

## **Dynamic Investing Alert: October 12, 2011**

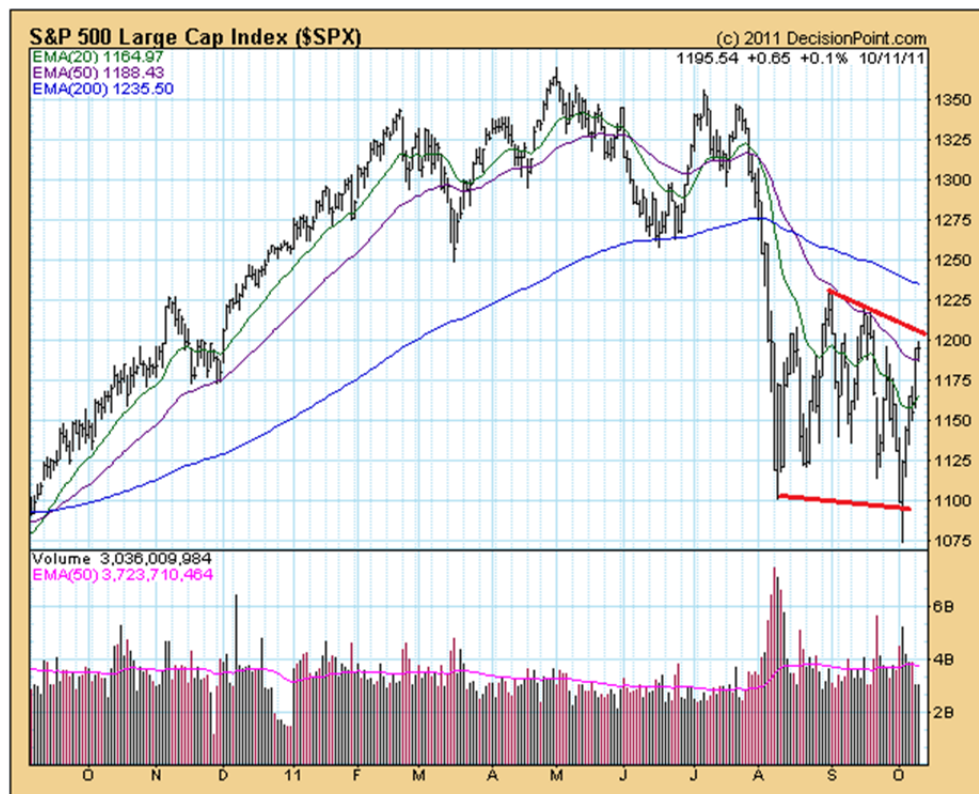
By Art Nunes, CMT, *Dynamic Investing Group*

### **Bear Market Rally or Bear Market Bottom?**

After the stock market's steep decline from July through September the market has been extremely volatile and has traded in a sideways range for the last two months. There is currently a debate as to whether the stock market's rally for the last week is just another short-term "bear market" rally similar to the four others in the last two months or it's a sign that the bear market has made a bottom and a new bull market will begin soon. One thing for sure, it will take time to know the answer.

After the initial 19% decline for the S&P 500 index that began the last week of July the stock market has traded in a sideways trading range for the last two months. It made a new low just over a week ago at 1,075 and looked poised for another leg down but instead the market has rallied about 8.5% over the last week and is approaching the upper end of its trading range again. The market's trading action since July looks very similar to the October 2007 – March 2008 time period which was phase 1 of the 2008/09 bear market.

### **Stock Market's Recent Trading Action**



You'll soon see that the 10/07 – 3/08 time period not only looks very similar in terms of the market's price action for the last few months, but it was a very similar period in terms of how the fundamentals of the financial crisis were evolving. Back in March 2008, the market was trying to come to terms with the impact of the sub-prime mortgage crisis and how it was going to be resolved. Most Wall Street forecasts at the time were that the crisis would be "contained" to the real estate and homebuilding industries. The stock S&P 500 put in a technical "double bottom" around March 18, 2008 and then it rallied back up to the 50 day moving average (DMA) within one week. The following week, the S&P broke above the 50 DMA and then gyrated for another 15 days or so, back and forth above and below the moving average. Over the following 2 months, the market ratcheted higher and then crossed up and over the 200 DMA before beginning "phase two" of the bear market when it declined another 48% below its initial low.

Here is a look at phase 1 of the 2008/2009 bear market: The chart below shows how the S&P500 index declined 19% from its October 2007 high to its January 2008 low, went sideways for two months then rallied about 13% back to its 200 day moving average in May. The rally up through the 200 DMA turned out to be a short-term bear market rally prior to phase 2 starting.

### September 2007 – May 2008 Period: S&P 500 Stock Index

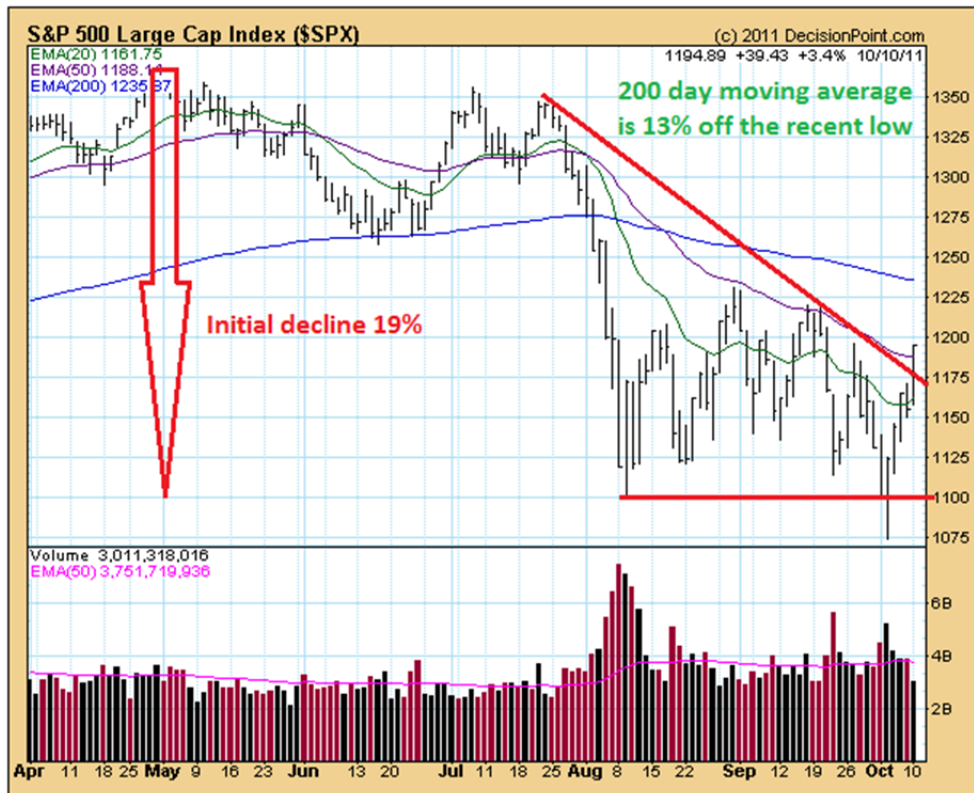


The chart on the next page is a look at phase 1 of the current bear market: Once again the initial decline from July through September has been about 19%. The market has gone sideways for the last two months and if the current rally can breakout to the upside of its trading range it may be headed for the 200 day moving average which is 13% above the recent low. We are only about 5% below that point now. Getting above the 200 DMA is not enough to end the bear market as the March-May 2008 period proved. Prices must stabilize above the 200 DMA

long enough to get it rising again. Until that happens any rally from here should be viewed as a short term bear market rally and be used as an opportunity to sell weaker holdings.

The aftermath of the 2008 bear market rally was a devastating decline that took the market 48% lower than its initial low at 1,270. This is why we will not re-invest cash in a broad brush manner until the market's longer-term price trend is rising again. Our focus will continue to be on reducing the risk of further decline from here and only re-investing cash available into holdings that are in their own "bull markets".

### April - September 2008: S&P 500 Stock Index



The aftermath of the 2008 bear market rally was a reversal down and a devastating decline that took the market 48% lower than its initial low at 1,270. In other words the market's long-term price trend continued to decline despite the bullish Wall Street forecasts. Being patient and waiting for the market's trends to start rising again can pay huge dividends. This is why we will not re-invest cash in a broad brush manner until the market's longer-term price trend starts rising again. Our focus will continue to be on reducing the risk of further decline from here and only re-investing cash available in holdings that are in bull markets. Areas on our watch list to buy include:

- Inverse stock funds so long as stocks remain within the trading range
- Utility, Consumer and select Technology Stocks
- Corporate, Municipal and International Bonds
- "Cash is King" during bear markets as it allows us to "bank future profits" from buying low once the bear market ends.

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