

EQUITIES PERSPECTIVE

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DJIA: 8,979

Glad that bear market's over . . . again. Financial panics obviously are about selling, but they're also about psychology. In a financial panic the selling is about fear – fear of a financial collapse or as importantly, fear that prices will be even lower tomorrow – so you had better sell today. The selling itself begets more selling until finally the sellers are through. When the selling is through, prices move up relatively easily, as they did Monday following last week's waterfall decline. We've likened this to 1987, a sort of five day version of October 19th. Despite the end of the world feeling then, the market did make a low. And despite the end of the world feeling now, the market appears to have put in low with last Friday afternoon's reversal. But if this analogy with 1987 holds, we're almost certain to find this idea of making a low is a process.

Last week's waterfall decline ended in a selling climax/reversal last Friday afternoon. From the low Friday to the open Tuesday the S&P rallied an amazing 25%. That looked like the real deal, reversal-wise, but the market peaked Tuesday morning and sold off sharply. Rather than unusual, that action is pretty much the norm – the so-called “test of the low.” If last week's action was the five day version of the '87 crash, the action following the 22% decline October 19, 1987 offers some guide as to what a test looks like. Following that Monday's decline and Tuesday's reversal, resulting in a 6% closing gain, the market rallied another 10% the following day. On October 26, however, the Dow fell to 1794 versus the October 19 low of 1739 – a test of the low. From that low the Dow rose 12% to 2014 by November 2, only to drop to 1767 by December 4, another test. It was basically higher from there, the Dow closed at 2194 at the end of 1988. But wasn't that fun. Hence the idea that making a low is a process.

We all have a pretty good idea that the market is down a lot, but we're here to tell you it's really down a lot, it's stretched. Last week only 2% of NYSE stocks were above their 200 day moving average and, after a bounce, that was again true on Wednesday. That, by the way, matches the record low which occurred in '87. By way of perspective, even 20% can start a new bull market. Also, the S&P is 22% below its 200 day moving average. The six times that's happened since the early 50's, the market was higher 30, 60, 90 and 250 days later. Down a lot, of course, doesn't mean the market has to go up. From Tuesday morning to Thursday afternoon we've had a test of last Friday's low. What makes that test look successful is what happened Thursday afternoon. The market didn't just hold above the Friday low, it rallied from the low. And it rallied well – from 300 down to 400 up, from 2-to-1 down to 2-to-1 up, and volume in the rally. To follow-through Friday would be nice but, it's still likely to be a process.

The sentiment background also seems right for an important low. You don't even need indicators, the gloom is all around us. We're even beyond that, “oh well, I'm a long term investor” stuff. Everyone seems resolved to working the rest of their lives because 401-K performance won't let anyone retire. Of course, not everyone has that luxury like those, for example, at Lehman – there's a story around that someone smacked one of the leaders there. Does that give new meaning to, hit the bid? Fear, panic, helplessness, unfortunately these are a part of bear market lows. So too is the disappearance of venerable Wall Street names like Lehman Brothers. Even violence among the wimpy Wall Street boys isn't new – remember when Mulhern, may he rest in peace, loaded his six-shooter and took out after Boesky? All these feelings are part of that human nature thing at or near a bear market bottom. To look to the bright side, as before, this too will pass. Then we get to go out and make new mistakes.

Clearly we are in the midst of a global slowdown, or worse. And nowhere is the globalness of the slowdown more evident than the Baltic Dry Index, featured Thursday at a five year low. Another clear indication seems the price of Oil, though here other things seem at play as well. Remember back when Oil was trading \$130-140 and they swore it wasn't speculative buying, it was global demand, China and whatever. Sure China demand, global demand were real, but not to the tune of \$130-140. And what seems the proof of that is the way Oil has fallen apart, down 50% from the peak. Global demand hasn't completely fallen apart, yet Oil and other commodities have. It seems more than co-incidence that this should happen as hedge funds are being forced by redemptions and losses to unravel these trades. They drove them up, having never met a trend they didn't follow, and now they're driving them down. Of course, forced selling by hedge funds also likely has a lot to do with the recent weakness generally. This selling too will get done.

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