



## ENERGY COMMENT

### MONTHS OF BASE-BUILDING HAVE POSITIONED ENERGY STOCKS FOR A MAJOR RALLY BUT A DECISIVE BREAKOUT MUST OCCUR SOON

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Since the early days of this mini-bull we have become its advocates. Our February Energy Comment observed "Energy stocks continue to strengthen their case for a relief rally." Then in April we continued: "The recovery rally has put the Energy sector on a stronger footing." It was only recently that we noticed the need for a pullback: "The Energy sector is going through a summer slowdown."

Indeed, since this mini-bull sprinted out of the starting gate in early March, the market action has been up and away, interrupted by brief consolidation periods.

In June, the much-needed pullback has arrived with the Energy sector correcting from 1/3 (TTEN) to about 1/2 (XOI). In early July a rally restarted with all major stock indices quickly moving above the June highs. But that wasn't the case with Energy stock indices. What happened? Why have Energy stocks been lagging behind other areas of the market?

The slow start has been a normal, and paradoxically positive, "trademark" of the Energy sector. Energy stocks have tendency to lag in the early stages of an advance but over-deliver toward the end of an up-leg. Ironically, this 'delayed' start has its own benefits. While the general market quickly reached a "full speed" (with help from Banking and Technology stocks), Energy stocks have taken a slightly different approach. They ignored the early excitement and concentrated instead on building bases from which the advance could be launched. This effort should allow

Energy stocks to initiate a rally with enough "fuel" to carry them higher than other sectors that haven't spent adequate time building such bases.

The XOI index, portrays this situation the best. Since October, 2008 the XOI index has been trading within a wide horizontal trading range. This palatable price action resembles a base-building effort which, if confirmed by a breakout, could result in a multi-month rally (see charts on the next page).

The most recent price action, with the index moving above 50- and 200-day moving averages, has increased the chances for such a breakout. However, a decisive move above the upper boundary of this range must occur shortly. A prolonged delay could jeopardize the sector's bullish potential and leave it a little time to move higher in this shortened bull market.

***The Energy sector has been lagging behind other areas of the market so far but it hasn't been wasting its time. The months of base-building have strengthened the sector and positioned it for a major advance. A rally scenario, however, comes with the proviso that a decisive breakout will occur shortly.***

***Continue to focus on the strongest names but be sure to use stop-loss orders at all times.***

Olaf Sztaba



# XOI

Daily chart with 50- and 200-day moving averages



# TTEN

Daily chart with 50- and 200-day moving averages

