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KEEPING A CLOSE EYE ON PALIO

The never-ending rally continues. It shouldn't ... but when dealing with the market, "shouldn't" doesn't count. The only thing that counts is what "is." The rally continues to push higher, and I expect it will nudge its way until Palio, my broad market timing model, finally leaves its positive stance behind and kicks in with a sell signal.

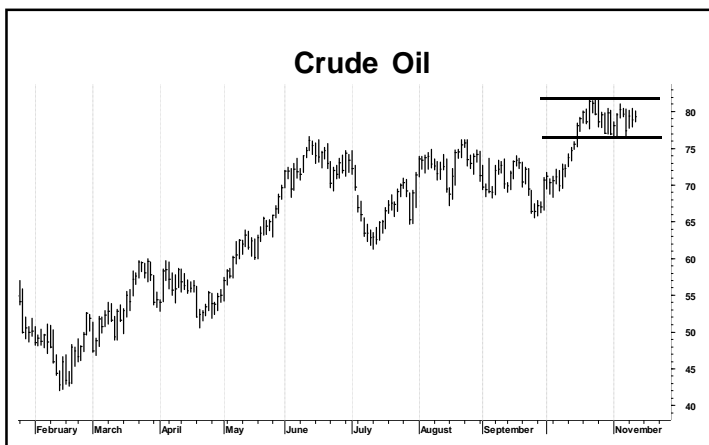
Our Nasdaq timing model, the Nasdaq Slow Tracker, did give us a sell on November 3, only to reverse back to a buy on November 16. That's a thumbs up for the near term, but the Nasdaq continues to lag the big caps. That is a danger signal, and it's definitely not bullish longer term. The Slow Tracker will reverse back to a sell if the Nasdaq Composite falls to 2,024 or lower.

Something to watch, if you have a mind to, is the NYSE new high/new low data. I get mine from *The Wall Street Journal*, but you can use this Yahoo site just as easily: <http://finance.yahoo.com/advances>. I like to follow a 10-day moving average of the new highs divided by the new highs plus new lows – NH/(NH+NL). The ratio is bullish over 70%; and as we go to press, the reading is about 96%. The key "sell" will occur when the moving average drops below 70%. However, Gerald Appel, systemsandforecasts.com, who I believe created this tool, is currently warning that a drop below 80% will be cause for alarm.

Until I see a sell from Palio, I just have to bite my bearish tongue, stay vigilantly on guard for some "black swan" surprise, and let my near term outlook ride along with the rally and with Palio. That is not to say this is a good time to be a buyer. As prices advance higher unabated, the greater becomes the market's potential instability.

Gold, of course, is all the rage, and it's perhaps more emotional than the popular averages. That does not make gold a good buy at this point any more than high prices make the Dow or the Nasdaq a bargain. My general advice is to hang on to your precious metals (and other commodity investments) and wait for the next buying opportunity to develop. When might that be? Well, I would have expected something by now, but Mr. Market does not always see things exactly my way. That is no reason to throw caution to the winds, though.

Our more recent purchases in this sector (Royal Gold, etc.) have been rewarding enough, but it's tough to find a decent buy here. I have at times tossed out an idea that I wouldn't mind buying even if a bit too high, but the gold market is just too whooped up right now to do that. Hold on and wait for a low risk opportunity to develop at lower levels. The published downside buy prices are still valid.



In the last letter, I mentioned that I thought Simplicity would work its way up to 7.00-7.25, and I still stand with that. Such readings from Simplicity will confirm that it is time to look at jumping on some more gold.

The U.S. dollar is, of course, a player in the commodities market, and its weakness this fall has been partially responsible for the strength in gold, and perhaps crude as well. Nevertheless, gold has been able to make new, all-time highs without the dollar. The current U.S. Dollar Index stands at about 75.00 with all-time lows just shy of \$72.00. Gold is in a bull move for reasons beyond a weak dollar. Some of that is anticipation of worse economic conditions next year in the U.S. and a desire on the behalf of banks and individuals to diversify out of dollars into something more reliable as a store of wealth. My technical work on the dollar is still negative; but if the Dollar Index basis March moves to 77.85 or higher, we will have to gird for a deeper correction in the metals and energy. Just because there is a reversal point, though, does not mean that point will actually be reached and triggered.

Crude oil holds more interest for me than gold and silver. The metals simply have to cool off some before we can get more involved with them. Crude has been consolidating between \$76.00 and \$80.00 for several weeks now. I mentioned in the last letter that there is minor support at \$72.00 - \$74.00, but perhaps we will not see prices pull back quite that far.

I have two new recommendations to add to our list. First is **Kinder Morgan Energy Partners** (KMP-NYSE-\$56.75). This is a stock that we have profitably been in and out of in the past. Kinder Morgan operates pipelines in the U.S. They are organized as a limited partnership, which means you will have to do a little extra reporting to the IRS if you buy this in a taxable account. They send all the partnership information you need to file, but my experience is that it arrives a bit later than I would prefer. I like to get my taxes done early. The good news is that you generally get to participate in some partnership deductions which will shelter some of the dividends from taxes. The current dividend is \$1.05 per quarter, and that will give you a decent 7.4% at the current price. My downside target for this one is a little lower - at \$54.00 - where I recommend you have your open orders entered.

The second company is **Linn Energy LLC** (LINE-OTC-\$24.80). Linn is organized as a master limited partnership similar to Kinder Morgan. They acquire and operate long life oil and natural gas properties in the U.S. Since going public in 2006, they have had an impressive record of increasing production output. Check them out at www.linnenergy.com. I would buy a pilot position at \$25.50 or less – say 25% of what you would like to own. Then scale down with another 25% at \$24.00 and the rest at \$23.00. The company has a good record of dividend payment, and the current rate is \$0.63 a quarter. That will give you a nice 10% plus return. I do hate to chase stocks - which is the reason for the scale down strategy here - but the company's 10% dividend and past track record makes me comfortable holding on if the market corrects and pulls this one down temporarily. Over the longer term, Linn should become a gem in your portfolio.

My outlook for the economy cannot be as optimistic as the stock market would like me to be. There are simply too many obstacles to warrant the current extreme level of enthusiasm. I came across a comment the other day that was apropos, but I cannot find the source. The writer said that "Someone should begin issuing DUI's on portfolios!" Yes, things are getting heady, indeed, and risk in the overall market increases with each passing day.