

# MARKET STRATEGIES AND INSIGHTS

*...for Sophisticated Institutional Investors*

September 3, 2012

## AN OMINOUSLY LABOR-ING ADVANCE

An advance usually generates divergences or non-confirmations as it ages beyond a certain point. These divergences warn us that the advance's internal strength has dissipated enough of an extent to enable a reversal to occur.

A very large number of these classic divergences or non-confirmations have now materialized. To give you an idea of their scope, I'm listing some of them here (with thanks to Ron Griess of TheChartstore.com, Lowry's Research and He Who Prefers To Remain Anonymous for pointing many of them out):

- A breadth divergence in the S&P 500.
- A breadth divergence in the S&P Mid-Cap index.
- Breadth divergence in some of the strongest S&P sectors (consumer discretionary and healthcare).
- The Dow-Jones Transports' failure to confirm the Industrials' latest new highs.
- A non-confirmation by 30-day net upside volume.
- A non-confirmation by the percentage of stocks above their 30-week moving averages.

In addition:

- The NASDAQ/NYSE volume ratio is dangerously high.
- Sentiment indicators are "too bullish".

Waiting For Confirmation. Although a lot of warning flags are flying the market has yet to acknowledge them, and the uptrend of the past three-plus years is giving way only with great reluctance. The initial acknowledgement will come via a close below 1394, especially if it is accompanied or quickly followed by a 90% downside day. Ultimately, though, it will take a close below the June low of 1266 to indicate that something serious is underway – which may be more of a decline than some of you are willing to absorb to get confirmation of “something serious”.

The Long-Term Risk. There are two traditional rules of thumb to measure the potential downside risk in a bear market. The first one states that a bear market has to be a bigger decline than the biggest correction of the prior bull market. In this case, that “biggest correction” was last year’s decline of 21.6% -- and a 21.6% decline here would take the S&P to 1115. In addition, legendary analyst Stan Berge maintained that bear markets always break the first intermediate low of the prior bull market. The first intermediate low in this bull market was made in mid-2010, with the S&P at 1010. There is thus a good possibility – not 100%, but not zero either – that the S&P will trade both below 1100 and below 1000 before it makes its next Four-Year Cycle bottom that’s due in the first half of next year. Investors of all shapes and sizes need to consider this possibility – very, very carefully.

The Bottom Line. Whatever may or may not happen over the short-term, long-term risks are unacceptably high.

Fidelity Sector Funds. 92% positive vs. 87%. Switching program holdings: #4 Consumer Finance, #9 Biotechnology, and #14 Banking.

The Election According To Intrade. As long-term readers of these reports are well aware, Intrade has a much better record at predicting Presidential election outcomes than just about anything else. In that regard, Intrade’s prediction markets currently say Obama has a 57.7% chance of being re-elected and a 57% chance of winning Ohio, one of the two key swing states in this election – but only a 48% chance of winning Florida, the other key swing state (and the home of the elderly, confused voter).

FIDELITY SECTOR FUND	PRICES (in cents)				R/C	DTR		STRENGTH		RATINGS	
	Aug 29	Aug 22	Aug 15	Aug 8		Aug 29	Aug 22	Aug 15	Aug 8	Aug 1	
Multimedia	5380	5369	5372	5381	23	115	92	111	112	102	
Technology	10392	10358	10114	9989	25	96	70	61	33	23	
Wireless	799	754	805	791	76	94	18	97	65	47	
Consumer Finance	1386	1378	1371	1365	13	93	79	83	74	85	
Telecommun	5049	5013	5123	5039	11	92	82	112	92	103	
Constr/Hous'g	4398	4380	4278	4223	23	91	68	60	38	45	
Retailing	6266	6194	6092	6074	28	86	57	53	27	36	
Computers	6512	6527	6396	6399	20	83	63	68	48	30	
Biotech	10834	10670	10713	10515	25	82	58	89	87	136	
Software	8681	8640	8537	8419	30	79	50	57	27	21	
Comm Equip	2230	2213	2155	2138	44	76	31	8	-29	-57	
Energy Serv	6768	6873	6777	6771	-8	76	84	112	62	54	
Consumer Stpls	8043	8039	8076	8108	13	69	57	82	84	79	
Banking	1935	1924	1914	1907	17	69	52	61	50	62	
Energy	5085	5137	5112	5094	6	61	55	79	47	39	
* * S&P 500	141049	141349	140553	140222	12	59	48	56	38	39	
Insurance	4990	5021	4966	4935	8	58	50	56	39	28	
IT Services	2410	2405	2398	2397	25	58	33	60	35	13	
Pharmaceutical	1506	1499	1515	1501	16	58	41	65	52	67	
Consumer Discr	2711	2697	2678	2677	17	57	40	44	26	28	
Healthcare	13907	13739	13736	13549	19	57	38	50	30	43	
Chemicals	11258	11446	11316	11287	-13	56	68	69	54	55	
Broker/Invest	4607	4616	4567	4538	13	54	42	54	29	23	
Nat Resource	3171	3215	3178	3168	2	52	50	66	29	15	
Natural Gas	3122	3156	3147	3161	5	52	47	69	54	54	
Materials	6816	6932	6812	6810	-4	50	54	48	29	21	
Industrials	2430	2445	2426	2417	13	49	36	50	25	18	
Financial	5813	5817	5758	5757	13	48	36	51	36	49	
Indust Equip	3512	3536	3510	3492	14	46	32	44	21	12	
Environmental	1589	1607	1592	1574	3	37	35	43	20	7	
Utilities	5653	5690	5747	5742	1	31	31	50	47	58	
Electronics	4742	4769	4807	4773	34	28	-6	26	-12	7	
Defense/Aero	8231	8282	8190	8169	13	24	12	18	-7	-15	
Gold	3767	3840	3589	3588	-8	16	23	-35	-93	-120	
Medical Equip	2770	2748	2777	2740	19	14	-5	25	4	13	
Automotive	3368	3406	3337	3303	9	12	3	1	-36	-57	
Medical Del	6020	5955	5691	5884	8	9	1	-54	-34	-47	
** Emerging Mkts	3937	4041	4030	4037	-6	4	10	31	4	1	
* * T Bills	1985	1985	1985	1985	0	0	0	0	0	0	
Leisure	10122	10075	9892	9785	10	-14	-24	-39	-74	-73	
Transport'n	5080	5203	5171	5136	-18	-26	-8	8	-19	-5	
Airlines	3677	3765	3710	3704	-18	-32	-14	-8	-22	-17	