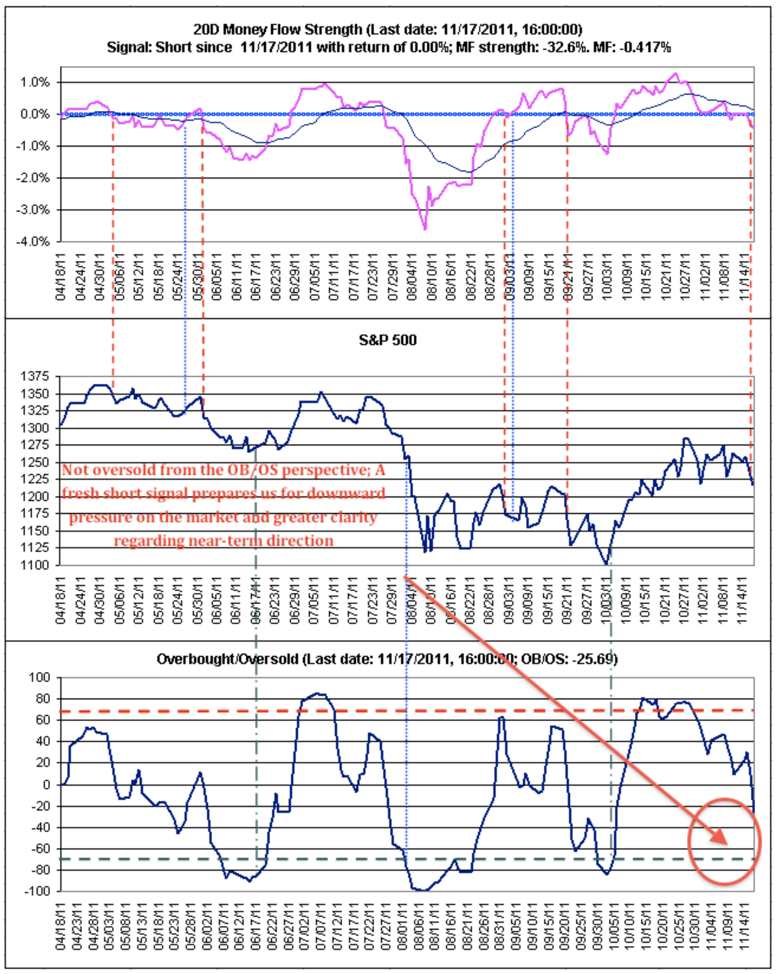
Market Observations: 11/18/2011
By Eric Coleman

Summary:

A neutral to positive view of equities at the start of last week was undercut by more important developments during the past few trading days. A primary benefit of performing analysis is the feedback received when one's anticipated outcomes do not come to fruition. Simultaneously, one must remain astute to underlying market action and subtle changes in character, which belie the importance of maintaining an open mind, flexibility, and willingness to recognize when things are changing.

Pascal's 20-Day MF indicator is like a trustworthy friend – reliable, and able to give truth and guidance even when a situation is both challenging and confusing. And what I am hearing is that the market is now in a very precarious place.



Over the course of the past month, traders postulated multiple scenarios regarding the market's destiny. The two most dominant are 1998 and 2008. I've come to appreciate Mike Scott's use of the terms "high road" and "low load," because while the market may rhyme with history, its path will ultimately be characterized by the unique circumstances of "this time around." Deterioration in Jerry's Leader's Index coinciding with the confirmed short signal on 11/17 suggest downward pressure outweighs any positive developments noted over the past couple reports.

Stage Analysis:

Until recently, daily short-term dips were catching a bid. Buyers at this juncture have yet to emerge, though. What can be inferred is that if near-term support at or around the 50-day MA's is to appear, it should happen sooner rather than later if a more serious daily decline is to be avoided.

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

Last week concluded with overall negative developments for the weekly stage structure of the major etf's. The inability for progress into accumulation stages for all but the Q's is a cause of concern for longs. The faltering structure merely suggests that the rally from the October lows is quickly losing steam and vulnerable to a more pronounced sell-off and possible 2nd leg down in a bear market.

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

My personal belief is that the action of last week *mostly* invalidates my previous view that large players were accumulating for yearend strength. There were some interesting pullbacks developing, but the short signal removes those considerations for the time being. One should not discount some of the extraordinary circumstances that dot our landscape, yet there are coinciding forces that are flashing warning signals:

- Neutral daily stage structure against a backdrop of a deteriorating weekly stage structure
- 20-Day MF short signal that triggers just as price remains barely below the 200-day MA and barely above the 50-day on DIA IWM SPY. Price is currently contained below *declining* 5, 10, and 20 day MA's.
- Q's now *below* major short and long-term MA's (5, 10, 20, 50, 200)
- More weakness in Jerry's Leader's index

The weekly scan further confirms said warning signals:

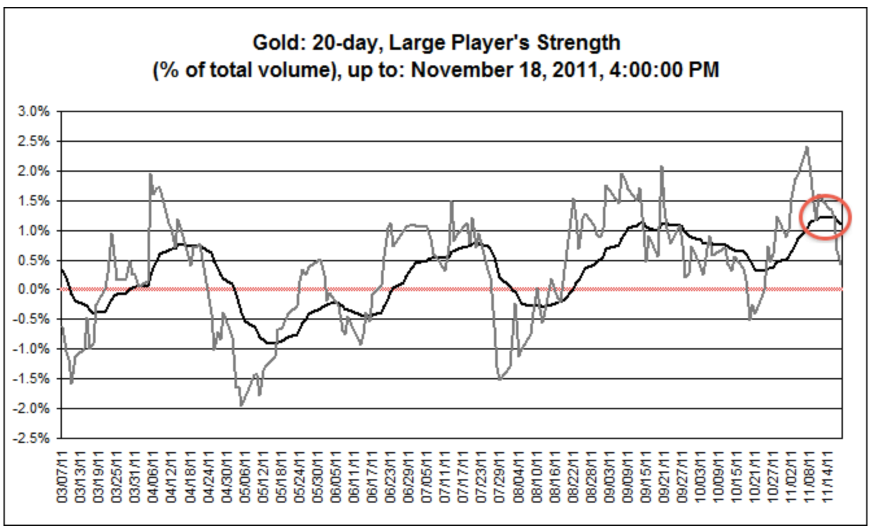
Weekly Strong Mark-Up + (Daily Late Accumulation-Strong Mark-Up)	29 Results
Weekly Strong Mark-Up	144 Results
Weekly Strong Decline	595 Results

The first scan witnessed an extreme decline in the number of issues that are advancing with a backdrop of strong daily and weekly markups. In fact, there is hardly a presence of even defensive stocks – does that indicate large players raising cash in anticipation of tightening liquidity? Time will soon tell. As noted in last week's report, the market would need to see an expansion of leadership for a sustained move higher, and the market is really showing the opposite.

Most noteworthy is the doubling of weekly strong decline stocks during the course of last week. The dramatic increase induces caution; the market may not be able to withstand much selling pressure here, and is quite susceptible to a nasty retrenchment barring quick improvement.

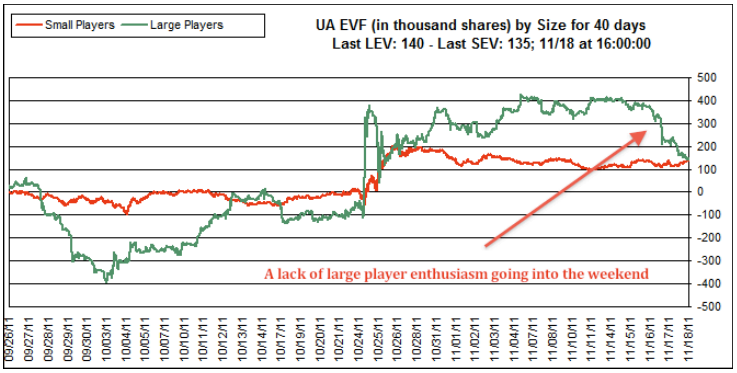
Highlights:

Noteworthy was the action in precious metals and their related equities. Such action causes me to speculate that cash is subtly being raised, which is more important than immediate inflationary concerns at the moment.

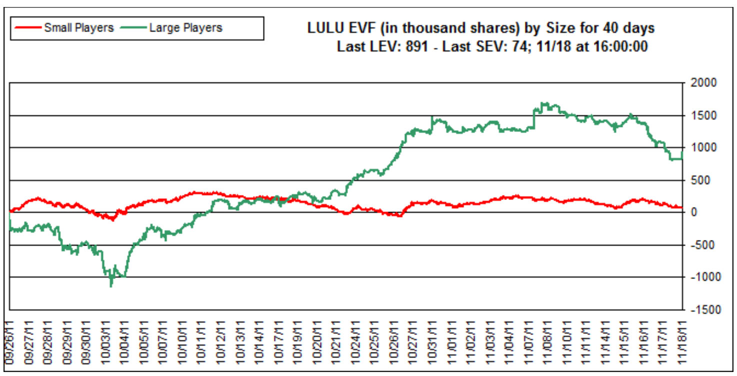


UA and LULU:

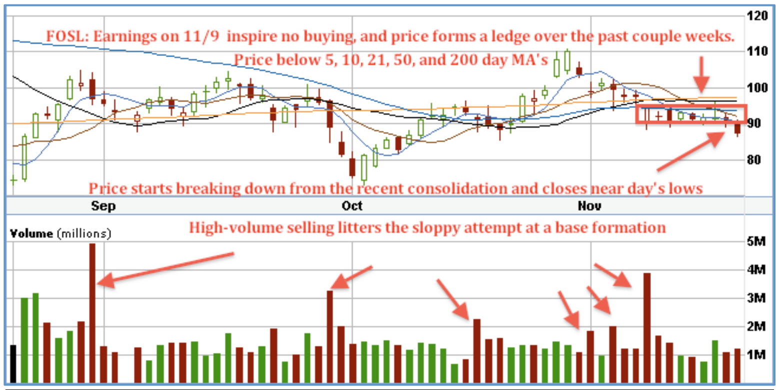
UA, a leader that made new highs at the end of October, starts showing some cracks.

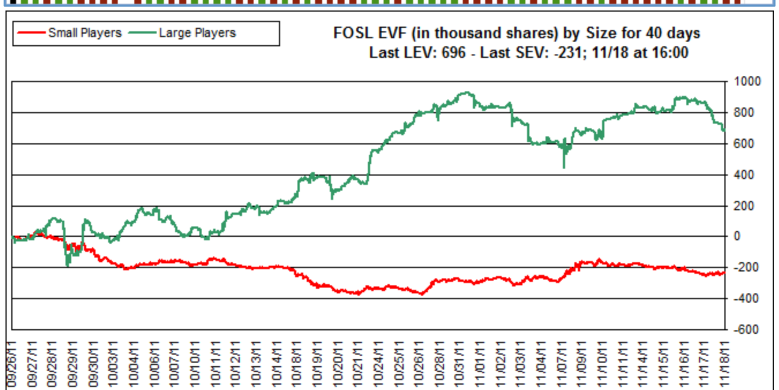


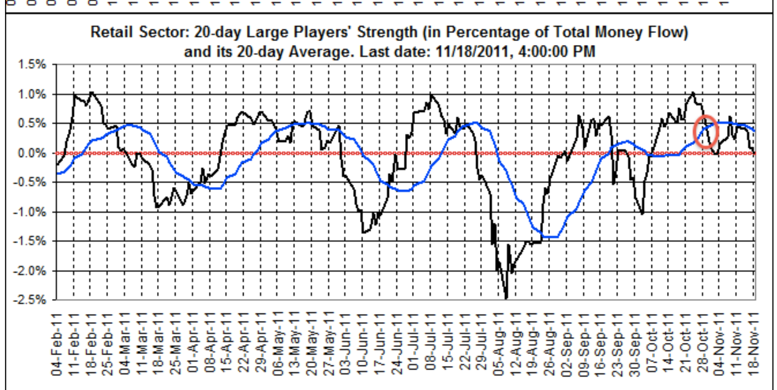
Meanwhile, LULU looks like it is rolling over, casually giving up the 50 and 200 day moving averages.

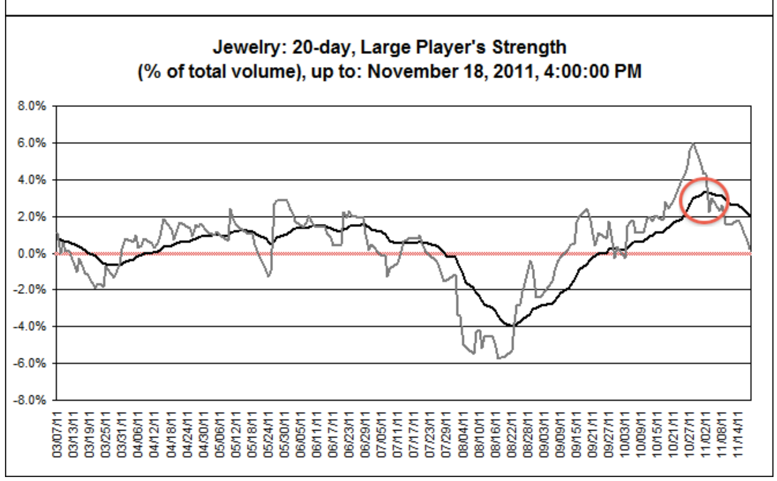


Short Setup – FOSL:









FOSL Stage Structure:

- Current Daily Stage is 3-2 (Mid Distribution) Has been in current stage for 2 day(s)
- Current Weekly Stage is 3-2 (Mid Distribution) Has been in the current weekly stage for 7 week(s)

A day before the confirmed 20-Day MF short signal, FOSL had a large volume reversal, opening at the confluence of the 50 and 200 day moving averages and selling down throughout the day, closing slightly in the green. The confirmation of market, sector, and industry group short signals offers bearish implications. Additionally, FOSL remains one of the few “old leaders” that hasn’t blown out in a spectacular fashion – I consider FOSL extremely vulnerable to any market weakness. And the slow dropping out of the price ledge on Friday, despite the muted action of the indexes, is confirming the short bias. Daily and weekly stage structures are neutral at best, yet other inputs suggest a bearish resolution.

Other Notes:

On Wednesday, other recent leaders showed high-volume selling and/or reversals late in the day. The swift pullback was fast and furious. TSCO, for example, reversed course late Wednesday and closed near day’s lows on significant volume. EGO, which was forming a consolidation pattern above the 50 and 200 day moving averages, simply fell out bed. Both are in Friday’s *Worst Thrust* filter.

Simultaneously, energy and tech stocks were appearing in the *Positive Divergence with AB* filter. The performance in certain large cap tech issues is something I still find notable. INTU RAX SNDK and TXN were seeing some buying in the face of weakness. SGY OXY and WLL represented the energy sector. In other words, monitoring how certain sectors and stocks perform in the event of a market sell-off will be insightful. Stocks like FIO FTNT SWI and NUAN are worth monitoring, too. Their recent strength may indicate underlying demand, which is being suppressed by lackadaisical action in the broader market.

Conclusions:

I am under the impression that transitional periods, like the one we are in, can be some of the most tricky and difficult to navigate. One may simply say that we are following the normal script of a topping bear market rally that emerged from extremely negative sentiment readings in early October. At the same time, one might say we are pulling back before entering a seasonally strong period for the market, supported by various indications of higher prices based on certain historical precedents. All this is against a backdrop of blatant intervention, which leaves price vulnerable to the push and pull of HFT’s and algorithms as liquidity levels ebb and flow. Remaining flexible, and recognizing the extraordinary circumstances that characterize the market landscape are probably the most important things to do.

I remain very concerned that liquidity can evaporate instantly. The action on Wednesday highlighted what might be described as a “miniature air pocket” in price. For me, that action seemed rather ominous, an early warning sign, perhaps. After all is said and done, one can cleanly write the narrative of events that lead from point a to b; however, piecing together the market’s puzzle in real-time will always be a challenging task.

I don’t know where we go from here. What is known is that the 20-Day MF is on a short signal. The stage structure has evolved into more bearish settings. Leadership contracted instead of expanded. And based on Aly’s CSI report, sentiment is at best neutral in the context of a cyclical bull market and extremely bullish in the context of a cyclical bear market trend. Given that the Q’s, IWM, SPY, and DIA trade below their respective 200-day moving averages, which coincide with deteriorating leadership evidenced in Jerry’s Index, one may view the bullish side with more skepticism.

Best Always, Eric.