

EQUITIES PERSPECTIVE

October 16, 2009

DJIA: 10,063

Going up . . . pretty much the way it went down. If nothing else, you have to admire the symmetry of sorts. And it makes you realize just how stretched we must have been back there in March. But it also seems likely this market has taken on a bit of a life of its own, black box and momentum driven. It is what it is, they're still going up and, in the case of Wednesday, impressively. In this latest leg up breadth hasn't been a problem, in fact the Advance Decline Index has outperformed the averages. It's volume that has been the problem but not so on Wednesday. And with the volume came the push through resistance, new highs in the averages – "Dow 10,000" for something like the fifteenth time. If there's a symmetry in price action, that doesn't seem true of investor psychology, at least overall. In March the feeling was, "just get me out." Now there may be growing complacency, but certainly no panic to get in. There still seems a healthy amount of caution, including our own.

The market's relentless advance has ignored in its wake a number of seeming technical problems. For example, the market has found little issue with resistance levels, overbought levels, low-price stock excesses and lagging volume. Looking to any of this hasn't proved useful and, in a sense, has proved harmful. This is not to say the technical stuff isn't working, it's the short term stuff that isn't working. We and every other tech analyst have pointed out the overall momentum – 95% of NYSE stocks above their 200 day moving average – and the durability for the rally implied there. Similarly, if you believe as we do that the average stock, market breadth, peaks before the market averages, this market has been perfect. There are no divergences, breadth is better than the averages. There will be a "weak rally," one in which breadth lags the averages, before big problems.

We all know the market is a "discounting mechanism," it's anticipatory. And we all know things are better – the financial crisis over, the economy on the mend. Where there's disagreement is about the reality of the recovery – inventory rebuilding and the like, or real growth. And even if things truly are better, there's plenty of disagreement about the extent to which the market has done its discounting thing. Given the recovery seen to date, and what we might anticipate, the speed and extent of the market's recovery is virtually without precedent. As we suggested, that may well be a reflection of the extent of the decline to the March low. Or the rally may yet prove justified by the extent of economic recovery. However, the market in this case also may have gone a bit afield. It's a market that may have taken on a life of its own, driven by momentum, chasing the trend. Fortunately for now it doesn't matter, the technical background is still fine.

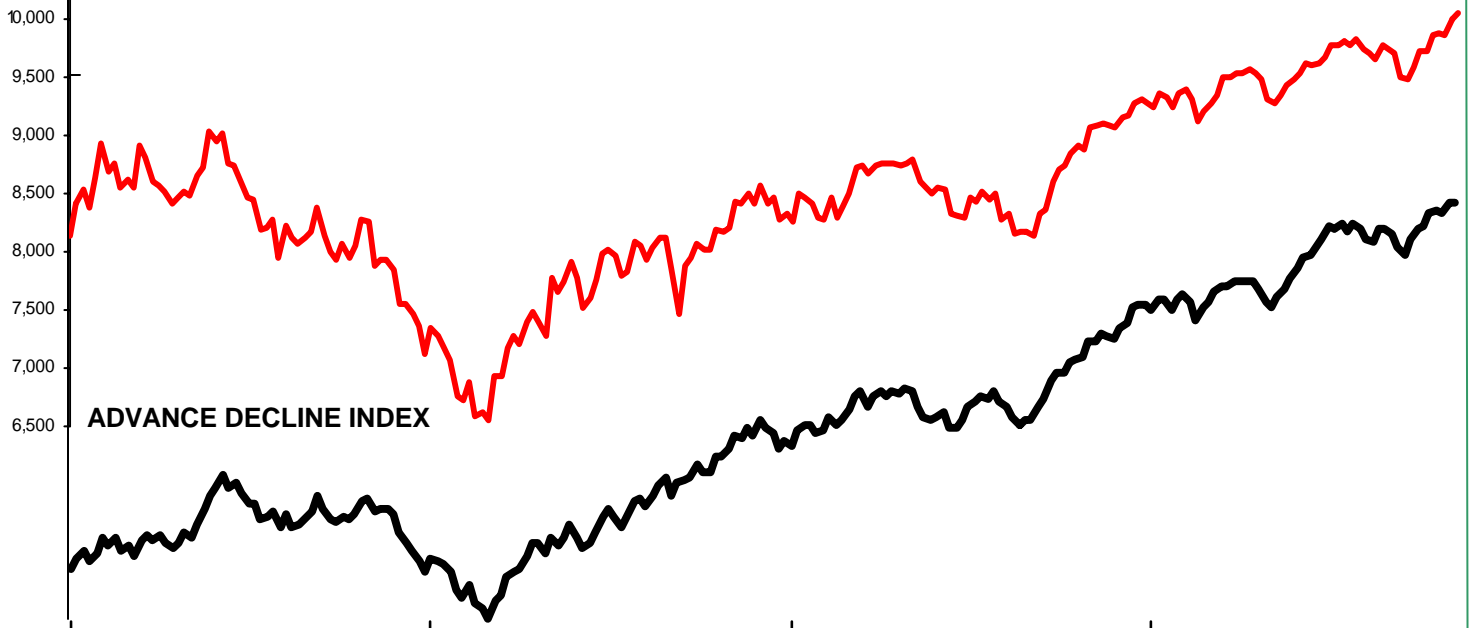
Given the very positive breadth, it's not surprising that 12 month New Highs have had an impressive expansion. At the same time there remain virtually no 12 month New Lows, and after six months of recovery that is surprising. It may be the tide that lifts all ships, but you would think some stocks might reflect ongoing problems, and there are problems out there ongoing. Commercial real estate, for example, still has its problems and many are yet to come to the fore. Those problems, in turn, rest largely with regional banks. Certainly most of those stocks have lagged, but they hold together, they're not exactly reflecting/discounting problems at least yet. Much the same seems true of the Homebuilders. To many of us the turnaround there seems a false dawn in light of an upcoming wave of new foreclosures. Meanwhile, the stocks have lagged recently, but they hold.

We've had a 60% rally while the economy has lost a couple of million jobs. By this time you typically see the creation of a couple of million jobs. They say there's a "cash mountain" out there but, as it happens, cash in money markets is the same as October 2007, when the bear market began. Obviously dollar weakness can't go on forever, but it can go on provided it remains orderly. And it will remain orderly until, well, it doesn't. Then the Fed will be forced to act, the dollar carry-trade ends, and so on. Meanwhile, GE just reported industrial revenue growth declined 8%. A lot of problems get masked by rising markets. It's not until the market turns that problems, problems that were always there, become obvious. Time will tell, to coin a phrase. For now the market is yet to turn, the technical background remains good. That's not to rule out some pullback, for no good reason.

Frank D. Gretz

STOCK AVERAGE VS. AVERAGE STOCK

DOW JONES INDUSTRIAL AVERAGE



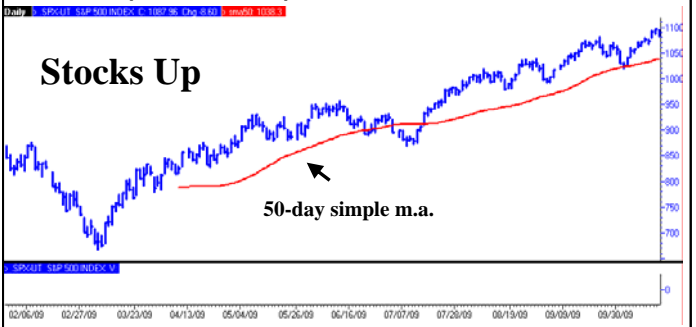
Dec-01-08

Jun-03-09

US \$ (UUP - \$22) - DAILY



S&P 500 (SPX - \$1097) - DAILY



GOLD (GLD - \$103) - DAILY



US OIL (USO - \$40) - DAILY



KBW REG BANKING (KRE - \$22) - DAILY



HOMEBUILDERS (XHB - \$16) - DAILY

