BULLS AND BEARS: BEWARE OF THIS MARKET RALLY

Markets oscillate, they don't go in a straight line. Novice investors often don't realize that. When I speak at a conference, and for example I am bullish on the stock market, an investor will come up and say, "But you're wrong because the stock market was down the past two days."

Such an investor should buy US Treasuries and go golfing.

Oscillations and waves occur everywhere in the universe. Did you hear about the recent discovery of "gravity waves" the existence of which was predicted by Einstein? Finally they have instrument to prove their existence.

In the stock market, waves occur no matter which way the market is heading. Straight line moves in one direction don't last long. In the markets, it's always a battle of the bulls vs. the bears. No matter if you are bullish or bearish, you must count on counter-trend moves.

The last important stock market low occurred on February 11. The next day I wrote that a bear market rally was ahead. At this writing (March 1), it is still in progress. The next great opportunity for active investors is to determine the rally top. My tools have been very good at detecting the turns historically, since founding Dohmen Capital Research 38 years ago.

I happen to believe that this is a bear market rally. There are plenty of bulls who think it is the next phase of a bull market. But even the bulls should be on the lookout for the next correction, or if a bear, the continuation of the bear market.

The only way to identify turns to the day is by using advanced technical analysis. It's a way to measure money flow, into or out of the markets. **Only a change in the supply-demand for a stock or an index, whether the change is short term or long term, can change its price.**

Earnings don't do that. The effect of earnings on a stock price is random. Sometimes good earnings cause a rise in a stock, while other times it is followed by a big decline.

But for the bulls who think earnings are important, you are not paying attention to what is happening. GAAP (generally accepted accounting principles) earnings last year were down 12.7% . In late 2014 I had written that corporate earnings would decline in 2015. Wall Street consensus was for a 15% rise.

Shouldn't that big of an earnings decline at minimum justify an equal stock market decline?

Well, if you look at the more important and broader indices, like the Russell 2000, you will know that this index was down about 27% on Feb. 11 from the mid-2015 high. The DOW and the S&P 500 indices are a poor measure of the stock market. Yet, in the media, those are the only indices usually discussed.

Technical analysis is a little more complicated than just parroting earnings and sales results. That's probably the reason so few analysts practice it. But it works…most of the time.

For example, how did I identify the February 11 market low? There were numerous indicators saying that selling was substantially less on that day than at the previous low on January 20, which was at a similar level on the major indices. That is always indicative of at least a short-term bottom.

One indicator was the number of stocks making new 12-month lows on February 11, which was 139 on the NYSE. That was much better than the 1,395 new lows on the NYSE on January 20. It showed that money was flowing back into many stocks on February 11, even while the major indices were manipulated lower.

I also look at the sentiment of investment advisors, as measured by Investors Intelligence. In early February, bearish sentiment was at one of the highest levels since the low during the last global crisis. That's usually a good signal to go in the opposite direction. Sentiment is not a measure of intelligence, just an indicator of where the most money is. And most of the money is usually not ready for a turn.

The powers at the highest levels in government, central banks, and the financial world didn't want another stock market crash.

I wrote on February 12, *"the fix is in to have the markets make a stand here. The conclusion of governmental, central bank, and financial industry leaders yesterday was: 'we have to do something."*

On that day, Feb.11, the CEO of JP Morgan announced he would buy about $26 million of JPM's stock. That equals about one year's salary for him. It's reminiscent of the original Mr. JP Morgan buying stocks during market crashes in the early 20th century.

Right after the February 11 bottom, the very top leadership in Japan asked for an "emergency meeting" of top financial ministers of the world.

Hedge fund manager and billionaire John Paulson chimed in saying at a conference that there is a "disconnect" between how companies are doing and how the market is doing. Other financial market figures said something similar to assure the markets that 'all is well.'

The bulls always make one mistake in the early phases of a bear market: they look at the economy, apparently not recognizing that every financial crisis comes from the credit markets and not from the economy, such as employment.

My work shows that we are now starting a global financial crisis, which has the potential of being much worse than the last crisis. The 2008 crisis was triggered by subprime mortgages and their Wall Street-created derivatives. It was a US crisis which then infected the globe.

Now all major economic areas of the world are in the same danger of crisis. There is no one who can come to the rescue, unless it is angels from above.

The signs are everywhere, but they are ignored by the bulls, most of whom have big conflicts of interest, which I don't have. I don't manage money, and I don't broker stocks or other investments.

Look at what is happening in the financial world:

A hedge fund from Blackrock had the worst performance for any January **in 19 years.**

For the first five weeks of this year, here are some performance numbers of major funds (according to InvestmentNews):

Bill Miller and his Legg Mason Opportunity fund plunged **27.9% in five weeks,** according to Morningstar Inc. That's horrendous for a mutual fund. During the same time, the S&P 500 is down 9.19% including reinvested dividends.

Heebner's CGM Focus fund (CGMFX), is **down a hefty 25.10%.** He was one of the top managers of the 1990s.

Baron Partners fund (BPTRX), the $1.6 billion fund run by Ron Baron, **is down 23.4%.**

These are all very intelligent money managers. In comparison, a program I run, HedgeFolios, (not a managed account program), had gains of **up to 10.6% in its five model portfolios.** I am not a genius, but I use technical analysis for timing, combined with my theory of "Liquidity and Credit" for the big picture background environment.

I developed this theory over 40 years ago. It basically states that the main determinants of the major stock market trend are changes in liquidity and credit. Liquidity & credit have been contracting since last summer.

A financial crisis is so much more powerful than just an economic weakening. And we are having a developing financial crisis globally: China's $34 TRILLION of private sector loans, over $2 TRILLION of loans to the US energy sector, European banks having surging troubled loans, especially to other countries, like Italy, Greece, and others, which will trigger the next EU crisis.

CONCLUSION:

Markets have to inhale and exhale, just like living things. I am watching this current rally closely. When it ends, and the next decline commences, there will be a renewed rush to the exits in most sectors, and some will soar.

That will create more great opportunities for the bears. This is the year for active trading. The opportunities have been and will continue to be exceptional.

Wishing you successful investing,

Bert Dohmen, Founder
Dohmen Capital Research, Inc.