Rohr Report

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Overview

After the recovery of the fixed income late last week it is now true of all markets that there is good news and bad news. The good news is that we know what kind of markets we are in. The bad news is also that we know the kind of markets with which we are dealing, and that they are substantially erratic trading range affairs.

After the foreign exchange predictably lapsed into more of a trading reaction after extended US dollar weakness ended into mid-May, and the equities went into a somewhat significant consolidation after their significant trend high was hit around the same time, the fixed income was the last potentially strongly trending market. And the US and European short money forwards have indeed sunk below their spring lows in response to reinvigorated aggressive central bank inflation vigilance.

However, even though the long ends were able to revisit the area of the mid-May lows, the internal technical tone has been improving. Last week's late week recovery in the wake of the third successive weak US Employment report was enough to tip the balance in favor of the markets entering what are likely extended basing attempts. Which is not to say that they are bullish.

Rather they are now moreso likely to complete those extended bottoms, and only once they fail to sustain UP breaks are they going to become more aggressively bearish and complete the second phase of the bear market (which began in earnest with the failure of previous upside leader Bund from its last major upside reaction highs in mid-January.) That said, the scope of the patterns in which they are now likely stuck creates the potential to remain range bound until at least late August, and possibly beyond. This is a classical phase for extended fixed income bears, and we provide quite a bit more background on this tendency below.

This potential for choppy trading range activity is reinforced by the lack of critical US economic reports as we are into the first half of the typical US mid-month reporting vacuum. While somewhat significant influences begin again later this week with Friday's Retail Sales, Import Price Index and Michigan Sentiment, the really major influences only begin with next week's US inflation numbers and FOMC meeting minutes, and intensify into the following week's Beige Book and first look at Q2 GDP. As such, with the seemingly softening US labor market situation as a backdrop, the markets will have plenty of reason to ignore quite a bit of the near term economic release impact, and focus on the potential slowdown in the US.

Of course, this also has the ability to affect the other markets as well. There was a time not so long ago that the sort of overshoot witnessed in the past couple of days on French and Italian Industrial Production (both MAY), as well as the German Wholesale Price Index and UK BRC Retail Sales Monitor (both JUN) would have sent the Bund and Gilt into a spin. However, under the influence of the US long end they are both stabilized above the higher of their split lower supports at the even money and lower half areas. While short money forwards will likely continue to lag in the face of continued hawkish pronouncements from central banks, they will also psychologically stabilize in the wake of any sustained (if choppy and measured) long end improvement. As such, the real question for the near term extent of any recovery is moreso the degree to which the September **T-note** can Close above its congestion and gap resistance in the 105-08/-11 range on the way to 106-00 area prior to falling too far back below the low end of the 104-20/-16 congestion once again.

Near term trend support in the equities remains pegged to the **DJIA** 11,000 psychological support, which also happens to be near term technical support for the next couple of days. While this would seem to be obvious, in fact to this point 11,000 has not been very prominent technically, and as soon as the trend indication advance from that level late this week that will be the case once again. The more major resistance and support remain at 11,300 and the 10,900-10,870 areas, respectively.

Foreign exchange remains the choppy erratic consolidating markets that we had previous noted is both good news and bad news: both are the fact that we know what kind of market this is likely to remain for the foreseeable future. This is especially so now that we are into the summer holiday season as well. Having punished the US dollar bears two weeks ago, it was time terrorize the US dollar bulls. Yet, even though **EUR/USD** is back above the major recent congestion in the 1.2700 area (with a Tolerance to 1.2660), in spite of the influence of last Friday weak US jobs report it failed to Close above the 1.2820 Tolerance of the previous 1.2780 DOWN Break (from its overall up channel support from the 1.1827 late February low.) While the full Tolerance of that resistance is as high as the 1.2920-30 area recent daily and weekly DOWN CPR's from the mid-May through mid-June topping action, the failure to Close strong enough on Friday left the US dollar buoyant once again.

The energy markets are fully reinvigorated, with the **Crude Oil** variously on UP Breaks from a weekly Bull Triangle at 72.40 and daily Flag at 72.00. Only back below the lower of these is it failing near term support. While the market stalled at the obvious congestion resistance at the previous high in the 75.00 area, much above that the market could get explosive on a violation of weekly oscillator resistance.

Reports & Events

As noted above we are into the first half of the typical US post Employment report mid-month reporting vacuum. While some significant influences begin again late this week, there is really a bit of an extended hiatus from trend decisive influences as the critical nature of the influences actually builds across the next several weeks, especially as the markets anticipate the release of the Beige Book in preparation for the August 8th FOMC meeting, and the first look at Q2 GDP. As such, while we will still review which reports we feel are the most prominent this week, in fact they are not likely to be very trend decisive in the wake of the potential softening of the US labor market as a sign that the Fed is moreso right than not to rely on their internal forecasts projecting a US economy weakening toward trend levels.

Speaking of central banks, other than this morning's broadly expected "no action" by the Bank of Canada, and Thursday's release of the ECB Monthly Bulletin, this week is notable once again for its lack of economically significant pronouncements from financial officials until Friday's BoJ Monetary Policy Announcement. While ECB President Trichet is speaking both today and tomorrow, his comments are respectively on the launch of new European short term paper trading, and general commentary on how the European economy relates to its citizens. Neither is likely very trend decisive.

The other interesting comments will be Thursday's speeches by Reserve Bank of Australia's Governor Stevens on monetary policy, and the Minneapolis Federal reserve President Gary Stern's comments on the US economic outlook. These are unusual from a market influence perspective, as the first occurs prior to the opening in Europe, and the latter commences after US fixed income markets are closed for the day. Another couple of likely less than market critical speeches by ECB governors on Friday finishes out the week.

Which is not to say there are not any interesting reports this week. While limited in number, there are some key releases, and we will stick to reviewing those instead of listing all of the reports for the week. Tomorrow brings the UK Employment report (MAY), including the important Average Earnings component, and Euro-zone GDP and associated economic indications. The only US release of any significance is the Trade Balance (MAY) that is typically more critical for the foreign exchange than either the fixed income or equities.

Thursday sees the Australian Employment report (JUN) about the same time as Governor Stevens speaks, and release of Japanese Industrial Production and Capacity Utilization (MAY) to round out the Far Eastern news. This is followed by German and French CPI (both JUN) prior to the ECB Monthly Bulletin (JUL), and the UK Leading Indicator Index (MAY) late afternoon (European time.) As noted previous, Friday brings not only the BoJ Monetary Policy Announcement and Italian CPI (JUN), but also the return to somewhat critical US data in the form of Retail Sales and the Import Price Index (both JUN), and Michigan Sentiment (JUL preliminary.)

Markets

LONG DATED FIXED INCOME

While we remain bearish overall on fixed income, the **T-note** recovery back above the congestion in the 104-20/-16 range turns it back into support once again, likely for the intermediate term future. As such, an upside reaction to 105-00/-08 resistance (with a Tolerance to the top of the gap to the June 15th Close at 105-11) is likely to ensue. Any Close above that will lead to a test of the more formidable resistance back in the 106-00 area. After quite a bit of disparity of late, the T-note support correlates very well to the September **Bund** split supports at the 115.00 and (more major) 114.50 areas. Higher resistances in the Bund are in the 115.50 and the 116.00 areas. Yet, a T-note recovery to the 106-00 area might also encourage the Bund to test higher resistance as high as the mid-upper 116.00 area to mostly complete a daily Double Bottom (even it that fails to reverse the overall down trend.) While the September **Gilt** was seemingly more critical against its 108.50 continuation support, it has now also recovered back above the higher resistance in the 109.00-.20 (which is now support once again.) Any Close above that encourages not only a retest of the immediate next higher resistance in the 109.60-.80 range, but also completion of its own potential daily Double Bottom pattern to the mid 110.00 area.

SHORT MONEY

After the failure from no better than key resistance (in spite of the previous rally in the long end) that managed to stop December contract **Eurodollar** at 94.61, the subsequent sharp selloff turned into a complete rout. It dropped straight through the next interim support at 94.52 (now resistance), and even directly below more major support in the 94.40-.35 area (now resistance.) While below that the next support was not until the 94.20-.15 area last seen in August 2002, the weakness of last Friday's US Employment report encouraged recovery from a minor new low at 94.28. What is most interesting now is that the recovery two week's ago actually turned daily MACD UP, and this is now reinforced by last week's recovery from the midweek pressure. As such, while resistance at the top of the 94.35-.40 area remains, the broader trend resistance is back up into the 94.50 area.

While the **Euribor** managed to recover previous back above its own interim resistance at 96.51, it stalled yet again at next resistance around the recent 96.63 high. The previous long end pressure finally dropped it back below that support again as well. It is very interesting that the European short money completed the same sort unconvincing H&S Bottom from which the US T-note failed in early-mid June. While the same sort of daily MACD DOWNturn also afflicts the December Euribor, it was previous also more convoluted due to daily Area Gap and congestion below the late April 96.41 low (from which it failed on the latest very weak bounce) that extends to the 96.365 level which was finally knocked out last week. Yet, just as with the Bund, if the US and UK markets remain buoyant, it will be hard to pressure Europe too much further in the near term, even though next support is still ostensibly not until the 96.25-.20 area.

Short Sterling failure around the top of higher resistance that has slipped down to 95.06-.10 remains a problem. Yet, as the December contract did not Close significantly below the 94.94 support on the late June break (which might have fomented a break to the next congestion and daily oscillator support in the 94.80-.75 range), a move to higher resistance in the 95.20 area remains likely if the other fixed income remains well bid.

EQUITIES

We remain skeptical that the **DJIA** recovery can carry back above 11,300 area resistance in the near term now that it is finally reflecting a "bad news is (indeed) bad news" psychology after Friday's weak US Employment number. Yet, that does not necessarily make it a bear market. As noted previous, history has demonstrated many times, equity bull markets have very long tails, and can defy higher interest rates for quite some time. This is especially so in this cycle, as the key US market still expects very strong corporate earnings into later this month. Especially with the long dated fixed income diminishing potential to fail its important intermediate term supports (see above), there is a question as to whether any further disappointing news will be enough to create a capitulation in the equities which includes the DJIA melting down below 10,870 support for a decisively bearish weekly Close.

In that regard, the equities are also a bit more interesting than the other markets, yet also quite problematic. They are still likely in a topping out process that will be strongly influenced in by whether the DJIA can indeed post a weekly Close back below the 10,900-870 support after the latest more sanguine FOMC decision and statement being reinforced by those weak US Employment numbers. If so, then the failure back into the major lower range will be complete (after dodging that bullet a month ago), with next significant supports into the 10,500-10,400 and 10,150-10,000 ranges. Resistance above the top of the 11,100-300 range remains in the upper 11,500 area.

If the DJIA, which had led the other international markets down, can continue to stabilize once again for continued interim rallies in the range, then all of the equity markets can continue to respect their own lower supports for now. In a clear indication of the importance of that area, even the September **S&P 500** (which had such a significant premium over the lead contract prior the June contract expiration) retested the daily congestion, Area Gap and oscillator indications at the 1,242 Tolerance of the 1,250 support two weeks ago, and is now significantly above that still critical support. If it should fail, next interim support is 1,225-20 congestion and daily oscillator support. Higher S&P 500 resistance remains in the 1,288-91 and 1,300 areas.

In a rightfully ironic twist of fate, the previous strong sister European suffered a bit more technically on the sharp selloff. The **FTSE** dodged the bullet by holding tenaciously at its 5,500 support (its major up channel support from the March 2003 low, with next support as early as the low 5,400 area.) Now it is back above previous 5,700 and 5,750 DOWN Breaks from its weekly up channels, as well the next resistance at the 5,802 high that was the Tolerance of those DOWN Breaks, there is quite a bit of underlying support. Above that it higher congestion in the low 5,900 area remains resistance, at which it failed last week.

On the other hand, the **DAX** more gradual up trend in 2005-2006 means that while it also left a 5,575 DOWN Break early last month (from its up channel from the August 2004 lows) that it also Negated on the recent rally (and is now support, reinforced by the daily Area Gap from the 5,581.67 June 29th daily Close.) Above there its higher DOWN Break and Tolerance are in the 5,745 and 5,790 levels, which remain resistance. Even if it fails badly back below 5,575, more major up channel support from the March 2003 low remains in the 5,100 area. Along the way there is interim support in the 5,200-5,150 range (congestion, Fibonacci and weekly and daily oscillator support.)

What is extremely interesting is that previously more buoyant **NIKKEI** had also capitulated below lower supports in 15,700-15,500 area, as well as the additional major critical level at 15,000. That had a Tolerance to 14,850 that is now an intermediate term up channel DOWN Break, which the market quickly Negated on the recovery. The market has once again been quite resilient, and is now back above the 15,000 area once again. Yet, even with the friendly US equities response to the FOMC decision, this market has stalled back into the 15,500-700 area again, likely waiting for Friday's BoJ decision prior to any further major trend decision.

FOREIGN EXCHANGE

The churning foreign exchange markets had done what was necessary to punish residual US dollar bears, and was ready to terrorize the US dollar bulls. These are just the whipsaws that are the key feature of near term trends. While there was modest, isolated previous weakness of the British pound and Australian dollar, **EUR/USD** holding 1.2500 was still the bellwether of the US dollar stalling at resistance, which included the .8700 area in the US Dollar Index.

Now EUR/USD is back above the recent congestion in the 1.2700 area (with a support Tolerance to the 1.2660 level), and challenging the 1.2780 DOWN Break (the overall up channel support from the 1.1827 late February low.) Yet, even in spite of Friday's new high, it was unable to Close above the modest near term Tolerance of that DOWN Break at 1.2820 last Friday, and is now back under pressure. As noted previous, the overall Tolerance extends to the 1.2920-30 area recent daily and weekly DOWN CPR's from the mid-May through mid-June topping action. If it continues to fail at no better than those lower levels, we

suspect it will find an excuse to swing back down at least to another retest of the 1.2500 area support, or even extended supports in the 1.2400 and 1.2300 areas. This is consistent with the US dollar trend elsewhere.

The more interesting activity was the serial weakness and return to strength of the Japanese yen, where **USD/JPY** has managed to ratchet back above the 113.50 resistance (now support with a Tolerance to the 113.00 area) which many of the US dollar bears were sure would not be breached again in the overall US dollar down trend. However, this is like the delayed version of the EUR/USD attempt to reinstate its H&S Top 1.1900 DOWN Break back in the early part of the year.

If that is the case, and the US dollar is going to strengthen further (as we suspected) prior to running the course of its upside reaction within the reinvigorated intermediate term (if not indeed the long term) down trend, then USD/JPY was also going to see further improvement. This meant either closing (which it has already accomplished), or ranging above the 116.58 weekly gap down (from the April 21st Close) from which it has so far failed on multiple tests two weeks ago. Higher resistances include heavy congestion in the 117.00 area, and every full point up from there, with special emphasis on the 118.00 weekly oscillator resistance. Lower supports below the mid 113.00 area are 112.50, 111.00 and 109.00.

The other currencies are conforming to the US dollar weakness within what likely remains an overall upward trend reaction set up by the EUR/USD and US Dollar Index reversals since the mid-May dollar low. The commensurate higher resistances and lower supports are:

USD Index: RESISTANCE: .8700; .8800; .8880 SUPPORT: .8550-30; .8450; .8400-.83.80

GBP/USD: RESISTANCE: 1.8550; 1.8750 SUPPORT: 1.8200; 1.81; 1.80-1.79; 1.77-1.76

USD/CHF: RES: 1.2500; 1.2650; 1.2900 SUPPORT: 1.2250; 1.2150; 1.2050-00

USD/CAD: RES: 1.1350; 1.1450; 1.1550 SUPPORT: 1.1250; 1.1100; 1.1000-1.0975

AUD/USD: RESISTANCE: .7550; .7650; .7750 SUPPORT: .7450; .7350; .7250; .7100

ENERGY

Energy markets have reverted to extensive strength. Both these markets and commodities and metals have been reinvigorated by the seeming vacillation of the Fed. While that has been reversed to some degree by the weak US Employment report, today's Iranian response will likely keep the geopolitical situation destabilized to a degree that will continue to underpin the Crude Oil if not the necessarily the products. Add hawkish views from the ECB after their "no action" last week, there is reason for energy markets to continue higher in the wake of a that consistently unsettled geopolitical situation.

Crude Oil is on UP Breaks from a weekly Bull Triangle at 72.40 and daily Flag at 72.00. Only back below the lower of these is it failing near term support. While the obvious resistance is the congestion at the previous high in the 75.00 area, much above that the market could get explosive on a violation of weekly oscillator resistance. Similarly, the **Unleaded Gasoline** had pushed out above the 215.00-220.00 key congestion and gap resistance prior to a late setback on Friday, and Wednesday's resumption of trading will be very interesting. The weekly oscillator still points to the 237.00 September high on sustained activity above 220.00.

Fixed Income Psychology

We still feel that the weakness of the US economic news might be a misleading sign for an FOMC that seems to have become short term data driven. It may all still end badly if the economic weakness proves only temporary as wage pressures are now building along with other deferred forms of inflation. This includes rents (a Core CPI component) increasing to reflect the extreme escalation of real estate asset values and the higher costs of heating and cooling, which landlords are compelled to pass along at rental contract renewal time.

However, as much as that continued pressure may turn up again later, there is a relatively strong psychology developing in the fixed income that after the third successive weak jobs creation component of the US Employment report that the Fed's internal forecasts of a slowing economy may be on target. If that is so, there is a corollary assumption that any near term wage pressure is a late phase phenomenon, which will correct as the jobs market weakens further in the second half.

Whether or not the economy actually slows as much as the Fed is inclined to believe, or the wage pressures that are the worst extension of the sustained inflation pressures (potentially turning into a demand-pull inflation psychology), the long ends of the fixed income market seems to want to give the Fed the benefit of the doubt for now. And that will allow the long ends to stabilize into the pattern bottoms noted above for the European long ends, and an extended Inverted Head & Shoulders Bottom for the US T-note. This is not the case for the T-bond, which left more of a Double Bottom (like the European instruments) after only retesting its mid-May lows in late June.

The basis for believing the long ends (and to some degree the short money forwards in their wake) are capable of this sort of sustained stabilization (yet not necessarily a fully successful reversal of the major down trend) is twofold. The first is the degree to which trend indications have quickly bottomed out in spite of the attempt at renewed pressure after last Wednesday's much stronger than expected Euro-zone Services PMI's. While the long ends fell back below their interim supports, none of them knocked out their low end major supports such as T-note 104-00/103-22, Bund 114.50 area, and Gilt 108.50 (which in fact it did not even challenge again in the wake of its own weaker than expected Services PMI last Wednesday.)

After weathering that pressure, the T-note and Gilt daily MACD turned definitively UP at the end of last week, and the Bund is currently following suit. As important is the weekly MACD for the T-note and Bund, which was mildly UP after the recovery into early June, and could have turned back DOWN on any bad failure at the end of last week (while the weaker Gilt remains technically DOWN, yet basing out at present.) Which is why we felt that the near term end of the aggressive fixed income bear trend which began with mid-May recovery from extended major support levels and seemed confirmed by the bullish reaction to the May US Employment Report (on June 2nd) is now complete; even if only for an extended holding action to attempt broader basing.

Allowing that the short money forwards did respond to more hawkish central bank language after mid-May, the recent activity there is also instructive. The Short Sterling has been on the mend for awhile, and even the December Eurodollar recovery two weeks ago saw the daily MACD to turn marginally UP. Of note, it did not turn back DOWN on last week's slippage to new lows, and is now solidly UP. Of course that still allows for slippage back to the 94.32-.30 range congestion if long ends break. Yet, it also sets the stage for more significant recovery

than in quite a while if the long ends rally to their highest resistances. The daily Runaway Gap at 94.45-.47 is backed up as trend resistance with congestion and channel projections up into the 94.55 area. Which would need to allow that the Fed may be done after a hike to 5.50% Fed Funds in August or September; not an inconceivable temporary assumption under best case circumstances that seem to be brewing if the long ends are building broader bases.

Yet, whether those bases amount to a bona fide trend reversal are going to be open to question, as there is also an historic reference for this extended pause still returning to a more aggressive bear trend in the long ends. In each of the significant intermediate term fixed income bear trends, there was a pause which in many cases was a poorly reinforced Inverted Head & Shoulders Bottom attempt that yielded to somewhat significant new lows once the pattern failed. Indeed, there were even previous examples of an initial H&S Bottom such as the one which formed between mid-April and early-June (failing in mid-June) becoming the precursor of a broader bottom formation. This is the case when the market is not ready to break significant lower support at new lows, such as just occurred on the T-note failure of the 104-20/-16 area holding the more major support into the 104-00 area.

A very similar pattern occurred back in 1994 with another April-June affair that was followed by an extended holding action (and subsequent failure in mid-September), and the 1999 initial pattern between June and late September, which was followed by a recovery from the more major 96-00 area support that left the market in limbo until the late December-January 2000 failure and extension to new lows. The 1987 bear and 1990 mini-bear also experienced variations on false H&S Bottoms as holding actions within their broader down trends.

The indication here, often the case, is that while the pattern may have significant deficiencies of either conformation or volume reinforcement, it will likely need to finish forming and fail prior to the market returning to strong trend activity. In this case that likely means not until around (or more likely after) the late summer bank holidays. And that is why the good news and bad news are identical: we know the sort of markets these are going to be in the interim.

We look forward to providing further comments as the situation warrants, and hope you have found these perspectives helpful.

-Rohr