

# EQUITIES PERSPECTIVE

October 23, 2009  
DJIA: 10,081

Ding, ding, ding . . . did anyone else hear that Tuesday? Or, as per the Sherlock Holmes story, did anyone else not hear that dog that didn't bark? Both Apple (205) and Caterpillar (58) reported blowout numbers Tuesday morning. But not only did the market not rally, it didn't even open higher. That inability to respond to good news seems a change, one suggesting that buyers might be stocked up, so to speak. But they don't ring a bell at the top, and maybe the poor dog had laryngitis, or so it seemed after Thursday. Tuesday coupled with Wednesday's nasty reversal left back-to-back 2-to1 down days on expanding volume, rare in a healthy uptrend. Thursday was impressive for its price gain and breadth, but volume not so much so. All this of course is short term stuff, and of itself confusing more than anything.

What the market does with Thursday's rally might clear the air for a while. Many stocks, including Amazon (107) were trading higher Wednesday night, and Microsoft (27) was higher before the open Friday. A follow-through, a breakout from the recent range, with volume, would make Tuesday and Wednesday another aberration. However, if once again that dog doesn't bark, it will leave that look of buyer's fatigue. Either Tuesday and Wednesday meant something, or Thursday meant something. Once again, observing will prove more productive than predicting. Having come as far as we have, there's always reason for concern, not about a big decline, but a 5-10% decline isn't much fun either. And in a market like this, up as it has been on declining volume, it wouldn't take a lot of selling to turn things. Hence our concern with Tuesday and Wednesday's back-to-back selling, and Thursday's less impressive buying. As Andy Grove or someone observed, you have to be paranoid to survive.

Wednesday afternoon's selloff was said to be caused by a downgrade of Wells Fargo (30). While we doubt the downgrade was more than a handy excuse, it was the Banks that led the market higher Thursday. PNC led the way with a 5+ point gain, as earnings beat estimates by more than 200%. Loan losses, of course, expanded to \$650 million from \$122 million. And so it goes, easy to make money with the rate spreads, but still plenty of rot. For the mid-size banks that rot may still be brewing, as they are home to most of the gazillion dollars in construction and commercial real estate loans. The Fed has acknowledged that losses on commercial real estate are mounting for community and regional banks, but sees it as a "manageable problem for the banking industry." That phrase itself is a bit of a contradiction, and the Fed itself has not been the best at recognizing systemic risk. It has been a struggle for many of these banks, pretty much a six month trading range. But they're holding, so far.

They say it's a market of stocks, but most focus on "the market," the market averages. Certainly that made sense last year, everything went with the market – there was no place to hide. And the same has been pretty much true this year – 93% of NYSE stocks are above their 200 day moving average. But that's not to say there haven't been a few changes recently. While about as mixed as we've seen them as a group, a number of Semi's, to be kind, have turned lackluster. Then there's Thursday's big breakout in Kimberly Clark (69), another flu play? More importantly, anything to with moving or making big and heavy stuff – Ingersoll Rand (36), Eaton (64), Caterpillar (59), Illinois Tool (48) – have been big winners of late. Call it a healthy rotation or whatever, this helps explain why breadth remains so positive. And as long as breadth remains positive, the rotation is just that, healthy.

We've often referred to a "weak rally," one that would set up divergences, before any important weakness. What we've had in mind is a rally with poor breadth – the averages break out, go up but most stocks don't. That is yet to happen. But there has been this divergence in volume and volume is, after all, a proxy for buying. You can make the case that buying peaked back on September 22, leaving since then a divergence as the market has rallied. This may be stretching for trouble, "buying" and even volume are not easy to put in perspective. But we do know poor volume is not good, stocks breaking out without volume are hard to trust. In turn, the higher volume in the Tuesday-Wednesday weakness could be a shot across the bow. The market has been amazingly resilient, rolling over these short term issues. But until we get a couple of good volume days to the upside, this doesn't seem the time to completely abandon paranoia.

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