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Greek Deal, Chinese Rebound Spark "Risk-On" Market

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Did Alexis Tsipras pull a rabbit out of the hat? It appears so, as the strong support of France for the new agreement virtually assures that the ECB will approve it on Sunday (or perhaps earlier) and extend further credit to Greek banks, enabling the banks to open early next week and forestalling an economic catastrophe for the Greek people. In addition, markets are encouraged by the continued bounce back of Chinese stocks. The Chinese measures to goose the markets didn't seem to work on Wednesday, but certainly worked Thursday and Friday. It is clearly a "risk on" market today with stocks rallying sharply and US and German Treasuries falling. These developments mean that two of the most significant short-term worries of the market, China and Greece are, at least for the time being, alleviated.

On Greece, I believe the EU agreement will kick the can down the road once again. There are reasons to doubt that Greece will abide by all the conditions of the new agreement, although the Greek people clearly saw the disruptions caused by closing the banks. But, hey, most of the developed world is kicking its cans of serious economic problems down the road – particularly the developed countries with respect to unsustainable Social Security and healthcare benefits. Markets can thrive a long time in these situations. On China, I expect a good short term rally, continued volatility and a retest of this week's lows. At current levels, the Shanghai Composite is selling for 19.8 times last year's earnings and 16.3 times this year's earnings estimates. These are not crazy levels, although many of the tech stocks are still overpriced. We could be nearer a bottom than a top in the Chinese markets.

Next week Janet Yellen will deliver her semi-annual monetary testimony before the House and Senate. I expect her to maintain that a September increase is still a very live possibility although the Fed's actions will be "data dependent." Indeed, we still have more than two months until that September meeting and a lot more data will have flowed over the dam. Fed funds futures markets are still giving the Fed less than a 50-50 chance of an increase in September and saying that the Fed will increase just once this year, if at all.

I would like to make a technical note. In my *Stocks for the Long Run* I do a 126-year analyses of trading the Dow Jones Industrials using a 200-day moving average (dma) criteria: exiting the market when the DJIA breaks one percent below its 200 dma, and buying when it is 1% above. Last Wednesday the DJIA closed at 17,515.42, breaching 1% below its 200 dma (17,693.61) by a single point, triggering a sell signal. If the Dow rises to 17,876 (about 100 points above its current level), a buy will be triggered. If that happens, technical traders will have been "whipsawed" by the markets, losing 2% and highlighting the risk of following these strategies.
