Bull Market in Stocks Remains in Place: Dow Theory

Thursday's selloff on Wall Street pushed the S&P 500 Index (which tracks the price performance of the stocks of 500 of America's largest companies) into negative territory. All four of the widely-watched indexes — the Dow Jones Industrial Average (DJIA), the S&P 500 Index (SPX), the Nasdaq Composite Index (COMP), and the Russell 2000 Index (RUT) — dropped the most on Thursday since February 8.

Dow Theory followers were more focused on the Dow Jones Transportation Average (DJT), as it came perilously close to triggering the last of three indicators needed to declare that the Bull Market in stocks is over.

Ironically, the Dow Theory, developed by Charles Dow, the founder and first editor of the *Wall Street Journal* and co-founder of Dow Jones and Company, was never used by him to trade stocks. But followers of his theory are legion, which could spell trouble for the market if that third indicator turns red.

Mark Hulbert watches the market watchers and regularly publishes their results in his *Hulbert Financial Digest*. And he noted back in early March just how close those three indicators were to calling the end of the bull market. The February declines in the DJIA and the DJT were "significant" — more than a 10-percent decline from their previous highs. That put Dow Theory watchers, including Hulbert, on alert.

The rebound in those indexes was significant, but not enough to cancel out the early warning. Dow Theory went from yellow to orange.

The declines on Thursday came close to breaking through the early February lows and, according to Hulbert, the critical levels — 23,860 on the DJIA and 10,136 on the DJT — have not yet been hit. If those levels are breached, either on Friday or in the days to come, the spectacular bull market that began in March 2009 would then officially be over.

As this article is going online, the DJIA is trading just above 24,000, a scant 140 points (or one half of one percent) away from that level, while the DJT is trading just above 10,350, or 215 points (just two percent) away from turning Dow Theory from orange to red.

This is important to market watchers and market timers for at least two reasons: First, Dow Theory has outperformed the traditional (buy, hold, and pray) style of investing in stocks by an astonishing 4.4 percent per year going all the way back to its early days.

The second reason may even be more important: If Dow Theory issues a "sell," then sellers are likely to unload significant positions and wait for the next "buy" signal before reentering the market. Although most investors buy and hold for the long term, a Dow Theory "sell" could give them some significant heartburn as the market decline gains momentum. Those who believe that the markets are overvalued focus on stocks that not only return to their historical level ("reversion to the mean") but often overshoot to the downside. Some predict that, once Dow Theory issues a "sell," that overshoot could take stocks, and their popular indexes, down between 20 and 50 percent.

For the moment, however, according to Dow Theory, the market remains in its current bull phase.

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