



Weekly Market Update January 6, 2010

The “Short-Term Trading Ideas” section can be found at the end of this report and summarizes all of our positions.

Bottom-Line: In our first research piece of 2010, we discuss our outlook for this year and touch upon the most likely trajectory for equities over the next few years. Over the last few weeks, given our belief that we had another leg higher with a minimum price target of 1160-1170 in the S&P, our strategy has been to identify sector trades that had a good risk/reward vis-à-vis the S&P. We maintain our long positions in semis (with a trailing stop) and utilities, and we are initiating a new long position in financials. Overall, we continue to maintain our neutral stance on the markets, and we continue to be selective with our trades. We also reiterate our shorts on the Yen and the Euro, and our structural long position in the dollar. Finally, we maintain our short-term long position in Gold.

Over the next few weeks, it is certainly plausible for the dollar and equities to move higher together, especially if the primary reason for the move higher in the dollar is increasing evidence of bona fide economic growth.

Equities: We have been arguing since mid November for one last move higher into year-end/early 2010 with a minimum upside target of 1160-1170. Given the deterioration in the market internals over the last few weeks, we had a short position on the markets as a hedge, which we removed with a confirmed breakout above 1116.

While our minimum target is 1160-1170, given that it fulfills the minimum requirements to complete the various price structures, there is a possibility that the market will aim for the ~1220-25 area, which represents the 61.8% Fibonacci retracement level of the entire move lower from the top in 2007, as well as a long-term pivot level (see Chart 1).

Given that we still believe in additional upside over the next few weeks, we screened all the sectors again and we think that financials (which has underperformed the broader market since the end of August of 2009) presents a compelling risk/reward at these levels. There are some signs of improving fundamentals in this sector, and the technicals are bullish on various time frames (see Charts 2 & 3) in the BKX Index and in several of the larger individual names that make up this index. We want to highlight Chart 2, where it is apparent that the daily RSI indicator has reversed the downtrend, and recall that RSI tends to lead price. Therefore, we believe that this sector has consolidated over the last few weeks mostly through time, and is getting ready to surge for its final leg higher. We think there is a good chance that given the price vacuum that exists above these levels, that this sector may reach the 38.2% Fibb retracement level at 57 of the entire move lower (recall that the s&p has already overcome the 50% retracement level).

New long position: BKX (Financials) – short term target of 57, stops at 42

On Dec 17th, we went long semis given that the overall fundamentals were improving in the group combined with bullish technicals on the sector and in several of the largest individual names that make up the index. The SOX has appreciated ~7% since we initiated that trade, outperforming the S&P that appreciated ~3.7% during the same time period. The relative chart has clearly broken out (see Chart 4), and despite reaching overbought levels we think there is a good chance of reaching the long-term pivot resistance level at ~385 (see Chart 5). Thus, we are going to stay with our long position for the time being and use a trailing stop – we are moving our stop level from 330 to 360. Those less bullishly inclined may consider taking partial profits against our initial target

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of 370 and using a trailing stop for the rest of the position, or simply overwriting with call options to give you an opportunity of participating in any future gains.

We have seen the Utilities sector undergo a correction over the last few trading days, but we are confident that this is just a typical corrective pattern, and that we should push higher from these levels to reach our original target of 450 over the next few weeks (see Chart 6). We maintain our long position in Utilities and we think this is an opportune time to initiate or add a new long position if you were unable to get long at the end of last year given that the risk/reward is once again compelling.

Our predictions for 2010:

-We believe that equities will peak at some point in Q1 in the 1160-1220 range on the S&P 500. We will then see a sizable (25-30%) correction in equities.

-The dollar will rise another 15-20% and we could see the dollar rise above last year's highs. In the next few weeks, we expect the dollar and equity markets continue to rise together.

-Commodities and emerging markets will underperform towards the back end of 2010 on a relative basis as the dollar strengthens. Over the next few weeks, commodity inflation should continue and most commodities will appreciate.

-We expect an increase in volatility in 2010. We expect to see a peak at some point in Q1 followed by increasingly difficult market conditions for most of the rest of the year. Please see the last section titled "Long-term outlook and scenarios for 2010".

Our major forecasts in 2009 for equities:

-In January of 2009, our prediction was for one more leg lower to 650-700 followed by a major primary cyclical rally (that will look and feel as the beginning of a new primary bull market) that should last for several months.

-In June after rising roughly 45% and in light of the evidence we saw at that time, we argued for one more set of new lows before starting a longer lasting cyclical rally, and while we got a ~10% correction, we were ultimately proven wrong. However, we did argue that a break back above 930 would argue for another sizable move higher and we introduced a target of 1100-1120 by mid-October.

Long-term outlook and scenarios for 2010:

Our work on the price structures, cycles, and longer-term oscillators, suggest that the highest probability scenario is that we have several years left before we see the conclusion of this secular bear market, which in our opinion started in 2000. However, as we saw last year, that does not preclude us from getting sizable cyclical rallies.

We believe that we are in the middle of a major A-B-C corrective pattern in equities that began with the top in 2000. Leg A went from the highs in 2000 to the lows in 2002, leg B concluded with the highs in 2007, and leg C has been unraveling ever since (see Chart 7). Once this final leg is complete, we expect to see the beginning of the next major primary bull market, but we still have 5-8 years left of moving sideways essentially, just like what happened throughout the 70s and late 60s before the primary bull market began in 1982.

If we breakdown major leg C that started at the top in 2007, we believe we are forming a triangle consolidation pattern and that we are currently in minor leg "B" of that pattern (see Chart 8). Thus, there are two scenarios for 2010 in our opinion.

(1) we are on the verge of completing leg "B" in Q1, which will be followed by a 25-30% correction lower in

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equities which should last until 2011 before we start another cyclical rally. We should go no lower than 800-900, which roughly represents the lows we saw in October/November of 2008 (see Chart 9).

(2) we are only completing the first part of leg "B" so after we undergo a 10-15% correction/consolidation over 6-9 months we will have another leg higher, similar to what occurred in 2004. If this scenario occurs, we will get the more sizable move lower towards the back end of 2011 (see Chart 10).

We believe that scenario (1) is the highest probability scenario and we would assign this roughly a 70% chance of occurring according to our technical work.

We assign the lowest probability ~5% to the scenario that the March lows was the beginning of a major primary bull market and that the secular bear market is over.

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BKX (Financials) – Positive divergence in RSI has developed. Has underperformed the S&P since the end of August '09, but relative strength is now attempting to bottom. RSI has reversed downtrend.

XOI (Energy) – Has reclaimed the 50 day sma broken in early December '09, and now retesting resistance at the 38.2% Fibonacci retracement level ~1100. MACD has crossed above the zero line. Has underperformed the S&P since early November '09, but has since broken that relative strength downtrend after finding support at a previous pivot low.

OSX (Oil Services) – Has reclaimed uptrend line broken in early December '09. Has underperformed the S&P since late October '09, but has since broken that relative strength downtrend after finding support at a previous pivot low.

IXI (Industrials) – Attempting to breakout above the 50% Fibonacci retracement level from the '07 high at ~285. Relative performance has been neutral overall since May '09.

IXR (Consumer Staples) – Has broken below the uptrend line from March '09 lows. Support has been found on the 50 day sma. MACD is testing the zero line. Appears to be in a corrective pattern.

IXB (Materials) – Continuing uptrend from March '09 lows since breaking above month-long consolidation area. Relative strength attempting to break out of consolidation and continue uptrend.

DRG (Pharmaceuticals) – Has been consolidating in sideways fashion, but remains in March '09 uptrend. Has been outperforming overall since summer of '08.

BTK (Biotech) – Continuing November '09 uptrend, and is approaching pivot high ~965. Overall, entered into a period of massive outperformance in summer of '08. More recently, relative strength has been trending upward since breaking out of September '09 downtrend.

DJR (Real Estate) – Has broken above resistance ~180, and now attempting to find support at that pivot level. Continuing March '09 uptrend. Broadly speaking, has been underperforming since early '07. Relative strength has once again failed to break above '09 resistance.

NDX (Tech) – Has gapped above resistance ~1815. Continuing longer-term outperformance started in '07 after relative strength broke to new multi-year highs.

SOX (Semiconductors) – Continuing uptrend since breaking above resistance ~340. RSI is now overbought. Relative strength continues outperformance having pushed to highest levels since mid '07. Approaching long-term pivot level at ~385.

UTY (Utilities) – Has fallen back to support ~408-410. RSI has fallen sharply after reaching overbought levels in mid December '09. Relative strength has also dropped off since that time, but remains above March '09 downtrend line. Appears to have completed a corrective pattern.

IRH (Retail) – Has slipped below uptrend line from March '09 lows, and continues to consolidate in ~92.5-95 range. Has found support on 50 day sma. Overall, has outperformed the S&P since January '09, but has been moving in sideways fashion for several months.

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Active Short-Term Trading Ideas

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

Long SOX (Semis) with a short-term target of 385. Stops at 360.

Long BKX (Financials) with a short-term target of 57. Stops at 42.

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.

Long USDJPY (Short Yen) with a short-term target of 100. Stops at 87.

Long GOLDS (Gold) with a short-term target of 1250. Stops at 1068.

Closed Short-Term Trading Ideas

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

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

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

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

Short MID (S&P 400) had stop elected at the 712 level.

Short RTY (Russell 2000) had stop elected at the 608 level.

Short SPX (S&P 500) had stop elected at the 1116 level.

*Stops on a closing basis

Symbol	Status	Position	Open Date	Cost Basis	Current Price	ST Target	IT Target	Stop	Gain/Loss	Performance
UTY	Active	Long	12/9/2009	412.74	414.47	450.00		402.00	+1.73	+0.42%
DXY	Active	Long	12/9/2009	76.22	77.38	81.00	86.00	74.00	+1.16	+1.52%
EUR	Active	Short	12/9/2009	1.47	1.44	1.38	1.30	1.52	+0.03	+1.84%
SOX	Active	Long	12/17/2009	344.61	367.38	370.00		330.00	+22.77	+6.61%
GOLDS	Active	Long	12/17/2009	1,098.90	1,139.60	1,250.00		1,068.00	+40.70	+3.70%
JPY	Active	Long	12/17/2009	89.10	92.34	100.00		87.00	+3.24	+3.64%

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Chart 1: SPX Daily



Chart 2: BKX Daily with RSI & MACD



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Chart 3: BKX Weekly with RSI & MACD



Chart 4: SOXR Relative Strength



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Chart 5: SOX Daily with RSI



Chart 6: UTY Daily with RSI



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Chart 7: SPX Weekly



Chart 8: SPX Weekly

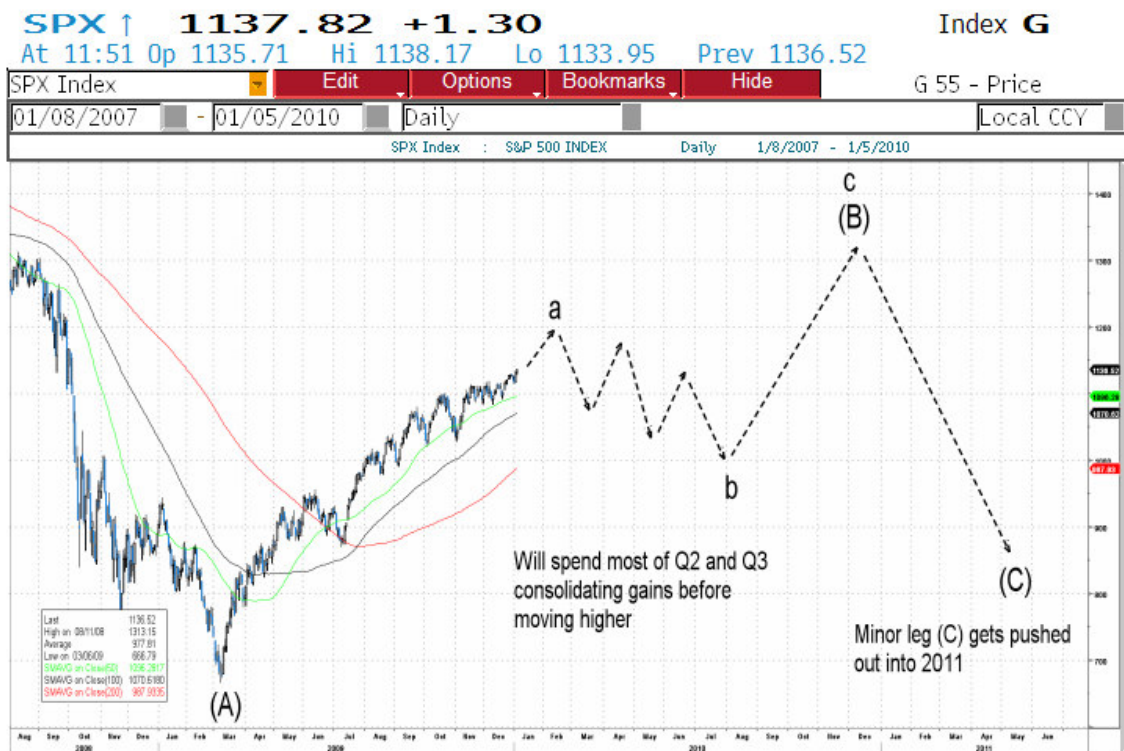


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Chart 9: SPX Daily Scenario 1 for 2010



Chart 10: SPX Daily Scenario 2 for 2010



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