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July 16, 2010

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State of the Markets - XXVIII

In the previous edition dtd May 20 2010, we had advocated that a new high suggested by the market players was premature, but select opportunities were calling out for attention. Some of these have been presented to you in the “Flavours” edition while some in the “Chart to watch” edition. Most have done well, some exceedingly so. It is time to re-look at the market as two months have elapsed since the last SOTM update –

The weight of evidence approach

The monsoons are touted as normal. We hope they are, though empirically, end of July is a better time to take a call. So far the deficit in rainfall is between 11 – 16 %. The Govt has bitten the bullet and raised fossil fuel prices. While there has been opposition from the broader section, the tax paying segment knows better. This segment is the relevant factor in stock markets. FII inflows remain positive and a cause for cheer. The domestic markets are out performing the global basket and the rise in oil prices seems NOT to have dented the domestic sentiments. For discerning players, parameters like total market cap to total turnover ratios are now looking better than the recent averages and the open interest (futures only) in the Nifty stocks vis-à-vis their market capitalization seems to indicate a buying bias. For now, the outlook seems optimistic.

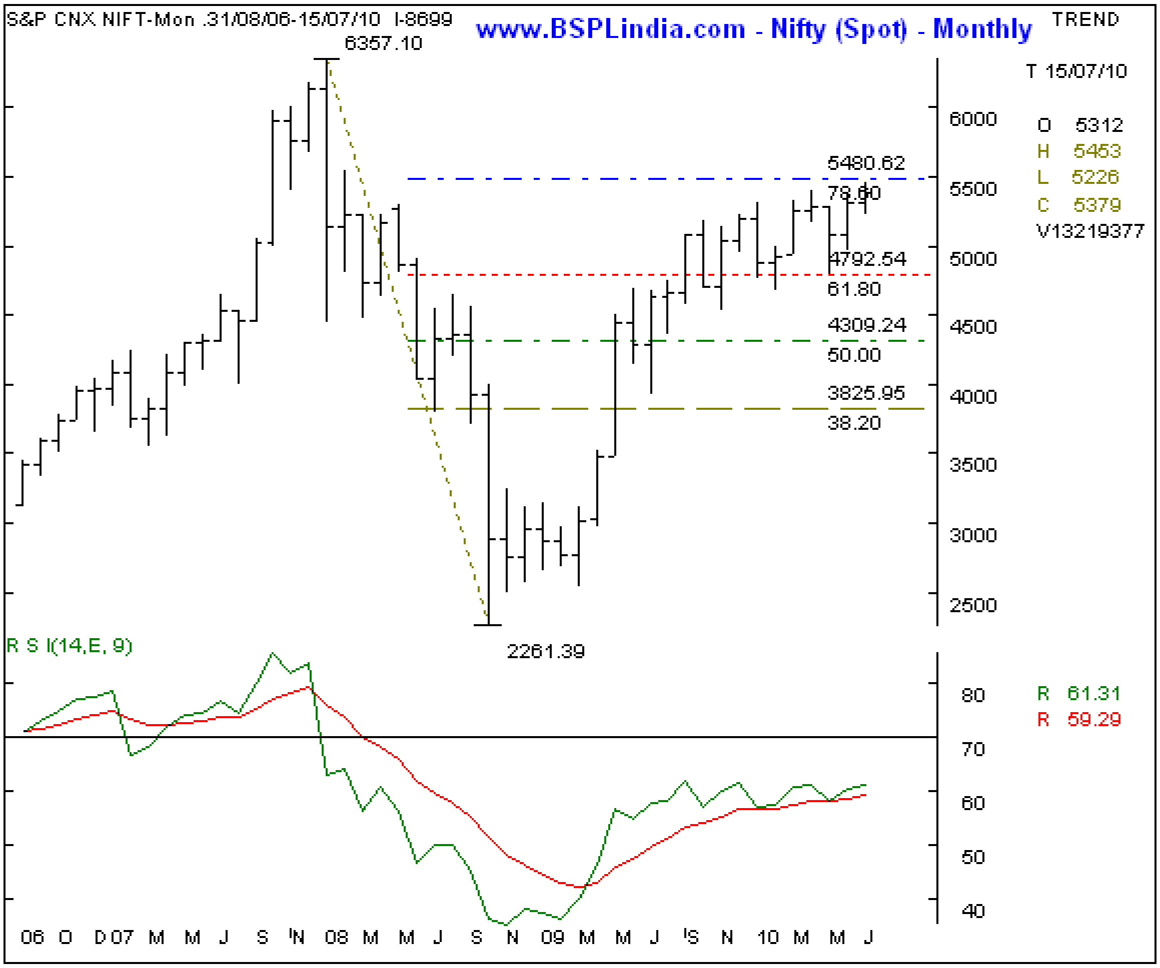
Commodity cues

More often than not, the industrial metals, energy and certain edibles provide a fairly reliable picture of the medium term outlook. Aluminium, Copper, Crude Oil, Lead, Natural Gas, Nickel and Zinc prices seem to indicate some upsides in the industrial activity, which will have a trickle down effect on the stock markets, albeit with a lag effect. On the flip side, Gold and Silver as safe havens are witnessing a profit taking bias, indicating a measured fall in the fear factor in the markets.

Technicals

Note the monthly bar chart of the Nifty below shows a persistent trade above the 61.8 % (Fibonacci golden ratio) at the 4792 levels on the Nifty. It is important that the bulls be able to defend the Nifty 4800 levels on the downsides, to keep the bullish momentum alive and kicking. On the other hand, the last mile resistance is at the 78.6 % (Fibonacci secondary ratio) at the 5480 levels. Should the Nifty manage to trade above this level consistently on a closing basis and bullish commitment is enhanced on the volume and open interest front, expect the next leg of the market upthrust to commence.

In terms of timing, the golden mean of the corrective phase ends in October 2010 and therefore any credible rally around this time would indicate that the overhead supply arising from the “memory effect” is minimal as compared to the attempted upthrusts of 2008 & 2009. Paper has changed hands from the weak to the relatively stronger ones. Should no negative surprises emerge, and this momentum persists, the end of calendar year 2010 can possibly bring positive surprises for the market participants. We will also examine the micro outlook in the coming pages below.



If the above chart shows a broad frame work of the upthrust, note the weekly chart below which gives us the nuts and bolts. <u>As again, we assume that no negative surprises spring up on the markets</u>.

Note a bullish converging pattern on the weekly chart below, which has measuring implications. A divergence is seen on the RSI in the lower window, which may appear as a negative divergence indicator as per conventional studies. However, a breakout above the falling channel will merely act as a confirmatory breakout (Nifty spot level 5535 and above) above which the outlook favours the bulls. What is important is that the bulls must be successful in defending the 5535 levels on a sustained closing basis and a bear period not exceeding 12 weeks, not resulting in a decline below the 5000 Nifty spot be permitted in the bullish scenario hypothesis.

In case a rally around / after October 2010 occurs, the bulls manage a sustained close above the 5550 levels, open interest and volumes are higher on this breakout, it would enable a bullish trader to take higher risks on the upside and possibly gun for the Nifty scaling a new high between May – July 2011 period as per time / price continuum studies.

What will take the markets higher will be the oil & gas, heavy engineering, capital goods, infrastructure, banking & financials and agriculture related stocks. Real estate, technology and interest rate sensitives maybe relative under performers.

Your call of action – <u>if all the conditions of the upthrust are met</u>, we expect the market players to get a reprieve to make good the losses / setbacks incurred in the decline of 2008 and onwards. What is required a focused approach in buying the right stock at the right price and encashing your chips at the appropriate time. We suggest choosing stocks that rise faster than the indices in boom times but fall less than the benchmarks in bear times, with such a performance for atleast 5 years in a row in the immediate past. The probabilities of success are enhanced manifold by sticking to this basic criteria of filtering out under performing counters.

We will continue t update you with our picks from time to time.

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