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Technical Analysis and Strategy

Technical Update January 28, 2009

• **SELL STRENGTH:** Our conviction level remains high that the S&P will head lower over the next few weeks and reach our 650-700 target.

The highest probability scenario, in our opinion, is that we are nearly completing this corrective move higher, and we believe that these levels represent a good opportunity to initiate/size into short positions.

We feel that its highly compelling to initiate short positions at ~870 and ~885 with stops just above 900.

We are mindful that month-end strength could continue until friday, and that we have a binomial event today with the Fed. However, we think that until the end of the week there will be some good opportunities to lay out some shorts in the 870-885 area resistance area.

• **TECHNICAL STRUCTURE:** On our last update, we argued that the minor corrective leg 2 (they tend to be sharp reversals) was going to continue to unravel, and we thought the most likely targets for leg 2 were 870, 885, and 895. Now that we find ourselves at these levels, we still believe that these levels represent good levels to initiate short positions with good risk-rewards.

We continue to believe that the highest probability outcome is that we started intermediate leg 5 on Jan 6th, and that this is minor corrective leg 2 of 5.

Alternate Elliott Wave Scenario: There is a possibility that we just started leg C of 4 from the lows on 01/23, and that we haven't even started the final intermediate leg 5 lower.

This is a low probability scenario in our opinion, but it's still on the table.
Thus, if we go above 900 odds are high that the minimum upside target would be 940 again before we turn back lower and head towards 650-700 again.

• **MAJOR RALLY:** We reiterate our view that we believe an important intermediate bottom will be formed no later than mid-March. 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 then expect to see a major primary counter-trend rally (that will look and feel as the beginning of a new primary bull market) that should last for a few months, which could last for the better half of '09.

• THAT'S A LOT OF RESISTANCE!: There is a confluence of resistance around the 870-875 area. 20, 30 and 50 simple moving averages are all converging in the same area, there is a gap that has been left open between 868-872 on S&P cash, which also coincides with Fibonacci retracement levels.

• SHARP REVERSAL IN SENTIMENT: We are always impressed by how quickly sentiment switches from bearish to bullish and vice versa, over just a matter of days.

Sentiment is quite bullish again, with the put/call ratio near the bottom part of the range near 0.6, which is very call heavy. We use this as a contrarian indicator and think that the market is vulnerable to a sell-off at these levels.

In addition, whenever you get sharp bounces in a bear market on declining volume, odds are high that it is just a bear-market rally. So far, we see limited signs of accumulation in the broader markets.

• SUB-STRUCTURE DETAILS: We believe we started intermediate leg 5 on 01/06 and that the fist minor leg of that move completed on 01/21.

We then started corrective leg 2, which subdivides in 3 waves (A-B-C). Wave A started on 01/21 and ended on 01/22 in three waves, then wave B started on 01/22 and ended on 01/23 in three waves, and we have since been in leg C, which has to be subdivided in 5 legs.

This is a typical "flat" pattern, which is a very common corrective pattern. For those of you that are less familiar with Elliott Wave theory, a "flat" pattern consists of three waves up, followed by three waves down that either holds at the previous low or forms a slight new low, and ultimately the pattern is completed with five waves higher.

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