



The Starboard Side Report

The week ending January 29, 2010

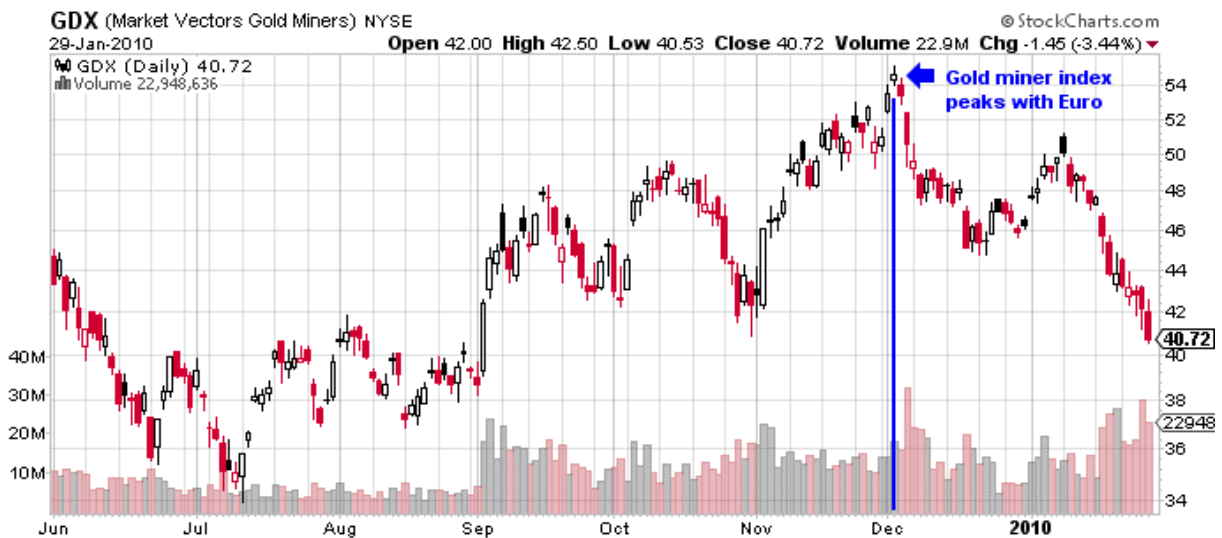
The global market correction gained steam this week and officially reversed the majority of bullish percent indexes back into O's. This means sellers have quickly taken back control of the market from buyers after only a two week run in X's. This dynamic supply-demand relationship is an important part of our technical analysis discipline. We don't know how long this corrective episode will last, but history suggests there is probably more downside risk before the storm blows over. Before we panic, it is important to keep in mind that markets do not go straight-up. Pullbacks are often healthy events that rid the market of weak players and set the stage for more meaningful advances. We believe that the party may be over for some stocks and sectors. However, stronger relative strength asset classes like emerging markets, gold and certain commodities should recover above recent highs at some point during the course of the year.

As we have laid out in past reports, we feel that emerging markets will increasingly become the drivers of global growth going forward. As such, it makes sense to spend extra time analyzing this area of the market. Last week we looked at China, this week we will look at the benchmark index for emerging markets, the iShares MSCI Emerging Markets Index Fund (EEM). During the last cyclical bull market for this index between 2003 and 2007, there were six separate violent correction episodes. On average, these lasted for one month and took 19% off the value of the index (see chart below). Yet, each correction set the stage for a new leg higher that ultimately took the stocks over 167% above the level they stood at the beginning of the first correction in April 2004. This series of "higher highs" and "higher lows" is text book bull market action.



This current episode feels familiar to many of those pullbacks. If it follows a similar path, it means we are about half way through the decline in both time and price. We suspect that this correction will be looked back upon as a buying opportunity, not the start of another collapse like 2008. This will remain our position until we see signs of a relative strength shift out of emerging markets. Relative strength still remains firmly on the side of emerging markets versus the developed world, but if that changes we will try to change with it.

Gold and the precious metals mining sector have had a rough go of it lately. Below we can see that the Amex Gold Miners Index (GDX) has shed 26.84% over the past two months. As with the emerging markets, the bull market in precious metals miners has not been immune to violent shakeouts. Bull markets are always trying to buck-off participants along the way and this decline is no different. One of the major reasons for the struggle in gold of late is the rally that is taking place in the US dollar. Concerns about the fiscal health of Greece are weighting on the Euro (which makes up 65% of the dollar index). Below we see that the peak in the Euro occurred at the exact time that the GDX hit its high on December 1st.



The Euro and gold have been joined at the hip for the past several months now, so the Euro will most likely need to stabilize before the gold market can bounce back. The sell-off has become very overdone on both fronts, so we should at least expect some short-term relief in the days ahead.

One of the warning signs that the emerging markets and the commodity trade were going to implode in 2008 was weakness in the Australian Dollar and the Canadian Dollar. Of all the G7 nations, these two have been the most stable over the past ten years due to their vast reserves of natural resources and relatively stable banking systems. So far, even with the recent commodity sell-off, both these currencies are doing relatively well with up trends still intact. Below is a look at the point and figure chart for each.

Currency Shares Australian Dollar Trust (FXA) NYSE

29-Jan-2010, 16:00 ET, daily, O: 89.38, H: 89.44, L: 88.71, C: 88.71, V: 150778, Chg: -1.00 (-1.11%)
 No New P&F Pattern

Traditional, 3 box reversal chart
 Bullish Price Obj. (Rev.): 126.0

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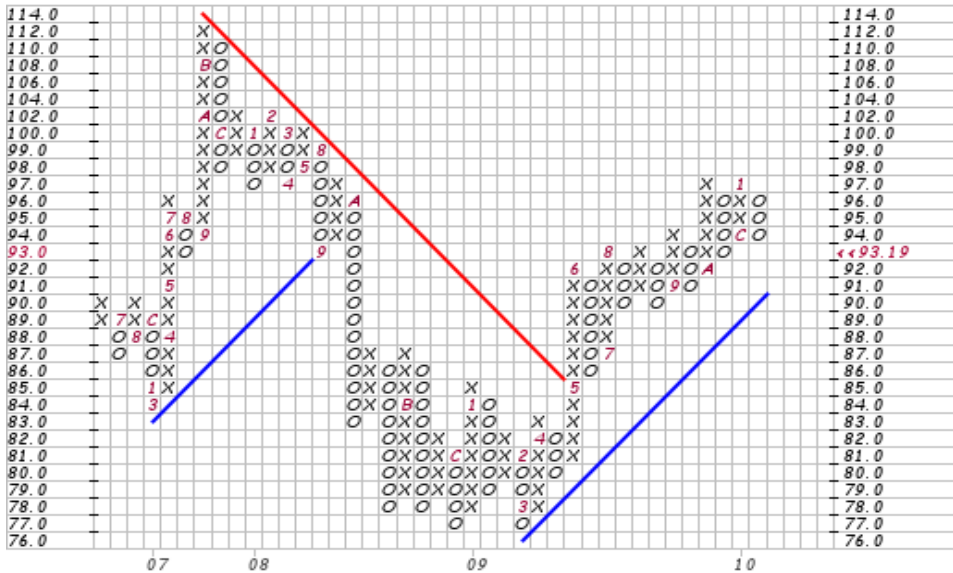


Currency Shares Canadian Dollar Trust (FXC) NYSE

29-Jan, 16:00 ET, daily, O: 93.51, H: 93.71, L: 93.18, C: 93.19, V: 118.4K, Chg: -0.24
 No New P&F Pattern

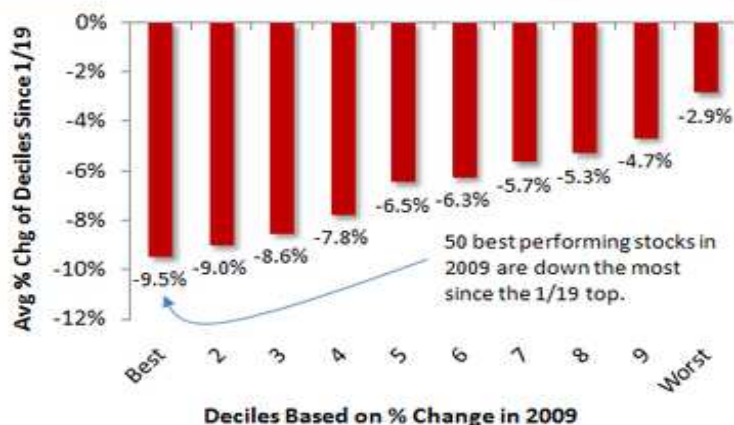
Traditional, 3 box reversal chart
 Bullish Price Obj. (Rev.): Met (96.0)

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Below is an interesting chart from *Bespoke Investment Group* that breaks down the recent correction into deciles based on 2009 performance (S&P 500 only). As we can see, it has clearly been the best performing stocks of 2009 that have been sold down the most over the past ten days.

Decile Analysis Based on 2009 Performance



Base metals are one area that did particularly well last year and as a result were hit very hard this past week. Below is a chart of the Deutsche Bank Base Metals Fund (DBB). The weakness in the commodities is hitting the stocks of the metals producers as witnessed by a 24% decline in the S&P Metals and Mining Index since 01/12/10. This panic selling is being caused by fears of a Chinese economic slowdown.



We commented a few weeks back on our 01-08-10 report that the risk levels in the market were getting to a historically high level and that a more defensive posture was warranted. This correction has not changed that view and has only driven home the point that this year is going to be much more challenging than the last. Prudent risk management and asset selection will go a long way in helping to navigate this more complex environment.