

TSG Weekly Market Watch June 26, 2009

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TSG Stock Market Letter Week Ending June 26, 2009 Topics Discussed This Week:

Stocks stuck in a trading range… Leaders head down PEs still showing ‘earnings-less’ recovery
 New home sales down, re-sales up and final GDP number in Uptrend still alive but… Elliott Wave SPX

Perspective

INDEX	June26-09	June19-09	Change	Change%	INDU	8,438.39	8,539.73		
-101.34	-1.19%	DJT	3,263.07	3,219.77	43.30	1.34%	SPX	918.90	
921.23	-2.33	-0.25%	COMPX	1,838.22	1,827.47	10.75	0.59%	RUT	
513.22	512.72	0.50	0.10%	EEM	32.32	31.75	0.57	1.80%	Last Time
INDEX	June19-09	June12-09	Change	Change%	INDU	8,539.73	8,799.26	-	
259.53	-2.95%	DJT	3,219.77	3,361.42	-141.65	-4.21%	SPX	921.23	
946.21	-24.98	-2.64%	COMPX	1,827.47	1,858.80	-31.33	-1.69%	RUT	
512.72	526.83	-14.11	-2.68%	EEM	31.75	33.74	-1.99	-5.90%	Quote of

the week “Stocks are the worst inflation hedge ever invented.” — John Brynjolfson, CIO Armored Wolf in a Bloomberg interview this week. Stocks stuck in a trading range… Stocks ended basically flat on the week with some sectors higher, and some lower as the consolidation continued. On a daily basis, stocks are now oversold which is positive short-term but remain overbought on a weekly basis. But are investors who are betting on higher prices being overly optimistic? As we said last week, the fundamentals and especially earnings are weak but both generally lag in a recovery. But at some point, both need to show steady improvement if a recovery is to grow legs. Technically Speaking Leaders head down Of the six stocks in Dan Zanger’s Sunday June 21 newsletter, only three, namely Celgene (CELG), Netflix (NFLX) and Blackstone Group (BX) were making any notable upside moves. The fact that these three stocks performed worse than most indexes this week is bearish. As Zanger commented in the opening paragraph, “most stocks are either breaking down or just chopping around making ownership or trading pretty much ineffective except for just a handful of stocks.” He believes it will take new earnings reports due out in July to get them going again. Figure 1 ‐ Five-day performance of Zanger’s last Sunday pix (green) compared to the S&P500 (SPX), the Dow Jones Industrial Average (DJX), Dow Transports (DTX), Nasdaq Composite (IXIC), Russell 2000 (RUT) and MSCI Emerging Market ETF (EEM). Data courtesy of The Zanger Report, performance chart courtesy of VectorVest.com. Weekly volumes for the major indexes moved up this week which is mildly bearish given that the Dow and S&P500 lost ground. A rally needs a steady supply of new bulls buying stocks to give it strength. Any increase in volume on falling prices shows bears coming to the party in growing numbers and the higher the volume, the more bearish it is. Summer has begun for traders and volumes are generally lower. This makes it easier to manipulate prices so caution is advised. This week the price of the S&P500 Index dropped below the 50 and 200 day moving averages but closed above both which is short-term bullish and means that technically, the rally is still alive. Meanwhile, the Market Volatility Index (VIX) continued to fall closing at 25.93 down from 27.99 last week and 28.92 May 29. Fear continues to leak out of markets and while still higher than average, the fact that the VIX is falling is bullish. This week the CRB Index slipped to 400.70 from 401.70 last week, down from 417.04 May 29. Since bottoming December 5, the CRB index is still up 25%. After the surge in gold to a high of \$1001.10/oz February 20, the precious metal firmed to \$939.20/oz this week, up from \$934.9 last week but well off \$992 during the first week of June. Each time the metal has approached \$1000 in the last 18 months, it has been rebuffed. Volume and open interest continue to look anemic and that is bearish. Gold normally has a seasonal low in July and then rallies into year-end. Meanwhile, the US Dollar Index has continued to struggle since March, closing at 79.87 down from 80.35 last week. A steadily weakening dollar is inflationary and generally bullish for commodities, interest rates and U.S. multinational corporations with a larger share of their revenues derived from overseas sales but bearish for stocks overall (see Quote of the Week). But although oil has continued to buck the commodity weakening trend, crude oil futures also weakened this week to close at \$69.16/bbl down from \$70.02 last week. Oil is still down more than 50% from its mid-summer 2008 high of \$147.20 and the rapid drop has had a negative impact on supply which is bullish for prices. The Baltic Dry Index, an indicator that tracks the cost of shipping dry goods by sea, reversed direction this week dropping 9% from last week to close at 3703. Continued strength in this index is bullish for oil and the economy. The U.S. bank prime rate and the Fed funds target rate held steady at 3.25% and 0.00% - 0.25% respectively while the effective Fed funds rate slipped to 0.19% (from 0.25% last week). Meanwhile, the 3-month London Interbank Offered Rate (LIBOR*) continued to fall closing at 0.5975% down from 0.61188% which is another new 52-week low. This compares to LIBOR 52-week high of 4.81875% last October. On the mortgage front, Freddie Mac mortgage rates firmed again this week to 5.42% (up from 5.38% last week) for the 30-year fixed mortgage while the one-year adjustable rate mortgage (ARM) slipped 4.93% (from 4.95% last week). *LIBOR is the benchmark for \$900 billion in subprime mortgage loans which typically adjust to it every six months. 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. About 6 million U.S. mortgages, including the vast majority of subprime home loans as well as 41% of prime ARMs are linked to LIBOR. PEs

still showing 'earnings-less' recovery underway On June 5, 2009 the average Price/Earnings ratio for the 8,011 US stocks of the VectorVest Composite Index (VVC) hit a new all-time high of 155.58 thanks to rising prices and falling earnings of \$0.13/share. But then on June 12 a strange thing happened. Earnings moved up to \$0.14. It was the first time earnings had risen since April 3 but that was to be a short-lived rise. On June 19 earnings rose again to \$0.16 which is where they stayed this week. Was this the beginning of the much-hoped-for earnings recovery? But on June 5 another thing happened. Earnings growth for the 8011 stocks in the VVC dropped from 2 to 1%, the lowest rate since VectorVest first began tracking earnings in 1995. Generally the first to move up, the earnings growth rate remains anemic. The VVC PE rose marginally to 131.68 from 131.21 last week. At the beginning of the last recovery, April 11, 2003 marked the 'golden cross' of the price of the VVC moving above its 50-week moving average (purple line) and the beginning of a 56-month bull market. VVC PEs peaked at 60.51 in mid-May 2003. As the rally was getting underway in March and April 2003, the earnings growth rate was a much healthier 8% and earnings had begun improving nearly a year prior after hitting a low of 3%. As we see from the chart, the 50-week moving average has proven a more difficult obstacle to cross for the SPX this time around.

Looking even further back to the lofty prices in March 2000, the PE although high was a much more benign 32 times and earnings growth was running at 11%. Figure 2 — Chart showing weekly prices, average Price/Earnings ratios for 8011 US stocks tracked by VectorVest. As the chart shows, the average PE for the broad range of publicly trading companies is in uncharted territory and well above any previous rally or recovery high. Chart courtesy of VectorVest.com Earnings for the 2,969 stocks in the Canadian Toronto Stock Exchange (TSX) tracked by VectorVest this week got better than last week (-\$0.02) but remained negative at -\$0.01. Earnings peaked at an average \$0.73 per share in September 2005 and have steadily fallen since. By the week of March 6, 2009 they had fallen to \$0.16/share and on June 12 to -\$0.02/share during a period in which the TSX exchange index rose more than 40%. Economic Reports New home sales down, existing homes up and final Q1-09 GDP figures are in… This week the Commerce Department provided its final revision to Q1-09 GDP at -5.5%, a slight improvement from the previous estimate of -5.7%. Year-over-year, GDP dropped 2.5%. Inflation was set at an annualized rate of 2.8%. Here is a chart showing building permits, starts together with new home sales and the current inventory of unsold new homes. As we see from the chart, inventories have dropped but remained stubbornly high at 10.25 months in May. May housing permits (at 518k) and starts (at 542k) remain well above sales; a situation that is not helping the builder's plight. New home sales unexpectedly dropped 0.6% in May to an annualized rate of 342,000 which represents just 7.4% of all single family homes sold, the lowest percentage since data started being collected in 1968. Between 1990 and 2005, new home sales averaged 16% of all home sales according to Bloomberg. This means that builder's margins will continue to be pressured by the double whammy of falling existing home prices and mounting foreclosures. New home sales have fallen 33.5% year-over-year and are down 66.4% from a peak of 1.019 million in December 2006. Meanwhile, existing homes sales rose 2.4% in May to 4.77 million (annually) while the unsold inventory slipped to a 9.6 month supply versus 10.1 months in April. The median price of an existing home also firmed to \$173,000 although prices are down 17% year-over-year according to National Association of Realtor data. After not having examined the University of Michigan consumer sentiment survey for a while, we took a look this week as the index hit 70.8, the highest reading since February 2008. But as we have said before, this is little more than a coincident indicator. We learn on Tuesday if home prices as measured by the Case-Shiller housing price index are showing any improvement. This has been a more reliable metric of what was really happening with home prices. Synopsis We are currently in a technical trading territory — the fundamentals are weak and we are currently in a trading range. Stock prices have been so far driven by little more than hype and hope — hype by the government that the greatest series of bailouts in history will solve the crisis and hope by investors that earnings start improving soon to legitimize the recent rally. Given that the S&P500 is back above both the 50 and 200-day moving averages means that the uptrend is technically still alive. However, it is probably not the time to be taking any sizable long or short trades until we get further confirmation one way or the other.

Elliott Wave S&P500 Perspective Last week, the highest probability wave count on the SPX had evolved from an Impulse back into a Zigzag with the top of Wave 5 forming the end of Wave A on June 11 followed by the retracement.

As we see from the first chart below, that is still the highest probability count (rating 342.8) with the most probable target area shown in dark gold between 770 and 870.

However, as we see from the second chart, the second highest probability count by a close margin with a rating of 332.4 was an Impulse with most probability target around 1000 on the SPX. So which one will turn out to be right? Chart courtesy of www.elliottician.com Chart courtesy of www.elliottician.com Chart courtesy of www.elliottician.com

Let's skip to the last figure which is a weekly chart of the S&P500 together with a MACD and a stochastic oscillator. As this chart shows, the SPX is currently overbought on a weekly basis and the stochastic oscillator is showing negative divergence. Although this doesn't necessarily mean that the rally is over, the fact that the highest probability target area (vertical dark red histogram area) has already been hit and the horizontal red time histogram probability is declining increases the chances that the up-move is running out of gas. However, we could see strength in the near-term. Ultimately however, the corrective upward wave will run out of steam and the Impulsive wave, and with it the bear market, should resume. On the lighter side…

Ten ways you know the economy is getting tough..... 10. You can now buy a corporate jet on Craigs list. 9. The IRS starts offering airmiles rewards for tax payments. 8. You get a pre-declined credit card in the mail. 7. People in Beverly Hills fire their nannies and learn their children's names. 6. Hotwheels and Matchbox cars are worth more than U.S. car company stocks. 5. The most highly-paid job is jury duty. 4. Mothers in Africa tell their kids, "finish your plate; kids are starving in America." 3. The Mafia starts laying off judges. 2. You buy a toaster oven, they give you a bank. And number one way you know the economy is getting tough…. 1. When your check is returned for "insufficient funds" you need to call your bank to ask if they meant you or them. Stories of interest this week… Five Banks Are

Seized, Raising U.S. Failures This Year to 45

<http://www.bloomberg.com/apps/news?pid=20601087&sid=aCbHA.m7rikc> Dollar Falls Most in Month as China Urges New Reserve Currency <http://www.bloomberg.com/apps/news?pid=20601087&sid=aQ.zWVPnOYYg> Bailout of U.S. Banks Gives British Rum a \$2.7 Billion Benefit <http://www.bloomberg.com/apps/news?pid=20601109&sid=amp5wXx35fkc> California, Las Vegas Home Prices Decline on Foreclosure Sales <http://www.bloomberg.com/apps/news?pid=20601087&sid=ap29J9krkBY0> Fed Trims Emergency Lending Programs as Crisis Wanes <http://www.bloomberg.com/apps/news?pid=20601110&sid=acr1J5.mPdNw> Volcker Gets Less Than He Wants in Curbing Wall Street Excesses <http://www.bloomberg.com/apps/news?pid=20601109&sid=atBblcvSgrFs> Building America With Obama Bonds Signals Munis' Fall <http://www.bloomberg.com/apps/news?pid=20601109&sid=aQqI3SKPm.t4> Japan Succumbs to Deflation as Consumer Prices Fall Record 1.1% <http://www.bloomberg.com/apps/news?pid=20601068&sid=aDflT6kiR9gs> New Zealand Economy Shrinks 1%, Extending Recession <http://www.bloomberg.com/apps/news?pid=20601068&sid=aGRMaqwDsOhA> John Brynjolfsson of Armored Wolf speaks on Treasuries and interest rates <http://www.allbusiness.com/economy-economic-indicators/public-debt-government-bonds/12362134-1.html> U.S. Savings Rate Jump, a Double-Edged Sword http://www.bloomberg.com/apps/news?pid=20601109&sid=aome1_t5Z5y8

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