Market Analysis | Daily Commentary

Epiphany Equity Research
"Setting the standard for technical analysis"

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Monday, January 2, 2006

That's a Wrap!

The year comes to an end with a whimper.

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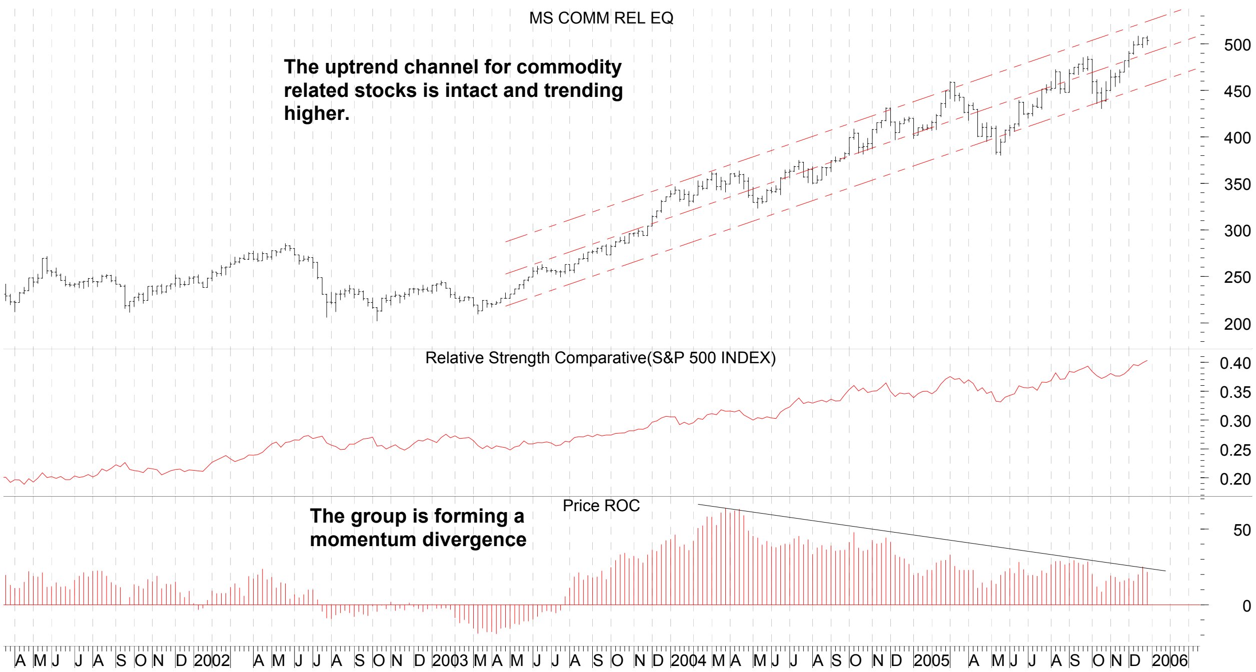
- The market ends the week without its seasonal rally.
- Negative divergences remain a problem as a new year gets underway.

Let's just take few minutes to sum it all up. The major indexes finished the year mixed: The S&P 500 gained about 3% the NASDAQ 1.3 % and the Dow Industrials had a fractional loss. That isn't exactly a banner year and is reflective of just how difficult the year was and the need to have been in the right sectors and stocks at the right time.

With 2005 behind us we find the market in a precarious position. Our concerns and reason for using the term precarious are based on the deteriorating internals the market has been displaying. Over the short-term, the market has been able to ignore these issues but they are still there and have only grown worse under the guise of strength from the major indexes. Without the help of the seasonal strength these issues may begin to have more of an impact. There has been a narrowing of participation and what leadership that exists is based in commodity and industrial stocks as well as precious metals. A rally in gold and having this group as leadership isn't exactly the best way for the market to move higher. Beside the fact there are only metals related stocks, of which 100 are gold, that isn't exactly a way to get broad based price participation. Also the rally in gold is suggestive of inflation or some kind of economic crisis. Either way it isn't good.

The rally may last a bit longer but we don't see how these issues will be resolved favorably at this point and as such continue to view the market action with one with increased caution and suspicion. The lack of a Santa Claus rally didn't warm our hearts either. When the market doesn't do what it should that usually is a negative sign. There may in fact be some strength to start the year as many participants did some selling in anticipation of January weakness. There is historic precedence for this as well as typically a down week in the last week of December is, more often then not, followed by a strong first weak of January. The first few days of the year are usually positive and the direction of the first trading week of the year is typically telling of the prospects for the rest of the year. These first few days and weeks of trading will be more important then usual.

We can speculate more about what might happen but won't. The prudent thing to do is to see how the year begins and take our queue from there.



Morgan Stanley Commodity Related Index (.CRX) Monday, January 2, 2006

My pick for the 1st quarter…Commodities.

Commodity related stocks are my pick for 1st quarter performance.

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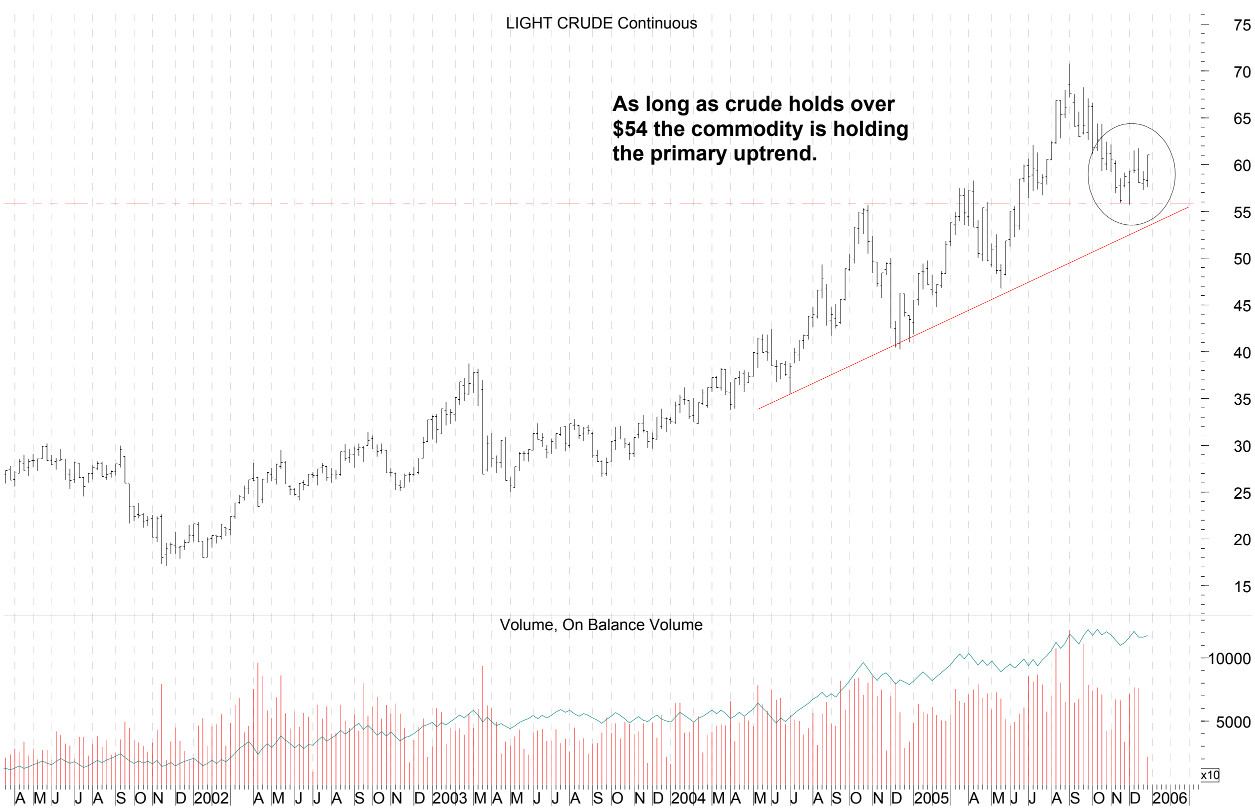
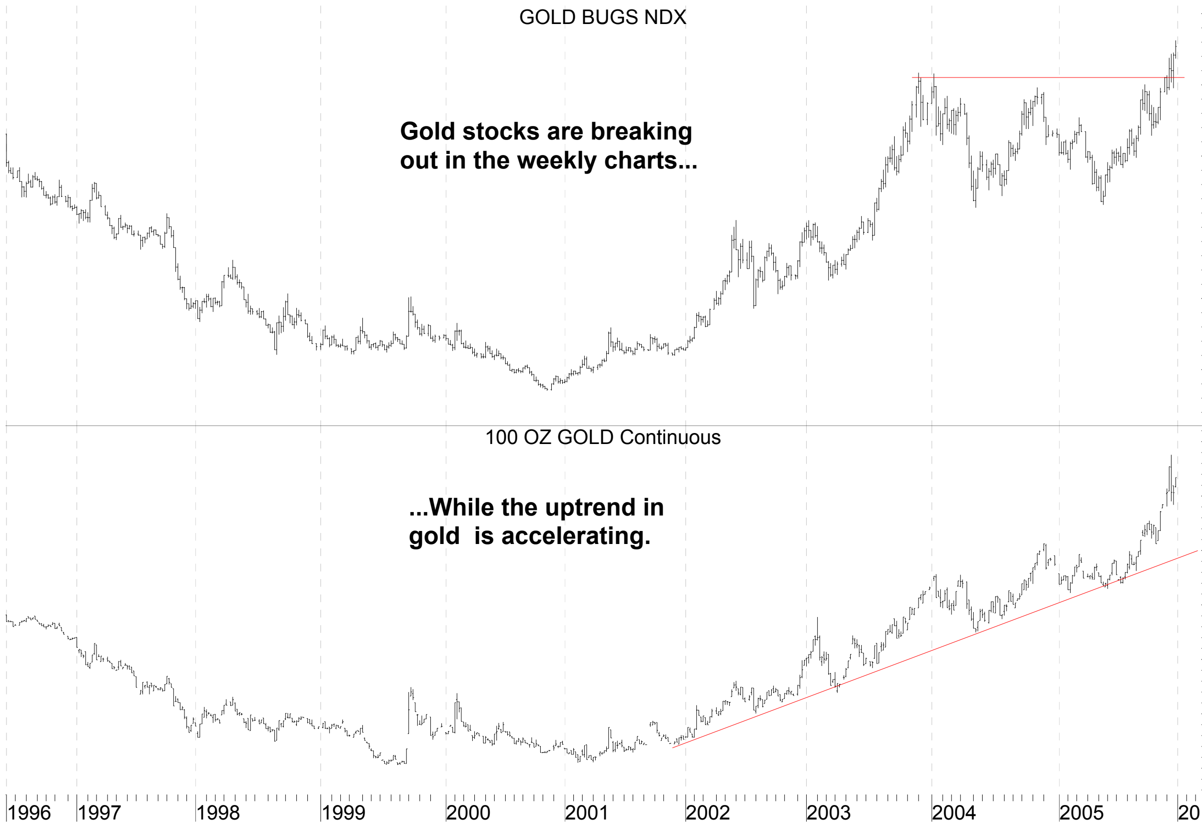
The first quarter should be tricky and hard to make an early call on. None-the-less here is my best shot at a group that can put some points on the board. The commodity related stocks are looking like a high probability trade in the first quarter of the year. The sector is still feeling the wind at it's back as oil, gold and the CRB index remain in primary uptrends. We should see the upward momentum of the sector carry through the early part of 2006.

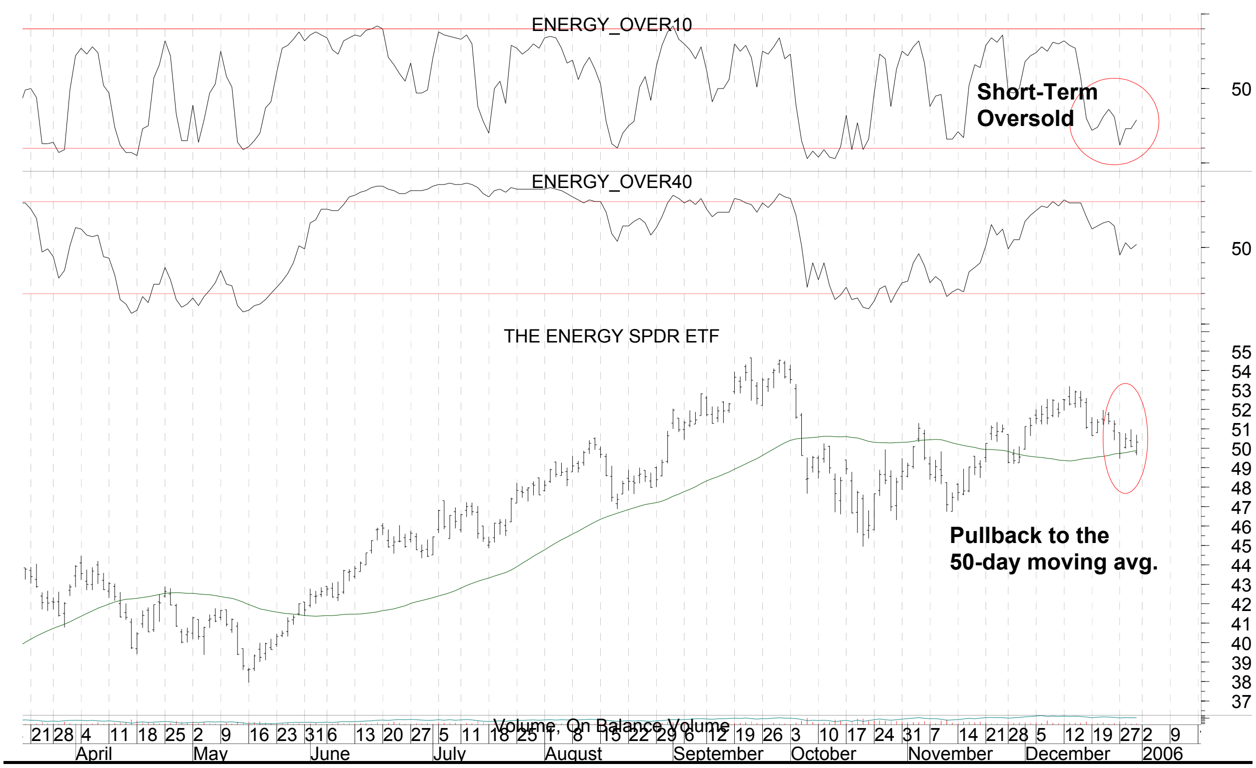
Crude oil appears to be completing a corrective phase that could take oil stocks higher as the commodity recovers. Gold stocks are also acting very strong and have moved out of a weekly consolidation formation. Oil stocks should be more sensitive to broader market conditions since energy has become a central theme in many portfolios and money managers will cover profitable trades if the market weakens, but gold may be a win-win if the market rallies or fails going forward. The gold sector is under-owned, it's in a strong bullish trend, and it's also defensive in times of market weakness. This is a good combination and the group should be bought on any weakness. We have already seen the metals outperform this month and they are leading the market in the 10 & 40-day periods.

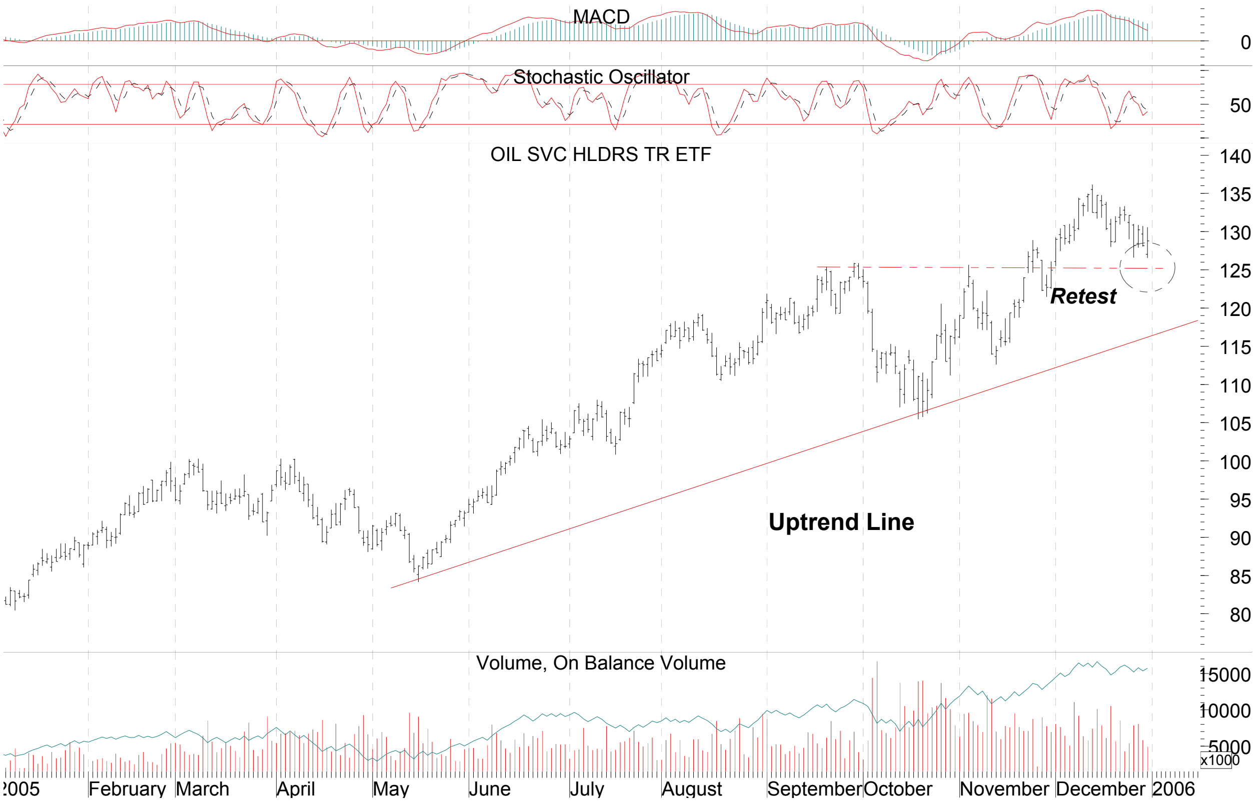
The commodity theme is still strong and intact but notice the diverging momentum indicator in the Morgan Stanley commodity related stocks index. This divergence tells us that it may be late in the game and a significant rally from these levels may be the "blow off" move. Look for the commodity related stocks to give you the best opportunity at a first quarter rally but don't look for much more than that at this point. The wind is at your back in this sector but the momentum divergences suggest that you should take the money and run.


COMMOD RSRCH BUR INDEX
The long-term chart for commodities remains very bullish as it continues to hold the long-term uptrend line.


LIGHT CRUDE Continuous
As long as crude holds over $54 the commodity is holding the primary uptrend.
Volume, On Balance Volume

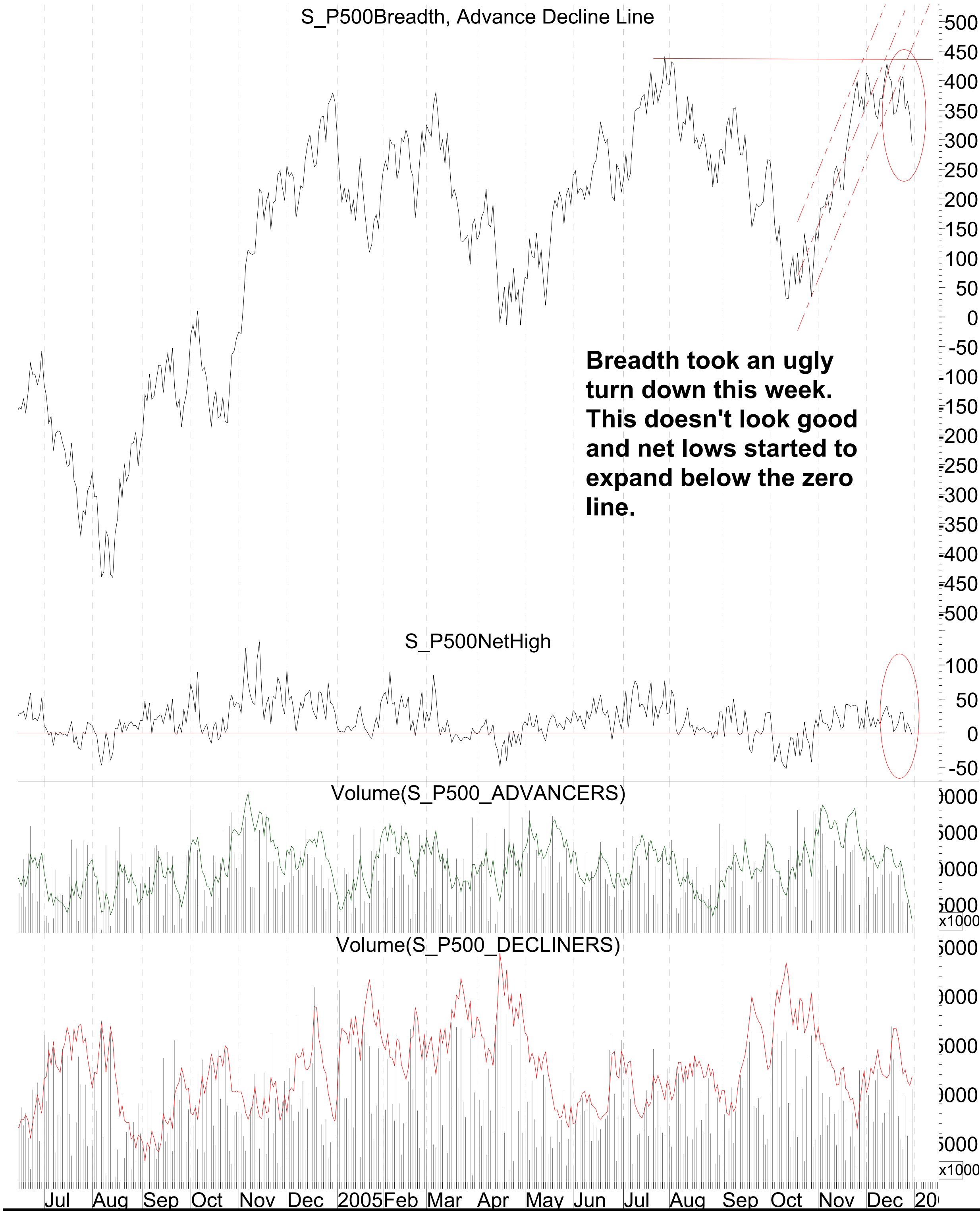

GOLD BUGS NDX
Gold stocks are breaking
out in the weekly charts...
250
200
150
100
50
100 OZ GOLD Continuous
...While the uptrend in
gold is accelerating.
550
500
450
400
350
300
250
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
20


ENERGY_OVER10
Short-Term
Oversold
50
ENERGY_OVER40
50
THE ENERGY SPDR ETF
Pullback to the
50-day moving avg.
55
54
53
52
51
50
49
48
47
46
45
44
43
42
41
40
39
38
37
Volume, On Balance Volume
April
May
June
July
August
September
October
November
December
2006

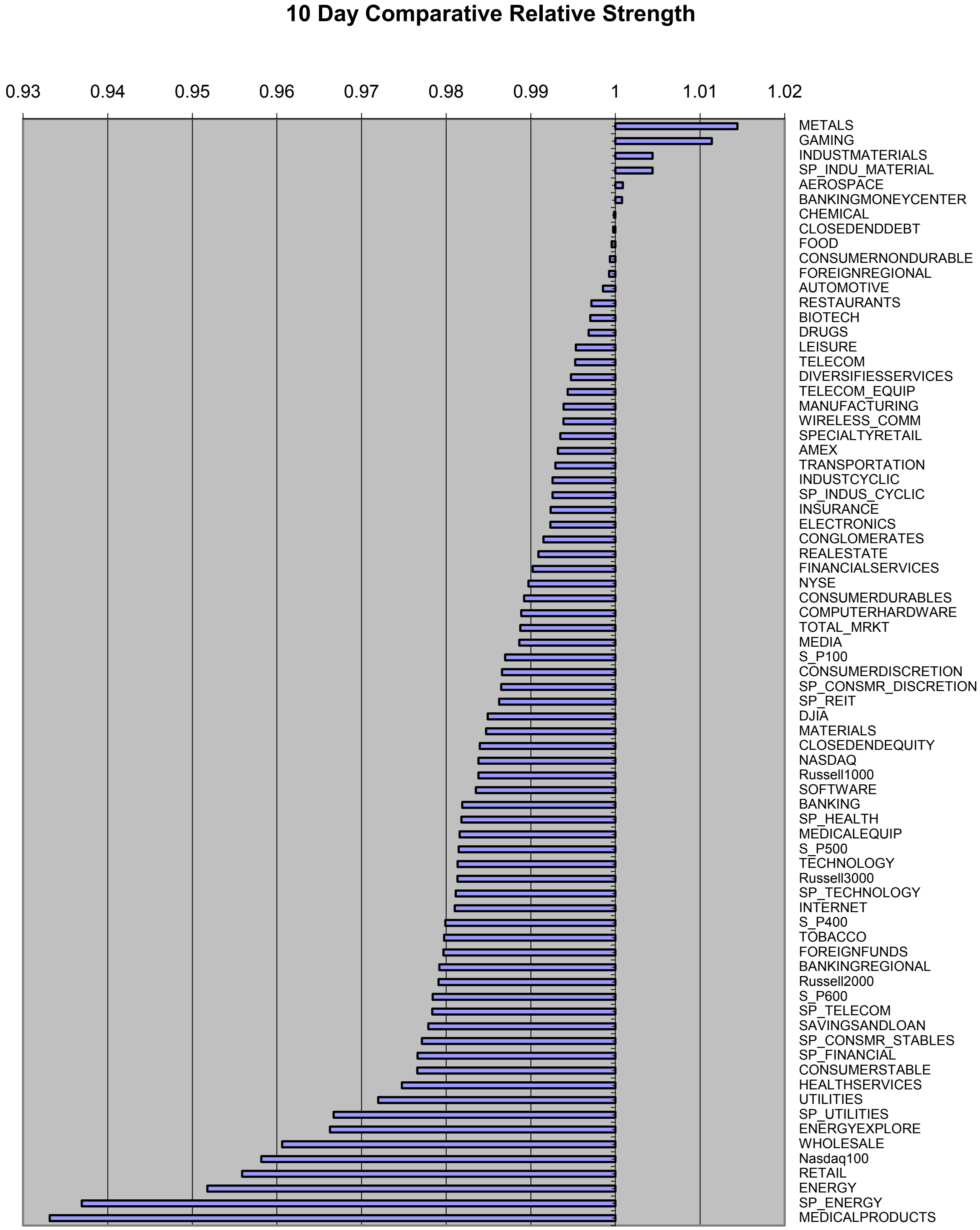

MACD
Stochastic Oscillator
OIL SVC HLDRS TR ETF
Retest
Uptrend Line
Volume, On Balance Volume
2005 February March April May June July August September October November December 2006


ENERGY_Breadth, Advance Decline Line
Breadth is still bullish
for the energy sector and the
uptrend channel is
intact.
ENERGY_NetHigh
Volume(ENERGY_ADVANCERS)
Volume(ENERGY_DECLINERS)

S&P 500 Index | Breadth, Net Highs, & Adv-Dec Volume



10 Day Comparative Relative Strength



40 Day Comparative Relative Strength