

Merrill Lynch . . . leaking like a SIV. Merrill wrote down \$7.9 billion in risky loans while reporting a loss of \$2.85 a share vs. estimates of a 45-cent loss. Earlier this month the write-off was thought to be \$4.5 billion which, apparently, was little more than a guess. They were off by more than \$3 billion, for goodness sake, this from a company that is supposed to manage risk. But that pretty much says it all about the SIV problem, no one really knows what the risk is. As Larry Fink of Blackrock put it, markets don't bottom when you mark to market, they bottom when you liquidate. The most important aspect of this, of course, seems the market's reaction. A few weeks ago the market responded positively to the writedown, this time it didn't. Indeed, the market is responding less well generally, but it has been an interesting week.

Following Friday's big selloff, Monday looked bleak but only momentarily. One more time they failed to fail, they failed to follow-through to the downside despite the excuse of heavy selling on foreign markets. The Dow rallied but breadth was poor. Tuesday proved a good day breadthwise, and the Dow gained 100 points, but volume was poor. The real story Tuesday, however, seemed the NASDAQ. Indeed, for the NASDAQ Tuesday harkened back to the days when cries of NAZ 5000 resounded through the land. The Composite jumped 1.6% on Apple's (183) 7% post-earnings romp and Research In Motion's (120) 10% run. RIMM shot up on the news it will sell its popular Blackberry smart phone in China. Buyers of the stock apparently have never tried dealing with Chinese characters on a small keyboard, but what do we know. NASDAQ breadth was good and the day left the Composite only about 1% from its July peak. For the NASDAQ, it was the kind of day that made you believe.

Meanwhile, especially for the NASDAQ, the whole sequence has been a bit of a disaster in terms of divergences. The NASDAQ Advance Decline Index, breadth, actually took out the August lows on Friday. The Monday-Tuesday rally, while regaining almost exactly all of Friday's 75 point loss in the Composite, saw breadth recoup only little more than half of Friday's loss. All this against a background of divergences that has been playing out since February. This is the "pattern of divergences" we've referred to many times as being particularly negative. The failed rallies in terms of breadth, distribution under the guise of strength in a few big stocks that dominate the averages. The NASDAQ is textbook stuff but the NYSE hardly is immune. In Wednesday's stunning reversal, whatever that was about, the Dow recouped all of its early 200 point loss. Breadth, which did have ample time to recover, still came up with a net of 800 declining issues. Everyone is looking at the Dow when, again, there's plenty of distribution going on beneath the surface.

Thursday saw yet another reversal day, at least for the Dow though not for the NASDAQ which was weak and breadth there one-sided. They're holding, more or less, but cracking. It seems just a matter of time but it's always that way – it's about the timing. These reversals or "comeback" days offer hope but little in the way of credibility. Meanwhile, Amazon's (88) action Tuesday-Wednesday could prove a tipping point of sorts. Nothing has been stronger than Amazon, and the stock was up big, breaking out in the process in Tuesday's rally. Something in the numbers that night wasn't to everyone's liking, however, and the stock gave back Tuesday and more on Wednesday. What happened to good markets making for good news? Amazon has been a market leader, and Amazon has a nasty reversal. There was more of that Thursday, weakness among some leaders, Cummins (112) losing 20+ points being one example. For the leaders the deterioration has been slow, but it seems to be happening.

The Dow has been up in the 4th quarter 9 times in the last 9 years. If you didn't know that literally, like most of us you probably felt it. That's not hard evidence of complacency, which there is, but that idea seems to catch the spirit of the sentiment background. The Fed is cutting rates, everything will be just fine, the market again will do well in the 4th quarter. To say this time is different is always risky, but clearly some things are. The Financial Index (XLF) and Regional Bank Index (RKH) are back to their July-August lows, telling you that financial stocks still have issues. Another big difference between now and 4th quarters past, there are divergences all over the place. The Transportation Average seems rather far removed from subprime and the like, yet it has gone literally nowhere since the end of August, and virtually nowhere in the entire rally. No, this doesn't seem your average 4th quarter.

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