



Weekly Technical Report

18-01-2010

Nifty 5252.20 (0.14 %)

Sensex 17554.30 (0.08 %)

Last week, it was argued that “The break of 17735 / 5300 did not appear decisive, as Indices reacted lower immediately thereafter ... leaves a question mark on whether we should drop the ‘b’ label for the post-15331 / 4550 rally. It would be better if we wait another week before doing that ... This is thought to be a better approach not only because 17735 / 5300 is indeed a crucial price level, but also because initial part of ‘Jan is always a crucial time zone.” For the second week, a stock-specific trading approach was found to be more appropriate.

The week saw the markets opening on a high note, almost hitting levels beyond the crucial 17735/ 5300-mark, only to lose nearly 500 / 150 points thereafter, hitting 17276 / 5169 by Wednesday.

The weakness found some support near previous resistance (Nov/Dec highs) at 17300 / 5170, from where, Indices bounced a bit towards the end of the week, and closed flat.

Stock-specific approach got justified as Small-Cap Index finished 3% higher. IT Index reversed and gained 9% for the week. Bank and FMCG Indices proved losers, down by 2% each.

The movement formed a somewhat bearish pattern on the Weekly chart, indicating a stalling action for the Indices, and decisiveness at higher levels. **Control of the market can shift to the bears if we see weakness continuing below previous week’s lows i.e. 17226 / 5169.**

Market has been going through sectoral rotations, when Indices themselves appears stalled at the current levels. While on the upside, it attracts selling near May’08 high of 17735 / 5300, on downside, it appears attempting to hold highs of ‘Nov and ‘Dec, near 17300 / 5170.

As mentioned earlier, the initial part of ‘Jan is always a crucial time zone. The year-wise percentage corrections seen from ‘Jan highs are as follows :

9th Jan’2002 : 5.5%

10th Jan’2003 : 15%

9th Jan’2004 : 32%

4th Jan'2005 : 9.5%

9th Jan'2006 : 5.5%

4th Jan'2007 : 5.5%

10th Jan'2008 : 64%

7th Jan'2009 : 23%

This year, i.e. '2010, the correction has been only 2.9% so far. **The drops still appear measured, and not alarming**, at least so far. **Downside acceleration or violent action below last week's low 17276 / 5169 will be required to stay with the bearish possibilities.**

Structure-wise, we can continue to mark the move post-15331 as a "b" leg, because time-wise, wave-b in a Flat can be 5-7 times than wave-a, only beyond which it becomes suspicious

The treacherous progress of 'b' has been despite the net FII inflow of nearly Rs.20700 crs. during its formation. **Strong move above 17800 / 5320 would cancel out bearish assumptions.**

As for the overall market, as represented by the Sensex and Nifty, it may be a crucial juncture.

Going by our 3-month old arguments:-

- (1) The PE ratio is touching maturity level under normal conditions of the market
- (2) Sensex and Nifty has doubled from their respective bottom levels
- (3) The main buying force, i.e. FII investment, has been generating reducing returns
- (4) Oscillators are on -ve Divergence.
- (5) On the Monthly chart of markets, the current rally has a questionable base-line, as a result of which, markets are virtually trading at the same level since last six months.

Caution after 115% rally in 8 months

if we compare last two rallies out of major downswings (which saw near-60% erosion in valuation), during '2003 and '2009. Both rallies are similar in terms of the time consumed and gains registered, both gaining about 115% in about 8 months and both making a similar structure called "Elongated Flat"

On its maturity, the '2003 rally got retraced by 60% in 60% time, dropping to 4227 / 1292 before the next move. **If the current rally matures at the current levels, it could also show a 60% retracement (11850 / 3650) by May'2010.**

Will the history repeat itself? Whether this happens or not, we need to be cautious on this front.

Markets maturing near current levels would also support our argument that market usually corrects after doubling. Ratio of 200% can be seen even for all the first rallies coming out of bear phases.

- After a 24-month bear phase during 1986-88, Sensex doubled from 390 to 798 and went into sideways consolidation for about a year before moving further up.

- After a 13-month bear phase during 1992-93, Sensex doubled from 1980 to 4643 and went into sideways consolidation for about four years before IT bubble happened in 2000.

- After a 39-month bear phase during 2000-03, Sensex doubled from 2904 to 6250 and saw a quick 60% retracement before resuming the bull phase further.

Current levels are about twice the value of 'Mar low of 8047 and 2540.

Nifty PE Ratio

We also explained our PE Ratio argument previously. While 28 appears to be the highest PE Ratio during the last two 8-year cycle tops, 22-23 appears to be the highest level otherwise under normal conditions. The lowest levels of PE Ratio are close to 11.

As we have been arguing that the maximum figure of 23 is seen under 'normal' circumstances. Only bubbles can push it higher towards 28. Such bubbles happened during '2000 and '2008, which were 8-year cycle tops. It takes 8 years to build a bubble. Bubbles have never been seen in two consecutive years.

Currently, as of last Friday, the PE ratio is at 23.46.

However, a sustained trading above 17800 / 5320 would bring in the alternative scenario suggesting what went down from 17493 / 5181 and ended at 16577/ 4944 two weeks ago was an "x" wave.

Under this alternative scenario, the 2nd wave can take the Markets beyond 17800 / 5320. As per this bullish scenario the size of 2nd leg would be about 5-6 months with a value target of 61.8% of the 1st leg. This would calculate to 22000 on Sensex and Nifty on 6500 by May'2010.

Holding 15500-16000/ 4750-4700 by 'Feb could be bullish as explained above.

Such a scenario would create a bubble-like situation in terms of valuation (PE Ratio). Our earlier analysis will accordingly need to be modified for upsides targets of 18100 / 5360 , 18450 / 5500, 18900/ 5750 before they reaches 22000 / 6500.

The larger picture

Our markets, remember, has seen multifold rallies, each time continuing for about 4 years, after which, it usually enters a multi-year consolidation phase.

Sensex rallied 10-fold from 390 (Mar'88) to 4546 (Apr'92) in four years, after which it consolidated for 11 years from '1992 to '2003.

In '2008 we completed another 4-year rally from '2003, during which Sensex went up 7-fold from 3000 levels to 21000. It may now consolidate for number of years, beginning '2008, preferably forming as a Triangle, having completed its "A" and "B" legs.

As we have been saying for a long time, the suspected Triangle would be completed in 3 to 5 years (by '2011 or '2013).

Alternatively, if we see the market rejecting the bearish implications at current levels, we may see this multi-year consolidation taking shape of a large decade-long consolidation, looking similar to the consolidation we saw from '1992 to '2003.

In such a case, it will be a longish affair, and we shouldn't be surprised to find the Sensex still languishing at 10000-15000 levels during '2018-19, 10 years from now.

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