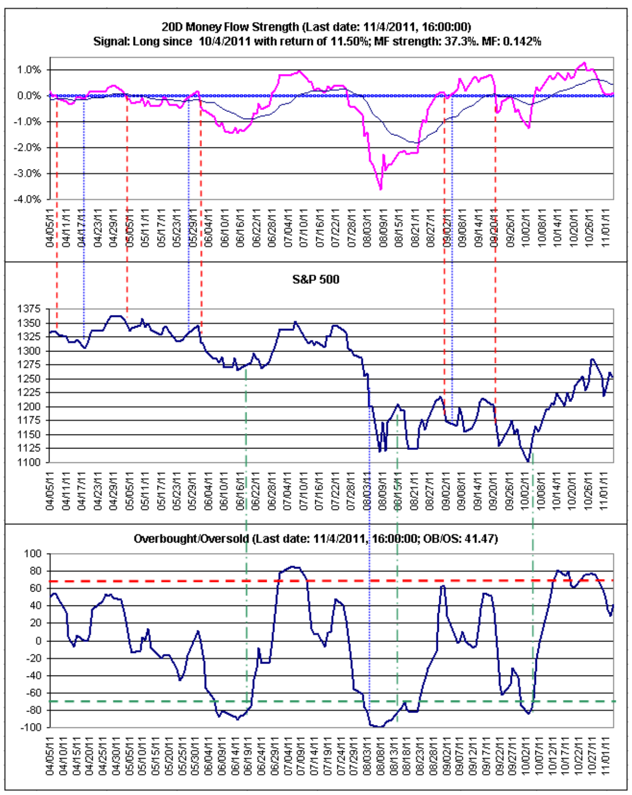
Market Observations: 11/05/2011
By Eric Coleman

Summary:

A fascinating aspect of the 20-Day MF is the signal provided for when to “step in” long with confidence as the entire market experiences a buying thrust. Such buy signals offer very favorable windows of opportunity and are rather clear-cut. That is not the case, today. Based on my interpretation, the 20-Day MF indicator is saying that *the market is correcting through time, and some choppy and difficult action may lie ahead, but a severe breakdown (sharp pullback notwithstanding) does not seem present.*

A primary reason for this view is that volatility remains high, but continues to decline from notable levels reached in August. High volatility suggests, to me, that the market is not necessarily “apathetic,” a condition that preceded the August crash, though the intraday volatility is enough to drive one mad.

Given what I perceive to be a difficult environment, I will refrain from more specific comments about the 20-Day MF. Pascal’s Daily Comment offers the most poignant assessment of the current landscape through the lens of this robust indicator.



Stage Analysis:

The primary message of last week’s stage analysis was that an underlying bid in the market remained, and a pullback or congestion of price was due anytime:

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 . . . 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. – 10-30-2011

While Monday's high-volume gap-down did not "feel good," the fact that the upward sloping 20 and 50 day moving averages firmly held provides evidence of a pool of active dip buyers. The Q's successfully defended the 200-day MA, and the NQ futures show that large players are not really selling even if they are only select buyers at the moment. Also, the latter stages of a daily uptrend are still bullish, as a pullback or quick distribution may provide a much-needed reset after a series of lofty advances. That appears the case last week . . .

Daily Stages: 11/05/2011

SPY	Current Stage is 2-1 (Strong Mark-Up) Has been in current stage for 2 day(s)
QQQ	Current Stage is 2-2 (Medium Mark-Up) Has been in current stage for 1 day(s)
DIA	Current Stage is 2-1 (Strong Mark-Up) Has been in current stage for 2 day(s)
IWM	Current Stage is 2-1 (Strong Mark-Up) Has been in current stage for 3 day(s))

The weekly stage structure continues to progress . . .

Weekly Stages: 11/05/2011

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

The backdrop of a weakening decline keeps one alert for sharp pullbacks at any moment. A possibility exists that the market is days away from a precipice, as price hangs below the 200-day MA on all but the Q's. Conversely, the ongoing transition through the weekly decline phase coupled with generally positive daily price action indicates that a weekly early-accumulation phase may soon arrive. That would allow covert bulls to pick-up shares on weakness while bearish traders experience exhaustion.

Scan 1: Weekly Strong Mark-Up + (Daily Late Accumulation-Strong Mark-Up)	88 Results
Scan 2: Weekly Strong Mark-Up	153 Results
Scan 3: Weekly Strong Decline	235 Results

This week's pullback reduced the number of stocks in Scan 1, which suggests that additional consolidation and digestion of the October advance might continue into next week. The fact that the number of weekly strong mark-up stocks stayed nearly flat is constructive; the decline last week was not enough to shake the bullish weekly structure of numerous leading stocks. One sees that weekly strong decline stocks increased, and that might be expected as some issues progress towards the latter stages of their downtrends. The coming weeks would benefit from a steady or expanding number of stocks in weekly strong markups if the market is to continue higher.

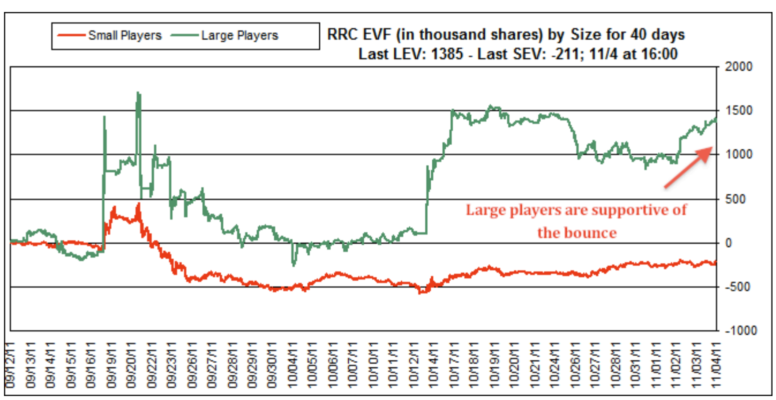
From a qualitative perspective, Scan 1 continues to reveal a broader swath of sector participation, which gravitates to more speculative components of the market – biotech (QCOR), energy (COG RRC), retail (PIR PII), software (SWI), restaurants (DPZ MCD), rails (KSU) and gaming (ATVI ERTS). Ultimately, one's analysis is an attempt to contextualize the market, a very dynamic entity, into something a bit more manageable. This week's stage analysis tells me that no matter how bearish I would like to be, the market continues demonstrating some constructive, albeit subtle, developments, and more evidence is needed before the move up from October 4th can be definitively called a bear market rally.

Highlights:

I'd like to highlight some stocks I reviewed over the weekend.

RRC: Range Resources

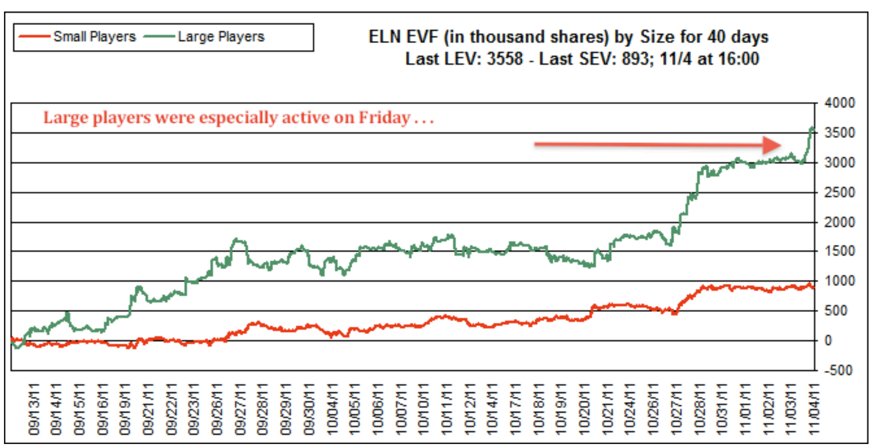
- 71.98 as of market close on Friday, November 4, 2011
- Current Daily Stage is 2-1 (Strong Mark-Up); Has been in current stage for 2 day(s)
- Current Weekly Stage is 2-1 (Strong Mark-Up); Has been in the current weekly stage for 4 week(s)



Energy stocks continue showing relative strength versus the S&P500 (Bespoke). RRC is an independent natural gas and oil producer that beat earnings estimates during the last 5 quarters. Low interest rates supportive of a market ripe for M&A (as evidenced by the recent acquisition of El Paso) likely offers some underlying context for recent 52-week highs.

ELN: Elan, Inc.,

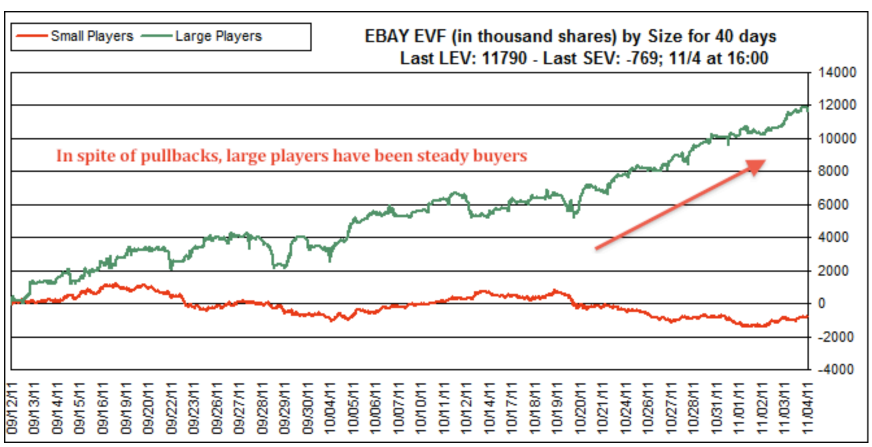
- 11.91 as of market close on Friday, November 4, 2011
- Current Daily Stage is 2-1 (Strong Mark-Up); Has been in current stage for 8 day(s)
- Current Weekly Stage is 3-1 (Early Distribution); Has been in the current weekly stage for 7 week(s)



The biotech sector continues to be a leadership sector. ELN reported an unexpected earnings surprise on October 27th. The 3-1 weekly stage setting simply indicates a bullish to neutral structure, which might precipitate a breakout under supportive market conditions. EV shows that large players have been accumulating while price moves sideways. This is an important "clue."

EBAY: Ebay Inc.,

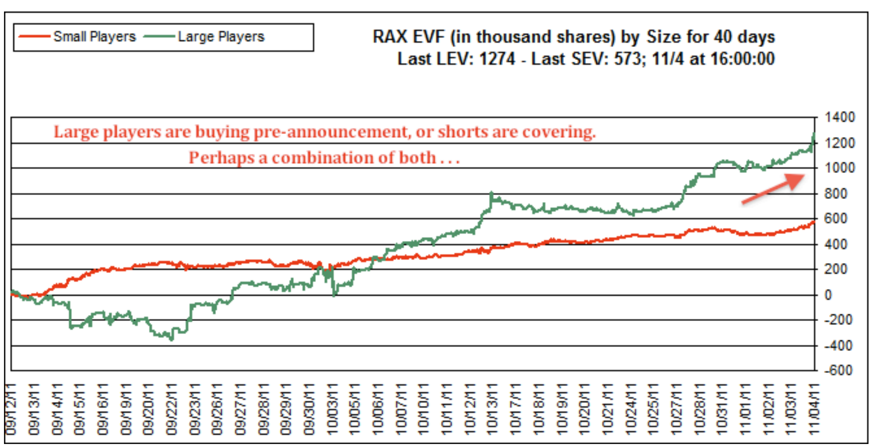
- $32.71 as of market close on Friday, November 4, 2011
- Current Daily Stage is 3-1 (Early Distribution) Has been in current stage for 4 day(s)
- Current Weekly Stage is 1-1 (Early Accumulation) Has been in the current weekly stage for 2 week(s)



EBAY illustrates a favorable technical picture under multiple timeframes and the backdrop of large player support. This may coincide with a typically strong November performance for Internet retailers, which gained an average 4.8% during the month since 2002 (Bespoke).

RAX: Rackspace Holdings

- $42.67 as of market close on Friday, November 4, 2011
- Current Daily Stage is 2-1 (Strong Mark-Up) Has been in current stage for 3 day(s)
- Current Weekly Stage is 3-3 (Late Distribution) Has been in the current weekly stage for 5 week(s)



RAX reports earnings after the close on Monday, which may act as a catalyst in either direction. Daily price performance is indicative of large player buying/covering in recent weeks. The cloud-computing sector has awakened recently . . . The 3-3 late distribution warns of any entry until after earnings, when the neutral condition is likely to be resolved.

Conclusion:

The onslaught of politico-economic news leaves one worn out and tired. Yet, anticipating a cathartic market event without a strong foundation of evidence can also be mentally exhausting. A plethora of comparisons to 2008 dot the blogosphere, which also makes one leery of an exact replay of those events.

The daily stages are once again constructive; a defense of widely followed moving averages that showed a presence of dip buyers in some major indexes was revealed. The weekly stage structure, while not inherently bullish, is moving closer to a period of early accumulation. Consequently, the bid in the market has not vacated. Finally, stocks representing more speculative and "risky" market components are entering more pronounced leadership roles.

Leaders like UA FTNT MA are holding or building on their gains. Other stocks are showing nice bottoming patterns, and sectors that led the August sell-off are now showing improving relative strength versus the S&P 500. Cloud computing stocks are showing signs of life. Railroad stocks are extremely resilient – see UNP and NSC. Additionally, stocks like STX have only built upon their gains in recent weeks while EV reveals other attractive long setups. If recent gains were on the heels of a major market advance and a low VIX, then the context would be different; however, a healthy correction or deep sell-off results in a potential bullish reset that can last weeks to months.

These observations come on the back of a seasonally bullish period for the market that characterizes the next six months. A positive backdrop would allow stocks like GMCR and NFLX to possibly form longer-term topping patterns, such as those witnessed in DRYS during 2008. Indeed, shorts are certainly covering evidenced by the EV patterns in each.

With that in mind, IWM and SPY have yet to re-capture the 200-day MA. Various global credit concerns remain of paramount concern. And the bankruptcy of MF global is disconcerting, to say the least . . .

Best,
Eric