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KEYS TO THIS WEEK
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Keys To This Week

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Tuesday, May 26th 2009

Key Influences On Market Direction For This Week

The US Stock Market

Last Week we said: "...all of our Keys fall into the Near Term Negative and/or Intermediate Term Negative categories. In fact, the only Key that falls into a Positive category this week is intermediate term market momentum -- which is a lagging indicator. The message of these data is that favorable conditions exist for last week's decline to continue for at least the next several weeks. Of this week's Factors, the most important change from a week ago is the negative (bearish) shift in near term market momentum. This confirms that the decline the US stock market has been due for is actually underway. We discussed this shift in momentum in greater detail in our May 15th Asbury Alert entitled, *Market Momentum Confirms Decline In US Stocks, Rise In US Treasury Prices.*"

This Week, despite this morning's Consumer Sentiment-driven spike higher, **our "Keys" continue to strongly indicate favorable conditions for at least a several week pullback in US equity prices -- and before they continue significantly higher.** Through the end of last week, both investor sentiment data and overbought conditions remain at multi-year extremes that have historically coincided with near to intermediate term market tops, not the beginning of sustainable new bullish trends. We are paying particular attention to *positively-correlated* copper prices and *inversely-correlated* US Treasury prices this week, as a decline in the former and a rally in the latter would probably be necessary to help facilitate the decline US equity prices are due for. We also note that, despite the recent rally, global equity prices are still hovering *below* major overhead resistance levels. We view this as another reason why **it is unlikely that a new sustainable bullish trend will begin from current levels -- at least without a significant correction first.** We discussed these key levels in 9 different global stock market indexes in our May 22nd **Commentary** entitled, *Major Overhead Resistance Still Holding In Global Equity Markets.*



US INTEREST RATES &
TREASURIES

last updated 4-24-2009

US DOLLAR & FOREIGN
EXCHANGE

last updated 4-24-2009

THE FED, INFLATION &
COMMODITIES

last updated 12-17-2008

THE US STOCK MARKET			
NEAR TERM (one to several weeks)	POSITIVE FACTORS	NEGATIVE FACTORS	FOR THE WEEK OF MAY 25, 2009
		NEAR TERM MOMENTUM	
		MAJOR OVERHEAD RESISTANCE	
		RELATIVE PERFORMANCE	
		INTERMARKET: US BONDS, COPPER	
		INVESTOR SENTIMENT	
INTERMEDIATE TERM (one to several months)	INTERMEDIATE TERM MOMENTUM	OVERBOUGHT	
		SEASONAL TREND	
KEYS TO THIS WEEK			

1. **Market Momentum: NEAR TERM BEARISH, INTERMEDIATE TERM BULLISH.** Through the end of last week, near term *daily* momentum remained *negative (bearish)* in the major US indexes while intermediate term *weekly* momentum remained *positive (bullish)*. This indicates that the US stock market has begun a near term decline within an intermediate term rise.
2. **Major Overhead Resistance: NEAR TO INTERMEDIATE TERM BEARISH.** Most major US, and some European, stock indexes are simultaneously testing critical overhead resistance levels. **This indicates a major inflection point / decision point for global equities.** How these indexes respond will indicate whether the larger October 2007 cyclical downtrend is still intact and is resuming, or if a more sustainable bottom is in place at the recent lows. (We displayed and discussed these key levels, plus some additional ones, in much greater detail in our May 22nd **Commentary** entitled, *Major Overhead Resistance Still Holding In Global Equity Markets.*)
 - o **S&P 500 (SPX):** 936 to 964 -- representing the 200-day moving average (936), the January 6th benchmark high (944) and the May 2008 downtrend line (964).
 - o **Dow Industrials (DJIA):** 8,512 to 9,088 -- representing the May 2008 downtrend line (8,512), the 200-day moving

average (8,844) and the January 6th benchmark high (9,088).

- o **Dow Transports (DJT):** 3,574 to 3,525 -- representing the January 6th benchmark high (3,574) and the 200-day moving average (3,525).
- o **NASDAQ 100 (NDX):** 1,354 to 1,447 -- representing the 200-day moving average (1,354), the November 4th benchmark high (1,383) and the July 2006 benchmark low (1,447).
- o **PHLX Semiconductor Index (SOX):** 248 to 286 -- representing the November 4th benchmark high (248), the 200-day moving average (248), and the July 2007 downtrend line (286).
- o **Russell 2000 (RUT):** 512 to 519 -- representing the 200-day moving average (512) and the January 6th benchmark high (519).
- o **German DAX Index:** 4,891 to 5,111 - representing the 200-day moving average (4,891), the January 2008 downtrend line (4,919), and the January 6th benchmark high (5,111).
- o **London FTSE Index :** 4,393 to 4,676 - representing the 200-day moving average (4,393), the November 5th benchmark high (4,640), and the January 6th benchmark high (4,676).

3. **Relative Performance: NEAR TERM BEARISH.** Although the NASDAQ 100 (NDX) has already *underperformed* the broad market S&P 500 (SPX) by 6% since late April, both momentum- and investor sentiment-based measures suggest *favorable conditions for recent outright and relative weakness by the NDX to continue*. Considering the Technology Sector and the NDX's tendency to lead the broad US market both higher and lower, continued weakness by Tech is likely to lead a broad market decline. **In addition**, the Dow Jones Industrial Average ((DJIA) has reached a quarterly oversold extreme versus the S&P 500, one which has previously coincided with the beginning of every period of *relative outperformance by the DJIA* in recent history. This is important because the relative performance line between the DJIA and SPX has been *65% inversely correlated* to the SPX over the past decade - meaning that the Dow has historically outperformed the S&P 500 during broad market declines (in a flight-to-quality) and *underperformed* during broad market rallies (as investors moved into more aggressive areas.) If the Dow begins to outperform the SPX as these latest data suggest is likely, it should coincide with a broad US market decline.

4. **Intermarket Analysis (copper prices): NEAR TERM BEARISH.** Copper prices are seen by investors as an economic barometer and have been *77% positively correlated* to the Dow Transportation Average since 1988. Since mid April the COMEX copper contract has been testing (and for the most part holding) major overhead resistance at its 200-day moving average (at 213.39 cents per pound as of the close on Friday), while technically overbought. This establishes ideal conditions for copper's larger August 2008 downtrend to resume, IF still valid. If a decline in copper does take place from here then, per the correlation, it should be *equally bearish* for the DJT *and* for the US stock market in general.

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5. **Intermarket Analysis: (US interest rates): NEAR TERM BEARISH.** The S&P 500 has been *86% positively correlated*

to the yield of the US 10-Year Treasury Note since December 2006 as the level of interest rates has become a barometer of expectations for economic growth during this period. As stated in the **US Interest Rates & Treasuries section** below, long dated US Treasury prices are amid ideal conditions for at least a near term rebound. If bonds do rally from here, and the relationship between US stocks and interest rates remains intact, then this should coincide with a decline in the S&P 500.

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6. **Investor Sentiment: NEAR TERM BEARISH.** Through Friday, the vast majority of the professional and retail investor sentiment measures that we track continue to suggest that the US stock market is within 1-2 weeks of at least a near term peak. However, the remainder of these measures suggest that the market is also in the process of establishing a more intermediate term bottom. One indication of favorable investor sentiment for a near term market peak is the **CBOE Put/Call Ratio** (blue line in upper panel of **Chart 1** below). The red vertical bars across both panels show that the ratio of puts versus calls is at a multi-year low extreme, indicating *an extreme in fearlessness of a stock market decline*, which has previously coincided with every important *peak* in the S&P 500 (lower panel) since 2007.

7. **Overbought/Oversold: NEAR TERM, INTERMEDIATE TERM BEARISH.** The major US stock indexes remain technically overbought on both a *near term* monthly and *intermediate term* quarterly basis. This establishes favorable conditions for the market to establish a one to several month top.

8. **Seasonal Trend: INTERMEDIATE TERM BEARISH.** May, the 7th *seasonally strongest* month in the S&P 500 since 1957, kicks off a five-month period of acute seasonal weakness that includes 5 of the US broad market's 6 weakest months during the past 51 years. June is the 3rd weakest month for the S&P 500 since 1957 and one of just three to post a negative return during this period. (The latest *monthly and intra-month* seasonal patterns for **17 different global financial markets** are available in our **May 8th Global Seasonal Analysis** report.)



Chart 1

US Market Sectors

Last week, we said: "...a 10-year over-invested extreme in the Materials Sector suggests that the February rebound in economic demand that helped to fuel the March rally in the US stock market is either at or near completion. The Materials Sector is sensitive to supply and demand fluctuations because the price of raw materials, such as gold or other metals, is largely demand driven. Considering that the relative performance line between the Materials Sector and the broad market S&P 500 has been 86% positively correlated to the CRB Index, 86% positively correlated to gold prices, and 76% positively correlated to copper prices over the past decade, relative underperformance by the Materials Sector should coincide with at least a temporary stall in the recent rebound in both

US economic expectations and in the US stock market."

This Week, a 10-year under-invested extreme in the defensive Health Care Sector suggests an emerging buying opportunity in this sector. It also indicates that investors are currently too unworried about a US broad market decline for the March rally to continue much further from here, at least without a near term decline first to work off this extreme in complacency.

1. **The Health Care Sector:** Investor assets tend to pile into the defensive Health Care Sector when the US broad market *is weak*, and rush out of this sector when the broad market *is strong*. Accordingly, the relative performance line between the Health Care Sector SPDR ETF (**XLV**) and the S&P 500 Depository Receipts ETF (**SPY**) has been **83% inversely correlated to the S&P 500 since 1998** (when these Sector SPDR ETFs began trading).

Chart 2 shows that, through the end of last week, **just 7% of all sector-related bets were being allocated to the Health Care Sector** according to our own metric based on the daily assets flows in the 18 Rydex Sector Funds. This is less than one-third of the 10-year average of 25% invested in Health Care (see **Chart 3**), and one of just two instances when the percentage of assets invested was this low during the past decade. The other instance **was at the end of Q2 2008, when the percentage of assets invested fell to 8%**. June 2008 marked the peak of the first bear market rally in the S&P 500, after the October 2007 top was established, and kicked off the huge 773 point, 54% collapse into the March 2009 lows. These data indicate that Health Care is at another under-invested extreme now which, if history repeats, should coincide with or lead a broad market US decline while investor assets pile back into this defensive sector. We discussed the latest sector allocation, including Health Care, in more detail in our **May 15th Commentary** entitled, *Following The Money: Current Sector Allocations Suggest More Broad Market Weakness Is Coming*

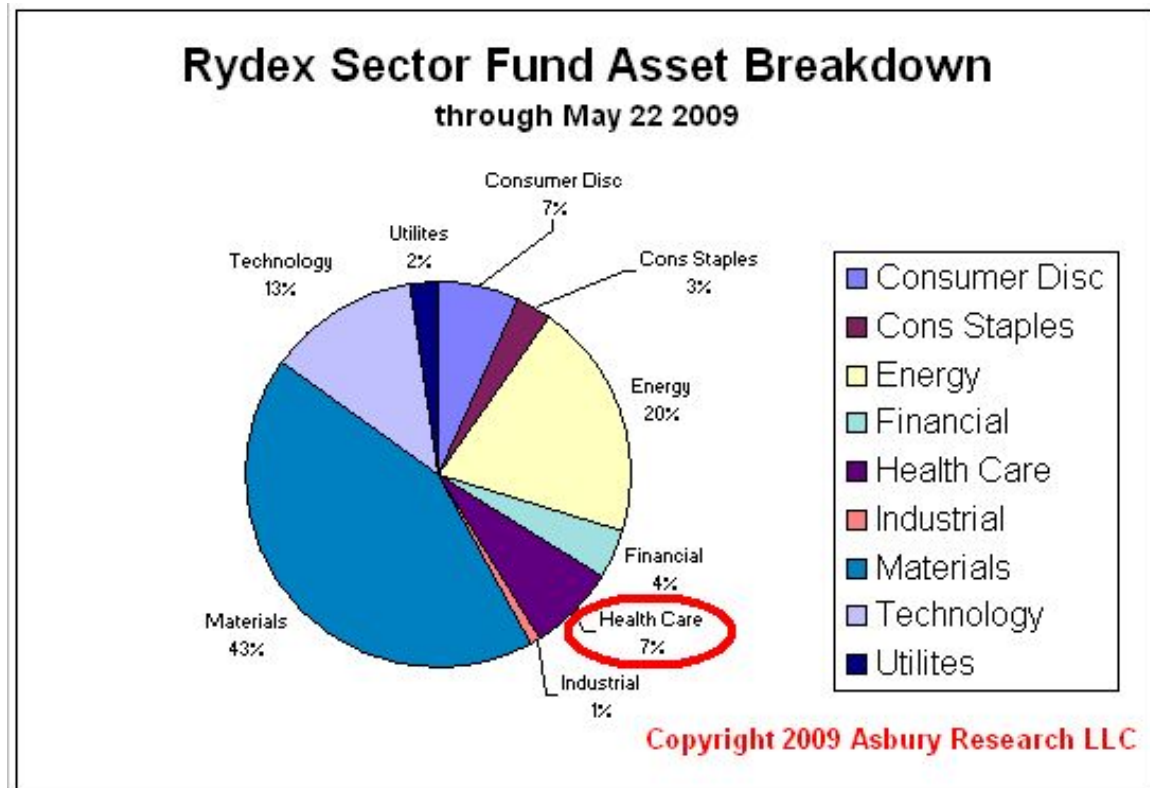


Chart 2

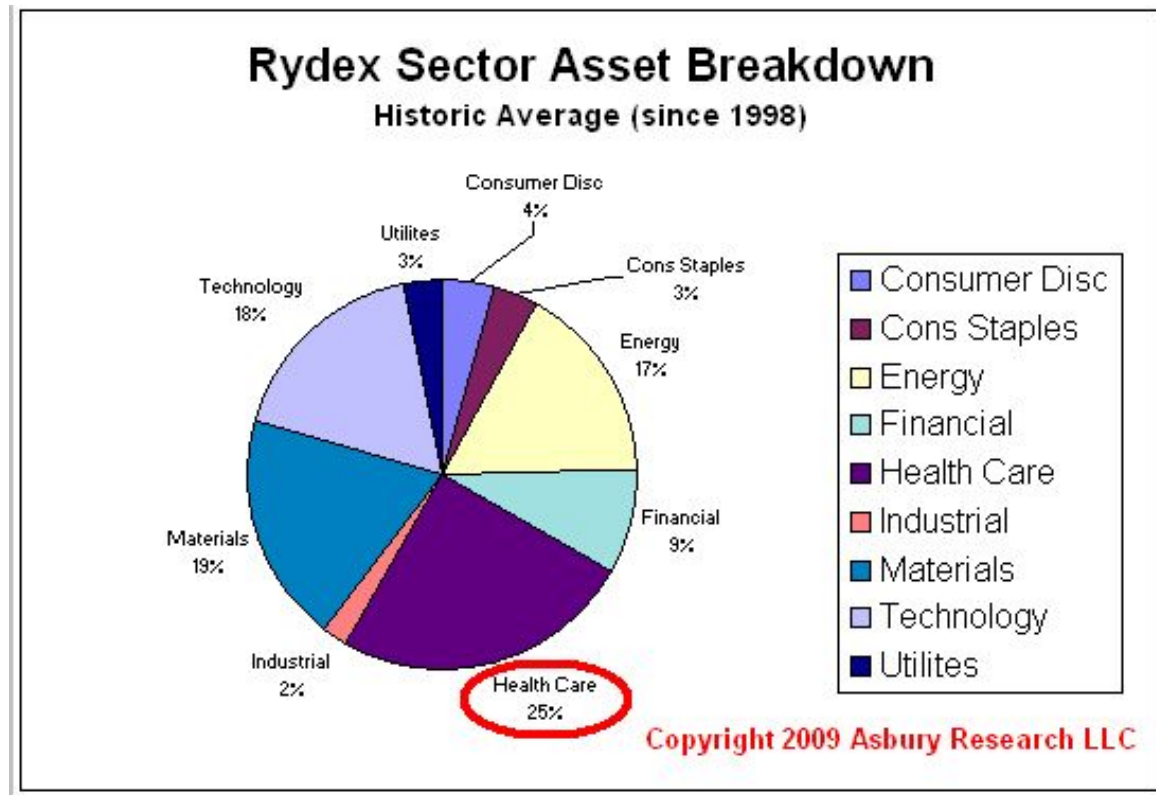


Chart 3

US Interest Rates & Treasuries

Last week, we said: "... literally all of our Keys are positioned in Near Term Positive category, with the exception of intermediate term market momentum. However, its important to note that intermediate term momentum is a lagging indicator, and this does not necessarily represent what the market environment is right now. The most important change from a week ago is that near term market momentum has turned positive, which confirms that the rebound that Treasury prices have been due for is actually underway. Also noteworthy is the that exact opposite alignment of Near and Intermediate Term Factors exists in the US stock market This is very important right now because of the tight 86% positive correlation between the S&P 500 and the yield of the US 10-Year Note since December 2006. Accordingly, per the correlation, a near term negative outlook for stocks would corroborate the near term rebound in long dated Treasury prices that the latest data suggest is imminent."

This week, the vast majority of our "Keys" reside in the Near Term Positive category, which again indicates that favorable conditions exist for a near term rebound in long dated US Treasury prices. However, near term market momentum turned negative (bearish) again

last week. **Although T-Bond futures open interest (which is perhaps the most important Near Term factor this week) still remains positive, it would take another positive shift in near term momentum to confirm that the rebound the market is still due for has begun.** From a more intermediate term perspective, major underlying support levels (and their corresponding overhead resistance levels *in yield*) were broken last week in long dated US Treasuries. Although this does not in any way absolve the market from the rebound it is due for, this tells us that *this rebound, when it inevitably gets here, is likely to be corrective in nature* and should eventually lead into an even deeper decline.

US TREASURY PRICES			
NEAR TERM (one to several weeks)	POSITIVE FACTORS	NEGATIVE FACTORS	FOR THE WEEK OF MAY 25, 2009
	T-BONDS OPEN INTEREST	NEAR TERM MOMENTUM	
	INTRAMARKET: THE NOB SPREAD		
	INTERMARKET: US STOCKS		
	TIPS SPREAD		
	OVERSOLD, INVESTOR SENTIMENT		
	SEASONAL TREND		
INTERMEDIATE TERM (one to several months)		INTERMEDIATE TERM MOMENTUM	
		MAJOR SUPPORT: BEING BROKEN	
KEYS TO THIS WEEK			

1. **Market Momentum: NEAR TERM, INTERMEDIATE TERM BEARISH FOR PRICES.** Through Friday, *near term* daily momentum had turned back to *negative (bearish)* in US Treasury prices across the yield curve while *intermediate term* weekly momentum remained *negative (bearish)*. This indicates that Treasury prices have resumed their larger December 2008 downtrend following a brief rebound earlier this month.
2. **T-Bond Open Interest (Measuring Investor's Trend Conviction): NEAR TERM BULLISH FOR PRICES.** Total open interest in the CBOT T-Bond contract finished last week more than 10,000 contracts *above* its 10-day moving average, which is near term bullish. However, preliminary data from the CBOT shows that open interest contracted by 10,256 contracts (1.4%) on Friday, which indicates that about one fifth of the open long positions added since May 7th were unwilling to hold them over the

long weekend. If open interest continues to contract this week, below its moving average, it would indicate that the bulls have given up and would clear the way for more near term weakness in long dated Treasury prices.

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3. **Intra-market Analysis (The NOB Spread): NEAR TERM BULLISH FOR PRICES.** The NOB Spread is 10-Year Notes over T-Bonds (Notes Over Bonds) and is a coincident or leading indicator of market direction in long-dated Treasuries. More specifically, as the NOB spread narrows long-dated Treasury prices rise, and as it widens Treasury prices decline. Since the beginning of the month the spread has been testing a multi-year wide extreme (see chart in our [May 4th Keys To This Week](#)) which had previously coincided with or led important bottoms in long dated US Treasury prices in January 2000, March 2002, August 2003, May 2004 and October 2008. These data suggest that both 10- and 30-year Treasury prices are either at or near another equally significant bottom now.

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4. **Intermarket Analysis (US equity prices): NEAR TERM BULLISH FOR PRICES.** The yield of the 10-Year US Treasury Note has been 86% positively correlated to the S&P 500 since December 2006 as investors have been interpreting the level of US equity prices as a barometer of US economic health. In our **US Stock Market section** above, we point out favorable conditions for a near term decline in US equity prices. If this decline materializes, and the 27-month relationship between US equity prices and US interest rates remains intact, then this should put near term upward pressure on long dated Treasury prices.

5. **Major Underlying Support: INTERMEDIATE TERM BEARISH FOR PRICES.** Most US Treasury-related securities in the 10- to 30-year maturity category broke down through major price support last week, while rising above major overhead resistance levels in yields. This indicates that a major trend change is taking place, toward rising long term US interest rates. These major levels are listed below.

- o **CBOT T-Bond contract (US):** 123-21 to 121-25 underlying support represents the 200-day moving average (123-21), the 61.8% retracement of the October to December rally (122-07) and the September 2008 peak (121-25). **This level was broken on last week's decline.**
- o **CBOE 30-Year T-Bond Index (TYX):** 42.60 overhead resistance represents the June 2007 downtrend line (indicating declining yields). **This level was broken on last week's decline.**
- o **iShares 20+ Year Treasury Bond Fund (TLT):** 94.60 underlying support represents the July 2007 uptrend line. **This level was broken on last week's decline.**
- o **iShares 10-20 Year Treasury Bond Fund (TLH):** 112.23 to 110.60 underlying support represents the September 2009 benchmark high (112.23), the 200-day moving average (111.92), and the 61.8% retracement of the November to December 2008 rise (110.60). **This level was broken on last week's decline.**
- o **CBOT 10-Year Note contract (TY):** 118-14 to 115-02 underlying support represents the 200-day moving average (118-14), the September 2008 benchmark high (115-21), and the 61.8% retracement of the October to December rally (115-02).

- o **The Yield of the 10-Year Treasury Note:** 3.18% to 3.34% overhead resistance represents the 200-day moving average (3.19%), the 61.8% retracement of the October to December 2008 decline in yields (3.31%) and the the March 2008 yield low (3.34%). **This level was broken on last week's decline.**
- o **CBOE 10-Year T-Bond Index (TNX):** 34.57 to 35.83 overhead resistance represents the 61.8% retracement of the June 2008 to January 2009 decline (34.57) and the June 2007 downtrend line (35.83, representing declining yields)..
- o **iShares 7-10 Year Treasury Bond Fund (IEF):** 93.16 to 91.77 underlying support represents the 200-day moving average (93.16), the March and September 2008 benchmark highs (92.59), and the 61.8% retracement of the October to December 2008 rise (91.77).

6. **Credit Spreads (10-Year, 5-Year TIPS Spread): NEAR TERM BULLISH FOR PRICES.** The 10-Year TIPS Spread (the yield of the 10-year Treasury Note minus the yield of the 10-year Treasury Inflation Protected Security, upper panel of **Chart 4** below) is at a quarterly overbought extreme (red line, lower panel) which has previously coincided with or led *every one to several month period of narrowing* in recent history. A narrowing TIPS Spread indicates *lessening* fears by investors concerning inflationary pressures, which has historically coincided with a *decline* in long term US interest rates. If the TIPS Spread narrows from here as expected, and its tight 78% positive correlation to US 10-Year yields since 2003 remains intact, then we should also see a coincident rise in long dated US Treasury prices.
7. **Overbought/Oversold: NEAR TERM BULLISH FOR PRICES.** Through Friday, long dated US Treasury prices remain technically oversold from both a *near term* monthly and *intermediate term* quarterly perspective. This establishes favorable conditions for a multi-week to multi-month rally, and probably before prices move significantly lower.
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8. **Investor Sentiment: NEAR TERM BULLISH, INTERMEDIATE TERM BEARISH FOR PRICES.** Through Friday, the latest data according to professional and retail investors is equally split between bullish and bearish indications. However, this seems to be more of a time frame issue rather than an indication of market indecision, and suggests favorable conditions for a near term rebound in long dated Treasury prices now -- within a more intermediate term decline.
9. **Seasonal Trend: NEAR TERM BULLISH FOR PRICES.** May and June, the 5th and 7th seasonally strongest months for *the yield of the 10-Year Treasury Note* since 1957, represent a *two-month seasonal setback* (and a coincident *rebound* in prices) within a larger trend of seasonal strength in yields than runs from January through July. (The latest *monthly and intra-month* seasonal patterns for **17 different global financial markets** are available in our **May 8th Global Seasonal Analysis** report.)

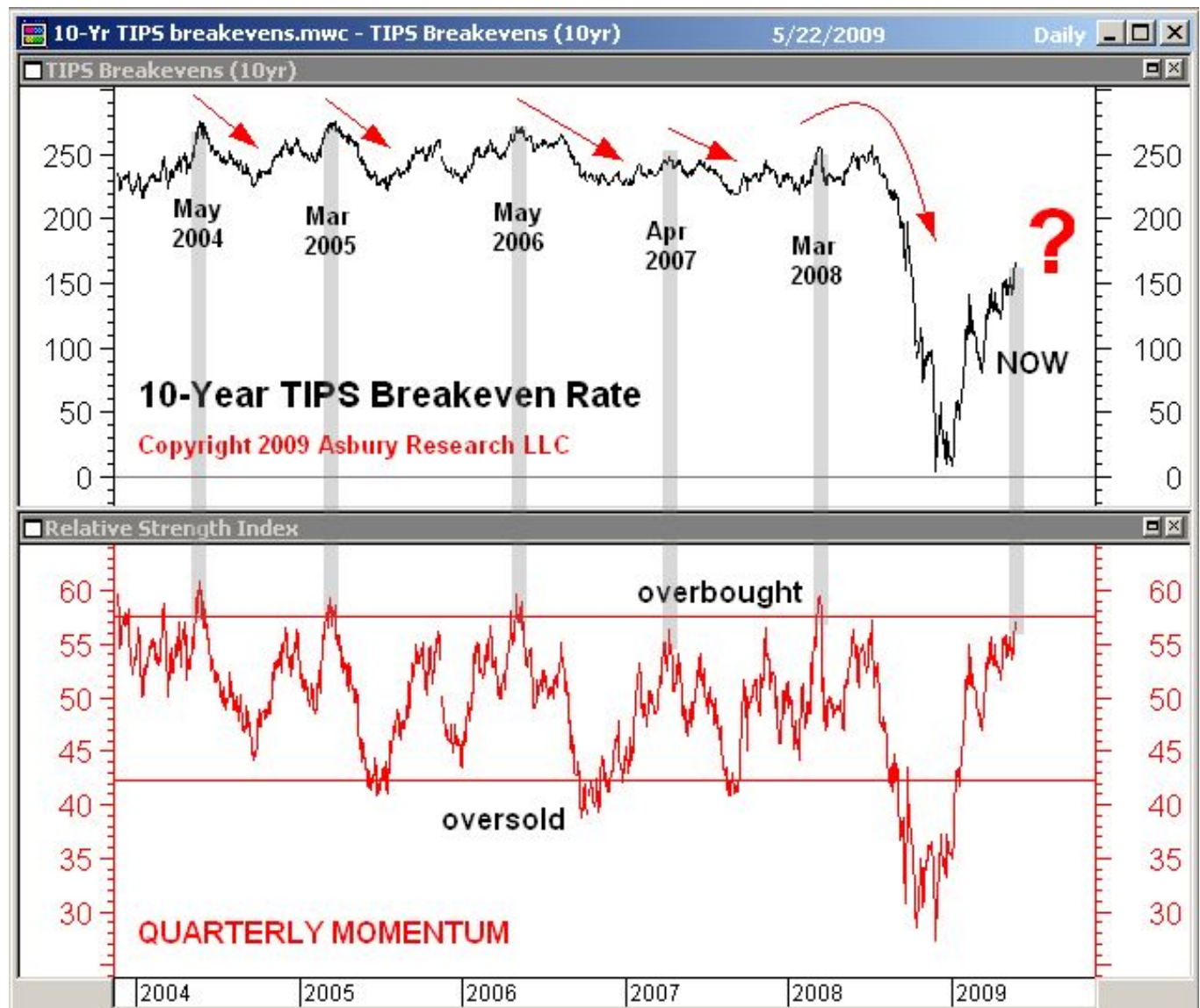


Chart 4

The US Dollar

Last week, we said: "...all of our Near Term Factors are Positive for the US currency except for near term market momentum, which is in the Near Term Negative category. This alignment suggests ideal conditions for a near term rebound in the Dollar, but indicates that the rally hasn't begun yet. The most influential of this week's factors are likely to be the yield of the 10-Year Note, which has been 65% inversely correlated to the US Dollar Index since 2008, and the S&P 500, which has been 85% inversely correlated to the US Dollar

Index since October 2007. As long as near term momentum remains negative in the S&P 500 (see The US Stock Market section above), and remains positive in long dated US Treasury prices (see the US Interest Rates & Treasuries section above), then the US Dollar should also eventually rise as investors migrate out of equities and into "safer" assets. However, we also note that the longer the US Dollar Index remains below major underlying support at 84.18 to 83.41, the more likely that this upcoming rally will be brief and corrective in nature. (Note: The US Dollar Index is an index of the exchange rates of six non-US currencies versus the greenback that is heavily weighted toward Europe.)"

This week, there was a pretty noticeable migration of key factors *moving into* the Intermediate Term Negative category. Perhaps the most important of these was last week's decisive breakdown through major support in the US Dollar Index. **Although oversold extremes and the latest investor sentiment data continue to suggest that an extended decline in the US currency is unlikely from here without a rally first, last week's breakdown suggests that this rally, once it inevitably takes place, is likely to be corrective in nature and should lead into a deeper decline.** Intermarket analysis also continues to be a major factor in US Dollar direction this week as it would probably take a decline in *inversely correlated* US equity prices, *which is overdue*, to chase enough investor assets back into the relative safety of the US currency to facilitate a rally. (Note: The US Dollar Index is an index of the exchange rates of six non-US currencies versus the greenback that is heavily weighted toward Europe.)

US DOLLAR			
	POSITIVE FACTORS	NEGATIVE FACTORS	
NEAR TERM (one to several weeks)	INTERMARKET: US STOCKS	NEAR TERM MOMENTUM	FOR THE WEEK OF MAY 25, 2009
	INTERMARKET: THE CRB & COPPER		
	INVESTOR SENTIMENT		
	OVERSOLD		
INTERMEDIATE TERM (one to several months)		INTERMEDIATE TERM MOMENTUM	
		INVESTOR SENTIMENT	
		OVERBOUGHT	
		SEASONAL TREND	
		INTERMARKET: GOLD	
		MAJOR SUPPORT: BEING BROKEN	
KEYS TO THIS WEEK			

1. Market Momentum: **NEAR TERM, INTERMEDIATE TERM DOLLAR BEARISH.** Through Friday, both *near term* daily and

intermediate term weekly momentum remained *negative (bearish)* in the US Dollar. It would take a positive shift in near term momentum to indicate that the rebound the greenback is due for has begun.

2. **Intermarket Analysis (US equity prices) NEAR TERM DOLLAR BULLISH.** The S&P 500 has been *85% inversely correlated* to the US Dollar Index since US equity prices peaked in October 2007 as investors have been viewing the US currency as a relatively safe place to hide when global stock market prices are declining. In our **US Stock Market section** above, we point out favorable conditions for a near term *decline* in US equity prices. If this decline materializes, and the 17-month relationship between US equity prices and the US Dollar Index remains intact, then this should put near term *upward pressure* on the US currency.

3. **Intermarket Analysis (copper prices and The CRB Index): NEAR TERM DOLLAR BULLISH.** Copper prices are often viewed by investors as a measure of both economic demand and inflationary pressures. As a result, they have been *65% inversely correlated* to the US Dollar Index since 1989, and *74% inversely correlated* over the past decade. The CRB Index, an un-weighted geometric average of 17 commodity futures markets, is seen as a barometer of market-based inflation and, as such, has been *69% inversely correlated* to the US Dollar Index since 1991. For the past three weeks both the COMEX copper contract and the CRB Index have been testing major overhead resistance at their 200-day moving averages amid ideal technical conditions for *at least* a several week corrective pullback. Per the correlations, If and when this pullback takes place it should coincide with *a rise* in the US currency.

4. **Investor Sentiment: NEAR TERM DOLLAR BULLISH, INTERMEDIATE TERM DOLLAR BEARISH.** The latest professional and retail investor sentiment data are divided between bullish and bearish indications, but this appears to be a time frame issue rather than an indication of investor uncertainty. These data suggest favorable conditions for a near term rally in the US currency now -- within a more intermediate term decline.

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5. **Overbought/Oversold: NEAR TERM DOLLAR BULLISH, INTERMEDIATE TERM DOLLAR BEARISH.** Through the end of last week, the US Dollar remained technically oversold on a *near term* monthly basis, but was still in the process of working off April overbought extremes from an *intermediate term* quarterly basis. This suggests favorable conditions for a near term rally now or soon, within a larger intermediate term decline.

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6. **Seasonal Trend: INTERMEDIATE TERM DOLLAR BEARISH.** May is the *7th seasonally-strongest month* for the US currency since 1977, and the beginning of a gradually-escalating period of *seasonal weakness* for the Dollar that runs through October. (The latest *monthly and intra-month* seasonal patterns for **17 different global financial markets** are available in our **May 8th Global Seasonal Analysis** report.)

7. **Intermarket Analysis (gold prices): INTERMEDIATE TERM DOLLAR BEARISH.** The COMEX gold contract rose appreciably above major overhead resistance at its 200-day moving average in early February, declined to retest it as

underlying support in early April, and has since begun another leg higher. Considering the long and relative stable *inverse relationship* between gold prices and the US currency, this apparent major bullish trend change in gold prices also suggests that a new sustainable bearish trend change is emerging in the greenback.

8. **Underlying Support: INTERMEDIATE TERM DOLLAR BEARISH.** During the past two weeks the US Dollar Index decisively broken down through major underlying support at 84.30 to 83.41 (see **Chart 5**, below) -- which represents its 200-day moving average (84.30) and the 61.8% retracement of the index's December 18th to March 4th rise (83.41). This indicates that a major bearish trend change has taken place in the US currency.



Chart 5

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