January 8, 2010
End of Week #1830

| | |
|---|---|
| DJIA | 10,618.19 |
| CI | 1675 |
| NCI | 1529 |
| Ratio | 1.098 |
| S&P Ratio | 1.057 |

# PETER ELIADES' STOCKMARKET CYCLES

P.O. Box 751060 Petaluma California 94975-1060 • (800) 888-4351
website: www.stockmarketcycles.com

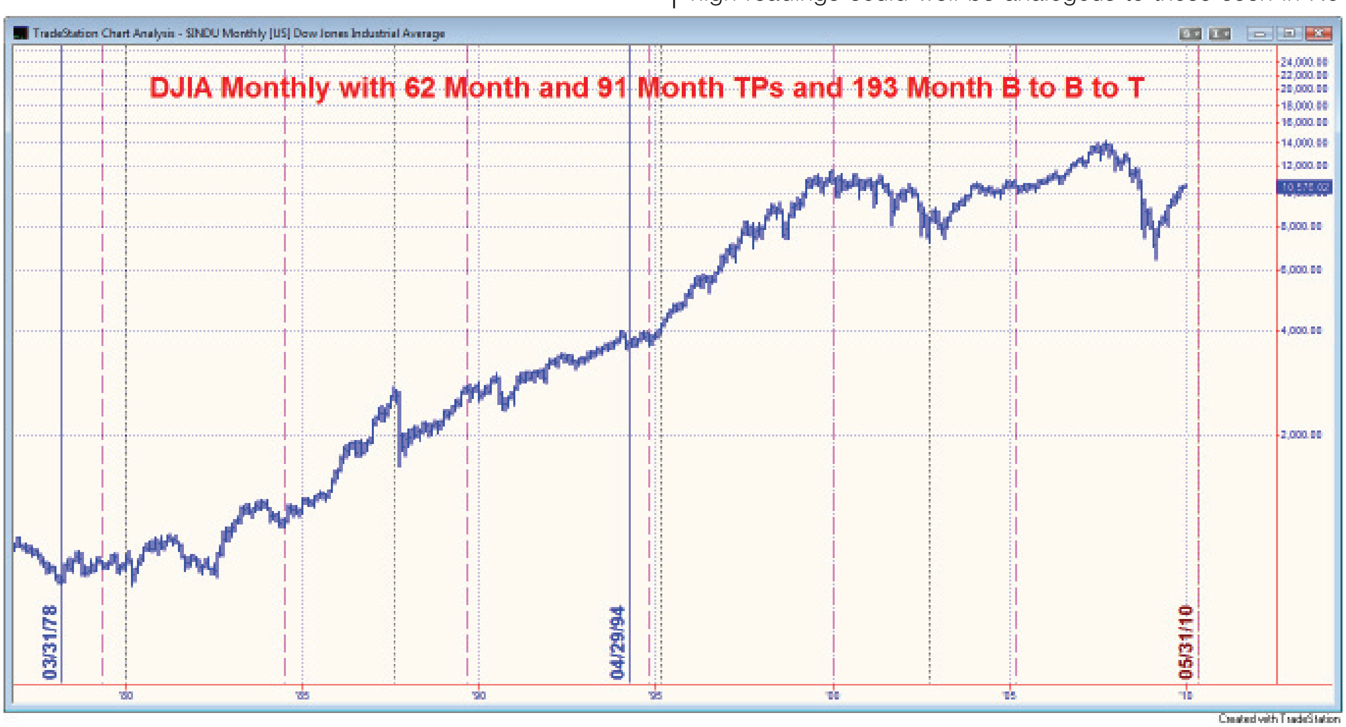
**Personal Note —** On August 19th, 2009, the very specialized and somewhat eccentric field of stock market analysis and prognostications was dealt a consummately sad blow— the death of my good buddy and friend of almost 30 years, (Lucius) P. Q. Wall. It's hard to believe it happened almost five months ago and I have waited until now to pay tribute to him for several reasons. It is almost as though I expected PQ to call me at some point over the past several months and confirm that his death indeed had been cancelled due to unavoidable circumstances. He had a classical Irish sense of humor and as brilliant a mind as anyone I had ever interacted with. Nevertheless, he was computer challenged and I somehow ended up being his Excel spreadsheet support person. There were precious few times I complained about that, however, because we always had such fun just talking and exchanging stories on the telephone.

Bob Prechter and I got a chance to visit PQ's fabulous widow, Ellen, and their two sons, Charlie and Jim when I was in New Orleans for a conference in October. It almost felt like an Irish funeral because we had so much fun reminiscing about our individual experiences with PQ. My heart and sympathies go out to them for the loss of a father and husband. I still personally mourn for the loss of this great friend and the world of market analysis will sorely miss his creative and original analysis. May his memory be eternal!

## —THE CYCLES—

In our last newsletter we went into a detailed explanation of our Cycle Indicator, Neutral Cycle Indicator, and the ratio between the two which we have dubbed the CI/NCI Ratio. The front-page chart of that newsletter pointed out in dramatic fashion that the recent readings above 1.100 were the highest readings seen on that indicator in over 60 years. Although we could not say with high confidence that the market would perform as it had in prior instances of such high readings, we believed we could say with a good degree of confidence that a market top of importance would not correspond with such high readings. Such high readings in the past usually corresponded to rare instances that marked "Very high momentum signalling an upcoming powerful and sustained market advance." We were not convinced that the market was telling us the same story this time around, primarily because almost half of the issues currently on the New York Stock Exchange are not common stocks and that is a marked distinction between the current period and prior periods of ultra-high momentum readings. It was our judgment, however, that despite the change in the makeup of issues on the York Stock Exchange, these ultra-high momentum readings were suggesting that even if the character of the advance/decline line had changed significantly, the chances were good the market would not begin a significant bear market move from such high momentum readings.

That conclusion was bolstered by the chart of the S&P 500 CI/NCI Ratio which appeared on page 2 of our last newsletter. It was clear from that chart that no previous excursion of the S&P Ratio above 1.070 was followed by an immediate bear market despite the very overbought nature of such a reading so we were confident that the reading of 1.071 registered on December 4th, 2009 was not occurring in the area of what would turn out to be an important market top. What then might these ultra-high readings be telling us if they are not predicting they will be followed by a multi-year bull market as has more often than not been the case in the past? It is our considered judgment that the current extraordinarily high readings could well be analogous to those seen in No-



vember 1935 when the CI/NCI ratio reached 1.101. The market was not near a top at that time price-wise or time-wise but it was the only time in the 80 year history of the indicator that a reading above 1.100 was not followed by a multi-year bull market. If that interpretation is correct, it would mean that the high reading registered on December 4th, 2009 could well be predicting that 2010 will not quickly see the resumption of the bear market.

At this juncture, we should emphasize to subscribers that we continue to classify the advance from the March 2009 lows as a bear market rally. In the unlikely circumstance that either the Dow or the S&P 500 or both should surpass the October 2007 all-time highs, we believe we would still classify the rally that led there as a bear market rally. It remains our firm conviction that the March 2009 lows did not provide investors with the classic values that almost always appear at major market bottoms. Mind you, we used this same logic after the October 2002 and March 2003 market bottoms and we were more than surprised to see the market rally from those lows up to the 2007 October highs. We should remind you, however, that the market of choice during that time span was the Nasdaq Composite and at the October 2007 market high when the Dow and the S&P were registering new all-time highs, the Nasdaq Composite was still 43.4% below its March 2000 all-time high. Much the same thing happened at the 1937 high on the Dow which followed the very high CI/NCI ratio reading in November 1935. By March 1937 the Dow Jones Industrial Average had rallied 271.6% from its July 1932 bottom. As impressive as that rally was, at the 1937 high the Dow was still 49.0% below its 1929 high. In retrospect, that rally from 1932 to 1937 could well be classified as a bear market rally. Even though the Dow never again went below the 1932 bottom, it did decline 52.2% on a closing basis over the next 5 + years.

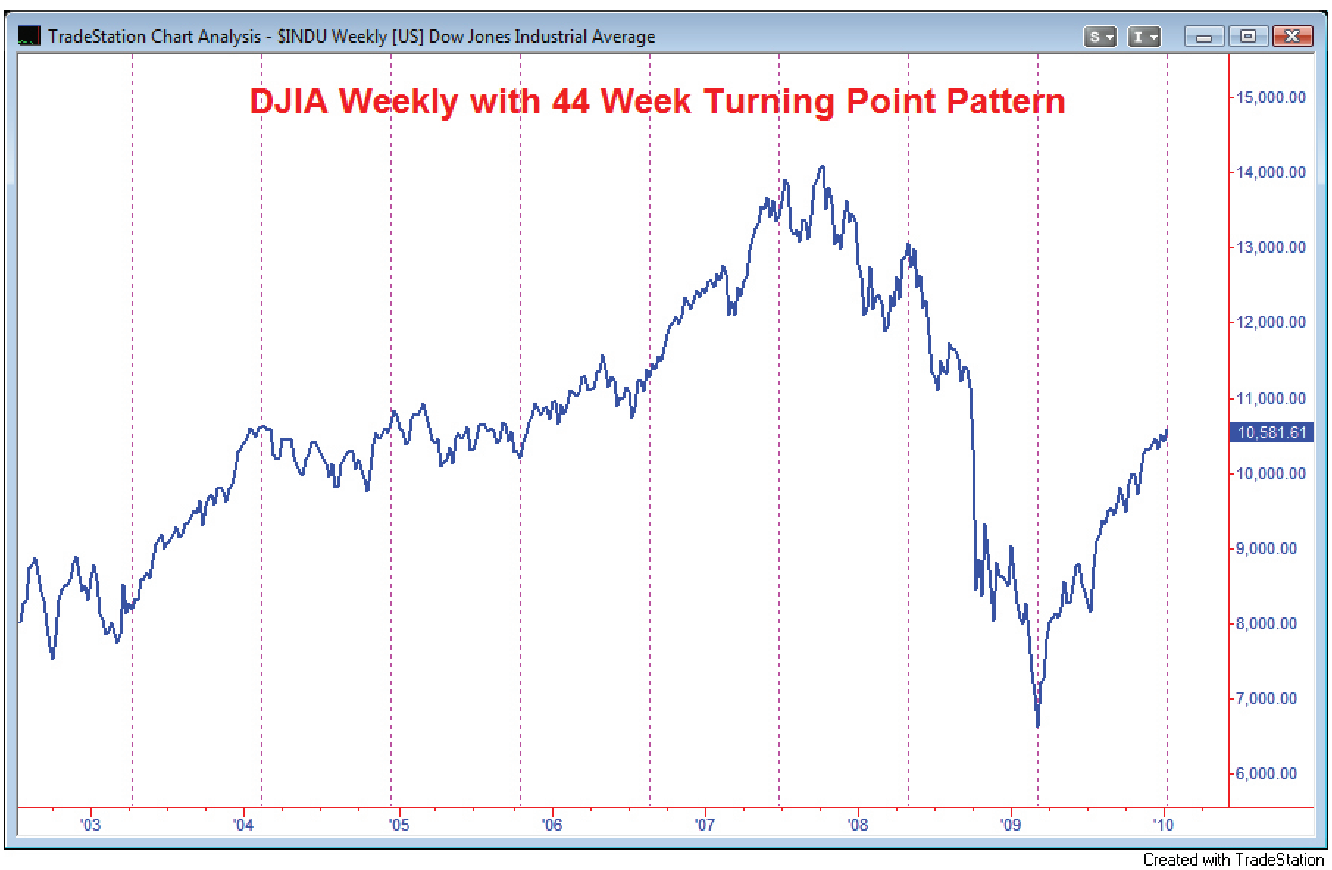
In general, that is the kind of market atmosphere that we expect to be in for the next several years. Whether the March 2009 bottom will remain a final low or not remains to be seen. That would be dependent on valuation readings at the next market bottom. If the valuation levels have improved at that bottom, then the excursion down to the area of the March 2009 bottom or slightly higher or lower could mark an important bottom. But based on prior market history, we should fully expect to see a Price/Earnings ratio in the single digits for the major averages and a dividend yield in the area of 6% or higher. Despite what happens in the meantime, whether or not some market averages or indexes move to interim new all-time highs, the odds are very high against seeing a generational market bottom that will not be visited again in a young man's lifetime until such historical values are once again seen.

Let's examine some patterns whose potential resolution could prove important in the year 2010. The chart on the front-page of today's newsletter contains three such patterns. The pattern designated by long dashes (pink if you are viewing in color) directs us to a 62 month turning point pattern with ideal resolutions in May 1979, July 1984, September 1989, November 1994, January 2000, March 2005, and May 2010. The pattern designated by the vertical short dashes (black if you are viewing in color) depicts the 91 month turning point pattern with ideal resolutions in January 1980, August 1987, March 1995, October 2002, and May 2010.

The pattern designated by solid vertical lines is the only one to be accompanied by dates. Those dates are March 1978, April 1994, and May 2010. This pattern points out a potential George Lindsay bottom-to-bottom-to-top pattern.

Notice that all three patterns have an ideal resolution scheduled for May 2010, and for that reason we will be watchful in that time zone for a potential market top of importance.

This is also an appropriate time to discuss the decennial pattern. The first generally acknowledged presentation of



a decennial pattern in stock prices was published by Edgar Lawrence Smith in a book entitled **Common Stocks and Business Cycles** published by William-Frederick Press in 1959. The pattern is discussed in detail in a publication that we would highly recommend to all market traders and it is appropriately titled **Stock Trader's Almanac**. The 2010 edition is the 43rd annual edition of this highly informative almanac. The book is widely available online. Jeffrey Hirsch has taken over most of the responsibilities of publication, a job that was previously handled by his dad, Yale Hirsch, the founder of the publication. If you are at all interested in patterns in the market, buy the **Stock Trader's Almanac**.

The Hirsches have gone back to the decade beginning in 1881 and catalogued the annual percentage change for each individual year within each decade. As it turns out, the years ending in zero have been the worst performers over the past 130 years. If you had begun investing in the year 1890 and invested only in the subsequent years ending in 0, by the year 2000 you would not only be older than 110 years old, but every $100 placed in the market beginning in 1890 would now have turned into $33.74. Since 1890 there have been only four positive years ending in 0 and 8 negative years ending in 0. The average percentage move for calendar years ending in the digit 0 has been a decline of 7.2%. For comparison purposes we should note that there has been only one other year within the decennial pattern that has shown a negative average percentage change, namely years ending in the digit 7. The average loss for such years has been a far more modest 2.5%.

If we look only at the years ending in the digit 0 that followed a double-digit percentage gain in the year ending in the digit 9 of the same decade, the results for the zero year are even worse. There were six such years and five of them ended in losses for the year with the average loss being almost 9%.

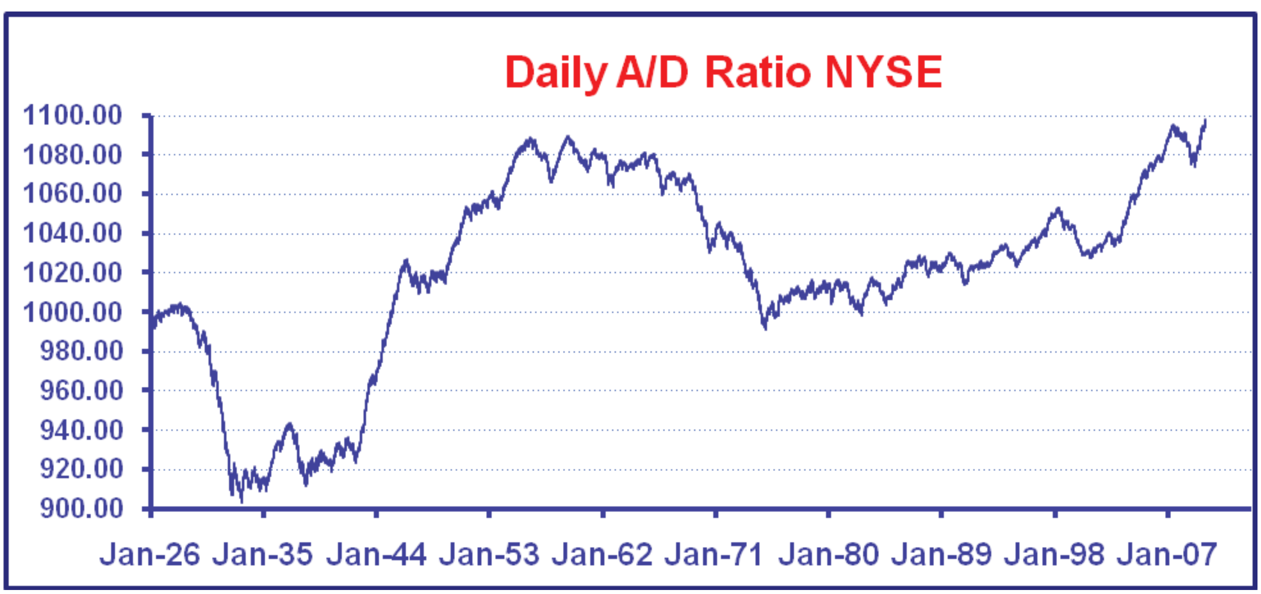
We have also uncovered a 44 week turning point pattern of good consistency that leads to the current time zone as a potential turning point. The chart of those turning points is presented on page 2 and you can see that it falls on some of the more important turns of the past few years. You can expect to see one of two things after the resolution of a consistently successful turning point pattern. Either it will mark an obvious market top or bottom or it will mark the beginning of a concerted upside or downside move. Because we have now seen 10 consecutive higher monthly highs on the popular averages, one could argue that the current potential resolution of this turning point pattern would be scheduled to mark a market top of some kind. This pattern alerts us to the fact that, although there are good reasons to look for this rally to extend at least several months into the year 2010, there is also a good reason to remain vigilant about a potential market top in the current time zone.

## —TECHNICAL INDICATORS—

Perhaps the most remarkable aspect of the rally which began in March 2009 was the scope and all-inclusiveness of that rally. The chart entitled **Daily A/D Ratio NYSE** points out that a factor quite dramatically. The daily advance/decline ratio of the New York Stock Exchange is now at new all-time highs. There are those technicians who do not agree with our interpretation of this advance/decline ratio and who believe this line is a legitimate representation of overall market movement. Perhaps the easiest way to overcome that argument is to ask those proponents of the argument to show you even one broad market index which is trading at a new all-time high. We are not aware of any and we thus look with suspicion upon any argument which refuses to acknowledge the distortions that have been present for quite some time in both the daily advance/decline line and the daily advance/decline ratio of the New York Stock Exchange.

Perhaps the best proof of the weakness of the New York Stock Exchange data occurs when we view the corresponding data for the S&P 500. At the close of the market today, January 8th, the S&P 500 had retraced almost exactly two-thirds of the total decline from the major high in June 2007 through the March 2009 bottom.

This failure of the S&P 500 advance/decline data to confirm and correspond to the advance/decline data on the New York Stock Exchange is a very important divergence, both in regards to the advance/decline lines and ratios themselves but also in regard to the CI/NCI ratios that are calculated from those advance/decline data. If the only data we had to work with were those from the New York Stock Exchange, and especially if we had no reason to doubt the current figures in relation to the prior historical figures, we would be forced to take a much more bullish stance than are current one. After all, with both the advance/decline ratio and the advance/decline line of the New York Stock Exchange at new all-time highs in asso-



ciation with an historically high CI/NCI ratio, the market would be in a very bullish configuration arguing for several years of a potential uptrend. The fact that the S&P 500 advance/decline ratio is not anywhere near its all-time highs and the fact that the S&P 500 CI/NCI ratio is not anywhere near out of bounds high momentum readings above 1.095 argue that, at least so far, there are no reasons for an ultra bullish long-term outlook such as the one engendered by the New York Stock Exchange data standing alone. We are showing you a chart of the daily advance/decline ratio of the New York Stock Exchange so you can easily see the distinctions between the S&P 500 data and the data from the New York Stock Exchange. Be aware of the different time scales on the S&P chart below which covers only 3+ years and the New York Stock Exchange chart on page 3 which covers 84 years.

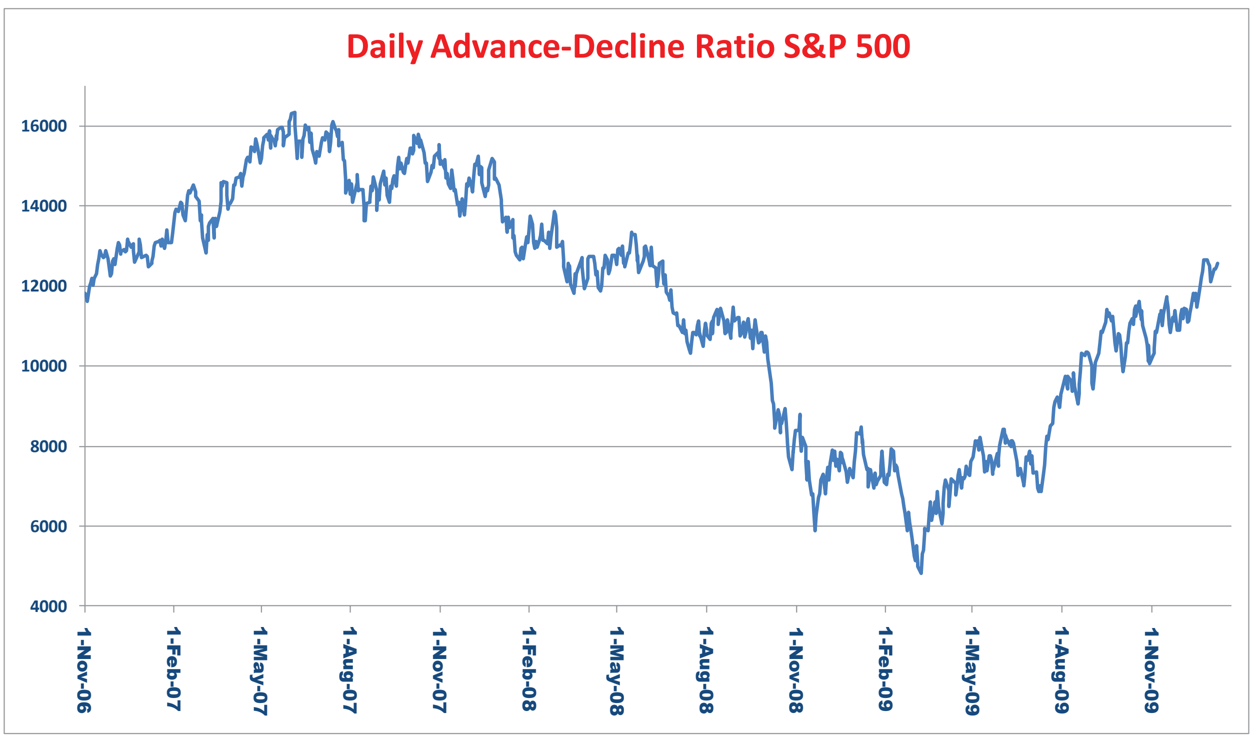
## —MARKET PROJECTIONS—

In our newsletter dated August 7th, 2009, we wrote: ***Because higher nominal 78-80 week projections have been generated over the past three weeks, our bearishness must be somewhat muted until or unless the nominal 78-80 week upside projections are invalidated. It is not an insignificant projection. The S&P projection calls for a move to between 1205-1245... and... a moved up to those levels in the next three months would invalidate the significantly lower nominal 10 + year projections by climbing back above the 278 week offset line.***

On the day of that newsletter, the S&P 500 had closed at 1,010.48. We made it clear at that time that we felt that projection would be invalidated but we also made it clear that until the projection was met or invalidated, we had to respect it. When that newsletter was written, the S&P was 19.3% away from that projection window. At today's close, it is just over 5% away. At this point, the odds are favorable that that projection will be reached. Whether it is reached directly from current levels or whether there is an intermediate-term decline before us that will then be followed by a move to the projected levels is the question. What we do know, however, is that the nominal 10 year + projections to below 400 on the S&P have now been invalidated.

## —MUTUAL FUNDS—

On December 7th, Rydex switchers bought the Rydex S&P 500 2X Strategy Fund at 21.77. The following day, December 8th, was complicated because we had given certain guidelines on our December 7th updates that led to the sale of the fund the following morning at the morning price of 21.23 for a loss of 2.5% on the trade. After reviewing the trendline which led to the sale instructions on December 8th, however, we recommended on our special updates before the close that Rydex switchers repurchase the fund at the close that same day, December 8th. It was purchased at 21.14. On January 6th, 2010, we did a special update which recommended the sale of the fund at the morning price. The fund was sold at 22.91 for a profit of 8.4% on the trade. Currently both Rydex and Fidelity switchers are in 100% cash positions. We have two different specific model portfolios— one for Fidelity switchers and one for the Rydex group switchers. How you distribute your own portfolio is up to you as an individual.

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