SG Capital Research

Global Market Insights

Research Note – Interim Update (A# 2)

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Market Strategy Global (A # 2) - SPX – Closed @ 1197

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

- ## Special Coverage

- **DOW 9EMA / 3X3 Strategy – DOW & SPX**
- **NYSE v/s Cash Position**
- **SPX - LT**
- **SPX – 50 /21 D Cross**
- **SPX – Sentiments with OSI , VIX**
- **XLF / XHB**
- **TLT**
- **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

- ***We recommend Fully Hedged on all Long positions that were triggered at POM 12 @ SPX 1020 in July 2010 and at 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 the weakest Equities in Setup # 2. This would capitalize on current extension situation (Within RA / RI framework for Risk management) .***
- ***No Net Short Position" till POM 15 Re- run is triggered. Our original Intermediate POM 15 @ 1200 of April. .***
- ***The price Equilibrium and favorable Risk / Reward opportunity will come at pull back to POM 13/ 12.***

- ## SPX Signals & Price Projections

- ***The current SPX signal is skewed by QE 2 for time being . The Extension is 8.3 % in 44 days above POM 14 (3rd Re run) @ 1104). This has surpassed the worst extension in past 4 yrs of 7.5% in 40 days (that was converted to POM 15 then subsequent CRASH !! .) We are seeing some signs of POM 15 Re run here especially one input signal of NASD but no confirmation yet on SPX.***

- ***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)***

- ## Daily SPX - " Trend Adjusted Signal"

3x3 /9EMA – Break Indicator – Buy Signal since SPX - 1115

Currently " Trend Adjusted Signal " has been on Long side since SPX @ 1115 (Mid – September) . This Indicator tends to catch the extension momentum move (Post POM 14) and often keep you on the right side of the trend till diagonal triangle is complete . The reversal points are stops and could get whip sawed at times.

Sym	Posn	Close	Reversal
DJ	Long	11226.9	11146.3
SPX	Long	1199.68	1184.71

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- ***Most of the Analytic charts in our lens will looks the same till we get a change of POM at least to POM 13 .***
- ***The message of the market has remained the same & sounds redundant***
- ***We are finding more clues with indicators of topping to demonstrate our findings***

QE

Market has been rallying after the elections and Fed announcements. The outcome of the elections should result in a gridlocked Congress. The gridlock is good during bull markets. But, it is very bad during bear markets.

The announced plan to print $600 Billion in new money which will be injected into the system over the next few months, supposedly buying government securities. The idea is to have the banks use to buy risk assets like stocks and Bonds to keep the interest rates down but amazingly the bond market sold off yesterday. Many seasoned observers disapprove of the actions of the Fed (including some members of the FOMC itself)

The elections and the QE2 announcement did not resolve much of the questions which have been plaguing the economy and the markets.

- An extension of unemployment benefits beyond the end of the month, A failure to extend those benefits would produce the same kind of downturn in the economy we saw over the midyear period.
- A clarification of the tax hikes scheduled to occur on January 1. If the tax hikes go into effect, there is likely to be a massive amount of selling pressure in the stock market just prior to January 1, which then brings up the question of just how much money the Fed is willing to spend to offset that selling.

We think things might get more murky, many of the crowd are on one side of the trade with the uptrend. Remember how bearish the crowd was in late August when the market was making a bottom at POM 12 or even POM 13? At least bottoms are sharp and the recovery rally made some good gains there for a few weeks. Tops are far more boring and require much more patience. There is ample evidence of a market that's running on fumes when you look underneath the covers.

Generally, a better time to buy the SPX is when they have become pessimistic then most optimistic as now , The contrary indicator has better Risk / Reward in SPX future gains .

INTERNALS

STOCKS - After all this market looks like it want to test the highs of April 1220 highs. They are taking almost all the stops this morning on the gap up . This gap may hold till those stops cave in but nothing has made sense fundamentally and technically past 6 weeks in this 8 % extension from Natural price of 1125 in front of QE 2. If market participants believe the Fed is targeting higher stock prices, it could turn as shorts cover blow out move before they take it down but such move could end up pretty nasty.

Currently the largest investment community (mutual funds) has all raised the price targets of SPX . Just look at the following chart. It shows the NYSE on a monthly basis and the mutual fund cash level since 2005, their predictions have stacked up when the market rises and they are forced to get fully invested to keep the cash levels down to minimum. We can see that as a group, these folks have never been net bearish. They've always had a bullish outlook , which makes sense since the majority of them are long-only managers. They have to be optimistic. They are most heavily invested near important market tops. And at market bottoms most of them turn bearish. That will never change …

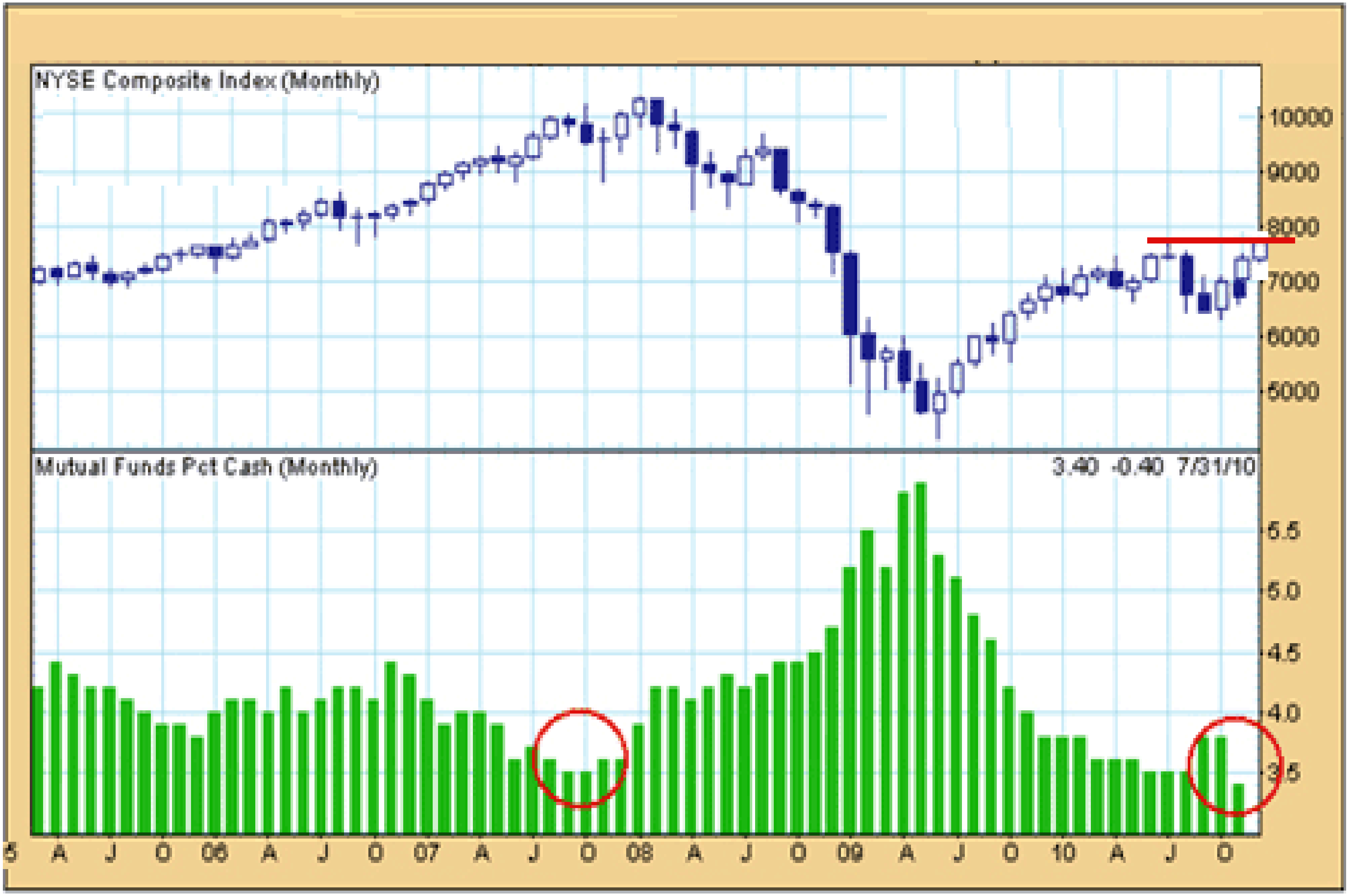
Hence it makes a lot of sense to look at what fund managers are doing — and take the *opposite position* whenever they are all doing the same thing. That's why one of the favorite cyclical sentiment indicators is the average cash level of mutual funds.

One thing we know from volume tape reading, the low volume breakouts and event driven gap ups end up very nasty at the end but still no mechanical signal for POM 15 for net Short, although it is very tempting .

Today close and tomorrows open price is quite critical. Several key Indices testing important April highs , we will review the volume in each one of them on test tonight , SPX 1200 has supply going all the way to 5 yrs ago where it broke off from (See the chart below)

BONDS . Sell off after Fed announcement in its statement , the Fed delivered QE2 details said it would buy **in long-term bonds.** Even though the Fed promised to buy, the **20+ year Bond (TLT)** fell sharply after the announcement. This means that long-term rates rose sharply. The bond market is obviously not impressed. In fact, the bond market appears to have something else on its mind.

NYSE v/s Cash positions



SPX – LT – Critical overhead Resistance

SPX has reached critical levels of cross current price zones with internal market being very weak , Please read the notes within the chart & all the trend lines crosses converges to gather.

SPX – 50D & 21 D cross

Yes certainly after today s move this chart may not look real but over intermediate term this indicator works well . The weekly chart of the SPX and stocks above its 50 DMA with 21 DMA, Three weeks ago the stocks above 50 DMA fell below its 21 DMA and triggered a sell signal by that method. The bottom window is the weekly NYSE McClellan Summation index. The Summation index normally rises and falls with the SPY and it also turned down about 3 weeks ago. There may be a move coming up, a short fast rally that attempt to catch the stop orders on the market before rolling over. If a Snake Bite is going to happen it may show up after the Fed announcement .

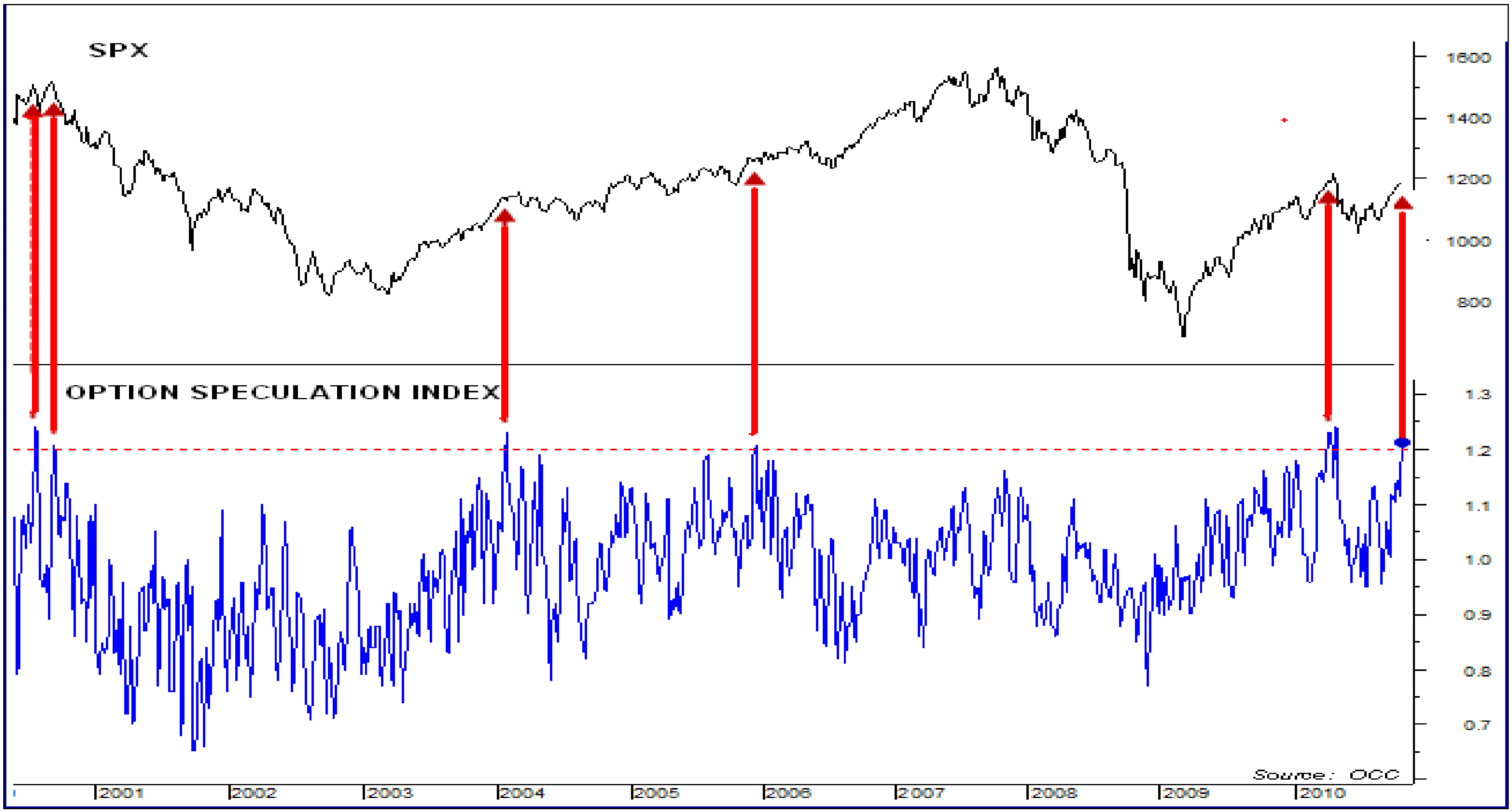
SPX – Pull back Targets

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)

For now due to Fed exuberance 1219 could get tested,

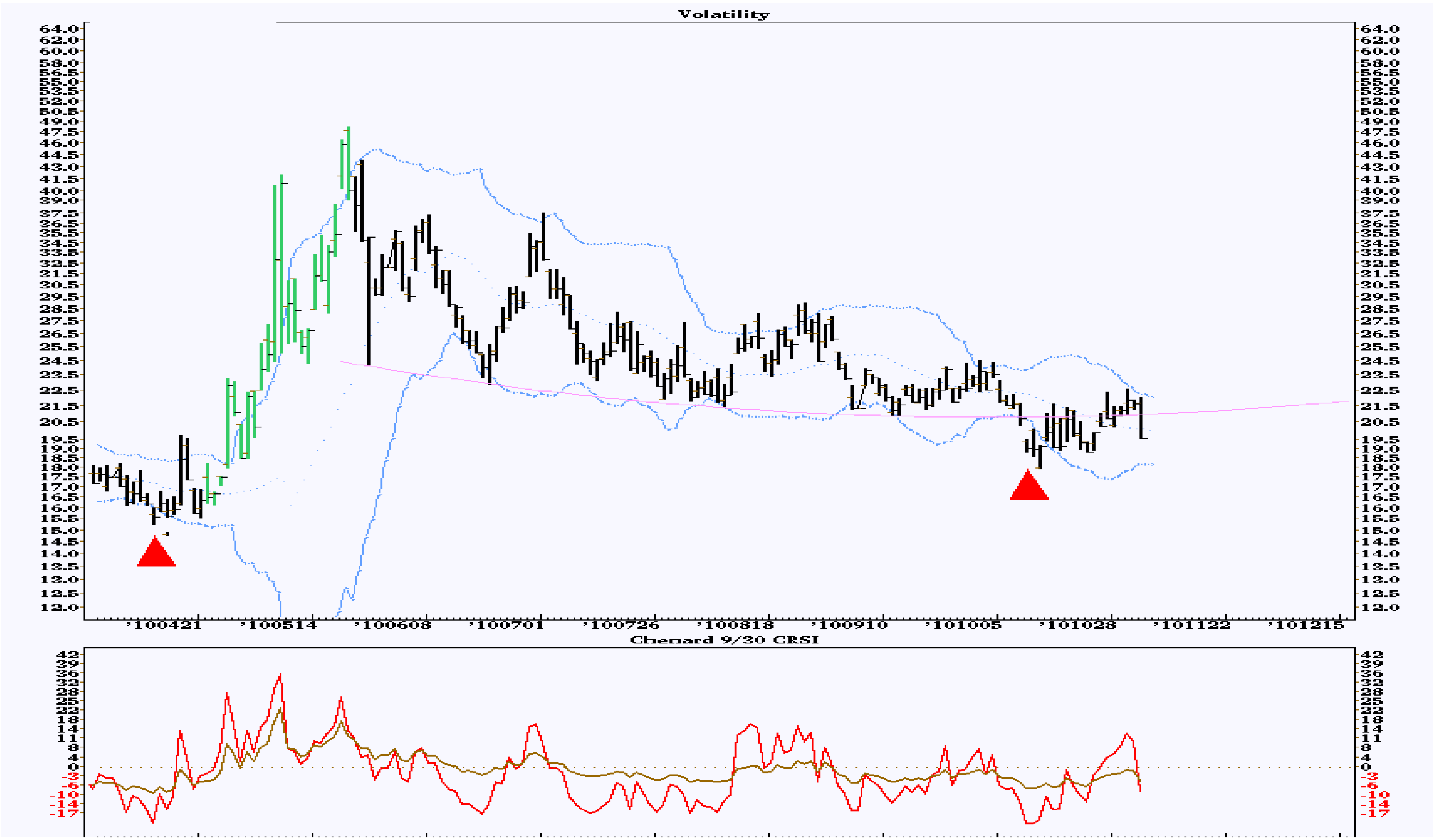
SPX – Sentiments with OSI

Extreme sentiments of OPTION SPECULATION INDEX since 2001 , read above 1.2 has marked a top , the OCC data from CFTC.



VIX

The index is recycling to the downside once again. If it closes below the lower band, it will be the third set of closes below that band within the last three months. Such closes are actually very rare. The red down arrows show the times when the VIX was under 20, When both measurements of excess bullishness were present at the same time as now.



XLF

(XLF) shows weekly chart . This large range in Blue is side ways consolidation forming a Head and Shoulder top.

XHB

HOMEBUIDERS CHALLENGES RESISTANCE.. and sideway consolidation but QE flow hasn't helped this sector, It is very puzzling that XLF, XHB, ITB is suppose to be the greatest beneficiary of the program but it is not helping these sectors.

ITB

Home Construction (ITB) hitting resistance and below the trend lines , QE hasn't helped this sector as well

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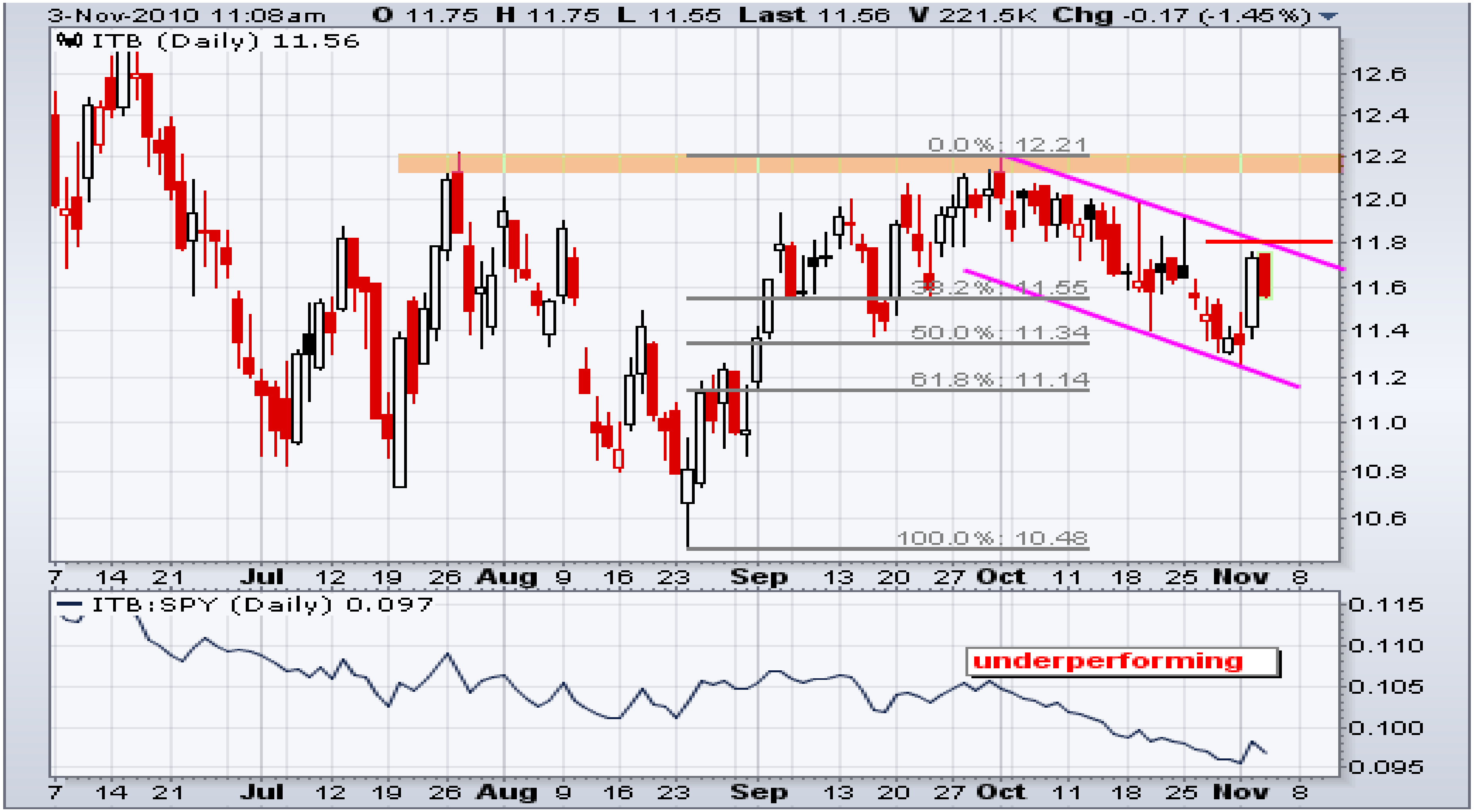


- **TLT - Weekly– 3 Year with RSI, CCI, MACD**
  (11 W / 40 W SMA)

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

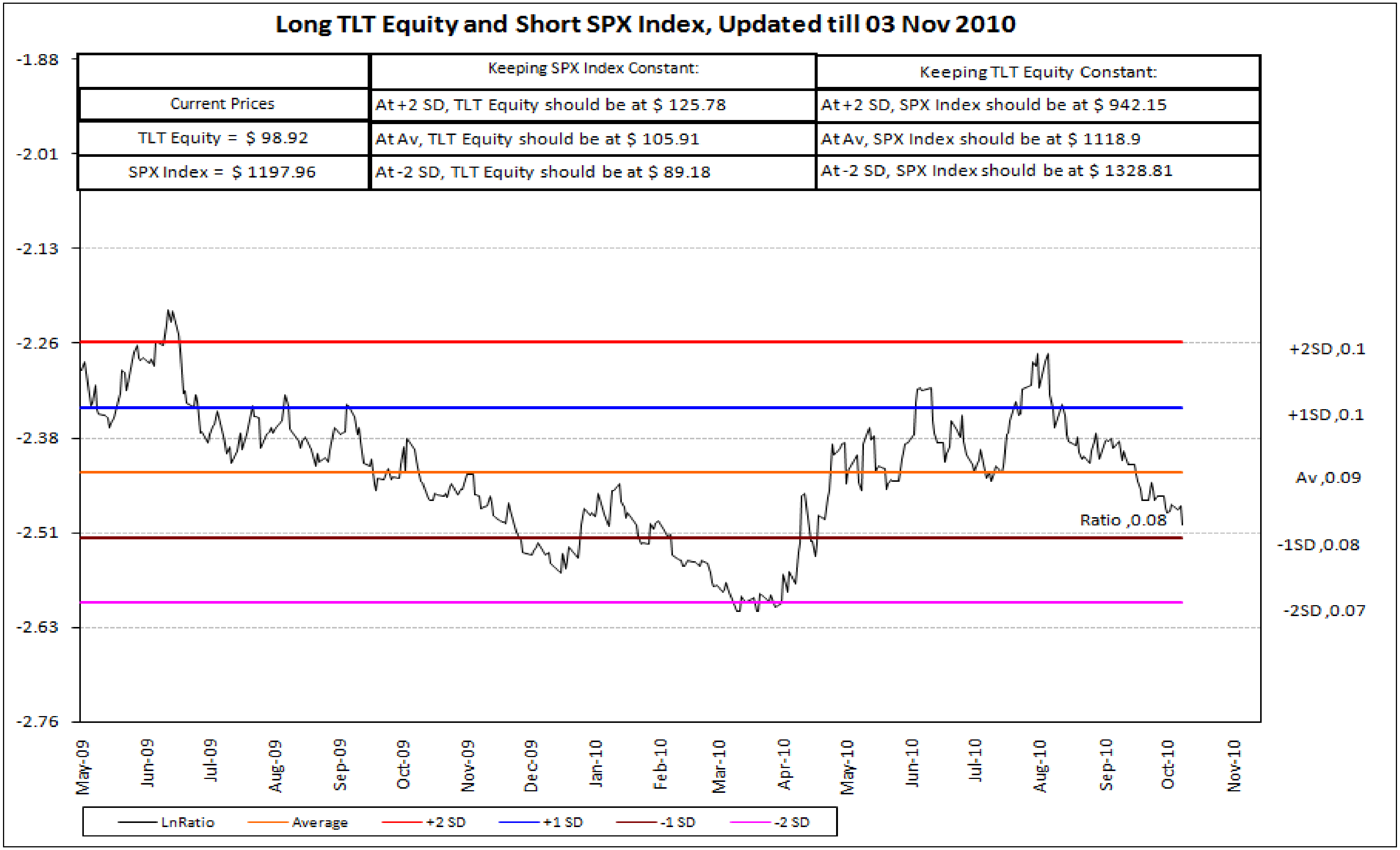
2 – TLT- PEC Analysis

Treasury Bonds - PEC D has occurred at 105 , it had nailed it perfectly, its still on track, target is 95, but by POM , target is 97

2 – TLT- POM – ST - Price , Volume & Pattern Analysis

TLT **peaking at the end of August BY BOTH Methodology POM & PEC , This was able to get the top on very bullish sentiments and moving lower the last two months. Today's decline is nothing new and corresponds to an advance, which is shown in the indicator window. TLT** opened strong and then moved sharply lower after the announcement**. The support level resides around 97. A parallel trendline extending down from the September low confirms support here as well.**

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



Appendix

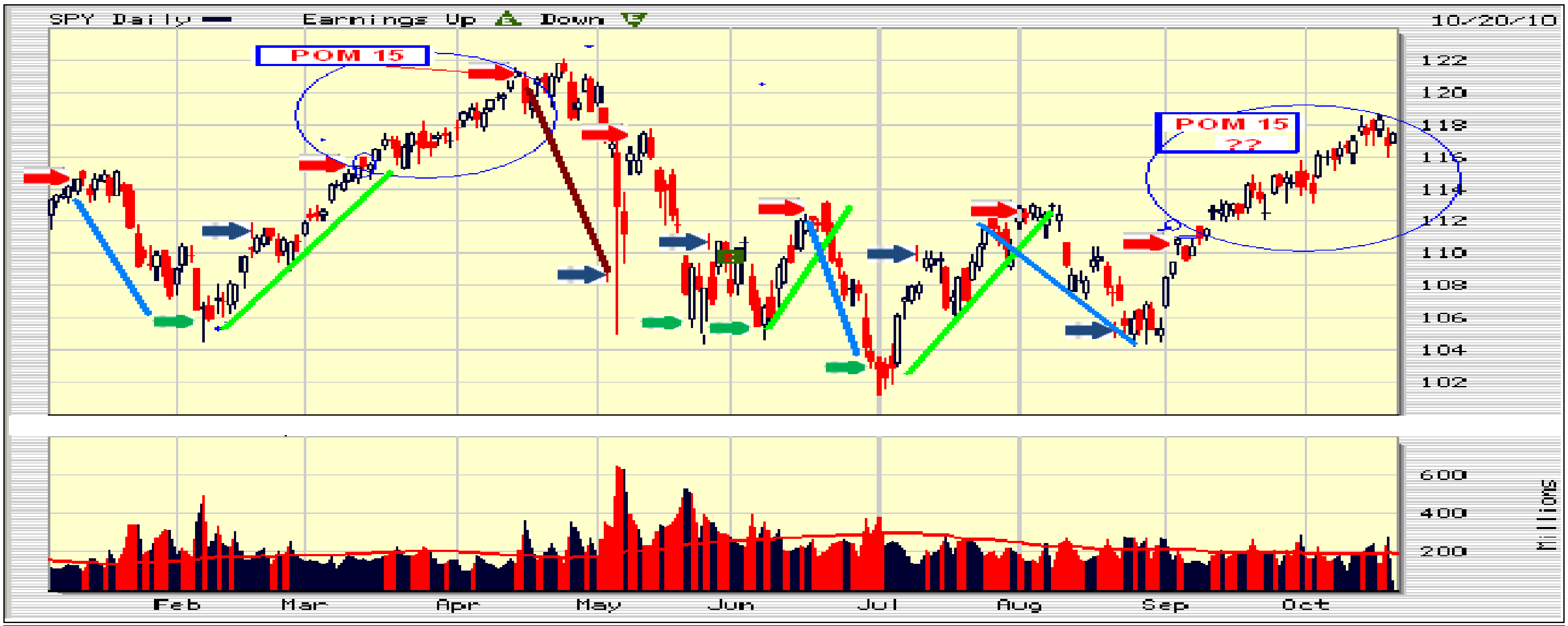
- **History - " SPX – POM Signals & Projections"**

- *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).