

EQUITIES PERSPECTIVE

July 30, 2009
DJIA: 9,071

Too far, too fast . . . what happened to Isaac Newton? One might wonder but in the stock market, simple logic rarely holds sway. Rather, in the stock market, strength often begets strength. We're speaking of course of unusual strength, like the strength we've seen recently. Back in June the market had its opportunities to rally, at S&P 920 and again at 905, before finally holding 880. By then, of course, everybody was talking head-and-shoulders, watch out below, and so on. Failing to hold support, or rally when oversold, the background then was a bit worrisome. In turn, despite being overbought, this rally has run through resistance at 920 and the formerly impenetrable 950, on its way to new recovery highs. And it has done so with volume and breadth, momentum of unusual proportions. Ordinary rallies can be sharp, but they don't look like this. The market has ignored "overbought" levels, and blown through resistance levels. This kind of non-response to the downside typically means more gains.

The NASDAQ broke its winning streak last Friday, thanks in large part to bad news from both Amazon (83) and Microsoft (23). Looking at the day, however, it's tempting to say, is that all you got? One might have thought the market would have fared a lot worse. While the NASDAQ did break its winning streak, the loss was negligible and prices closed near the highs of the day. Even breadth was positive on the NASDAQ. Once again, what didn't happen seems a telling commentary. And when it comes to AMZN and MSFT, clearly both had run up in anticipation of "better than expected" rather than the "worst than expected" news. We don't like downside gaps, but when they occur in overall uptrends they're much less significant. If you recall, Google (438) had a similar earnings reaction a couple of weeks ago, but since has been consolidating around the old highs. A similar pattern in both AMZN and MSFT would not be surprising, the key in all three cases being the weakness has not changed the overall uptrends.

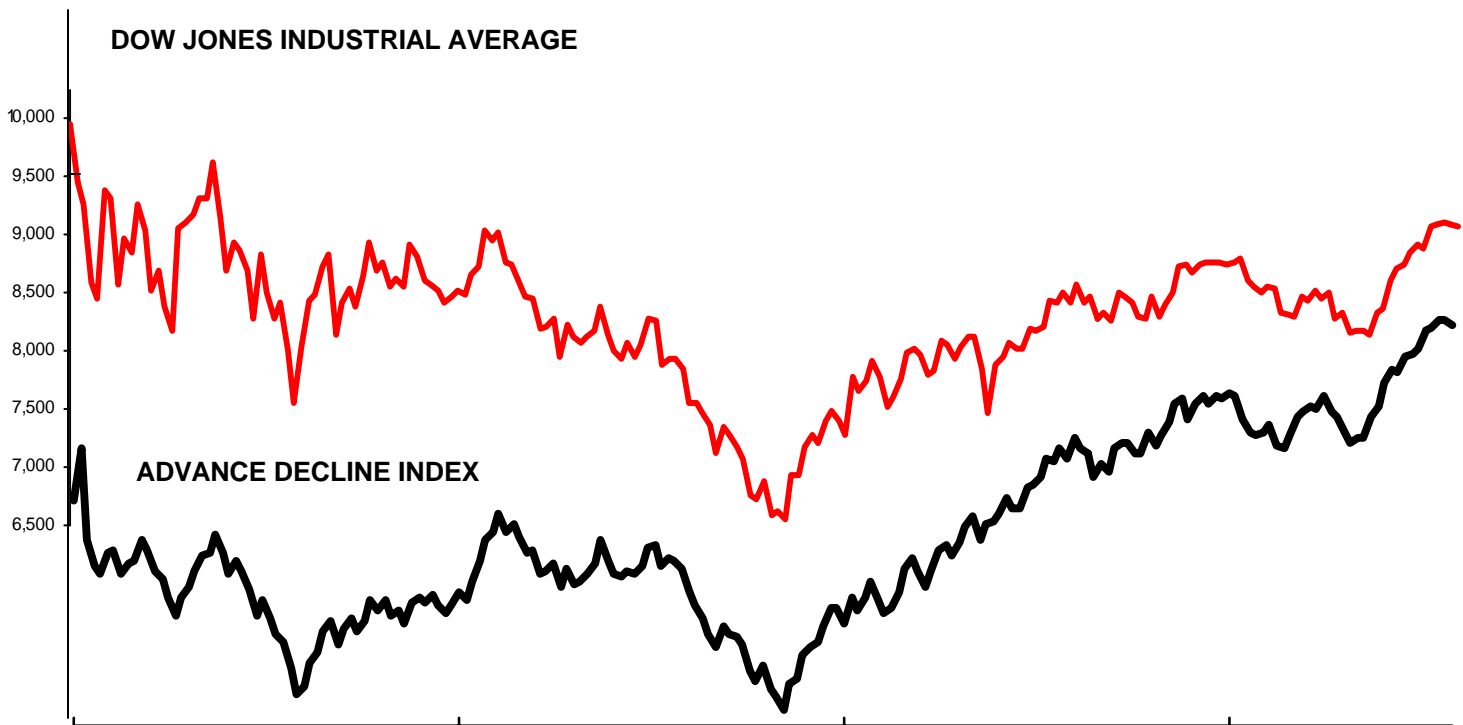
NASDAQ's winning streak of itself seems significant. Obviously that left the NAZ overbought, but in the past such winning streaks didn't find a meaningful peak for a couple of months on average. That doesn't mean no weakness, it just means no meaningful peak. Similarly, something like 90% of S&P components are trading above their 10-day moving average and 75% are trading above their 50-day moving average. Short term that has often left a mixed market, but one higher one to three months later. The S&P has risen more than 10% above its 200 day moving average, another sign of an extended market. However, while again the short term proved mixed, further out performance was positive. And, once 10%+ above the 200 day, it took months for the S&P to fall back below that average. Finally, NYSE stocks above their 200 day moving average are at 87%, up from the lowly level of 1% in March. In a typical range of 20% to 80%, this too is extended. However, when this measure moves well above 80% it tends to stay there, the momentum doesn't dissipate quickly. Moreover, while stocks may bottom together they don't peak together, they peak a few at a time. Because of that this measure will always peak before the averages.

The above notwithstanding, there's always the possibility that out of nowhere we'll have an extreme bad day – the 5% selloff in China overnight Tuesday being a good example. That's not fun, but it's important to remember that the odds overwhelmingly favor higher prices in the weeks ahead. Moreover, as we've suggested many times, markets don't get into big trouble out of the blue. There will be signs of waning momentum, divergences. Momentum peaks before the averages, the average stocks peaks before the stock averages. Market breadth, the Advance Decline Index, continues to keep pace with or outpace the averages. Volume continues to expand in the strength and 12 month New Highs have begun to pick up. The June correction had its scary moments, but lacking divergences at the peak it proved more consolidation than correction, in retrospect of course. Breadth and volume remain the key.

There has been much made of bottom line versus top line, earnings enhanced by cost cutting, versus sales growth. Pick, pick, pick, what's the fuss? It's hardly unusual that toward the end of a recession cost-cutting overshoots, and that combined with lowered expectations help earnings beat. Managements were geared up for the next depression and, apparently, so too were analyst's estimates. As for sales, why would they grow when the economy is yet to grow. For now the market is in a happy place, its "anticipatory" place, where reality doesn't matter because reality isn't yet known. Sure there are plenty of positive signs including, of all things, employment. Four week unemployment claims have dropped 90,000, something that has never happened in a recession. New home sales spiked 11% in June and the Case-Shiller Index is up three months in a row. So maybe the rally is just stocks doing their thing, being anticipatory. In terms of the technical background, for now at least it doesn't seem they're being hallucinatory.

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STOCK AVERAGE VS. AVERAGE STOCK



Oct-06-08

Mar-04-09

Jul-29-09

