EQUITIES PERSPECTIVE

May 27, 2016
DJIA: 17,829

The Fed and rates … a spectator sport. In the immortal last words of Gary Gilmore when facing the firing squad, “Let’s do it.” You probably thought that was Nike (56). Meanwhile, you would think the market had come to embrace higher rates. Ever in need of an explanation, the media suggests the market suddenly feels the economy is strong enough to live with higher rates. Have they looked at those Retailers? Could it simply be that the market has a good memory – when the Fed hiked in December, rates went down, not up. Or it could be that the market doesn’t discount the same news over and over. Brexit seems a bigger concern. It’s not discounted because no one believes it. What the rally comes down to is what we like to call “the failure to fail.” Release of the Fed Minutes last week had the market take a hard look at the downside. On Friday, however, it decided to pass. It was set up to go down, but failed to do so.

Whatever the cause, the rally has its credentials. In theory, secondary stocks peak before the big-caps, that is, the market averages. The Russell 2000 is the go-to measure here, and as we often point out, it peaked in mid-2015 and continues to underperform the S&P. However, it has at least revived. It has rallied above its declining 200-day moving average, and though it may sound like technical analysis hocus-pocus, stocks and the averages often go to the 200-day to die. If secondary stocks were to continue their rebound, this would be a game changer. Also S&P stocks above their 200-day moving average have moved back over 70%. In the dark days of late-January-February, this measure was down to 17-18%, pretty much a sold-out sort of number. Those sold-out numbers, of course, can become more sold-out or stay sold-out. Impressive now, however, is the extent of the recovery. A move through 40-50% has marked rallies of substance, if not of bull market proportions.

Even if improved, as per the above, the rally remains a bit deceptive. In their technical commentary on May 22, Lowry points out that of their Operating-Companies-Only universe, 56% of small-cap, 30% of mid-cap and 16% of large-cap stocks are down 20% or more. Half of all listed domestic common stocks are in what most would call bear markets, that is, down 20% or more. The pattern here also seems noteworthy. As bull markets peak, it is secondary stocks that peak first. So there is little solace in the idea of large caps holding together better than the rest. If the past is any guide, they should have their turn. Another seemingly deceptive measure these days is the Advance-Decline Index, a measure of the “average stock” and one on which many of us rely. The problem is that the A-D Index measures direction, not price, whereas the QCHA measures the average percentage movement of stocks. The A-D Index, a cumulative measure of stocks up versus stocks down, is at a new high. The cumulative QCHA is not. Stocks are going up, but not to the extent that the A-D Index would have you believe.

It invariably is better to observe than to predict. Better, and certainly much easier. At this juncture this seems particularly so. The market has had a good rally off the February low, far superior to what we expected. It’s enough to make you wonder, as bear market rallies often do. The market is back to the upper end of a year-long trading range of sorts – no new high in a year. We are not great believers in support and resistance, but now we’re up against the latter. If the levels, per se, are not remembered, investors likely remember rallies like this one have proven good times to sell. In any event, a look at the S&P makes it clear that we’re back to those levels where investors might reasonably wish they had sold. This is called supply, or in technical analysis terminology, “resistance.” Overcoming this area, a move to new highs, would be impressive. We’re observing, not predicting.

Aside from the market’s potential overhead supply, the rally also has taken us back to the land of the overbought, at least short term. Different indicators work better in different markets or time periods. In this cycle, the percent of stocks above their 10-day moving average is an indicator of overbought/oversold, and it has done a good job. Over the last year and more, levels of 20% and 80% have pointed to extremes. At 81% on Thursday, we could be at another such extreme, though overbought doesn’t necessarily mean over. Strong markets become overbought and stay overbought, last October-November being a good example. Another opportunity to observe. Last week the market had an opportunity to fold but did not, so there wouldn’t seem a lot of risk right here. However, this also wouldn’t seem to be the best entry point.

Frank D. Gretz

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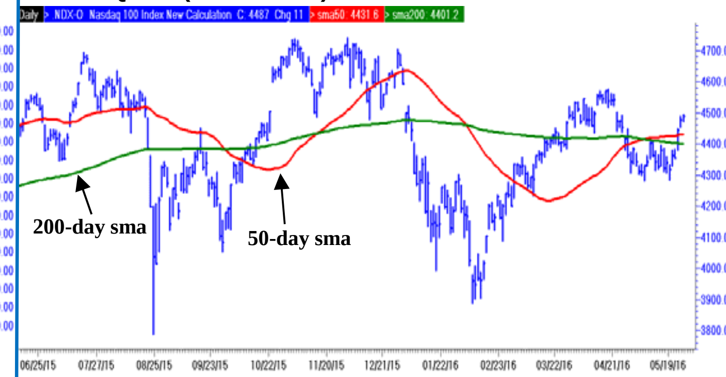
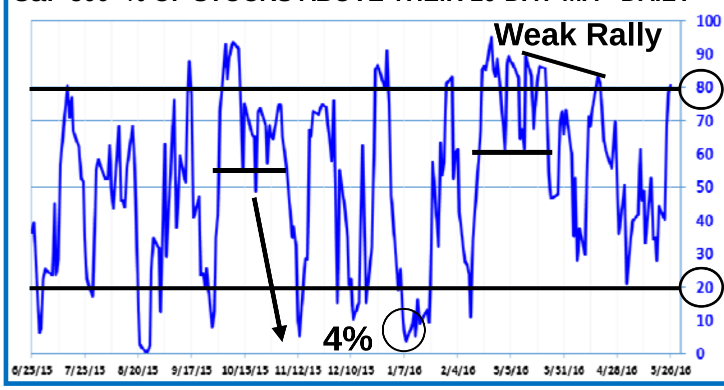
S&P 500 (SPX – 2090) – DAILY

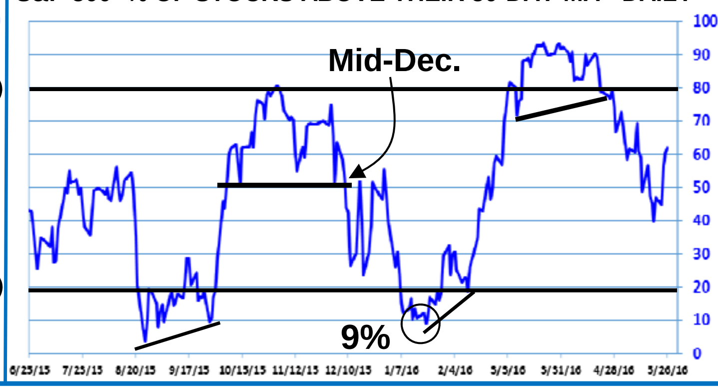
NASDAQ 100 (NDX – 4488) – DAILY



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

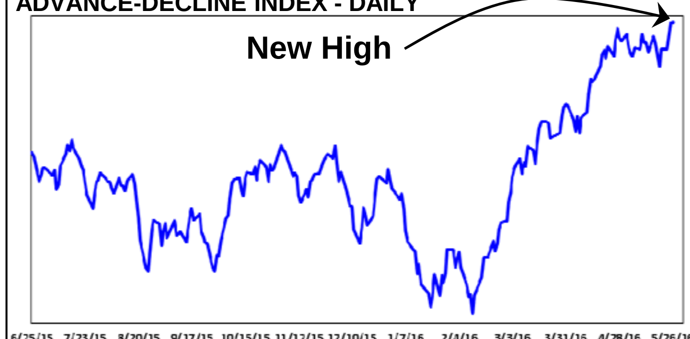


S&P 500 -% OF STOCKS ABOVE THEIR 50-DAY MA - DAILY

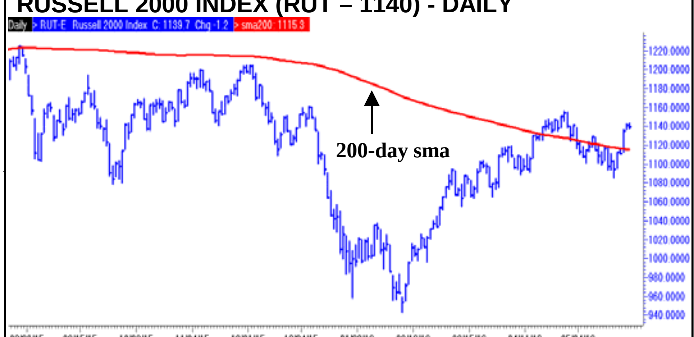


S&P 500 -% OF STOCKS ABOVE THEIR 200-DAY MA - DAILY

ADVANCE-DECLINE INDEX - DAILY

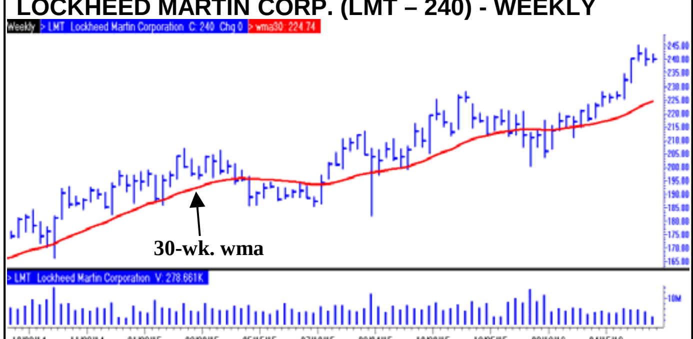


RUSSELL 2000 INDEX (RUT – 1140) - DAILY



CBOE INTEREST RATE 10 YR TSY (TNX-UT – 18.2) - DAILY

LOCKHEED MARTIN CORP. (LMT – 240) - WEEKLY



VULCAN MATERIALS CO. (VMC – 119) - WEEKLY