

TSG Weekly Market Watch May 9, 2008

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TSG Stock Market Letter Week Ending May 9, 2008

Topics Discussed This Week:

- * Stocks run out of gas…
- * But leaders hold their own
- * Earnings take another downturn
- * Pending home sales drop but ISM service index rises
- * Stocks testing key resistance

	INDEX	Weekly Close	Last Week	Change	Change%
INDU	12,745.88	13,058.20	-312.32	-2.39%	
DJT	5,193.98	5,308.58	-114.60	-2.16%	
SPX	1,388.28	1,413.90	-25.62	-1.81%	
COMPX	2,445.52	2,476.99	-31.47	-1.27%	
RUT	720.05	725.74	-5.69	-0.78%	
EEM	146.9	149.64	-2.74	-1.83%	
	Last week	INDEX	Weekly Close	Last Week	Change
INDU	13,058.20	12,891.86	166.34	1.29%	
DJT	5,308.58	5,117.37	191.21	3.74%	
SPX	1,413.90	1,397.84	16.06	1.15%	
COMPX	2,476.99	2,422.93	54.06	2.23%	
RUT	725.74	721.88	3.86	0.53%	
EEM	146.3	149.64	3.34	2.28%	

Quote of the week – “As losses from the bursting of the US housing bubble ratchet higher and show little sign of slowing, Fannie [Mae] was granted more room to expand its portfolio of home loans from the Office of Federal Housing Enterprise Oversight (OFHEO). Fannie’s total debt stands at about \$800bn against core capital of less than \$50bn for a debt-to-asset ratio of 90%, which is the kind of high-octane leverage that provokes palpitations among risk managers,” said Michael MacKenzie in a May 9 FT article entitled The elephant in the room (see “elephant” article below). Unless home prices are truly near a bottom, this approach has ‘disaster’ written all over it. Stocks run out of gas… This week, stocks gave back what they had gained in the last month thanks to fresh credit worries and skyrocketing oil prices. Traders and investors both large and small continue to prefer the relative safety of the sidelines, especially over the weekend as the big Friday drops that have occurred over the also few months demonstrate. Deteriorating housing markets and corporate earnings continue to make stocks less attractive and until there are signs that these trends are nearing an end, we expect this increased appreciation for risk and caution to remain. Technically Speaking Leaders hang in This week Dan Zanger included 15 stocks in his Sunday picks including Baidu.com (BIDU), Google (GOOG), Research in Motion (RIMM), Sohu.com (SOHU), Giant Interactive (GA), Mosaic (MOS) and Potash (POT), LDK Solar (LDK), Trina Solar (TSL), Goldman Sachs (GS), PetroBras (PBR), Excel Marine (EXM), and Dryships (DRYS). As a group, while they outperformed the major indices, they ended the week in negative territory, if only just barely, which is mildly bearish. Figure 1 –Five-day performance of Zanger’s market leaders compared to the S&P500 (SPX), the Dow Jones Industrial Average (DJX), Dow Transports (DTX) and Nasdaq Composite (IXIC). Data courtesy of The Zanger Report, performance chart courtesy of VectorVest.com. Over the last six weeks volumes on the NYSE and Nasdaq have remained below average and index prices have stalled. In the case of the Nasdaq, there has been more volume on down weeks than up which is inherently bearish. Rallies occurring without strong volume are suspect because it means that there is a lack of commitment from buyers. Volatility reversed its trend this week as the Market Volatility Index (VIX) rose modestly to 19.41 from 18.18 last week and 19.59 two weeks ago. While generally bullish, the VIX can be, well, quite volatile. The 17 commodities that make up the NYFE CRB Index surged again this week to 554.95 from 532.97 last week and 542.68 two weeks ago. On a weekly basis the index remains well above the 2 standard deviation top trendline and has moved back above its mid-line channel support line on the daily chart. After falling for the last five weeks, gold rebounded this week to close at \$885.90 up from \$858.10 last week but still below the \$889.50 it closed at two weeks ago on the 100oz continuous contract. While gold is in its strong seasonal performance period between the end of January and end of June, it continues to show signs of weakness but has found support on at the mid-channel uptrend support line which is bullish. After ten weeks engaged in a potential bottoming pattern that until two weeks ago looked like a bear flag, the U.S. Dollar Index ended the week at 73.06 from 73.50 last week and 72.79 two weeks ago. It is looking more like the dollar could be forming at least a temporary bottom which would be good for the U.S. consumer. Crude has rallied strongly over the last six trading days as the NYMEX crude oil continuous contract closed at \$126.05 up from \$116/bbl last week to put in yet another new high. It was the tenth consecutive week that it remained above \$100. Take a look at a chart of the price of oil going back to 1950 and you will see a classic parabolic move since 2004 on a monthly chart when prices surpassed \$40/bbl for the first time in history. Prices are up more than 300% since then and crude has experienced a rate of price appreciation that is not sustainable. This week the Fed funds target rate remained at 2%. The 3-month London Interbank Offered Rate (LIBOR) slipped to 2.685% from 2.77% last week showing that commercial credit markets are easing somewhat. LIBOR is the benchmark for \$900 billion in subprime mortgage loans which typically adjust to it every six months. According to data company Dealogic, corporations around the world have the interest rates on roughly \$9 trillion in debt pegged to LIBOR and rates on more than \$380 trillion in derivative interest rate swaps also are based on LIBOR. But Freddie Mac mortgage rates haven’t budged much slipping to 6.05% from 6.06% last week for the 30-year fixed mortgage while the one-year adjustable rate mortgage (ARM) rate held steady at 5.29% for the third week in a row. Earnings Earnings weakness continues Q1-08 earnings season ended it

fifth week and with a total of 2807 companies having reported so far (up from 2058 companies last week) earning improvements took a big drop falling 26% from the same quarter last year (from -19% last week). Earnings have shown a consistent trend over the last two quarters to fall as more companies have reported and this is bearish. This compares to -20% two weeks ago and -22% three weeks ago. Looking at past seasons, there was a drop of 57% for final Q4-07 (3900 companies), a 21% drop (4205 companies) for Q3-07 and a 13% jump for Q2-07. Economic Reports Here are the reports we were following. Chart 1 – On Monday, we learned that the Institute of Supply Management’s non-manufacturing or service index moved out of contraction territory above 50 with a reading of 52 in April which is good news. But as we see from the chart, it just came back to trend and that trend remains strongly negative.

Chart 2 – No surprise on Wednesday when we learned that pending home sales, a gauge of contracts signed but that have yet to complete, fell another 1% in March. While sales declines look to be hitting some sort of plateau, it will take time before the market bottoms. It is also important to remember that this index is produced by the National Association of Realtors, does not include cancellations and for both reasons has an optimistic bias.

Chart 3 – This chart with the latest reading of \$15.3 billion in March shows that consumers are still borrowing to finance their spending habits. As long as this continues, consumer spending may weaken somewhat but should not fall completely out of bed. Next Week Here are the economic reports we’ll be watching next week. - Monday, April U.S. Budget Balance (expected -\$160 billion) previous -\$48.4 billion. - Tuesday, April Import Prices (expected 1.5%) previous 2.8%, April retail & food sales (previous 0.2%) and retail & food ex-autos (previous 0.1%). - Wednesday, April Consumer Price Index (previous 0.3%), CPI ex-food & energy (previous 0.2%). - Thursday, March Treasury International Capital Flows (previous \$60.1 billion), May Philadelphia Fed Business Index (previous -24.9), May NAHB Housing Market Index (previous 20). - Friday, April Housing Starts (previous -11.9%). Synopsis Stocks testing key resistance Since the middle of last year when the credit crisis erupted onto markets around the world, traders and investors alike have struggled with the direction in which to place their bets. Here is a technique that provides valuable insight. In his book, *The Logical Trader: Applying a Method to the Madness*, veteran trader, CEO and leader to more than 150 proprietary traders and support staff at MBF Clearing Corp., Mark Fisher outlines his ACD trading system. One key component of this system is the concept that highs and lows set in the first two weeks of January and July can be used to determine where markets are headed and whether the trader should be bullish or bearish. “High and low pivot points set during the first two weeks of the year and first two weeks of the second half of the year (FOY) often set floors or ceilings in the market and become crucial trading points,” Fisher said in a recent email. “We saw that happen very clearly this year in natural gas. Early in January, natural gas (NG) briefly moved below the FOY pivots and 14-day moving average. But it held above the 30-day moving and that was bullish. When the market snapped back above the upper resistance level NG was a buy.”

Figure 2 – Daily chart of the S&P500 Index showing Fisher’s first of the year (FOY) two-week pivot highs and lows that are used for determining market direction and levels of support and resistance. Chart by Metastock.com On the other hand, look at the S&P500 (see chart above) and Nasdaq (not shown). FOY pivots have provided good places to take short trades since August 2007 and in 2008 both have returned all the way into their FOY pivot ranges which will continue to provide resistance. But if prices break above the FOY pivot high of 1425 for the SPX and 2535 for the Nasdaq Composite, it will again be time to buy if volume supports the move. But given that both indexes are overbought on weekly momentum indicators, it probably won’t happen in the next week or so especially given the anemic weekly volumes on the NYSE and Nasdaq over the last two months. Fisher uses the FOY levels in conjunction with a 14-day moving average and a sentiment parameter to provide confirmation. If a stock or future is reacting to good news with bad action, it is bearish and implies lower prices. If on the other hand, prices react positively to bad news, it’s bullish. Stories of interest this week… The Forbes Tax Misery Index 2008

<http://www.forbes.com/global/2008/0407/060.html> The elephant in the room – Government GSEs

http://www.ft.com/cms/s/0/a72537e2-1de5-11dd-983a-000077b07658.html?nckick_check=1 Credit Seizure? \$6 Million Pay Turns on Relationships

<http://www.bloomberg.com/apps/news?pid=20601109&sid=aGXjedykUjho&refer=home> SEC's Bear Stearns

Oversight Points to Fund Shortage

http://www.bloomberg.com/apps/news?pid=20601110&sid=a.iGE_gZAxR0 Countrywide Takes Away Home-Equity

Credit Lines in Las Vegas

<http://www.bloomberg.com/apps/news?pid=20601109&sid=adSiHtVyQXmc&refer=exclusive> Lampert, Wood Reveal

Failings of 'Concentrated' Hedge-Fund Bets

<http://www.bloomberg.com/apps/news?pid=20601109&sid=azobDABpF9ZU&refer=h> Canadian home sales to fall 12% in 2008

<http://www.nationalpost.com/newsletter/story.html?id=496476> Canada’s new housing market cools in April

<http://www.nationalpost.com/newsletter/story.html?id=501160> ECB, Battling Inflation, May Keep Rate at 4% as

Growth Slows

<http://www.bloomberg.com/apps/news?pid=20601110&sid=anG.4vWfkrR0> Citigroup Plans to Shed About \$400 Billion of Assets

<http://www.bloomberg.com/apps/news?pid=20601087&sid=av9LBfQzYsP4&refer=home> Citigroup Leads Wall Street Drive to Hurt Taxpayers

<http://www.bloomberg.com/apps/news?pid=20601109&sid=a4diP6p3gZ4w&refer=exclusive> Tax Rebates Won't Spark U.S. Economy, Survey Shows

<http://www.bloomberg.com/apps/news?pid=20601109&sid=atR6I5T3u.78&refer=exclusive> -----

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