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## listeningin

# Uncomfortable Transition

*Justin Mamis Spies Deterioration Under Market's Cheery '04 Facade*

*What a difference a year makes. As 2003 began, Wall Street was hung with crepe. Three savagely down years in a row had taken an enormous toll, on portfolios and on confidence. Expectations for the coming year were muted, if not downright bleak. So of course, Mr. Market threw one heck of a party, and made sure the festivities were led by some of the rankest speculative holdovers from the late, great bull.*

*So now what? Wall Street research publications, business magazines and newspapers of late have been bursting forth (tis the season) with predictions for the nascent year. Virtually all of them following the hoary journalistic tradition of mindlessly extrapolating the present into the future. Happy days are here, and forever, again.*

*Did that sound too harsh? It wasn't meant to be. For the amateur and professional prognosticators alike are merely doing what they know how to do best: projecting conventional wisdom. And, as measured by a variety of sentiment gauges, investor sentiment has rarely been this bullish. Nor has it—ever—stayed this buoyant for anywhere near this long.*

*Indeed, if I hadn't learned, the hard way, in the late 1990s, that Lord Keynes was entirely correct to suggest that markets can stay irrational far longer than investors can stay solvent, I might be tempted to do something foolish, like call a top. Instead, I called Justin Mamis, over the holiday. My mission: to find out what clues his gimlet eye for technical trends and his vast expe-*

*rience in the market were providing him. What I found was a portrait of the analyst as a frustrated man.*

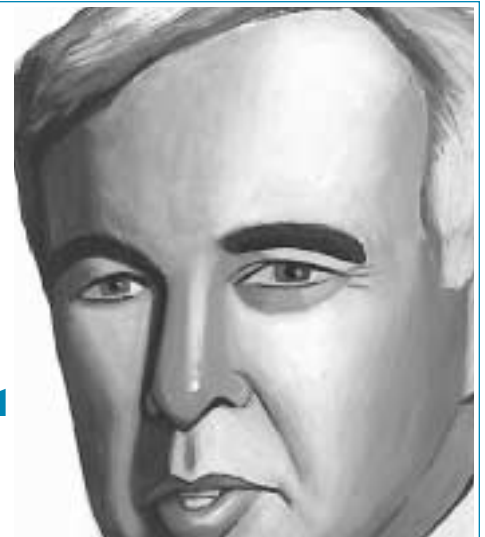
*The "good" news, Justin relays, is his wife's observation that his is the rare sort of frustration that has always, in the past, heralded truly significant changes in market trends. The bad news is not only that the change will likely be in a significantly negative direction, but that nothing he watches is giving Justin a clue on timing.*

**KMW**

**Justin, did I catch you muttering about a "flawed market," as everybody was preparing to welcome the New Year?**

You and my wife. The thing is, all the indicators everyone has relied on for years to try to get a handle on what the market will look like in the future have become unreliable. All the familiar indicators are ineffective. And yes, I realize that to call the market flawed here reveals an "old" man's prejudices—make that his preference for what he's used to. Then again, what has changed about the **NYSE Specialist System**

**"See, I'm  
firmly convinced  
that all  
of the debris  
from the stock  
market bubble  
hasn't been washed  
away, yet."**



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**Charles Powell**  
Page 1 Illustration

since I once roamed the floor is, indeed, flawed. And it does seem that a Pandora's box has been opened by the bursting of the bubble: **Enron, Tyco, Parmalat** and all the rest; the mutual fund malfeasances, the one-way Street kind of breadth days, **penny spreads**, the dominance of **program trading** and **ETFs** [exchange-traded funds], public disinterest (except from hard-core speculators), etc., etc. Then too, you see, I'm firmly convinced that all of the debris from the stock market bubble hasn't been washed away.

### Happy New Year to you, too!

Not much chance. I think the situation is a variation on the cliché about "If it ain't broke...." In this case, it's, "What has broke, can't be fixed"—at least until the impact of the bubble's bursting has run its course and we can start over. But that describes a market bottom, *not a top*.

### I detect no little frustration in your voice—

The frustration, for me, is that I have lost almost every meaningful indicator that I used to follow the market for years—because of changes in the nature of the business. People—and institutions—simply are not trading or investing the way they used to. It's part and parcel of how dramatically the business has changed, of the ways so many hedge funds and trading desks work these days. I know someone who used to be a very active trader—and technician—in Boston. But his desk has no time—or use—for technical studies anymore. His traders don't day trade, they "moment-to-moment trade." He's invited me up there to watch, but I really don't want to see it. I wouldn't understand what they are doing anyhow—and it would annoy me terribly when I saw it.

### You wouldn't understand?

Actually, I do. They make a trade here and a trade there, buying 5,000 of this or 50,000 of that—and then they sell it before you know it. That can generate a very profitable day, when they're trading for 13 cents and don't take any real risk. So they do it all the time. They buy virtually any stock that is down 5, figuring, simply, that it is sure to bounce—then they sell. That is *all* they do. They are not doing anything more than just scalping, really. Trading in pennies has made it all so easy, because there's almost no cost anymore to the way most of them do business. In the old days, even a floor trader had to figure on making at least a quarter-point on a trade to come out ahead. Now the institutions, the hedge funds, all trade for 2 or 3 cents a share. If they make 13 cents on a trade, their profit is a dime, and if they've bought 50,000 shares, and if they can do that even 6-

7 times a day, without breaking a sweat—

### Those pennies add up.

Absolutely. There is also a lot of ETF and program trading going on. Now, I haven't worked out yet exactly how either of those two affect the market—except that there are many more transactions than there used to be that are merely arbitrage; many more trades that are merely minute-to-minute; and a lot fewer that represent any commitment to any sort of long-term investment thesis. All this is supposedly wonderful; the computers let everybody do five different things at once and hedge every which way. But the ETFs *have* to be dangerous long-term.

### Why do you say that?

Because if—when—the market turns down again, they will have to accelerate the selling—if someone is dumping ETF shares, someone else is going to be dumping the baskets of stocks those ETFs represent. That just *has* to accelerate a decline

### A la program insurance?

Yes, that is the underlying problem with all derivatives. It's also part of what

happens now, when the averages spike up so frequently. I know hedge fund people—and you must, too—who do nothing anymore but trade ETFs. They can't be bothered trying to figure out which stock in a group is the right one to buy. Being able to buy the entire group—or the market in a single transaction—is a real advantage for them. Old timers like you and I are outmoded. We have been left behind, in the sense that very few people think about individual stocks these days. There are any number of my clients today who simply want to know market direction and, to a lesser extent, timing. I bet I get fewer than half of the questions that I used to get about individual stocks—from a client base that includes the mainstream institutions and hedge funds. *Not the lunatic fringe.*

### Why?

Part of it, I think, has to do with pressures on their time. Talk to just about any portfolio manager and what you hear is, "I don't have time to do any research. The research calls that I get are no good. I don't want to listen to those kinds of analysts anymore. My in-house analysts are no good, either. And I have to spend three-quarters of my time either answering emails, listening to conference calls or going out and talking to prospective clients. I don't have any time to do anything!" In other words, they don't have time to do what made them successful. Why not, then, just come in and say, "Okay, they are going to take technology back up because it has been

**"The noise level in the market has been raised tremendously, exponentially...You have to put blinders on, to avoid being distracted by lots of activity with no substance."**

down for five days in a row, so I am buying?"

### Then just buy a package or an ETF?

Sure. If they get a quick three points out of it, they're happy. Even the guys who were long-term in the old days—and didn't want to talk to me because I was too "short-term" are now trading like that.

**I know, all the program trading, derivatives and ETFs—if you listen to the hype—"enhance liquidity." But I suspect what they're actually enhancing is the illusion of liquidity—not to mention commissions and banking revenues—in certain quarters of the Street. I suspect, too, that the wide-spread dispersion of risk they entail could have a nasty side effect: turning specific market risk into systemic risk. Someone, somewhere, is still holding the underlying securities—and just might decide to sell. At which point, he, she or it may not be too pleased, if prices sink like stones before a buyer emerges. Pardon my soap box, but what's the point of all the financial rocket science if we let it undermine the market's—and investors'—ability to perform their basic function—the intelligent and efficient allocation of capital?**

It is all cleverness.

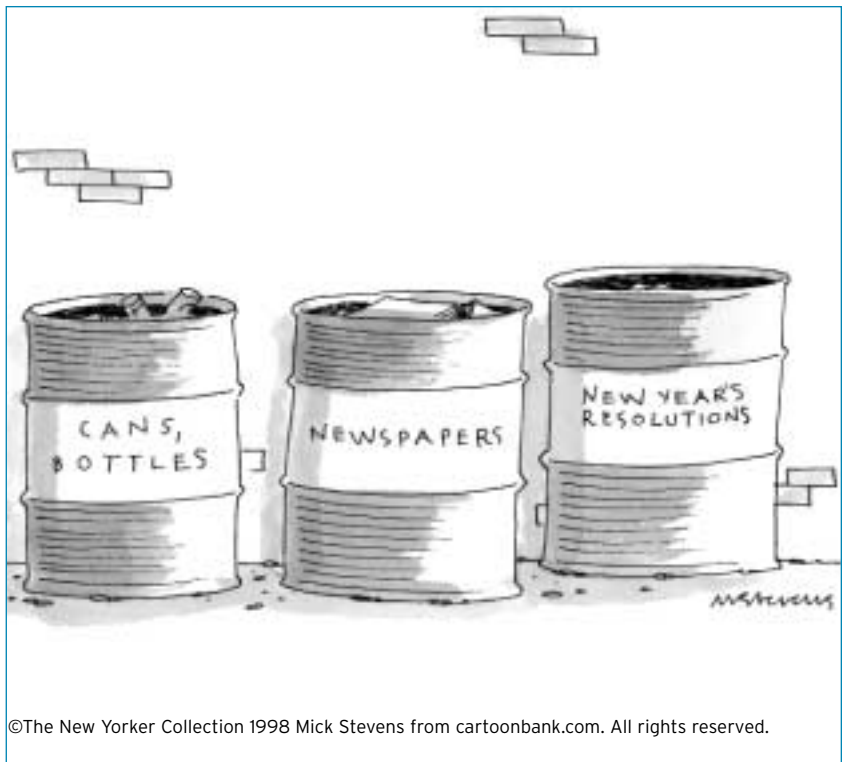
### "Too clever by half" is the way my mother would have put it.

If all these things really enhanced liquidity, you wouldn't get all these days with lopsided breadth. It is all one-way Street stuff. It may be a facile way of "putting money to work," but nothing about it lasts, because it has no substance. And that lack of meaningful intent behind any observable actions is making it very difficult for people like you and me to figure out what the market is saying. All action is superficial, momentary. Every little move is a peculiarity. Why is **Avon** down 5 points today? Because it said one little thing. Why was **Wal-Mart** just bludgeoned? Because earnings came in a penny less than expected. A reaction that violent, to something so transitory, doesn't make sense in terms of any framework we learned growing up. There should have been bidders ready to snap up **WMT** as an opportunity on the buy side, long before it dropped that far. But now there's nobody willing to take the other side of a transaction. You couldn't have these extremes in breadth statistics if there were. In the old days, I can remember when **Bob Farrell** would call 2-to1 breadth a big day! Now, that doesn't strike anyone as lopsided.

### You're complaining there's a lot more noise—meaningless information—in the market today?

The noise level in the market has been raised tremendously, exponentially. More than ever, if you are managing money, you have to do your own research; your own thinking. You have to put blinders on, to avoid being distracted by lots of activity with no substance.

### Research is precisely what you just told me



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### your clients don't have time to do—

That's where you and I come in! And it may be that my complaints will largely resolve themselves, as the aftermath of the bubble recedes. I am inclined to think that we are not done yet with the downside. If that is the case, then much of this superficiality and illusory liquidity are just standard components of a typical intervening rally. It will only be clear in retrospect, but we might be experiencing something akin to the intervening rally in 1971-1972. I actually lived through that one, which took the market up to the Nifty-Fifty highs before the bear market resumed with vengeance in 1973-1974. The subsequent decline was, in simple terms, a final wave down. Elliott had a fancier way to describe it, I've lost track of those terms, but that's what it was. But the rally that preceded it was something to behold: Lasted 18 months, went almost back up the high in the Dow. Yet it had no substance, either.

### None?

Let me get the timing right. The bottom was in the middle of 1970. That was followed by six months of a good rally into April of 1971. Then Nixon announced some game plan on a Sunday night that capped the rally.

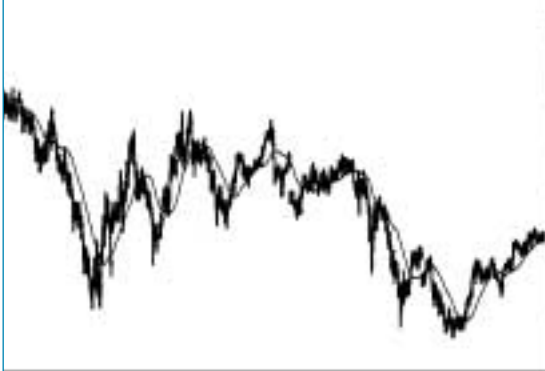
### Probably a plan to withdraw a few troops from Vietnam, or begin ping pong diplomacy.

Whatever. What I do remember is that I started the *Professional Tape Reader* at the end of 1971 and quickly found, by early 1972, that there was nothing to write about. The market had been drifting down since that April and absolutely nothing was happening. In desperation, I went down to the exchange floor, and started standing around the specialists'

Merck (MRK) weekly



Heinz (HNZ) weekly



Kellogg (K) weekly



Duke Energy (DUK) weekly



posts to pick up chatter. It was the sense of communicating that sense of being on the floor that made my letter a success. Which was lucky, because I didn't have much else to communicate; no stocks to recommend.

Then along came the Nifty-Fifty and the market exploded—for 8 weeks—and peaked. Then came 1973 and 1974.

**Which are definitely not recalled fondly around the Street. Are you predicting a replay in 2004?**

Not really, comparisons like that are really too facile. The markets were very simple then. That's the problem with looking at historical experience. The lessons we can learn from the Nifty-Fifty era or even from the 1929 Crash are quite limited. We've never had, in modern times, a bubble anything like the late 1990s. There's nothing of the same magnitude to compare it with, except Japan's bubble in the 1980s. And you know as well as I that a host of cultural differences probably mean Japan's bubble wasn't very comparable, either.

**That's arguable, to say the least. And we *did* have an enormous commodities bubble here, in the late 1970s.**

Yes, but there is no question in my mind that this is a much more complex global financial phenomenon than any of those.

**There's always a wall of worry, like the disappearing dollar and bottomless oceans of consumer debt, to worry about—**

Certainly, but there's an interconnectedness today and lots more layers of complexity. My sense is that it is just too soon for the aftermath of the bubble to be exorcised from the market. It is going to take time for it to work its way through. And if so, the Bush Administration likely gets re-elected—only to find itself in a very Herbert Hoover-like position.

**Yikes, Wall Street isn't discounting that**

So I can see a final leg coming in '05 and '06 that could be awful. Even dangerous to our well-being. Meanwhile, the China story is just as obvious as can be. Sure, it will have its ups and downs, its really big selloffs, as it gets going. But there is *substance* to what is happening in China. Its long-term prospects have got to be very powerful. It is just too big. Still, I cringe every time they talk about it on CNBC.

**And fan the speculation. The sleeping giant may really be awakening, Justin, but the question is whether any Western capitalists will be allowed to make a nickel on it.**

Well, they are very shrewd and their merchants are all over Asia, so they know what they need. And they have infinite patience, which none of the rest of us have. This is 100-year kind of thing. When I talk about Chinese stocks in conference rooms, I say, "These are things you buy for your grandchildren," and then they listen. That matters to them. If you say, "Here is a stock you should buy right now," they say, "Oh well, it has already tripled; I don't want to buy it now." Anyway, when I play with this China thing in my head a little bit, I start to see that what is missing now *in this market*, its drained-off substance, has gone to a different, younger, more vibrant place. No wonder we complain that we're only doing dribs and drabs of the things we did in our youths. Our markets really aren't like they used to be.

**You must really have had a melancholy start to the New Year!**

Not really. Despite my complaining, I know it takes just as long now for a top to form as it ever did. I know that stocks breaking a trendline is only a short-term signal. I know it's not until that is visible on the weekly charts that it's meaningful. Likewise, I know that for all of the yearend ugliness in Intel (INTC) and Texas Instruments (TXN) and KLA-Tencor Corp. (KLAC), they are not ready to go down in any meaningful way—because you can't see that terrible stuff on the weekly charts yet. It is just too soon. They are deteriorating, but that word is wonderfully Fed-like: imprecise in terms of time. This bit-by-bit deterioration can go on for months, so can this lack of substance; this lack of any underlying long-term investment thesis to believe in. The only way out of it—it is like a football team. You

don't come out of a 1-and-15 season ready to win the Super Bowl next season.

**Bad news, Giant fans!**

Everything has to change. They have to get rid of the bad players. In the stock market, you need some kind of enema.

**An elegant image, that.**

It's accurate. There has to be a cleanout, like the ones before the major turns, in the U.S. in 1932 and in Japan, in 1974, before you can start over again. That is what this deterioration is all about. The enema is still to come—but I can clearly see that it is not around the corner yet. Then there's the election, which probably pushes it off. But no matter which party wins, the enema almost certainly comes after the election—

**Why not sooner? You've got an awful lot of company in the everything-is-okay-til-after-the-election-camp.**

True, but the public is extremely confident and it'll take time for that to dissipate. The Fed has to tighten after its "considerable" time, whatever that means. And I expect the public will absorb that, at first, with surprising equanimity. So it will probably take a year for stocks to deteriorate overtly enough for people to start to recognize how bearish this is. Maybe longer. The market is often halfway down before most investors wake up. And the Fed isn't any more alert. By the time it starts to tighten, the market will have already tightened. The Fed is always late.

**So you see the market just drifting, until then?**

There really are almost no public investors left out there. Only some residual speculators who cling to the idea they'll do it right the next time. Some of whom even were reasonably successful in low-priced tech stocks last year, but they are now losing money in the Chinese techs, the SOHUs and the SINAs that were hot six months ago but now are not. Because they don't own the Chinese prosaics that have gone up instead. They are tech speculators; people who came into the market in the bubble days and in one way or another became addicted to the market. It is their opium.

**Tech junkies. Another wonderful image.**

Also a dying breed. Which makes it all the more interesting when wife, who is a retail broker at Merrill Lynch, comes home with a big brochure her firm has just put together on ETFs. All of a sudden, ETFs have hit the mainstream. After all, who wants to talk about mutual funds now? Clearly, over the next 2, 3, 4, 5 years, however long it takes, there is going to be an enormous change in the way brokers do business.

**The brokers have to love it. Every ETF purchase or sale is a commission-generating trade.**

Even better, they—or their customers—don't have to pick stocks. That is what works. Someone can speculate in the homebuilders or in the biotechs, without having to know anything about the stocks, even their names. This change is well underway in the institutional world. Now, ETFs are being marketed heavily to individual investors. And reported trading statistics will become even more deceptive.

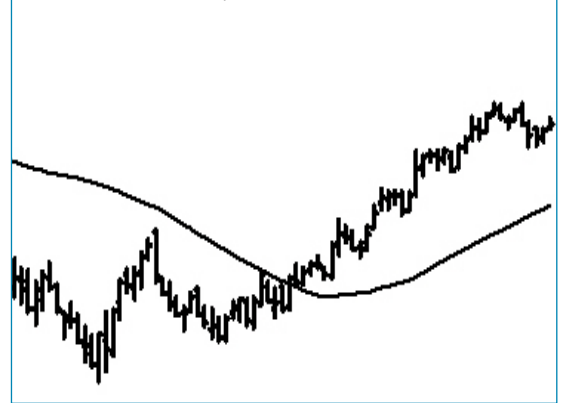
**In what sense?**

Deceptive because so much volume is involved in—"program trading" is such an abused term, means so many different things—but an enormous proportion of today's trades involve index arbitrage in one way or another. An awful lot of buying and selling activity is "ganged" and executed mechanically, automatically.

**And the resulting exposures hedged away, supposedly, in the blink of an eye.**

All the upstairs desks are arbitraging this stuff constantly, because they can do it for pennies or less. Or just for something to do, to look busy. But they never hold a position overnight.

Intel (INTC) daily



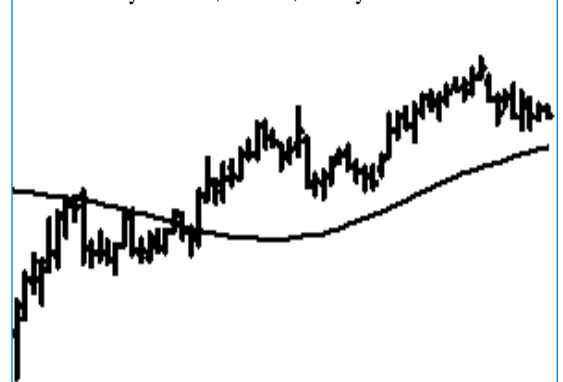
Applied Materials (AMAT) daily



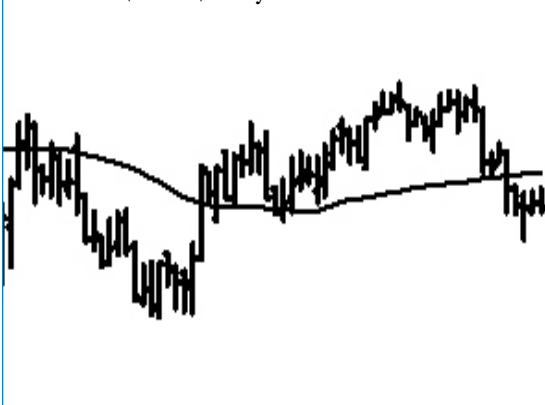
Dell Inc. (DELL) daily



Adobe Systems (ADBE) daily



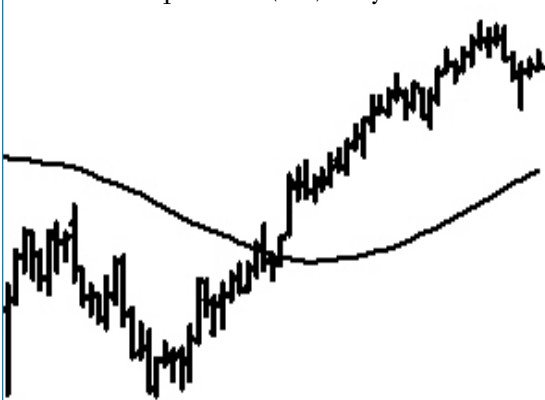
Wal-Mart (WMT) daily



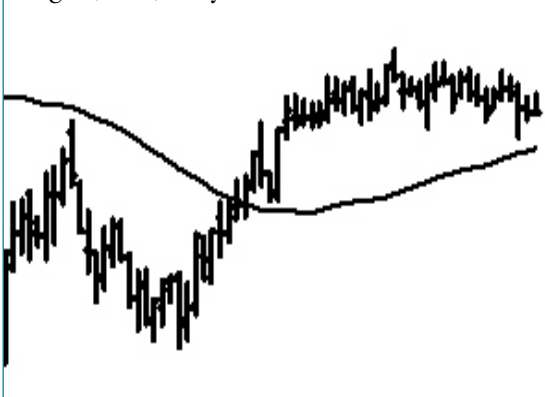
May Dept. Stores (MAY) daily



Federated Dept Stores (FD) daily



Target (TGT) daily



**Your complaint, then, is that there's too much volume and too little investment?**

That is fair to say. It sounds a little glib and superficial. But it's fair to say that very little Wall Street activity now has to do with investing. I could name only a handful of people who still are truly investing with three-to-five-year horizons. My favorite manager has been sticking with **Oregon Steel Mills (OR)**, up and down from 2 to 4 to 2 to 4 to 2 to 4. Now, at 6, he is right. But he has a capacity to endure, which is not run-of-the-mill anymore. The notion of investing is not what it used to be.

**The whole society is hooked on instant gratification, why should portfolio managers be any different?**

Good question. But I think it's more than that. The bubble changed the investment landscape in many ways, but one of the most significant is that an awful lot of experienced value managers retired. The portfolios they used to manage are now being run by a new generation, more specifically, by people who aren't at all used to acting like what you or I would call investors. Long-term is not their style. They weren't brought up in markets that rewarded patience or research. That's not what they expect to see.

**No, it's all about momentum and short-term trading, in their book.**

Right. Gains and losses, they understand. Being able to watch the market in the way everybody now watches it has only exacerbated this. You can't watch CNBC all day, while at your computer able to access all sorts of information, without "investing" moment-to-moment. Because the information you are feeding your mind *is* moment-to-moment. Maybe we shouldn't call it a problem. Maybe they are entitled to be this way. Who are we to be so prejudiced that "investing" is the right approach? We are not being open-minded.

**I'd stay on the side of "closed minds" like Ben Graham and Warren Buffett, thanks! But clearly, the market has been commoditized by all the program trading and is being reduced to a casino by this relentless focus on the short-term, instant gratification.**

The mentality has changed. The attitude now is that the stock market *is* Las Vegas, perhaps a classier Vegas, perhaps not. The bet is, "I'll buy and hope it goes up." And the shorter-term you are, the greater the sense of control you have. That goes for the professionals, too. Most of them learned one thing in bear market: not to hold onto positions. Now, they have a lot of lost ground to make up, and are determined to take profits whenever they have them. Another reason the climate has become anti long-term, anti-investor. I see it all the time in the questions portfolio managers ask.

**Such as?**

I've had a lot of questions in the last week or so about the homebuilders. The stocks *are* rolling over and topping out. But it is still a little early to act in most of the issues, so I've been careful in my answers. Probably turned off clients with long-winded explanations about the specifics in various charts. Their instant reactions have been, "Well, why can't I just short the ETF?" So I've given them some parameters. I'll draw a couple of lines and fax pictures to them. That's where their heads are. Everything has to be quick and dirty now; all the trading bunched into ETFs and programs, for pennies. It creates the illusion that breadth is overwhelmingly positive, but there's no investment substance to the volume. Then, if you step back and look at the stocks that have *not* been participating on the upside since, let's say, the first of December—or actually going down, like Applied Materials (which recently made a second lower high, below its peak of last June), you find there are dozens and dozens of stocks in that category. Despite the supposedly strong breadth and new highs in the indices.

**Telling you, what?**

Well, I know when I felt this way before: In '87 and in '99, when I got enormously frustrated, seeing all kinds of indications things were not good, yet watching the market go up and up. It got to the point that I walked around the house muttering. As my

wife points out to me, I get that way when a big trend is about to change. There is this enormous confidence out there now in the market. But everyone is grabbing piddling profits and running. There's no follow-through.

**No kidding. No one wants to hold a position overnight.**

They sell them at the end of the day. But what is the risk? A terrorist attack? The Fed is not going to act overnight. There is not going to be some kind of terrible economic number overnight. The risk in this game is that someone will take their 3 or 4 cents away from them. So there's also no volatility.

**Just a couple years ago, everyone was complaining that there was too much volatility.**

That was in the early stages of the bear market. Everyone was frantic to figure out how to deal with the bursting of the bubble, how to get out of stocks and how to make some money. The swings were huge. Now we largely see very tiny, and sideways, moves. Look at **Anheuser-Busch (BUD)**. The stock has hardly budged. Nobody cares. If someone recommends a stock, it will go up a point for the first hour and then trading will dry up. Don't get me wrong. This is not boring. But it is challenging. At least there are a few groups where something is going on, like the homebuilders, gold and the semis, to keep people calling me. But in the vast majority of stocks, there's just no interest. I bet if I walked into almost any trading room and asked, "What does **General Mills** look like today?" no one would answer. Half of them wouldn't even know what symbol (GIS) to punch into their machines to find out.

**Are you suggesting that this is a calm before a storm?**

Your question suggests to me that you're relying on some gut level experience that says the complacency and the confidence have gone too far, so they are about to be punished. I'd rather rely on the charts. What I see there, if I can put on blinders and just look at the charts, doesn't fill me with that sort of foreboding. I have always believed in the weak stocks getting weaker and the strong stocks getting stronger. So I am worried now about the weakness in certain areas and I am not going to worry about **Caterpillar (CAT)** or **Inco (N)**. Those stocks haven't had a correction, so when they do have a first correction, it will properly be called profit-taking and they will find buyers. They are not long-term vulnerable. But when you look, by contrast, at an Intel or Applied Materials or **Adobe (ADBE)** or **Dell (DELL)**—these stocks have not been acting well now for 6 weeks. They probably will violate some important uptrend lines that go back, not just to last October, but to last March, in the next correction. So that is where I can see some vulnerability.

**What about the housing stocks?**

What I see in the homebuilders' charts is that the group is somewhere in between those two extremes. The homebuilders have to make *very* large tops because they have had such a big move. This takes me back to the teachings of John Magee, who kept no indicators, no breadth numbers, no sentiment numbers. Just his charts. What he would do here is look at his charts and say something like, "The charts themselves are saying to me that I have an increasing number of rolling over, failing stocks." His basic philosophy was that weak stocks get weaker—and those are the ones that haven't rallied here, even as the Nasdaq has made new highs. The ones that have made second and third successive lower highs, I don't want to own anymore. But do I want to short them? That depends on how bad is the market going to be. How widespread the correction is.

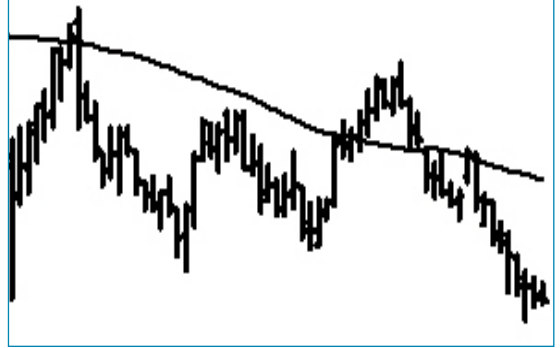
**What's your bet?**

I think we have to have a correction in the broad averages somewhere in here soon.

**Just because trees don't grow to the sky?**

That is pretty much it. Granted, it's the conventional view. But sooner or later, the coin is going to come up heads. The breadth oscillators, as I've said, would normally give us a warning, but they have been very unreliable in this market, except over the very short-term. So about all I can say with confidence here is that we *should* have a short-term correction, and that we are overdue for something on the order

Kohls (KSS) daily



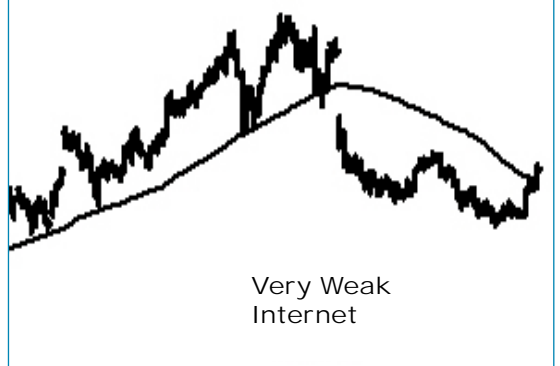
Sohu.Com (SOHU) daily



Sina Corp. (SINA) daily



Netease.Com (NTES) daily



of, not just 3-5%, but 10-15%. And in that case, the techs look like they'd be the weakest stocks, probably followed by many of the retailers: **May Department Stores**, (May) **Federated** (FD); you can see **Target** (TGT) and **Kohls** (KSS) weakening already. Wal-Mart would probably top the list. Of course, in a broad correction, my cyclical would also be vulnerable to profit-taking, but that would be their first correction, and it's unlikely that they'll violate any support levels. Their long-term moving average lines will still be going up. It is stocks that have been doing well that you'd want to buy in a correction, and there are just two groups that spring to mind. The solid electric utilities, like a **Duke Energy** (DUK), which has gone from 17 to 21 or something like that, comprise the first group. If it comes back to 19, you want to buy it. Then there's a **Merck** (MRK), which went from 42 or 43 to 47. If it comes back to 44, you want to buy it.

### Nothing else?

Well, the so-called laggards, the stocks that have been moving in some kind of basing way, are probably going to be okay. If we do get a 10% to 15% correction, they could look like relative strength stocks. If so, that would suggest to me that the market has changed. That the cyclical has probably peaked. They might have another run or two, but that would mean the parabolic part of their rise is over. And in that case, I suspect the market's interest would shift into "safe" stocks like a Merck, the electric utilities, probably things like a **Heinz** (HNZ) or a **Kellogg** (K). If relative strength still means anything, those will be the safe havens and the bond market will probably be in some trouble. After all, the bond market does not care when the Fed hikes. It knows what the next direction is. So the safe haven won't be going into bonds. What we're going to see will be asset allocation switches, lots of very short-term stuff. Which should tend to make this year into what I've called a transitional market. So don't count on any trend lasting too long. I firmly believe that we haven't had the final leg-down yet in the post-bubble bear market. So there is something out there that could really send this market into a one-more-leg-down, serious bear market. One that isn't over, overnight. What I am most reminded of is 1974. Like then, there won't be just one tightening. Which is going to depress the market immensely over a long time. It will probably have implications for the dollar and for gold, too. And you can't have the kind of market transition, with failures in the techs leading the way, without having a more serious and culminating bear market.

### Lasting how long?

Well, if the transitional market lasts through the

election—I am presuming that the Republicans win and that the transitional market of 2004 will likely feature a bout of optimism, as well as the correction I see in the not-too-distant future, what I expect to unfold after the election is the culminating leg of the bear market. Something that is very long term. Meanwhile, this is going to be one of those treacherous years when portfolio managers will have to be in the right places—and avoid the wrong places. I am not sure what the right places will be, but I would rather own three simple-minded stocks like Heinz, Bristol Myers and Duke Power than I would any tech or any retailer or any financial—especially anything to do with mortgages and home building. Or the stuff that has been very bubbly, like the Chinese stocks, especially the techs whose charts are now failing.

### You sounded pretty high on China earlier.

Very long term. But before they can really come on again, the analogy I would make is that they have to have their 1929. There has been so much speculation in the stocks, I wouldn't be surprised to see it. Just look at the **China Fund**. It is trading 65% above its net asset value—even though the Shanghai market is scarcely up at all. All the Chinese people are betting here on their stocks. They are not buying locally. The movement is global. Just like the interest in commodities funds.

### Care to single out any vulnerable Chinese stocks?

Well, **Sohu.com** (SOHU) and **Sina Corp.** (SINA) are the really obvious ones. And **Netease.com** (NTES). Also looking weak: **China.com** (CHINA), **China Yuchai** (CYD), **Bonso Electronics** (BNSO), and even **Aluminum Corp. of China** (ACH). By contrast, there were 8 or 10 Chinese stocks that exploded last Friday on the upside, all prosaics. But even those look extended and vulnerable. There has been a real mini-bubble in these Chinese issues—and this sort of action just has to be warning us that we're coming to an emotional peak in here. Plus, profit-taking is going on just like it was in early 2000. Nobody wanted to recognize it then, either.

### Just like the insider trading.

That's right. But portfolio managers keep telling me things like they can't afford to miss a move. That is the feeling you have when you get into this kind of gambling. You really, truly don't want to leave money on the table. You get too greedy. I can remember people taking that way in February and March of 2000.

### Enough said. Thanks, Justin.

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