SG Capital Research

Global Market Insights

Research Note – Interim Update (A# 2)

MAEG- INTERIM UPDATE # 02 SG 2010 # OCT 21

For Immediate Release – Thursday AM (EST)

By: Suneil R Pavse

Contact: apavse@aol.com

Market Strategy Global (A # 2) - SPX – Closed @ 1178

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

• Special Coverage

- **STIMULUS / INTERNALS**
- **DOW 9EMA / 3X3 Strategy**
- **DOW ST /MT**
- **NASD A/D**
- **NASD ST / 87 Cycle**
- **XLF / XHB / SMH**
- **TLT**

• Current Takeaways

- *As mentioned in Commodity Report, Silver is at 9 out of 10 on POM 15 validation. Today we are going to bite on Silver. Our approach to capitalize on SLV – POM 15 by fining more Silver stocks in SETUP 4 that have exhaustion Alerts to add to our PQV list. We will cover more ideas in our PQV portfolio this weekend). We have intentionally not utilized SLV as vehicle for 2 reasons - (1) It can be volatile due to currency wars and need a stop above 10/14 highs and (2) we would prefer to spread our risk in multiple stocks.*

- *If NASD was a core Index, it certainly qualify for POM 15 (See the charts below) but overall SPX we are not there yet for POM 15 Re run. . The base criteria for it is to have min (3) of the broader Indices to double top and reject. We see DOW, NASD & NYA almost in that vicinity and once complete then we will assess the other internal criteria to confirm.*

- *Currently on POM 14 – Re run (for Fully Hedged positions) and SPX is extended by 6.6% during that time frame but we are not for NET SHORT, till it triggers POM 15 within POM – RA / RI framework. The price Equilibrium in this market is at lower prices from here (at POM 13) & favorable Risk Reward opportunity will come at POM 12 within RA / RI framework. This is the area we would be interested again. At that time one could certainly wear a Bullish Hat*

• Trading & Investment Conclusions

- ***Accumulations continues in the "SETUP - PQV VALIDATED EQUAL WEIGHTED PORTFOLIO (in Section E – MAEG) during this SPX extension of 6.7 % with desired price points & scaled entry @ the Mean Confluence Zone on the weakest Equities in Setup # 2 capitalizes it (within RA / RI, these Equities to be Monitored with Risk management factors). We prefer to add SILVER stocks in SETUP 4 since SLV is almost at POM 15***

- ***The current 3rd Re run - POM 14- @ 1104 is to "Hedge Long position" on ideas that were triggered at POM 12 @ SPX 1020 in July 2010 for rally and / Or the last POM 13 at 1045 for a bounce (with above ideas).***

- ***"Net Short Position" should come in at POM 15 Re and we have no indication of that signal. Therefore we stay with our original Intermediate POM 15 @ 1200 OF April is still Intact.***

• SPX Signals & Price Projections (Update Signal)

- ***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 %)*
  - *Current Signal is skewed by QE2 for time being .*

- *Extension of 6.6% is more than we would like to have. The worst extension in past 4 yrs have been 7.5% of 40 days but that was converted to POM 15 (NET SHORT) and currently we are on day 33th of extension of POM 14 re run. The Last POM 15 in April resulted in a CRASH !!*

- *If we just take " One Step at a Time" . Our First Pull back will be to 1130 and Second pull back we are looking for DEATH CROSS of past 1115 to be the GOLDER CROSS of future or check for something more serious. Too early to tell (let us wait and watch) due to Presidential Cycle & Positive Seasonality "*

- **Market Insights**

STIMULUS of PAST and effects

For the last 7 weeks we seem to be in a market period like 2007, 2009 end and April 2010 in which the market is not trading on its normal money flows, but on the extra liquidity provided by stimulus efforts.

Except that this time the rising market has not yet received the extra stimulus. It has been rising in anticipation that it will receive it, Markets have taken the Fed at its word that it will take action and anticipating that its effect will be like the stimulus efforts of last year. Except that this time there are no programs to go along with it, like rebates to home-buyers or cash for clunkers.

Global currency traders have trashed the dollar on the promise that the Fed will be pouring more dollars into the system through a second round of quantitative easing. The power of Promise from Government was extra ordinary. However, the government does not have the kind of power that some assign to it. If the government, and particularly the Fed, had the power to prevent corrections we certainly would not have seen the 2000-2002 bear market, and particularly the 2007-2009 bear market, and all the havoc that added to the financial crisis.

On that same note , We have a great deal of respect for **Steve Keen** and has closely followed his work for long time. Here are the thought he articulates. We invite to read this.

http://www.debtdeflation.com/blogs/2010/10/19/deleveraging-deceleration-and-the-double-dip/

INTERNALS

USD still ruling these markets with tremendously high historical correlation with SPX as we enter the G20 meetings.

In spite of this back drop and high level of Bullish sentiments we have not capitalize on POM 15 for being “NET SHORT” only due to Seasonality and Presidential cycle . Therefore preferred to have conservative approach. (As we always say the market can't be timed by sentiment alone, but it does provide quite accurate warnings).

On the market itself , Monday we had equivalent of 80% day, usually that is followed by 2-4 up days on lighter volume bounce to form lower highs or double top (If we have our way, we would not want the volume to pick up 3x3 bounce) . If volume increases it just tends to extend the prices further short term)

Yesterday market regained quite a bit of it had lost the previous day. We're not convinced and extremely suspicious, especially since it corresponded to a dollar-weighted call-put ratio of **29** on OEX. Much money spent on call options than put options very bullish sentiments.

We went back and looked at how the previous market corrections this year began.

The 8% January-February correction began with the Dow experiencing a one-day decline of 100 points. It was then up 115 points the next day. However it then was down three straight days, with declines of 120 points, 210 points, and 220 points and the correction was underway.

The 17% April correction began the same way. The first down day (April 17) was a decline of 215 points. The Dow then closed up 50 points the next day and up 120 points the third day, almost back to its top, everyone convinced the big down-day had only been a one-day glitch. The Dow was then down 160 points the next day, only to be up 140 points the following day . But the top was in, the rally days were being sold into, creating lower highs. And then the Dow closed down 800 points in just four days. But it then closed up a huge 400 points in one day. That pattern continued for almost three months, until the July low, the Dow was down 17%,

So it's too early to say that yesterday's big decline was a one day event because the market is back up today.

One thing certainly to watch is **Jerry Minton** scenario of 20 days power period **–** **phase 1** - a final surge rally into the end of month ("Monthly Buying “ period which starts on the 28th and extends to the 3rd of November). It all seems very well timed and calibrated to peak the market on the Election (November 2). We Just remember market tends to act ahead of the News to surprise everyone :

DOW / SPX – 3X3 / 9EMA

Sym	Posn	Close	Reversal
DJ	Short	11103.4	11111
SPX	Long	1178.21	1165.32

Daily 3-Line Break Wed Oct 20

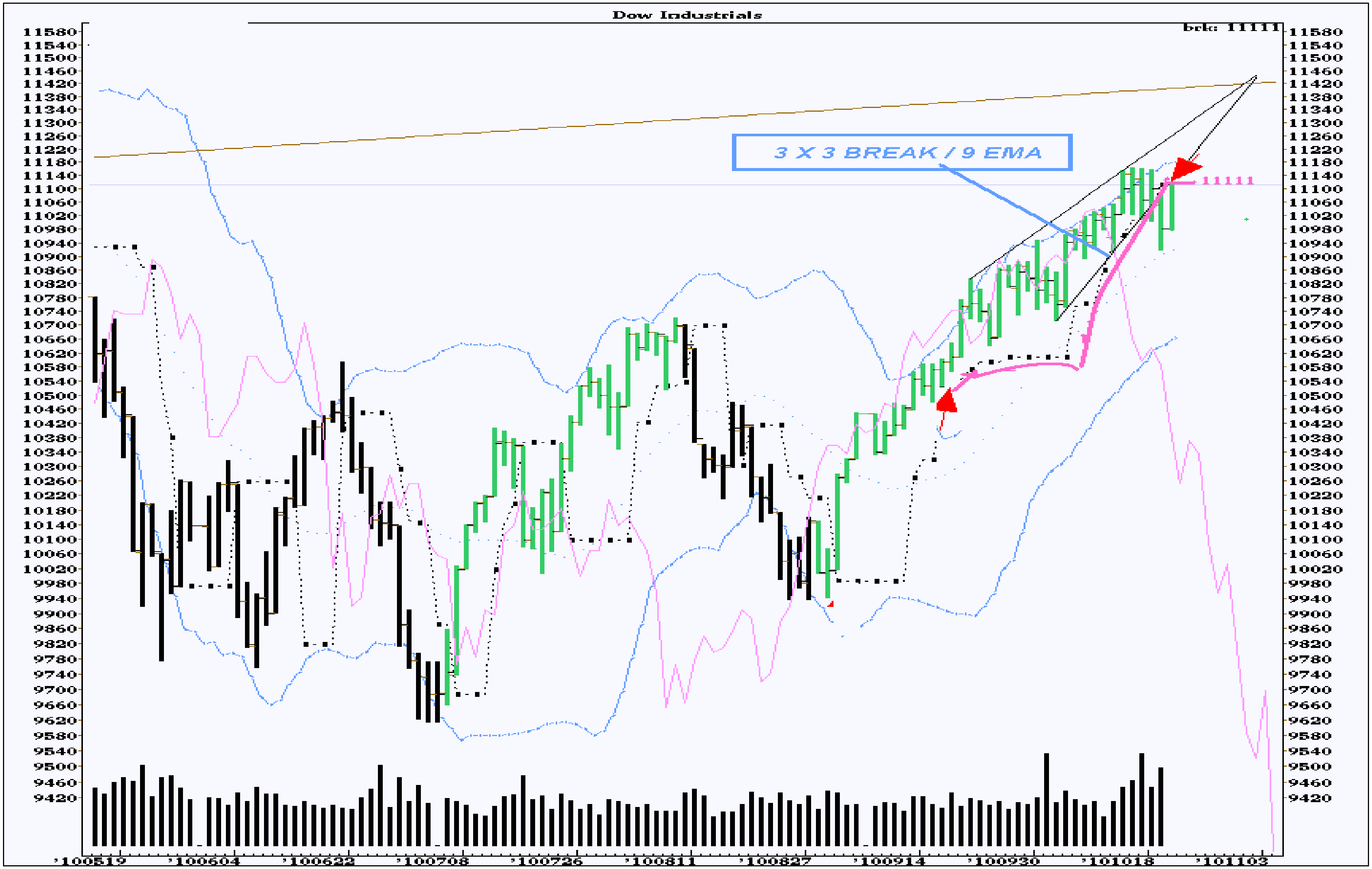
3X3 AND 9EMA is utilized by MO – Program traders on Extensions . This a cumulative algorithm with price trail. Although POM 14 extensions have been based on 20% Probability,. This methodology can certainly be played from the price points stated above and Chart below. The draw back of the strategy is, it can whip saw time to time and conservatively if we walk in with 20% probability of extension into this and if the extension does not materialize then it may not serve the purpose. .

On the day POM 14 was triggered , the DOW was at 11400 & SPX 1105. Since then it picked up 700 Dow points (Now Reversed 2 days ago at 10950) and for SPX its picked up 70 points (and Still open) . Good profit for quick fingers.

The Dow chart below shows the 3X3 / 9EMA price path tracking in (pink). This is played till the end of Diagonal Triangle.

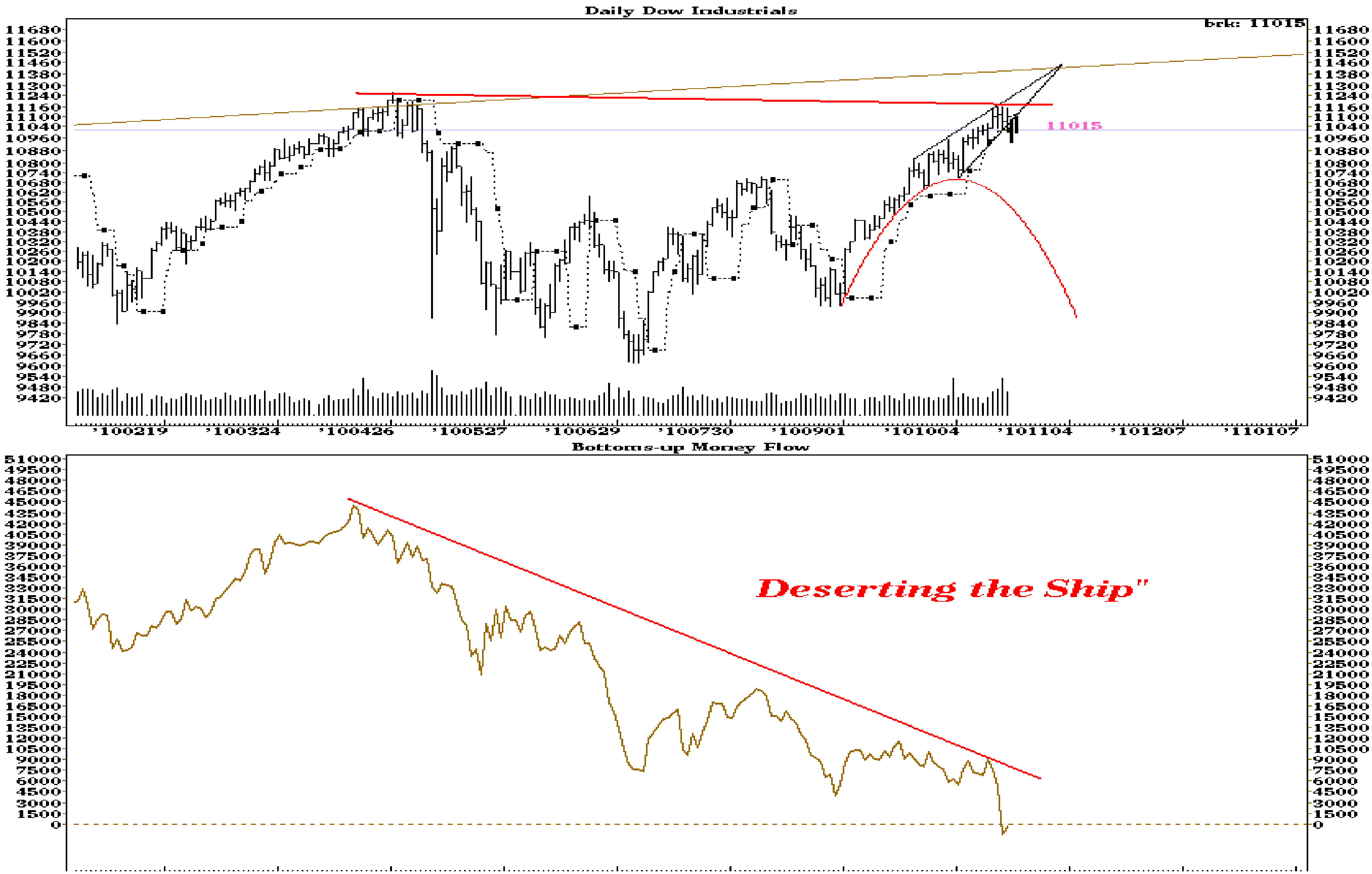
We could certainly incorporate this in thinking with trigger point of POM 14 and then keep it Independence of its own merit

DOW / SPX – 3X3 / 9EMA – Prices stayed above the computed price channel in Pink post POM 14



DOW – Wave & Money flow

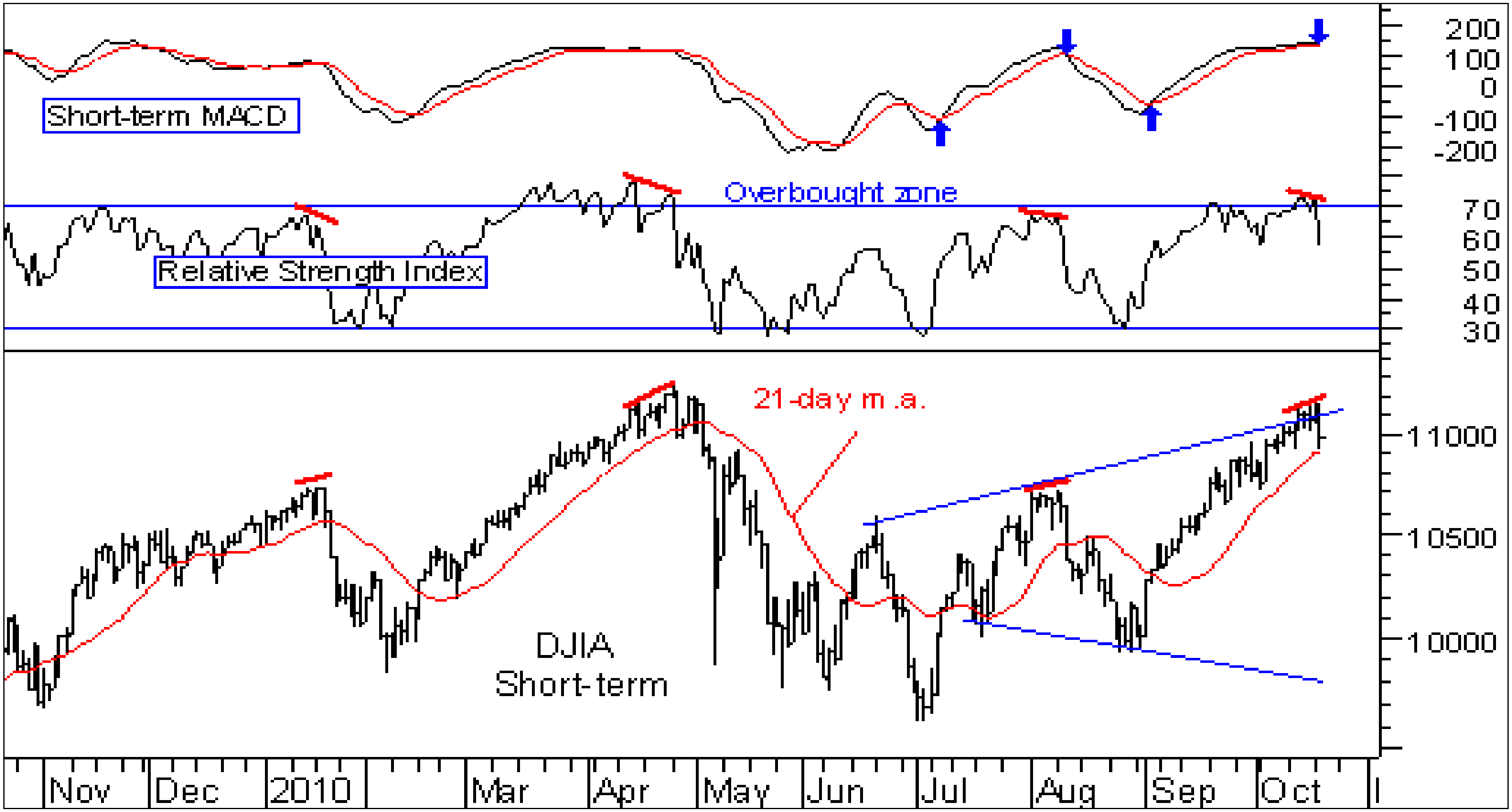
Breadth is rapidly diminishing and a correction here could be a setting up. However, according to the wave count, time and price are running out



DOW – Megaphone with Divergences

(We previewed the same Megaphone on SPX & NASD in previous notes)

The Dow is still in the area of the resistance at the top of a rare and usually negative broadening top, or 'megaphone formation'.



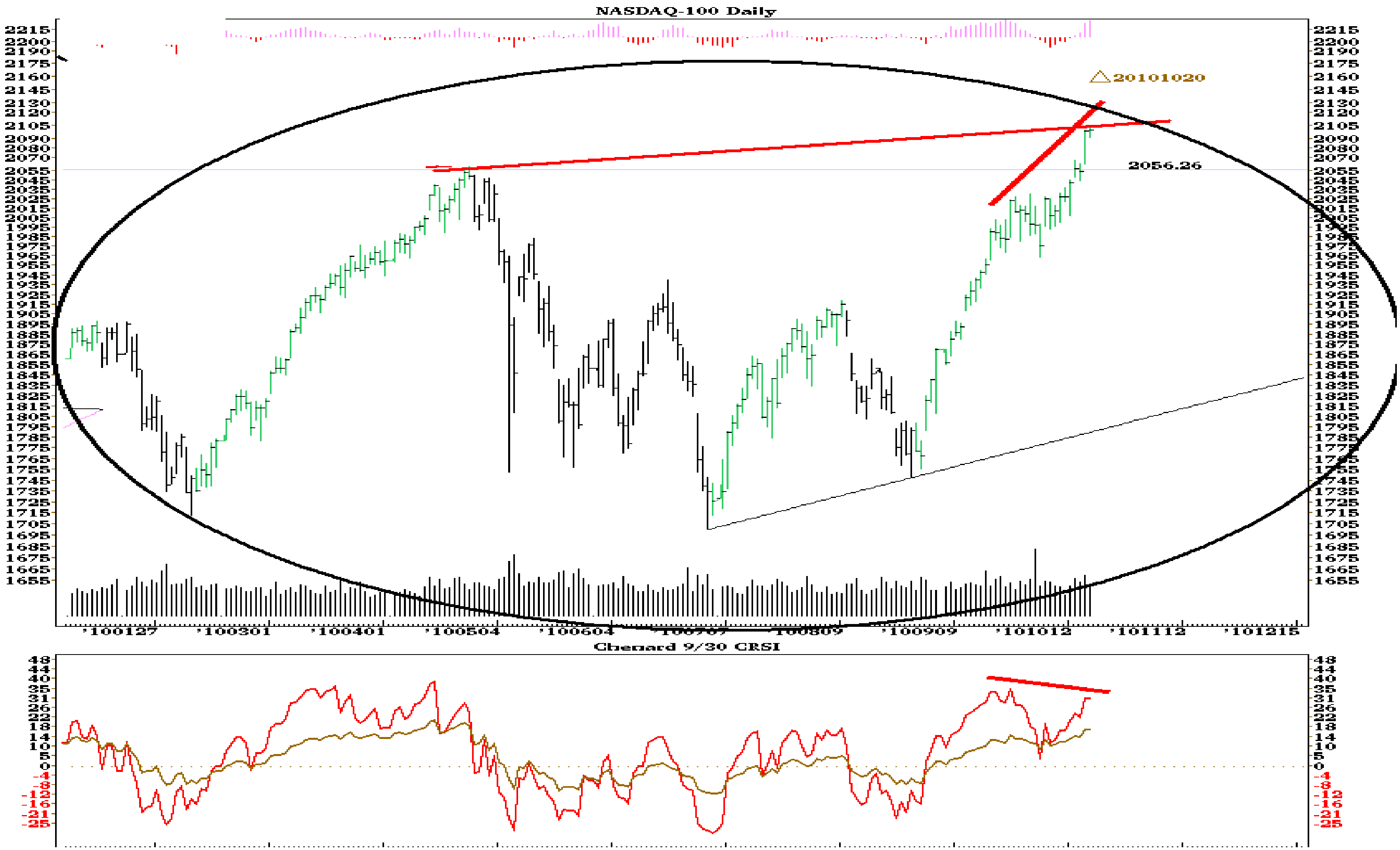
NASD – A/D Breath on the day of decline

BREADTH INDICATORS SHOW STRONGEST DOWN DAY SINCE AUGUST... Net Advances and **Net Advancing Volume.**

Even though the Nasd surged to a new high last week, these breadth indicators barely made it above +1000. With Tuesday's decline, **both moved below -1500 for the first time since August**. This shows the strongest selling pressure since the rally began.

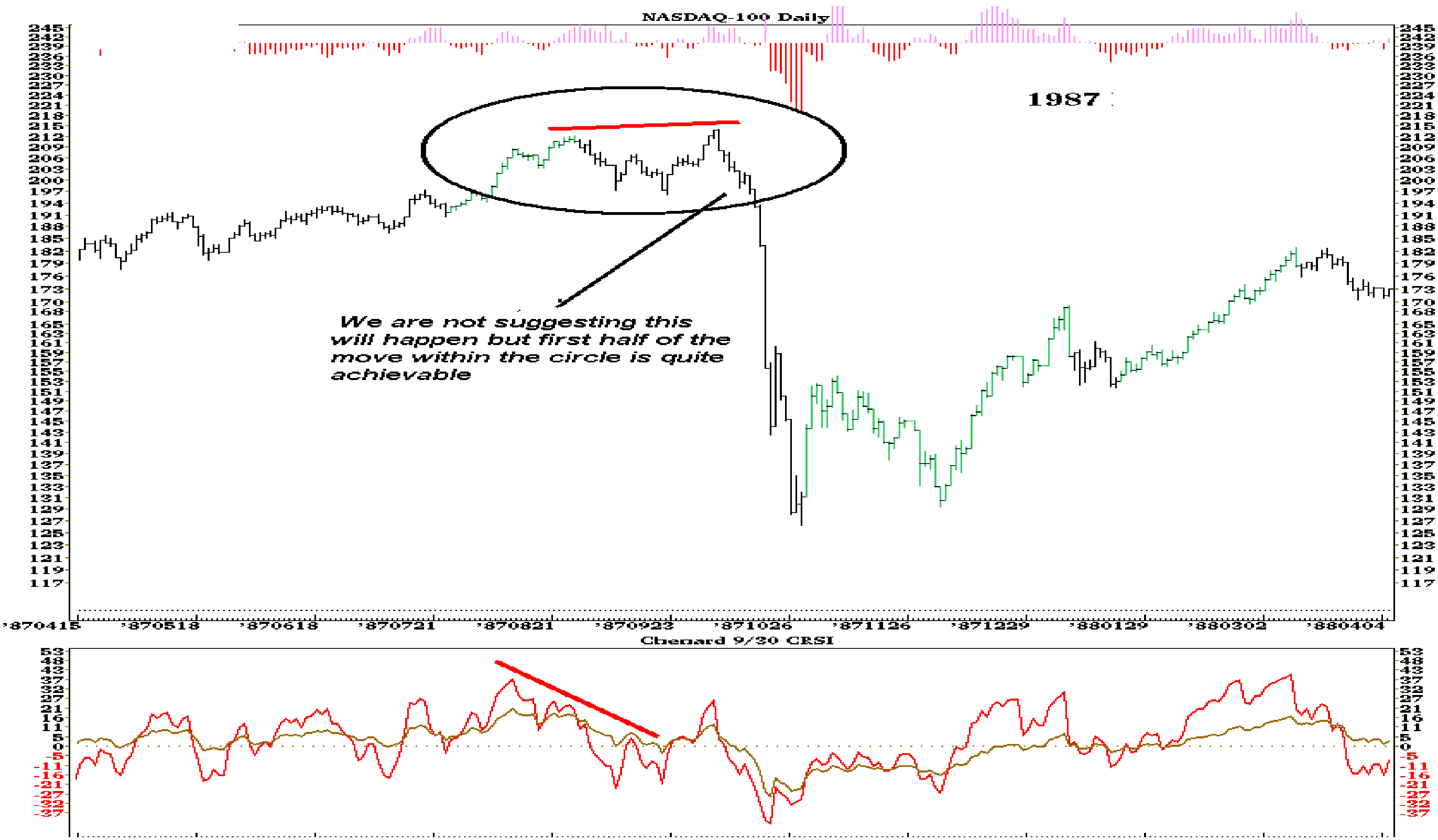
NASD - Divergence

If NASD was Independent Index its on scale of 8 out of 10 within POM 15 Framework. This Index has been held up by a thread consisting of a Apple and Google (30% of NDX) . The NASD shows a clear five-waves up, completing a wave C upward correction and beginning a trend lower:



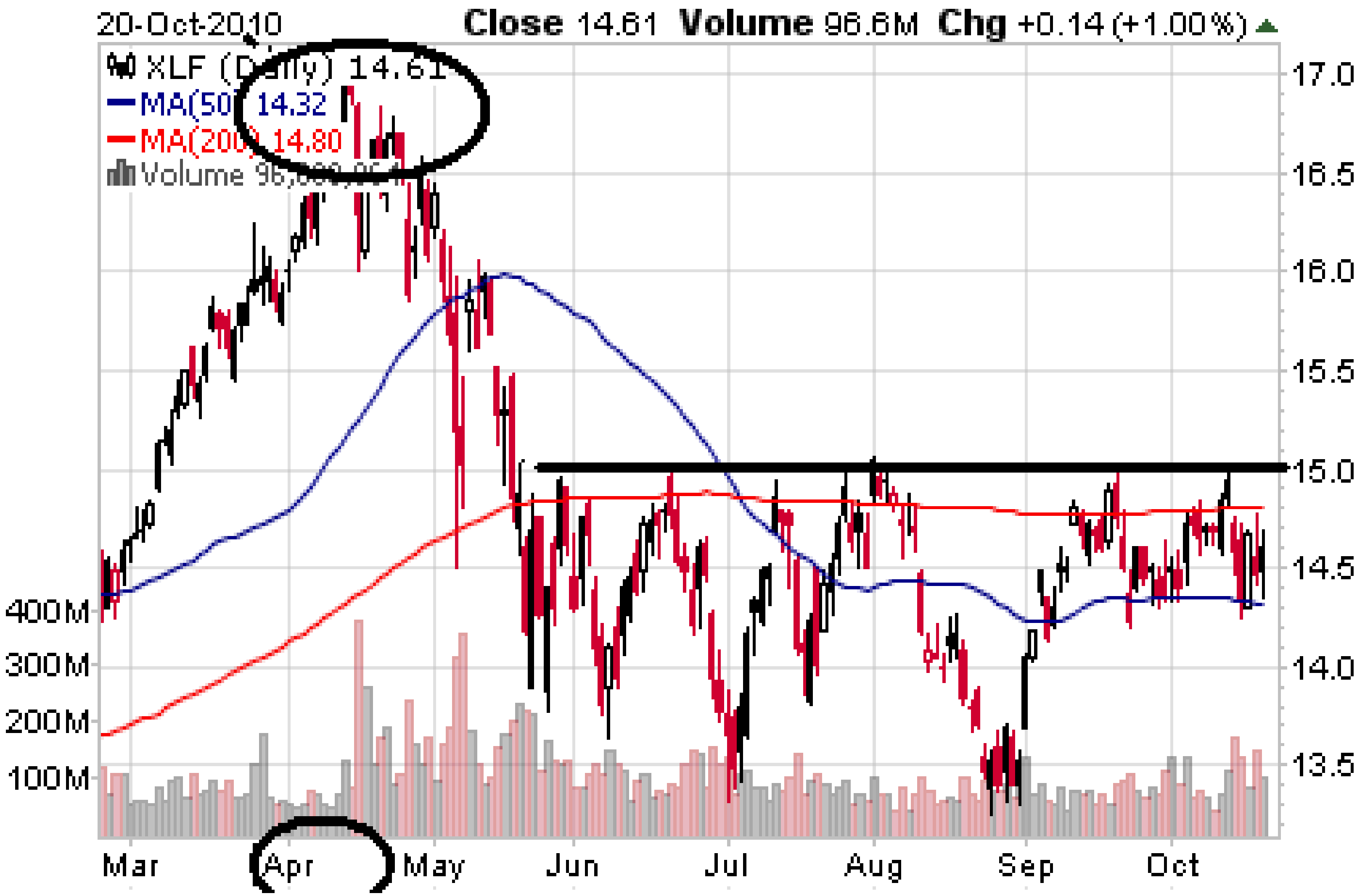
NASD - 1987 Cycle

By no means we are suggesting this, but patterns with back up from market internals tend to repeat with ½ the price path. Today's bearish divergence on NDX looks a lot like the bearish divergence before. Back in 1987, the Dow and SPX failed to make new highs in early October, but NDX certainly did so, then led the way down. The Circled part in black is material to think about .



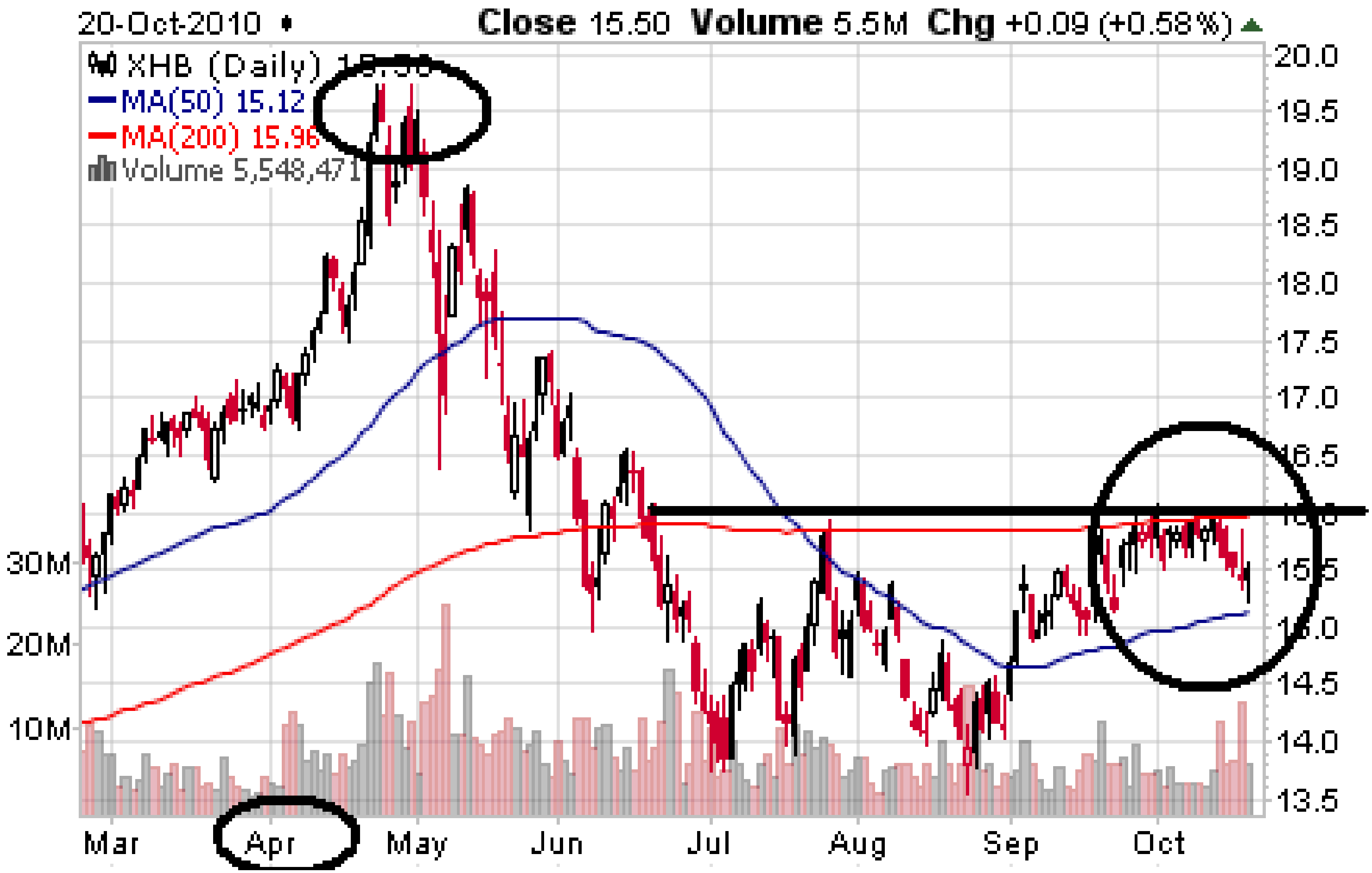
XLF – Divergence - 1

XLF finance sector remains the big laggard, April highs are way up, Current prices are below 200D and QE 2 is suppose to help these stocks but where is the Rally !! . Market is efficient mechanism of pricing they say !! but hasn't done so with XLF and Time is running out .



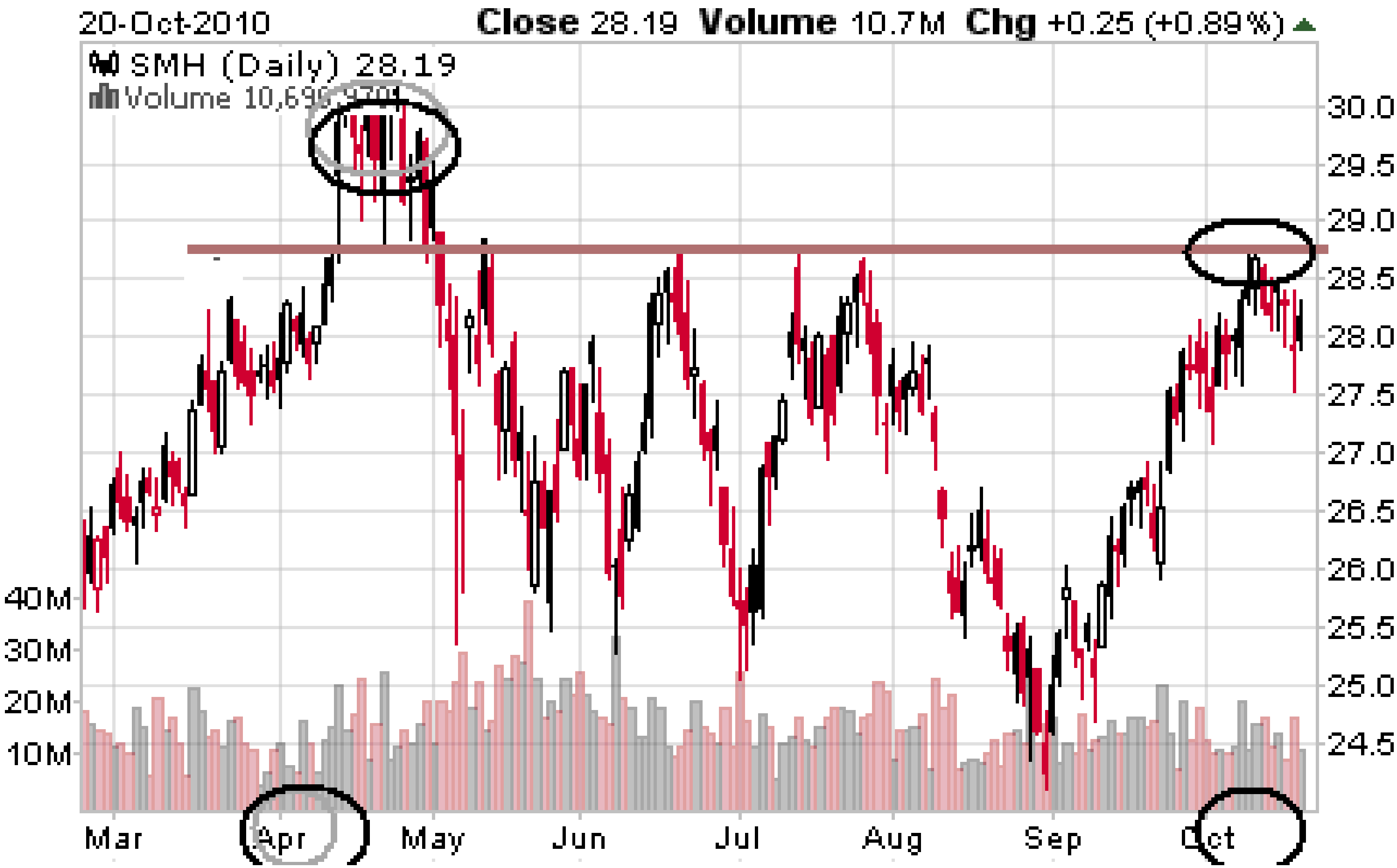
XHB – Divergence - 2

Home builders , same story as XLF - All QE 2 money should be going into this stocks which has been source of the problem. Past one week it has sold off compared to SPX still at its highs



SMH – Divergence 3

Semis suppose to led NASD for balanced market , April highs are way up. Past one week it has sold off compared to SPX still at its highs



- **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 nailed it again is perfectly on track but there was no conformation from POM at 105 price point

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

First POM 14 came in at 108 and then a Drop to 101 with High volume . Currently by this method High volume lows at 101 needed to be tested (we have been indicating it past 2 weeks) . It did so this week and the volume came in little heavy plus price broken to 100 therefore there will be a bounce to 104-105 .

Once the test is complete we will have clear picture. <u>So its inconclusive POM / PQV</u> . SD chart below on Correlation also is at Neutral zone <u>that is inconclusive as well</u> (Once we get all lined up it will confirm the trade , Keep a watch)

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

Intermediate-term in an overbought condition above the 30-wm.a., with a potential 'double-top' in place. But in the short-term charts, bonds look like they topped out in early September. The current chart shows 105 Area to re visit on bounce see how reacts there to make next call .

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