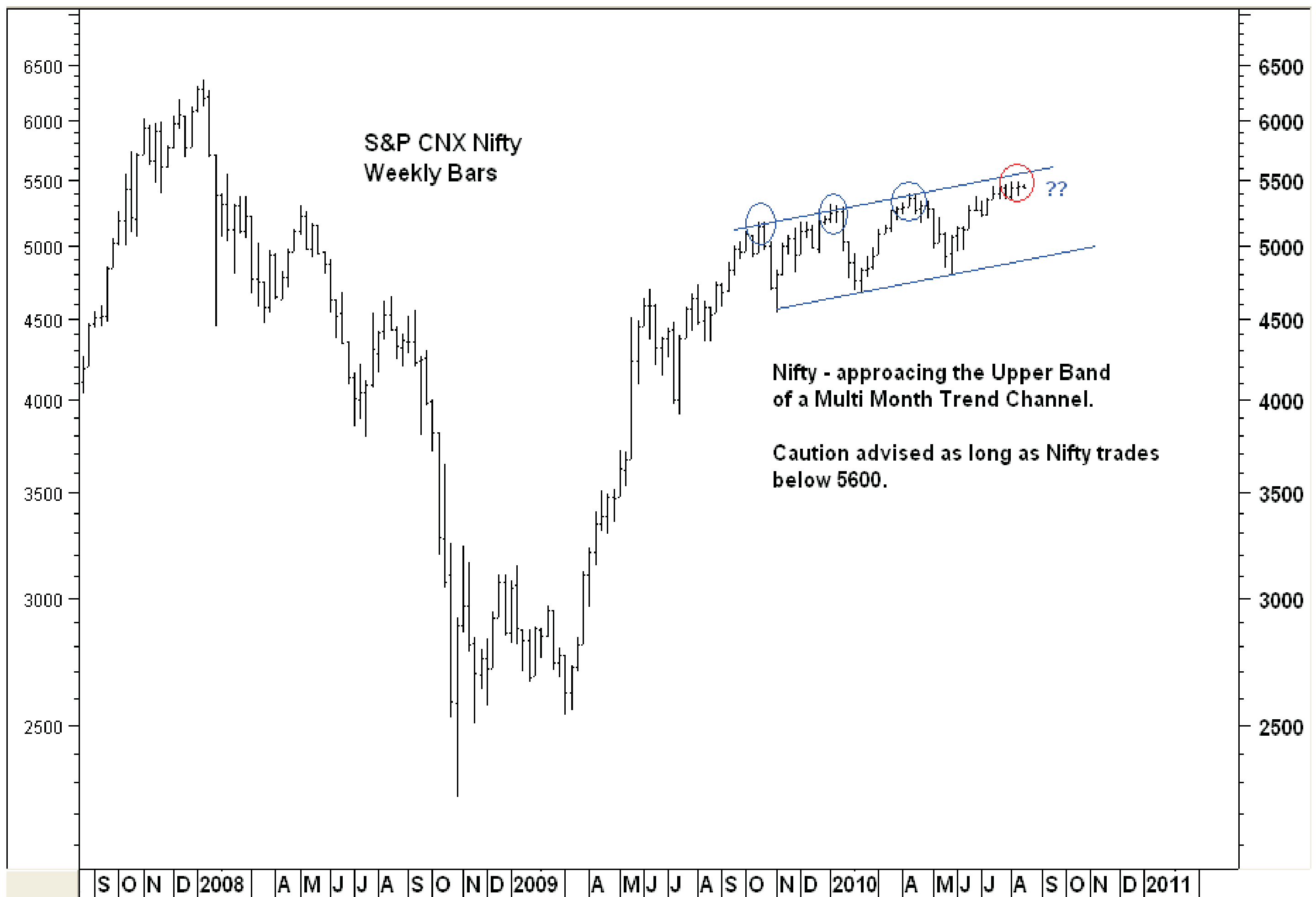
GEPL- Crucial Junctures

17 August, 2010
Data in the report till 13-08-10

S&P CNX Nifty - Intermarket Analysis suggest an intermediate Top is near



We are issuing this urgent report at this juncture as S&P CNX Nifty appears highly susceptible to a significant potential downside based on inter-market analysis between various asset classes. Technically all of the studies/ Intermarket relationships we have covered appear to be placed at crucial junctures, with each market having a ripple effect on the other. We urge investors as well as traders to remain highly cautious as long as Nifty trades below 5600. Though the present trend in Nifty continues to be up, the potential for intermediate negativity remains high if it breaks the level of 5350. The objective of this report is to be proactive in case a correction sets in rather than react to it so that we can position our clients on the right side of the trend. Cautious approach is thus advised. Continuation of bullish trend will be confirmed only above 5600.

GEPL Investment Research | **Rajesh Manial** | +91 22 66182433 | rajesh@guptaequities.com |

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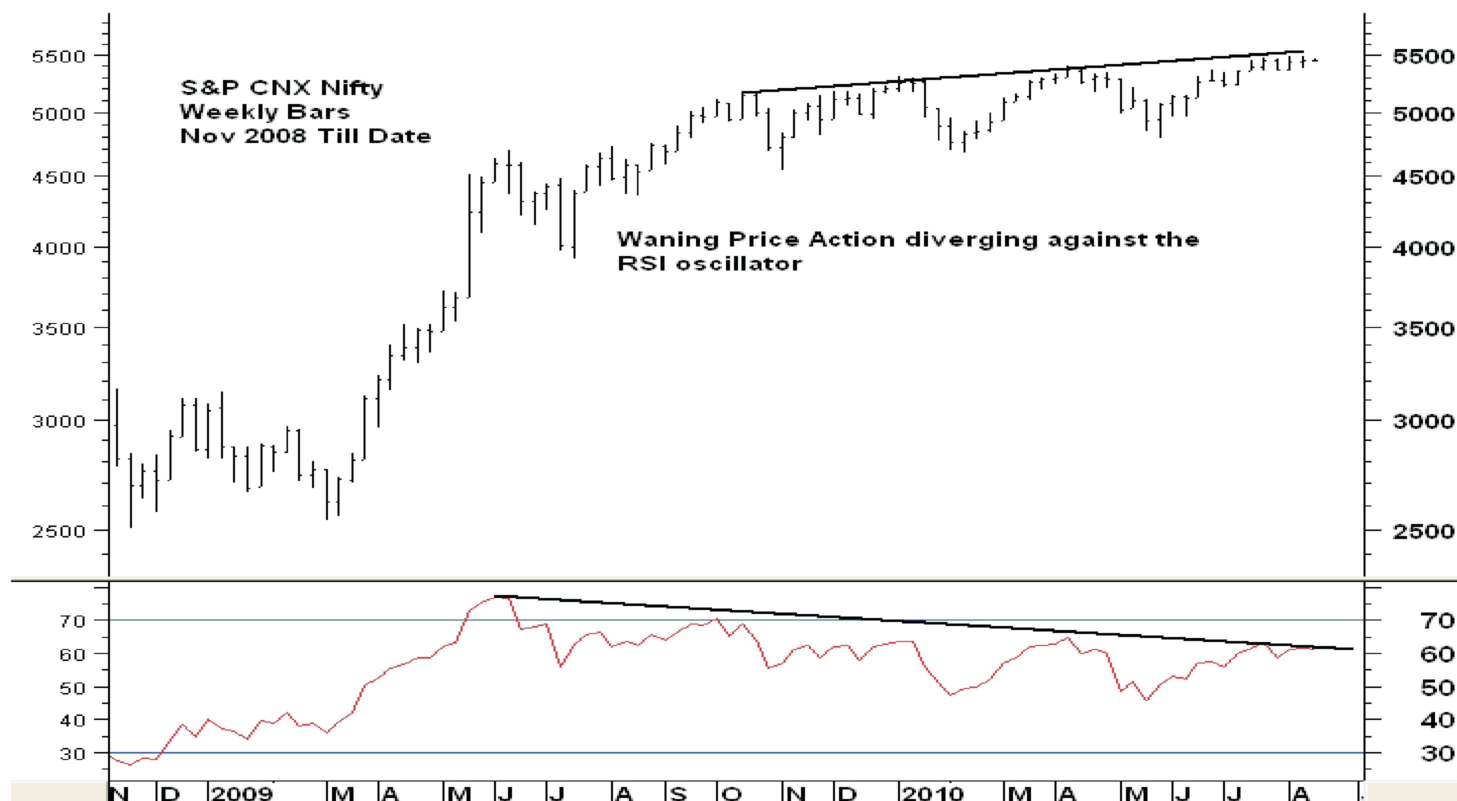

Since our last crucial juncture report on Nifty titled S&P CNX Nifty-At Make Or Break Point - dated 8th of May'10 Nifty managed to take support below the indicated level of 4880, made a low of 4786 and rallied past the resistance of 5200 to register a fresh 52 week high of 5492 last week. That was despite the confluence of several bearish indicators which were all lined up on the sell side.

Analysing the movement of Nifty since October 2009, it has been trading within the confines of an "Upsloping Trend Channel" which has ensured rangebound moves. Nifty has managed to register "Higher Tops – Higher Bottoms" in this entire Channeled upmove. So far, every time it attempted to give a break out beyond the earlier highs of 5181 registered in Oct '09 and 5310 (Jan'10) it managed to form a higher high by almost 129 points and 89 points respectively. The new highs thus formed however proved to be unsustainable and a substantial correction in each instance soon followed. The bouts of selling retraced close to 78.60% of the entire upmove. The declines although swift in nature, found support near the 200 Day EMA each time and formed a base for the next round of gradual upmove. This has been the pattern of Nifty since almost more than nine months now.

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As of now, yet again Nifty managed to breach the high of 5399 registered in April'10 last week and registered a high of 5492. It now trades close to the resistance of the mentioned multi month "Upsloping Trend Channel". As long as Nifty trades above a crucial support of 5350 and also above its 21 day EMA placed at 5414, it still remains in bullish territory. However on the Intra day hourly price chart Nifty appears to be forming a top as it forms the "Right shoulder" of "Head & Shoulder" pattern forming since late July'10. We feel the range of 5350 - 5375 should serve as a stiff resistance in case of a bounce back over next couple of sessions.

The upside momentum is also waning as Nifty is unable to clear the 5500 mark. The limp upside since past few weeks on the back of "Negative Divergence" registered by the "RSI" oscillator and the "MACD" indicator on the daily chart and the overbought nature of Nifty on the weekly chart where the "RSI" oscillator clearly diverges against the prices are indicative of exhaustion of the present uptrend.

Given the breach of a "Trend Line" connecting the lows of 4786 and 5351and the formation of "Head & Shoulder" pattern on the intraday hourly chart, the upside potential beyond the recent high of 5492 appears diminished, nonetheless a move beyond 5500 may take it higher to 5526 followed by 5556 in a very bullish scenario, these are extension targets of the recent correction from 5477 to 5349. Even in case of such a move Nifty would remain within the confines of the mentioned "Trend Channel"

However a breach of 5350 over the course of next two to three sessions would also imply a breakdown below the low of a "Doji" candle formed last week and should induce potential intermediate weakness which can drag the Nifty down to 5222 at least, which is the 38.20% Fibonacci retracement of the entire rise from 4786 to 5492. The weakness may further exacerbate if the global scenario remains gloomy and in that case Nifty may correct further till 5056 and below that 4937 is a possibility, these are 61.80% and 78.60%Fibonacci retracement levels of the entire rise from 4786 to 5492.

The Trend Channel support placed at 4900 level on the Nifty is a crucial level to watch out for. A breach of that can even threaten the swing low of 4786 and cause far greater damage.

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Time Cycle Analysis points to an important Turn Date

A fixed period Time Cycle on the BSE SENSEX that we have been tracking and quoting in our research reports often, now points to an important turn date on or near 12th of August' 10. Though the Time cycle did not coincide exactly with a Top/Bottom in past couple of instances it was pretty close. We yet again consider the Time Cycle to see if its still valid or we can discard it for future references. Time cycles may be taken as a supporting evidence to predict turn dates. Though there is no rule that the base security would react making a top or bottom, once established the cycles work well until some time after which they cease functioning for no reason. Whether or not it works this time remains to be seen.

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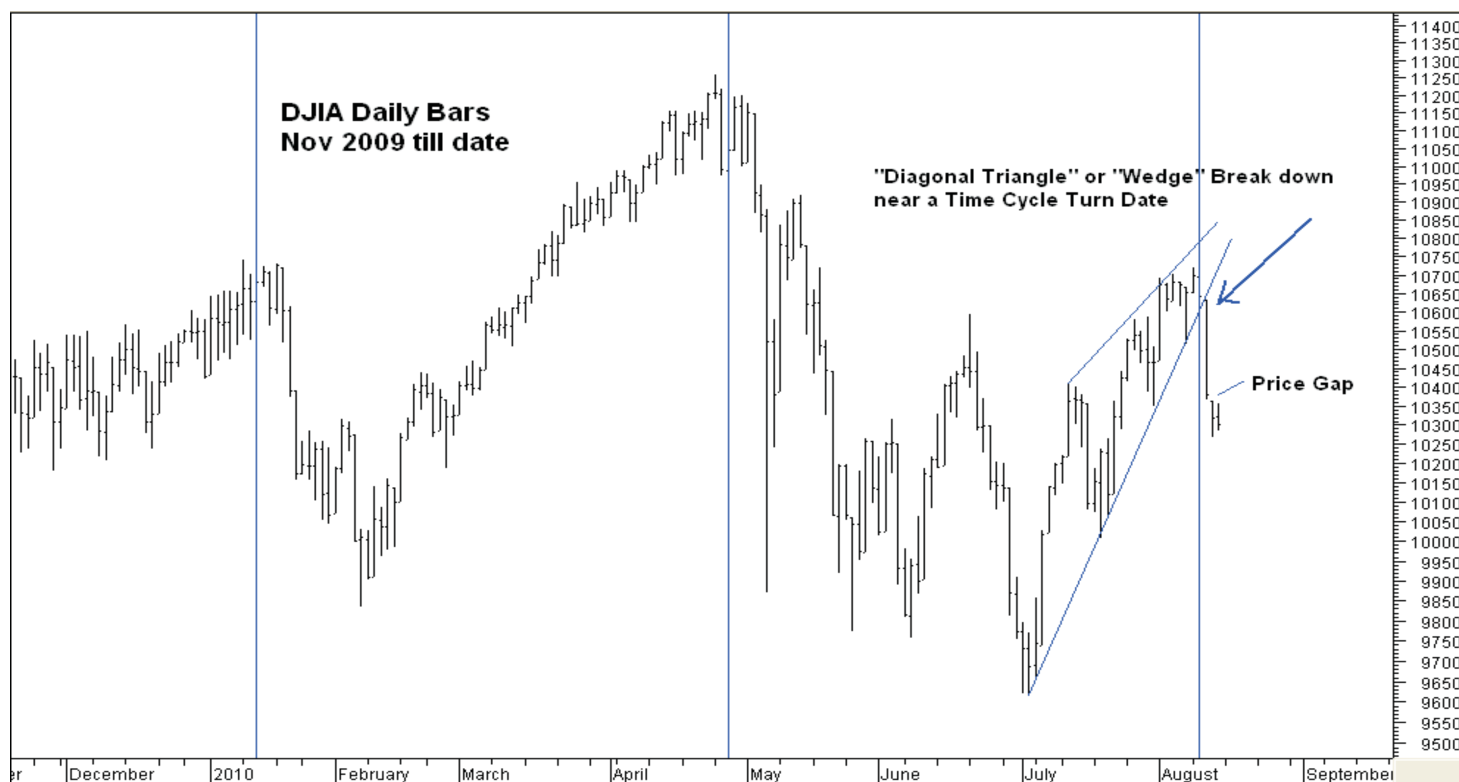

Intermarket Analysis compliments the Cautious Stance

We have been tracking the S&P 500 index in our earlier Crucial Junctures report. We initiated coverage on 6th of April indicating a top near the crucial range of 1200 - 1225 just few days before the now infamous "Flash Crash" and had a target of 1019. We later revised the target to 865- 877 range based on the "Head &Shoulder" pattern in the report dated 30th of June'10. Back then we also indicated the level of 1000 on the S&P as a crucial resistance in case of a bounce back. Though we have seen prices retrace much higher that the earlier envisaged 1000 level on the S&P 500, we maintain the earlier mentioned target range of 865 - 875. The index has bounced off its low of 1010 registered on 1st of July '10 and has now retraced slightly less than 61.80% of the entire fall from 1219 to 1010, whereas the DJIA has already retraced marginally beyond the 61.80% of the comparative fall from11258 to 9614 which creates a non confirmation of sorts, again a bearish sign . The recent upmove from the July'10 lows may prove treacherous for traders as the bounce off its lows has developed as a "Diagonal Triangle" or a "Wedge" which got completed near an important Fibonacci retracement level near a very relevant fixed period "Time Cycle" turn date. The entire rise from the recent low of 1010 has been on the back of lower volumes which also supports the construction of the presumed "Wedge". There is a high probability that the bounce back may now be complete and the index may now plunge lower very sharply as the break down of "Diagonal Triangle" always implies a dramatic reversal which takes the prices down to the base of the formation which in this case is the 1010 mark in S&P 500 and 9614 in the DJIA.

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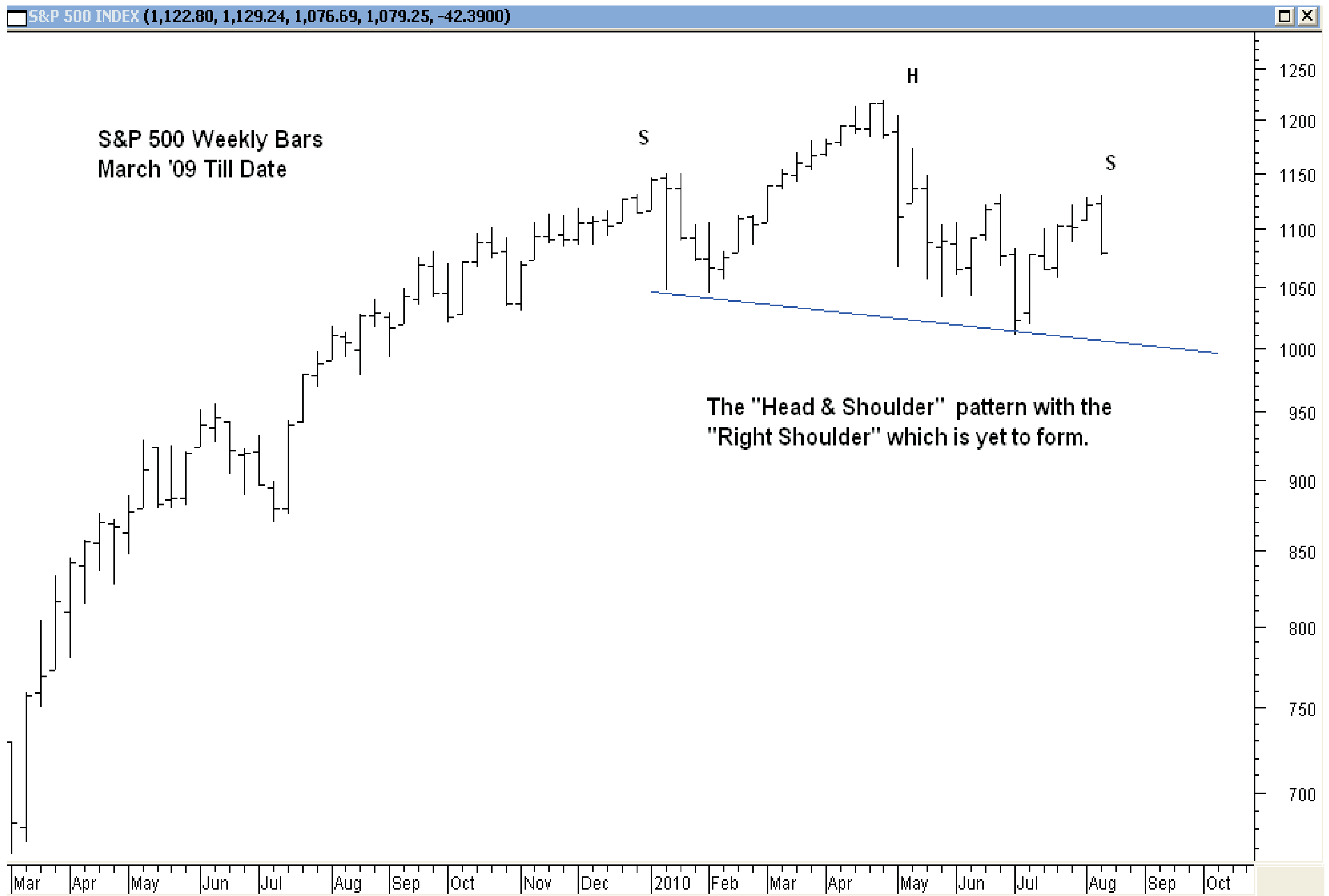

If the pattern we are reading is correct then the prices should tumble swiftly in the coming few sessions after a probable minor bounce back till 1088 - 1092 range on the S&P 500 and 10367-10405 range on the DJIA preferably, however we feel any bounce back should be capped below 1106 -S&P and 10527 -DJIA. We would also like to discuss the observation of "Head & Shoulder" pattern we had indicated in our previous report. Back then we had anticipated the pattern to be complete on 30th of June' 10 but it managed to scale higher to a recent recovery high of 1129 on the S&P 500. On hindsight we can now attribute one important reason for the greater than anticipated bounce (we anticipated 1100 level as a severe resistance in case of a bounce back). The presumed right shoulder had not achieved time equality with the left shoulder back then, which now appears to be almost on the way to be satisfied. As pointed out the upsides have been on the back of low volumes which satisfy the prerequisite of formation of the shoulder. We maintain the bearish contention for the S&P 500 and the target of 865 for it as the pattern suggest potential for a significant downside over the course of coming few weeks. The target for DJIA works out to 8285.

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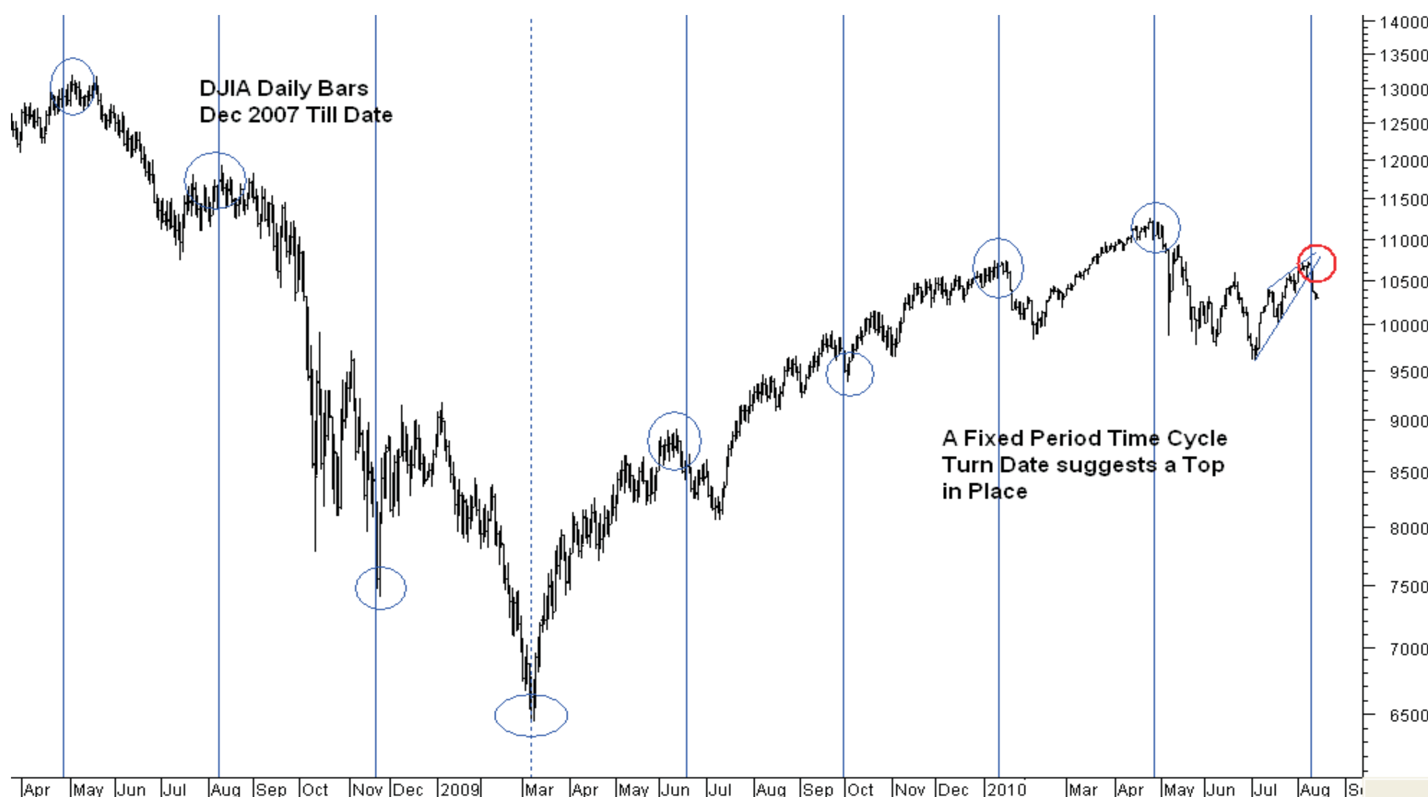

There has been a divergent behavior between the Nifty and the DJIA. While the DJIA appears to have formed a top in April the Nifty recently made a new 52 week high of 5492 last week. However similar divergences were also visible during the 2008 Top formation in Nifty . While Nifty made a high in the month of Jan' 08, its American counterpart DJIA had already peaked in the month of October 2007. It remains to be seen whether it pans out the same way this time around.

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The Dollar Index

In the midst of the Indian indices approaching a crucial "Trend Channel" resistance and their American counterpart giving a breakdown of a bearish pattern, another important asset class the US Dollar has taken support near 61.80% Fibonacci retracement level of its earlier rise from 74.17 to 88.71, after remaining southbound since June' 10. The US Dollar Index has formed "Bullish Engulfing" pattern on the weekly chart and now quotes at 82.74. It has potential to head higher till 85.40 in a short span of time as the "RSI" has corrected itself from the overbought territory. However if we look at the medium term charts since Nov' 08, a potential "Inverse Head & Shoulder" in the making is visible. The pattern however is not complete yet. A confirmation will come only if the Dollar Index manages to sustain beyond 90 levels. The Inverse correlation between the Equities and the Dollar Index is something that majority of the market participants are aware. However, it is yet too early to conclude anything about the medium term trend of the index till it does not surpass the level of 90. Nonetheless observing the medium term chart we remain aware of long term bullish possibilities for this index.

For the immediate term however there are some clear bullish signs on the chart which support further upmove till 85.40 which is the 61.80% Fibonacci retracement level of the recent fall from 88.34 to 80.09.

The strengthening dollar may have bearish implications for equities as an asset class going forward.

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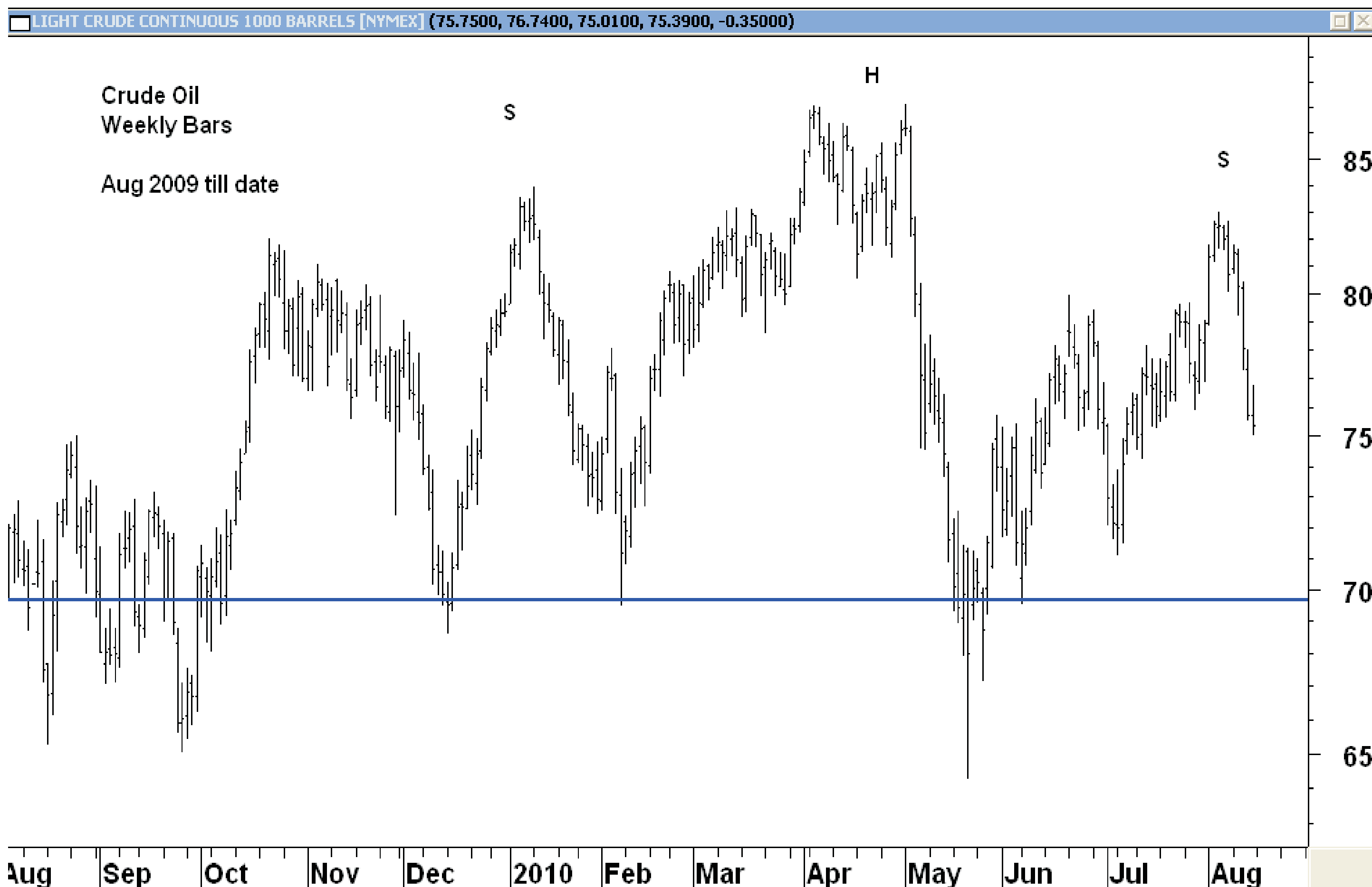

Crude Oil - Forms a "Head & Shoulder"

Crude Oil has a positive correlation with economic activity and thus equities. After a relentless fall since its peak in July 2008, Crude Oil prices have traded in tandem with the trends in equity markets. Crude Oil appears to be forming an extended "Head & Shoulder" pattern on the chart since October 2009. The Peak of the right shoulder now appears to be in place at $ 82.9 . The level of $ 71 is a crucial level to watch out in crude. A breach of 71 would further confirm our view. In that case it may further come down and breach the "Neck Line" placed at $ 68 and complete the pattern. We are looking at further downside in this commodity which may drag it down to a minimum of $ 57 and lower. However we await a confirmation of a breach of $ 71.

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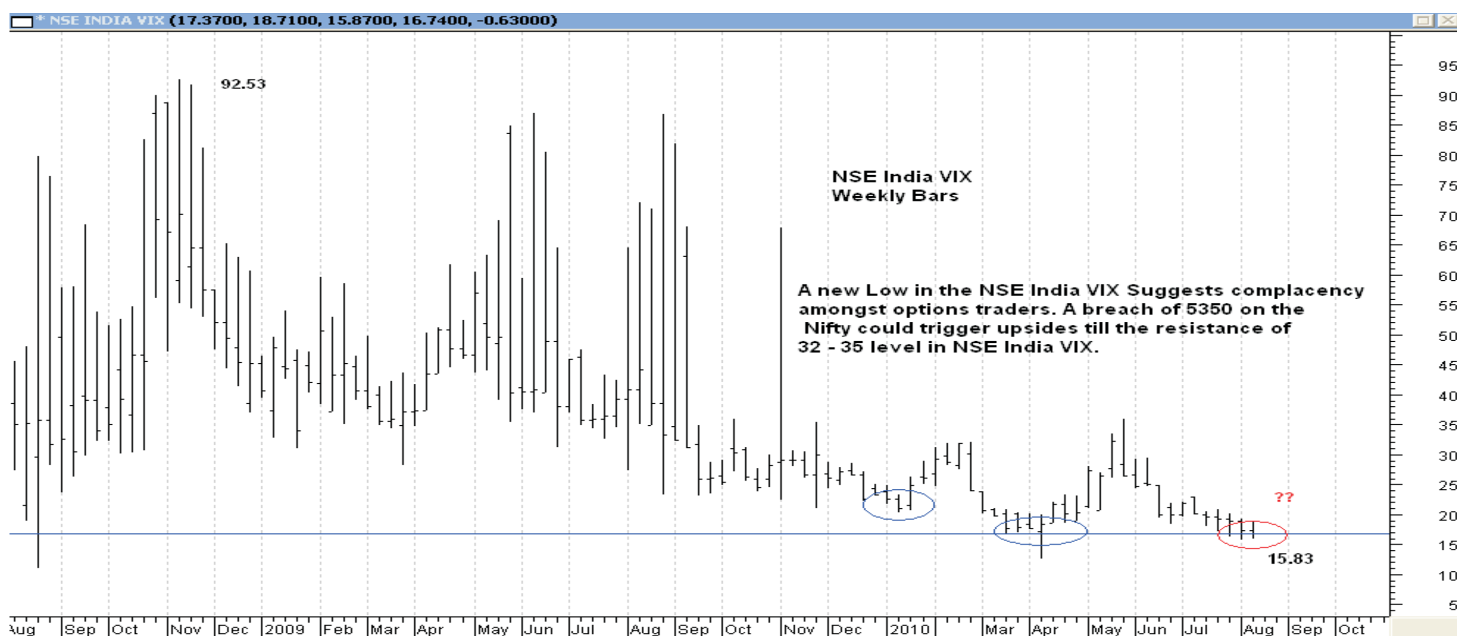

The Volatility Index (VIX) and the Put/Call Ratio (PCR) suggest complacency amongst the Traders.

Let us discuss some interesting observation from the Derivatives Market. The Volatility index is considered as the gauge of fear. The NSE India VIX is now quoting near the all time low of 16.74. The index made a high of 92.53 in Nov ‘ 08 just when the Nifty was about to form a significant low after a massive bear phase that lasted for more than a year. The present low levels in the index may well be taken as the reflection of the complacency of the participants.

The Index has remained between a band of 20-17 levels just before major corrections and on the higher side it has tested 32-35 levels just before the formation of a bottom - an observation as pointed by our Derivatives desk. This time however it tested a new all time low of 15.87. With any correction in the immediate term there remains a significant risk that the index may head back to the resistance of 32 or even higher.

The put/call ratio is a reliable indicator of future market direction and a contrarian-sentiment measure. It is a predictive tool to gauge the feelings of traders. With the PCR right now quoting at 1.74 most of the options traders are betting on further upsides. However 1.75 level has proved as an overbought reading since past 10 months and has been a precursor to market drops-An observation confirmed by our Derivatives desk.

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Conclusion

We are issuing this urgent report at this juncture as S&P CNX Nifty appears highly susceptible to a significant potential downside based on inter-market analysis.

We reiterate the objective of this report is to be proactive and guide our clients IF the Technical events stated herein occur as envisaged.

The intermarket relationships mentioned in the report have had a definite correlation in the past and thus we foresee a predictive value in exploiting them for our benefit.

With the S&P CNX Nifty now approaching a stiff multi month "Trend Channel" resistance and the market internals from the Derivatives segment suggesting complacency amongst options traders coupled with the break down of a bearish “Wedge” pattern on the DJIA/S&P 500 close to an important “Time Cycle” turn date calls for caution till Nifty trades below 5600 level. We feel it's a time apt enough to step back and adapt a neutral stance.

Though the present trend in Nifty continues to be up with a minor probability of testing the level of 5555, the potential for an intermediate negativity remains high if it breaks the level of 5350 based on the intermarket analysis.

Aggressive traders can go short on Nifty with a stop loss of 5600 on a closing basis. Whereas Investors are advised to book some profits in stocks that have done exceedingly well in past few months and are further advised to hedge their portfolios by buying some out of the money Put Options for coming month series.

In our view it pays to disassociate oneself from the herd.

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