

The Futures/Intermarket Report, June 8, 2007

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The Futures / Inter Market Report Trading the World's Markets

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Inflection point for Bonds and Interest Rate Sensitive Markets It was hard for anyone watching bond prices this past week to not be amazed by the sell off that occurred on Thursday and Friday, it was certainly the most volatile market this past week. Market observers have to go back to early 2005 to see any daily moves in the bond market that compare to Thursday and Friday. Two weeks ago we looked at the bearish sentiment in the 10yr bond futures and the possibility of the market finding a bottom. Sentiment has become even more bearish with 97% of market advisors being bearish. Such a unified opinion among advisors is synonymous with market turning points. However, 2 weeks ago there was not much technical support to help stop the falling bond prices. This has now changed. The bond market is at an important inflection point. Figure 1 shows a weekly chart of 10yr U.S. treasury notes reaching a major support trendline. The importance of this trendline is increased due to the bearish sentiment already discussed, as well as a large increase in the position of commercial traders. Commercial traders are the smart money in the market and when they accumulate large positions, traders should take notice. As well, bond prices rallied sharply off their low Friday to close only slightly negative, and higher than where the market opened. The ability for prices to test the trendline and close much higher is a definitely a bullish sign. Although there is a great deal of evidence to support the idea of a rally in bond prices, traders may question the validity of the trendline. Trendlines are a subjective tool and traders can argue that numerous other trendlines can be drawn that show a different picture. The best way to know whether a trendline is valid or not is to see if other markets are giving a similar picture, this is where the power of intermarket relationships is critical. Bond prices affect certain markets more than others. Interest rate sensitive markets such as the Swiss Franc, Japanese Yen, and Utility stocks are dependant largely on bond prices and interest rates. Falling U.S. yields are bullish for the Swiss Franc, Yen, and Utility stocks for a variety of reasons. Monitoring these markets will help investors to have a greater understanding of what the bond market is doing. Figure 2 displays both the Swiss Franc and Japanese Yen up against long term up trendlines. The Swiss Franc has already tested the trendline on 4 other occasions and all 4 times it held as support as can be seen by the green arrows in figure 2. Advisor sentiment is also very bearish for these two currencies and commercial traders are holding large position as well. The utility sector spdr can viewed in figure 3. Utility stocks have also tested an uptrend line last week and closed higher after initially falling lower to test the support. Advisors (dumb money) are also decidedly bearish on utility stocks which is a bullish factor. Where does this leave us? It seems bond, stock, and currency investors are all facing the same situation, and all 4 markets are at supportive trendlines. After looking at figure 1,2 and 3 it would not be wise to disregard the trendline that all markets are now up against. As well, advisors (dumb money) are decidedly bearish in all the markets and therefore increased the likelihood for a bottom. The smart money (commercial traders) are bullish in the currency and bond market. It is clear that all markets are giving the same signs. It is highly probable that all of these markets will begin to reverse to the upside. All of these markets tend to top and bottom together as seen in figure 4. The thin dotted lines show tops that occurred in all 4 markets, and the thick dotted lines show bottoms. The tendency for these markets to top and bottom together and the complimentary signals in all markets definitely present the high probability for higher prices in all markets. In the event that the uptrend lines are broken to the downside, it will be likely that much lower prices in all market will be seen, however given the similar evidence for a bottom in all of these markets, it is unlikely to happen. The ability to see signals from multiple markets in order to help confirm the direction of future prices such as in this case clearly shows the benefit of using an intermarket approach.

Figure 1

Figure 2

Figure 3

Figure 4