NED DAVIS RESEARCH INSTITUTIONAL HOTLINE
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STATUS OF BUBBLE OF 2000 VALUATION EXCESSES

So far so good on our bullish trading strategy with the Dow now up six straight weeks! Nevertheless, my ***Hotlines*** on November 8th, 11th, and 13th argued that all the excesses from the "Bubble of 2000" had not been corrected, and, thus, we most likely remain in a secular bear market. For that reason, I have a stop-loss on the trading strategy at 855 on the S&P 500.

To get a lot more bullish or turn bearish I am watching Big Mo's Tape, now at 46.1% bullish. Above 72% would be very bullish. Below 45% and lower than five weeks earlier would be bearish. Right now the indicator evidence is neutral but improving.

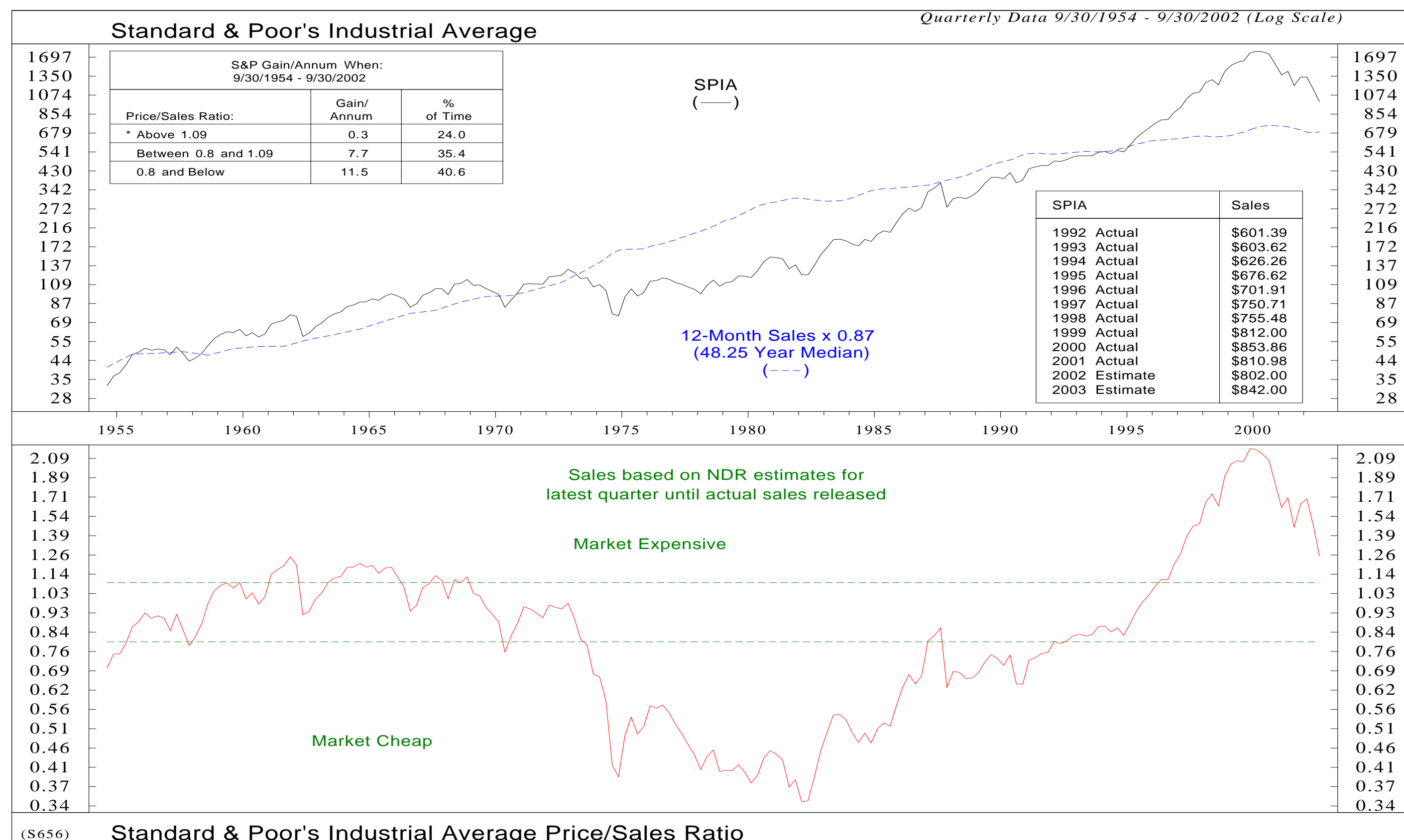
One of my favorite pictures to illustrate the "Bubble of 2000" is our chart S702 which compares the value of all U.S. common stocks to the value of GDP. The reading at the end of October was 92.5%, which is 39% above the mean since 1954 of 66.5%. If we substitute the S&P 500 instead of all U.S. common stocks, the ratio to GDP is 77.9%, still 17% over the mean since 1954.

Nevertheless, this chart and concept have come under heavy criticism. The main complaints were that many of our stocks do business in the global economy and, thus, it was not fair to compare them to U.S. GDP. The second complaint was that we now have many more listed companies, which could distort the stock market value numerator upward. I tried to solve the number of stocks problem by just using the S&P 500 market value (as noted above) which always has 500 stocks, but I was told even that was unfair since S&P 500 companies had gone on a huge merger binge meaning that the 500 are now much bigger companies than in the past.

Yet, I continue to view the chart as valid. The reason for this is shown on chart S656 below. This tries to do the very same thing as S702, which is really a price/sales ratio for all stocks using GDP for sales. The chart below is the price/sales ratio for the S&P Industrial Average. It gets around all the criticisms by comparing apples with apples -- S&P Industrial companies versus their sales, whether in the U.S. or globally. The S&P Industrials closed Friday at 1043. The latest four quarters of reported sales are $783.02, but I think revenues for the year will likely be around $802. That will be two straight years of down revenues, but I would hope that a solid 5% growth next year could bring revenues to $842. That leaves the S&P Industrials at 1.33 times latest four quarter sales, 1.30 times our year-end estimate of $802 and 1.24 times next year's hopeful estimated sales of $842. When we compare a ratio using **next year's estimate** to the median of .87 since 1954, we are 42% above that average, which is almost exactly in line with the reading of all stocks versus GDP.

My conclusion is that my bullish trading strategy must be put in the context of a still-risky secular background. Thus, I would continue with a stop at 855.

--Ned



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