

Walter Deemer's

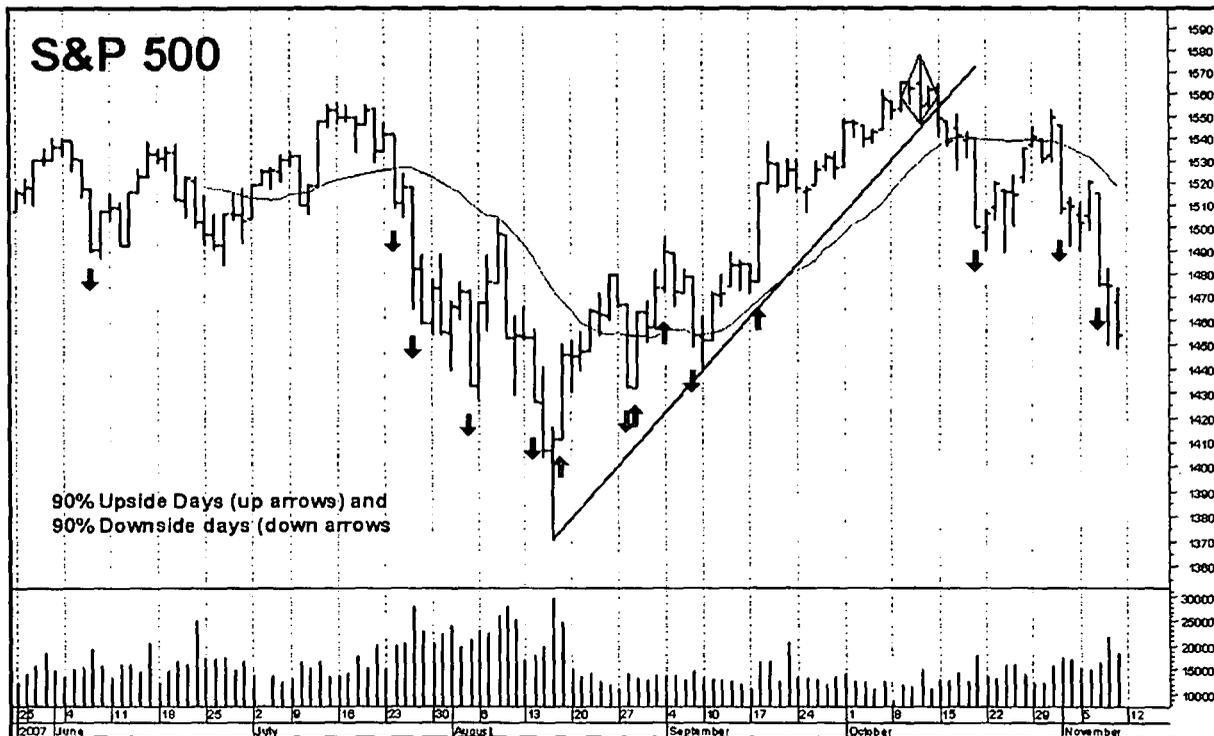
MARKET STRATEGIES AND INSIGHTS

...for Sophisticated Institutional Investors

November 11, 2007

IN THE MIDST OF A RATHER NASTY INTERMEDIATE DECLINE

Five-Second Summary. The market is in the midst of a rather nasty intermediate decline. The red flag is out.



The Market Now. The S&P plunged through its October low on Wednesday. In the process, the market staged its third 90% downside day (94%, actually) in three weeks, and the post-90% downside day recovery was then weaker than usual. This all indicates that we are in the powerful middle phase of a rather nasty intermediate decline. The red flag remains out.

"How low is it going to go?" As a guess, the low 1400's -- but in an emotional decline like this it can only be a guess (although we're obviously starting to get to wherever we're going in a hurry). I should also point out that given the widespread differences in group performance the ultimate bottom for each group is going to be unique to that group.

Looking For A Bottom. Now that the market is clearly in an intermediate decline, it's time for an anticipatory market strategist like myself to start looking for the market's next act: a bottom. Here are some of the things I'm watching:

ISI's Hedge Fund Survey. Did an admirable job (again!) of warning of a top. Had a record one-week decline this week and is now back down to its August low of -2.6. Its four-week moving average, though, was a still-above-normal 2.8 this week and needs to get to -1 or so to confirm the one-week reading (although the four-week average is, at least, falling rapidly). This week's Carpenter Analytix report, meanwhile, showed no change in hedge fund sentiment during the week ended Tuesday; according to this work, hedge fund sentiment remains modestly above average

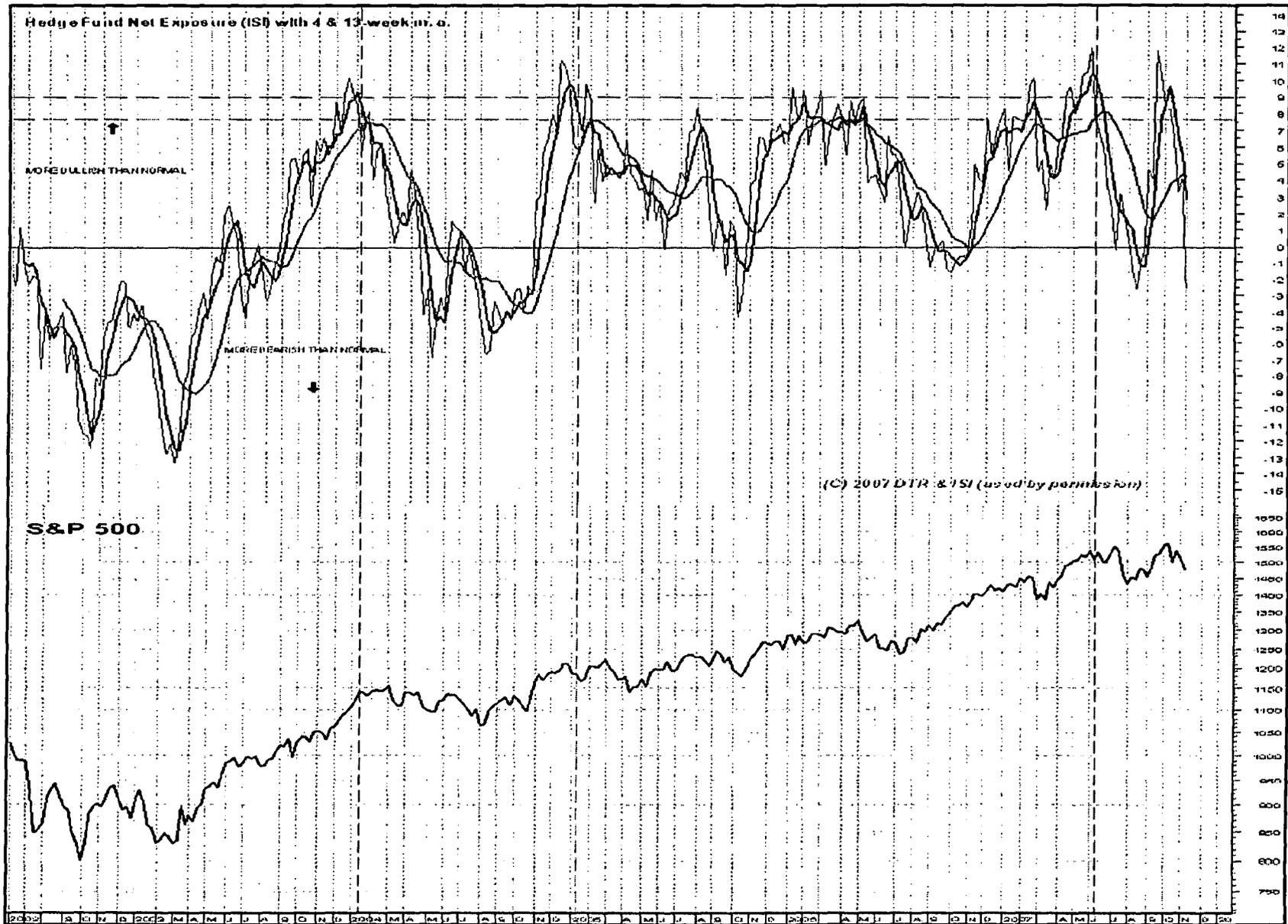
Note: That "record one-week decline" in hedge fund sentiment occurred as the S&P was falling 4.76%. Does anyone still doubt that hedge funds, in aggregate, represent a consensus that must be faded?

90% Upside/Downside Days. 90% downside days did an excellent job of confirming early on that the decline was something serious, and we now need a 90% upside day to turn off the alarm. Unfortunately, the first 90% upside day won't sound the all clear, just turn off the alarm; as the chart on the front page shows, the first 90% upside day last summer was followed by further 90% days in both directions.

NASDAQ/NYSE Volume. Warned of trouble when it rose to 1.24 last week - and delivered the *coup de grace* by falling to 1.20 this week and confirming that a top in the ratio had been seen. Now has to drop to at least a neutral 1.00 to give an all clear.

Lowry's Short-Term Buying Power (The "Dotted Line"). Should get down to 60; it's currently 70, down from a peak of 90. (Note: It only got down to 71 in August, although it bottomed at 52 in July 2006.)

NYSE Volume. Needs to remain below last August's peak of 2.96 billion shares to indicate that this is not a full-fledged cyclical bear market. The high so far is 2.18 billion.



**NASDAQ/NYSE 4/52
WEEK VOLUME RATIO**

DANGER LEVEL

WARNING LEVEL

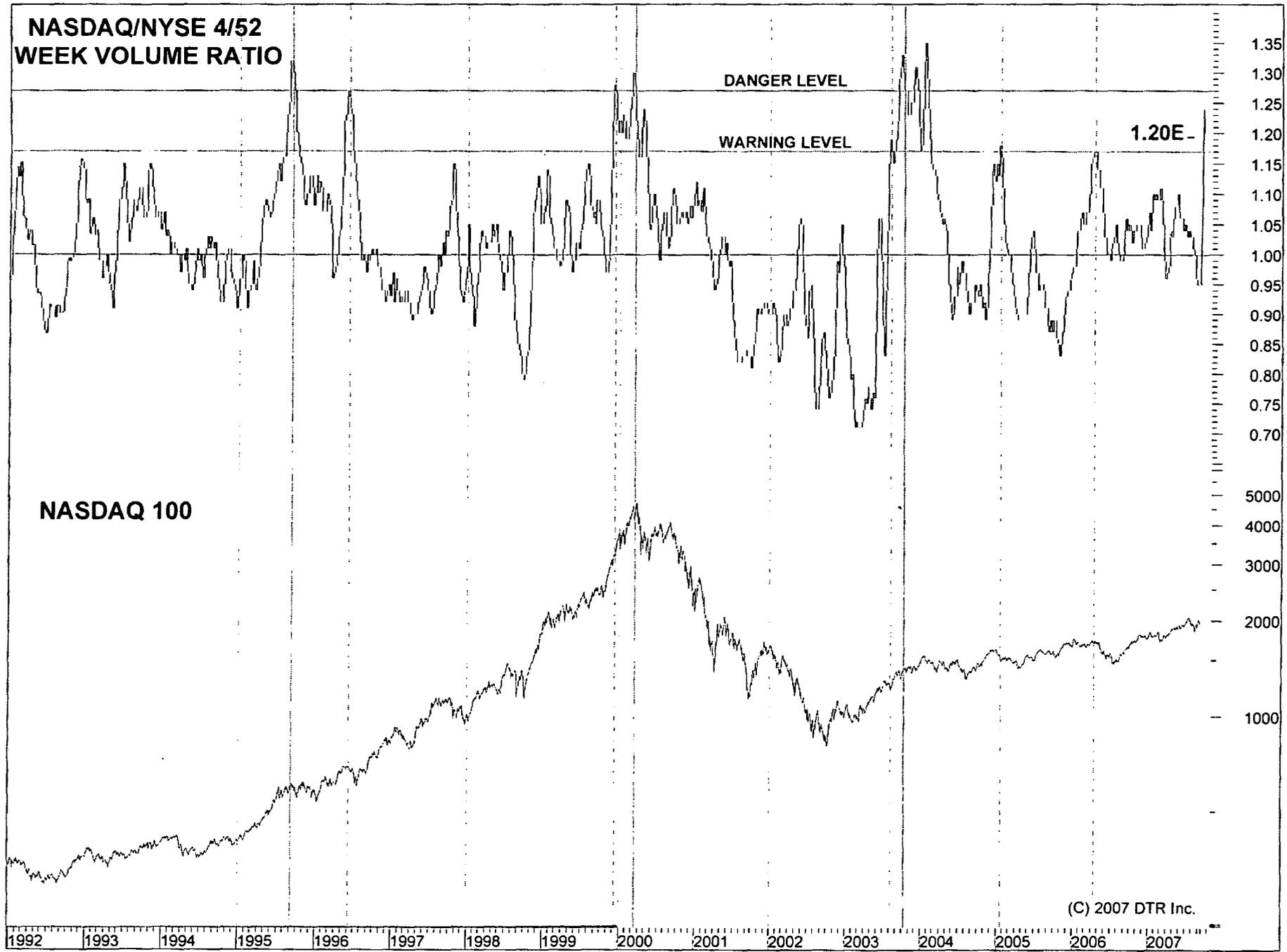
1.20E -

1.35
1.30
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0.70
5000
4000
3000
2000
1000

NASDAQ 100

1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007

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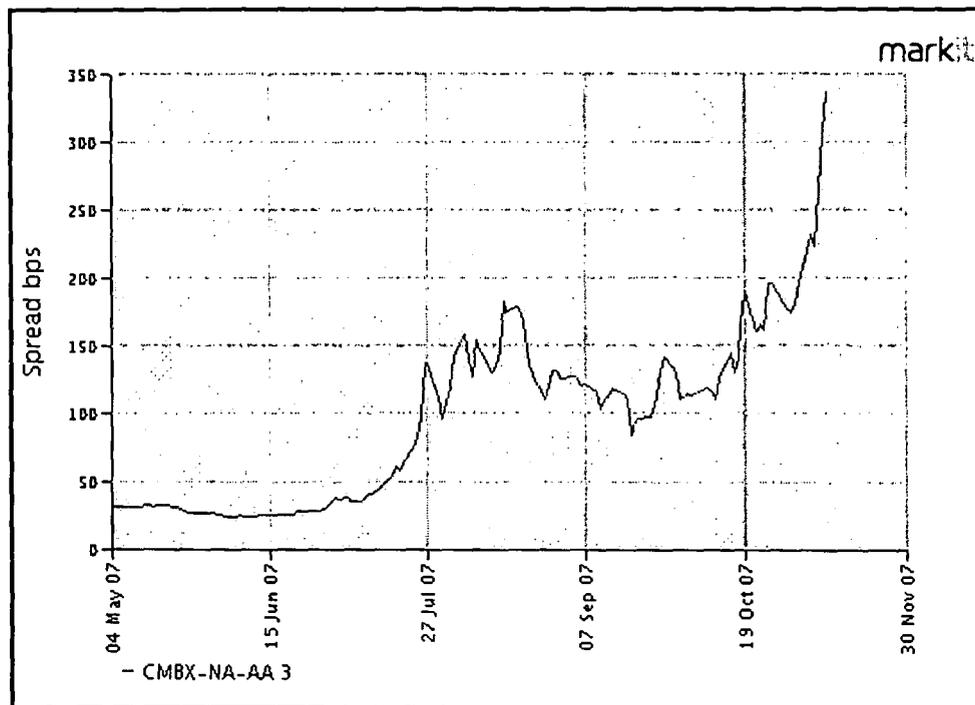


VIX. Needs to remain below last August's peak of 37.5 to indicate that this is not a full-fledged cyclical bear market. Thursday's high was 29.15.

Financial Sector. The financial sector is clearly leading the decline, both technically and fundamentally, and the worst won't be over until financial stocks tell us, via their market action, it is. So far, they haven't. (One day of relative strength, such as we saw during Friday's decline, isn't nearly enough to reverse their protracted negative message.)

Rydex Sentiment Composite. Currently 30, it needs to get to at least 45 to be positive (it hit 55 in March and 48 in August).

Summary: ISI's hedge fund survey shows that the indicators are starting to lay the groundwork for a bottom, but most other indicators have a way to go yet (some of them a rather long way) to reach similar positions. The red flag thus remains out. (As always, though, price action will trump indicator readings.)



The Credit Markets. This remains the great unknown. Markit's ABX indexes are testing their October 28th lows as this is being written, although only the AAA and AA

tranches have broken them thus far. ISI is also monitoring Markit's CMBX indexes, which measure credit spreads on commercial real estate mortgage-backed paper and which look even worse than the ABX indexes do here. (The chart is of the AA CMBX tranche, which is selling at 337; the BBB-tranche is 1013.) Given all this, we're going to have to wait for the financial sector to tell us, via its market action, that the worst is over in the credit markets.

Leadership. A few small cracks have appeared in the upside leadership, This is hardly surprising, though, since we have been warning all along that none of the leadership areas' alphas are high enough to offset their betas in a serious market decline. The NASDAQ 100, emerging markets and energy thus still look like long-term leaders here. Growth, meanwhile, continues take over long-term market leadership from value and large-caps continue to take over long-term market leadership from smaller stocks (although so far they are doing so at the expense of small-caps much more than mid-caps). And, from a shorter-term standpoint, utility stocks have also assumed a leadership role as they benefit from investors fleeing financial stocks.

We should comment further on the NASDAQ 100 given its huge implosion last week (6.23% during the last two days of the week and 8.53% in the last three). This, I'm afraid, is a dramatic illustration of what can happen in an overly crowded trade when everyone decides to take profits at the exact same time; they just can't all get through the door at once. The NASDAQ's decline began from a relative strength high and without a top having been formed, though, so the real problem will be if it stages a rally failure on the other side. This, unfortunately, appears more likely than not; our normalized NASDAQ/NYSE volume ratio fell to 1.20 this week from last week's peak of 1.24 and thereby confirmed its warning signal. I should quickly add, however, that even this won't necessarily affect the NASDAQ 100's longer-term leadership role; as we've been warning, in a market decline like this the leadership areas' alphas are not high enough to offset their betas, but the alphas should again dominate on the other side.

The downside leadership, meanwhile, remains as strong as ever with the financial, housing and retail areas continuing to hit new lows on a regular basis.

The Bottom Line. The red flag is out; the market is staging an intermediate decline -

and there is a risk that it could evolve into something worse. On a scale of 0-100, with 0 representing an individual portfolio manager's most defensive position and 100 their most aggressively-invested position, a portfolio should be at 0.

Portfolios should be concentrated in the market's longer-term leadership areas: the NASDAQ 100 (which is being led by technology, especially computer, communications equipment, networking, software and wireless stocks - but not semiconductor stocks!), emerging markets, the energy sector, growth stocks in general and big-cap stocks in general, plus the agricultural chemical, biotech, defense/ aerospace, environmental services and utility groups. (I suppose I should also list the market's current fad groups, ocean shipping and solar energy.) Please be aware, though, that none of the leadership groups' alphas are high enough to offset their betas in a serious decline.

Our Own Money. No change. My retirement funds are still fully-hedged via 22% positions in the NASDAQ 100 tracking stock (QQQQ), the Energy SPDR (XLE) and the Vanguard Emerging Markets ETF (VWO) offset by a 33% position in the UltraShort Financials ProShares ETF (SKF), which moves twice as much as the underlying index and thereby completely offsets the long exposure. My more aggressive sector fund portfolio, meanwhile, is also fully-hedged via 33% positions in Energy Services (FSESX) and Wireless (FWRLX) which are also offset by a 33% position in the UltraShort Financials ProShares.

(Why am I not in a maximum defensive position, as I'm advising you to be? First, both the positive and negative sides are currently generating positive returns. Secondly, these are retirement funds -- and at my age I am very reluctant to ever go 100% short with my retirement funds.)

Fidelity Sector Funds. Our Fidelity sector fund relative strength work deteriorated this week as seven funds (Financial, Transportation, Telecommunications, Insurance, Paper, Airlines, and Brokerage/Investments) fell below the money market rate of return. This took the percentage of funds outperforming cash down to 68% from last week's 85%, but it is still within overbought territory (66%-plus). It will take a move below 66% to turn this work bearish again, which can sometimes take a long time to happen. The holdings in our switching program, meanwhile, are unchanged from last week: the #1 Gold fund, #6

Wireless and #8 Energy Services. Finally, this week's top two funds are Gold and Computers and the bottom two, as usual, are Home Finance and Banking.

The 75 Most Liquid ETFs, ranked via the same methodology as our Fidelity sector funds. The top and bottom 5 this week in order of strength/weakness (duplicate sectors are omitted, new additions asterisked and returnees double-asterisked):

Top Five		Bottom Five	
INP	India iPath ETN	XHB	Homebuilders SPDR
FXI	China iShares	KRE	KBW Regional Bank ETF
EWZ	Brazil iShares	KBE	KBW Bank ETF
*USO	U. S. Oil Fund	XRT	Retail SPDRS
ILF	Latin America iShares	SMH	Semiconductor HOLDERS

Dropoffs:

EWH Hong Kong iShares

And the long and short holdings in our switching program:

	<u>Long</u>		<u>Short</u>
EWC	Canada iShares	JOF	Japan Smaller-Caps
EWY	South Korea iShares	KBE	KBW Bank ETF
FXI	China iShares	KRE	KBW Regional Bank ETF
IYE	Energy Sector iShares	RTH	Retail HOLDERS
OIH	Oil Service HOLDERS	XHB	Homebuilders SPDR

2008 Presidential Nominee Markets & Change From Last Week (from intrade.com; the probabilities that a particular candidate will be their party's nominee):

<u>Democrats</u>			<u>Republicans</u>		
H. Clinton	72.0	+0.7	R. Giuliani	43.8	+3.3
B. Obama	13.5	+0.7	M. Romney	29.2	+0.7
J. Edwards	5.2	+0.2	R. Paul	7.9	-0.5
A. Gore	5.0	-3.0	J. McCain	7.3	+0.2
			M. Huckabee	6.0	+0.9
			F. Thompson	5.9	-2.2

Odds Democratic Candidate Will Win Presidential Election: 62.3 -0.7
" Republican Candidate Will Win Presidential Election: 36.2 unch
" Third Party Candidate Will Win Presidential Election: 2.1 +0.5

-- *Walter Deemer*

FIDELITY SECTOR FUND	PRICES in cents)				R/C	DTR STRENGTH RATINGS				
	Nov 7	Oct 31	Oct 24	Oct 17		Nov 7	Oct 31	Oct 24	Oct 17	Oct 10
Gold	4808	4758	4407	4365	-12	273	285	246	272	303
Computers	5081	5280	5115	5059	-42	153	195	155	150	163
Software	8129	8484	7982	7909	-60	150	210	139	138	157
Technology	8871	9143	8821	8873	-34	147	181	145	166	176
Nat Resource	3953	3993	3855	3919	-25	147	172	143	195	217
Wireless	964	997	994	982	-56	129	185	182	177	215
Natural Gas	4962	5075	4853	4914	-36	128	164	119	163	176
Energy Serv	9962	9999	10074	10416	-17	118	135	168	246	288
Energy	6627	6720	6558	6721	-27	116	143	125	186	208
Comm Equip	2558	2590	2549	2568	-16	110	125	113	137	167
Networking	288	295	289	292	-21	98	120	102	123	139
Defense/Aero	9584	9709	9667	9662	-22	83	105	108	108	129
Chemicals	8400	8693	8510	8555	-61	71	132	97	116	138
Indust Equip	3733	3798	3737	3783	-37	71	108	87	108	133
Consumer Stpls	6715	6844	6699	6676	-26	69	96	88	85	100
Materials	5964	6218	6022	6011	-71	65	136	94	106	138
Biotech	7057	7322	7205	7250	-33	62	95	97	120	138
Industrials	2357	2409	2375	2395	-40	59	99	80	97	120
Environmental	1915	1974	1949	1930	-53	54	108	93	90	111
Utilities	6451	6601	6234	6324	-41	47	89	27	55	64
Healthcare	13424	13915	13597	13647	-42	36	79	64	73	93
Medical Del	5265	5390	5189	5230	-20	33	53	10	27	51
Leisure	8342	8758	8537	8571	-64	32	96	67	72	100
Pharmaceutical	1178	1225	1192	1195	-45	30	75	53	59	78
Automotive	4388	4717	4533	4607	-119	28	147	70	88	78
Medical Equip	2555	2636	2589	2627	-39	17	56	53	75	121
IT Services	1801	1880	1838	1866	-52	14	66	43	70	101
Electronics	4901	5007	4966	5189	-21	8	29	12	70	67
* * T Bills	1965	1965	1964	1963	0	6	6	6	6	6
* * S&P 500	147562	154938	151588	154124	-60	-9	51	27	49	71
Broker/Invest	7015	7625	7285	7410	-114	-12	102	43	64	81
Airlines	5078	5388	5344	5363	-70	-13	57	45	50	74
Paper	3319	3519	3395	3405	-68	-26	42	-12	-6	19
Telecommun	5435	5798	5862	6017	-82	-30	52	58	84	130
Transport'n	5223	5583	5553	5514	-80	-36	44	25	21	34
Multimedia	4244	4396	4447	4513	-30	-42	-12	-4	14	36
Insurance	6690	7137	7101	7296	-79	-55	24	10	36	59
Consumer Discr	2404	2542	2512	2555	-65	-66	-1	-20	-3	38
Retailing	4772	5071	4927	5019	-76	-92	-16	-57	-42	15
Financial	10383	11376	11151	11477	-106	-93	13	-18	6	34
Constr/Hous'g	3921	4218	4136	4164	-87	-100	-14	-54	-48	7
Banking	2719	2980	2919	3029	-99	-135	-36	-68	-44	1
Home Finance	3247	3663	3592	3845	-105	-230	-125	-151	-110	-57