

EQUITIES PERSPECTIVE

August 21, 2009

DJIA: 9,350

How often does Japan come out of recession . . . so often you won't even notice. And, apparently, no one did. Joining Germany and France as the only Group of Seven economies to pull out of recession, Japan's GDP grew at a 3.7% annual rate in April and June. On the good news, Japan's Nikkei 225 fell 3.1%. The real news, of course, has been out of China, where earnings have proven disappointing. Before Monday's open, China's Shanghai composite dived 5.8%, the most this year, and close to that again Wednesday morning. That market has had a decline of 20% just since the early August peak. Was much of their stimulus non-productive – washing machines for people without electricity? Did they do a Greenspan – stimulate stocks instead of the economy? Has China's "investment boom" also created overcapacity in industrial materials and commodities, that is, a bubble? Two years ago China's exports grew 20+% while at the end of June they had declined 20+% - look at U.S. retail sales last week. Everyone says the U.S. is ahead of itself, more likely it's China. That wouldn't be a problem except for most of the last year we've been following them.

Of course China's 4.5% rebound Thursday morning may make all this a moot point. What does concern us though is the idea of a China-like sharp correction – you dribble up for a while and then poof, it's gone in a week. Monday was a bit scary like that, but there was no follow-through. Then, too, the rally back hasn't been all that exciting, and has carried only to the recent trading range. The bigger problem is getting through that range and doing so with some real buying, that is, volume. You recall the market's problems with 950, this 1010-1020 area is proving much the same. Back then we had a 5% correction, for now the correction is a sideways one. But we are correcting, most stocks have backed away from breakout points. Surprisingly, though, the already weak stocks are holding and that's not a bad sign – weekly New Lows are at a record low. This seems another time when reacting is likely to prove more productive than predicting.

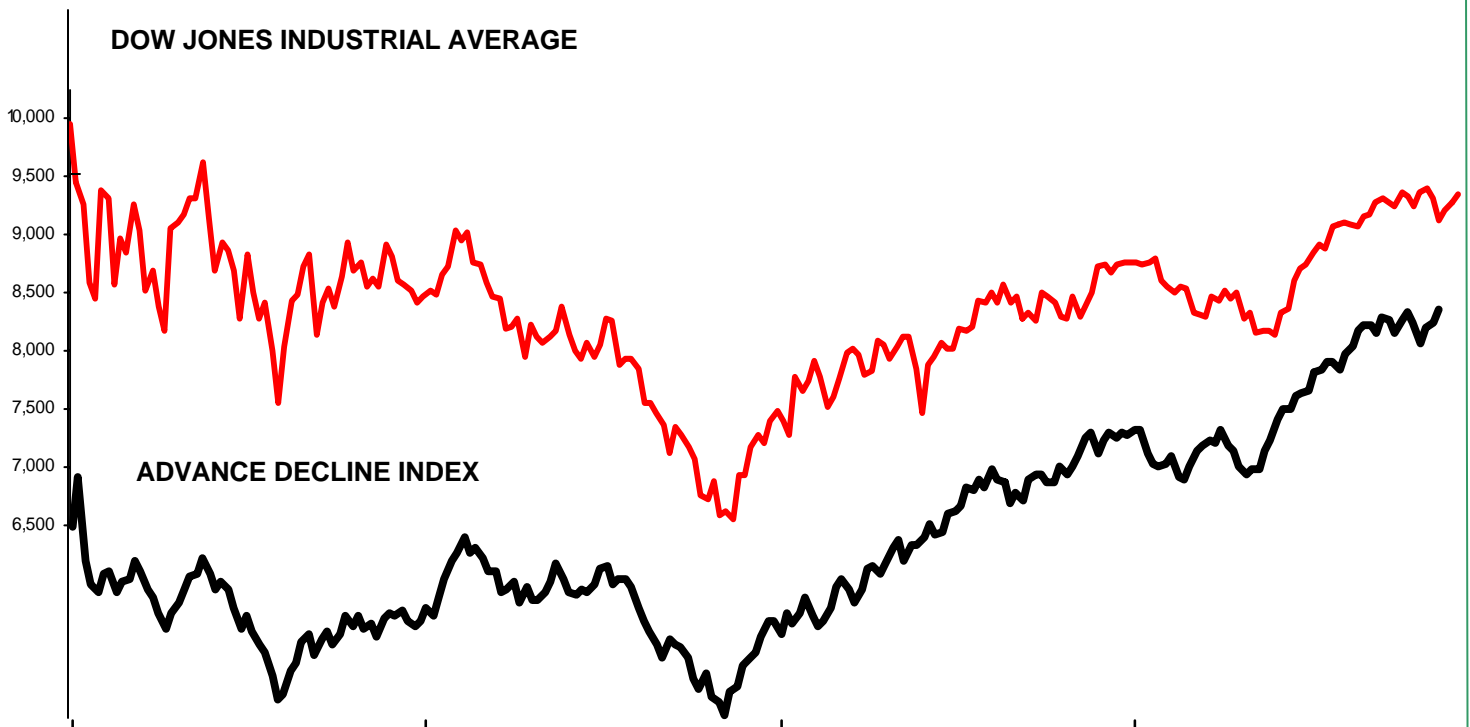
Another problem is there's a lot less worry which, of course, is worrisome. Sentiment isn't always easy to get a handle on and it's certainly not a timing tool, but we'll venture a guess that these newspaper and other low-price stocks aren't up five-fold on some seminal change in fundamentals. While this sort of speculation never lasts, there are other changes that are worrisome as well. Trade-Futures.com has a daily sentiment index which recently showed back-to-back readings of 88%, the highest extreme since December 2007. A less trading oriented but similar story comes from the American Association of Individual Investors. In early March of this year they showed 19% bulls versus a record 70% bears. The latest figures show 51% bulls versus 33% bears, a big change but a figure that is still more neutral than bearish. A market bottom is the point of maximum pessimism – the just get me out point – and we saw that in March. When optimism becomes extreme, and it's not, that means all that March liquidity has been spent, and the market is vulnerable. We're somewhere in between but far enough from the March extreme that the easy part could be over.

With China suddenly a question mark it's little surprise that some commodities have struggled. China has been a big buyer of oil and other commodities this year, leaving many to fear that could end as massive government stimulus fades and banks curb lending. When it comes to China and commodities, there's also the fear that China has been hoarding rather than using. Both oil and oil stocks have been lagging, failing to so far surpass June peaks. Maybe this is bad news for the global recovery, maybe it's just the harsh reality of oil these days. There is no shortage – inventories of crude, gasoline and heating oil remain well above their five year averages. And meanwhile, natural gas is making new lows. This isn't last summer. Rather than oil this summer's speculation seems about low price stocks, especially those low price Financials.

Short term the market has its reasons to come down. What makes that such a tough call is that the same might have been said from April on. Such as they are, fortunately these problems seem short term in nature. Even in terms of the economy, rather than worry investors likely will cheer the recovery as stock prices peak, in true contrarian fashion. There's reason to expect longer life to the recovery, that based foremost on its upside momentum – when NYSE stocks above their 200 day moving average reach 90%, it's a long unwind. Or, consider liquidity. Money market cash is at something like 32% of market-cap, down from its peak of 47%. In a bull market, however, cash typically falls by 50%, in this case to the 25% level, before time's up. Then, too, we might note that in 1929-30 the rally lasted 22 weeks and carried the Dow 52%, virtually the same as this one - lest we become too complacent.

Frank D. Gretz

STOCK AVERAGE VS. AVERAGE STOCK



Oct-06-08

Mar-16-09

Aug-20-09

