



Morning Comments November 19, 2009

The market deteriorates under cover of strength in blue chips

While most dismiss old Wall Street lore out of hand, I have found that there is often a reason certain sayings persist, but you have to know when it matters and when it doesn't. You have often heard it said that, "the market deteriorates under cover of strength in blue chip stocks." It seems pretty clear to me that this process is unfolding now. We spoke about return lines and what it means to fail these descriptions of a trend a couple of weeks back, and this has been playing out inverse to capitalization as of late. We note that the market leading small and mid cap indexes that have showed the best returns on the year are looking horribly weak versus their large cap brethren recently; and we think the sweeping up of large cap laggards is an expression of a market in the late stages of advance. This doesn't necessarily mean that a major top must now be manifested but it does signal consolidation and the need for refreshment of momentum and the grueling process of marking time until such refreshment can be found. Fleeing winners to move up the cap scale is indicative of rotation at best and the hiding or parking out of money to protect gains at worst and this can be a painful game for those without the flexibility or the will to move quickly. I have seen in our flow lately and in speaking with customers that the arrival of "blind money" is the largest factor causing this phenomenon. I have often said that America is in the business of buying the high and selling the low. What we see here now is people desirous of, "putting money to work," in the market lured in by the gains that have already been made. Blind money tends to flow into the biggest names – XOM WMT PG JNJ and the like – via attraction to index linked product, this is probably not a good thing as it forces a narrowing of leadership through cap selection. To some extent one may easily argue that valuation is a heavy factor as well given that small and mid cap valuations relative to large/mega caps has widened to unsustainable levels. At any rate, a number of factors are conspiring to predict a trading range developing – let's call it 1040-1120 in the SPX for now – and we think this persists through year end and into the January reporting season. We are better sellers of the market based on this and will await the low end of the range to reassess.

Note the successive weakening in the charts below as we walk down the cap scale and as natural arbitrage attempts to close the YTD performance gaps by making the weak look strong while in reality the strong are weakening.

Technical Analysis & Strategy

INDU 10426.31Y as of close 11/18

Index **G**



SPX 1109.80Y as of close 11/18

Index **G**



MID 705.89Y as of close 11/18

Index **G**



RTY 600.15s as of close 11/18

Index **G**



SPC 317.12s as of close 11/18

Index G



Technical Analysis & Strategy

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