Financial Research, Education & Data

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Charts as of 12/30/11

The FRED Report – Monthly Review

Research Piece for January: FPO's on Stocks, Bonds, Gold, Oil, CRB and Currencies

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Summary of Monthly Piece

ASSET CLASSES:

STOCKS:

Rating the three Market Principles:
As readers know, we break the stock market down into three basic market principles: (a) Sentiment, (b) Internal Momentum, and (c) External Momentum. I will review these here.

Sentiment: We use two indicators to measure sentiment. These are options activity and certain sentiment polls. For options, we use total CBOE volume and take the figure directly from the CBOE website. For our sentiment poll numbers, we prefer using % bears from Investors Intelligence. We use only the % bear's number because, in our opinion, the bears almost always take action. It is rare to find a complacent bear. Sentiment is what we call a "Condition Indicator". By this we mean it has nothing to do with timing trades – rather it is part of the overall mosaic of market activity.

Our current reading of the sentiment indicators is POSITIVE. Sentiment indicators still suggest a high level of bearishness. The Put/Call indicator remains elevated although it has fallen off a bit. Investor's Intelligence % Bears Readings gave a buy signal in September and has continued to remain elevated (the last was 32%). Our model has barely fallen as recent strength has unfolded, but is still near the highest levels we have seen since May of 2009. Anecdotal sentiment suggests that few investors are fully invested, and these indicators support a rally in the first quarter, as do short-term price charts.

Internal Momentum: We use several Breadth indicators to measure internal momentum. We publish three indicators in this Monthly Review: the McClellan Oscillator, an Indicator of New Highs on the NYSE vs. New Lows, and our own breadth oscillator – called **Fred's Breadth Oscillator**, or FBO. The McClellan gives great trading signals, while the last two are also "Condition Indicators".

Our current reading of the internal momentum indicators is NEUTRAL. The weekly or intermediate FBO has failed to advance since August 2011, and is the biggest negative indicator for stocks. The daily FBO had a strong up-move into mid November, but retraced much of the move into year end. It has built a positive pattern and is not overbought. New highs continue to exceed new lows as the market pulled back in November. These numbers have continued strong enough to suggest a new uptrend, but they are weakening a bit. The McClellan Oscillator is overbought but again with a favorable pattern. Should the market rally in the first quarter without a corresponding surge in breadth momentum, we would be concerned – we must wait and see how this Catch 22 plays out.

External Momentum: We use several price indicators to measure this, and these are primarily tactical indicators. We use the 5 and 20 period moving averages, and a simple crossover to determine trend. We use Stochastics, another standard indicator, to measure overbought/oversold levels, or as we prefer to consider them, areas of risk and reward. The one criticism of Stochastics is that they are too sensitive, so we also have our own Price Oscillator we publish, called **Fred's Price Oscillator, or the FPO**.

Summary of Monthly Piece…..continued

Our current reading of the External Momentum indicators is NEUTRAL. Short -term Stochastics have moved to overbought, as have weeklies, but moving averages are positive and this configuration often occurs just before an uptrend commences. Both weekly and daily FPO's suggest a short-term rally is possible and should start quickly in the New Year.

CONCLUSION: Stocks have appeared to have etched out an Inverse Head and Shoulders – a positive short-term price pattern. For this to be valid, stocks should start to rally in the first couple of weeks of 2012, which we expect. Should breadth remain weak (on an intermediate basis) as this rally occurs, we would have concerns. Sentiment suggests a rally could carry further than people expect – **a test of the 137 area highs on SPY is not out of the question.**

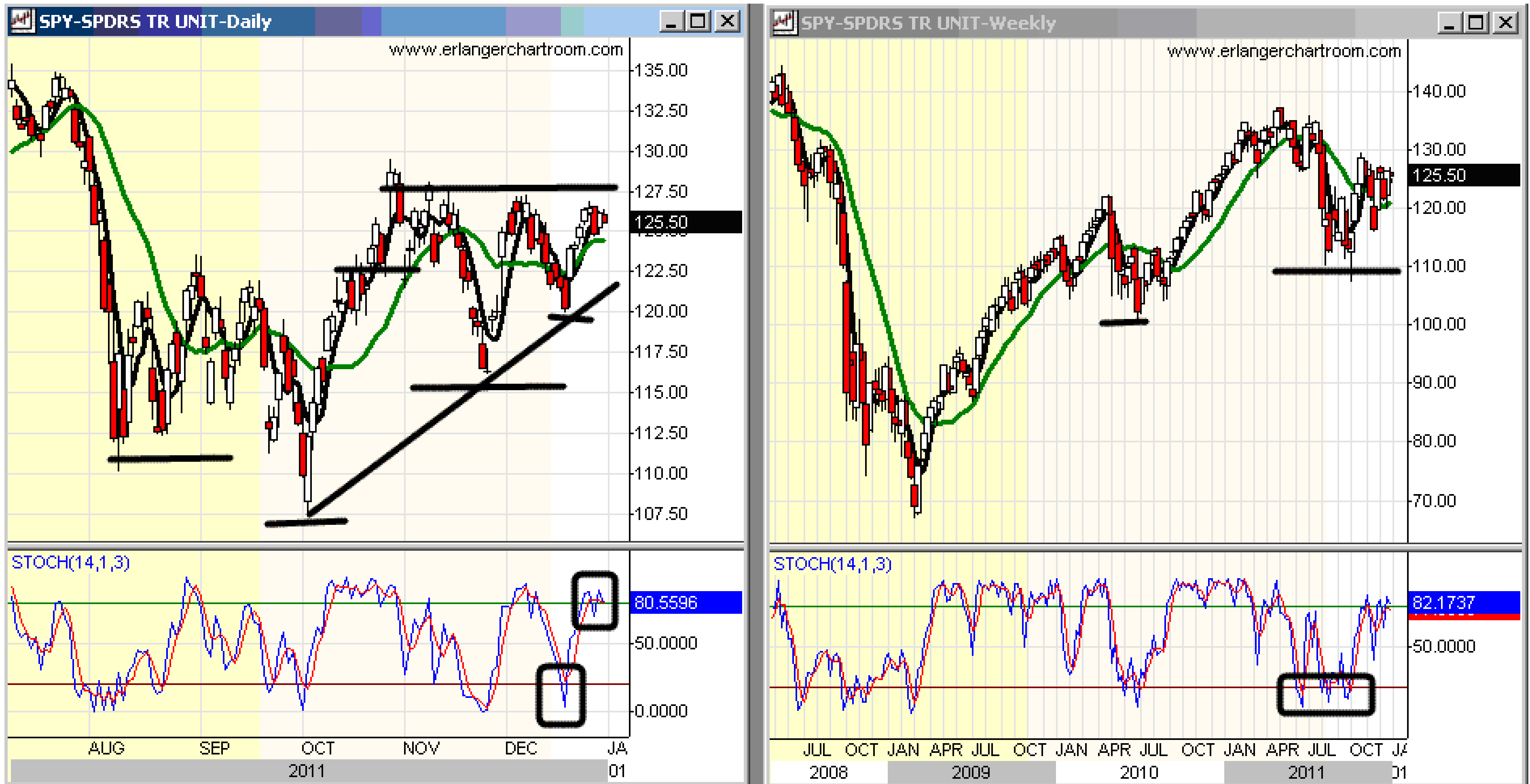
FIXED INCOME:
Treasuries have been strong than we anticipated, and have rallied again. However, accumulation models on the TLT have started to weaken, enough to suggest a correction in the first part of 2012. We encourage advisors to watch Municipals as well – charts are favorable but these ARE overbought. Corporate bonds have been volatile, as have international bonds**.** Junk bond ETFs may rally more in early 2012.

COMMODITIES:
Integral to our longer term strategic view of the markets is that we have entered an era of commodity inflation. Recent volatility has been challenging, however. Metals dropped sharply at the end of 2011. Our new 8-month target for gold is $2100/oz or 210 on GLD, whichever occurs first. Right now this is still in effect, but may be revised down as a couple more data points come in. There is a strong seasonal tendency for the Petroleum Complex to rally in the winter, and we advocate overweight energy and energy stock positions into the end of January. We note that USO has actually already hit the bottom end of our target range for 2011 (40 – 43), and while we expect a strong January for oil there may not be much upside left here. We look for an opportunity in agricultural commodities late January/early February.

INTERNATIONAL:
International markets still look weaker short-term than the U.S. market. Emerging Markets have been volatile, and now look slightly stronger than Developed Markets – but we continue to suggest de-emphasizing international. The Euro is weakening, and Dollar strengthening as forecast. The FXY has fallen as Japan intervened. Australia trading well, and remains an interesting alternative to the metals. FXA has improved relative to GLD. Australia and Canada may be set to outperform in 2012.

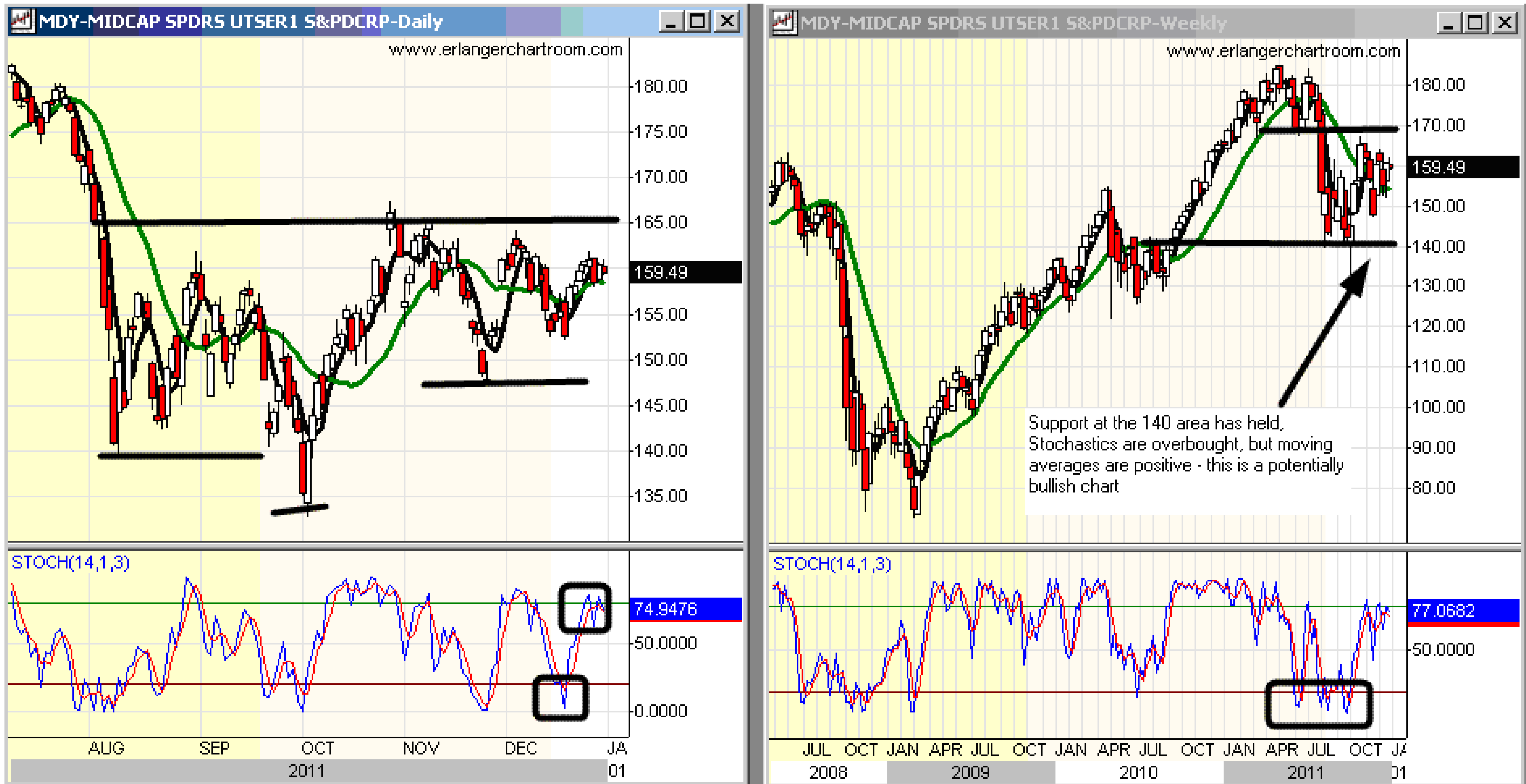
SECTORS:
We have two over weights, the XLE (ENERGY) and IYW (Technology). Our two under weights are XLU (Utilities) and XLF (Financials). Our favorite DEFENSIVE sector remains Staples (XLP), now at all-time highs. Energy is showing more signs of strength in our accumulation models, and should advance into February. **Energy and Technology were mentioned in Barron's (October 31) as institutional favorites, so they could see substantial inflows over the next few months**. The most interesting "up and coming" sector is XLV (Healthcare). Both price charts and accumulation models have improved substantially in recent weeks. We note that financials have weakened again. Realize that XLF could stage a meaningful rally short-term, and still look "icky" on an intermediate basis (which is how we do our sector weightings). **So far, our underweight on XLU has not worked**. Bonds have been stronger than expected – but this may very well change in the next few weeks, and advisors should formulate a plan in the event that XLU starts to decline – it could be a deeper decline than people expect.

Market Review: Price Charts – SPY – SP 500 ETF



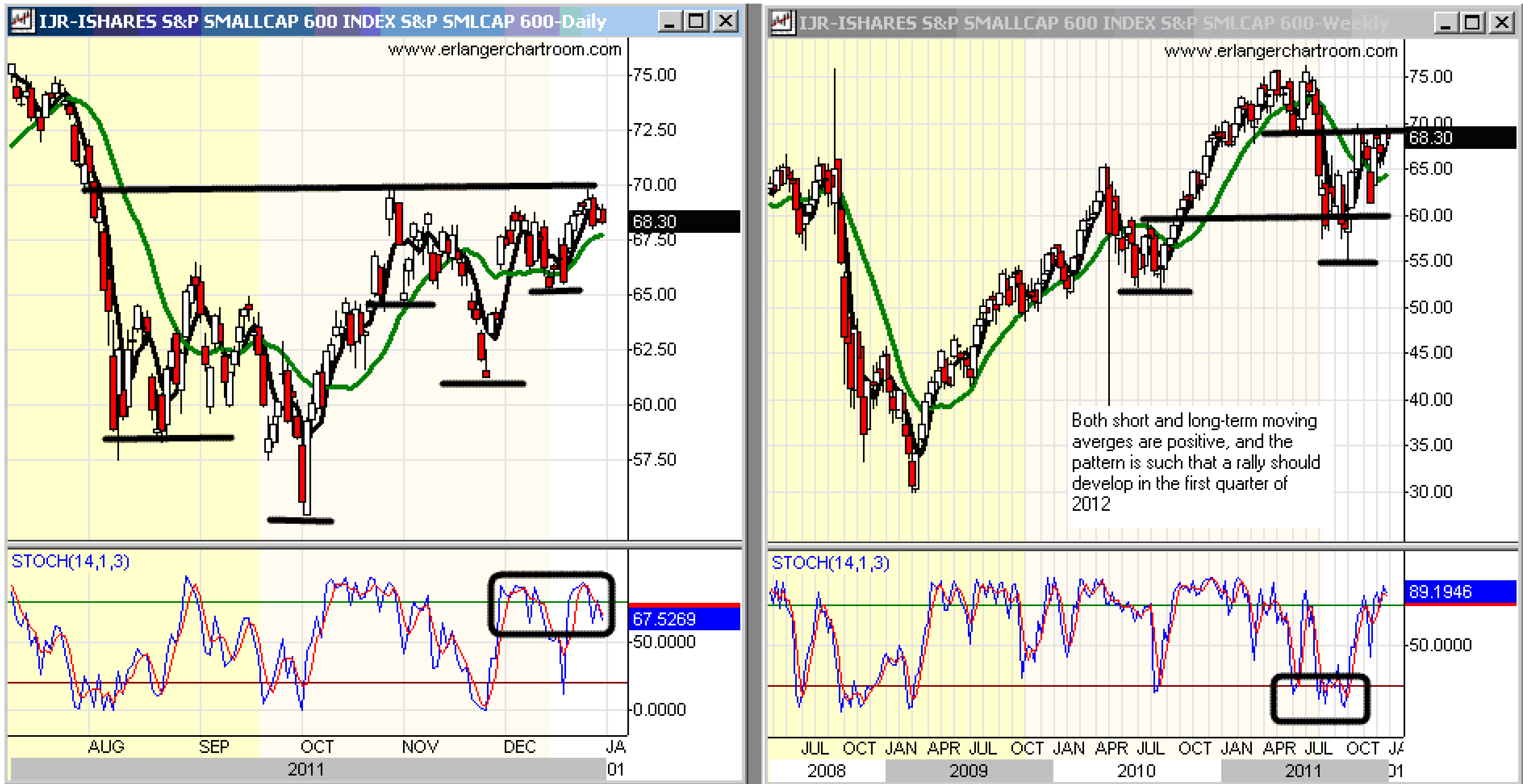
<u>The SPY has got three interesting technical patterns to ring in 2012:</u> The SPY has developed two inverse Head and Shoulders patterns, as well as a possible wedge. The biggest Head and Shoulders bottom actually takes up the whole short-term chart. The Wedge is formed by the trend line drawn from the lows in October up through the recent low. Both of these patterns would be completed by an advance through 127.50, then 130. A move below 120, then 116 would tend to negate these. All moving averages are positive, suggesting upside resolution.

Market Review: Price Charts – MDY – MidCap SPDRS ETF



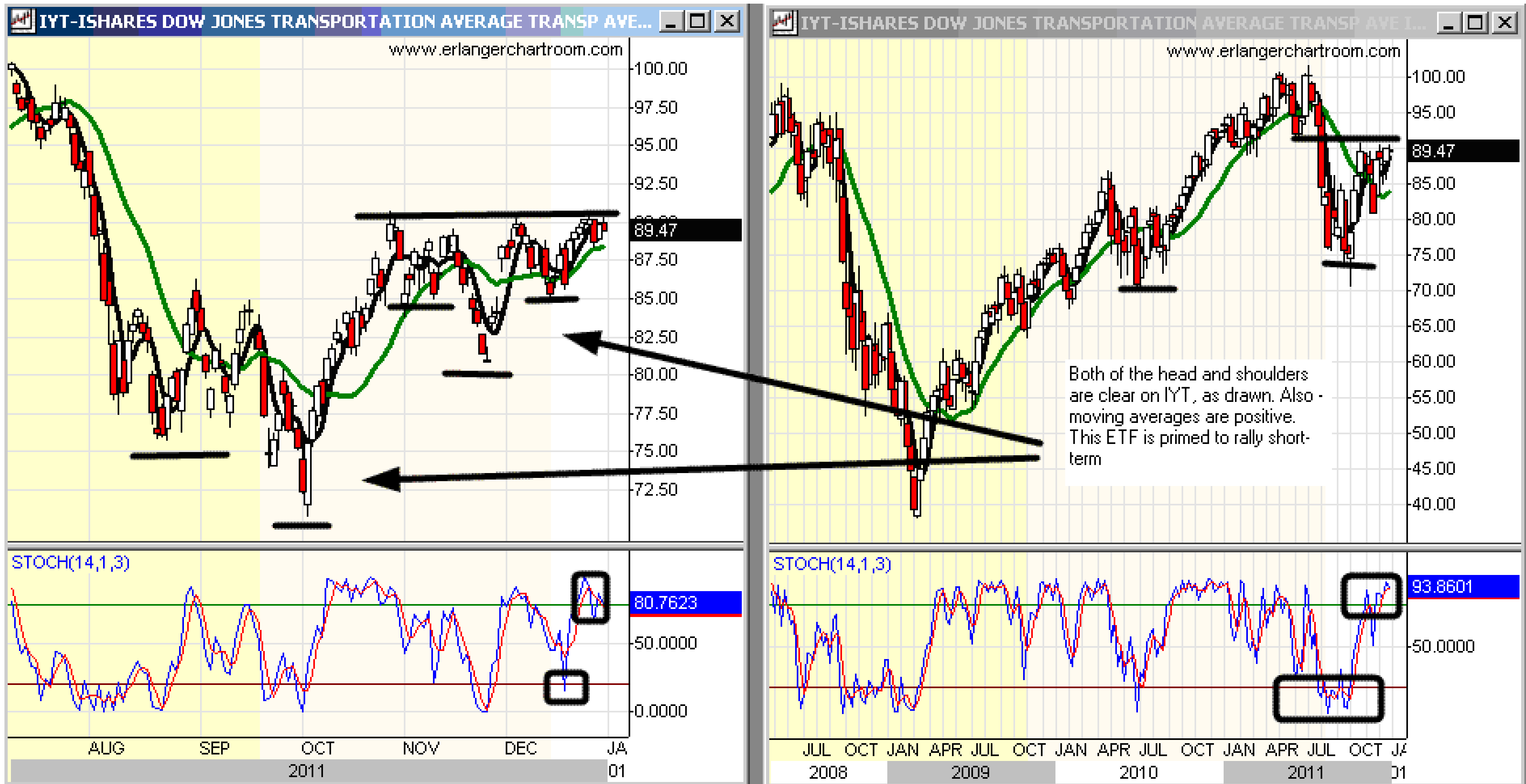
The MDY has similar patterns to SPY, but is weaker, for now: Mid-caps made all-time highs in 2011, suggesting a longer-term bullish trend. Most indicators remain bullish and accumulation models are still positive. However, Mid-caps are weaker than large-cap indexes right now, suggesting (a) foreign money is coming into the US markets, and (b) short-term rally we are forecasting could give way to substantial weakness at the end of the first quarter, or before.

Market Review: Price Charts – IJR – IShares S&P SmallCap 600 Index ETF



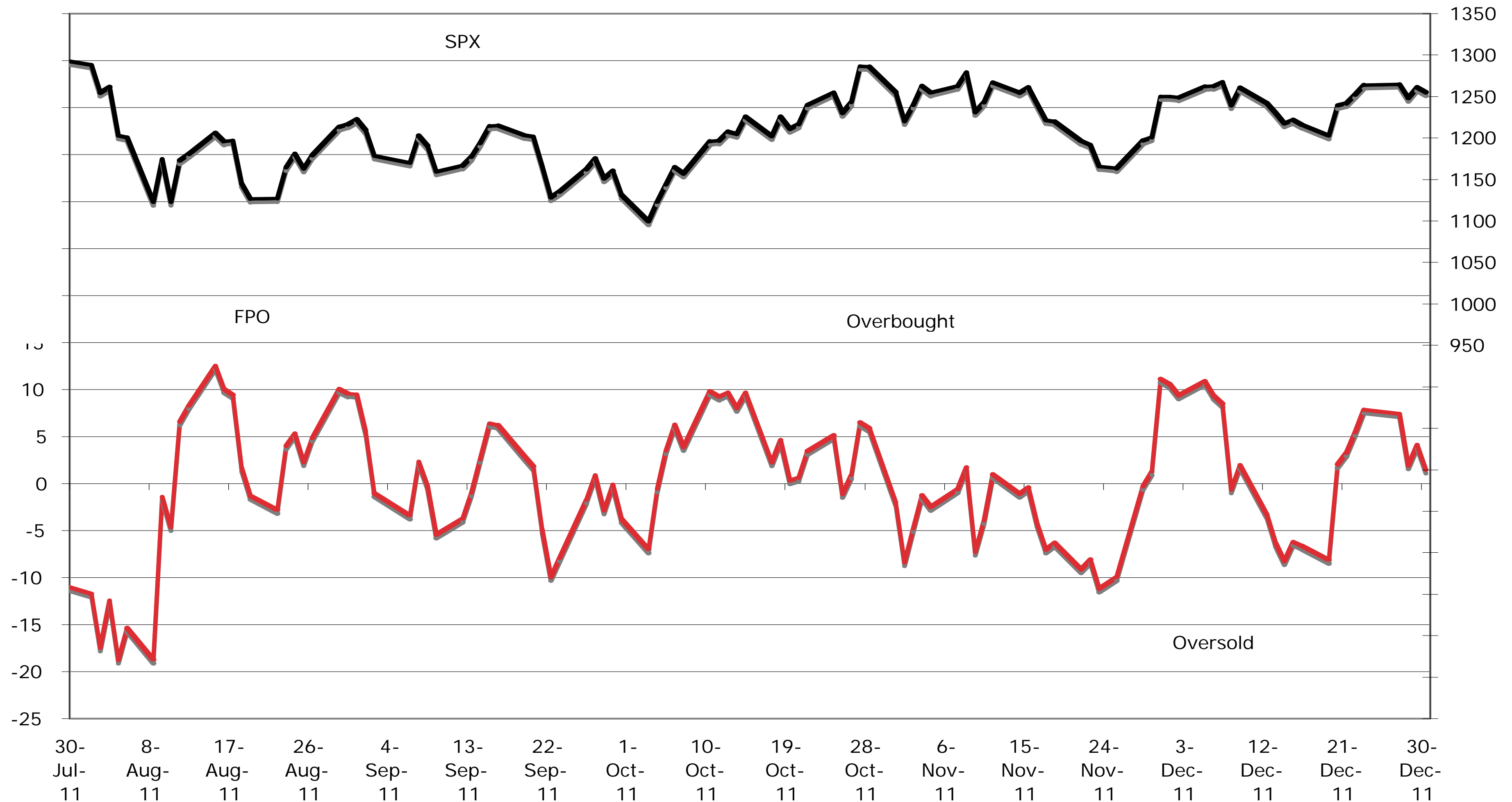
The Small Cap ETF has similar patterns, and has also made all time highs in 2011: Small caps made new highs in July 2011, but the short-term has weakened relative to large caps over the last month or so. The accumulation model on IJR still remains positive. We note that economists continue to forecast a new recession, and small cap does less well in a recession. This index should out-perform as recession fears abate later in 2012. We also think speculative money could flow into small cap names and out of emerging markets. Accumulate slowly.

Market Review: Price Charts – IYT – Transportation



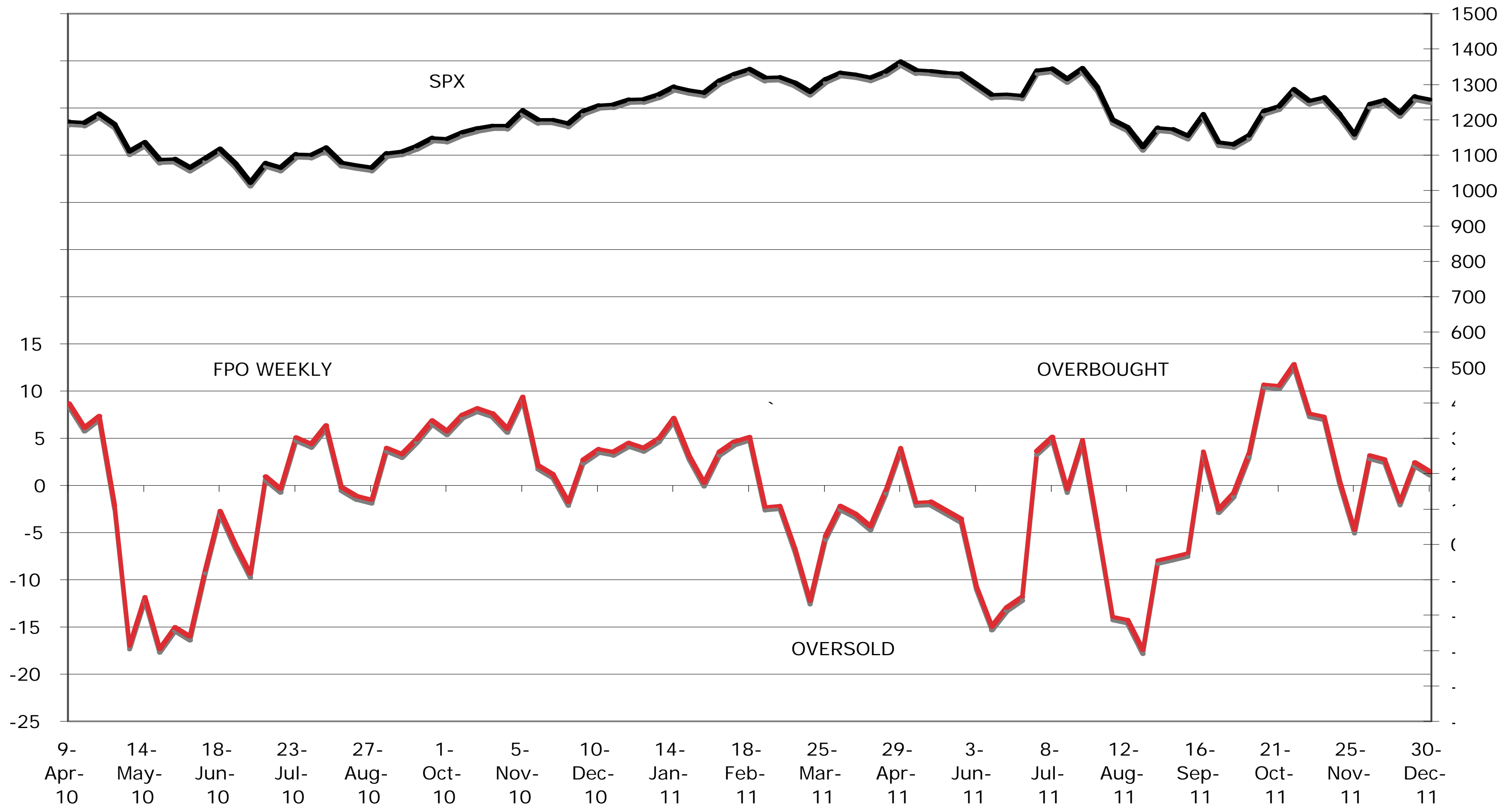
The Transports also made the divergence bottom but remain weaker than SPY, stopping below the short-term resistance, a concern: Long time readers will recall that this index is our favorite measure of economic strength. We remain concerned that IYT now has a worse price structure than the SPY, and the accumulation model remains weaker than that of the broad market, although it continues to improve in recent weeks. Last month we indicated that if price does not improve by moving above 93 soon, the transports may be forecasting a weak 2012. So far, this seems to be occurring and may suggest a weaker economy, or even recession, is in store.

Market Review: Price Charts – Daily – Fred's Price Oscillator



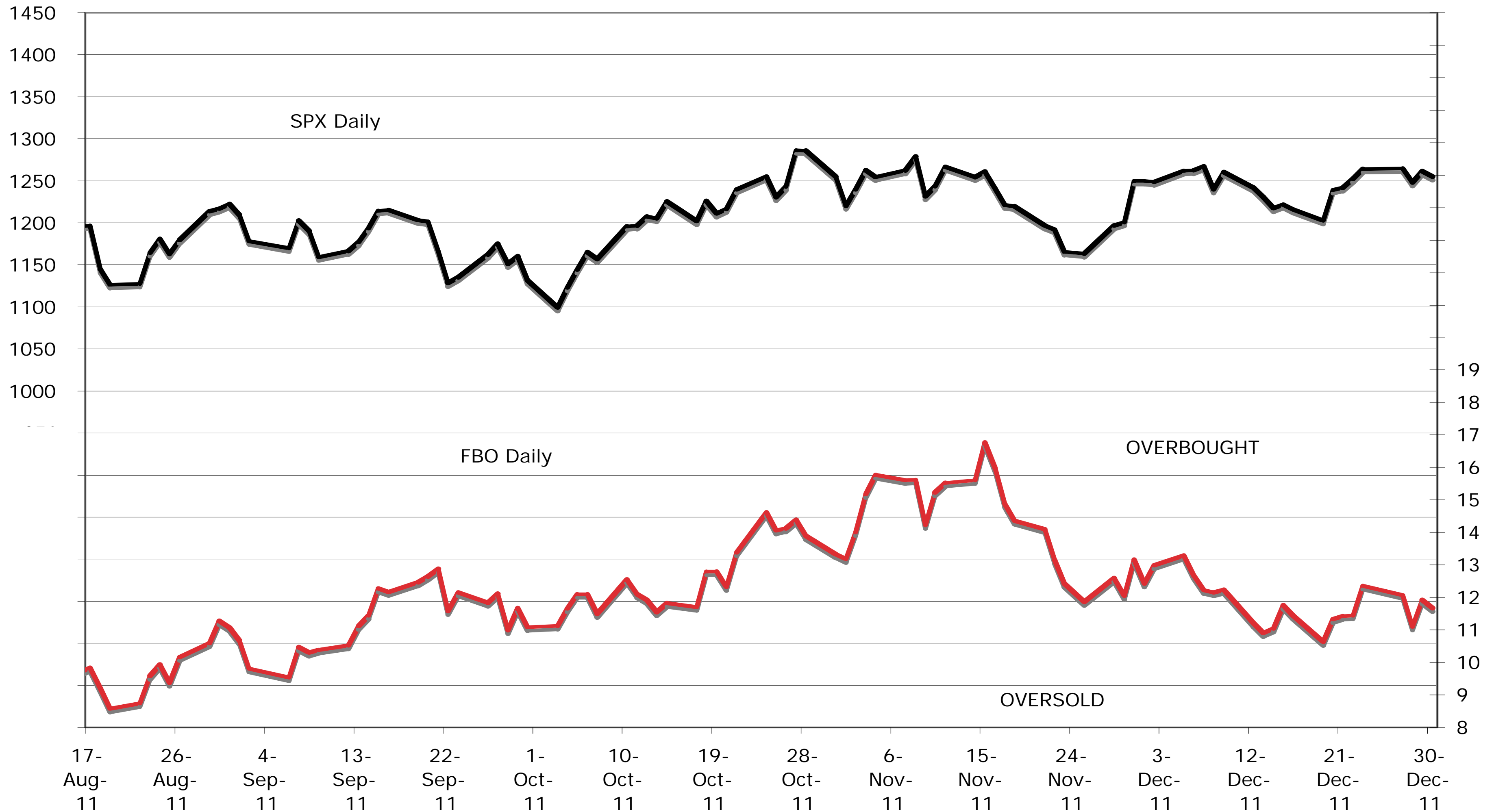
The daily FPO has made a series of higher lows: The daily FPO is slightly overbought, but with a favorable pattern. The August move into the -20 area suggested a divergence bottom was likely, which occurred. The indicator is near zero, suggesting more upside is possible. This indicator supports a short-term rally. We will look carefully at prices again should this indicator test the +10 area, which we expect. Our concern is that Monthlies (see this month's research piece) will be overbought once again, should the market rally into January.

Market Review: Price Charts – Weekly – Fred's Price Oscillator



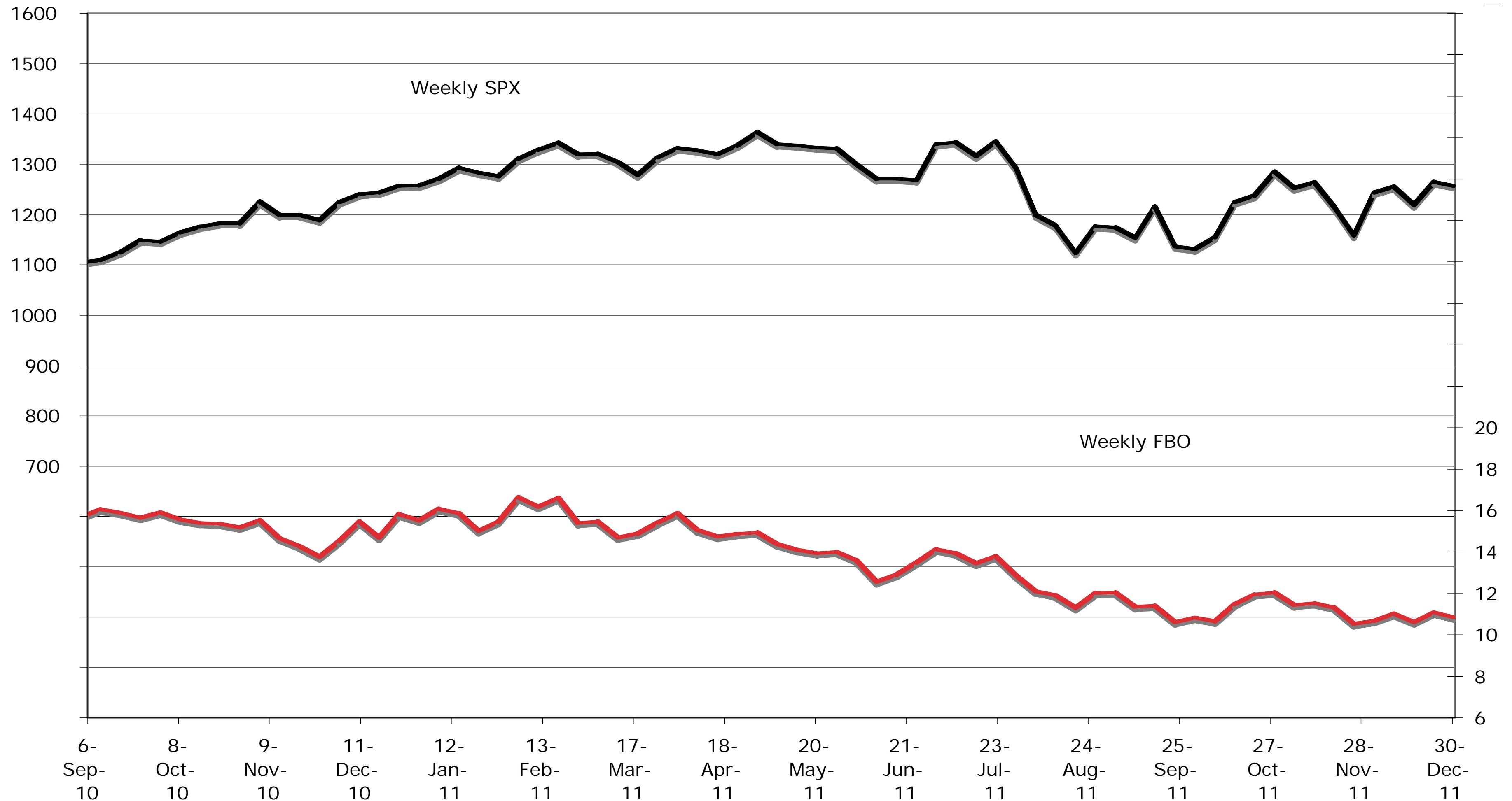
The Weekly FPO moved to the highest level since 2010, a positive, before the November pullback: The November pullback was more severe than expected. This is actually a positive, as this indicator normally peaks through divergence and it should take several weeks for divergences to develop. This indicator continues to look positive longer-term. We rate it neutral, but note, once again, that the next overbought reading will correspond with a monthly overbought, ushering in a period of higher risk.

Market Review: Internal Momentum – Daily Fred's Breadth Oscillator



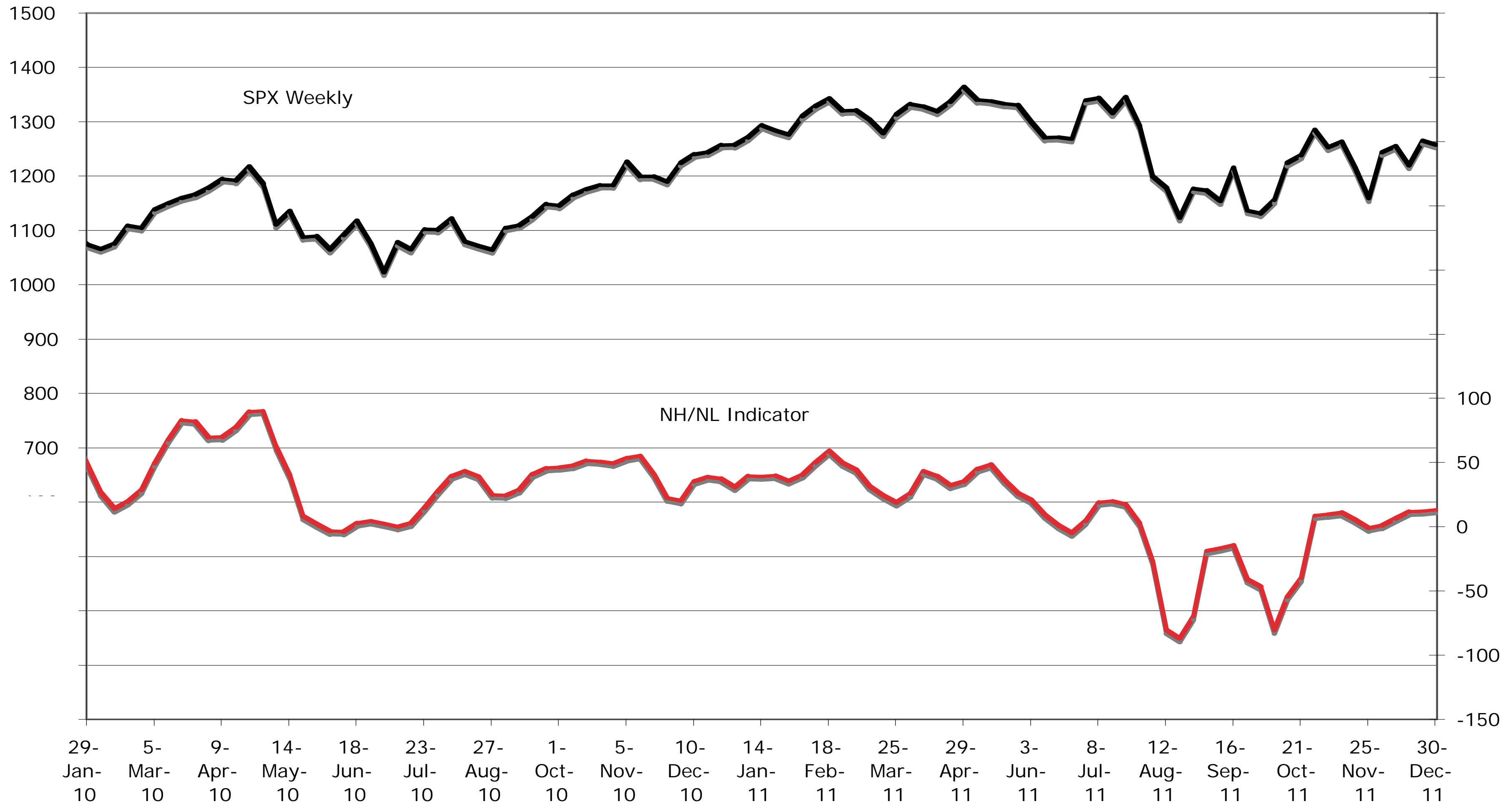
<u>The short-term FBO is moving up</u>: The indicator moved down into the 8 area, an extremely low reading, during 2011's corrective phase. More work at low levels has occurred, and this normally suggests a reversal in trend, which has occurred. Short-term breadth momentum indicators had a nice surge, and the current pattern supports a short-term rally. We rate this neutral/positive.

Market Review: Internal Momentum – Weekly Fred's Breadth Oscillator



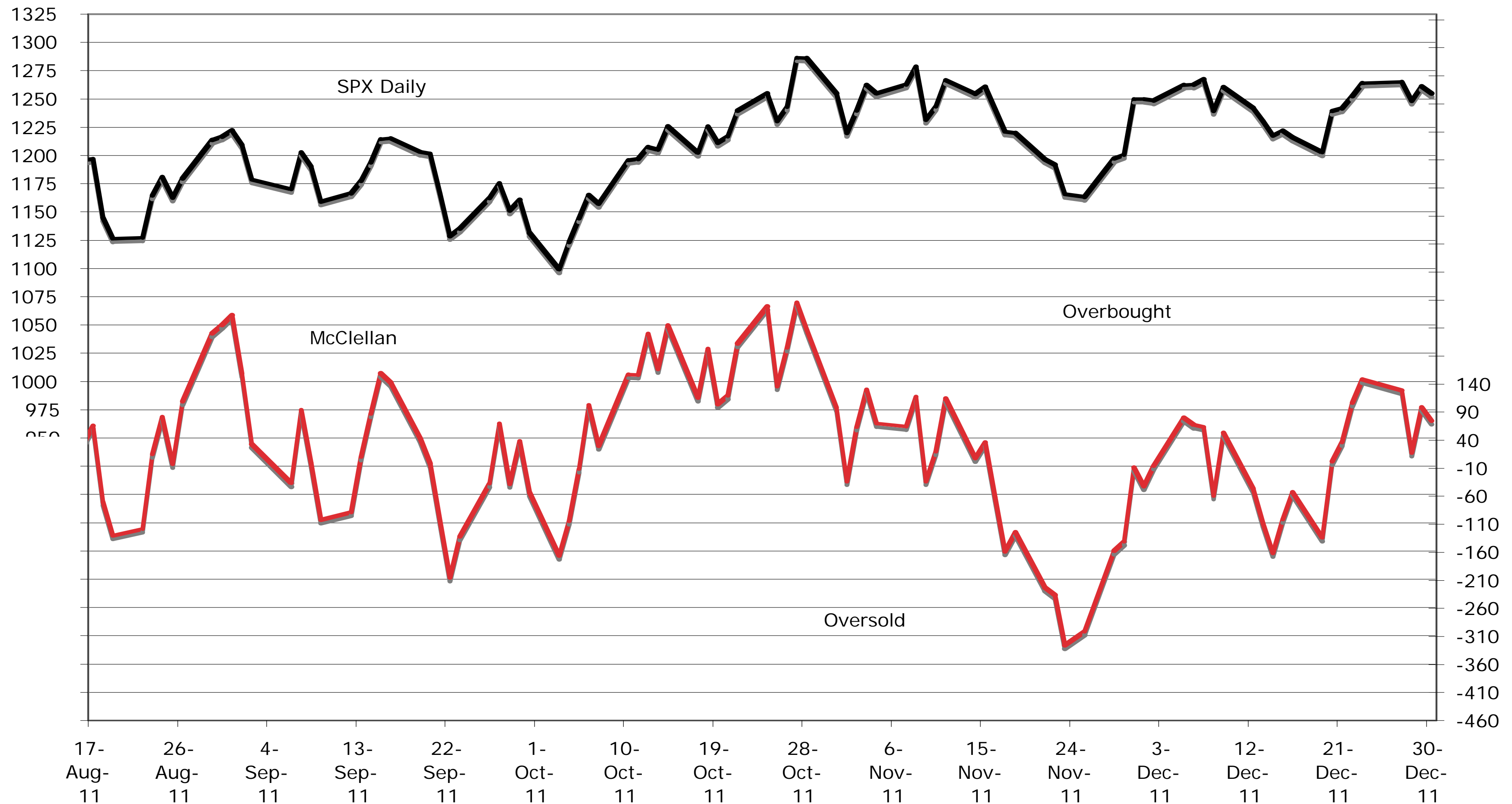
<u>The Intermediate FBO is building a base</u>: This indicator did not confirm the rally from August to December 2011. Weekly breadth numbers are our biggest concern for stocks as a whole. Currently, we expect stocks to move out of the head and shoulders patterns shown earlier, and should this occur without a breadth thrust that would be a negative sign. Currently this indicator is neutral with a bit of a negative tilt.

Market Review: Internal Momentum – Fred's New Highs/New Lows Indicator



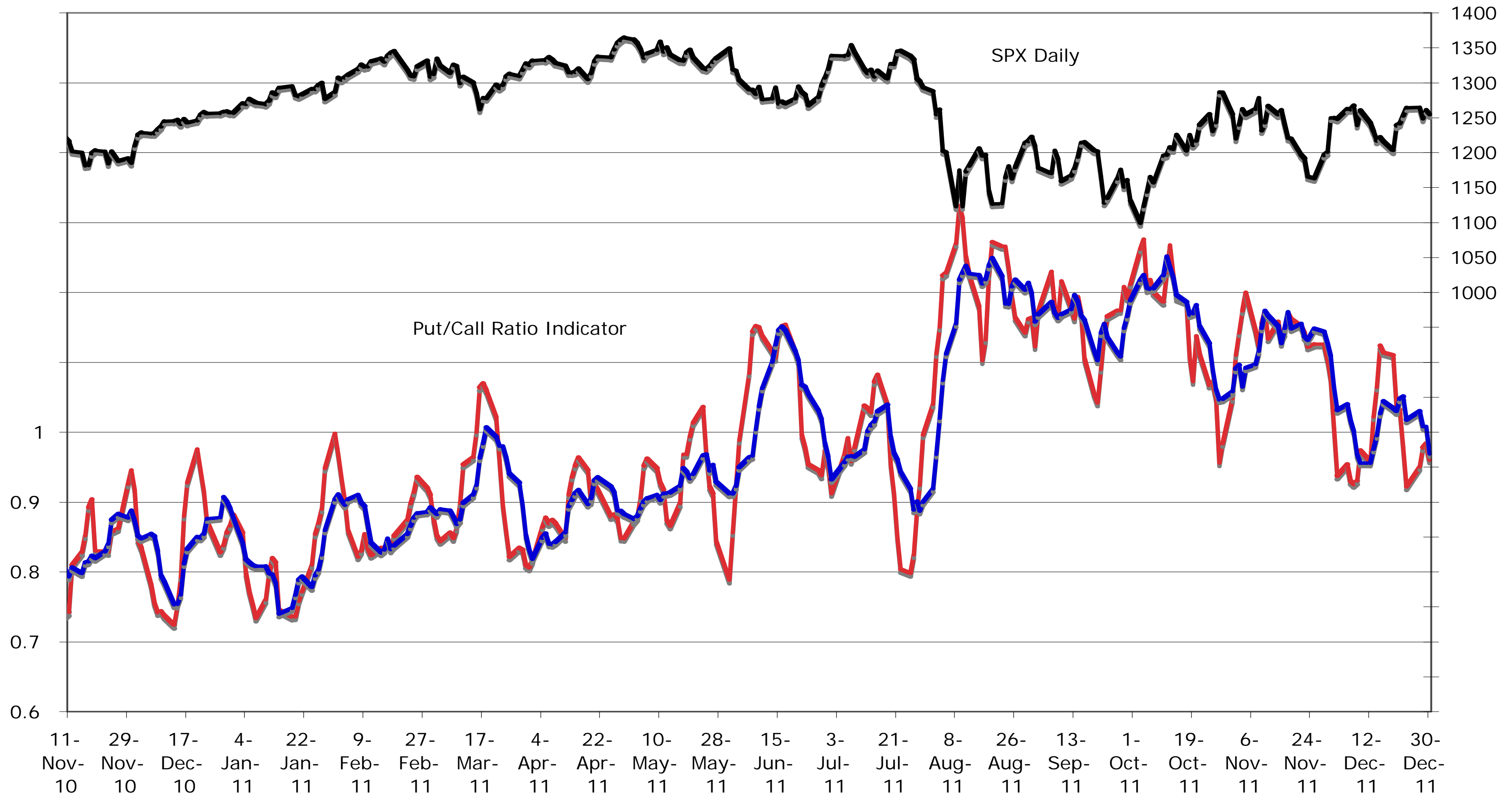
New Highs/New Lows have improved slightly since last month's report: This tool measures the difference between the amount of new highs and new lows on the NYSE. New lows have started to contract slightly over the last two weeks, and so far there are still more new highs than new lows. This indicator often peaks and troughs early, has given bottoming signs, but no new signs that a peak is occurring. Should the market rally in the first quarter, we would like to see a surge in the amount of new highs – yearend maneuvers can distort this indicator.

Market Review: Internal Momentum – McClellan Oscillator



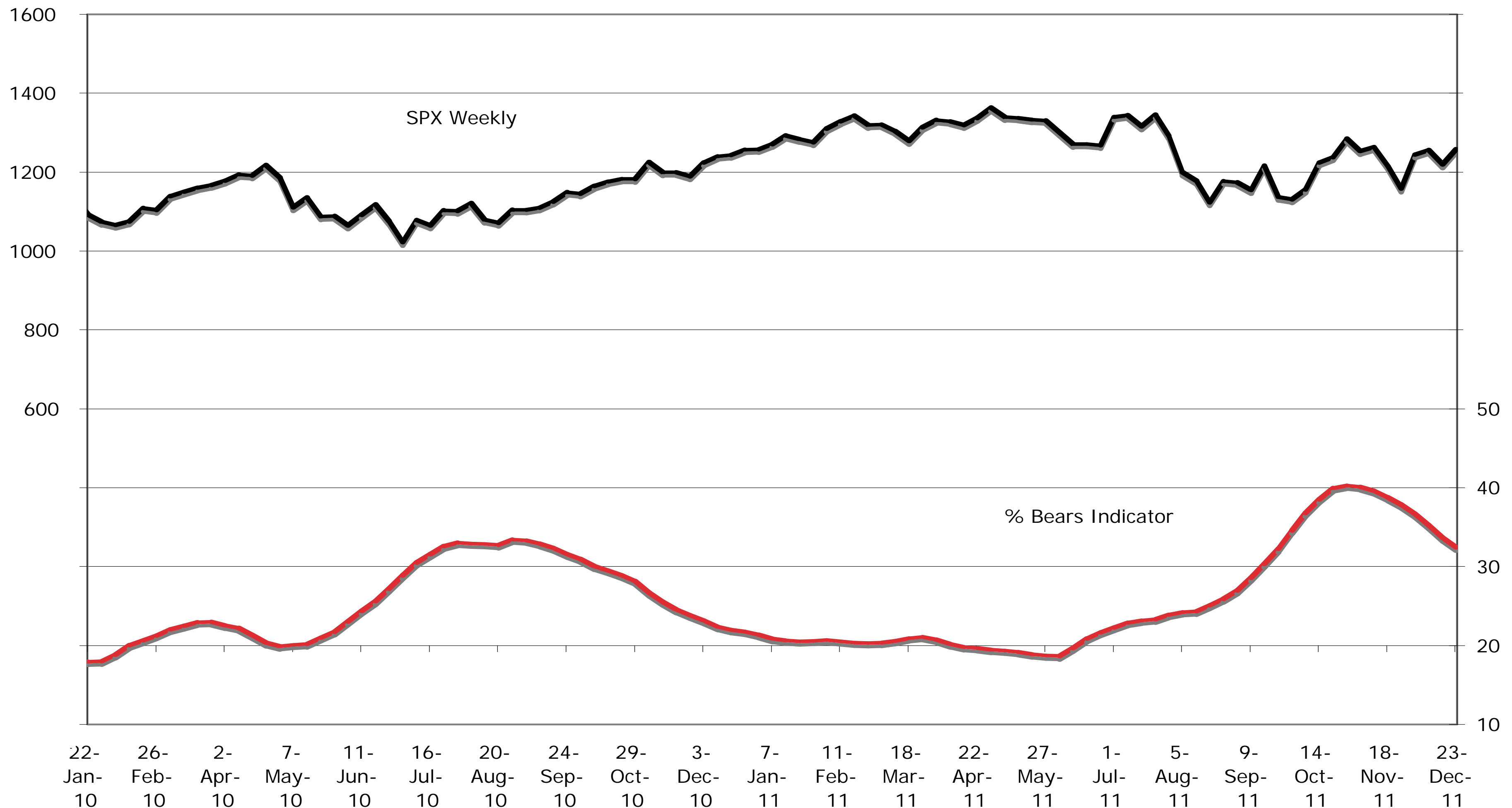
The McClellan Oscillator slightly overbought: The McClellan is one of our favorite short-term timing tools. The pattern on the oscillator is favorable, supporting our rally thesis for the first part of the New Year. One sign the rally could have "legs" for more than the first month or so would be a "breadth surge", which would take the oscillator above 300. Should this fail to occur, we would watch for signs of a stronger than average correction.

Market Review: Sentiment – Put/Call Ratio



The Put/Call ratio is positive: Sentiment indicators are "condition" indicators for us, and not timing tools. This indicator moved up sharply into the buying area on the correction is 2011 and has come off a bit, but still suggests further upside. Our % Bears indicator is also positive (see next page). Sentiment indicators suggest further upside is likely here – many are out of the market, and the chart patterns are quite favorable short-term.

Market Review: Sentiment – Investors Intelligence % Bears Indicator (moving averages)



Investor's Intelligence %Bears indicator has started to fall off as the market rallied: The current reading is 32%, down from 38% since the last report, and this is normal behavior for this indicator. On September 2, 2011 this indicator gave a buy signal, and it continues to suggest further upside intermediate-term. The indicator hit the highest levels seen since May of 2009, in 2011.The indicator remains in bullish territory, and still has a ways to fall, a contrarian plus. Normally a strong of readings in the low 20's occurs before a market peak.

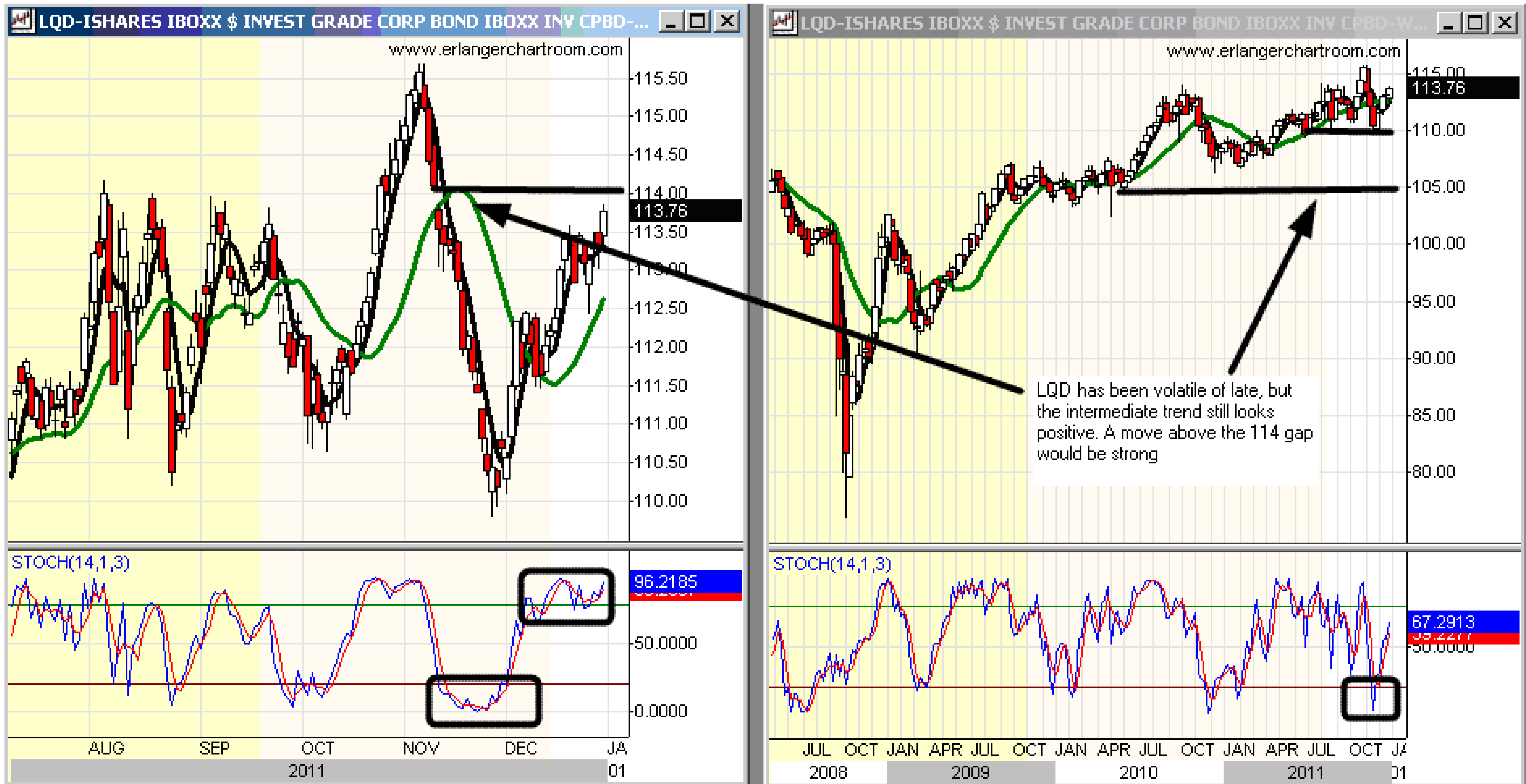
Other Markets: Bonds – TLT – iShares Barclays 20+ Year Treasury Bond

<u>The TLT remains stronger than expected but there are some signs of deterioration</u>: The TLT tested 110 are support and held. Accumulation models improved on the decline, but now have started to weaken. We continue to have concerns based on high sentiment numbers (Market Vane back over 72), and a strong overbought condition on monthly indicators. Our biggest concern for stocks is that the TLT is forecasting a "surprise" event that will hurt stocks - but indicators suggest a decline on TLT is no more than 2 months away.

Other Markets: Bonds – BWX – SPDR Barclays Capital Intl Treasury Bond

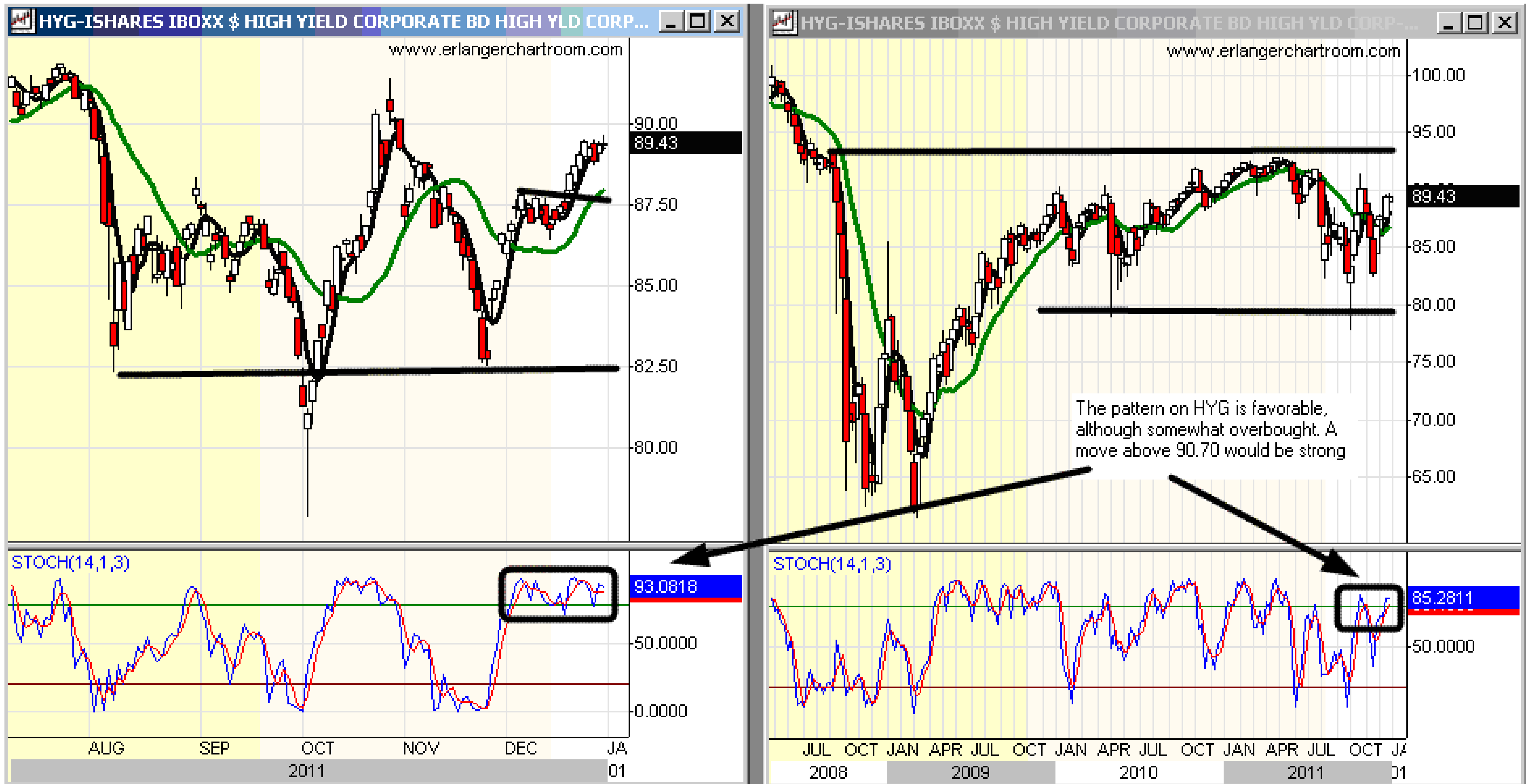
The BWX has broken the very short-term support: Currently this ETF is volatile, and weakness in the Euro has had an effect. The intermediate-term chart remains positive as long as BWX is above 56 to 57, which is being fully tested. Daily and weekly moving averages are now negative. The Japanese Yen pulled back due to intervention, which pressured this ETF. We have suggested strategies to protect profits, and would tend to avoid international bonds at this juncture.

Other Markets: Bonds – LQD – iShares iBoxx $ Invest Grade Corp Bond



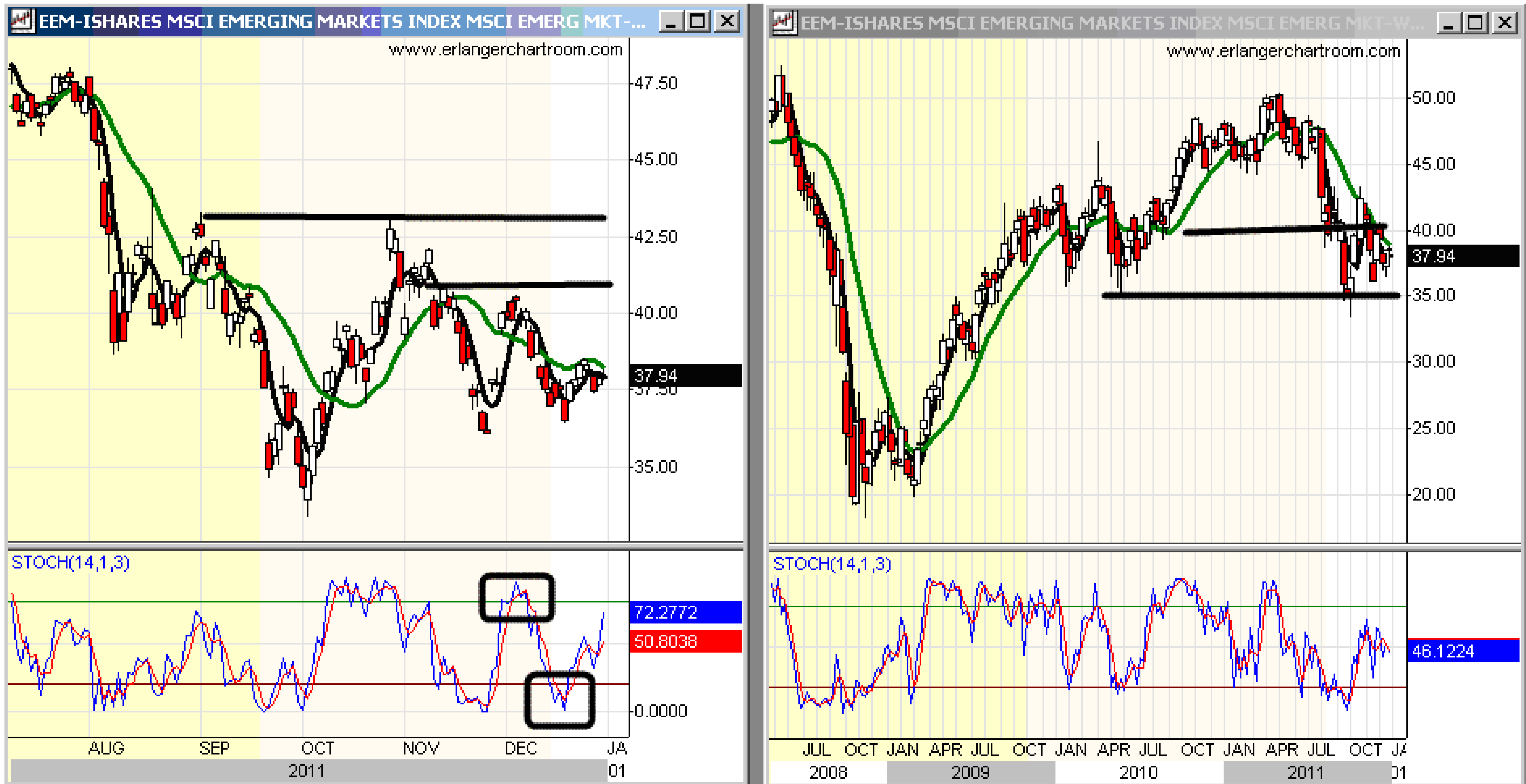
The Corporate Bond ETF held long-term support, and while volatile, still looks to be up: The overall condition of rates remains a concern, and accumulation models on LQD have weakened. This ETF remains intermediate-term up, and has been our preferred bond investment over the last few months. Most of the bond patterns we follow are weakening, suggesting higher rates, or at least concerns about debt levels. Below 105 on LQD would suggest the uptrend in LQD is over. Above the gap at 114 would suggest new highs.

Other Markets: Bonds – HYG – iShares iBoxx $ High Yield Corp Bond



The High Yield Bond ETF has traded as a proxy for risk in 2011: This ETF broke below support as the stock market corrected. It rallied along with stocks, but failed near resistance. This ETF looks to be a range from 80 to 90 or so. One way to trade HYG, safeguard profits, and capture yield, would be to buy both HYG and PHB (another, less volatile, high yield ETF). Then, sell HYG near 90 (assuming this works!), and hold PHB – using the points gained on HYG as a hedge. We may see HYG trade more in line with rates in 2012.

Other Markets: International – EEM – iShares: MSCI Emerging Markets



The EEM has continued to underperform the US in 2011, and volatility has increased: Intermediate relative strength continues to deteriorate. We recommend de-emphasizing allocations to Emerging Markets, as accumulation models continue to weaken as well. For new international money, we would look at individual country funds, and if flexible would use US small or mid-cap funds instead. Note how EEM failed to test resistance at 45 and is much closer to the October lows than many US indexes.

Other Markets: International – EFA – iShares: MSCI EAFE Index

<u>The EFA continues to under-perform the US and is now under-performing EEM</u>: This ETF continues to under-perform the SPY and MDY. EFA looks weaker than SPY both on this recent correction and on the rally as well. Advisors may want to use individual country ETFs for foreign allocations rather than EFA, while realizing we continue to see movement from Europe into the US. We believe that US markets, particularly the Dow and SPX, should outperform EFA in 2012.

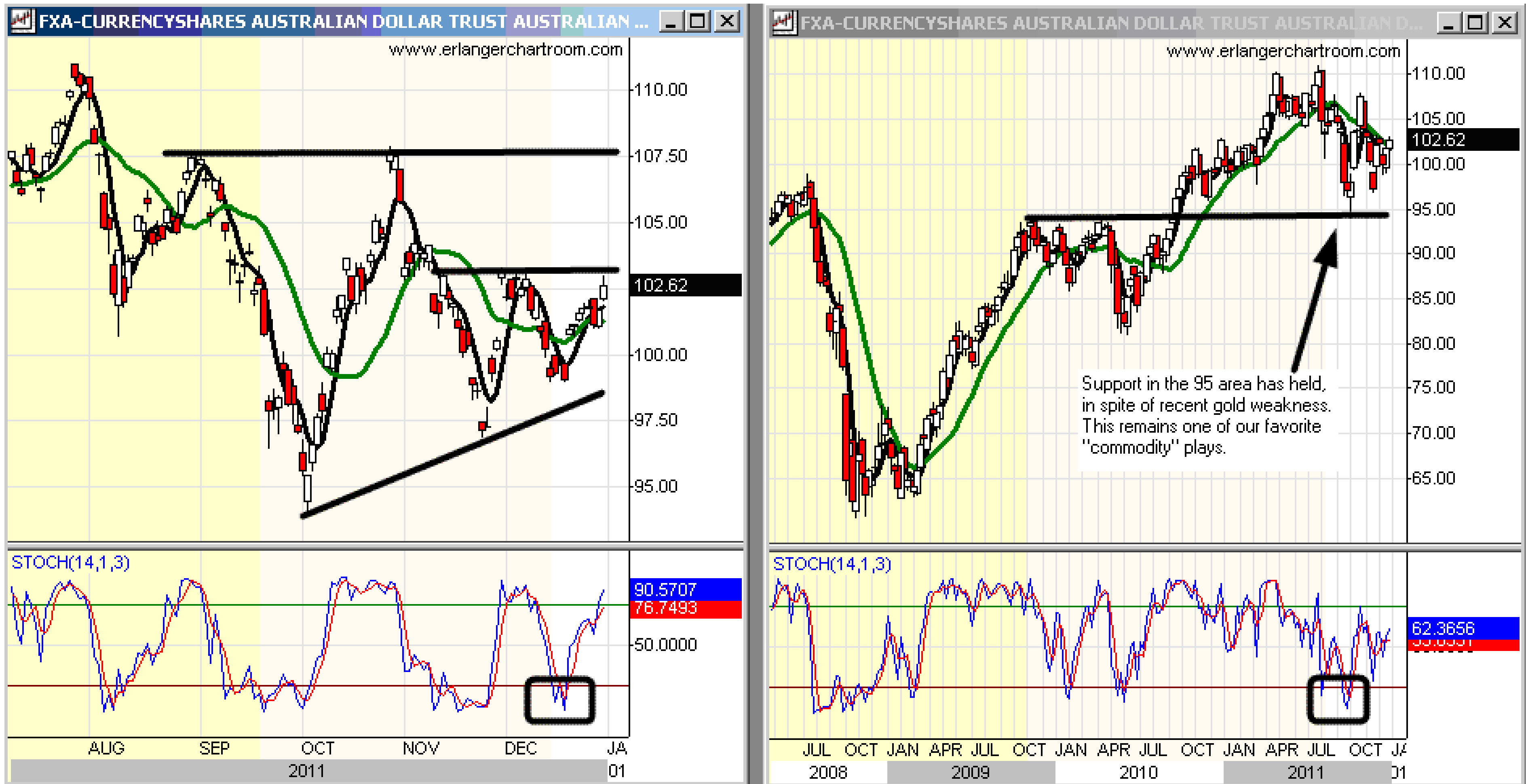
Other Markets: Currencies – FXE – CurrencyShares Euro Trust

The Euro ETF has failed at the 140 area resistance: The failure at 140 on FXE suggested a retest of the 132 - 130 area, which has occurred. Accumulation models suggest the FXE should continue to weaken (not a big surprise!). A move below 128 targets 120. Subscribers should be on their guard here – the fundamental reasons for this decline are such that some of the intermarket relationships we have seen over the last few years could change, and we will be alert to new trends in 2012.

Other Markets: Currencies – FXY – CurrencyShares Japanese Yen Trust

The Japanese Yen ETF remains long term positive - BUT: Over the last two months we had been suggesting that government intervention in the Yen was likely, and this has occurred. Should FXY move below the 125 area support a move to the 115 area would be likely. This would help the dollar to rally even if the Euro stabilizes - something which is looking less and less likely. We note that accumulation models continue to weaken, but stochastics became oversold. Should FXY test 115 the long-term trend would still be positive.

Other Markets: Currencies – FXA – CurrencyShares Australian Dollar Trust



The Aussie Dollar has held support: This currency is part of one of our longer-term themes, which is that commodity inflation is alive and well, and that the growth markets in Asia will ultimately lead the world in a global recovery. This currency trades with gold, and our 8 -month objective for gold remains $2100/oz, or 210 on GLD in spite of recent weakness (see p.27). FXA tested support at 95, retested successfully, even as gold has weakened. This currency may be a surprise out performer in 2012.

Other Markets: Currencies – DXY – US Dollar Index

The Dollar has rallied towards our target areas: The dollar index rallied above 80, but has, so far, fallen slightly short of our 83 – 85 objectives. We expect these to be hit in the current move up. Unlike the previous up-move, the Yen is helping the dollar along, and should weaken further even if the Euro stabilizes (see pages 22 and 23), which we feel is unlikely. Note that because of changing long-term fundamentals in the Euro, the intermarket relationships that have prevailed in the dollar over the last few years may change.

Other Markets: Commodities – DBC – PowerShares DB Commodity Index

The DBC commodity index has formed an intermediate-term wedge: Commodities have a tendency to decline in spring, and this occurred this year. The next seasonally favorable time for oil and the metals is from November through the end of January. Oil has continued strong, but gold has had a sharp drop, which we feel is ultimately positive. A move up through the downtrend line, as drawn, would tend to suggest new 52 week highs. We expect this in 2012. Also see pages 27 and 28.

Other Markets: Commodities – GLD – SPDR Gold Shares

<u>The Gold Market is consolidating within a strong uptrend:</u> Gold remains one of our favorite long-term investments. We moved back to an equal weight in Gold, and continue to caution advisors against Silver, which could under-perform. **Our 8 month objective is 210 on GLD, or $2100/oz on the nearby gold contract**. Gold often advances from November to January, but this year has been weaker than normal. More consolidation is certainly possible as this market has been very strong in 2011, but gold should still have a strong 2012.

Other Markets: Commodities – USO – United States Oil

Crude Oil has rallied to intermediate resistance: Oil strength and a commodity rally is in line with our long-term bias towards inflation and not deflation. Last month, we suggested that the seasonal move that occurs from November to January is occurring once again, and while we expect higher prices into January, the bulk of this move may have been completed – cautious seasonal traders should consider sale here, as we mentioned in the weekly.

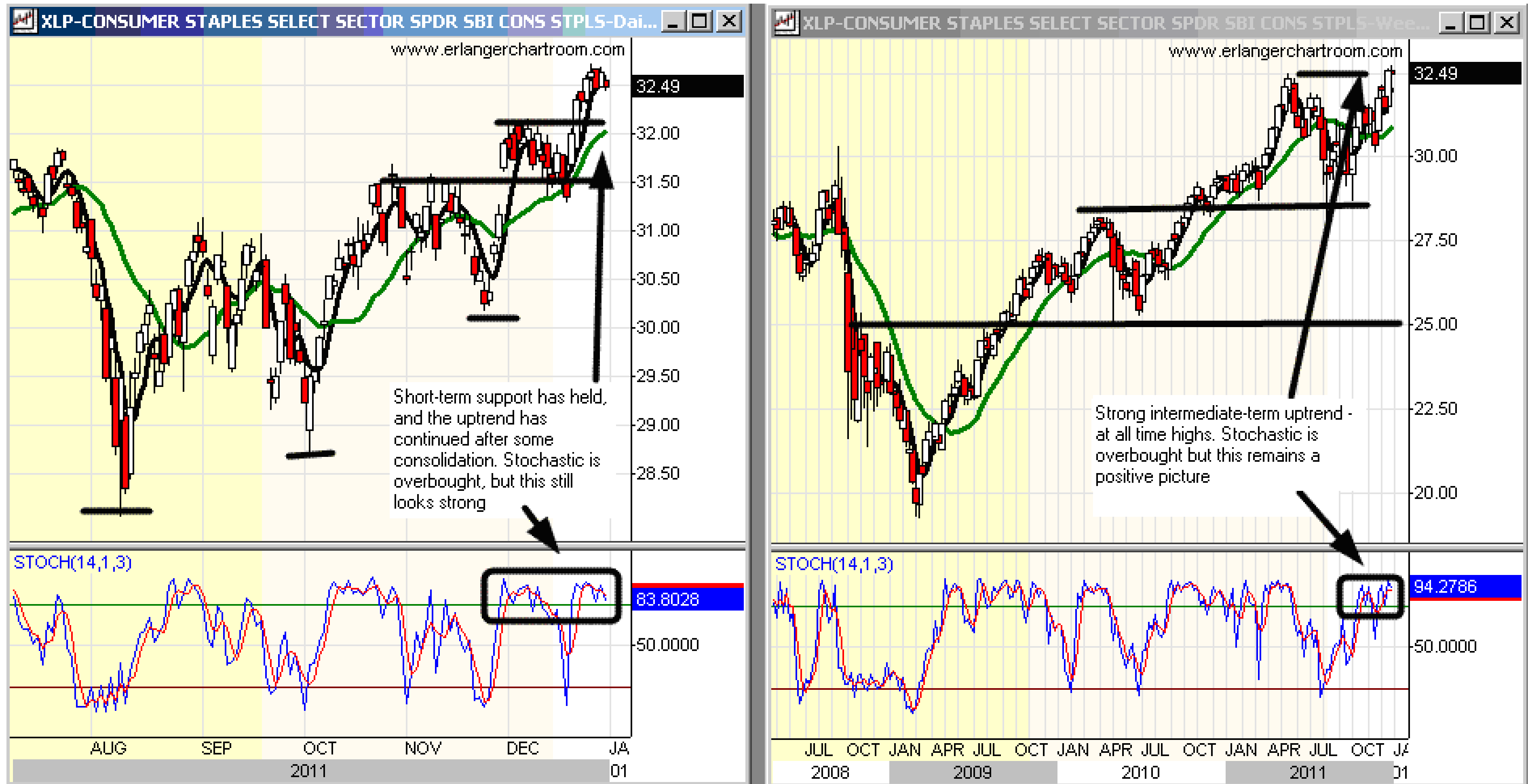
Other Markets: Commodities – UNG – United States Natural Gas

<u>The UNG has made new lows, after testing the short-term resistance at the $8.00 area</u>: We note here that **there have been issues surrounding the viability of the UNG due to contango.** We use it here simply because many advisors have no other way to get quotes on Natural Gas, and advise readers to check with their compliance departments regarding this. There are layers of resistance between 7 and 8, and this market has surprised us several times with weakness. New breakdown unless above 7.50 soon.

ETF Sector Charts: Consumer Discretionary (XLY)

Consumer Discretionary has been one of our top sectors since January of 2009 and it continues to perform well: This sector remains long-term positive, especially compared to weaker sectors such as XLF. Accumulation models on XLY have started to improve and continue to be stronger than SPY. We had concerns that this sector would experience problems in a weak market, but it traded better than the market overall. This improvement in relative strength during the last several months suggested an improving economy, in our view. The numbers are now slowly bearing that out, although we could see slowing again mid-year 2012. EQUAL WEIGHT.

ETF Sector Charts: Consumer Staples (XLP)

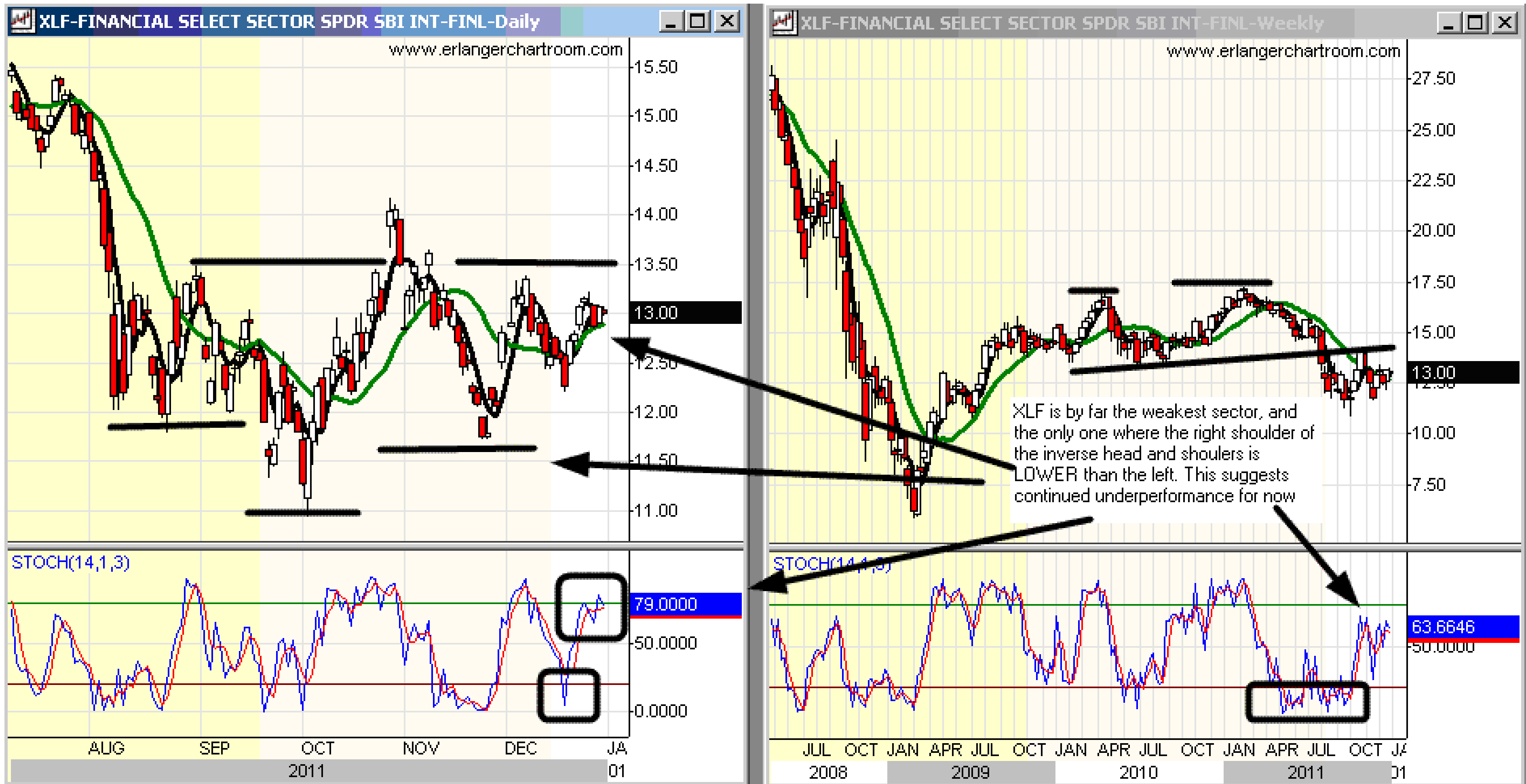


Consumer Staples is our favorite defensive sector and performed well in the last few weeks, breaking out to all time highs: The accumulation model remains one of the most attractive of the sectors and has improved. Note higher lows made in October vs. August, is a plus. We would continue to hold an equal weight in this sector even if the market rallies through January. Foreign money buys these names. EQUAL WEIGHT.

ETF Sector Charts: Energy (XLE)

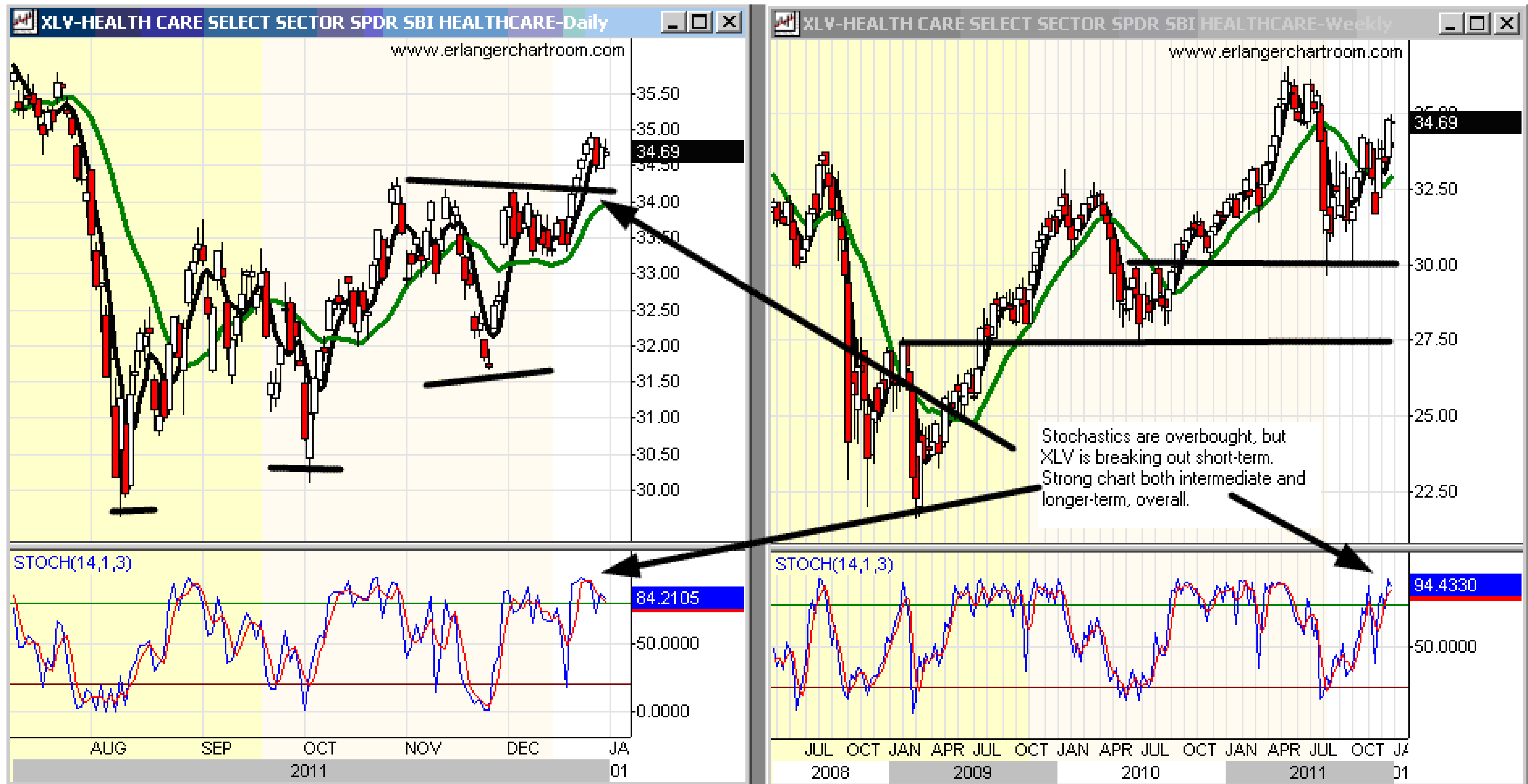
The XLE has held intermediate uptrend support: Energy stocks corrected along with the market last summer, but look stronger overall. We note that the intermediate-term uptrend has held, so far. Energy stocks tend to rally in the winter, and we believe this will happen into 2012. We will remain overweight as oil itself is trading well, and the stocks often follow the commodity (see p.28 for the chart). The market as a whole seems poised to rally in the first quarter of 2012, and energy stocks, in particular large cap names such as Chevron, are attractive. **Energy was mentioned in Barron's as a top institutional favorite (Barron's October 31) and this may help the sector**. OVERWEIGHT.

ETF Sector Charts: Financials (XLF)



Financials have consistently lagged since March/April 2010, and remain weaker even as market rallied in October: Overall this ETF is weak as this sector barely exceeded the April 2010 high. We remain underweight this sector, and recent price action has validated this. A move back above 15 would improve this chart, but this seems unlikely. We note the break of the July 2010 lows, while most sectors have held these lows. This sector is the only one with a lower right shoulder than left shoulder, a concern suggesting continued underperformance at least for the next quarter. UNDERWEIGHT.

ETF Sector Charts: Health Care (XLV)

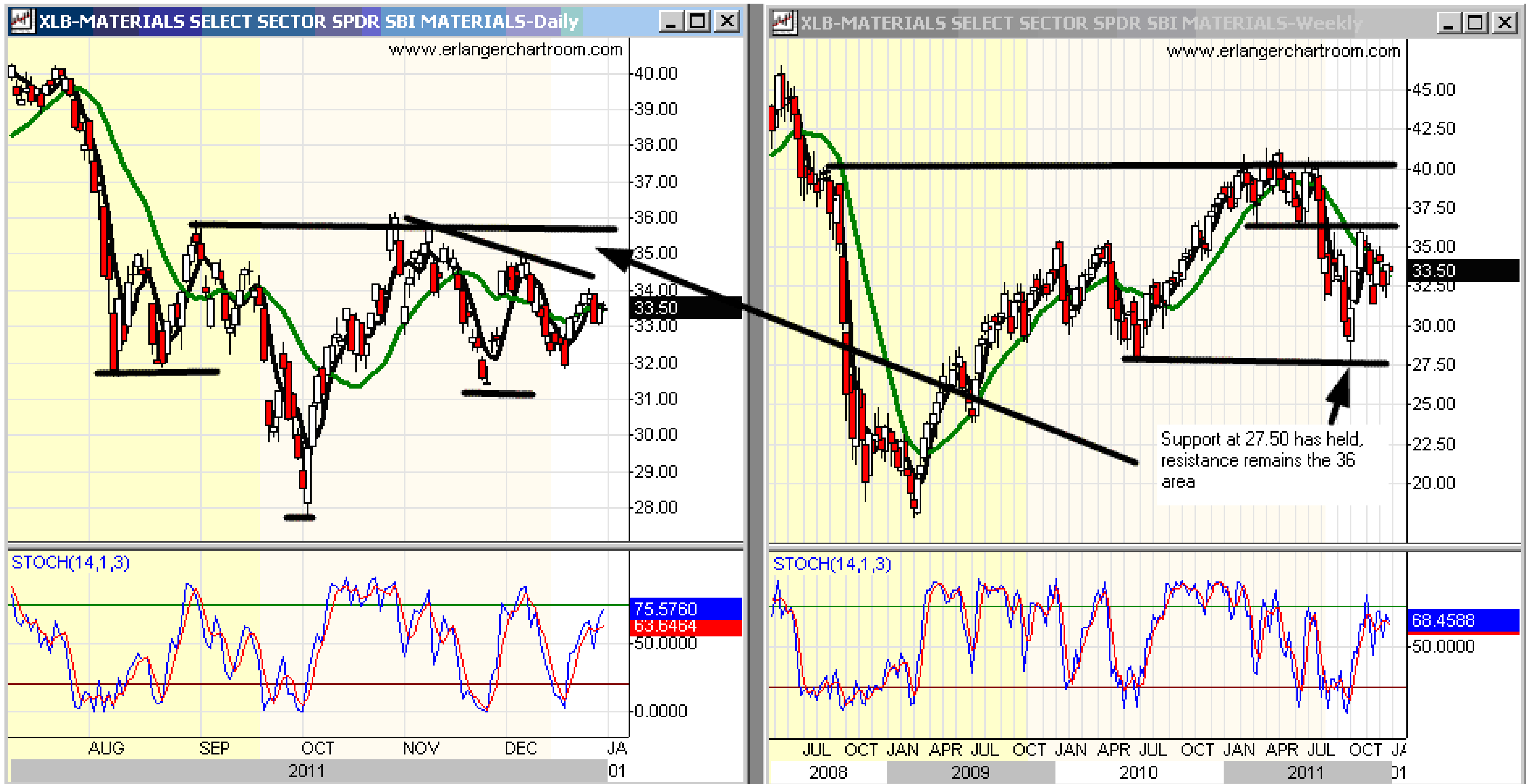


<u>Health Care is breaking out short-term:</u> XLV has lagged a little coming off the October lows, after outperforming during the correction. Our accumulation model continues to improve, and now price has broken out short-term. This makes three months of improvement in the sector. Moving into 2012, an election year with a contentious healthcare bill dispute and a key Supreme Court case, this improvement bears watching closely. The stronger individual stocks are performing well, but weak stocks are hurting XLV. EQUAL WEIGHT

ETF Sector Charts: Industrial (XLI)

Industrials have lagged over the last few months, but the pattern is now positive: Longer-term, the XLI is below 35 area resistance. Our accumulation model is neutral, not what we would expect to see to suggest a major improvement in the economic outlook. This sector continues to give conflicting readings from month to month, and is neutral unless 35 is penetrated soon. We remain an equal weight and believe this sector could do well should economic sentiment change. EQUAL WEIGHT

ETF Sector Charts: Materials (XLB)



XLB declined more than the broad market: This sector is economically sensitive. Intermediate-term support at 27.50 has held, but recovery has been less strong than other sectors. Short-term this sector has lagged Industrials but accumulation models have continued to improve. The 36 area now offers intermediate resistance, and has failed so far. This chart suggests that the economy may continue to lag even if the market stages a rally into 2012, but the picture has improved again this month over last month. EQUAL WEIGHT

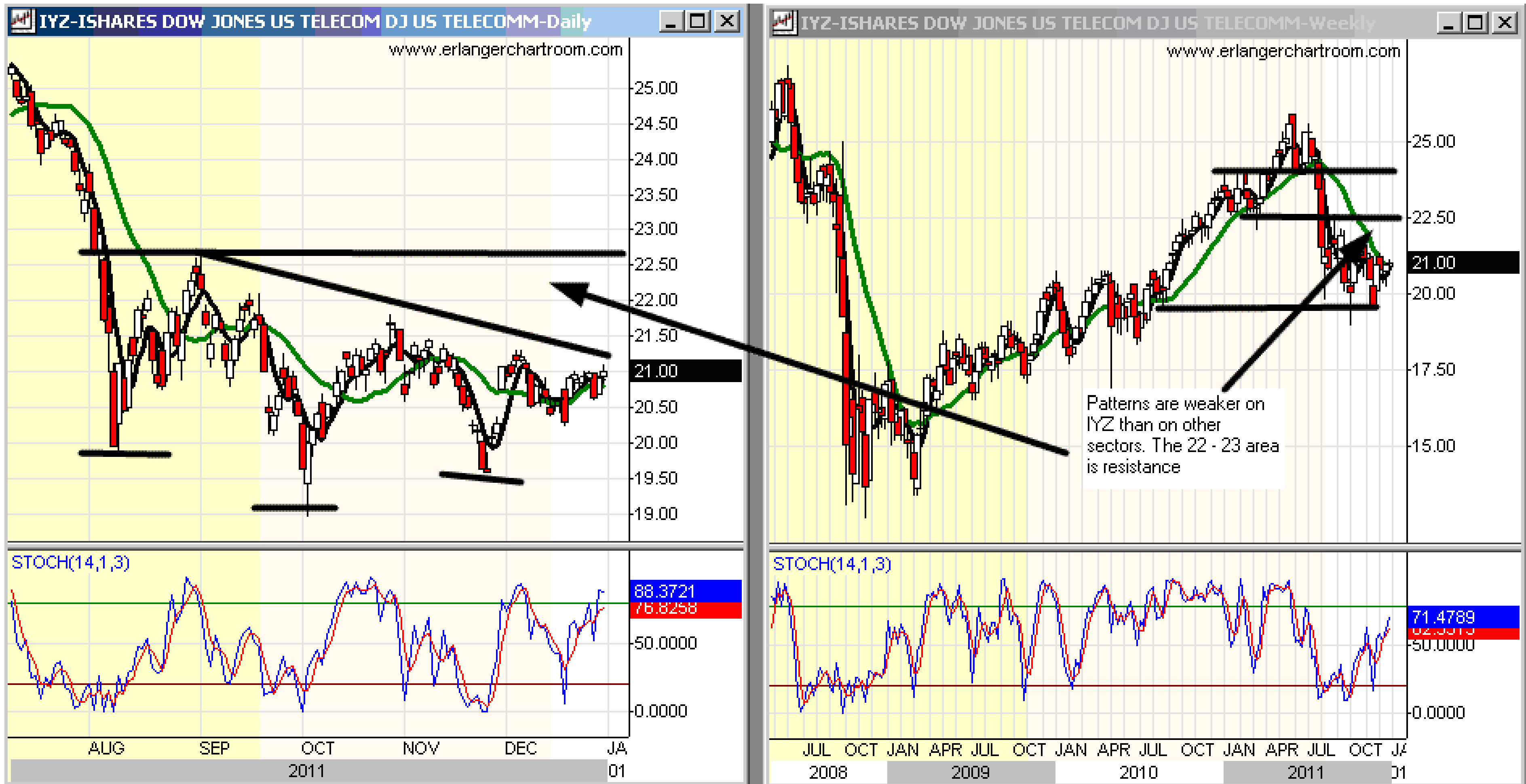
ETF Sector Charts: Utilities (XLU)

Utilities have continued to improve, as the market has improved: The 2008 breakdown point resistance is at 37.50, still a ways from here. Our accumulation models have improved a little over the last month. This sector may be trading more with LQD and less with TLT, as it did not decline along with government bonds. It is still a long-term underperformer from 2007 through 2010, but was among the best performers in 2011. Advisors do need to have a plan in place, should XLU correct substantially in 2012, as we expect. UNDERWEIGHT.

ETF Sector Charts: Technology (IYW)

Technology has started to lag a bit moving into 2012: It remains one of the strongest sectors long-term, and in the October rally traded again near multi-year highs. Higher lows as the market retested is also a big plus. Strong stocks have outperformed during the market correction and have led into year end. Tech is “everybody’s favorite overweight”. We will stay with this for now, but may make changes in the next Sector Review. OVERWEIGHT

ETF Sector Charts: Telecom (IYZ)



Telecom has weakened short-term, and has lagged, during the recent rally: Short-term resistance is now the 22 to 23 area, as drawn. IYZ is still substantially below the 2007 peak. Note lower highs than the August/September peak. This is normally a defensive sector, and has stocks with good yields, but continued bad news on a major component (AT&T) has hurt this sector. That news may now be behind the company. Many stocks have high yields, and individual components may do better. EQUAL WEIGHT

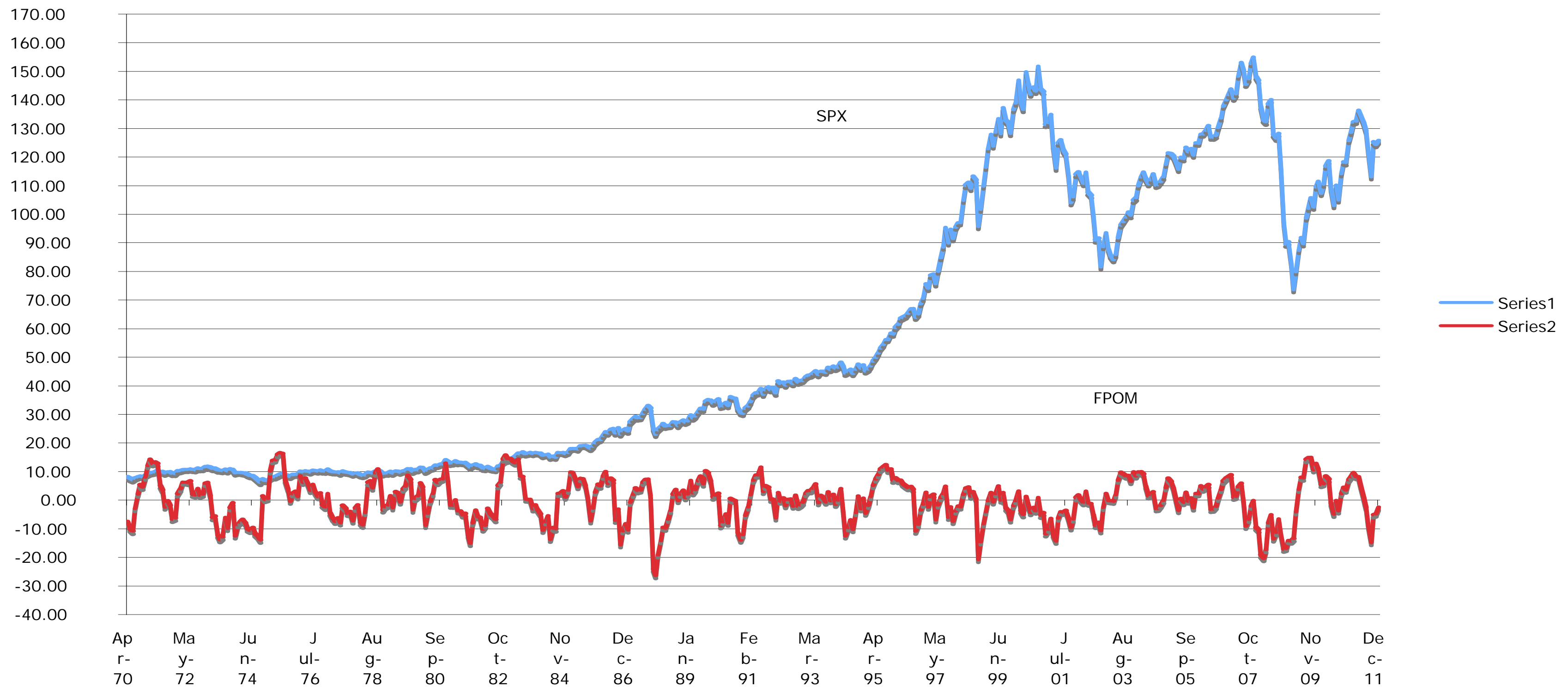
Research Piece: FPO's on Stocks, Bonds, Gold, Oil, CRB and Currencies

For this year's "year ahead" piece we will look at monthly FPO's (Fred's Price Oscillator) on stocks, bonds, gold, oil, the CRB, and currencies (the dollar and the Swiss Franc). We note that monthly indicators are best used in conjunction with shorter-term tools, and as such we caution readers that our conclusions may (will?) change, and the timing of them may be a bit more difficult. Still, overall this method of developing a roadmap for the year has worked well for us in past years, particularly when I was writing this piece in Los Angeles in the 1980's, and also at Robinson Humphrey in the 1990's.

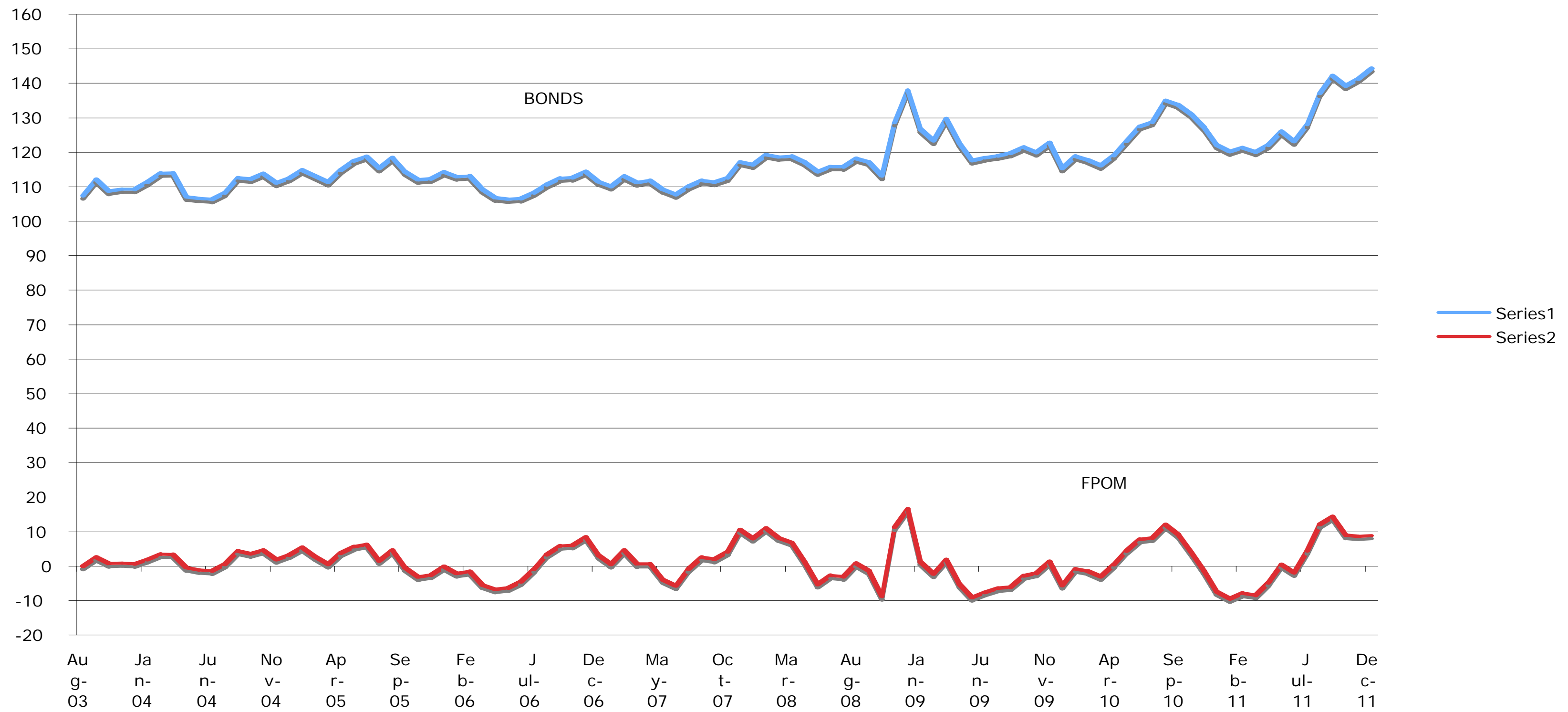
There are two ways I would think about this research piece. One way to think of this research piece is as a "Mystery Novel". By this I mean that while looking at indicator levels, and assessing probabilities for movement to other levels, is interesting - often things happen for reasons other than people could reasonably expect. We give a quick example: We are concerned about the mid-year performance of stocks because the Swiss Franc looks oversold and should stage a rally during the year. Often the Franc performs well in turbulent times. But this year it could be because of changes in the Euro that may not adversely affect US stocks (to me, the surprise would be that NOTHING changes, and everything is fine). The second way to think about this piece is that it is a roadmap, but something could change our routing that is currently unplanned for. So – ENJOY, but take with a grain of salt.

Here, we will give you some notes on the FPO to assist in reading these charts. First, the indicator is designed to find turning points within trends. These will often occur in the +10/-10 area. When the indicator moves outside those boundaries, one moves to shorter-term indicators to refine analysis. Moves outside the +15/-15 area are almost always reversed quickly, and market action, no matter how extreme, rarely puts the indicator outside the +20/-20 area without a reversal. NOTE: in all charts, price is the top line, and the FPO is the bottom line.

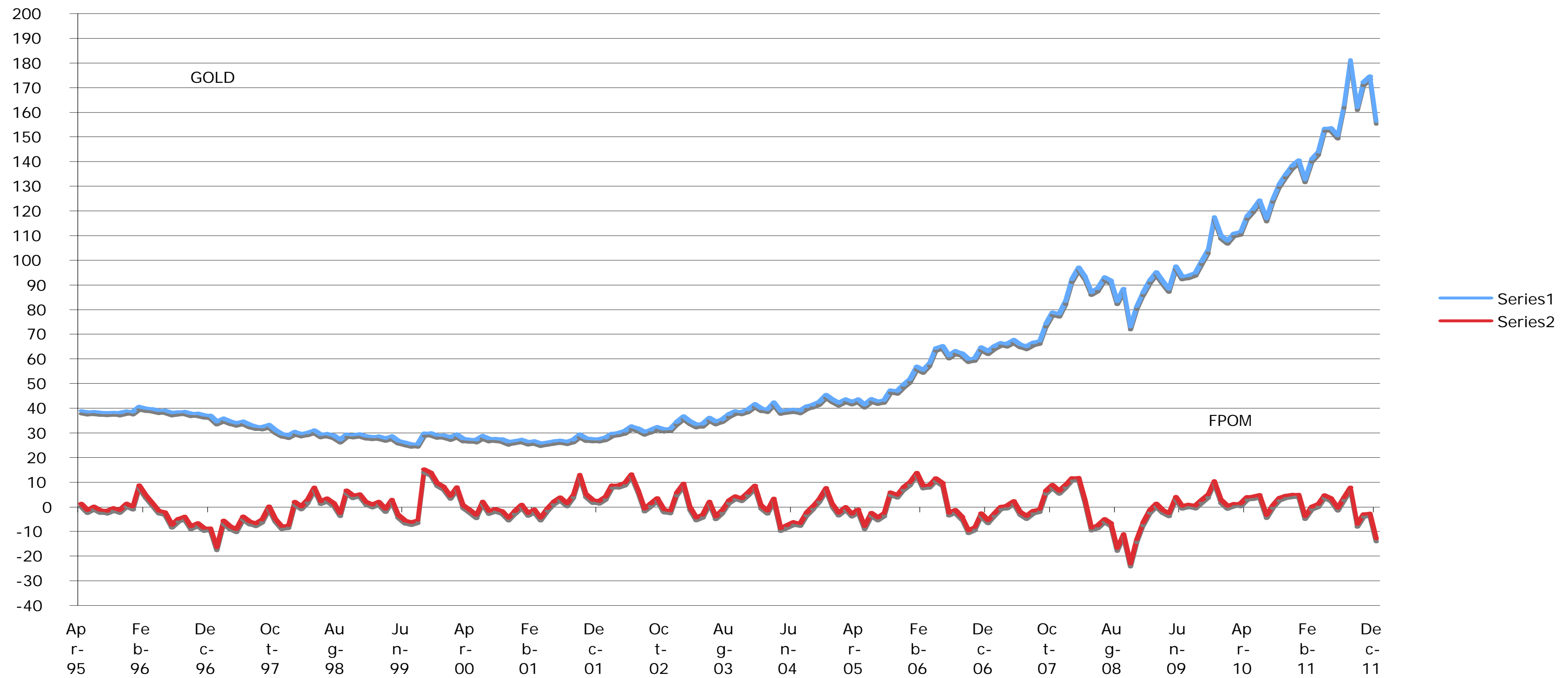
First, stocks: The monthly suggests that the first part of the year, at least the first month (and possibly the quarter) is likely to be up. After that things become less clear and are dependent on how short-term indicators perform. The concern we have is that a good run in January will move the monthly FPO back into the overbought zone for the first time since last March (recall last March's research piece where we illustrated this). The good news is the level of the indicator suggests that we could test, or exceed, the 1370 area high on the SPX, and sooner rather than later in the year. After that a decline at least into summer, possibly longer, could result. We show a chart back to 1970. Note that the momentum thrust from the 2009 low is stronger than all we have seen except for 1974 and 1982 – we remarked on this at the time, and indicated the low in 2009 could be highly significant, as boomers retire.



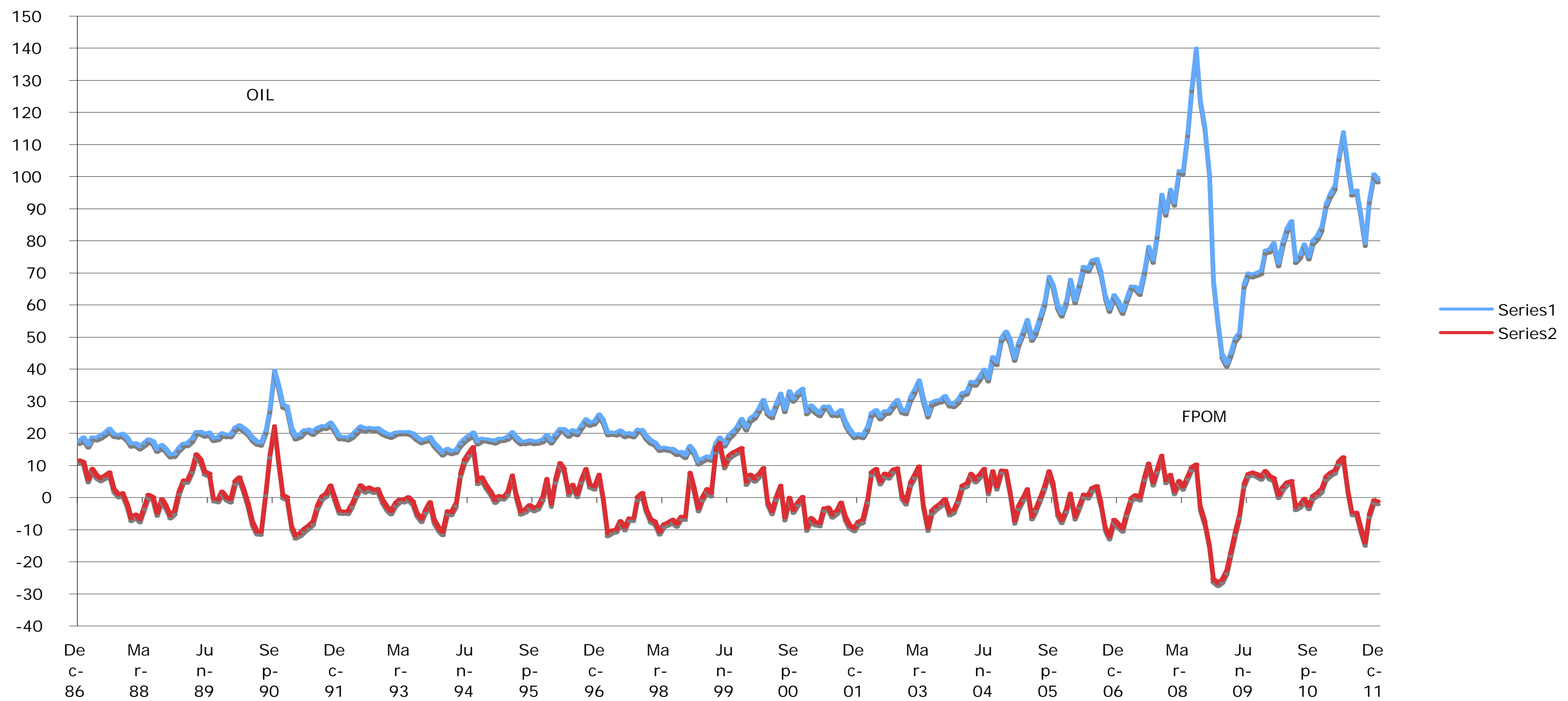
Second, bonds: The monthly suggests both via level and via pattern, such that bonds should start down almost immediately, or at the very least in February. This decline should be at least 2 months, but then may be reversed. Bonds did better than we thought in 2011, but may make up for this in bad performance now. If this occurs – careful of utilities – XLU may follow this market down. We remain underweight. Our only chart goes back to 2003 and is below.



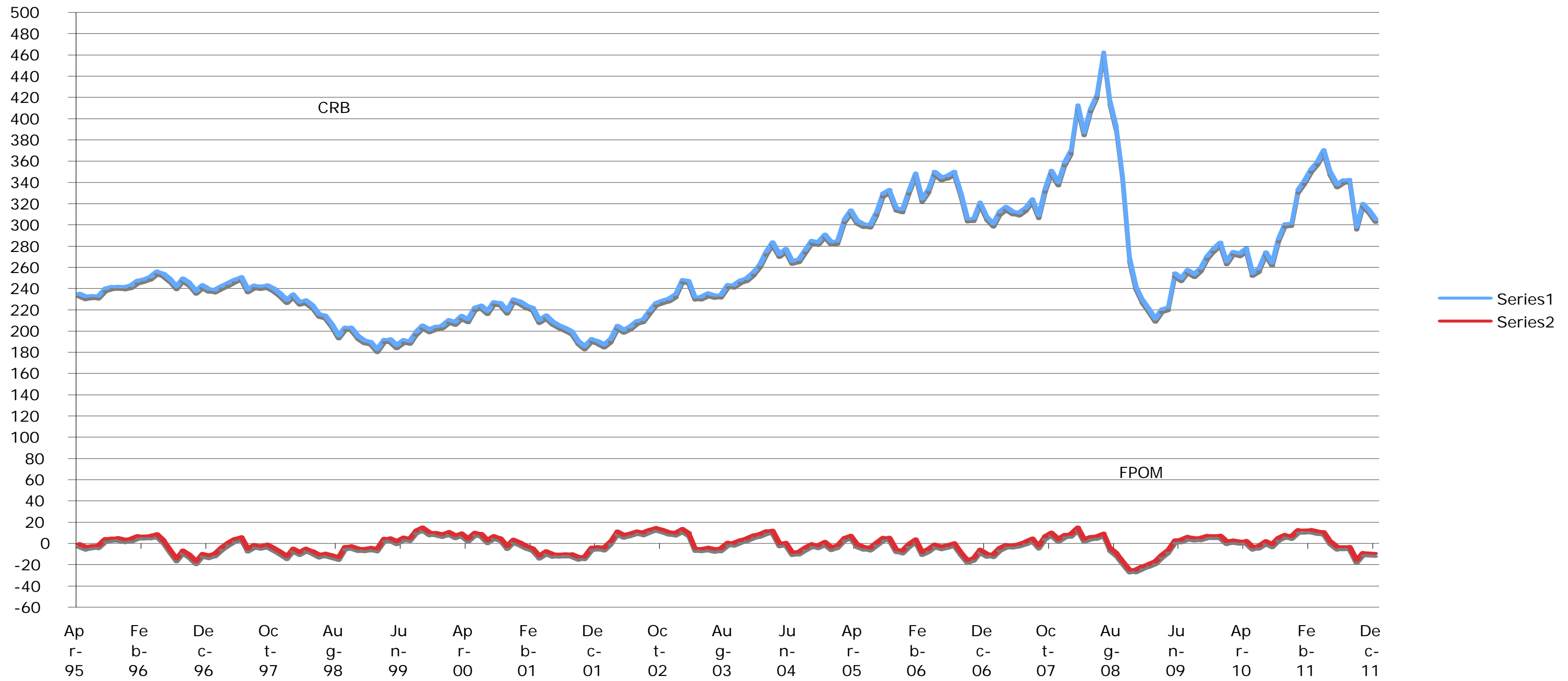
Third, gold: gold's monthly is oversold at just below -10. The 10 range is very important on gold – note that gold has only been outside that range a few times and only one of these has not been close to a major reversal. This suggests that gold is going to hold the 144-area support on GLD, and rally from here. Since the trend remains up on gold, as it has made higher highs and lows on each oversold recently – we continue with our target of 210 on GLD in eight months for now, but note that is a substantial move and advocate looking for a rally, but with risk management in place.



Fourth, oil: this commodity is rallying from the -10 area and is almost exactly neutral. Since there is a seasonal tendency for oil to rally into the end of January we will be very interested to see if the monthly can move up into the +10 area – should this move occur, we would be inclined to really de-emphasize oil – and this is what we, in fact, expect.



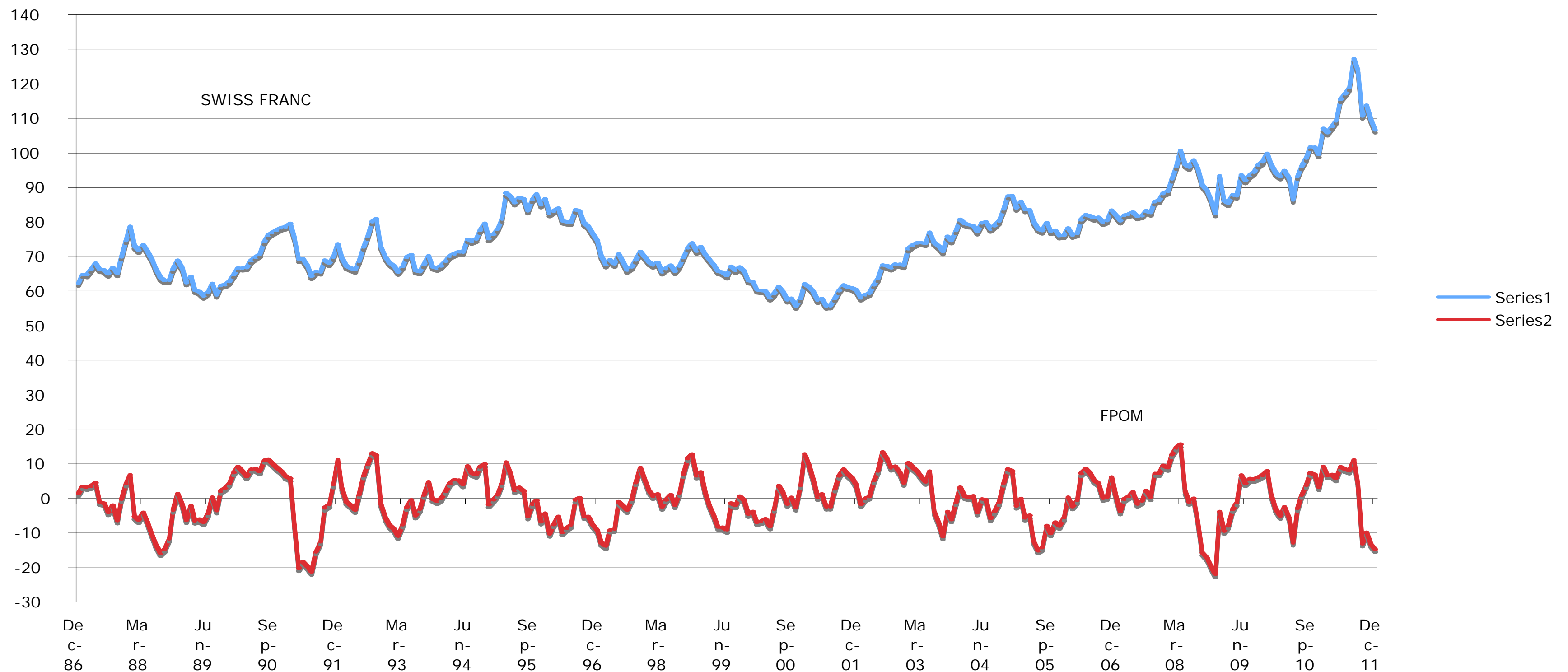
Fifth, the CRB: the CRB index is a fairly broad based commodity index, and it tends to confirm our long-term view on commodities, as it is oversold, and should at least start to advance in 2012. Our suspicion is that this advance will include agricultural commodities and the "softs", such as sugar, cocoa, and coffee. This suggests that the worldwide economy should start to improve, and could continue this improvement in the next few years (and THIS forecast puts me at odds with most of the economists on the Street!). We have seen some worldwide inflation in food, but this has been somewhat of a laggard over the last few years – we think this could change. Should this change, it will be a multi-year trend so there is plenty of time to get aboard.



The last markets we will discuss are currencies, and we will comment a bit more here before going to the charts, as Europe and the Euro are the biggest concerns in the current environment. Many stock people are unaware that the currency markets are much larger than worldwide stock or bond markets. Trends in currency markets tend to last longer and be smoother than in stocks as well. We follow two currencies on a long-term basis: the Swiss Franc, and the US Dollar. While it is not surprising that they tend to move in opposite directions, every once in a while that is not the case, and 2012 might be one of those years. The reason for this is the Swiss may rally along with the dollar against the Euro, because of the fundamental issues.

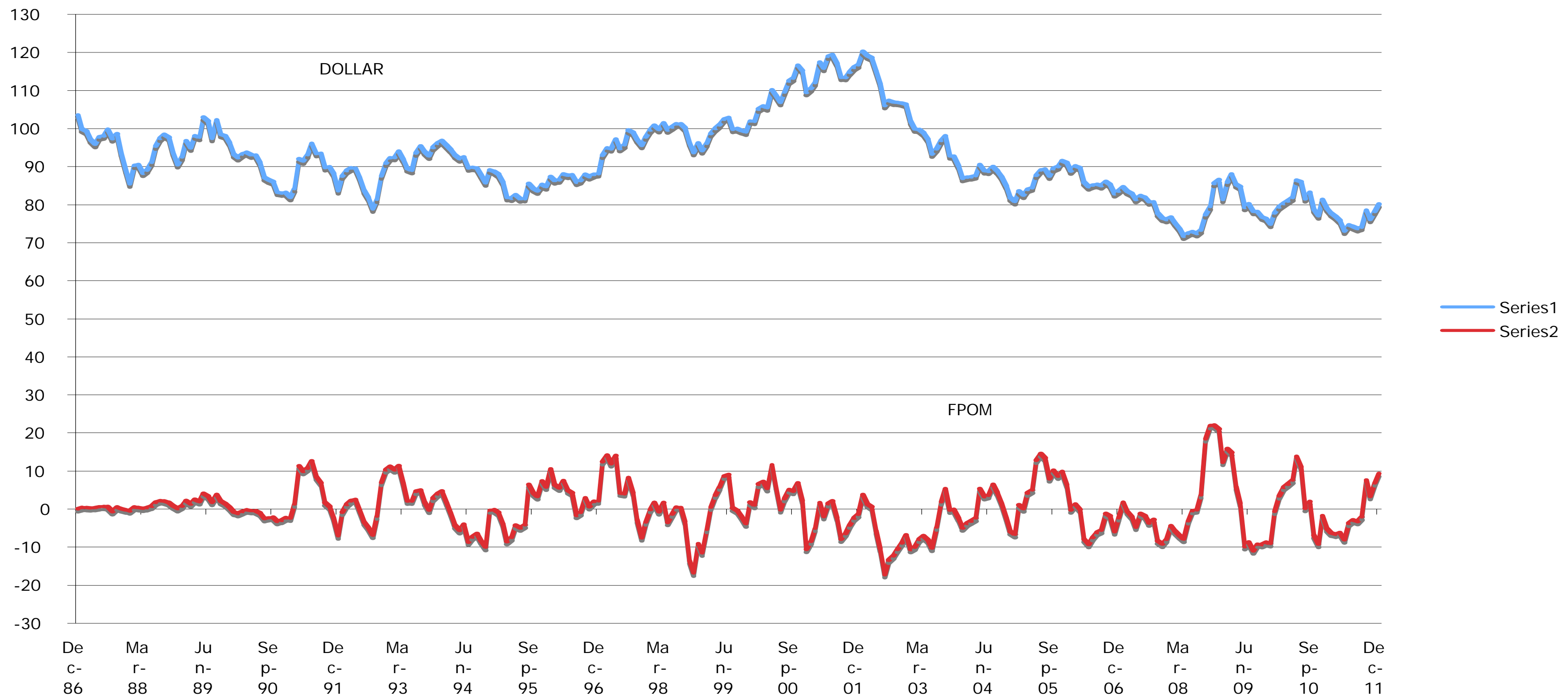
First, the Swiss Franc: the franc has enjoyed a strong uptrend since 2000, and resembles gold in this respect. However, unlike gold (the franc is the last currency left to be backed by gold) it was relatively stable in the 1990's while gold declined. We like to analyze the franc because it is "real money". By this we mean it is backed by gold, and is relatively free from political factors – the biggest Swiss exports are pharmaceuticals, watches, clocks, and of course cheese and chocolate. These are not controversial, politically charged items!

In terms of the technicals, the franc is quite oversold within an uptrend and looks ready to rally sometime in the next month so (as does gold and the CRB). This could mean some stock market turbulence is coming, especially when related to the dollar.



Second, the US Dollar index: the dollar has had two major moves since the chart we have data – the move from the August 1992 low at 78.87 to the peak at 120.14 in January of 2002, a ten year move. The second move of interest is obviously the decline from the January 2002 peak to the March 2008 low of 71.80 – a six year move. What is interesting about this chart is that the biggest momentum surge in the dollar FPO on the whole chart was the surge into the October 2008 peak. It interests us that in 1995 the dollar tested, but did not exceed, the 1992 low (3 years later) - just as the dollar retested, but did not exceed, the 2008 low in 2011 (also 3 years later). While the forgoing suggests a multi-year bull market is developing, near-term the monthly FPO is overbought enough to suggest consolidation, and/or a decline should occur mid-year.

While the dollar and franc chart should be examined together, but realize they may move together for part of the year should the Euro continue to have difficulty. Indeed – we must be on our guard as many of the intermarket relationships over the last few years could very well change this year.



What do we conclude from this analysis? First, the biggest surprise this year could very well be dollar strength, particularly in the fourth quarter. One reason for this could very well be a strong up-move in the Swiss Franc and gold in the middle of the year. We also expect an improving economy in 2012 – the interest rate picture suggests this. While stocks could finish the year well, it may very well be a “U” shaped year once again, with a surge in prices in the beginning of 2012 as the inverse head and shoulders pattern resolves in upside movement, followed by a mid-year correction, and then a positive finish to 2012.

Below is a listing and definition of various proprietary and non-proprietary technical indicators we rely on during our analysis of the markets:

Moving Averages:

Moving averages are one of the building blocks of Technical Analysis, and there are almost as many ways to use this indicator as there are technicians.

At the FRED report we teach and use a dual moving average crossover system to determine trend. Our favorites are the 5 period and 20 period moving averages. We consider the trend to be up if the 5 is above the 20, and down if below it.

Stochastics:

The Stochastic Oscillator is one of the commonly used momentum oscillators and is standard on charting programs. There are two lines on the chart below, %K and %D.

%K is the faster of the two lines, and represents a mathematical formula that *measures where the current close is in relation to the trading range of the last "X" periods of time*. We use a 14 period look-back, so in plain English %K says where the current close is in the trading range of the last 14 days, expressed as a %.

At the FRED report we use it somewhat differently than is commonly taught. The standard way to use the indicator is to register a buy signal when it moves below, and then above, 20 (the lowest 20% of closing prices in the last 14 days). A sell signal is when the indicator moves above, and then below 80 (the highest 80% of closes over the last 14 days).

The other line, %D, is a 3 period moving average of %K. We have found that the Stochastic is sensitive, so we advocate taking signals only in the direction of the trend. When looking at the standard FRED report chart, this would mean taking buy signals when the 5 is above the 20, and sell signals when the 5 is below the 20, but using a different technique to exit positions. The reason for this is the Stochastic is quite sensitive, and can give early indications, especially in new trends. It also can get "stuck" in the direction of trends, which connotes strength and not weakness. Another, preferred interpretation is to use the indicator to measure risk. An example: buy in an uptrend, not when the stochastic is at 90% but rather wait until it falls below 50%, This way, even if a stock, commodity, or ETF does not give one of the "classic" signals, you can still use the indicator to assess risk, and leg into positions.

Fred's Price Oscillator (FPO):

This is an oscillator that I invented, using a combination of high, low and closing prices. Unlike the Stochastic, which is really sensitive, this indicator is designed to be less sensitive. Other than that it is, of course, proprietary, so we do not disclose much about the construction of the indicator. One of the characteristics of the tool is that when the Oscillator moves below/above -15/15 the market often creates a divergence. For those of you who do not know that term it means that price will make a new low/high and the oscillator will not confirm it. That is usually the sign of a turn. On really sharp strong market moves, a couple of these divergences can occur. We use weekly data in our examples for you, as we have that data going back to the 1970's on the SPX, and farther on the Dow Industrials, which work the same way. We would note that we keep FPO's on the commodities, but rarely publish these, as most subscribers are interested in stocks. Like most oscillators it is most useful at bottoms, so our examples show bottoms. We can, and will, show some analysis of tops as they occur.

Fred's Breadth Oscillator (FBO):

This is an Oscillator that I invented. Unlike the McClellan Oscillator, which is sensitive and gives a lot of signals, this tool is more of a trend following indicator. It is proprietary to the FRED report, so we do not disclose much about the construction of the tool. It generally moves between 12 and 18. Moves below 12 or above 18 imply a divergence bottom or top is coming with fairly high probability. This tool works best at extremes, and patterns can be significant. It also gives clearer signals at bottoms than tops, although when tops are perceived to be occurring we will publish these charts, appropriately annotated. The FBO is only useful on the stock market, where advance/decline data is published.

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