

EQUITIES PERSPECTIVE

October 30, 2009
DJIA: 9,963

Turning on a dime ... ten of them. A dollar rally, how shocking. Along with death and taxes, dollar weakness was supposed to be forever. So much so that selling the dollar has become, as they say, a crowded trade. That alone no doubt explains the stunning reaction to Monday's dollar reversal, and knee-jerk swoon in stocks. While correlations between the dollar and inflation expectations or interest rates are dubious, since March the dollar's inverse correlation with stocks jumps out at you. But the dollar isn't the market's real problem, just as next week it won't be about divining the meaning of this or that phrase of Fed-speak. The market's problem has been pretty basic, a lack of demand. Last week companies like CAT (57), Apple (196) and Microsoft (28) all gave the market what it was looking for. The stocks responded, but not the market. Buyers' fatigue, call it what you like, it's a change.

Even when the buyers have been there lately, they haven't really. There's been no volume, no real buying. In individual stocks that leaves you susceptible to days like Wednesday, where stocks go down as though they were in a vacuum. It's hard to know just yet what to make of Thursday's rally but, at a glance, it was more of the same – big gains, big breadth, not so big volume. Oversold, it could be the start of a rebound, but a lot of damage seems done. For example, it's very unusual for a market to be so weak, to become so oversold, after just making a new yearly high. Typically this kind of action has had negative implications for the intermediate term, suggesting a drive back to new highs by year end may not be in the cards. And then there's market breadth, an area where the change is considerable and worrisome. As of Wednesday, the Advance Decline Index was back to the October 2nd low, a level comparable to 9,488 in the Dow versus its Wednesday close of 9,743. Whereas breadth, a good proxy for the average stock, had been outperforming, it's now underperforming. The NASDAQ Composite and Russell 2000 also are back to those early October lows. So it seems fair to say "the market" no longer is as strong as the Dow and S&P make it look.

Like last week, much depends on where we go from here. The weakness, especially in breadth, seems to have broken the uptrend. The extent of Thursday's rally, in turn, seems to have stemmed the downward tide, eliminating the risk of some dollar-unwind, panic decline. As last time, we would feel much better with a couple days of good volume to the upside. More of the same, poor volume in strength, would not be good. Poor breadth in a rally would be still worse. Weak breadth in a rally is the key to the "weak rally" we often allude to, and weak rallies set the stage for major declines. For now, the market's problems seem relatively minor, short-term stuff. There's all that upside momentum – 95% of NYSE stocks above their 200 day, and so on – that always takes time to unwind. But we are up 60% and ahead of other recoveries historically. It is not some new bear market that worries us; it's more of these little 8-to-1 down days like Wednesday.

The latest Consumer Confidence Index showed not so much of it. The less important present situation index surprisingly fell to a 26 year low, the more important expectations index also fell sharply. A greater portion of consumers anticipate business and labor conditions will worsen in the months ahead, according to the Board's consumer research director. Economists and, indeed, the numbers tell us the economy is on the mend. But, if the consumer is 70% of the economy, and they don't see the recovery, something seems amiss. The answer, of course, lies in the nature of "the recovery," one with declining home prices and employment. Something like 40% of the families now on food stamps actually have "earned income." Throw in a 60% rise in gas prices from December last year, it's little wonder consumers aren't exactly giddy.

All this is enough to make you wonder if the happy holidays will be just that. However, there's an almost 90% correlation between stock market performance September-December and holiday sales. So far, we're still up almost 4% from the August 31 S&P close of 1020. Glad tidings also seem borne out Retail stocks, with the somewhat ironic exception of Wal Mart (50). In a different area, other exceptions in Retail are Home Depot (26) and Lowe's (20). Despite a boost from their own variety of "cash for clunkers," the housing recovery seems tentative at best, and many of us believe there's a whole new round of foreclosures out there. In the event, the Housing stocks are teetering, to put it nicely. Most Tech stocks, the Semiconductor Index for example, look like the NASDAQ Composite, back to the early October lows. Apple, Amazon (122), Google (550) and Microsoft, are the obvious exceptions. IBM (123), however, has had trouble after its downside gap a couple of weeks ago. For it and the market, holding the 118-120 level seems important.

Frank D. Gretz

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