Sy Harding's

STREET SMART REPORT

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INDICATOR SUMMARY:

Our *Seasonal Timing Strategy*™ remains in its favorable season (since Oct. 18). Our non-seasonal *Market-Timing Strategy* is neutral on the U.S. market, on a buy signal for the Japanese market, a buy signal for the U.S. dollar, a sell signal for gold, and we have now come off the sell signal for U.S. Treasury bonds, but only to neutral.

January 19, 2011.

The dramatic rescue of the economy and financial system worked. Great Depression II did not arrive, and even the Great Recession and near collapse of the financial system are becoming a distant memory.

The economic recovery is back on track after the scare last summer that it was tumbling back into a double-dip recession (when housing, auto sales, retail sales, factory orders and the like plunged after the stimulus programs for home and auto buyers expired, and the Fed halted its massive treasury bond-buying program (QE1).

But the Fed decided to provide another round of quantitative easing (QE2).

And we're already back to buying new cars, packing the airports and vacation destinations, piling money into the stock market, and even moving out the risk curve to bet on currency and commodity markets. No fear.

Bankers are not jumping out of office windows as in the 1930's. Those eased out of their positions are enjoying impressive golden parachute retirements. Those still in their positions are already celebrating huge performance bonuses again. The government has even made sizable profits from many of the temporary bailout loans and investments.

Of course it's not that great for everyone.

While the handful of major banks are prospering, 7,000 smaller banks are struggling. More than 300 have failed since 2008, and the FDIC's 'troubled bank list' continues to grow, reaching 860 as of November.

According to the latest tally, the unemployment rate is 9.4%, with 14.5 million people unemployed, and Fed Chairman Bernanke says it will take five more years for unemployment to come down to acceptable levels.

More than a million foreclosed home owners lost their homes last year, with more than a million more expected to receive the same treatment this year.

But the Federal Reserve is aware of all that and is on the case. As noted, the Fed decided on another round of quantitative easing to keep the economy growing and bring relief to those who are still struggling.

It provides great support for the historical pattern of the third (and fourth) year of a presidential term almost always being positive. There hasn't been a negative 3rd year since 1940.

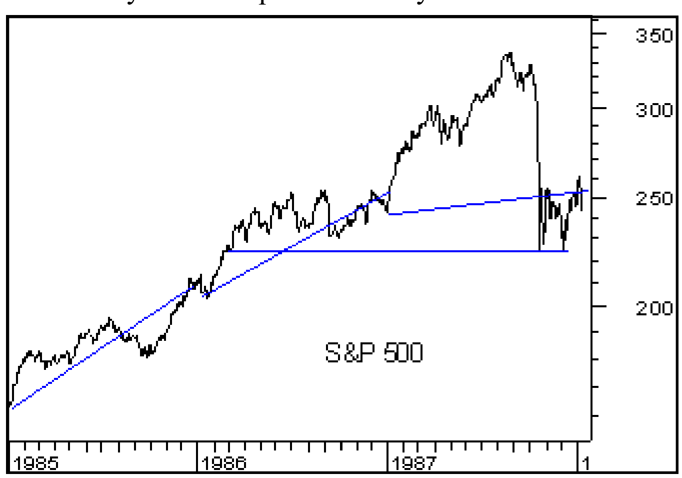
We may have to pay the price for the huge government deficits down the road, but the rewards should continue for the next year or two.

However, that does not mean that 2011 will be without problems, or that the market will continue straight up to the expected positive ending.

There have been some scares *within* third years.

Most notable was probably 1987, the third year of President Reagan's 2nd term.

Like this year, in 1987 the market had been up for each of the previous two years, escaping the history of serious corrections usually taking place in either the first or second year of the presidential cycle.



The market was only up 2.3% for 1987, qualifying as a typical positive third year of the presidential cycle. But 1987's main feature was a 33% market decline within the year, including the 'Black Monday' crash, which took back almost two years of gains.

No we're not predicting a crash in 2011. Just pointing out that there can be times for caution, even in years destined to wind up positive for the full year.

Those times are frequently when unusual recent market gains have investors super bullish and confident. The first 7 months of 1987, and the 6 months since last July's low seem to qualify in that regard.

Let's look more closely at what we're talking about.

Investor Sentiment.

Sentiment has been thoroughly covered here in recent issues and elsewhere in the financial media. But a few more comparisons should be of interest.

As you know, investor sentiment is a 'contrary' indicator, reaching extremes of bullishness at market tops, and extremes of bearishness at market bottoms.

We mentioned 1987 as having also been the usually positive 3rd year of the Four-Year Presidential Cycle, but experiencing a serious correction and crash within the year.

Let's look at investor sentiment in 1987. Did it provide any warning of the decline?

Currently, the poll of its members by the American Association of Individual Investors **(AAII)** has been in its warning zone above 50% bullish for a number of weeks. It was as high as 63.3% bullish Dec. 23, and readings since have been 51.6%, 55.9%, and 52.3%.

In 1987 its highest reading was a bit lower, at 60.0% on August 21. Three trading days later the market topped out into a two-month decline. Bullish sentiment remained above 50% through September as the market decline continued, investors not believing the decline could amount to anything. The market was already down 16% when the October crash took place.

Another method of measuring sentiment, the **Investors Intelligence** poll of investment newsletters, is currently at 57.3% bulls, well into what Investors Intelligence considers to be *its* danger zone.

Bespoke Investment Group took a unique approach, combining the recent AAII and Investors Intelligence sentiment readings for comparisons to previous periods. At the end of December they noted that taken separately the two polls show historically extreme bullishness, and combined they have not seen this level of bullishness since just before the 1987 'Black Monday' crash; at the height of the Nasdaq bubble in 1999, and for a few weeks in 2003-2004.

So current sentiment is at extremes of bullishness and confidence usually associated with market tops.

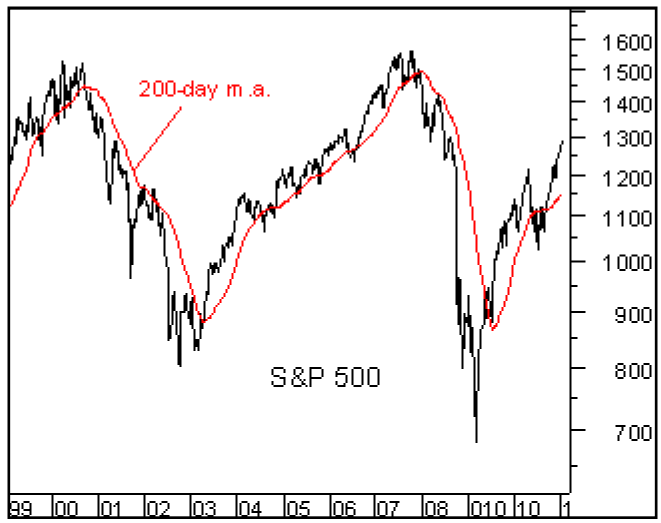
It might be different this time, but certainly has us concerned and watching our indicators closely.

To repeat, we are not predicting a 1987 style crash, or a 1999 type major top.

But that sentiment is so extremely bullish is one reason we remain significantly invested but watching closely, expecting a correction of 10% to 12% on the blue chips, and 15% or 16% on the Nasdaq and Russell 2000, at any time, before the upside resumes.

As we've been saying, it's not just the high bullish investor sentiment usually present at tops, but also that on the technical side the market is very overbought above 200-day moving averages.

That overbought condition is also more extreme than seen at previous important tops.



But even when not marking a major top, such overbought conditions soon resulted in at least a 'pullback' to retest the support at the moving average (and often overshooting some to beneath the m.a., as in the 2003-2007 bull market).

A pullback only to the m.a. from here would be a decline of 11% for the S&P 500, and 14% for the Nasdaq.

So far no one seems willing to take profits, the thought being that the market has been so resilient that maybe still more can be gained.

That approach has worked so far. But it sure has us on the edge of our seats, nowhere near as complacent as the majority of advisors and investors.

Typical of the current sentiment is this comment we saw yesterday on Yahoo Finance in response to a cautionary commentary, "I'm ALL IN as of last Thursday. Missed the boat last year. Not missing this one. Happy sailing!"

Not always the best criteria for an investing decision, chasing performance by buying something only because it's already made gains.

What could cause a correction?

Sentiment is saying the majority sees no catalyst that could cause even a 10% to 15% pullback, that now is the time to pile in even more aggressively.

If only conditions in the U.S. ruled the world.

Unfortunately, that's not the situation.

Problems outside the U.S. have had significant effects on the stock market since the new bull market began in early 2009.

The 8% January-February pullback last year began when the potential debt crisis in Greece came to the world's attention, even though U.S. companies were reporting super 4th quarter 2009 earnings.

Markets recovered when European central banks and the IMF cobbled together a potential rescue plan for Greece.

The more serious 16% April-July correction then took place when the debt crisis in Greece resurfaced, along with similar concerns for Portugal and Spain, even though U.S. companies were by then reporting super 1st quarter earnings.

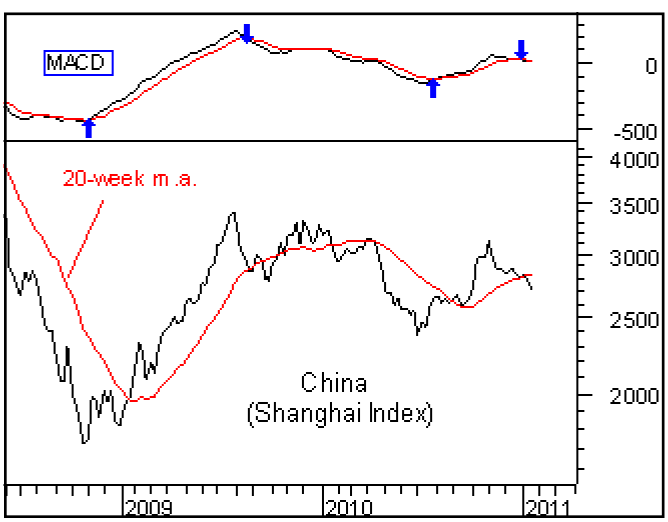
The market pullback in November, although minor at just 4%, took place when it was evident that the debt crisis in Greece had not been solved and the crisis had spread to Ireland.

We are dreaming if we think the debt crisis in Europe has ended in spite of such assurances after each additional country almost defaults and is temporarily rescued. Which is next? Portugal, Italy, Spain?

Then there is China.

China was worried about its over-heated economy, real-estate bubble, and rising inflation even before the U.S. Fed decided to flood global markets with more dollars. It raised the reserve requirements for its banks six times last year and another half-percent this week, and has raised interest rates twice since October.

China's own market has been worried since last year that its officials may not be able to bring its economy in for a soft landing.



After rallying with other global markets for part of 2009, the Chinese market dropped into another bear market, losing 33% of its value to last year's July low. It then rallied again with other global markets.

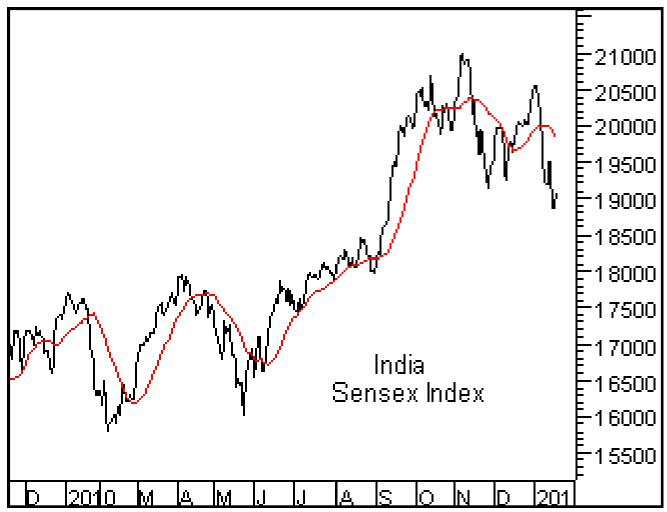
But while many, including the U.S., rallied again after the November pullback, the Chinese market continued to decline and is now down 15% again.

China's efforts have not had much effect in slowing its economy, or lowering inflation, and economists expect further tightening moves will be necessary.

Each such move has worried global stock markets for at least a few days. But if the stock market of the world's 2nd largest economy is worried, that worry could easily spread globally.

And there is India.

Another high-population surging economy.



India's stock market moved in tandem with the U.S. market last year, with a correction in Jan-Feb, another from its April peak, and then a big rally.

But here also, while the U.S. market continues to rally, the market in India, like that of China, topped out in November and is down 11% since.

The market doesn't need a catalyst to send it into a correction. As the old saying goes, they don't ring a bell at tops.

But if a catalyst is needed it could just as well come from Europe's debt crisis, or China, or India, or Brazil, or emerging markets as a group, most struggling with rising inflation, particularly food and energy inflation, and now raising interest rates to combat the problem.

Stock markets do not like rising interest rates. And more than one previous downturn in global markets began with declines in Asia.

However, just the high level of investor bullishness and the market's overbought condition is enough to have us worried.

Our Seasonal Timing Strategy (STS) triggered its official re-entry signal at the close on October 18 for entry the next day. The STS portfolio is now 100% invested in the SPDR DJIA Index etf, symbol DIA.

The STS portfolio is up 8.4% since the re-entry. If a short-term correction takes place in the favorable season, the market has usually recovered by the exit signal in the spring. So the STS rules call for remaining invested. We have deviated from the rules in the past, but each time was a mistake.

There was no 'lost decade' for our Seasonal Timing Strategy *following its rules without interference*.

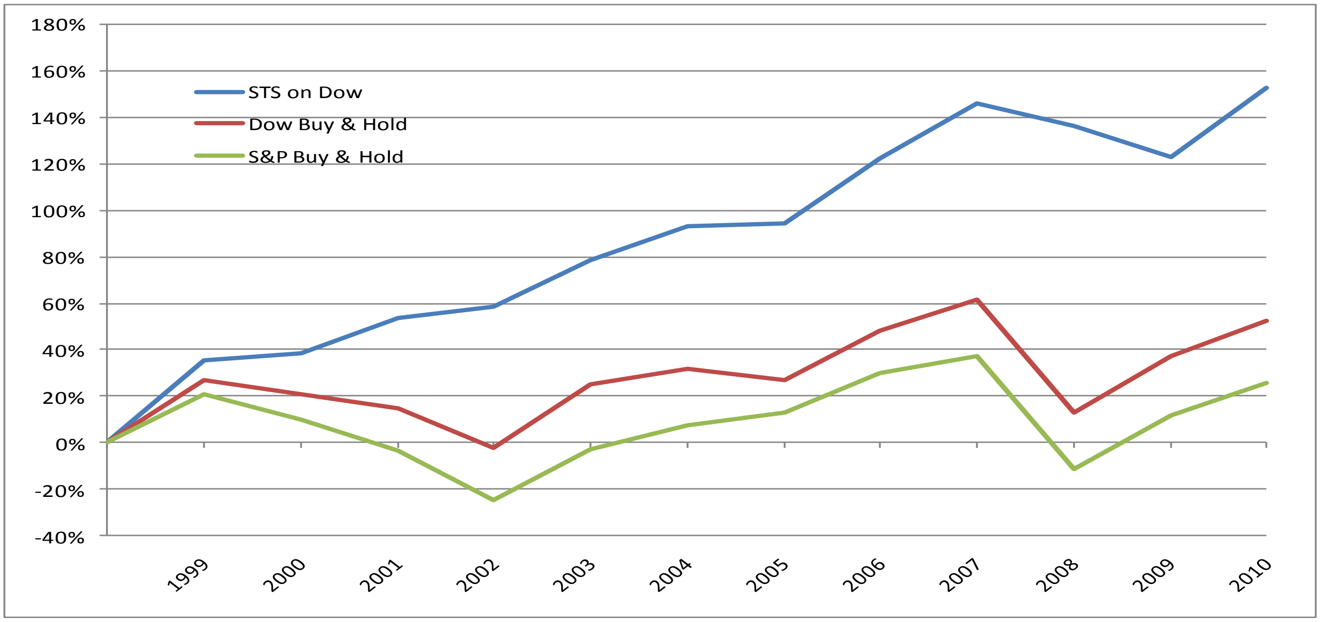


Table below is to yesterday's close.

Seasonality!

The market's long-term pattern of seasonality (making most of its gains in the winter months and suffering most of its declines in the summer months) has been clearly documented in independent academic studies, as well as research by numerous respected research firms.

And our STS has been proven to double the performance over the long-term of the basic seasonal history documented in the academic studies of 'Sell May 1, and Buy Nov. 1'.

We did not follow its rules last year with our portfolio, exiting in February, a mistake.

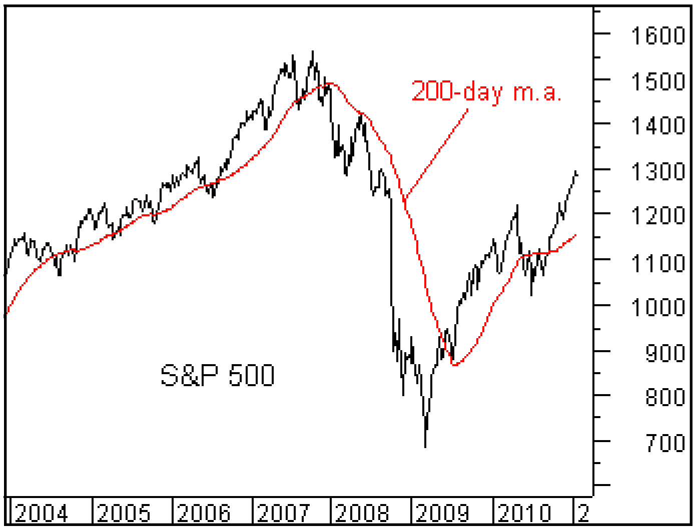
The table at right is the performance of the strategy since 1999 based on following its rules, waiting for its signals, and entering and exiting the Dow Index 100% each time.

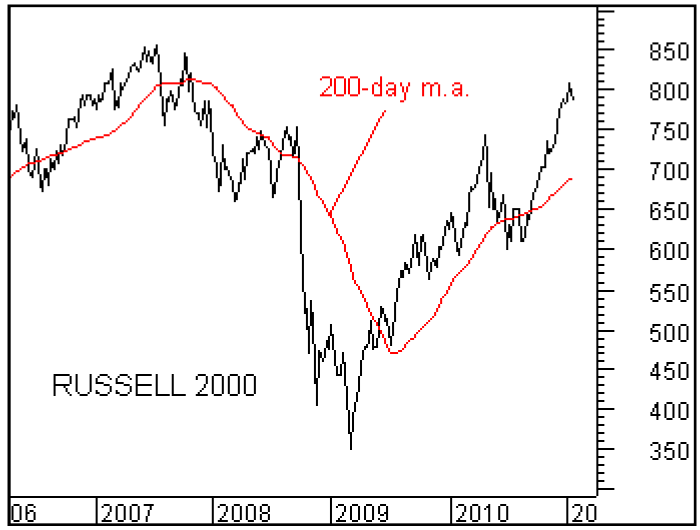
Not much over-performance in 2010, but at least it was accomplished with only 50% of market risk, even though by hindsight the risk was not as great as it normally is in 2nd year of presidential cycle.

YEAR	NASDAQ	S&P 500	DJIA	STS using DJIA Index Fund
1999 (Bull Market)	+ 85.6%	+ 20.1%	+ 26.8%	**+ 35.1%**
2000 (Bear Market)	- 39.3%	- 9.1%	- 4.6%	**+ 2.1%**
2001 (Bear Market)	- 21.1%	- 11.9%	- 5.3%	**+ 11.1%**
2002 (Bear Market)	- 31.5%	- 22.1%	- 14.7%	**+ 3.1%**
2003 (Bull Market)	+ 50.0%	+ 28.7%	+ 27.6%	**+ 11.2%**
2004 (Bull Market)	+ 8.6%	+ 10.9%	+ 5.5%	**+ 8.1%**
2005 (Bull Market)	+ 1.4%	+ 4.8%	+ 1.6%	**+ 0.6%**
2006 (Bull Market)	+ 9.5%	+ 15.4%	+ 18.5%	**+ 14.2%**
2007 (Bull Market)	+ 9.8%	+ 5.4%	+ 8.6%	**+ 11.2%**
2008 (Bear Market)	- 40.5%	- 36.1%	- 31.1%	**- 3.6%**
2009 (Bull Market)	+ 43.8%	+ 22.4%	+ 18.8%	**- 4.2%**
2010 (Bull market)	+ 16.9%	+ 12.8%	+ 11.0%	**+ 12.0%**
2011 so far	**+ 2.8%**	**+ 2.2%**	**+ 2.1%**	**+ 2.1%**
1 - Year Return	+ 16.9%	+12.8%	+ 11.0%	**+ 12.0%**
3 - Year Return	+ 0.02%	- 11.8%	- 9.4%	**+ 3.4%**
5 - Year Return	+ 20.3%	+ 7.3%	+ 16.6%	**+ 31.3%**
10 -Year Return	+ 7.4%	+ 10.2%	+ 28.8%	**+ 81.9%**
12– Year Return	+ 21.0%	+ 20.3%	+ 55.8%	**+ 151.0%**

We remain neutral on the U.S. market, but believe we may be potentially close to a sell signal.

While expecting a positive year, we expect a market correction soon before the upside resumes. As noted earlier, it's the extreme overbought condition of the market above long-term 200-day moving averages, combined with the extreme bullish investor sentiment, that has us expecting a correction at least down to retest the support at the m,a's.



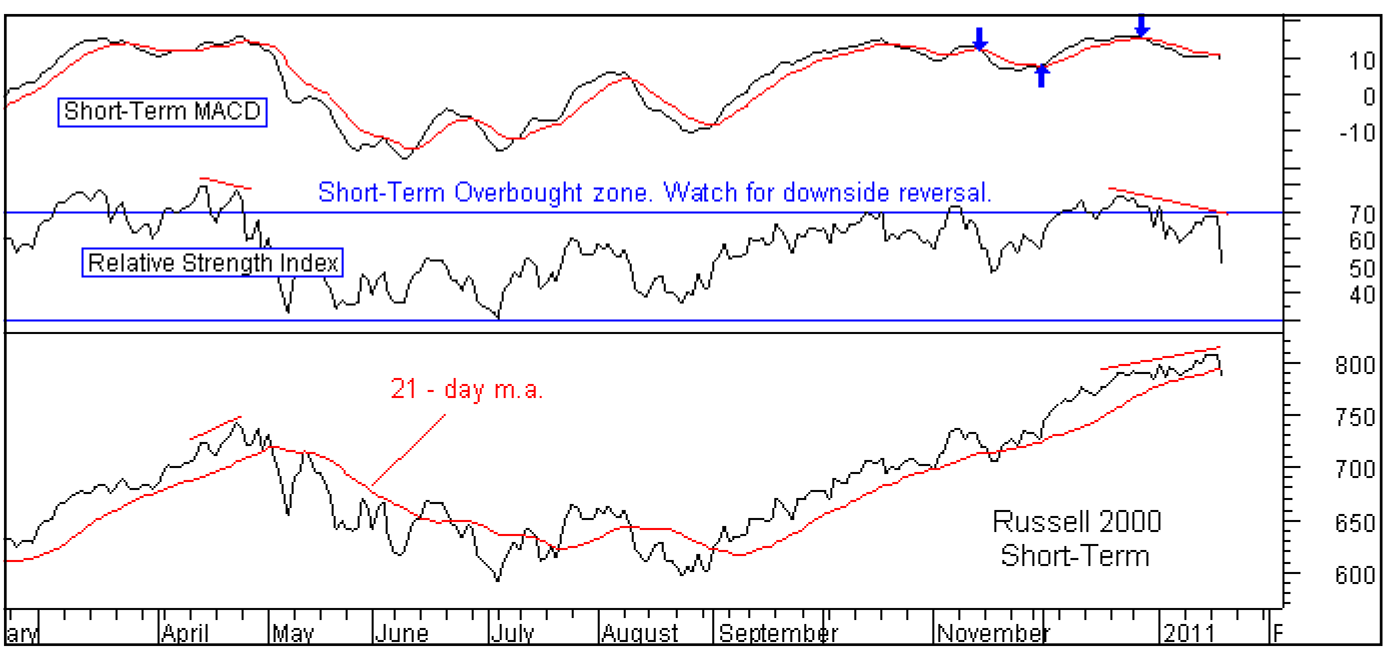


Today's market action got our attention in that regard. It was only one day, and we never mention one day's action, or even one week's, as they are always meaningless in the intermediate to longer-term.

However, given our other concerns and expectations, it was very interesting that today, while they brought the more easily manipulated 30-stock Dow back so that it closed down only 12 points, or 0.1%, the rest of the market was ugly, not at all indicative of a market down only 0.1%. For instance, the S&P 500 closed down 1.0%; the Nasdaq closed down 1.5%; the Russell 2000 closed down 2.6%; and the DJ Transportation Avg. closed down 1.8%.

And in the broad market, there were almost four times as many stocks down as up on the NYSE, and almost five times as many stocks down as up in the broad Nasdaq. That is ugly breadth for a market in which the Dow closed down only 0.1%.

It turned short-term market momentum negative on some of the most overbought indexes, potentially confirming the early warning when the Relative Strength Index did not confirm recent new highs (RSI making lower highs).



It was only one day, and probably means nothing. But it was an unusual day that increases our concern and reinforces our recommendation of the last few weeks that you stay tuned to the hotline.

We have come off the sell signal for U.S. Treasury Bonds, but only to neutral, not to a buy signal.

However, that is reason enough to take our profits on the 20% position we have in the 'inverse' bond etf, symbol TBF, which we will do tomorrow (Thursday).

Nervous investors piled into bonds at a record pace in 2008, resulting in a bubble that burst.

In spite of their very low yields, bonds also became a popular investment on a safe haven play last year, when the stock market topped out again, into its April to July correction.

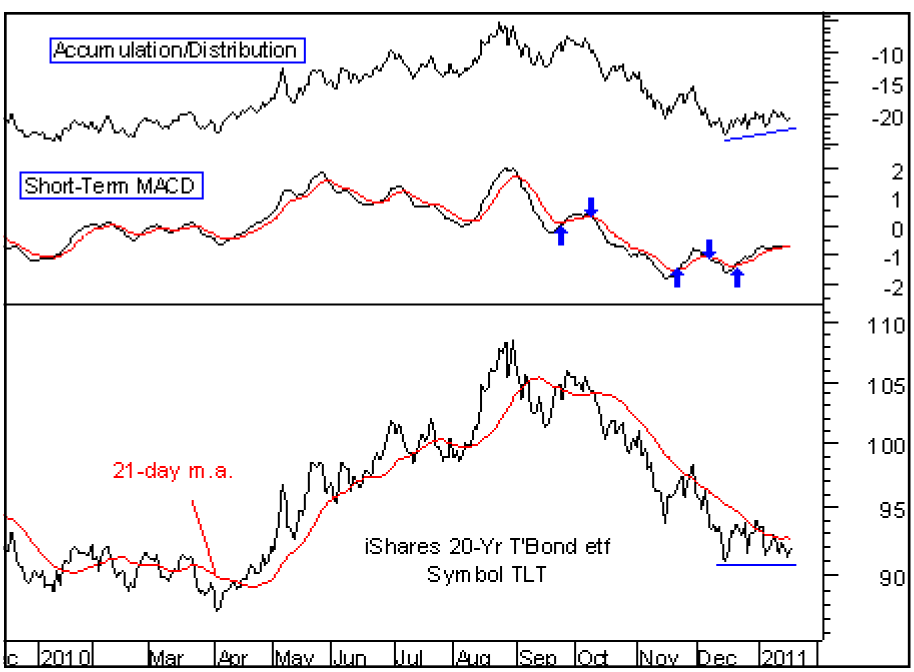
After the stock market rally resumed, bonds topped out again in September, and have declined double-digits since, as stocks have rallied.

However, as noted in the last issue, bonds had become oversold beneath their 20-week m.a., and our technical indicators had reached their intermediate-term oversold zones.

Meanwhile, investors have become very bullish on stocks while investor sentiment for bonds is turning quite bearish after this second bond decline in two years. (Bearish sentiment is probably also spilling over into treasuries from the rising concerns about the safety of state and municipal bonds, given the publicity regarding state and local budget deficits).

The move off the sell signal, (but only to a neutral outlook) is due to a combination of the oversold intermediate-term condition, the appearance of potential base-building, and some improvement in the short-term indicators.

Treasury bonds. Short-term.



The decline in bonds paused in mid-December, which shows up better on the short-term chart, and the TLT bond etf appears to be building a base.

At the same time several of the short-term technical indicators, like short-term MACD and the Accumulation/Distribution indicator, are turning positive again.

We also expect a stock market correction, which would also be a positive for bonds again.

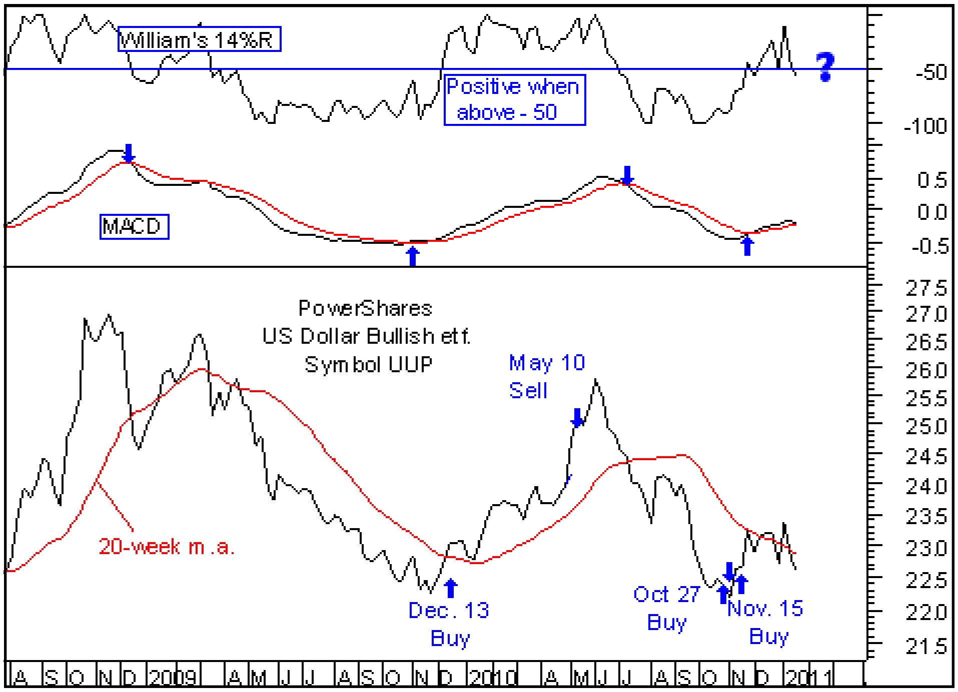
However, we would have to at least see bonds and the etf close clearly above the resistance at the 21-day m.a. before considering turning more positive, that is to a buy signal.

But the situation is enough to take our profits from the downside position.

It will be confirmed this evening on the hotline, where all portfolio changes are made. But tomorrow, Thursday, we will take our profit by selling the 20% downside position in the ProShares Short 20-yr bond etf, symbol TBF.

U.S. Dollar.

For the moment anyway, we remain on the intermediate-term buy signal for the dollar.



However, it no longer looks promising.

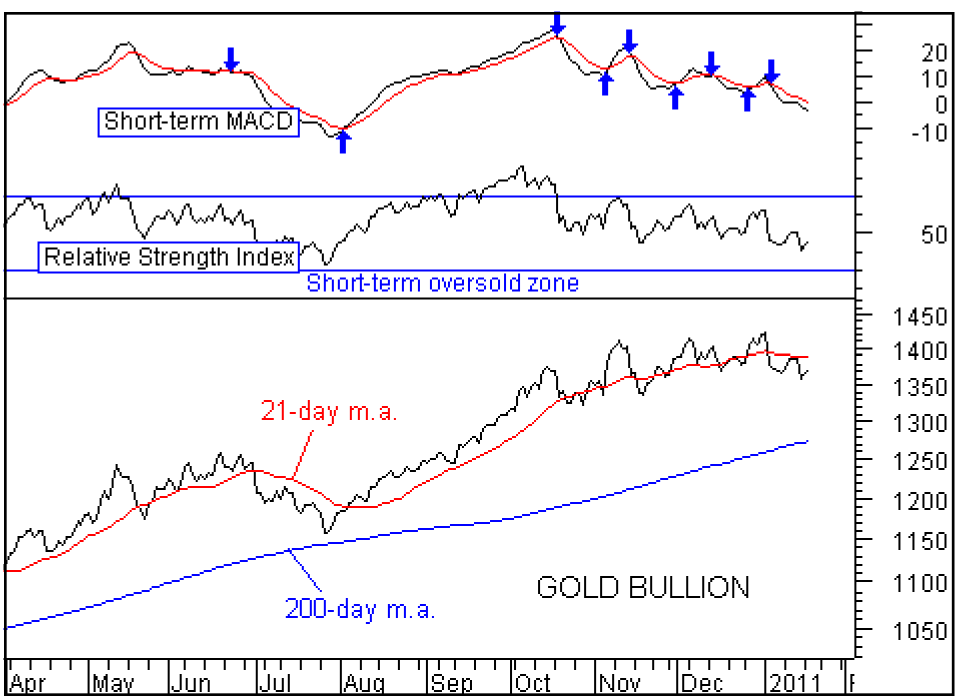
The PowerShares U.S. Dollar Bullish etf, symbol UUP, has broken back below its 20-week m.a., and the technical indicators have turned mixed, with a sell signal threatening.

The previous small profit has been given back, and as of today's close we now have a small loss of 1.1% on the position.

On the fundamentals, inflation has become a problem in a number of countries, which is prompting them to raise their interest rates. So far they include Brazil, Canada, China, Norway, South Korea, Sweden, and Thailand, while under pressure to do so are a number of European countries including the U.K. Higher interest rates elsewhere while rates in the U.S. remain low can cause global investors to move investments from dollars in order to obtain higher returns.

Gold.

We remain on the sell signal for gold.



Although our signal is an intermediate-term signal, we show you the short-term chart and indicators in this issue, because any potential for reversal of the signal would show up in the short-term indicators first.

Gold's short-term movements have continued to be very volatile, with daily gains or losses of $10, $20, and even $44 an ounce.

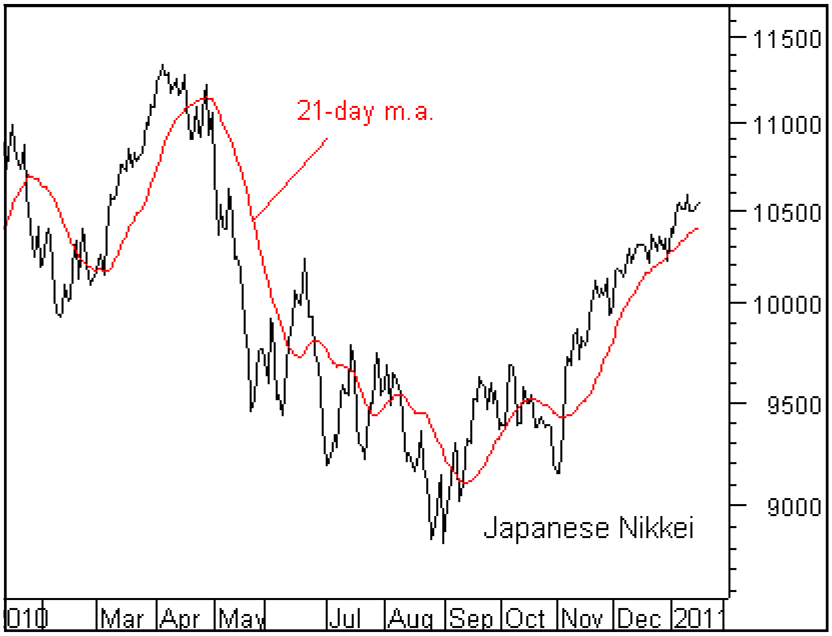
That has had the *short-term* indicators cycling back and forth between buy and sell signals.

But at this point, not even the short-term indicators have reached their oversold zones.

Meanwhile, gold is indicating that its 21-day m.a., which was previous downside support may now be short-term overhead resistance on rally attempts.

Our downside target is still the 200-day m.a., currently at $1,275 an ounce.

Japanese Market. We remain on the buy signal for the Japanese market.



Unlike the U.S. market, the Japanese market experienced a more meaningful correction from its April high, a decline of 22% that did not end until early September. So when the market's favorable season began in October we took a 20% position in the iShares Japan etf, symbol EWJ.

It has outperformed the Dow since, up 10.2% compared to the Dow etf DIA being up 8.4%.

The Nikkei continues to rally, finding support on pullbacks at its 21-day m.a.

But we will have to watch it if the U.S. market, and particularly if global markets, go into correction.

It's not likely the Japanese market could move opposite to global market pressure. But for now we remain on the buy signal.

Portfolio holdings: The Seasonal Timing Strategy portfolio is 100% invested in the DJIA Index etf DIA. The market-timing portfolio is 20% in the iShares Japan etf, symbol EWJ; 20% in the dollar etf UUP, and 20% in the ProShares Short 20-yr bond etf, symbol TBF (but taking the profit tomorrow).

Next issue: February 9. Meanwhile, please stay tuned to the hotline and the blog at www.streetsmartpost.com

OUR TIMER DIGEST RANKINGS:

1990: #2 Stock Market Timer in the U.S.
1991: #2 Long Term Market Timer.
1991: #1 Gold Timer (Gold Timer of the Year).
1992: #1 Gold Timer Two Year period.
1992: #1 Stock Market Timer 3 Year period.
1993: #1 Gold Timer 3 Year period.
1993: #2 Long Term Stock Market Timer 3 Yr Prd.
1994: #5 Gold Timer last 12 months, May 16.
1998: #10 Stock Market Timer in U.S.
1999: #2 Bond Market Timer last 12 months. July, 1999
1999: #4 Gold Timer last 12 months. Sept 1999.
1999: #3 Stock Market Timer last 6 months. Dec., 1999
2000: #3 Stock MarketTimer last 6 months. Jan., 2000.
2001: #3 Bond Timer last 12 months. Sept. 2001.
2001: #7 Stock Market Timer for 2001
2002: #3 Gold timer last 12 months. Mar. 2002
2002: #3 Stock Market Timer last 12 months. July, 2002
2003: #4 Stock Market Timer last 3 months. Aug, 2003.
2003: #1 Gold Timer last 12 months, Sept. 2003
2004: #2 Gold Timer last 12 months, Feb., 2004.
2004: #9 Stock Market Timer last 3 months. May, 2004.
2004: #5 Bond Timer for 2004.
2005: #2 Gold Timer last 12 months. Nov., 2005.
2006: #5 Bond Timer last 12 months. Dec., 2006.
2008: #4 Stock Market Timer last 6 months. Sept, 2008
2009: # 9 Stock Market Timer 12 months. Apr. 2009
2010: #1 Gold Timer last 12 months, Oct. 2010.

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