Rohr Report

TrendView

BRIEF UPDATE: FIXED INCOME/EQUITIES/FOREX/ENERGY

Friday, September 24, 2010 (09:30 CDT; 10:30 EDT; 14:30 GMT)

Key Views

▪ **Equities "Showdown at the Head and Shoulders Corral": Critical Decision Very Soon.** However the overall equities trend should turn out, we can't fault the market technical structure for being nebulous at present. What is occurring is very unique, and a bit challenging to discern for all but those experienced technicians with an 'inferential deduction' aptitude (more below.) The resolution of the battle between the unusual "Siamese Twin" countervailing patterns of the exact same type in the S&P 500 will determine the next major move in equities after almost a year of broadly sideways activity. And that will most likely be a major influence on the trends of all the other asset classes; even if the form and timing of that influence is a bit convoluted, as we noted in yesterday's *TrendView* **BRIEF UPDATE (http://bit.ly/aXIA9v)**. And a quick review of the most salient points from that analysis is warranted as a preface to the equities technical decision discussion that will impact the other asset classes.

And among the key factors is the economic data influence from a German IFO that was a bit better than expected this morning. That has equities recovering from the low end of the key **December S&P 500 future** 1,126-21 range (more on that below), and was especially important in the wake of last week's weaker than expected German and Euro-zone ZEW. Yet it also puts real emphasis on the 'extended' market response today to US Durable Goods and New Home Sales (both AUG) as the last economic influences of the week. The latter's drags will be telling as a *coda* to yesterday's somewhat better-than-expected Existing Home Sales figures.

▪ **And as to the various asset classes response mostly to what we have seen from the Fed and Bank of England, some seem a bit confused by the Gold and government bonds pushing up together. Yet, that is a matter of anticipation across different time frames.** Significant return to bond strength is a response to the greater potential for weakness into early next year, while Gold is undoubtedly focused on the specific commitment the Fed seems to have made to actually creating inflation. It is important to consider this as a very specific additional potential beyond the sheer expansion of its balance sheet through the purchase government bonds (if it sticks with previous methods of quantitative easing.) Needless to say, that is a real role change for an otherwise classical Guardian at the Anti-Inflationary Gate.

Similarly, the **Crude Oil** dropping along with the **US Dollar Index** is another anomaly that a lot of folks are having trouble fathoming. Here again, that is perfectly natural with equities heading up on the potential for further extensive Fed liquidity expansion to counter stubborn economic weakness, rather than discussing the withdrawal of liquidity due to what should already be a firm recovery, but isn't. Under the current scenario, it is neither a surprise that the energy market should drop, nor the US dollar should fear significant expansion of the Fed's balance sheet from massive levels. Of course, the other factor is that the drop in energy prices denominated in US dollars was much worse than it appeared by occurring in conjunction with US dollar weakness. Now there's a sign of near-term economic stagnancy if we've ever seen one.

Concise Trend Perspective

▪ ***General Comment*: And if equities should weaken badly at some point (as failures of December S&P 500 future back below 1,126-21 and 1,105 would indicate), it is thoroughly possible that the US dollar will develop a 'haven' bid once again as well.** A bit of that is already in the air on the US Dollar Index holding key support at .7950, which was missed when it held right near .8000 back in early August. Of course, it would need to also recover at least back above the .8050 area to really stabilize once again. This will also be the case for similar tendencies of strong sister **December T-note** pushing above both its own high in the 126-00 area and lead contract high (from the September contract) at 126-28. And so on for the other asset classes dependent on the implications for them from a weakening economic picture.

▪ ***Equities*: And on that theme, it has definitely been the case the market is still killing all the players on both sides prior to proceeding with the real trend. The current punishment of the bears has carried on (even if just temporarily) above 1,121-27 in the wake of the December S&P 500 future holding up no worse than 1,110-15 (as we suspected it might.)** Lead contract September expiring last week reinforces importance of 1,110-15, and the issue of whether the December contract will need to finish back below its own 1,105 Close from two weeks ago to completely shut off last week's Monday's gap higher opening. Lower interim support remains 1,090-84 and 1,066-64, with major critical supports still 1,055 and 1,040-32.

▪ ***Govvies*: The general holding action into support of the heavily discounted December contracts was impressive. And not just because of equities strength, but also obvious in the face of massive amounts of government debt auctioned in the past couple of weeks.** Suffice to say **December Bund** reached its major UP Break at 129.50, and held without slipping below its Tolerance in the 129.00-128.80 area. While it is back above somewhat significant next higher resistance at 130.50, there is some heavy congestion into the upper 131.00 area that likely restrains the market unless and until equities actually fail. That said, on expiration rollover psychology it pays to keep in mind that the September contract expired at 133.44 after trading as high as the 134.77 level just prior to expiration. Unless the December contract breaks the 129.50-128.80 range sometime soon, we can expect it to classically revisit lead contract levels. **December Gilt** being the second best technical picture after T-note has also rebounded nicely from its Fibonacci and congestion support in the 122.00 area. There as well it has somewhat more challenging resistance into the upper 124.00 area, even if the 123.00-122.0 area is now reinforced as support by recent congestion and gaps. Keep an eye on the equities.

▪ ***Foreign Exchange*: The Japanese government shocker was not so shocking after all in light of their continued weak economic numbers. Deliciously perverse, isn't it, that the weaker the numbers out of Japan, the stronger the yen should get on an overall global "risk-off" mentality?** This only reinforces the degree to which we believe that there is no incentive for inward investment into Japan. As such, the strength of the currency is therefore nothing more than massive risk aversion on the part of Mrs. Watanabe, who wants her savings bank at home as she senses the hoped-for global recovery is less than likely.

With commodity currencies thriving, euro fragile, yen still stubbornly strong (no sign of a trend reversal), and US dollar Breaking DOWN temporarily (below .8190-50 on US Dollar Index) but essentially still waiting for a more convincing sign of whether any equities weakness might still restore its 'haven' bid from the .7950 area, things are still critical as well rather than decisive. Especially note that whether the Australian dollar can maintain the push above previous multiple AUD/**USD** .9350-.9407 tops will be critical, with near-term resistance in the .9650 area for this leading Asia-centric commodity currency. Closer to home, it will be important for the general foreign-exchange psychology whether **EUR/USD** can sustain a push ruin its 1.3450-1.3550 congestion resistance, which may signal ability to extend to the 1.3900-1.4000 area.

Concise Trend Perspective: (continued)

▪ ***Crude Oil*: Given strength of commodity currencies and general sense of economic well-being the recovery in equities should have provided, it is kind of surprising that this normal bellwether of economic activity remains so weak. It is looking more so than ever like the 'tell' that the real economy is still not as friendly as bulls would like to believe.** The failures since the push above the lead contract and **October Crude Oil** 80.00 resistance on equities strength into early August has seen this market fail back below not only that level, but leave a 77.50-78.00 area gap lower, at which it failed on the recent recovery. Recent churning by the November contract (which became lead contract at a two dollar premium to the October contract) back in the 75.00-74.00 support range is a weak sign given the sustained bid of the equities above the June-August trading highs. Lower supports remain 72.50-71.90 and 70.50-70.00, and especially the reinstated (after the mid-may plop to 64.24) 69.50 and 68.50 lows.

▪ ***Gold*: Still a truly schizophrenic market, as one might suspect the talk of weakness on the part of the Fed and Bank of England would cause it to soften, along with the relatively firm bid in equities removing any panic dimension. Yet its strength is a very interesting sign of just how much markets believe that a lack of capacity for major fiscal stimulus by constrained governments will ultimately bring massive central bank action if the global economy weakens to the degree anticipation of renewed US weakness would suggest.** As the market extended its rally beyond previous intermediate-term resistance at 1,250-65 previous highs, it was no surprise that it was quickly able to achieve a test of the resistance (needing to be based on oscillators and topping lines at new all-time highs) at 1,300. While the next reason is clearly close by in the 1,320 area, much above that the next oscillator threshold and significant topping line is not until the 1,380-1,400 area. If the market should dip prior to extending through the 1,320 area, the next lower support is obviously 1,265-50. While that is very likely to hold any initial retest, interim lower supports are in the 1,238-35 area and most definitely at the old 1,221 November 2009 high.

All other fundamental background and technical trend projections remain consistent with last Friday's *TrendView* GENERAL UPDATE (http://bit.ly/9OOWaV), and we refer you back to that for any further insights on those two fronts.

TECHVIEW: The S&P 500 Siamese Twins

▪ **We have made repeated reference to conflicting patterns that create opposing trend influences which must be resolved on many occasions in all markets. And for the most part clients asked us to stop sending chart pictures over a decade ago because they had become technically adept to the point of being more interested in our trend psychology.** However, in this instance the nature of the technical forces is not simply two separate patterns or indicators creating a battle between bullish and bearish influences at two different levels. Almost incredibly, this battle is linked to the intertwined concurrent opposing major technical patterns in the **S&P 500 future** (both December contract and the weekly continuation chart) in the 1,126-21 area. We always appreciate (and have used to good effect on behalf of our clients) those phases when technical indications evolve in a way that allows us to view the failure of one pattern or specific technical as a sign we can be more confident that an opposing pattern will dominate the trend. This is because price trend evolution tends to occur through a constant state of Dynamic Disequilibrium. While there may be confusing crosscurrents at times, instead of remaining stuck like the proverbial deer in the headlights markets tend to resolve that by dynamically picking a direction. For more on that and 'inferential deduction' aptitude mentioned above as it applies to assessing countervailing trend influences, we once again refer you back to our ***Sherlock Holmes and Dynamic Disequilibrium*** article **(http://bit.ly/FeNkQ.)**

TECHVIEW: The S&P 500 Siamese Twins (continued)

▪ But beyond that, it is important to dissect the current major technical pattern set up in the S&P 500 future from both the daily chart pattern evolution (December contract) and the broader weekly overview to achieve the best chance of putting the current trend dynamic into the proper perspective. While we have noted this is a bit convoluted, it is also well worth understanding just how intrinsically entwined the bullish and bearish psychology have become right now. To sum it up before the extended technical discussions, this is a struggle to decide whether the major H&S Top (H&S-A on page 5) survives one of the most aggressive tests ever seen, or the bullish Inverse H&S Bottom (H&S-B) will succeed in putting the market back on a bullish track. Part of the dilemma for the bulls is that latter pattern is highly suspect for reasons we will discuss below. That said, after almost a year of sideways activity we are now likely to get the decision on whether the "1,350 bulls" or "850 bears" have it right.

And for those who are not clear on the implications of one pattern failing leaving the opposing indication far more likely to succeed, it would especially add downside emphasis to any failure if the H&S-B were to fail, as that would be an indication the S&P 500 low near 1,000 in early July was not the low of the move that completed the bear trend. Rather, if that basing pattern fails it is not likely there will be only a minor new low, as the low of a 4-month basing pattern being Negated would be a potent sign that more major slippage below the 1,000 area will be likely.

Our precedent for that was another premature US equity market bottom back in 2008. The DJIA Double Bottom that formed around the 11,650 area between January and March of that year was also very suspect for the same reasons as H&S-B on the chart below. It was too much of a bottom after too modest a selloff, and projected a higher target that was unrealistic in light of the likely fundamental influences. It was the case back then that failure back below the 12,765 UP Break (i.e. violation of its 12,500 Tolerance) led to the expected failure to new lows by a very significant margin. For further insight on that you can refer back to our report that was issued in early June shortly after that failure back below 12,500 (**http://bit.ly/g9lP**.)

Which is important because we currently see the same sort of dynamic in a more intense form, due to the current patterns of the S&P 500 being so significantly intertwined (as opposed to the countervailing minor Double Top facing off against the DJIA Double Bottom in spring of 2008.) Just a brief review of the labels in the charts below is likely essential at this time. 'LS' is the designation of the Left Shoulder of each pattern, and 'RS' is used for Right Shoulder of each. Obviously the Head and Neckline of each are clearly labeled, with the latter projection across the intervening lows (for the HS-A Top) or highs (for the HS-B Bottom) being the key to where the breakouts from each have been attempted. One other note: the difference between slightly higher breakout levels noted on the weekly continuation chart (Chart 2), which are due to the modest discount to the lead contract (basis for the weekly continuation chart) and the second contract months. Ergo, both the DOWN Break back at the end of June and the UP Break this week are at approximately a five dollar premium on the weekly chart to the daily chart levels.

As to the actual face-off between the patterns, the convoluted part is that the selloff into the low between the Head and Right Shoulder of the H&S-A Top in late May and early June was also the beginning of the formation of the H&S-B Bottom (even though it could not yet be apparent at the time.) As such, while H&S-A Top continued to evolve by forming a Right Shoulder (RS-A) and dropping below its Neckline to leave a DOWN Break, the quick recovery back above that 1,040-32 DOWN Break also led to stabilization and formation of the H&S-B Bottom. It is most important now whether the current rally will sustain extended activity above June and August highs, and ultimately higher resistances in 1,150 and 1,165 areas. That would tend to Negate the credibility of the H&S-A Top. Or, does an H&S-B failure back below 1,126-21 area signal a failure of the four-month bottom that could foreshadow a major failure below the 1,000 area?

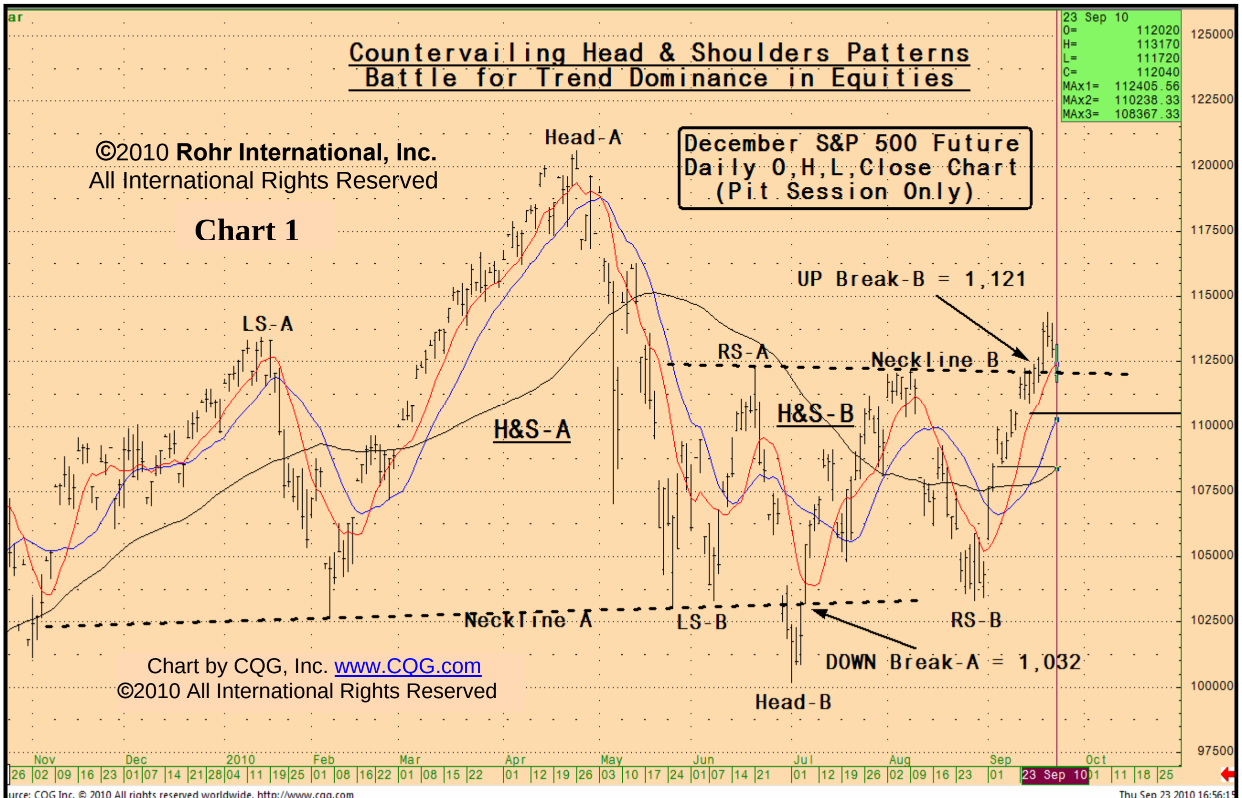
Countervailing Head & Shoulders Patterns
Battle for Trend Dominance in Equities
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Chart 1
December S&P 500 Future
Daily O,H,L,Close Chart
(Pit Session Only)
Head-A
LS-A
H&S-A
RS-A
Neckline B
H&S-B
UP Break-B = 1,121
Neckline A
LS-B
RS-B
DOWN Break-A = 1,032
Head-B
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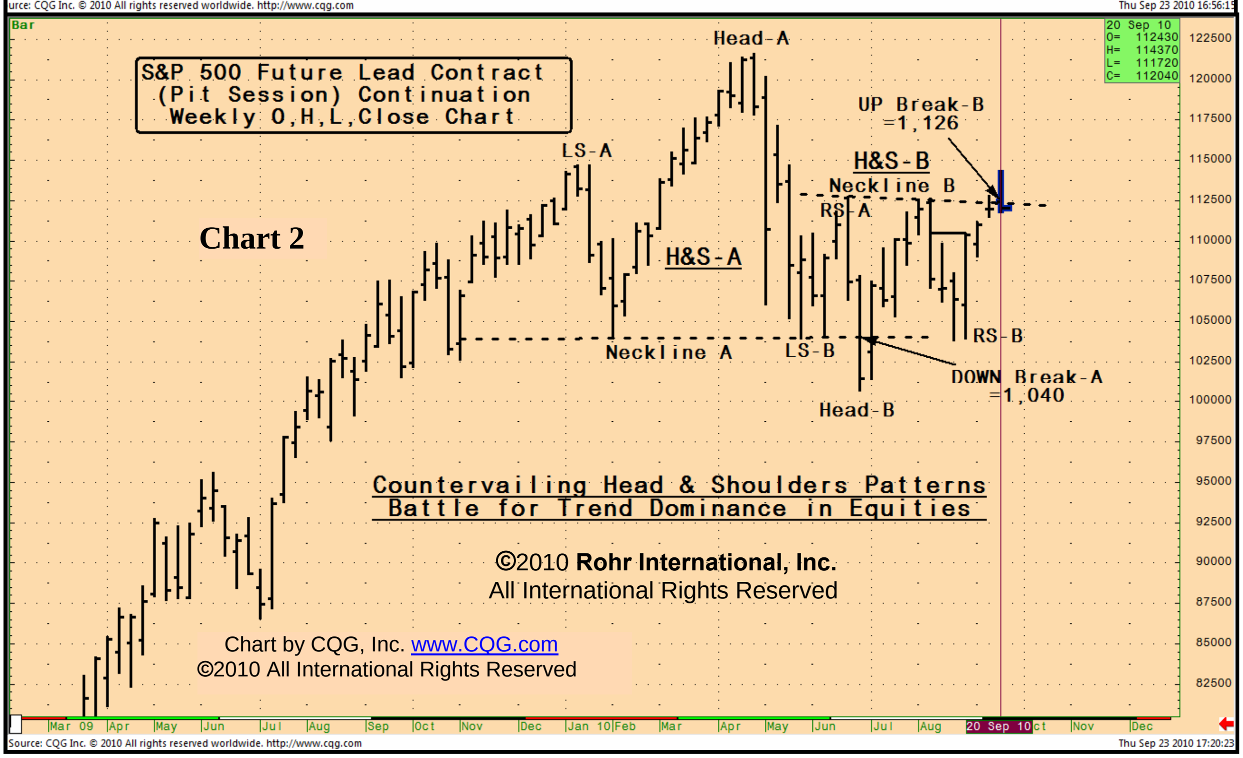
S&P 500 Future Lead Contract
(Pit Session) Continuation
Weekly O,H,L,Close Chart
Chart 2
Head-A
LS-A
H&S-A
UP Break-B
=1,126
H&S-B
Neckline B
RS-A
Neckline A
LS-B
RS-B
DOWN Break-A
=1,040
Head-B
Countervailing Head & Shoulders Patterns
Battle for Trend Dominance in Equities
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TECHVIEW: The S&P 500 Siamese Twins (continued)

For anyone who still does not find that clear, it can be restated simply in these terms: a Head & Shoulders Top (H&S-A) formed in the S&P 500 between last November and June of this year, and exhibited a DOWN Break in approximately the 1,040-32 range at the end of June into July. While it was still in progress from mid-May onward, another distinct countervailing pattern of the same genre formed (even if indeed intertwined with the previous pattern in progress.) That was Head & Shoulders Bottom (H&S-B) formed from mid-May right into the present, which exhibited an UP Break just this week above the 1,121-26 area. If that Head & Shoulders Bottom (H&S-B) UP Break is maintained across time, it will be a major indication we have seen the lows prior to a return to a sustained bullish momentum; or if Negated, it will be that much more telling a sign that extensive further weakness below 1,000 is likely.

That is why the gaps and other significant support below the market in the 1,110-05 area and especially extended support back in the 1,090-84 area are such critical interim support levels. While the full classical Tolerance of the Head & Shoulders Bottom is back at the low of its Right Shoulder (RS-B) in the 1,040-32 area, in practice the 'working' Tolerance of such a deep pattern is also very important. And in this case any significant slippage back below the 1,121-26 UP Break too soon after it occurs would tend to confirm that this very critical UP signal is aborting well ahead of any failure back below 1,040-32.

The key here is that the two patterns are intertwined in a way that leaves one level intrinsic to each of the patterns success or failure. As noted above, even though there was a countervailing DJIA minor Double Top that created a very symmetrical sort of opposing psychological influence to the far more significant (albeit still very suspect) early 2008 DJIA Double Bottom, those were separate from each other even though they both were critical in the mid-12,000 area. In this case, the success or failure of the overall trend in either direction is ingrained in the **December S&P 500 future** 1,126-21 area (and a reasonable Tolerance either side of it.) It is occurring in a way that is most unusual, yet likely extremely critical in the near term for the overall trend of the equities markets. And as noted previous, the influence of that decision regarding the next major sustained trend likely extends far beyond equities.

We hope you find this helpful.

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