EQUITIES PERSPECTIVE

February 12, 2016
DJIA: 15,660

The next time we say it's a bear market … remind us to pay attention. This is not our first trip to the rodeo or a bear market but still, it's hard to grasp how quickly things have come undone. In 2000, the Dow peaked in January but the NAZ lingered on until March-April, and even then didn't die easily. In the summer of 2008, oil was thought to be on its way to $200, so money could be made there and in other commodity-related stocks like the Rails, of all things. Typical of bear markets is that the strongest stocks are the last to give it up. If those would be the "FANG" stocks, that's hardly the case this time. Weakness there has helped take the NAZ down 15% in just 30 days. There's little left standing. Sure there's Kimberly-Clark (126) and Clorox (127), but after the hit to McDonald's (117) last Friday, it's hard to trust anything. On the positive side, it's talk like this that you hear around lows.

As we suggested last time, lows in markets like this come about not when buyers step up but, rather, when sellers are done. Typically a sign of this is one or more 90% down days – 90% of up-down volume to the downside – and one or more 90% up days. This was the pattern at the August-September low last year. On January 6 and 7 this year, we saw downside days of 85% and 89%, respectively, and on January 26 and 29, we saw upside volume days of 90%. Against this backdrop, the market has stabilized, but we haven't exactly rallied. Like last August, the numbers say the market is sold out, but the market's inability to move higher says that it's not. Unfortunately, this means more weakness until it is sold out. Just what this would look like is hard to say other than scary. Then, too, there's an outside chance things aren't as dire as they seem.

Divergences can be both good and bad. It was the divergence between the market averages and most stocks that got us into this mess. The Advance-Decline Index peaked last April, the Transports peaked early last year, the Russell in June. The first of the indicators to peak, however, was the number of New Highs, which did so in May 2013. It is somewhat interesting to note that at the market low on January 20, there were 2,000 12-month New Lows, a number which hasn't come close to being matched since then. Last Friday, the NASDAQ Composite made a new low but only 8% of the stocks there reached a new low versus 30% on January 20. All of this is very short-term stuff, but it does leave the possibility that the current weakness is part of a "test" of the January 20 low. A test often does involve lower prices. What makes it a "successful test" is less selling pressure – a positive divergence.

There are other signs of this "test" thesis as well. Virtually any measure of downside momentum is well above the January 20 lows despite the lower lows in most of the market averages. For example, the percent of stocks above their 10-day moving average is 11% versus 4% back on January 20, 19% versus 9% for stocks above their 50-day average, and 17% versus 15% for stocks above their 200-day average. All suggest less downside pressure versus the lows on January 20, in other words, the pattern of "a successful test of those lows." Admittedly you can add a big "so far" to this and at that, it's a stretch. The beaten-up FANG stocks were up pretty much all day Thursday and the afternoon turnaround came pretty much out of the blue, unless you believe the Saudis. The VIX, or fear index, hasn't spiked as we might have expected, but to look at bonds or Gold, fear seems rife. All of this is something to think about if we do rally.

Banks were supposed to have a good year in 2016 – rising rates, rising spreads and that kind of thing. So down 25% from their highs is surprising, if not shocking. And Banks being banks, you can't help but wonder what they've messed up this time. What comes to mind, of course, is how many loans to the Energy sector are buried on those balance sheets. The price action speaks to a rat somewhere, though not nearly to the same degree as Deutsche Bank (16) or Credit Suisse (13). And, after all, 60% of all S&P stocks are down 20% or more, so Banks may not be the canary they were in 2007-2008. Instead of commodity-based derivative problems it could be just good old-fashioned regulatory-inspired bad business. Let's hope, and history would seem to bear this out. There were the canary years of 1929, 1999 and 2007, but going back to 1928, 25% declines in Banks have not "precursed," so to speak. Then, too, we speak of U.S. Banks. European banks may only now be having their 2008.

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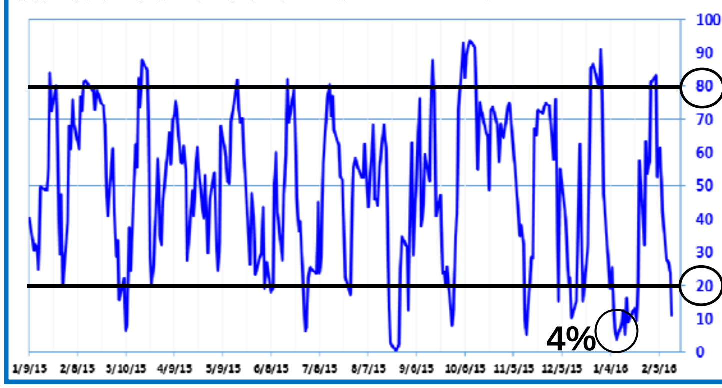
S&P 500 (SPX – 1829) – DAILY

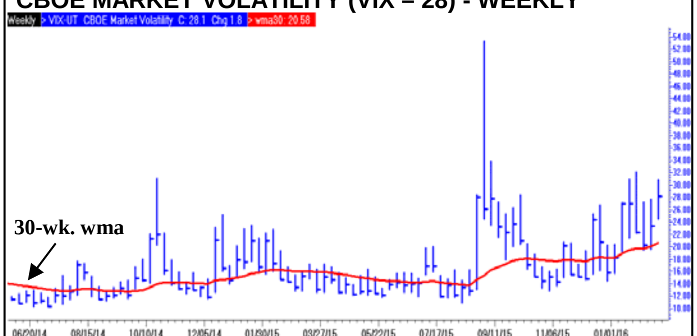
NASDAQ 100 (NDX – 3962) – DAILY

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



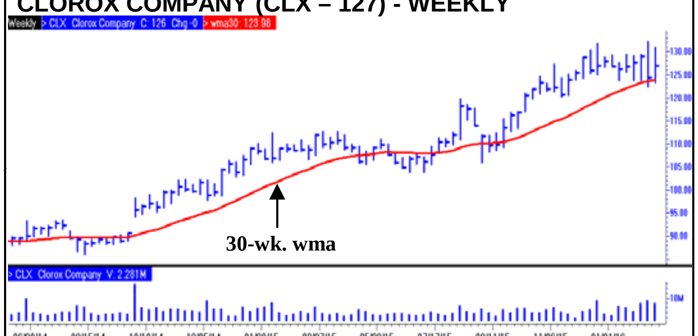
S&P 500 -% OF STOCKS ABOVE THEIR 50-DAY MA - DAILY

CBOE MARKET VOLATILITY (VIX – 28) - WEEKLY

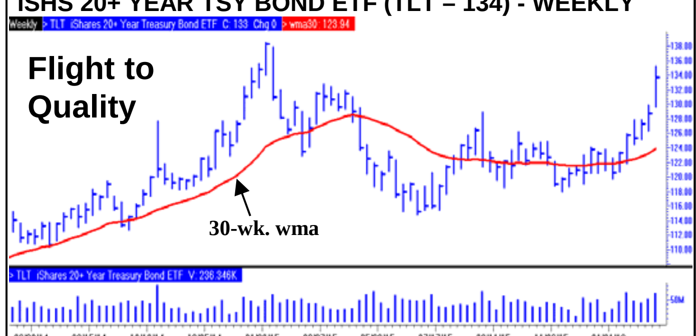


SPDR S&P BANK ETF (KBE – 27) - WEEKLY

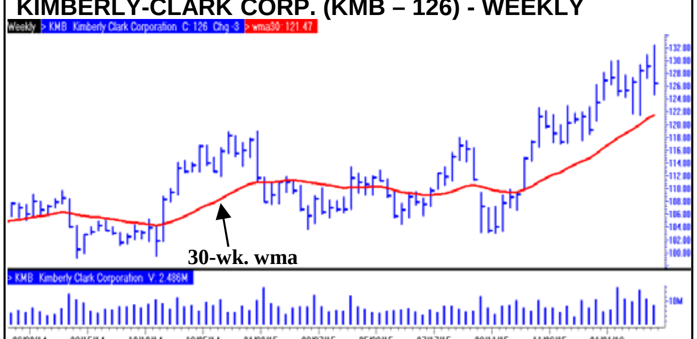
CLOROX COMPANY (CLX – 127) - WEEKLY



ISHS 20+ YEAR TSY BOND ETF (TLT – 134) - WEEKLY



KIMBERLY-CLARK CORP. (KMB – 126) - WEEKLY



SPDR FD ENERGY (XLE – 54) - DAILY