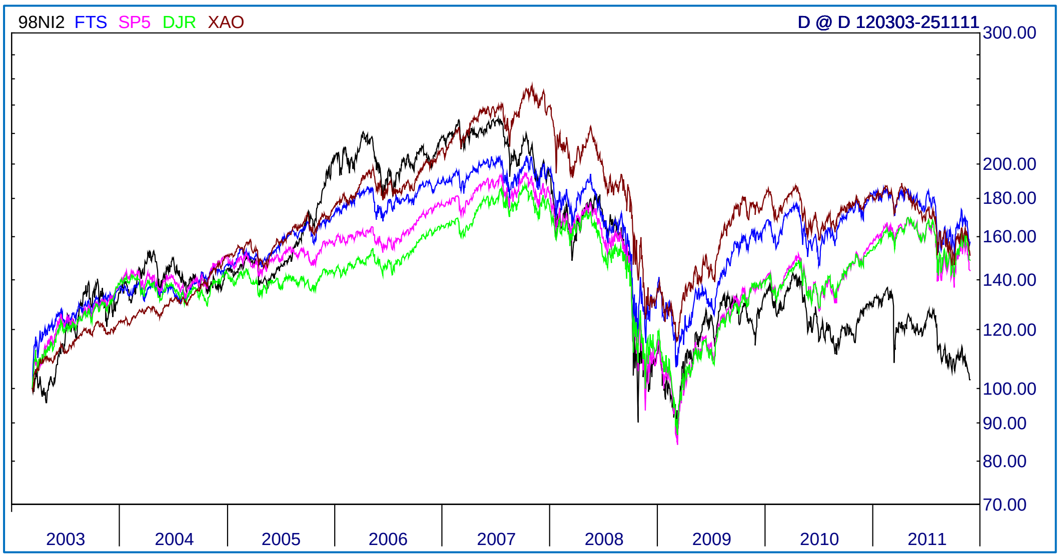
Macro View of the Main Overseas Stock Markets

This article was written in November 2011. The general ideas still hold true, though I have since made modifications in the posts on the members website.

I am always a little surprised at how many investors and speculators I talk to seem to be heavily influenced by what is happening overseas. On the one hand, we cannot ignore what is happening in the world economy and our stock market seems to be affected by what happens overseas. That is for sure. The major markets do tend to roughly fluctuate in tandem. The chart below shows the DJIA, the ASX, the US S&P500, the FTSE100 and the Nikkei225 indices:



The indices have been rebased to 100 on 12 March 2003. The black line is the Nikkei 225 index. The blue line is the FTSE100 index. The red line is the US S&P500 index. The green line is the Dow Jones Industrial Average. The brown line is the ASX All Ordinaries index. The chart is up to last Friday 25 November 2011.

It seems to me that there two interesting similarities about these market benchmarks:

1. It is fascinating how often it is that they all fluctuate up and down at around the same time. I am looking at the synchronicity here, not the extent of the moves, which can vary greatly at times.
2. Although the indexes were rebased to 100 at the start, they do not greatly differ at the end of this chart, except for the Nikkei225 index, which is very weak of late.

It is important to note that point two above is highly dependent on the starting date. By careful choice of the starting date the numbers may be tortured to confess anything we want. By choosing the start of the bull market before the current one, our prisoner is singing the particular song that suggests more similarity than is the case at other times, even on this chart.

It should also be kept in mind that the other two major indices that I track: the Nasdaq Composite and the Shanghai All Ordinaries are not shown here and have moved at times far differently.

I will leave this point here. The key thing to take away is that in the short term at least there is some synchronicity in the timing of the swings in these markets.

Now return to the other issue of why so many Australian investors and speculators seem obsessed with overseas markets. After all, their task is to invest or speculate in the Australian Market. If we accept that all the markets that are important to us move together, joined by a rubber band, this is only interesting background information for our market.

In my opinion, speculators can generally disregard overseas market movements. Their effect will be obvious quickly on our index and stock charts, triggering buy and sell orders as necessary.

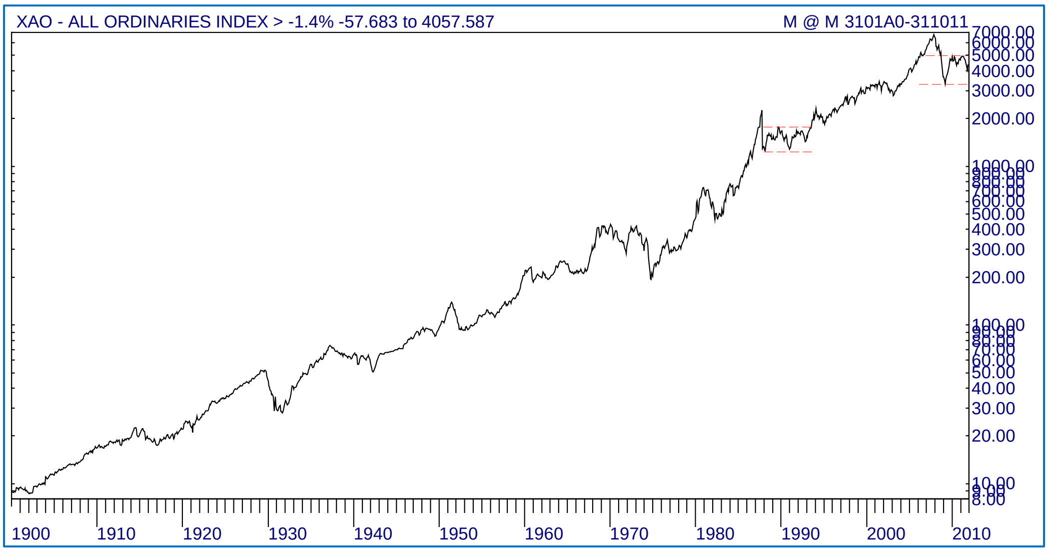
I also take the view that investors should make market exposure decisions based on the Australian market index chart.

Decisions to buy or sell individual stocks by Australian investors should, in my opinion, be based on their price charts. If they give a buy signal, we research them and decide whether to buy. If they hit a stop, we sell them. In my experience, trying to finesse buying decisions by reference to overseas markets or the market index is a good recipe for missing opportunities, because we judge a stock chart on the basis of what is happening in or about other stocks or markets. Before buying a stock, we should have already set our market exposure strategy from my three tools described in detail in my book *Building Wealth in the Stock Market*. If that strategy calls for buying stocks, the decision to buy any stock should be driven entirely by information about that stock alone.

Even more dangerous is the attempt to finesse stops that have been hit based on an optimistic view of the market index. This is guaranteed to increase the losses made by delaying action on something that has gone wrong with a stock because other stocks do not exhibit that problem. It just does not make sense to me.

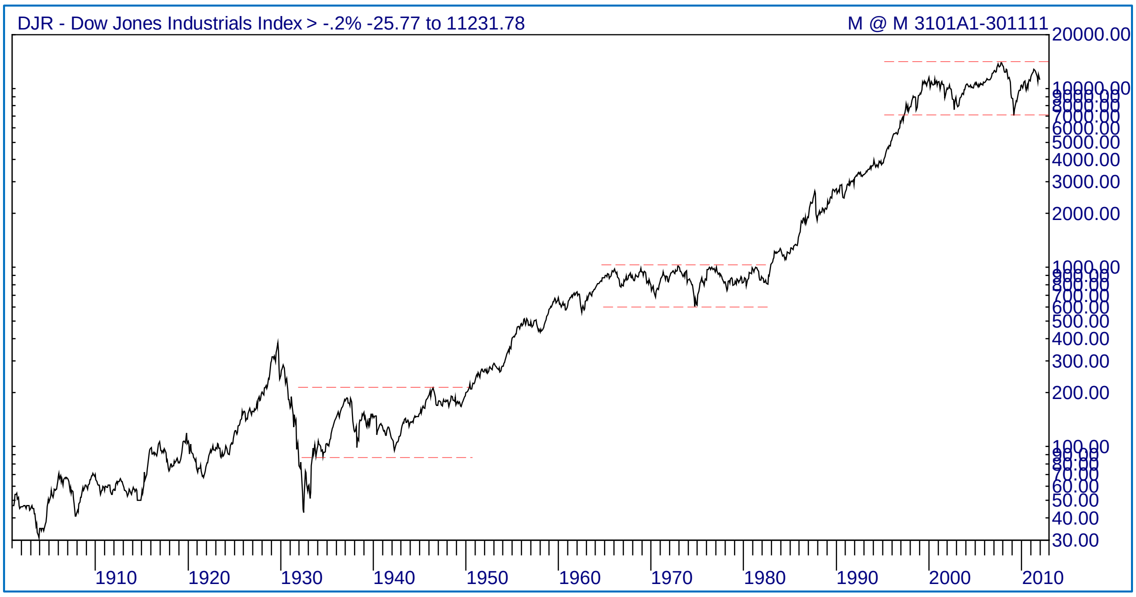
I will now climb down off my soap box and take a look at individual overseas markets that I follow. I am not going to analyse them in detail. What I want to do is to look at some of the larger, or macro, patterns.

The ASX All Ordinaries index



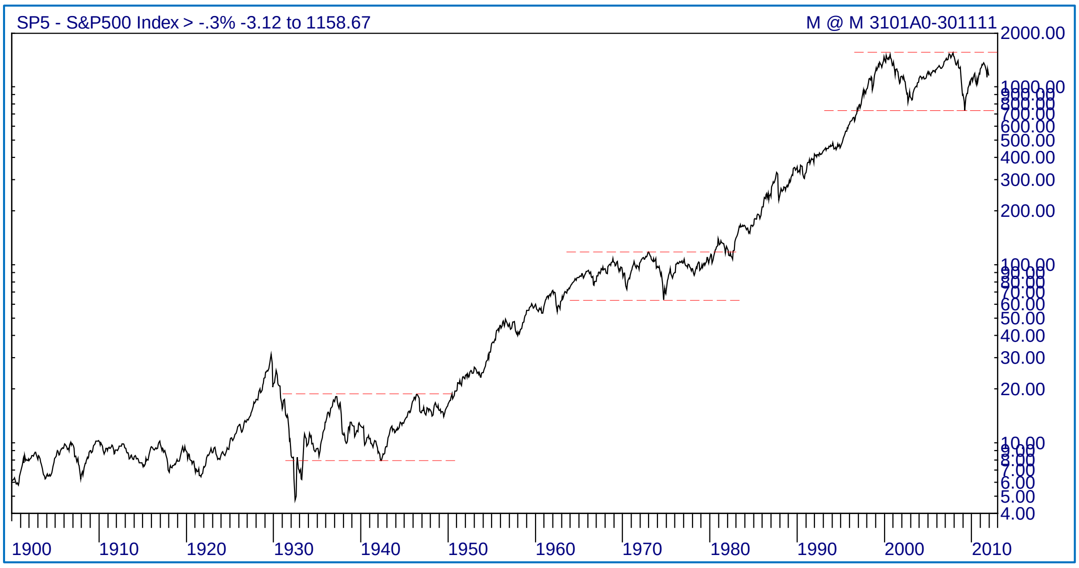
In free newsletter 116, I pointed to the apparent similarity between what is happening after the last bear market and what happened after the last bust of a debt-driven boom in 1987. One thing to note, though, is that I struggle to find any other examples of this price action on the long-term chart. Yes, there are other sideways patterns, but the only other one I would be inclined to include is the 1970s. I will not discuss this chart further here.

The Dow Jones Industrial Average



This chart, like the chart of the ASX on the previous page, covers just over eleven decades of the Dow Jones Industrial Average. I have marked on it three periods when the market went basically sideways for many years after a long bull market. The similarity between the period centred on the 1970s and now is most strikingly similar. I marked in the 1930-1940s period out of interest because it was vaguely similar. However, the plunge from the 1929 top was an extreme event and the similarity to the two later periods is less satisfactory. What seems to me as being arguable is that the US market works off the excesses of its major booms in long sideways patterns. The swings within those sideways patterns have so far been quite extreme, some falling up to around 50% from the high point. If this thesis is valid, there is a case for fearing that the present sideways trajectory may have more time to run.

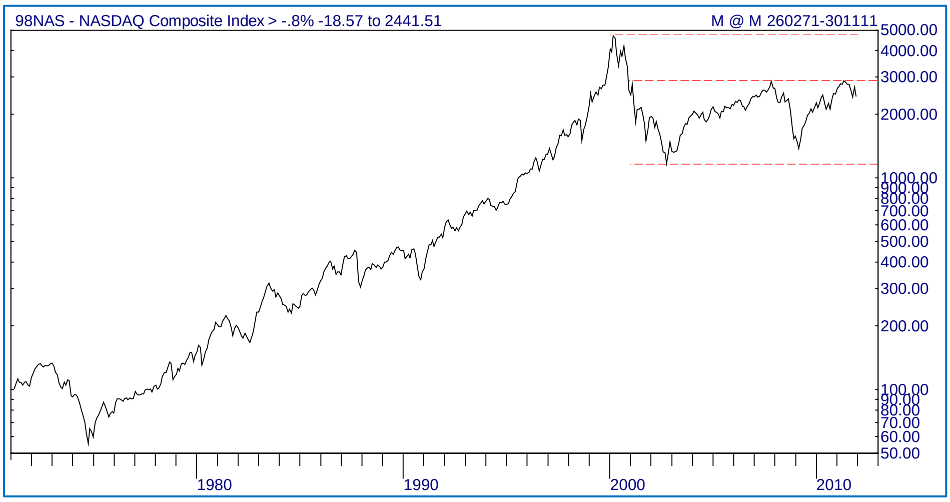
US S&P500 index



The same three patterns are, not surprisingly, obvious on the S&P500 chart. However, there are some subtle differences which I will leave members to discover and ponder. I don't think that the differences are material in terms of the prognosis that the present sideways pattern may continue for some time.

That said with respect to both the US charts that we have just examined, the thing to stress is that this is a very big-picture view and the swings within the patterns allow great scope to profit from them. Indeed on a micro scale, they are individual bull and bear markets.

Nasdaq Composite index

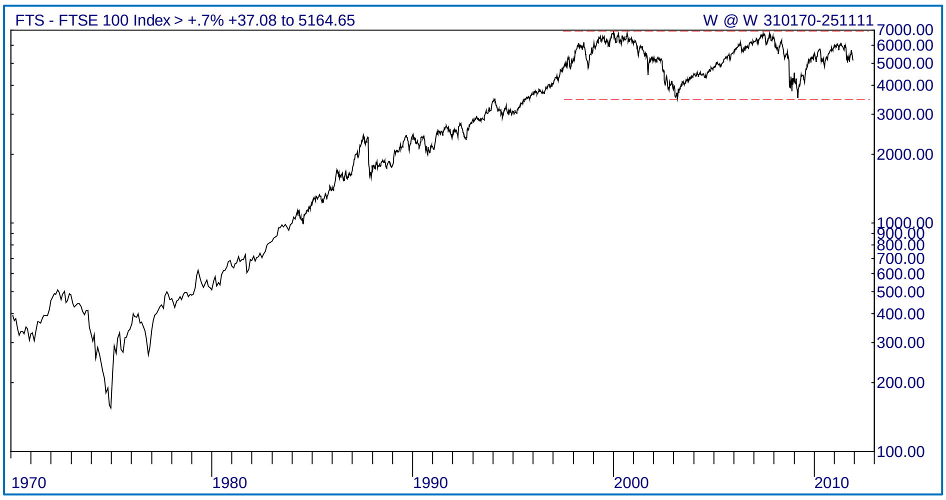


I only have data for Nasdaq going back to 1970. This limits the historical parallels available. However, with respect to the 2000-2011 top pattern after the huge boom in technology to 2000, there are two possible interpretations of what is happening:

1. The obvious one is that the Nasdaq is forming the same pattern – a big sideways pattern – as the DJIA and the S&P500. I would favour this view, which is why I have a line out from the 2000 peak.
2. Nevertheless, the Nasdaq is not, so far, as close to that pattern as would make me very comfortable. What is happening is suspiciously like the pattern forming on the Australian market: A pull back to just above half the big bear market fall followed by a sideways pattern between that high and the bear market low.

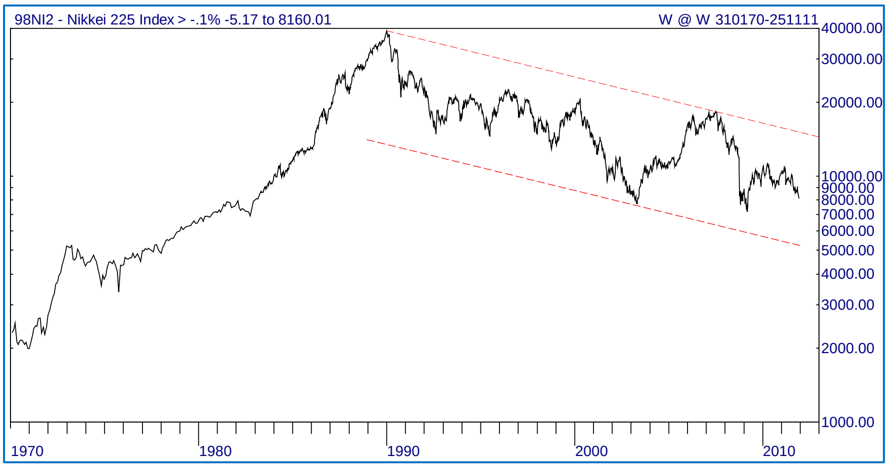
The problem here is that any fool can draw lines through one or two points. It is not until the subsequent price action continues to roughly respect those levels that we can gain greater faith in them. So, for all three US indexes, what I am suggesting is that readers take these macro possibilities into account in their analysis.

FTSE100 index



Again, in this market, I am hindered by lack of data prior to 1970. However, there is a quite remarkable similarity in the pattern post the 2000 top on this chart and the US S&P500 chart. I feel that this macro view is worth keeping an eye on. There are strong levels of potential support and resistance already set on this market chart.

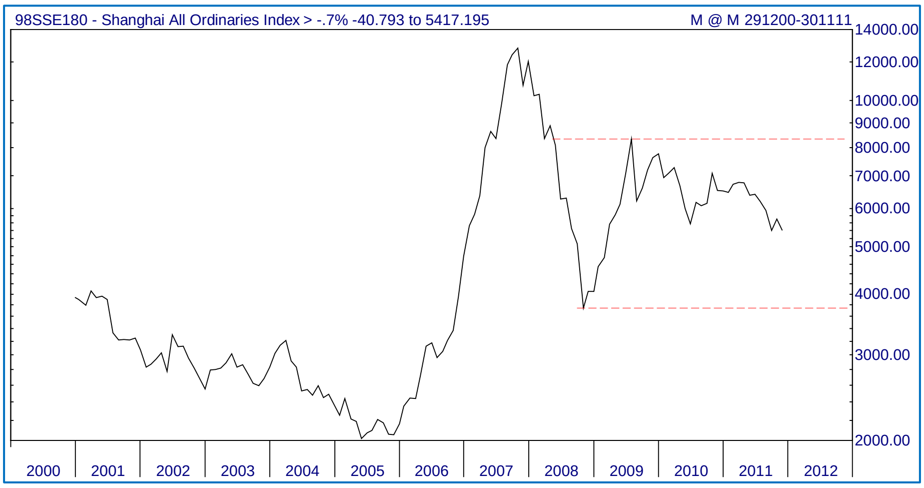
Nikkei 225 index



The Japanese market is running a race of its own. Although it tends to swing up and down in time with the US and UK markets in the short term, the macro view could not be more different. As marked on the chart, the Nikkei 225 index is tracing out a long bear market that has already run for over 20 years from the 1990 top.

The really uncomfortable suggestion from this chart is that for us to sustain the mantra that stock markets always rise in the long term will require a very long term view in the Japanese market. This must give pause to the buy-and-hold great stocks or index fund approaches to investing. The only way to have prospered as an investor in the 1990 to 2011 period will have been to invest on a market timing approach – the most difficult part of the investing craft.

Shanghai All Ordinaries index



I am hampered by even less historical data in this young market. I have marked in two lines suggestive of a similar pattern to the Australian market. However, these lines are each drawn through only one point and must be seen as highly speculative. I ask myself whether I am finding what I might think should be there.

Really, we cannot deduce anything from this chart until it has respected those lines or set in place some other key levels.

Conclusion

I hope readers may gain some insights from this macro view. I think that these charts are well worth following. Since most of the members of my website will not have this data, I intend to publish these charts at the end of each month in a new file on the members' website.

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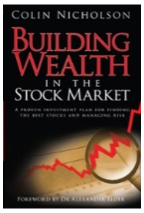

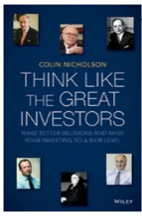

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