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Stock Market Weekly

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Rally 'Round The Recovery

It is indeed impossible to say with any degree of certainty whether the current activity in the US stock market indicates the end of the bear market, or just another bear-market rally. In an ideal investing world, we would be able to gaze into a crystal ball and get a glimpse of the future direction of the stock market, invest accordingly, and increase our wealth. Instead, we turn to analyzing technical factors and economic data in our attempt to project what the market has in store for us. We are of the opinion that the current rally is in fact sustainable, and the lows observed on March 9, 2009, are quite possibly the lowest levels that we will see for quite some time.

Let's start by jolting our memory of the market activity over the last seven months. The S&P 500 Index (SPX) experienced the following movements:

- November 20, 2008 – January 6, 2009: SPX 752 to 935 (+24% in 48 days);
- January 6, 2009 – March 9, 2009: SPX 935 to 677 (-27% in 63 days);
- 9 March, 2009 – May 8, 2009: SPX 677 to 929 (+37% in 61 days);
- Since then and up to the time of writing, the market has experienced a pull-back of about 4%.

According to the Ned Davis Research firm, a bull market occurs whenever there is (1) a 30% rise in the stock market over a 50-calendar day period, or (2) a 13% rise after 155 calendar days. Under the first definition, we have already experienced a bull market between March and May. The second condition is yet to be fulfilled, and if it is, then this would surely signal and confirm the rally as a sustainable bull market. The following arguments also lead us to affirm our position that this rally will be sustained going forward.

A key indicator that we pay close attention to is the VIX – the Chicago Board Options Exchange (CBOE) Volatility Index – often referred to as the "fear index". It represents one measure of the market's expectation of volatility over the next 30-day period. A low index value corresponds to a less volatile market, and investors' increasing appetite for risk. Investor sentiment has clearly improved in the market over the last seven months. The VIX recorded its one-year high of 80.86 on November 20, 2008 (the date of the beginning of the bear market rally we observed late last year). Since then, the VIX has trended generally downwards and has not retested that high. In fact, over the last month, the VIX has remained below 40 and is now approaching 30. Although more comfortable levels for the VIX are in the 20s, the fact that the index has been trending downwards is a clear sign that market fear is steadily declining. Noteworthy is the fact that even though the SPX recently dipped below the psychological 900-point level, the VIX did not experience a sharp spike reaffirming our conclusion of decreasing risk aversion/ increasing risk appetite.

Next we look at the 200-day simple moving average (SMA) of SPX – an important market indicator used to determine long-term trends in the market. The 200-day SMA would generally be seen as a level of resistance which, if tested and broken, will be a powerful indication that the market is bullish. During the current rally, SPX has climbed through its shorter SMAs, specifically the 20-day and 50-day SMAs. In addition to this, on April 6, 2009, the 20-day SMA made a "golden cross" upward through the 50-day SMA. Such an occurrence generally indicates that a bull market is on the horizon.

Another argument for the sustainability of this rally lies in historical observations of the timing of such recoveries in stock markets during periods of economic contraction. The stock market has tended to recover and rally several months before the end of the recession. Over the last 55 years there have been nine recessions, and in most of them (excluding the downturn of the early 2000s), the stock market began its recovery well ahead of the economy which was still in the trough of the business cycle.

Apart from the somewhat optimistic outcome from our analysis, however, the reality is that the US economy is still weak. Traders and investors are still likely to react to the release of certain key economic data, especially jobless claims and retail sales, for both of which we will take a quick look at the most recent data.

On May 13, the market reacted negatively to news regarding retail sales in the US. This sales figure that was projected to remain unchanged, dropped unexpectedly by 0.4% in April, following a plunge of 1.3% in March. The market declined the day the figures were released – a reflection of underlying investor sentiment that the economic recovery will likely be subdued and protracted. On the other hand, consumer spending increased 2.2% in Q1 2009, following sharp declines of 3.8% and 4.3% in the last two quarters of 2008 that suggests a return of confidence.

With regard to the job market, the number of jobless claims in April was actually less than in the previous month (539,000 in April, versus late March where it topped off at 674,000). Keeping in mind that new filings for unemployment benefits have a tendency to peak at or just ahead of the end of the recession, we are somewhat reassured by seeing these signs of a declining pace of economic contraction. The recession is by no means over, but the fact that a number of key economic indicators show some signs of leveling off after sharp declines definitely provides some expectations for economic growth. Nevertheless, data released on 14 May 2009 indicated new claims rose to 637,000 for the four-week period ended 9 May, an unwelcomed reversal in direction, but still considered to be within an acceptable range.

It is important to keep in mind that the stock market is considered to be a **leading indicator** of economic activity, therefore a market recovery is not a current reflection of the health of the economy but is based on forward-looking analysis of data being released and the effect on profits. Historically, the economy has always been weak when a bull market starts, which is generally between six to nine months before there are signs of economic recovery. So with this in mind, we are of the opinion that the worst of the stock market losses are over as far as it goes for this recession.

Current Happenings in Local and International Markets:

- BNB: Job cuts not on cards
- Capital & Credit records J$80-million profit in first quarter
- Caribbean countries look to the IMF for financial relief
- JP makes $2.8b loss - But first quarter signals turnaround - Agri-processor launches new snack line

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- Europe's Economy Contracts 2.5%, the Most Since 1995
- China's Factory Output Grows Less-Than-Estimated 7.3%
- Toyota Cuts Production 28% to 7-Year Low as Auto Sales Plunge

Table 1: Regional Market Performance (as at 14 May 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	799.63	-0.01	-1.15	-5.14	-23.56
All Trinidad	1,084.76	-0.41	-1.69	-6.06	-18.51
JSE Index	80,919.27	1.34	1.90	0.96	-27.93
JSE Select	1,778.92	3.58	4.64	-10.37	-44.60
All Jamaica	65,246.60	3.13	3.23	-11.82	-43.79
BSE Composite	841.21	-0.01	-3.90	-8.55	-17.89

Table 2: International Market Performance (as at 14 May 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	893.07	-1.58	6.13	-1.13	-36.60
Nasdaq Composite	1,689.21	-1.57	3.91	7.11	-32.34
Dow Jones Industrial	8,331.32	-0.93	5.19	-5.07	-35.41
German Dax	4,738.47	-1.37	3.98	-1.49	-33.10
FTSE 100	4,362.58	-0.82	9.37	-1.61	-29.82
Nikkei 225	9,093.73	-3.11	2.84	3.96	-35.59
Hang Seng	16,541.69	-3.93	6.17	14.97	-35.22
DJ Eurostoxx	2,353.53	-2.18	3.29	-4.00	-38.99