

Bit more downside... before a pullback

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Nifty to see further weakness before we see a meaningful recovery

Further to our recent report which suggested that Nifty is expected to decline towards 10,750-10,850 levels before resuming its journey towards, the recent turn of events triggered by IL&FS credit crunch or sell off in NBFCs suggests that some steam is left on the downside before we see a meaningful recovery. We now believe that our earlier estimation of decline in NIFTY towards a target of 10,700-10,750 levels can be further extended lower towards 10,500-10,600 levels. Various experts on electronic media have created hopes for a rebound from 200-DMA which is placed around 10,770. NIFTY may bounce from 200 DMA but rally would be short lived and create a meaningful bull trap. However, our analysis suggests otherwise, and we will not be surprised if these crucial levels are breached convincingly later on before we see a meaningful rebound.

Critical factors that would act as a catalyst for rally in Nifty towards our ultimate target are as follow-

1. The open interest (OI) tally in Nifty Futures is so far sluggish due to lack of any significant buildup on either side and the total OI has been placed below 1.7 crore. This suggests that market participants are undecided whether to go on long side or on the short side. In fact, positional traders will be convinced of bear market if prices in Nifty futures starts trading below 10,770. They may thereafter start using every rally to add short positions. This scenario may be used by smart bulls especially institutional players to trigger a surprise rally. This tug-of-war situation will open gates for increase in OI which we think will expand all the way to 3 crores+.
2. Another indicator which depicts inherent strength in NIFTY is the consistent rise in spread (difference) of NIFTY 50 to NIFTY 500 Index. With FII flows almost drying out, outflows from small cap and mid cap would be basic factor for rise in NIFTY 50 beyond 12,500.
3. The long-term support for NIFTY to USDINR ratio is placed at 140 levels which earlier acted as breakout line and should be an ideal case where even long only FIIs will be tempted to create fresh positions. For FIIs, level in dollar terms would correspond to 8,900 levels. And we reiterate strong case for Tornado rally from levels closer to 10,550-10,620 towards 12,500. FIIs should be a position of a 26-29% gains in dollar terms from these levels.

Conclusion

One needs to be patient before entering long positions at these tempting levels. We advise entering as much closer to 10,500 in Nifty as possible for an ultimate target of 12,500.

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NIFTY TO USDINR Ratio Analysis



Spread of NIFTY 50 TO NIFTY 500 INDEX



USDINR Spot



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