

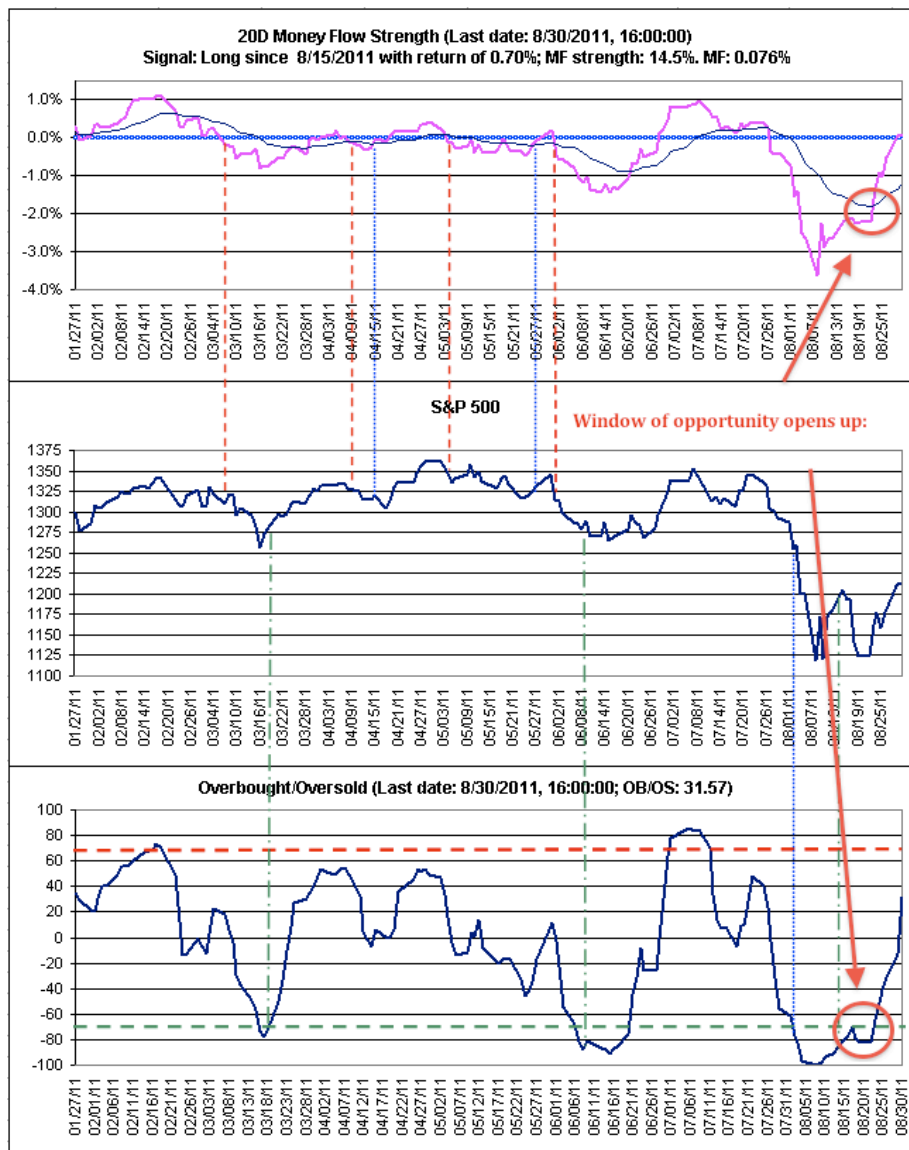
Market Observations: 09/01/2011

By Eric Coleman

Summary:

Actively tracking the 20-day MF, while paying attention to sector developments, is key to spotting windows of opportunity. The steep nature of the August sell-off meant that a bounce from oversold conditions was eventually going to happen. Indeed, Pascal warned of the failure-prone nature of the first rebound from new lows, yet the second bounce has produced various mean-reversion trading opportunities, for which we prepared.

The edge for entering new long positions is quickly diminishing: however, the price action may not resolve immediately to the downside, and caution is warranted against excessive bearish or bullish biases. Positive technical development in some issues suggests that any weakness or consolidation be monitored in order to properly evaluate the always-unfolding scenarios. Nonetheless, the damage over the past month is significant enough to suggest that the correction may encounter more choppy trade in the coming weeks. Volume should pick up post-Labor Day, which will be helpful in determining large player risk appetite.



The weekly stage structure confirms a corrective phase in the market. Indeed, a sustainable uptrend characterized by broad participation is unlikely to emerge from such a setting. Select sectors and industries may buck the overall trend, though. Overall, time to stabilize is needed.

SPY	Current Weekly Stage is 3-2 (Mid Distribution) Has been in the current weekly stage for 3 week(s)
QQQ	Current Weekly Stage is 3-2 (Mid Distribution) Has been in the current weekly stage for 3 week(s)
DIA	Current Weekly Stage is 3-2 (Mid Distribution) Has been in the current weekly stage for 2 week(s)
IWM	Current Weekly Stage is 3-2 (Mid Distribution) Has been in the current weekly stage for 3 week(s)

Daily stage structure is now "late downtrend." Consequently, the next pullback/selloff may not be as swift and large as the ones seen early in the month as many sellers are exhausted and late buyers are probably on the sidelines willing to offer some support. In other words, big money was made on the short side a few weeks ago and good profits have been made on the two bounces in the second half of last month – so a period of neutral trading and consolidation appears a plausible scenario in this participant’s view.

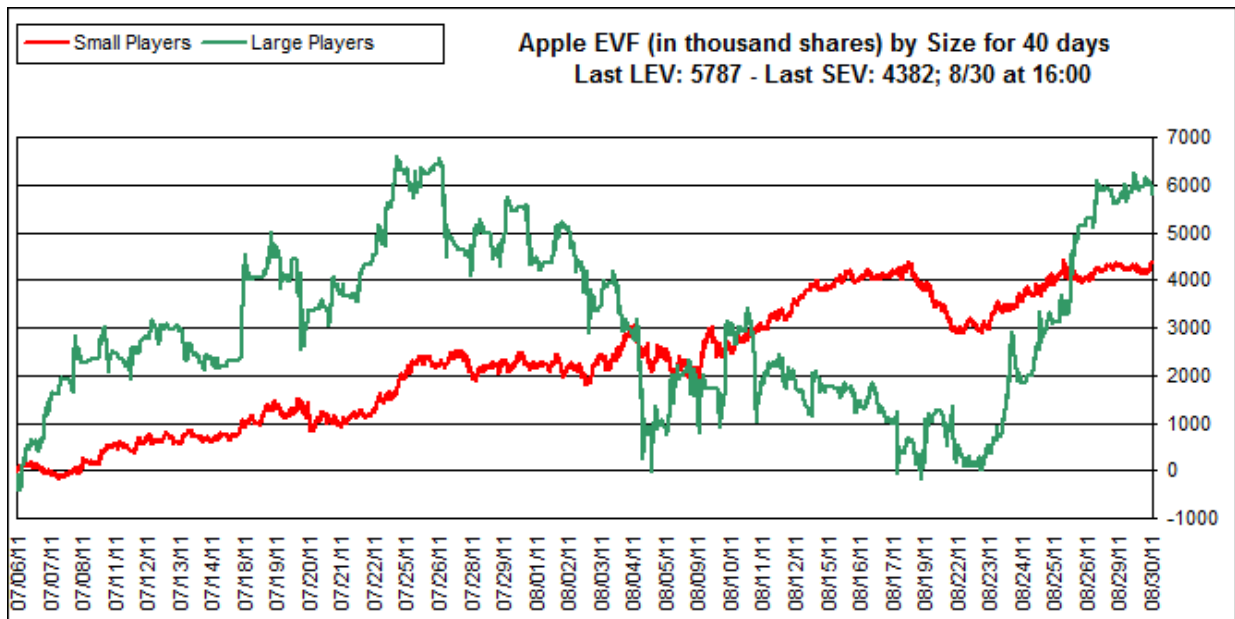
SPY	Current Stage is 4-3 (Weakening Decline) Has been in current stage for 2 day(s)
QQQ	Current Stage is 4-3 (Weakening Decline) Has been in current stage for 2 day(s)
DIA	Current Stage is 4-3 (Weakening Decline) Has been in current stage for 2 day(s)
IWM	Current Stage is 4-3 (Weakening Decline) Has been in current stage for 2 day(s)

Leading Issues:

We see a divergence in the performance of leading bull market stocks. Some remained leaders while others experienced technical damage. AAPL, BIDU, GMCR, HANS, FOSL, LULU, & NFLX are important tells on market sentiment. For example, compare AAPL and FOSL, which are shown below:



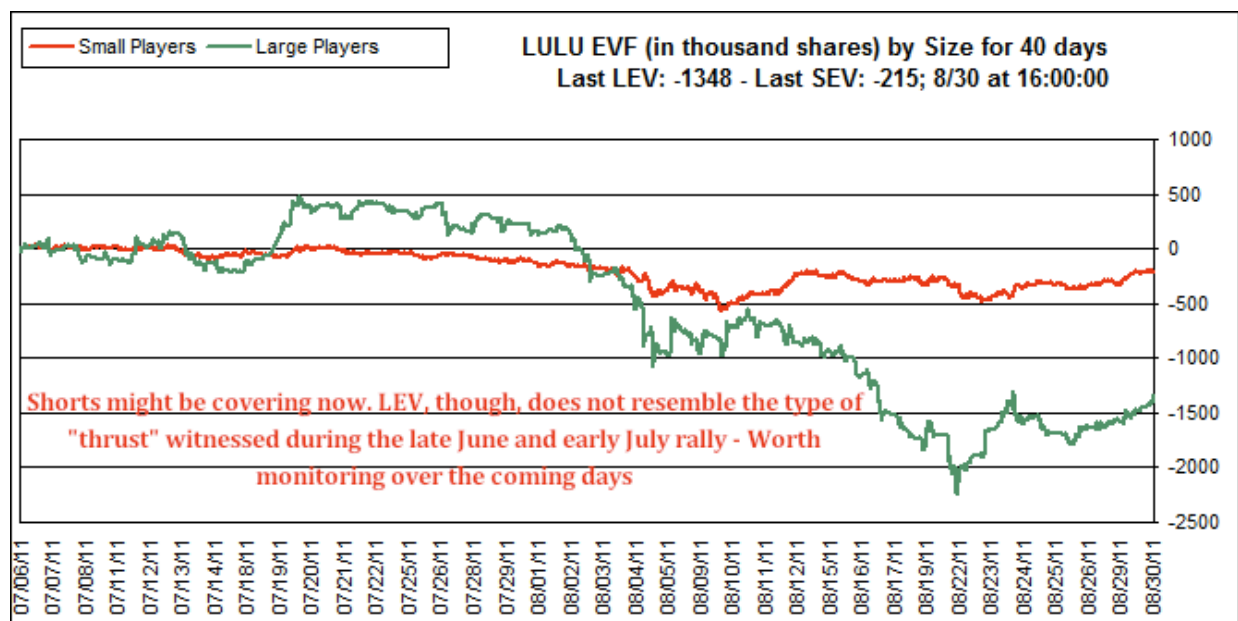
Large player's stepped up their buying in recent days, but overall volume is still tepid . . .



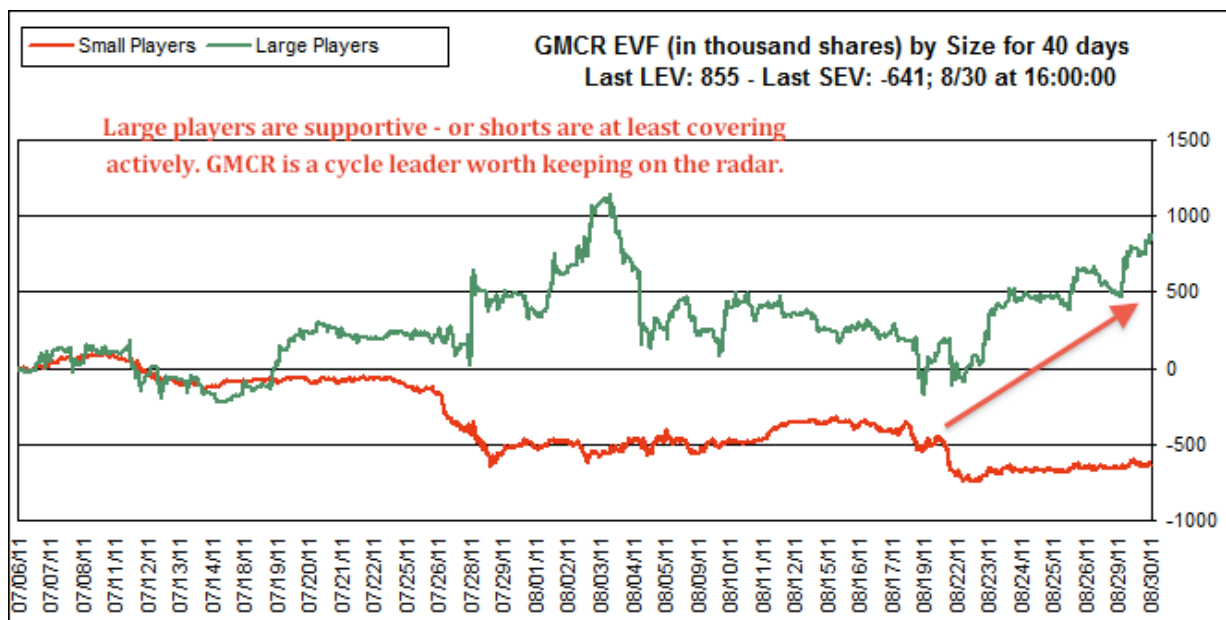
Compare the action in AAPL to that of former leader FOSL:



Next week will offer another clue regarding large player attitudes toward this cycle's growth stocks. LULU reports earnings on Friday, September 9th before market open. Recent action remains volatile, although some buyers showed up at the 200-day MA. Notice the wide moves over the recent months compared to the types of long and constructive bases that launched previous advances. A 5-year chart of LULU illustrates such points:



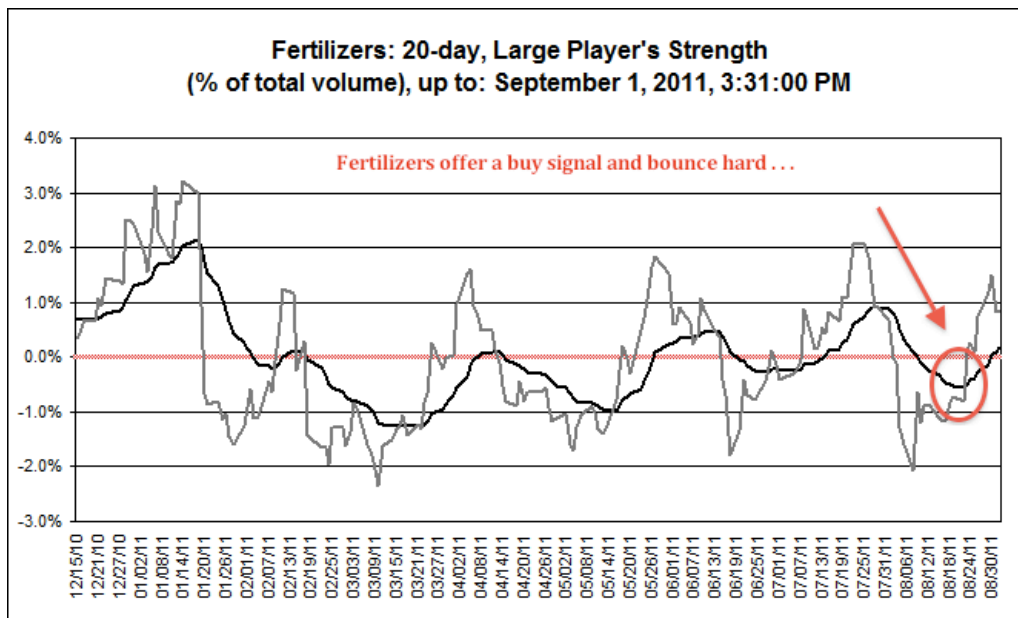
Corrections and sell-offs provide important clues about the nature of the market and fading or emerging leadership. If anything, the current action suggests an active lookout for issues that held up during the August sell-off and attract the interest of large players. GMCR is one example – this leadership stock is certainly worth monitoring. GMCR shown on the following page:



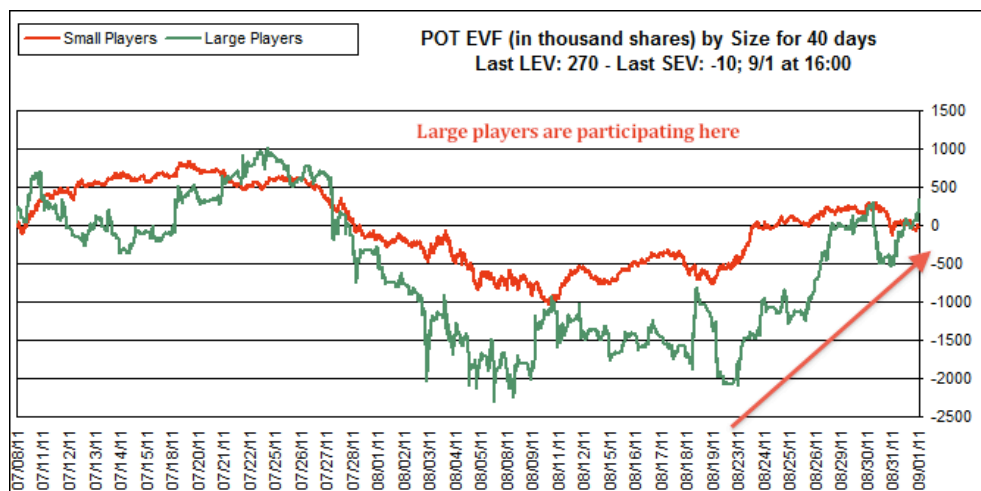
Overall, the type of broad participation that characterized the September 2010 rally is simply not present. That period witnessed breakouts representing a wide swath of sectors seemingly everyday. Nascent pockets of leadership are appearing during the current phase, though. Additionally, a period of correction will undoubtedly allow for new leaders to emerge and institutional favorites to hold their own. With that in mind, there are three groups that I want to highlight - Agriculture, Gold, and Silver.

Agriculture:

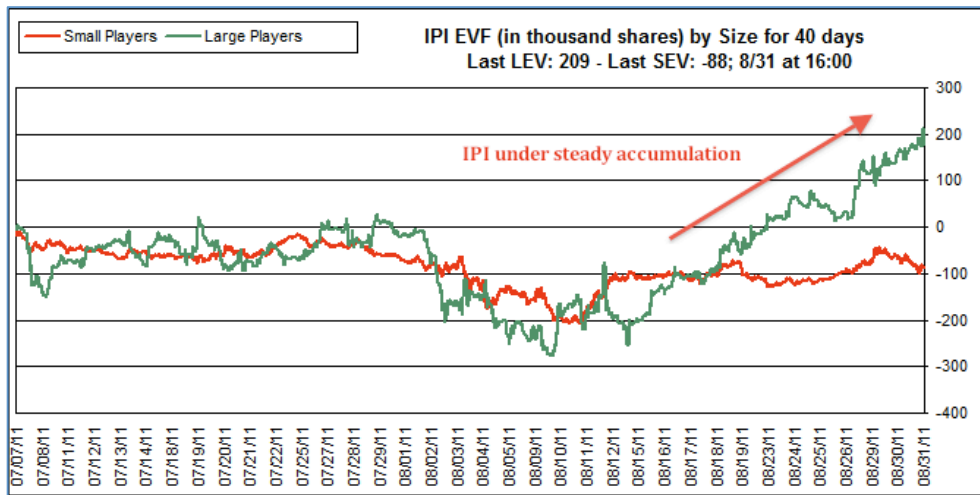
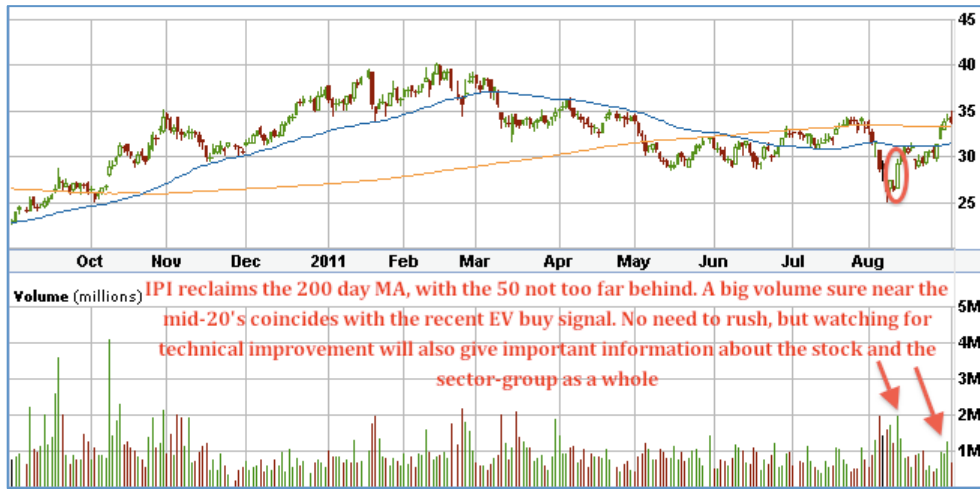
The *fertilizers* group issued a buy signal last week, and they remain an important group to follow. POT and MOS offered mean-reversion trading opportunities from deeply oversold conditions that coincided with the sector buy signal; however, one should monitor the ability of these stocks to demonstrate relative strength against the market. Additionally, a pullback and/or selloff will reveal whether these stocks have staying power.



In my 8/15 reports, we were still awaiting a buy signal from the sector, yet CF was already emerging as a sector leader. POT maintains the current range with a steadily improving RS line near new highs (86), and the current range + large player accumulation is significant enough to monitor. POT below:



Intrepid Potash (IPI) is another fertilizer with interesting action. Note the steady accumulation and the washout selling into the August lows – followed by an EV buy signal:

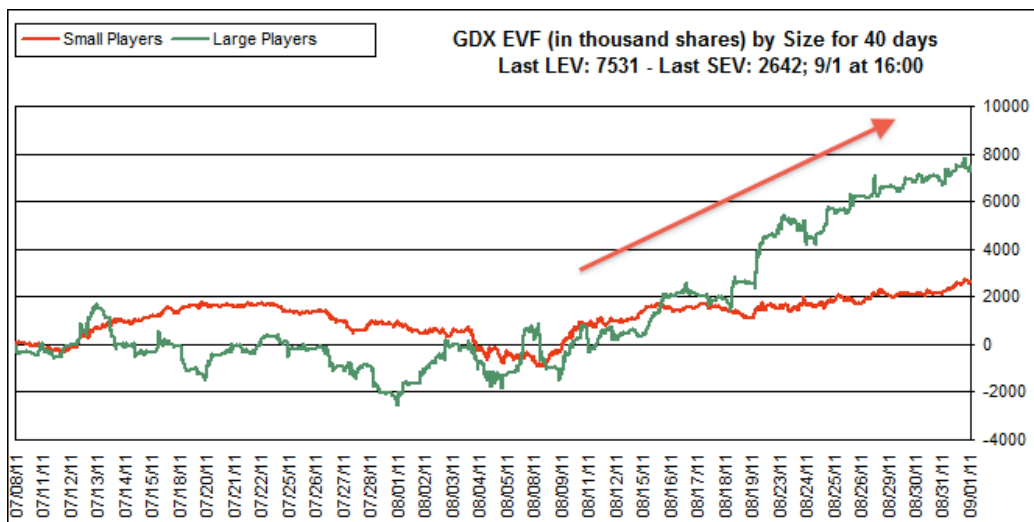
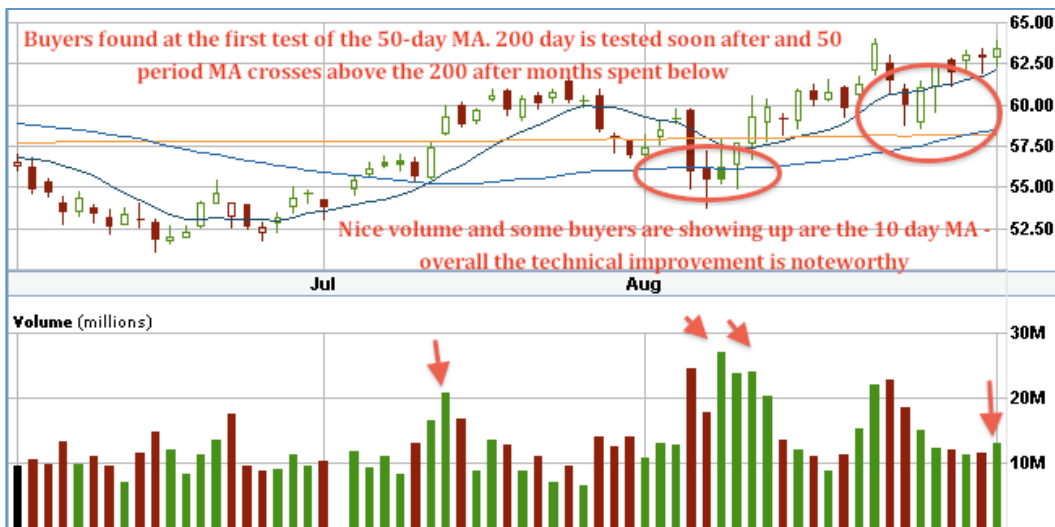


Gold and Silver:

The precious metals shares are currently dancing to their own drum, but from what I observe, their drumbeat remains on the quiet side. I see little enthusiasm for pm shares on public display, which leads me to conclude that large players are not ready for their accumulation campaign to be disrupted. First, I like how the PM sector buy signal is confirmed by the action in both Gold and Silver stocks. And second, I like that the action has been less “spikey,” perhaps suggesting that stronger hands are in control. Finally, the stage structure continues to improve for our GDx benchmark ETF. From Billy’s March 14th Alphascanner blog post, we see that the weekly 1-1 stage is “bearish to neutral – still opportunity for shorts.” Indeed, the swift pullback in mining shares last week demonstrates the propensity for quick shakeouts in the group as a whole. Nonetheless, the most recent pullbacks were buying opportunities and a transition to mid-accumulation may be close at hand.

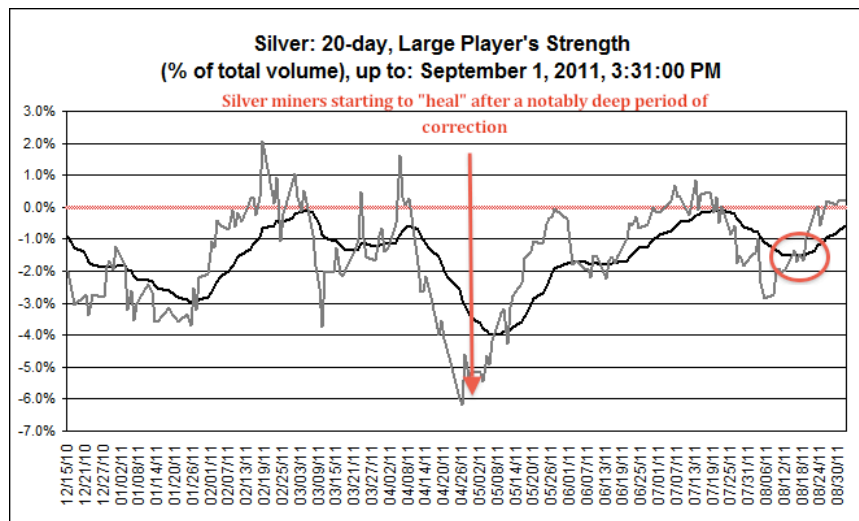
September 1, 2011

GDx Daily	Current Stage is 2-1 (Strong Mark-Up) Has been in current stage for 6 day(s)
GDx Weekly	Current Weekly Stage is 1-1 (Early Accumulation) Has been in the current weekly stage for 1 week(s)



One can spend some time reviewing the individual components . . .

Silver miners were highlighted on 8/15. One sees technical improvement that confirms this sector as an area of importance, especially after a long and somewhat gruelling correction.



And the updated silver miner ETF SIL, shown here:



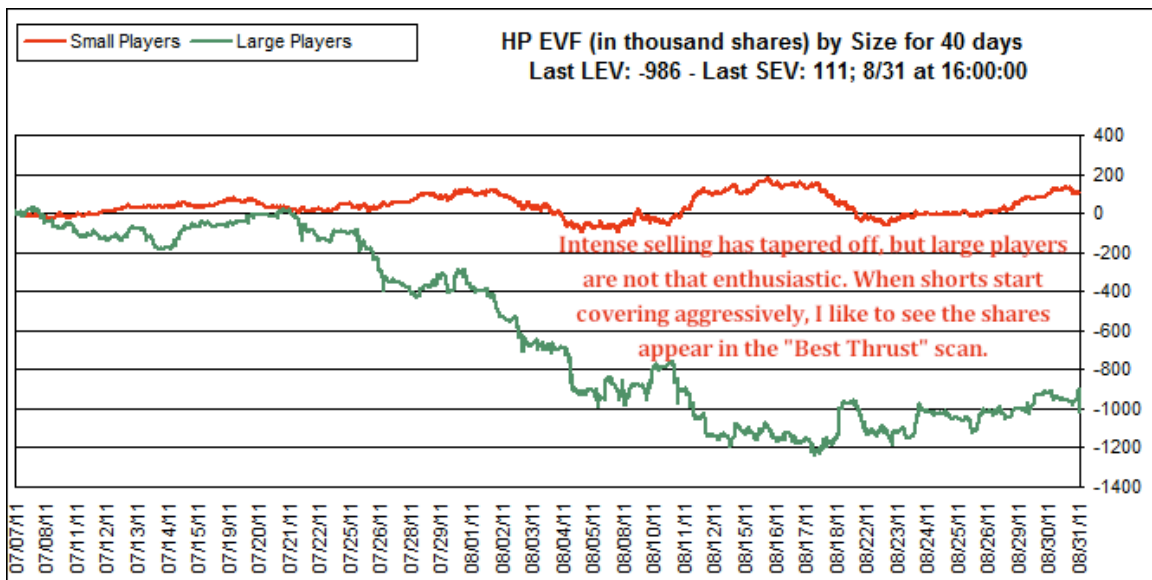
Mining shares, especially GDX, often disappoints traders looking for a way to leverage a rise in gold prices; however, the current action shows technical improvement for both gold and silver pm miners. Overall, gold miners are the sector leader with many gold stocks close to new highs or moving out of their long-term ranges, but action in both groups is encouraging on short and intermediate timeframes.

Short Opportunities:

There are no doubt short setups emerging. The stocks that broke down on extreme volume after major tops may offer such opportunities. One such example is HP:



Effective volume chart shown on next page:



When the 20-day MF issues the next short signal, there will likely be numerous short setups resembling HP. Until that time, letting price evolve over the coming days and using the “Negative Divergence with AB” scan should prove beneficial.

Conclusion:

The 20-MF gave an early warning last month of the impending selloff, even if we didn’t know the depth of selling until after the fact. The first sharp bounce quickly failed, but the second offered a chance to take advantage of the oversold conditions as numerous sectors began issuing buy signals.

Currently, the precious metals stocks in conjunction with some stalwart leaders like AAPL and GMCR provide a backdrop of select leadership. The agriculture sector continues to attract buyers, even though the technical picture must improve in order to further solidify their leadership. Nonetheless, if the market finds footing in the weeks ahead, the fertilizers may finally be ripe to rally.

There are short opportunities that are beginning to emerge; however, my best conjecture remains that profit on the short side is likely to be characterized by swift downdrafts as opposed to another slow-motion crash that intensifies over many days – at least at this juncture. Nonetheless, one must prepare for numerous scenarios, and price action and the 20-Day MF will continue to guide the way.

All the best,

Eric Coleman