

Your debutante, she just knows what you need . . . that Bernanke, he knows what you want. The Fed, at its crowd pleasing best, cut rates again. And though they hinted they were about to kick the habit, it didn't matter Wednesday. Stocks rallied, and they did so impressively. Not only was breadth impressive, for a change volume expanded into the strength. Indeed, overall it was the best looking day since September 18, the last time the Fed cut. There was, however, one dramatic difference between the two days, one that took on new meaning in light of the weakness Thursday. Back in September rate-sensitive stocks responded to the news, Wednesday they did not. Thursday they collapsed. The Financial Indexes like the XLF and RKH are back to but just at their August lows. Taking out those lows would not be a good sign. It's the Financial stocks that got all this downside started. It seems likely they'll have to stop going down for the downside to really end.

In light of that Financial stock underperformance Wednesday, apparently it didn't take much to push those stocks over the edge, and Thursday's Citicorp (39) news seemed to do it. It was, however, just a downgrade, not some new news, that undid the stock and that itself is more than a little scary. Good markets ignore bad news, bad markets take any news as bad, and all that. Structured Investment Vehicles (SIV's) are investment pools that issue Commercial Paper and use the money to buy longer term assets. Citigroup manages the most SIV assets, and short term funding has dried up. The proposed \$80 billion Treasury-backed bank-run rescue effort on SIV's has done little to calm anyone's nerves. Indeed, the impact may have been just the opposite. Given what is at the heart of the matter, the lack of transparency on the subprime losses, the magnitude of the solution may well have increased market perceptions about the size of the problem – there is a banking crisis! Back in August it had seemed that the worst of the credit crunch was behind us. That because, very simply, Financial stocks held and rallied. New lows among those stocks would suggest otherwise.

In what seems a real testament to smoke and mirrors, in the heat of Wednesday's action the NASDAQ managed a new high. Volume expanded and breadth was the best in a while. This good day, however, came just two days after another lower low, below the August lows, in the Advance Decline Index there. That follows a weak rally in that index, below the summer peak which was, in turn, below the February peak – a pattern of divergences. The NASDAQ average is doing well, the average NASDAQ stock is not. This is textbook stuff, distribution under the guise of strength in a few big stocks which, because they're big, have a big impact on the averages. As of Wednesday's close the NASDAQ Composite was up 18% on the year. Unencumbered by Financial shares, the NASDAQ 100 was up 28%. Of that 28% roughly half the index's rise has come from just three stocks: Apple (187), Research In Motion (122) and Google (703). That seems a startling illustration of how a few exceptionally strong stocks can give the impression it's a bull market.

This divergent action will end and, like 2000, it won't end well. Like 2000, however, it's difficult to say for sure that it's not still '99. With Google above 700 it hasn't ended yet, but there is some slippage. That action in Amazon (88) last week, the breakout and reversal, looks a bit ominous, and AMZN certainly has been among the NASDAQ leadership. Another leader to take a hit this week was CROX (53), gapping down 30% on Thursday. Stocks tend to bottom all together but they peak a few at a time. Topping is a process, the leaders are the last to go, dragged down eventually by the average stock. That dragging down might have begun, but it's simply hard to know and there's very little warning. That CROX chart, for example, was a good one Wednesday night, as was Amazon the prior week. They both made new highs the day before they broke for goodness sake. This is when instinct and the big picture probably are more valuable than the charts.

We find it a bit hard to believe that anything in Friday's employment report will undo Thursday's damage. If Wednesday's rate cut didn't help, a weak number, the prospect of more cuts, seems unlikely a call to rally. But, then too, this market has had a way of holding itself together. A couple of weeks ago, after the 370 point plunge, they had a chance to give it up but they didn't. Holding up isn't the same as going up, but it is something. It makes you wonder if they might not just muddle through the rest of the year, but there's that complacency, even we can see the "muddle through." With it, and the increasingly divergent background, November could prove a tough month. Especially given the renewed onslaught on the Financials, it's more than fair to say that risk here has dramatically increased.

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