SG Capital Research

Global Market Insights

Research Note – Weekly Market Strategy Global (A # 1)

MAEG- WKLY MKTSTR- GL- POM -SG 2011 # FEB 14

For Immediate Release – Monday AM (EST)

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Market Strategy Global (A # 1) - SPX – Closed @ 1329 – Wkly change (+ 19 points)

Analysis of Broad Market that includes – Jan 1st 2011 – SPX 1257 (+ 5.7% YTD)

- **Primary Market SPX (or SPY) & DOW (DIA) as main market driver and**
- **Secondary Markets NYSE, NASD (or QQQQ), RUSS (or IWM) .**

We have picked up charts (below) that has some distinct characteristics and values from last weeks observation at Inflection points based on our assessment:

- ## Detail Coverage

- **Daily Trend Adjusted Strategy - 3x3 / 9EMA – DOW, SPX**
- **Primary Market Analysis – SPX, MID, ST , LT**
- **Secondary Market Analysis for SPX clues – DOW,NASD,RUSS,**
- **Sector Analysis for SPX clues – BKX,SMH,**
- **Time / Cycle Analysis- Bradley Cycle, 4 yr Cycle,**
- **Advance / Decline Internal market behavior – A/D – SPX**
- **Sentiment Analysis with Extreme character – TICK , VIX**
- **Global Market Analysis for SPX clues – CHINA, AUST, BOVESPA**
- **Appendix - History of past SPX –POM Signals & Key Criteria**

- ## Objective

Focus is on the Short & Intermediate term turning point of the SPX via POM's Price projections. POM is Unidirectional Judgmental Model, It utilizes multiple input signal via the Global Inter market Analysis (GIC), Price & Quality Volume (PQV), Pattern Recognition (PEC) , Cycles, Internal & External price equilibrium points to assists in output signals . POM is supplementary Analytics to add value to RA/ RI Framework for Risk Management.

- ## Trading & Investment Conclusions

Our start point 2011 in SPX @ 1257 – Current Indicators

- ***Long Side –***
  - ***POM 12 Call – None so far this year.***
  - ***Trend Adjusted Signal – Buy at SPX 1307. (Stop @ 1307) Revised***

- ***Hedge Longs / Risk Management for Downside Corrections -***
  - ***We recommend fully Hedge on long positions via the SETUP – PQV Hedge Index, we have a Drawdown – 7.0% with Setup 2's & PQV – CZ Validated Equities ,***
  - ***Model Avoided Setup's 4's completely hence minimizing drawdown and maximizing mental capital (either due the CZ – PQV – NON- validation or the underlined Index did not confirm to POM 15 sub criteria's of its own)***
  - ***Our SD # 2 –CZ – PQV Validated SECTORS - EQWT Index has Drawdown -0. 44% in past 8 weeks***

- ***Net Short –***
  - ***POM 15 Calls – None so far Triggered this year***
  - ***Our Target has remained for SPX 1280 (Monthly close for highs) , Pre – Lehman Crash Area tests. This has not happened yet.***

SPX – POM Signals & Price Projections with Setup Index

- ***UPSIDE Target*** *- (Monthly close below 1280 should be a good signal). POM 15 for Net Short has not Triggered. Although this extension is counting time the best case scenario would be the highs of Pre – Lehman crash price tops 1280 on Monthly . We could very well trigger POM 15. Meanwhile we continue to remain POM 14 since Jan 1st 1257 (Our new reference point for 2011).*

- ***DOWNSIDE Target - SHORT TERM*** *- SPX 1220 first then , Daily Bearish Wedge has the downside target of 1175. On Intermediate term Our Pull back from here should be to 1130 - 1145 (This area is false break top side driven by QE 2). The natural equilibrium price is at 1125, which also happens to be the GOLDER CROSS (SETUP 1) @ 1120. Volatility will increase in this area. Its too early to tell if something more serious (let us wait and watch)*

- ***EQUILIBRIUM Price*** *- favorable Risk / Reward opportunity will come at POM 13/ 12. This area we would be interested again*

- *Our TREND ADJUSTED SIGNAL Post POM 14 – Trend Adjusted Signal for the 3rd time is on Buy Signal at 1307 stop on close at 1307 (REVISED) .*

  - *Currently, Our Model continues to recommend the fully hedge position via SECTORS with SD # 2 Qualified and Tested CZ – PQV Validation only , (Currently this Equally weighted Index has Drawdown of (-0. 44 %) This is the preferred risk management considering market is not at POM 15 and our Longer term time horizon for holding. (Note – if Market continues up we may have the risk of Stop being Triggered)*

  - *Secondly our next Hedging process also recommends Setup # 2 and/ or Broken down Setups # 4 validated at the CZ- PQV. Currently has the Drawdown of(-7.0%) (inclusive of all stopped outs, as on last week close).*

We prefer to AVOID, MO – SETUP # 4 combination till such time.

Daily SPX - " Trend Adjusted Signal" – Long at 1307

3x3 /9EMA – Momentum Break Indicator –

- **For Bull case - Previous long exit was on 11/17 at 1193 from 1105 entry 09/05 for 8%**
- **For Bull case – long position from 1228 to 1276 = 4.0 % (From reference point 2011@ 1257 = 1.5%)**

Currently " Trend Adjusted Signal " Triggered Long at 1307 - STOP 1307 (Revised)

In the Momentum Market the " Trend Adjusted Signal" seem to have worked well for QE – 2 pump after the Initial profit taking on Longs from POM 12 @ 1020 to POM 14 @ 1105.

- **Market Insights**

- ***This has been a grind to get the change of signal. Market seem to have given up on conventional " Mean to reversion" completely violating " Newton's Law" – What must go up must come down"***

- ***The Fed POMO Rally continues, We had a continuation last week in a period which should have been a resting period and, once again, the Fed's injections of cash into the market is the likely culprit. As long as the Fed is pumping money into the market, barring a fundamental shock, the path of least resistance in equities still remains upward.***

- ***We've noted odds are for the major indexes to decline down to retest the support at their 40 WMA , which even in strong bull markets they tend to do once or twice a year. And even in years when the government is providing unusual stimulus, as it did in 2008, 2009, and 2010. From current extreme overbought levels such a pullback would amount to 12% for the Dow, 13% for the S&P 500, 16 % for the Nasdaq, and 18% for the Russell***

- ***The reason last week should have been a resting period is that we had come off the rising trend from an earlier T. (14th FEB) However, we didn't think it would be a big down move. Indeed, that was prudent as we didn't even get a sideways market, but a breakout to new highs. Now that we're past that correction, dips are clearly buying opportunities.***

- ***Most markets have been in uptrends, the so-called "It's All One Market" hypothesis. That approach has worked very well since almost all markets have been rallying together, with the obvious exceptions of the bond market and the US Dollar. But, it appears there are some markets now which are going to soon diverge from the hypothesis. First of all, the bond market is showing strong signs of turning its trend from down to up. The TLT etf is also showing bullish divergence***

CONT ……

- ***Past 12 weeks, we are BEARISH in our Mid term opinion but we do not have indication of Net SHORT SELL, especially since 10th of Jan. As we have been highlighting in MS, the bearish wedge price path for the Currently 5TH time, the miniature wave 5 / (wave C) (rally) on its completion has ended with drop of 20-25 very quickly and then back to highs again . Each time after the rally closes up even by Tick, wave re starts itself and negates the fall on SPX .***

- ***Although the rally going into February still continues it is Risky participating. The larger correction will come in completion of this as the Time termination sets in approaching soon on 14th FEB.***

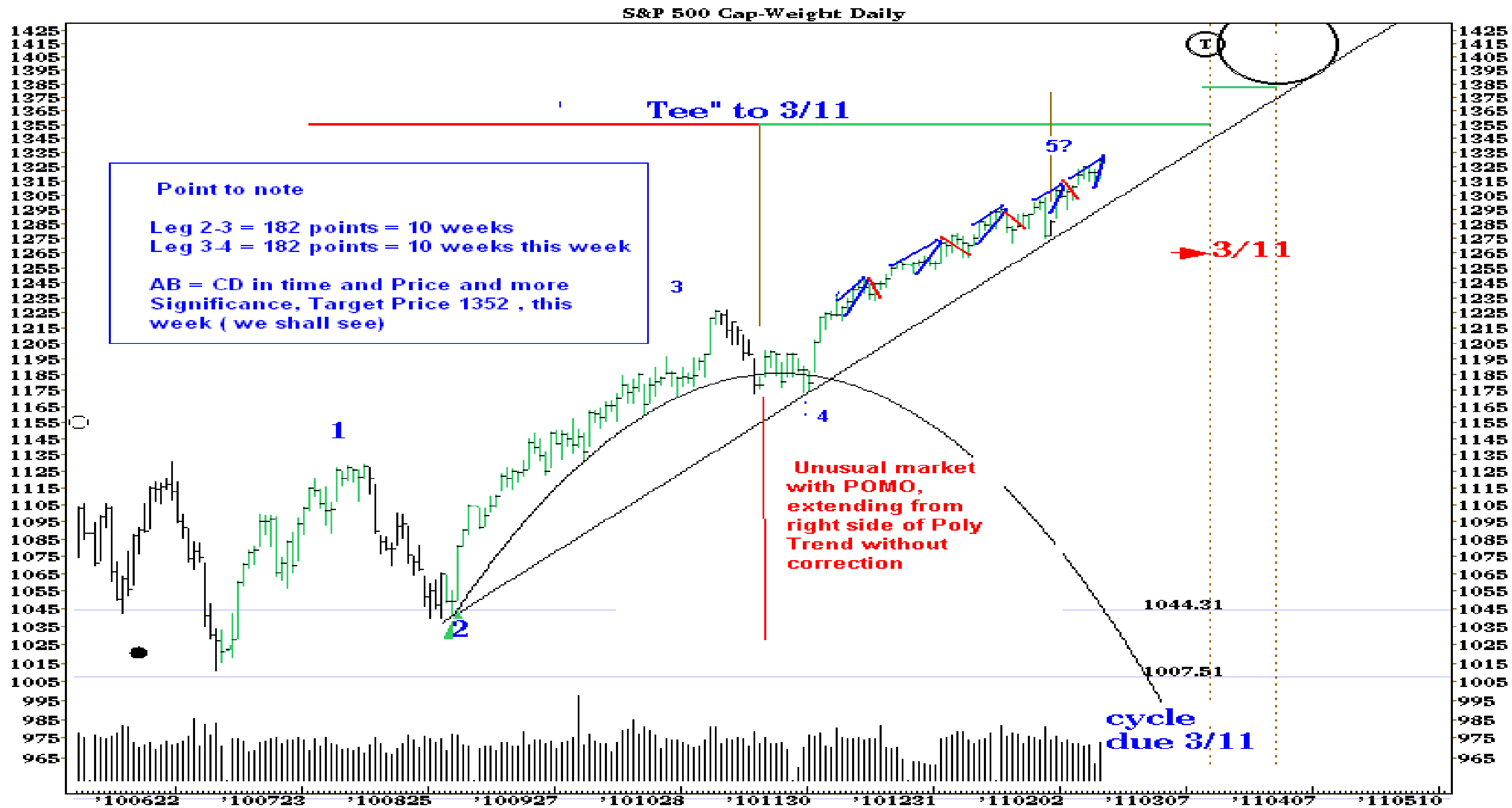
- ***The early March, 2-year anniversary of the 2009 low acts as historical turn date and gets to be meaningful either for Primary top or the Secondary top (which can be lower highs) .***

- ***Post POM 14, for any New longs we recommend the Momentum Strategy VIA " Trend Adjusted Signal with STOPS ", this has done well to capture the MO move of the market post POM 14 whiles Hedging process continued. But NO NET SHORT***

Primary Market Analysis -

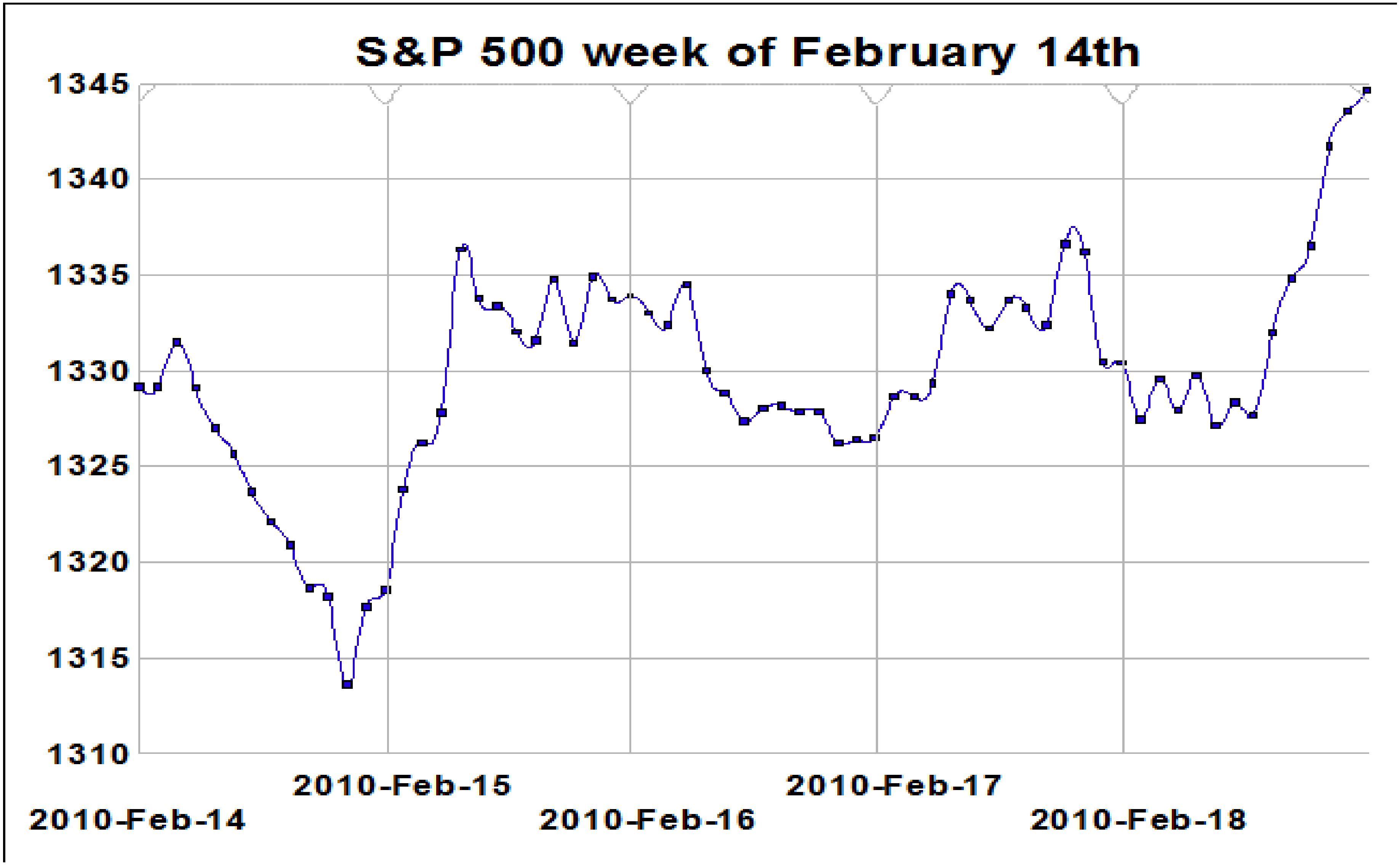
SPX – ST

Last week, we mentioned the 5th Bearish wedge being completed to wave 5 rally / wave C in the Key Indices (SPX) . Now again the 14th FEB is the T termination , In Short term we would not be surprised with another quick snap back to downside 20- 25 points before the larger correction sets in . In Intermediate Term the early March, 2-year anniversary of the 2009 low some times those historical turn dates gets to be meaningful. (it could very well make the top or secondary top). … In search of a clues we noted a price and time study (notes below) . This pattern is usually hard to trace.



THIS WEEK ON CYCLES – Still Bullish

5C wave up still in progress.



SPX – TRIN - SHORT TERM

Since 10th of Jan , this chart has been showing that , the Short term Traders have been driving the TRIN higher in uptrend that coincides well with this 5th/- C . We have showed this chart in our earlier Reports. This has been one of our Indicator for POM 15 which never triggered on SPX . TICK/TRIN ratio normally starts to trend down before the SPY makes a top and right now the TICK/TRIN ratio is trending higher and no sign of POM 15

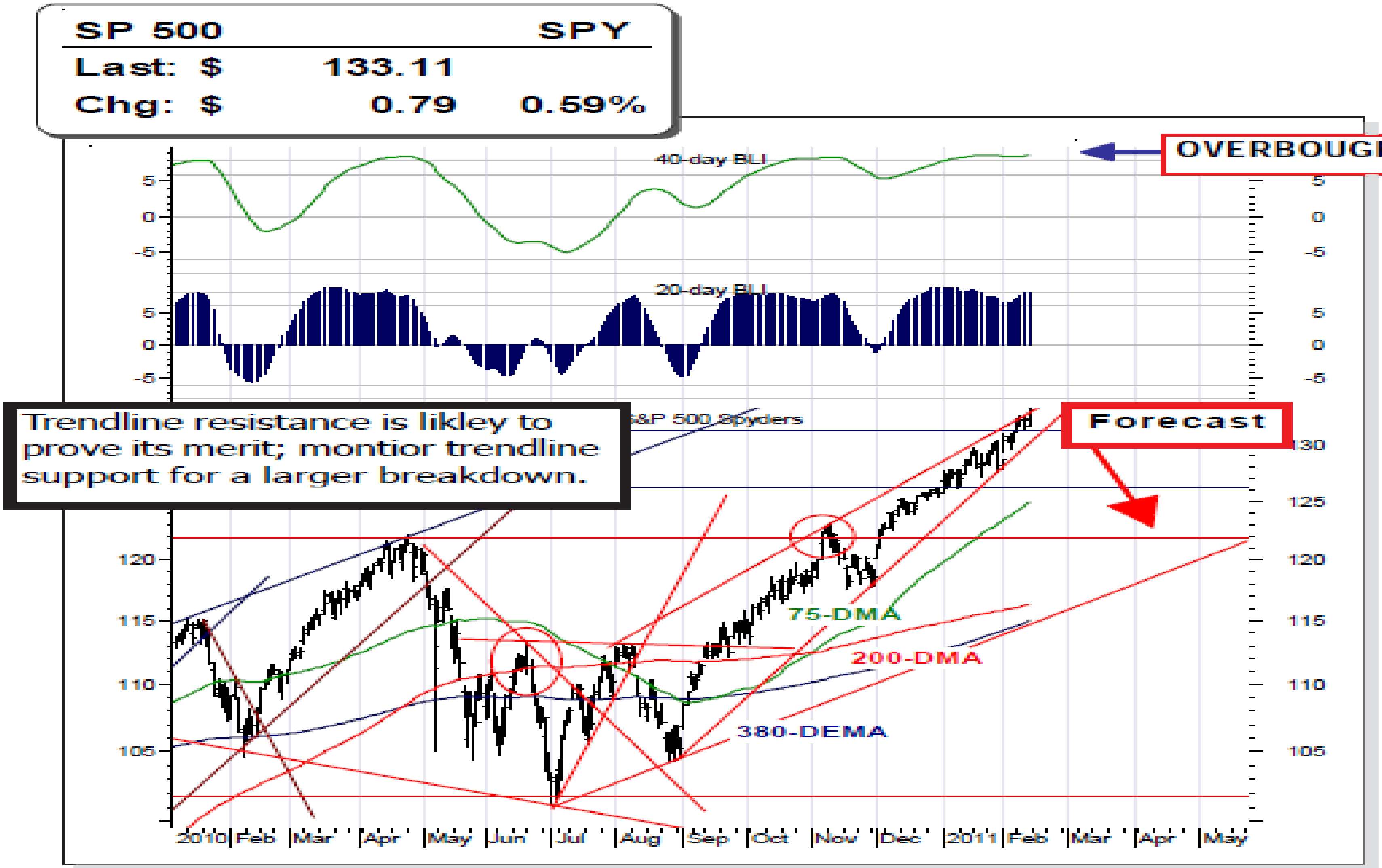
SPX – TRIN - MID TERM – *Longer term view of what may be expected in the coming weeks for the SPY.*

The top window is the TRIN/SPY ratio. There is a red line and a blue line of the TRIN/SPY ratio and when there is a wide separation of these two lines it has predicted a significant reversal in the market in the past. Right now there is a wide separation but both line are still trending down and suggests the trend for now is still up. When both lines reverse up and start to trend will imply a reversal is being generated in the market. The bottom window is the SPY/TRIN ratio that works as an oscillator and readings above 160 shows the market is extended.

In early January this ratio reached 180 and has backed off since. Previous tops have taken several months to form and the SPY/TRIN ratio made at least a couple of tests of its high.

SPX – MT - MA's & Trend lines

Although on ST , we continue the Wave 5 & Wave C for 5th time , Earlier the Larger Bearish wedge failed.   Our Target <u>back to 1230 target</u> and then daily Wedge indicated at <u>the base is 1180 and</u> then finally to the false breakout area as <u>our downside targets 1135</u> (the last target may take time and not in straight line) . 1280 is material resistance, and we'll look for a correction to develop then assess the market condition once this level is achieved. The 20-D and 40-D models are showing signs of turning.

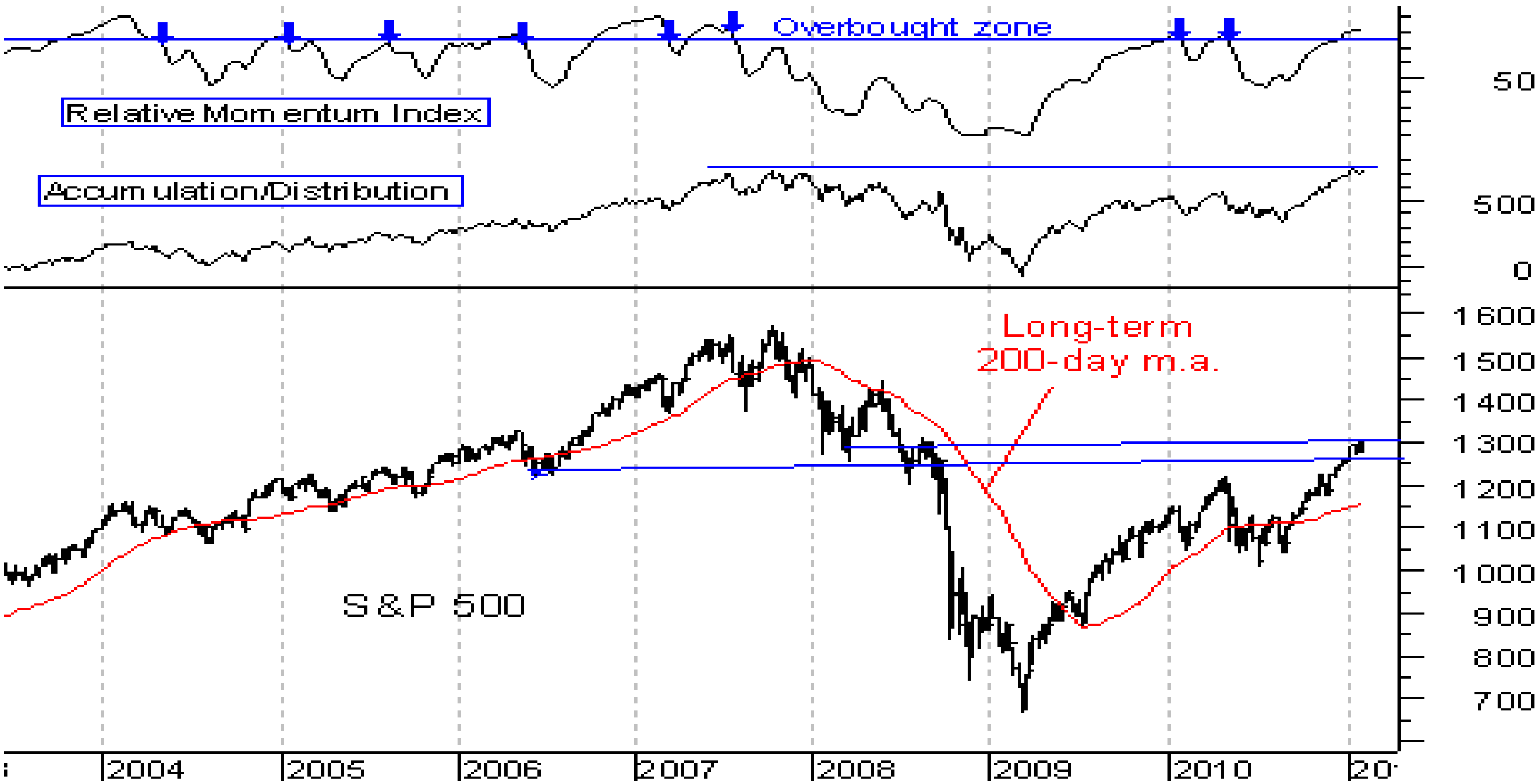


SPX – LT – wkly Bigger Picture – NO CHANGE – Volume declined on weekly test

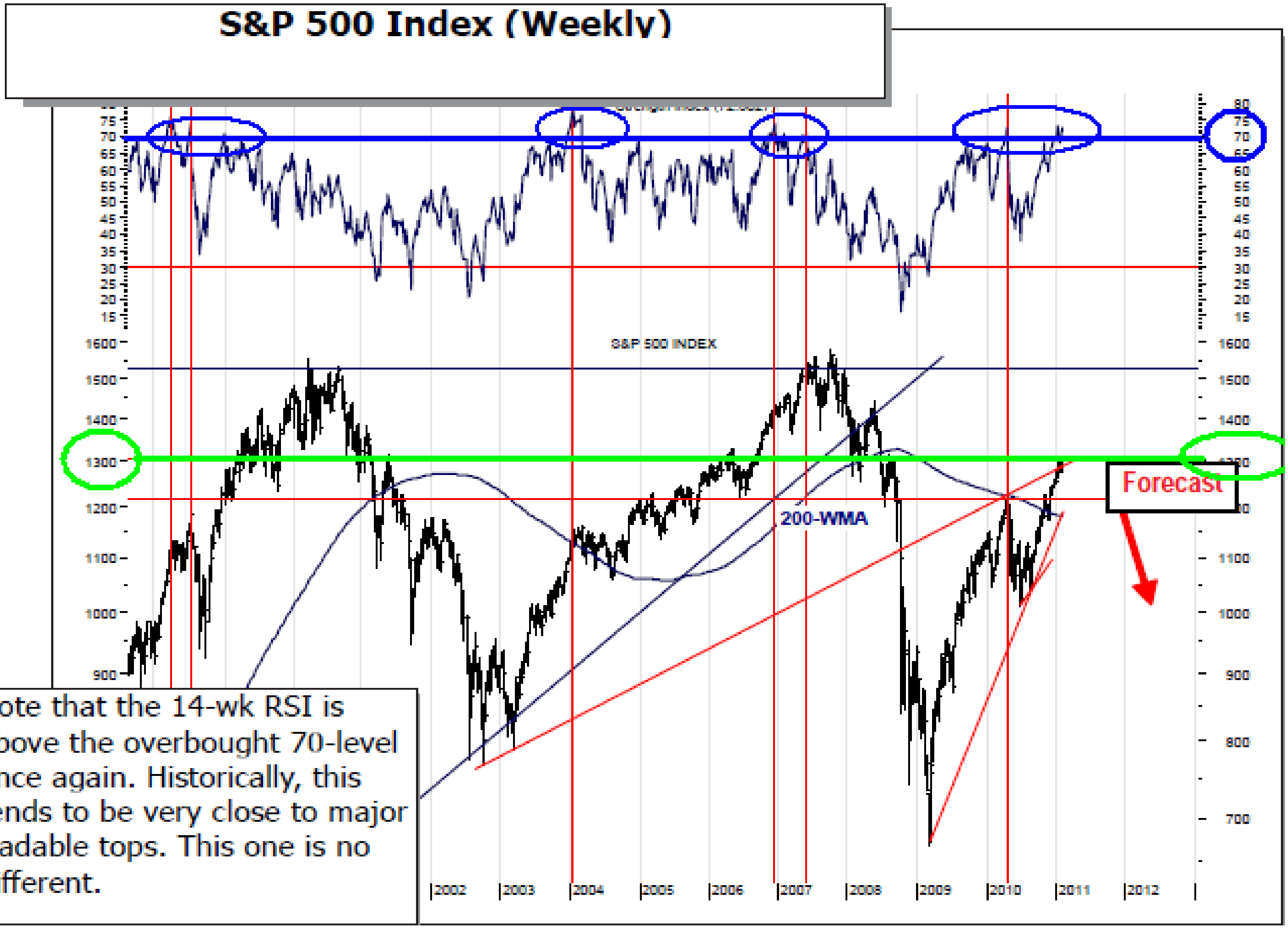
And closed below 1280 – Monthly

The weekly bars show the market trading at the highest level in more than two years and in a potential resistance zone marked by the early 2008 low near 1270 up to the summer high near 1280 (see lines). The S&P 500 has also retraced two-thirds of the 2007/2009 decline which often acts as a resistance level. More importantly, the RSI line on weekly (which is more critical to achieve 75 plus) has reached the overbought 80 level for the first time since April and diverging If nothing else, that may be a warning that the market rally has reached a point where it's in need of a pullback

The volume is contracting , This week we are into these area on SPY with 650 v/s 1000 and v/s 2.0B required by Benchmark for confirmed breakout. This is the 4th failure . There is a larger bearish wedge on Declining volume.



SPX – LT - Bigger Picture – Holding this chart from previous week



Note that the 14-wk RSI is above the overbought 70-level once again. Historically, this tends to be very close to major tradable tops. This one is no different.

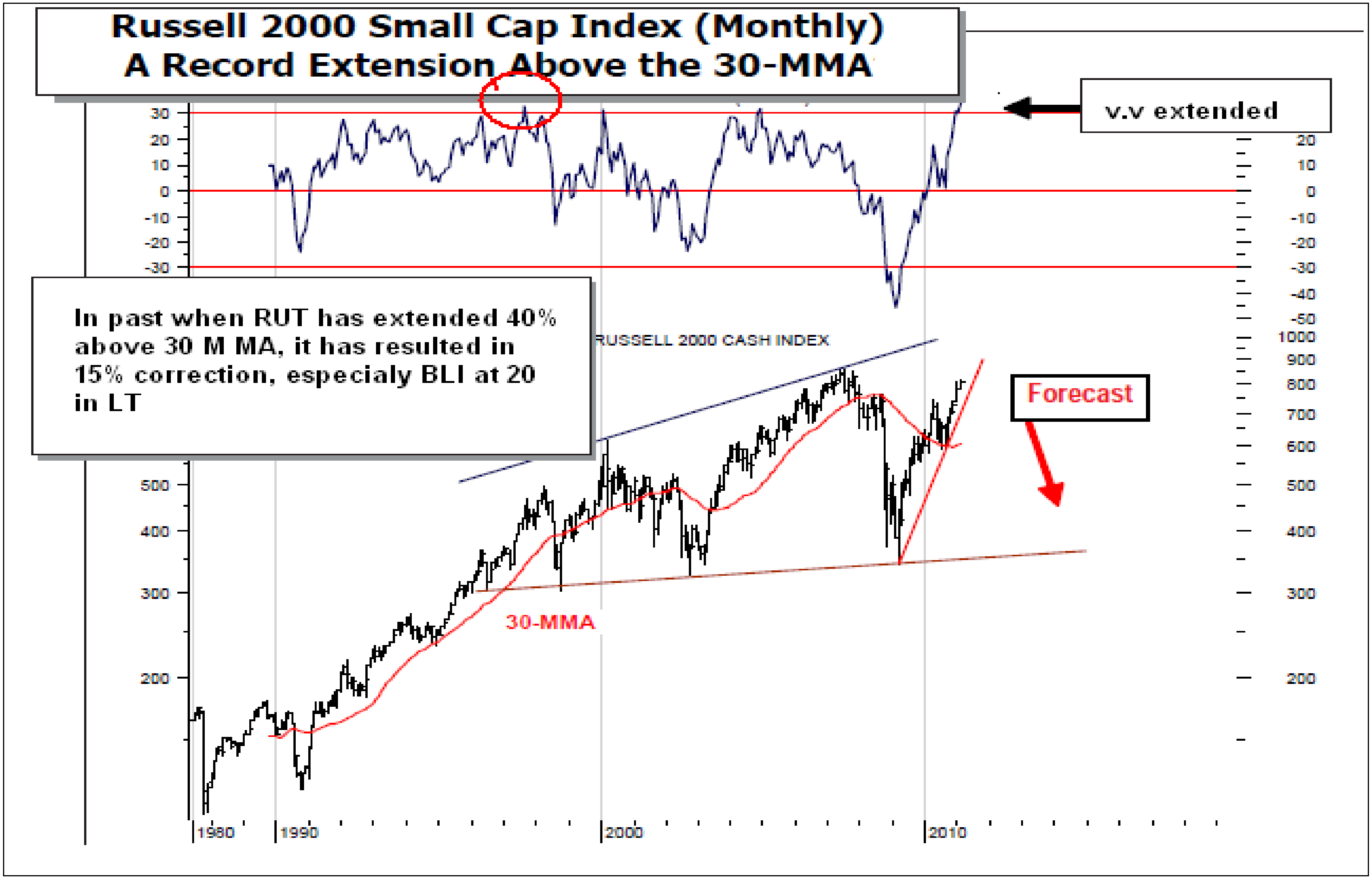
- **Secondary Market Analysis for SPX – POM clues – DOW , NASD, RUSSEL**

DOW –

If Money flow will matter. Our interpretation of this divergence is that we will see a top similar to 2000 where the Dow topped in February and the SPX and NDX topped in March In 2000 and NYA in later

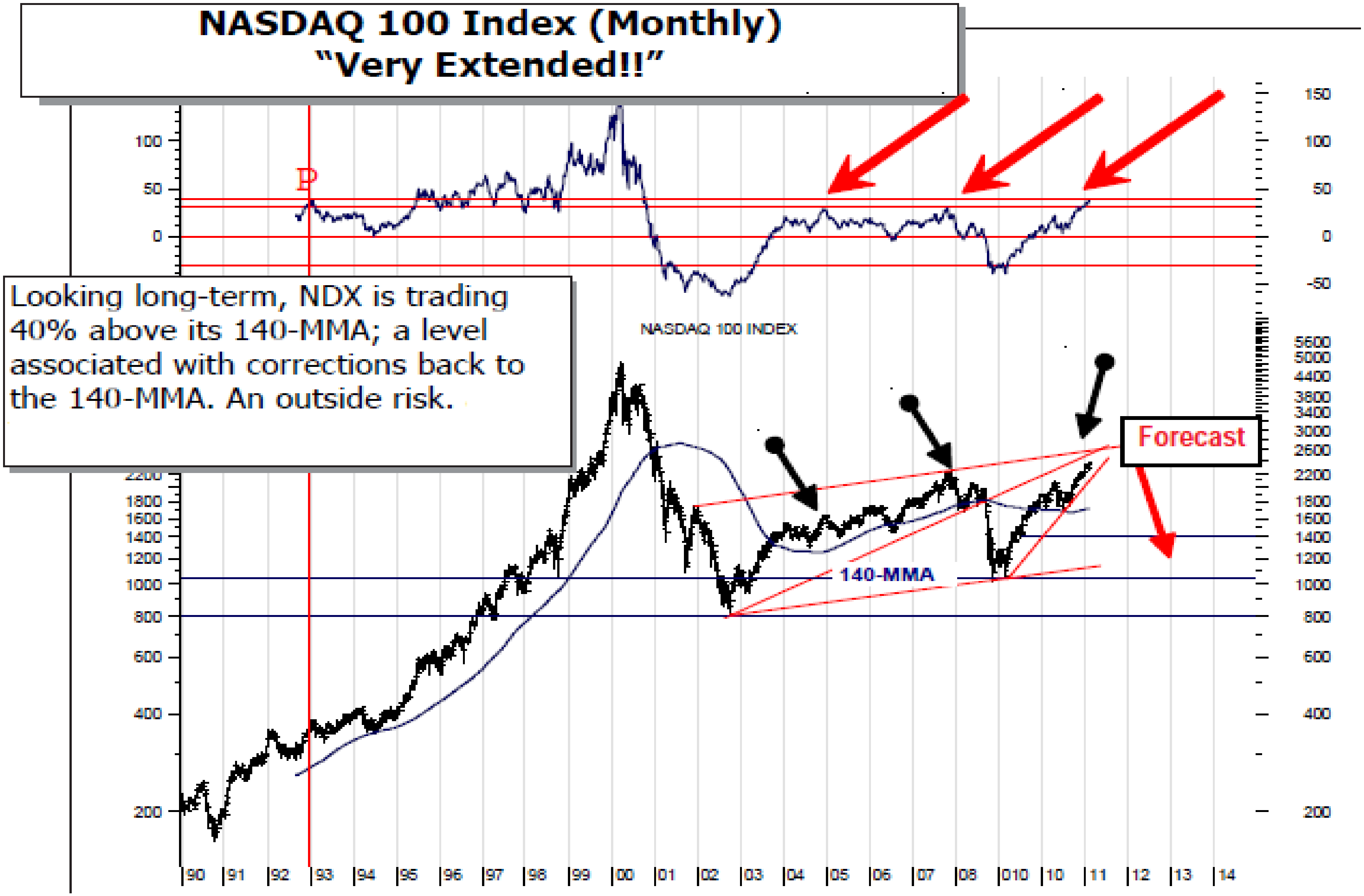
RUSSEL

This is a very LT View on Russell similar to SPX chart above.



NASD

This is a very LT View on NASD similar to SPX chart above.



NASD

Bearish 38% Retreatment of larger move .

- ## <u>Sector Analysis for SPX – POM clues –   BKX, SMH (lead Sectors)</u>

BKX & SMH are the Lead Sectors on radar either for market tops or Bottom, Money flow into these are very critical for market advances.

<u>BKX</u>

The whole banking system is Fed injections of money keeping the sector afloat and giving bank the chance to liquidate their massive positions in bank stocks demonstrated by Moneyflow. .

SMH

Once again, we are seeing bearish divergence on the semiconductor . Can Fed liquidity injections overcome selling in the semiconductor demonstrated by Moneyflow. .

- ## Time Cycle Analysis

Our Time - cycle Analysis is based Seasonality, Calendar events, Astros Harmonics, Geomagnetic (including Bradley Model) & T – Termination. Based on current market condition our observation points out the following condition

Current upcoming Cycle dates (WRONG SO FAR)

- ***8th Jan also coincides with CITI Group study for Major market top 2011-2012***
- ***2011 is 3rd year of the presidential cycle and historically has positive returns***
- ***Our own Study for January in (2003 – 2006) Uptrend & (2007 – 2010) Sideways Market.***

From 2003 - 2006													
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	**Annual**
	Average	**-0.25%**	0.36%	-0.40%	1.41%	1.55%	0.73%	0.57%	0.76%	0.72%	2.07%	2.43%	2.37%	13.00%
From 2007 - 2010													
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	
	Average	**-4.24%**	-3.45%	3.71%	4.99%	0.36%	-3.94%	2.53%	0.28%	1.71%	-3.44%	-1.60%	2.06%	0.32%
Average		**-2.25%**	**-1.54%**	**1.65%**	**3.20%**	**0.95%**	**-1.60%**	**1.55%**	**0.52%**	**1.22%**	**-0.68%**	**0.42%**	**2.21%**	**6.66%**

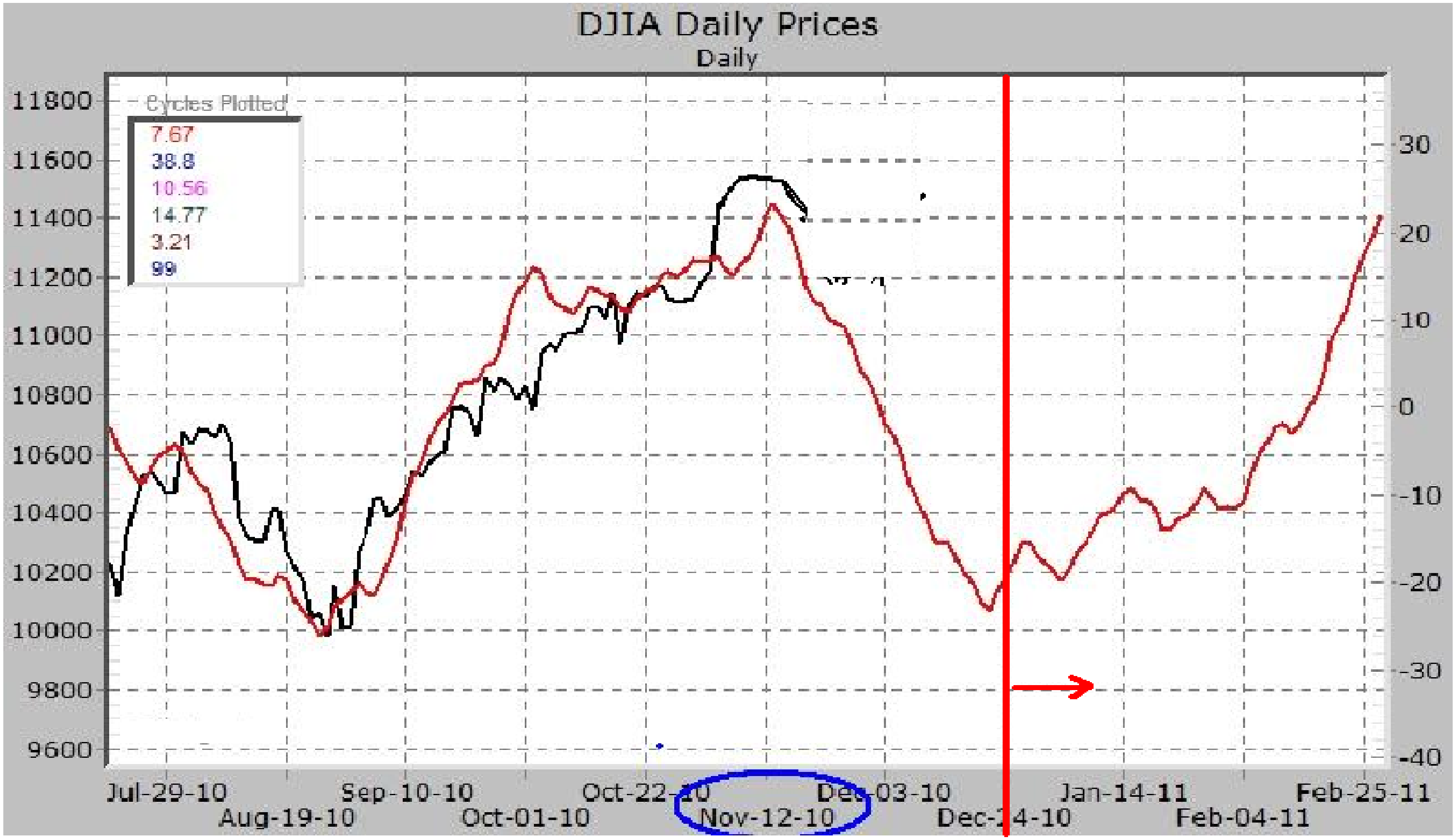
The Bradley Model – Turns Bearish 1st JAN 2011 till 28th FEB - (WRONG SO FAR)

If you look at the model on a long term basis, it also provides a very good outline of what should happen (not always what will happen) over a period of months (We will retain this chart and monitor with SPX)

The 4 Yr – Price path Cycles – Turns Bullish - 28th DEC to End FEB - CORRECT

(We will retain this chart and monitor with SPX)

NEXT TWO MONTHSON CYCLES - BULLISH



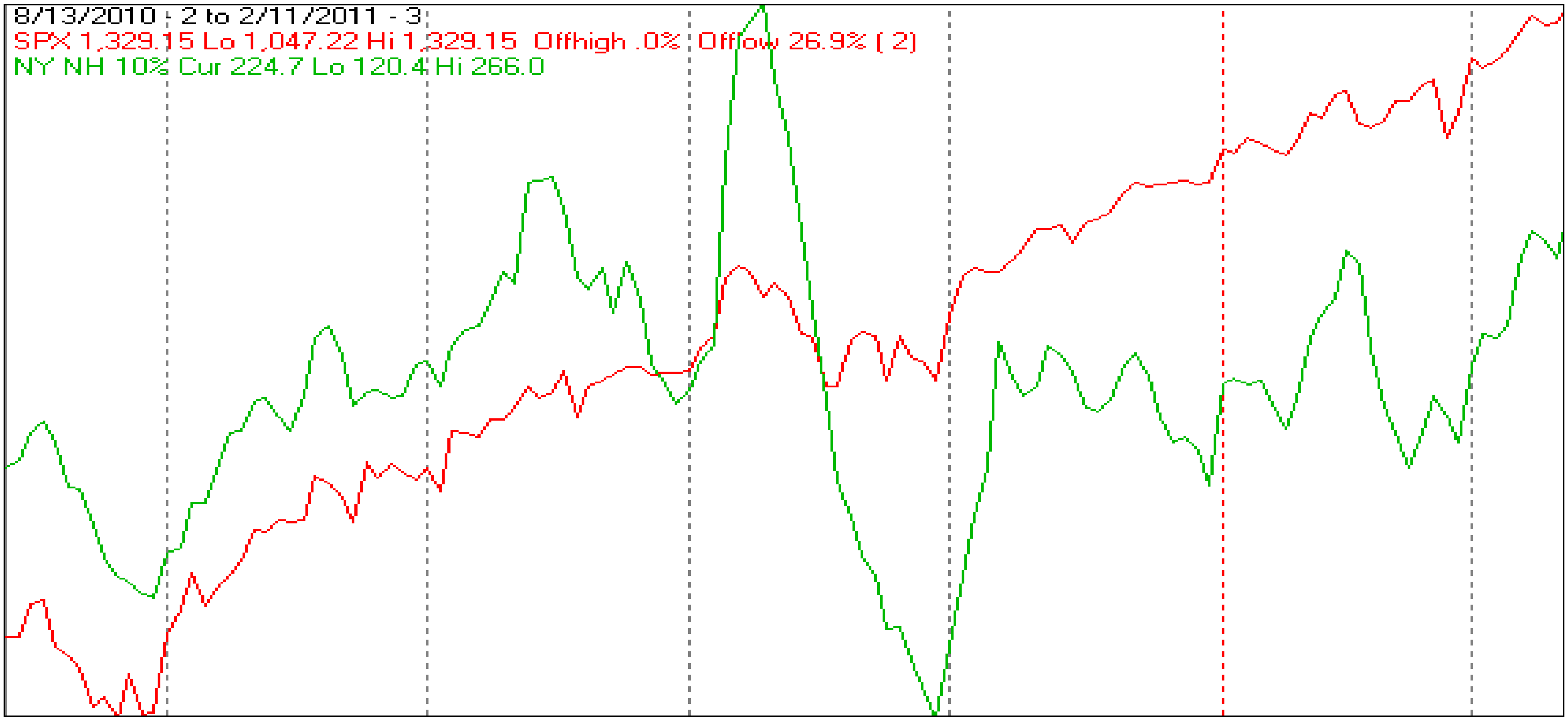
- **Advance / Decline Internal behavior Analysis**

Our A/D Analysis is based on 3rd derivative complex A/D Oscillator instead of conventional A/D Line , secondly it needs to be conformed by the % of stocks above critical SMA's divergences. Based on current market condition our observation points out the following condition

SPX – NH - . NON-CONFIRMATIONS IN SPX BREADTH...

(METHOD 1 – Excluding the Bonds, ETF's and Large cap Equally weighted)

The chart below covers, showing the SPX in red and trend of NYSE new highs:. NY HL diverging substantially since 1st Jan 2011. Last week although lagging was Neutral.



NASD (OTC) – AD Price line - . NON-CONFIRMATIONS IN NASD BREADTH...

NASD doesn't have ETF and Bond funds , Equally weighted AD line . The multi month high in NASD, HL is significant because this indicator has a decidedly negative bias

NH - New highs continue to lag, but, for prices, the trajectory is upward.

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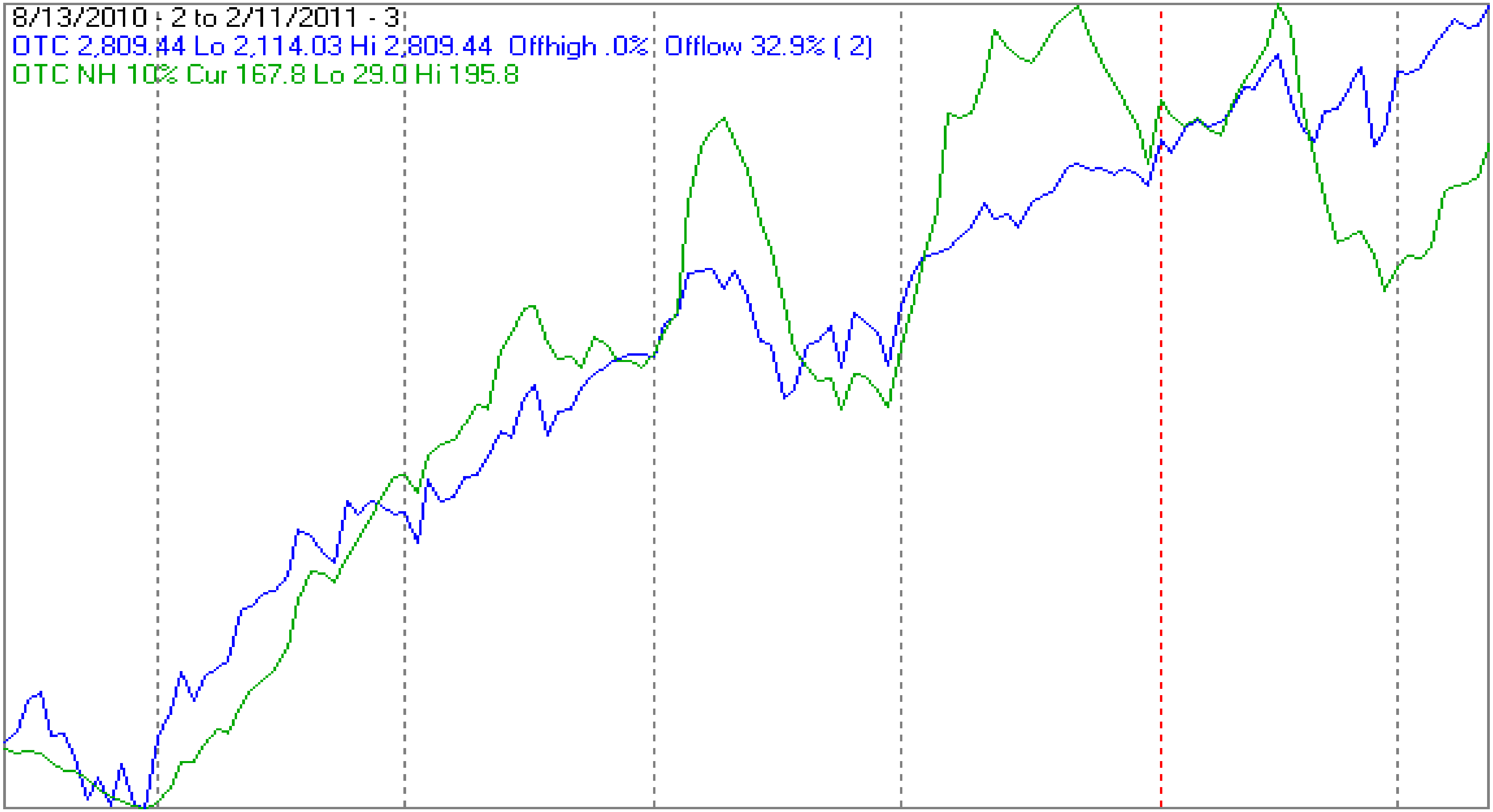


- ## Sentiment Analysis

Our Sentiment Analysis has "Intermediate & Short term" composition. We evaluate (8- 9) Indicators for sentiments out of which some are working well for Short term and other for Intermediate terms These are either Numerical Indicators as the Investors sentiments is expressed through purchases of the market

The Numerical we track are Tick, TRIN Arms, Put / call ratio, VIX Transform volatility (all 2nd / 3rd derivatives) , Rydex flow, Insiders activity. The Emotional / Survey sentiments we track Investors Intelligence sentiment Advisors sentiments. etc. All these are Integral part of POM composition ,

Based on current market condition and the probability of Indicators we point out the EXTERME INDICATOR ONLY as a observation points.

EXTERME INDICATORS

- . **Sentiment (Short term) has reversed** Our Mathematical Indicators such as **OEX Ratio, ARMS, TRIN, TICK, VIX** in their first and second derivatives have reached areas where at least a meaningful pull back has happened.
- **Commercial Hedgers** are at extremes Net position where the Previous tops have occurred
- **Rydex NASD Bull Ratio** are at Positions where the Previous extremes tops have occurred
- **AAII** @ at Positions where the Previous extremes tops have occurred
- **Insiders Selling** @ at Positions where the Previous extremes tops have occurred
- **Speculator Buying** @ at Positions where the Previous extremes tops have occurred
- **Mutual fund cash levels are at 3.5 percent — very close to their all time low of 3.4 percent.**

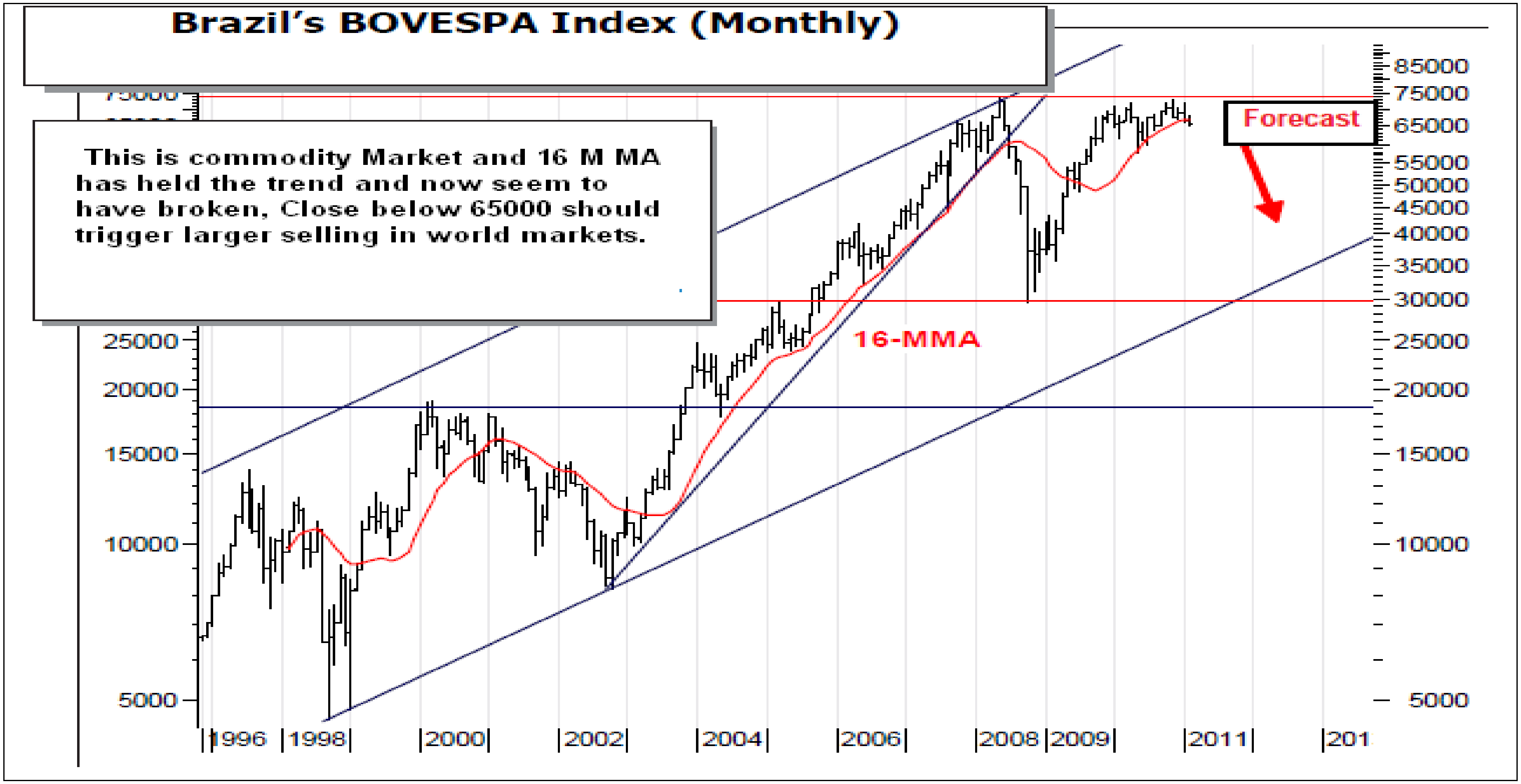
VIX

On Fib level , Retraced back 100% & 1.27 of the breakout Areas to complete ABCD Pattern, usually had quick reaction as change of trend.

- **Global Market Analysis for SPX – POM clues – BOVESPA, AORD,CHINA**

BOVESPA

This is commodity market as the herd is convinced that the "recovery" is about to accelerate and many money managers are convinced that there is no end to the commodity bull market. The CRB Index, which is showing bearish divergence right now, could be in danger of entering a downtrend but BOVESPA looks like ringing the Bell.



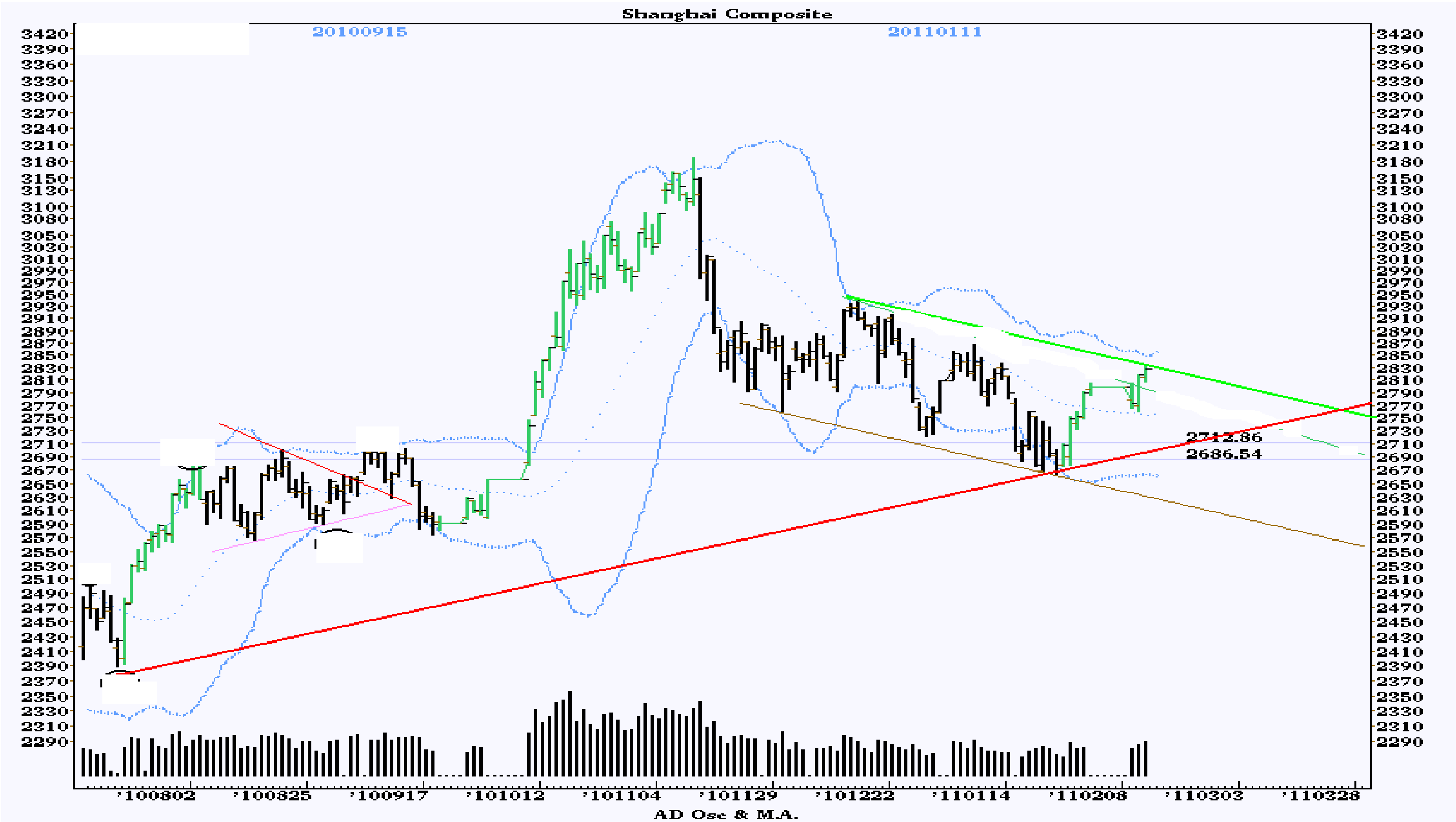
AORD

Australian market, double top and Bearish wedge. It is setting up for a big decline later on. The 50% retracement level represents significant resistance. The bear market rally. We are Tracking EWA closely with this move in Sector PQV

CHINA - MID TERM

Short term we are getting the oversold bounce we expected last week on reaching critical Triangular areas as shown in the Sector Report. China continues to be danger to world markets. Currently we are at the channel lines

Larger picture - 50 % Bounce is still a Bear Market . A critical point at 3000. We have EWH & EEM at the CZ – PQV to capitalize on this move.



Appendix

On closure of 2010,

As we begin 2011, let us Summarize 2010 and put the year behind us. The Aggregate POM Signals for the Full year on absolute basis irrespective of the SPX market moves. Our review is to attempt to do better in the following year as best as we can within our limitations and capabilities.

- ***Long Side – We had (4) clear POM 12 to POM 14 (7.5% FEB, 7.0% MAY, 10% JULY, 9.5% AUG) = Total of 34% up move***
- ***Hedge Longs / Risk Management for Downside Corrections - We had (4) , POM 14 to POM 13/12 (9% JAN, 8% JUNE, 8% AUG & In the last Qtr extended move we had – 5% Drawdown) = Total of 20% Risk management move***
- ***Net Short – We had (1) Clear POM 15 to POM 13 – April / May for decline of 9% = Total move of 9%***
- ***In last 4Q , 2010 – We began tracking " Trend Adjusted Signal" 3X3 / 9EMA - on Long Side - post POM 14 (8% & 4%) = Total move of 12% .***
  - **History - " SPX – POM   Signals & Projections"**
  - ***2010 YTD – This year, we have had (3) clean TREND SIGNALS rise from " POM 12 to POM 14 " for LONG IDEAS***
  - ***FEB - 7.5% ,***
  - ***MAY - 7.0%***
  - ***JULY - 10.0 %***

And   (1) POM 15 to POM 13 (drop of - 9% - April /May) for Net Short Ideas

(3) Risk Managed POM 14 declines to POM 12 or 13

- ***JAN - (drop of - 9 %)***
- ***JUNE - (drop of - 8 %)***
- ***AUG - - (drop of - 8 %)***
-


SPY Daily
Earnings Up Down
10/20/10
POM 15
POM 15
??
122
120
118
116
114
112
110
108
106
104
102
600
400
200
Millions
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct

POM criteria for Implementation on SPX

- ***POM is rated from 10 to 15***

- *POM 14 , 15 (is Sell Signal) and 12 , 11 (is Buy Signal) both are the Actionable Area whereas POM 13 is A Neutral Signal for Risk management*

- *On way UP move, POM 13 signifies to STOP executing additional 'New Buys" that was initiated at POM 12 or POM 11 levels*

- *On way DOWN move, POM 13 signifies to STOP executing additional " New Short Sells" that was initiated at POM 14 or POM 15 levels*

- ***(Bear Markets) POM 15 is for - Net Short & POM 14 is for - Hedge Longs***

- ***(Bull Markets) POM 15 is for -Hedge Longs & POM 14 is for - Partial Hedge***

- *POM 12 & 11 is for Net Long*

- ***POM 10** is Climatic Crash low Buy Signal to add to Net long position **(Rear event)***

Daily SPX - “ Trend Adjusted Signal”

- ## 3x3 /9EMA – Break Indicator

The process utilizes the cumulative Algorithm of price trails 3x3 / 9EMA input signals for Trend formation. This signal tends to work well in Market extensions (i.e. Post POM 14).

This Methodology is implemented by Program Traders especially in Momentum extensions and diagonal triangle formation Trend-following system which bases its reversal signals on breaking a significant closing Break Indicator l to confirm the new trend. (it's important to use a stop if you act on a signal). The reversal price is generated on the close of a bar. (The drawback of strategy is that it can whip saw).

INTERNALS OF 3X3- 9EMA – Break Indicator.

The line break indicator has captured the post POM 14 Moves on a mechanical basis. Although can't guarantee it will continue. But, even if it misses on occasion , it's still is the best indicator we've ever seen in Market for extensions.

Tight trading ranges tend to cause whipsaws and those are environments where trading multiple markets can help for diversification, in SPX & DOW. The reason is that we have a purely mechanical indicator, our line break indicator, that is much better to use. That indicator has proven extremely good over the past several months in many markets in many extensions.

As a reminder of how simple this indicator is, when the market closes above the "break" price level, the indicator is ""bullish"; when the market closes below the break price, the indicator is then "bearish". at the close