

Market Strategy December 14, 2011

Morning Comments & Trading Levels

Highlights

- **Stocks reverse gains after the Fed's announcement. It puts them right into our previously-stated tactical buy zone to do some nibbling.**
- **Gold tumbles this week to get close to the top end of our downside target range.**
- **The dollar's strength helped break out the greenback vs. the Swiss franc. Our previously-stated favorite currency pairing has an inordinate amount of people on the wrong side of it.**

Daily Sentiment Index readings at extreme levels

(i.e. >84% bulls or <16% bulls)

Market	Raw	3DMA	5DMA	9DMA	18DMA
S&P Index	15	22	25	28	24
Nasdaq Index	15	22	26	29	25
Swiss Franc	7	11	13	15	17
Euro FX	6	11	14	20	23
Platinum	13	17	18	20	25
Corn	13	12	12	12	11
Wheat	13	11	11	15	13
Soybean	13	11	12	14	13
Soybean Oil	13	14	15	17	17
Soybean Meal	14	12	12	13	12
Cocoa	21	15	13	12	11
Cotton	15	17	21	25	23
Nikkei Index	12	16	18	19	16

Significant Overnight News / Today's Economic Releases

Good morning. Stocks are lower globally as the Fed refrained from taking measures to boost the US economy. The Munich-based Ifo institute cut its 2012 economic growth forecast for Germany, Europe's largest economy, to 0.4 percent from 2.3 percent today. Western Europe CDSs are trading at 382, just 3 points from their record high. The euro fell to its lowest level vs. the dollar since Jan. 12th. Oil in New York declined to near \$98.50 a barrel on speculation the Organization of Petroleum Exporting Countries will set an output ceiling near current production levels at a meeting in Vienna today.

Import Price figures get released at 8:30am NY time.

The U.S. Equity Market

Equity investors didn't much like the FOMC's statement, and early gains continually evaporated, to finally see the market turn and stay negative at about 2:30 NY time. NYSE volume was 875mm shares, some 17% beneath its 30-day moving average. Breadth showed 6 declining issues for every one advancing. The long-term breadth picture appears to be at an interesting juncture (See Exhibit 1 below.) This monthly NYSE cumulative advance-decline chart has stalled for the bulk of the latter half of 2011, and by chance, has a Sequential +13 reading that was followed by a second Setup +9 count. Moreover, this line has stopped right up against the stop-out level of the 13's signal (the dotted pink line). Though a new decline doesn't mean that stocks necessarily immediately decline, it would be some new piece of potentially bearish news for long-onlys to deal with. Conversely, a strong push higher up through that same line, could very well indicate a new round of net stock buying, and then increased possibilities that the recent November bottom in the SPX near 1160 could be a more substantial bottom. Time will tell on this one.

We have been espousing that the equity markets would "hold up" into year's end; neither substantially breaking beneath the higher of the two unfilled gaps (1221.50—1196.50) in the March S&P futures contract, nor likely materially pushing well above the top of the weekly cloud (1310), but that more likely, we'd end up within a few percent on either side of the 200-day moving average (currently 1259 on the daily continuous futures pit chart). With about two weeks to go, we still look okay with this scenario.

In the past few Morning Comments, we have said that we'd be willing buyers into the aforementioned higher gap area. Yesterday's low of 1213 was almost half way into this range, so we are mildly comfortable to do some nibbling. Note in Exhibit 2 below, that the top of the cloud also happens to be where the daily base line (in yellow)

falls. What this sadly means for those of us who like action, adventure, the thrill of victory, and the agony of defeat, is that the midpoint of the past 26 price bars (a.k.a. the daily base line) happens to be where the midpoint was of the 9- and 26-bar midpoints calculated as much as 52 days ago. It implies we have not trended at all in the past couple of months. But yes, we are willing to do some buying into this decline, with the hope that the uptrend line (today at 1178) and the bottom of the daily cloud (1172 for the foreseeable near-term future) will not be materially challenged, and that bulls may again start to bid for stock.

Some I speak with, along with what I read, are quite bearish for 2012, saying Europe is in or near recession, and that the European crisis can and will not leave its ability to negatively influence the market, dissuading PMs from making major equity market capital commitments. Others seem incredibly bullish about the market's prospects for the year, saying that cheap stocks, good economic numbers, and a growing ability for European officials to work together to make fiscal changes is at hand.

To us, until stated otherwise, we expect 2012 to be a heck of a lot like 2011.

Commodities/Treasuries/Currencies

GOLD: We have been vocal gold bears for a month, noting not just the continual price rejection of the downtrend line from all-time highs, but also our belief that if the major uptrend line would get a qualified downside breach, that we could see a move down to about \$1600, +/- \$15. Yesterday we commented on the gold market on Fox Business TV (http://video.foxbusiness.com/v/1325558218001/is-gold-a-buy/?playlist_id=87185) that although we could see a trading bounce from near \$1663 – the major uptrend line from the 2011 lows in February – that we expect to see gold get down to \$1625—1575. And although the decline from \$1921 to now has been about a 14% decline, we think one should not purely look at gold moves in percentage terms relative to the price of zero (as this aforementioned example was), but more likely to something like a floor of \$1000, which we suspect would contain downmoves for the foreseeable many years to come. (So in this latter case, a move down to \$1575 would be more like a 38% retracement, which we think could have “natural” merit.)

SWISS FRANC: readers know that this has been one of two favored currency pairs we've written about being short vs. the dollar (the other being the yen). Monday's upmove and close at .9332 was the breakout close we had espoused would likely come, and in it doing so, those long dollar and short Swiss now have a trade on that got its best close since February. We counted, and that is 208 consecutive days worth of people who were long Swiss and short dollars who are now on the *wrong* side of this trade. (See Exhibit 2 below.) We have always targeted a move to the .9700 neighborhood, and now we even have more confidence that price will get there (.9675--.9750).

Trading Levels for March S&P Futures (more stars = more significant)

RESISTANCE

1367--68** **2011 FRONT MONTH HIGH + EQUAL LEGS UP FROM EARLY OCTOBER LOW**
1339/1344* **3RD TREND FACTOR UP FROM NOVEMBER LOWS + SECONDARY TDST LINE IN CONTINUOUS FRONT-MONTH FUTURES**
1326* **TDST LINE IN CONTINUOUS FRONT-MONTH FUTURES**
1276/1282* **2ND TREND FACTOR UP FROM NOVEMBER LOWS + POST-SUMMER HIGH**
1259—1262** **200-DAY MOV AVG IN CONTINUOUS FRONT MONTH FUTURES CHART + DOWNTREND LINE FROM 2011 HIGH ON CONTINUOUS FUTURES CHART**

SUPPORT

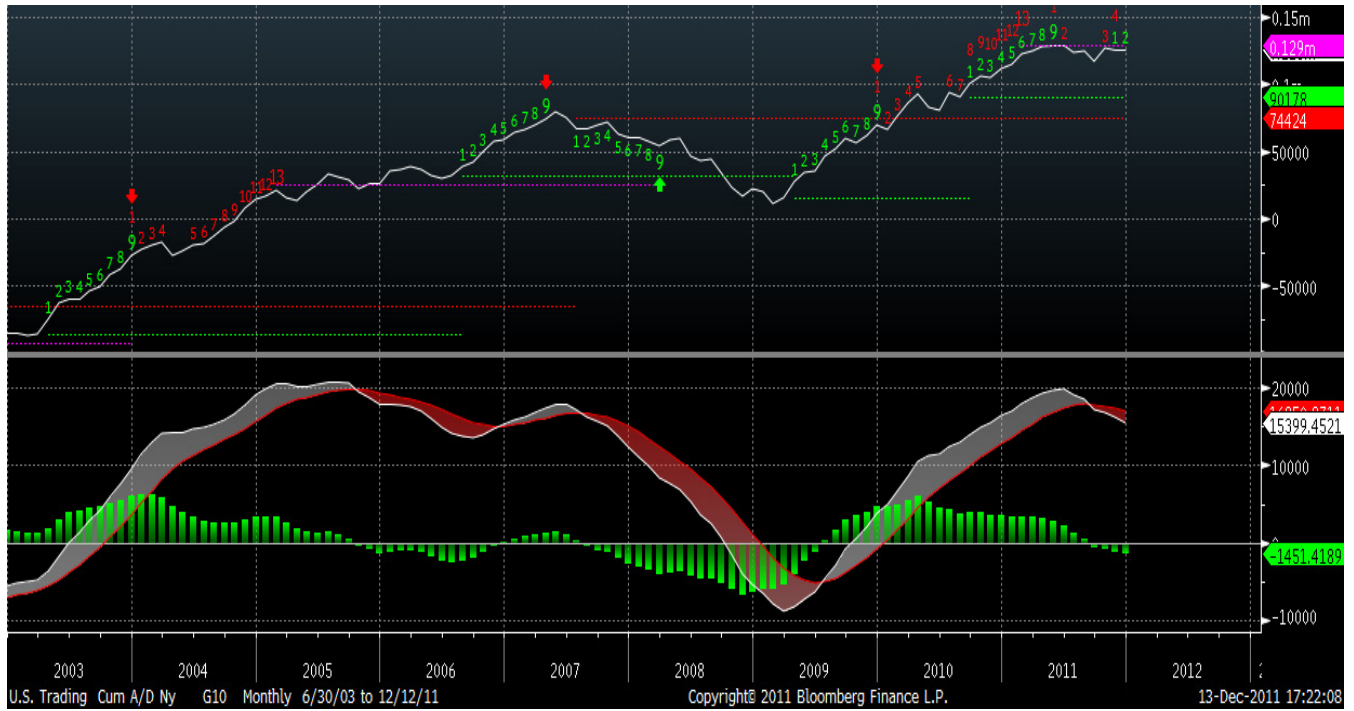
1222—1197** **UNFILLED GAP + TOP OF DAILY CLOUD + DAILY BASE LINE**
1178—72** **UPTREND LINE FROM 2011 LOW + BOTTOM OF DAILY CLOUD**

1155--49** **FIBO 62% DOWNWARD RETRACEMENT + WEEKLY TD MAGNET PRICE + 2nd TREND FACTOR DOWN FROM OCTOBER HIGH**
1133*** **WEEKLY LAG LINE HITTING BOTTOM OF CLOUD**

----- THE REPORT CONTINUES ON THE NEXT PAGES -----

Charts

Exhibit 1: NYSE Cumulative Advance Decline Line



Source: Bloomberg

Exhibit 2: Dollar vs. Swiss Franc – Weekly



Source: Bloomberg

Explanation of Terms

At the core of our research are newer technical analysis models, some of which are not as commonly utilized as classic, textbook indicators like RSI, MACD, Stochastics, Bollinger Bands, etc. A brief description of the indicators we most frequently employ follows:

Cloud Charts

“Cloud Charts” is a far-eastern technical model that was developed over 50 years ago, but is still not commonly used in the US (nor is there much English language reference material). Although the mathematics involved in the construction of each of the 5 lines that make up this model are simple math and not open to much interpretation themselves, the proper understanding and use of this model is still somewhat a mystery to many.

The names and calculations of the 5 lines are as follows:

- Conversion Line: the arithmetic midpoint of the most recent 9 price bars (inclusive of the current bar).
- Base Line: the arithmetic midpoint of the most recent 26 price bars (inclusive of the current bar).
- Leading Span 1: the midpoint of the previously calculated Conversion and Base Lines, plotted forward 26 bars (including the current bar).
- Leading Span 2: the arithmetic midpoint of the most recent 52 price bars (including the current bar), plotted forward 26 bars (including the current bar).
- Lagging Span: the current price plotted backwards 26 bars (including the current bar).
- The “Cloud” is the area on the chart bounded by the two Leading Spans.

Demark Studies

DeMark Studies consist of models created by Tom DeMark, a noted market-timing indicator developer and consultant to many major Wall Street institutions. Two of these models that look for the timing of trend exhaustion include TD Sequential and TD Combo. A third, TD Propulsion, looks for a specific price exhaustion level after a trend momentum level has been properly identified and thrust through.

Some key phrases we use in our writing include:

- TD Setup: Nine consecutive price bars that the closing price is above the close from four bars prior. When completed and “perfected” (i.e. the 8th or 9th bar’s high is higher than both bar 6’s and 7’s highs), a near-term top may be in place. Conversely, nine consecutive price bars that the closing price is beneath the close from four bars prior. When completed and “perfected” (i.e. the 8th or 9th bar’s low is lower than both bar 6’s and 7’s lows, a near-term price bottom may be in place.
- TD Sequential: After a completed Setup +9 count, if the security continues to move higher by a certain amount, a full trend has developed. This model looks to identify the exhaustion point of the trend, from a timing perspective. Subsequent to the Setup +9, the model then looks for 13 price bars (that needn’t be consecutive) that the closing price is greater than the high from two bars back. When this happens, odds have increased that first buying within the current uptrend is much riskier. Conversely, after a Setup -9 count, the model then looks for 13 price bars (that needn’t be consecutive) that the closing price is less than the low from two bars back. When this happens, odds have increased that first selling within the current downtrend is much riskier. Aggressive-style accounts often use this model to take profits or even play new counter-trend positions.
- TD Combo: This is a sister timing model to Sequential. It also reaches its trend exhaustion reading at a +13 or -13 reading. It counts to the 13th bar using a different calculation.
- TD Propulsion: This model looks to define the initiation of a momentum move (higher or lower) that once correctly surpassed, then pinpoints an exhaustion level to that same move. We often refer to these moves as the Propulsion Momentum and Propulsion Exhaustion levels.
- TD Trend Factors: This model looks to define important support or resistance levels from previous highs or lows of moves, measured in increments of 5.56%.

Daily Sentiment Index (DSI)

The DSI is a daily trading-oriented poll we monitor because its respondents are non-professional futures traders (i.e. “pure retail”). We like to observe this group’s opinions on a variety of futures markets, especially when they are 85% or more bullish, or only 15% or less bullish on a particular futures contract. Historically, this group is usually (but not always) wrong at these extreme readings. Each morning, we list those futures markets that have DSI readings on a raw, 3-day, 5-day, 9-day, or 18-day moving average basis that are >84% bulls or <16% bulls. These, along with other unrelated measures, often help us call market turns well before they would be obvious using conventional methodologies and commonly looked at polls.

Important Disclosures and Certifications

The information presented in this report is for informational purposes only. It was prepared based on information and sources that we believe to be reliable, but we make no representations or guarantees as to the accuracy or completeness of the information contained herein. This report is not to be construed as an offer to sell or a solicitation of an offer to buy any security. The opinions expressed in this report may change without notice. This material has been compiled by Merlin Securities, LLC market strategy personnel based on analysis of publicly available market data and news sources. It is not intended to be a comprehensive summary of newsworthy business or economic events nor is it a substitute for Merlin Securities, LLC fundamental research, and it may not be relied on as such. This communication is not for distribution to the public or a large number of persons but is personal to named institutional recipients.

Certification

The author certifies in accordance with SEC Regulation AC, that this report accurately states his/her personal views about the subject securities, which are reflected in the substance of the report. The author certifies that no part of his/her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report.

Potential Conflicts of Interest

Analysts employed by Merlin Securities, LLC are compensated from revenues generated by the firm. Merlin Securities, LLC prohibits any analyst and any member of his or her household from executing trades in the securities of a company that such analyst covers. Additionally, Merlin Securities, LLC prohibits any analyst from serving as an officer, director or advisory board member of a company that such analyst covers. Merlin Securities, LLC does not trade on a proprietary basis, therefore, we would not maintain a long position for less 1% or a short position or deal as principal in the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. Should Merlin Securities, LLC have a 1% ownership position in covered companies they will be specifically disclosed in this report. Recipients of this report are advised that any or all of the foregoing arrangements as well as more specific disclosures set forth below, may at times give rise to potential conflicts of interest.

Company Specific Disclosures

Merlin Securities, LLC does not engage in investment banking or market making and does not receive compensation from any public companies for such activities.

Additional Information

Please write to Merlin Securities, LLC, 101 California Street, Suite 3050, San Francisco, CA 94111. Attention: Compliance Department

© Copyright – Merlin Securities, LLC 2011