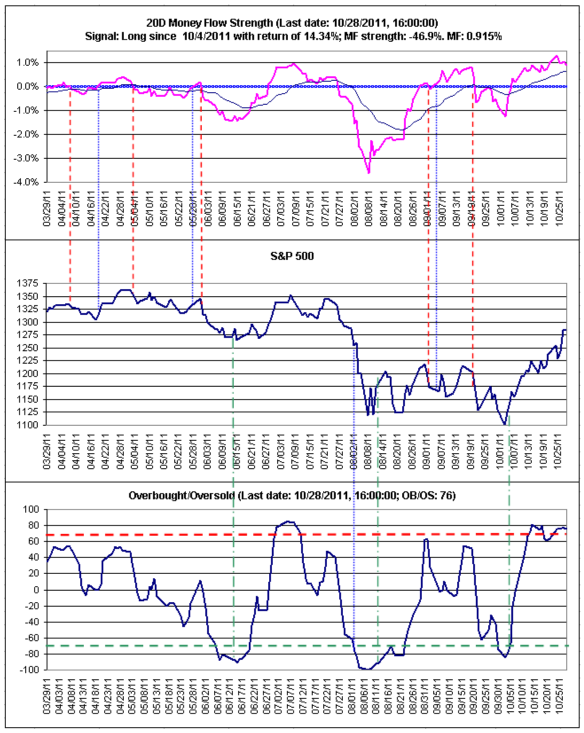
Market Observations: 10/29/2011
By Eric Coleman

Summary:

I have nothing to add to Pascal's October 28th *Daily Comment* – this rally deserves respect. Increasingly, the weight of evidence suggests the uptrend is not yet exhausted, even though near-term price congestion might be expected. Remaining open to possibilities, while utilizing the market as a feedback mechanism, proved prescient this week . . .



Stage Analysis 10/30/2011:

The previous report highlighted the strong position that marked the daily stages going into last week's trade:

Meanwhile, both large caps and small caps remain in daily accumulation modes, a neutral precursor to more potential short-term gains – 10/22/2011

This week reveals simultaneous strong daily mark-ups on the SPY, Q's, IWM and DIA. This bullish stage, set against the backdrop of accommodative monetary policy and a broadening base of select leadership, suggests that pullbacks may be shallow and short-lived. Indeed, the 20-day MF indicator helps reveal where weakness is most aggressively bought; moreover, one may continue monitoring signs of strength and breakouts that give little, if any, back.

SPY	Current Stage is 2-1 (Strong Mark-Up) Has been in current stage for 5 day(s)
QQQ	Current Stage is 2-1 (Strong Mark-Up) Has been in current stage for 2 day(s)
DIA	Current Stage is 2-1 (Strong Mark-Up) Has been in current stage for 6 day(s)
IWM	Current Stage is 2-1 (Strong Mark-Up) Has been in current stage for 2 day(s))

The weekly stages kept me skeptical for a fair portion of this rally. Indeed, stage analysis provides clues and context, but rarely is there a concrete answer. If one is searching for concrete answers, though, then perhaps the market is not the best place in which to forage. Today, the weekly stage structure remains similar to prior weeks, although progress through the decline stages continues:

SPY	Current Weekly Stage is 4-3 (Weakening Decline) Has been in the current weekly stage for 2 weeks
QQQ	Current Weekly Stage is 4-3 (Weakening Decline) Has been in the current weekly stage for 3 weeks
DIA	Current Weekly Stage is 3-3 (Late Distribution) Has been in the current weekly stage for 7 weeks
IWM	Current Weekly Stage is 4-3 (Weakening Decline) Has been in the current weekly stage for 1 weeks

The anticipated pullback never materialized. Pascal's indicator showed that money was not moving out of the market, and the market proved resilient against any and all weakness. Given resolution in other markets (UUP, GLD, TLT), in conjunction with the price action throughout last week, I've accordingly had to shift my views. The first signs of weakness may result from trend exhaustion in the daily timeframe; however, any such pullback will only offer bullish longs an opportunity to test their mettle in defending hard-fought October gains. Whether the catalyst is more QE, improving earnings, or more mergers and acquisitions, the market revealed that an underlying bid for shares remains.

An updated review of recent scans provides more insight about the market (ETF's excluded):

Scan1: Weekly Strong Mark-Up + (Daily Late Accumulation-Strong Mark-Up)	101 Results
Scan 2: Weekly Strong Mark-Up	156 Results
Scan 3: Weekly Strong Decline	134 Results

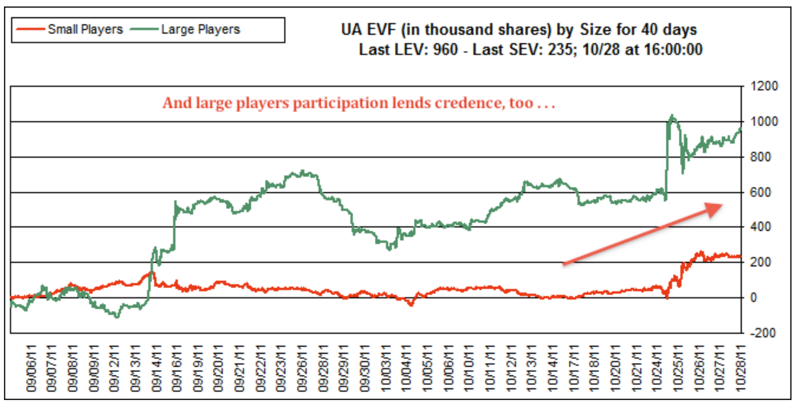
This week marks a significant improvement – equilibrium between weekly strong mark-ups and weekly strong declines has nearly been struck, with strong markups outnumbering strong declines for the first time in many weeks. Stocks breaking out, or pending breakouts, are also improving their numbers. And represented sectors are expanding further. Defensive issues populated much of bullish scan #1 a couple weeks ago. Today, the presence of tech companies like INTC, restaurants like DPZ, and consumer discretionary shares like UA and VFC, bode well for the current rally. Defensive names do remain, but participation that spans the gamut of an increasing number of sectors is constructive.

The current stage structure should keep one on watch for a pullback at anytime – some consolidation at minimum. The extreme strength of the market, though, suggests that a serious element of surprise remains a necessary catalyst to shake the noteworthy progress achieved by bulls this month. A scenario I postulated a couple weeks ago suggested a low-probability chance of some blow-off tops, and given the recent price action, such a scenario does not seem as implausible now.

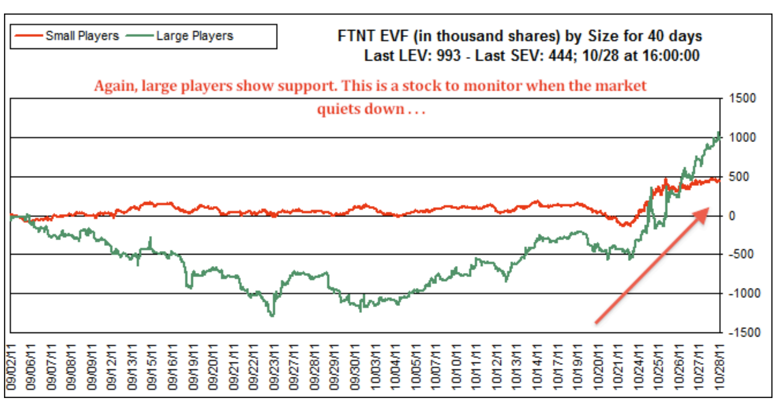
Stocks and Gold:

As the market enters the next phase, there are some issues that show constructive price action and large player accumulation. While weakness in some leading stocks like AMZN and AAPL were a cause of concern the past few weeks, a number of new leaders are showing signs of life and vigor. See corresponding charts on the following pages.

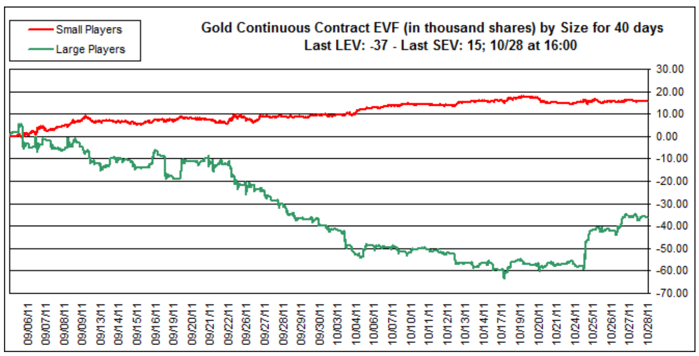
Under Armour (UA) emerges as a leader:



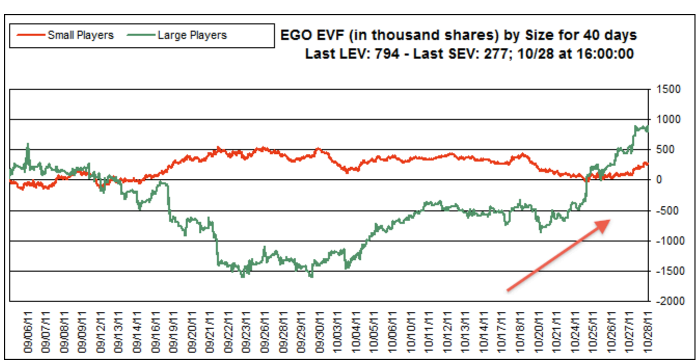
Fortinet (FTNT) discussed earlier this year, after a first meaningful correction:



With some degree of surprise, I noted gold's lack of participation during the October rally in last week's report. Indeed, shares seemed to be getting all the love recently. The precious metals reasserted themselves once again, though. GLD entered a strong weekly mark-up stage with the backdrop of early accumulation on the daily timeframe. Whether this bull market ends in a euphoric advance marked by fear or greed, or both, remains to be seen. Regardless, the commodity and a favorite miner are shared below:



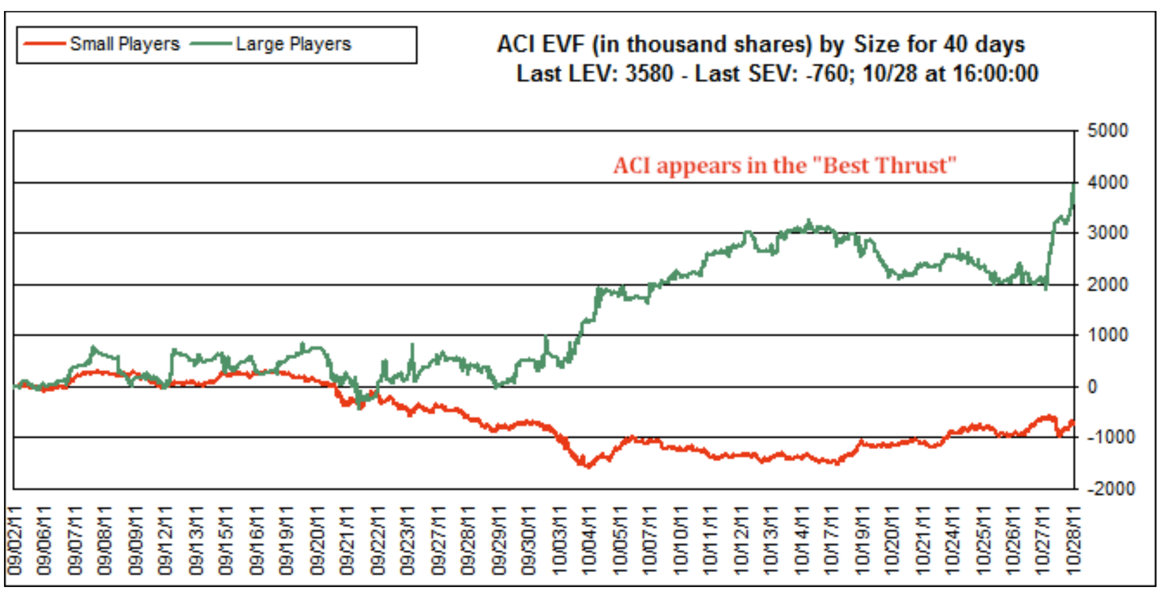
Eldorado Gold (EGO):



The coal sector was mentioned in last week's report:

Deep pessimism and sell-offs can spark large rallies under the right conditions. Clearly, time is needed as the weekly remains in a weekly strong 4-1 decline phase . . . Nonetheless, bearishness and neglect can lead to explosive rallies.

A quote from Pradeep Bonde of Stockbee was shared last week regarding situational awareness. Indeed, as disappointing earnings reports from the sector were greeted by rallies despite misses, the prospect of a major bottom for the group emerged early last week. Several stocks in the sector traded close to their 2009 lows early this month. This sparked interest. Arch Coal's report on Friday seems to be a sector catalyst – big moves in numerous names from the group, including ANR BTU JRCC PCX and YZC.

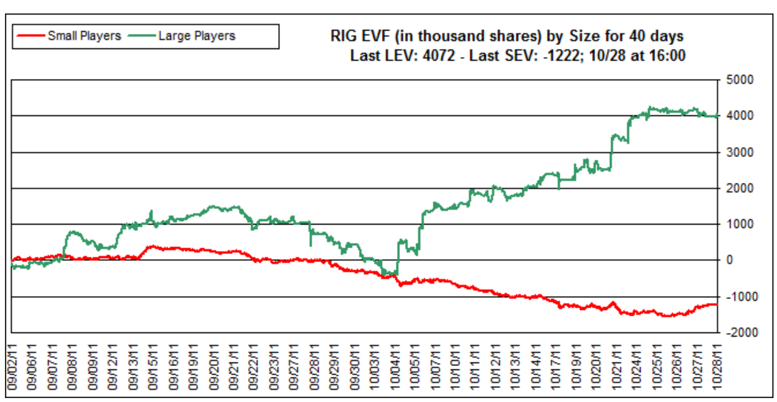


One trait I've learned about commodity stocks is that when they are hated, they are *really* hated. This sets the stage for some profitable trading opportunities. Note long-term support for both ACI and RIG on the following page.

50
40
30
20
2009
2010
2011
Volume (millions)
The ovals indicate where "value" investors stepped in . . . A 10% rally in a large float stock on an earnings miss signals a likely bottom for the group
50M
40M
30M
20M
10M

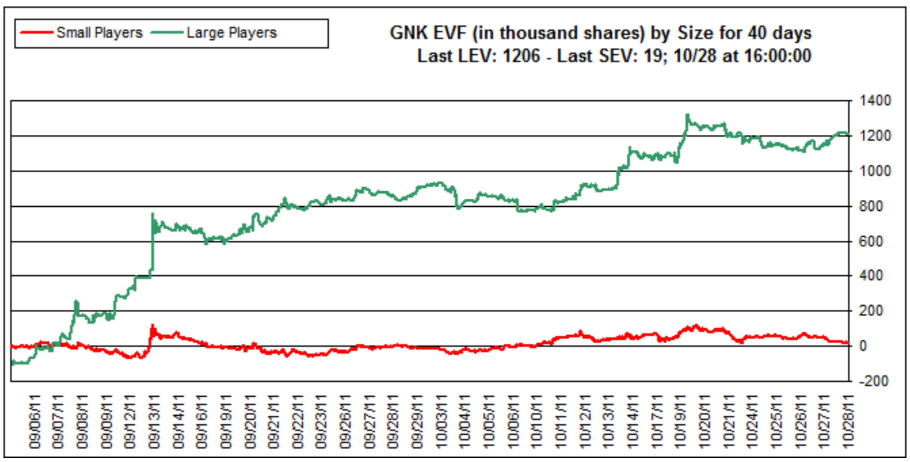
EUPHORIA
ANXIETY
THRILL
DENIAL
BELIEF
FEAR
OPTIMISM
PANIC
CAPITULATION
DISBELIEF
HOPE
ANGER
DISBELIEF
DEPRESSION

RIG: Not a high-flying growth stock, but big funds often buy beaten-down shares in large-caps like this. Last year's rally took the stock up close to 100% from the lows . I like to watch this sort of thing.
140
120
100
80
60
2009
2010
2011
Volume (millions)
Once again, value investors are starting to look active in some of the large cap commodity and energy stocks . . .
200M
100M



Small Players
Large Players
RIG EVF (in thousand shares) by Size for 40 days
Last LEV: 4072 - Last SEV: -1222; 10/28 at 16:00
5000
4000
3000
2000
1000
0
-1000
-2000

Besides some commodity stocks, noteworthy action in the transportation sector continues. Even the battered shipping stocks are showing signs of life, and may embark on some speculative fervor and aggressive short covering, should the market permit. Genko Shipping (GNK) shown below, with 18.5% short interest.



The IPO market is perking up, too. Fusion IO (FIO) attracts the attention of aggressive growth investors. Skull-Candy (SKUL) attracts some buyers, too. Of course, many large players dump shares on debut, only to buy back during the next correction – soon we'll see whether or not they are committed. Earnings reports for both are on 11/3.

Conclusions:

The 20-Day MF showed support for the market since the 10/4 bottom. The daily stages progressed into a clearly bullish configuration over the past couple weeks. The weekly stages suggested a cautious stance in conjunction with ominous action from some cycle leaders like GMCR, NFLX, and BIDU. That stance may have resulted in some early profit taking or sidelined cash – that is ok.

The environment has been challenging, but keeping an open mind, monitoring the 20-Day MF, and looking for select opportunities proved an appropriate course of action. Last week, the market moved in ways that must be respected. Until a window of opportunity on the short side emerges, my focus remains long-oriented. Indeed, brief forays into the short side were short-lived, as they were not working like they did in August and September. When something that was working, no longer does, that says the market is undergoing change, and being tuned into that change is important.

An expanding, though not stellar, base of leadership dots the landscape. Mike Scott covers this area wonderfully. A plethora of slaughtered commodity stocks that likely attract value investors willing to hold through pullbacks is encouraging. The IPO market might be perking up as some recent offerings show a bit of life. New issues like Groupon are slated to increase their offering price and anticipate a favorable market to even consider such thing (*and experience shows that retail traders anxiously await such new issues, despite the overwhelming evidence of immediate underperformance*).

Overall, the market appears to have the ingredients to hold here, and possibly move higher into year-end. Flexibility is a must, as the recent debacles with the US debt downgrade and Euro Zone crisis remain skeletons in the closet, not easily disposed of. Meanwhile, underlying skepticism about China's growth remains real, and social discontent worldwide will likely *not* be short-lived. As always, headline risk continues, but the real clues are found in the market anyway.

Best,
Eric