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## Technical Update February 9, 2009

**Note: This page provides a quick summary of our research. Please see the full report for detailed analysis on each topic.**

- **SAME THESIS!:** We reiterate our intermediate outlook - the S&P 500 will reach the 650-700 area followed by a major counter-trend rally. Whether equities fail in the next day or two, or try and consolidate before moving higher over the next few days towards the 900 area in the S&P 500, we feel that it's highly compelling to initiate short positions at ~885-895 with a stop above 905 – we find the risk/reward highly attractive at these levels.
- **TECHNICAL STRUCTURE:** We now increasingly believe that we have not yet completed corrective leg 4, which means we still have a final leg 5.
- **PRIMARY COUNTER-TREND RALLY:** We are looking for a robust/sustained rally that will last for a few months, but we don't think we are there yet, and believe we need one more new low.
- **SIMILARITIES TO 1938 MARKET:** The market in 1938 exhibits the closest correlation to the current price action. The market is currently in a very complex corrective pattern, and it's becoming increasingly clear that we are trying to complete a "running triangle" pattern just like we did in 1938, which ultimately resulted in new lows – we could see the 895-900 area before turning back lower.
- **GOOD OLD GANN ANALYSIS:** Gann is telling us that the 890-900 area is going to provide formidable resistance.
- **SENTIMENT IS ALL OVER THE PLACE!:** Sentiment is extremely bullish again, with the put/call ratio at 0.6 which is very call heavy. In the past when this ratio has reached these low levels, the market has traditionally sold-off soon after.
- **YES BUY CALL OPTIONS ON THE VIX!:** We are looking for a pick-up in risk aversion over the next few weeks. We believe the VIX is going to be at significantly higher levels by the end of March/April.
- **HIGH FLYING NASDAQ!:** We believe that Nasdaq's outperformance since late November '07 could be coming to an end.
- **SHORTING GOLD AGAIN!:** We think the risk/reward is too compelling at these levels not to give it another shot. We believe gold could head towards the 600-700 area before resuming its long-term uptrend. Our stop lies above 935.
- **BUT AREN'T BONDS THE SHORT OF A CENTURY?:** We think bonds will become a long-term structural short but we expect one final rally, one final blow-off that could take bonds to new highs. We find the risk-reward attractive and recommend buying weakness at these levels. Our stop lies below 99 in the TLT.

The results presented should not and cannot be viewed as an indicator of future performance.  
Charts courtesy of Bloomberg Finance L.P.

• **SAME THESIS!:** We reiterate our intermediate outlook - the S&P will reach the 650-700 area before we get a major sustainable primary counter-trend rally.

Whether equities fail in the next day or two, or try and consolidate before moving higher over the next few days towards the 900 area in the S&P 500, we feel that it's highly compelling to initiate short positions at ~885-895 with a stop above 905 – we find the risk/reward highly attractive at these levels.

We understand and adhere to the famous adage that “markets can stay irrational longer than one can stay solvent”, which is why we always have well defined stops, and we will not fight the markets should they move against us.

Having said that, should the S&P head towards ~1000, we think it will simply be an extension of the corrective leg, which means that we will then still see the markets turn and head lower towards new lows. In other words, we believe there is a very low probability that we have seen the intermediate bottom. That's why a stop and reverse at 905 makes sense to us.

On the other hand, we believe there are some global indices that have bottomed. Their technical structure looks complete, and the technicals are all lining up on the long side. Please contact us if you want more details regarding this.

Our intermarket analysis suggests that we will see equities come under pressure over the next few weeks, while bonds will start rallying again.

We recommended shorting at ~870-885 on Wednesday Jan 28th just before the Fed announcement – the market traded down and its right back up to those levels. We had moved our stops lower to ~870 but we are willing to give it some latitude and move our stops back to our original stop level of 905.

We could go as high as ~900 in the S&P and it could take a few days for the market to consolidate and to extend higher towards those levels, but we think the highest probability scenario is that this bounce/rally is nearly complete and that we will soon start turning lower. Maybe we will see a classic 'sell the news' type if equities begin selling off right after the stimulus plan gets announced tomorrow.

There is a confluence of cycles coming due today. The next confluence of cycles occurs on Feb 19th/20th. Recall that these often cause an inflection point in the markets.

• **TECHNICAL STRUCTURE:** We have been arguing that the highest probability outcome is that we started intermediate leg 5 on Jan 6th, and that we are either in leg 2 of 5 or leg 2 of 3 of 5. This remains a possibility but as you will see when we discuss the ‘running triangle’ pattern below, we now increasingly believe that we are still in corrective leg 4. That means we haven’t even seen the beginning of leg 5 yet.

• **PRIMARY COUNTER-TREND RALLY:** We are looking for a sustained rally that will last for a few months, but we don’t think we are there yet, and believe we need one more new low.

We thought that an intermediate bottom could be formed no later than mid-March but the timing has been pushed out in our opinion. We will inform our clients when the timing is right to begin aggressively accumulating shares. We will also provide a list of the most promising stocks/sectors that we expect to outperform the broader market.

We believe this major primary counter-trend rally will look and feel as the beginning of a new primary bull market, and it will last for a few months.

• **SIMILARITIES TO 1938 MARKET:** Since we believe history has a tendency to repeat itself, we often analyze historical time periods that show similarities to the current price action, and we believe the price action in 1938 exhibits the closest correlation to the current price action.

The last few weeks have been trickier than usual to forecast. The reason for that is that we have been forming a very complex corrective pattern that is a result of indecisiveness amongst market participants. That is the reason why there have been so many contradictions and dichotomies from a technical perspective.

It is becoming increasingly clear that we could be trying to complete a “running triangle” pattern. See charts below. It appears that we are currently in leg E and that once we complete that leg we will turn around and head towards new lows for that final leg 5.

It’s also noteworthy that these symmetrical/running patterns have a failure rate of less than 5%. These are continuation patterns, so once they are complete the long-term downtrend should resume.

The S&P could consolidate for a few days and then move higher to the 900 level before failing at the upper trend-line but if you look at the NDX index we have already seen a “throw-over”, which suggests that we could already be done and we begin the sell-off as early as today or tomorrow.

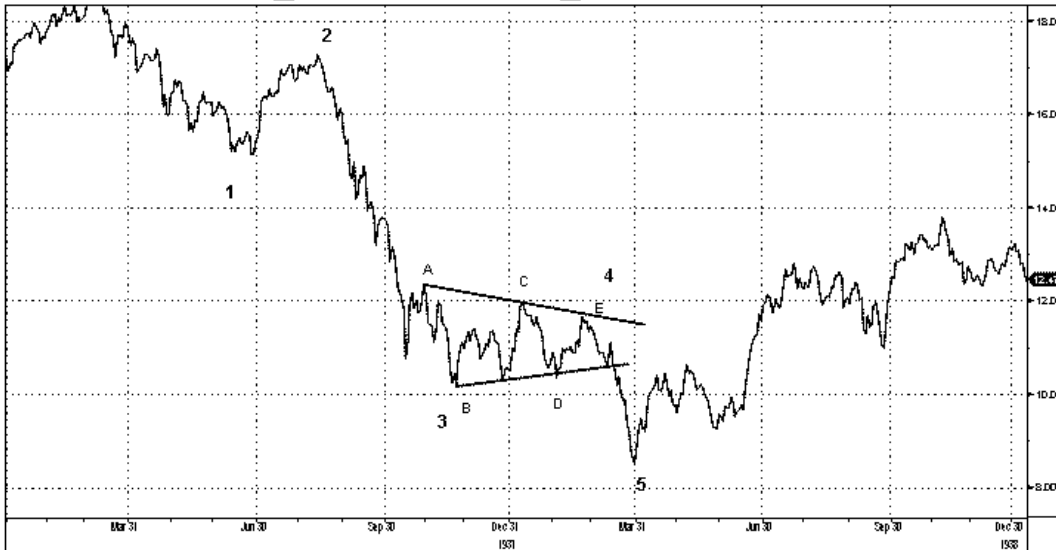
Furthermore, what we also find interesting, is that if we use traditional measuring techniques to measure the downside price objective for the final leg lower, we arrive at a price target of ~650 on the S&P 500, which coincides with our original target that was derived using other techniques.

Furthermore, bullishness always dramatically rises the most in leg E, and we think it’s fair to say that the vast majority of people have been getting really bullish over the last few days, which increases our conviction that there is a good chance that we will be proven right.

SPX 868.60Y as of close 2/ 6

Index GP

SPX INDEX  GP - Line Chart Page 1/13  
 Range 02/11/37 - 02/03/39 Upper  Line Chart  Mov. Avgs    Currency USD   
 Period Daily  Lower  None  Mov. Avg 15  Events



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 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2009 Bloomberg Finance L.P.  
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SPX 868.60Y as of close 2/ 6

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SPX INDEX  GP - Line Chart Page 1/7  
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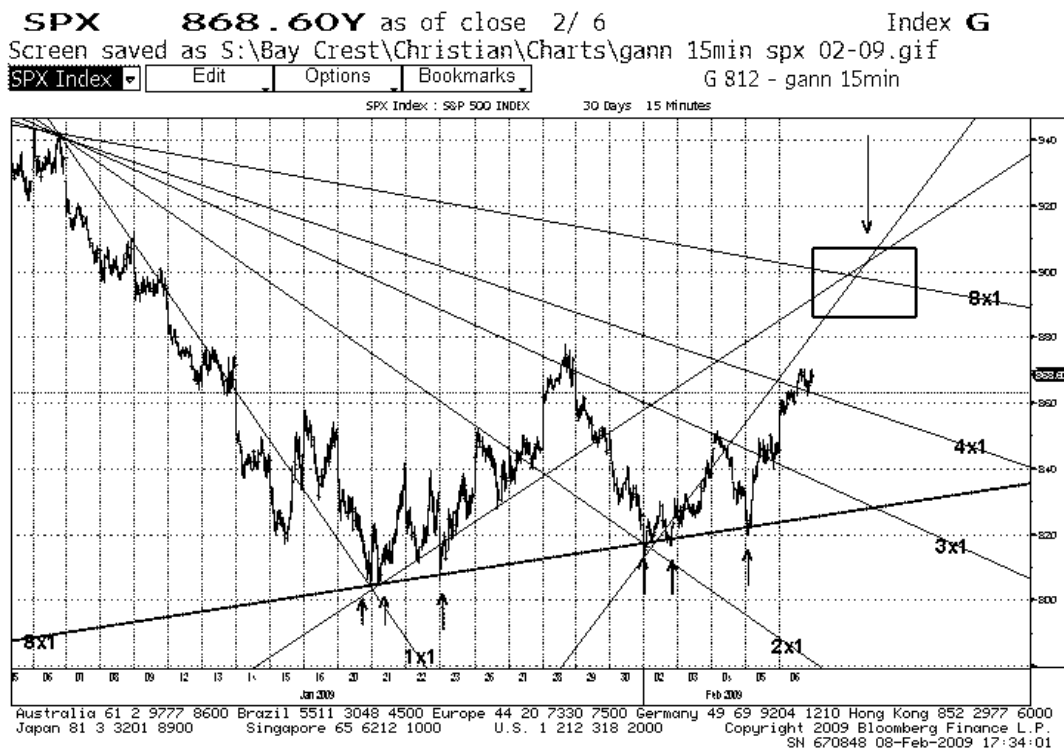


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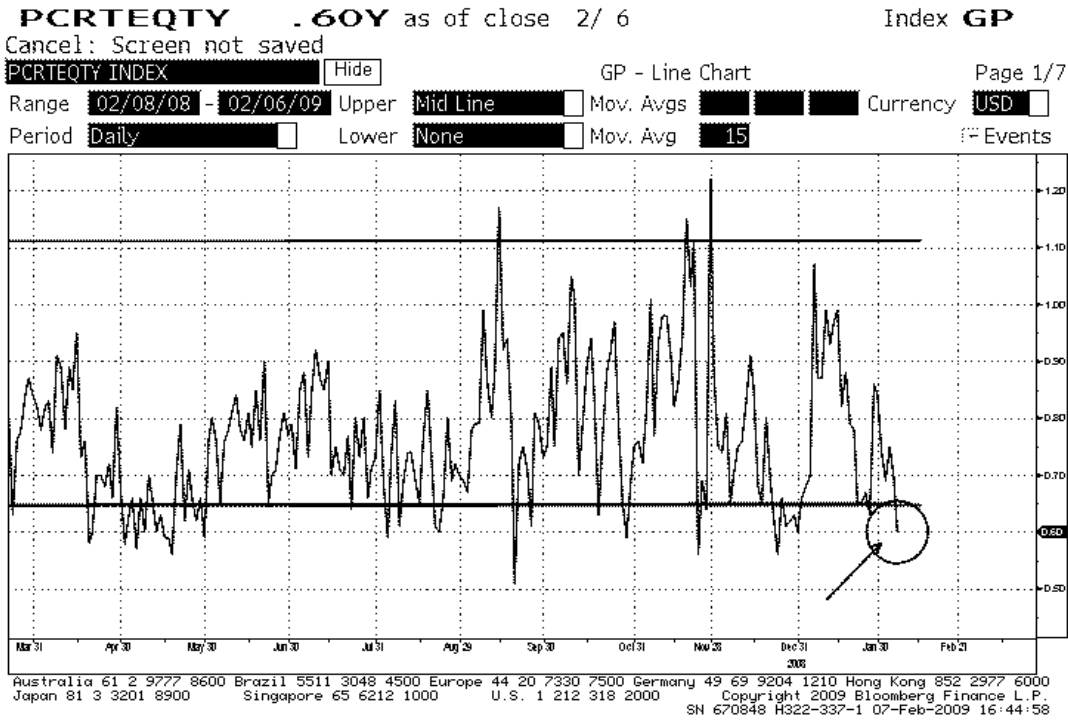
• **GOOD OLD GANN ANALYSIS:** Gann is telling us that the 890-900 area is going to provide formidable resistance, especially the downward sloping 8x1 gann line, which is why we decided to use 905 as a stop level. We believe the confluence and intersection of gann angle trendlines in that area will provide a ceiling to the recent rally.

Furthermore, it's interesting to see how many times the market bounced off the upwards trending (from the 740 lows in November) 8x1 gann line (we counted six times) including last Thursday's intraday reversal.

We will be looking for a breach of this trendline as confirmation that the final leg lower is underway. That gann line is rising and is currently approaching ~835.



• **SENTIMENT IS ALL OVER THE PLACE!:** Sentiment is extremely bullish again, with the put/call ratio at 0.6 again which is very call heavy. In the past when this ratio has reached these low levels, the market has traditionally sold-off soon after.



• **YES BUY CALL OPTIONS ON THE VIX!:** We are looking for a continued pick-up in risk aversion over the next few weeks. We believe the VIX is going to be at significantly higher levels by the end of March/April.

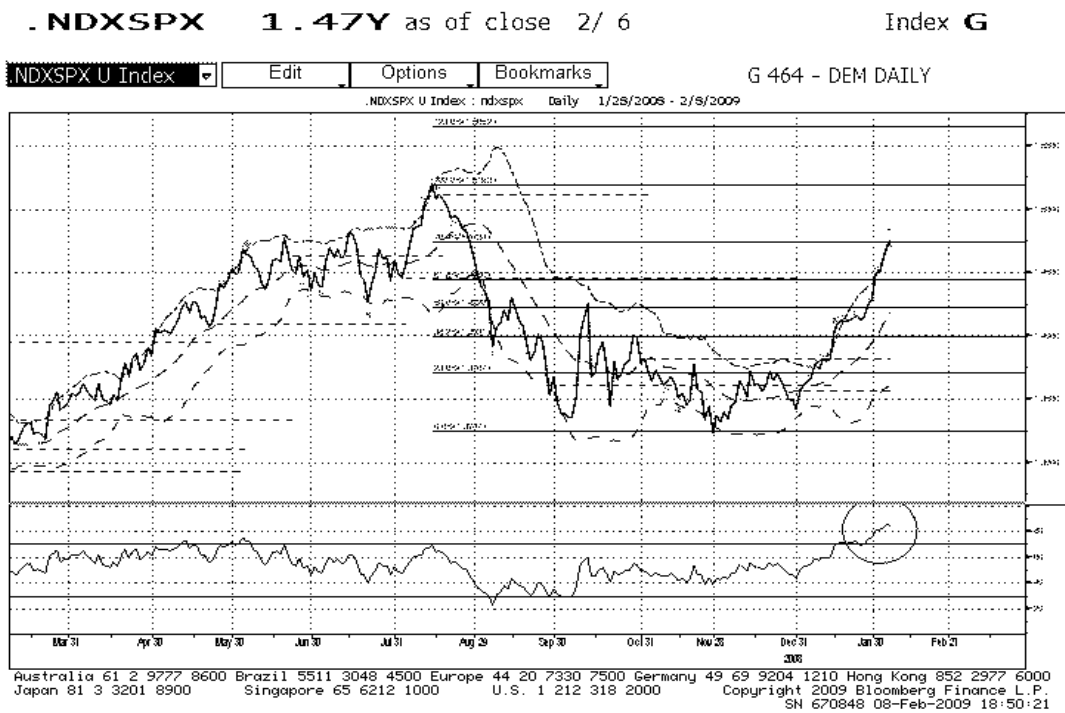
We have seen bullish candlestick patterns form on the VIX over the last few days despite the sharp rally in equities, and we believe the market is trying to tell us something. There is also a demark red 13 buy signal on the VIX – the sequential timing technique has worked well over the last couple of years to time the turns in the VIX (these buy and sell signals have been illustrated by the circles on the chart).

Also looking for new lows in the DollarYen and the EuroYen.



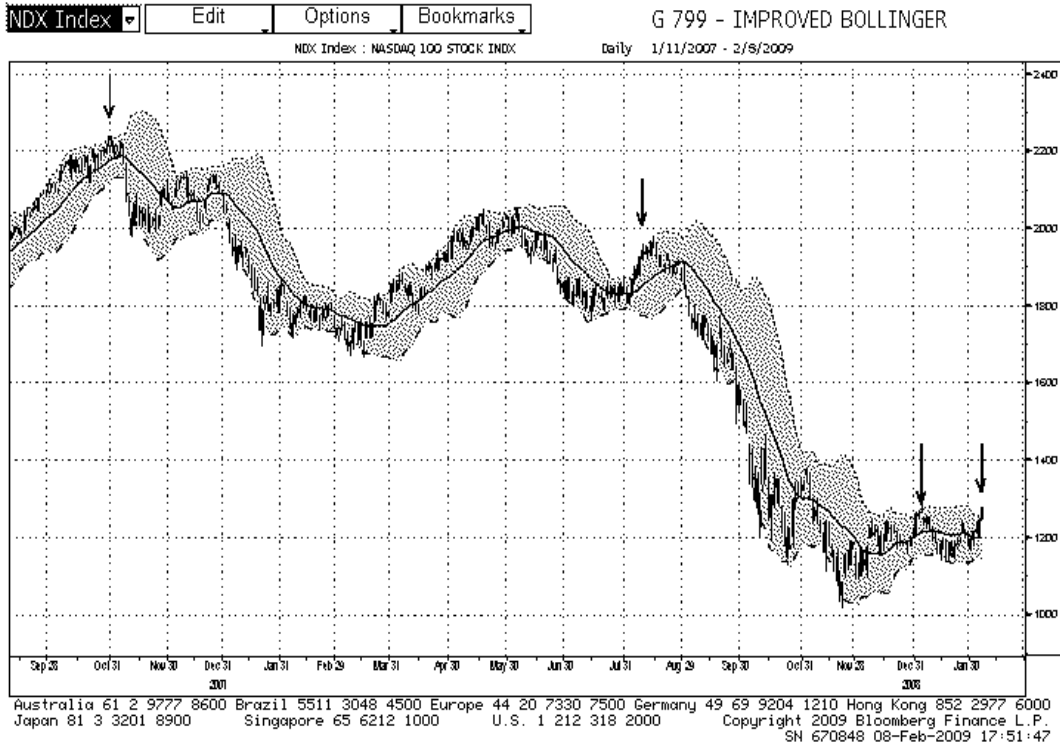
• **HIGH FLYING NASDAQ!:** The nasdaq has been clearly outperforming the broader markets since late November, but we believe we could soon see a turn.

We have a Demark Sequential sell signal on the ratio chart, which has worked well to time the turns over the last couple of years. Furthermore, we are at 1.47 on the ratio chart, which is the 76.4% fibb level and the RSI is above the 80 level. We think there is a good chance we could see the NDX begin to underperform the S&P 500. If you believe this, we recommend going long the S&P 500 vs going short the NDX. Stop just above 1.5.



Furthermore, the nasdaq is the only index that has managed to go above the top band of the Bollinger bands (2 standard deviations). The last few times the nasdaq closed above the bands, we saw an important top being formed. See chart below.

**NDX**      **1277.49Y** as of close 2/ 6      Index **G**



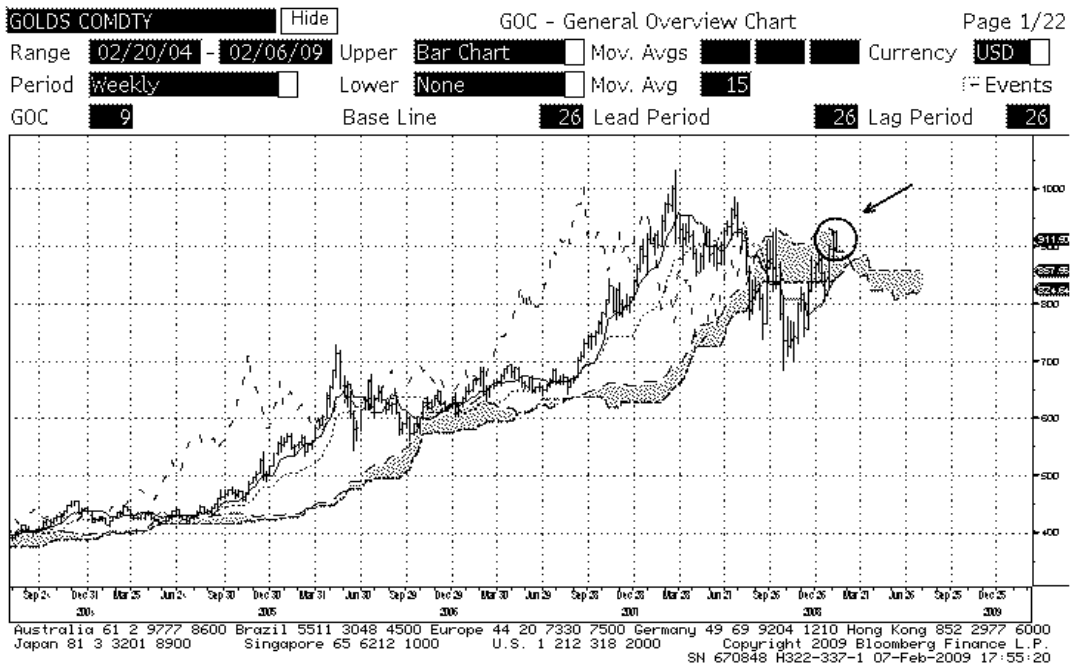
• **SHORTING GOLD AGAIN!:** We think the risk/reward is too compelling at these levels not to give it another shot. We believe gold could head towards the 600-700 area before resuming its long-term uptrend.

We find the risk/reward at these levels even more attractive than before with a tight SAR stop just above 935.

We believe that all the technicals have been increasingly lining up on the bearish side in terms of the intermediate outlook. In addition, we believe gold needs to fail right here right now, since if it manages to close and build value above 935, we will see gold break out and head towards 1100. The weekly ichimoku chart below illustrates this with the shaded area providing long-term resistance.

GOLDS **911.50Y** as of close 2/ 6

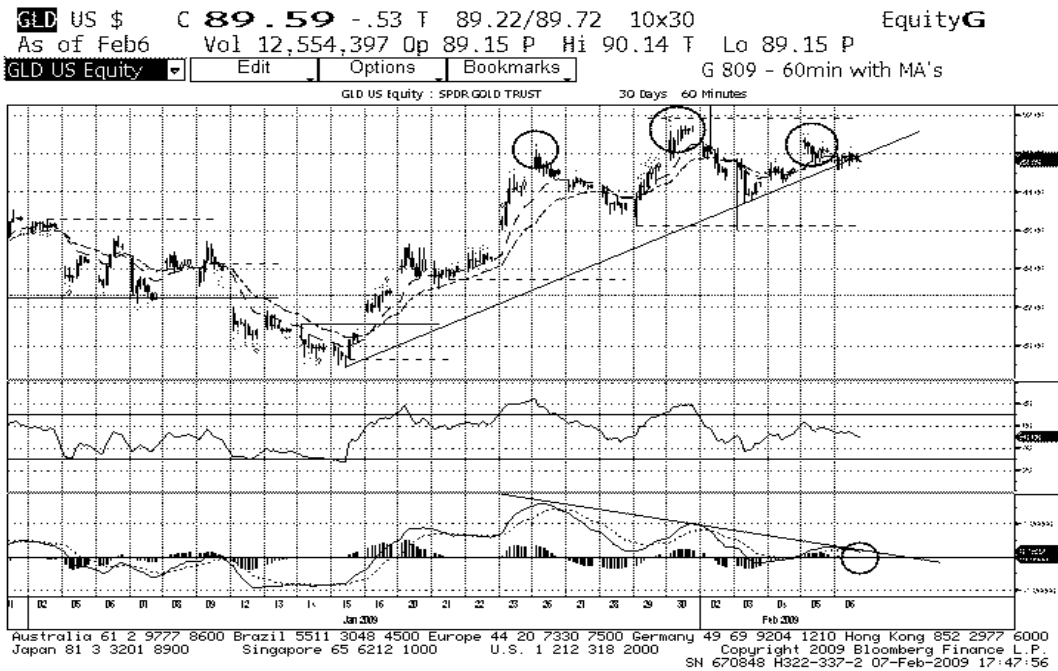
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To become increasingly aggressive on the short side, we want to see gold break and close below 900 in the next few days.

Studying the hourly chart below, we are starting to see some short-term technical deterioration, with bearish divergences continuing to play out. If we sell-off from here we will also have a head and shoulders reversal pattern, so we can't break above 930-935 again.

The hourly chart started breaking the trendline towards the end of last week.

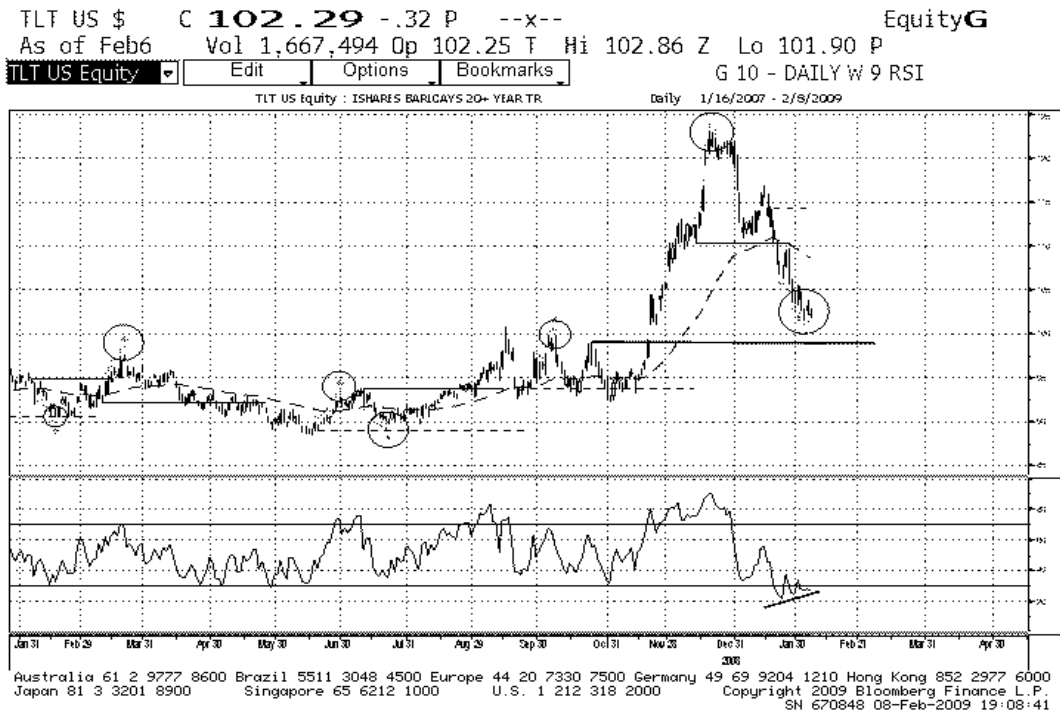


• **BUT AREN'T BONDS THE SHORT OF A CENTURY?:** We think bonds will become a long-term structural short but we expect one final rally, one final blow-off that could take bonds to new highs.

In our initial reports, we argued that bonds would continue to sell-off (yields rise) for the foreseeable future, and that yields could reach the ~3-3.2% area. We now think its time to start covering your short positions, and start to get long again.

We think the risk-reward is attractive at these levels. From an Elliott wave perspective, one cannot go below 99 in the TLT since that is the top of wave 1 and we believe this sell-off over the last few weeks has been wave 4.

We now expect a powerful wave 5 that will likely make new highs, which should coincide with new lows in equities.



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