



Topping Markets

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Dow Jones: 10,610

We believe that the stock market is in a topping phase, and is likely to head lower. This is a time for caution and adjustment of equity levels and holdings.

As you may recall our December 2008 study, *Rally at Hand*, explained that the stock market can move in a direction opposite to the economy for a time. We concluded: “We look for a very strong intermediate term rally, not the end of the bear market, but a rare chance to profit from bear market volatility. For underinvested accounts, it is time to buy stocks.” Stocks staged a phenomenal rally. The upswing has been led by lower quality stocks, those most beaten down in the prior bear phase.

Recent data now makes us believe that it is prudent to take some profits and reduce equity exposure. Part of our caution comes from excessive optimism. A few weeks ago, investment advisor surveys showed 35 percent more bulls than bears; an extraordinary level. A number of large financial institutions suggest adding equities, right on top of a 201 day market advance. Last week more than 800 stocks set new highs against only 3 new lows, not uncommon near market tops. Wall Street now averages 7.4 “buy” recommendations for every “sell”; an indication of speculation. This is especially true in light of the recent actions of corporate insiders, who are heavy sellers. The VIX “fear index” touched 16.9 last week, a sign of excessive complacency.

We’ve all heard the talk about the return of strong economic growth. Regrettably, the facts are more stubborn. Employment, especially on the job creation front, remains sluggish, with more than 6.3 unemployed individuals for every job opening. December, with its holiday season, saw declining sales. Many consumers save in preference to spending: consumer credit, which includes auto loans and credit card use, recently fell a record \$17.5 billion, its tenth straight monthly decline. Washington continues to create clouds of uncertainty for businesses and consumers. It’s no wonder that only one of three S&P 1500 companies show positive earnings growth, and one of four increased revenue.

Finally, we note that our leading intermediate indicators have continued to shift into the unfavorable camp by more than a 3-to-1 margin. A conservative approach is in order. Another buying opportunity like last March will likely arise, but this is a good time to take some profits, reduce equities and raise cash.

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