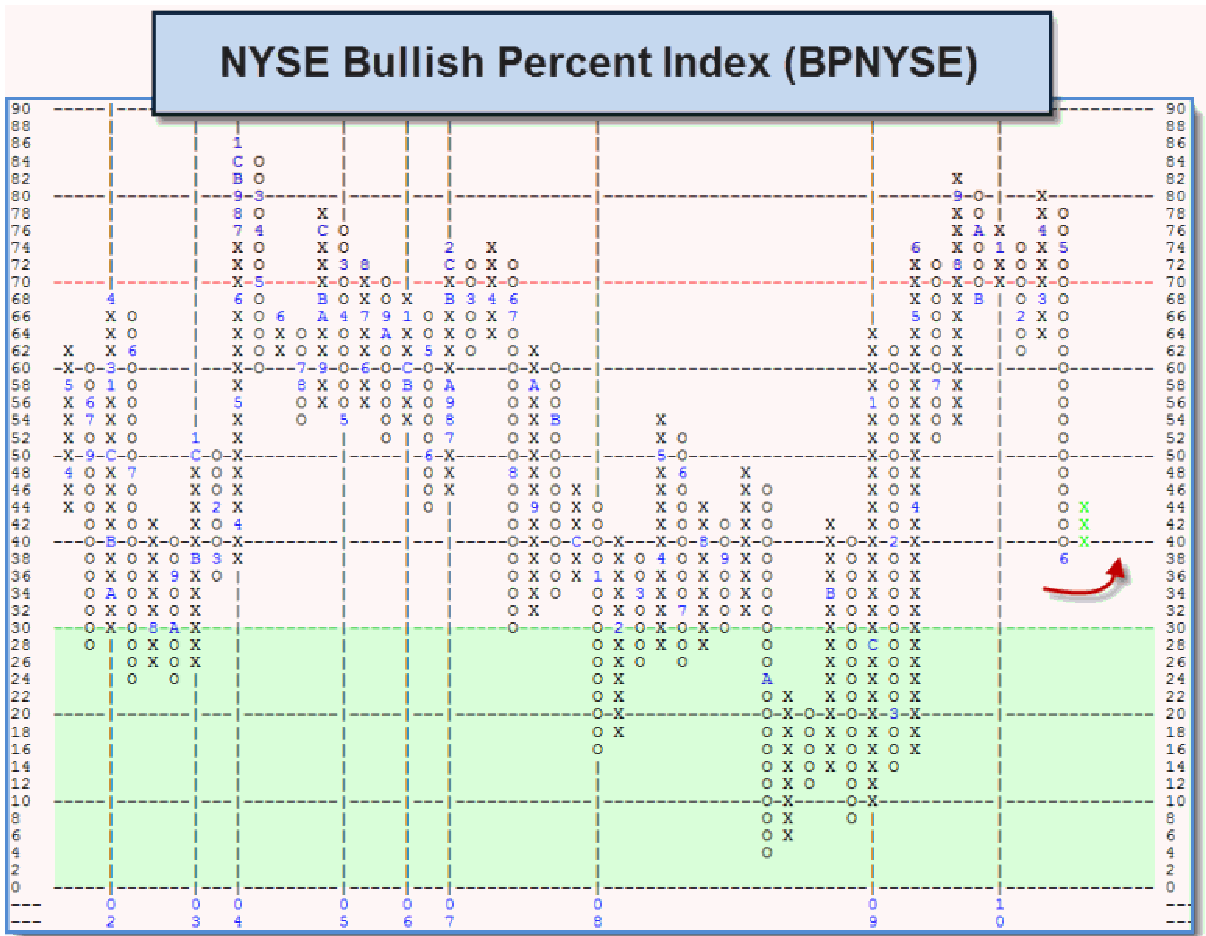




# The Starboard Side Report

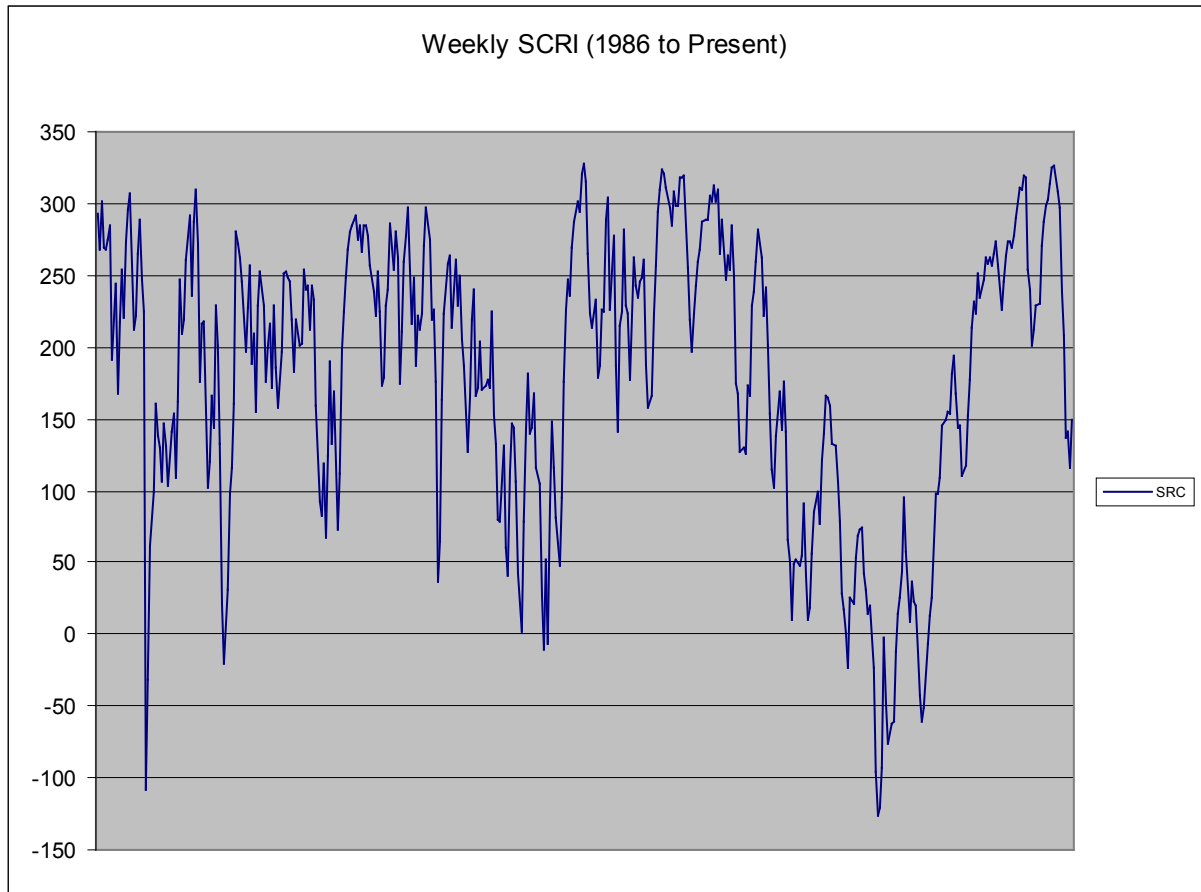
The week ending June 18, 2010

The relief rally that we discussed last week appears to be in full swing and is now being confirmed by our indicators. The NYSE Bullish Percent Index reversed back into X's on Wednesday from a fairly attractive risk level (see chart below). Historically, a reversal from below 40% has been a good time to put the offensive team back on the field and let them run with the ball for a while. We never know how long these rally phases will last, but we are optimistic that we should have at least several more weeks with buyers in control of the market before we consider becoming defensive again. There is no doubt that this is shaping up to be a volatile year in the global markets, but hopefully our risk management toolbox will continue to help us navigate the challenging environment.



Source: Dorsey Wright & Associates

Below is our in-house Starboard Composite Risk Index (SCRI). We highlighted this barometer several times in the first quarter of this year in order to point out the elevated risk in the market. Over the past two months, we have seen the SCRI fall over 200 points and bring risk levels down to more palatable levels for investment. Unless we have a recession, it is rare to see this index fall below the 100 level (it bottomed at 116 last week). As we discussed in our 5/21/10 report, we think that the recent correction was the result of a mid-term election year growth scare, not an imminent recession.



One interesting dynamic of the global economy since the US credit markets imploded in 2008 has been the emergence of China as the driver of worldwide risk appetite. Back in the fall of 2008, China bottomed before everyone else and led the world out of recession on the back of a massive stimulus program. After its stock market doubled in only eight months, China has been going through a long consolidation of those gains. This has partly been driven by the Chinese government's attempt to cool off their real estate market. Looking at the chart below of the iShares FTSE/Xinhua China Index Fund (FXI), we can see that Chinese stocks are at exactly the same level as they were one year ago. Long consolidations like this do not last forever and this will have to be resolved one way or the other. The direction of the break will go a long way towards telling us the kind of environment we are in store for over the next twelve months. While most observers are focused on Europe, we are more attentive to the new leaders of the global economy like China, Brazil and India. It is those emerging powers that we will be watching closely to see what they are telling us about the path ahead and the sustainability of this rally.



**iShares FTSE/Xinhua China 25 (FXI) NYSE**

18-Jun-2010, 16:00 ET, daily, O: 40.63, H: 40.85, L: 40.49, C: 40.67, V: 4934818, Chg: +0.05 (0.12%)

**P&F Pattern** Double Top Breakout on 15-Jun-2010

Traditional, 3 box reversal chart

Prelim. Bullish Price Obj. (Rev.): 50.0

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The FXI point & figure chart just went to a buy signal for the first time since breaking down in January. Incidentally, that breakdown in January was also a key leading indicator of the turbulence that the global markets just went through. Once again, this is an example of China's newfound leadership status.

The buy signal just given on the point & figure chart above may be giving us clues that this consolidation will break to the upside. Should that occur, it would be a good indication that this cyclical economic expansion has more time to go before it runs out of steam.

Below is a chart of the S&P 500 showing the initial recovery phase of the last cyclical bull market from the depths of despair. The highlighted box shows a similar consolidation to the one that China has just gone through. This is a good example of gains needing to be digested after a big move higher. This chart pattern was ultimately resolved to the upside after a very tumultuous year of back and forth trading in 2004.

