



Weekly Technical Report

25-01-2010

Nifty 5036.00 (-4.12 %)

Sensex 16859.68 (-3.96 %)

Last week, it was argued that “The bar pattern on the Weekly chart is indicating a stalling action for the Sensex and Nifty, and decisiveness at higher levels Control of the market can shift to the bears if we see weakness continuing below this low of 17226 / 5169... **Downside acceleration or violent action below last week’s low 17276 / 5169 will be required to stay with the bearish possibilities...**”

Indices exactly did the same, by accelerating downside violently; Indices broke the previous week’s lows and finished almost 4% lower for the week. While all sectors ended lower, the Realty-CapGoods-OilGas-Healthcare indices lost 6% or more.

The daily action formed a Hammer like candle with a long lower shadow. The shadow indicated bouncing action, as some of the shorts covered on profit booking, as we suspected near our target area of 16600 / 4950. It may also be indicating some buying at lower levels. However, for us, the bias remains negative (Sell on Rallies) since our upside level were not crossed.

The weekly action formed the largest bear candle for three months, which broke lows of last three weeks. The bias, therefore, remains negative on daily charts and even on weekly charts. Monthly bias is positive but will turn negative below 16577 / 4943.

Last week’s low of 16608 measures as 7% cut from 6th Jan high of 17790. History has shown a minimum cut of 5.5% from initial highs during every ‘Jan. That historical requirement has been satisfied.

We should remember that 5.5% is minimum; actual can even be more. Once the indices trade below 16577 / 4943, they would seek a downside of 16200-300 / 4800-4850.

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.

These arguments have ensured that whatever euphoria we witnessed in the market was limited only to selective individual stocks. Overall markets are oscillating around 16000 / 5000 levels for last eight months since Jun '09.

Need to be cautious was already there 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 22.24 (against 23.46 last Friday).

Mail your comments and suggestions at – kuldip@ajcon.net

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