Financial Trends: Why the Bad News May Not Matter

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I receive dozens of emails a day from readers and it is interesting to see how the questions change over time. Right now a lot of people are worried. One thing that is standing out a lot is people asking about news items. For instance going into last week I had someone email and ask about the earnings for airline stocks. They wanted to know if they should buy or sell because of the earnings. How to game the news so to speak.

This is something I do not do at all. I don't base buying decisions based on news items and certainly not ahead of them. Usually if you react to a news item the news has already been priced in by the market so you are putting yourself way behind the curve. As far as trying to game the news I simply can't predict what an earnings report is going to be or what the economic news is going to be either. All I do is figure out what the trend is and try to ride that trend for as long as possible – and do my best to realize when it changes.

If you watch CNBC or read the financial press though you get bombarded by news and opinions. It can prevent you from sticking with the trends by putting unnecessary fear into you. For instance a lot of attention is put on the employment numbers. Going into employment numbers the reporters will say the the market is waiting on the numbers and if they are bad it might dump. They say something like that so you get scared to act. Then the news is bad and the market goes up anyway.

The important thing is always the trend of the market. Not the news. News can be bad and the market can go up nonetheless.

We are through the first big week of earnings reports from corporate American and over half of the companies that have reported so far have missed their earnings estimates. 50 of the 92 companies in the S&P 500 that have reported have missed, while many of these companies have refused to give earnings forecasts for the rest of the year.

56% of the companies that have reported have shown a drop in sales from a year ago. This is the sixth quarter in a row that earnings have shrunk – a run of quarters not seen since 1951.

If that news isn't bad for you how about this. On Friday the government is going to release 4th quarter GDP numbers. They are expected to post a decline of 5.2%. That would be the worst quarter for the US economy since 1982.

Well with all of this bad news you would think the stock market would be in total collapse, but it isn't.

You see the market has already been dropping into all of this bad news. It fell over 10%

from its January high in just the space of a few weeks.

Last week the S&P 500 held the 800 level and bounced of it on Friday. Earlier this month I had been looking for the market to fall below this level and bottom nears its November lows – but last week's strength suggests that it might be bottoming right here. If that's the case then everyone who has been selling because the news is bad is going to be left behind when the next rally really gets going.

It all has to do with the trend of the market. The easiest way to identify a trend is to see if the market is making higher highs and higher lows. If so then you have an uptrend in progress. Now if you have lower highs and lower lows in progress then you have a downtrend going. I talked about this last year in a video I put together about using this type of trend analysis to figure out where to place stop loss orders. You can watch it here.

It also helps to see what is happening in multiple time frames to keep your mind not only on the big picture, but what is happening right now too.

Let's break down the broad market and see what is happening.

For over a year now the stock market has consistently been making lower highs and lower lows on daily, weekly, and monthly charts – the textbook definition of an overall downtrend. In fact it has been a brutal bear market.

The last lower low was made in November. After that low the market rallied into the beginning of January and then made a peak. It has since fallen to the 800 S&P 500 level. If 800 marks a bottom then the market will have made higher low – which is a sign the trend may be changing. The odds would then favor the market going through its most recent high January high to make a higher high.

That would not necessarily mean a new bull market is in order, but would suggest the trend for at least the first half of this year would be up – we should expect a rally up to the S&P 500's 150 and 200-day moving averages.

Now will 800 hold? Let's look at the short-term chart and apply this type of analysis to it:

For the past few days the S&P 500 has been locked into a trading range of 840-804. I believe that its move out of this range will define its next big move. So if the S&P 500 were to close below 804 I would take that as a sign that a retest of the November lows is likely, while if it closes above 840 I would take that to mean that the short-term downtrend that has been in place since the beginning of January is over.

After 840 the next resistance point is around 860 – this is the point of the S&P 500's last peak on its hourly chart made on the 15th and represents a 1/3 retracement level of the January high and 804 low. If that gets taken out then I would take that as confirmation that the market is now in an uptrend on the hourly chart – one that would also turn into an uptrend on the daily chart.

The daily stochastics for the S&P 500 – and the DOW and Nasdaq for that matter – are oversold. The S&P 500 has held the 800 level in the face of some very bad news the past few days and has based on its hourly chart. If it closes above the 840 level it will cause the daily stochastics to give a buy signal.

To sum up if the market does not break 800 in the next two sessions I expect it to rally and turn up. The daily stochastic would generate a buy signal. I would also expect such a rally to fully go through the 950 level on the S&P 500.

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