Philequity Corner (April 13, 2009)
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666 on 3-6-9

It is such a coincidence that the S&P 500 Index bottomed at 666 on 3-6-9 (i.e. March 6, 2009). While these numbers may have important meanings when viewed in the concept of numerology, for us, they are significant because they quite possibly marked the ultimate bottom in stocks – the opportunity of a generation.

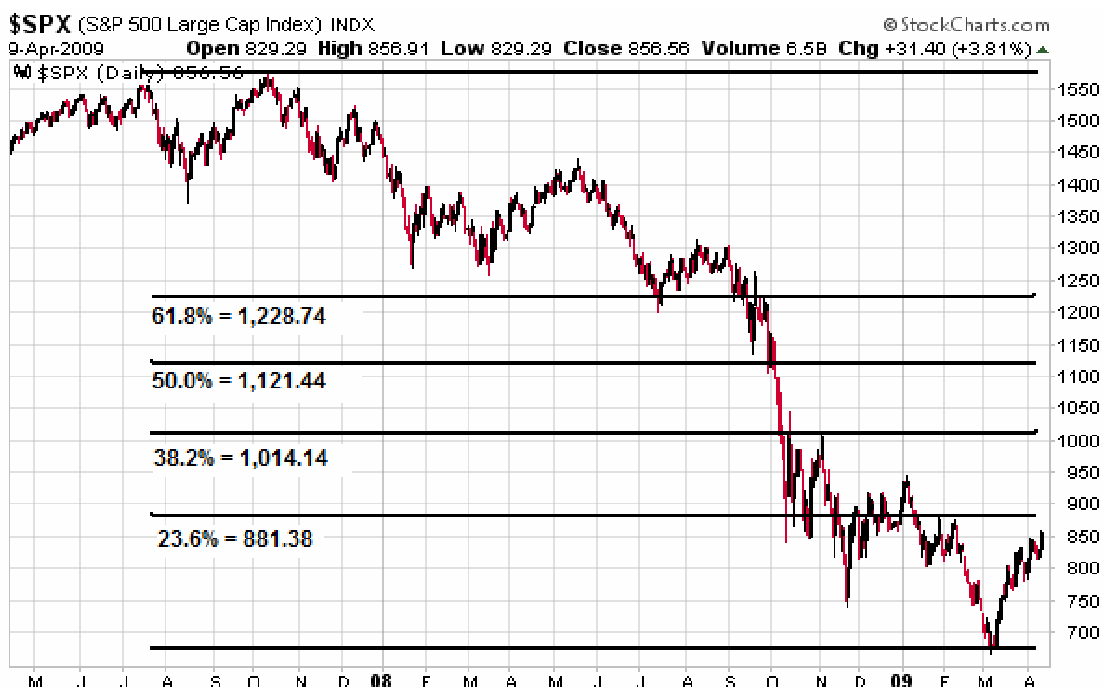
Whether it is just pure chance or one that is written in the stars, these lucky numbers are definitely something that people will remember. In fact, you may even want to try something like 3, 6, 9, 33, 36, and 39 the next time you fall in line for lotto.

Fibonacci retracements

Related to numerology is an esoteric technical trading tool called the Fibonacci retracement. Named after Leonardo Fibonacci, who was reputed to be the greatest mathematician of the Middle Ages, a Fibonacci retracements is created by taking two extreme points (usually a major peak and trough) on a stock chart and dividing the distance by key Fibonacci ratios of 23.6%, 38.2%, 50%, 61.8%, and 100%.

For reasons unclear, these ratios seem to play an important role in the stock price movements, just as they do in nature. Once these levels are identified, horizontal lines are drawn to indicate possible support and resistance levels.

Applying Fibonacci retracements to the S&P 500 Index shows that the initial resistance is at 881.38 (23.6% retracement). Usually, the minimum target of a rally is the 38.2% retracement level and the maximum is the 61.8% retracement level. In this case, the minimum and maximum target is 1,014.14 and 1,228.74, respectively. Any move above the 61.8% retracement would mean that this isn't anymore a rally but a new bull market that will break new highs.



Is the rally over?

According to the Fibonacci retracements, the S&P 500 Index has not yet reached the initial target of 881.38. However, the S&P 500 Index has now gained 27 percent since the low of 666 on 3-6-9. The easy call here is to say, *"Sell into the rally, lock-in the profits and wait for a re-test of the bottom."* In fact, a number of well-known investors and analysts came out early last week, predicting that the rally in equities will falter.

Nouriel Roubini said that bank takeovers have deepened the financial crisis, while George Soros called all US banks insolvent. Notable bank analyst, Mike Mayo, advised selling bank shares. Meanwhile, Marc Faber said he expects a 10 percent drop in equity prices.

And when most people were saying that this rally is not real and that the lows will be retested, shares zoomed last Thursday, capping the biggest five-week rally since 1933. Financial shares led the market, gaining 10 percent for the week, as Wells Fargo reported record profits for 1st quarter of 2009.

Despite what is seemingly obvious and what most experts expect (that prices need to pull back from these levels), nobody really knows where the market bottom is or where the market top is. It is only on hindsight, now, that one can say that 666 may possibly be the bottom.

Don't fight the Fed

What is clear, however, is that the government is doing all it can to save the financial system and revive the economy. Policy actions recently implemented and those being proposed include:

- Quantitative easing with interest rates near zero
- Relaxation of mark-to-market accounting rules
- Reinstating the uptick rule in short-selling of stocks
- Geithner's plan for a "public-private partnership" to buy toxic assets

As a consequence of the Fed and government actions, banks' profits are now improving. With interest rates almost zero, a recovery in the mortgage business is stabilizing margins and lifting earnings. In other words, rules are being changed in favour of the bulls. Thus, there's no use fighting the Fed. It's better to have the Fed on your side.

Don't fight the tape

As stated last week, the market appears to be at the tail-end of a bottoming process characterized by very sharp rallies and deep corrections. Thus, it is crucial that we don't lose focus on what the tape is telling us, despite what all these prominent naysayers are claiming.

Recent trends show:

- Financial stocks leading the market rebound
- Outperformance of small cap stocks over large caps
- Strength in reflation trades and in growth-oriented sectors like technology, basic materials and consumer discretionary

- Strength in TIPS, commodities and emerging market stocks
- Pullback in gold and the Japanese yen which acted as safe-havens during the downturn in stocks

All these are the kinds of signs that say the tide is turning for stocks.

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