

Is It Really This Bad?

With apologies to Irving Berlin and Bing Crosby...

*I'm dreaming of a green quote screen
Just like the ones I used to know
Where my profits glinted
And I squinted
To see tech stocks that would grow
I'm dreaming of a green quote screen
With every margin check I write
May your audits be honest and clean
And may all your quote screens flash some green*

Wake-up calls often take strange forms. The long regulatory delay in launching [single stock futures \(SSFs\)](#), a topic quite near and dear to my heart, has afforded me the time to update [my stock selection algorithm](#), originally compiled in late September 2001. Many issues in the original database, such as Ariba, CMGI or 3Com, have fallen out of various major indices. Others, such as Compaq Computer and Enron, have disappeared as the result of merger or bankruptcy.

Still others fall into a more painful category. The SEC requires a stock to settle at \$7.50 per share on a majority of trading days in the three months prior to listing. Some stalwarts of the 1990s, including Sun Microsystems and Ciena, are wracking up entries in the "days below" category, and Worldcom has already played its way off the team. And if the chart on Oracle looks like a bottom to you, come see me immediately. What do you think Larry Ellison's kimonos will fetch at a local garage sale?

In fact, a cruise through the charts last Tuesday – a day before last Wednesday's monster bout of short covering – failed to produce a single non-decrepit chart. I joked with a colleague that Bloomberg had only one chart stored on the system, and that it was simply changing the label. Since a wide selection of major stocks all looked worse than the averages composed therefrom, and since the market has been doing a decent job of selling off on bad news and ignoring good news – Cisco's earnings excepted – it gave me pause to wonder about my own misplaced optimism from earlier in the year.

After all, I do teach that when technicals and fundamentals diverge that you must trade the technicals, and that the only working definition of a good trader I know is someone who admits mistakes quickly: Recall Keynes' bon mot "When the facts change, I change my mind. What do you do, sir?" Today's technicals are unmistakably bearish and the facts have changed.

The Federal Swamp

For those of you who have asked, and by way of full disclosure, I am a Libertarian politically, neither a Democrat nor a Republican. Libertarians believe in free markets, individual liberties, minimal government, and strict interpretation of the Constitution and a couple of other subversive ideas. Oh and yes: If the dimmest Libertarian defected and became a Democrat, he'd raise the average in both parties.

Governments, like all large organizations, often see their best intentions derailed by various inefficiencies and institutional constraints; I'm convinced without evidence that whether business or government, the probability of any large organization achieving any stated goal is well under 50%.

The Bush administration [has ventured into protectionism](#) and just out-and-out shameful vote buying in the form of [the new farm bill](#). This has sent a clear signal that the unhappy days of the [first Nixon administration](#), characterized by trying to outspend the Democrats at home to obtain a consensus for foreign adventures, are back. Deficit spending will be back for the foreseeable future as all of those capital gains of the 1990s are gone and interest income has dwindled along with the fed funds rate. Lower marginal tax rates would be stimulative, but I'll bet on the Nasdaq going back to 5,000 first. So, color fiscal policy a big negative.

Monetary policy is totally useless at the moment. I've never been a big fan of the Fed, to say the least, but they've managed to put themselves into a position where they can't cut rates without risking a surge in inflationary expectations, and they can't raise them without threatening the economy. So, the maestro has hit the sticks and started yammering at the insight level of a typical commencement speech about what a wonderful thing productivity is. The world is your oyster, folks, just don't get hepatitis.

To top things off, there's trouble on the international front as well. Our good friends on the European Commission's antitrust team, fresh from their torpedoing of the General Electric-Honeywell merger, (read about it in the *Harvard Business Review*, found in local bookstores next to "Jack: I'm Really One Heck Of A Guy!") have decided to target Microsoft. Hasn't Bill Gates suffered enough?

The Darkest Hour

Two alternatives present themselves at times like these. One is that things really are this bad and that we haven't seen the ultimate demoralization and capitulation of the market yet. The other is that we should remember about buy low and sell high. Most of us were pretty good at buying high, and with all of the bad news out there, would we be selling low?

I wrote [right at the beginning of 2001](#), "Rate cuts are not a magic bullet for equities...Without reasonable expectations for solid growth in earnings and/or falling long-term interest rates, the Fed could pour money on the floor and have little to show for its efforts." In addition, I noted that the economic stimulus of lower short-term rates usually arrives through a weaker dollar and its various effects on all sectors of the economy.

At present, 10-year note yields are higher than they were at the start of January 2001 and the trade-weighted dollar index is higher. However, both of these indicators have started moving in the desired direction. The Economic Cycle Research Institute's weekly leading index continues to grow stronger, and the Bullish Consensus for U.S. stocks shows only a 30% bullish tally.

So, where do we go from here? Even though I haven't been hot lately, I'll offer a path-dependent scenario. First we'll test the September low; we're not all that far from it. The test will be successful. Then the weight of lagging good economic news will turn the market higher during the second half of the year.

Just as I'm a Libertarian, neither one nor the other, I'm not a bull or bear right now. Call me a conservatively invested chicken. Next week I'll outline some option-linked strategies for this outlook.