SG Capital Research

Global Market Insights

Research Note – Market Strategy – Bi – Weekly Interim Update (A# 2)

MAEG- MARKET STRATEGY INTERIM UPDATE # SG 2010 # DEC 23

For Immediate Release – Thursday AM (EST)

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Market Strategy Global (A # 2) - SPX – Closed @ 1258

We have picked up charts (below) that has some distinct characteristics from observation & Special Situation this week based on our assessment:

- ## Coverage

- **9EMA / 3X3 Strategy – DOW & SPX**
- **SPX – ST,MT,LT**
- **TLT**
- **IWM – PQV Pattern Analysis (only If > 2.0 SD)**
- **EWA - PQV Pattern Analysis (Special Situation)**
- **QQQQ – PQV, Pattern Analysis (only If > 2.0 SD)**
- **EEM – PQV, Pattern Analysis (only if > 2.0 SD) –**
- **EEA – PQV Analysis (if > 2.0 SD)**
- **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 <u>Unidirectional</u> 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

- ***Post POM 14 (SPX 1104) - We recommend <u>Fully Hedged positions</u> for Longs that were triggered at POM 12 @ SPX 1020 in July 2010 and / Or at last POM 13 @ 1045.***
- ***Via accumulations in the "SETUP - PQV VALIDATED EQUITY INDEX – EQWT (from Sec E – MAEG) , with desired price points & scaled entry @ the Mean Confluence Zone on these weakest Equities in Setup # 2. This would capitalize on current situation (Within RA / RI framework for Risk management) .***
- ***No Net Short Position" till POM 15 Re- run is triggered.***
- ***The price Equilibrium and favorable Risk / Reward opportunity will come at POM 13/ 12. This area we would be interested again***

- ## SPX Signals & Price Projections

- ***Our post POM 14 move in SPX has been extended. We are seeing signs of POM 15 and extensions especially NASD / IWM and confirmed POM 15 for on SLV stocks.***

- ***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)***

- ***Due to seasonality 1160- 1150 SPX may hold first time around for the bounce.***

- ## Daily SPX - " Trend Adjusted Signal" - UPDATED

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%**

Currently " Trend Adjusted Signal " has Reversal stop @ 1244 (Revised) SPX & DOW 11433(Revised) .

- **Insights**

Some history on QE -2's – Reports from Reuters……… *" When Japan fell from 40,000 to 8,000 in the Nineties, one of the programs the Japanese Central Bank embarked upon was Quantitative Easing (QE), which the Bernank is emulating today. While QE was a total failure at stimulating the economy, it was a total success in levitating stocks---not back to the old highs, of course, but the Japanese market did rally to 18,000 while QE was being conducted. When QE ended, the stock market prompted fell in half (i.e., it dropped 50%). And, a second round of QE had the same result.*

We've seen a similar result right here in the US. QE1, which the Fed engaged in until April 2010, saw the market rally from 666 to 1220. The market then suffered a mini-crash into July. At that time, the Bernank and the other Fed members started talking about QE2 and the market has risen from 1010 to 1259. So, it's apparent that the plan was always about lifting stock prices, not bond prices as was publically advertised, and QE2 is actually a big success in achieving its real goal. It has levitated stock prices to nosebleed valuation levels and will surely create another big downdraft once it ends, which is scheduled for June 2011. Of course, it could end earlier if the Fed decides that inflation is going to be a problem and/or the economy is apparently on a sustainable growth path. The irony will be a stock market dropping 50% as the real economy resumes "normal" levels of growth. But, it wouldn't be unique and it has happened before. The Fed can't manufacture earnings out of market buying power (the Bank of Japan couldn't either, which is why QE was an abject failure for them while making stock traders happy").

- ***As far as we are concern, without QE 2 , this market would have topped out by SPX - 1145 – give or take 20 points on extension and that was our potential spot for POM 15 to be Net Short. But the Fed pump as produced extra 100 points which we don't think(in the intermediate term) is there to stay forever. Although at 1173 we had the reversal signal in few matrix especially EURO & FTSE gave that warning but we thought it was not tradable (that itself has lasted 70 points)***

- ***However this extension has made us look for points of stoppage on this run. Below we have provided the case study on SPX – Price and volume at potential stoppage points purely based on laws of physics.***

- ## Internals

- ***For us based on our market read the bigger picture shows early January as a potentially significant change in trend period of time. If the stock market is rallying into the first week of January, it could be vulnerable.***

- ***The Bullish is at extremes that most of the market observers are expecting a minor correction, followed by a move to new highs into January, February, March or April on Presidential cycle to finish in May. It would fool the most if the market actually topped right here, but we will see.***

- ***Near term we could get a dip, (possibly Fed is on vacation and may not send its daily check of $ 10b to the market every morning) then with a quick recovery back to the upside due to seasonality , which would undoubtedly convince the sideliners in cash to dip back into the market on the bullish side.***

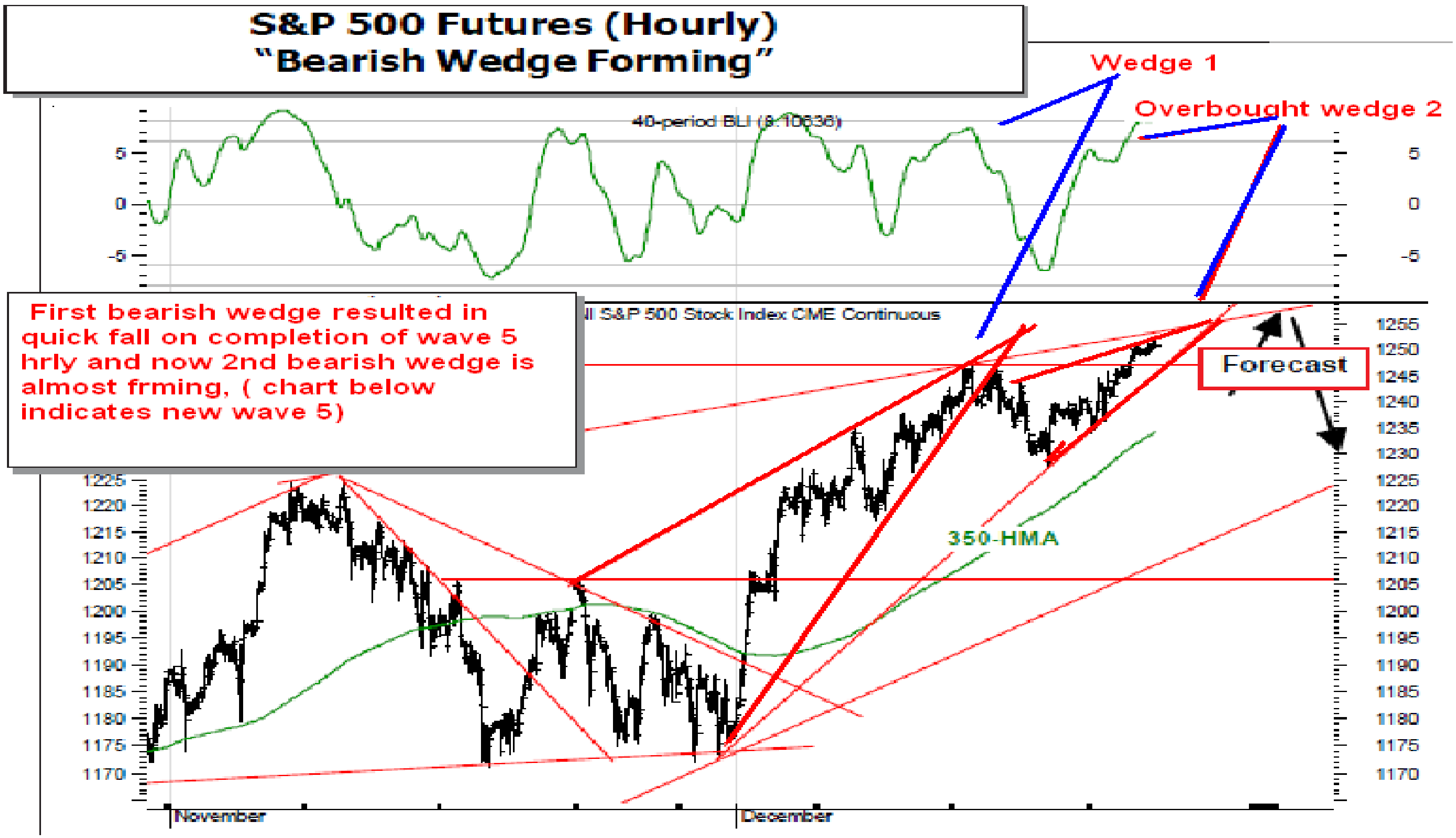
- ***That would setup the first few days of January as a potentially significant "bull trap" as the market tends to make trend changes in January due to forecasts for the entire year affecting near term positioning.,***

- ***On very short term - The pattern in the market appears to be the typical topping pattern, a diagonal triangle. We had two of them back to back and could very well have the 3rd. In market usually things happen in " Three" . But as we know , this is a weak pattern even though it occurs at new highs. The pattern involves internal 3-wave sub waves, to 5-wave moves. Although our focus is intermediate term, but short term 3X3 / EMA is still on right side from 1228 and revised stop is 1244 (where momentum traders may bail out) .***

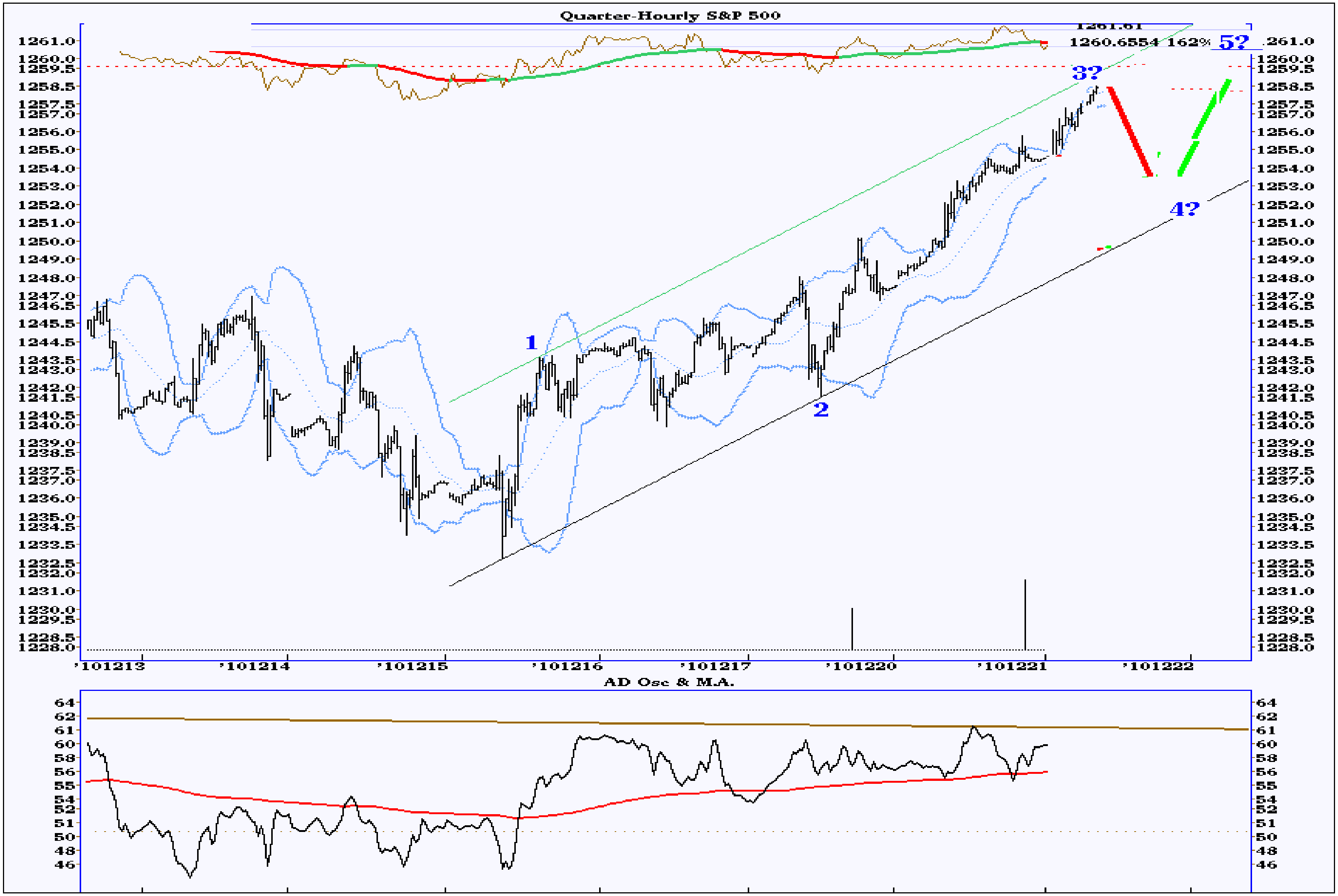
- ***Jerry Minton 3rd phase – 20 day seasonal began last night at 1258 – SPX we will monitor this till 31st Dec close price***

SPX - Hourly

The second bearish diagonal triangle is in process and almost on hrly wave 5 which had a projection of 1262 and then market could snap back 20 points quickly juts similar to last time as ST indicators suggests (See the notes within the charts).

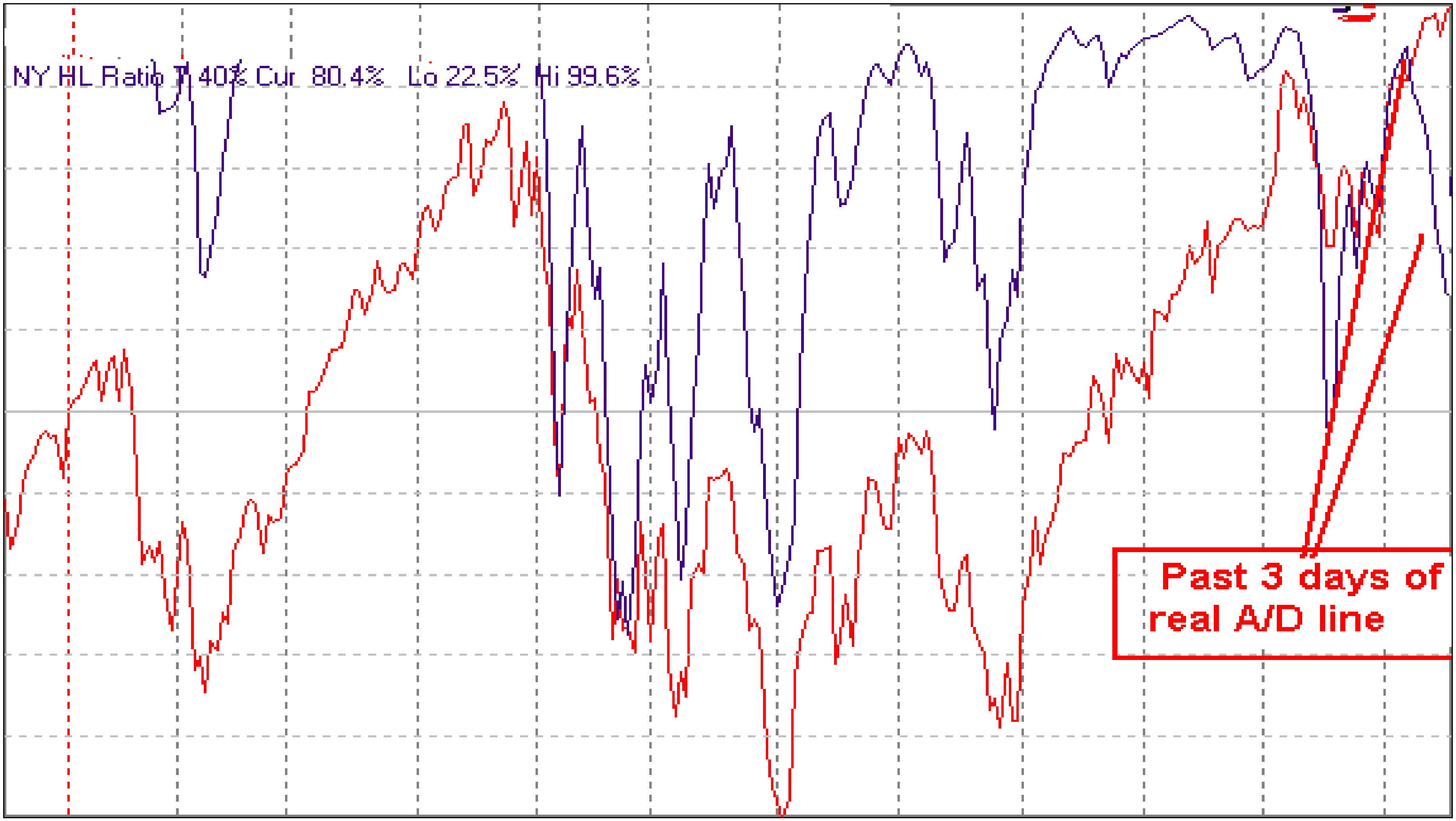


SPX – Wave 5 hrly



A/D -   (Actual) - NH – NL – Past 3 days

The new high / new low is not confirming the new highs in the indices, especially past 3 days. That may be a very Short and intermediate term negative, This suggests QE -2 flow continues entry into Indices and not as much in Individual stocks.



A/D - (Followed to make Bullish case)

Now even if we take the A/D line that Bullish case is made by market observers based on A/D line has followed the market with respect to April….by this measurements Market is topping out.

In this case we measure, the percentage of stocks above a certain moving average is a breadth indicator designed to measure the degree of participation. At their most basic, these indicators have a bullish bias. This indicator is always late. Currently this indicators is also diverging negatively

SPX – Case Study on Price and Volume at Inflection point @ 3 D

Chart 1 – SPX (This is case study to demonstrate chart 2,3 behavior below)

- ***The first chart below is our main chart of Lehman Brothers Crash date , which stopped the April rally right on its Track.***
- ***This time we have two stoppage point, Lehman Crash date and Flash Crash date.***
- ***The volume is is contracting , This week we are into these area on <u>SPY with 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 .***

Chart 2 – SPX – Inverted - example

- *This charts shows, how upon the high volume breakout comes back for low volume tests on 3rd time circled in Blue is a stoppage point , If this was a real market , then the charts indicates and complete Bullish case , (Would one be Buyer or Seller of this market look ?)*
- *Second issue, is the pink vertical lines and black circle indicates that the volume has increased as we passed the green line suggests the market when it moves higher should go the price point of black circle (that happens to be SPX 1010 (at some point it will get tested) .*

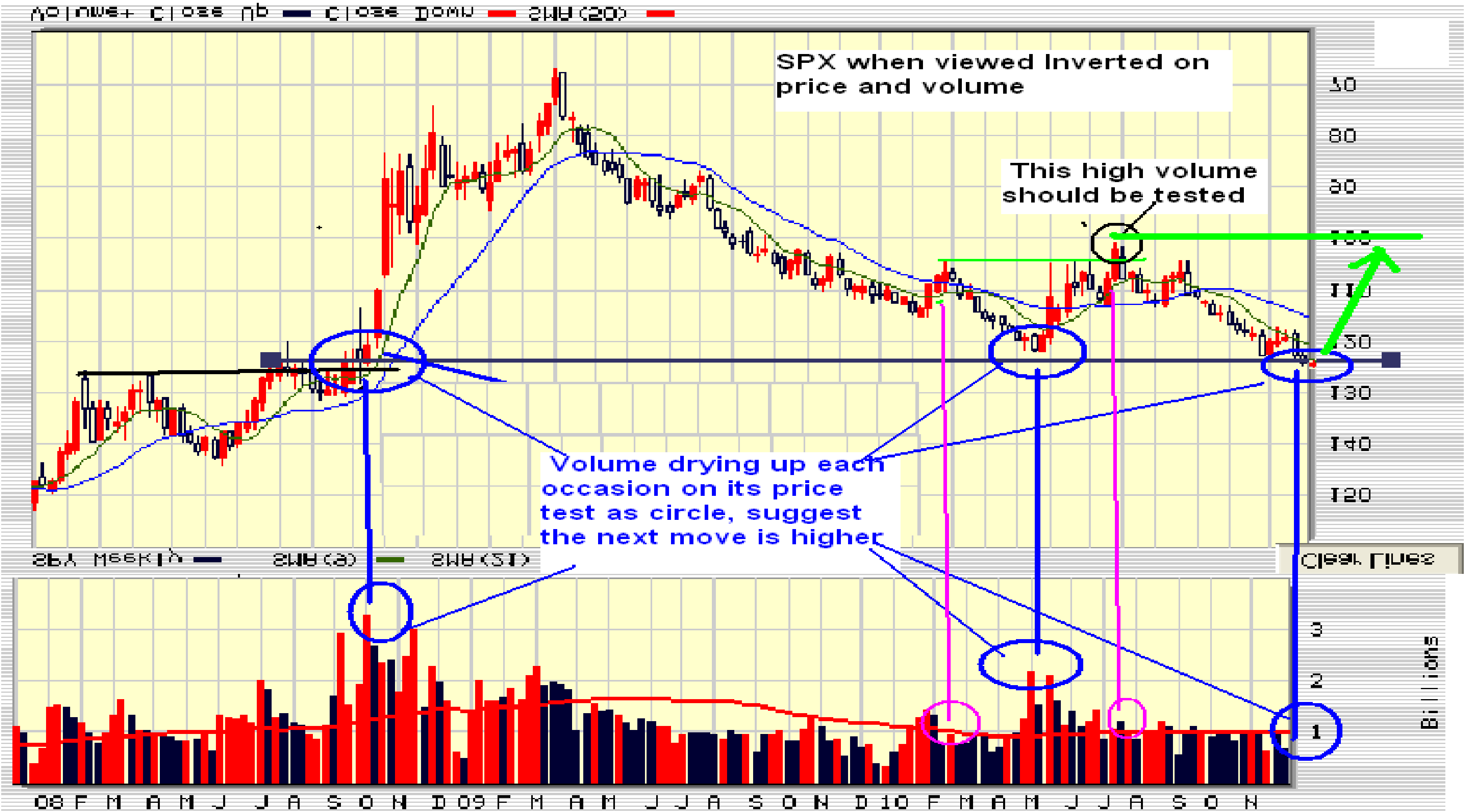
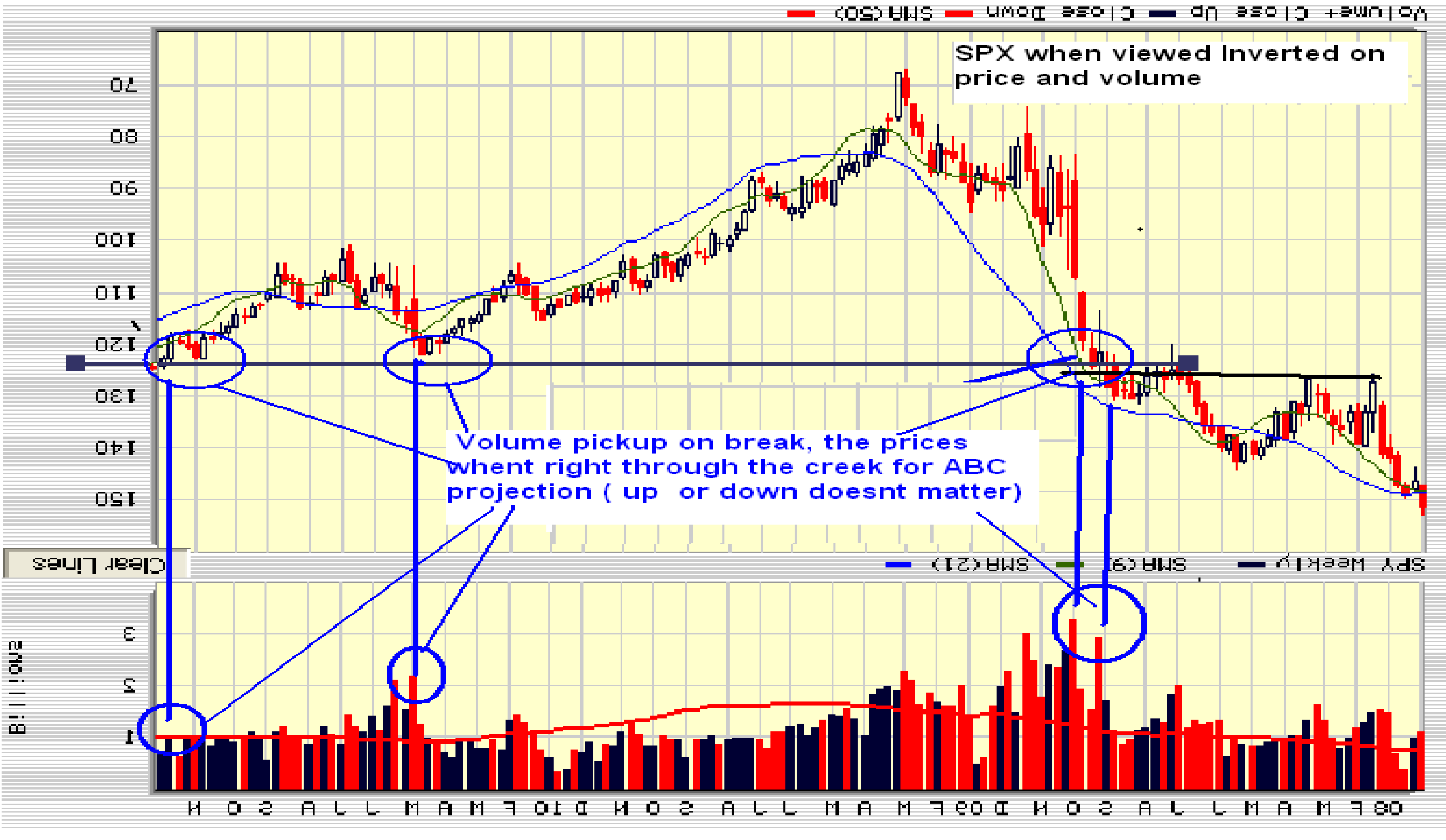


Chart 2 – SPX – Inverted Breakdown - example

- ***This charts shows, how the top heavy market breaks the lows if the circle blue points can be penetrated on heavy volume , then the market falls and never looks back and crumbled on its own weight***
- ***Once we see this situation in 3 different angles it looks more clear to us***

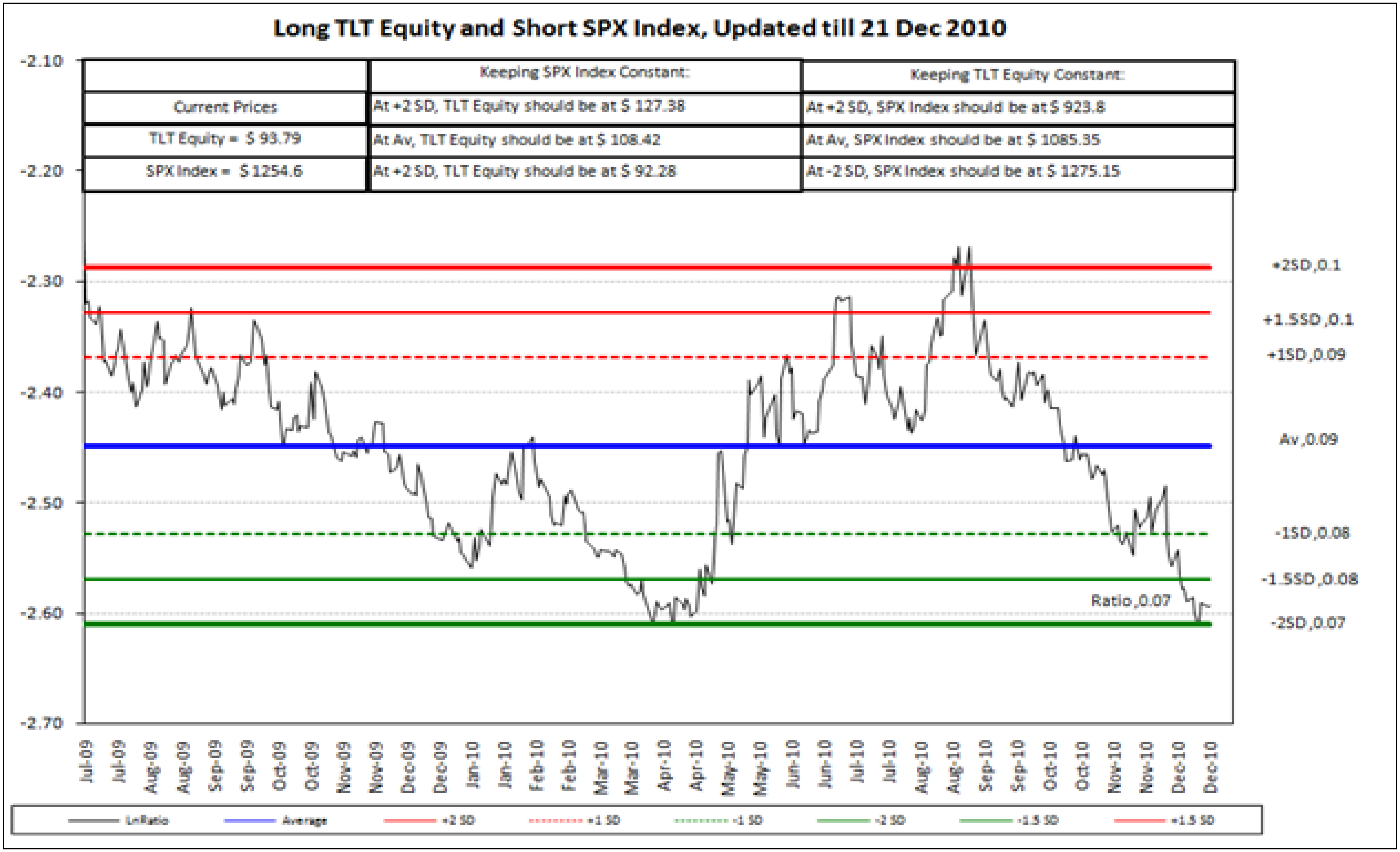


- **TLT - Weekly– 3 Year with RSI, CCI, MACD**
  (11 W / 40 W SMA)

TLT - Daily – 3 Year with RSI, CCI, MACD
(11D / 55D)

TLT – Correlation Ratio Analysis with SPX – 365 days Time basis

We ware watching this carefully for SD# - 2 , for undervaluation Zone



2 – TLT- PEC Analysis

***PEC D – Target on TLT has reached 91** (completing a 0.786 retracement) . Overall, bonds appear to be oversold and are due for a rally.* **if SD # 2 & POM 's lines up , We may re visit this market on buy side with TLT.**

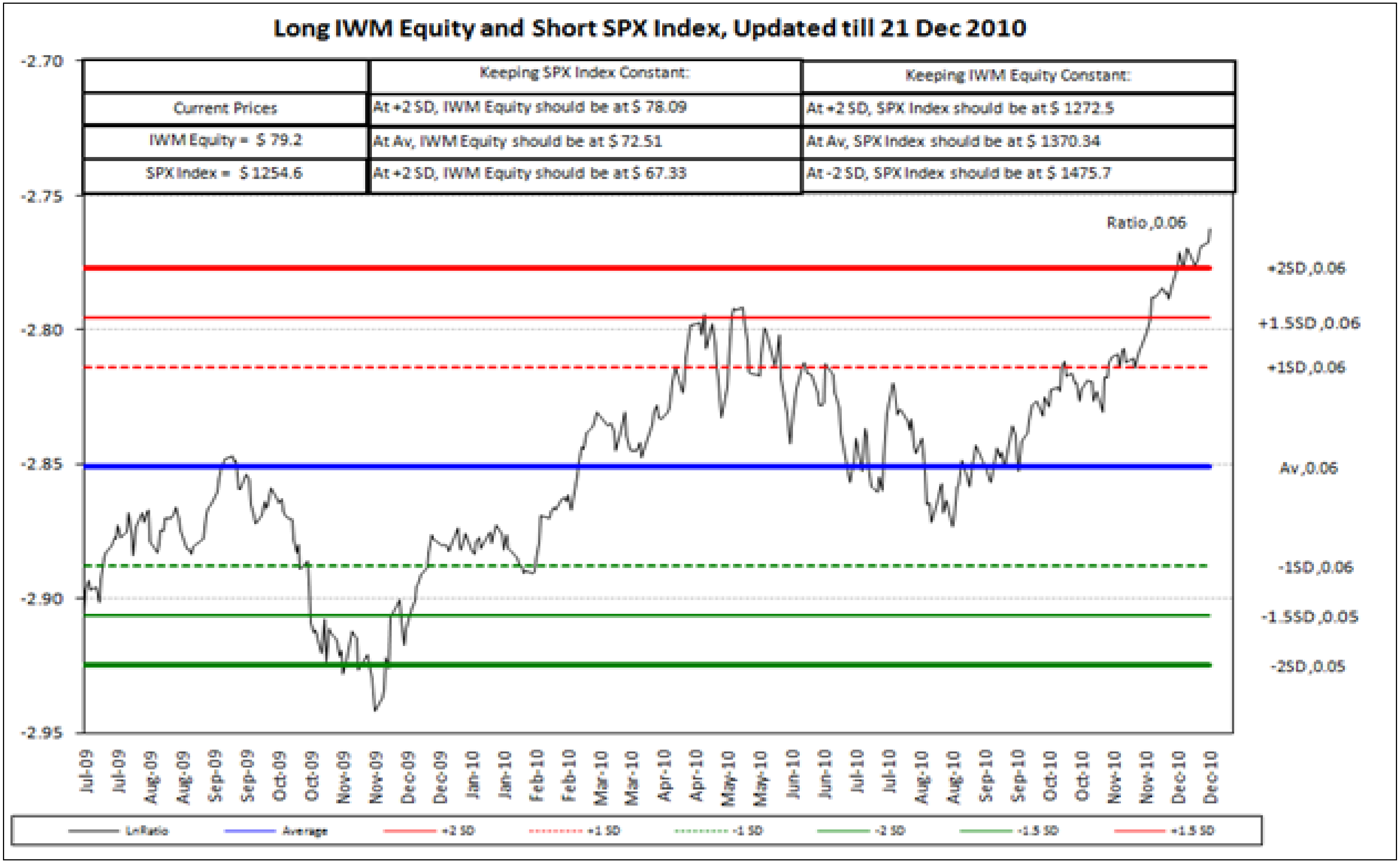
Our first PEC D point came in at 107 with Extreme " Bullish Sentiment " and that marked the Top with Triangular formation,

2 – TLT- POM – ST - Price , Volume & Pattern Analysis (MONITORING CZ –PQV)

TLT –Our price target of 89 - 90 should be CZ by POM / PQV . If SD # 2 / PQV qualifies , might give a next good signal on POM. PEC D at 91 has been reached. Our price target of 89 - 90 should be CZ and test to be with 40 M shares weekly, but volume is expanding 96 m) this suggest after the bounce the lows of 90.50 will be tested and market may go into consolidation)

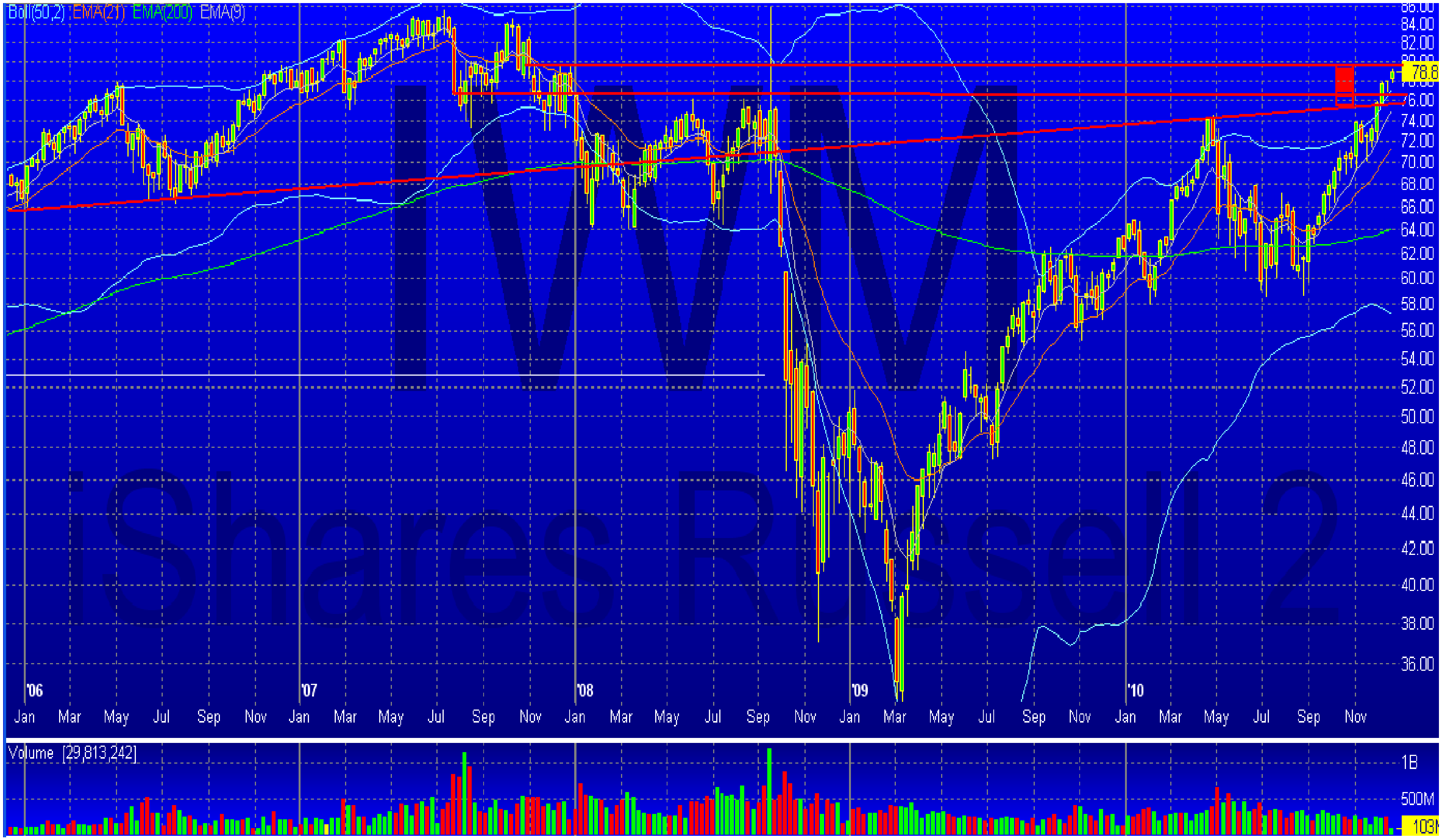
IWM – Correlation Ratio Analysis with SPX – 365 days Time basis

Is at SD# +2.0, for overvaluation



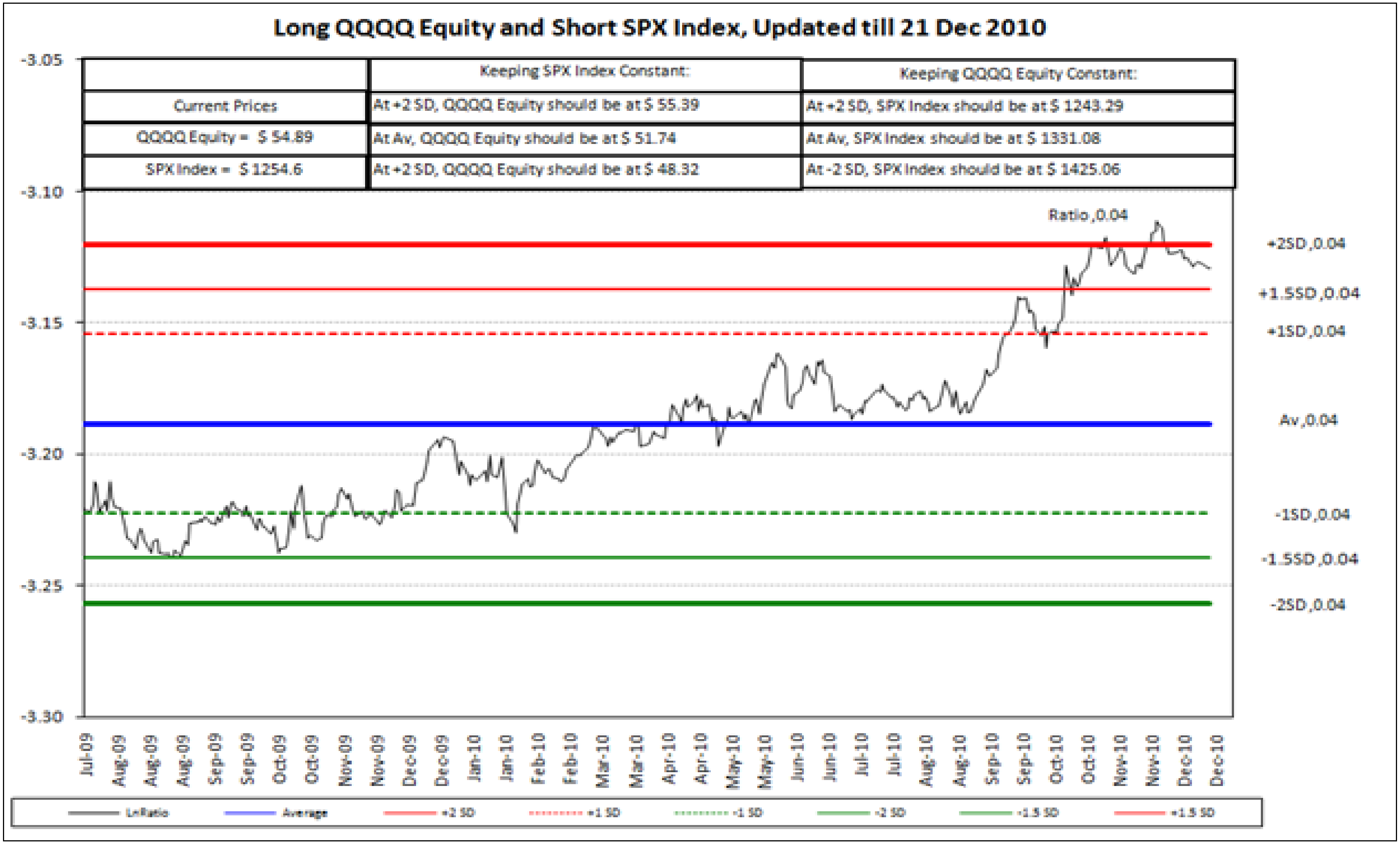
IWM- POM – LT - Price , Volume & Pattern Analysis - (MONITORING CZ –PQV)

IWM did not validate the PQV – CZ test in first get go and got extended with heavier volume then our benchmark. Currently it is testing 2008 Jan breakdown area & 2008 highs of Sept an its derived CZ of 76.50 – 80.00 (currently it is in the zone) and test with 175 M and weekly close under 75.50 should be a good test If SPX declines this will follow.



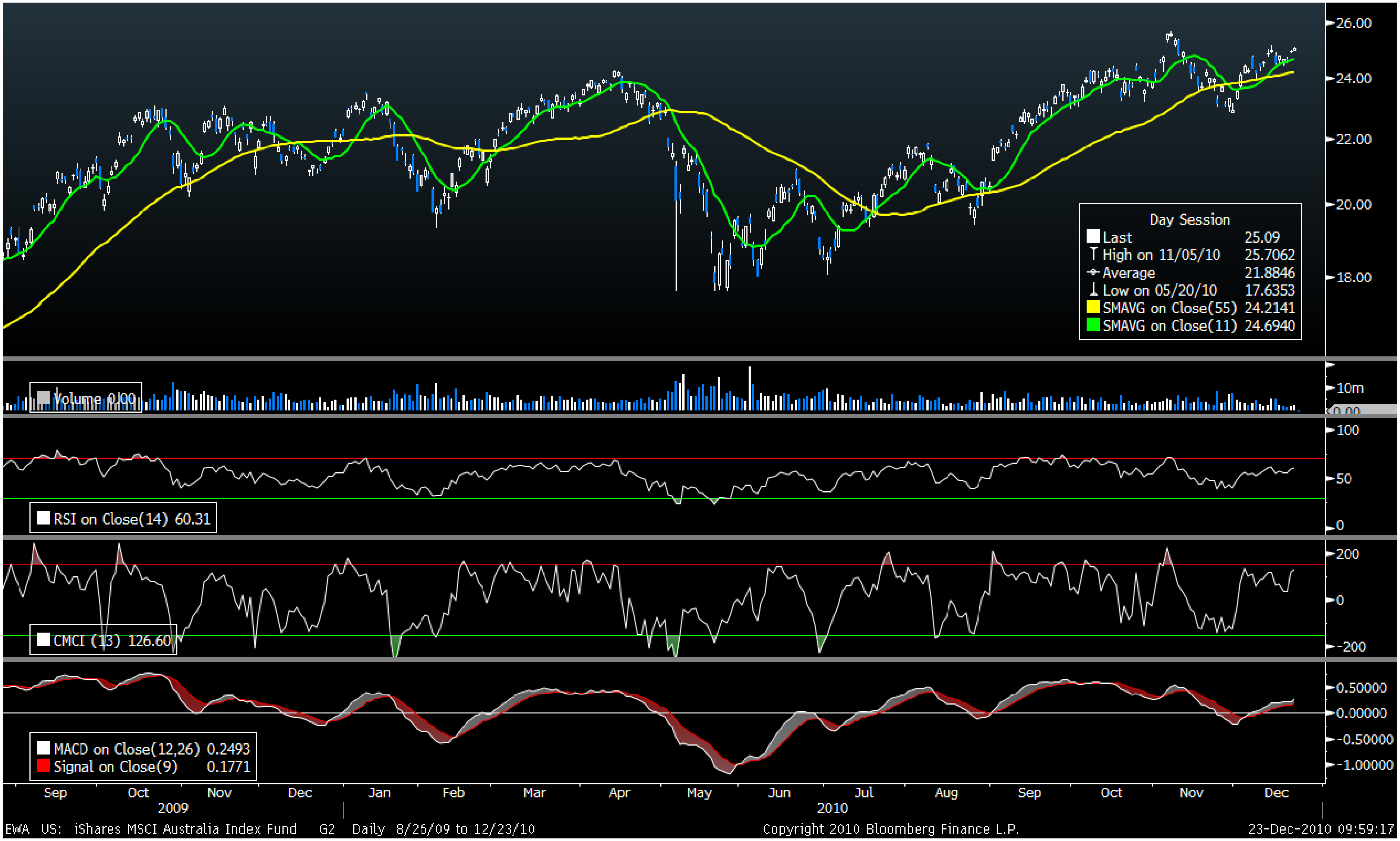
QQQQ – Correlation Ratio Analysis with SPX – 365 days Time basis

Is at SD# + 1.75, for overvaluation – We covered this for PQV and CZ, now it is in watch list Tracker SECTION - D # Wkly Sector Analysis, part II , (MONITORING CZ –PQV)



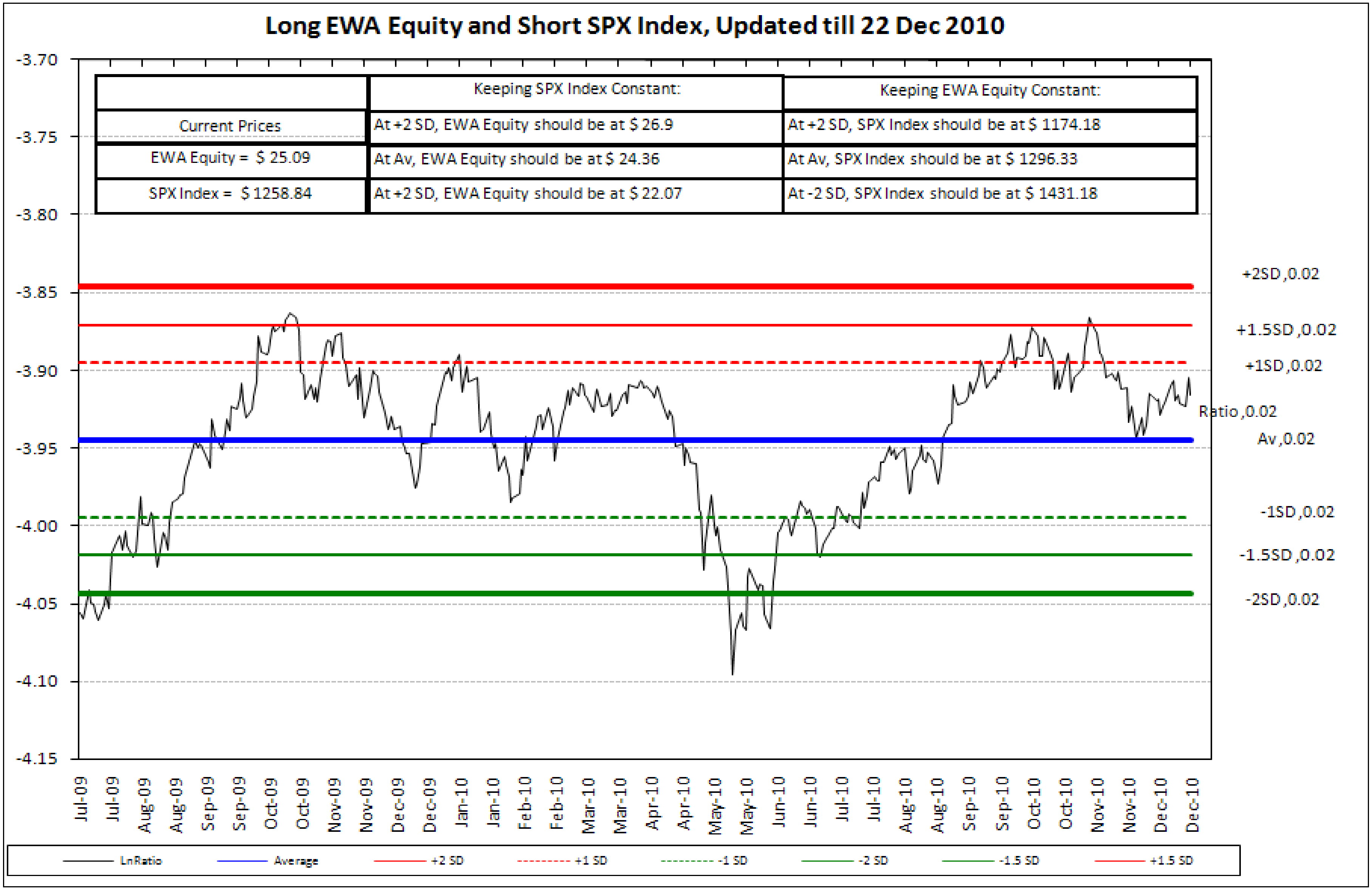
EWA- Weekly– 3 Year with 11 W / 40 W SMA with RSI, CCI, MACD

EWA- Daily – 3 Year with 11 W / 40 W SMA with RSI, CCI, MACD



EWA– Correlation Ratio Analysis with SPX – 365 days Time basis

SD# is at Neutral Zone – wih slightly overvaluation bias for Risk / Reward,



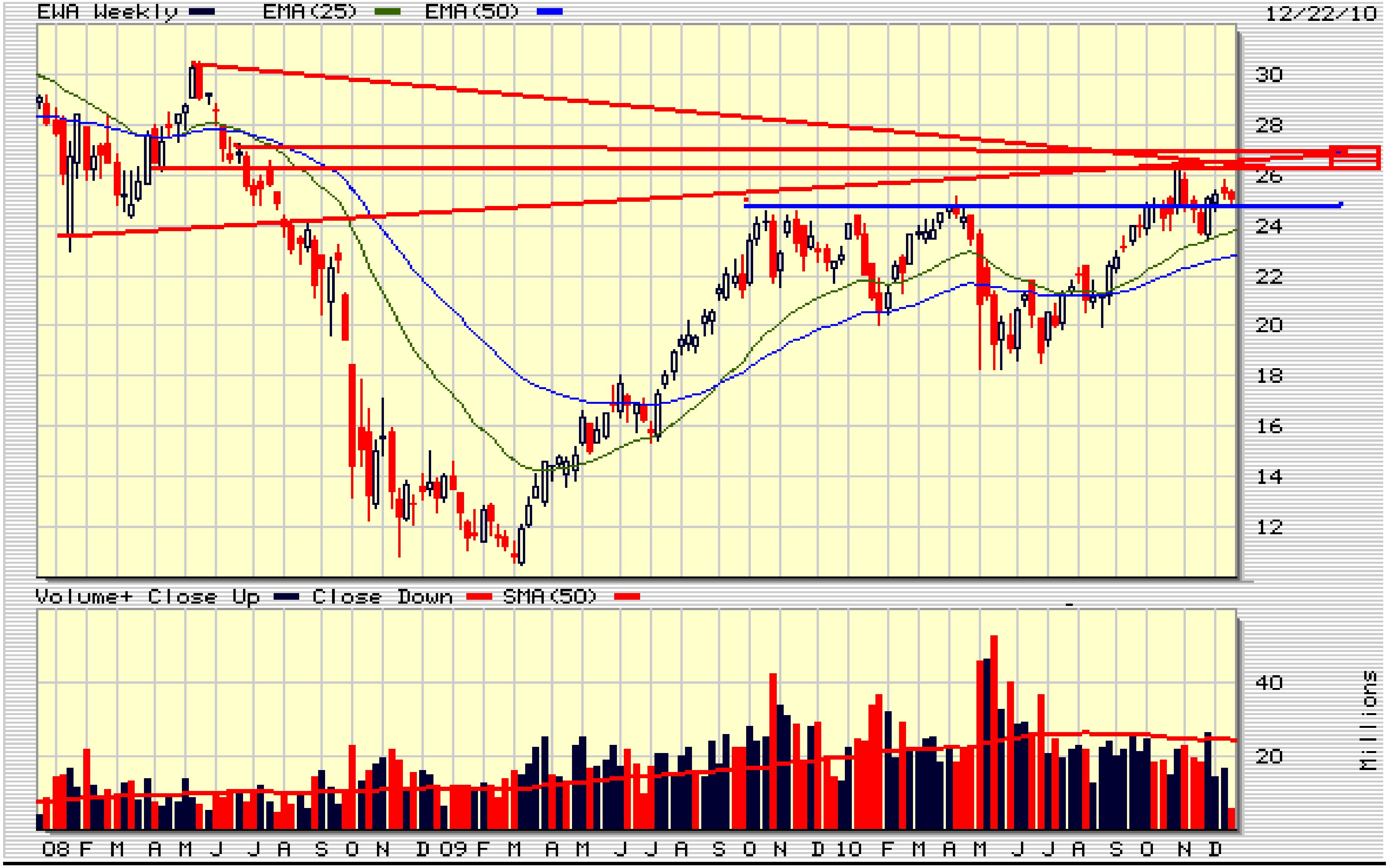
	Keeping SPX Index Constant:	Keeping EWA Equity Constant:
Current Prices	At +2 SD, EWA Equity should be at $ 26.9	At +2 SD, SPX Index should be at $ 1174.18
EWA Equity = $ 25.09	At Av, EWA Equity should be at $ 24.36	At Av, SPX Index should be at $ 1296.33
SPX Index = $ 1258.84	At +2 SD, EWA Equity should be at $ 22.07	At -2 SD, SPX Index should be at $ 1431.18

EWA- POM – LT / ST – Key Points

- SD # Levels are below +1.0 SD and Neural Zone ,
- EWA is closely related with Commodity Market which in turns tied up with USD , if DXY rally's ,SPX should decline and so as EWA follow on downside
- Currently SPX is at POM 14 and EWA belongs to AOM

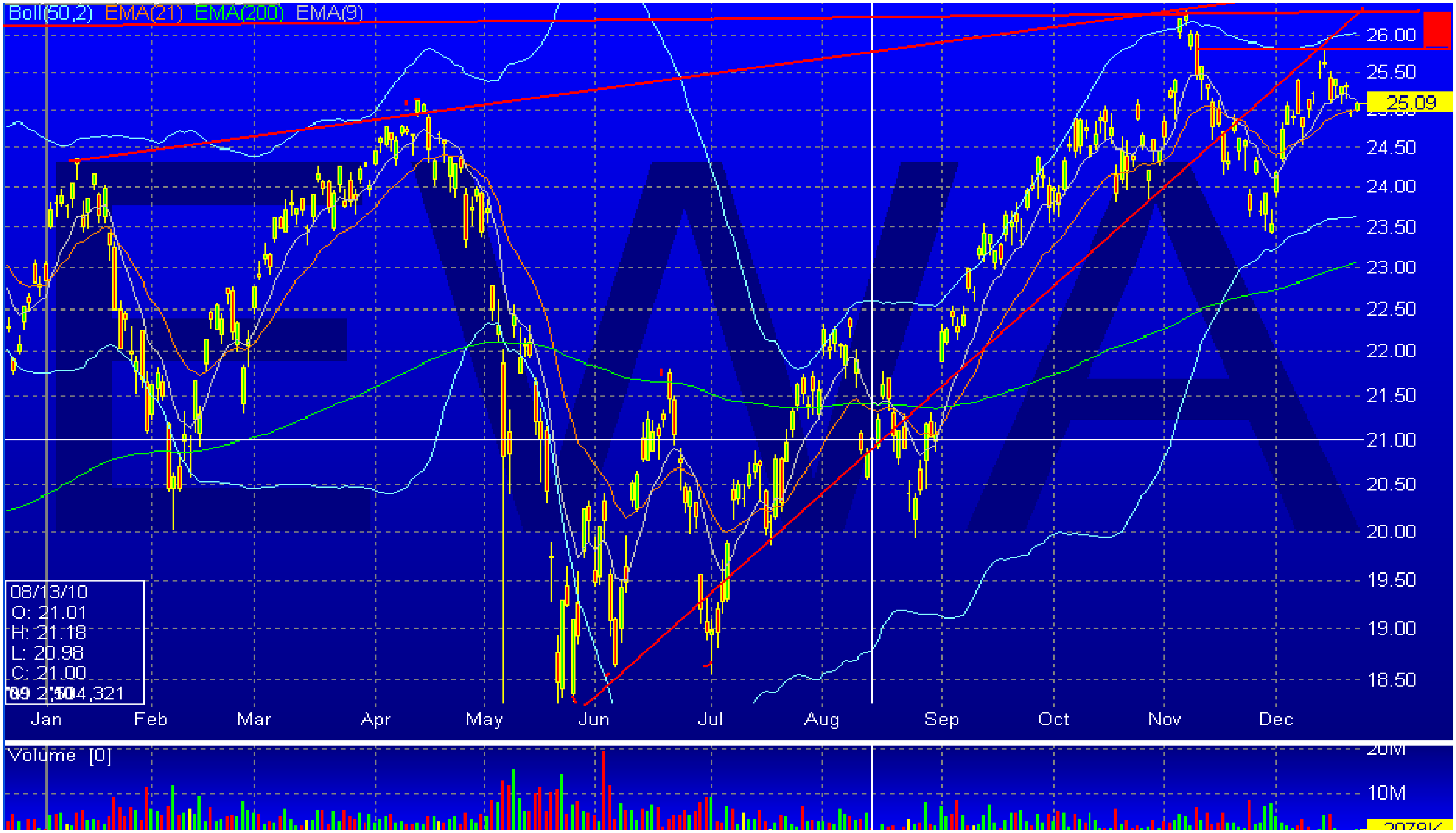
EWA – Wkly - Technical & Pattern Analysis & Price / Volume

The best Risk / reward would come in the CZ test of 26 -27 and test with 16 M weekly & close under 25.75 (weekly) should be a good test. But if SPX declines this will follow.



EWA – Short term - Technical & Pattern Analysis & Price / Volume

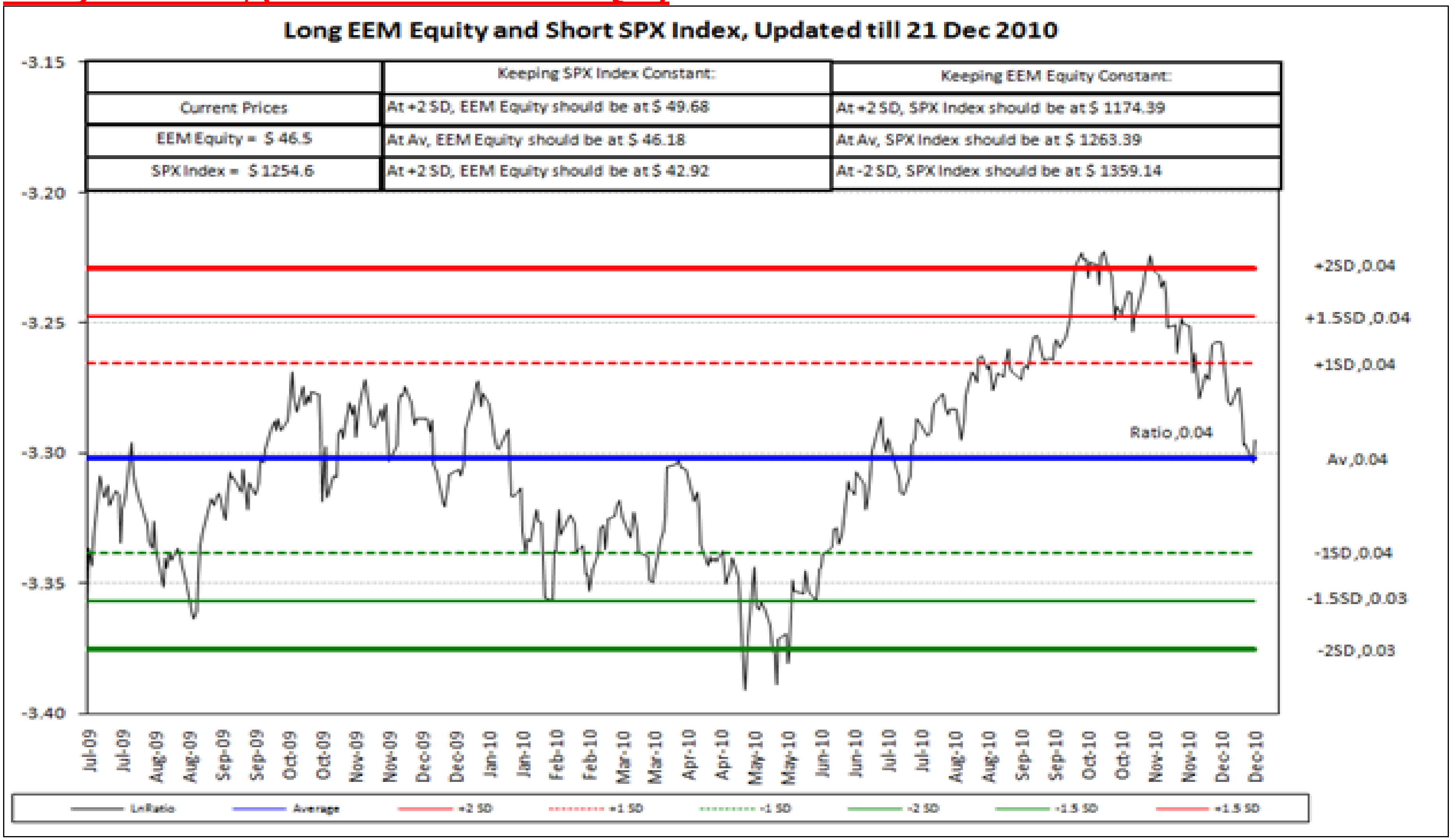
On premature basis , this area could very well be the top the CZ test of 26 – 26.5 and test with 3.5 M daily & close under 25.50 Daily should be a good test to initiate the position.



EEM – Correlation Ratio Analysis with SPX – 365 days Time basis

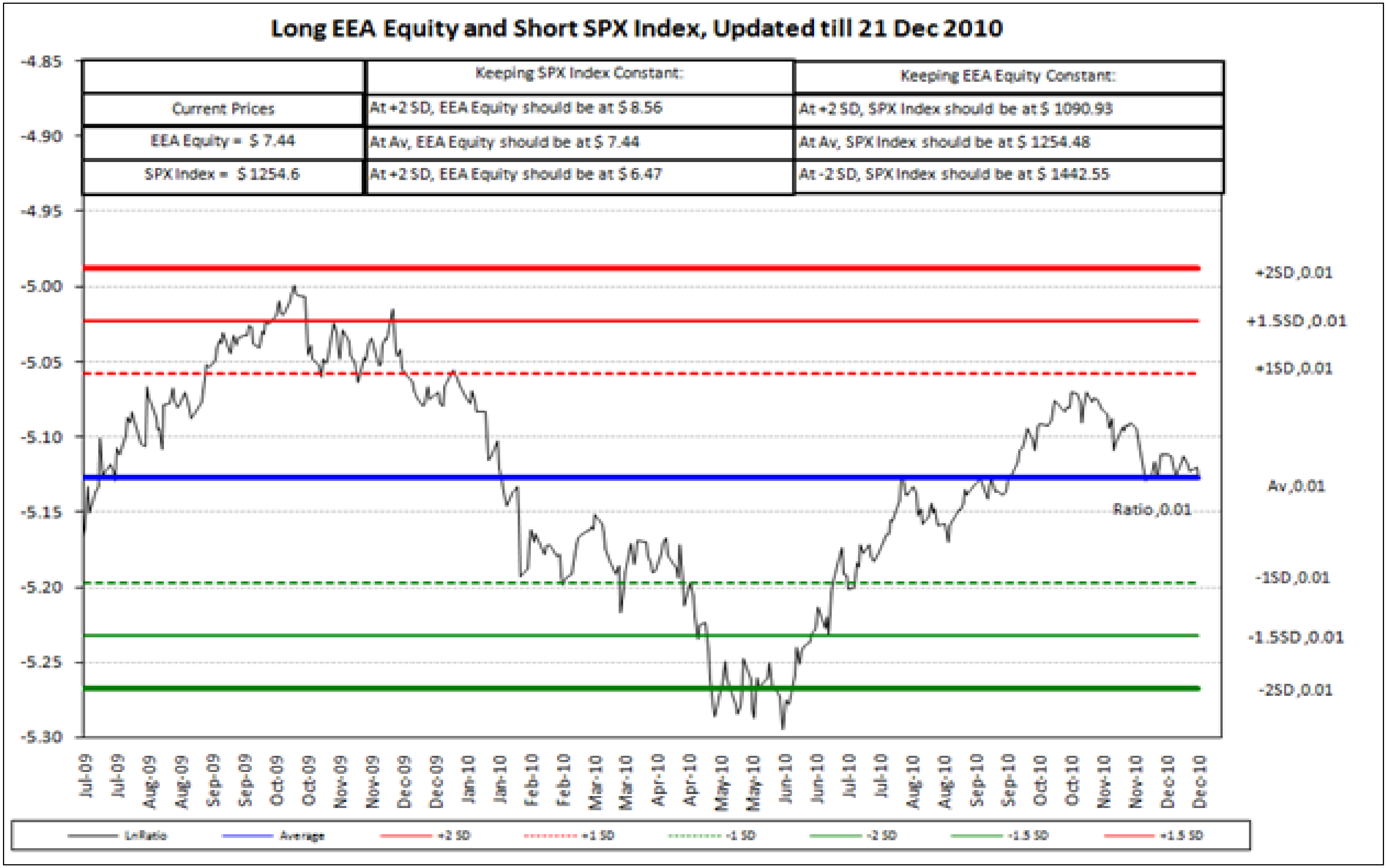
It made entry into our SD# +2.0, for overvaluation Zone and now into +1.0 Neutral Zone

We covered this for PQV and CZ, now it is in watch list Tracker SECTION - D # Wkly Sector Analysis Part II, (MONITORING CZ –PQV)



EEA – Correlation Ratio Analysis with SPX – 365 days Time basis

SD# is at Neutral Zone – No meaningful Risks Reward,



EEA- POM – LT / ST – Key Points

- **SD # Levels are at + 1.0 SD and Neural Zone , but any bounce should take to Target Zone into +2.0 SD, we should monitor this**

- **EEA is closely related with SPX – and will follow the decline on downside , Our in dept Analysis suggest that POM – Buys and Sells of SPX are closely related with EEA**

- **Currently SPX is at POM 14 and so does EEA**

Appendix

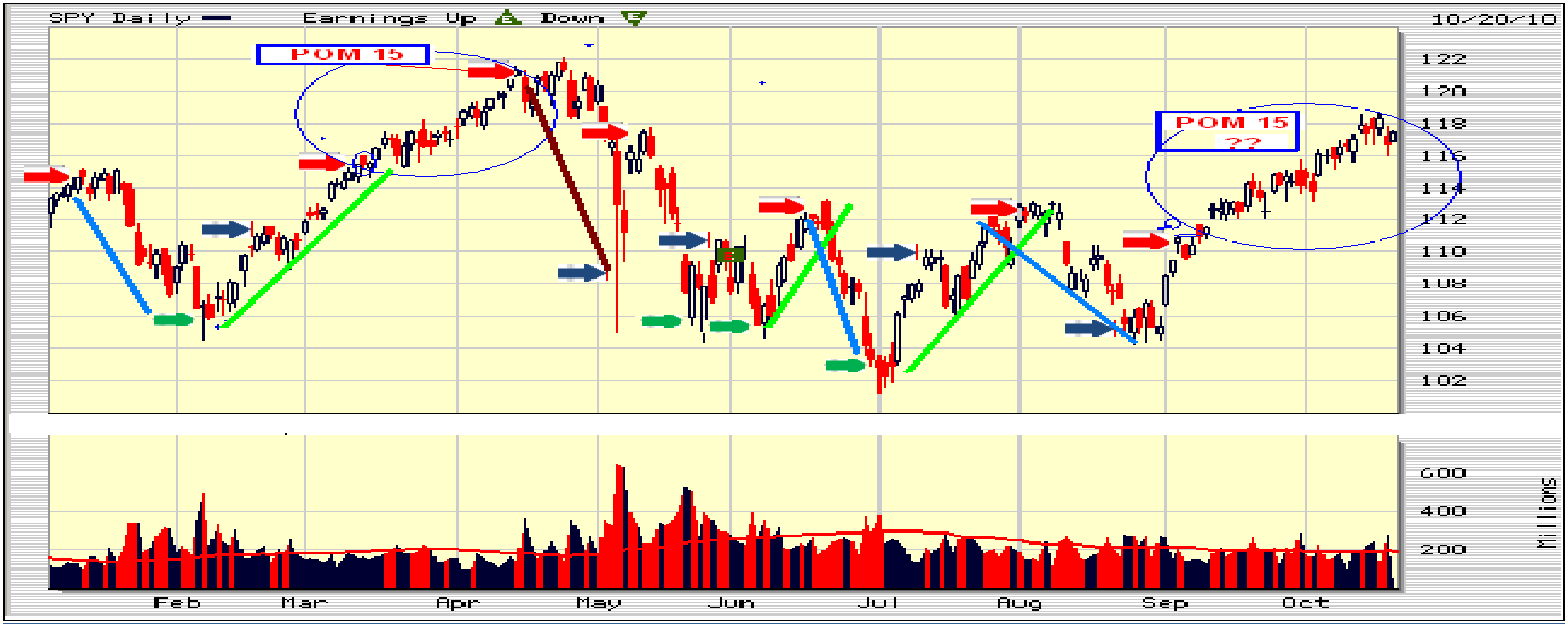
- **History - " SPX – POM Signals & Projections"**

- *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 %)*



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 – On Buy Signal since SPX - 1115**

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).