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US Stks Outlook: Analysts See Signs Bear Easing Its Grip

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NEW YORK -(Dow Jones)- This summer may have become too hot for the bears.

Since the stock market hit its most recent low on Aug. 5, the Dow Jones Industrial Average has risen 700 points and the Nasdaq Composite Index is up 125 points. What's more important is that the movement hasn't been straight up, which has been a precursor for subsequent moves that went straight down.

Instead, the indexes are tracing a new pattern resembling stairsteps, a halting move up. This suggests to technical analysts that stocks are doing some healthy backing and filling, trying hard, when they rise, to make highs that are above previous levels. And when stocks fall, they are not dropping below prior points. In technical parlance, the activity is called making higher highs and not making lower lows.

One technical analyst, Richard Rhodes, editor of the Rhodes Report, is so sure that better conditions for stocks are in the offing that he has told his clients to stop betting against the market. In a note to clients Thursday, Rhodes said, "Upon receipt of this commentary we would exit all short positions. If you are unable to exit by the close, do so at the opening of trading tomorrow morning."

Another potential measure of growing confidence in the market is a sharp pickup of insider stock buying, particularly among technology companies. Last week, just 27% of insiders - which include executives and board directors - were sellers of their company's stock while 73% were buyers, according to **Market Profile Theorems** , a research firm that tracks insider trading activities. Two two weeks ago, 54% of these transactions involved selling and the week before that, 63% of the action was to lighten up on stocks, according to Market Profile.

But even if the tide is turning, it may not be smooth sailing for all sectors.

Semiconductors, for instance, are said to remain very vulnerable, with Standard & Poor's Corp. on Thursday saying the long awaited chip recovery is further off, say in 2003.

And consumer stocks, especially retailers, are being questioned more frequently, based on how long people will be able to keep up their robust spending patterns. Wal-Mart offers an example. The discount retailer posting positive results on Tuesday, but reduced its sales forecast for the rest of the year, citing the uncertain economic environment for consumers.

And chip maker Applied Materials, when reporting fiscal third quarter results on Wednesday, said that while orders rose 5%, demand is expected to fall 5% to 15% in the fiscal fourth quarter, which ends in September.

But the two companies, while offering concerned outlooks, suggest something of a shift in investor sentiment. Just a few weeks ago, a poor outlook would have sent shares tumbling. This time, shares of Wal-Mart and Applied Materials rose.

There is even an example from Thursday, when the market shrugged off an early report showing jobless claims grew by 6,000 to 388,000 for the week ended Aug. 10, a very different outcome from the 1,000 drop analysts expected. The Dow proceeded to rise more than 110 points.
But this session's activity also shows the market is hardly Teflon coated. Later in the session, stocks pulled back sharply when the Philadelphia Federal Reserve said manufacturing activity in the region plummeted in August, with the Fed's index coming in at a negative 3.1 after a positive move of 6.6 in July.
But that may be just part of the process, not the beginning of another extensive downward sweep, analysts said. Even in bull markets, stocks never go straight up - they experience periodic pullbacks. And this is hardly a bull market, so expect more volatility on accounting scandals, negative profit surprises and even options expirations and periods where fund managers engage in window dressing - all the things that can and often send the market into a tizzy. And there will be more days of big selling, traders said.
But they add these big downward moves may become less frequent.
"Reason has returned to the market," with people making more pragmatic decisions and perhaps buying for the longer term, said Brian Pears, head of equity trading at Victory Capital Management, the money management side of KeyCorp. "People seem to be starting to again believe the system works."
The tone is also different on some of the trading desks. "Sentiment has changed, especially if you compare it with the tone a month ago," Pears said. "You might call it healthy caution." .--

Two events this week suggest that investors may be building some confidence in the stock market. Companies certified their results with the Securities and Exchange Commission without any bombshells dropping, and the market rallied. And the market moved through the Federal Reserve meeting, losing ground right after, but then resuming an upward climb.
Credit pension funds for a lot of the recent buying, some traders said. These money managers oversee plans that companies fund for their employees, not the 401(k) plans that employees make contributions to. Corporate pension funds are said to hold over $1 trillion and the balances between stock and bond holdings has gone out of whack over the past year, with managers boosting their bond allocations.
This means that pension managers may be expected to do lot of stock buying in the coming months to bring their allocation models back in line, some analysts said.
Joanne Hill, head of derivatives and trading research at Goldman Sachs, says the imbalance could be as high as $185 billion and if even half that money comes into the market, stocks would experience a nice push over the next few months.
What's more, if the market continues to improve as a number of analysts are predicting, some pension finds may even up their equity allocations, bringing more dollars into the market.
The importance of pension funds cannot be understated because these money managers tend to be long-term investors who can help put a floor under the market and with additional buying start it heading up, analyst said. These money managers already hold about 25% of all U.S. equities, with mutual finds and retail investors making up 60% and foreign investors holding the balance, according to Federal Reserve fund flows data.
But pension fund managers and other investors still need incentives and what about that big question mark - profits. This bridge certainly hasn't been crossed yet.
Early indications from Thomson First Call show that negative prannouncements for the third quarter are outpacing negative preannouncements at this time in the second quarter. Plus,

analysts continue to reduce their estimates for the rest of the year, but there is a consensus in some quarters that the initial projections were way too high, so analysts may be just bringing their expectations in line with reality.
It's a matter of considering those factors and putting them in perspective, some analysts said.
"With analysts reducing their estimates for the third and fourth quartèrs and companies guiding numbers lower, investors can be forgiven if they have gotten the perception that earnings for the rest of the year will not be favorable," said Charles Blood, senior capital markets strategist at Brown Brothers Harriman. "But nothing could be further from the truth."
Profits, despite the trimming, "are still bouncing back smartly from last year's poor reports and third quarter earnings are likely to show the third straight period of robust quarter-to-quarter gains," meaning the bottom has been hit in terms of profit declines, Blood said.

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