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Market Commentary: A Notable Divergence

It was the \$6 billion bombshell on Wall Street. That's what they told us the Amaranth hedge fund lost this month.

Despite the breakout in bond yields this week to new swing highs as seen by the inverse breakout in price on the chart below of the 10-year Treasury note, stocks refused to follow.

Since July, stocks have moved up following yields lower -- until this week. That's a notable divergence.

The market got a dose of reality this week as the Philly Fed report was telegraphing more weakness than would be inherent in the idea of a soft landing. The fact that the Philly Fed report is typically a nonevent underscores the nervousness among market participants.

What really is amazing is the complacency with which the financial markets greeted the Amaranth news. This was not the case when Long Term Capital Management fiasco broke. Then, the Street was panic stricken and there was less than half as much money involved back then.

In my experience, reactions and pullbacks are bred from overbullishness, while crashes and waterfall declines come from too much complacency.

We are at an interesting juncture. After three years of rallies since March 2002, the S&P topped out last spring. That high has been tested. A test failure will be confirmed on trade back below 1292 in the **S&P 500**.

However by that time, should it play out that way, a lot of damage will have been done to your portfolio if you wait until that level is breeched.

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Already there are many stocks that have refused to rally significantly over the few months, as witnessed by the meaningfully lower high in the Russell 2000. Already there are many leaders that have shed significant point count on the mild pullback from this week's highs. Those names include **M-Systems Limited** (FLSH), **Fomento Economico** (FMX) and **U.S. Global Investors** (GROW) just to mention a few.

What is important going into next week is your stance as to whether or not you believe that this is just a pullback in a sustained uptrend or a rollover. I believe that the news breaks with the cycles, and that this week's Philly Fed report and the Amaranth blowup are a sign of the cyclical pressures looming.

Conclusion: In the last 40 years, the yield curve has inverted seven times, and each time a recession has resulted. Despite the most extraordinary bull market in real estate ever seen, over the last five to six years, there seems to be an abundance of sentiment that believes an equal and opposite reaction in the housing market will not result in a hard landing. It is my job to look for the canaries in the coal mine in the hourlies and dailies that will alert us to the possibility of oxygen depletion in the financial markets from the scent of this possible whiff of deflation.

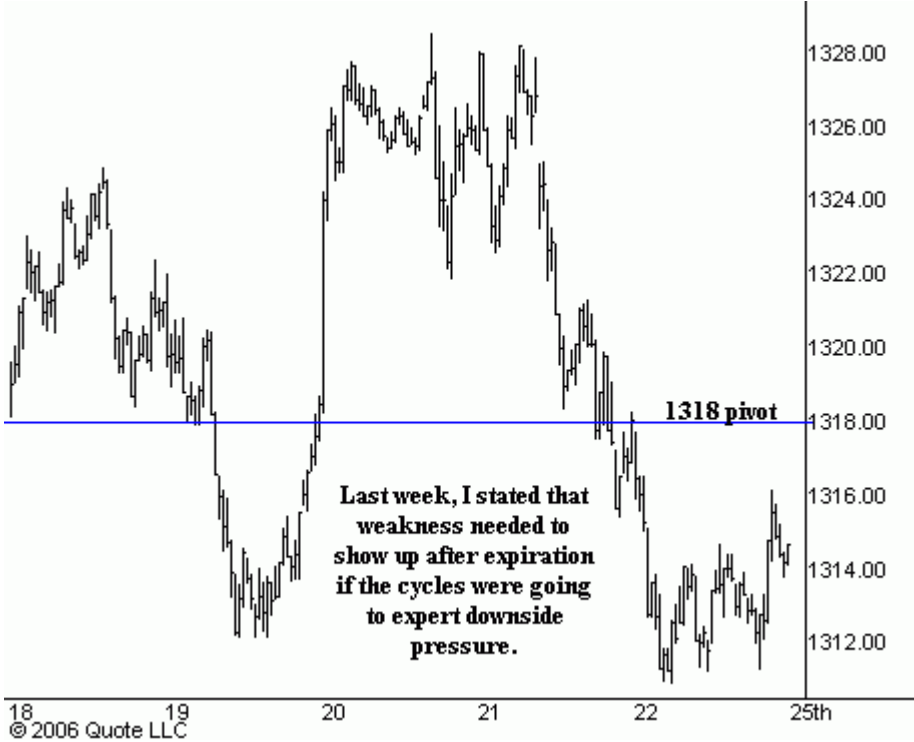
Strategy: Most mutual funds do not want to show heavy energy positions going into quarter-end. Consequently, there may be a lot of hedge funds leaning into the oils next week. However, as mentioned previously, my work suggests that the oils are poised to attempt a retracement rally from current levels. But is there any reason to believe that hedge funds have a franchise on smart ideas, especially after this week?

Although I suspect that most traders think that eclipses, solstices, and equinox points are either too esoteric or just not valuable in determining the trend, they have done a very good job of identifying turning points over the years -- particularly in 1987 and 2000, just to mention a few.

Friday morning was the solar eclipse, which fell on the same day as the autumnal equinox -- potentially enhancing the impact of this natural turning point. This event may have triggered the big picture cycles that are overhanging. The market seems to have responded appropriately on Thursday. Be that as it may, mutual funds are mandated to be invested at quarter-end. So, unless somebody panics and breaks the conga line, things may more or less hold together until quarter-end. However, if a big fund breaks ranks, and downside momentum picks up, it will underscore the market's vulnerability prior to quarter-end.

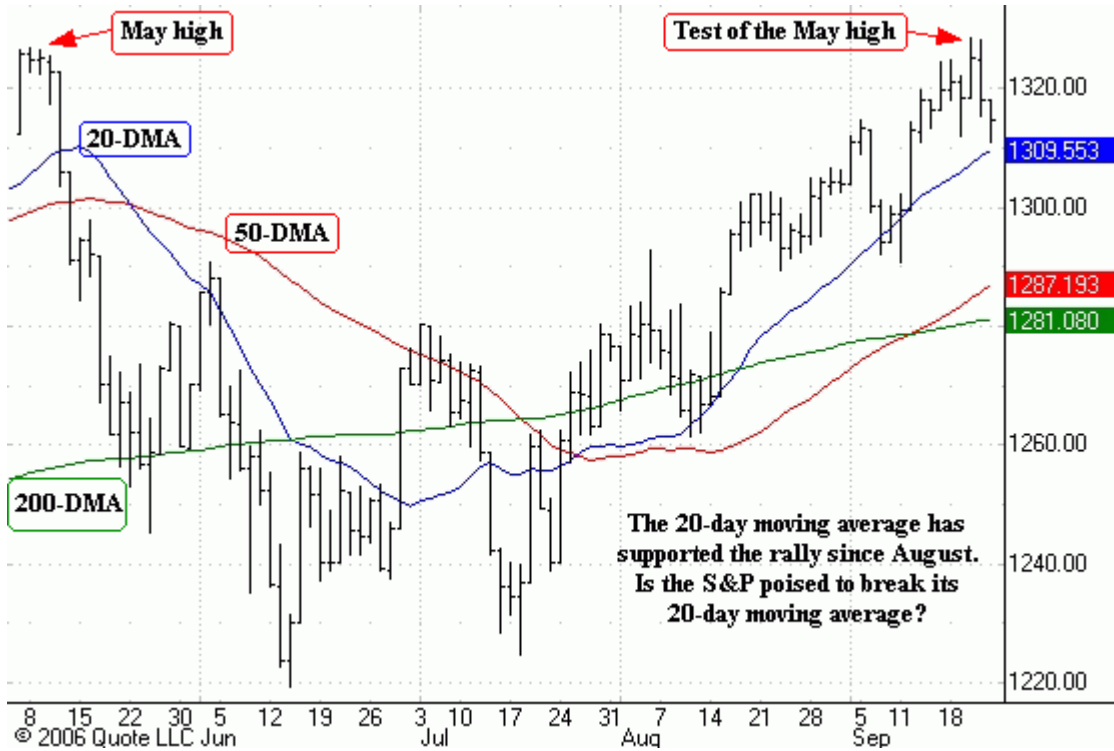
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S&P 500 -- 10-Minute



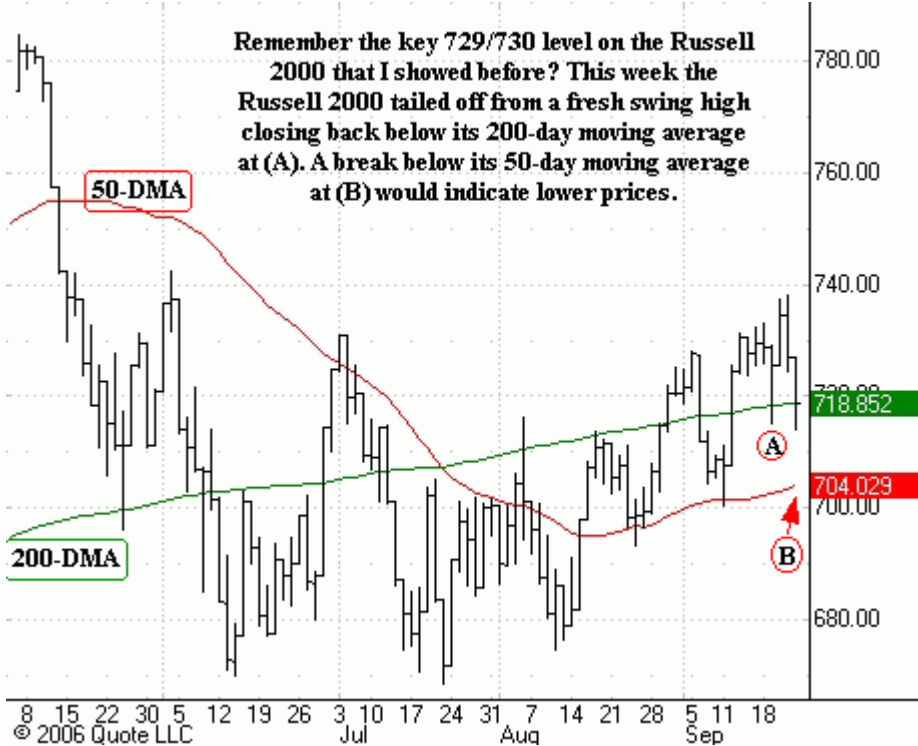
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S&P 500 -- Daily



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Russell 2000 -- Daily



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U.S. Treasury 10-Year Note -- Daily



Pivot Points

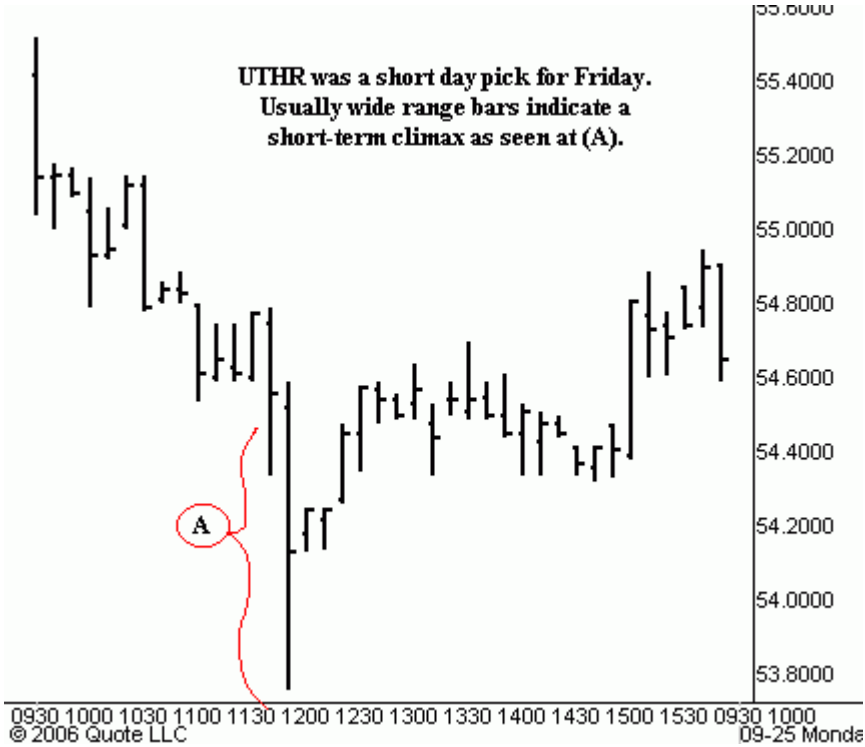
S&P 500 -- 10-Minute



S&P 500 -- 60-Minute



United Therapeutics (UTHR) -- 10-Minute



THE DAYTRADING REPORT

Chart 1

Arena Resources ▲
(ARD:NYSE)
Short

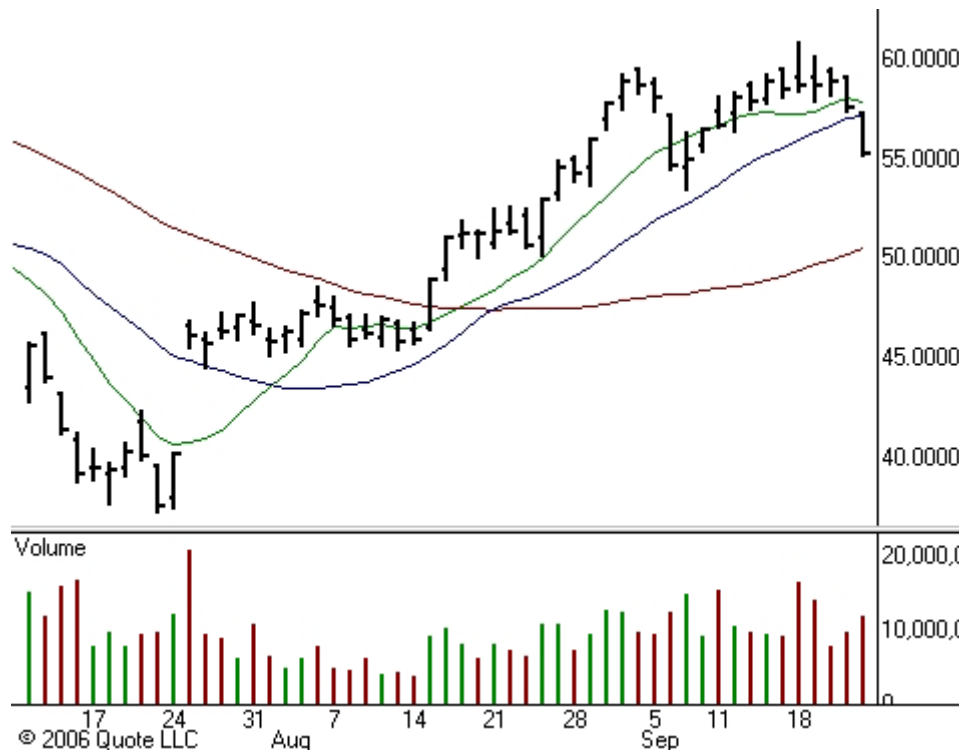
Entry: 30.15
Stop: 31.15
Pattern: Expansion Breakdown / 180



Chart 2

**SanDisk
(SNDK:Nasdaq)
Short**

**Entry: 55.15
Stop: 56.15
Pattern: Angular Rule of 4 Breakdown**



THE SWING REPORT

Chart 1

Ipsco
(IPS:NYSE)
Short

Entry: 83.40
Stop: 85.40
Initial Target: 81.40 (trade toward)

Pattern: Expansion Breakdown / Rule of 4 Breakdown

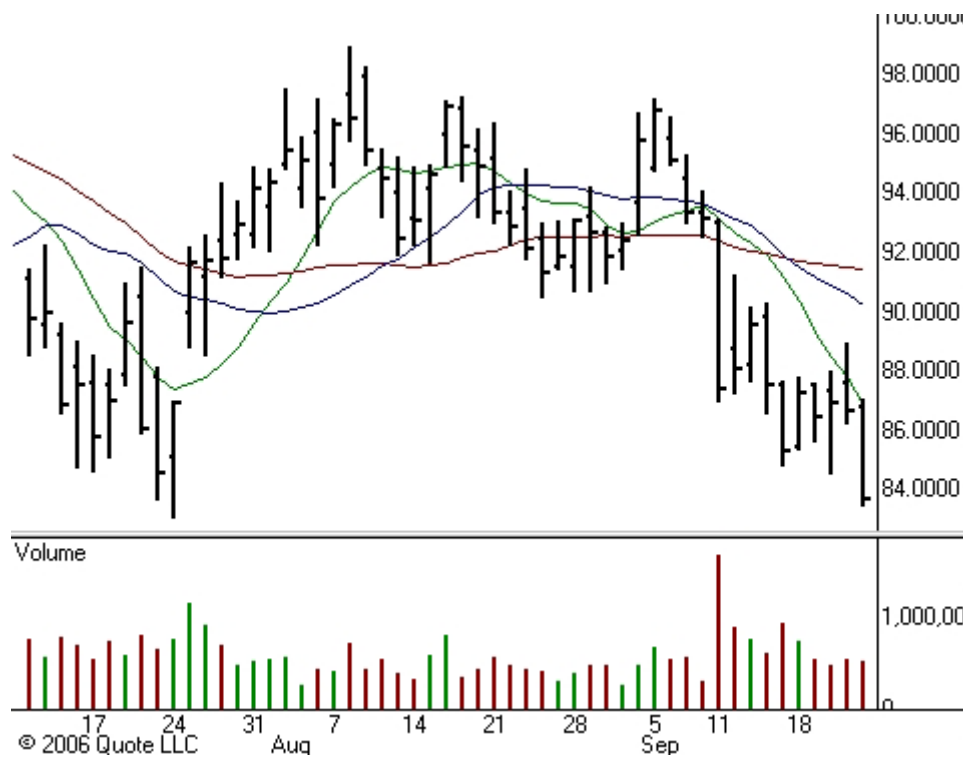


Chart 2

**Lufkin
(LUFK:Nasdaq)
Short**

**Entry: 52.75
Stop: 54.75
Initial Target: 50.75 (trade toward)**

Pattern: Expansion Breakdown

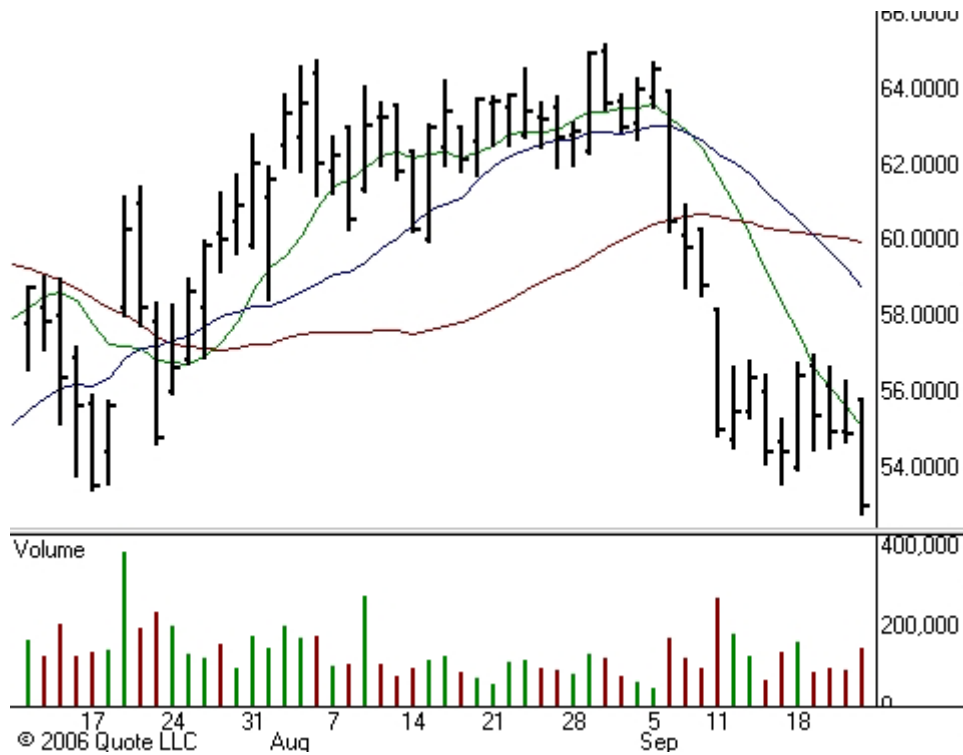
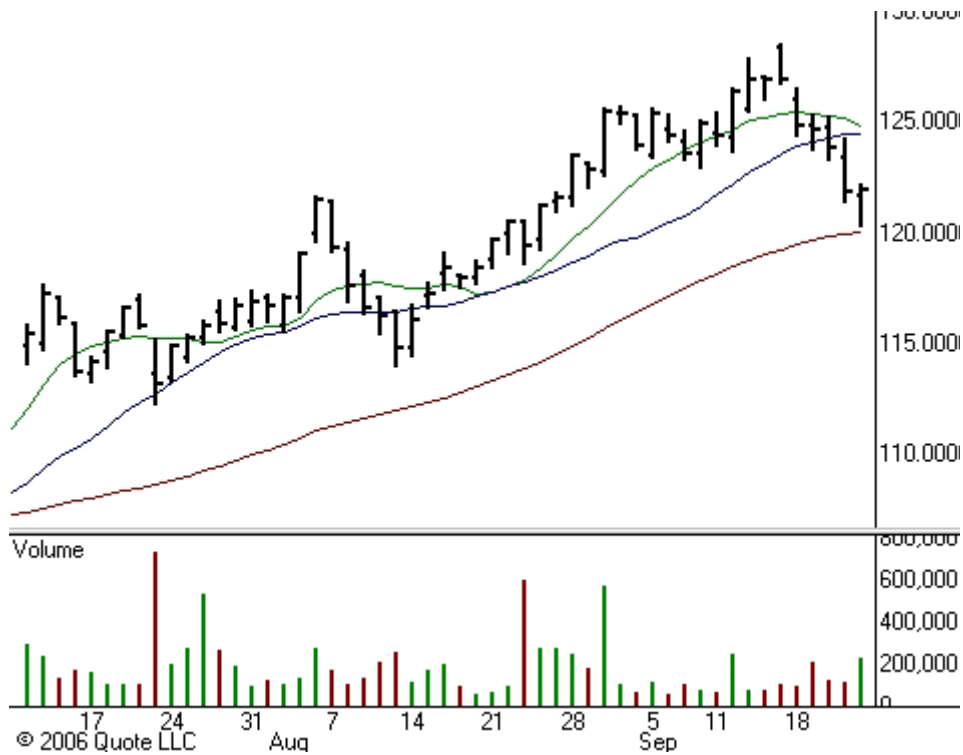


Chart 3

**Essex Property Trust ▲
(ESS:NYSE)
Long**

**Entry: 122.40
Stop: 120.40
Initial Target: 124.40 (trade toward)**

Pattern: Lizard



OBSERVATIONS AND TRAILING STOPS

- Monday is day two in **Occidental Petroleum** (OXY) (long). You are long from 45.75. Maintain the stop at 43.75 and the initial target on trade toward 47.75. As of Friday's close, you are down 52 cents.
- Monday is day two in **Caterpillar** (CAT) (short). You are short from 64.15. You should have covered your first piece on trade toward 62.15, locking in a gain of 2.00. Lower the stop on the second piece to 63.25. As of Friday's close, you are up 1.38 on the second piece.
- Monday is day two in **United Parcel Service** (UPS) (short). You are short from 70.70. Maintain the stop at 72.70 and the initial target on trade toward 68.70. As of Friday's close, you are down 19 cents.
- On Friday in **Valmont Industries** (VMI) (long), you were stopped out at 52.25 for a loss of 2.00.
- Monday is day three in **TXU Corp.** (TXU) (short). You are short from 59.70. Maintain the stop at 61.70 and the initial target on trade toward 57.70. As of Friday's close, you are down 44 cents.
- Monday is day three in **Veritas** (VTS) (long). You are long from 65.10 on an ORB. Maintain the stop at 63.10 and the initial target on trade toward 67.10. As of Friday's close, you are down 50 cents.
- On Friday in **Carpenter Technology** (CRS) (long), you were stopped out of the second piece at the open at 105.68 for a gain of 1.68, after selling the first piece on Wednesday for a gain of 2.00.
- Monday is day four in **Equinix** (EQIX) (short). You are short from 60.70. Lower the adjusted stop to break even at 60.70 and maintain the initial target on trade toward 58.70. As of Friday's close, you are up 1.14.
- Monday is day five in **Rackable Systems** (RACK) (short). You are short from 26.75. Maintain the stop at 28.75 and the initial target on trade toward 24.75. As of Friday's close, you are down 98 cents.
- On Friday in **Altria Group** (MO) (long), you were stopped out at 81.40 for a 2.00 loss.
- On Friday in **Psychiatric Solutions** (PSYS) (long), you were stopped out at the open at 34.60 for a loss of 1.10.

THE TRADING REPORTS HIT LIST

For the week beginning Sept. 25, 2006

The following is a list of those strongly trending stocks (up and down) that my work shows to be the most interesting for the current week. Not all strongly trending stocks are created equal. The following stocks are culled from screens that meet my proprietary criteria based on patterns, time and price.

Uptrending

VF Corp. (VFC:NYSE)
Vornado Realty Trust (VNO:NYSE)
Essex Property Trust (ESS:NYSE)
Apartment Investment & Management (AIV:NYSE)
Corrections Corp. of America (CXW:NYSE)
Prologis (PLD:NYSE)
Akamai (AKAM:Nasdaq)
Zimmer (ZMH:NYSE)
GEO Group (GEO:NYSE)
Altria (MO:NYSE)
Baxter (BAX:NYSE)
Harley-Davidson (HOG:NYSE)
American Financial Group (AFG:NYSE)
Reinsurance Group (RGA:NYSE)
MasterCard (MA:NYSE)
Veritas (VTS:NYSE)
Vimpel Communcations (VIP:NYSE)
Vertex Pharmaceuticals (VRTX:Nasdaq)
Boston Properties (BXP:NYSE)
Abercrombie & Fitch (ANF:NYSE)
WebEx Communications (WEBX:Nasdaq)
Jones Lang LaSalle (JLL:NYSE)
CorVel (CRVL:Nasdaq)
Integral Systems (ISYS:Nasdaq)
Deckers Outdoor (DECK:Nasdaq)
Priceline.com (PCLN:Nasdaq)
Gymboree (GYMB:Nasdaq)
Commonwealth Telephone (CTCO:Nasdaq)
Wyeth (WYE:NYSE)

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Downtrending

Navteq (NVT:NYSE)
Omnicare (OCR:NYSE)
Walter Industries (WLT:NYSE)
USG (USG:NYSE)
Chipotle Mexican Grill (CMG:NYSE)
FedEx (FDX:NYSE)
3M (MMM:NYSE)
Peabody Energy (BTU:NYSE)
Rackable Systems (RACK:Nasdaq)
Palomar Medical Technologies (PMTI:Nasdaq)
Komag (KOMG:Nasdaq)
FMC Technologies (FTI:NYSE)
Manpower (MAN:NYSE)
L3 Communications (LLL:NYSE)
United Therapeutics (UTHR:Nasdaq)
Terex (TEX:NYSE)
Toro (TTC:NYSE)
Textron (TXT:NYSE)
HydriL (HYDL:Nasdaq)
Garmin (GRMN:Nasdaq)
Baker Hughes (BHI:NYSE)
Newmont Mining (NEM:NYSE)
Dril-Quip (DRQ:NYSE)
Thomas & Betts (TNB:NYSE)
Ventana Medical Systems (VMSI:Nasdaq)
American Commercial Lines (ACLI:Nasdaq)
Cooper Industries (CBE:NYSE)
Marathon Oil (MRO:NYSE)
Millipore (MIL:NYSE)
Monster Worldwide (MNST:Nasdaq)

Notes and Guidelines

DayTrading Report:

Trades marked ▲ indicate stocks that are considered small-cap, trading 500K shares or less. As you know, thin stocks are generally more volatile and trade with a wider spread.

Trades marked * indicate patterns that don't conform to the original rules of the pattern but are defined as "in the spirit of" their namesakes.

The 1-Point Gap Rule: Any stock recommendation that opens 1 or more points above the listed entry price (for longs) or 1 or more points below the listed entry price (for shorts) should be ignored for the day. Please note that history suggests that entering a stock on a gap open increases your potential for a loss.

Reminders: A signal is not valid unless the stock trades at or above the listed entry price for longs and at or below the listed entry price for shorts. ***If a position moves 1 point in your favor in this choppy environment, it is a good idea to sell half the position and move your stop on the remaining position to break even.***

Charts: The green line is a simple 10-day moving average, the blue line is a simple 20-day moving average, and the red line is a simple 50-day moving average.

The Swing Report:

Trades marked ▲ indicate stocks that are considered small-cap, trading 500K shares or less. As you know, thin stocks are generally more volatile and trade with a wider spread.

Trades marked * indicate patterns that don't conform to the original rules of the pattern but are defined as "in the spirit of" their namesakes.

The 2-Point Gap Rule: Any stock recommendation that opens 2 or more points above the listed entry price (for longs) or 2 or more points below the listed entry price (for shorts) should be ignored for the day. Please note that history suggests that entering a stock on a gap open increases your potential for a loss.

Initial Target: Target price at which you should look to sell/cover half your position.

Reminders: A signal is not valid unless the stock trades at or above the listed entry price for longs and at or below the listed entry price for shorts. ***If a position moves 2 points or more in your favor in this choppy environment, it is a good idea to sell half the position and move your stop on the remaining position to break even.***

Charts: The green line is a simple 10-day moving average, the blue line is a simple 20-day moving average, and the red line is a simple 50-day moving average.

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