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MORNING BRIEFING

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FRIDAY a.m.
April 4, 2003

The Victory Trade

by David Nichols

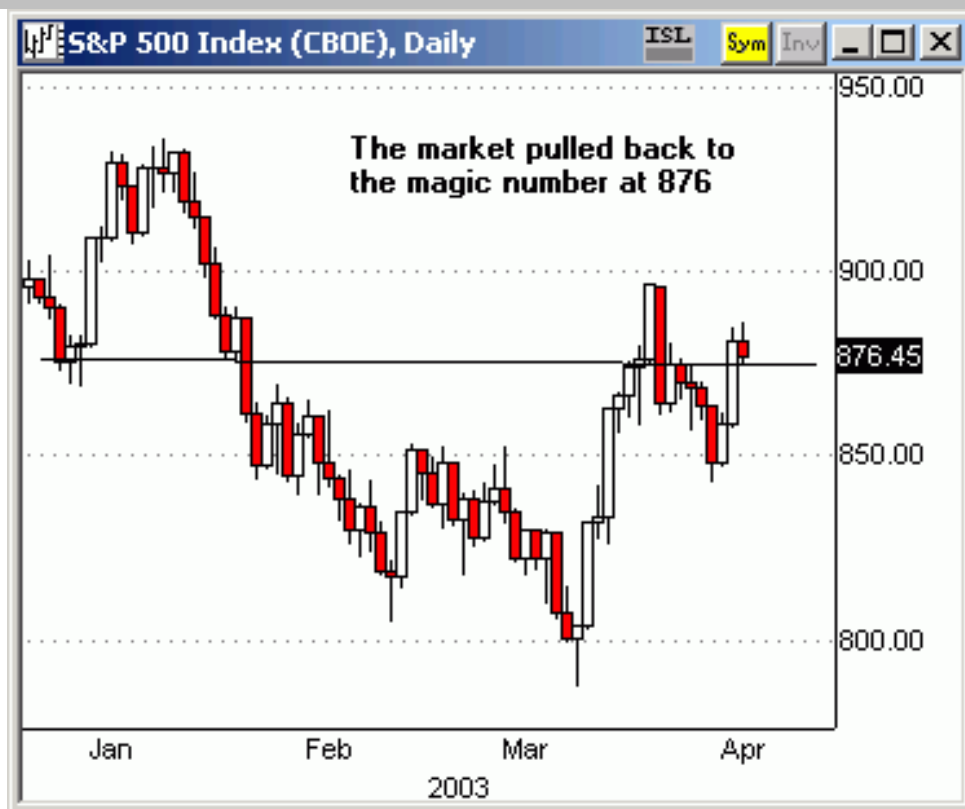
It should have been no surprise that the S&P 500 (SPX) closed at 876 yesterday. It's the magic number, and a natural spot for the market to pull back to.

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If you're a little on edge lately as far as the market goes, you have good reason to be. We have now seen 8 straight "gap openings", where the bulk of the price moves have come in the overnight futures sessions.



So don't beat yourself up if you're feeling skittish, or sitting on your hands right now. Not a lot of people are making money, I can assure you. This "war trading" is a tricky business, and there's really not a big need to roll the dice on the overnight news flow. That's how I feel anyway, as our usual edge from technical and

sentiment analysis can be easily overwhelmed in this reactionary, gappy market.

But I think we're getting down to the end-game for the war market. Saddam's already gone, according to our source Debka, which explains the unorganized, half-hearted resistance our troops are encountering just outside Baghdad. It's always been my feeling that Saddam was going to copy Bin Laden and just disappear at the moment of truth, to continue sniping at us from afar.

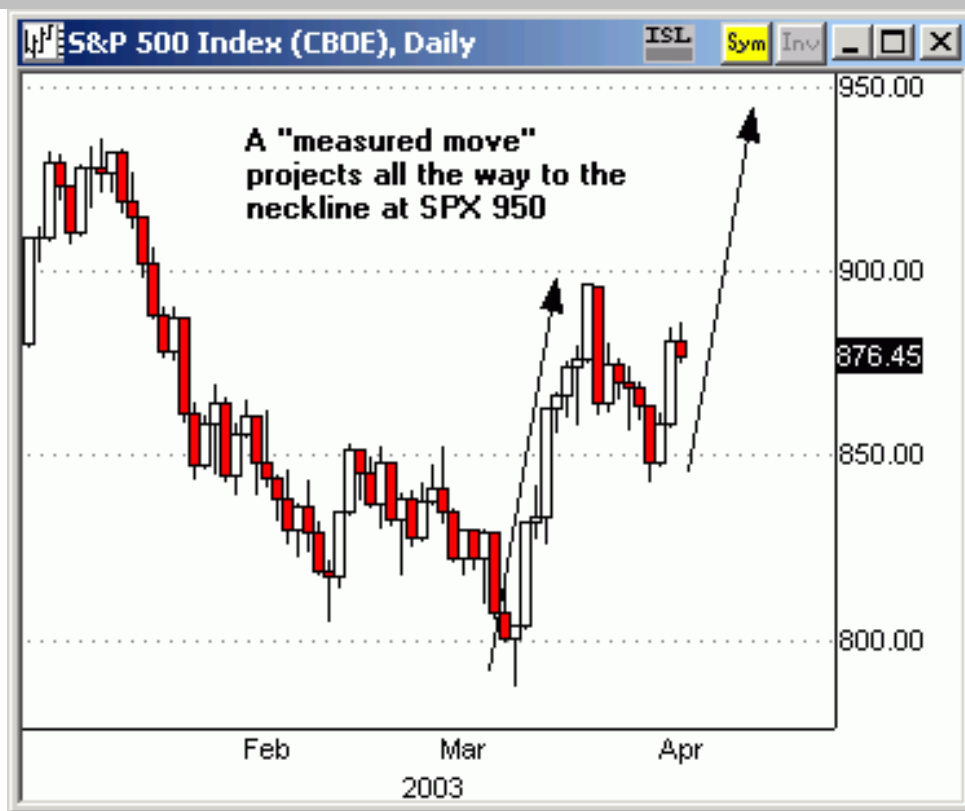
It looks clear that the market is now starting to price in a big victory in Iraq, and that the victorious moment is coming soon. It's interesting that the SPX is still far below the crucial neckline at 950 to 965, so it doesn't look like the war's going to trigger a big breakout -- which was always the best hope for the longer-term bullish case.

But a quick victory now could mean another trip to the neckline, which is still a pretty darn good trade from current levels. There's just enough sentiment fuel in the tank to take us up to that level in an all-consuming rush of bullish euphoria. It's that sort of sentiment extreme that has led to very successful Rydex trades for us over the past two years, by taking the other side of the majority. When the bulls have run out of fuel, and the VIX has dropped down as far as it's going to go, we can simply step in and take the other side of the trade.

But before we get such a low-risk opportunity, if you want to make some profits you'll have to join the building crowd to the upside. These opportunities can be good, but they always make me nervous. Essentially, you're betting that sentiment will indeed hit extremes, and you're going to join the crowd to ride the last part of the swell in majority opinion. You're also betting that you can deftly hop off the bandwagon before sentiment reverses on the majority.

It's tricky, but it can be done. It's actually easier to do this trade to the upside, as tops tend to be more rounded, and bottoms are scarier, spikier affairs.

How far can the war rally go? All the way to the neckline at SPX 950.



So how to play it? Buy your favorite stock or index ETF, and hope the victory party ignites.

The warning sign that the party is a dud would be the SPX falling convincingly under 868. At that point, I'd take the loss on the "victory trade", and re-assess the landscape. Of course, the closer you can buy to this stop point, the less risk to the trade. So if the market offers an opportunity to buy between 868 and 876 -- maybe on a weak jobs number? -- that's the time to pounce.

Otherwise, play small enough that if you get stopped out below 868, it won't be too painful. In other words, trade the amount that is comfortable enough that you don't live and die by every tick. If you find yourself pacing nervously, shouting at the market, worried about every tidbit of news from Iraq, then you're playing too large.

[Editor's Note: We'll have the dashboard for you later this morning, in a separate update, due to an e-mail blunder on my part.]

Definitions

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