From: 21st Century Alert [SMTP:mail1@email10.net]

To

Cc:

Subject: Morning Briefing, 05/13/2003

Sent: 13/05/2003 14:59 **Importance:** Normal

21ST CENTURY ALERT

MORNING BRIEFING

TUESDAY a.m.
May 13, 2003

Reluctantly Long

by David Nichols

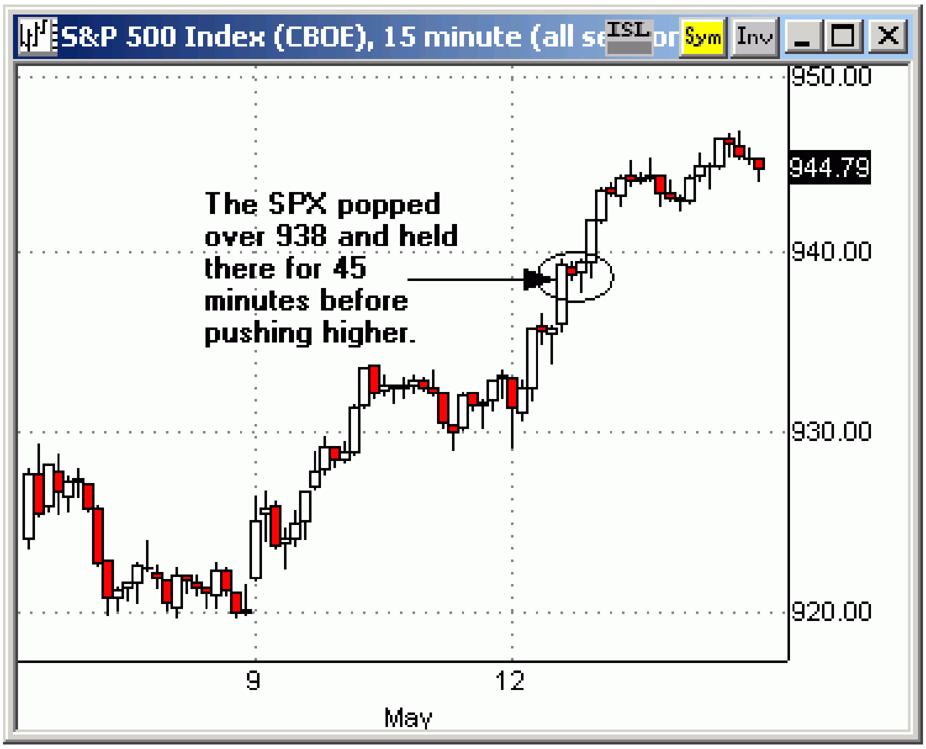
Often trends in the market go further and last longer than anybody thinks possible. We've got a stellar example of this on the current uptrend. It's been extending for weeks, refusing to knuckle under.

This is one of those trends that is going to make every last bear give up on short positions, or even convert to the bullish camp. Part of the reason why I've recommended going long above SPX 938 is I realize that the "Trading Gods" need appeasement on this, and I shouldn't hold out. The market *needs me* to see the bullish case here.

But we should be on our toes. When the market forces those on the sidelines, or in the bearish camp, to join the bullishness, then a major trend change is usually in the works. This kind of "give-up" happens at the end of trends, not at the beginning. That's why I've got very specific instructions here to "stop-and-reverse" to short positions on a move back down.

This is the mistake most people make. They become bullish or bearish at the end of trends, and then stick to their guns when the market starts going against them. They buy the top, or sell the bottom, and don't have a plan to change directions immediately if the trend doesn't extend from there. But we're not going to fall into that psychological trap. We'll go short on a move back down.

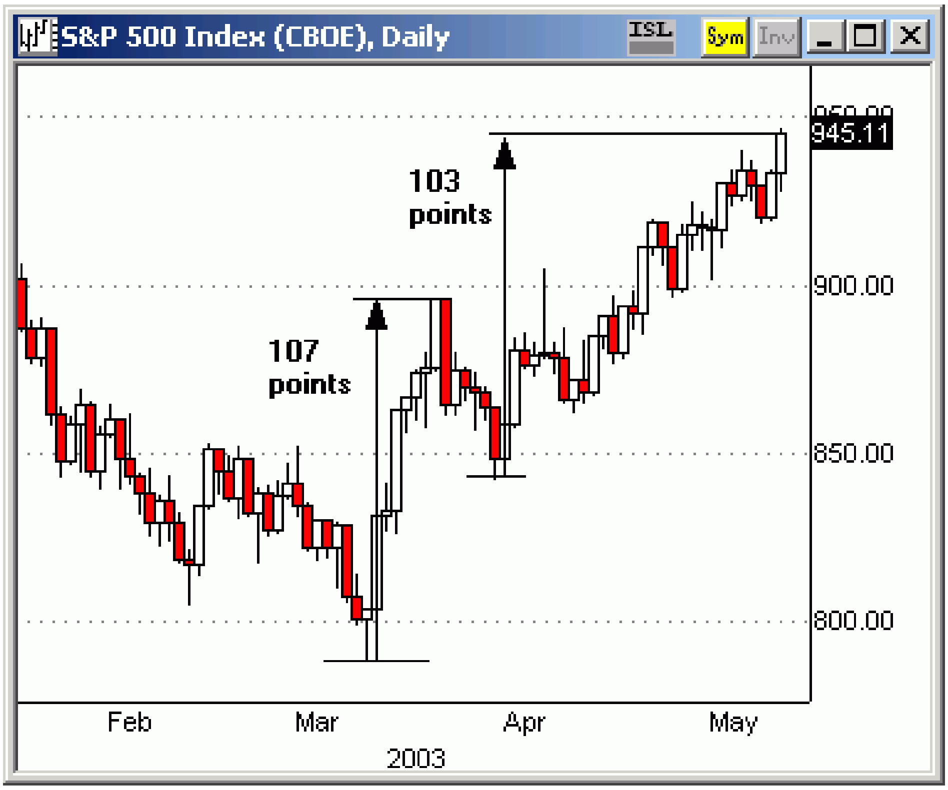
So now all those participating in this "stop-and-reverse" trade at SPX 938 need to be vigilant. The market ran over our 938 threshold, parked there for 45 minutes or so, then screamed away to the upside the rest of the session. It looked like an upside capitulation, in fact.



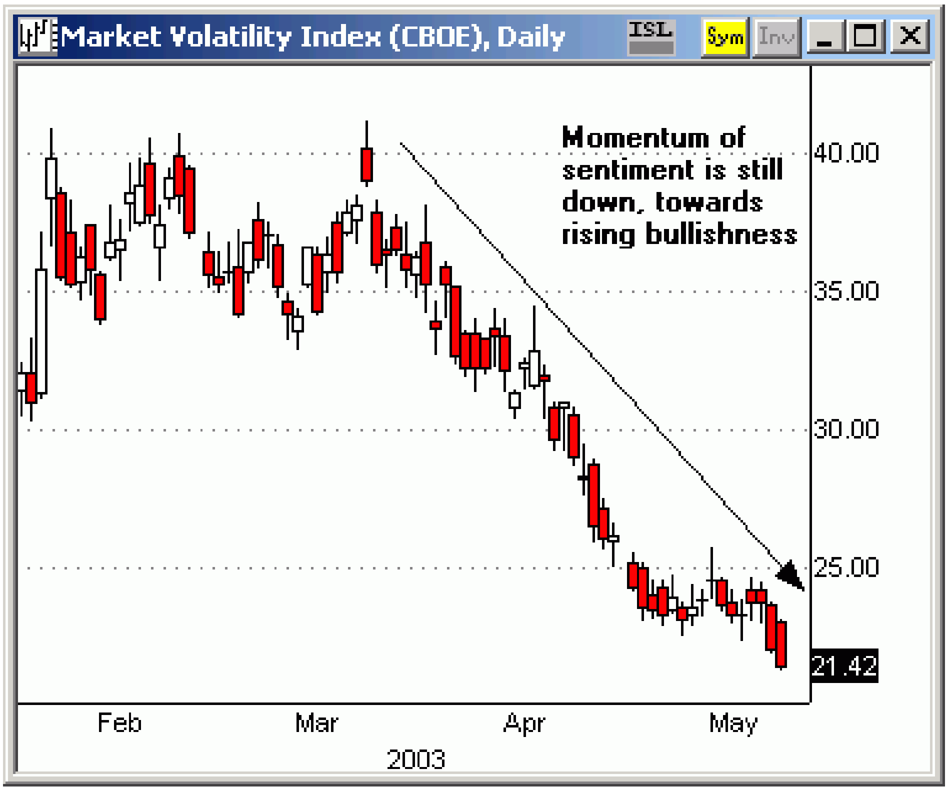
The upside may not be over. As I mentioned yesterday, expiration weeks often carry a bullish bias. I calculate some weekly support/resistance numbers which help me gain some clarity into the action. Since we're in this long trade, I want to share what they are saying, to give you a head's up on the potential action for the remainder of this week. If prices stay above SPX 944, then there is a great chance that the market can tack on another 20 points *this week* . 944 is the weekly breakout line. Such a move would take prices right into "neckline" resistance, where every technical analyst in the world will be watching -- and likely acting.

However, if prices slip back below SPX 938, then they are likely to quickly head back down towards our stop-and-reverse point at SPX 932. This area between 938 and 944 is now especially critical.

In the bigger picture, this breakout doesn't really change anything. Often the market moves in wonderfully symmetrical ways, and this extension of the rally so far is just fulfilling the prophecy from the first leg up off the bottom. That move was good for 107 SPX points, from 789 to 896. After the pullback to SPX 843, this move has now been good for 103 SPX points -- certainly close enough to qualify as an "AB=CD" move, as some technicians refer to this. (It's also called a "flag" or a "measured move", or other different things.)



I still believe that we won't know what this market is really made of until we see a trend change on the VIX, and the momentum of sentiment swings back against the bullish majority. We need to see how the crowd reacts to lower prices. We haven't seen this yet, remarkably.

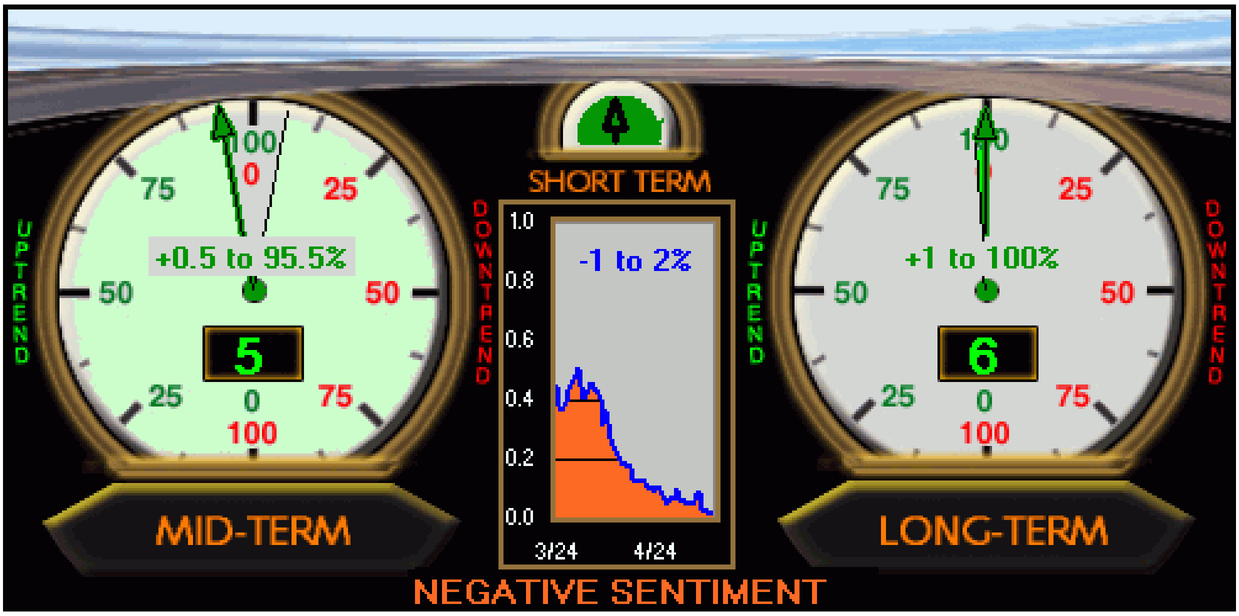


I know that now that we're tentatively long, we're going to react very quickly to lower prices. This is how we preserve a good risk-to-reward ratio when sentiment is this extended in one direction. We can do a position with the crowd, but we have to be very quick to react to a move in the opposite direction. That's the trade-off. Others may not react in this same way. It's this reaction to lower prices that will really tell us the information we need to know, as we'll be able to discern whether the sentiment patterns have indeed turned bullish. So far they are still decidedly bearish overall.

We're still looking to go into the short Rydex funds for a low-risk position trade against the bullish crowd, as soon as we get confirmation that this crowd is on the run. This suggested long trade above SPX 938 doesn't change that. It just gives us a low-risk way to participate if the market is going to keep zooming off to the upside.

Sentiment Dashboard

by Adam Oliensis



SENTIMENT TANK: The tank **drained by 1 point to 2% full of negative sentiment** on Monday. The last time the tank was at this low an absolute level was May 24, 2002. On that date the SPX closed at 1084, 139 points above the current price, and about to embark on a 2-month decline of about 300 points.

SHORT-TERM: The hourly gauge **is in an aggressive advance phase. The VIX has dropped through 23 and is on its way to an extreme low.**

MID-TERM: The mid-term gauge **pipped up by about ½ a point to 95.5%, just barely moving into an advance phase.** We could call it neutral if we parsed the data a bit less finely, but our Confidence Diffusion Index continues to drive in the bullish direction, moving up by a point to a bullish 5. The CDI's bullish momentum forces us into a bullish take on the gauge.

LONG-TERM: The weekly gauge **progressed one point to 100% in its advance phase.** Our weekly CDI moved to an all-but-maximal extreme of 6 (out of 7).

BOTTOM LINE: By virtually all possible measurements sentiment is too bullish for the market's own good and is long overdue for a reversal. However one of the good rules for understanding markets is that they can stay overbought (oversold) longer than "you" can remain liquid if you are fighting against them. Just as the market had to find new and creative ways to scare the majority on the way down, it probably has to find new and creatively extreme ways to lull the majority into complacency on the way up. It has to go further than you think it can or else you are not truly scared or truly complacent.

We are extremely overbought in terms of sentiment, and probably very susceptible to a negative shock. However it's no smarter to jump on the nose of a rocket than it is to catch a falling knife. So, until we get a spark of fear in the market it is probably wise to make the trend your friend. When this big bad rocket can no longer run on fumes, it will let us know.

Definitions

You can find this article on the Web at:
http://www.21stcenturyalert.com/page/tcx/morningbriefing/2003-05-13/