Opportunities when the Dead Cat Bounces

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A dead cat will bounce if it falls from a significant height. Though this thought is unpalatable, history reveals that the same principle applies to the stock market.

After the crash of 1929, the market bounced back twice only to rescind its gains within a short time. The first was five months after the market low of November 12, 1929 when the S&P rose 47.2% only to fall again. This unsustained bounce was repeated even more dramatically two years later. In 1932, the S&P rose by 111% in 10 weeks and then fell once more. After that, the Great Depression dragged on for several decades. It was only those who could play the ups and downs of the market that made money.

In 1975, after the 1973-74 downturn, the market rose 53.8% from October 12, 1974 to July 15, 1979. Then the rally died and a bear market was in place for the next decade. Only those who capitalized on the fluctuations of the sideways movement made money in that period. It was not until 1982 that the market started going up again and then transitioned into the tech bubble with only a down breather briefly during 1986-87.

More recently, the S&P increased almost 50% as of this writing since its recent low on March 9, 2009 of 677. One wonders if this market bounce is like that of a dead cat. This is because there is a great deal of optimism more than fundamental data to support the rise. One case in point is the U.S. jobless rate. Though it fell in July, the number is not as positive as it seems. The drop was slight and largely due to individuals who stopped looking for work. If they re-engage in the labor market, the jobless rate may rise again. Good news followed by bad news could be the instigator for the up market to lose momentum.

The point here is not that a dead cat will bounce, but that the periods surrounding such a bounce in the market can lead to opportunity. It isn't the 'buy and hold' investors who make money during these time periods. It is those who capitalize on its ups and down. Though statistically, this strategy hasn't paid off over extended time periods, there are certain segments within the longer time frame when it is profitable. If you think the recent rally is about to plummet and then be followed by peaks and valleys within a range for some time, the strategies below are worth considering.

• For a core stock portfolio, use lower cost index and exchange traded funds that historically perform better than managed funds. The specifics for this strategy are covered in "Bear Market Defense".

• For stabilization of a portion of a portfolio, consider market neutral funds which attempt to remove market risk by buying both long and short positions. Though these funds are managed and thereby cost more to own, they can be worth the

added expense if they alleviate portfolio havoc in an unstable market. This concept is covered in “Making Money Now: Market Neutral Funds”.

• To pump up returns in a sideways market, it is worth considering some short term trading for only a small portion of a portfolio. The reasons for this and how to do it are explained in “Opportunity During Market Volatility.”

• Another option is to buy covered calls on existing positions. In this way money, can be made even though a position decreases in value or remains unchanged. For more on this tactic, see “Making Money Now: Covered Call".

As wise investors say, “Luck is being prepared for an opportunity.”