PETER ELIADES' STOCKMARKET CYCLES

June 4, 2010	
End of Week #1851	
DJIA	9,931.97
CI	1628
NCI	1534
Ratio	1.061
S&P Ratio	1.031

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—THE CYCLES—

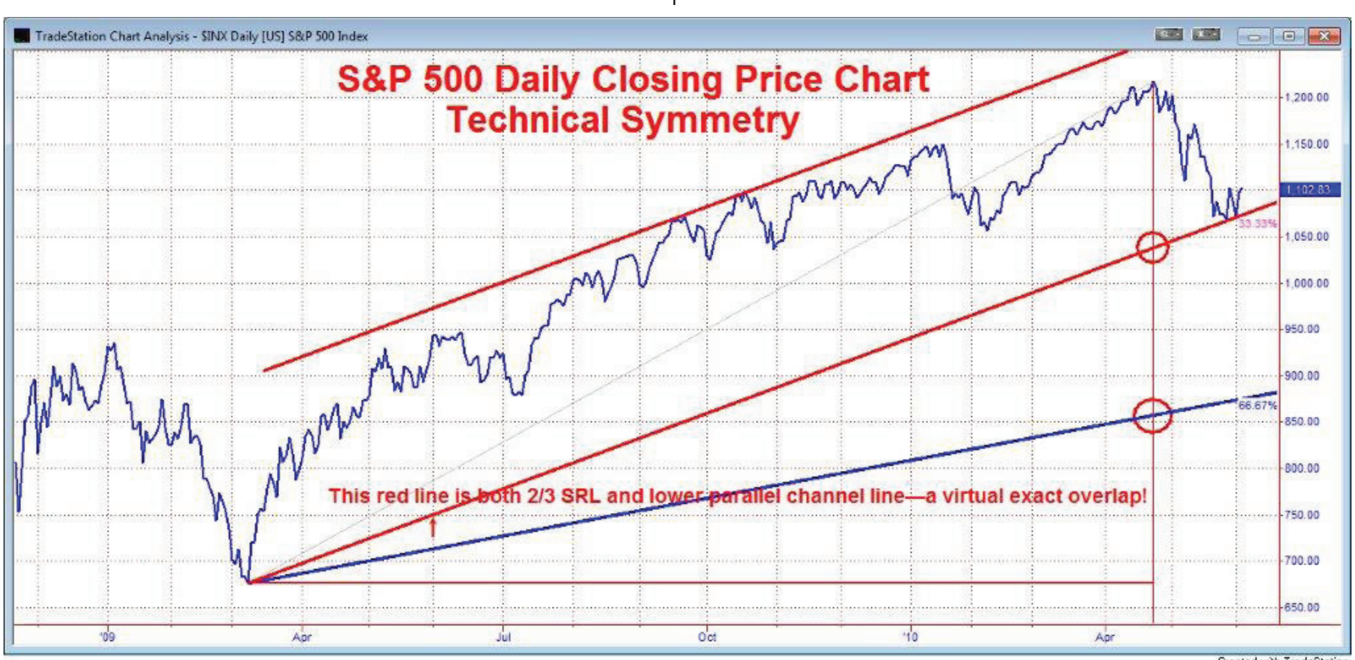
In our newsletter dated May 7, 2010, we told you that the NY Composite Index generated a lower nominal 40 week projection on its closing basis projection chart calling for a closing price around the 6600 level. On the day we gave you that projection in the newsletter, the NY Composite Index had closed at 6917.25 so the projection was calling for an additional decline of 4-5%. Thirteen trading days later, on May 26, the NY Composite Index closed at 6630.94. At that point it had met all its downside projections without generating any lower projections. That is usually a good setup for a market bottom. Since that date, however, although any further downside probings intraday failed to follow through on a closing basis, it is also true the market has had a difficult time making any headway to the upside.

The first two charts in the newsletter should provide you with good visual information as to why the market has reached critical territory. The first chart, a daily closing price chart of the S&P 500, contains some rather remarkable market symmetry. The lower parallel channel line (colored red for those of you who receive the newsletter via e-mail) actually represents two technical lines determined completely independently of each other but which which overlap virtually exactly. The first of those lines is simply a parallel line generated from the upper parallel line which intersects the September 2009 and October 2009 closing highs on the S&P. The placement of that lower parallel line is simply determined by the closing price at the low in March 2009. Notice how the two recent low closes on the S&P 500 came down and stopped virtually exactly on that line.

Now let's describe the line which overlaps the lower parallel channel line almost exactly. That line is simply a 2/3 Speed Resistance Line determined by the closing low on March 9, 2009 and the closing high on April 23, 2010. For new subscribers who are not acquainted with the concept of Speed Resistance Lines, we have added a few lines to describe the concept. Notice the horizontal line extended to the right from the March 2009 closing low across to April 23, 2010 where it meets the vertical line that comes down from the April 23, 2009 closing high. That vertical line allows you to measure the distance from high to low in points. That distance is then divided into three equal parts (notice the circles which delineate the points which mark the 1/3 and 2/3 points in the division of the vertical line marking the distance from the March 2009 bottom the April 2010 top) and two lines are drawn from the March 2009 bottom through the 1/3 and 2/3 points below the April 2010 top. As we noted above, the line which goes through the circle closer to the top overlaps the lower parallel channel line virtually exactly even though there is no connection between the methods of construction of the lines.

We believe the fact that these two lines overlap almost exactly marks them as very important technical support. As you can see from the chart, the lines have held the S&P 500 on a closing price basis despite the fact that intraday prices moved well below the closing price levels. Both the closing prices of May 26 and June 1 held perfectly at those two overlapping technical lines.

The next chart in this section is a close up of the chart just shown with price activity beginning just a few trading days before the April 23 closing high. This chart shows you how a downward sloping parallel channel has been formed since the May 3 closing high which occurred just days before the initial collapse. That channel is bounded on the upside by the closing



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prices of May 3 and May 12, and on the downside by the closing prices May 7 and May 20. The close today as this section is being written (Thursday, June 3) was just below the upper parallel channel line.

As you can see on these two daily closing price S&P charts, the market decline was stemmed by the rising 2/3 Speed Resistance Line. We are also about to find out if the rally attempts will be stemmed by the declining upper parallel channel line displayed in the second chart. As you can see, that chart allows for no higher closes on the S&P unless the upper parallel channel line is penetrated. Such a penetration would have to be assigned a bullish connotation, at least for the short-term.

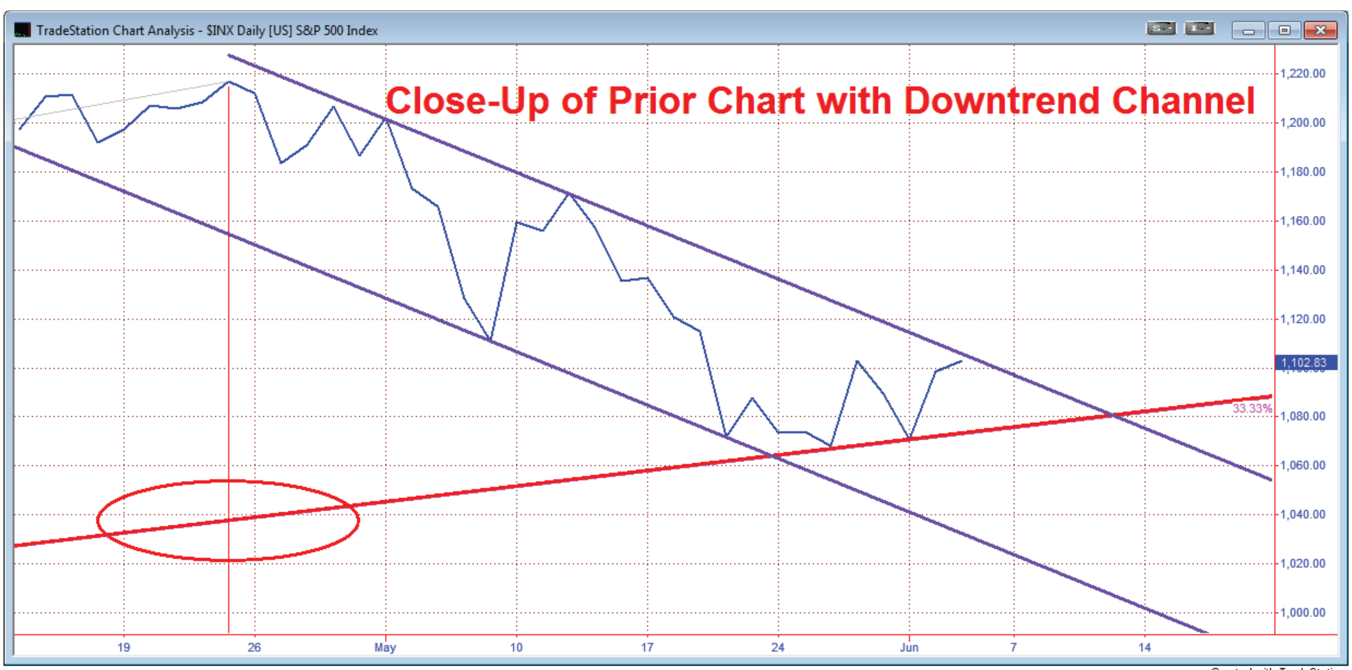
The preceding paragraph was written last night (June 3) and this paragraph is being written after the market close on Friday, June 4. As the old song of that title proclaims, **What a Difference a Day Makes**. Broadly based market indexes were down anywhere from 3-5% at the close today. This places the market in a potentially very dangerous position because it closed just below the rising Speed Resistance Lines depicted in the two charts just discussed. Speed Resistance Lines differ somewhat from trendlines because they often act as general support and resistance levels rather than the more exacting barriers represented by trendlines. There is a chance that today's decline will simply be the third test of the Speed Resistance Line and lower parallel channel as explained in the discussion of the first chart. But, should the market close more than another percent or two below that uptrend line, the theory of Speed Resistance Lines would argue that the next support for the market would not occur until a move down to the 1/3 Speed Resistance Line which, as you can see on the front page chart, is currently around 875 on the S&P 500. We will show you some charts in the **Market Projections** section that will also give you a good idea how important it is for the market to hold current support levels. A continued sharp decline next week could indeed generate a nominal 78-80 week projection for a decline on the S&P down to the general area between 850-875. Notice that those levels coincide with the current location of the 1/3 rising Speed Resistance Line on the S&P 500 as noted just above.

The next week or two will be important to the stock market in many ways. If the market breaks down from these levels and begins to give a projection around the 875 level on the S&P 500, the odds will increase significantly in favor of the contention that the second leg of a major bear market has commenced. If, on the other hand, the market can hold these levels and regain its footing, it would still be possible to see the market stage a rally into the July-August time zone. Based on what we have seen over the past week, we are beginning to lean more strongly in the direction that an important market top has been registered. We would ask you to refer back to the May 7 newsletter, especially to the first two charts in that newsletter, to see why we began to change our opinion last month concerning the potential importance of the late April high. The fact that the top registered in late April fit in virtually perfectly with the technical lines drawn in those first two charts of the May newsletter caused us to reconsider the potential importance of that April high. And now, one month later, we have seen very little that might change our mind about the potential importance of that top.

—TECHNICAL INDICATORS—

One of the reasons that the market is so vulnerable moving into next week is that the McClellan Summation Indexes have now moved below the neutral numbers of zero for the Ratio Adjusted McClellan Summation Index and +1000 for the orthodox McClellan Summation Index. Accelerated market declines seldom begin when the McClellan Summation Index readings are well above their neutral levels. Mind you, that does not mean that readings below the neutral level on the Summation Index will necessarily lead to accelerated declines in the market. It simply means that there is far greater risk to the downside when the Summation Index moves below its neutral level.

This section is being written after the close of the market on Friday, June 4. There were some remarkable readings after today's destructive decline. The single-day reading of the Trading Index (TRIN-Arms Index) after the close today was 13.22. There have been only three other double-digit single-day TRIN readings over the past 50 years. If you are curious, they occurred on February 27, 2007, October 26, 1987, and October 19, 1987. Those last two days were associated with



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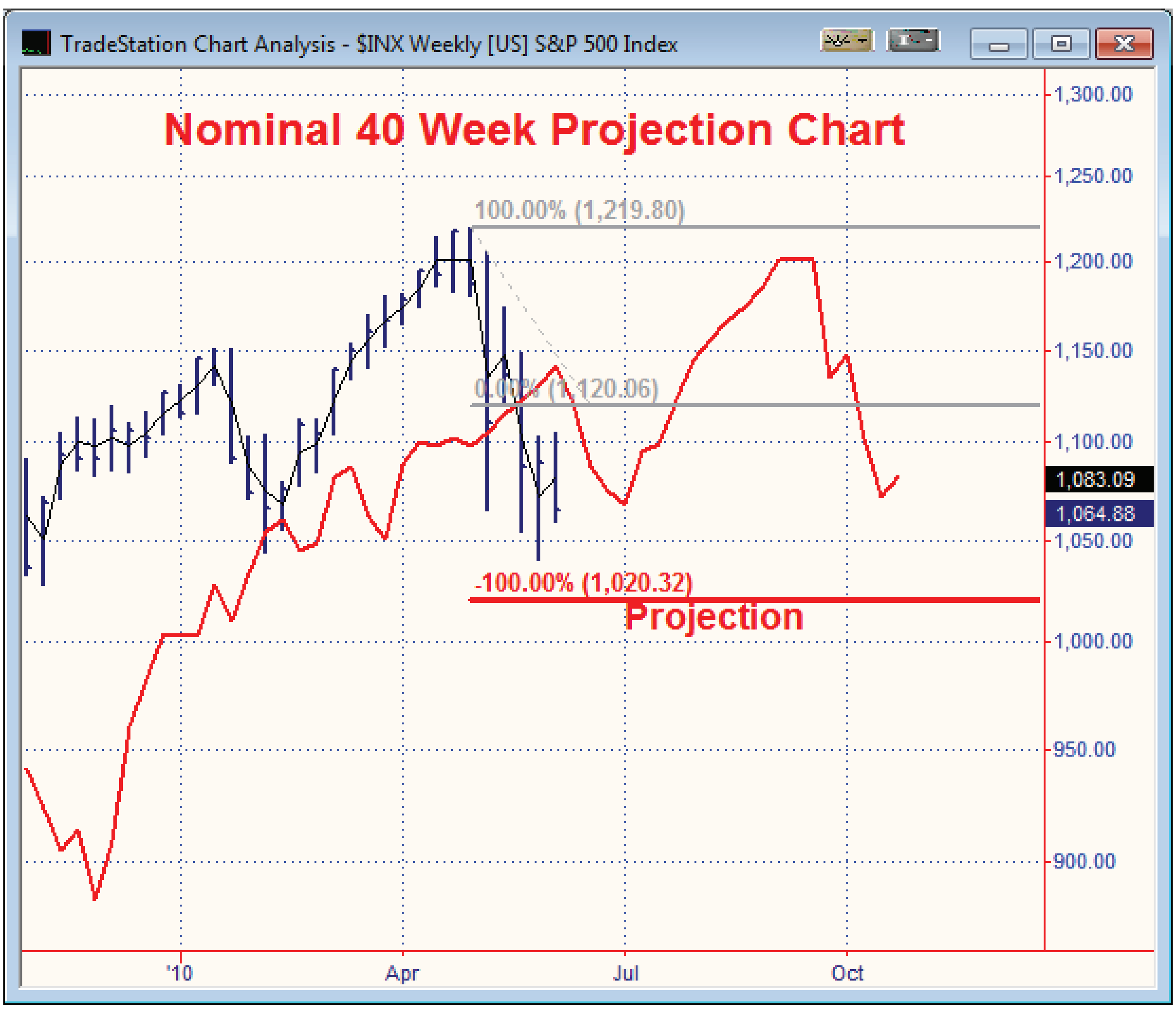
the market crash in October 1987 with October 19 being the exact day of the crash. All three readings were closely associated in time with market bottoms.

It is entirely possible that we are witnessing the formation of another of those market bottoms and that is why the next few days of next week are so important. If the market is forming some kind of short to intermediate term bottom at these levels, there should be little to any follow-through to the downside early next week. Further downside weakness next week could begin to generate significantly lower nominal 78-80 week projections as we will show you with some charts in the following section. A further decline early next week would also strongly suggest that the support lines in the charts shown above are failing to hold and as we noted in our commentary above, a convincing break of the 2/3 Speed Resistance Line would suggest that prices could fall relatively quickly to the 1/3 Speed Resistance Lines. On the Dow and the S&P, that would equate to a further decline of 15-20%.

—MARKET PROJECTIONS—

Market projections à la J.M. Hurst (**The Profit Magic of Stock TransactionTiming**) are our specialty. They have been for a few decades now, and although we have never had a monopoly in their implementation, we would like to think that we have had enough experience with the technique and added enough touches of our own to qualify us to do it better than anyone else. The first projection chart shows the S&P 500 with its nominal 20 week offset that is used to generate nominal 40 week projections. A line is drawn from the midpoint or median of each weekly bar connecting it to the median of the following week. That median line is then moved forward 20 weeks in time (the half span offset of the nominal projection being examined is used) and any cross above or below that offset generates a price projection. The price projection is generated by measuring the distance from the highest point prior to the crossing (or the lowest point if an upside projection is being made) to the point of crossing and then assuming that an equivalent distance to the downside (or the upside for upside projections) will be reached. In the current case with the S&P 500, the highest point prior to the downside crossing was 1219.80 and the crossing occurred at 1120.06, a difference of 99.74 points. The projection is calculated by assuming another 99.74 points will be traversed beyond the crossing point. Subtracting 99.74 from 1120.06 gives a projection of 1020.32. Allowing for a 10% margin of error measuring the total distance from 1219.80, the actual high, down to 1020.32, the projected low gives us a final projection of 1020.32 ± 19.95 points.

At the intraday low of 1040.78 registered on May 25, the S&P came within 0.51 points of entering the projection window. That could have been enough to satisfy the projection, but we need to examine the possibility that projection will be fully met at around 1020.32 or even exceeded to the downside



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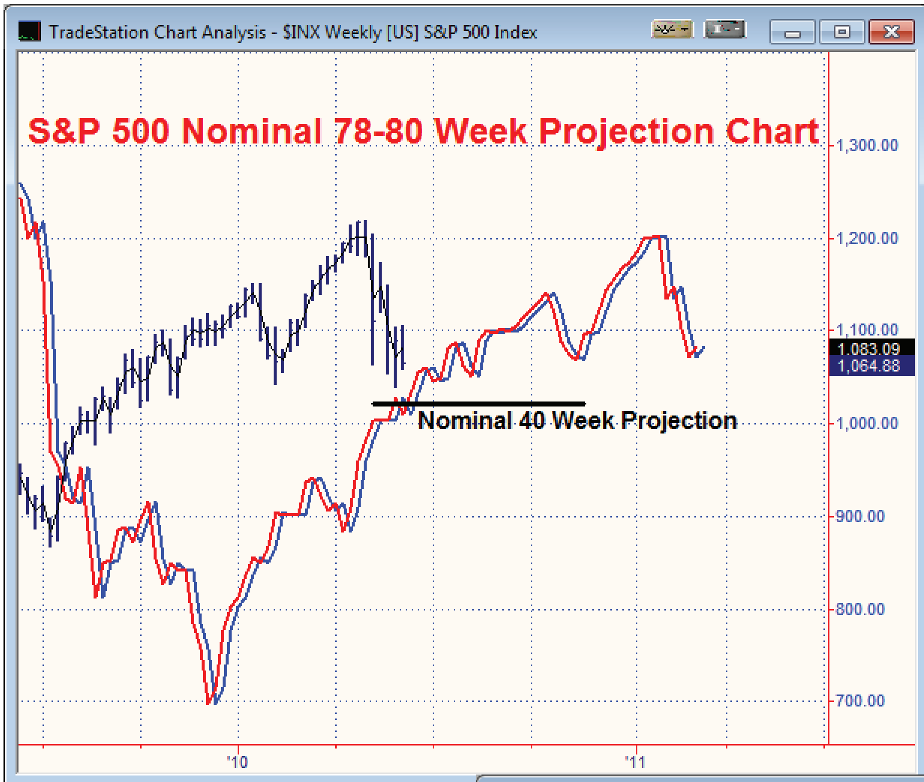
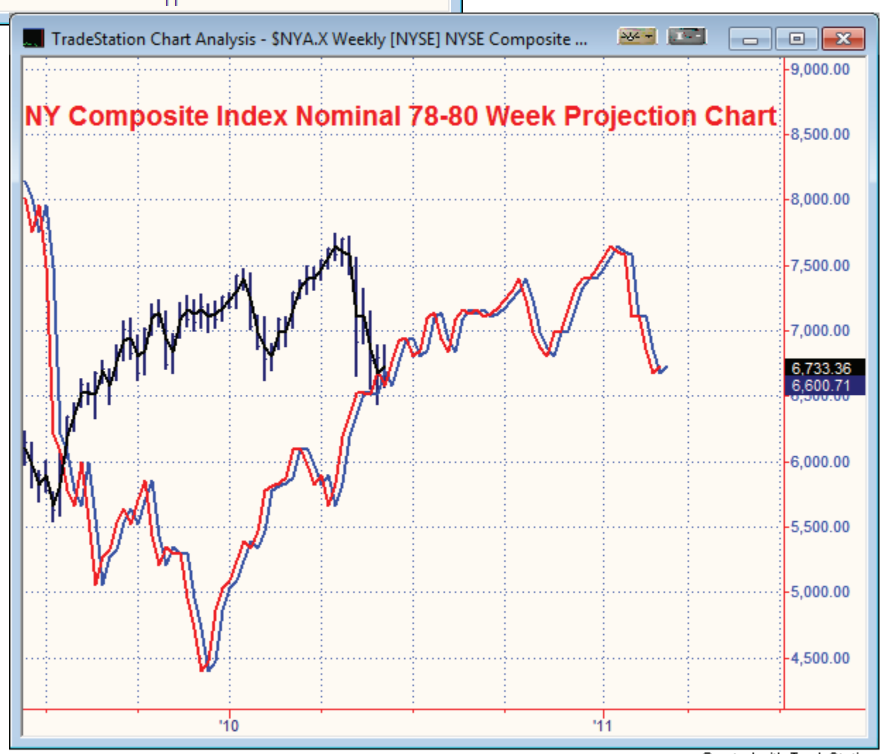


—MUTUAL FUNDS—

On June 2, Rydex switchers bought the Rydex S&P 500 2X Strategy Fund at the morning price of 20.39. Just two trading days later, at the morning price on June 4 (this particular Rydex fund is priced twice a day, at 10:45 AM Eastern time and at the market close), they sold that fund based on the instructions given the previous evening at a price of 20.68 for a gain of 1.4% on the transaction. As of the close today, June 4, both Rydex and Fidelity mutual fund switchers are in 100% cash positions. We have two different specific model portfolios—one for Fidelity switchers and one for the Rydex group switchers. How you distribute your own portfolio is up to you as an individual.

within a 10% margin of error which leads to a lower window of 1000.58.

With that in mind, examine the chart labeled **S&P 500 Nominal 78-80 Week Projection Chart**. This chart has offsets of both 39 and 40 weeks, and notice the bold horizontal line drawn at the projection level just discussed, namely 1020.32. If that level is reached in the next week or two, and especially if it is exceeded to the lower window of the projection around 1000, it is possible to see an even lower nominal 78-80 week generated. That is what we will be watching closely over the next week or two. The final projection chart shows the NY Composite Index with its 39 and 40 week offsets used to generate a nominal 78-80 week projection. A lower projection has not yet been generated but it is easy to see that a downside crossing could take place with any further weakness next week. That is another area we must watch closely.



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