Which Way Will the Market Break?

U.S. equity markets continue to be range bound but hold above the all-important 200-day moving average at 3000 (S&P 500). I read over the weekend that there remains a record amount of money in cash via money market accounts. The belief among the "experts" is that this is evidence that the rally off the March 23 lows was mainly the result of short covering as those traders who made money betting on stocks to go down began taking profits and covering their positions. This activity by professional traders causes the share price of equities to go up as the traders buy the shares that they had previously sold short. If there is a great deal of "short interest" and stocks begin to rise (or even appear to have bottomed), the act of taking profits by buying the shorted shares can cause the market to move up rapidly. The more short interest that exists, the more explosive the rally can become. We certainly saw a lot of people betting that the market would continue down in the middle of March and we have certainly seen an explosive rally since. The idea among the pundits who have examined this is that the rally has run out of steam and we are headed for another leg down since no new money is coming in to move prices higher. This may very well be true, but I can think of another possibility.

What if some good news suddenly shows up and the market does begin to move higher, even if on low volume? Well… I will tell you what might happen. All those people who are parked in money market accounts, and have missed out on a huge move up in stocks are going to feel pressured to move that money back into stocks, lest they miss out on even more upside. This is the primary problem with jumping out of the market and going to "cash". It is awfully hard to know when to get back in. This record amount of cash sitting around out there represents a lot of people, professional and otherwise, who are in this predicament. If the experts are wrong and the market does break out higher, look out for a potential move much higher as the pain of sitting out becomes too great and people are forced to buy stocks.

So, which way will the market break? That I don't know ,but as long as the broad indices hold above their 200-day moving average, the chances are better than even in my opinion that it breaks up. If that happens, we are going to see a lot of people chasing a fast-moving train.

Last week's market commentary can be found here.

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