Technical Analysis and Strategy

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• **Trade into Expiration?** Now that we have washed out the short-term overbought conditions, we think there is the potential for equities to rise into the end of this week (risk/reward is attractive here for a trade), but like we outlined in our initial report, the secondary counter-trend rally is nearly complete. We argued that the S&P had to remain above the 918 and 900 support levels but after re-studying our charts, we now see an area of support confluence at the 885 level. To us, we are at a 'make it or break it' point in the stock markets.

• **Preferred Timing Scenario** Our preferred scenario is that we form a short-term top around the 20th of January (which could simply be a lower high), followed by a severe sell-off into mid-February, at which point our cycle work suggests we will see a major inflection point in the markets. We expect this to mark the beginning of a multi-month primary countertrend rally that could last till the summer.

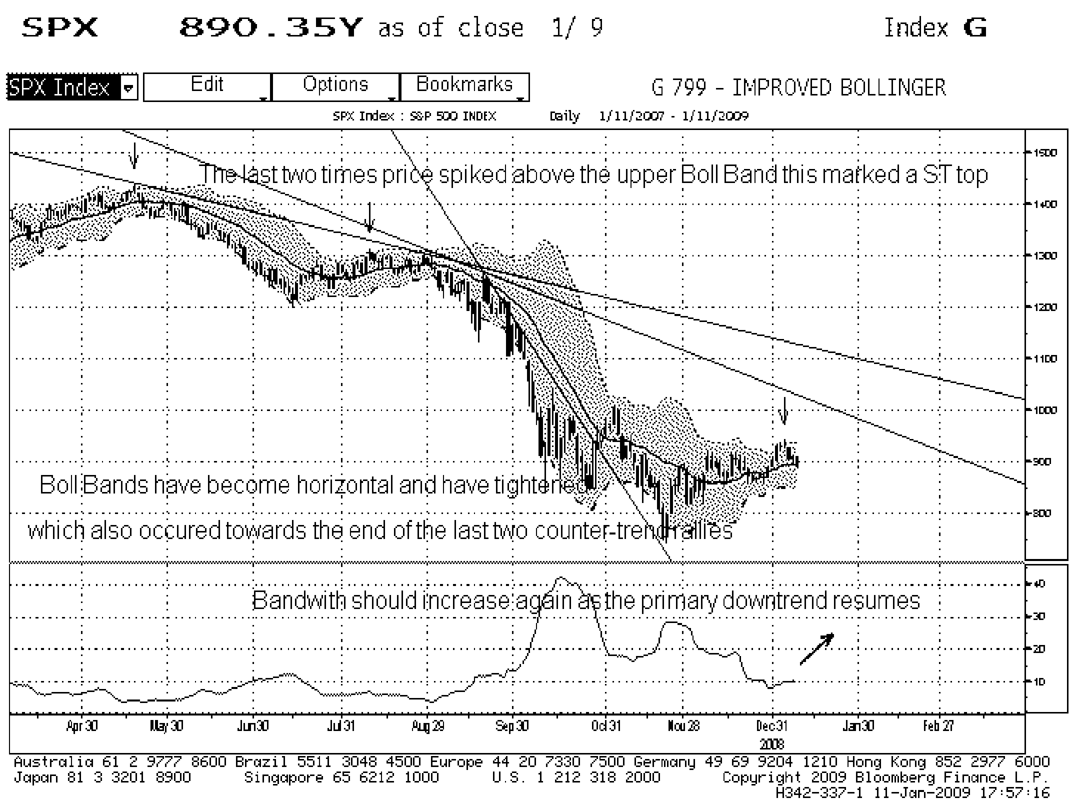
• **Next Major Move?** The very short-term outlook is always tricky. What we have high confidence in is that the next major move in percentage terms is going to be another leg lower. We expect to see at the very least a retest of the November lows, but we find it more likely that price forms a new low somewhere in the 650-700 area.

• **Technical Structure** Our EW technical counts suggest we are either at the latter stages of completing leg 4, or we have already started leg 5 to the downside. The completion of leg 5 should complete the move from May 19th. Leg 5 will also further subdivide in 5 legs and once that is complete, we will see a primary counter-trend move higher.

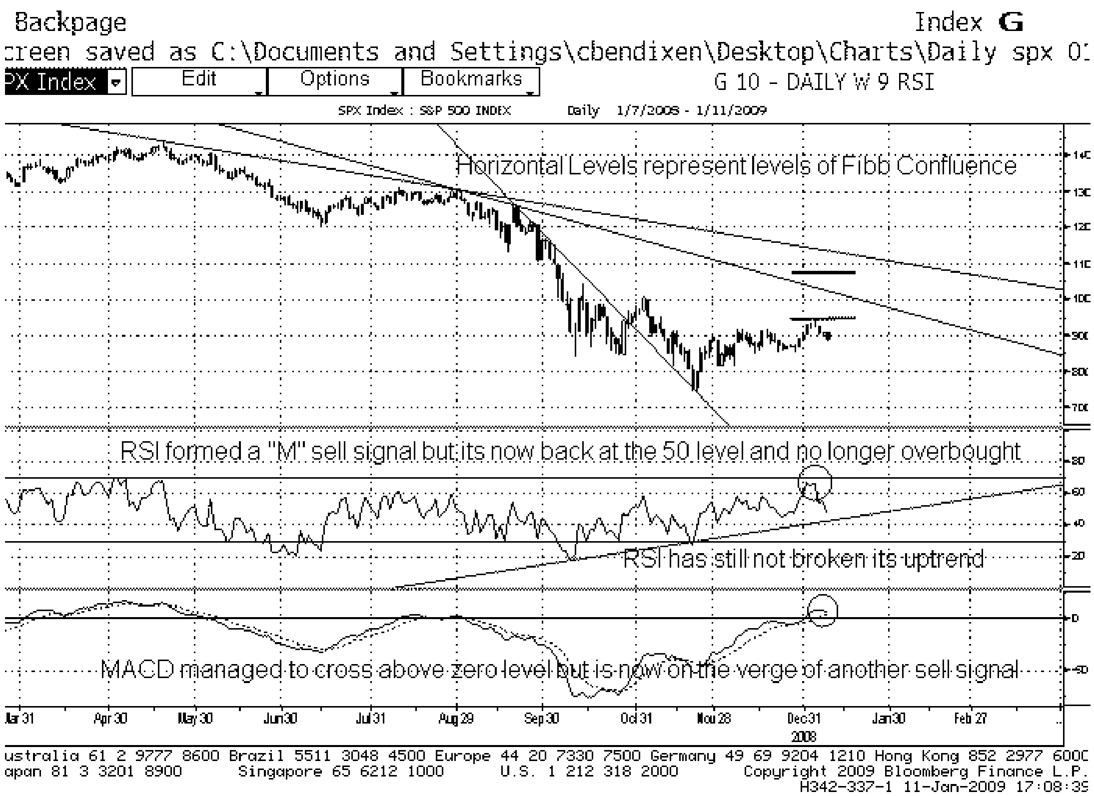
• **Volatility** Coincident with the sell-off in equities, we expect the VIX to move back up to the 58-63 area , which is an area that has a confluence of Fibonacci retracement/resistance levels. However, over the next few days we would not be surprised if the VIX came in a little. A move above 44.5 (new important pivot level) would confirm a change in trend for us and would open the door for higher levels of volatility.

We’ve included the next few charts in this report, simply to point out a few interesting things that have occurred in the S&P over the last few days.

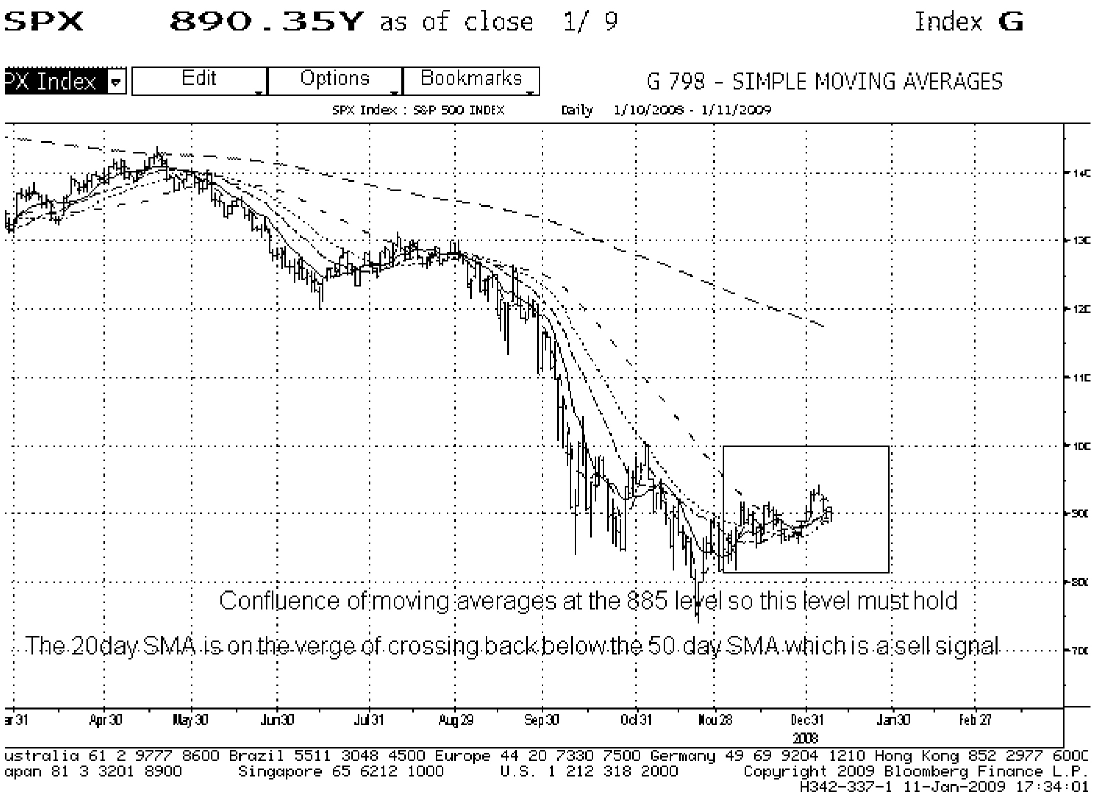
The daily chart that has Bollinger Bands (2 standard deviations) superimposed, shows us that the last two times we saw prices spike above the top Bollinger Band, while the bands were horizontal and tighter than normal, marked important short-term tops. Will this scenario repeat itself? It remains to be seen, but we have high confidence that the next major move will be lower. However, keep in mind that we are nearing the end of a major primary move (hence the final leg 5 from the move since May 19th) so the next move lower will not be as sharp and severe as the last one.



This is an updated chart that we used in our initial report. The S&P ended up finding strong resistance at the first level of Fibonacci confluence, while forming a bearish short-term “M” pattern. However, what’s really interesting to us now, is that after just a few days of selling pressure we have washed out those short-term overbought conditions and the RSI is back at around the 50 level (and it remains above its uptrend). It’s also noteworthy that volume remained below average even as key support levels were breached, which to us means that volume, so far, has not confirmed an imminent breakdown.



There is a confluence of moving averages at the 885 level, and it is crucial that we hold this area of support. If we breakdown through 885, that will open the door for a retest of 855, and similarly a breach of 855 would open the door for a retest of the critical 816 pivot level.



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