The Psychological Investor

Bringing Psychological Analysis to Stock Market Investing

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Watch For 1,400 On S&P500

Looking For a Bottom At Critical Support Levels

The watchword for the week will be retesting support levels, as last week the major indices hit new lows not seen since August. The financial press loves to ridicule the whole idea of support levels, yet it can't stop talking about them, which shows the psychological power they have. No market analysis method is 100% accurate, but since it is psychological factors that ultimately move markets, ignoring a useful psychological indicator like this is foolhardy.

Before I get too caught up in bashing the lackeys in the press, let's review the numbers. The most important one for the Standard & Poors 500 **(SPX)** is 1,400, the closing low hit August 15 (the precise number is 1406.70, but we'll round off). There were two distinctive features to this low: the decline and the following bounce were very fast, and there was an extreme level of stocks hitting 52-week lows. Those factors have always been followed by a retest of the lows in a few weeks or months, and we are close to that level now.

Waiting for this retest has been painful because we've had too much cash since August, but if you maintained the recommended cash holding of 50-60% you are in great shape now. The perfect scenario would be a closing price very close to 1,400 followed by a broad-based rally.

If we get it we'll turn to a fully bullish outlook and start loading up immediately. Unfortunately the market is rarely this easy to play, and it's possible that we've had all the testing we'll get for now. If we get a broad-based rally from here we'll give it the benefit of the doubt and start buying cautiously.

If you are willing and able to trade index options, I'd recommend that you buy a few options on **SPX** and/or the Nasdaq 100 **(NDX)** at this point in case we don't get a retest at 1,400. I'd favor January calls, but we don't make specific option recommendations. If you don't trade options, it's too early to make a big new commitment to the market. As always, keep following the hot line for our take on whether it's time to move.

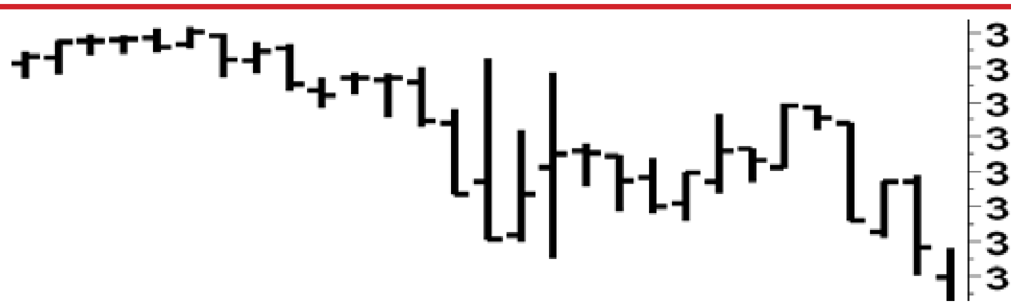
Remember that December is historically one of the three best months of the year for the stock market, which is why I'd like to see a turn soon so we'll be fully invested by the end of November.

If the 1,400 level doesn't hold and **SPX** closes below 1,395, then all bets are off. In that case we'll switch to bearish mode and look for opportunities to raise cash and go short. The odds that the mid-term bull move will continue after a close below 1,395 are extremely low.

The Nervous Nellies are predicting a major correction because of some combination of credit problems, the declining dollar, and inflation threats. For what it's worth, I agree that the economic and fiscal outlook is darker now than it was in August, but it's absurd to insist that the market has not taken this into account already. And it's even more absurd to predict a market move in any direction. The whole theme of this newsletter is to listen to what the stock market has to say, not project our thoughts and emotions onto the stock market.

One exception to the rule of not predicting market moves is when we can clearly see how psychological factors are working. In the case of the subprime mess, it's obvious that executives in the financial sector are going to hide and downplay credit problems for as long as possible, so we are certain to have a continuing trickle of "surprises" coming out. In this environment, we will keep our bets against the sector for a long time.

Financials Continuing Collapse



The S&P Financials ETF started falling in June and still looks bad

Indicator Basket

SPX Above 50 EMA	▲
SPX Below 200 EMA	▼
OTC Above 50 EMA	▲
OTC Above 200 EMA	▲
R2K Below 50 EMA	▼
R2K Below 200 EMA	▼
R2K Underperforming	▼
Money Supply	▶
Interest Rate Direction	▲
Odd-Lot Ratio	▼
Put-Call Ratio	▼
Newsletter Sentiment	▲
Weekly New Highs	▲
Weekly New Lows	▲
High/Low Ratio	▼
Stocks In Uptrend	▲
Stocks In Downtrend	▲
Dow Theory Signal	▲
Up/Down Volume	▲
Volume Trend	▶
SPX Rate Of Change	▲
SPX MACD	▲
OTC Rate Of Change	▲
OTC MACD	▲
R2K Rate Of Change	▼
R2K MACD	▼
IPO Meter	▶
Totals:	
15 Positive	▲
10 Negative	▼
3 Neutral	▶

Portfolio Updates

Obviously this was a good week for our hedges and a bad week for almost everything else. The bright spot was our alternative and solar energy holdings.

The biggest disappointment was Hansen Natural **(HANS)** dropping 30% on a big earnings disappointment. We are looking to abandon the position soon. Right now it's in a dead-cat bounce, but that will end and the hot line update will issue a sell recommendation.

The whole megatrend of healthy and organic foods gaining acceptance continues to deteriorate. Lifeways **(LWAY)** is on a slide, but the company still looks solid and we'll consider buying more near the 200-day moving average at 13. Whole Foods Market **(WFMI)** continues to fall, and we recommend setting a stop just below 42.

Alternative and solar energy is a very long-term megatrend so we don't want to get caught up in weekly gyrations there, but it's instructive to note that share prices are finally following the price of oil. Last year they didn't do much as oil soared, but this year they are more in fashion as hedges against rising energy prices. Bear Sterns helped us by downgrading Evergreen Solar **(ESLR)**, which knocked the price down for 24 hours and gave us an excellent chance to add shares.

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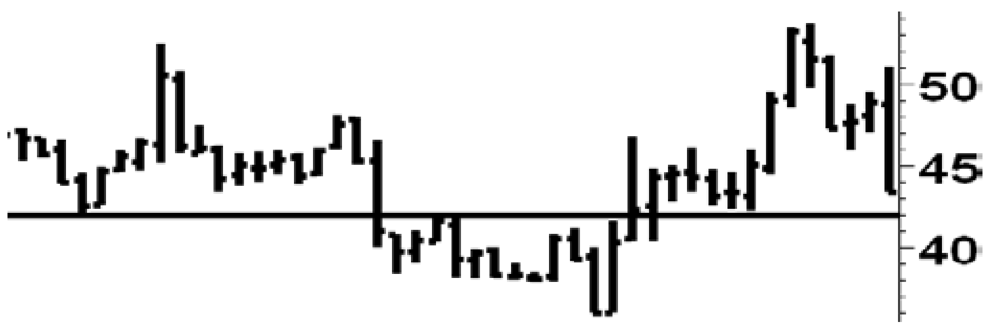
The flip side is that my worst sell of the year, First Solar **(FSLR),** continues to run wild and taunt us with new highs.

The best news is American Superconductor **(AMSC)** continues to rise. The market clearly likes the company and isn't just jumping on a hot sector.

Selected Stock Charts



Sell Whole Foods Market below 42 (marked by horizontal line)

EBay's biggest pullback of the year is a good time to buy