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Commentary

Market Opinions and Topics of Interest

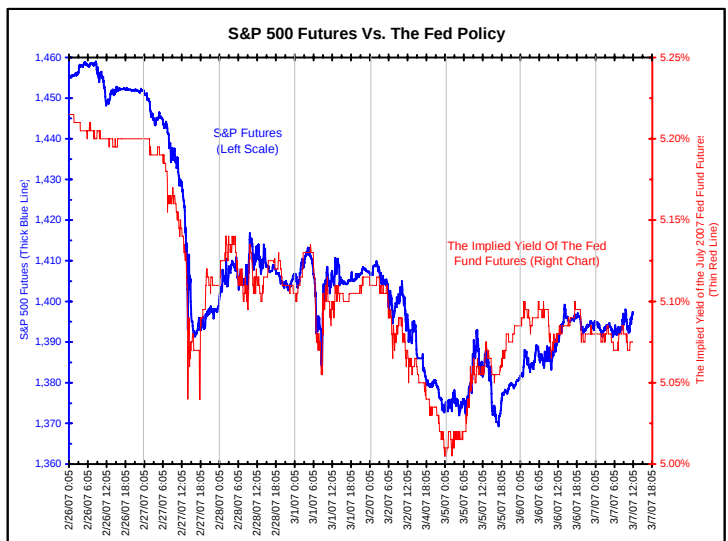
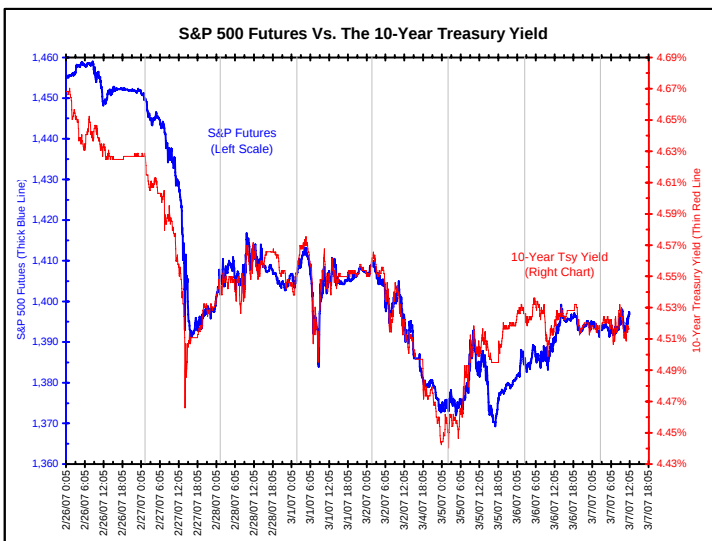
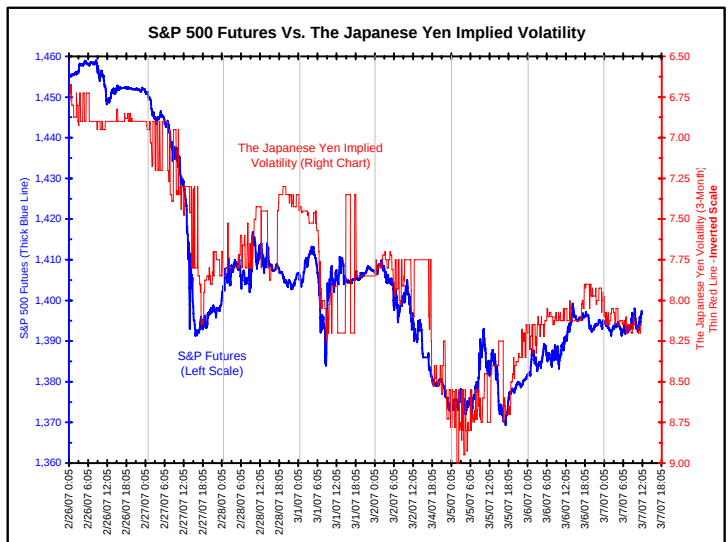
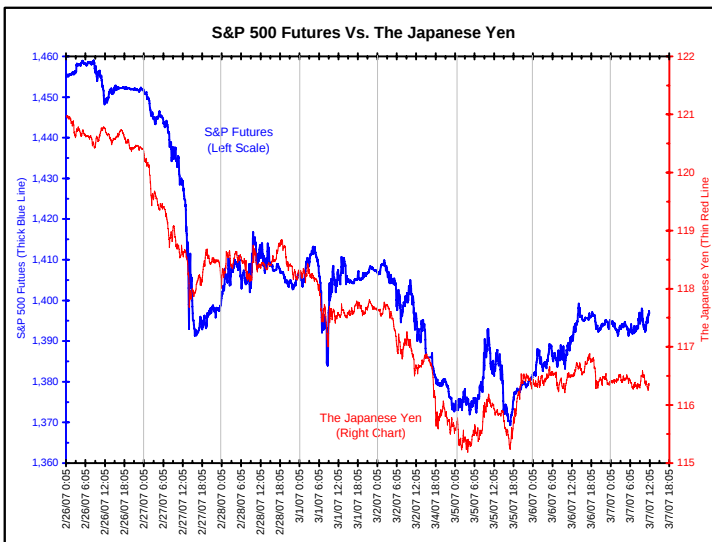
By James A. Bianco (847) 304-1511

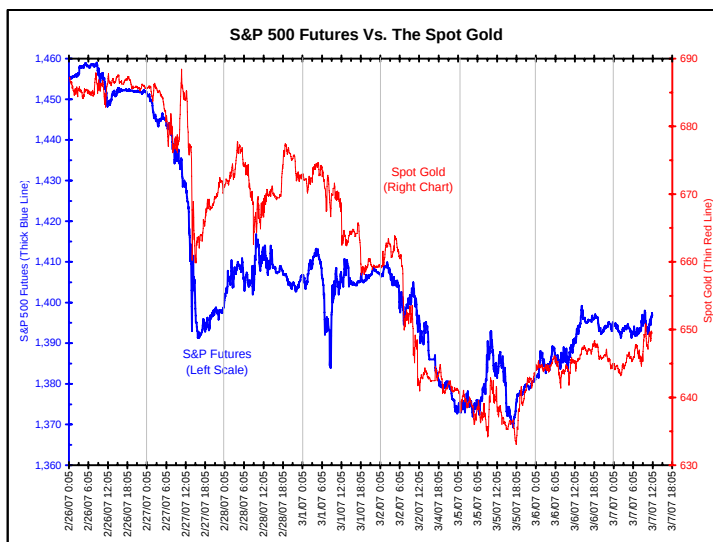
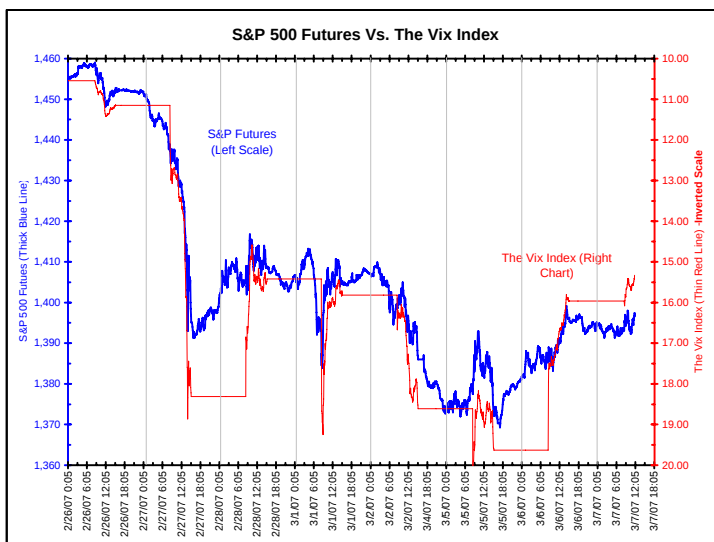
March 7, 2007

We're All Stock Traders – Part 2

In [Part 1 of this Commentary](#) last week we showed how the S&P 500 was correlated to credit, emerging markets and implied volatility over the last few years. We suggested that most markets would follow the

S&P 500. In the series of charts below, we show that this relationship applies down to the minute over the last week.





The series of charts above are five minute plots going back to Monday, February 26, the day before the 3+% drop in U.S. stocks. The blue line is S&P 500 futures (it trades nearly 24 hours versus 6 ½ hours for the cash S&P 500). The red line shows various market and volatility measures overlaid.

What becomes clear from all these charts is everything has been moving in lockstep with equity prices since stocks broke last week. Of course, one could argue that everything is moving in lockstep with, say, yen volatility as well. Since correlation does not imply causation, we have to look beyond the statistics to find causation. In a [Commentary](#) last month, we took a detailed look at stocks in this light.

[T]he stock market heavily influences the economy and the deficit, it also influences interest rates as never before. This results in both interest rates and stock prices moving up and down together, in defiance to what most were taught in business school.

Most are having a tough time accepting this relationship. Therefore, many have not even addressed this issue. The few that do dismiss it as a divergence, implying it is a temporary situation.

Conclusion

Twenty-first century markets only seem to do one of two things 1) they expand and we call it a bubble or 2) they collapse because of a systemic failure and crisis of confidence. Nothing in-between is possible.

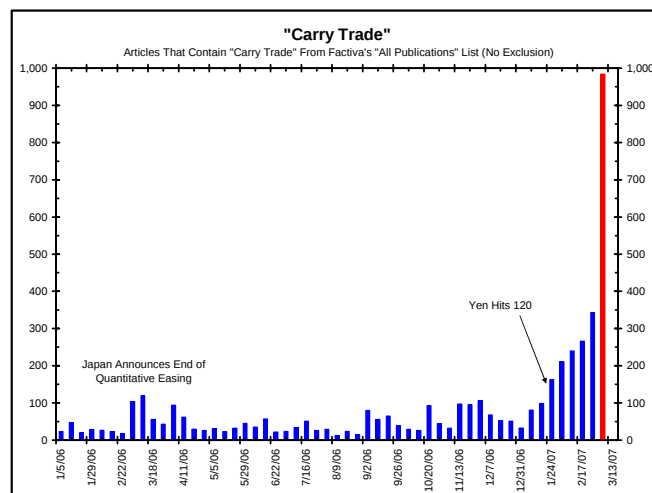
We would argue that what we are seeing is indeed something in-between. As we wrote last week, it is a *financial correction* due to a 228-day rally without a 2% correction. All other markets are reacting to U.S. equities.

What about the yen carry trade, the implosion of subprime credit, the re-pricing of risk and all the other worries being cited?

If these issues were in play, then the markets highlighted above would **not** be moving in lockstep with U.S. equities.

If the yen carry trade was truly being unwound, the yen/dollar exchange rate and/or yen implied volatility would move independently or lead U.S. equities, as we noted in a [Market Facts](#) earlier this week.

What appears to be happening this past week is nothing more than a garden-variety stock market correction. Yes we had the biggest down-day in four years, but things like this happen when stocks are correcting. Should stocks decline more than 10% or if credit, yen volatility, fed fund futures, or gold move independently of the S&P 500, then more could be brewing. After an exciting week and 1,000 stories about the Yen Carry Trade being unwound (below), this does not yet appear to be happening. If it hasn't started now, is it going to start tomorrow?



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