"I Should Have?!!"

“. . . A man has rigged up a turkey trap with a trail of corn leading into a big box with a hinged door. The man holds a long piece of twine connected to the door that he can use to pull the door shut once enough turkeys have wandered into the box. However, once he shuts the door, he can’t open it again without going back into the box, which would scare away any turkeys lurking on the outside. One day he had a dozen turkeys in his box. Then one walked out, leaving eleven. ‘I should have pulled the string when there were twelve inside,’ he thought, ‘but maybe if I wait, he will walk back in.’ While he was waiting for his twelfth turkey to return, two more turkeys walked out. ‘I should have been satisfied with the eleven,’ he thought. ‘If just one of them walks back, I will pull the string.’ While he was waiting, three more turkeys walked out. Eventually, he was left empty-handed. His problem was that he couldn’t give up the idea that some of the original turkeys would return . . .”

. . . Why You Win or Lose, by Fred C. Kelly

“I should have sold when the S&P 500 broke below its rising trendline on April 9th at 1397” (see chart on page 3). “I really should have sold on May 11th when the S&P 500 (SPX/1295.22) traveled below its April 10th intraday reaction low of 1357.38.” So exclaimed one disgruntled portfolio manager last Friday since the SPX continued to surrender ground. Plainly, the “I should have” crowd surfaced again last week as the SPX knifed through my envisioned support zone of 1320 – 1340, causing one savvy seer to exclaim, “Markets always go further than most pundits believe, both on the upside and the downside.” Yet the recent downside dive from May 1st’s 1415 level into last Friday’s close of 1295.22 has caused many of my indicators to register readings not seen in a long time. For example, the McClellan Oscillator is now at oversold readings not seen since the recent April 10th trading bottom (see chart on page 3). Then there is the CBOE Equity Put/Call Ratio, which is flashing a “buy signal” that has proven profitable at every downside inflection point since 1994; or, as the astute folks at Bespoke write:

“Following today’s 0.44% decline (5/16/12) in the S&P 500, the 10-day Advance/Decline line for the S&P 500 has now dropped down to –1,930. This is an extreme oversold reading based on historical standards. For those unfamiliar with the indicator, the 10-Day A/D line is simply a rolling 10-day total of the daily net number (of similar readings) shows that equities have historically rebounded after hitting such extreme oversold levels. Over the next week, the S&P 500 averages a gain of 1.21% with positive returns two-thirds of the time. Over the next month, the S&P 500 averages a gain of 5.58% with positive returns 83% of the time. Going out three months, the S&P 500 averages a gain of 7.68%, and over the next six months the index averages a gain of 13.35%.”

Adding to the litany of downside inflection-point indicators is the AAII (American Association of Individual Investors) survey that recorded its lowest bullish reading (23.6% bulls) since August 2010. Moreover, my parade of short/intermediate-term indicators shows a composite reading that is at historic levels. To wit, there have only been only four other times when my indicators have combined to show such negative inclinations. More than seventy percent of the time, given such readings, the major market averages have been higher a week later, while 92% of the time they have been higher a month later. Accordingly, unless we are in “crash mode,” and I don’t believe that, it is time to ready your “buy list” and begin judiciously recommitting some of that cash to stocks; and, that is what I have been recommending. Indeed, over the past week I have been recommending recommitting some of the cash we suggested raising in February – April. One of the techniques we have used to accomplish this at similar inflection points was first proffered by our friends at Riverfront Investment Group back in 2009. As stated:

“First, identify the quantity of cash to be put to work – example: 20%. Second, break the trade into digestible chunks – example: break it into four parts, 5% each. Third, implement the first trade today – example: invest 5% into equities today. Fourth, set a date for implementing the second trade – example: two months from today invest the second 5%. Fifth, implement third and fourth segments if market pullbacks occur – example: invest the remaining 10% of the cash on market pullbacks. And six, after the date of the second trade occurs, return to step one with the remaining cash – example: two months from today, if the market never provides the opportunity to buy on a pullback, break the remaining 10% up into 3-4 parts and follow a strategy similar to the one utilized for investing the first 10%.”

Please read domestic and foreign disclosure/risk information beginning on page 4 and Analyst Certification on page 4.
I think Riverfront’s strategy is appropriate since the SPX is probing its next downside energy level. Further, the stock market’s internal energy level is totally exhausted on the downside, implying a tradable bottom is likely at hand unless we are involved in a mini-crash. The real question thus becomes, “If we get a rally from this oversold condition is it the start of a new “up leg,” or is it just a compression rally that will be brief followed by still lower prices?” Speaking to that point, it is worth considering the SPX is currently trading at a P/E ratio of 13.1x earnings. Since record keeping began there have only been five occasions when a bear market began with the SPX’s P/E ratio below 15x. Another timely question is, “Will the recent Dow Dive trigger QE3, Operation Twist II, or targeting GDP?” While equity markets can clearly do anything, at worst we should at least get a relief rally from here and at best it could be the start of a new “up leg.” Therefore, I think the gradual re-accumulation of investment positions is the correct strategy. For those participants not wanting to try and “catch a falling knife” by purchasing the exchange-traded product of your choice, a more conservative approach would be to accumulate dividend-paying stocks. Some that screen well technically, and have a Strong Buy rating from our fundamental analysts, for your potential shopping list include: 3.0%-yielding Automatic Data Processing (ADP/$51.98); 3.8%-yielding Rayonier (RYN/$42.08); 4.3%-yielding Digital Realty Trust (DLR/$68.48); 5.2%-yielding Enterprise Products Partners (EPD/$48.48); and 8.2%-yielding Linn Energy (LINE/$35.24).

**The call for this week:** The brilliant Lee Cooperman, captain of hedge fund Omega Advisors, quoted Joe Rosenberg on CNBC last week, “You can have cheap equity prices, or you can have good news, but you can’t have both!” Clearly, we currently have “bad news,” which in my opinion has resulted in “cheap equity prices.” Playing to that quote, my father always told me, “Good things tend to happen to cheap stocks.” So, unless we are involved in a “mini crash,” my sense is at least a short-term bottom is due. As stated, the real question is, “If we get a rally from this oversold condition is it the start of a new ‘up leg,’ or is it just a compression rally that will be brief followed by still lower prices?” And now that the Internet distraction is behind us, the stock market’s focus should turn to the declines last week of 4.3% for the SPX and 5.3% for the NASDAQ, marking their worst weekly performance since last November, leaving the markets severely oversold. Indeed, most of the major indices I follow are down 13 out of the last 14 sessions, while Technology is down 12 days in a row. Such downside skeins are at historic proportions since markets tend not to go more than 11 sessions in any one direction. Interestingly, the big winners last week were wheat (+15.2%) and corn (+9.3%), possibly because the Intercontinental Exchange (ICE/$123.59/Strong Buy) began trading grain future contracts for the first time. To celebrate, pop the top on a box of “The Breakfast of Champions” and enjoy!
S&P 500

Source: Market Q.

McClellan Oscillator

Source: Thomson Reuters
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<tr>
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<td>Raymond James &amp; Associates co-managed an offering of preferred equity for Digital Realty Trust, Inc. in September 2011.</td>
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