



OUTLOOK

"Financials Rise from the Dead"
3/12/2009

In our Outlook on 2/19/09, we expressed our bullish view on financial stocks, expecting the ETF, XLF, to rally at least 5% from our entry point. Rally it did as XLF rose 9% above our entry point as we took profits on 3/12/09. The rally did, however, come with some volatility as XLF initially surged a week after our entry, tanked to new lows, and then rallied again to reach our target exit level.



Our target was to exit XLF when it reached its 20 day moving average or higher. As you can see by the graph above, the 20 day moving average (blue line) has been a formidable resistance for XLF to overcome. Anytime XLF has risen above the 20 day moving average, it has not been able to mount a sustainable rally and has declined soon afterwards. One week after our entry on 2/19/09, we came very close to exiting our position since XLF almost reached its 20 day moving average on 2/26/09. Going forward, we may adjust our exit strategy to more effectively lock in our profits.

In our Outlook on 2/19/09, we also noted an extreme divergence between the financial sector (shown as XLF) and Gold (shown as GLD). The divergence illustrated an inverse relationship between a crowded trade in Gold and an uncrowded trade in financials. The crowd was fleeing out of financials into Gold as a safe haven from the turmoil in the financial system. Since then, things have reversed as financials have rallied and Gold has fallen, a sign that the demand for safety has diminished. This reversal can be seen in the graph below with XLF (dotted line) and GLD (solid line). If we see this kind of divergence in the future, we may consider going long on financials and short on Gold to profit from a convergence between the two.

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