Tuesday, July 5, 2005

INSIDE THE NUMBERS

Secular Thoughts

The markets are grinding, but the positive seasonal cycle is getting long in the tooth. Is the sentiment picture going to save the day?

The dictionary defines "secular" as:

"Occurring once in an age or century… taking place over an extremely long period of time." (North American Encarta Dictionary)

For the purposes of stock market research, we view secular in terms of the standard 4 ½ year market cycle. A secular trend is a span of two or more standard market cycles, which generally rounds out to 9 or 10 years minimum.

We believe the last secular bull trend was from 1982 to 2000. With the new millennium came the beginning of a secular bear trend. Despite the advance from 2003 lows, the secular bear trend remains intact and is expected to last for the balance of this decade, tracing a path somewhat similar to the 1970s. For most of the '70s the Dow frequently bumped against resistance at roughly 1000, and fell back again until the breakout in 1981. This was then tested by the 1982 bear market; it defined 1000 as support. Today that level of resistance is 10,500, a level that has been touched numerous times this decade. Remember our "drunken crow" analogy? The Dow has traveled (up and down) more than 20,000 points this decade. However, in the exactly 5 ½ years since the end of the last decade, the Dow has dropped 10.63% - not a positive trend on a secular basis. If it weren't for the historic drop in interest rates, it could have been worse.

There are technical clues to the bearish nature of the current secular trend. These include both seasonal and sentiment factors.

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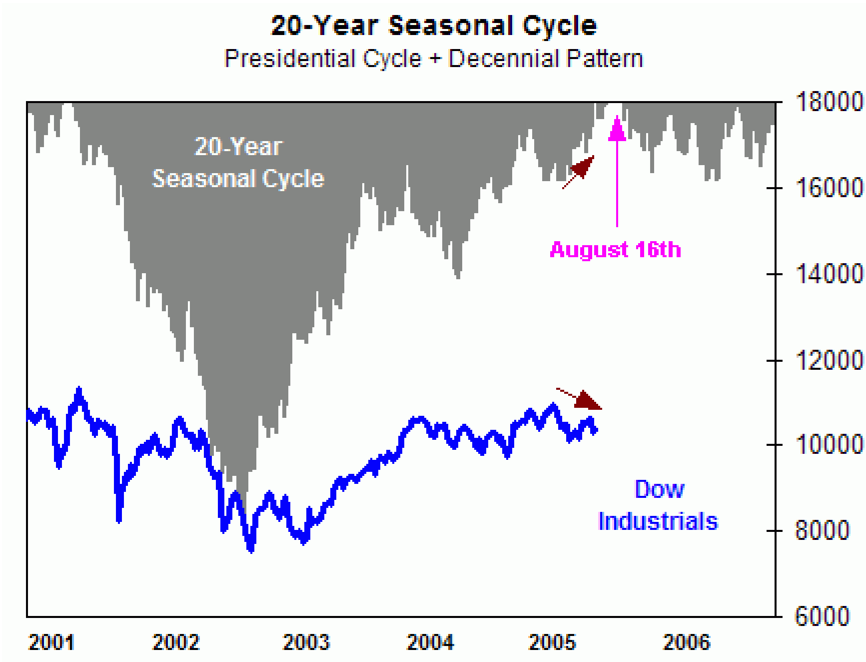
We have often discussed our 20-year Seasonal Cycle – a combination of the Presidential Cycle and the decennial (year of the decade) pattern:



The above is a partial view of our 20-year Seasonal Cycle. It shows a broad peak around August 16, 2005. This is not only a peak for the period since April 15, but it also represents the beginning of an extended negative phase that ends in October 2006. Moreover, though the market is higher since April 15, it has moved only a meager amount. The market is currently negatively diverging relative to the seasonal trend by not moving to higher reaction highs along with the seasonal cycle (see arrows in chart above.) There is still time left in the currently positive seasonal trend, but not much (August 16 at the latest.) After August, the seasonal cycle is long-term negative, with a lot of choppy action that will be lucrative for traders.

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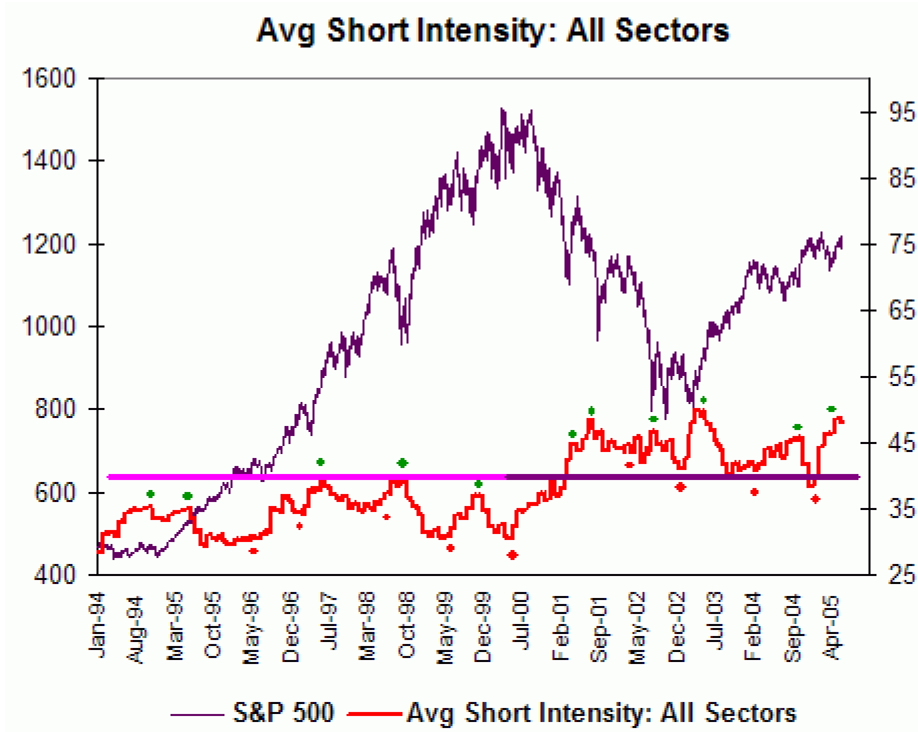
Over the past few months we have noted how elevated the short selling has become. This is perhaps the most favorable technical factor going forward:



The above chart of the S&P 500 also shows the average of all 18 Erlanger Sector Short Ranks. There is a lot to glean from this chart. The Erlanger Short Rank is designed to capture recent short intensity by looking back 5 years (to cover the span of an entire 4 ½ year market cycle.) It normalizes each stock's short ratio and is weighted towards recent years and months. Thus (and this is an important distinction) it does not necessarily reflect absolute levels of short selling, but rather the breadth of short selling intensity over more recent periods. Moreover, the parameters of this measure are non-stationary – which means that extreme levels change over time. In the above chart there is a two-colored line at the Average Short Intensity 40% level. The red line is the Average Short Intensity for all 18 sectors combined. There are green dots and red dots which are aligned with major S&P 500 peaks and troughs. The first observation is that the green dots occur at peak levels of short intensity (good times to buy the market) and red dots are at low levels of short intensity (bad times to buy the market.) This is normal because price advances tend to squeeze out the shorts and price declines tend to encourage short selling. Note the 40% line where it changes color – this occurs when the 40% line changes from being associated with peak levels of short intensity and becomes a parameter for low levels of short selling. This upward shift in the range of this measure occurred with the beginning of this decade and the current secular bear trend. Peaks and troughs are still respectively bullish and bearish in their implications, they simply now occur at higher echelons.

The recent posture of the above All Sector Average Short Intensity tells us two things. The level is high even for a bear secular cycle. This bodes well, but we also remain in a bear secular cycle, *because* the level is so high. One might consider the higher the better in this regard, but these secular bear parameters exist because the market is less able to squeeze out the shorts as efficiently as it would in a bull secular cycle. To put it more simply, bears are more often correct in a bear secular trend than in a bull secular trend. *The increased parameter levels reflect the increase in successful short selling that occurs in secular bear cycles.*

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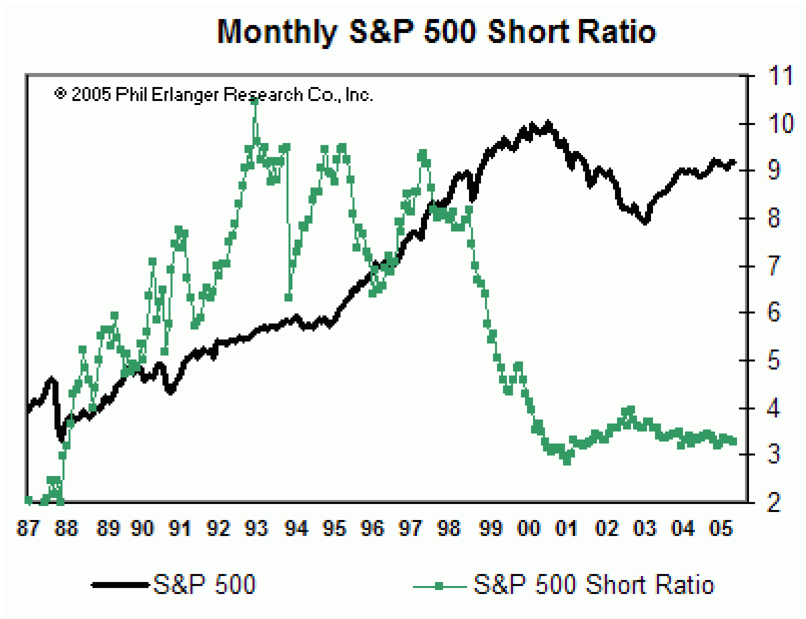
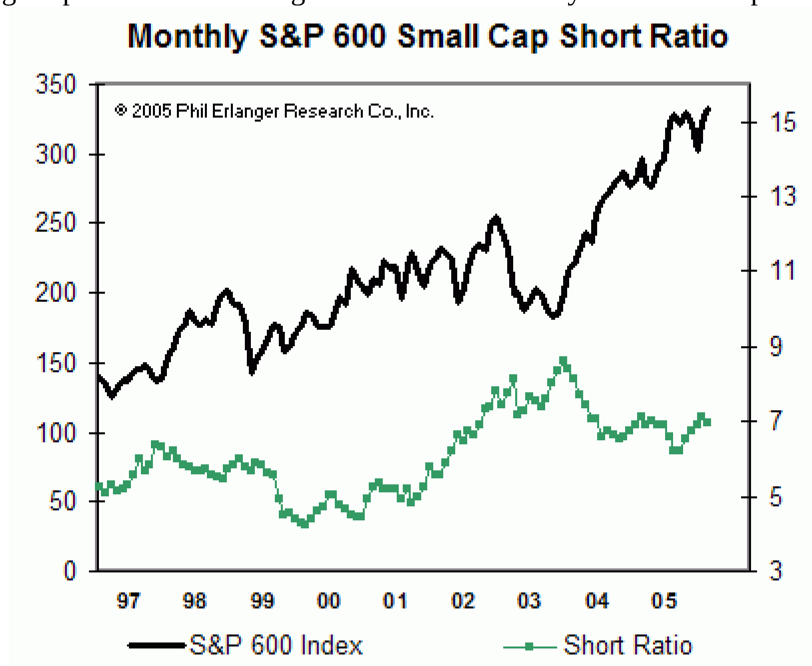
Bringing this into sharper focus, short selling intensity is not broadly based… it is concentrated in lower capitalized issues:



This chart shows the short interest ratio of the component S&P 500 issues. Throughout most of the secular bull trend of the 1990s, short interest was massive on an ratio to average daily volume basis. Only towards the end of the last decade did the S&P 500 short ratio fall to low levels. Except for a moderate move up in late 2003, the short ratio of large cap stocks has been light. It is a different story for smaller cap issues:



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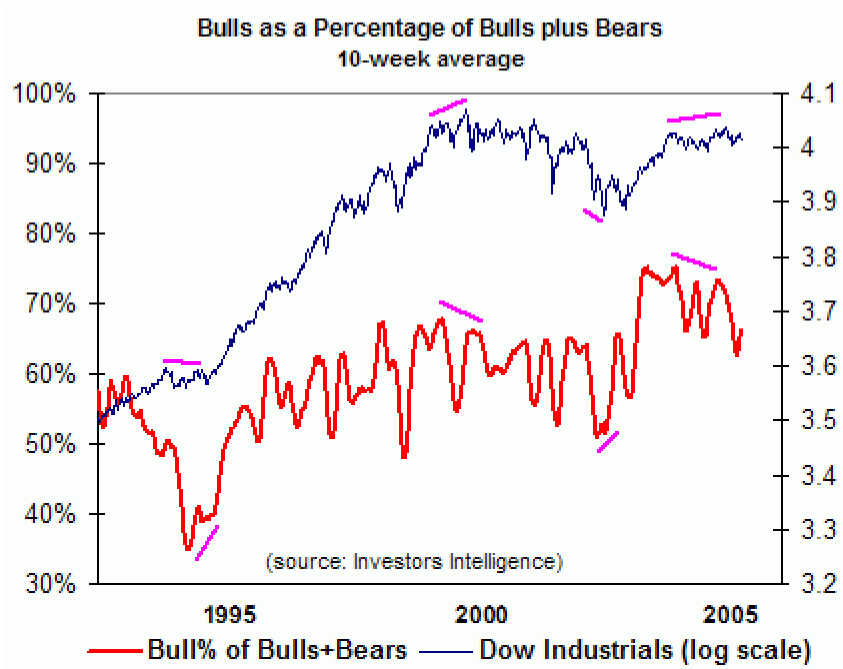
The above chart shows the short interest ratio of the component S&P 600 issues. These are all small cap stocks. This short ratio peaked in mid-2003, and remains on the high side. This is a factor in the relative strength of small cap issues, as there is still a healthy level of losing short sellers that are poised to cover (buy.)

Another sentiment measure we look at is Investor's Intelligence tally of market letter writers. The percentage of bearish letter writers recently dipped below 20%, so we thought it worth while to examine this from a secular point of view:



We observe that the overall level of bullishness as measured by the "10-week average of Bulls as a percentage of Bulls plus Bears" has been oscillating higher since 2003. Overall there are more bullish letter writers than in decades –not a plus from a secular point of view because the markets did not achieve a higher high with the greater expectations. The *trend* of sentiment is also key! The chart above shows many points in time when sentiment diverged from the market indices – and the markets ultimately turned with the direction of sentiment. The action in 2005 shows a particularly glaring downturn in sentiment from these lofty levels, despite higher highs in the averages. This tells us that while the market may be able to rise over the next few months, the secular trend is still bearish. Why? This is because, if this decade were a bull secular trend, the averages should be at all-time new highs, given the just described posture of the "10-week average of Bulls as a percentage of Bulls plus Bears." Secular trends are all about what you get for major swings in sentiment. This decade, despite greater enthusiasm and historically low interest rates, we have a 10.63% loss in the Dow.

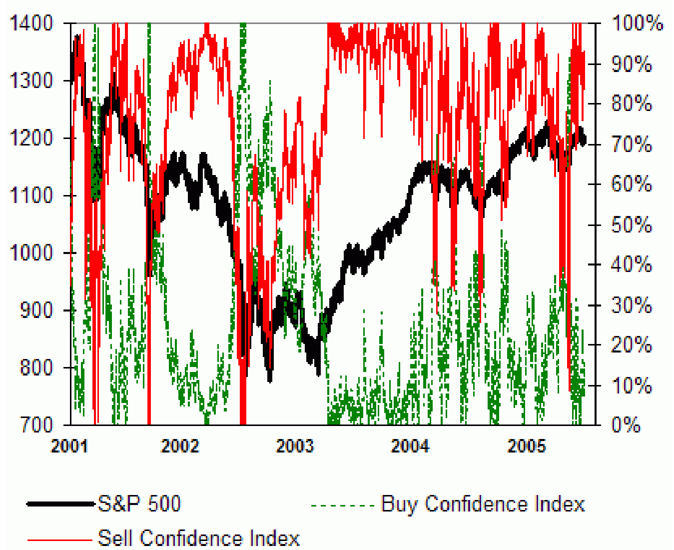
ERLANGER S&P 100 CONFIDENCE INDICES

S&P 100 SQUEEZEOMETER 07/01/05

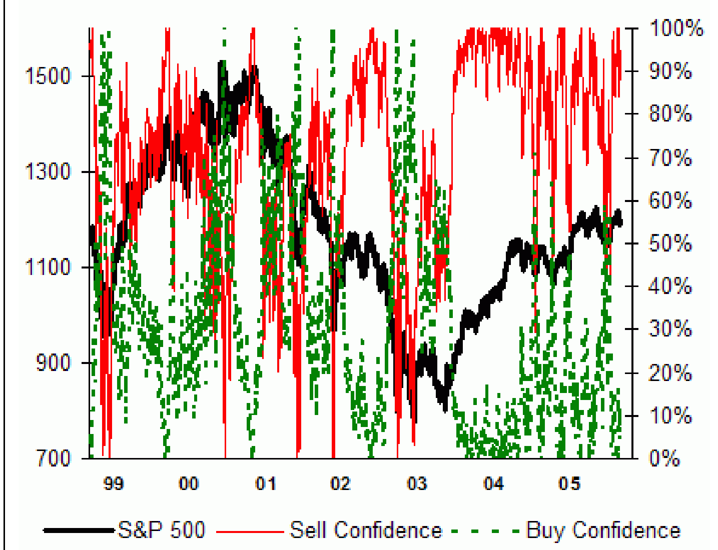
Closing Data

	MEGA	LT	INT	
Uptrend				Buy
Pullback in Uptrend				Cash/Speculative Sell
Downtrend			95	Sell/Sell Short
Rally in Downtrend	7	0		Cash/Speculative Buy
	MONTHLY	WEEKLY	DAILY	

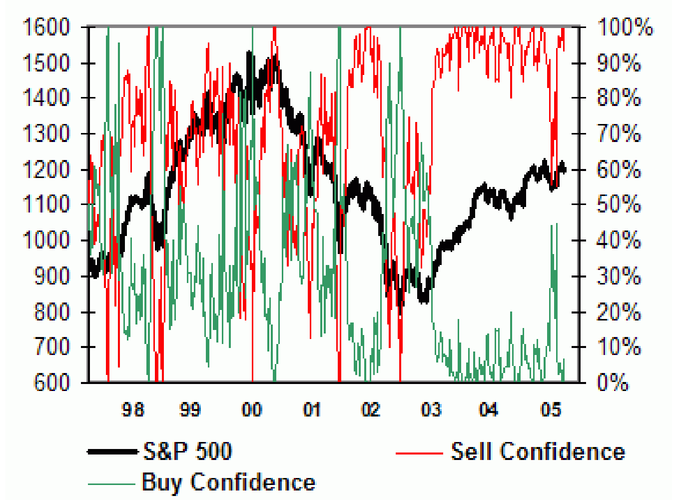
Hourly S&P 100 Buy/Sell Confidence



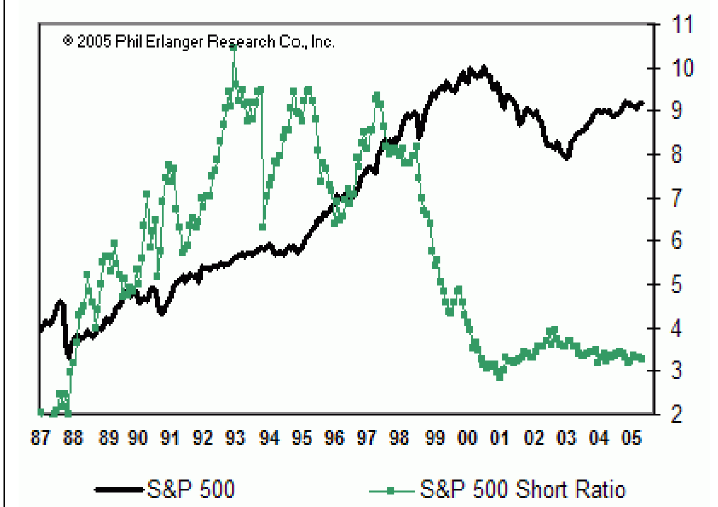
Daily S&P 100 Buy/Sell Confidence



Weekly S&P 100 Buy/Sell Confidence



Monthly S&P 500 Short Ratio

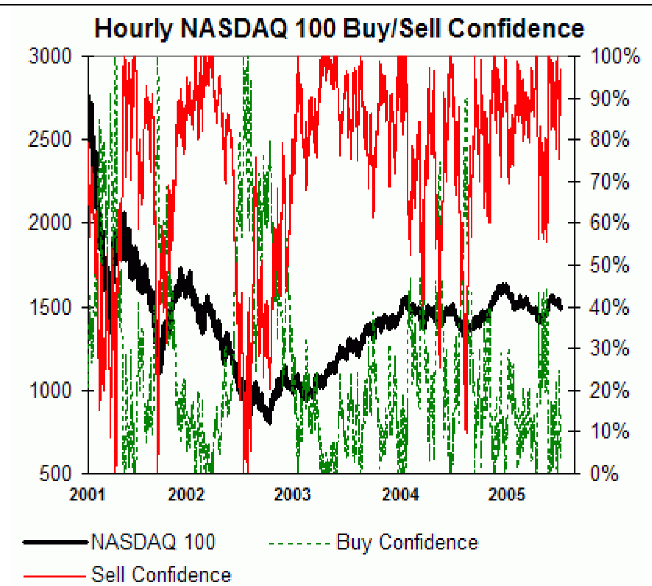


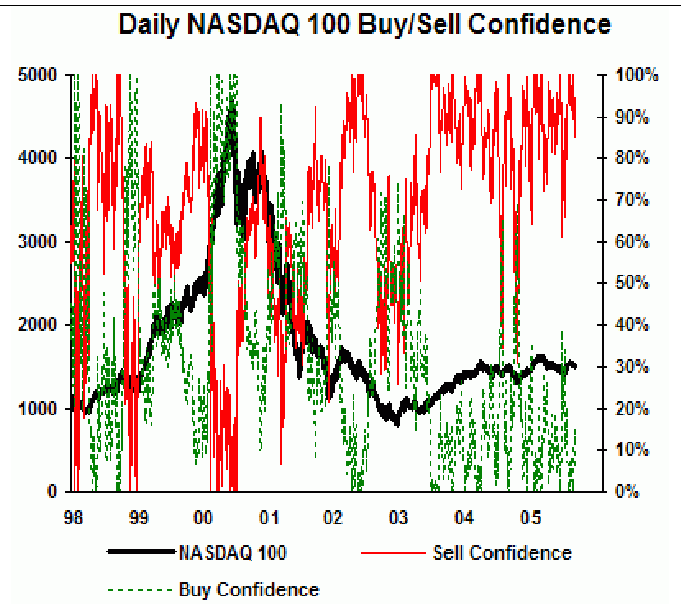
ERLANGER NASDAQ 100 CONFIDENCE INDICES

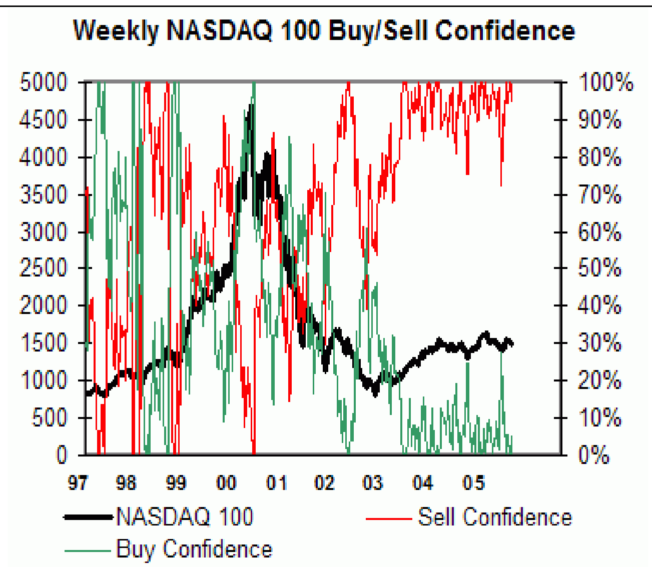
NASDAQ 100 SQUEEZEOMETER 07/01/05

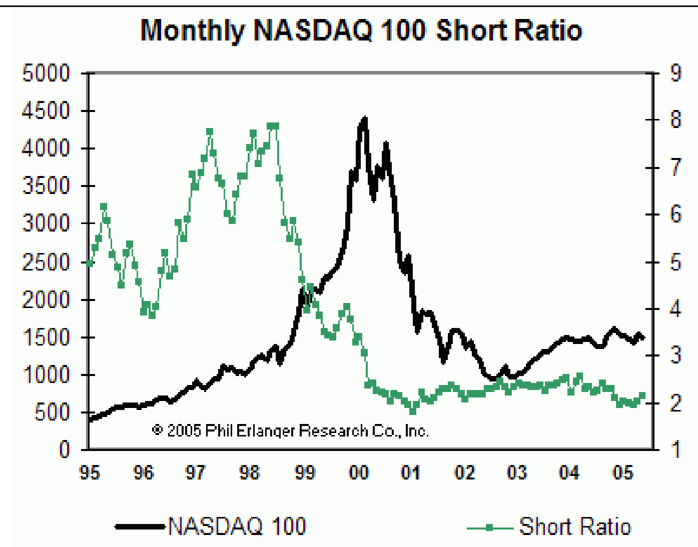
Closing Data

	MEGA	LT	INT	
Uptrend		0		Buy
Pullback in Uptrend				Cash/Speculative Sell
Downtrend			95	Sell/Sell Short
Rally in Downtrend	5			Cash/Speculative Buy
	MONTHLY	WEEKLY	DAILY	









ERLANGER SECTOR RANKING

1=BEST 18=WORST

Sector Name	Power Rank	Tech Rank	Short Rank	Rank *7/1/05*	Rank *6/24/05*	Rank *6/17/05*	Rank *6/10/05*	Rank *6/3/05*	Rank *5/27/05*
ENERGY MINERALS	**62.82**	**73.04**	**42.29**	**1**	1	1	2	5	14
INDUSTRIAL SERVICES	**59.74**	**65.53**	**48.13**	**2**	2	2	5	6	12
RETAIL TRADE	**56.31**	**58.72**	**51.64**	**3**	3	3	1	1	1
UTILITIES	**56.24**	**61.81**	**45.08**	**4**	7	7	10	4	11
FINANCE	**55.49**	**56.15**	**53.92**	**5**	5	8	7	10	9
COMMERCIAL SERVICES	**54.43**	**55.26**	**52.79**	**6**	10	12	12	12	10
HEALTH TECHNOLOGY	53.86	56.04	49.47	**7**	8	11	14	13	5
CONSUMER DURABLES	53.82	53.27	54.94	**8**	4	4	8	14	8
HEALTH SERVICES	52.01	56.84	42.34	**9**	6	5	3	3	4
ELECTRONIC TECHNOLOGY	50.99	50.02	52.73	**10**	9	6	4	2	2
TECHNOLOGY SERVICES	50.79	49.70	53.49	**11**	11	10	6	7	3
CONSUMER NON-DURABLES	49.67	51.72	45.61	**12**	14	15	13	15	15
CONSUMER SERVICES	**49.49**	**49.91**	**48.57**	**13**	12	13	9	8	6
PRODUCER MANUFACTURING	**48.84**	**47.99**	**50.75**	**14**	13	9	11	11	7
NON-ENERGY MINERALS	**47.12**	**48.00**	**45.23**	**15**	16	14	17	18	18
PROCESS INDUSTRIES	**46.33**	**45.85**	**47.34**	**16**	17	16	18	17	17
MISCELLANEOUS	**45.54**	**51.38**	**33.87**	**17**	15	18	16	16	16
TRANSPORTATION	**43.72**	**42.08**	**47.01**	**18**	18	17	15	9	13

Strong Sector Ranks **Neutral Sector Ranks** **Weak Sector Ranks**

Sector Changes From Prior Week

New Buys Ranked 1-6	*New Holds Ranked 7-12*	*New Sells Ranked 13-18*
Utilities 4 +3	Consumer Durables 8 -4	Consumer Services 13 -1
Commercial Services 6 +4	Consumer Non-Durables 12 +2	

TOP GROUPS IN TERMS OF SHORT/LONG SQUEEZE POTENTIAL (as of 06/24/05)

Industry Groups (139 total)	Rank	Avg Tech Rank	Avg Short Rank	Avg Power Rank	Short Squeeze Potential	Long Squeeze Potential	Type 1 %	Type 2 %	Type 3 %	Type 4 %
Aluminum	134	15.0	74.3	35.0	75.0%	0.0%	0.0%	0.0%	75.0%	0.0%
Accident & Health Insurance	2	76.3	67.1	73.3	50.0%	0.0%	50.0%	0.0%	0.0%	0.0%
Casinos/Gambling	25	56.4	57.1	56.5	50.0%	9.1%	31.8%	0.0%	18.2%	9.1%
Catalog/Specialty Chains	24	50.7	68.6	56.6	50.0%	0.0%	21.4%	0.0%	28.6%	0.0%
Textiles	40	48.3	64.8	53.7	50.0%	16.7%	16.7%	0.0%	33.3%	16.7%
Electronic Production Equipment	20	55.8	61.8	57.8	47.4%	13.2%	23.7%	7.9%	23.7%	5.3%
Department Stores	5	71.8	50.4	64.6	45.5%	27.3%	36.4%	27.3%	9.1%	0.0%
Insurance Brokers/Services	85	37.3	67.9	47.6	45.5%	18.2%	9.1%	0.0%	36.4%	18.2%
Home Furnishings	69	40.0	67.4	49.2	45.0%	10.0%	15.0%	5.0%	30.0%	5.0%
Biotechnology	23	55.9	59.0	56.9	44.7%	5.3%	30.3%	2.6%	14.5%	2.6%

Industry Groups (139 total)	Rank	Avg Tech Rank	Avg Short Rank	Avg Power Rank	Short Squeeze Potential	Long Squeeze Potential	Type 1 %	Type 2 %	Type 3 %	Type 4 %
Pollution Control Equipment	116	56.7	16.0	43.0	0.0%	66.7%	0.0%	33.3%	0.0%	33.3%
Major Chemicals	136	22.5	35.3	26.9	25.0%	62.5%	0.0%	0.0%	25.0%	62.5%
Steel/Iron Ore	138	21.9	35.1	26.3	18.8%	50.0%	6.3%	0.0%	12.5%	50.0%
Specialty Steels	137	23.3	33.8	26.8	16.7%	50.0%	16.7%	0.0%	0.0%	50.0%
Air Freight	139	18.9	33.4	23.8	22.2%	44.4%	0.0%	0.0%	22.2%	44.4%
Railroads	129	40.0	33.4	37.9	0.0%	44.4%	0.0%	11.1%	0.0%	33.3%
Contract Drilling	6	80.0	33.3	64.4	18.8%	43.8%	18.8%	43.8%	0.0%	0.0%
Coal Mining	96	56.0	26.6	46.4	0.0%	40.0%	0.0%	0.0%	0.0%	40.0%
Managed Health Care	32	71.8	20.9	54.9	0.0%	36.4%	0.0%	36.4%	0.0%	0.0%
Diversified Electronic Products	126	42.9	34.9	40.3	0.0%	35.7%	0.0%	14.3%	0.0%	21.4%

MAJOR INDEX REVIEW- Data as of June 30, 2005 close.

June Statistics (changes reflect week over week moves)

Technical ranks are still decisively weak. Put activity remains excessive across the board.

Index	Tech Rank =>70	Tech Rank <= 40	Neutral Tech Rank	Options Rank =>70	Option Rank <=30
Dow Jones	3	11-5	16+5	14+3	2-3
NDX 100	19	61+1	20-1	33+2	12-8
S&P 500	151+36	178-31	165-5	172-1	69-17
S&P 400	129+1	109+8	110-4	168+5	39-9
SMH	4	15+3	1-3	7	1-2
BBH	5+1	5-4	8+3	6	3+1
SWH	4+1	8	5-1	6-2	3-1
BKX	2+1	2-4	18+3	8	1-1
RTH	7+1	7+1	5-2	7+2	2-4
OIH	14-1	2	2+1	8-1	1

Data as of 6/30/05 close.

May Statistics (changes reflect week over week moves)

Technical ranks are still decisively weak. Put activity remains excessive across the board.

Index	Tech Rank =>70	Tech Rank <= 40	Neutral Tech Rank	Options Rank =>70	Option Rank <=30
Dow Jones	3	12-1	15+1	8	7+1
NDX 100	29-13	45+17	26-4	27+2	30-5
S&P 500	120+39	203-16	171-29	170+10	87-8
S&P 400	110-7	115-30	116-22	155+1	53
SMH	14-1	5+4	1-3	5+3	4-2
BBH	3-1	13	2+1	4+3	4-1
SWH	3-3	9+2	5	6	3-4
BKX	0-1	9+1	13	9-2	4+3
RTH	6+2	5-1	8-1	5+3	5-1
OIH	11+7	3-4	4-3	9-4	1

Data as of 6/09/05 close.

Type 1 Short Squeeze Type 4 Long Squeeze Screen Update

Over all, since our first screens on March 8 2002, the hedge between the short squeeze and long squeeze screens has cumulatively gained 145.10%, while the S&P 500 rose 10.30%. We hedged (on a leveraged basis) the market and outperformed the S&P 500 by 134.80% in 1211 calendar days.

CUMULATIVE RETURNS:			Started 3/08/02 during 2005		
	Short Squeeze Screen	Long Squeeze Screen	Hedge	S&P 500	Hedge over S&P
1/7/05	84.15%	-47.07%	131.22%	9.37%	121.85%
1/14/05	82.98%	-49.34%	132.32%	7.83%	124.49%
1/21/05	84.06%	-47.50%	131.56%	8.13%	123.43%
1/28/05	91.28%	-45.30%	136.58%	10.83%	125.75%
2/4/05	92.02%	-45.56%	137.58%	11.02%	126.56%
2/11/05	92.38%	-45.81%	138.19%	10.71%	127.48%
2/18/05	93.33%	-44.20%	137.53%	11.52%	126.01%
2/25/05	93.95%	-43.88%	137.83%	12.41%	125.42%
3/4/05	91.32%	-46.37%	137.69%	10.61%	127.08%
3/11/05	90.10%	-48.15%	138.25%	9.74%	128.51%
3/18/05	88.83%	-48.52%	137.35%	8.21%	129.14%
3/24/05	89.49%	-49.78%	139.27%	8.34%	130.93%
4/1/05	88.79%	-49.61%	138.40%	9.05%	129.35%
4/8/05	85.14%	-55.18%	140.32%	5.78%	134.54%
4/15/05	85.06%	-53.31%	138.37%	6.61%	131.76%
4/22/05	83.89%	-54.17%	138.06%	7.02%	131.04%
4/29/05	84.76%	-53.42%	138.18%	8.27%	129.91%
5/6/05	84.07%	-57.56%	141.63%	6.79%	134.84%
5/13/05	87.07%	-54.56%	141.63%	9.84%	131.79%
5/20/05	87.85%	-53.26%	141.11%	10.64%	130.47%
5/27/05	87.77%	-54.01%	141.78%	10.41%	131.37%
6/3/05	89.41%	-53.47%	142.88%	10.58%	132.30%
6/10/05	91.72%	-52.16%	143.88%	12.15%	131.73%
6/17/05	89.00%	-57.18%	146.18%	10.06%	136.12%
6/24/05	88.76%	-56.34%	145.10%	10.30%	134.80%