Institutional Investor

Will April Showers bring a May Market Correction?

First Coverage's Sentiment Index Continued to Drop in March; Possibly Signaling a Looming Market Correction

By Roland Beaulieu
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While inclement weather and health care reform debate dominated the majority of conversations and media coverage during March, we financial services professionals have been happily watching the markets continue to climb, and anxiously awaiting better weather, both metaphorically and literally. Yet, even as the Dow climbed 5.15% for the month, and it seems warmer weather is quickly headed our way – the sell-side on the First Coverage platform is indicating that a market correction may be looming in the not so distant future.

Over the past 30 days we've seen our First Coverage Sentiment Index, an index that measures the overall bullishness or bearishness of the market, fall 4.18%. The index also fell .8% during the last week of March. Currently, the index is still sitting in bullish territory at 55.86 (anything above 50 is considered bullish, anything below is considered bearish), but we've seen drops in sentiment in specific industries as well, with Consumer Services falling 3.6% and Financials dropping 5% during the last week of March.

The drop in Financial sentiment is something we have been watching closely because it's been considered common knowledge since this rally began last spring that there will be a fairly sizable market correction as many of our nation's largest banks and corporations are weaned off of their bailout money and we see what various earnings reports look like minus the massive government money; which if economic knowledge holds true, won't look so hot. With Financials dropping sharply in sentiment the last week of March, we believe it could be an indication that the sell-side is beginning to take their money off the table.

When will the correction occur?

Even the best analyst out there will tell you it's impossible to accurately predict when this market's correction will occur. The lack of accurate timing, as many of you know, is partly because of our free market system and the impossibility of predicting anything long term in today's market. But, more importantly, nobody knows when the Fed will begin pulling bailout money, which is what we believe will lead to a sizable correction. That being said, our indicators are pointing to a correction occurring in the not so distant future – especially with President Obama saying his next fight is going to be financial regulatory reform.

Other interesting sectors to watch in April?

To move away from the doom and gloom talk for a moment, there will be opportunities to make money in the market in the short term. The two largest jumps in sentiment sectors we saw in the last week of March were in Health Care and Oil & Gas. We attribute this to the passage of the Health Care Reform Act and President Obama's announcement to lift the moratorium on certain offshore oil drilling areas and allow companies to begin drilling much more extensively off our nation's coasts.

Health Care stocks, despite what the overall market does, should continue to climb in the short and long term as health care companies take on more subscribers who will now be insured. Also, another interesting area of health care to watch will be genetics companies that make drugs known as biologics or biosimilars. These are a fairly new class of drugs that contain living organisms and are often used for the treatment of long-term chronic illnesses, such as rheumatoid arthritis, breast cancer, etc. In the Health Care Reform Bill, this specific class of drug was granted a 12-year patent exclusivity period – meaning companies that manufacture these drugs could likely see increases in their stock prices.

Oil & Gas stocks may also continue to rise as large oil companies jockey for new drilling spots off our coasts and begin producing more oil and putting people back to work. Keep an eye on Oil & Gas both in the short term and the long term, as the price of oil has recently gone up, which has led to a fall in other sectors in sentiment, such as Consumer Services. Likely, because oil has become more expensive again, and with hospitality and travel companies' balance sheets already hurting, we are seeing a slight pull back in Consumer Services.

Lastly, Tech. Tech's bullishness level peaked at 74.68 points on March 2 for the year as hype continued to grow around Apple's latest gadget, the iPad. Yet, throughout the rest of the month, Tech slowly slipped down to 65.34 points. However, with the iPad set to be on shelves in early April, and depending on its popularity and actual workability, Apple and the iPad could push Tech higher in April, or lower if the iPad turns out to be a bust.

So, what's next?

As we've said before, predicting the market long term is about as accurate as predicting the weather long term. However, our indicators are pointing to the fact that the sell-side is beginning to take some of their money off the table, and with a government fight over financial reform looming, and the announcement of when and how the Fed will roll back the bailouts also looming, we see a fairly sizable market correction in the not too distant future. In the meantime, baseball season is here and the Red Sox are going to be World Series Champions in 2010, invest in that.

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