



An Anatomy of a Collapse: Lehman Brothers

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The other day I came across an article about Lehman Brothers [\[LEH\]](#). It's not like this was the only one, as the company has been very much in the news lately, due to its latest financial troubles. What I did find interesting was the fact that Lehman started as a cotton trading firm down in Alabama back in 1850; and given all that has transpired over the past year, they may well wish they never had left the deep South for Wall Street. What was not new in this particular article, or all the other recent scripts, was how LEH has fallen upon hard financial/fundamental times. Their fundamental challenges have been unfolding for roughly a year now; and such woes have not been limited to just LEH. But LEH has now become the new poster child for the sub-prime crisis now that Bear Stearns has been absorbed by JP Morgan. Given all this attention that Lehman has been receiving, it prompted us to take a closer look at LEH from a technical standpoint. We thought we would share our insights, as LEH provides an excellent case study of the perils of "jumping the gun" in the face of "resistance". In short, this will serve as yet another example of why you must marry the technical picture with the fundamentals when making investment decision.

In analyzing the behavior of LEH over the course of this year, we will look at two scenarios: one from February 1st, 2008, and then more recently in early May. In both situations a point or two can, and did, make all the difference.

I. Scenario One: Failure to Break Out of Big Base

Let's turn the clock back a few months to February 1st, 2008. Recall the first leg down in the market (for 2008) had occurred and signs of reprieve were falling into place. For example, the market indicators had gone back to offense after reaching very washed out conditions; this can be seen in the summary table below. Furthermore, the Wall Street sector, as of February 1st, was also on offense with "Average" status. All told, with the market and sector on offense this dictated at least a trading posture for the WALL sector on a technical basis; and from a fundamental standpoint many may well have dubbed this sector a "value play".

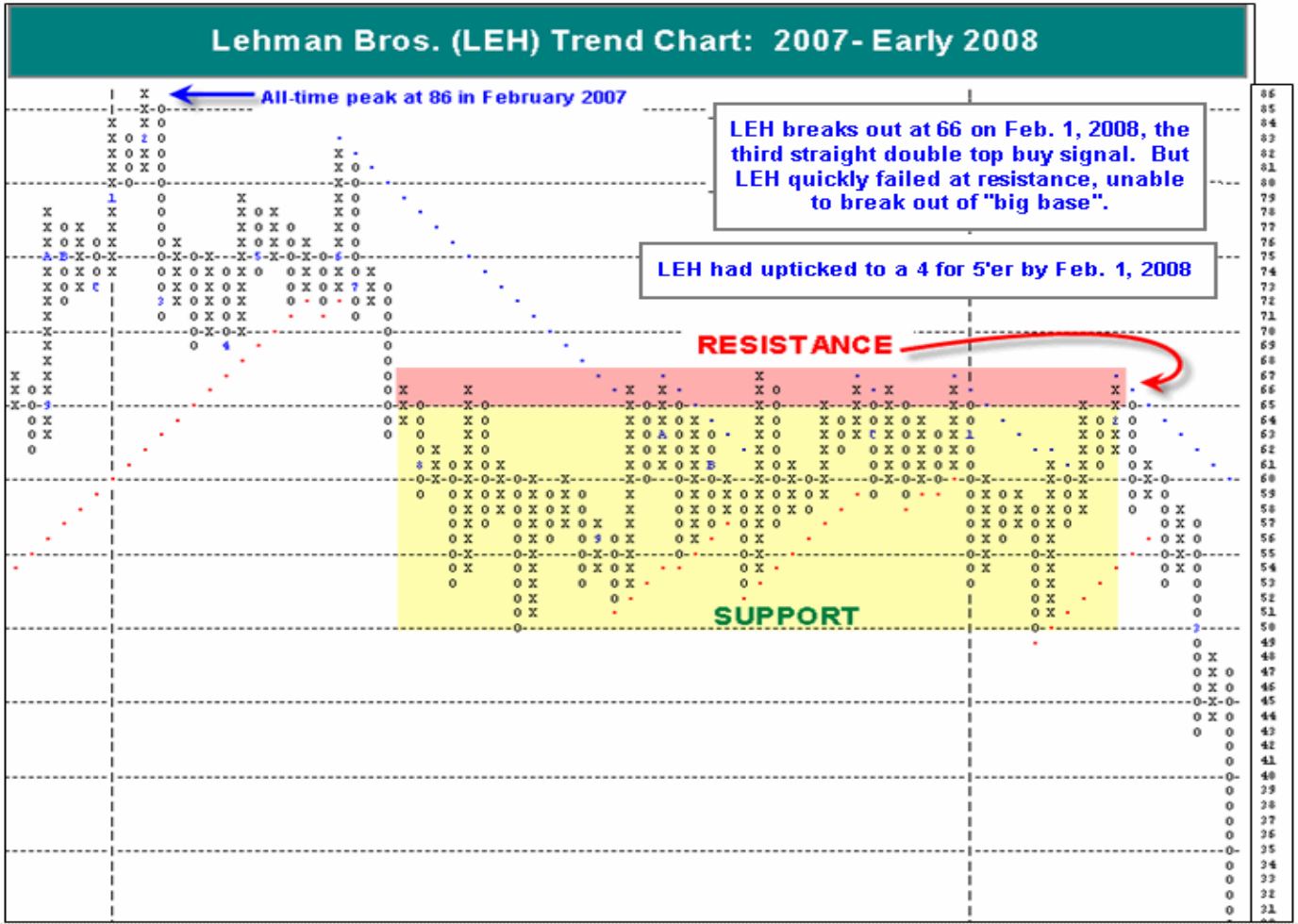
So let's imagine that you wanted to gain exposure to WALL then. Had you done a basic "Search and Sort (Query)", Lehman surely would have been on your list of hits -- meeting the basic criteria that is initially desirable: in an uptrend, on a PnF buy signal (as it just gave a third straight double top buy signal at 66), good relative strength as indicated by its 4 for 5 positive technical attribute reading, down only half as much as some of its counterparts (and therefore better peer RS), and a bullish price objective of 84. At initial glance, LEH was worthy of consideration for purchase. But had you gone to the next step in the process, that of evaluating the actual trend chart, you would have not jumped the gun and bought LEH. Why? In a word, resistance.

Lehman Brothers (LEH) Breaks Out at 66 on Feb. 1, 2008									
Market Data on 02/01/2008					Sector Data on 02/01/2008				
Symbol	Chart Level	Status	Column	Actual Value	Symbol	Chart Level	Status	Column	Actual Value
BPNYSE	32.0	BULLALERT	X	32.8	BPWALL	56.0	BULLCON	X	56.1
PTNYSE	28.0	BEARCON	O	33.2	RSPWALL	60.0	BULLCON	X	61.0
30NYSE	30.0	BULLALERT	X	30.2	RSXWALL	56.0	BEARCON	X	56.1
HILO	32.0	BULLCON	X	34.0	PTWALL	38.0	BULLALERT	X	39.0
TWNYSE	46.0	BULLALERT	X	47.7	30WALL	34.0	BULLCON	X	34.1
BPOTC	18.0	BEARCON	O	23.5	TWWALL	40.0	BULLCON	X	41.5
PTOTC	24.0	BEARCON	O	23.6					
30OTC	24.0	BULLALERT	X	24.3					
OTCHILO	12.0	BULLALERT	X	12.7					
TWOTC	36.0	BULLALERT	X	36.9					

Performance: 2007 Peak to Feb. 1, 2008	
Bear Stearns (BSC) =	- 46%
Merrill Lynch (MER) =	- 40%
Morgan Stanley (MS) =	- 36%
Lehman Bros (LEH) =	- 23%
Goldman Sachs (GS) =	- 16%

Average ←

Notice in the image below how LEH had managed to find notable support in the low 50's from August 2007 through January. At the same time, on rally attempts LEH would assert itself up to the 66-67 area only to stall out and meet resistance; in essence, LEH had formed a "big base". But...LEH was never able to break out of this big base and penetrate the formidable resistance at this 66-67 level. Although on the surface the majority of the technicals supported a long posture on LEH, it would have been more prudent to wait and make LEH move a couple of points more to the upside, as that would have produced a clear break through its overhead resistance. Of course, we all know this did not materialize, as this resistance level remained in force for a ninth time! In fact, after the February 1st breakout and subsequent failure at resistance at 66, it got downright ugly for LEH as the stock slid from 66 to a low of 21. If you had waited for the breakout of the big base, and therefore not bought the stock, you would have avoided this train wreck -- which amounted to a 68% drop in price!



II. Scenario Two: Failure to Penetrate Bearish Resistance Line

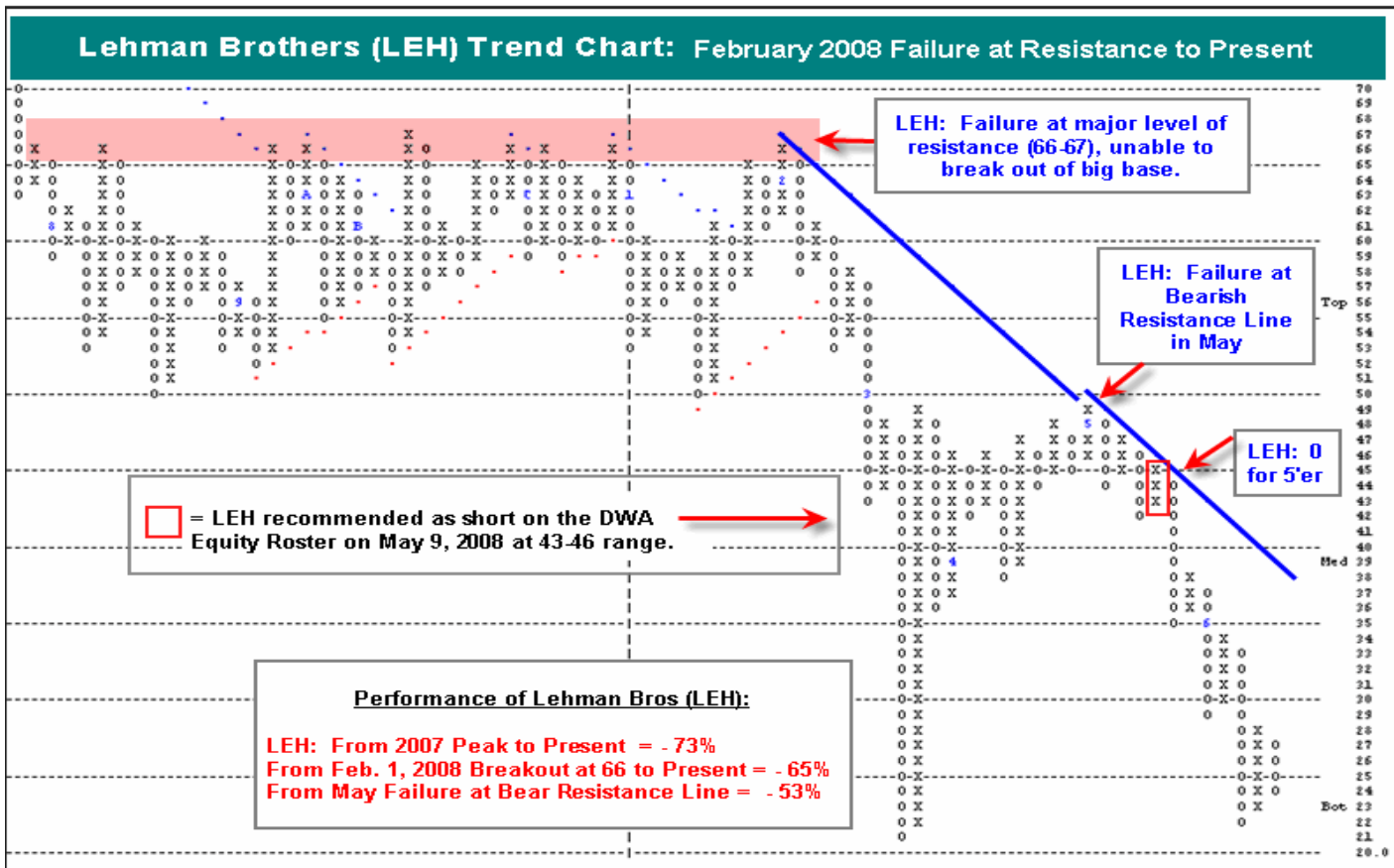
After the Bear Stearns-driven capitulation at the end of March, many of the Financial stocks put in a bottom and bounced up from very depressed levels. LEH itself produced an admirable performance off its lows of 21, rallying to the high 40's. During this time, the market rotated back to offense, as did the Wall Street sector. But the best LEH could do from a technical standpoint was to uptick to a 2 for 5'er, within the confines of a still overall negative trend; and this 2 for 5'er reading was very short-lived and LEH quickly reverted back to its lowly 0 for 5 technical attribute reading. Despite this, by early May LEH had once again presented a tempting situation; it was on the verge of penetrating its bearish resistance line. The stock had completed a bullish catapult formation and given three straight upside breakouts. It now resided at 49, right at this downtrend line. But failure for LEH was once again in the script; and instead of taking a long posture in LEH a point too soon, prior to a violation of trend (to positive), it would have been better to be tempted to short this stock. For those that pay attention to the DWA Equity Roster, you may well have done so, and have been justly rewarded.

Below is an excerpt from our Daily Report when we recommended shorting LEH on the Roster. This can also be seen in the image below, marked by the "red square" on the trend chart of LEH. By consulting the trend chart once again, a bona fide short presented itself.

Excerpt from Daily Equity Report (DWA Equity Roster) for May 9th, 2008: 05/09/2008 [LEH]

Lehman Brothers Holdings Inc. R (\$42.930) - Wall Street - The market remains on offense and this suggests that the majority of our energy is spent generating long-oriented strategies. That said, LEH has already seen a notable recovery from its exaggerated lows back in March and of late has actually shown an inclination to stall out just beneath the bearish resistance line. The stock is still a 0 for 5'er and the sector BP for Wall Street is actually at 70% and in O's right now. Short exposure should not dominate our books right now, but as far as LEH goes it appears that the greater opportunity in the near-term may well exist on the short side of this stock. Okay to sell LEH short in the 43-46 area and we will employ buy stops at \$50, a violation of all near-term resistance. On the downside the potential for the stock to revisit the low-20s in there, but this would likely only be possible in a faulty market.

In sum, by not jumping the gun to buy LEH, and instead taking the time to consult the trend chart, you would have saved yourself a great deal of money, and the temptation to use the gun for something else. Remember that sometimes the best "value" may come from waiting a "cotton-pickin' minute" for a point or two higher.



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