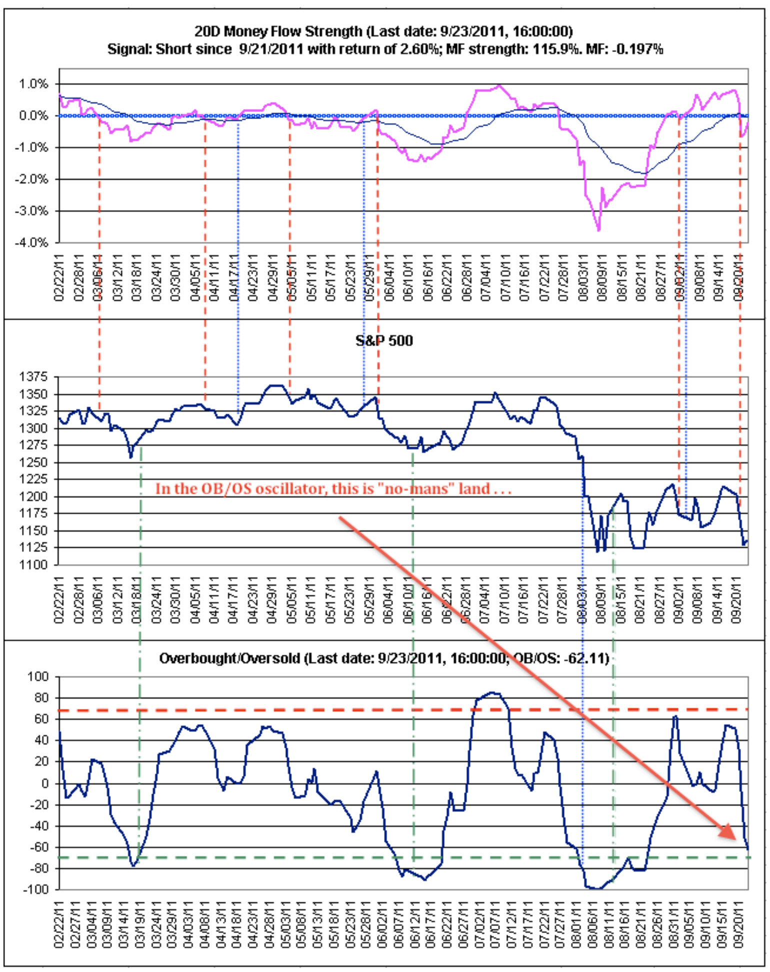
Market Observations 9/25/2011:
By Eric Coleman

Summary:

Last week's trade was very insightful – important feedback regarding the overall market was provided. First, I follow up on some of the changes I noted in my previous report.

- The ability for the market to hold gains proved entirely elusive
- Sentiment remains bearish, but the weak sentiment adds to mounting evidence of the primary bear trend
- The 20-day MF went to a short signal
- Pockets of leadership that began appearing suddenly vanished – no follow-through present

The current state of the 20-day MF indicator, in conjunction with the OB/OS oscillator, is in dangerous territory.



Many forum posts and daily comments are shared on the EV site. Many are noteworthy, but a few such "words of wisdom" get stuck in memory like no other; therefore, some are worth repeating often. Originally shared in my 8/5 Report was a quote from Pascal's article titled Monitoring a Buy Signal using the 20-day MF, written in October 2009:

The previous 8 occurrences where we touched this sweet "-65" oversold line were not the signal to "buy all you can," but to "stay short all you can," because from those points you would have another 2-3 days of nasty selling in front of you.

Some buying appeared in the Nasdaq 100, S&P, and Dow futures last Friday. I won't be surprised with another day or two of choppy trade, though price may simply press downward. Based on the structure of the market, though, my best speculation is that such buying merely represents early short covering. A resumption of the downtrend or break of the August lows is a real possibility in the coming days. Indeed, the evolution of the stages offers more clarity this week than during the previous report.

Daily Stages of Benchmark ETF's: 9/23/2011

SPY	Current Stage is 1-2 (Mid Accumulation) Has been in current stage for 3 day(s)
QQQ	Current Stage is 1-2 (Mid Accumulation) Has been in current stage for 4 day(s)
DIA	Current Stage is 4-1 (Strong Decline) Has been in current stage for 2 day(s)
IWM	Current Stage is 4-1 (Strong Decline) Has been in current stage for 2 day(s)

Weekly Stages of Benchmark ETF's: 9/23/2011

SPY	Current Weekly Stage is 4-1 (Strong Decline) Has been in the current weekly stage for 1 week(s)
QQQ	Current Weekly Stage is 4-1 (Strong Decline) Has been in the current weekly stage for 1 week(s)
DIA	Current Weekly Stage is 4-1 (Strong Decline) Has been in the current weekly stage for 1 week(s)
IWM	Current Weekly Stage is 4-1 (Strong Decline) Has been in the current weekly stage for 1 week(s)

I characterize the past two weeks of stage evolution in the following way:

The DIA was pre-leading in the daily mid-accumulation stage last weekend. Hindsight reveals that such neutral territory quickly succumbed to aggressive selling, once again confirming a bearish bias with opportunity for shorts. My conjecture is that the SPY and Q's will follow the path of the DIA and IWM into strong decline ground, especially with the 20-day MF on short signal.

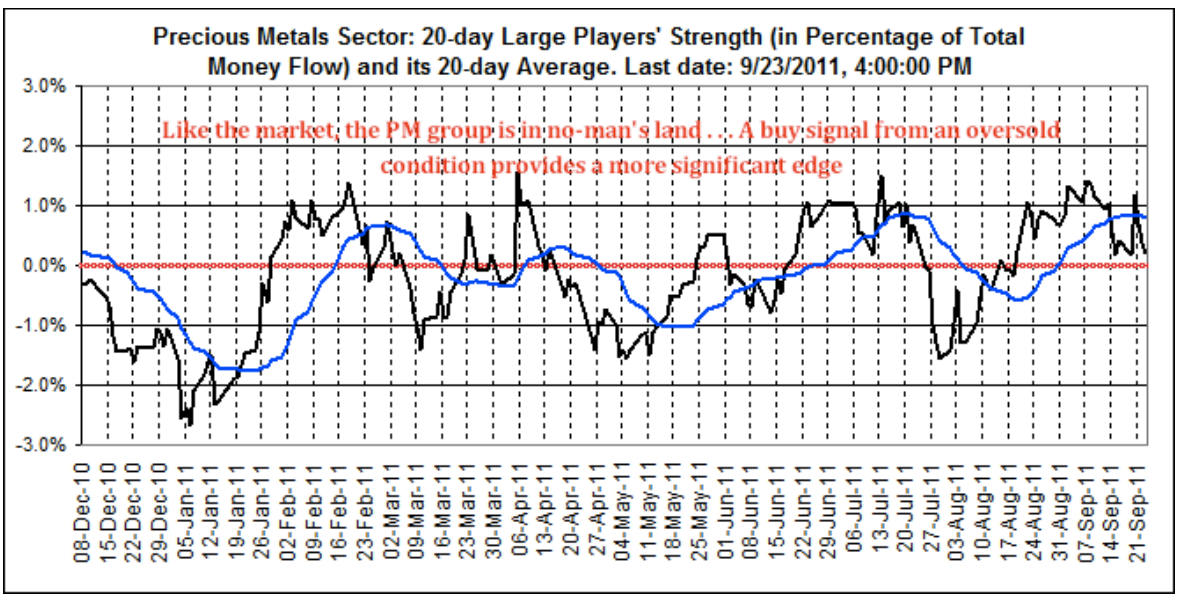
Last weekend, a backdrop of indecisiveness characterized the weekly stages, where the current decline may have been a deep shakeout in a bull market that had not ended. The alternative was that a reversion into the 3-3 late-distribution stages was simply a bull market gasp in a bear market set to resume. I believe the action of the preceding week strongly confirms the second scenario, buoyed by weakening action in leading stocks quickly distributing into strength.

Interpretation of the stages is subjective. Conflicting and choppy action amongst the index ETF's, and back and forth action characterized the stages on short and long term timeframes over the previous weeks; however, we may be entering a more defined decline phase. All the weekly stages are in a 4-1 strong-decline zone, and the daily stages for the DIA and IWM also entered that territory on Wednesday. The SPY and Q's may be only a few days away before the stage is set for a strong decline to characterize the daily and weekly timeframe on all the major indexes.

Shared below are some additional thoughts on precious metals, agriculture, leading stocks, and possible short-setups.

Precious Metals:

During my last report, I noted that, "the current weakness (in precious metals) looks like a normal pullback in an up-trending asset." I was handily wrong. I reduced most of my exposure by the end of the Fed day when bids started evaporating for both gold and silver miners. The following two days witnessed brutal selling in both groups. I completely agree with Billy, in that the current weakness does NOT characterize a simple shakeout. When a leading stock like EGO opens gap-down right below the 50 day MA and cannot rally back, then significant headwinds are present.

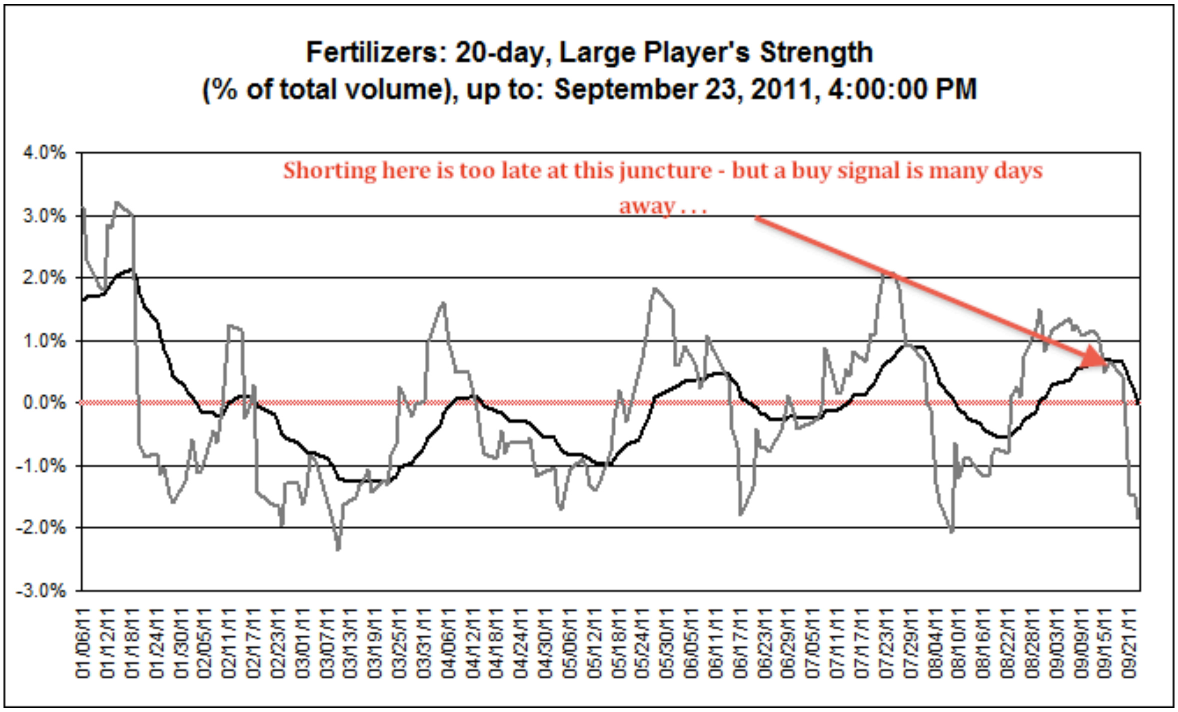


The mining group was one of the last strong groups, which lent a degree of support to the overall market. The decimation of this group only lends further evidence to the weakening stage structure of the overall market, as the last bastions of strength are decimated.

Agriculture – Fertilizers:

Reports since mid-summer focused heavily on the action of fertilizers and miners – perhaps because of an underlying subjective bullish bias, which I recognize. Nonetheless, the action over the past week decisively illustrates the peril of both groups. Both groups previously held top spots in terms of sector ratings, with certain issues outperforming the indexes – CF, for example. Change comes quickly, though, and preparation is paramount.

POT currently appears in the Negative Divergence with AB scan. POT has broken the long-term trading range and CF quickly shaved all gains made from its August breakout. The best part about following groups, specifically leadership sectors, is the feedback one receives from them and their respective constituents. Again, the weakness in the fertilizers only adds further evidence to the quickly deteriorating stages of the overall market.



Leading Stocks:

Some action in the early part of the week led me to believe that a bear market rally may be underway. For example, breakouts from leading issues like AAPL and AMZN, some pocket pivots, the presence of early-accumulation in certain stocks and indexes, and a decisively bearish sentiment were a few factors that I considered. After all, the September 2007 rally fooled most expecting a rapid bearish descent.

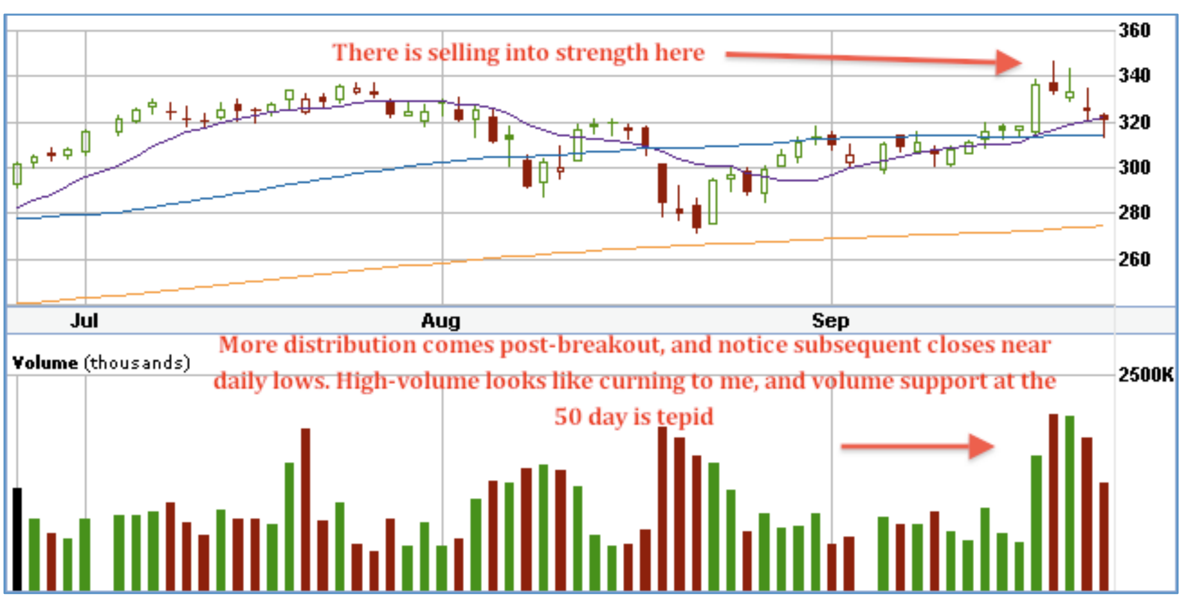
Commodity and energy issues have led the market lower. Many of these stocks have now retraced their entire bull market moves. I believe the leading stocks that fail at their late stages will lead the next leg down. There are a few characteristics I note:

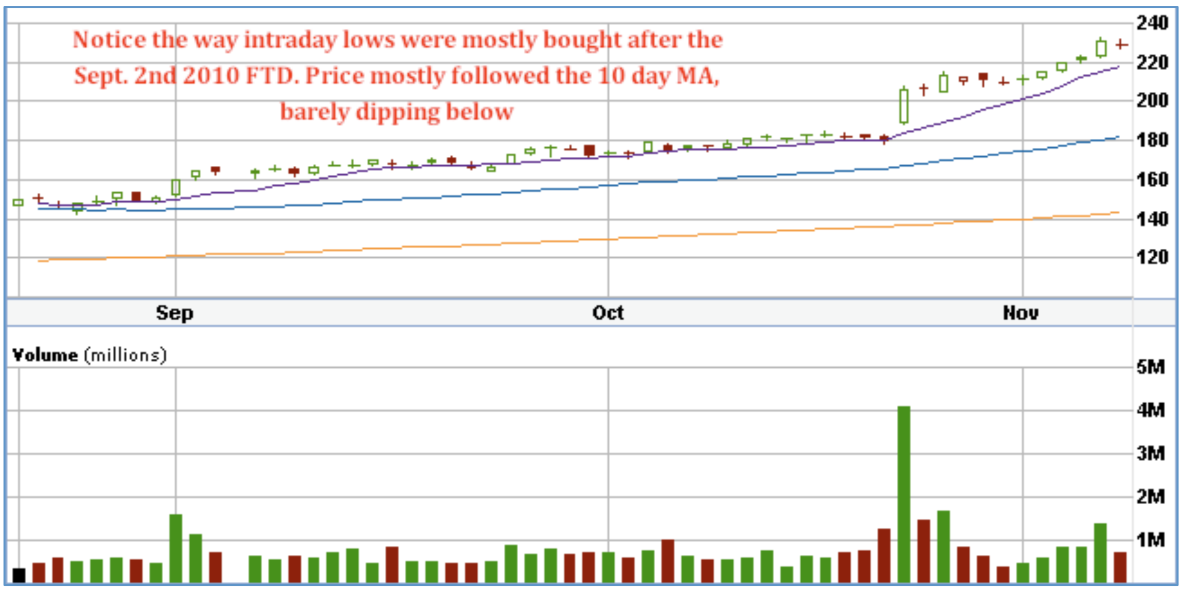
- Immediate distribution following breakouts
- Some V-ish bases that are more prone to failure
- The general short-duration of said bases and late structure
- A market that is now in a strong decline phase on the weekly timeframe will be very unsupportive of upside breakouts

Highlighted here are possible late stage failed breakouts - only time will tell, but this is my subjective interpretation.

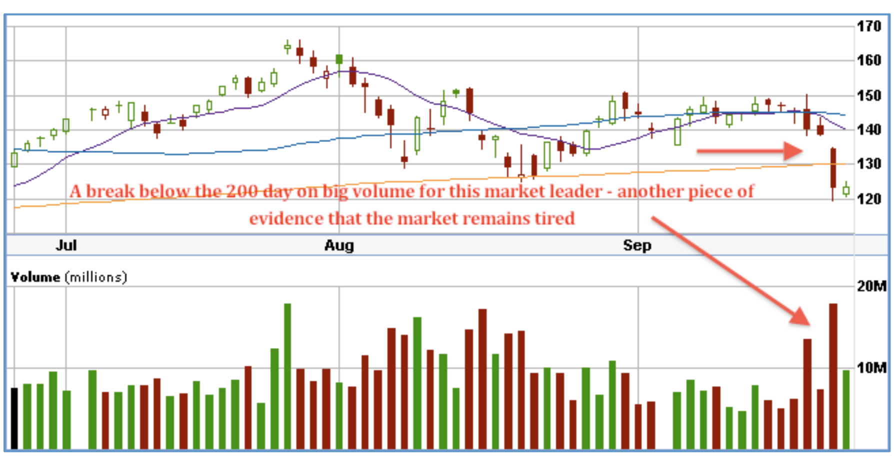
AAPL: Apple Computer

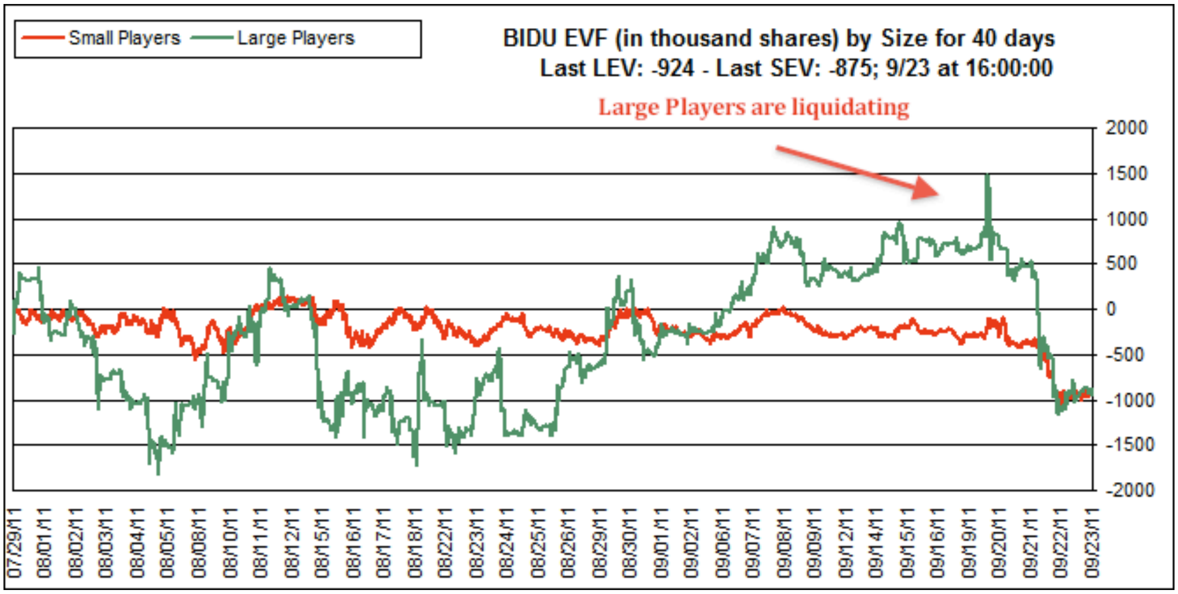
CMG: Chipotle Mexican Grill with comparisons to prior breakouts





BIDU: Baidu, Inc.,

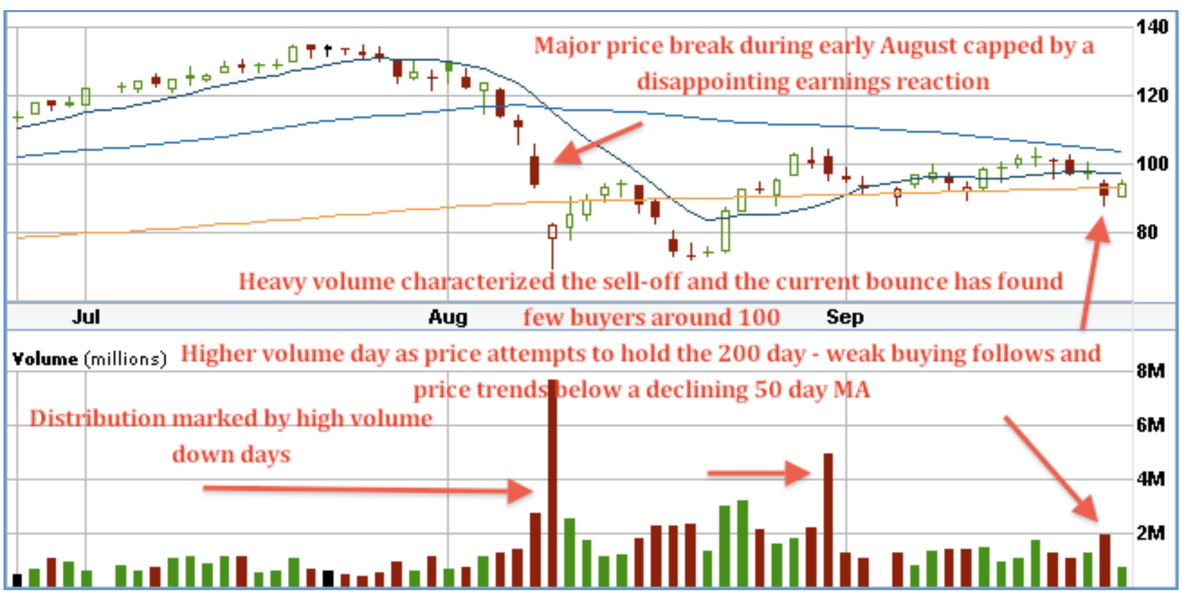




The above represent a few noteworthy patterns. AAPL isn't showing heavy selling, yet, nor is AMZN. What concerns me most is that immediate, high-volume selling immediately following the early week strength – see WYNN and LULU for examples. The most optimistic scenario is that such action indicates hesitancy on the part of large players and a need for more time to establish a base that can sustain a rally to new highs. A more pessimistic scenario is that these remaining leaders no longer possess the necessary attributes to lead the market higher.

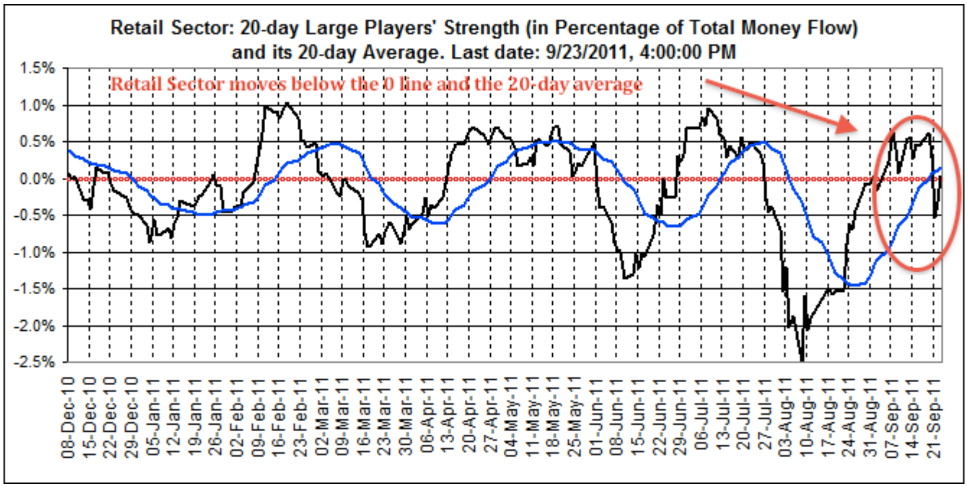
Analyzing a potential short sale:

One stock that I am monitoring as a potential short-sale target is FOSL. FOSL had a major price break during the early August sell-off. These breaks are significant in a leading stock.

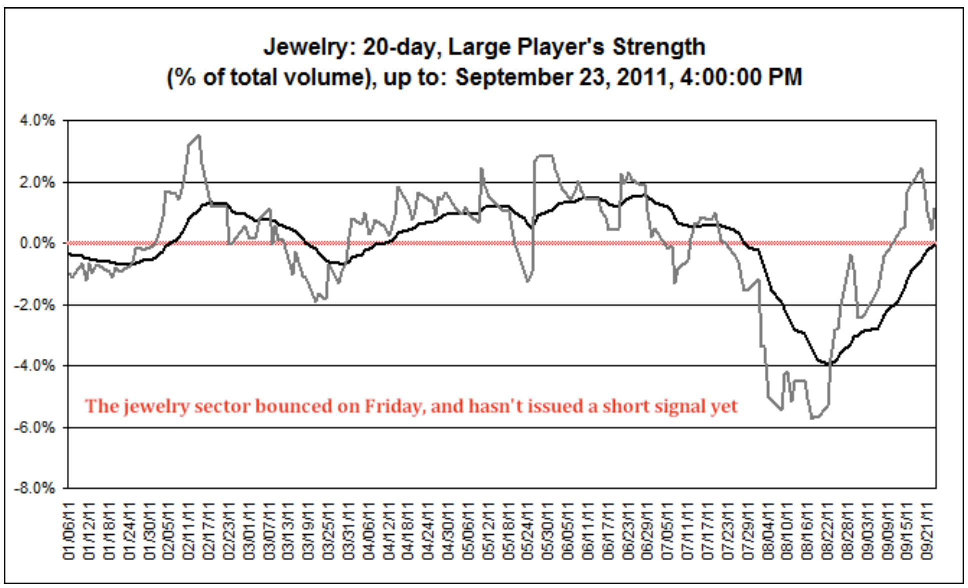


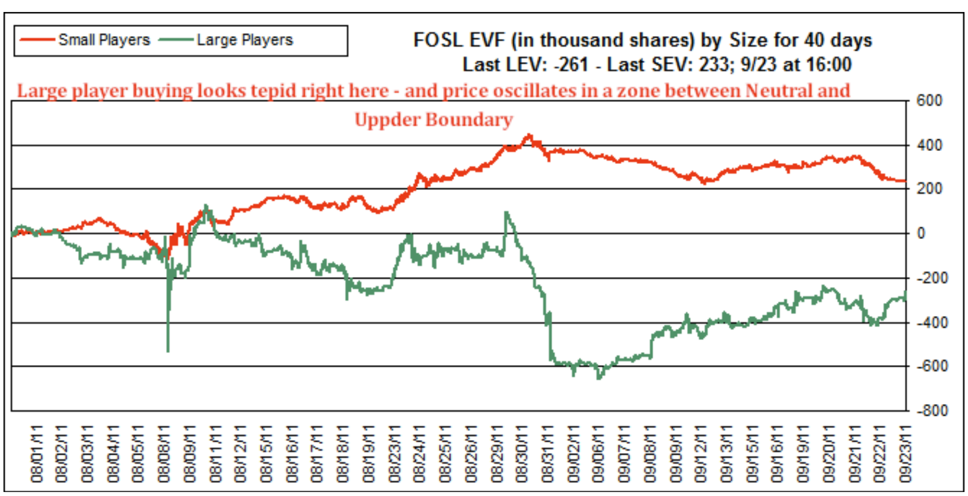
Since the August lows, FOSL rallied twice into the high 90s, low 100-price level. This allowed the 50-day to play catch-up with price. The declining 50-day MA is containing price currently.

The Retail Sector has broken the recent days



FOSL belongs to the Jewelry sector, which has not issued a sell signal, though.





Large player buying lacks the thrust one likes to see. For example, LULU powered above the 50-day MA on significant large player buying, while reclaiming the 50-day MA and moving into new high territory during the summer. At this juncture, FOSL lacks the type of convincing thrust from oversold levels that marks a tradable short-term uptrend.

The market backdrop, coinciding with the massive earnings break, 20-Day MF short signal, and large player selling in the retail sector, lead me to believe the FOSL may succumb to another round of selling. Consequently, FOSL remains on my short-sale watchlist.

Conclusions:

When developing a trade plan for RDWR in late August 2010, I wrote the following:

"Quantifiable Edges notes that when sentiment has reached the levels we are currently at, the possibility of a rally is rather favorable. The caveat is that current bearishness could perpetuate a more severe sell-off in the event of continued market weakness."

The current situation characterizes the latter part of this statement – current bearishness in the face of a market that refuses to improve may indeed perpetuate, causing a more severe sell-off. Aly provided some wonderful commentary over the past weeks, and unfortunately he was not able to post his usual thoughtful analysis this week. Nonetheless, his weekly CSI and shorter comments this weekend has given numerous scenarios to consider regarding sentiment.

Watching Charles Kirk's Weekend Chart Show today revealed daily and weekly ATR sell signals, with a monthly ATR sell signal close at hand. The 20-day MF indicator remains on short mode. And my best conjecture from listening to a recent Dr. K and Gil interview confirms my suspicion that the MDM model remains on a sell. Confirmation from three different market-timing models, followed by three different yet very talented traders, is confirming a similar downside bias. The stage structure reveals a market ready to succumb to more selling, before the decline weakens.

The final remaining leadership issues are showing lackluster action. These stocks are typically the last to fall and should they break, will likely carry the market lower. While the possibility of maintaining the range, or even bouncing higher cannot be dismissed, such scenarios are very unlikely under present conditions.

Best to everyone,

Eric