JUNE 2006

State of the Market

Monday, June 19, 2006

We are in Bear market.

A correction is widely viewed as a drop of more than 10 percent while a 20 percent decline is seen as a bear market. We have seen a decline of more than 28%. We got another confirmation last week that we are in bear market.

Buy on rumour and sell on news – Bull market
Sell on rumour and buy on news – Bear market

The market sold off on fears of inflation at the start of the week (Sell on rumour/expectation). Then came, the real data on inflation, worse than expected, and market rallied (Buy on news). (Hindalco and NALCO announced cut in aluminium prices. But the stock rallied. Interesting!!!)

There are lot of people still debating whether it's a bull market or bear market. I guess the issue is now just academic as the damage has been done. It really doesn't matter what one thinks. The issue is what one should do now.

We are in bear market. Weakness is not to be bought; strength is to be sold into. I guess, this will be only a retracement rally in an ongoing decline, so investors should use the opportunity to reduce remaining holdings. This can be an excellent opportunity to minimize losses.

I know lots of investors are still in doubt – "What if this fall from 12600 to 9000 was just a correction? May be we have bottomed out. What about last two days of strong rally?"

I don't know. It's hard for me to imagine that in last one month, everyone got mad and sold off everything, and now suddenly value logic will take over and take the market up. I get the feeling worst is yet to come. I pray I am wrong. What scares me even more is the way market rallied in last two days. It just indicates that there are still lots of desperate bulls out there, and we may see another round of strong selling to shake them out.

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S	M	T	W	T	F	S
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	

Bulls	Bears	Flat (less then 0.5%

Sometimes, there is a pattern even in chaos

I have been facing lot of technical issues in posting my message to different yahoo groups. From next week, I will post my newsletter only to "**stateofthemarket**" group.

Group name: State of the Market
Group home page: http://groups.google.com/group/stateofthemarket
* Group email address stateofthemarket@googlegroups.com

Please Join

Review of my last one Month Newsletter

It has been more than a month since I have been writing this newsletter. Thanks for all the support in terms of feedback and ideas. I thought it's a good time to review the topics I covered in this last one month, and it's relevance. Here's a quick summary, if you are a new reader –

May 17 – There are more Category 3 and 4 Hurricanes on the way. (Probably, I underestimated as there were category 5 hurricanes on the way.)

May 18 – There will be massive sell off. I also criticized the role of Central Bank, and the way inflation is measured.

May 19 – We are in age of Instant Price Discovery. That's why we see swings of 300-500 points on daily basis.

May 22 – When markets go up, there are no resistances; when markets go down, there are no supports.

May 23 – Do not buy the Value Logic.

May 24 – Recent Experience can be dangerous in financial markets. Correction may have deeper legs.

May 26 – Why all asset classes are declining at the same time?

I changed the format from May 29 newsletter

May 29 – Realized profit or cash in the only fact in investing. Also, I raised the issue of investing for water.

May 30 – Hope for the best and Prepare for the worst.

June 01 – There is no great stock, there's only great price.

June 05 – Let the market talk to you, rather than you talking to market.

June 08 – Economic war is on – Inflation and Oil are the weapons.

June 12 – Where are we heading next?

June 15 – No newsletter. I was on vacation

I was fortunate that I was able to read the market right throughout last one month. May be it was a fluke. But that's not the intention. The intention is to provide a simplistic view of the market. It really hurts me when I see seasoned market experts misleading investing public with complex ideas, and stories. "Buy on dips" investors really got hurt in this carnage.

One of the lessons we all can learn from this last one month carnage – No one has any edge on you when it comes to how market will behave. All are guessing.

DMA = Day Moving Average.

Nifty Level	2890
200 DMA	2912
100 DMA	3212
50 DMA	3314

Market is hovering around 200 DMA. The interesting thing to watch is what happens next. Will market convincingly cross 200 DMA?

The newsletter contains my personal views. This is just food for thought. I can be totally wrong. I am no expert, and do not have any crystal ball to look at future. This is just a common sensical view of the market.

How can the last two day rally be described?

If you recall my last newsletter, I wrote the following - *If on June 14, inflation data comes below consensus estimates, and Global equity market reacts positively to the data, then one can invest with fair degree of safety that market has seen a bottom for time being.*

Interestingly, markets rallied after June 14 data, but the only issue is that inflation came worse than expected. The core CPI, a closely watched inflation gauge that strips out often-volatile food and energy costs, rose 0.3 percent, the same rise seen in April. That April report helped spark a sell-off in worldwide stock markets. Economists had forecast only a 0.2 percent increase in May. This means prices paid by consumers for goods other than food and energy rose more than expected in May, making it all but certain the Federal Reserve will raise interest rates at least one more time.

How come the same reason that triggered sell off can be the reason for rally? It can be safely called as bounce back from oversold conditions. Also markets hate uncertainty – this data came as a big relief. Uncertainty is over – Inflation is a legitimate concern, and Fed will raise interest rates on June 29.

Since, Indian markets were strongly oversold, they bounced back strongly.

If you remember, in my last newsletter, I also mentioned that this market has become like a mad elephant which is trampling everyone that comes its way. If it goes down, bulls are decimated, and if it goes up, bears get decimated. You know what is done when elephant becomes mad, someone shoots it down. I guess that's what eventually SEBI will do – Shoot the Volatility.

It is easy to get carried away when the market is rising. It is equally easy to panic when the market is tanking. When markets exhibit these characteristics and wild swings of 500 points, the best strategy should be to wait on the sidelines. These are times when investors need to remain patient and not get caught up in the daily market swings.

What will be the trigger to invest? - Complete collapse of Volatility. This will be a time when no body wants to be in the market neither bears nor bulls. I still don't see that. Right now, the market is in Yo-Yo condition.

Why bears still have strong case over bulls?

Bull markets are always driven by liquidity. Liquidity is always driven by low interest rates. World over, all central banks are tightening the liquidity, and there are no clear signals that they will stop any time soon. China is the latest country to join the tightening bandwagon.

The reasons global equity markets sold off still remain – Inflation, Oil and Fed. Inflation data came worse than expected. Oil hovers above $70 and Fed policy is now hazier on where they will stop. Fed fund futures have now fully priced in an interest-rate hike at the Federal Reserve's next policy meeting on June 28-29, and chances are at about 70 percent for another increase in August.

India story is still strong. But the issue is - we do not have domestic money tankers to take the market up on our own. We need FIIs support, and that support will depend on global liquidity. So, there's no point singing a tune (Valuation) that does not move the market.

Market Outlook

View – Neutral to bearish

This is what some analyst gave their outlook on TV –

- § We are in long term secular bull market (I don't know what this means?)
- § Anyway, then we are in bear market in this long term secular bull market (Interesting)
- § Then, we are in intermediate uptrend in this bear market (Very interesting).

Now, if we go down on Monday, then they may say, we are in correction in this intermediate uptrend. So simple!!!

Anyway, to be honest, I term this rally just a bounce back from strong oversold conditions. I have only one question – If India story and Valuation logic is so strong – Why market sold off as there is no tomorrow? There is something big which we are missing, or somebody is making fool of us. It's tough to say.

Indian market will vote on following factors on Monday –

- § Global equity market is now in uncertain zone after two days of rally.
- § Positive Inflows by FII in last few days
- § China has announced policy measures to tighten liquidity
- § Bank deposits in India at historic low.

In total, market may open flat. It would be interesting to watch how market behaves in last 60 minutes of the trade.

About me

I am Deepak, a keen market watcher, and a passionate believer of free market economy. The State of the Market Newsletter is a compilation of my opinion on the market. The newsletter is written before the market opens on Monday and Thursday.

The objective of the newsletter is to share and enlighten the investing public on the economic factors that drive the market. All factual materials are believed to be reliable, but I cannot attest to its accuracy. I am not an expert on the markets, and I believe no one is. You can mail me your comments, and ideas at deepakmeenakshi@yahoo.com

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