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Downside risk next week could set the stage for broader relief rally into August

Last week we highlighted the potential for a reversal under the 45-degree resistance line (light blue in the daily chart below) at 1100 on the S&P 500 with downside risk to 1040-1060. After pulling back to 1056 on 7/20, a strong overnight session last evening has sent equities rallying up to 1095 and through the 45-degree resistance line. We suspect the internal structure of the advance off the 7/20 low (complete impulsive 5-wave advance decline, followed by a corrective 3-wave decline – as shown in the 20-min bar chart) suggests the larger degree trend (off July 1010 low) is still up. Based on a mosaic view of looking at stocks, groups, and sectors, we arrive at the conclusion that a multi-week/month advance started in early July and has legs into August. In addition, the improvement in price momentum and breadth (as measured by NYSE ticks) at the daily level warns us not to look for a significant decline here, but to view recent volatility as more of a basing process where the market is doing what it can to position as many people as possible on the wrong side of the future multi-week/month trend. Given overbought intraday conditions and a daily oscillator that may not have bottomed yet, we would not be surprised to see a setback next week (think European bank stress results after the close on Friday) that could give us more backing and filling that some may come to assess as a right shoulder on the daily chart. Either way, we believe any near-term weakness next week should be viewed in the context of a potentially larger uptrend into August. The potential emerging alpha trends in the Basic Material, Energy, and Transport sectors, combined with the potential for the rally in bond prices to soon take a break (a review of the daily chart of long dated Treasury bonds suggests waning price momentum (i.e., yields may briefly turn higher) could imply that the recent “growth scare” may see a temporary reversal in sentiment.

The deterioration at the weekly level (not shown) still keeps us cautious regarding the ultimate upside potential for August and we would reiterate our belief that the 15-week cycle of lows (next due September 10) and Fibonacci time projection of late September (for a natural termination of the cyclical bull correction) causes us to lean towards an idea of a multi-week rally into August (taking us anywhere from 1120 to 1180) with vulnerability later returning for a more sustainable low in September. While questions may arise as to ultimate downside risk, our experience leads us to assess that risk once we see what the nature of the potential August rally looks like (where a deep retracement would allow hope for simply a 1010 retest; conversely, a shallow retracement could imply 950).



Source: TradeStation, Market Methodology Inc.

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Past performance is no guarantee of future results.

Alpha refers to the performance differential between a specific investment and its benchmark.

Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 75% of the total US equities market.

For further information about Elliot Wave theory or Point and Figure charting, visit <http://stockcharts.com/>

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