

## EQUITIES PERSPECTIVE

September 12, 2008  
DJIA: 11,434

Fannie, Freddie, and now Lehman . . . the feeling is (Washington) Mutual. The market celebrated the weekend bailout of Fannie and Freddie with a near 300 point rally Monday. While that's all well and good for Fannie and Freddie, the action in Lehman (5) and Washington Mutual (2) later in the week certainly made clear the world is not yet a financially safe place. And, as it happens, 300 point rallies in the Dow are not to be trusted – they don't happen in bull markets. There were no 300 point rallies in the bull market from October '02 to October '07, but it now has happened 7 times in this bear market and it happened 12 times in the last bear market. The 300 point rally on August 18<sup>th</sup> saw 3-to-1 breadth and a 58 point gain on the NASDAQ. Monday's 290 point rally saw breadth that was 1.8-to-1 up and a gain of 14 points in the NASDAQ. Tuesday's 280 point decline saw breadth that was 7-to-1 down and a loss of 60 points on the NASDAQ. For all the bad news at least the market didn't waterfall, but there's little you could call positive.

The Brokers, WAMU and American International (16) are not inconsequential. But most Financial stocks aren't acting all that badly. The Financial ETF (XLF), as it happens, so far has traced out almost the exact same pattern that followed the March low. In both cases the best part of the rally was the initial move from the lows. And after some consolidation, in both cases it eventually moved above the initial peak, only to fall back into the pattern – never a good sign. Back in March – April the pattern held together a while until the uptrend line eventually was violated. Then followed the near 40% decline into the July low. Though not what we're expecting this time, we certainly would take seriously any break in the current uptrend line.

The issue of financial solvency seems one that just doesn't want to go away. But there now seems a distinction between the good and bad Financials. The Regional Bank ETF (RKH), for example, is a much better pattern than XLF, and even had a decent gain on Thursday. A bank like City National (56), located in the foreclosure capital of the world, has been strong as it apparently gains depositors from its brethren. The market has begun to distinguish among the Financials, though the Brokers, the AIG's, the weak, remain weak. Even if you want to argue the worst is over for many of the Financials, that doesn't mean a return to their glory days, it just doesn't work that way. Commodity stocks peaked in the early 80's and stayed dormant until a couple of years ago, Cisco (23), one of the survivors of the NAZ 5000 days, hasn't quite made it back to its 2000 peak of 82. When a leadership sector peaks, Tech in 2000, Financials more recently, they don't come back to lead.

You could argue the market hasn't acted all that badly this week, given the Lehman bashing and Washington Mutual hitting a low Thursday of less than a subway ride. After Tuesday's rout and Wednesday's nothing rally, the early Thursday weakness could have turned into the proverbial waterfall. But after five fairly dramatic moves the Dow closed up 160, capping a 300 point reversal. Normally that would be positive but breadth was very negative for most of the day and negative at the close, while volume was mediocre. And as Monday's failed rally aptly showed, rallies premised on news aren't really to be trusted – is Bankamerica (33) or whomever buying Lehman any more important than the Treasury bailing out Fannie and Freddie? Though, if Bankamerica bought Lehman it would become part of a "bank too big to fail," and the government then could bail out both. At some point the market will rally not because of news but, rather, because it's soldout. That's the only rally that counts.

It's hard to remember a week, and it's doubtful there has even been one, when two major institutions fail and two more seem on the brink. Yet, the news was met with euphoria on Monday and then complacency. That doesn't sound bad, but it is. The Bear Stearns news was met with panic, and panic begets selling and the selling, a washout, gives you a decent low. With the July uptrend broken that scenario is likely to evolve, though things could string out for a while. Certainly though, poor rallies like Monday's and Thursday's, setting up divergences, will only make matters worse. On a positive note, a decline in the averages doesn't mean lower lows in all stocks. Consumer Staples, out of favor for years, are in important uptrends, it's not just defensive. The same is true of many shares in Healthcare. And even when it comes to many Banks and Financials, the worst seems over. As the weakness in Commodities and Tech suggests, any weakness will more likely reflect the global slowdown.

Frank D. Gretz

# STOCK AVERAGE VS. AVERAGE STOCK

