Hold on tight: It's likely market anxiety will only continue

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Get used to white knuckles as investors ponder inconclusive evidence about the economy, and the stock market refuses to free investors from worry.

Last week's three-day, 550-point plunge in the Dow industrials had investors on edge, and looking for direction, to start the week. Tuesday looked like it might provide some relief: Early in the day, bolstered by some improvement in the Consumer Confidence Index, the Dow climbed more than 80 points. But it turned down in the afternoon, as edgy investors used the upturn as a reason to sell, and finished with a slight loss.

Investors would like assurances that they didn't overpay for stocks in the 65 percent rally in the benchmark Standard & Poor's 500 index from the March low through the end of last year. But the signals are mixed.

"This market is strongly divided, with bulls who think we're fine and bears who feel that we're not going to continue to grow," said Randy Cass, founder of First Coverage, a Boston firm that tracks market sentiment of institutions buying and selling stock. "Both believe there is data that supports their position, but the data is ambiguous, and neither side can point to irrefutable data that back them up."

Cass runs through the debates First Coverage has been following between brokers and institutions: "Health care reform: Dead or slowed? Ben Bernanke: In or out? (Paul) Volcker plan (for financial regulation): Real or rhetoric? Double-dip recession: Valid or paranoia? China: Able to engineer a soft landing or not?"

And, finally, the big one that has been making investors especially uneasy: "Last week's market drop: Blip or bear?"

Sam Stovall, S&P's chief investment strategist, is among those who believe that earnings during the last couple of weeks present a positive tilt. But he said investors are so nervous after going through the harrowing bear market that their emotions could cause a 5 percent downturn like last week's to spiral into a 10 to 20 percent decline.

"Good earnings aren't good enough," Cass said. "Even the bulls agree that earnings need to be better than the consensus. They can't be middling to take this market higher."

Yet many of the earnings reports are considered middling. Starbucks, for example, recently exceeded analysts' estimates. But S&P restaurant analyst Mark Basham didn't see enough in the earnings detail to remove his "sell" recommendation on the stock.

He noted Tuesday that although the company did show solid sales during the holidays, some earnings growth came from triggers such as foreign currency rather than the lasting revenue improvements investors are waiting to see. "We still think the market is pricing in stronger economic recovery than S&P forecasts," he said.

Many investors are looking at recent pullbacks in stocks and wondering if global markets have more to come.

"The recent 9 percent pullback in Latin American equity markets, partly linked to moves to tighten liquidity in China, is a preview of what may happen later in 2010 when the Fed prepares the ground for higher interest rates," said Citigroup Latin America strategist Geoffrey Dennis.

He thinks the recent downturn in stocks worldwide is "not the start of a major sell-off."

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Washington, D.C., money manager Michael Farr sees a reason to be defensive now. With potential major changes in issues ranging from U.S. taxes to leadership at the Federal Reserve, he said, it's difficult for companies to plan and difficult for investment managers to analyze profit potential.

Meanwhile, despite trillions of dollars in government money flowing into the economy, "We are not seeing a lot of increase in demand from the consumers," Farr said. And it's difficult to determine whether the economic signs of strength are real or simply a result of government money that eventually will stop flowing.

That's not simply an area of confusion for investors. Randall Kroszner, a former Federal Reserve governor and economics professor at the University of Chicago Booth School of Business, said trying to dissect real growth from government-policy-induced growth will be difficult for the Federal Reserve as it tries to pick the point at which it can raise interest rates.

"We do seem to have a recovery under way, but it must be naturally generated," Kroszner said. "Given the size of policy, it's more difficult to determine if it's self-sustaining."