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Dullsville, U.S.A.

The stock market's stuck in a rut, but getting out could be painful

By MICHAEL SANTOLI

STOCK INDEXES HAVE BEEN LOCKED in a tight trading range all year, frustrating bulls and bears alike and generating suspense about the market's next big move. The benchmark Standard & Poor's 500 index has shed just a handful of points since the start of the year, and has spent all of 2004 hemmed between 1076 and 1163, a range of just 8% from low to high. This stretch of 128 trading days spent in a range of 8% or less ranks among the longest in recent market history.

The market has hit a lull of at least 80 days' duration about once every two years since 1979. But only three times has such a tight range persisted for longer than this year's. If history is any guide, stocks are likely to break out above or below the current boundaries within a matter of months.

The stalemate has confounded the consensus view that prevailed as the year began -- that stocks would deliver low-double-digit percentage gains in 2004, with most or all of the upside coming in the first half, due to surging earnings and low interest rates. But consensus views exist to be confounded, and this one has been undone by the Federal Reserve's shift to a rate-boosting posture, the loss of economic momentum and periodic scares about inflation, high oil prices and messy geopolitics.

Perhaps the market is telling us the easy money and revived risk appetites that drove last year's huge rally now have run their course, setting stocks up for a worrisome fall. Bullish observers, however, see not lethargy but consolidation -- a period in which earnings catch up to share prices, which soon will lift off.

At the least, the near-stasis has knocked measures of stock volatility to multiyear lows and sapped the exchanges of energy, as evidenced by a steep drop in trading volumes so far this year. On Tuesday the S&P moved less than 0.3% from low to high, the tightest daily range since November 1996.

History offers few conclusions to the market's future course, but several noteworthy patterns. Since 1979 most tight trading ranges of at least 80 days occurred in the midst of bull markets. After the range was broken, stocks headed modestly higher in the next one, three and six months. Of course, bull markets have prevailed for most of the past 25 years.

Seasonal factors often are at work in range-bound periods. Most of the 13 prior occurrences took place in the summer, and ten were broken in July, August or September. Typically, sleepy summers give way to volatile falls, and also the weakest months of the year, September and October.

Presidential election years, too, seem marked by tentative trading, at least ahead of the balloting. Five of the seven

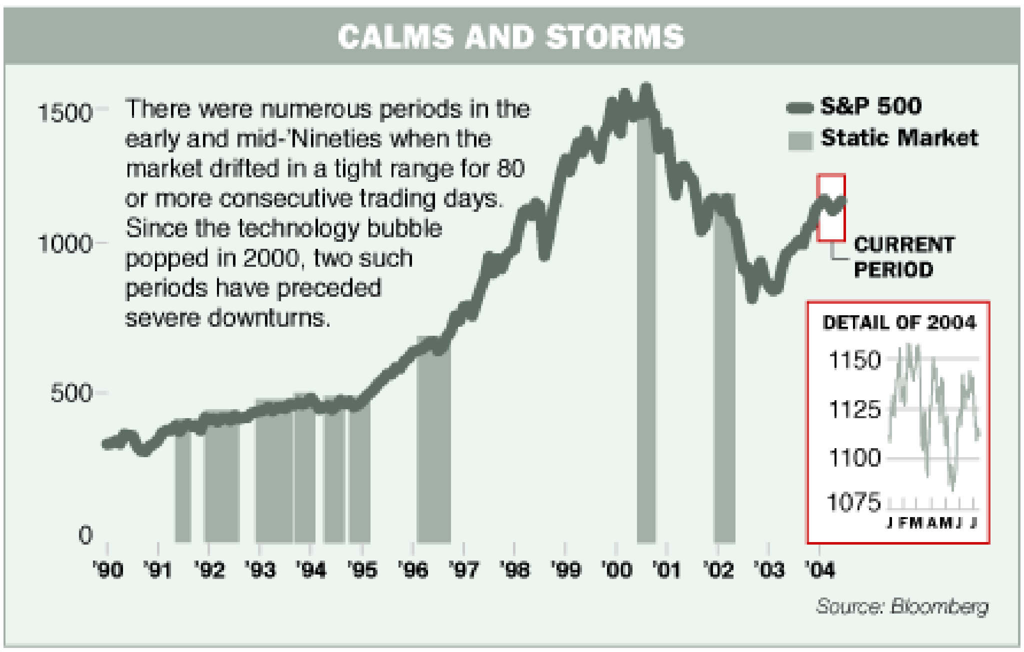
Table: In the Doldrums[1]

election years since 1980, this one included, have contained a flat market stretch. Of the four prior election years, stocks snapped out of their doldrums in July (1984 and 1992), September (1996) and October (2000), perhaps as investors began to assimilate the likely results. Two of the bigger upside breakouts -- in 1984 and 1996 -- occurred when an incumbent president was cruising to re-election.

One of the worst resolutions to a flat market stretch came in 2000, when a close election resulted in confusion and the eventual loss by the incumbent party. A stock-market bubble was bursting too, and corporate earnings were collapsing.

John Harris, a market historian and a retired University of Tulsa professor, also finds a political link. This year, he notes, had one of the four least volatile first halves since 1928 in terms of the S&P's range from low to high. The others were 1952, 1992 and 1993, so three of the four were election years.

Harris finds five earlier examples of election years in which the S&P's first- four-month move was between positive 1% and negative 1.9% (this year it was minus 0.4%). In every case -- 1952, 1968, 1980, 1992 and 2000 -- the incumbent party was booted from office. Sure, this looks like mere fun with numbers, not rigorous statistical analysis. But it can't hurt to recall such patterns, whether you are an investor or a Republican campaign strategist.



What has it taken to jar the market awake? In 1979, the appointment of Paul Volcker as chairman of the Fed seemed to galvanize buyers. In early 1994, the Fed's surprising interest-rate increase sparked heavy selling. A year later, another trading range ended, on the upside, when the Fed raised the federal-funds rate by half a percentage point, to 6%, which would mark a high for that credit-tightening cycle.

Signs from the Fed, then, whether friendly or hostile, appear crucial in determining a range-bound market's next turn. Note the Fed's policy-making committee meets again Aug. 10, and is expected to nudge rates higher.

This year's dog days invite comparison with the compressed market channel that stretched from December 2001 to April 2002. Then as now, a strong rally led many to believe the bear market had ended, and investors were preparing for an economic revival. Yet a shortfall in output and earnings growth combined with corporate scandals to drive stocks south for the next three to six months.

The prior sojourn in Dullsville, from mid- to late-2000, resulted in the second-steepest six-month slide after a range-bound span.

So will history repeat? There's no way to know, but investors should keep in mind that sometimes the market's gentle slumber ends in a rude awakening.

E-mail comments to editors@barrons.com[2]

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The S&P 500 has traded in an 8% range 14 times since 1979, including this year. On average, a modest rally has followed.

		Number	**Later Returns**	
Start	**End**	**Of Days**	**3 mos**	**6 mos**
Dec 21, '92	Aug 26, '93	172	0.29%	0.70%
Feb 7, '96	Sep 13, '96	152	7.17	16.55
Dec 26, '91	Jul 30, '92	150	-0.89	3.48
Jan 5, '79	Jul 6, '79	126	6.32	3.08
Feb 9, '84	Jul 23, '84	113	12.76	17.64
Aug 27, '93	Jan 31, '94	108	-5.93	-4.37
Mar 29, '94	Aug 26, '94	104	-4.54	2.11
Apr 18, '86	Aug 27, '86	91	-2.03	11.71
Dec 14, '01	Apr 26, '02	90	-20.76	-18.01
Jun 5, '00	Oct 9, '00	88	-7.22	-16.67
Oct 5, '94	Feb 3, '95	84	8.67	16.78
May 21, '85	Sep 17, '85	82	16.15	29.91
Apr 30, '91	Aug 23, '91	81	-3.58	4.59
AVERAGE			0.49%	5.19%

Source: CSFB Quantitative Equity Derivatives Strategy

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