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INSIDE

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tradingideas By Kathryn M. Welling

Don't Fade This Rally

Steve Goldman Made A Call In 2002 That Stands The Test Of Time

Steve Goldman really likes the way this rally is developing legs. "They're fast. It's broad, sustainable." Which is very good news for investors, since the **Weeden** market strategist's calls on the twists and turns of the S&P 500, the Nasdaq and kindred indices have been eerily on-target ever since last summer, as the long bear market started to etch out the pattern a growing chorus of market watchers is now suggesting amounts to a triple bottom.

Not that Steve has ever been out of sync with the market's major trends for terribly long or by very far in the four years ***w@w*** has enjoyed daily access to the fruits of his labors. The veteran analyst's constant tinkering with an ever-expanding arsenal of monetary, sentiment, momentum and valuation indicators, from his privileged perch on Weeden's equity trading desk, have kept Steve's proprietary quantitative forecasting model on top of the majority of short and intermediate-term swings in what has been the most unpleasant and volatile market in memory.

Both at the highs and at the lows, as well as during those painful, seemingly interminable, stretches when most traders wandered, lost in the wildnerness, but inevitably found themselves south of where they started, Steve has been imperturbable. Sifting through his indicators. Assessing the probabilities. It's just that even Steve, who ordinarily tempers his natural optimism with wickedly honed contrary instincts and a quant's reflexive reliance on probabilities, could find scant satisfaction in tracking a bear that slashed 50% from the price of the S&P in the steepest decline since 1934.

But beginning last summer, just after the July plunge pushed the major averages well into oversold territory and knocked sentiment measures lower than they'd been at any time since 1974, Steve started uttering the word "rally" within earshot of traders. Specifically, at that point, speculating that they might miss a great 3-5 week 1974-style snap back if they didn't cancel plans to spend August loafing at the beach.

When that upside materialized on cue but didn't bring with it any enhancement in market internals, Steve lost little time predicting a gory retest of the lows. Sure enough, by late September the S&P was following Steve's script, testing and then bouncing smartly from its July nadir. The strategist's office demeanor brightened. Goldie's indicators, at long last, were telling him to urge the trading desk and clients to give the ensuing rally the benefit of the doubt. The first signs were tentative, barely more than straws in the ill-wind that had been buffeting the Street for nearly as long as the worst bears in the past 100 years. But just two weeks before the market's Oct. 9 bottom, Steve's daily sentiment model moved into the constructive zone against a backdrop of essentially neutral readings on his monetary, momentum and valuation gauges. He allowed himself to prophetically write, "Stock prices are in the process of etching out a trading bottom, in preparation for a yearend rally, albeit [one that] may be limited due to Iraq concerns."

As sentiment hit panic pitch over the next couple of weeks, Steve held his ground and just two days after the bottom sketched out for clients the kinds of "explosive" upward price spikes they could expect, assuming that October's lows marked a *real* bear market bottom: Looking at every bona fide bottom since 1938 (20 instances), the Dow had bounced on average 2.25% one day later, 4.6% five days later, 7% ten days later, 8.4% a month later, 13% three months later, 22% six months later and

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34% a year later.

His gratification was almost instant, as the S&P rocketed 13.4% over the next four trading days, its steepest advance in 60 years, and his confidence grew as data on the Value Line indices became available that put the market's valuation, at its October low, within hailing distance of the most favorable levels in the past dozen years. The turn "is likely to be perpetuated," he promptly opined. "Buy the pullback." Goldie's conviction then was bolstered over the next couple of weeks as he got a classic momentum "buy" signal from, of all places, the Nasdaq.

Not that his idea that a bottoming process had begun wasn't tested. First, war and economic jitters conspired to turn the "yearend" rally he'd predicted into an eye-blink affair in the first days of January. At which point Steve started warning traders that the market wasn't displaying the resilience typical of a new bull. Then, as the consolidation that Steve had told clients to expect dragged on through February and into early March, he warned that another retest of the lows was imminent.

But when that retest started to unfold as predicted, Steve found in it reason again to give his bull case another try. Trading action in the Nasdaq was continuing to produce positive divergences in internals and strong momentum signals, even as of number of the sentiment series that Steve follows reflected a deep (and contrarily positive) funk.

Case in point, the Conference Board's Consumer Confidence Index, which declined to 64 in the late February report. Going back to the 1967 inception of that "nice little data series," Steve told traders, "a reading below 65 has been bullish for stock prices on an intermediate term basis," producing a signal that has lasted until Consumer Confidence rebounded to the 85 level." The trade was profitable in 5 out of 6 previous instances, Steve reported, with the S&P up 29% over 14 months after November 1974, up 33% over seven months after May 1980, up 37% over 16 months after February 1982, and up 47% over 42 months after November 1990. The only false signal was registered in March of 1974, when the S&P proceeded to decline 6% over the next two months.

Steve's nail-biting culminated in mid-March, with the S&P sliding to within 1.5% of its lows but with Nasdaq performing noticeably better in relative terms and with various measures of the over-the-counter market's internal strength, such as cumulative up volume minus down volume, simply blowing away like gauges on the NYSE. Also buttressing Steve's faith that better times lay ahead in the dark days of March were his views on the market's valuation.

"You had 20% of the stocks in the S&P 500 trading for less than 10 times earnings. That's similar to what we saw at the 1994 low; a very high percentage. By contrast, that percentage was near zero at the 1998 top in the secondaries. At the same time, the P/E on the Value Line was very low and the Value Line Appreciation Index got up to a very bullish 115%." The upshot: "By early March, you had valuation, you had the internals, you had sentiment and you had the continuation of the bottoming process that would allow the market, at the very least, to rally for a few months." As it certainly has,with the S&P again shooting up from the 800 area up to almost 950.

Now, just as many market commentators, nervously eyeing indicators like the VIX, which is scraping along near a 9-month low, are predicting that the S&P will again run out of steam around its current prominence, Steve (like Mike Belkin, who is interviewed on page 1) finds himself "quite constructive." Indeed, expecting the rally to continue displaying legs that will carry it through yearend.

Steve's conviction stems from a basic observation: "When you leave a bear market and enter a cyclical bull, you don't crawl out; you don't walk. You tend to rally sharply. You tend to have advances of 30-35% a year later. The rubber band that's maybe been pulled too tight snaps back and you see very strong internals. You see a market that doesn't consolidate. Pullbacks are shallow and don't undermine the internals. That's what we're seeing now. Plus, numerous momentum gauges went positive when the S&P was in the 800s."

Steve is particularly heartened by what he describes as the emergence of the sort of broad leadership we haven't seen on either the Naz or the New York over the last several years. "The Nasdaq not only isn't rolling over, it's actually leading the advance and during consolidations, it acts *better*. It's being resilient. In late April you were seeing 85% of NYSE stocks trading above their 50-day moving averages based on my proprietary operating companies-only database — the highest level since 1990-'91.

(Steve has constructed a list of the 1700 issues on

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the NYSE that are the stocks of operating companies by eliminating the roughly half of all Big Board listings that are preferreds or closed-end funds. Those interest-rate sensitive issues, whose stock prices have been largely *inversely* related to declining interest rates over the past two years, have been mucking up a lot of forecasters, according to Steve, by producing misleadingly high readings in traditional technical indicators such as TRIN, which is computed by dividing advancing issues by declining issues and then dividing the result by upside volume divided by downside volume.)

By his gauge, Steve says, "the last time we saw the 4-week advance/decline line as strong as it's been was in 1991; the last time we saw 1 out of 3 stocks making 50-day new highs was in 1991." With momentum registering this strongly, Steve isn't overly concerned that investor sentiment has also taken on a bullish cast.

"When you have momentum projections like I do, sentiment becomes secondary information. When the crowd starts to be somewhat one-sided as we've been starting to see over the last couple of weeks in the *Investors Intelligence* polls, in *AAII*'s poll, it may slow the advance. But it won't *stop* it. I remember people saying about a month ago that the VIX had fallen to around a 9-month low, so the market should pull in. But it didn't — and that's a characteristic of a cyclical bull market. Sentiment just is not of paramount importance at this juncture, given these momentum signals."

What *would* give him pause, Steve adds, would be seeing the market running out of Mo. He expects any pullbacks to be limited to roughly 5% over the next 4-6 months and to see the indices power to fresh peaks every month to month and a half. Their 40-day rates of change, under those circumstances, shouldn't sink below minus 3% or so, and the A/D lines should continue to power upwards.

"You're just not going to get the classic pullback that people are looking for here, because this market has these strong underpinnings. I look for declines to be quite shallow and for us to continue to rally."

How far? Taking a six-month view — which approaches an eternity for Steve — he sees room for the S&P 500 to tack on another 10%-15% from current levels. "That would still only be a typical cyclical rally off of a secular bear market bottom," he shrugs. But it would easily take the index into the high 1000s, low 1100s by yearend. "*That's only a guesstimate, for you press-types*," he quickly qualifies.

What Steve is sure of is that the market isn't now perched perilously near the top of just another unsustainable 15% bear market rally.

"What makes this different from the others is all the ingredients that are coming into play. This time we had massive divergences, improvements in valuations and confirmation in just a host of momentum indicators. Everything has been participating. Growth is outperforming, secondaries are outperforming, Nasdaq is outperforming, even semis don't back off. We've blasted off. And while the market's a lot higher than it was a month ago, the ride isn't close to over."

Steven Goldman is the Principal, the founder, the sole director and shareholder of Goldman Management, Inc. since October 1985. Steven Goldman has been registered as an Associated Person of GM since January 1986. He is responsible for all aspects of the firm's operations including market research, trading operations and management. From April 1986 to September 2011 Steven Goldman had been the Chief Market Strategist and partner at Weeden & Co, LP. Weeden & Co, LP was founded in 1922 and is a medium size equity brokerage company, which provides execution services for institutional clients. Mr. Goldman still presently owns a minority ownership of the firm.

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