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EQUITIES PERSPECTIVE

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Five will get you ten . . . that two will get you five. But you have to act now, supply is limited. We're talking about $2 stocks which all seem on their way to $5, and today's $5 stocks on their way to $10. From a trading perspective a run in low-price stocks is a thing of beauty, if your idea of beauty is making money. But runs like the present one are always fraught with risk. After all, did something change at Rite Aid (2.25) the company to make Rite Aid the stock worth almost 50% more than just a week ago? It's like that can of tuna that traded from $1 to $10 – whatever you do don't open it, it's just for trading. Trading low price stocks is a little like musical chairs – lots of fun until you get caught standing or, in this case, holding. This will end and when it does there's very little warning, no process of distribution. The charts look great and the next thing you know, it's over. Or, maybe we just run out of $2 stocks.

The run in low-price stocks we're seeing is out-and-out speculation. It's not dot-com speculation but it's speculation. In the stock market there's always speculation but, like everything, it's anything in excess that's worrisome. In this case, however, we're not sure the consequences for the market are all that dire. Back in the first half of 2007 the speculation in commodity stocks had dire consequences when it ended, as did the speculation in dot.coms back in 2000. In both cases, of course, the stocks themselves had an outright impact on the market averages. But in both cases as well, commodity stocks in 2007 and dot.coms in 2000, these were the market. These were the market, these were the movers while little else was going on – all anyone worried about was the price of oil or, in turn, the "new economy." At least in that respect, this market is much different. There's more to this market than just speculation in low price stocks.

First and foremost, breadth shows the expanse of the rally. Until Thursday's setback breadth had been positive for an amazing nine straight days, including Wednesday's 5-to-1 up day. Market breadth, the average stock, has outperformed the market averages. So most stocks go up most days but what about the overall picture? The 200 day moving average is a good guide to the overall picture, and on the NYSE 95% of stocks are above that average. So not only is just about everything going up these days, these days just about everything is in an overall uptrend. A couple of weeks ago we mentioned that despite the good market numbers a lot of stocks were going nowhere, "the 50 good charts doing nothing." That's changed, and the change is across many groups and sectors. IBM (121) finally broke out, Caterpillar (54) did so dramatically, as did Amazon (90). And, after acting a little scary, even many of the Banks broke out. Against this background 12 month New High broke out, reaching 450.

With 95% of NYSE stocks above their 200 day, things obviously are about as good as they get. Indeed, they're about as good as they've ever gotten, even surpassing the 94% in June 1983. Against this background, of course, everyone is screaming "overbought," and we are. Particularly in the case of this measure, however, overbought is far from over. This degree of upside momentum takes considerable time to unwind. After the peak in '83 the first serious correction didn't start until early '94. You have to remember that while stocks may bottom together, they don't peak together. They peak a few at a time, typically the last being those that dominate the averages. So we should see this 200 day measure start down well before "the market" starts down. Momentum precedes price. Another look at the 200 day moving average is versus the market itself. And there the prognosis is a little more problematic. At present the S&P 500 is 20% above its 200 day moving average, another relatively rare event. In the past this didn't mean imminent doom, but generally speaking it did mean much more choppy action.

An IBD poll finds that 80% of economists surveyed believe the recession has ended. So, up more than 50% from the March low, they agree with the market. And now what? It's nice that things are getting better, if it lasts, but we're already up 50%. Historically it's a push to get much more. Indeed, the biggest part of the recovery typically comes by the time a recession ends. As per the above, there is nothing in the technical background to suggest big time risk – no divergences and big upside momentum. But with the news better and the market up, certainly there's a greater level of complacency, the willingness to take a risk on almost any $2 stock. The market has become stretched to the upside, no doubt because the holdouts are being pushed in. After all, September isn't the bad month everyone had expected, and it's the end of the quarter. Well, October often isn't any fun, and we likely have borrowed ahead enough to make things more difficult from here.

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