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Markets have broken out

The Nifty has managed to log it's highest weekly closing (though the week is not done yet) after week ended Jan 11 2008, which was the reversal week for the 55 month old rally. While a re-test of the all time high of 6357 is miles away, the consistent trade above the 5600 levels raises hopes that the 6000 levels will be re-tested or even overcome in the coming months.

Technically, the time wise correction was slated to end around October 2010 (61.8 x 55 months old rally), which can be deemed to have occurred. That the Nifty weekly chart shows a convincing and forceful breakout past the bullish channel-cum-diagonal formation (refer graphic below), is validation of my hypothesis. I had put forth this hypothesis vide our mailer dtd July 16, 2010 (click on the following hyperlink to access the report) - http://bsplindia.com/files/archives/jul10/sotmxxviii.pdf

In order for the bulls to prevail over the bears and retain their initiative, it is important that the Nifty close above the 5600 levels as far as possible and a decline below this threshold be shallow and short lived. Traded volumes should be lower on such a decline and open interest should not rise, or a short buildup maybe suspected. While this checklist seems like a tall order, it is not – bull markets are known to trample over the opposition and a bear squeeze will now be a fair probability. The short covering itself can lend wings to the extent of 2 % on the Nifty in the near term.

As the above graphic illustrates, the downsides are now capped at the 5350 levels in case of an extreme bout of profit taking and / or an unforeseen trigger setting off alarm bells. This is a pessimistic estimate and possibly the 5525 level will be a more realistic support in the near term.

Traders may note that the texture of the market is such that small sized exposure maybe initiated to garner higher profits as the markets are likely to make larger moves. In times of non-trending (flat markets), traders should initiate large positions for smaller gains. Since a "big move" market has arrived, trend following and patient moves are likely to yield big profits.

In terms of sectors, oil and gas, heavy engineering, capital goods, automobiles and select pharmaceutical shares are likely to out perform the broader bench mark indices. Buying is recommended preferably in those stocks which have returned a 100 % higher return than the Nifty gains for atleast 5 years in a row. That will ensure that the market leaders and out performers alone are purchased.

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