PRIVATE WEALTH ADVISORY

AN OMNISANS RESEARCH PUBLICATION MAY 20, 2009

History Rhymes, It Does Not Repeat

As noted in last week's issue, the rally in US equities has begun showing signs of weakness. The S&P 500 met with strong resistance at its 200-DMA and has begun forming a triangle pattern between the 50-DMA and the 20-DMA.

Triangle patterns are tricky beasts to play because they can easily break to the upside or the downside. And in today's world of "trade first, think later," you definitely don't want to be on the wrong side of a trade like this when the "electronic herd" (moron institutional traders) pile in.

However, with fundamentals worsening in the US (despite the media's claims to the contrary), it seems highly probable that when the S&P 500 breaks this pattern it will be to the downside. Students of historical trading patterns can find supporting evidence for this in last year's chart of the S&P 500.

I often joke that history rhymes, it does not repeat itself. Looking at the S&P 500's performance during the first six months of 2008, you'll see what I mean:

As you can see, the S&P 500 staged a similar triangle pattern in 2008 **almost to the very day.** Indeed, for any investor not suffering from short-term memory loss, this year has felt suspiciously familiar to the last from a trading perspective: both 2008 and 2009 had a March crises/ interventions (Bear Stears and the market collapse/ Stimulus Package, respectively), followed by a massive two to three month rally, and a subsequent failure to break above the 200-DMA.

So how'd the 2008 triangle pattern play out?

I am fairly confident we'll see a similar plunge in 2009. The question is when it will happen and what will be the instigator (last year it was Fannie and Freddie).

Commercial real estate seems the most likely candidate. As more and more businesses close offices or outlets, rents will fall which in turn will put downward pressure on the commercial real estate sector. It's also worth noting that during the housing bubble, commercial lending standards were just as bad as they were in the residential sector (that is, non-existent). A lot of deals were done at exaggerated levels. And as owners start finding it difficult to cover their debt load, the likelihood of default will soar (look at General Growth Properties, for instance).

Real estate:

Another sector I'm keen to short is retail. Consumers have begun saving money and paying off credit cards. Neither of these bode well for retail stocks. It's also worth mentioning that monthly retail sales reports are highly massaged using everything from weather and seasonal adjustments as well as all kinds of other accounting voodoo. So the real story is not widely known by the stock market (which makes for very rude discoveries later on).

However, in spite of this, the sector has rallied strongly in the last two months. Indeed, retail stocks (and finance) have led this stock rally, accounting for 50% of the gains in April. That's extraordinary when you consider how poor the fundamentals are in the sector.

Retail:

From a bird's eye perspective, stocks are clearly still in a bear market, which makes this is a bear market rally. It certainly has the hallmarks of one. Indeed, bear market rallies have three key features. They are:

1) Dramatic (typically the market moves are sharp and quick)
2) Led by former losers (the worst performing stocks during downturns tend to lead the upturns)
3) Dominated by short covering

This current rally follows all three to a "t." Stocks are up 30% in a few months. That doesn't happen during bull markets. Bull markets typically see more gradual (and sustainable growth).

Similarly, a bull market typically shows broad growth across multiple sectors. This rally has been dominated by former losers during the downturn (financials and retail). Indeed, these two have accounted for 50% of the market gains through the end of April.

Finally, much of the fuel from this rally came from short-covering. During the first two weeks in May, over $2.9 billion worth of financial shorts were covered in the Russell 3000 alone. When the market rallied these guys all had to cover their shorts (buy financials) which in turn pushed stocks higher.

We've now got two new candidates for short sales: real estate and retail. However, it's still too early to establish new positions in either: both sectors have recently bounced aggressively. Remember, you never make money fighting the trend. And both retail and real estate have trended higher in the last few weeks. So just put these on your radar for now. Both will breakdown in a big way once stocks roll over. And judging by the market's recent action (and its similarities to last year's 2Q rally), this will likely play out in the next few weeks. But right this second, we're still too early. In the meantime, our "inflation trades" continue to rise. Gold mining stocks in particular have shown us some solid double digit gains in two weeks.

I'll be watching the market closely over the next week. If anything changes you'll hear from me via an email alert. However, if nothing develops I'll speak with you next Wednesday in our next issue of *Private Wealth Advisory.* Until then…

Good Investing!
Graham Summers

Portfolio

Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Gold ETF	GLD	5/6/09	$89.54	$92.25	3%
Gold Miner's ETF	GDX	5/6/09	$36.86	$40.47	10%
Rogers Agri ETN	RJA	5/6/09	$7.62	$7.83	3%
Lehman 20-year+	TBT	5/6/09	$50.11	$49.95	0%