



Christian Bendixen CMT +1 212 480 1400

cbendixen@baycrestpartners.com

Equities/Derivatives Trading + 1 646 878 0005

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- **Short-term:** The secondary counter-trend rally from the Nov lows is nearly complete (we are at short-term overbought levels), but there is still a chance that equities can extend higher towards the 1000 resistance level going into the 20th and 21st of January, as long as it can stay above the 918 and 900 support levels. Our cycle work indicates that these dates will signal an important inflection point in the markets, which coincidentally occurs with the Obama inauguration.

We then expect to see a severe sell-off in equities that could lead to a retest of the Nov lows or even a new low before we see the beginning of a major primary counter-trend rally.

- **Intermediate-term:** Our cycle work also indicates that mid-February could be a significant turning point in the markets, and our preferred scenario is for an important intermediate bottom.

Then, we expect to see a major primary counter-trend rally in equities that will last for a few months most likely into the middle of summer.

- **Long-term:** We believe the market remains in a long-term bear market, and we will resume the major downtrend in the second half of '09, but we will keep an open mind and re-evaluate the technical environment when that time arrives. Our longer-term target stands at 650.

- **Dollar:** We expect to see the dollar continue to rise and expect the DXY index to go above 88 over the intermediate-term, which we believe will coincide with the major primary counter-trend rally we foresee in equities.

- **Treasury Bonds:** Our technical indicators/techniques suggest that we will see bonds continue to sell-off (which doesn't preclude any short-term bounce). For the foreseeable future, we see lower prices in bonds and higher yields.

For a number of months, the markets have been developing key positive/bullish divergences, and they have been taking place across a number of indicators and indices. For example, while price kept making new lows the number of new 52 week lows on the NYSE began to diverge. Also recall that back in November we saw a divergence between the VIX and the S&P. While the S&P made a significant new low in price on 11/20, the VIX failed to make a new high and in fact made a lower high on 11/20. This non-confirmation by the VIX marked the beginning of this secondary counter-trend rally we currently find ourselves in.

Recently yields treasury yields have been moving higher, and nothing that we look at suggests this will stop anytime soon. This is usually a positive for equities as bonds are sold and stocks are bought. Furthermore, investment grade corporate bonds (as measured by the LQD exchange-traded fund) are trading back above par broadly, which is also a positive for equities and CDS spreads have also tightened recently. Furthermore, the dollar has been strong and we think that the intermediate-term outlook is for higher prices in the dollar, which we perceive as supportive for equities over longer-term time frames.

There have been a number of other positive technical developments in the market for the last few weeks, which suggest (that possibly following one more severe sell-off) we will see a major secondary counter-trend rally, which could last for the better part of the first half of '09, and which will look and feel as the beginning stages of a new primary bull market.

The results presented should not and cannot be viewed as an indicator of future performance.

Charts courtesy of Bloomberg Finance L.P.

This outlook is corroborated by the monthly chart below. This chart is fascinating to us because it shows us that we have not been this oversold on a monthly chart on the RSI (9 periodicity) since Sept of '74, and this can only signify that we are close to seeing a multi-month rally in equities that will take us significantly higher.



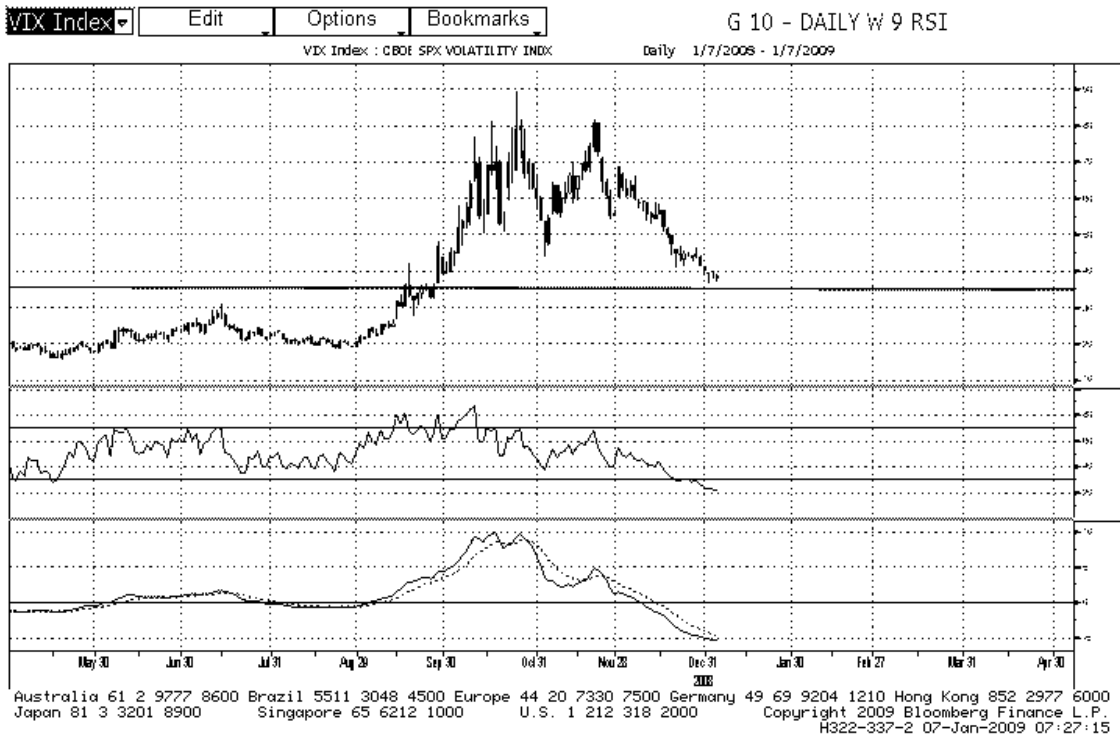
Our cycle work suggests there are going to be important inflection points in the market on Jan 20th/Jan 21st and in mid-February. Our preferred scenario is that we rally into the 20th of Jan and that we then get a severe sell-off into mid-February. This would coincide with the Obama inauguration. Furthermore, the busiest part of the S&P earnings calendar will take place soon after the 20th of Jan.

There are some signs of exhaustion right here right now, but we think that there is a better than 50% chance that the market (as long as it continues to build value above the 918 and 900 resistance levels) pushes higher and ends up extending its gains going into Jan 20th. If that scenario plays out, then there is a high probability that we get a severe sell-off right after the inauguration of President Obama (sell the news). Consequently the highest probability scenario is that we form an important intermediate bottom in mid-February (once again indicated by our cycle work), which would mark the beginning of a multi month primary counter-trend rally that could last till mid-summer.

The VIX index shown below also suggests that we are getting close to seeing a severe sell-off in equities, but again, as long as it continues to build value above 918 (and 900), markets can continue to extend higher for another few days until possibly the 20th of Jan. The RSI on the VIX is at an extreme oversold level and the MACD is starting to turn but this can take a few days to unravel. Also, the horizontal level represents an important long-term support level at about the 35 level. We expect to VIX to go back up to somewhere

between 58 and 63 based on a confluence of Fibb retracements and resistance levels, which will coincide with a severe sell-off in equities.

VIX 38.56Y as of close 1/ 6 Index **G**



In the very short-term, the technical structure suggests that there is the potential to extend higher for a few more trading days, but we warn you that we are starting to see a lot of technical deterioration so caution is warranted. For those of you that follow the Elliott Wave technique, our counts suggest that we are in a secondary counter-trend rally leg 4 and that we are currently in leg C (third and final leg) of that leg 4. Leg A being the move from the low on Nov 21st to Dec 8th, and leg B being a corrective pattern (expanded flat pattern) that unraveled between Dec 8th and Dec 29th. Thus, leg C began on Dec 29th.

We believe that leg C will subdivide in a zig-zag pattern that consists of a 5-3-5 leg pattern. We believe we are just starting the final 5 legs higher. Any move back below 918 invalidates this short-term scenario that we have another 5 legs higher over the next few days and something else is in the works in the short-term. If you are already long, we would recommend staying long unless you go below 918 or better yet below 900. Also keep an eye on the VIX, since if it goes above 42.2 then odds are good that we have started the next leg down in equities. If it can overcome 936 and then 944 (a Gann resistance level which proved to be strong resistance yesterday morning) then that should open the door to the 1000-1005 resistance area. Recall that in these zig-zag 5-3-5 patterns the A leg usually equals the length of the C leg, which would take us to roughly the 1000 resistance level.

The very short-term outlook is always tricky. What we have high confidence in is that the next major move in terms of percentage move will be down followed by a major primary counter-trend rally move higher that will last for a few months. That is why we will not argue with the market if we go back below 918

As you can see on the weekly chart below, since mid '07 the weekly RSI (14) has traveled in a well defined trend channel, and we are once again approaching the upper part of the trend channel after the RSI reversed from the most oversold reading since July of '02. Therefore, once again you can argue that this last rally is in the final stages and that we will soon turn, and get another severe sell-off before the beginning of the major primary counter-trend rally. However, keep in mind that the last time we approached the top return band of this trend channel in May of '08, it took the price another two weeks to reach a high after the RSI peaked. If this were to occur again, that would roughly coincide with Jan 20th marking a short-term top.

Also notice that the MACD had a confirmed "Buy" signal on the weekly chart and still a lot of room to the upside before reaching the zero level, keeping in mind that this may only occur with the primary counter-trend rally, which we believe will start in mid-February.



On this daily chart, you can see that the RSI is getting close to the 70 level (traditionally the upper resistance band for a bear market). The last time we reached this level was May of '08, which marked an inflection point and a short-term top in the markets. If we go above 70, it will suggest that we have started the primary counter-trend rally, and it will open the door for the RSI to travel to the 80 resistance level.

Another bullish development on the daily was the ability of the MACD to go above the zero level after failing the first test of this level.



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