



What a Week: Strange Bedfellows

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By Nick Godt

Crude oil hit a new all-time high this week and stock proxies continued to rally to within striking distance of their yearly highs. Looking strictly at the market headlines, one could easily assume that positive momentum will continue to drive both higher next week and (why not?) even beyond.

But one will continue rallying while the other is about to drop, according to Woody Dorsey, founder of Market Semiotics. "Oil is a strong market," he said Wednesday at a lunchtime presentation at the New York Palace Hotel. "It rebounds strongly after weakness."

Indeed, after reaching its all-time high in early April, crude oil first fell back toward the \$50 level before rebounding again. On Friday, the price of a barrel surged \$1.89 to \$58.47 in Nymex trading, topping its prior all-time high of \$58.28.

Stocks, on the other hand, are still "in the midst of a messy correction," Dorsey says. That appears counterintuitive if one considers that for the week, the **Dow Jones Industrial Average** rose 1%, the **S&P 500** gained 1.5%, and the **Nasdaq Composite** advanced 1.3%.

On Friday, the S&P 500 added 6 points, or 0.5%, to 1216.96, approaching its 2005 high of 1222, reached on March 4. The Dow rose 44.42 points, or 0.42%, to 10,623.07 and the Nasdaq gained 0.96, or 0.05%, to 2090.11, within earshot of key resistance at 2100.

But Dorsey expects the major indices to start declining sometime next week, then start selling off in earnest before hitting a low on July 12 or July 18. The ensuing rebound will last well into August, he forecasts. After this, stocks will likely fall "very, very hard" until another low in January, when **Federal Reserve** Chairman Alan Greenspan takes his leave.

If anyone is wondering why they should pay attention to what Dorsey thinks more than say, their neighbor, here is one reason: He had correctly predicted that stocks would start rising the week of April 20. Since then, the major averages have had a nice run. The Dow gained 6.1% from its 10,012 low, the S&P 500 is up 6.9% from a low of 1137 and the Nasdaq gained 9.8% from its low of 1,904.18.

Dorsey uses a methodology he calls Triunity Theory that, although it sounds like a new religion, is actually attracting increased interest from very conventional Wall Street powerhouses. Notably, the lunch at the chi-chi hotel felt like a spiritual spa for burned-out equity managers.

Asked about his presence at the presentation, a J.P. Morgan investment manager somewhat coyly admitted this was "a symptom" of today's tough trading environment. Investors want (traditional) hedge-fund style returns while major stock proxies will likely offer paltry yearly returns. You therefore have to beat the market by playing the short-term swings.

Anyone who's ever noticed the wide discrepancies between fundamental news such as, let's say, stocks rallying counterintuitively in the face of fairly bad economic news, is aware that something

else is at work. If you want to understand where the market is going, you need to understand the psychology behind it, or, as Dorsey says, "man is the measure of all markets."

His three-pronged approach therefore takes the temperature of the market's mood (psychologicals), mind (fundamentals), and body (technical).

One of the keys of Triunity Theory is sentiment. "Bad news is good news, if you want to buy," Dorsey says, in a purely contrarian fashion. A good example recently is to take a look at the soaring price of **General Motors** ([GM](#): NYSE - [news](#) - [research](#)) shares after its credit downgrade in March.

More recently, **Goldman Sachs** ([GS](#): NYSE - [news](#) - [research](#)) rallied 3.3% Thursday and 1.2% Friday after posting weaker-than-expected earnings. Of course, the Street had discounted trading problems at Goldman since early April and its shares had fallen more than 12% since then.

Conversely, it's time to sell at the height of enthusiasm over an asset. The real trick, of course, is to catch the right window of time to catch an upswing or a downswing. When he predicted that oil would come down from stratospheric levels in April, one of the main clues used by Dorsey was a headline in *The Washington Post* that read "What is OPEC smoking?"

Housing is also a strong market and still has some bright days ahead, according to Dorsey's indicators. There was little this week to dispel that view. On Thursday, **KB Homes** ([KBH](#): NYSE - [news](#) - [research](#)) reported stellar earnings and raised its outlook for the year. The report followed news that construction of new homes and housing permits rose slightly less than expected but remained incredibly strong in May.

According to Dorsey, housing and oil are part of a global trend he calls "repricing the planet," which amounts to a massive global land and asset grab. "This year it's still early for that bubble to burst," Dorsey says, although he's conducting a "slogan search" for a client to see if anything like the "OPEC smoking" headline could spell a near-term correction.

To buttress his argument that stocks will touch a high next week, he points to the existing enthusiasm over low inflation being near a climax.

Certainly, the bond market, which often plays the role of oracle to stocks, has started pointing this way since last week. The benchmark 10-year Treasury has fallen while the yield has rallied up to 4.07% from 4.04% last week and 3.8% after the weak employment report on June 3.

News that producer and consumer price inflation remained tame in May did little to counteract Greenspan's reiteration last week that the Fed would continue raising rates, presumably to stay on top of future inflation.

Bonds have had their fill of tame inflation news lately. More of the same this week failed to spur additional buying enthusiasm for the benchmark 10-year note, whose yield had fallen below 4.0%.

And oil, past a certain level, which Dorsey pegs at around \$60, will be again perceived as eating into growth. On Friday, the market cheered news that consumer confidence, as measured by the University of Michigan, roared back past expectations in June; the decline of gasoline prices over the past two months had clearly played a role.

But the market will likely use these factors simply to rationalize the next move downward that's destined to happen, Dorsey says.