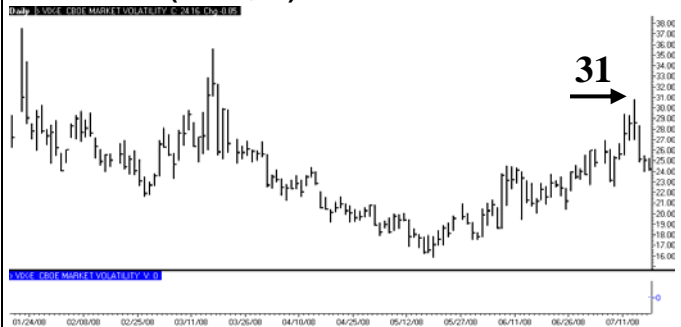
FINANCIALS (XLF - \$20) - DAILY



STEEL (SLX - \$188) - DAILY



VOLATILITY (VIX - \$25) - DAILY



GOLD (GLD - \$94) - DAILY

