May 6, 2011	
End of Week #1899	
DJIA	12,638.74
CI	1611
NCI	1519
Ratio	1.061
S&P Ratio	1.055

PETER ELIADES' STOCKMARKET CYCLES

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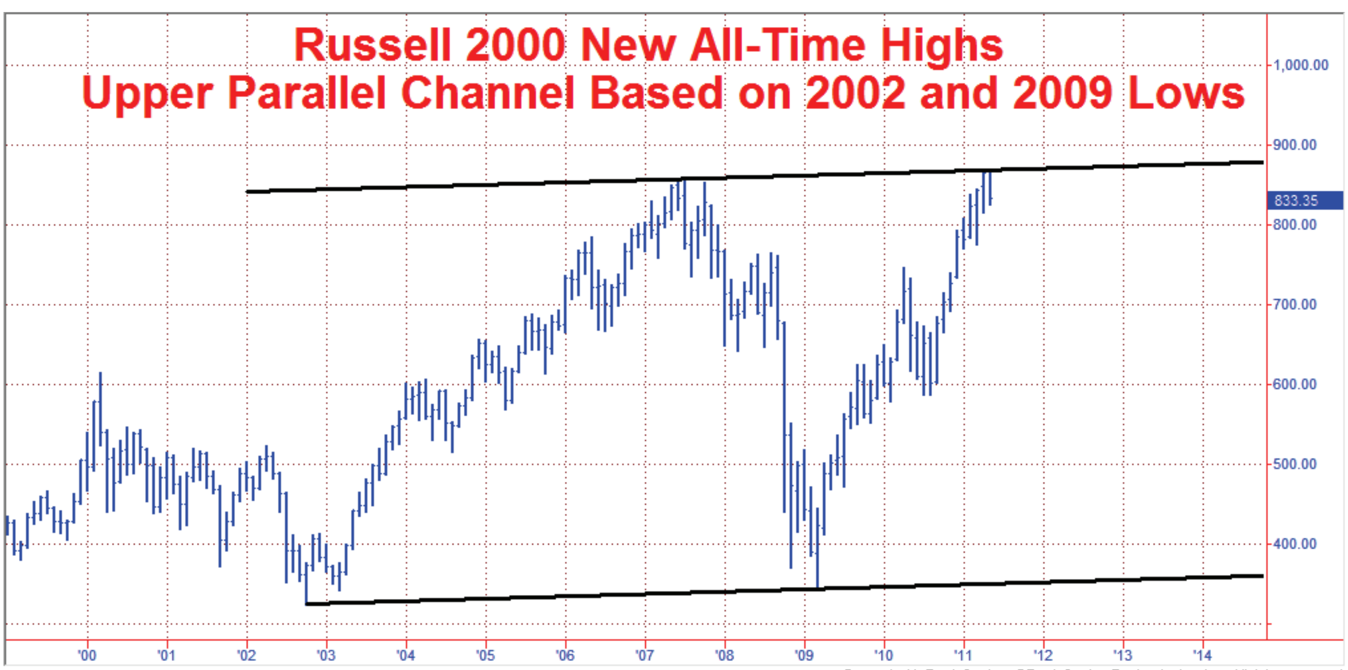
—THE CYCLES—

Our analysis over the past several months has kept us steadfastly bullish in the face of some rocky market declines. That bullishness has been engendered by different facets of our cycle and technical work. In fact, because of our long-term nominal four-year upside price projections, we remain bullish on the market's prospects for at least several more months. But the market has now approached some price levels on some of the averages and a time objective on the daily advance decline line and these factors are alerting us we may well be seeing or have seen an intermediate-term market top. In this first section, we will examine some of the charts that lead us to that conclusion.

The first chart is a monthly chart of the Russell 2000. The Russell 2000 is a small capitalization stock market index of the smallest 2000 stocks within the Russell 3000. The Russell 3000 represents approximately 98% of the total market capitalization of all stocks traded in the US. The Russell 2000 represents only approximately 8% of the total market capitalization of the Russell 3000. But look at this chart. Over the past two months the Russell 2000 has moved to new all-time highs, exceeding the highs established in June-July 2007. To some, that might be considered a bullish breakout. We, however, have trained ourselves to be looking for patterns and especially possible parallel channels that might tell a different story than the story as interpreted by more commonly used analysis.

Let's look more closely at some of the numbers associated with the Russell 2000 chart. The important low established on that index in October 2002 was 324.90. That low led to a rally of 164% over the next 4 1/2 years. From the June-July 2007 highs that index suffered through the devastating 60% decline that began in 2007 and lasted until March 2009. Let's calculate the slope of the lower channel line that is anchored on the October 2002 and March 2009 bottoms. Those respective lows were 324.90 and 342.59 with the March 2009 bottom 17.69 points higher than the October 2002 bottom. Those lows were 77 months apart so if we divide the 17.69 points by 77 months then we see the lower channel line advanced 0.22974 points per month between those two bottoms. Now let's move to the June 2007 high of 856.39. A line parallel to the lower channel line would have exactly the same slope of 0.22974 points per month. From June 2007 to April 2011 covers a time span of 46 months. If we multiply the number of months times the slope of 0.22974, it gives us a total of 10.568 points. If we add that 10.568 points to the top of 856.39 established in June of 2007, it gives us a reading of 866.96 in April 2011. The actual high in April was 866.90! That tells us that at the April high, the Russell 2000 had reached an upper parallel channel line from the 2007 high. There is no guarantee, of course, that the market rally will stop at that parallel channel but it is a potentially important technical roadblock that should be watched closely.

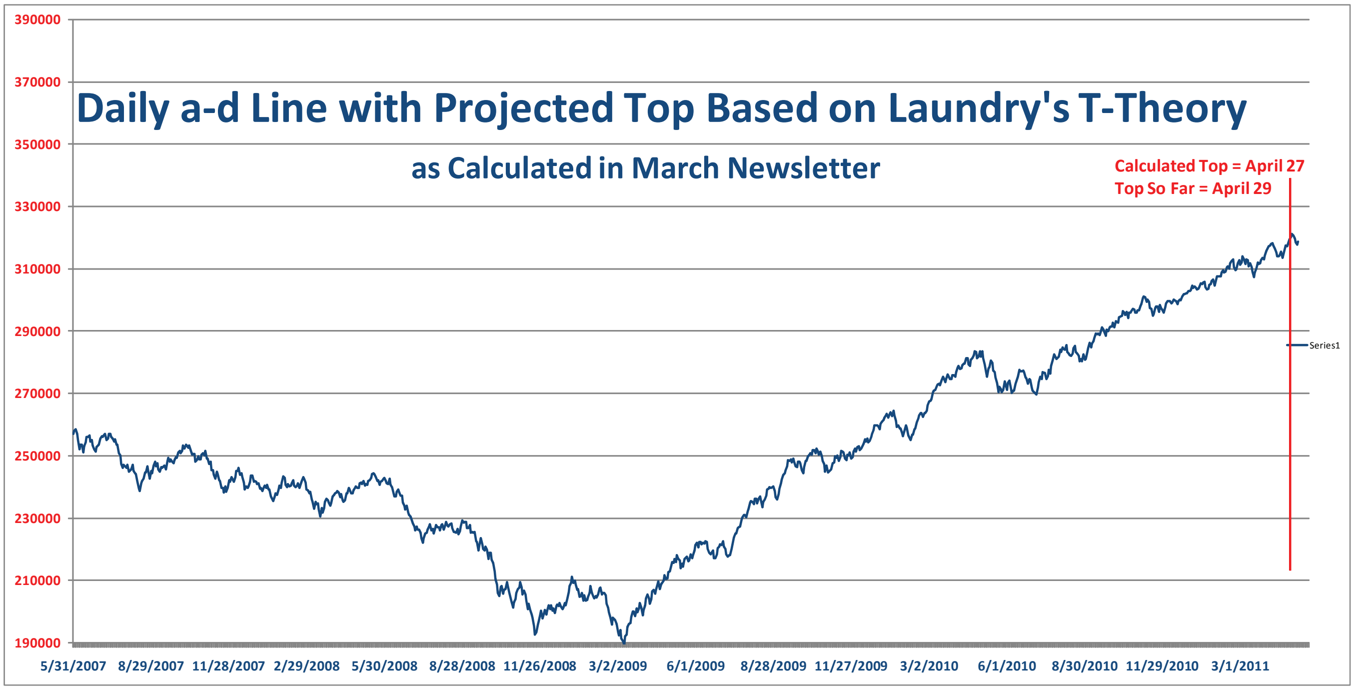
The next chart shows the daily advance decline line of the New York Stock Exchange going back almost 4 years. In our March 4, 2011 newsletter, we did an in-depth analysis of the daily advance decline line going back to the double tops in 1956 and 1959. The analysis was based on Terry Laundry's T-Theory and it came to the conclusion that a potentially very important top in the daily advance decline line could take place in a time zone centered around April 27. Two trading days after that date, on April 29, just as the Russell 2000 was hitting the upper channel line described above, the market rally abruptly ended and over the next several trading days, the advance decline line declined 3346 units and the Russell 2000 suffered a comparably abrupt 5.0% decline from its intraday high registered the trading day after April 29 to its low registered only



three trading days later.

Is there any more evidence that at least an intermediate-term decline could well have begun at that late April closing high? Look at the third chart in this section. It is a daily chart of the S&P 500 Composite Index going back to just before the July 2009 bottom. The channel on this chart was suggested by our management associate, Garrett Jones. The lower parallel channel line is anchored on the July 2009 and August 2010 bottoms. The low established on July 1, 2010 falls just slightly below that lower parallel channel line but the consecutive lows of the following two trading days again fall almost exactly on the line. The upper parallel channel line above the line just described is anchored on both the mid April and late April tops of 2010. The validity of that line is established when the February 18, 2011 top stops exactly at the line. The line has now been tested yet one more time on the first trading day after April 29 and, once again, the rally was stopped dead in its tracks. The market is still close enough to that upper channel line to make one think it could attempt another challenge over the next few weeks. We will be watching closely for that possibility but we want our subscribers to be aware that the three charts just shown make a strong argument that an intermediate-term top of some importance may well have been registered at the close on April 29.

What are the possibilities that the recent highs established could turn out to be highs of long-term importance rather than simply intermediate-term market tops? Our current opinion is that the possibility of that being the case remains relatively low. We say that for several reasons. First of all, it is rare indeed to see market indexes and averages reach important

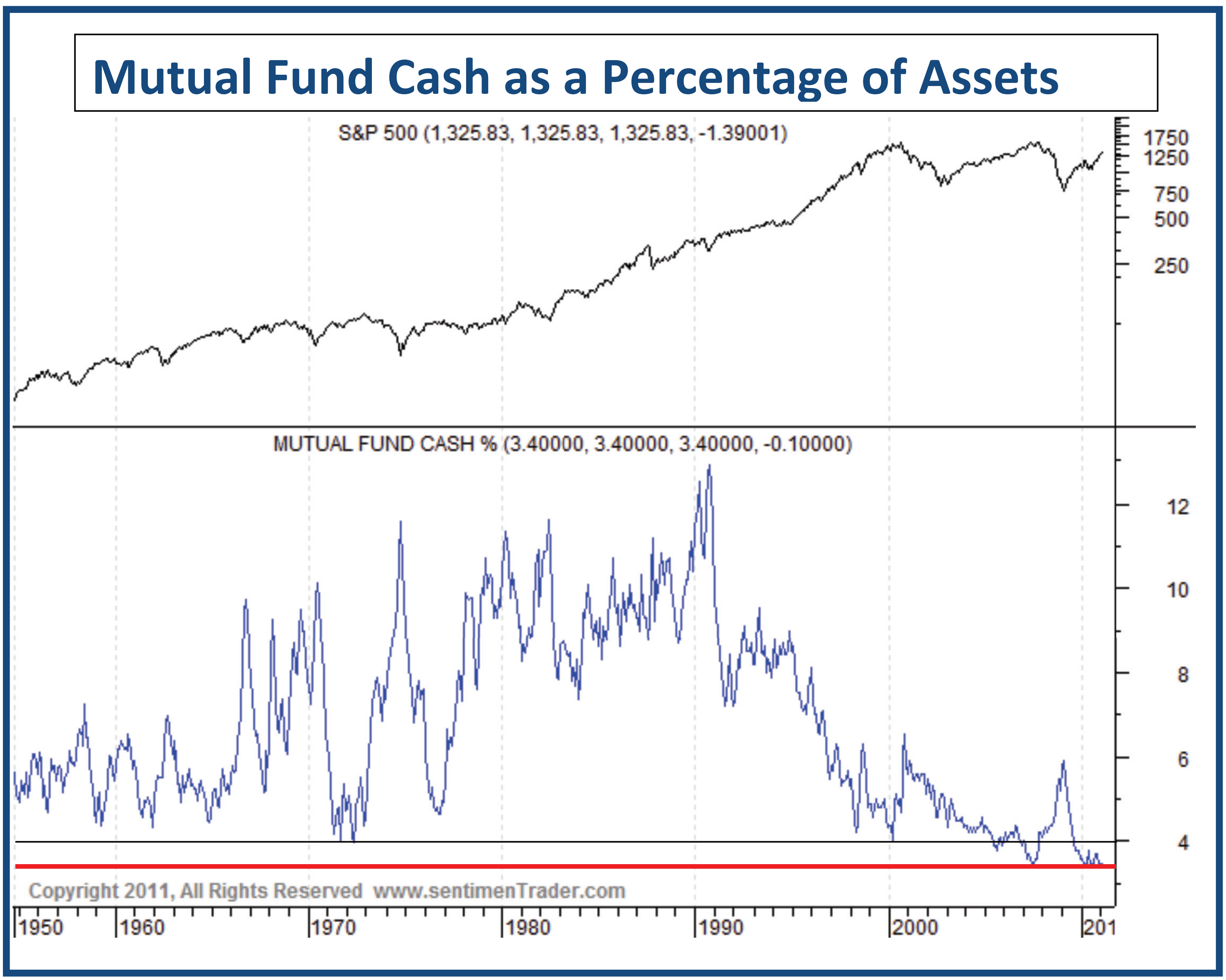


highs coincident with an important high in the advance decline line. Divergent market behavior between the advance decline line and the market averages is almost always seen at important tops. That is one argument against the possibility that an important top in the indexes could also have been reached in late April. Another argument against that possibility is the fact that we still have nominal four-year upside projections outstanding that have fallen quite a bit short of being achieved at the late April highs. As noted in our November 2010 newsletter, the lower windows of those nominal four-year projections call for a minimum high on the Dow at 14,043.48 and a minimum high on the S&P 500 of 1500.15. The recent highs fell 9.1% and 9.5% short, respectively, of the minimum projected intraday four-year objectives.

—TECHNICAL INDICATORS—

There are serious and experienced market analysts who believe we have already seen the bear market of our generation, the one that lasted from 2007-2009. Some even profess that the bear market began in 2000 with the end of the Nasdaq bubble, and it then lasted into early 2009 where it finally ended. Many of them seriously believe we are about to embark on one of the greatest growth periods in the economic history of the world. Personally, we love that kind of optimism, but we believe it is very premature. We have produced charts over the past several months that show the market as being historically overvalued in terms of important long term valuation principles such as dividend yield and Shiller's Price-to-10-Year-Earnings Ratio. These tools are seldom useful for market timing but they present an invaluable long term perspective. They are currently telling us that, although they cannot rule out a continuing market advance, they can give us strong confidence that the major market indexes are not about to advance in a multi-year bull market. The chart that accompanies this section is not a valuation chart at all, but its usefulness is very similar to that of good valuation charts.

This chart is courtesy of Jason Goepfert at Sentimentrader.com, a service we heartily recommend for its historic observations in terms of sentiment data and other technical tools. The chart depicts mutual fund cash as a percentage of overall fund assets. As you can see if you study the chart, it would be difficult to formulate a strategy based on these data alone. There should be little doubt, however, in viewing the history, that historically low levels of cash are not conducive to long bull market runs. Three of the greatest bear markets of the past century began with cash levels at the 4% line or lower. This chart is current through the end of April and cash levels are currently at or within a hair of the lowest cash levels in history. Jason actually adjusts these numbers based on current interest rates and, on the face of it, it appears to be a logical adjustment. After all, it is far greater incentive for a fund manager to place his assets in cash equivalents when interest rates are around 10% than when they are around 0%. Whether an adjustment is made or not, however, it should be



clear that cash reserves as a percentage of total assets in mutual funds are at the lower end of the historic spectrum. It has been a long, long time since mutual fund cash reserves were above 6% but we believe the chances are high that sometime in the next 5-6 years fear will once again enter the marketplace and mutual fund cash positions will likely approach or exceed double digits at that time. Should that occur, we can be confident that some serious price damage will be incurred in order to bring that defensive psychology about, but for now we are satisfied with the assessment that when mutual fund cash as a percentage of assets is at an historic low the market is almost surely not faced with the prospects of a long-term advance.

—MARKET PROJECTIONS—

We noted above that one of the reasons we believed that even if the highs registered on November 29-May 1 turn out to be intermediate-term highs, they will not end up being important highs, is that nominal four-year upside projections remain outstanding and have not yet been approached or invalidated. The next chart in the newsletter shows an updated version of the nominal four-year projection chart for the S&P 500 Composite Index. There are a few things to note from the updated chart. First of all, the S&P has already advanced almost an additional 20% since the preliminary nominal four-year projection was given when prices crossed above the 100 week offset (in red if you are viewing the chart in color). The second point to make is that over the next 12 months, if prices do not reach the projection window (that would require a price of at least 1500.15 on the S&P) it will become easier to invalidate the projection by falling back below the offset lines which are advancing smartly underneath the current price action. Within 9-12 months the offset lines will be between 1090-1200.

On a short-term basis, the S&P 500 cash index has generated a nominal 20 day downside closing price projection to 1306.68-1318.43 and that projection would only be invalidated if the S&P closes above 1360 on May 12 or earlier.

—MUTUAL FUNDS—

Both Rydex and Fidelity switchers are currently in 100% cash positions. After the S&P generated higher projections in early April, we recommended subscribers buy the Rydex S&P 500 2X Strategy Fund (RYTNX), splitting the purchase between the morning and closing prices on April 5. The average purchase price was 30.655. We followed strict parameters on the trade and told subscribers ahead of time we would exit on any two consecutive closes below the exponential 10 day moving average of the S&P cash. That discipline forced us to exit on April 12 at a price of 29.74 for a loss of 3.0% on the trade. So far this year, we have zigged and zagged at the wrong time with this fund. We plan to take another long position if the market moves itself into a strong oversold position and there are no downside projections outstanding.

We have two different specific model portfolios—one for Fidelity switchers and one for Rydex group switchers. How you distribute your own portfolio is up to you as an individual.

Next Publication Date: June 3, 2011