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Subject: Morning Briefing, 03/20/2003

Sent: 20/03/2003 09:50 **Importance:** Normal

21ST CENTURY | ALERT

MORNING BRIEFING

THURSDAY a.m.
March 20, 2003

Flying Consolidation

by David Nichols

There's something I want to bring up quickly about Iraq, because it's an idea that's helped to alleviate some of my anxiety about the situation, and I'm hoping that it might have some of that same effect for you. So here goes.

I've been reading, seeing, and hearing lots of talk about the possible use of chemical and biological weapons by Iraq, and also the increased likelihood of terrorist attacks in the U.S. upon the commencement of military operations. Just like you, I'm worried by a lot of things right now, but I'm not particularly worried about these things.

Saddam Hussein is a shrewd guy. He knows he can't possibly beat the US military. It must have taken him about two seconds to figure that out. So if he's chosen war, we've got assume he has a fully developed strategy. He knows the war is going to end one of two ways: unconditional surrender by Iraq and his ouster; or a cease-fire without "regime change".

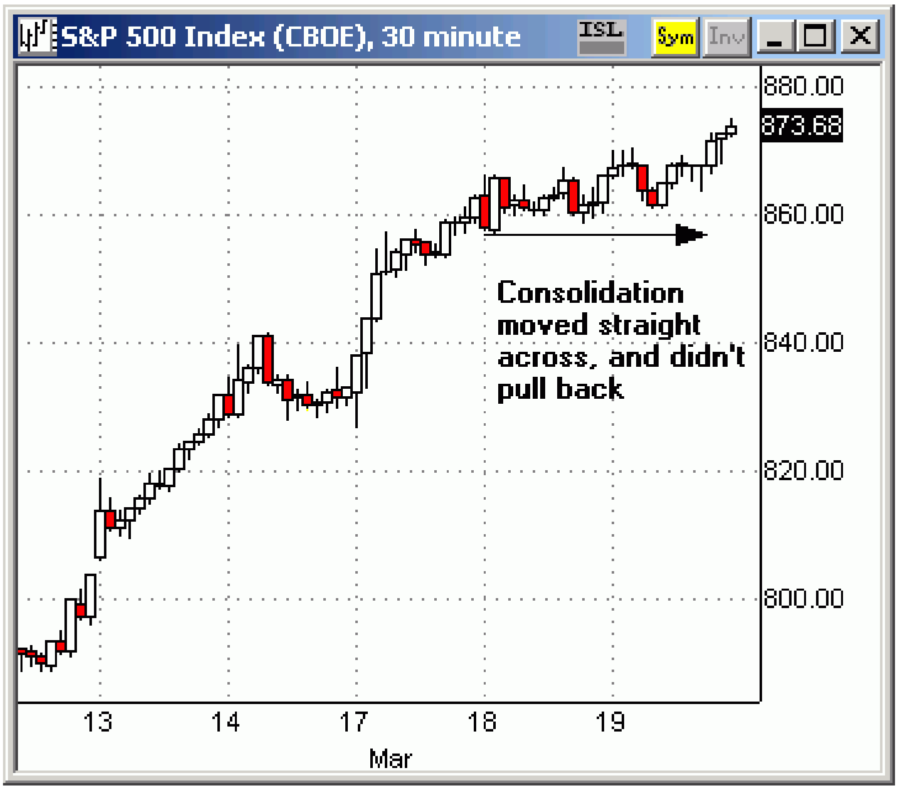
Saddam's betting he can pull off scenario no. 2. And there's really only one way he can pull this off -- by making sure that popular opinion is so united against the military operation that it is forced to stop. If he uses *any* weapon of mass destruction -- or even if stockpiles are found -- this entire strategy is immediately and irrevocably damaged, and the world will unite against him with fury. Even the French will come in if he uses chemical weapons.

This also goes for terrorist attacks. Any terrorist action will galvanize popular opinion that the U.S. is on the right course. A guaranteed way to stoke up American and global resolve is to start attacking civilian targets. It just doesn't make any sense strategically for Iraq or Al Qaeda to do this.

Yet this is an unpredictable journey the world is embarking upon, and it's not going to be safe to assume much of anything. None of this is going to go according to a script -- and that goes for financial markets too.

I pointed out before Tuesday's trading that the uptrend had reached a point of temporary exhaustion. A typical pullback would then retrace some of the gains, instilling a little doubt into the proceedings and getting the markets ready for another leg higher.

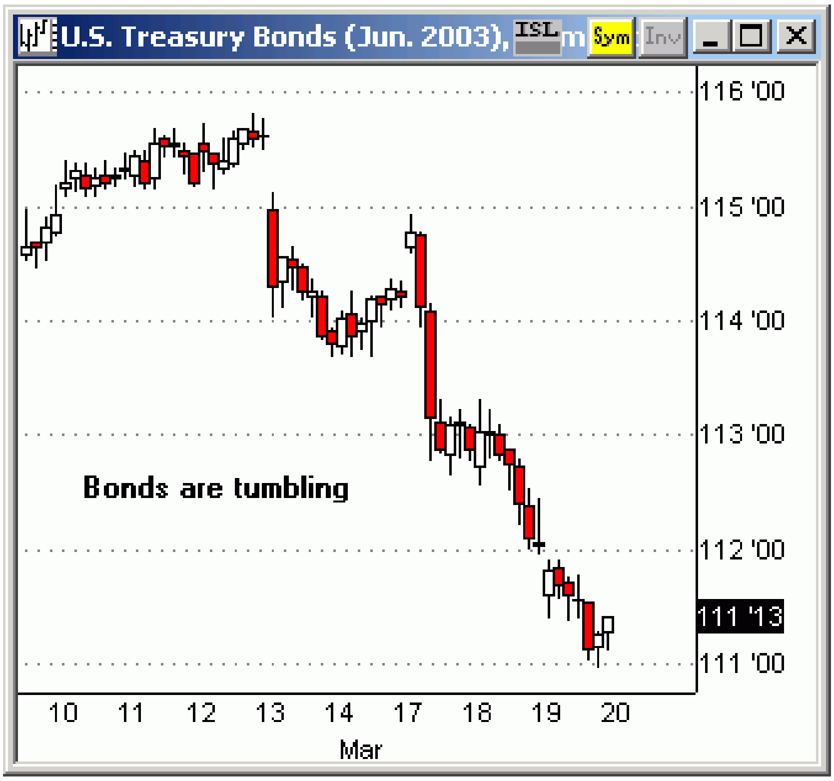
Sure enough, the uptrend took a perfect two-day breather, right on schedule. But remarkably, the SPX did a flying, straight-across consolidation and didn't retrace any of the gains. This is the most bullish way for an uptrend to behave, and usually indicates more upside once the markets are again congested and ready.



The downside to this flying consolidation is that it generally puts a damper on the longer-term upside. The markets *need* to pull back to acquire the energy to push considerably higher. At some point in a healthy uptrend -- which it looks like the markets are initiating here -- we'll need to see a decisive pullback, which will give a lot of information about the trend, and likely deliver a good entry point.

So I'm still of the opinion that this will be a "sell the news" event on the outbreak of war, and the markets will have a hard time staying over SPX 870 on the first try. But a pullback will definitely not be a bad thing for the bullish case.

So far we have a plurality of world markets confirming the rally in stocks. Oil and bonds are both tumbling, and the dollar is strengthening.



The weirdest thing right now is the behavior of the VIX. It's not giving clear directional signals at all. Since much of my timing and decision-making is predicated on prices and sentiment confirming one another, there just hasn't been much to work with lately. But this fuzzy, mixed-up sentiment picture is probably an accurate assessment right now.

So I'll continue to wait for a good entry point and a nicely confirmed mid-term trend before recommending that you commit money into Rydex positions.

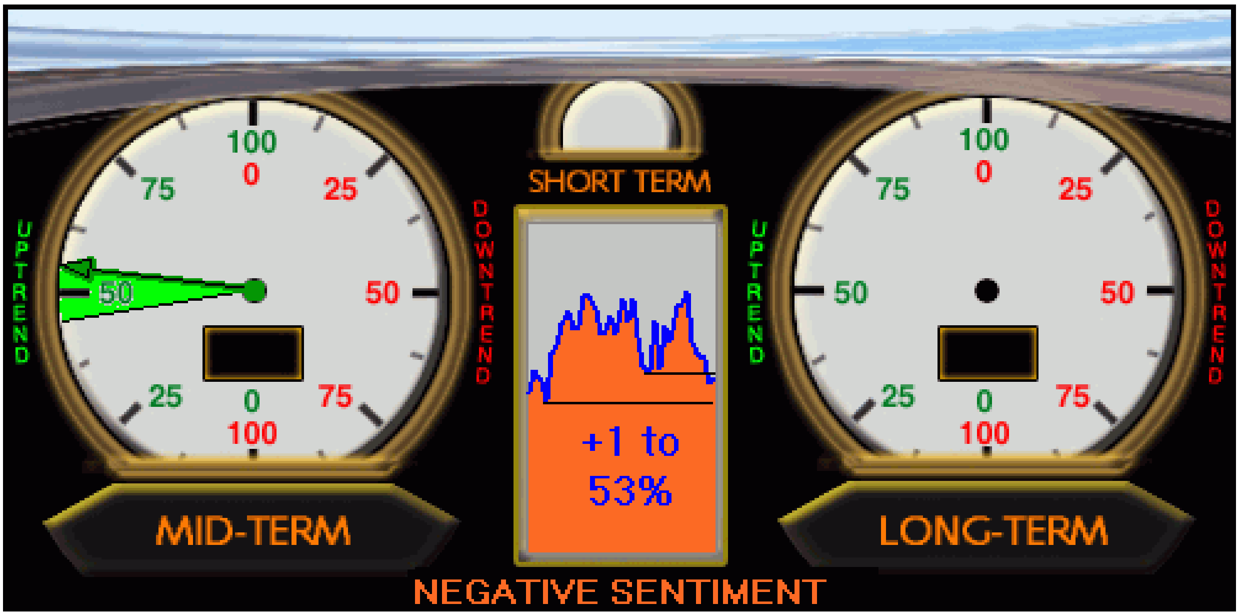
Speaking of Rydex, I've had some questions about how to hedge these Rydex positions during the day, if you feel like you're stuck in a fund with no way out until the close. It's quite simple, actually, and there's no magic formula you need to know.

If you have, say, $5,000 in the Rydex Venture Fund, which gives 200% of the inverse performance of the Nasdaq 100 (it's a 2 to 1 "bear fund"), and you wanted to exit the position intra-day, then you could immediately buy $10,000 worth of the QQQ. This would almost perfectly hedge your short exposure in the Venture fund, as the long QQQ position offsets your Venture position. Then you simply sell everything "MOC", or market-on-close, and you've effectively locked in your exit price intraday.

With the Tempest and Titan funds, you can use the SPY in this same way as the proxy for the S&P 500.

Sentiment Dashboard

by Adam Oliensis



SENTIMENT TANK: The tank filled by 1 point to "53% full" of negative sentiment. Both the Put/Call Ratio and the VIX rose, representing increases in fear, though their rises were small.

The most interesting thing here is how the VIX (one of the components of the tank's calculation) has refused to drop. Since the market's intraday low last week the VIX has dropped only about the same percentage as the SPX's price has appreciated, and normally moves on the VIX average 4x the magnitude of SPX price moves on a percentage basis.

The Put/Call Ratio has experienced a decline in its 20-dma from 0.94 to 0.762. While that is represented in the tank's decline, the Put/Call Ratio 20-dma line has never bottomed after a major decline at a level this high. Its highest major bottom in the past has been at 0.72. In the past it has taken at least 6 trading days for this line to move from 0.76 to 0.72.

Sorry to have to break it down and make it complicated, but by doing so I think we can see that with the high VIX and the non-climactically low Put/Call Ratio the market does have some technical room to run before sentiment becomes complacent by historical standards.

(If you would like more info on the VIX, the Dashboard, and the Put/Call Ratio please see **Agile Trader: Technical Indicators Explained** and check out the articles on those subjects there.)

SHORT-TERM: The hourly gauge has been idling in neutral as the market has moved up the last two days, expressing the same bullish divergence as the VIX.

MID-TERM: The mid-term gauge progressed 8 points in its advance phase to 54% yesterday. The Confidence Diffusion Index (CDI) gained a click to 4 out of 7, representing an increase in the bullish factors on the charts. There's room to run here as well.

LONG-TERM: The weekly gauge progressed one point in its decline phase to 58%. But with a CDI that's regressed to 0, the weekly decline phase continues to live on borrowed time. If the market does not reverse strongly to the downside this gauge will soon turn up and confirm the mid-term gauge's bullish momentum.

Definitions

You can find this article on the Web at:
http://www.21stcenturyalert.com/page/tcx/morningbriefing/2003-03-20/