Lindisfarne Investments, LLC
An island of safety in a sea of risk

Market Update
February 7, 2014

Garrison Keillor starts his weekly radio program by saying, “It’s been a quiet week here in Lake Wobegon”. Well, it’s been anything but quiet in the market his week. So I thought it appropriate that we take a peak and review what happened last week and then take a look at what the future might hold.

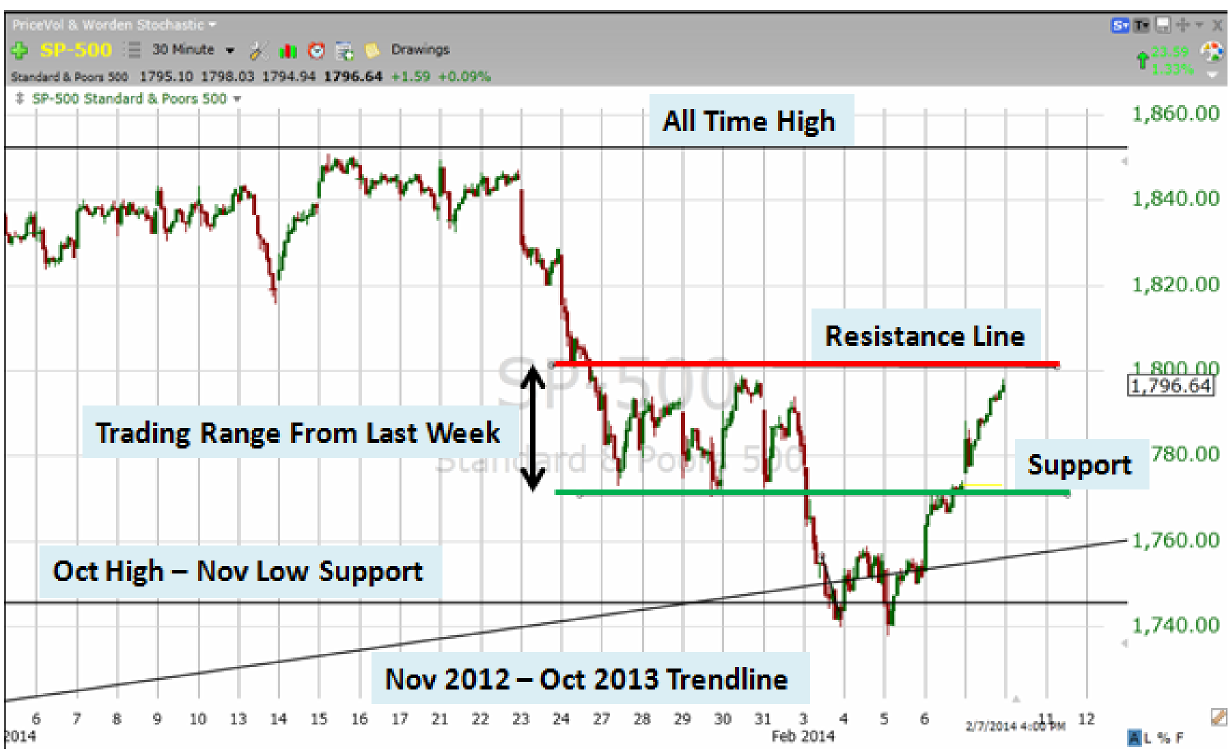
First, our longer term trend is still intact as shown in the first chart. We pulled back from the all time highs to both the longer term trendline and the Oct – Nov support line. Then, on Thursday and Friday we had the typical bounce up off of the support that these provided. But we had the first warning signs that the uptrend may be in trouble. For the first time, we made a lower low in the S&P 500. This hasn’t happened since early in 2009.

S&P 500 ... Daily Bars

In last week's report, we thought the intra-day Trading Range between 1772 and 1800 would hold and the market resume its uptrend. No sooner did we hit the send button than the market proceeded lower dropping through the Trading Range down to a double area of support marked by the horizontal Oct – Nov line and the longer term Trendline. After spending three days in that vicinity, the market rallied strongly, right back up to the Trading Range's upper boundary Resistance Line (red horizontal line in the chart below).

But during the excursion, most of our equity mutual funds gave us a sell signal. Our trading system signals are constructed to tell us that we are entering a period where the market usually doesn't perform in a safe and constructive manner. Staying true to our trading systems, we exited those positions that went to a sell. We are currently about 40% invested, mostly in Hi-Yield Bond and Growth & Income funds. This varies by account, especially in the 401k plans with their limited universe of choices.

S&P 500 … 30 Minute Bars



The question is where do we go from here. The following three charts show the possibilities and the key levels to watch for.

The first Scenario is that this latest pullback is only a pause in the longer term uptrend. For this to be fulfilled, the S&P 500 needs to work its way higher and significantly break through the 1850 price level. Although this could happen quickly, building on Thursday's and Friday's powerful moves, it could take several weeks with some advances and pullbacks before it happens.

Only a Pause ???

The second Scenario is that we stay a while in a Trading Range between the 1850 and 1750 levels on the S&P 500. Given that the 4th quarter earnings reports were mixed and that there were some not-so-positive forward guidance given by companies, a market pause might just be in order until there is more evidence that the economy is recovering.

Potential Trading Range

And the third scenario is that we will head lower from here. If the market stalls near its current level and then turns lower below the 1750 level, we will have formed what is called a Head and Shoulders (H&S) pattern. The H&S pattern is usually quite reliable and predicts a lower move below the Neckline of the pattern. The Neckline is at the 1750 level, just where there is a confluence of support for the market. Breaking this level, the pattern predicts a move down that is equal to the distance between the Head and the Neckline. This would take us to the 1650 level on the market. This would be an 8% drop from Friday's close and an 11% drop from the January highs, close to the typical pullback that the market experiences every year.
Why might this happen? Bad news from any economic area could be the tipping point here. Even though the initial reaction to Friday's disappointing jobs report was a strong up-move, that may dissipate quickly next week. And we can develop a long list of other potential downers for the market: China headwinds, new European bank issues, Olympic Games trouble, etc.

Potential Head & Shoulders

The key is to not be in a rush to commit funds at this time. The safest approach for protecting our monies is to wait for the market to declare its intentions and then take appropriate action.

Please feel free to pass this update on to anyone that you think might be interested in it. If they wish to be on the mailing list or would like more information about the services of Lindisfarne Investments, we can be contacted by phone at (440) 623-0775 or by email at bill@lindisfarneinvestments.com .

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