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listeningin

Bearing Up

Louise Yamada Sees Convergence of Secular, Cyclical Downturns

Who knew when I interviewed **Louise Yamada**, of **Louise Yamada Technical Research Advisors** on Tuesday morning, that market action over the next several days would be downright dreadful? Actually, Louise pretty much knew. Which is not to say she was — or is — happy with prospect. But forewarned is forearmed, and whole rafts of technical indicators were telling Louise to make capital preservation priority No. 1. Not only was she discerning no improvement among the multitudes of stocks still mired in secular declines from peaks they notched back in the bull that expired in 2000, Louise was detecting indications aplenty that the materials, utilities and transports that led the broad averages to fresh peaks last year are slip sliding into cyclical corrections, or “bear markets.” An unfortunate linkage of secular and cyclical trends, if ever there were one. But one undeniably in motion by Thursday, at the same time that Louise’s “inflation in all the wrong places” notion was playing out with a vengeance in the energy market. Unsettling and dangerous times, to be sure, for investors, but Louise has a clear view of what to expect. When I checked back in with her Thursday evening, Louise was reeling a bit from another day spent watching markets “breaking down not only here, but internationally.”

Markets in the developed world, she remarked, are tracing out patterns very reminiscent of the broad double top in the S&P 500 between 2000 and 2007, and giving off a whiff of the same sort of secular decline afflicting groups like housing and financials. Meanwhile, the emerging markets, she observed, are behaving uncomfortably like the industrial leadership stocks that paced this market’s cyclical bull run from the 2003 bottom: In a word, *topy*. And due for a cyclical decline. With this week’s selling on the domestic front, she reported, “We’re on the verge of losing stocks that have been the leaders ever since the rally began off of the 2003 bottom — stocks like Emerson,

Caterpillar, Deere, broke down badly. These are not good breaks for our leaders. And look at Google, it is coming off; Look at a weekly chart of Apple; if that doesn’t look like a double top, I don’t know what does. I don’t have good feelings about this at all. The way the industrial leadership is pulling back is definitely not telling us that something out there is good. And closing on the lows of the day tends to indicate there’s more selling to come.”

Just how much damage she expects to be wrought, and where, Louise graciously spelled out during a lengthy chat on Tuesday, which is presented below.
KMW



welling@weedenco.com

Kathryn M. Welling
Editor and Publisher
welling@weedenco.com

*Published exclusively
for clients of
Weeden & Co. LP*

Lance Lonergan
National Sales Manager
(800) 843-9333 or
(203) 861-7670
lance@weedenco.com

Thomas Orr
Director of Research
(800) 843-9333
tom_orr@weedenco.com

Noreen Cadigan
Director of Research Sales
(203) 861-7644
ncadigan@weedenco.com

Jean M. Galvin
Business Manager/Webmaster
(203) 861-9814
jean_galvin@weedenco.com

Karin-Marie Fitzpatrick
Editorial Assistant
fitz@weedenco.com

**Subscriptions:
Pat Quill**

(203) 861-9317
pqull@weedenco.com
Deirdre Sheehan
(203) 861-7636
dsheehan@weedenco.com

Published biweekly
on Friday mornings,
by **welling@weedenco.com**,
a research division of
Weeden & Co. LP.
145 Mason Street
Greenwich, CT 06830.
Telephone: (203) 861-9814
Fax: (203) 618-1752

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Victor Juhasz
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What's your read on equities, Louise?
The stock market is breaking down.

You don't see a bounce coming, considering all of the dreadful news lately, from consumer sentiment to banking woes to Detroit?

I'm not convinced that the technicals will support it. You've been getting a lot of little bounces, but there's never any real buying

behind them. That's the problem. There's so many individual issues here, in which we basically started to see deterioration in mid-2007 in terms of the underlying indicators, and the rallies haven't been particularly strong. You broke late last year the initial support, which was, what, Dow 13,000, from a little, tiny multi-month head and shoulders and quickly achieved the downside target, which took you down to 12,000 basically.

Below, actually.

You hit 11,740. Then you had the rally this spring, and this selloff back to the lows. So now it looks as though you have a complex head and shoulders, in which the old little head and shoulders pattern from June to October now becomes a complex head. Then the rally back in December of '06 into early '07 becomes the left shoulder, and the three-month rally that we've just experienced and that has disap-

peared, becomes the right shoulder. And the neckline on this new, bigger head and shoulders is at 12,000. When you take the measured move from the top of this new head down to the neckline at 12,000, which is a 2,000 point move, you can get a target of 10,000. The S&P's chart is a little bit more crooked, but the Dow is showing just a perfect count. Basically, we're slipping under.

"Our expectation was that the structural bear market beginning in 2000 would be less like the immediately prior one and more like the alternate, where we would have falling rates and deflationary pressures - and it has turned out exactly like that."

Isn't the old saw that even a drowning man pops to the surface a few times?

Sure, and we'll get rallies along the way -

But you're convinced this is a secular, or long-term, bear market that we're experiencing?

I actually think we're in a hybrid market.

Depending on which stocks you're in, it's either a secular bear market, or the beginning, probably, of a cyclical correction-or bear market. I'll get to

that in a minute. But for the majority of stocks, which are still in bear markets from their highs in the 2000 period, it's structural. You don't get over a structural bear market in three years; not even in five years. They usually last 10, 12, 15 years.

That long? That's several lifetimes-

It is a long time. When we started to anticipate the bear market of 2000, we went back and did

Dow Jones Industrial Average Weekly Bar Chart



Note the DJIA, from a smaller "head and shoulders" (see small arcs, top) of April 2007 to January 2008, achieved the downside count at the March 2008 low ("b"): A move from the "head" to the "neckline" ("a"), measured equally from the neckline "a" down to "b." Now a more complex "head-and-shoulders" pattern has taken shape, in which the "head" is comprised of the entire previous "head-and-shoulders" pattern (see larger upper arc), and the "right shoulder" is represented by the March to June 2008 rally and retreat, balancing what becomes a "left shoulder" from October 2006 to March 2007; with the neckline defined at 12,000-11,740. The measured downside count, from the head to the larger "neckline" ("at "b"), then projected down from that neckline "c," carries to 10,000.

- Louise Yamada, 6/25/08

Sources: Update Technical Analyst, Bloomberg and LY Advisors

a study to try and prepare people for what to expect of a long-term bear market. When we looked at the history that's available in any detail, we could only find about three of them: There was 1966 to '82 (16 years), which was a horizontal bear market around a pivot low in a period of rising inflation and rising interest rates; there was the 1929 to '42 (13 years) experience, which began with the Crash and featured deflation and falling rates; and then there was the bear market of 1905 to '21 (16 years), which was a horizontal bear market around a pivot low, like the one that began in '66, and that was also accompanied by rising rates and rising inflation. So taking Elliott Wave's alternation of cycles into consideration, our expectation was that the structural bear market beginning in 2000 would be less like the immediately prior one and more like the alternate, where we would have falling rates and deflationary pressures – and it has turned out exactly like that.

Exactly?

Close enough. I mean, the symmetry is just incredible; we had a three-year crash in both instances. Then we started to see that the rally from 2002 into 2004 that looked identical to the corresponding 1932 to '34 structure. Then the more or less sideways correction in 2005. That's when we put forth what we call our "Alternate Hypothesis," of alternating cycles [right] suggesting that, should the pattern continue, the market from 2002 to 2007 might be like 1932 to '37, which was a five year rally. And we've seen it!

So history did rhyme, to say the least. But are you suggesting that's continuing? Because what came next wasn't too pleasant, if I remember my history.

Well, the market's structure in '37 became a little bit more complex; you got a double top and a 47% decline. The eerie thing is that we've been tracking that to perfection here in '08. I mean, it's just extraordinary when you see the alignment of the charts of those two periods, whether you look at the New York Stock Exchange Index or the Dow. What's even more amazing, to us, is that if you look at the S&P financials over the recent past, they have already accomplished much of that 47% decline. Now the question is, does the rest of the market have to follow?

You're making this too easy for me –
The fact is, a lot of stocks already are. I mean,



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look at the structural bear market profiles of pharmaceuticals. **Pfizer** (PFE) has never recovered from the 2000 decline and is now a teenager. **Eli Lilly** (LLY) has never recovered from the 2000 decline. And then you've lost other healthcare stocks, the **UnitedHealth Groups** (UNH) of the world. Plus, you've seen the financials with their tremendous six-year relative strength top and the potential that what is happening now is simply delineating a secondary top to the 2000 period, which would mean you've got like an 8-to-10-year topping process in the S&P financial sector.

Is there a glimmer of a silver lining, at least, if the financials have already taken a drubbing, as you said, that's analogous to the hit the market took back in 1938? Couldn't that imply an end to the suffering?
Well, they're not quite there yet, but the tracking has been rather extraordinary. And there are many similarities between the periods because both were marked by financial crises. I think this financial crisis is *much* worse than what we saw in '98 or even in 1990, even though you've seen a lot of comparisons made in the press trying to show this is "just another crisis like we had in '98."

Why?
The technicals tell you that it's something *far* larger, *far* more structural, and *far* more serious than what happened in '98 or in '90 - '91, because of the tremendous distribution that's been taking place.

What do you mean by structural here?
Our concept is that we're in the *midst* of a 20-year shift of capitalization weightings in the market, a process which we haven't seen since the 1981 - '82 period. And at the same time, we've been seeing all these other 20-year structural reversals: Gold moving into a new bull market, breaking its 22-year bear market that began in 1980; the CRB breaking out, and oil breaking out in 2004. These are all structural moves, and many of the young people in the business have never experienced a structural shift. But if you think about the capitalization shift that's taking place, the financials in 1980 were 6% of the S&P 500. Last year they were 22%, and now they're, you know, 16%, probably on their way back to 6%, single digits. By comparison, you've got the energy sector, which was 27% of the weight in the S&P in 1980 and fell to about 6% in 2003. It has now grown to 14% and is probably going to grow

back into the 20s, and maybe to 30% eventually. That's a structural shift. Certainly, all of those structural shifts are going to encounter interim setbacks. But they've all got quite a way to run.

Though they're not all going in a southerly direction –

That's why I mentioned earlier that I think what we're really in is a hybrid market, which we started to identify last year when the Dow and the New York Stock Exchange indices broke out to new highs. The thing was that, characteristically, structural bear markets do *not* go out to a new high during a repair rally phase. You've typically got a declining phase into a pivot low for every structural bear market, and then you have a repair phase, in which you get a series of cyclical bears and cyclical bulls. But the bulls never go out to new highs and the bears never exceed the pivot low for X number of years, whether it was from '74 to '66, or from '29 to '42. So *if* 2002 is our pivot low, *theoretically*, the indices should stay above it, No. 1, and No. 2, should *not* have gone out to new highs.

So your hybrid market idea is a way of dealing with the fact that those indices did go to new highs, without declaring a new bull market?

Actually, what I am implying with the term hybrid market is that 2002 probably *did* mark the initiation of a *global* structural bull market, and the U.S. stocks that have been participating in that, in fact, remain in up trends to this day. Even though you have secular downtrends in motion for consumer discretionary stocks and for financials and for healthcare, and for a host of other issues, some of the corrections that have taken place and are taking place in the market's leadership sectors – in industrials, energy, materials and utilities – are really pullbacks in ongoing uptrends. Include railroads, too, in that list of leaders, of course. And, yes, they *can* pull back, as we've seen, by 20 - 30 - 40 points, and it's not fun for the investor. But those sectors have retained their uptrend progressions, and that is what's sort of fascinating. So if those global leadership stocks are now suffering a bear market, we would consider it a *cyclical bear market*.

You're saying the relatively strong groups are the ones tied most closely to the global economy?

Yes. We did a comparison of the global devel-

opment that has been taking place from 2002 forward to our domestic build-out in the U.S., from 1942 to '66, which initiated that great bull market. What we found was that the first corrective trend, or cyclical bear market pullback, occurred in 1946 – four years into the secular move. So I would say that the stocks that have been our leaders this time around now are probably looking at a cyclical bear market environment – at the same time that the stocks that continue to be mired in their structural bear phases that began in 2000 are undergoing their final declines and ultimate repair periods. What's interesting is that if you look at the analogous historical periods for both of these cycles (the secular downturn from 1938 to '42 or the cyclical decline from 1946 to '49), you find that each was a difficult three-year period.

So with both the cyclical and secular declines happening at the same time, you're implying –

We're looking at probably three difficult years. You'll get your rallies and you'll get retreats, but you're not going to get a sustained move in either direction, or at least not for a while. I mean 1942 ended at a new low for the structural bear market. And a structural bear market is the look we're seeing in the charts of a lot of stocks.

For instance?

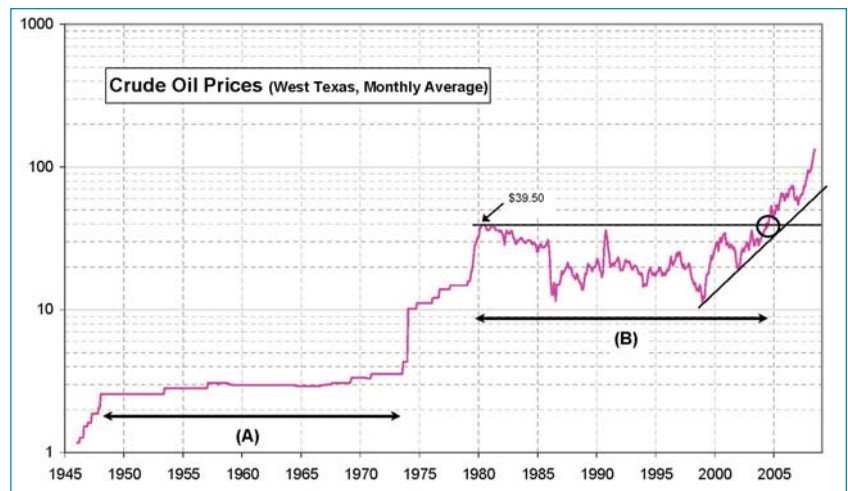
Take a look even at **General Electric (GE)**, which looks like it still might be in a structural bear market. **Goodyear (GT)**, **General Motors (GM)** are at new lows; **Ford (F)** is at new lows. You've got so many stocks that are at new lows. **International Paper (IP)** is at new lows, having broken support that goes back to 1996. What I am saying is that these stocks have broken down through 10-year supports, so they're probably the ones that are *not* going to be the survivors in the new global, less "Americentric" environment.

In contrast do the energy and industrial and utility and materials companies that have been leading the market have a chance of being global survivors, even if they suffer a cyclical setback here?

Right.

Yet we are seeing the price of energy and a bunch of other commodities go through the roof – how do you reconcile that with the "deflationary environment" you mentioned?

Clearly, we have pockets of inflation and pockets of deflation, but that takes us back to another



er of our concepts. Do you remember how we started talking, back in 1996 or so about “looking for inflation in all the wrong places”? Well, the CRB broke out through a 22-year down trend in 2002 - 2003. And the observation that we had made even way back was that the CRB is 40% agricultural, and with agriculture you have to consider water, because agriculture utilizes 87% of the fresh water in the world. So as much as a decade ago we were suggesting that water would be the new oil of the 21st Century. The CRB is also 40% energy and 20% metals. Now the energy aspect of it is no longer a *capital goods* commodity in this country, in the sense that we use 50% less oil to produce goods than we did in the 1970s. But our energy consumption keeps going up because *consumers* are using it, whether by moving to the South and air conditioning everything in sight, or whether by plugging in the way we all are. I often wondered over the past 10 years when the airports were going to catch on to the fact that their electric bills were going up, probably sky high, because everybody was plugging in while sitting there. Now they have kiosks where you can pay to plug in when there are no “free” plugs available. That’s another thing, the “hidden” cost of this electronic age: 40% of the cost of data storage is electricity. Obviously, data storage is an important factor, but I would call whatever energy input goes into it a consumer commodity or a consumer essential. So what were suggesting in saying that we might be looking for inflation in all the wrong places, was that in the last century, the inflationary forces really showed up in the capital goods arena, which has now moved offshore. So you’ve got lower wages and lower prices (although there’s a small amount of equalization coming into play). But now, coming into the 21st Century, the inflationary forces would show up in the consumer essen-

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pquill@weedenco.com

Deirdre Sheehan
(203) 861-7636
dsheehan@weedenco.com

tials: food, water and energy.

Now, of course, the agricultural complex has just broken out through a 34-year consolidation, which is extraordinary. It's not that commodities are going to stop being volatile. But they're being volatile at a much higher level of demand now, for whatever reason – and I'm not going to get into attempting to parse the reasons. But if you think of these consumer essentials in terms of the population – when I was born there were fewer than three billion people on the globe; last year, there were six billion; now there are seven billion, I understand, on the way to nine billion in the not-too-distant future. Meanwhile, we have finite land, finite water, finite energy. It's a no-brainer where the pricing power is going to be. It's going to be in the consumer essentials.

Most of those folks also have finite money.

Yes, but their purchasing power is growing. That gets back to what we've said about this being a less Americentric world. We've got two billion Asian consumers coming to the fore to replace the U.S. consumer as the engine of the world, or at least partly. China only exports about 25% of its output to us, and Europe exports more to China than she does to us, so the world is becoming less U.S.-dependent. Today we have 58% of the world's market capitalization, 79% of its GDP; 86% of its listed companies and 95% of the population outside the United States. So things are different this time. It's not that market psychology is going to be any different, but the *underlying environment is different* because there are so many more options and variables to consider and so inflation is showing up in all the wrong places. You probably saw the chart in *Barron's* last weekend, where they juxtaposed oil to the NASDAQ bubble and called the rise in energy prices a bubble.

Sure, and other more elaborate efforts to do the same sort of thing. It does look like a pretty good "fit."

Well, the only thing I could think of, and what I wrote on that page, was "NASDAQ, no earnings; Energy, earnings." It's not a bubble. I'm not sure at all that oil belongs on that sort of chart. Could it pull back? Yes, it could break, but it'll still be in a very normal uptrend above 120. If it comes under 120; maybe it pulls back to 110 or 100, but I can't see it going back to substantially lower prices. I mean, sure, we're getting a global slowdown, so it's bound to come off a little.

But your charts place energy prices very firmly in a long-term uptrend?

Yes, let me just find my chart on oil. When it broke out in 2004, we went back to see what history could be telling us about this new lift in oil prices and found that in the 1940s there was a multi-year step-up in the price of oil, and it never came back down to the old lows, and –

Oil's price has always risen in a series of step functions, hasn't it?

Yes, exactly. The rise in the 1940s was followed by a 24-year plateau, albeit slightly up-trending. You didn't get the next big step-up in oil until the '70s. But again, it was a multi-year step up, that never saw prices come back down to the old lows. So in 2004, when we broke out above 40, we had essentially broken out of another 24-year resistance. You know, we don't make up these cycles: 24 years. What this perspective has done is allowed us to suggest that we were in the next multi-year step up for the price of oil and that is not likely to ever come back down to the old lows. I think there's a good possibility that oil is in one of those multi-year step-ups. You had quite a correction, from 80 to about 50, a year and a half ago. If we have another pullback; it's no big deal. Your long-term uptrend is still in place well into the 70 - 80 range, so you *could* see it come back. We don't see it coming back that far, but it could come back to 110 - 100 in a perfectly normal consolidation.

So there's a lot of scope for a correction in energy prices before you'd have to reconsider your secular bull story on it?

Exactly, and we know that sometimes bull market setbacks can be sharp and steep. When we had a 70% - 75% run in gold and then a 25% decline in 2006 that was pretty steep and quick. It's a possibility. But longer term, I think we're still looking at a secular bull market in oil, notwithstanding all the new technologies that will inevitably be coming into place, they're not going to be effective for quite some time.

Well, the higher oil goes – and stays – the more attractive it is to search for alternatives –

Yes, exactly. And don't forget that oil is priced – mostly – in dollars. I think the weak dollar is behind a lot of the strength in oil.

It's the flip side of the coin?

Yes, the dollar just looks awful. I know they were trying to jawbone it up recently –

And it does seem to have found some footing.

Yes, a little bit, above 71 (Dollar Index, DXY). But it just hasn't gone anywhere. One of the prime problems here is that when growth is driven by high levels of business investment, it leads to currency strength, but growth driven by strong consumption and government spending leads to currency weakness – and that's exactly what we've been doing for years with individual consumption and government spending. You can't just keep doing that and maintain any-

thing but a weak currency. Plus, you've got foreigners who are getting tired of losing out on their dollar holdings. There's less demand for the Treasury auctions, and eventually, since most of our debt is held outside of this country, we won't really have control of the long end at all. If people stop buying the long Treasuries, you're probably going to see interest rates at the long end lead up; that is our hunch, because the short end is still struggling with the deflationary crises in the financials.

When you look at the buck on your charts, what do you see?

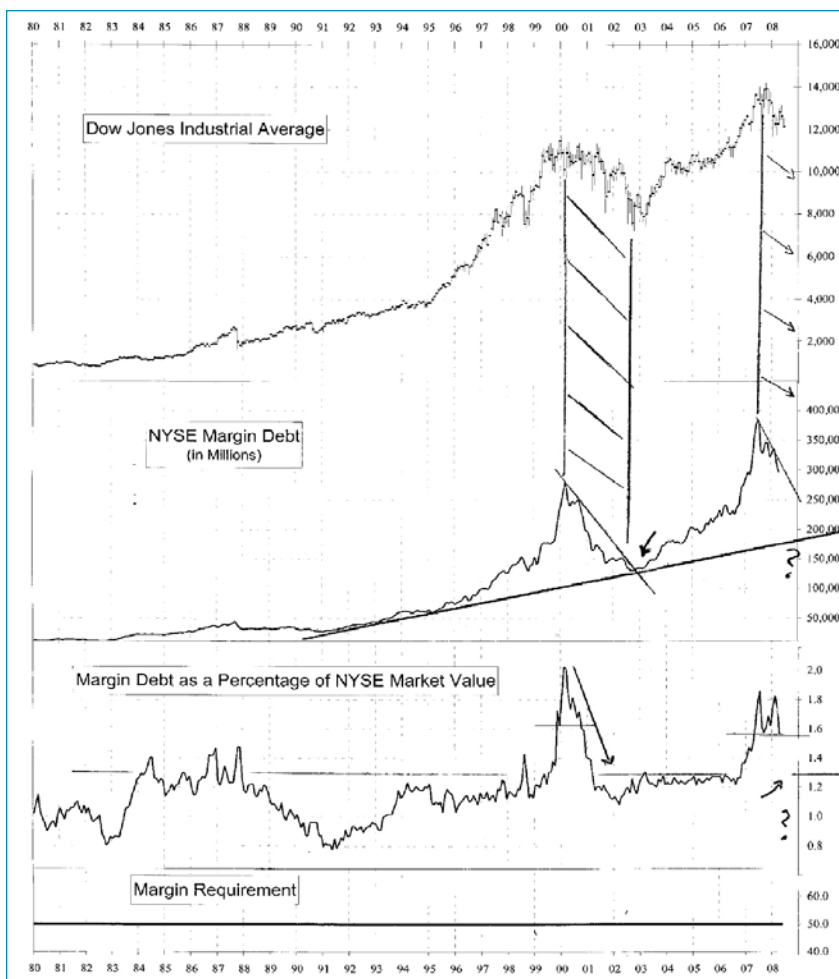
Well, it broke a 34-year support when it went under 80. That was a pretty critical level. We've had long-term targets out there at 67 and 60 for the dollar. Whether it gets there or not is going to depend on how fast people eliminate their holdings abroad. But if you look at the broad trade-weighted dollar, which I like to look at, because it includes all the countries that have surpluses against us, you have had an incredible 25-year trend break from a six-to-seven year top. It's a very different picture from the spot dollar or the trade-weighted dollar. The broad trade-weighted dollar is much more dramatic, in the sense that it's reversing another 25-year structural trend. So it's another of the many sequential 20-plus-year structural trends that have been reversed over the past four or five years and that, along with the capitalization shift



we talked about, don't paint a pretty picture. If you think about history a little bit, 19th Century Britain was the economic world leader and the pound was the currency of choice, yet somewhere post-the Second World War that baton got handed over to the U.S., and we've been the economic leader, and the dollar has been the currency of choice. But I suspect that somewhere in this century, we're going to hand that baton over to China or somebody else, and they'll become the economic leader, and so maybe the yuan will be the currency of choice. If they are smart, they'll back it, at least partially, with gold. The dollar has become a fiat currency, along with all the other developed nations' currencies; they're printing as fast as we are.

That's one thing that does tend to support the dollar: Considering the alternatives.

Yes, well exactly. But the way the dollar's going and the way people are diversifying out of dollars – certain countries are asking for euros in exchange for oil, and actually we've seen anecdotal evidence that there are stores in New York that are asking for euros—that's all early evidence that the dollar may be losing its reserve currency status. I'm not quite sure what's going to replace it at the moment, but it'll evolve.



Other than being the current fave of hip hop artists and such, as a store of value, the euro looks even worse than the buck.

I agree with you; it's just *perceived* as better at the moment. But, ultimately the winners are going to be whoever has a surplus. Those are the currencies that are strengthening, and if the ones that are linked to the dollar get to the point where they de-link, the dollar is going to have a really hard time.

Let's segue back to the stock market. Even the Lowry's data, which has been super in navigating this downturn, is pointing to at least a short-term oversold condition developing. Doesn't that argue at least for a bounce?

Mm-hmm. But in a bear market a lot of short term indicators periodically get to oversold levels. So you might get a little bounce, but a persistence of oversold levels is the empirical evidence of selling pressure. That's what "oversold" means. While traders are anxious to use it as a signal for a pop, you can get into long periods – the way we did in the 2001, 2002, 2003 decline – where some of the indicators

remain oversold for enormously long times. Part of the way, in fact, that we were able to identify that we are in a very different environment was that the TRIN indicator became deeply oversold. You never saw it so consistently oversold. Traders would say, "For two days in a row, the TRIN has been over 2; it's time to buy." But clearly it wasn't.

And it stayed oversold?

That's right. That's an indicator that – in a stable, advancing market – may only get deeply oversold once every year or 18 months, and it was becoming more oversold more frequently.

What else is making it challenging to "read" this market?

There are a few things that we have to consider that may very well be changing some of the characteristics of the market's volume and of the declines themselves – and the main one is the uptick rule. If you look at the volume data from the point last year when the uptick rule was eliminated, you have had some enormous volume spikes in the declining phases over this span. I mean significantly larger than in declining phases in any other portion of the data we have that combines NYSE and off-floor volume.

Even in other bear markets?

Well, we only have that combined data back to 2001; but we didn't see any spikes like these in previous declines in that stretch. That brings to the fore questions about what does this excessive down volume do in terms of registering 90% down days? What does it do in terms of smoothed total volume, not just New York Stock Exchange, but total composite trading volume, on and off board? Does it skew it to the down side? Will it skew it to the down side? There are a lot of unanswered questions that are going to have to be evaluated as we go forward with this, and clearly we don't have any modern history to compare today's volume to. We'd been living with the uptick rule for 70 or 80 years. So it's going to be a question of the evolution of behavior without the uptick rule; we just have to watch to see how the volume characteristics come in. But so far what you basically can say is that you have not had volume support on the rallies, and that's important.

What's another change in the market's underpinnings that you're watching?

Margin debt. I wrote about it last week.

Your chart [nearby] was eye-opening.

Yes, the de-leveraging that's going on here in margin debt looks like it's just the beginning – and very similar to the pattern of the 2000 - 2002 period. Which would suggest that you've got a considerable way to go before the unwinding is over.

So that's not a ladder to heaven you drew in there?

Scarcely. The data is only released monthly, so you don't see it right off the bat. But when we saw the last update at the end of the month, it was pretty much of a shocker, the way the decline is paralleling what happened at the beginning of the 1999-2002 stretch. That kind of decline in margin debt can have a drastic effect on the market. Another interesting thing to look at is the action in the S&P 500. This index never did make it out, sustainably, through its 2000 peak. So there's your one index that *is* characteristic of a structural bear market, and the S&P has essentially double-topped, in 2000 and then last October, and of course that's the index with such a large portion of its capitalization in the deteriorating sectors: the pharmaceuticals, the financials, the consumer discretionary. You add it all up, and versus the New York Stock Exchange index, which was 87% small and midcap stocks when the rally began, the contrast is sharp. The small and midcaps were the new leaders and the S&P 500 has been the laggard, the – what should we say? – poster boy for the structural bear market pattern.

If you wanted to reach for a positive spin on all this, could you at least say that the groups in structural bear markets, like the financials, drugs, at least have probably sustained most of the damage they're likely to suffer?

I'm afraid not. Remember, this looks like it could go on for another three years or so. I mean we had a very dear, old friend who, you know, was buying Pfizer a couple of years ago, when we were just starting LY Advisors as an independent research firm. It had a great yield, 5%. But I said, "Please, don't buy Pfizer. It's in a long-term structural bear market." Then it broke 24, and then it broke 22, and now it has broken 20. I called him recently and said, "I hope you sold your Pfizer," and he said, "Well, at least it's yielding 6% now." Well, that's the old story about "value" stocks that only become more valuable. I mean, two years ago, would you have expected the stock to be at 17? Most people wouldn't have. Yet it's been in a consis-

tent decline and the bear market for a lot of the pharmaceuticals actually started in 1999. Pfizer topped in 2000, and if you look at a weekly or monthly chart, in every rally since then it has settled at a lower peak, which is a classic multi-year distribution in a structural bear market.

You can't project a bottom?

You don't know. That's the thing. You have got to wonder how many of these are going to survive, and how many are going to be handing the baton over to someone else, perhaps foreign drugmakers or biotech, or whatever. So could Pfizer go to 15? Sure. Could it go to 10? Yes. So could **Citicorp** (C).

Too big to fail, but not to shrink?

Right. Look at an AIG [**American International Group**] as another example. I mean that has had phenomenal decline.

What's that chart telling you?

You're going lower. You're going much lower. I mean, this is just incredible. When you look at AIG's chart, it has broken every single support. It topped at over 100 but then broke originally through 80 at the end of 2000. Couldn't make it back through 80 in any of these subsequent bull moves. Failed at lower levels around 70, and then 60 became the next support to break. And then 50 was broken early this year, which took you back to a level last seen in 2003. And now you've broken a support that goes all the way back to 1998, under 40. This tells you that this stock could become a teenager before it's over. So you have to be cautious in interpreting oversold conditions, because what they really represent is the empirical evidence of selling. At some point these stocks will wash out, but I think you've had so many people buying them on hope, that I suspect it may take a while to wash them out.

Does anything look better?

Not much. Even a stock like **DuPont** (DD) that we thought was starting to look better, isn't acting well. If that stock breaks 40, all bets are off. And **General Electric** (GE), certainly isn't acting like a leader. The stock rallied back through 40, which was the major resistance level from its 2000 decline, but then couldn't sustain that level and fell back. Now it's breaking 30, which should actually take you through 2003 support. So could GE become a \$20 stock? Yes, it could. When you think about it, it's got a big broadcast component; it's got a big financial component, and those are two of the areas that are in struc-

tural decline.

So the likes of GE and AIG aren't the only financials with dreadful-looking charts?

No. Many of them look that way. This whole thing is becoming a tremendous top. These also are some old tech sectors that are going to remain old tech. Watching **General Motors (GM)** break through 20 was just mind-boggling. It could go back to 11, if not 5.

Okay, but as you said, it has been a bifurcated market, and some stocks enjoyed a new bull market since 2003. Surely those charts aren't so dismal.

Sure, but one of the things that we've seen happen recently is some splintering in the leadership areas. Aerospace was one of the first industrial groups to go by the wayside, **Boeing (BA)** being the primary name here. It has in place a rather large head and shoulders top taking you all the way back to 2006. The critical support here is around 71 roughly, and the stock is moving right around that. So that looks like a structural top, although it's well above the 2000 peak. This it is an example of a stock that was clearly in a bull market, but now it's looking like it is running into structural headwinds. The point is that we are starting to lose our leaders so the leadership is getting thinner. And you're going to get profit-taking in the groups that have been outperforming. You know, there's always something that outperforms into a top. So the question becomes preservation of capital, because even the groups that have been outperforming start to pull in and possibly break short-term support – even if, in many cases, they stay within longer term up-trends.

Are there indicators you are paying partic-

ular attention to, today?

One of the indicators that have kept us on the right side of things is the percentage of stocks above their 200-day moving averages. It's been well under 50% for quite some time; call 50% the oversold threshold, if you want, so there is an example of an indicator that's been oversold throughout this entire rally. It has stayed oversold ever since we started seeing deterioration in other indicators, which was in mid-2007. It hasn't come back over 50%; it was similarly oversold from 2002 into 2003, until the market lifted. We're watching it, because once it gets over the 50% threshold, you have a better chance of having some kind of a rally.

What about the tech sector? People have been detecting signs of life there.

We actually wrote up technology last summer – to our subsequent chagrin – when its relative strength line broke out through a downtrend. But it immediately went on sabbatical and retreated. And even at the time we said you have to be very selective, which is a theme – old tech/new tech – that we've been reiterating since the mid-'90s. You have to look for new techs because technology is so quickly commoditized or copied by China; sometimes whatever competitive edge a tech has is incredibly short-lived now. Meanwhile, a lot of the older tech companies have not been able to recover. Even some of the ones that we selectively picked out a summer ago have not done all that well. You've got a few that have done nicely; **BMC Software (BMC)** comes to mind as one that has inched its way along over the past couple of years. It broke out of a multi-year base in 2006 and consolidated for a year above 30. Now it looks poised to challenge resistance at 40. But something like **MEMC Electronic Materials (WFR)**, which did extremely well, now looks

like it has traced out a huge year-long top; a break under 60 would be devastating to the stock. So it's very selective, you've had to be quite nimble to play the rally and keep your stop losses in place. Now, **IBM** has done very well since the 2003 bottom and **Hewlett Packard** has done very well. But I think they're both looking at corrective action now. Then there is **Apple (AAPL)**, of course. But at this point you have to wonder, looking at its chart, if it does-

LY Advisors' Parameters For The Major Indices

Index	Recent Closing High	Recent Closing Low	Decline % From High To Low	Resistance Levels	Downside Targets	20% Off High	30% Off High
Dow Industrials	14,164.53	11,740.15	-17.12%	13,000; 13,500	11,000 - 10,000	11,331.62	9915.17
Dow Transports	5,492.95	4,140.29	-----	5,500	4,800	4,394.36	3845.07
Dow Utilities	552.74	473.43	-14.35%	540 - 550	460; 420	442.19	386.92
NYSE Composite	10,311.61	8,489.38	-17.67%	9,200; 9,600	8,000; 7,700	6,249.29	7218.13
NASDAQ Composite	2,859.12	2,169.34	-24.13%	2,550; 2,600	2,200; 2,000	2,287.30	2001.38
S&P 500	1,565.15	1,273.37	-18.64%	1,375; 1,450	1,250; 1,175	1,252.12	1095.61
S&P 400	926.23	744.89	-19.58%	900	800; 700; (650)	740.98	648.36
S&P 600	445.19	344.69	-22.57%	400; 420	360; 340; (320)	356.15	311.63
Russell 2000	855.77	643.97	-24.75%	750; 800	700; 650; (600)	684.62	599.04

n't have more of a correction ahead.

That doesn't bode terribly well, does it, for the Nasdaq 100, which has been one of the better performing indexes, and is heavily weighted to a handful of glam techs, Apple included?

It's the same old story. Of the "four horsemen" in that index, only **Microsoft** (MSFT) has been a disappointment, and even it was a relatively good performer in the cyclical bull; it didn't go down. Meanwhile, Apple, Research In Motion (RIMM) and Google (GOOG) did very well. But now they all look like they could all use, at least, a rest.

Google, too?

It looks like it's poised to break again. I've been wrong before, but it rallied right up into resistance just over 600, which was the level that acted like support in its runs to its tops over 700 in late '07. I'm just looking at the chart, the breakdown in the original distribution came at around 614, then you went all the way down to 400-something and you came right back up to 600. But now you're failing at that resistance level, which is interesting. The stock has seen a lot of trading, so there's been a lot of upside and downside, but if you step back a little from the daily noise, you can see that it stopped right at the critical resistance level. So I'd be careful with it – and with everything here. It's a question of preservation of capital.

Sure, but lots of folks don't have much choice but to be in equities. What's a safe haven?

It's hard to because we don't see anything coming up from the ashes. We don't see major bases in the charts the way we were seeing in 2003. Well, one: **Wal-Mart** (WMT), which really has turned around its profile. That stock had been in a seven-year downtrend and then we started to see evidence of accumulation just before its breakout and it seems to be in a new bull market.

Can you put some numbers into that description?

From the peak at 70 at the beginning of 2000, every single rally in WMT failed at a lower level. But then all of a sudden you started seeing this basing coming into the stock chart in 2005 - 2006. Essentially, there was a failure to go lower rather than distribution, creating this sort of nice sort of heavy weight in the chart above 42, and you finally broke out of that channel, climbing to 52, consolidating briefly and

then continuing to move up. The stock looks good. The next level of resistance here is 60; if we can get through that you take it through the '02 peak, which was just shy of 65. So, yes, that one does look quite interesting. But it's virtually the only stock you can spot that's coming out of a good base. In a similar vein, **Costco** (COST) doesn't look bad; of course, it's in the same group, and also fills the bill when people need to be frugal. And you do have the stocks that have been leaders in the rally from '02 - '03, stocks like **Caterpillar** (CAT), which we think are going to continue to participate in global growth. But pulling up the chart here, this stock could continue these wide swings, from 60 to 80 to 60 to 80 to 60 to 80 – and now it's coming down again. It could certainly continue to do that for quite some time and still stay well within its uptrend. And in doing so, it would establish a platform from which to rise at a later date – which may not be for another year.

I'm getting the sense you're reaching.

You're right. Now, we still like the railroads, which are pulling back. Hopefully they'll give us another opportunity to come in and participate. We don't talk much about electric utilities, but selectively we like them. We did a piece back in 2000 and again in 2005 or '06, suggesting that the electric utilities may well be "basic materials" in the new high tech world when you consider that electricity is 40% of the cost of data storage. In fact, I will make a bet that they are going to be one of the groups that grows in capitalization over this 10- 20-year cycle because we're not going to be able to live without them. How are you going to plug in a car when you can't even keep the lights on in a heat wave?

Been wondering that myself.

But we're in a situation right now where the electric utilities are going to be caught up in this cyclical decline. For people who have to stay 100% invested, to me, that means it's time to hedge, however they can, because there's still a very furious unwinding taking place. This is a time to err on the side of caution. Remember Alan [Shaw]'s old saying?

Which one?

"I'd rather be out of the market wishing I were in than in the market wishing I were out."

The perfect closer. Thanks, Louise.

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