



Commentary

A Picture is worth a thousand Words

A picture can be worth a thousand words. It is a time when the opinions of the ‘financial experts’ contradict. Most are saying this is a bear market rally. Stocks are moving up on hot air and we might have to test the lows and or go lower. Some say the US financial system is completely bankrupt and the only thing to own is the yellow metal, but then others say the recovery is upon us and the worst is behind. What should one believe when rhetoric contradicts?

This is when a picture is worth a thousand words. Charts are often more telling than rhetoric because they ‘don’t lie’. Charts show you what has happened, what is happening now and often, what is most likely to happen next. The most telling thing about charts these days is that many are looking attractive and point to a sustainable recovery. A great chart (one that has a high degree of predictability) is a chart with a firm floor or base, followed by a gradual increase. This is called the ‘intermediate ski slope’ as the price is increasing at a manageable rate which signals that that trend is likely sustainable. Almost all the deep cyclical stocks from copper to energy and transports exhibit this chart pattern. They generally have bases of 1 to 3 months followed by prices increasing at a gradual 30 degree slope.

If we are in a serious recession as many predict, one would not expect deep cyclicals to be recovering yet. Let’s look at US Steel as an example of a great chart with good risk reward. In June 2008, US Steel was trading at a high of \$190. The stock then proceeded to collapse at an 80 degree angle to \$20 per share in November of 2008. It then tried to rally only to re-test \$20 per share in March 2009 (i.e., it built a four-month base). Since then the stock has been moving up at a gentle 30 degree angle and is currently \$30 per share.

Many experts have suggested that this move is over done as the stock has appreciated 100% from the bottom. The point they might be missing is that this appreciation has been done gradually and over 2 months from a panic low. US Steel is still 500% from its old high. This is why the risk reward is so attractive in buying panic lows. It took 5 months for Freeport McMoran to decline from \$120 to \$20. It then traded sideways for 4 months and has been in an uptrend for 2 months. One might be more suspect of the gains in financial stocks where price recoveries have been more accelerated. For example, CIBC was at a high near \$100 in October 2007 and the stock declined at a 45 degree angle to \$36 in March 2009. Since then the stock has appreciated at a 45 degree angle to \$60, or appreciated 66% in 3 months. This rapid appreciation might be construed as unsustainable and in need of a significant pull back. CIBC is 66% from its old high.

The point is that no one knows where the economy is headed. Rhetoric is cheap, but charts in the absence of earnings are more telling. Gradual, persistent charts are always more telling of future trends than volatile charts. Many are calling the recovery in the financial and tech stocks a bounce. That might be true, but the deep cyclical stocks seem to portend a more convincing recovery.

-Derek Webb

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