SG Capital Research

Global Market Insights

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

**MAEG- WKLY MKTSTR- GL- POM -SG 2011 # JAN 17**

***For Immediate Release – Monday AM (EST)***

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# Market Strategy Global (A # 1) - SPX – Closed @ 1293 – Wkly change ( +22 points)

**Analysis of Broad Market that includes – Jan 1st 2011 – SPX 1257 ( up 2.9%)**

- **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 – NASD, RUSS, NYSE**
- **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**
- **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 Calls – None so far this year.***
    - ***Trend Adjusted Signal – On Buy Signal carried over from 2010 . On Jan 1st 1257 – SPX to Current Stop 1269***
- ***Hedge Longs / Risk Management for Downside Corrections -***
    - ***We recommend fully Hedge on long positions via the SETUP – PQV Hedge Index, we have a Drawdown of -5% 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 )***
- ***Net Short –***
    - ***POM 15 Calls – None so far Triggered this year ( 8 of 20 Sectors have reached CZ / PQV & 6 More Sectors pending tests)***
    - ***Our Target has remained for SPX 1250 -1280, Pre – Lehman Crash Area tests***

- ## SPX Signals & Price Projections

- ***UPSIDE Target*** *- 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 1250-1280. ( We have approached this area, Monthly lose below 1280 should be a good signal ). We could very well trigger POM 15. Meanwhile we continue to remain POM 14.*

- ***DOWNSIDE Target -*** *Our Pull back from here should be to 1130 ( 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*

- ***SHORT TERM Target*** *- Daily Bearish Wedge has the downside target of 1175.*

- ## Daily SPX - " Trend Adjusted Signal"

### 3x3 /9EMA – Momentum Break Indicator – Long @ 1228 SPX

- **For Bull case - Previous long exit was on 11/17 at 1193 from 1105 entry 09/05 for 8%**
- **For Bear case - SS from last Sell Signal at 1193 to 1225 = - 2.6%**
- **For Bull case – Current long position from 1228 is up 3.7%**

***Currently " Trend Adjusted Signal " has Reversal stop @ 1269 SPX .***

***We would consider all 3 major Indices to Trigger below Trend Adjusted Signal, Upon rejection of volume in CZ – PQV***

***SPX – 1260 , DJ – 11650 , NDX – 2275, RUT – 785***

- **Market Insights**

- ***The Fed's QE2 operation continues to provide buying power for equities and make it very difficult for stocks to actually go down, so any correction which does play out could turn out to be a buy-the-dips setup for Traders and some weak hands. The Fed has pledged to hold the financial system up as long as it takes to reflate it.***

- ***Currently the market is at the point where crucial small stock sectors are weakening in relative strength to the big blue SPX and Dows and that's a warning that we are approaching the end of the rally phase on several timeframes. Another sign of an approaching high in equities is the strength in the USD, which for many years has moved contrary to the stock market. Past week Euro has been weak and this morning its translating into weakness in European markets.***

- ***Last week the market continued sideways overall, but important bearish divergences are building which are typical of late stage top formations. In particular, some of the strong broad market indices which had been the backbone of the advance are begin to diverge substantially on rallies. Overall, we expect a minor correction in January, but another move to higher going into early February in Majors . But, that may be the final rally move off the March, 2009 lows before a resumption of the major trend to the downside.***

- ***Although this market is showing telltale signs of breaking down in MID CAP & RUSELL, the risk-reward of a Net Short position comes in after the first break and failing rally. Till we get a that scenarios, nothing changes in the chart as topping process continues, we are awaiting for any Exhaustion here to Trigger POM 15***

- ***On very short term - The pattern in the market is the typical diagonal triangle. We had three of them back to back and now the 3rd one should diffuse very soon with quick 20-30 points drop similar to previous 2 occasions. Although our focus is intermediate term, the short term 3X3 / EMA stop is 1269 ( where momentum traders may bail out) .***

# Primary Market Analysis -

## SPX – ST

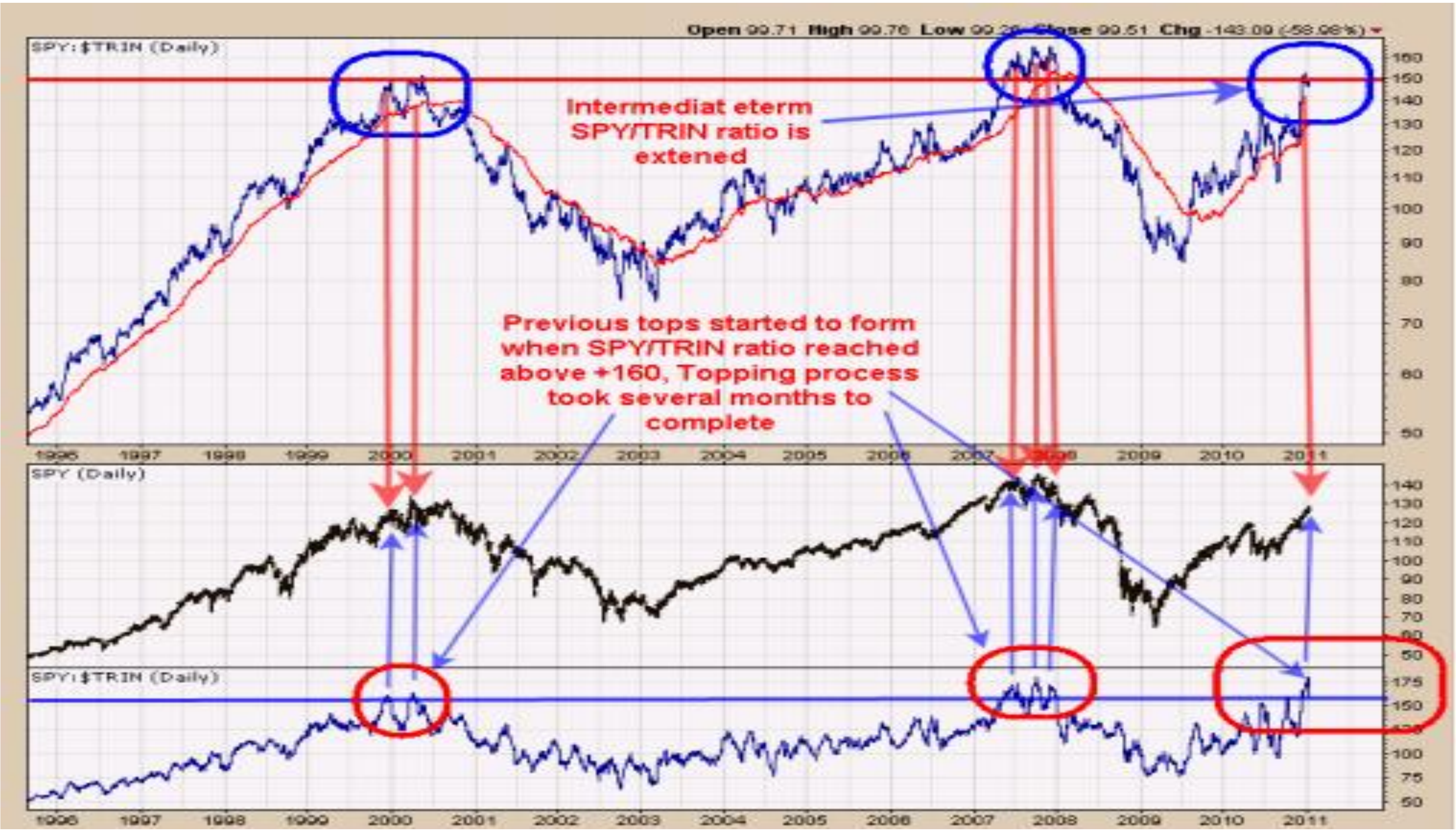
***According to the count shown, we're in a wave 4 with a final wave 5 rally to go to finish, the most unreliable of waves . Most of the time the market will make a higher high, though. On Short term the oscillator acting little bullish may have little room to move. Intermediate the early March, 2-year anniversary of the 2009 low some times those historical turn dates gets to be meaningful ( This can very well be lower highs or Secondary if not the top). The point to note – Momentum based price projections in overbought territory can fizzle out on slightest of the triggers***

## SPX – MT - MA’s & Trend lines

***On Mid term basis we are looking at the Bearish Wedge to fail, then snap <u>back to 1230 target</u> first 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 – TRIN ( View 1) - MID TERM –

***Intermediate term view of the SPY. There are two different configuration SPY/TRIN ratio to determine a short term view (A couple of months) and an intermediate term view (6 months or longer). The bottom window is the short term view of the SPY/TRIN ratio and it has reached levels where in the past has stalled the market, which is a reading above 160. The top window is the intermediate term view of the SPY/TRIN ratio and it also has reached levels where the market made little headway. Market may hold up into the March timeframe.***



## SPX – TRIN ( View 2 ) - MID TERM

***Longer term view of SPY dating back to mid 2008. When the blue and RED line of the SPY/TRIN ratio has a big separation (like now) it suggests than an intermediate term move is not far off. For a top to be signaled by this indicator both the red and blue line to turn up. Both the blue and Red lines are on separation the uptrend is nearing an end. Market could hold up into March***.

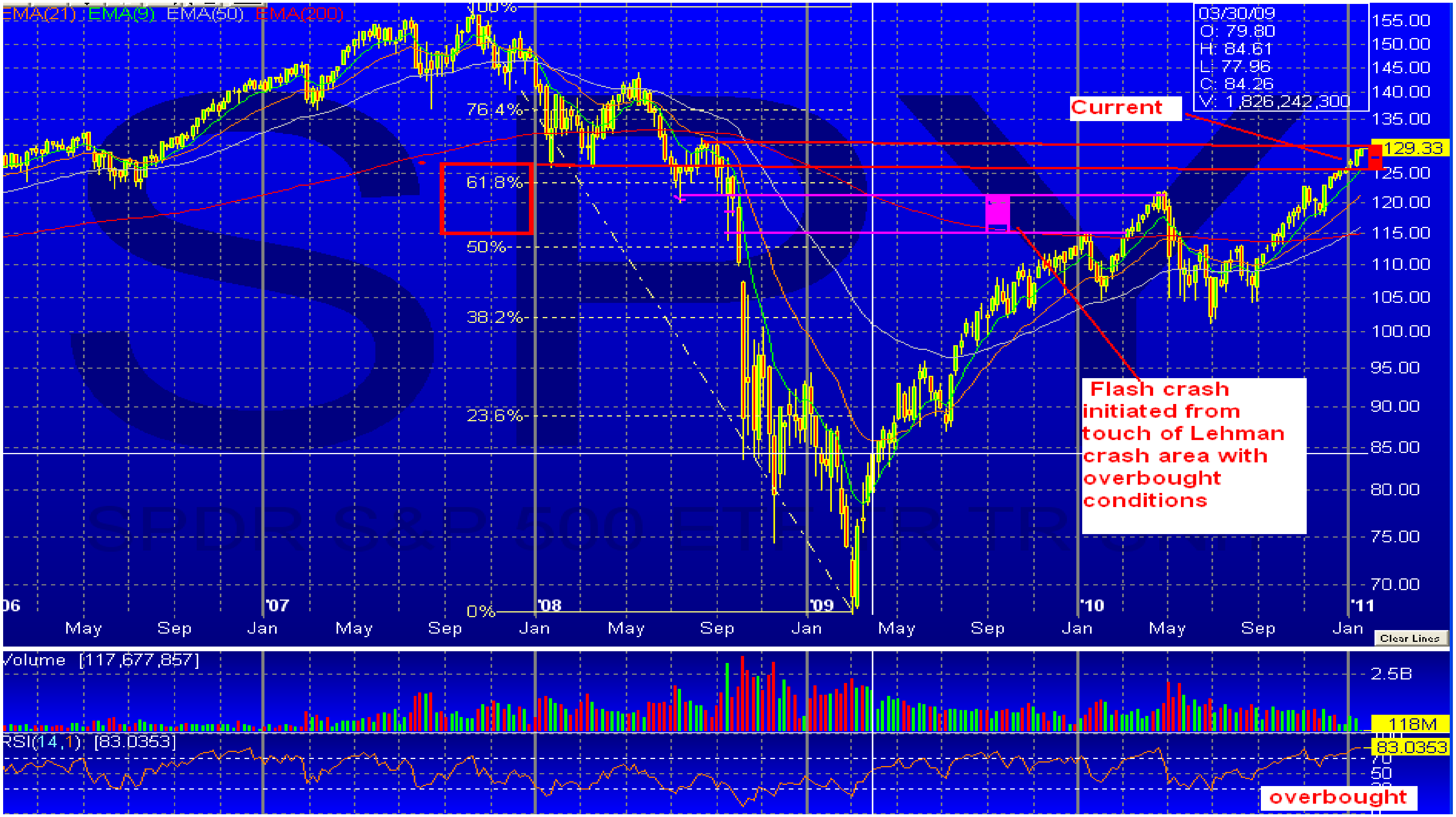
## SPX – TRIN ( View 3 ) - SHORT TERM

***On short term there could be little more room to move ( The second window from the bottom the Tick indicator) can stretch itself and go to +300. We have marked with red arrows when there were ticks above +300 and some room for SPY to move higher or sideways as the tick approaches above +300. Right now the ticks are +259 and below the area where highs in the SPY can occur.***

# SPX – LT – wkly  Bigger Picture

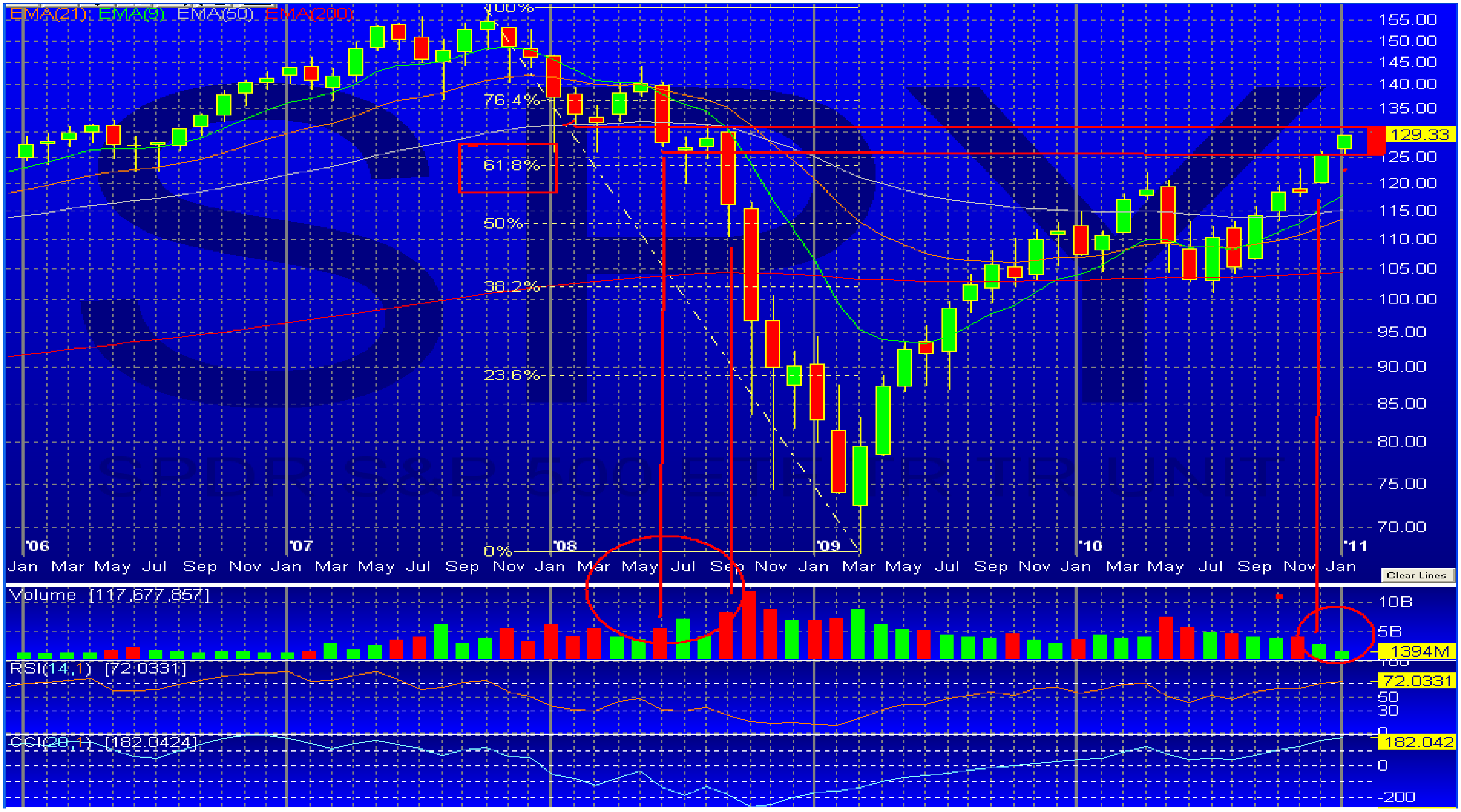
***The weekly bars show the market trading at the highest level in more than two years and in a potential resistance zone marked by the early 2008 low near 1270 up to the summer high near 1280 (see lines). The S&P 500 has also retraced two-thirds of the 2007/2009 decline which often acts as a resistance level. More importantly, the RSI line on weekly ( which is more critical to achieve ) 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 <u>SPY with 500 v/s 325 v/s 350M v/s 600M v/s 800 M v/s 1000</u> 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.***



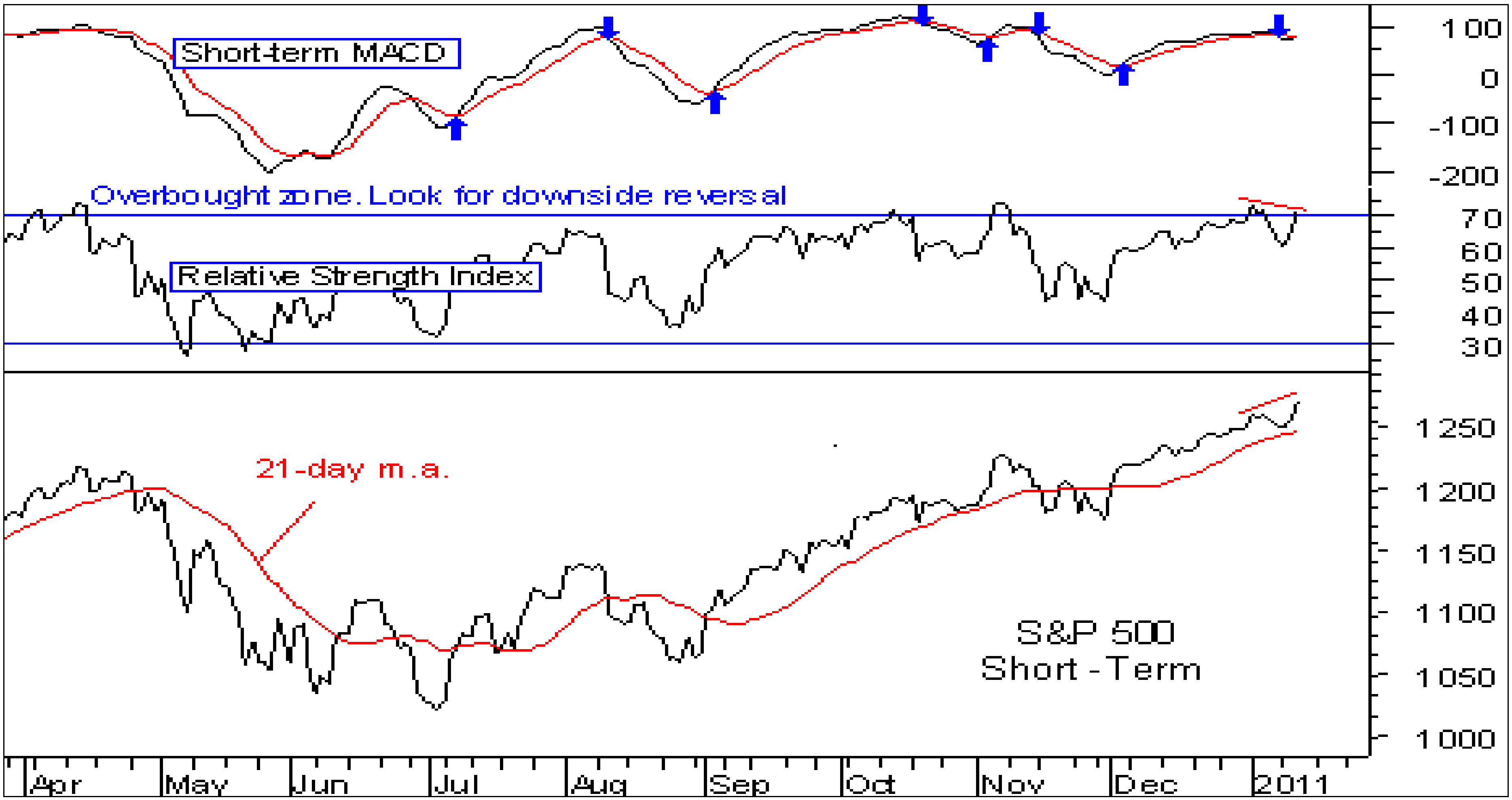
# SPX – LT – Monthly - Bigger Picture

***The Monthly RSI above 70 is very hard to achieve, we are currently in that area as indicated in red, approaching with lighter volume. The Leman Crash month is more visible here. If we close below 1280 this month, it should be rejection on monthly basis. We are in 61% retracement area which suggests the market may be trading range from 1280 to 1135 for some time .***



## SPX -

***Extended beyond 21 – DMA by wide margin and MACD has turned down. RSI is clearly diverging, First wait for 21D to break and then test it under below the DMA, that should be intermediate Sell Signal***



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

## NASD –

***Strength in NDX keeps the line break indicator from breaking , On poly trend lines suggest the risk to downside, Diverging money flow.***

## NYSE –

***The volume oscillator is diverging and like SPX - T looks for an uptrend into The 1ST Feb and then 2-year anniversary of the 2009 low.***

## RUSSEL

***Small caps are diverging negatively and that is a warning sign, . Russell had high olume with Bearish engulfing and currently testing the highs of Bearish engulfing. This is all part of topping process within CZ of PQV price criteria.***

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- **Sector  Analysis for SPX – POM clues –  BKX, SMH ( 2 lead Sectors)**

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

## BKX

***BKX  right on the other side of Poly Trend  and diverging bearishly against the money flow index. This leading sector is very weak and warning of problems to come. Not much interest in Bank stocks in spite of the SPX rally.***

## SMH

***Despite a last-gasp rally in SOX, the insiders are not bullish.  GDX had the similar situation 3 weeks ago before its fall.***

- ## [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

- ***Past 6 yrs since 2004, NASD has dropped every year from $8^{th}$ Jan to $31^{st}$ Jan with average -3.5% loss worst being -7.5%.,***
- ***$8^{th}$ 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***
- ***Time cycles are concerned, is forecasting a January peak in the stock market and a decline to mid-February, which fits very well with the extended condition of this market.***
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- ***Earnings Cycle to begin very soon, Last January, April, July had triggered the Selloff, however the September it did not work . We would certainly like to see the impact post $15^{th}$ January if the good earnings are already priced in or not***
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- ***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%** |

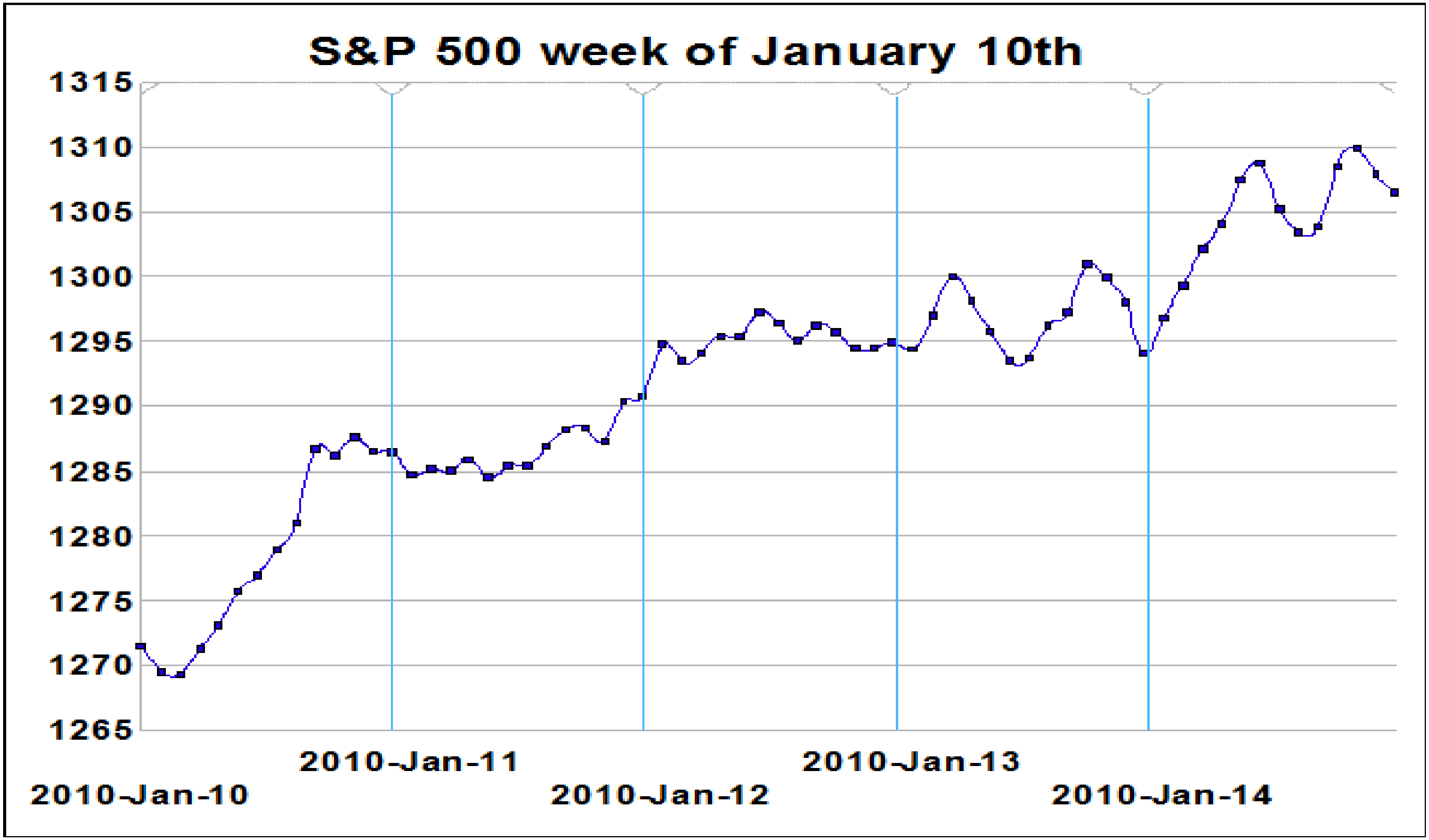
## The Bradley Model – Turns Bearish 1st JAN 2011 till 28th FEB

***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 )***

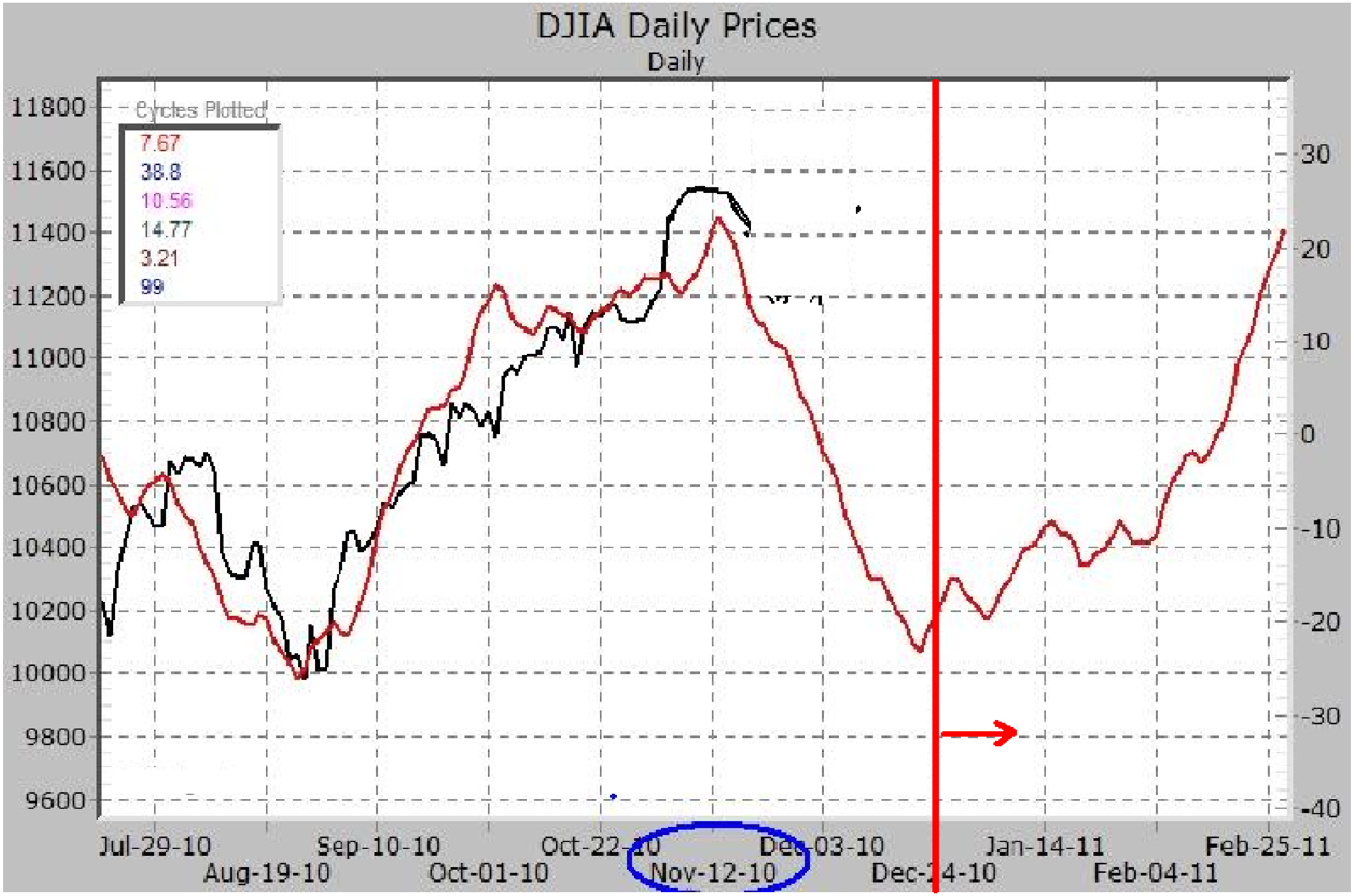
## The 4 Yr – Price path Cycles – Turns Bullish - 28th DEC to End FEB

*( We will retain this chart and monitor with SPX )*

***NEXT ONE WEEK ON CYCLES - BULLISH***



***NEXT TWO MONTHSON CYCLES - BULLISH***



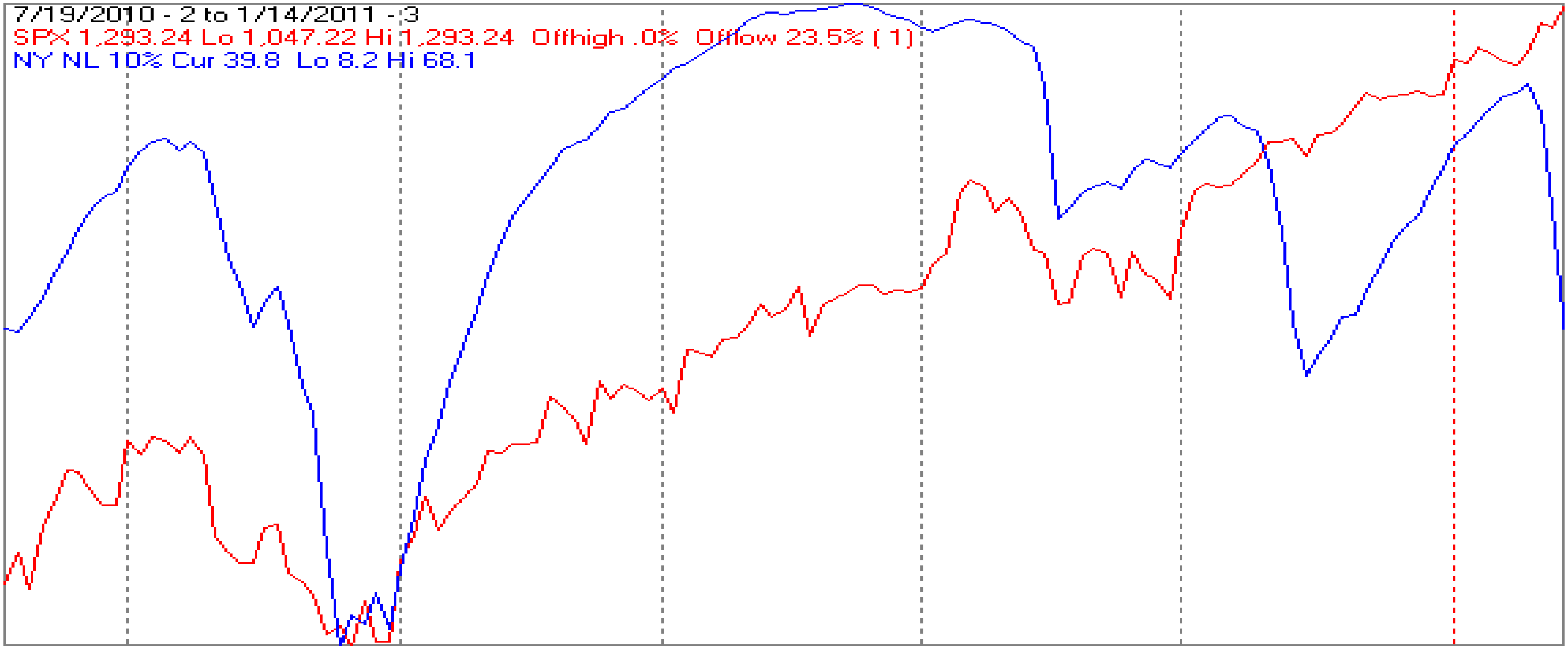
## • Advance / Decline Internal behavior Analysis

***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...**

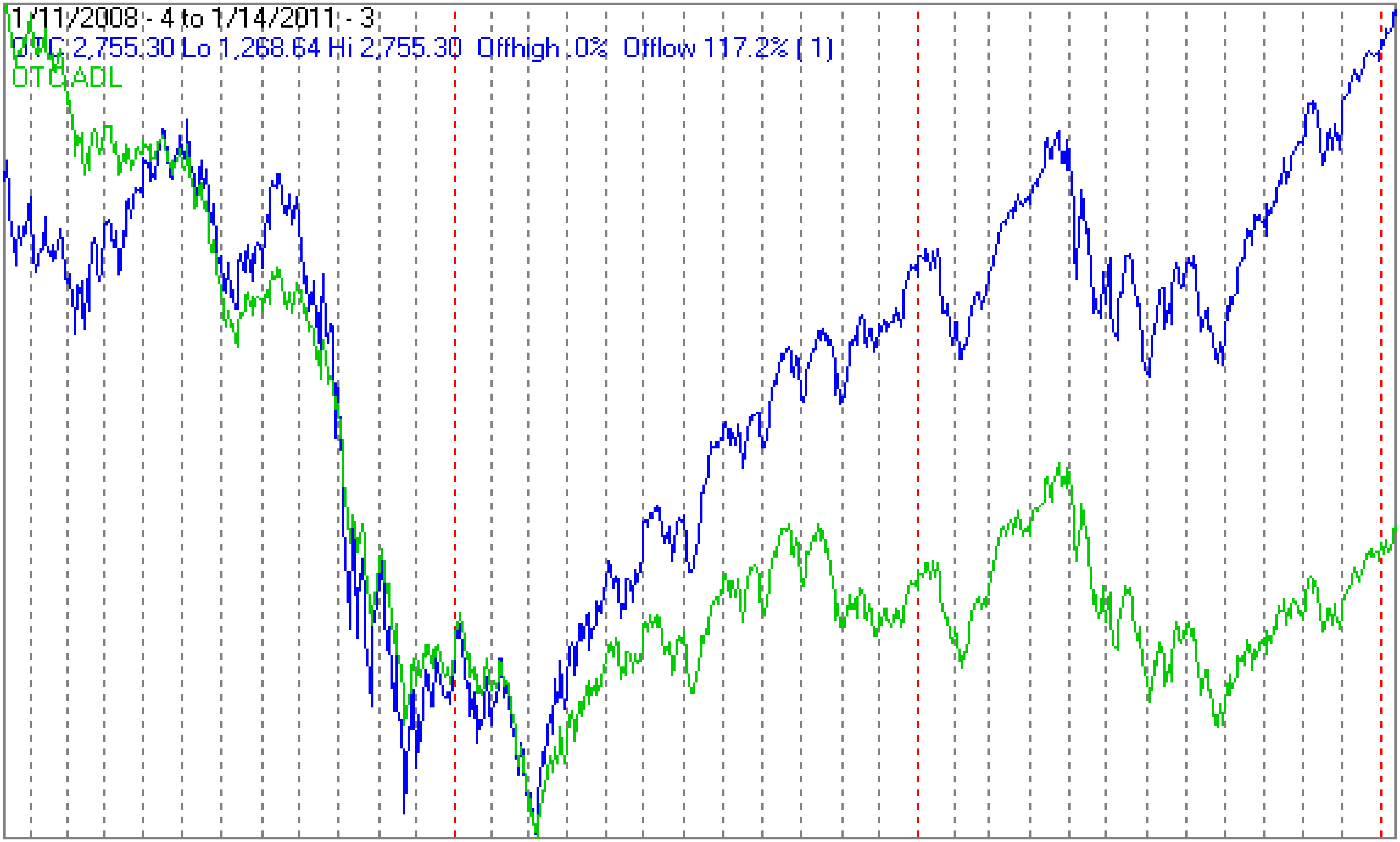
**( METHOD 1 – Excluding the Bonds, ETF's and Large cap Equally weighted)**

***The chart below covers, showing the SPX in red and a 10% trend of NYSE new highs (NY NL) in Blue. NY NL moved sharply lower last week. NY NL also fell sharply in mid December with no effect on Index , but that pattern (new lows increasing sharply while SPX ).***



## 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, ADL is significant because this indicator has a decidedly negative bias.***



**NASD (OTC) – % Stocks below 50 DMA are lagging - This AD line has worked well even from Sept to Nov time frame and now diverging from Nov to Jan**

- ## 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 ,***

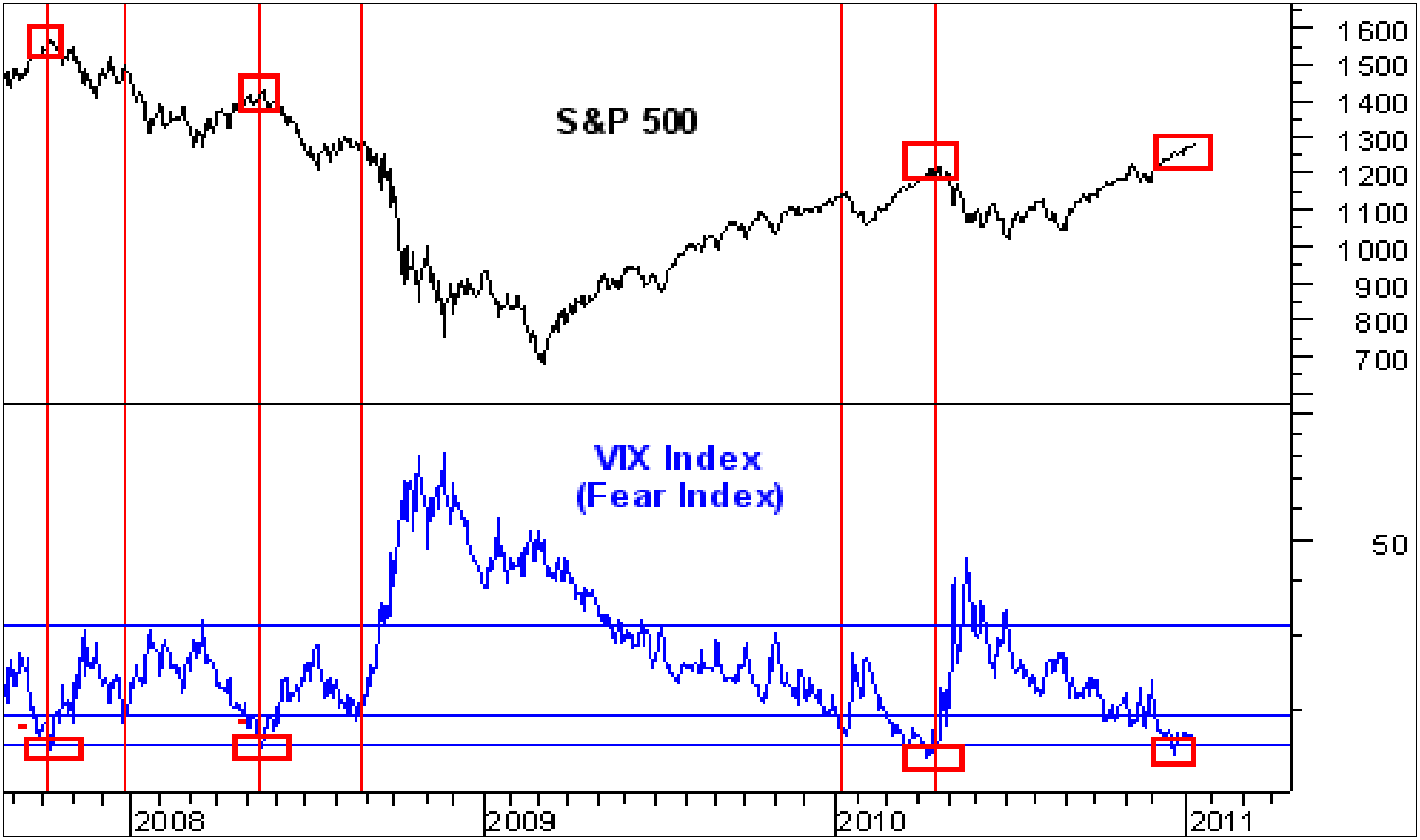
***Based on current market condition and the probability of Indicators we point out the EXTERME INDICATOR ONLY as a observation points.***

## 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

***Since October, the VIX index with sentiment of options players, has been in the zone of extreme low fear seen at each of the rally peaks since 2007, and in the last two weeks declined to the lower limit of that zone. But it is at levels where the risk is high, especially when combined with the unusually overbought condition.***



## VIX – This is very significant

***VIX had finished ABCD pattern similar to last April .***

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

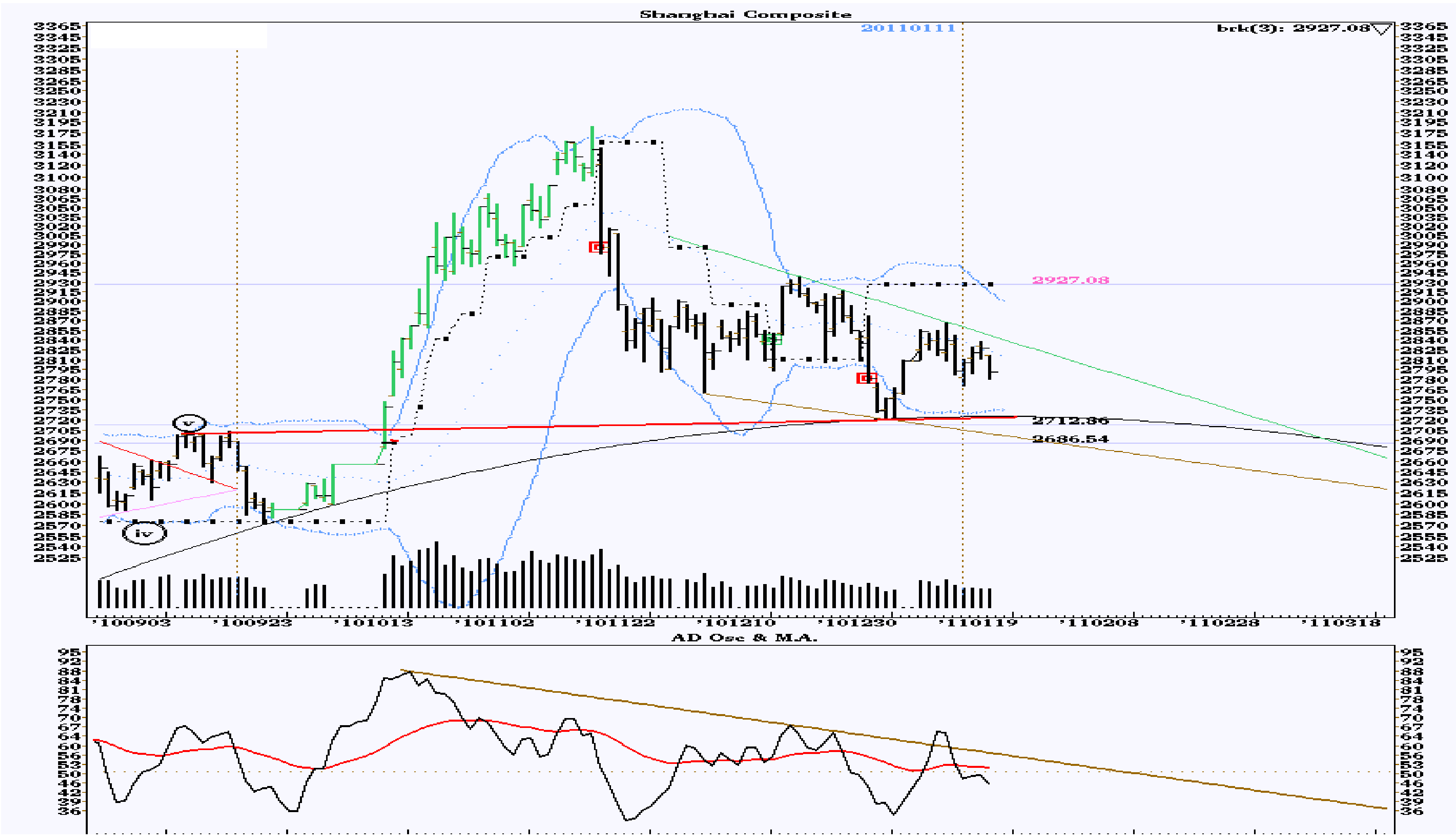
## AORD

***Bullish Oscillator divergence from past week proved its merit for rally  spot on . EWA should be reaching the CZ . This market is double topping***

## .CHINA -  MID TERM

***SSEC remains in a descending channel as it approaches a support line. China's economy is on thin ice with inflation out of control.***

***50 % Bounce is still a Bear Market . Shanghai has been very weak recently, At a critical point at 2950 , Converging trend lines & EMA's produces a formidable resistance . We have EWH 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% .***

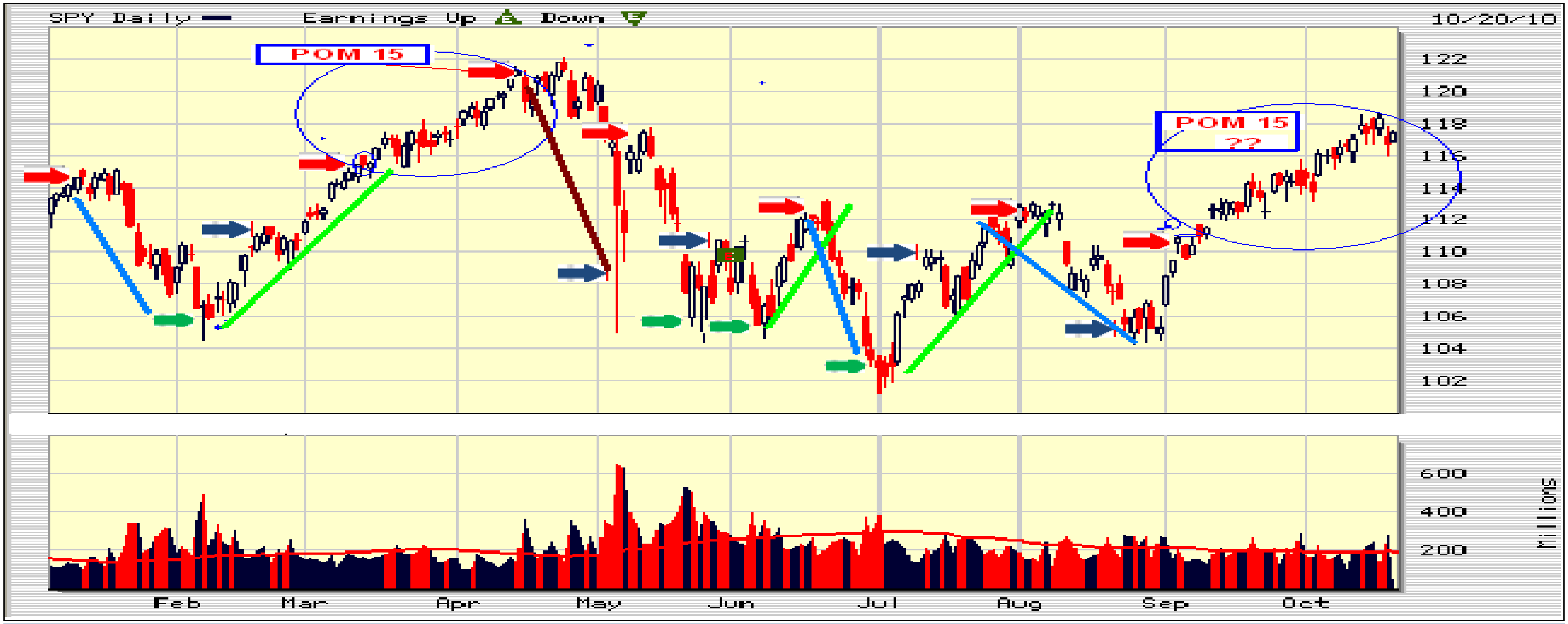
- **History - " SPX – POM Signals & Projections"**

- *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*