



Weekly Market Update December 9, 2009

Bottom-Line: Overall, we continue to maintain our neutral stance (we turned neutral from bullish on Oct 16th) on the markets. Within that context, we argued on Nov 18th (SPX closed at 1110) for a short-term “correction” (minimum price target is 1060), followed by one last move higher into year-end/early 2010 – our upside target remains 1160-1170. We expect a few more days of selling pressure, so we maintain our short positions for the time being, but we will be looking to reverse at our price levels for the final move higher.

Equities: We continue to argue that the market internals are deteriorating, and that we continue to advance on the strength of a narrowing base of rising stocks. We believe we have started the “topping” process for an intermediate top. The market has become increasingly defensive but once again, despite not boding well for the sustainability of the rally, it does not preclude the markets from going higher or staying at elevated levels into year-end.

The S&P has been trapped in a range between 1115 and 1085 since mid-November. We think a break of 1085 will elect a number of stops, but chances are it will become a failed breakdown, and shortly thereafter we will get the final surge higher into year-end.

Although we did get a 3-4% sell-off in the UTY index (Utilities) after we initiated a short position in mid-October, we overstayed our welcome, and we have since broken out above an important pivot level. The market dynamics have changed considerably since then, and we are intrigued by the recent price action in this sector.

See Charts 1 and 2. We broke out on high volume and have since been forming a pennant consolidation pattern just above the short-term resistance level, and just below an important Fibonacci resistance level. There is little resistance to the upside once we break above the 417 level. In this light, we find the risk/reward attractive, and we are initiating a new long position in UTY. We think funds are flowing into utilities because we are in an increasingly defensive market, and investors are attracted to the yields in this sector because of a rising belief in sustained low treasury yields.

See Chart 3. Furthermore, the relative chart of UTY versus the SPX has broken its downtrend, suggesting that we are entering into a period of outperformance by the Utilities sector for the next few weeks. Recall that when this relative index moves higher, it signifies that the UTY index is relatively outperforming the S&P 500.

New Trade: Long UTY with a short-term target of 450. Stops at 402.

Foreign Exchange Markets: We may have seen the turn in a number of currencies including the U.S. dollar, and the carry trade looks like it could be in some real trouble.

It has been well publicized that the Japanese Government is trying to depreciate the yen. While the recent stimulus may be too small to make a large impact, there is evidence that the total money supply in Japan is expanding, which will also help depreciate the currency.

Technical Analysis & Strategy

We are also keeping a close eye on the Aussie Dollar (AUD/USD) since the AUD is a large beneficiary of the dollar carry trade, given that the Australian government has been increasing rates on the back of a stronger economy. Borrowing in dollars and buying the Aussie Bonds has become a popular trade. Despite bearish divergences with our oscillators, lower highs, and a break below the 50 day sma, there has been no confirmation of a trend reversal as of yet, but that would come with a break below 0.9.

At the end of September, we started to argue that we were likely beginning the bottoming process in the dollar and we initiated a long position in the dollar, with a stop just below the critical support level of 75. For weeks that support level held until we had a failed breakdown at the end of November.

See Charts 4, 5, and 6. We are reinitiating our long position in the Dollar and our short on the Euro. The technicals continue to suggest that we are on the verge of a major intermediate move to the upside in the Dollar, and we now believe we have confirmation after two closes above the 50 day sma which has contained the downtrend for the last few months. The RSI, which tends to lead price, has clearly broken the downtrend and reversed, and we expect the dollar to continue its ascent higher over the next few months. Keep in mind, that when you have an initial impulsive reversal that changes a major trend, it can retrace most of the initial move before going any higher. Because of this, we are placing our stops below the recent lows.

New Trade: Long DXY with a short-term target of 81-82 and an intermediate target of 86-88. Stops at 74.

New Trade: Short EURUSD with a short-term target of 1.38-1.4 and an intermediate target of 1.3-1.32. Stops at 1.52.

The difference between short-term (ST) and intermediate targets (IT) is that we expect our ST target to represent major resistance/support, where we expect to undergo a period of retrenchment or consolidation whether through price or time, which will set the stage to reach our deeper intermediate targets.

Technical Analysis & Strategy

BKX (Financials) – Consolidating in a sideways fashion after breaking below uptrend. Oscillators confirmed breakdown, and we are now testing important resistance levels at 44.80. Recent high volume buying failed to break above the 100dma. Financials have underperformed the S&P since the end of August.

XOI (Energy) – Has fallen below support at the 50dma after finding resistance at 38.2% Fibonacci retracement level of ~1100. Oscillators are holding above important support levels. Outperformed the S&P from August to early November, but has since underperformed.

OSX (Oil Services) – Showing further signs of deterioration as price has slipped below the March uptrend line as well as support at ~183-185. In general, has outperformed the S&P since December '08, but pace has moderated since June, and has outright underperformed since late October.

IXI (Industrials) – Price continues to fight with resistance in the 275-280 area. A Bearish divergence in daily RSI still exists despite RSI breaking its downtrend. Relative performance versus S&P has been neutral overall since May.

IXR (Consumer Staples) – Remains in uptrend, but has found resistance at ~270. Price is currently testing the uptrend line. New index high has not been confirmed by RSI, suggesting a weak technical uptrend. Has been underperforming the broader market since March.

IXB (Materials) – Divergence with daily RSI. Has outperformed since end of October, but neutral performance since August.

DRG (Pharmaceuticals) – Has pulled back after breaking above resistance at 300. Remains in its March uptrend. Overall since summer of '08 has been outperforming, and longer-term we expect this trend to continue.

BTK (Biotech) – Finding support at the intersection of the 50dsma and the 100dsma. RSI is breaking out of its downward trend, and MACD has crossed above the zero level resistance. Overall, entered into a period of massive out-performance in the summer of '08 and we expect that to continue longer-term.

DJR (Real Estate) – Has reclaimed its 50dma, but is once again finding resistance in the 175-180 area. Maintaining March uptrend. Broadly speaking, has been underperforming since early '07. Interestingly, the relative chart failed near the '07 pivot low and December '08 resistance, suggesting that we are entering another major period of intermediate underperformance by this sector.

NDX (Tech) – Bounced off of the 50dma, continues to find resistance ~1815. Broadly speaking, began a period of longer-term out-performance in 2007 and we expect that to continue in the longer term.

SOX (Semiconductors) – Testing resistance ~340 after finding support on the 100dMA and reclaiming its March uptrend line. RSI continues to move upward above 50, which is an important level. Relative strength has rebounded sharply since breaking below its late-2008 uptrend.

UTY (Utilities) – Finding support on broken resistance ~410, and is currently forming a bullish pennant pattern at that level. RSI has found support at 40 and is now testing the ceiling that has bound it since late 2008. Relative strength has broken its 2009 downtrend as well as an important resistance level, and looks poised to outperform over the next few weeks.

Technical Analysis & Strategy

Active Short-Term Trading Ideas

Short SPX (S&P 500) with short-term target of 1060. Stops at 1116.

Short MID (S&P 400) with short-term target of 665. Stops at 712.

Short RTY (Russell 2000) with short-term target of 555. Stops at 608.

Long UTY (Utilities) with a short-term target of 450. Stops at 402.

Long DXY (Dollar) with a short-term target of 81-82 and an intermediate target of 86-88. Stops at 74.

Short EURUSD (Euro) with a short-term target of 1.38-1.4 and an intermediate target of 1.3-1.32. Stops at 1.52.

Closed Short-Term Trading Ideas

Short IBOV (Brazil) had stop elected at the 65,500 level.

Long DXY (Dollar) had stop elected at 75 level.

Short EURUSD (Euro) had stop elected at 1.505 level.

Short UTY (Utilities) had stop elected at 412 level.

*Stops on a closing basis

Technical Analysis & Strategy

Chart 1: UTY Index Daily with RSI

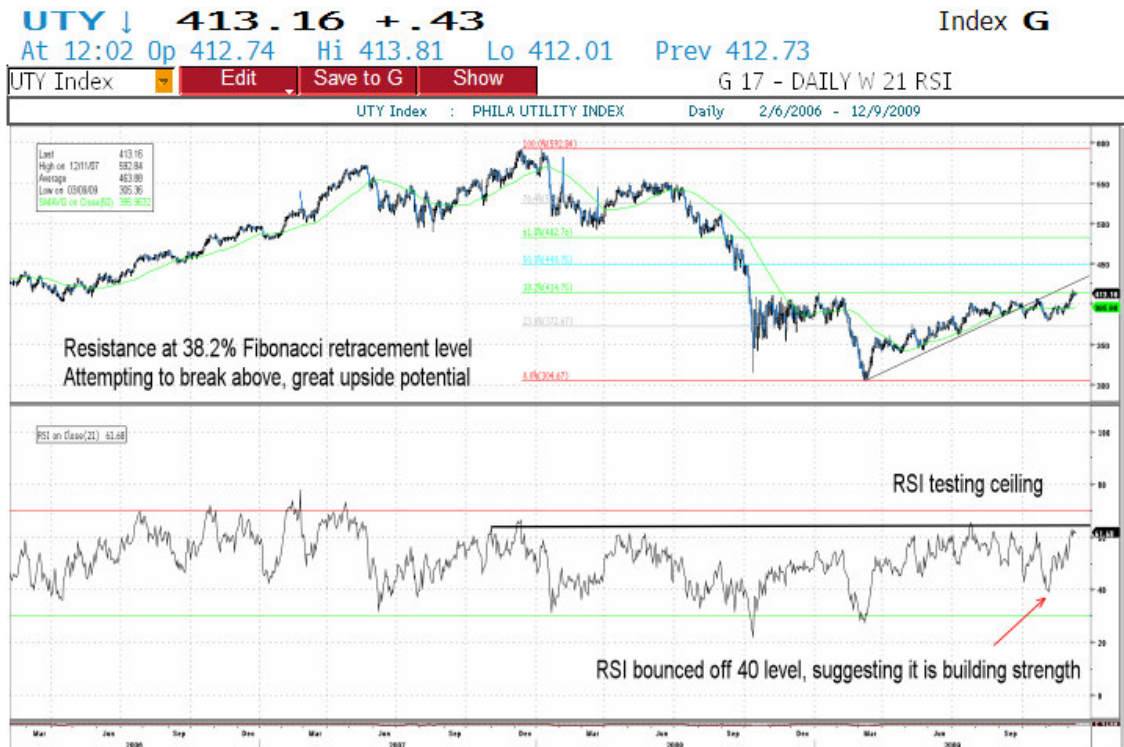


Chart 2: UTY Daily with Volume



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Chart 3: UTY vs. S&P 500 Daily Relative Strength with RSI & MACD



Chart 4: DXY Index Daily with RSI

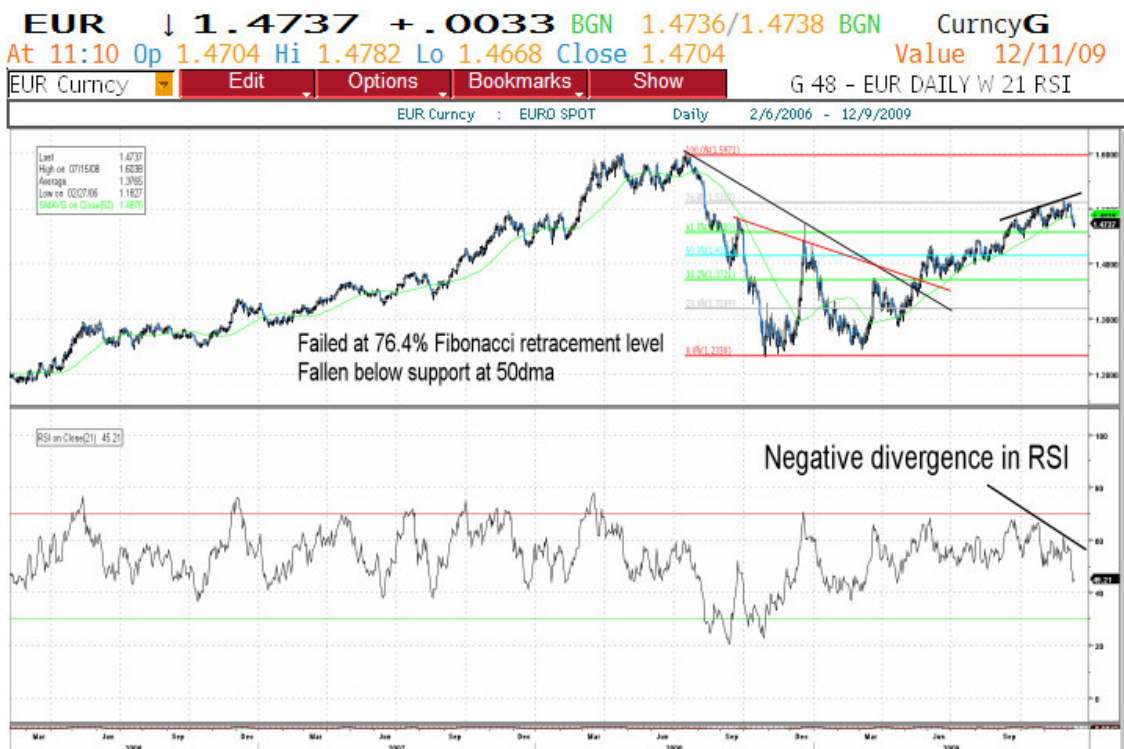


Technical Analysis & Strategy

Chart 5: DXY Index Weekly with RSI & MACD



Chart 6: EUR Index Daily with RSI



Technical Analysis & Strategy

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