

We continue to believe that the high of 876 last Friday completed a major move that began at the low in mid-March, and the markets should continue to pullback/retrace over the next two to three weeks, as we discussed in our update on Monday morning (see below) so we have positioned ourselves defensively. Once this pullback is complete, we still have confidence that we will extend this counter-trend rally higher and reach our minimum target of ~950.

Yesterday's bounce was normal in our opinion after such a big one day sell-off and we retraced roughly 50%, which is normal for a 'b' leg or '2' leg correction, so we should get the next leg lower over the next few days - 865 should contain this bounce and we don't expect it to go higher than that level in the next day or two.

Since we believe that SPY will be 75-78 in the next two to three weeks, one potential options strategy that our derivatives team is recommending is to buy the May 83-75 put spread for 1.62 (using last night's closing price). Yesterday's bounce allows you to buy a higher strike put spread while capitalizing on yesterdays move down in implied volatility.

Let me know if you want to discuss this strategy or any other options strategies with our derivatives team.

From 04/20:

The goal of this product is to complement our intermediate-term technical outlooks with short-term actionable calls. In addition, we feel it's important to provide technical color and highlight technical developments as they arise, even if we do not make a call. This does not alter our intermediate and longer-term views.

SHORT-TERM UPDATE

Bottom-Line: We are at another critical juncture, and this time we believe we are going to get a significant setback from this recent move higher. We believe that in the next day or two, we will see the beginning of a sharp pickup in risk **aversion**, and this could last for the next two to three weeks and could take the S&P 500 back to ~750-780. We recommend a defensive positioning in the short-term, and we recommend increased allocations to more defensive sectors such as healthcare. Alternately, initiate short positions at these levels with stops above the 885-890 area.

We do believe that the low set on March 6th will not be broken until later this year, and we are still confident that we can reach our minimum upside target of ~950 in the S&P 500 over the next few months but over the next two to three weeks, the highest probability outcome is that we have a severe sell-off. Thus, we would advice extreme caution at these levels given that we have witnessed some significant technical developments over the last few days that suggest that the potential for this outcome is elevated.

To us it's not a question of whether we get to ~950 or even higher levels over the next few months but it's a question of how we get there? Currently, our highest probability

scenario is that we simply get a deep pullback that lasts approximately 15 trading days. There are several targets for this pullback given the multitude of scenarios that exist at this juncture, but the range between ~750 and 780 is our most likely short-term target at this time. We should be able to sharpen our pencil over the next few days as more of the price structure is revealed to us. As we stated in our last few updates, we continue to have confidence that we have entered into a new paradigm technically meaning the potential for significant more upside over the next few months exists, but we think there is a good chance that we have completed the first wave of this move, and we are on the verge of seeing the beginning of a corrective wave 2. Most major primary counter-trend rallies occur in three waves.

On our last update, we mentioned that our preferred scenario was a shallow pullback to ~835-840 before we exploded to the upside again. We also argued that we believed that most participants continued to fight this rally, and that we were likely to continue surprising to the upside. While we expect this theme of continued upside surprises to continue for the most part into the summer months, we would position ourselves defensively in the short-term. We have also been arguing for a breakdown in the VIX and we expected to see the VIX ultimately reach ~28-30 (we closed at 33.9 on Friday). While we still expect this over the next few months, we believe we will get a significant bounce in the VIX in the short-term and should once again test the 40-42 area before heading lower once again.

Furthermore, regardless of whether you believe in just a sharp pullback or whether you believe that this is the beginning of the next major move lower that will result in new lows, you want to be positioned defensively for the next few weeks and you don't want to be caught on the wrong side of this move. There are a few ways of accomplishing this. You can take advantage of recent lower readings in implied volatility to buy protection. You can increase your allocations to more defensive sectors such as healthcare that should outperform in the shorter-term and decrease your exposure to some of the sectors that have outperformed the most in the last few weeks and look the most stretched such as financials and consumer discretionary. One could also add some long exposure to some of the assets that would reflect a pick-up in risk aversion, such as the US dollar as a hedge. If one is more inclined to trade the short-term swings aggressively, one can short at these levels with stops above the 885-890 area.

Below we highlight a few of the technical developments that we have noticed that suggest that the potential for a renewed major surge in risk aversion is very high. Charts are attached below.

1-There is a confluence of resistance at the 875-890 area. 876 was a potential short-term targets (intraday high on Friday) since it represents a Fibonacci ratio based on calculations derived from using the distance traveled for the first leg from 03/06 to 03/26. 881 is the 23.6% Fibonacci retracement level of the entire bear market. 875 also represents the short-term tops from 01/28 and 02/09.

2-We have seen an 'Ending Diagonal' pattern develop in the price structure which often develops at the ending stages of a major wave and our counts appear complete for the

first major wave since the low was formed at 666, and suggests that price momentum has decreased recently, which is also being confirmed by a number of our indicators.

3-The RSI Oscillator using a 21 day periodicity has reached an overbought level that has coincided with short-term tops since this bear market began.

4-The NYSE Bullish Percent Index has become overbought recently and we are at levels that have coincided with previous tops.

5-Our cycle work indicates that April 20th and 21st are potential turning points for the markets in the short-term.

6-The DXY Index has broken above the 86 level which has opened the door for further appreciation of the dollar in the short-term, which can also be viewed as a renewed pick-up in risk aversion.

Options Strategy:

On March 31st, we suggested clients buy the SPY June 85-95 call spread to take advantage of the short term rally we are expecting. The cost of the spread was \$2.40.

Today we are suggesting you unwind the position. As of Friday's close (87.08) the spread was worth \$4.30. Given the lower indicated opening, we expect to be able to sell the position for around \$3.90 with SPY trading around 85.80. We may utilize a similar options strategy in two to three weeks to bet on an eventual move up to our minimum upside targets in the S&P.

Chart 1 – S&P Daily with RSI (21)

SPX 869.60Y as of close 4/17

Index G

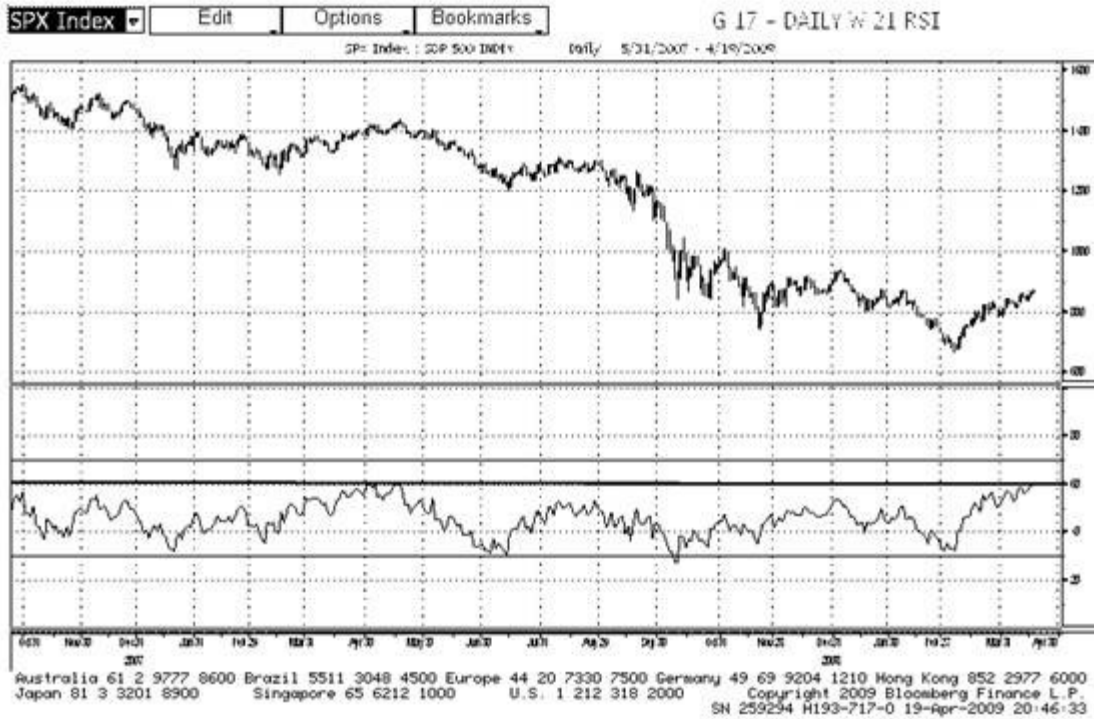


Chart 2 – S&P Daily since October of '07 with Fibonacci retracement levels

SPX 869.60Y as of close 4/17

Index G

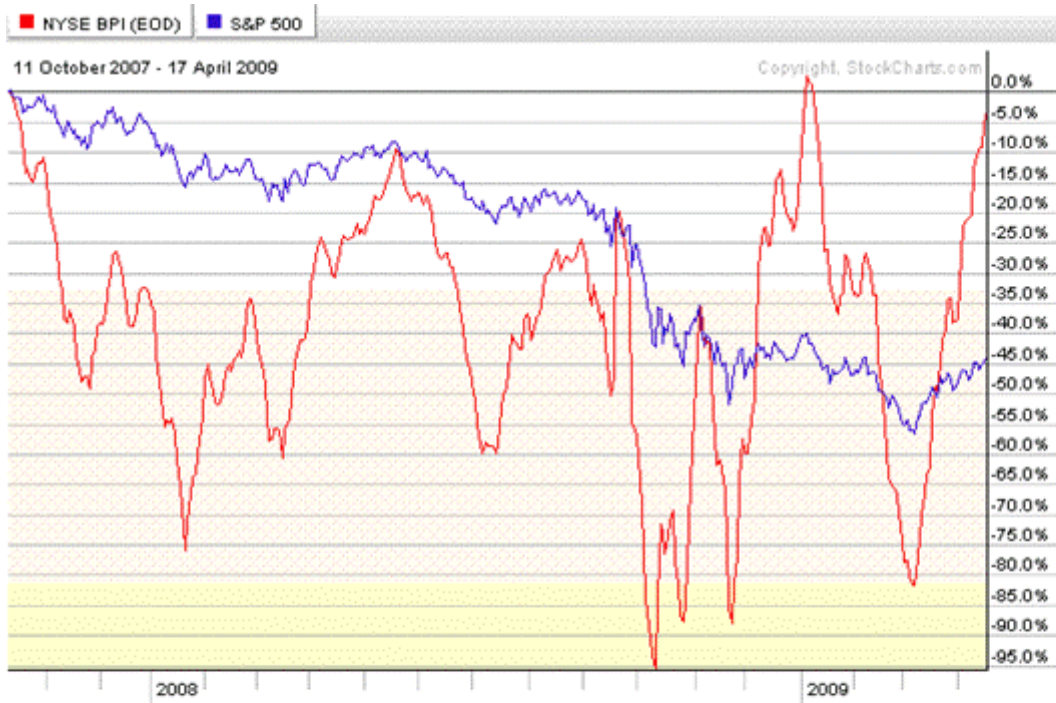
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Chart 3 – S&P 60min



Chart 4 – NYSE Bullish Percent Index with S&P Daily



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