EQUITIES PERSPECTIVE

May 8, 2015
DJIA: 17,924

Coal mining … it's not God's work! The Church of England said it would divest its assets from companies making more than 10% of their revenues from coal. The Church said it was its "moral responsibility" to act on climate change. Left unsaid, perhaps, is that other moral responsibility – stop losing money. It comes as little surprise that moral sanctitude should rear its ugly head just as the stocks finally have stopped going down. Mind you it will take a visit or two to Lourdes to get much going on the upside, but it's proof again that the market knows more than up and down – it knows rotation. Aside from Coal, Iron Ore and most of the Industrial Metals, a perfect example of this rotation is Freeport McMoRan (23), a stock which a few short weeks ago it seemed only heaven could help. A company, you may argue, that has been looking for earnings in all the wrong places, and through considerable fault of its own. The redemption of FCX is coincident with that of Oil and other of the fallen. That's rotation.

One man's rotation, of course, can be another man's "rally in the laggards" – typically an end game. Given the rally is centered in the commodities stocks, for it to last you have to be looking for good things from China, though they say infrastructure is no longer their path to growth. For now we wish we had swapped all our Biotechs for Drillers, but doubt that's the right overall move. When oil was in the low 40s, 70 seemed possible premised on the technicals – oversold and under-loved. Already we're well along the way. Meanwhile, the Biotech weakness has been painful if you're in them, but in the scheme of things has taken the stocks only down to the lower bound of their overall trend channel. It does seem we've reached the stage where the tide no longer will lift all Biotech ships. That said, then comes along that 100+% move in Synageva (214) on the back of the bid by Alexion (163).

There are a few other changes in leadership which seem a bit less arbitrary. Rather, they're based on the recent fall in bond prices, that is, the rise in long-term rates. This is bad news for the REITs and the Homebuilders in the form of higher mortgage rates. There are, you'll be glad to know, winners here and those should be the Banks. Over the years we've noticed this is an industry that continually finds new ways to screw up. However, at a market cap of 16% of the S&P, sometimes you just have to hold your nose and admit they exist, and that rising long-term rates should be good for their business. And for most professionals a rotation to Banks is far more preferable than one to commodities stocks. Even fleeting rotation is never a bad thing provided the rest of the market at least holds together. That's where market breadth becomes important – you want to be sure that what's being rotated to isn't alone in going up.

There's another change taking place, induced it seems by the Dollar's reversal to the downside. There always are winners in dollar strength – anyone with a passport for one. However, with 40% of their earnings overseas, S&P stocks are not among them. In turn, the currency problem seems to have been a help to the small-cap Russell 2000, where most components are domestic and therefore not affected by dollar strength. This connection seems borne out in the Russell's recent weakness coincident with the Dollar's recent weakness. Over time this evens out of course, and investors adjust, but it can cause disruptions as it likely is doing now. Though not of concern for now, there are possible implications for the bull market as well. As markets peak, typically it's the small-cap stocks that peak first, last are the large caps that dominate the averages. So it's possible we're losing one crutch in terms of the bull market's longevity.

The weakness has been such that the market could rally anytime. At the recent low of 25%, stocks above their 10-day average were down to where the market lifted a couple of weeks ago. However, deterioration this time seems greater. This last rally, for example, was a poor one in terms of momentum – one in a series of lackluster rallies all year. Hence, the trading range. It seems possible we may see a more thorough washout in order to set the background for a better rally than those of late. The extent of price weakness is not the issue, it's about becoming sufficiently sold-out to provide a springboard of sorts. Also, it's about getting away from the imbedded complacency. Like 2013 and the "taper tantrum," the weak bond market could garner more attention. When the market wants to go down, bad news always seems to follow. In the meantime, probably the best we can expect out of the current background is another half-hearted move across the trading range.

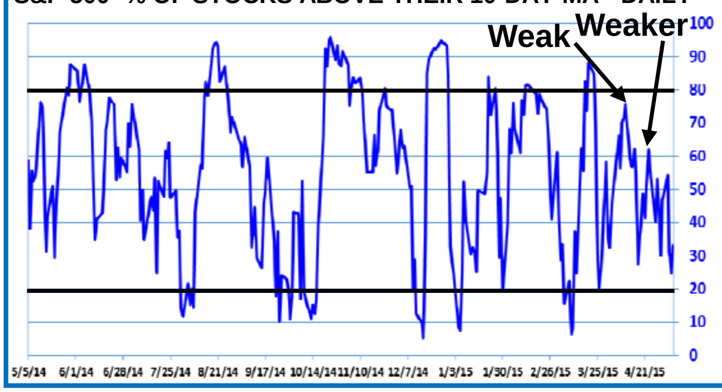
Frank D. Gretz

140 BROADWAY NEW YORK, NY 10005 TELEPHONE: (212) 320-3000

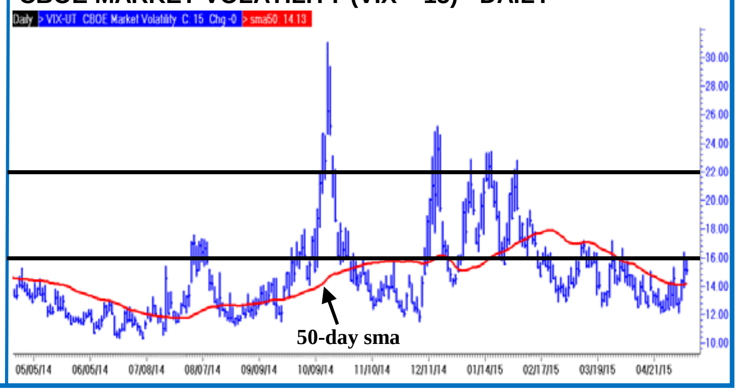
S&P 500 (SPX – 2088) – DAILY

NASDAQ 100 (NDX – 4402) – DAILY

S&P 500 -% OF STOCKS ABOVE THEIR 10-DAY MA - DAILY

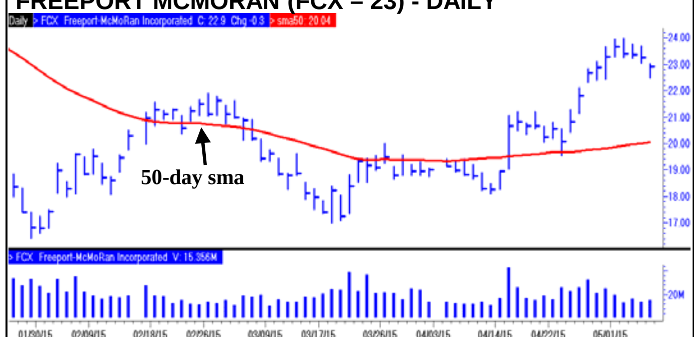


CBOE MARKET VOLATILITY (VIX – 15) - DAILY



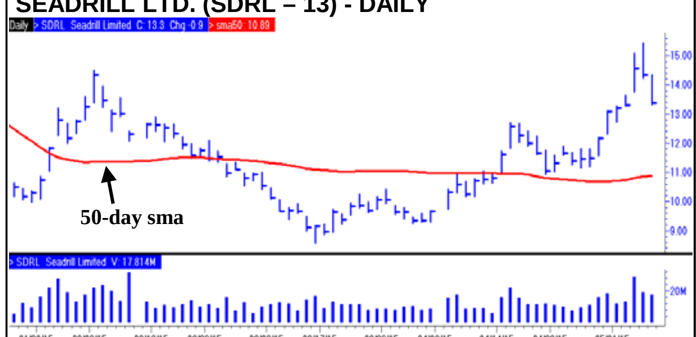
KBW BANK INDEX (BKX – 74) - DAILY

FREEPORT MCMORAN (FCX – 23) - DAILY



RUSSELL 2000 INDEX (RUT – 1226) - DAILY

SEADRILL LTD. (SDRL – 13) - DAILY



DB US DOLLAR INDEX BULLISH FUND (UUP – 25) - DAILY

ISHS 20+ YR TREASURY BOND ETF (TLT – 122) - DAILY