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THE GEOMETRIC MARKET

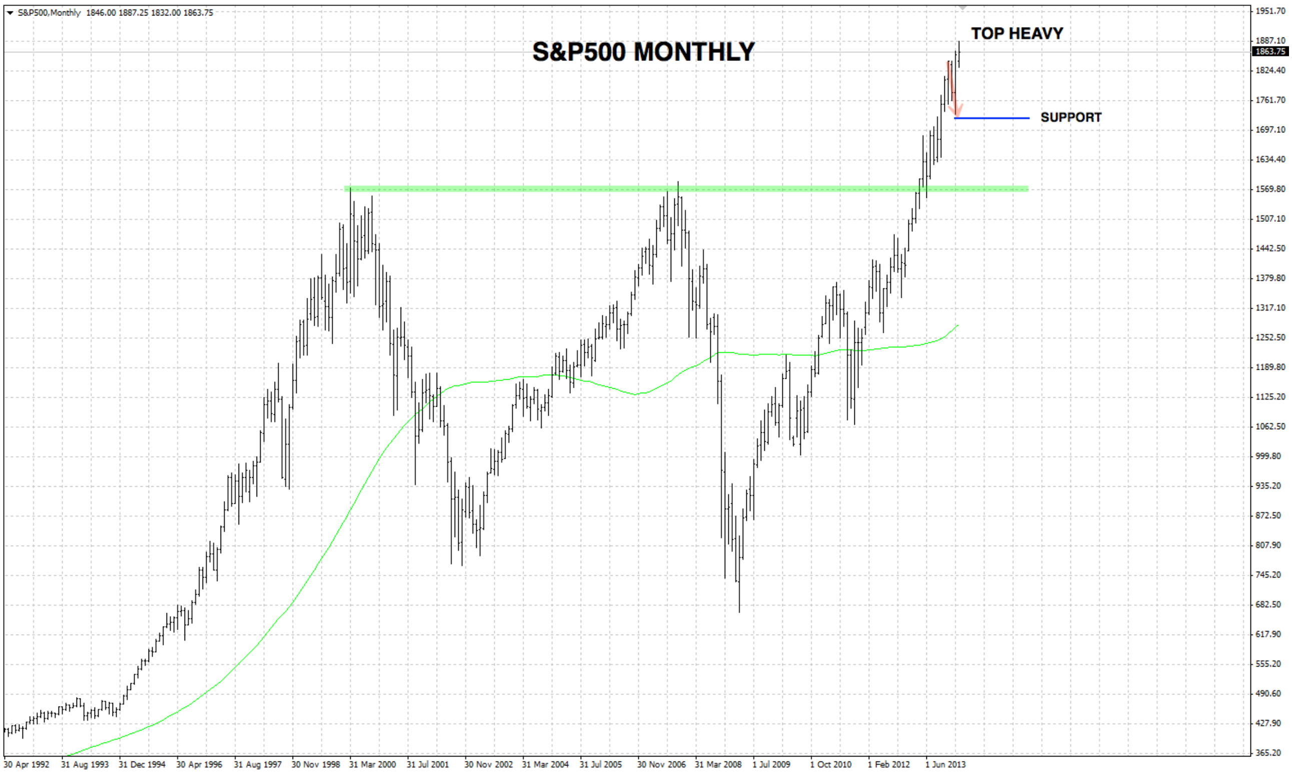
12th March 2014

S&P500: 1868.20

Bernanke is officially out and nothing has changed.

It appears that Yellen will do whatever it takes to stimulate the US economy and Quantitative Easing is here to stay indefinitely. The Fed is promoting the purchase of securities and national assets to put more money into the financial system. The expectation now is that interest rates will stay low barring unforeseen inflation or at least until US unemployment drops below 6.5%. And so we've seen the S&P continue its rampage after a short-lived 6% correction in January.

Whilst I am still expecting a deeper *and longer* retracement you can't argue with what you see. Also for what it's worth reporting season has turned out to be mostly positive and the FED's comments have again instilled confidence in US equities. 2014 has started off where 2013 left and for the time being the market is still extremely sensitive to QE and news of intervention.



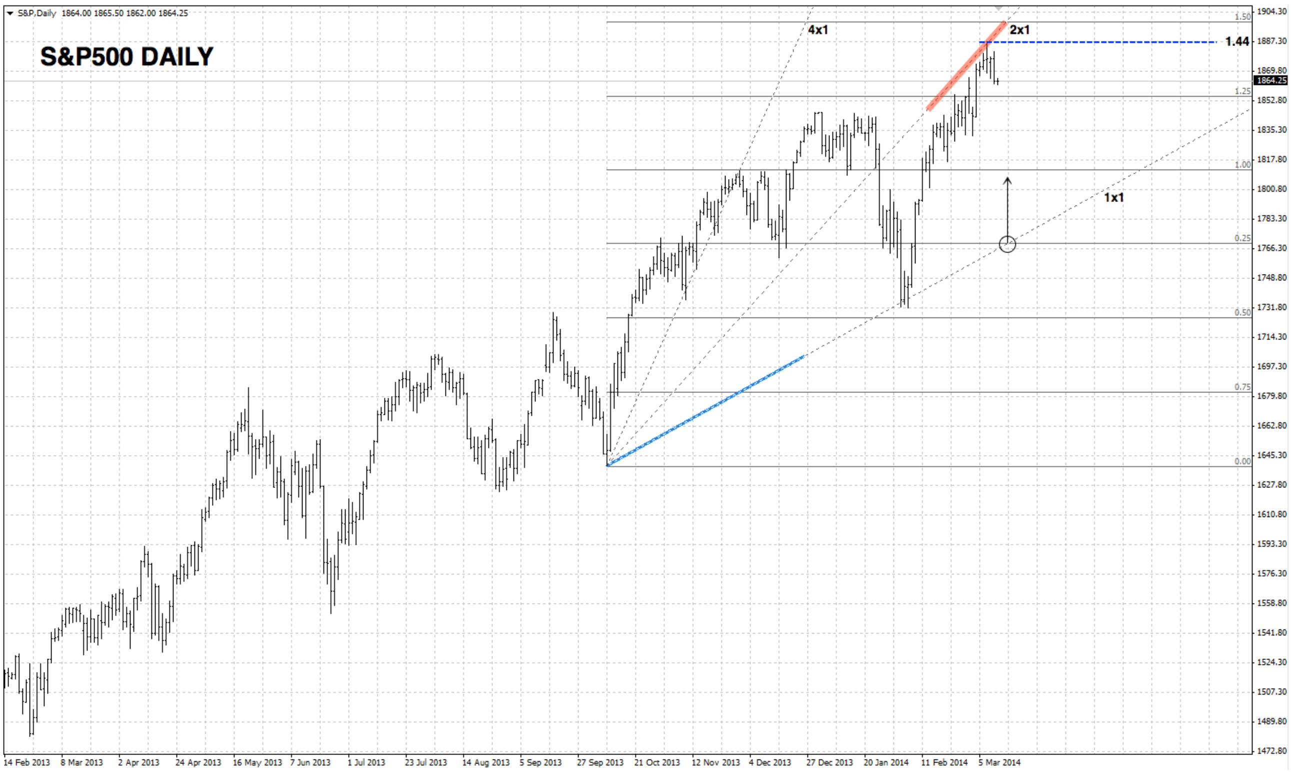
The Jan-Feb correction is small peas in the bigger scheme of things. Last month I said we're due for a *serious correction* and it was very volatile, but not of the order you expect from such a prolonged move to the upside. And so we again find ourselves due for another correction; however this time around you should expect one of greater magnitude.

Next **Friday 21st March** is Triple Witching, one of the four most volatile dates of the year. On this day (third Friday of Mar, Jun, Sep, Dec) all US index futures, options and stock options expire on the same day with volatility often reaching quarterly highs as speculators offset and/or rollover positions before the closing bell. March is a seasonal month and important yearly HIGHS (or LOWS) are almost a certainty every year. Over the last 118 years (since 1896) March has failed to deliver a significant top or bottom 31 times. You could therefore make a case with a ~75% chance for the above to occur. Considering the S&P has entered the 6th week of its rally since the Feb 2 LOW, every Tom Dick and Harry is now anticipating a TOP.

For the astro nazi's- **Thursday 20th March** is also the autumn equinox whereby the earth's poles share the same distance from the sun. In layman's terms that means on this day, the number of day and night hours are equal. We almost always see minor swing highs and lows printed on and around these dates (the spring equinox falling on 23rd September).

There is also a cycle square out from the Oct 9th 2013 LOW due on **Tuesday 18th March** (±1 day) suggesting a final TOP between the 18th – 21st March. In the short term don't rule out a spike past the current 1887 high taking us to 1905.

The exception to everything above is we form a minor swing LOW *this week* with a final spike high early April; however the odds still favour a TOP next week.



The chart above shows two important points of resistance- one at the 2x1 angle and another at a 144% extension of the retracement. Now is the time to take profits on any short term LONG positions.

Fundamentally we now have some worrying signs for this bull market:

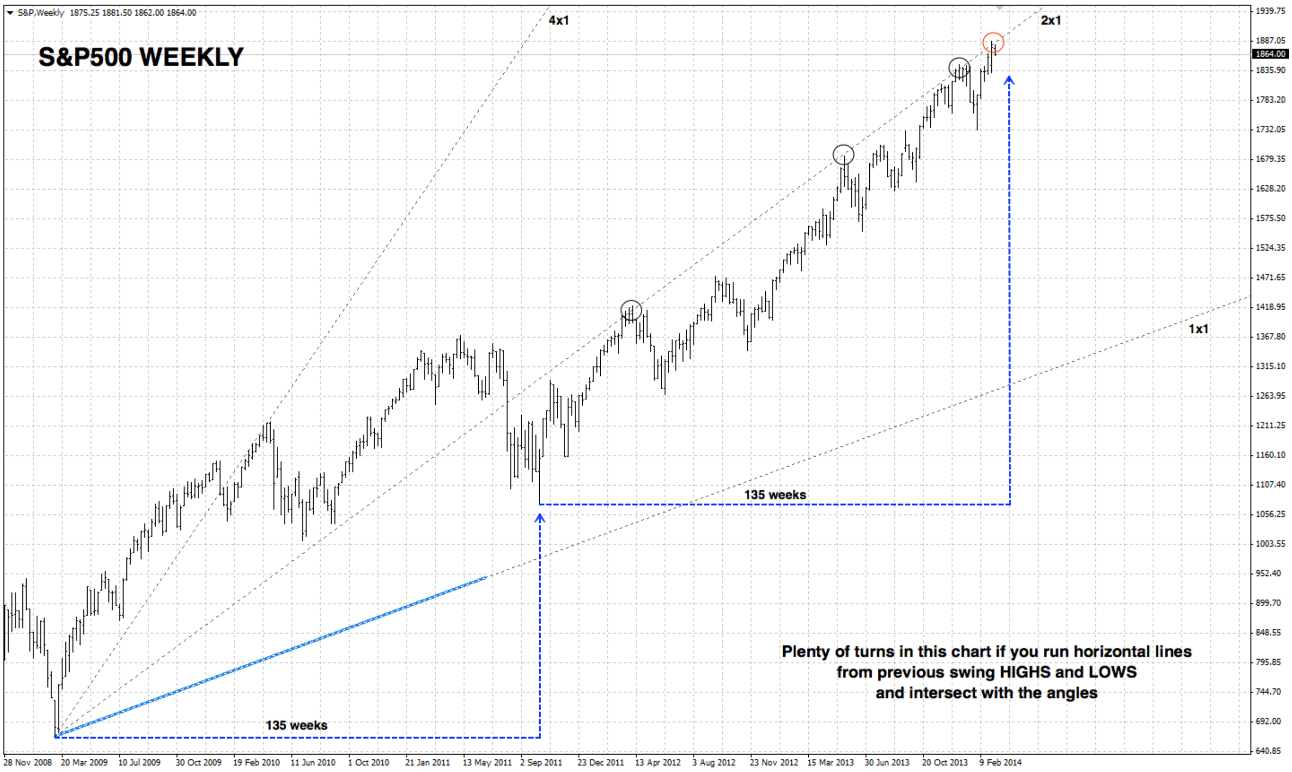
1. The market is long overdue for a multi-month correction
2. This bull is now at 5 years, 5 days since the Mar 6th 2009 LOW.
3. Valuations are lofty to say the least. P/E ratios are currently averaging 16x with speculators seeking expansion to 17x-18x. These are high by historical standards given on average we see companies at 13 – 14x earnings.
4. P/E's suggest the S&P500 is 15% overvalued (operating EPS)
5. We've already seen some ridiculous valuations on speculative IPO's (Twitter, Dropbox, Alibaba) and now mergers (WhatsApp @ 16 billion). These are early warning signs.
6. Household ownership of stocks now at same levels they were at back in 1999.
7. US Bullish sentiment at near record highs.
8. US Stock prices continuing to rise despite falling/stagnant prices in other regions.

Of most concern are the high valuations, ludacris acquisitions and household ownership at this stage of the bull market. I've seen forecasts for the S&P topping out to 2300 which demonstrates how much further participants feel the market can go.

For lack of a better word, this sort of 'sentiment' means one of two things-

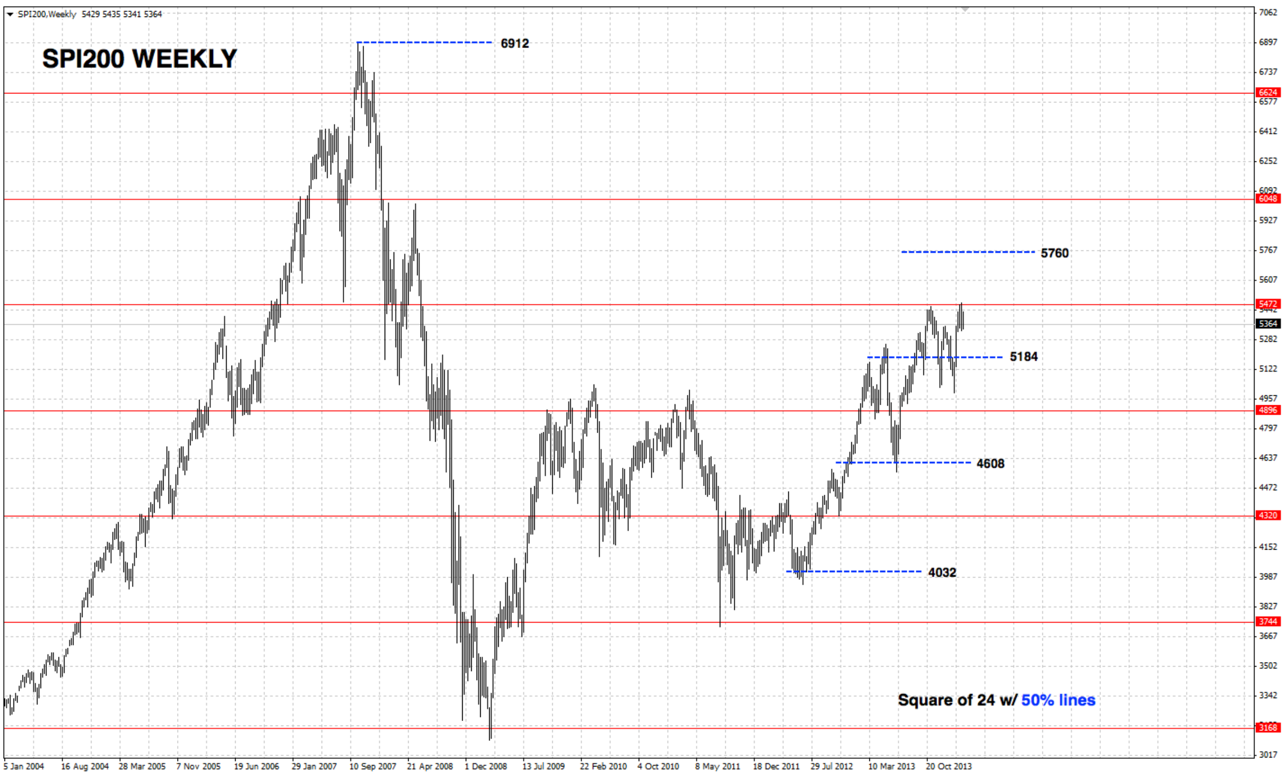
a) We are midway through one of the largest bull markets in history; rivalling the 1990's tech boom or roaring 20's (pre Great Depression) or
b) We are entering the final stages of the bull market.

Here is one last chart that should put this bull market into perspective:



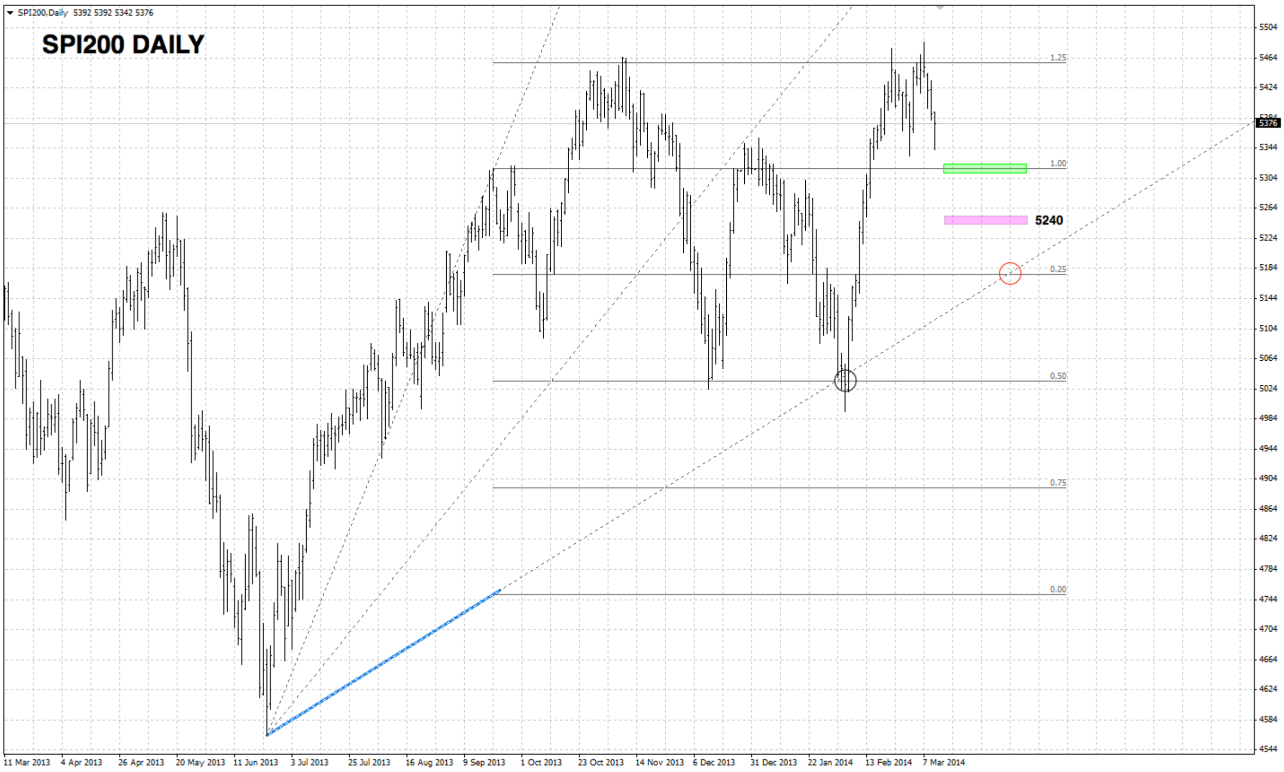
Locally the SPI200 has been in a wide range since November 2013 with near resistance at 5450 and critical support at 5317. A break of either will see us head to 5748 or 5174 respectively.

To the unbeknowing big ranges like this may seem irrelevant but I've always said whenever you see a big range (either through price swings or in TIME duration) then you should investigate the larger timeframes as something major is happening. The charts below couldn't be any more clearer:



Given we're now at a MAJOR 61.8 resistance I expect the bears to try and sell this market again. Should we breach 5450 we'll see surge to the upside as bears are caught the wrong way.

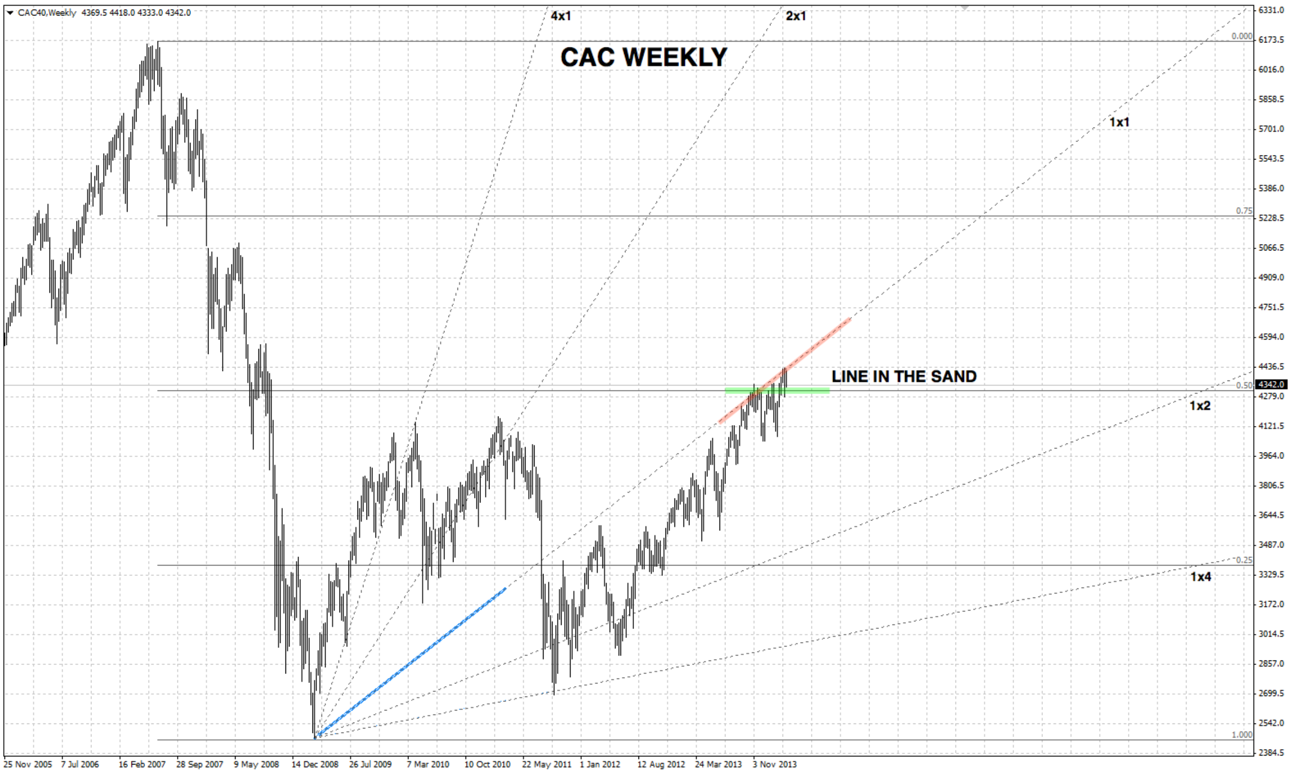
Here is an updated chart from last month's newsletter outlining the importance of the 1x1:



The picture on the Hang Seng hasn't changed much since January, still expecting a move lower.

The bullish channel above can also be interpreted as a bearish 5-wave flag to the move down that occurred in Q3 2011 (Euro sovereign debt contagion). A break of the channel to the downside is confirmation and could lead to a larger mirror image foldback.

The CAC has broken the MAJOR 50% retracement and this is now a line in the sand.



Having fallen off the 125% extension shown in January, the DAX is now in a sideways wedge.

The DAX chart above contains 4 simple trend lines and numbers 1-4. In actual fact there is far more information here. This is a great example of market dynamics; in particular how a directional move can be broken down into 4 segments (labelled 1-4 above)

1. The initial *Impluse* move spiking the market into a direction
2. A *Pullback* following the initial move
3. A *Channel* defined by the Impulse and Pullback swings
4. A *Range* following the break out of the Channel

The range here has actually formed a wedge (in blue). As we move from the Accumulation (rally) phase into the current Distribution (sideways) phase you should expect the next phase to again be broken down into the same 4 segments, so we now wait to identify the next impulse move.

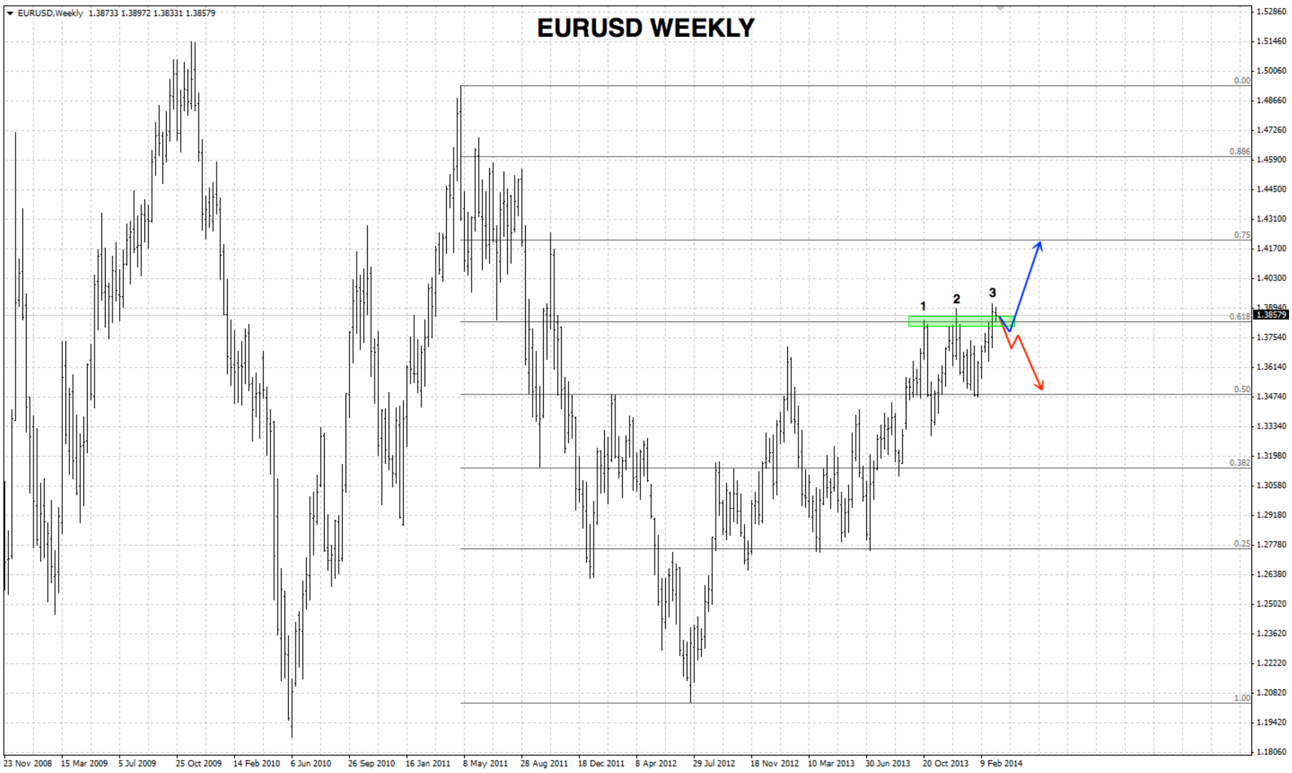
You will see this on any market for any timeframe once you've identified an impulse move, pullback, channel or range. Look at the other charts in this letter. You will always see a range, following a channel, which follows a pullback after an impulse. Al Brooks talks at length on this topic and his first book *Reading Price Charts Bar by Bar* is an excellent text on the subject.

In the UK the FTSE corrected as expected by retracing to the 'Balance Point' area shown previously before rallying again to test the all-time highs. We've now tested this high 4 times over the past year and have yet to break higher. This is a huge double top going back 7 years pre GFC.

<u>Should we break below the 2x1</u> angle a move to 6000 should be expected. However this shouldn't be interpreted as a license to SHORT (mid-term) as all along we're still making higher lows and no matter how you look at it the trend is still <u>UP.</u>

We’ve yet to hit the 0.8500 handle I was looking for last month on the $AUD but I’m seeing more and more reports calling 0.7500, and even lower to 0.6500 over the next 12-18 months. Personally those figures are irrelevant to me until we hit 0.8500 and then 0.8000.

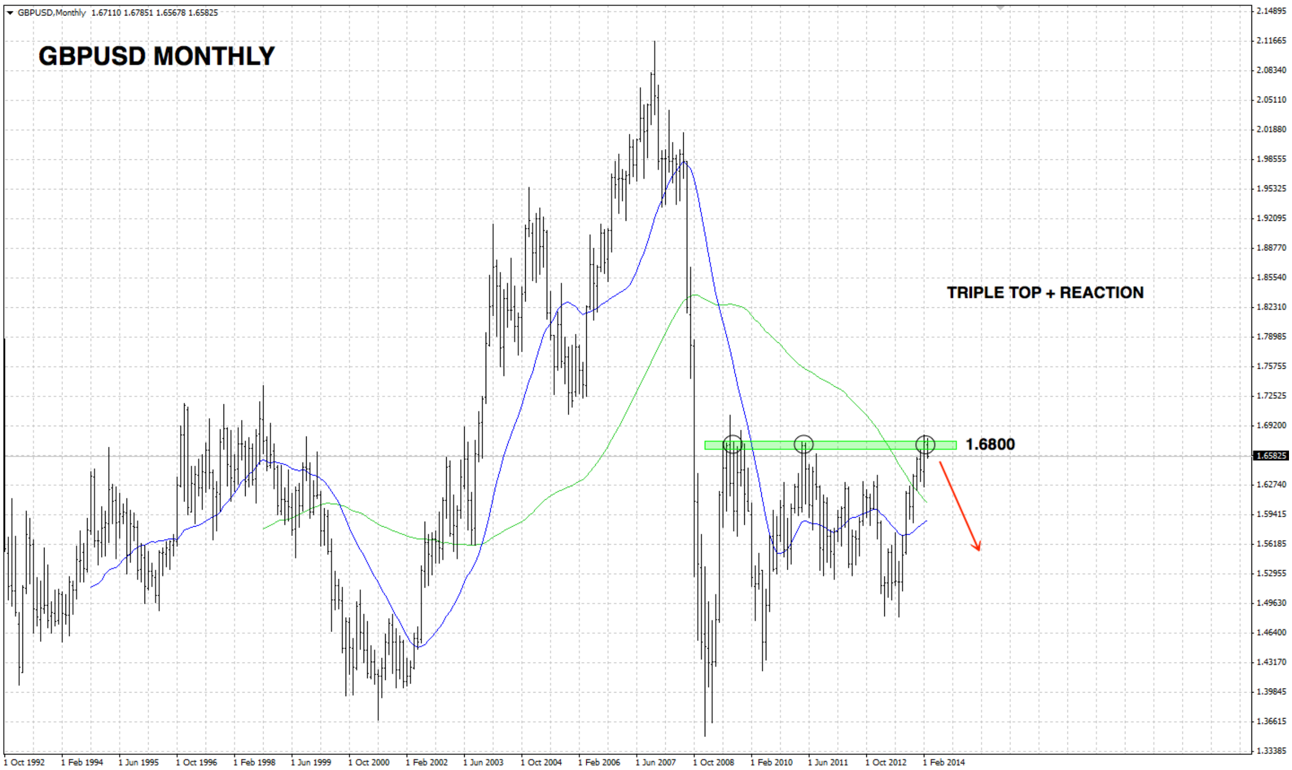
Obviously if everyone is calling substantially lower $AUD the crowded trade becomes a possibility.



The EURO is again testing the 618 and has now tested this 3 times.

Should we retrace and test the 618 again I would want to see a break on the 4th test in order to push higher on its way to 1.4400; otherwise this market will sell off sharply.

If there is one market that looks set to sell off it’s the Cable.



A huge TRIPLE TOP going into a long term moving average reaction calls for a move down. Keep in mind this is a monthly chart and as such may take a few months to play out. I’ve seen this pattern above countless times on 5, 15 and 60min charts whereby the short term MA flattens out as price goes sideways into the long term MA (which is pointing straight down hence reaction); with the outcome often being a sharp move down.

NOTE: If 1.6800 is taken out then the reaction pattern is void.

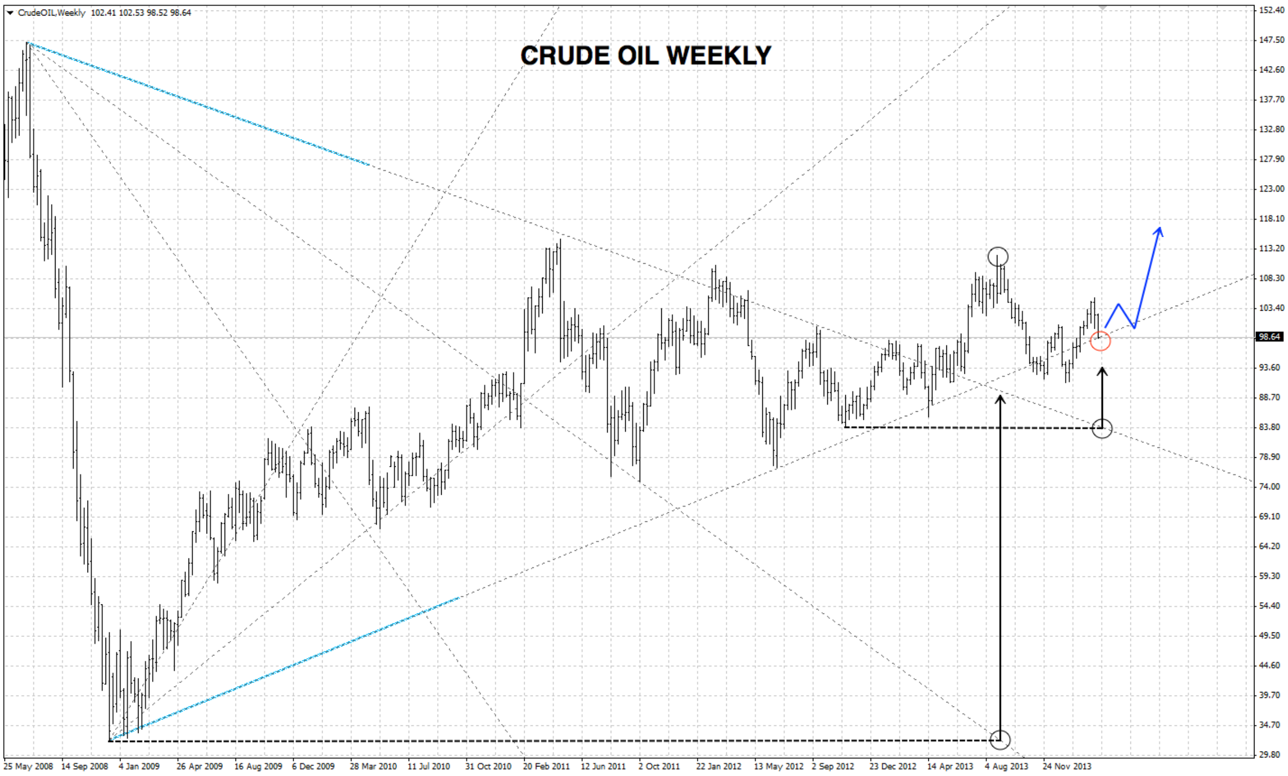
Here is an example of a great low risk/high reward opportunity (read the disclaimer at the end). A SHORT on a pullback higher towards 1.6800 with a stop just above 1.6850 would give you a 1:10 risk:reward profile. The inputs would look like this:

ENTRY: 1.6750 on a pullback
STOP: 1.6850
TARGET: 1.5600

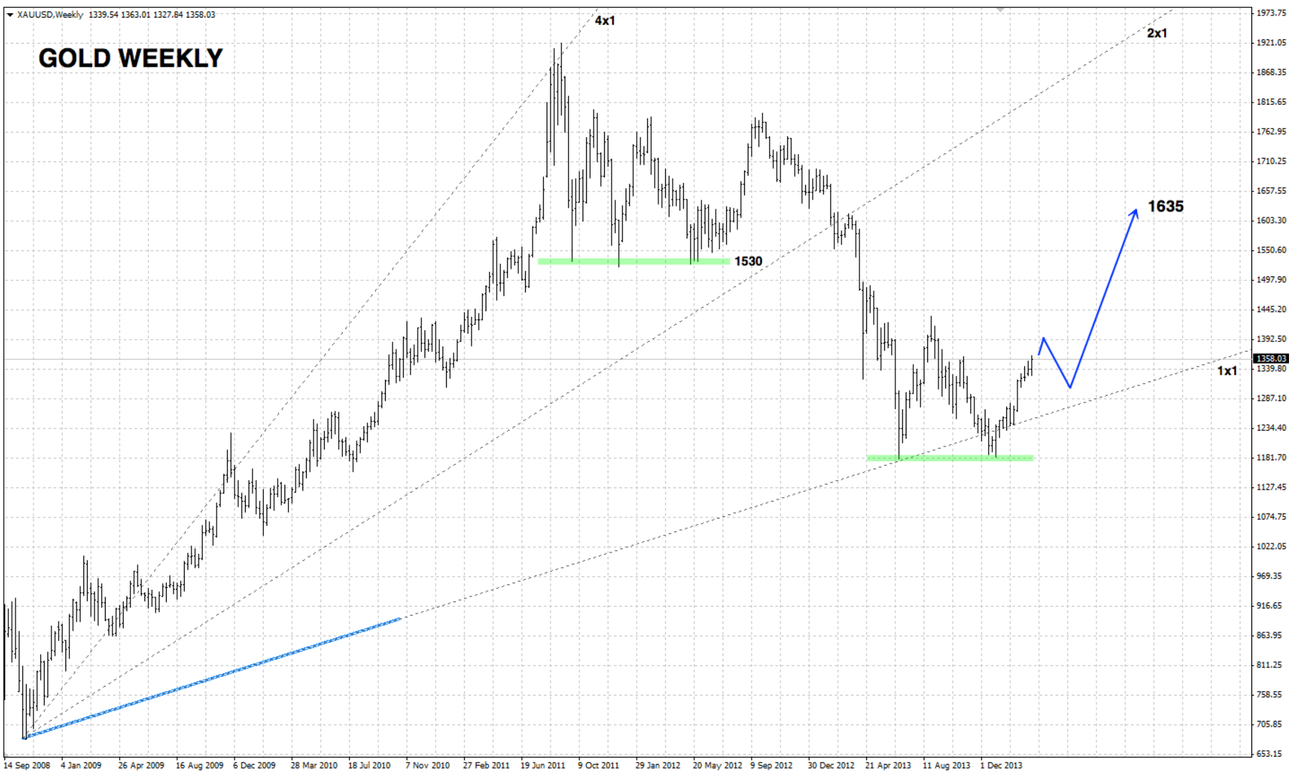
That 1.5600 handle is not out of the question considering the average magnitude of previous UP/DOWN swings. That level also falls in-line with a 61.8 retracement from the Jul 2013 LOW – current HIGH.

At the end of the day it’s *irrelevant* whether a move down occurs or not.

It’s about the low risk/high reward opportunity. When you can identify these opportunities over and over again the odds become stacked in your favour as the rewards far outweigh the risks involved.



The energy complex has failed to take off like other commodities. If crude can consolidate for the next 6 weeks and hold support we'll see a substantial rally eclipsing the $105 HIGH.



Gold has now begun what I believe to be the first left up of a bull market with a long term target of 1635. This will be obvious should doubt creep into equity markets and a flight to safety to Gold. Obvious resistance at 1362, 1432 and 1530.

SUMMARY:

It's no secret the current bull market in equities has been funded by borrowed money- in particular margined debt purchases.

At a time when global sentiment in equities is bearish in Asia and neutral in Europe, I expect US equities this year to be a 'supported' market rather than a fully fledged bear. The number of Top 500 stocks below their long term MA's is falling, suggesting that Top 500 participation in this bull market is fading (now at 69%, we were at 76% a month ago). As such the sharp drops we witnessed last month will become more frequent followed by sharp short covering rallies. The PTMAP I showed in the last newsletter calls for sideways for the next 3-6 months and that's very similar to many of the consolidation patterns we're seeing in global markets right now.

Commodities on the other hand have rocketed off lows. Quite a few markets have been through a 2yr+ bear; however the charts are now screaming a new bull market is underway in what should be a 2 year bull at minimum. Provided nothing changes in the BONDS market over the coming months, 2014 will be a trader's market until Europe and emerging markets stabilise.

Again just because my analysis says US and EURO equity markets are top heavy, *I never consider a market too high to buy or too low to sell.* A perfect example of this is the $AUD. There is still plenty of bullish sentiment for the $AUD against other currencies, however you'd be wiped out on the LONG side as the market has been steadily declining for 2.5 years. The trend is clearly DOWN.

Always trade in the direction of the trend.
Money is made with the trend and NOT by following sentiment.