CNBC Market Dispatches 5/13/2003 4:03:17 PM

Bears sink teeth into stocks

But the injury isn't heavy. Given the flow of bad news Tuesday, Dow's drop isn't too impressive. Valuation debate rages. Insiders are buying Coca-Cola.

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Posted 5/13/2003

The bears finally got their say today, but the message didn't exactly blow the market away. While the Dow Jones industrials dropped a few dozen points, other indexes traded close to the flat line. And as our Markets page illustrates, advancers nearly kept pace with decliners.

The day was filled with news that bears could sink their teeth into: a worsening trade deficit, a terrorist attack in Saudi Arabia, weak store sales figures and a Merrill Lynch downgrade of the semiconductor sector.

And yet, despite the impressive run-up in recent weeks, the market didn't flinch too hard. Gold fell, and the dollar rose today. All this offers up more fodder for the bull-vs.-bear debate. To offer your view on the near future of the market, click into our poll at the left side of this page.

LIVE VOTE

Voting ends 8/31/2003

How high will this rally take the Dow?

- 11,000 or higher
- 10,000
- 9,500
- No higher than 9,000; the rally is about to collapse.

Vote View results

Does valuation matter?

One of the bears' most persuasive arguments involves valuation. How, they ask, can the market justifiably surge when stocks are valued so richly already?

The price-to-earnings ratio for Dow stocks is 27.4, CNBC's Bob Pisani noted. That's well above the historical mean level of 16 or so. But does this disparity doom the current market surge?

History says no, according to the McClellan Market Report, which offered these numbers to Pisani: At the end of 1991, the Dow P/E was 64.3, and yet the market advanced from there. Then in December 1998, the Dow P/E was 23.9; again, the market advanced.

Bottom line, says Pisani: Market valuation is not a good indicator of market bottoms or tops.

To see how the Dow-member stocks are now valued -- and how each has performed so far this year -- see this screen.

The insider perspective

MSN Money columnist Michael Brush, who writes the Company Focus column,

Indexes

Dow	8,648.03	-31.22
Nasdaq	1,533.25	-6.43
S&P	939.31	-2.99

Coca-Cola

Price	44.190
Change	-0.060

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PULTE

Price	60.270
Change	-0.780

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WAL*MART

Price	54.630
Change	-0.860

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filed this Dispatch item on stocks to buy and sell:

Given the recent market strength, should you plunge in and add to long positions? Based on the recent work of Michael Painchaud of Seattle-based Market Profile Theorems, the answer is: Not yet.

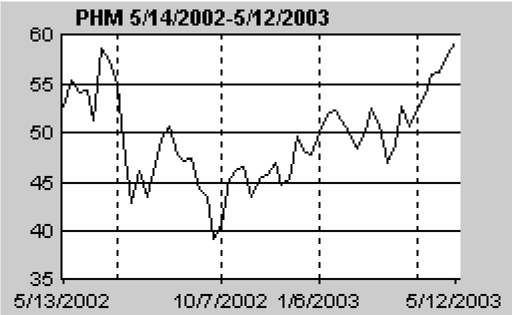
Stocks, Painchaud believes, are likely headed for a correction in the next 3-6 months before resuming a long-term upward trend.

"If you are buying stocks here, I think that is a mistake," says Painchaud. Instead, investors should be reducing risk by raising cash or selling calls on stocks they own. "This may be a good place to hedge your portfolio, buy a fishing boat, and go away for three months," he says. "The prices you see this week and next week will be the best prices you'll see over the next three to six months."

Painchaud is worth listening to because his models have called several recent market turns -- including the sharp reversal last October and the market slide that began last spring.

Why the gloomier outlook? Insiders are more bearish. And investors seem too bullish -- often a sign of a market top. Plus fewer companies are reporting stronger earnings year-over-year, compared to those posting weaker results.

Painchaud still thinks the market is in a long-term cyclical upturn that will see the Dow Jones Industrial Average finish the year at 10,400. A near-term correction may play out in part as a return to leadership of value stocks over growth stocks.



Based on insider selling, homebuilders look especially vulnerable. "What makes this more of a concern is that we are seeing selling in the entire home building complex, including savings and loans and real estate investment trusts," says Painchaud. He cites insider selling at **Pulte Homes** (PHM, news, msgs), **Hovnanian Enterprises** (HOV, news, msgs), **Golden West Financial** (GDW, news, msgs), **Washington Real Estate Investment Trust** (WRE, news, msgs) and **Simon Property Group** (SPG, news, msgs).

On the flip side, insider buying at these companies makes them attractive: **RailAmerica** (RRA, news, msgs), **Kansas City Southern** (KSU, news, msgs), **Raytheon** (RTN, news, msgs), [[snapnquote(NOC, Northrop Grumman), **Pepsi**

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Bottling (PBG, news, msgs), and **Coca-Cola** (KO, news, msgs).

Cashing in

At least some investors today cashed in, perhaps deciding this rally has gone far enough. Take **Wal-Mart Stores** (WMT, news, msgs), which reported a nearly 10% jump in quarterly sales today, albeit with cautious guidance looking forward. Shares slipped -- in large part, CNBC's Joe Kernan says, because Wal-Mart is up 20% from its low in early March, tempting investors to cash in their gains.

That a trend you see elsewhere, as well. **Walt Disney** (DIS, news, msgs) was down about 3% today without any news to push it lower. But Disney is up almost 20% from its lows in February; another attractive profit for the taking.

That could make the next few days interesting, since nearly half of the stocks in the Dow club -- 14 of 30 stocks -- are up more than 10% in just the past three months. Four of them -- **Caterpillar** (CAT, news, msgs), **Intel** (INTC, news, msgs), **American Express** (AXP, news, msgs) and **Citigroup** (C, news, msgs) -- are up more than 20%.

Gains like those have raised concern that stocks may be getting ahead of themselves. Brian Belski, fundamental market strategist at U.S. Bancorp Piper Jaffray, told CNBC's "Squawk Box" that the market is in for a long-term rally, but may have gained "too much, too fast" in the short term.

"The key thing for the market going forward is if we get the combination of sales growth and operating margins expansion," Belski said. "The market could be priced to perfection on a near-term basis, but in the long term, things look very good transitioning from bear to bull."

Still, the day's selling was mild. Given today's news -- especially the terror attacks in Saudi Arabia -- that's barely a blip. The rally train may be moving too fast, but most of those with tickets to ride don't care.

(For more on the Saudi bombings from MSNBC, click here.)

Also today, the Commerce Department reports that the U.S. trade deficit hit $43.5 billion in March, the second-highest level on record. Fueling the 7.6% jump from February: sharp increases in oil prices.

The bears are still growling

The bear market won't go away without some protest.

Take Richard Bernstein, chief U.S. strategist at **Merrill Lynch** (MER, news, msgs), who told Reuters that the current surge bets on an economic recovery that isn't going to happen anytime soon. "You can have tremendous rallies in bear markets, and I think that's what we are seeing," Bernstein said, in remarks reported Monday. "With this one, we're getting close to the end."

"The surprise will not be on the upside," Bernstein said. "If you think of what bets people are making in their portfolios, they are squarely in the camp of economic boom."

Then there is the view of Doug Cliggott of Brummer & Partners , another well-known bear. "We're very close to the highs on equities. If we go higher, it's just speculative," he told CNBC after yesterday's close. "The higher we go from here, the more violent the correction will be."

The bearish arguments are many. Corporate outlooks this earnings season have been fairly cautious; economic numbers remain fairly weak. The data doesn't justify the rally. And stocks have done this before: last October, for example, the Dow rallied from around 7,200 to nearly 9,000. And of course, a year ago, the Dow was trading above 10,500 after a run from below 8,000.

However, bulls argue that the corporate and economic numbers are taking a turn for the better. And, they point out, the bears are bound to be wrong eventually.

Getting some attention on the Street today: a bullish pronouncement from Peter Wuffli, president of banking giant UBS: ``While some further degree of volatility cannot be excluded, we do feel that the downward pressure on our industry from the business and market environment could be beginning to ease and that the worst earnings declines may be behind us,'' Wuffli said, according to CNBC. ``It starts to smell like the end of the bear market.''

What does a weak dollar mean for markets?

Market watchers tend to agree with Treasury Secretary John Snow's comments over the weekend that a weak dollar will help exporting companies. But will stocks suffer with international investors hesitant to buy dollar-denominated assets?

U.S. Bancorp Piper Jaffray's Belski said the dollar's weakness isn't a big concern for stocks, but it needs stability. He said a weak dollar will help big-cap stocks, but there continues to be volatility in the flow of money from domestic and international funds.

Meanwhile CNBC's senior economic reporter Steve Liesman said recent data show exports falling along with the dollar in April, contrary to the usual trend where exports rise on greenback weakness. But Liesman cited one expert who said it's just a temporary phenomenon caused by businesses reining in their spending because of the war in Iraq. If things get back to normal, the weak dollar should be a boost to the beleaguered manufacturing sector, Liesman said.

-- CNBC on MSN Money staff

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