CitiFX® Technicals – Bulletin

Technical Developments in the Foreign Exchange and Asset Markets

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U.S. Equity market forming a bottom? You must be joking…

Over the last few weeks we have observed a lot of "reasoning" as to why we are close to turning in the stock markets and thought we would give our "10 cents" in this regard.

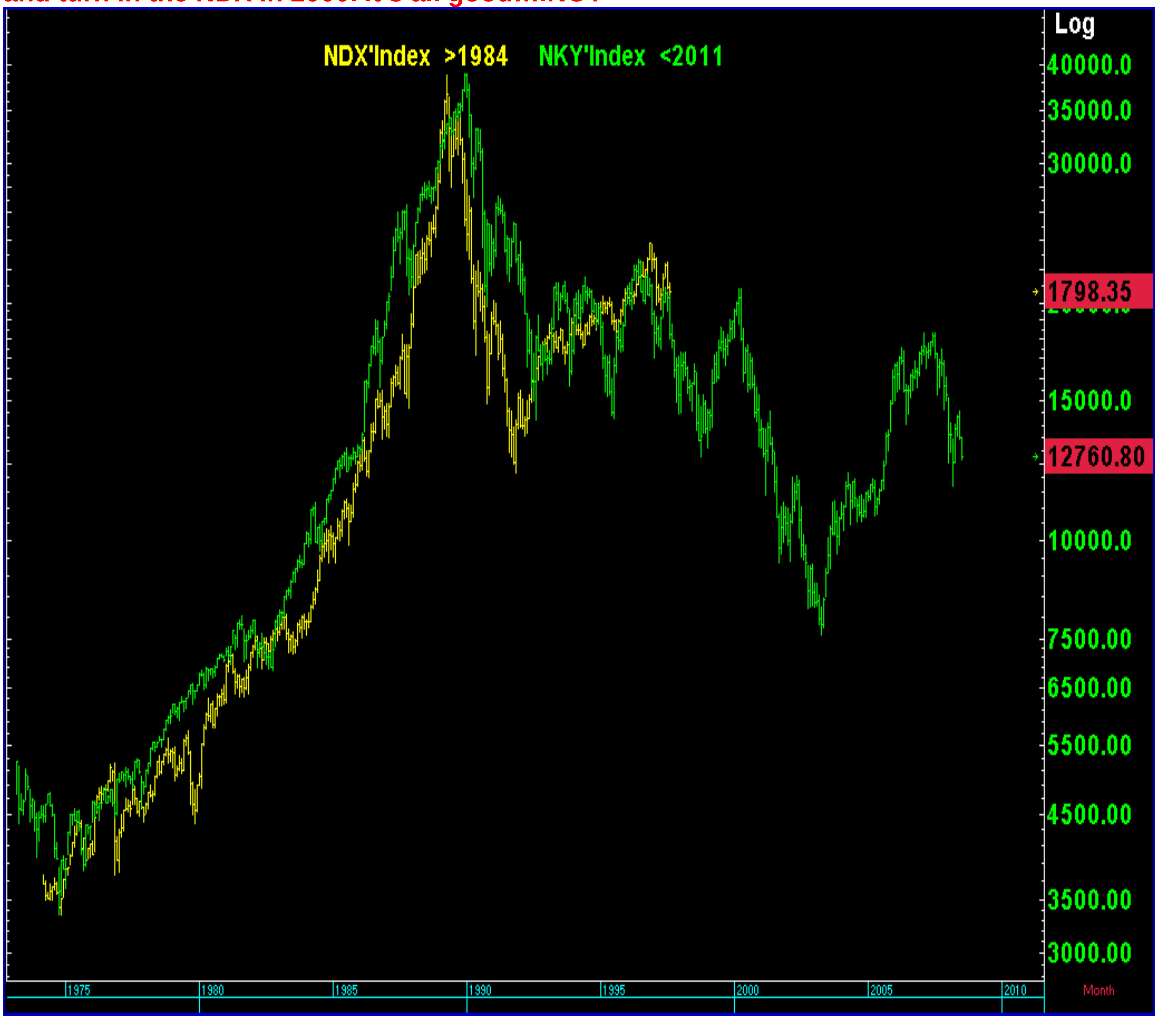
In general there are 2 comments that have been most predominant in that reasoning.

1.Sentiment is so bearish now that this is warning of a turn.

We have a few issues with this

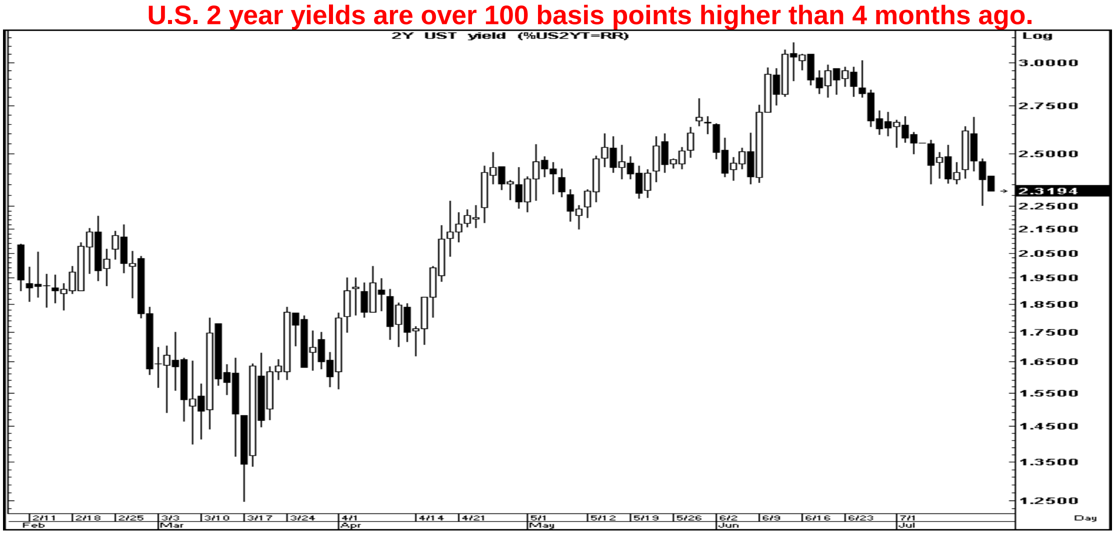
- Tell this to the Japanese who have essentially been negative since the early 90's when the Nikkei turned from 39,000 (Presently below 13,000).Funnily enough that came from excessive asset market appreciation (Equities and housing) which then turned to Asset market deflation, banking problems and policy mistakes.

Comparison of the bull market and turn in the Nikkei in 1990 and the bull market and turn in the NDX in 2000. It's all good….NOT



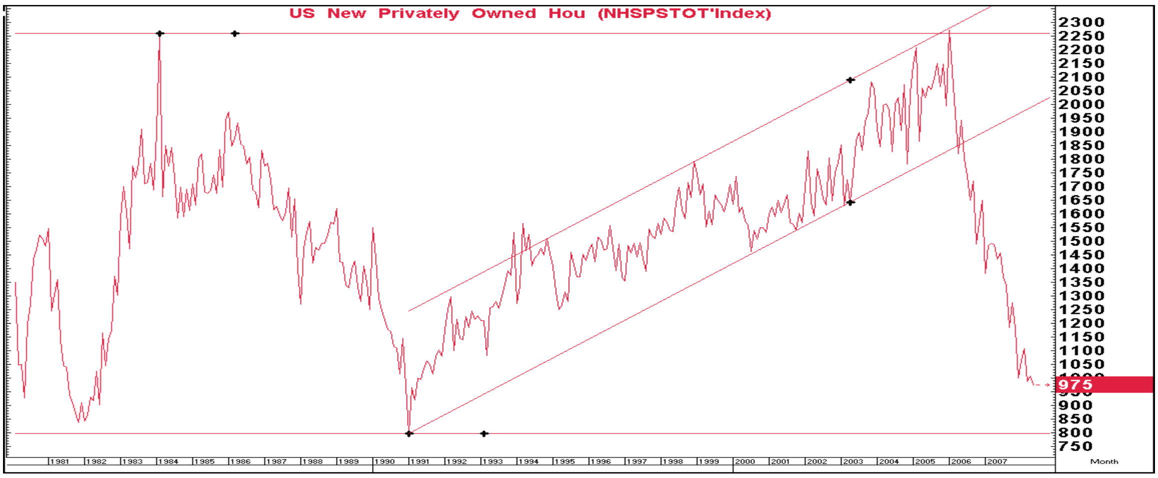
- If everybody were so bearish we would not be hearing this comment every single day by definition, because even these people would be bearish. Not only are we hearing the comment every day but with some "vehemence"
- We are somewhat astounded at this newfound idea that a strengthening negative view is somehow bullish. How does that work??? If the argument was "everybody is bearish and ignoring all the good news around us" such that there was a total disconnect i.e. plunging equities while surrounded by bright lights we could see where this was coming from. Even the sub-section of the market that has been bearish has talked of trimming back or going long on this premise. **However, to us, the bright lights look to be those of the oncoming train wreck.**
- **Let us look closer for the good news:**
  - **Credit markets? We do not think so.** We remain mired in probably the greatest credit crunch of our lifetime with credit standards increasingly tight and financial institutions very slow to lend.
  - **Interest rates? We don't think so.** Despite 325 basis points of cuts by the reactive Federal Reserve consumers and businesses are mostly borrowing at higher rates that before the FED easing began. In fact the curve from 2-year yields to 30-year yields is between 107 and 35 basis points higher than it was 4 months ago. (We have had a de-facto tightening in policy)

U.S. 2 year yields are over 100 basis points higher than 4 months ago.



  - **Housing? We do not think so.** Despite the attempts of some market commentators and officials to once again try and call the bottom here (I think Chairman Bernanke told us it was basing out in January 2007- oops) there remains little compelling supportive evidence outside of hope. We are seeing the blow up of a 15-year bull market when the longest bull market outside of this in the last 50 years has been 6 years in duration.

Housing starts. Is the glass half full of half empty. Actually neither- It's broken

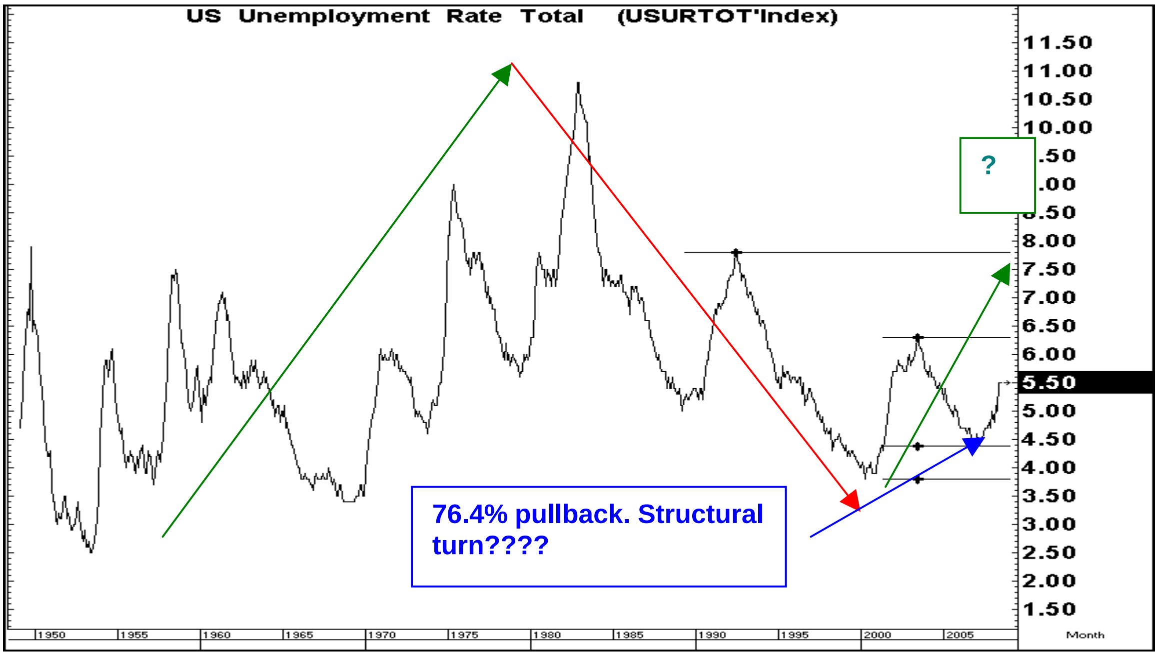


- **Crude Oil? We do not think so:** As with the downturns of 1980-1982, 1991 and 2001 this period has been marked by a strong move higher in crude Oil and while recent days have seen yet another pullback the reality is that this week last year Crude closed just over $75. This present pullback hardly provides much solace. Even as recently as March we were at $99 and are now almost 40% higher at the same time as yields have risen and Equities are at the low of the trend

Crude Oil. Even if it comes off it is a long way back to the January 2007 low below $50

- **The Economy? We do not think so:** There is a strong likelihood that the positive effects of the stimulus package are already waning. In addition unemployment is rising. While the weak USD has somewhat supported the domestic backdrop (And we think it will weaken further) this could also come under stress as warning signs of difficulties in overseas equity markets and economies are growing.

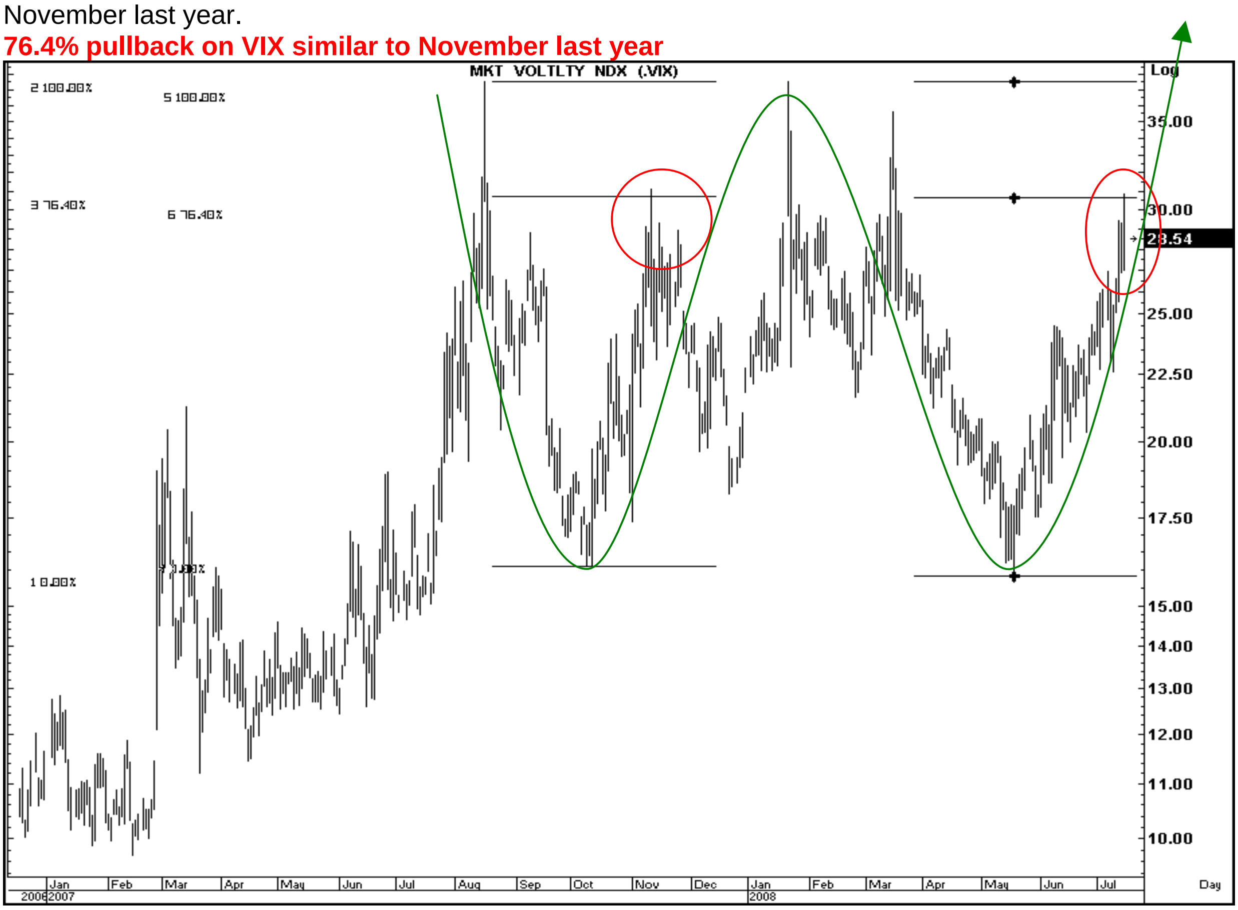
Easy to remember the Golden years of the last quarter century and easy to forget the not so golden prior quarter century.



So therein lies our problem with that argument. If anything we would argue that people are too complacent and that the underlying backdrop is MORE NEGATIVE than sentiment

The second great selective reasoning of recent weeks has been that once the VIX gets above 30% we are good. The logic here being that when it moves into the 30's that is the precursor to a turn. Yesterday we did move over 30% and held some good technical resistance similar to what we saw in November last year.

76.4% pullback on VIX similar to November last year



While that 76.4% pullback in November did yield a strong rally in the following 2 days of over 50 points it then fell over 80 points in the subsequent 2 weeks.

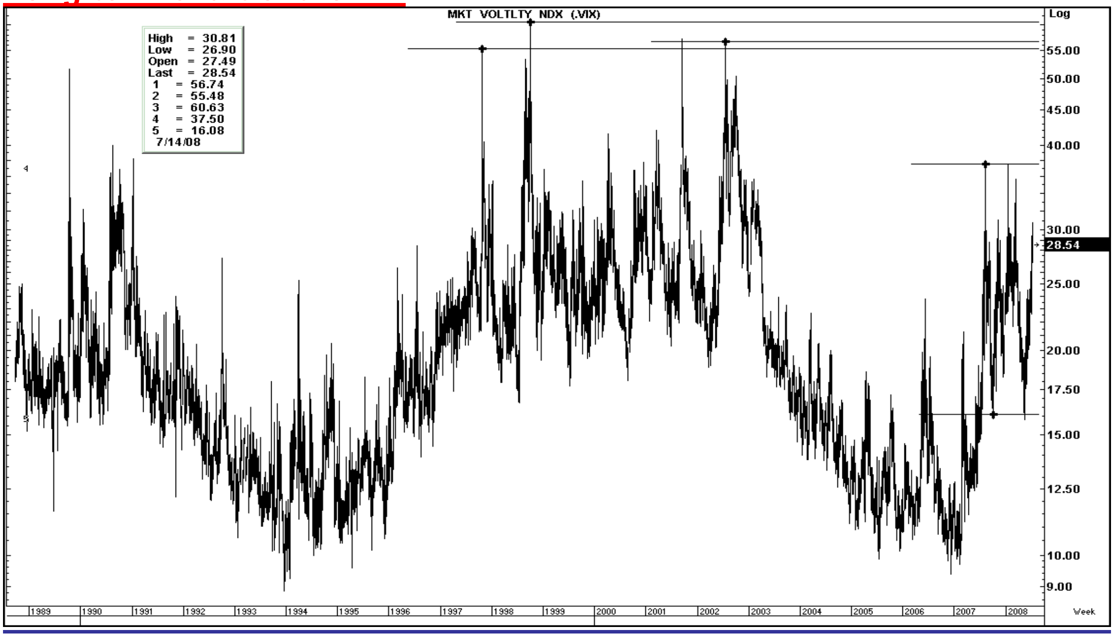
We would not be surprised (As per our note yesterday) if we see a consolidation/correction in the short-term but this in no way suggests to us that a turn is in.

The chart above also shows that this is the 6th time since August 2007 that the VIX has moved over 30% (range of highs is 30.8% to 37.57%) and we have seen corrections in favour of the stock market in these instances.

However the reality is that despite all of this we sit just above the low of the down move in the S&P
In fact the danger could be that a major double bottom is actually forming here with a neckline at 37.5% and a target on a break of that level of 59%.
That may seem extreme but the trouble here is that this chart is very selective in making that argument at peaking in the 30's

If we extend the time frame below the picture looks a little different.

Long-term chart of the VIX

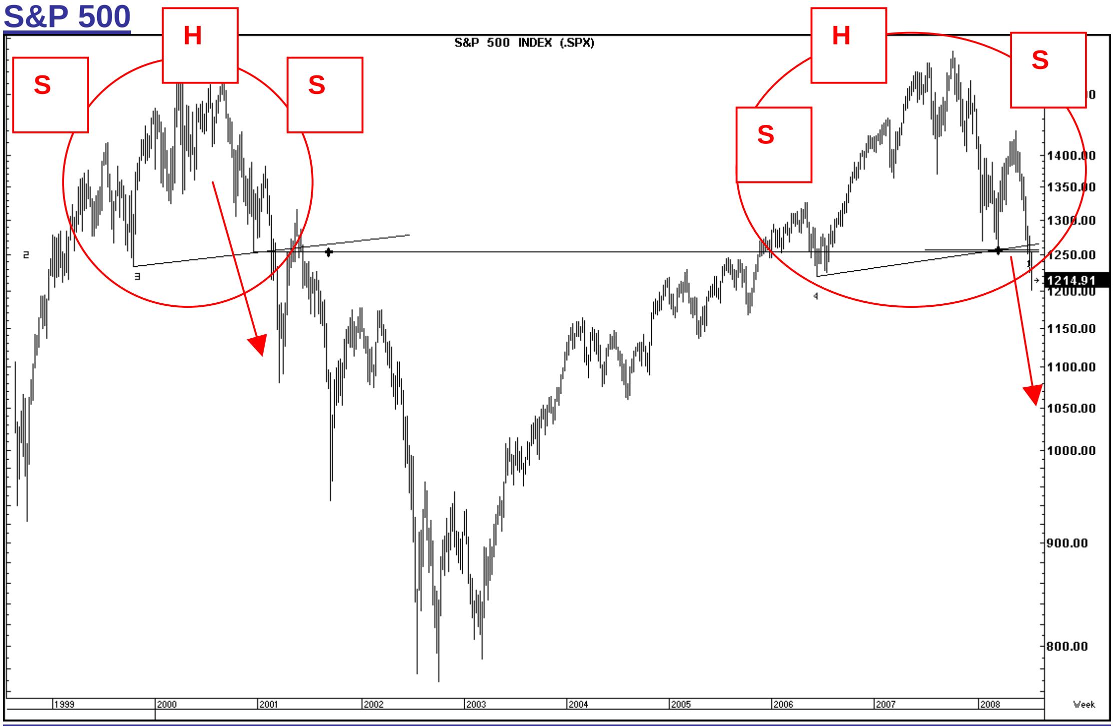


In 1997,1998,2001 and 2002 we saw the VIX rise above 50% (range was 55 to 61%)

So for us this VIX argument is another example of selective reasoning

Finally let us look at the charts that still concern us.

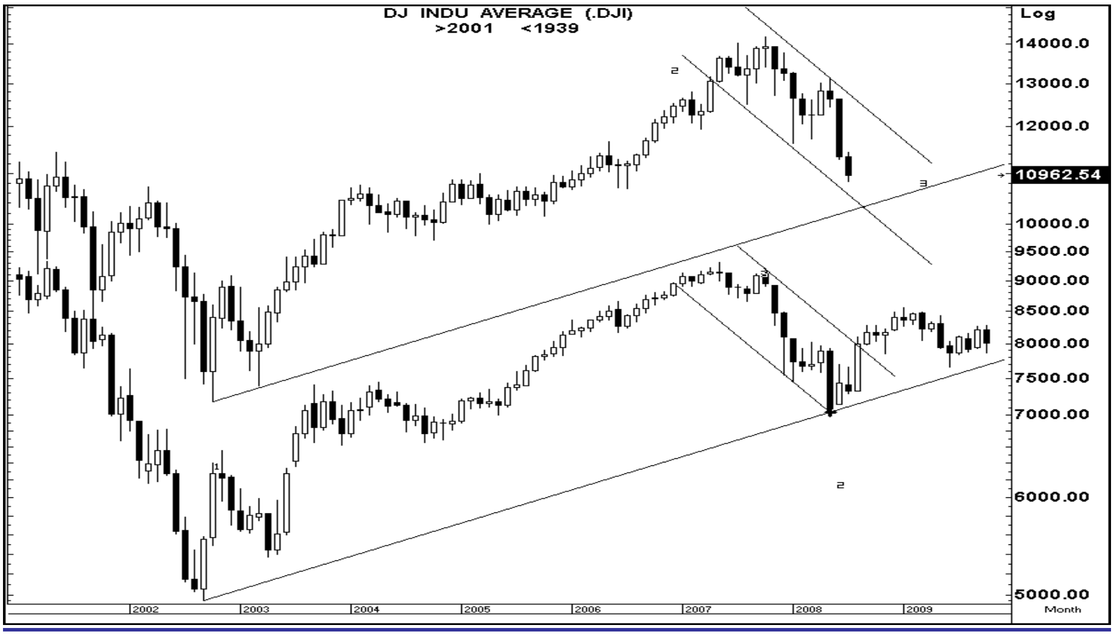
S&P 500



The recent break below the 1,257 level looks very similar to us to that seen when it broke below 1,254 in Feb/March 2001 setting up for a rapid move to 1,081.

At a minimum you would need the index back over 1,265-1,270 to suggest stabilisation.

DJIA 2000-2007 compared to the DJIA 1929-1937



It took until 1946 to test the 1937 high and 1950 to eventually break it.
Between the peak of the 5-year rally in March 1937 and March 1938 the DJIA halved in value

S&P 500 chart reconstructed back 80 years.

A pessimist would look at this long-term chart and see a danger of a major double top with a neckline at 768.

A test of that support would be bad enough but obviously a break would be worse than bad, as it would suggest a move to at least sub 400

So here is our bottom line:

- Contrary to a lot of commentary recently we do not believe the issue is one of people being too negative. We believe it is an issue of people being too complacent.
- 25 years of growth and wealth creation as the U.S.A. has become the World's largest hedge fund has bred an "It cannot happen to us" mentality
- The perfect storm of a housing crash, a credit crisis, tighter credit conditions, a broken transmission mechanism, slower growth, large deficits, rising unemployment, excessive consume borrowing has, in our view, created a toxic mix not seen during this era of unbridled prosperity that looks extremely difficult if not impossible to get out of easily.
- On top of this the only shining light (global growth holding up the U.S. economy) is looking increasingly fragile as equity markets and property markets around the world look to be seeing the domino effect feed through. The era of cheap, easy, leveraged credit has ended with a large bump and we are likely to see these problems spread further in the months ahead.

On the basis of this we just cannot see a scenario that will lead to a sustainable Equity market rally and expect the outlook could be very concerning indeed.

Our fear is that we are very close to the point where we will likely see a painful downside acceleration in this equity market fall in the coming months.

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