Is This a New Bull Market?

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A month ago when this rally began most people were skeptical, but now all anyone is asking is how much higher will the market go? It is still down for the year, but now almost everyone is looking for the rally to continue from here – with many thinking this may be the start of a new bull market.

Many people are wondering whether or not this is the start of a bull market and whether they should buy now. Most guests on CNBC have been gushing over the market rally and some of the recent earnings reports.

My view is that it is one thing to try to play a rally like this but another thing to buy into it as an investor who wants to buy and hold.

In no way do I think it is time to start to do that yet.

Let me show you why.

One thing that has characterized the market the past few months is extreme volatility. You know this yourself from the wild swings we have seen in the market, but it also shows up in several key technical indicators that I follow closely. For instance the VIX, which measures the premium being paid for volatility in the options market, has been trading above 40 all of this year – something that is has never done for such a long period of time before.

At the same time the 200-day Bollinger bands, which measure the long-term volatility in prices(the bands contract when the intraday volatility in a stock or index shrinks and widens with greater volatility) have remained at an extreme distance between one another.

Both of these indicators are trading at levels not even seen in the last bear market.

When this bear market comes to an end these indicators will move back to their more normal levels. In other words the extreme volatility in the market will begin to dissipate.

Stocks will enter a trading range and at some point simply drift.

Heightened volatility is typical of a bear market and once bear markets end markets tend to go through what I call a stage one basing process which paves the way for a new bull market. During this time on the charts the 200-day Bollinger bands come together while the 150 and 200-day moving averages flatten out as the market trades around them for months.

Once this bear market comes to an end I expect we'll see a sharp rally in the market and then 6-12 months of stage one consolidation that builds the base and technical patterns needed for a new bull market.

A lot of people are thinking that this is the start of a new bull market or a rally that will last for months. I'm still bearish on the market and believe we won't see a real bottom until next year, but right now I want to give the bulls the benefit of the doubt. There is nothing certain in the stock market and if you want to make money in the market you always have to be open to changing your opinions and consideration of the other side of the story.

If this rally represents the end of the bear market I would expect the market to perhaps rally a bit more over the next 4-8 weeks, but then to make a major top and dive down to at least give up half of its gains on this move or even to fully retest its March lows. It would then bounce back up and enter a trading range for the rest of the summer – and maybe even into the end of this year. It took a full eight months of base building after the July 2002 stock market bottom for the stock market to enter a bull market and with volatility even more extreme this time it may take even longer for the market to enter a new bull market if it bottomed last month.

In other words after making a peak somewhere over the next few weeks I would expect that top to represent massive resistance for the stock market going forward – it will represent a major resistance point for the stock market for the rest of the year no matter whether the market has put in a bear market bottom or not.

In the most bullish of scenarios the market would simply enter a trading range.
What this means for you is that there is no need to buy stocks now with the intention of buying and holding for a long time. You would be better off to be patient and to see what happens once the current rally comes to an end.

Watch what happens on the next correction – will volume pickup or dissipate? Will many stocks participate in a decline or will many sectors and individual stocks simply hold up and display a powerful positive divergence from the market and hint that a healthy consolidation phase is indeed beginning?

The market will tell us over the next several months whether or not this is the start of a new bull market or just another bear market rally. If it is going into a base building phase then I would look to be a trader for several months of tops and bottoms with the view of eventually buying for the long-term sometime next year.

One good thing is that such an environment would probably enable a few sectors to go up into new bull phases ahead of everything else. Gold would be the primary candidate to do this since if the market did bottom part of the reason would be the money printing on the part of the Fed.

Now I say all of this thinking that this is just another bear market rally myself. I just wanted to talk with you about the other side of the story today and what would happen if the market had indeed put in a real bottom – some of the things to look for that would prove it to us and some ideas on how money would be made going forward.

There is no need to simply assume the market has bottomed and throw money at in in a desperate gamble. The market will tell show us when a new bull market will begin and provide a good safe risk to reward entry point.

Right now it is doing neither for buy and hold investors and that's the straight dope.

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