The PRECISION REPORT

Precise Market Timing

July 31, 2009

COMMENTARY FOR THE eMINI S&P 500 SEP 2009 CONTRACT (the "ES")

The Precise Take – 7 Year Auction buys time for bonds as equities finish record strong month

We were at a crossroads this week contemplating that our primary theory of the markets, the dominant theme of which is the interplay between US Treasuries and equities, was no longer or was never correct. After yesterday's 7 Year auction, we are more convinced than ever that this is the case, and that the markets are caught in a tug of war between Bernanke's Federal Reserve (FR) in Washington attempting to keep down long term interest rates and Dudley's FR Bank in New York (FRNY) trying to keep equities on a tear for the large member banks. The administration prefers both as they help keep public opinion from swelling to be too negative and hurting the chances of pursuing its agenda (which is already in danger).

The entire week's price action in the ES with all its zigs and zags could have been forecast in two scenarios as early as last Friday, with the correct scenario being known Tuesday afternoon. It involves the varying dynamics of (1) the paint-the-tape closes induced by permanent open market operations (POMO) by the FRNY, (2) the Treasury-supportive signals broadcast early in the week in the EuroYen forex cross as well as the gold and Treasury futures markets (to this we note that the FRNY contains massive gold holdings as well as foreign currency reserves in exactly two currencies—the Euro and the Yen), (3) declining M2 non-seasonally adjusted which has a strong historical tendency to increase volatility, (4) the record Treasury auctions that needed to show enough demand to prevent a dangerous rise in yields, and (5) the need for equities to close the month on a high note. It was as to 4 and 5 where we went slightly askew because 5, above, was *the* priority (equities needed to post as much gain as possible end of month) and, as to 4, we had hypothesized that Treasuries needed to rally at the expense of equities whereas they actually only needed to tread water until the eventual equities takes place.

As an aside, M2 NSA as reported yesterday continues to shrink, thus increasing the likelihood of continued or increasing volatility. A reader correctly commented yesterday that the FRNY's POMO forays are money printing. However, this increase in the monetary base is not working its way into M2 for whatever reason, and it is M2 that has the most effect on the economy and not M1 or M0 (the monetary base). Historically, the Fed has had little control over M2, but we suspect that, with its increased powers, the Fed has more control than previously and may be intentionally counteracting the money printing of the NYFR.

To further support the priority of a strong equities close, the FRNY announced yesterday it would conduct POMO for Agency securities (Fannie/Freddie) today, and we commented pre-auction yesterday:

> After $3 B yesterday and $6.5 B today, another (probable) $1.5 – $3 B tomorrow [Friday] in Fed funny money sent to banks that can be leveraged 100x or more should give the bears pause, especially into month end (tomorrow). Our question is, what is the NYFR so worried about? The contrarian in us would believe it's to overcome a weak GDP report tomorrow and/or a very strong 7 year auction today.

That the 2 and 5 year auctions did not send the 10 and 30 Year futures down by 3 or 4 big points into Wednesday afternoon was evidence enough that demand was being saved for the 7 Year. As we updated yesterday post-auction, "Bernanke has probably bought himself two weeks of long term yield control until the August 12 10 year auction is conducted." We will by tying all this together in a more comprehensive report over the weekend that includes possible scenarios for the next couple of weeks. Register free here to receive this and other updates.

The time profile for the day after a POMO day (as was yesterday) that is also a POMO (A) (n=5 since May 09) shows a strong tendency for the ES to head down and bottom in the first hour, with no clear further bias until the close, which shows a strongly bullish bias.

As we write, GDP has clearly disappointed as expected; however, equities are ensured a good close as we find a close below 973 unlikely. In light of the new comprehensive analysis above, we are removing our 1008 target and suspect the equities correction is underway, but waiting for price to indicate this early next week. See the chart on page 3 for support and resistance. We don't get outright bullish again until 991.25. As before, 970-974 could be a reversal area to watch, as is 960 to 964.

Day Trading Guide

Daily Gap
- 982.75 (4:00 pm close)
- 982.25 (4:15 pm settlement)

Daily Pivot
- 986.00 (day-session-only)
- 983.25 (day & overnight sessions)

Unfilled Gaps
- 903.50 to 912.50 (price)
- 955.00 to 962.50 (volume)

Upside Targets
- 1008.50, 1066.00

Downside Targets
- 922.25, 913.00, 854.75, 846.00, 828.00, 811.75, 777.25

Countertrend Longs*
- 917.75, 933.25, 940.75, 945.25, 963.25

Countertrend Shorts*
- 993.50

* Countertrend trades have a 2 point target and 2 point stop, are valid during the day session only, and are not recommended on high volume moves or around major news releases.

Today's Scheduled News (all times EDT)

Major Market Movers
- GDP at 8:30 am

Minor Market Movers
- Chicago PMI at 9:45 am

Tomorrow's Scheduled News

Major Market Movers
- ISM Mfg Index at 10:00 am

Minor Market Movers
- Construction Spending at 10:00 am
- 3 & 6 Mos. Bill Auctions at 1:00 pm

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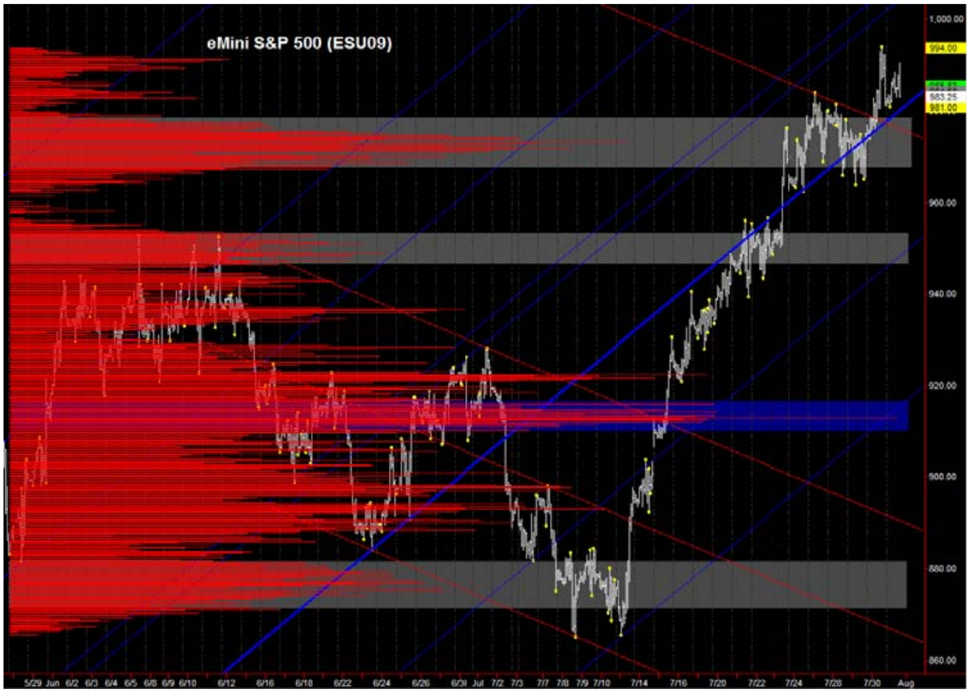
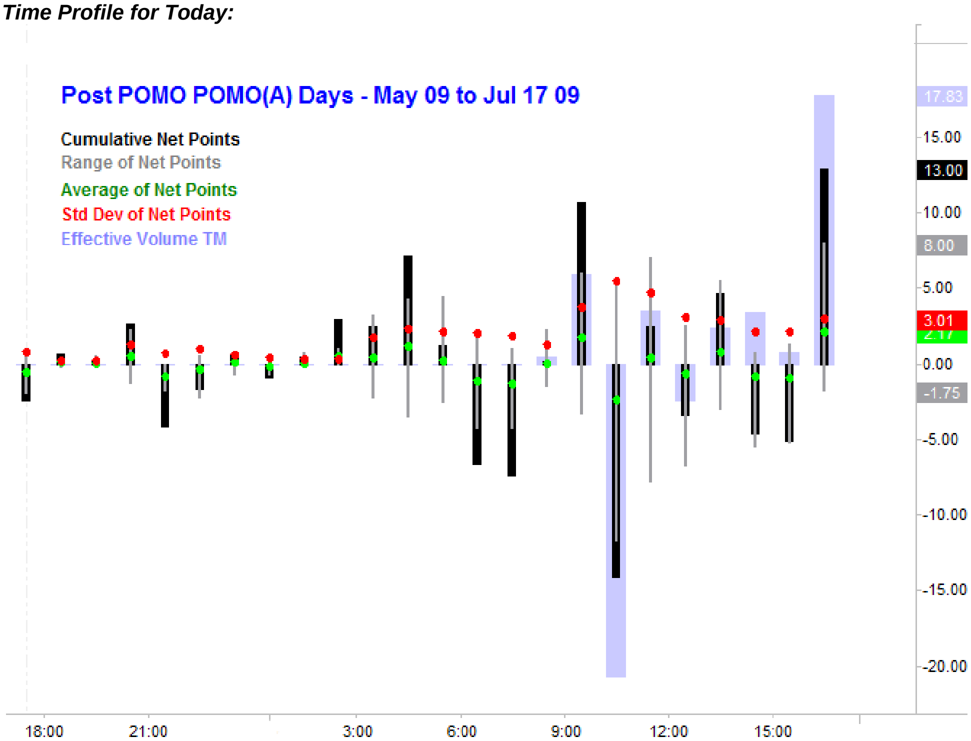
Volume Profile:



Time Profile for Today:



* Thanks to Thanassis Stathopoulos and Billy O'Nair for the *POMO effect* discovery and development of trading edges. Thanks to Pascal Willain for the development of Effective Volume TM and hosting the Value in Time Group.

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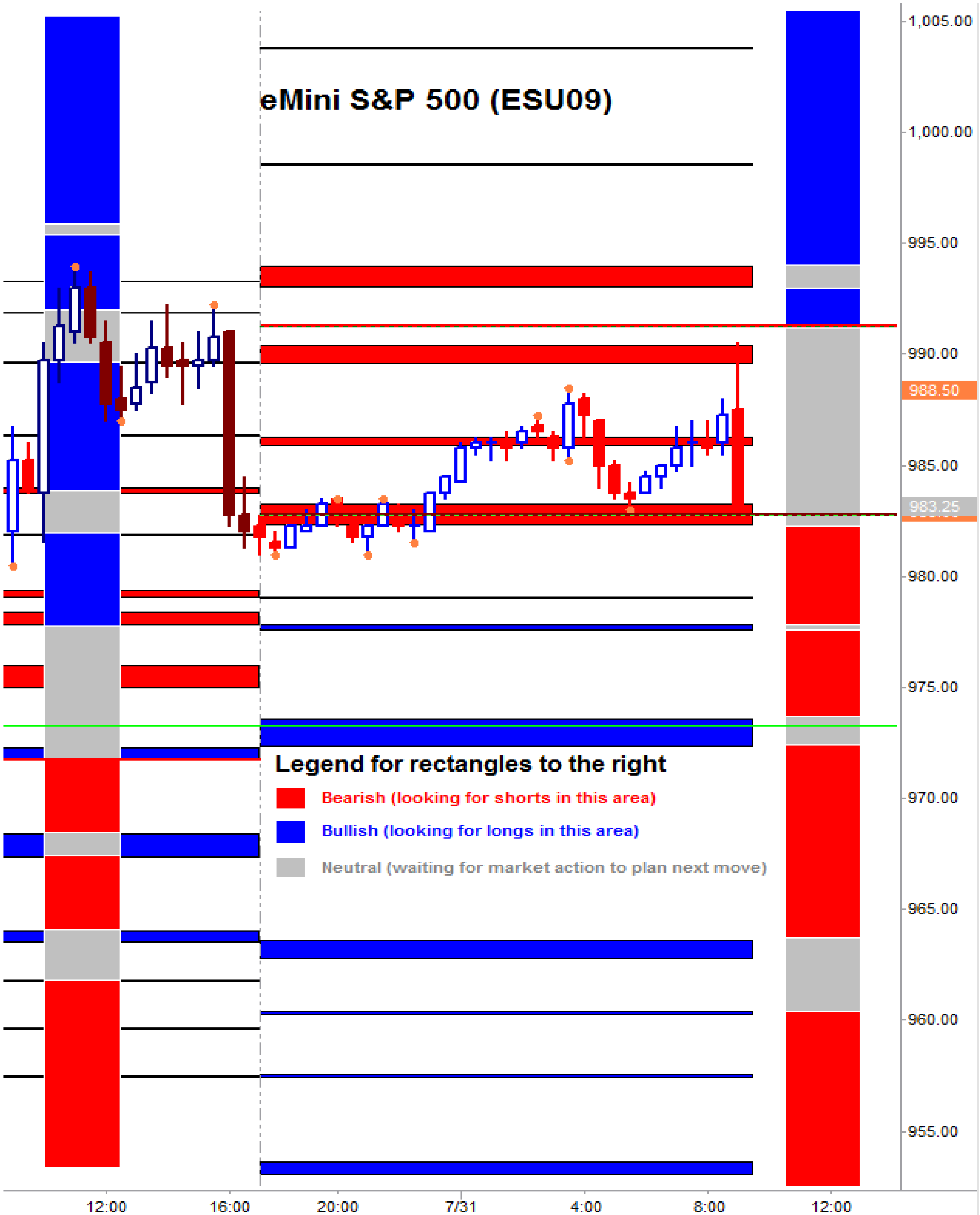
Support and resistance is as follows:



Legend: Market Profile points of control (POC's) are calculated each day and displayed as lines colored shades of green or red. Shades of green measure POC's over the life of the contract. Shades of red measure POC's for the previous day only. Confluence areas of support and resistance are calculated using Fibonacci retracement and extensions, market profile POC, and pivot formulas calculated on monthly, weekly and daily (day-session-only and day/overnight combined) time frames. They areas are drawn as shaded blue (support) and red (resistance) boxes. Previously drawn areas have not been adjusted retroactively.

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