CHART PATTERNS	SECTORS	MARKET UPDATE
A Double Bottom For LUV	Band Index Still In Correction Mood?	Is Gold Do Or Die?

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ABLESYS

Seek to Boost Profits With AbleTrend Intelligent Stops and Sweet Spots

Two Major Benefits of Principle-Based AbleTrend

By John Wang, Ph.D., CTA, AbleTrend Developer

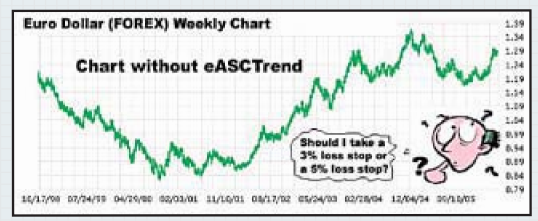
AbleTrend is the principle-based decision-making trading software that uses actual price movement to generate recommendations. Our buy and sell signals are calculated by a proprietary, back-tested algorithm that uses real-time or end-of-day price data - providing timely, specific, and objective signals for every trade. Because AbleTrend is principle-based, it offers the following unique benefits.

Rational risk management with "Intelligent stops"

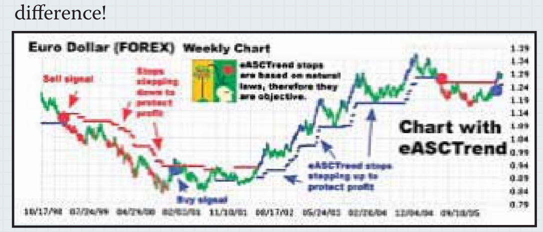
Traders use a stop loss to help protect gains and limit losses. When the market hits their stop, they liquidate their position. Any trading software can suggest stop-placement, but traders should be aware that the type of stop they use could determine if they win or lose. There are stops, there are arbitrary stops, and there are the AbleTrend principle-based stops -- the new generation of intelligent stops that are defined by the market's own support and resistance levels.

These intelligent stops are dynamic and are automatically adjusted by the software as prices change. A built-in feedback loop retrieves the data for market direction, price range, and momentum. And, because the stops are determined by actual market conditions, they are objective, back-testable, and can be used in real-world trading.

Here's a chart without AbleTrend. It's open to lots of interpretation - and that's where distracting and misleading emotions can come in.



Now, here's the same chart with AbleTrend, showing stops with small blue dots below the bars for buy positions, and small red dots above the bars for sell positions. What a difference!



With AbleTrend you can see where the trend changes. Where it's recommended to buy or sell. Where to place stops to help you stay in a trade as long as possible without taking on too much risk. And you have the confidence of knowing that the software is based on meticulous formulas that have been back-tested for years.

Seek to cut losses short, let your profits run, and trade the "sweet spots"

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With AbleTrend, you get clear, precise, easy-to-read "buy" and "sell" signals on every trade. All you have to do is log onto the system and look at your screens. Any time you see a LARGE BLUE CIRCLE on your chart, it's time to buy. Any time you see a LARGE RED CIRCLE on your chart - stop! It's time to call your broker and say, "Sell now."

And if you're in a trade where the market is moving in your favor, you can add to your position at more favorable times as the market progresses. We call these recommended optimum times to get in on a trade "sweet spots." The AbleTrend software signals sweet spots with the first blue bar to appear after a series of green bars.

You can also use sweet spots to get in on a trade if you missed the first entry, giving you a second chance to take advantage of a moving market. Sweet spots help you buy with confidence - and seek to expand your total gain on the trade.

It's our principle-based formulas that give traders the AbleTrend edge. Sign up for your AbleTrend test drive today, and experience the confidence of using intelligent stops and sweet spots.

Dr. John Wang, CEO and co-founder of AbleSys, as well as the creator of ASCTrend indicators and the AbleTrend trading system, holds a Ph.D. in physical chemistry and has been trading commodities since 1990. He is a registered Commodity Trading Advisor (CTA) with the Commodity Futures Trading Commission (CFTC) since 1995. **Use this discount code for a 30-day trial with a $20 discount: SCT8MA**

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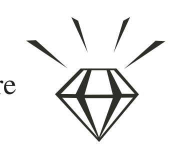

METALS AND ENERGY

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TRADING NOW

A fall in the US nonfarm payrolls and a rise in unemployment was enough to spark a selloff on Wall Street on June 8, 2008. When an economy is in bad shape — especially as bad as it is in the US — even a small bit of negative news is going to initiate a selloff among traders. But the bad news doesn't stop here. In fact, it gets worse when we turn our focus to the falling US dollar and rising oil prices. While this situation continues, even though the weaker dollar is helping exports, the US economy will continue to weaken. This is a good enough reason to sell off your equities and focus on other markets.

In this issue of **Traders.com**, we cover all sectors of the markets. Mike Carr asks a pertinent question of "Are We Finally At A Bottom?", puzzling whether a potential buy signal may be on the way for the SPY. Chaitali Mohile looks at the French CAC 40 Index and Koos van der Merwe at the Toronto Index,examining on whether the turmoil in either can be useful in some way. Ron Walker and Arthur Hill takes a look at the Nikkei and the NASDAQ, wondering the same thing.

What about gold? Alan Northam avers that the "Gold Rush Is Over," but Carr points out that we can still be "Profiting From Gold." What about the oil companies? Is "Exxon Running Out Of Gas?" Northam asks that question as Americans settle uneasily into paying more for a gallon of gasoline than they ever have before.

And that is only a fraction of the useful articles you'll find here and at our online publications, *Traders.com Advantage* and *Working Money*, or even STOCKS & COMMODITIES magazine. Take a look at our website and see what we have to offer. Check us out — that will enable you to:

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- Visit our Message-Boards, where you can share your opinions of trading technical analysis, and most everything else you can imagine with other traders.

So what do you think? Are there enough possibilities for you to look at other markets, those that may hold more profit for you? These articles make it clear that the markets are changing, and while your old, familiar ones may be harder to profit from right now, there are others that may do the job. And it's up to you, reading these articles, to figure out if they'll work for you.

Jayanthi Gopalakrishnan

Jayanthi Gopalakrishnan,
Editor

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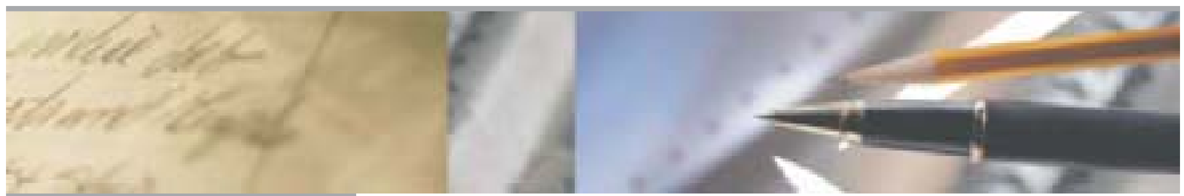

TRADER'S NOTEBOOK

Identifying Profitable Setups

by Larry Swing

This term is thrown around, but what's it really mean?

Lots of words are thrown around in trading terminology, but it's not always easy to understand exactly what they mean. At least that's the way it is for me when it comes to the reality of trading. One word I have difficulty with, in particular, is "setup," mainly because it is an all-encompassing word. So some clarification is needed.

WHAT EXACTLY IS A "SETUP"?

A setup means different things to different people. In general, for our purposes, a setup is an area (price or indicator) where a trader would take action; this can be opening a position or closing one. The setup has to meet criteria from price, volume, or any number of indicators being used. Setups can occur at different times of the day or week. For a scalper, setups may appear, one after the other, during a trading day, providing him with many trading opportunities and maybe even make a profit. For a daytrader, these setups may appear from time to time during the trading day. For the swing trader, these setups may appear a few times a week. It all depends on the strategy and indicators the trader uses.

SOME EXAMPLES

Let's take a look at an example. A setup for a stochastic indicator may be to sell whenever the value of the indicator goes above 80%. Conversely, whenever the value of the stochastic indicator goes below 20%, or it is oversold, it may be a setup to go long. In the 15-minute chart of Apple, Inc. (AAPL), the overbought areas, or short setups, are marked with a red arrow, whereas the oversold areas, or long setups, are identified with a blue arrow (see Figure 1).

Another type of setup could be to use the overbought and oversold readings of the stochastic with the crossovers of the two stochastic lines. For example, when both the red and blue lines go below 20%, there is no setup. It is only when the red line crosses above the blue one that a setup to take the long trade is indicated (vice versa for short-trade setups).

If you take a look at Figure 2, you can see that there are five long and five short setups. The number of setups would work well for a swing trader, but for others it may be too few or too many.

Another type of setup is based on price action. On the 15-minute chart of JDS Uniphase Corp. (JDSU) in

FIGURE 1: OVERBOUGHT OR OVERSOLD. Here you see an example of a simple setup. When the stochastic is overbought, it's a setup to open a short position. When the stochastic is in oversold territory, it is a setup to open a long position.

FIGURE 2: CROSSOVER OF STOCHASTICS. In addition to the stochastic being in overbought or oversold territory, the crossover of the %K and %D lines of the stochastics can also be used to identify setups.

FIGURE 3: PRICE ACTION SETUP. Once a bottom is formed, it is a setup to open a long position until a top is formed. After you exit that position you can enter a short position when a top is formed.

FIGURE 4: PRICE PATTERN SETUP. Often, setups are formed based on chart patterns. Here you see an example of a price channel. You can create your setups based on when price touches one of the channel lines.

Figure 3, you see an example of such a setup. One setup (shaded in pink) is a bottom, from where a long setup is created till a top is formed. After that, a short setup is created.

It is possible to assign one setup to a single pattern or a single movement of the market, either in a downtrend or an uptrend. Basically, a trader can decide that a market top for him is a setup and there will be no others for him until another market top appears. For pattern traders, a triangle breakout is a setup and there will be no others for them until another triangle (or pattern) and prices break out of it. In Figure 4, you see a pattern setup. Here, the pattern is a price channel. When prices touch the bottom or top of a price channel, it could be a setup to enter or exit a position.

How many is too many?

By identifying one setup from the next, the trader can evaluate how many trades there are in a setup or how many setups there are in a day. This would give an idea of how many trades he should be making per day in order to avoid overtrading. In addition, if he can identify the maximum number of trades he's going to take, this should eliminate taking too many trades from just one setup. By spreading out his trades, he has more opportunities to profit from a setup that will possibly bring him back into the black. ■

This article was originally published on 4/17/2008.

Suggested reading

Swing, Larry [2008]. "Daytrading With The NYSE Tick Indicator," *Technical Analysis of* STOCKS & COMMODITIES, Volume 26: June.

INDEXES

BULL/BEAR MARKET

Bank Index Still In Correction Mood?

by Chaitali Mohile

The Philadelphia Bank Index failed to sustain the consolidation range and the strong support as well, with the correction from this area leading to retesting previous lows. Will the correction continue?

Tradable: $BKX

As the average directional movement index (ADX) (14) in Figure 1 shows, the Philadelphia Bank Index ($BKX) was in a strong downtrend, pulling the price lower and lower. Even the recovery rally failed to surge above the moving average resistance.

Earlier, the downtrend was well maintained by ADX (14) sustaining above 20, even after its declining rally from 35. But since late January 2008 the positive and negative directional index had a tug of war, resulting in a consolidation, and the downtrend turned weak. The price therefore consolidated in the range of 85–90 in the support/resistance area of the 50-day moving average.

Just speaking technically, the same resistance kept $BKX away from any recovery rally, dragging the index lower and forming new lows on every retest. So the consolidation in this area with oversold stochastic (14,3,3) gave an optimistic view to the Bank Index.

The stochastic (14,3,3) rallied higher from the oversold area but took a nosedive to below 30 after going above the 50 level. The price too slipped below the consolidation range, and fresh correction was initiated. The correction was hard to hold back as volatility in the global market continued. The $BKX, after a week's correction, is closer to its potential support of 75 (spikes by previous candles). This brings up the question of whether the correction still has some room left or the index may consolidate with the potential support.

The moving average convergence/divergence (MACD) (12,26,9) is still weak, and the ADX (14) has moved above 15 with selling pressure. If the ADX (14) again moves above 20, the bears would spread the hands to capture the trend, but the present levels suggest consolidation at lower support.

The banking sector in India is troublesome. The volumes are pathetic in this sector and even in the overall Indian financial market. So building up positive sentiment on this sector for the short-term will be difficult. $BKX may take some time to bring back an optimistic view and rally higher.

Figure 2, the weekly chart, shares the bearish long-term view. The stochastic (14,3,3) has seen 50 as its strong resistance level in its recent run as well. The index lost its strongest support of a 200-day moving average in October and November as the oscillator failed to surge above the 50 levels. Since then, $BKX has lost approximately 30 points. The resistance then never converted to support. Again, the moving averages are showing a bearish crossover possibility, which can further weaken the index. The MACD (12,26,9) also indicates volatility as the indicator tried to turn bullish.

The overall scenario points to some further correction but we are talking very long-term. ■

The MACD (12,26,9) is still weak, and the ADX (14) has moved above 15 with selling pressure.

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This article was first published on 3/12/2008.
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FIGURE 1: $BKX, DAILY. This chart shows how the Philadelphia Bank Index plunged on violating the 50-day moving average support.

FIGURE 2: $BKX, WEEKLY. The indicators are still weak and the downtrend is very well developed. The chart suggests some additional softness in the index.

FIBONACCI

Where Will The SPY Land?

by James Kupfer

In the likely event that the S&P 500 and other equity indexes continue to fall, we can calculate support levels for them based on Fibonacci levels.

Tradable: SPY

If the Standard & Poor's 500 and other major equity markets continue their multimonth downtrend, where are they likely to stop? We can answer this question by using Fibonacci levels, with which we can project future potential price targets for SPY and subsequently apply the same techniques to other stocks and indexes as well.

Traders have successfully applied the science of the Fibonacci numbers to a variety of financial markets using common Fibonacci retracement levels. The most ubiquitous of those levels are 38.2%, 50%, and 78.6%, but other lesser-utilized — but just as important — levels exist, such as 127.2% and 161.8%. To find support and resistance levels, I find it helpful to apply Fibonacci levels between major pivot points and look for where these levels cluster together. The more levels that converge on a price range, the stronger the support or resistance.

Using the S&P 500 tracking stock, SPY, as an example, we find 50% of the difference between the SPY low in October 2002 and the SPY top in October 2007, and then subtract that difference from the SPY top to determine the support level. Many common charting packages will do the math for you, but if you do the math yourself you will see that support is at $117.30. If you calculate 127.2% of the difference from the market top in October to the January bottom and subtract that from the top you reach a price target of $117.43. The same exercise based on 161.8% of the difference from the January low to the February rebound high yields a target of $117.59. So look out around $117.50, the SPY is coming in for a landing! See Figure 1. ■

	Example 1	Example 2	Example 3
Major High	$ 157.52	$ 157.52	$ 139.61
Major Low	$ 77.07	$ 126.00	$ 126.00
Difference	$ 80.45	$ 31.52	$ 13.61
Fibonacci Ratio	50%	127.2%	161.8%
Fibonacci sub-value	$ 40.23	$ 40.09	$ 22.02
Fibonacci Target Level	$ 117.30	$ 117.43	$ 117.59

MICROSOFT EXCEL

FIGURE 1: FIBONACCI EXAMPLES

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STRATEGIES

Are We Finally at a Bottom? SPY Buy Setup

by Mike Carr, CMT

The DeMark sequential is set up to provide a potential buy signal in the SPY.

Tradable: SPY

Tom DeMark has been developing technical trading indicators and systems for decades. He has consulted with the greatest traders in the world, including hedge fund legends like Steve Cohen. The sequential is a complex pattern that often identifies exhaustion points in trends, helping traders enter at the reversal point.

Sequential begins with a setup. The close is compared to the close of four sessions ago. For a buy signal, when there are nine consecutive closes where the close is less than the close of four bars ago, the setup is complete.

After a market is set up, the countdown begins. The count increases by one whenever the close is lower than the close two bars ago. When the count reaches 13, the market is obviously deeply oversold and we look for a buy signal. The buy occurs the first time the market closes higher than the close four bars ago, indicating that the trend may have reversed.

When the count reaches 13, the market is obviously deeply oversold and we look for a buy signal.

On March 14, the SPY reached a 13 count (Figure 1). The buy signal will be triggered with a close above 129.62. The signal will be negated if there is a resumption of the downtrend, marked by nine closes where the price is lower than it was four bars ago.

The DeMark sequential is an indicator widely followed by market professionals. With stocks being deeply oversold, it is an indicator worth watching for a buy signal. If it occurs, the indicator would coincide with a double bottom on the SPY, and should lead to a profitable trading opportunity. ■

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Kiev, Ari [1998]. *Trading To Win: The Psychology of Mastering The Markets,* John Wiley & Sons. (A collaboration with Steve Cohen.)

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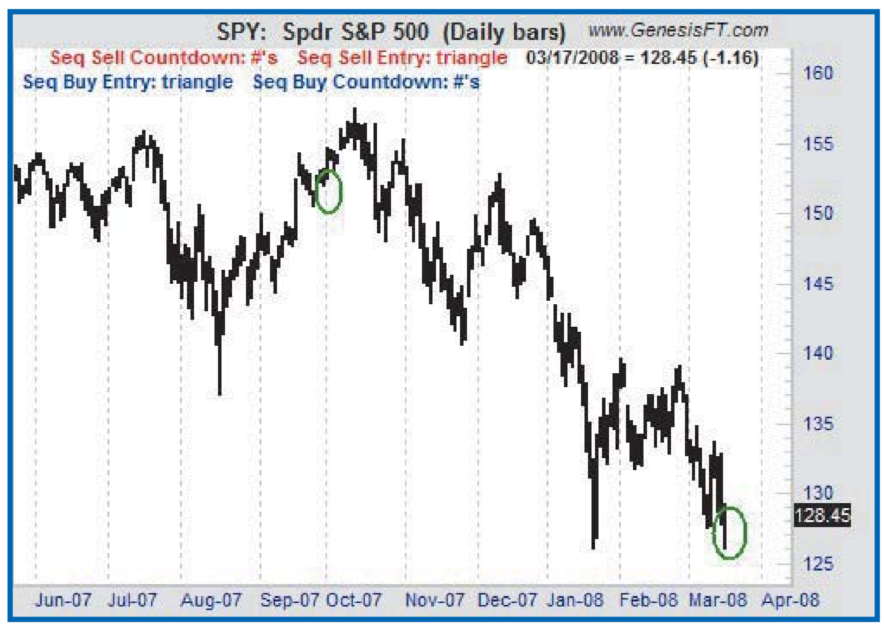

TRADE NAVIGATOR

FIGURE 1: SPY. The SPY is set up for a possible DeMark sequential buy signal. The last occurrence, in September 2007, resulted in a small profit.

France Index Had Two Major Breaks

by Chaitali Mohile

Present correction in the French CAC 40 Index is the combination of global uncertainty and two major breakouts on technical charts.

Tradable: $CAC

An ascending triangle can be a reversal pattern at the end of the downtrend but it is typically a continuation pattern. The pattern breaks upward, being a bullish continuation pattern in an uptrend or reversal pattern in downtrend. So if the pattern fails to follow the rule and drifts in the opposite direction, a serious bearish tide floods in (Figure 1).

The French CAC 40 Index is therefore under a flood watch. The index is in a deep downtrend since the beginning of 2008. The gap down in mid-January boosted the bears, finally capturing the trend after a long battle. The index then entered a consolidation period indicating the end to the downtrend and formed an ascending triangle. As mentioned, the pattern is seen as a reversal signal. But it failed as the index was pulled down in favor of bears and fresh selling pressure was seen.

The pattern failure was robust and plunged the index further about 350 points. The relative strength index (RSI) (14) has room left below to hit an oversold area. Meanwhile, the possibility of a corrective phase to sustain is wide. In addition, the moving average convergence/divergence (MACD) (12,26,9) has a bearish crossover in negative territory and the downtrend is intact. So the pattern failure here can lead to a bloodbath.

Figure 2 has an important reversal pattern, a head & shoulders top. As the name suggests, the pattern appears at the top in the uptrend and warns the bulls. The pattern shows the slowdown in bulls as the neckline is turned to resistance. In Figure 2, the neckline appears at the 5400 level and the crossover cracked the index almost 768 points since early 2008. This proves how reliable and strong the pattern is. The pattern was completed almost after one year, giving many trading opportunities. The volumes do fluctuate, as the pattern is formed, gradually increasing the sellers.

The target on the head & shoulders top is measured by calculating the distance between the head and the neckline from the right side. The distance is 6168 (head) - 5400 (neckline) = 768. So if you subtract 768 from 5400 you get 4632, which is the approximate downside target. And according to Figure 2, $CAC is close to this level. The low made in recent weeks is 4644, whereas the lowest level is 4505 (made by long lower shadow). The RSI (14) is in oversold territory for the last two months. The MACD (12,26,9) is in negative territory, reflecting the bearish mood, and the trend continues to be down. $CAC still has bears hover around, and thus can easily achieve the target and may test the lowest support as well.

To conclude, the ascending triangle breaking down and the head & shoulders top breaking out forecasts the storm ahead. ■

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FIGURE 1: $CAC, DAILY. The index has been in a deep downtrend since the beginning of 2008.

FIGURE 2: $CAC, WEEKLY. The MACD has a bearish crossover in negative territory and the downtrend is intact.

ELLIOTT WAVE

The Toronto Index

by Koos van der Merwe

Movement in the TSX300 index is heavily influenced by movement in the oil and gold prices. As both fell, so did the TSX — is the index now a thing of the past?

Tradable: TECT-T

Figure 1 shows an Elliott wave count starting from October 9, 2002. The count looks good, which is the first rule of Elliott wave analysis. As you can see on the chart, wave C down bottomed within the fourth wave of lesser degree. This suggested the start of a new bull market for the TSX, which then rose in a wave I to 13873.89 from a low of 12119.87. From this high, it then fell in wave II to find support at 12456.03, the high of wave III from the previous wave count.

Wave 1 = From the low 12119.87 to 13873.89 = 1754.02

Wave 2 = From the high 13873.89 to 12456.03 = 1417.86.

This is an 80.83% retracement of wave I. I have found that wave IIs are usually a 72% retracement of wave I, with a wave III then being a 1.618% or greater retracement upward. However, since the wave II fall was greater than 72% it does suggest that the wave III rise could be a failure — by this I mean a rise equal to or less than the rise of wave 1. Should this occur — and let me be frank, it very much depends on how the recession in the US resolves itself — then wave 5 will be less than wave III. This is the primary scenario at the moment.

A wave 3 target would therefore be 12456.03 + 1754.02 = 14210.05. Finally, remember that a bear market is usually a 38.8% fall of the rise of waves 1 to 5. This does suggest that my ABC count could be optimistic, because of time, and that the present rise to wave 1 and fall to wave 2 could be the completion of wave I down and wave 2 up of wave C (shown in green). One should not forget that major c-waves fall in a five-wave correction. This would put the end of the bear market in April 2009.

For the moment, until proven otherwise, I shall remain bullish, but will change my count without hesitation as and when the situation changes. ■

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One should not forget that major c-waves fall in a five-wave correction. This would put the end of the bear market in April 2009.

FIGURE 1: TSX. Here's a wave count of the TSX300 index.

The Nikkei's Technical Litmus Test?

by Ron Walker

As the Nikkei rises to test its down trendline, will it get a reversal at resistance? Or will prices break out? A technical litmus test should be applied to any breakout to determine if it is legitimate.

Tradable: $NIKK

The bullish rally on the Tokyo Nikkei ($NIKK) began on March 18 with a harami. This bullish two-day candlestick pattern requires that the first day of the pattern completely engulf the second day. Once prices close above the peak of the pattern, it confirms the harami and then becomes a three inside-up pattern.

The harami looks very similar to an inside day. The difference is that the harami is only concerned with the real body, which is the open and closing prices. The second day's body must open and close within the first day's real body, but an inside day uses high and low prices in its pattern.

In Figure 1, the upside journey started at the opening of the following day, when on March 19 prices gapped up at the open, completing a three inside-up candlestick pattern. This bottom on the Nikkei corresponded with the bottom that occurred in the US stock market.

The breakout of the three-day candlestick pattern led the way to a recovery for an oversold stochastic (20,20), as the stochastic line crossed above its signal line that same day. The moving average convergence/divergence (MACD) histogram (12,26,9) also showed prospects of higher prices, producing a higher closing bar. This brought about a divergence between the Nikkei and the MACD histogram (Figure 2).

In addition, bullish forces were at work, allowing prices to surge on March 21 as the slow stochastic (20,20) rose sharply above the oversold levels of 20.

Just three days after the three inside-up candlestick pattern occurred, prices increased to test the 20-day exponential moving average (EMA), while simultaneously the MACD (12,26,9) line crossed above its signal line. The MACD histogram (12,26,9) was equally as positive, as that day's bar rose above the value of zero into positive territory and the stochastic (20,20) line edged above the value of 50. Consequently, this allowed for a bullish divergence to appear on the MACD (12,26, 9), which coincides with the multiple points of positive divergence on the relative strength index (RSI) (14).

In Figure 2, after a brief consolidation, prices gapped above the 20-day EMA to test the 50-day EMA on April 2. This occurred in sync with the average directional movement indicator (ADX) (14) becoming bullish, poised as the positive directional movement (+DI) line crossed above the -DI line. The next day, the advance moved prices above the 50-day EMA, running into resistance at the declining trendline from the October high.

The attempt to test the declining trendline created such momentum in price movement that it choreographed a bullish aligning of the 10- and 20-day EMAs, which is one of characteristics of the early stages of a trend. The move also allowed the slow stochastic (20, 20) to become newly overbought.

Markets have a tendency of staying overbought in the early development of a trend. But buying the Nikkei at key resistance, once it becomes overbought, could prove dangerous, given the Nikkei's recent runup of 11%. We need evidence that the trend is truly changing before we can render a verdict. Any decision to buy the Nikkei at this level should come under extreme scrutiny, as some tough questions need to be answered. Can prices close above the highest peak made on the day when

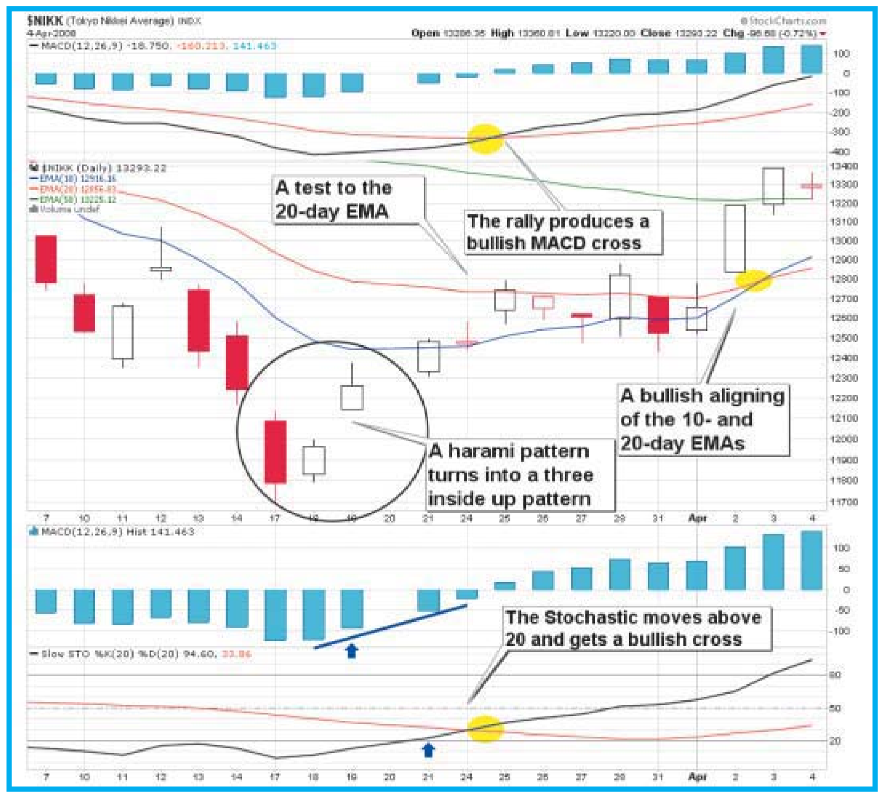

FIGURE 1: TOKYO NIKKEI AVERAGE ($NIKK), DAILY. The Nikkei produced a bullish harami candlestick pattern that evolved into a three-day inside-up pattern the following day. Prices then rose to test the 20-day EMA, allowing a bullish cross of the MACD and the slow stochastic (20, 20) to occur. Shortly after that, there was a bullish realignment of the 10- and 20-day EMAs.

FIGURE 2: TOKYO NIKKEI AVERAGE ($NIKK), DAILY. The stochastic (20,20) became newly overbought (highlighted in yellow) as prices tested the declining trendline. Prices must close above the highest peak made on the day when the slow stochastic (20, 20) first became overbought. That would trigger an entry point with a close above 13,389. That would break the downtrend, allowing the trend incators to thrive, as the ADX line could cross above the -DI line, while the MACD moved into positive territory.

the slow stochastic (20, 20) first became overbought? Can prices muster up the strength to close above the declining trendline? Will the ADX line on the ADX (14) be able to cross above the negative -DI line? Can the RSI (14) exceed previous peaks of resistance and go higher?

Let me first say that buying overbought markets can be tricky. However, buying overbought markets can be extremely profitable in the early stages of a trend. But wait for prices to close above the highest peak that was made, the day when they first registered as overbought (a move above 80) on the stochastic (20,20). So the highest high that occurred the day in which the stochastic (20,20) first became overbought is the benchmark. Prices must exceed and close above that level before considering buying the Nikkei at these overbought levels.

The next consideration should be given to the resistance of downtrend. Great priority should always be placed on an intermediate trendline whenever considering an entry point. If prices decisively break above 13,389 on the Nikkei, the downtrend will be broken. When a downtrend breaks, it signals that a market that was previously dominated by sellers is now being overrun by buyers, suggesting a shifting of the balance of power.

Positions can be taken on a decisive breakout of a trendline with strong volume, or sometimes a trader waits for a follow-through. When a trendline breaks, the usual consequences of either price consolidation or a retracement will occur. Consolidation transpires after the breakout in order to build the necessary momentum to build a new trend. If prices start the process of retracing lost ground, they should begin testing several points of resistance. If prices break above the trendline, there is a high probability that the move will be accompanied by the ADX line rising off its low, and crossing above the lower -DI line. Incidentally, the ADX would need to move above its current level of 20 in order to effectively change the trend.

Accordingly, the RSI (14) has now reached peaks that have previously acted as resistance throughout the downtrend. If prices begin to falter, turning lower and then get a bounce once the rising RSI trendline has been tested, it may be the catalyst that ignites the index to break out. That would create another point of positive divergence on the RSI (14) off the original reference low made last January. Multiple points of long-term bullish divergences develop on the RSI (14) right before a trend changes, just as they are right now. That gives further weight to a case for higher prices.

The breakout of the downtrend should cause the RSI to move above the value of 66.67, which would trigger a buy signal. An RSI reading of 66.67 marks the point when the RSI ratio shifts to two to one in favor of the bulls

Buying overbought markets can be extremely profitable in the early stages of a trend.

— meaning the amount of up days is twice the amount of the down days. This is why a stock in a downtrend usually cannot move above 66.67. Note that during the entire downtrend on Nikkei ($NIKK), the RSI never moved above 66.67. Now, should any of these technical events that we just discussed transpire, then it may start a chain reaction that could propel the Nikkei ($NIKK) higher.

It is in a trader's best interest to try and recognize a trend at its earliest possible stages in order to ensure an early entry point. But make sure the Nikkei passes the litmus test before you jump on the bandwagon. ■

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This article was first published on 4/9/2008.
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MCCLELLAN SUMMATION INDEX

NASDAQ Summation Index Hits Resistance

by Arthur Hill

The McClellan Summation Index for the NASDAQ hit resistance, and traders should watch for a moving average crossover to trigger a bearish signal.

Tradable: $COMPQ

First, let's review. The McClellan Summation Index is a cumulative measure of the McClellan oscillator readings. The McClellan oscillator is the 19-period exponential moving average (EMA) of AD Net% less the 39-day EMA of AD Net%. AD Net% equals advances less declines, divided by total issues. The McClellan oscillator fluctuates above and below the zero line. Positive readings add to the summation index and negative readings subtract from the summation index.

In Figure 1, the top window shows the NASDAQ with the 10-day simple moving average (SMA) and the bottom window shows the NASDAQ McClellan Summation Index with a 10-day SMA. Note that the McClellan Summation Index is much smoother than the NASDAQ. The McClellan Summation Index crossed its 10-day SMA nine times since August. In contrast, the NASDAQ crossed its 10-day SMA over 20 times. With half as many crossovers, the summation index provides fewer whipsaws.

The McClellan Summation Index signals are not perfect and there will be whipsaws (losses). However, the moving average crossover signals can augment other indicators and analysis. The summation index is currently meeting resistance from its prior highs around 600. The indicator dipped down in mid-April, but did not cross below its 10-day SMA. With the summation index at resistance, I am watching the index for a potential bearish signal from a crossover.

As long as the summation index remains above its 10-day SMA, the NASDAQ rally could continue with an upside target around 2450. The October trendline and broken support confirm resistance in this area. ■

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FIGURE 1: NASDAQ, DAILY. Note the McClellan summation index is much smoother than the NASDAQ.

With the summation index at resistance, I am watching the index for a potential bearish signal from a crossover.

CHART PATTERNS

MACD

A Dow Divergence

by Arthur Hill

The Dow Jones Industrial Average moved to a new low recently, but a key momentum oscillator sported a positive divergence. What will it take to trigger a signal?

Tradable: $INDU

While the Dow Jones Industrial Average (DJIA) moved to a new (closing) low in early March, the moving average convergence/divergence (MACD) remained above its January low and a positive divergence is working. The MACD is based on closing levels so I am showing a close-only chart for the DJIA. The positive divergence forms when the DJIA forges a lower low, but the MACD holds above its prior low.

Before looking at the current situation, let's review a similar positive divergence in January (Figure 1). The DJIA moved below its November low and then bounced in early January (blue circle). At the time of this bounce, the MACD was above its November low and a positive divergence was working (blue dotted line). However, the MACD never firmed and never broke above its signal line, which is the nine-day exponential moving average (EMA) of the MACD (pink line). Therefore, the MACD never turned up and never confirmed the potential positive divergence.

Looking at the current situation, the MACD is trading well above its January low and a sharp positive divergence is working. Even though the MACD firmed over the last few days, the indicator remains below its signal line. The DJIA bounced, but just for one day and this was not enough to push the MACD above its signal line. Follow-through holds the key. The DJIA needs to move higher in order to push the MACD above its signal line. Such a crossover would confirm the positive divergence and act as an early buy signal for the MACD. ■

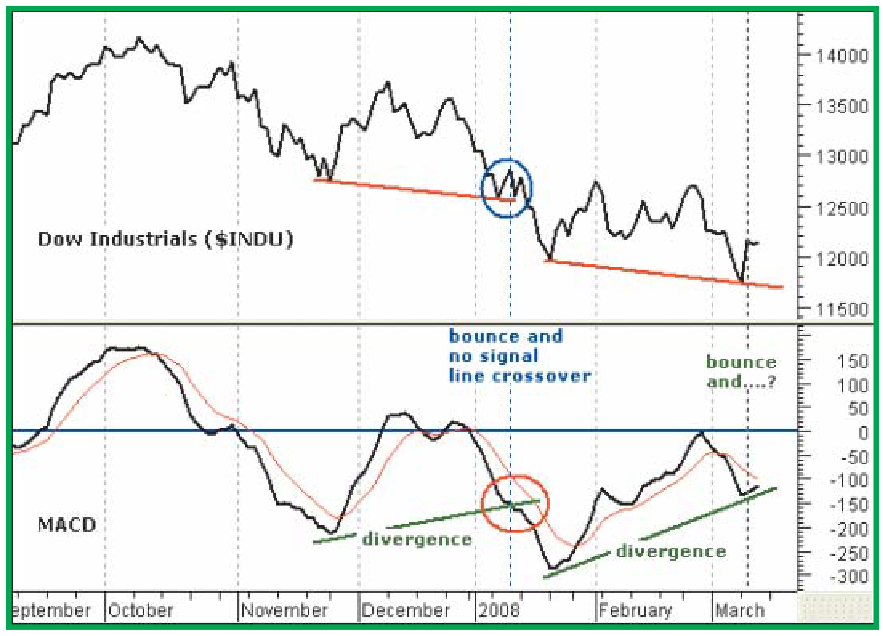

FIGURE 1: DJIA. The DJIA moved below its November low and then bounced in early January (blue circle).

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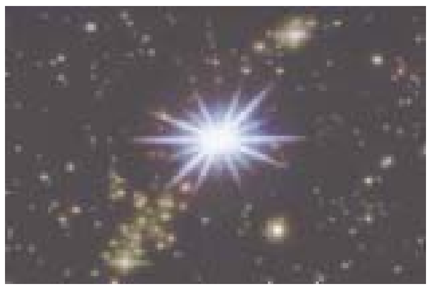
A Shining Star On The S&P 500

by Ron Walker

A morning star candlestick is shining brightly on the S&P 500, which might be a "shining star" for the market.

Tradable: $SPX



As Earth, Wind, and Fire sang in its hit "Shining Star," "Shining star come into view, Shine its watchful light on you," a morning star candle is shining on the S&P 500.

On March 11, the Standard & Poor's 500 formed a bullish reversal candlestick called a belt hold, as seen in Figure 1. The massive white-bodied belt hold candlestick pattern is very distinct, in that it opens at or near the lows and closes near the highs of the session.

One of the characteristics of the belt hold single-day pattern is an absence of any lower shadow on the candlestick. The elongated candlestick makes its appearance after prices have been in a downswing for some time. The *belt hold* pattern essentially halts the previous downtrend, as buyers come back into the market. The pattern must be confirmed by a close above the highest high of the pattern.

In this case, the pattern didn't yield any considerable follow-through to the upside. Therefore, the pattern was not confirmed because prices never closed above the 1320 peak of the pattern. After that, prices then deteriorated back down to test the 1272 closing low that was made on March 10.

I continued to watch for clues in expectation that another reversal pattern would emerge because the belt hold pattern failed. Another possibility presented itself just four trading sessions after the belt hold pattern appeared on the scene. On March 17, prices opened lower and sifted below the previous 1270 intraday low made on January 23, 2008 (see Figure 1). Support waned throughout the day, making a new intraday low of 1256, but prices managed to close significantly off the lows of the day at 1276.

This set up another possible reversal pattern known as a *morning star*. This is a three-day candlestick reversal pattern. The first day is a long black day that moves prices lower in the direction of the prevailing trend. The second day, a star forms that gaps away from the body of the first day, representing indecision among traders. The second day produces a small real body, but the candlestick color of the second day is irrelevant. On the third day, a long white-bodied candlestick forms and rises back into the black body of the first day of the pattern and sometimes exceeds it.

This candlestick usually gaps higher at the open. Confirmation of the pattern comes when prices close above the intraday peak of the pattern. This reversal pattern materializes after a significant downtrend has been in place. It signals that the impending downtrend is going to change.

In Figure 1, the following day, on March 18, prices slightly gapped up at the open and rose sharply for the rest of the session. Prices managed to close above the black body of the first day. The deeper the retracement moves into or above the first candlestick's real body, the stronger the recovery is expected to be. In this example, the third candlestick did gap up but only by one point.

In Figure 2, the NASDAQ, which formed the same pattern at this time, had a much wider gap between the second and third candlesticks. Should this bring the S&P 500 pattern into question? Greg Morris, in his book *Candlestick Charting Explained*, expounds on flexibility of the pattern: "Ideally there is one gap between the bodies of the first candlestick and the star, and a second gap between the bodies of the star and third candlestick. Some flexibility is possible in the gap between the star and the third day." So the gap between the first day and the second day are much more important, regardless if the third day significantly gaps up or not.

The morning star patterns that appear on the two averages both meet the criteria set forth in Morris's book, but he stresses the importance of the pattern receiving confirmation in order to have validity. ■

SUGGESTED READING

Morris, Gregory [2008]. *Candlestick Charting Explained*, 3d ed., StockCharts.com.

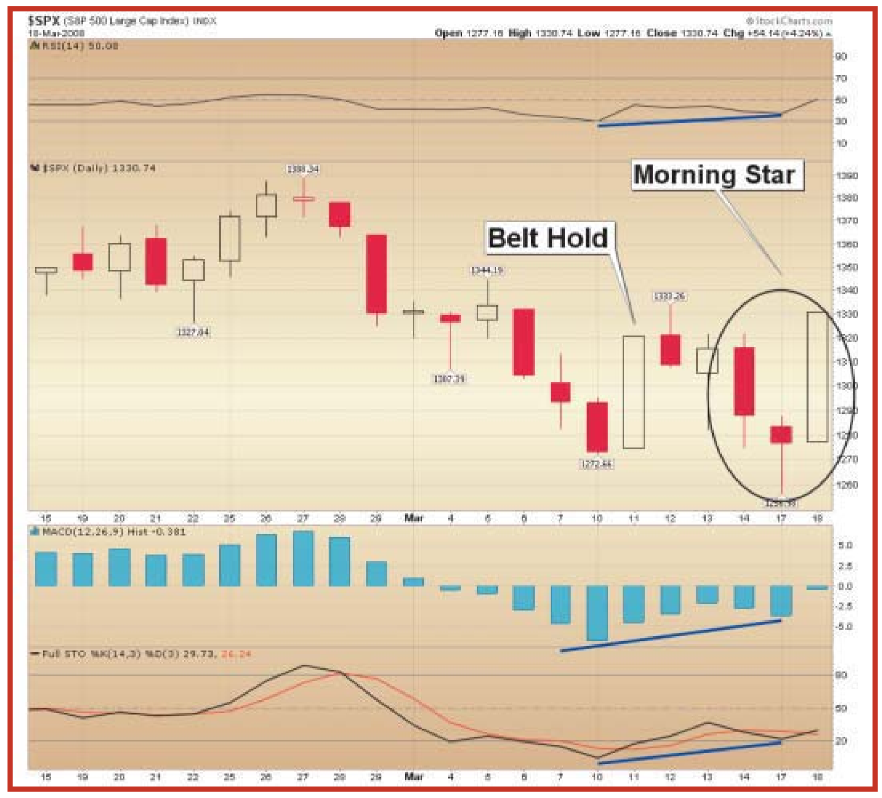


FIGURE 1: S&P 500, DAILY. After prices failed to confirm the belt hold reversal pattern on March 11, another reversal pattern emerged called a morning star. The gap that formed on the NASDAQ was much wider than the one-point gap seen here on the S&P 500.

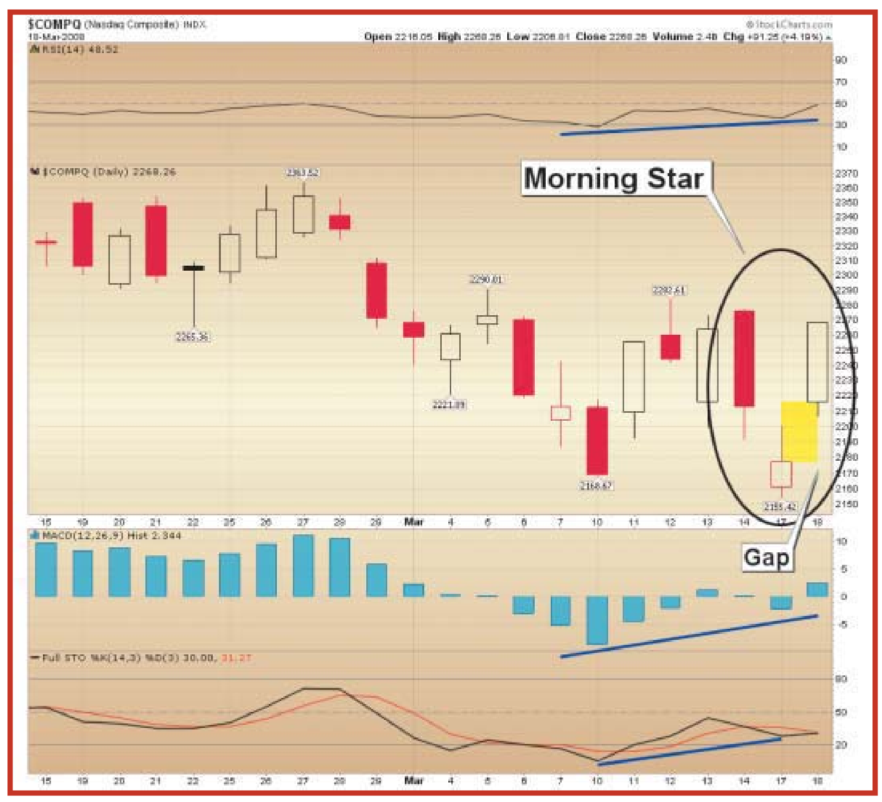
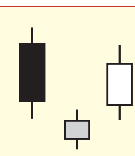
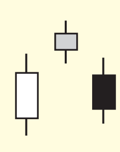


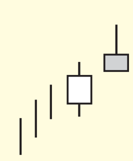
FIGURE 2: NASDAQ, DAILY. The morning star pattern on the NASDAQ didn't exceed the candlestick high from the first day, like the S&P 500 did. The NASDAQ produced a very wide gap between the second and third days of the pattern, highlighted here in yellow.



Morning Star (MS): It is a bottom reversal pattern. The first candle has a long, black real body. It is followed by a small real body that gaps lower. The third day is a white real body that moves well within the first day's black real body.



Evening Star (ES): It is the opposite of the morning star pattern. The first candle has a white real body, followed by a star. The third day prints a black real body that moves sharply into the first day's white real body.



Shooting Star (SS): It has a small real body at the lower end of its range with a long upper shadow. An ideal shooting star has a real body that gaps away from the prior real body. The shooting star is a warning of an impending top.

Market Volatility Alarms Participants

by Koos van der Merwe

The market has been hit by bad news almost every day. When will the market calm down?

We saw the market fall again despite a midweek rally. Last Friday, we saw sharp losses on the news that investment bank Bear Stearns had been forced to accept a bailout package after a client exodus and reduced access to credit. JP Morgan has agreed to pay $2.00 per share for the company. What did not make the headlines was that the CPI showed no inflationary increase from January to February, leading the US Federal Reserve to cut rates by a further 0.75%.

With Fed chaiman Ben Bernanke's attempts to limit market losses, will he succeed? I believe that he will. The market is close to bottoming, but the recovery will be slow and painful, and last well into 2011 or 2012. I believe that a very shallow saucer-shaped recovery will start forming on the charts. The days of 12% to 20% returns on our portfolios are now over, and the more conservative 2% to 3% will now become the order of the day. See Figure 1.

When should we start becoming the contrarian and start buying? Blood is already running freely in the streets; the Bear Stearns fiasco is an example, with many more disasters still to appear. One way to help you decide is to follow the investment strategy of the richest man in the world, Warren Buffett, and the easiest way to follow him is to keep an eye on the price of Berkshire Hathaway (BRKB).

Figure 2 is that of Berkshire Hathaway B-shares, simply because they are priced much cheaper than the A-share and therefore shows a trend far more easily.

The chart has given a buy signal for Berkshire Hathaway B-shares and shows the following indicators that are all a part of my final strategy:

a. In the chart itself is the Fisher MACD of the highs. This indicator is still pointing down, suggesting weakness, but it is a lagging indicator. I use it mainly as a stop, to get out of a position should the vote line be late in offering a stop.

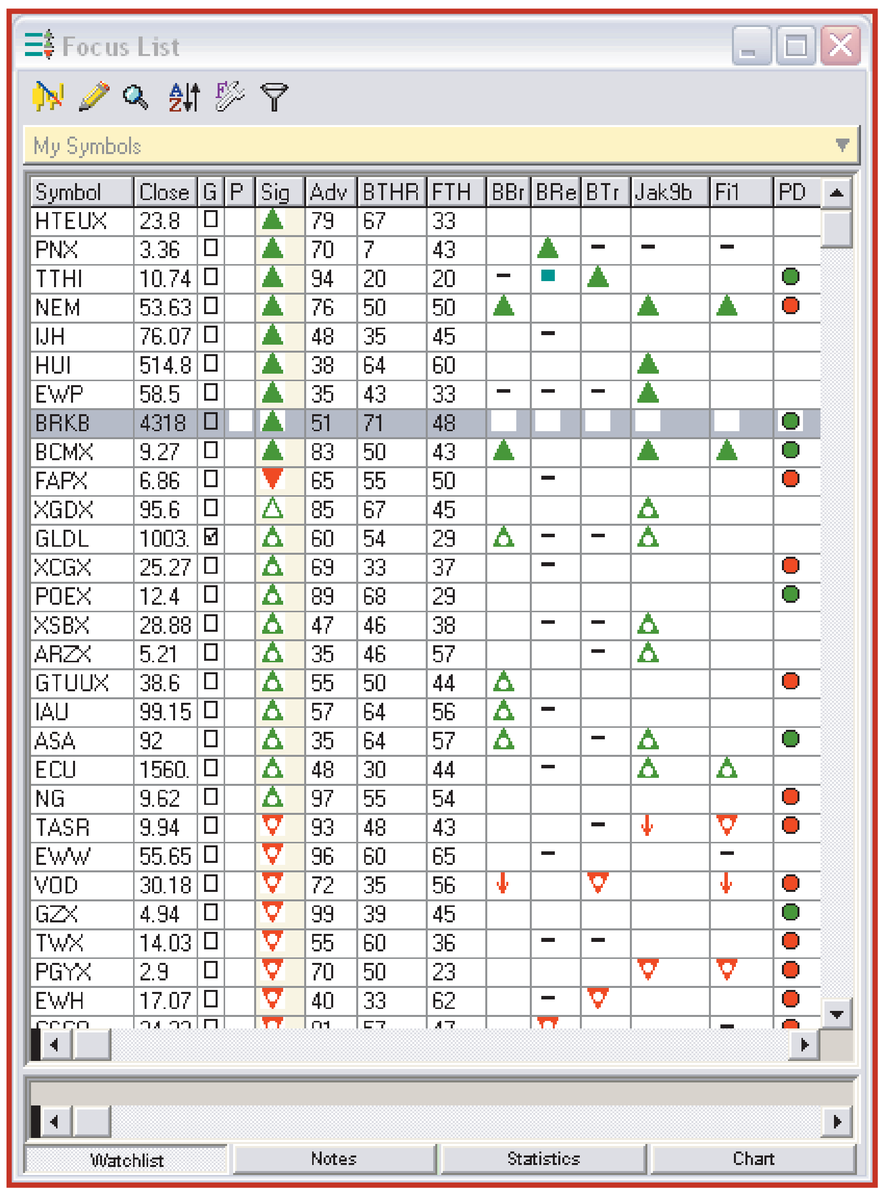
b. A trendline. The price has touched that line and reversed in a hanging man candlestick formation — a good buy signal.

c. A chart of the following strategies:

- The Carter squeeze strategy, which is suggesting oversold levels and is ready to turn up.
- A stochastic RSI combined with the Fisher MACD high indicator. This strategy is showing oversold levels but has not yet given a buy signal.
- A stochastic RSI cycle eight-period indicator that has given a buy signal.
- Volume, which has started to show a bit of strength as the price recovered, but nothing of importance ... yet.
- The vote line giving the final summation of all the strategies I have implemented and used in the program — viz. wit, B Breakout OPT (Stocks); B Reversal NN (Stocks); B Trending (Stocks); Fish MACDHighStochTurtle; Jak8r and Jak9b. The JAK8r is the strategy that triggered the present vote line signal.

OMNITRADER

FIGURE 1: VOTE LINE. Here's the vote line giving a buy signal.



Symbol	Close	G	P	Sig	Adv	BTHR	FTH	BBr	BRe	BTr	Jak9b	Fi1	PD
HTEUX	23.8				79	67	33						
PNX	3.36				70	7	43			–	–	–	
TTHI	10.74				94	20	20	–					
NEM	53.63				76	50	50						
IJH	76.07				48	35	45		–				
HUI	514.8				38	64	60						
EWP	58.5				35	43	33	–	–	–			
BRKB	4318				51	71	48						
BCMX	9.27				83	50	43						
FAPX	6.86				65	55	50		–				
XGDX	95.6				85	67	45						
GLDL	1003.				60	54	29		–	–			
XCGX	25.27				69	33	37		–				
POEX	12.4				89	68	29						
XSBX	28.88				47	46	38		–	–			
ARZX	5.21				35	46	57			–			
GTUUX	38.6				55	50	44						
IAU	99.15				57	64	56		–				
ASA	92				35	64	57			–			
ECU	1560.				48	30	44		–				
NG	9.62				97	55	54						
TASR	9.94				93	48	43			–			
EWW	55.65				96	60	65		–			–	
VOD	30.18				72	35	56						
GZX	4.94				99	39	45						
TWX	14.03				55	60	36		–	–			
PGYX	2.9				70	50	23						
EWH	17.07				40	33	62		–				

FIGURE 2: THE FOCUS LIST. The focus list is highlighting the parameters that filter Berkshire Hathaway B-shares as a buy.

Finally, I used a filter as shown in the focus list shown in Figure 2.

■ ADV is the Advisor rating of a signal. For a signal to be acceptable, it must be greater than 50.

■ BTHR is the Back Test Hit Rate, which must be greater than 70.

■ FTHR is the Forward Test Hit Rate, which must be greater than 100.

I will accept either a FTHR with and ADV rating, or a BTHR with an ADV rating. For Berkshire Hathaway, (BRKB) the BTHR is 71 and the ADV is 51.

Berkshire Hathaway B-shares has given me a buy signal. This suggests to me that shrewd investors believe that Warren Buffett is using the slowdown in the market to accumulate shares that have fallen too far, too fast. To take advantage of Buffett's acumen, one should add Berkshire Hathaway to one's portfolio. ■

When should we start becoming the contrarian and start buying?

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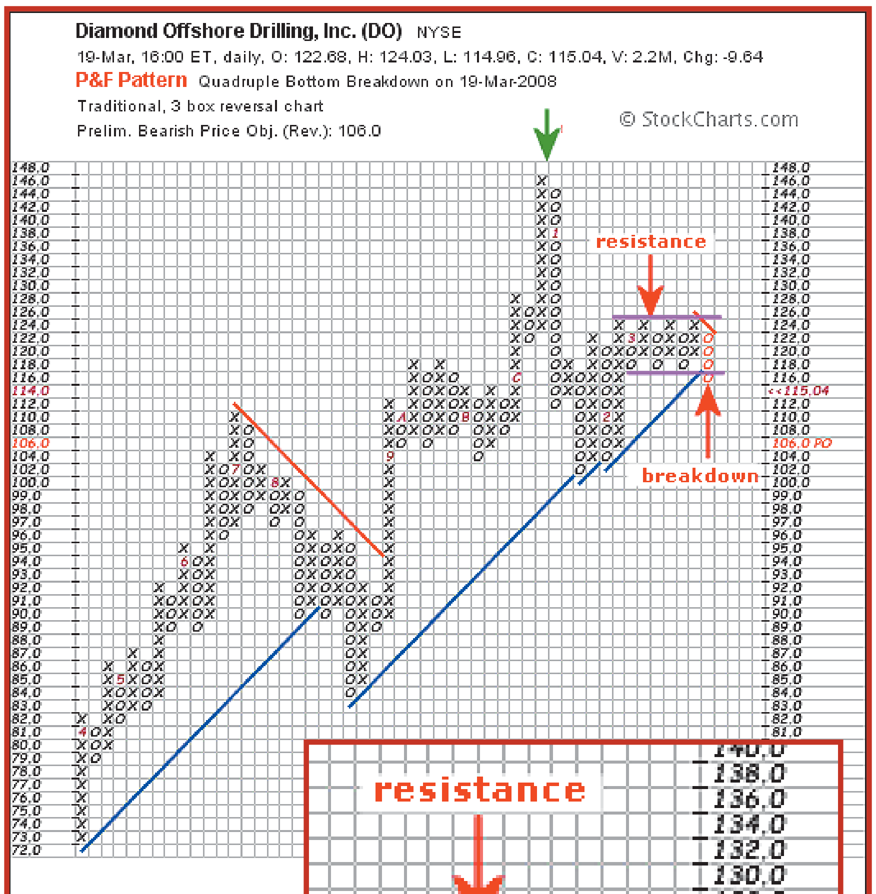
POINT & FIGURE



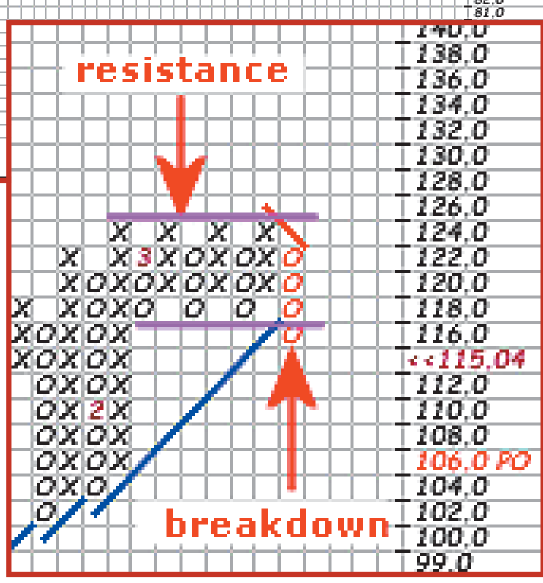
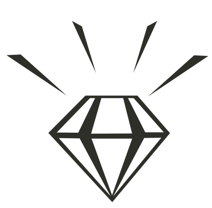


FIGURE 1: DO, DAILY. After peaking around 148 in December (green arrow), Diamond Offshore declined sharply in January.



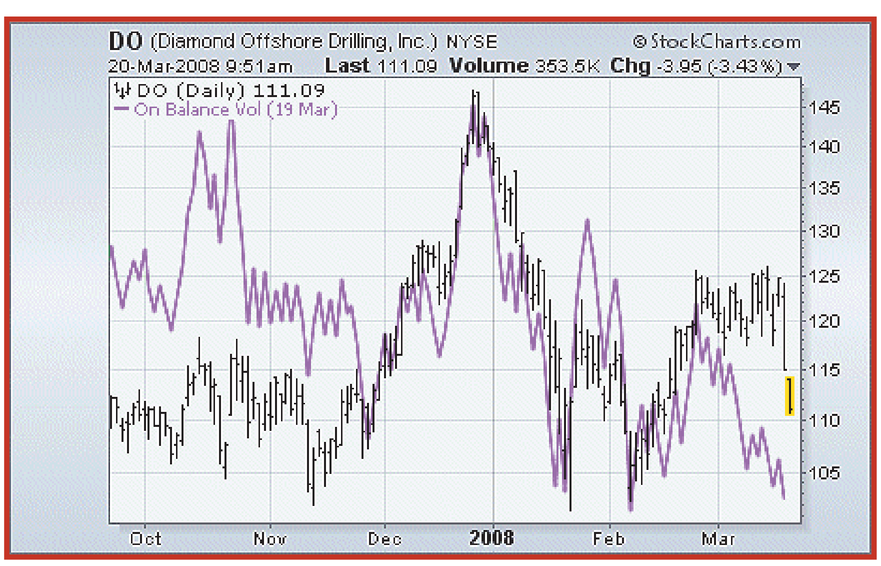


FIGURE 2: DO. Here's Diamond OffShore with on-balance volume as the pink line.

P&F Breakdown For Diamond OffShore

by Arthur Hill

After consolidating for a few weeks, Diamond Offshore broke support to trigger a point & figure sell signal.

Tradable: DO

Point & figure charts make it easy to establish support and resistance levels. After peaking around 148 in December (green arrow), Diamond Offshore (DO) declined sharply in January (Figure 1). The bounce after this decline retraced 50% of the prior decline and met resistance around 126. Resistance is clear because the stock failed at this level four times.

Despite falling at resistance, DO established support around 118 with three bounces. Basically, the stock consolidated between 118 and 126 with columns of Xs and Os in March (pink lines). This consolidation held the key to the next signal. A break above resistance would be bullish and a break below support would be bearish.

With a sharp decline over the last few days, DO broke support to trigger a quadruple-bottom breakdown. In addition, the stock broke the bullish support line rising from the February lows. This breakdown is bearish and support from the January low marks the first target around 102.

Figure 2 shows DO with on-balance volume (OBV) as the pink line. While the stock consolidated in March, OBV moved lower and the indicator is poised to record a new low. This shows distribution during the March consolidation and the recent breakdown shows increased selling pressure. ■

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This article was first published on 3/21/2008.
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Buying In A Confusingly Awful Market

by Koos van der Merwe

"When in doubt, stay out." So goes the saying, and with markets as confusing as they are now, this is probably the best strategy to take.

Tradable: AAPL

FIGURE 1: AAPL, DAILY. Here are the buy and sell signals given for Apple.

But how can you make money in this market? Long buyers are hurt by the uncertainty of new harmful disclosures almost weekly, and short sellers are hurt by the optimism that the market demonstrates on days when there is no news. Once again, there's another old saying: "No news is good news."

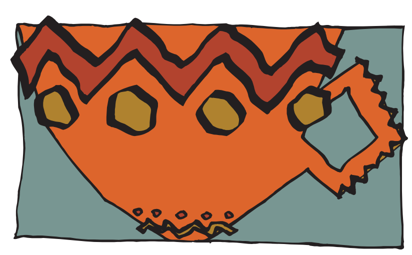
In Figure 1 is one of the very profitable recent buys — Apple (AAPL), purchased on February 29 at $126.20 in a falling market. When I purchased the stock, it was a typical "coulda, shoulda, woulda" syndrome, because the price continued falling, closing at $121.73 on March 1 and falling to a low of $119.37 by March 10. This gave a drawdown of 5.41%, far greater than I normally like, but the program did not give a sell signal, so I decided to stay with it. From that date the price started rising, and continued to rise, reaching a high of $145.74 by March 26. Since then the price has been moving sideways.

A very definite cup & handle pattern has developed, with the handle of the cup filling the gap of January 23.

The strategy used has not given a sell signal, nor stopped me out. As you can see on Figure 1, the strategy that originally gave me a buy signal was the FishMACDGighStochTurtle TRII strategy, which was confirmed on March 18 by the B Trending (Stocks) and Jak9b strategies. (Multiply 8 * 26 + 2 and you have the number of test strategies I developed before I settled on 9b as my ultimate.)

What is also interesting is that a very definite cup & handle pattern has developed, with the handle of the cup filling the gap of January 23. This is suggesting that should the price break above the $146.03 level, we could see a rise to a target of $172.91, as shown on the chart.

Finally, do note the previous buy and short signals. Although both signals never gave a signal at the low or the high of the price movement, they were nevertheless very profitable signals. ■



A Double Bottom For LUV

by Arthur Hill

Southwest Airlines formed a double bottom over the last few months, and further strength could forge the breakout needed to confirm this pattern.

Tradable: LUV

Figure 1 shows Southwest Airlines (LUV) with a double bottom that extends from January to March. The stock bounced off support around 11 twice and formed an intermittent high just above 13.

Overall, the trend remains down because the double bottom has yet to be confirmed with a breakout. A trend is in place until proven otherwise. A break above the February high would confirm this pattern and reverse the current downtrend. The upside target would be to around 15. The length of the pattern is added to the breakout for an upside target. In addition, there is resistance around 15 from the November high and resistance around 14.5 from the December high.

The black indicator shows the accumulation/ distribution line, which was developed by analyst Marc Chaikin. As its name implies, the indicator uses volume and price action to measure accumulation versus distribution. Accumulation occurs when the close is above the midpoint of the high-low range and distribution occurs when the midpoint is below. The indicator formed a positive divergence in 2008 and broke resistance in April. This shows signs of accumulation and increases the chances of a breakout in the stock.

Figure 2 focuses on the last few weeks of price action. LUV surged off support in March and then consolidated with a flat flag in April. This looks like a bullish consolidation, and a break above flag resistance would signal a continuation higher. This would also confirm the double bottom. A failure to break out and a move below flag support would put the double bottom on hold. ■

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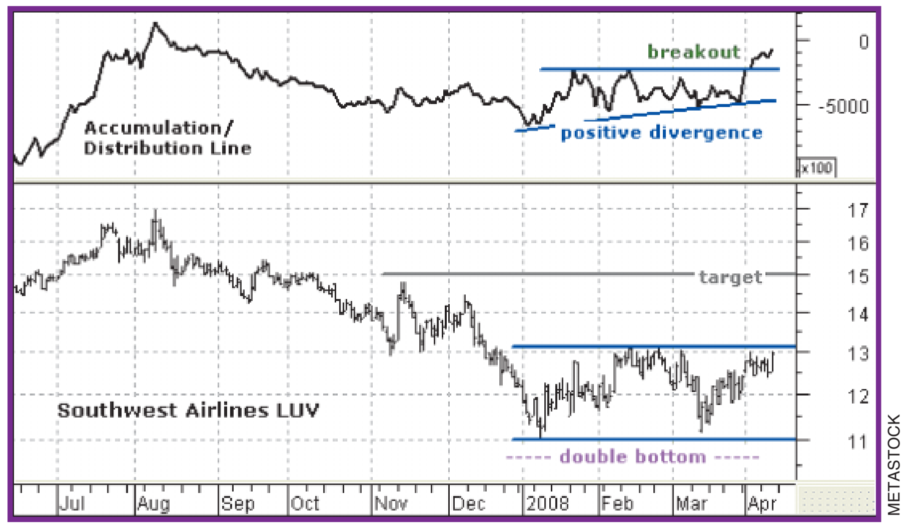


FIGURE 1: SOUTHWEST AIRLINES. LUV has a double bottom that extends from January to March.

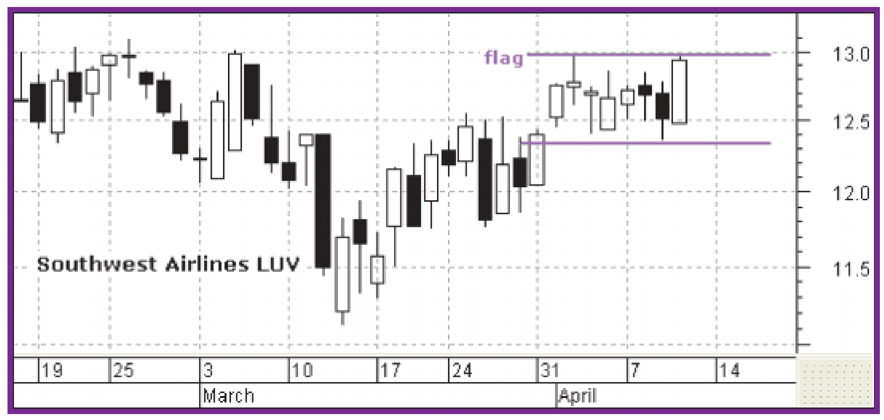


FIGURE 2: SOUTHWEST AIRLINES. Here, LUV focuses on the last few weeks of price action.

METALS & ENERGY

GANN

Is Gold Do Or Die?

by Koos van der Merwe

Gold is a US$ play. Take a look.

Tradables: UDX, DWIX, GLDL, NEM

If the price of gold is a US dollar play, and the pundits are calling for gold to test $1,000, where does that put the US dollar?

Figure 1 is a chart of the US$ Index (bar chart) and the London gold price (green line chart). We can see how the two have moved opposite each other. I have also shown the $1,000 target for gold, but will gold reach that target? To determine this, I look at two charts. Figure 3 is the US Dollar Index, on its own. Figure 4 is Newmont Mining, a mining company that epitomizes gold's movement.

FIGURE 1: US DOLLAR INDEX VS. LONDON GOLD. See how the two tradables have moved against each other.

The US$ Index (UDX) chart shown in Figure 2 is a weekly chart. The Elliott wave count suggests that the index is completing a fifth wave at the make or break (MOB) line. The MOB study is an excellent tool that can help you find the target price area for the end of an Elliott wave 5, or for any pattern that has an impulse-correction-impulse pattern. It is drawn from the bottom (market moving down) of the starting impulse pattern that is closest to the current market movement. Wave 5 is the area that the MOB will show a support area that will either "make" the end of wave 5 or "break" wave 5 into an extension. Should a price move extend beyond the MOB level, it will usually extend the same distance as it entered.

FIGURE 2: US DOLLAR INDEX, WEEKLY. The Elliott wave count suggests that the index is completing a fifth wave at the MOB line.

The chart is suggesting that the US Dollar Index could be finding support at the MOB level, and this is confirmed by the stochastic oscillator shown on the chart. However, closer examination shows that the UDX has penetrated the MOB slightly, and that the oscillator has on previous occasions given buy signals that did not follow through. The index could therefore be at a very decisive phase, either finding support at the present level or falling to a 53.71 (92.87 - 73.29 = 19.58; 73.29 - 19.58 = 53.71).

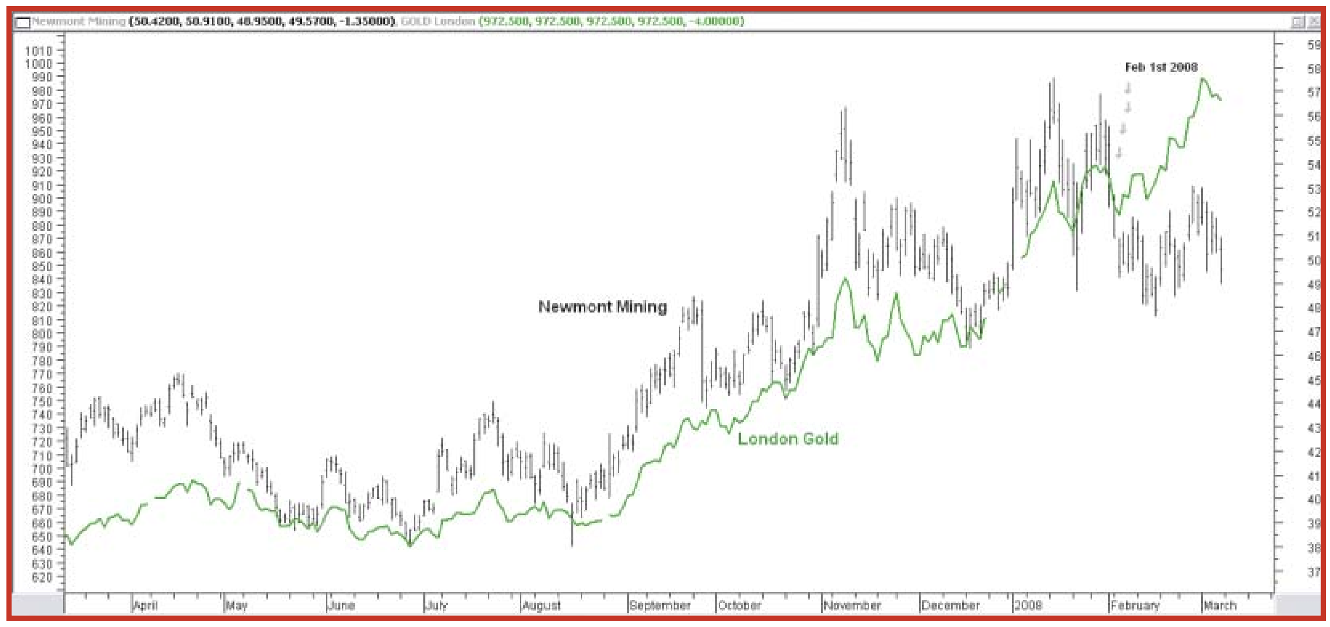
Figure 3 is a daily chart of the US Dollar Index, showing how the MOB

FIGURE 3: US DOLLAR INDEX, DAILY. Here are the MOB levels and support at the present level.

indicator worked in the past. I have shown the indicator at various levels, and the arrows shown indicate the levels they were forecast from. The chart also shows the relative strength index (RSI), with the buy levels indicating a reversal in the US$ Index, even if that reversal was temporary. The RSI is suggesting strength at the moment.

Figure 4, of Newmont Mining, shows how the price always followed the London gold price, but started deviating from the gold price on February 1, 2008. As a chartist, to (more or less) quote, "It is not to reason why, it is simply to do or die." Another reason why could be that gold could have reached its peak, or for that matter, that the US dollar has found a support level. ■

> **"It is not to reason why, it is simply to do or die."**



METASTOCK

FIGURE 4: LONDON GOLD VS. NEWMONT MINING. Newmont seems to have followed gold, but then started deviating from the price of gold on February 1, 2008.

ANDREWS PITCHFORK

Gold's Super Bull Move

by Gary Grosschadl

With the gold price at the doorstep of $1,000 per ounce, it makes me want to look back and see if that possibility was reflected on earlier charts.

Tradable: $XAU

I remember back in 2005 trying to figure where the gold price was going. Chartwise it was difficult because the gold price was reaching 20-year highs, hitting $540. I reasoned it was easier to look at the Gold & Silver Index ($XAU) as it was below 10-year highs. I wrote at the time, "With the gold price striking $540 in recent days, the previous high-water mark of $840 (in the early 1980s) seems too unlikely a future target." Hitting that target, never mind eclipsing it, seemed at the time way too outlandish to consider. Check out my article at 12/29/05, "This Gold Index Shows More Upside."

At that time I did a long-term monthly pitchfork chart (the Andrews pitchfork or the Andrews line method). Figure 1 is updated here and shows a rare bullish thrust on this type of chart. Typically in pitchfork theory, we assume a bullish move normally eventually thrusts to the median line target (center median line) and then retraces to below the line. A super bull move, on the other hand, would entail a much bigger move to target the upper median line (I have not seen very many of these and can't recall the last one I saw).

On this chart the original target (from the previous analysis of December 2005) was the median line, which roughly corresponded to the previous high of 1996. After that median line was hit, a consolidation period set in of about 18 months. Then a breakout move occurred in the latter part of 2007, boldly thrusting above the median line once again. This signaled the start of a bigger move toward the upper median line.

This view certainly entertains a thrust to $1,000 per ounce gold price if not a spike beyond. Whether this coincides with a strike of the upper median line remains to be seen. After such a bold move, a large move back down to test the center median line should not surprise as feverish profit taking could set in. What happens then could swing either way, either a resumption of the previous upthrust or a more serious down leg toward the lower median line. ■

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FIGURE 1: $XAU, MONTHLY. A 15-year chart shows the Gold & Silver Index eclipsing the previous high via a pitchfork chart.

Is The Gold Rush Over?

by Ron Walker

The gold trust shares have had an incredible run since mid-August, but is there still future upside potential? The answer lies in its trendline.

Tradable: GLD

Interest rate cuts over the past several months have put a lot of pressure on the US dollar. Many savvy investors have turned in their greenbacks for gold, which has provided a hedge against inflation and protection from a falling dollar. But with gold coming off its recent record all-time highs, many investors are wondering about its future prospects.

Is investing in the popular gold exchange traded fund (ETF) gold trust shares (GLD) a viable alternative to buying gold? GLD has enjoyed a nice runup since mid-August, but could the advance be over, given the recent volatility?

The answer lies in in its trendlines. Upon close examination of GLD's daily chart (Figure 1), it is clear that a visible intermediate uptrend is still present. This intermediate trendline is represented by a straight line of two reference points, one in mid-August and the other in mid-December. During the months of November and December, leading up to the second touch of the intermediate trendline, prices had been consolidating in the form of a symmetrical triangle. The second touch of the intermediate trendline coincided with the apex of the triangle. Once the second touch occurred, GLD found the momentum it needed to propel prices higher, breaking out of the symmetrical triangle.

This breakout brought about a price surge that changed the velocity at which prices were previously moving. Most trendlines rise at about a 45-degree angle, but during a rising trend, prices can accelerate higher and form what is referred to as an *accelerated* trendline. An accelerated trendline is a steeper trendline that develops as prices move away from the original intermediate trendline. This often occurs after a period of consolidation has taken place.

GLD prices rapidly accelerated away from the intermediate trendline until they ran out of gas just above $92, as seen in Figure 1. At that point, another short consolidation took place that developed another symmetrical triangle continuation pattern. Once the triangle broke out, GLD renewed the advance, marking a second touch of the accelerated trendline. Here again, it is no coincidence that the triangle's apex was concurrent with the accelerated trendline.

Then on March 13, prices gapped up and moved higher, trading in a narrow range for the next three sessions, thrusting prices above $100 per share. The advance was now mature and negative divergence was present on several indicators in the daily time frame. Four trading sessions later, on March 18, a bearish engulfing candlestick appeared, pushing prices lower and filled the gap.

This one-day reversal pattern was confirmed the following day as prices gapped lower. The gap lower did significant technical damage by carving out an island reversal pattern, confirming the engulfing candlestick and breaking the rising accelerated trendline (Figures 1 and 2). This triple-combination punch dealt a severe knockout blow to GLD, causing a correction phase to begin.

Accelerated trendlines are often too steep to be sustainable over a long period of time. In this case, the angle of ascent proved to be unsustainable. But as prices are in a freefall they will run into support at the intermediate rising trendline near $88.50. This may allow prices to successfully touch the intermediate trendline for a third time. But if the trendline is fractured, it will bring about the usual consequences of either price retracement or a corrective consolidation. Penetration of the intermediate trendline would bring about much more severe consequences than the violation of the accelerated trendline did.

In Figure 3, we can deduce from the weekly chart that prices are clearly overbought, which could jeopardize the intermediate trendline. Several indicators have now turned negative, which may cause the current correction to test the major trendline near $71. On March 24, the moving average convergence/divergence (MACD) got a bearish cross, while the stochas-

FIGURE 1: GLD, DAILY. Early detection of a reversal in GLD was manifested in the form of negative divergence on many indicators, which resulted in the breaking of the accelerated trendline.

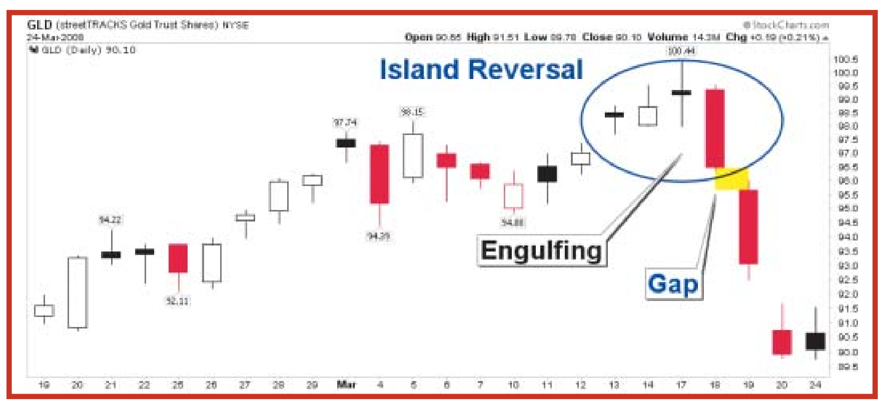

FIGURE 2: GLD, DAILY. The appearance of a bearish engulfing candlestick resulted in an island reversal topping pattern, which ultimately broke the accelerated trendline.

FIGURE 3: GLD, WEEKLY. The breaking of GLD's accelerated trendline signaled weakness of the weekly chart, with a bearish cross on the MACD and the stochastic line moving below the value of 80.

tic line generated a sell signal moving below the value of 80. The near-term future success of the ETF will be based on whether the intermediate trendline remains intact.

John Magee and Robert Edwards, in their work *Technical Analysis Of Stock Trends*, classifies a decisive break of a trendline as a move in excess of 3%. There is an adage that states, "Trendlines are made to be broken," but don't discount the authority of GLD's intermediate trendline, because "a trend is a trend until it isn't." ■

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Edwards, Robert D., and John Magee [2007]. *Technical Analysis Of Stock Trends*, 9th ed., W.H.C. Bassetti, ed. AMACOM.

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This article was first published on 3/25/2008.
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ELLIOTT WAVE

The Gold Rush Is Over

by Alan R. Northam

Through the use of Elliott wave theory, we can see that the market trend for gold has clearly reversed from one of bullishness to one of bearishness.

Tradable: GLD

In my previous article titled "Gold Rush Playing Out" (Traders.com, 02/29/08), I explained that GLD was forming an expanding diagonal. I further explained that according to Elliott wave theory, expanding diagonals were made up of five overlapping waves. I also explained that during the final stage of wave 5, price usually broke through the upward-sloping resistance line of the expanding diagonal, but it was not a requirement. I also made the statement that at the end of wave 5, buying power would dry up and profit-taking would step in and drive the price of gold down, reversing the trend.

As can be seen in Figure 1, gold has reached the upward sloping resistance line of the expanding diagonal, where profit-taking has taken over and driven gold down. In my previous article I also mentioned that the upward-sloping expanding diagonal formation would be complete once price broke through its lower upward-sloping support line. Again, in Figure 1 the price has broken below this lower support line, thus completing the expanding diagonal pattern.

Now that GLD has reached the end of wave 5 and the expanding diagonal formation is complete, how do we know that the gold rush is over and that there has been a reversal in trend? Perhaps the recent selloff is simply a market correction and GLD will continue higher once the correction is over.

To answer this question, I refer to Elliott wave theory. More than 70 years ago, R.N. Elliott developed a series of rules for analyzing the stock market. Since then, Elliott's rules have been used successfully in market analysis. One of Elliott's rules states that market direction is defined as an impulse wave made up of five nonoverlapping waves. Elliott also defined that after the completion of these five waves, the market corrects in a series of three waves to be followed by the next set of five nonoverlapping waves in the direction of the trend.

In Figure 2, I have expanded the area in the gold rectangle from Figure 1. In expanding this area I have broken the daily bars from the rectangle area of Figure 1 down into 60-minute bars so that we can easily see the wave structure. From the market top, GLD has traded downward in five nonoverlapping waves identified in blue as waves (1), (2), (3), (4), and (5). Note also wave (3) has subdivided into five nonoverlapping waves identified in red as waves 1, 2, 3, 4, and 5. This wave structure is referred to as an *impulse wave* and defines the direction of the market trend in gold, which is now down.

Since the completion of five waves down, GLD has gone through a three-wave correction shown in blue as waves A, B, and C. Having completed wave C, gold has now started a new impulse wave in the downward direction. This impulse wave has completed waves (1) and (2), where wave (2) appears to be subdividing into five waves. Since the current impulse wave has only completed two of its five waves, we can now predict that the future direction for GLD is still down and will continue down until all five waves are complete.

Looking at GLD from a more traditional technical analysis point of view, note that on the 60-minute chart that GLD has also formed a "dead cross," indicating that sentiment has changed from bullishness to bearishness. The 50-session (each session being 60 minutes) moving average is acting as resistance as price rallied up to this moving average, bounced off, and is now following it lower. Thus, even from this more traditional method of technical analysis, we can see that GLD is headed lower.

FIGURE 1: GLD, DAILY. The daily price chart shows a completed expanding diagonal pattern.

FIGURE 2: GLD, 60-MINUTE. The 60-minute price chart shows five waves down defining the price trend.

In conclusion, looking back at Figure 1, we have seen that wave 1 down is an impulse wave made up of five nonoverlapping waves. We have also learned that according to the Elliott wave principles, an impulse wave defines the direction of the trend, which in the case of GLD is now down. We have also learned that corrective wave 2 is made up of three waves, which are also complete. Further, we have learned that GLD has now completed waves (1) and (2) of the next impulse wave down. Having this knowledge, we can definitely say that "the gold rush is over." ■

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Prechter, Robert R., Jr., ed. [1994]. *R.N. Elliott's Masterworks: The definitive collection*, New Classics Library.
Prechter, Robert [1980]. *The Major Works of R.N. Elliott*, New Classics Library.

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This article was first published on 4/1/2008.
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DOW THEORY

Exxon Running Out Of Gas?

by Alan R. Northam

Ever since 2002, Exxon's share price has been consistently moving higher and higher. Does Exxon have the energy to continue higher, or is it running out of gas?

Tradable: XOM

According to Dow theory, a bull market is defined as a market whereby price makes a series of higher highs and higher lows, whereas a bear market makes a series of lower price highs and lower price lows. Dow theory also states that a change in trend has been made, such as going from a bull market to a bear market, when price makes its first lower high followed by a lower low.

A "dead cross" occurs when a shorter-term moving average, such as the 50-day moving average, crosses below a longer-term moving average, such as a 200-day moving average. When a "dead cross" occurs, it is a sign that sentiment in the market has turned decidedly against the stock.

Figure 1 shows a price chart for Exxon Mobil (XOM). As you can see, after a correction that started at the end of 2007 and ended in mid-January 2008, price rallied higher but failed to make a new price high, instead making a lower price high, marked "LH" on the price chart, in late February 2008. Since that time, price has been trading back lower but has not made a lower low as of this date. This recent market action has satisfied the first half of Dow theory tenet that a change in market direction has occurred for Exxon but has not satisfied the second half of the Dow theory requirement that the market must also make a lower low.

When we turn our attention to the 50-day moving average and the 200-day moving average, we note that the 50-day moving average has recently crossed below the 200-day moving average. This crossing is identified as a dead cross and indicates that market sentiment has turned against Exxon. This further signifies that buyers are not willing to buy the market higher and sellers are out there selling the market lower.

FIGURE 1: EXXON MOBIL, DAILY

In conclusion, price is now testing strong resistance of the 50-day and the 200-day moving averages from below. If the market sentiment has turned against Exxon, then the strong resistance price level of the 50-day and the 200-day moving averages should hold and Exxon should bounce off this wall of resistance and turn back down to test major support at S1, drawn off the mid-January low. A break below this support price level will satisfy the second half of the Dow theory that a trend reversal has occurred. Although it is not yet clear if Exxon will manage to break out above the 50-day and 200-day moving averages and push to make a new higher high price, in keeping the bull market for Exxon alive, it does appear that Exxon could be running out of gas. ■

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BOLLINGER BANDS

Profiting From Gold

by Mike Carr, CMT

If gold continues higher, smaller mining companies offer superior potential.

Tradable: RGLD

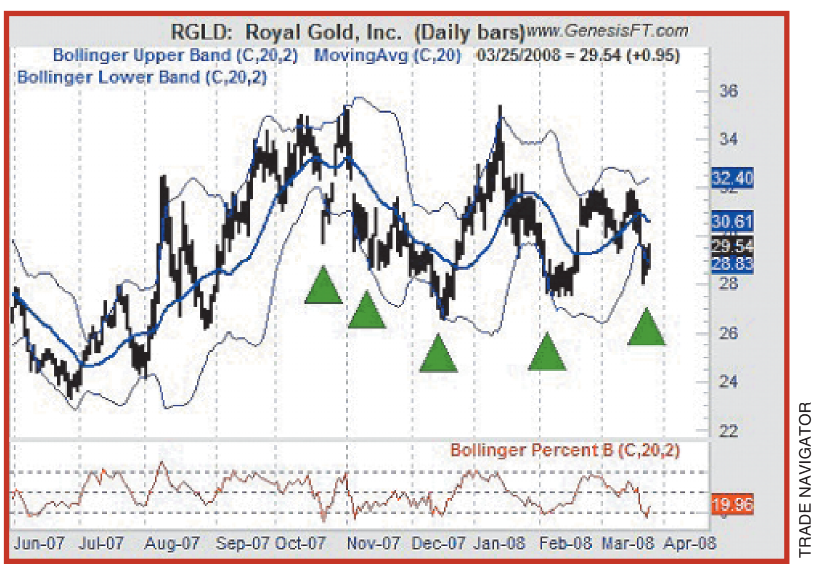


FIGURE 1: RGLD, DAILY. RGLD is near its lower Bollinger band, an area that has been a good buying opportunity in the past.

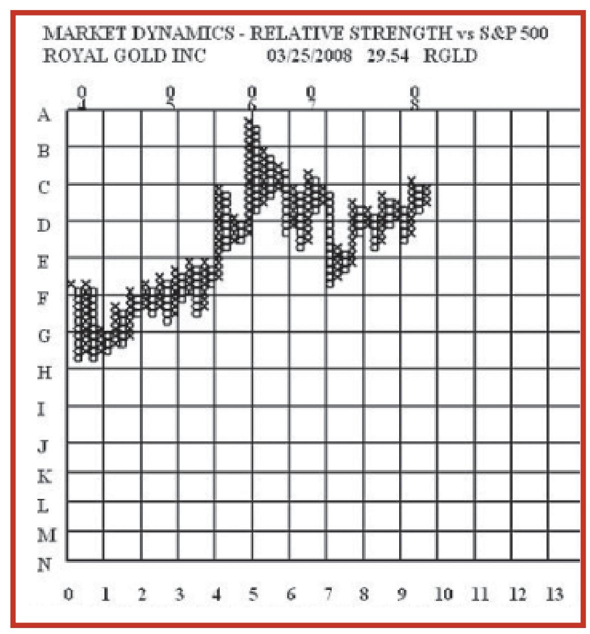


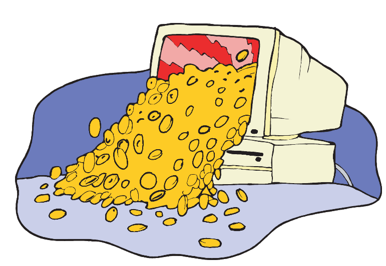
FIGURE 2: RELATIVE STRENGTH VS. S&P 500. The point & figure chart of relative strength is bullish.

Royal Gold (RGLD) is a US mining company. Although it has exposure to mines throughout the world, being based in the US makes it a way to play gold without worrying about the value of the dollar. RGLD is not overbought and technically vulnerable as many other mining companies are. And fundamentals support the stock price at current levels.

RGLD has operating margins more than four times the industry average and a price/earnings ratio in line with the industry. With margins indicating good management, this stock represents a balance between the rewards of higher gold prices and the risk associated with the possibility of lower gold prices. The stock also has a beta near 1, indicating that it is likely to move in line with the market.

In Figure 1, the daily chart of RGLD shows that prices have been in a year-long trading range. When price touches the lower Bollinger band, as it is now, it has usually been a good buy point. What is not shown in this chart is that the stochastics has just turned higher and the relative strength index (RSI) is also bullish.

Figure 2 shows the long-term point & figure chart of relative strength for RGLD. The stock has been steadily gaining strength and is currently on a buy signal. Many gold mining stocks are overextended on these charts, making RGLD less risky than its peers. Overall, RGLD represents a low-risk bet on continued gains in the price of gold. ■



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This article was first published on 3/27/2008.
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TECHNICAL ANALYSIS

Quicksilver Resources Nearing Support

by Kevin Hopson

Quicksilver recently broke out of a bullish trading range and is now falling back toward key support, making the stock an attractive buy at lower levels.

Tradable: KWK

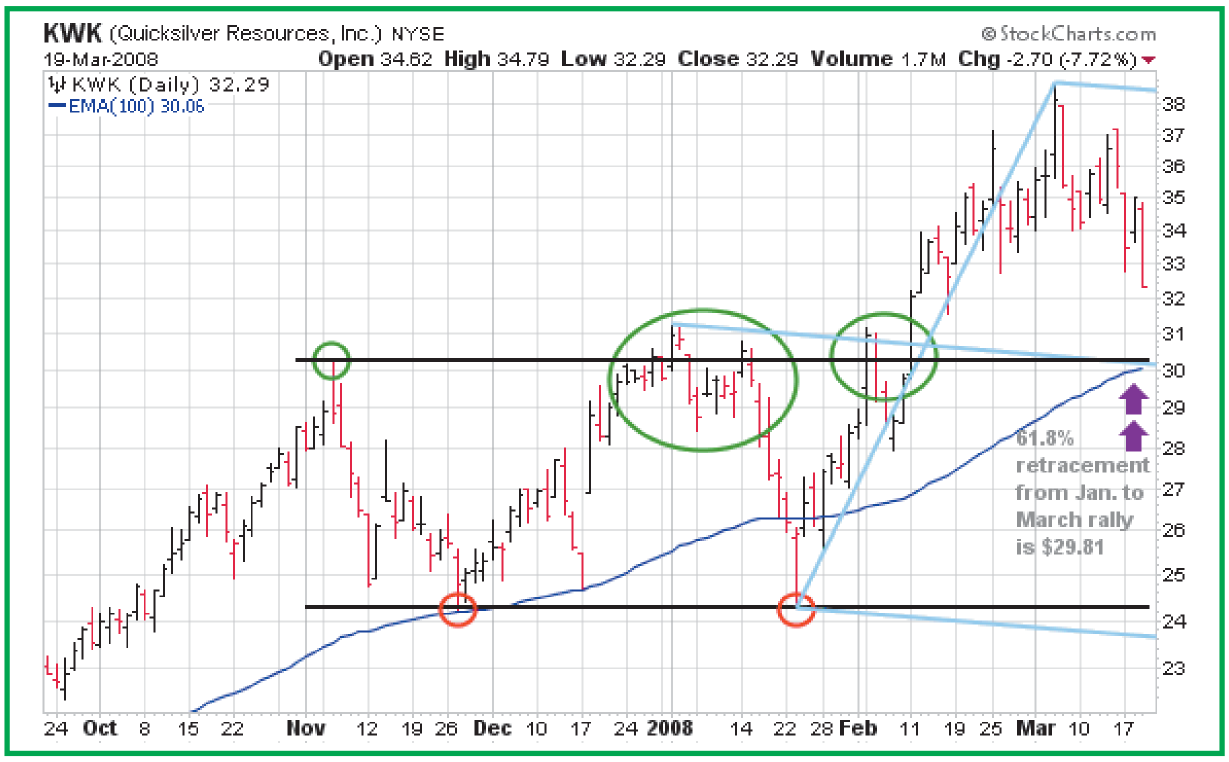

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FIGURE 1: QUICKSILVER, DAILY. Because KWK recently topped out around $39 and is now pulling back, $42 continues to be a minimum upside target for the stock.

Quicksilver Resources (KWK) broke out of a bullish trading range in early February, indicating a possible upside target of $42–48 (Figure 1). I calculated this target by taking the number of times the stock tested the top channel line in alternate sequence (3), multiplying this figure by the width of the trading range ($30 - $24 = $6) and then adding this amount ($6 x 3 = $18) to the bottom ($24 + $18 = $42) and top ($30 + $18 = $48) channel lines.

Because Quicksilver recently topped out around $39 (did not meet the first price target) and is now pulling back, $42 continues to be a minimum upside target for the stock. Though the stock is attractive at current prices (~ $32), I would look for a better buying opportunity near the $30 level. The reason I say this is because there is a huge convergence of support here.

For instance, the top of the prior trading range comes into play around the $30 level. Broken resistance tends to act as support during pullbacks, as those who previously sold here look to buy back in. Also coming into play here is the 61.8% retracement level from the January to March rally, as well as the stock's 100-day exponential moving average. If that is not enough, the blue median line (pitchfork) is converging here. As a result, I would consider accumulating on weakness and buying aggressively at the $30 level if the opportunity presents itself. ■

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This article was first published on 3/21/2008. See www.Traders.com for more.

OSCILLATORS

Antrim Energy

by Koos van der Merwe

With the price of oil going up as the market slowly moves into the recession, oil companies are the obvious choice as investment/speculative vehicles.

Tradable: AEN-T

FIGURE 1: ANTRIM ENERGY. This chart shows buy signals being given.

Antrim Energy is an oil and gas exploration and production company. Its operations are centered in Argentina, but its high-impact oil and gas exploration is focused in the United Kingdom. The company is currently drilling in the Fyne Field in the UK North Sea. On April 8, the company reported that drilling operations were successfully completed. Conclusive results are still forthcoming.

Figure 1 shows the following indicators.

1. *Fisher MACD of the high.* This indicator has given a buy signal.

2. *Rapid RSI modified.* This indicator has turned upward, suggesting a buy. It has however not fallen below its 32 level, which I would have preferred before a buy signal were given.

3. *Stochastic RSI cycle indicator.* This indicator has given a buy signal.

4. *Volume.* Volume has increased as the price rose. This is a sign of strength.

In a bear market, such as the one we are experiencing, market participants always look for good bargains to buy and hold for the long term. With the price of oil being as high as it is and likely to remain high as long as the United States remains in a recession, Antrim Energy could be a stock to play as soon as the oil price starts weakening or the indicators give a sell signal. When this happens, it may be best for the investor to take profits and say, "Thank you." ■

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SECTORS

INDEXES

The Transportation's Broadening Formation

by Ron Walker

The broadening formation on the Dow Jones Transportation Average could act as a continuation pattern or a reversal.

Tradable: DJTA

Back in October 2007, when the Dow Jones Industrial Average (DJIA) and the Standard & Poor's 500 were making new all-time highs, the transportation average failed to follow suit. The transports meandered around during October and moved sideways for some time, until ultimately prices eroded along with the rest of the market after the October highs. As the market put the January lows, the transports was one of the sectors that led the charge toward recovery. The transportation index reaped huge gains as it catapulted higher, but then it ran into resistance in early February. Prices started forming a base, but after several attempts of trying to break above resistance, the bulls conceded to the bears. As seen in Figure 1, before breaking down near the end of February, the transportation index rose a whopping 19.70% off its January 22nd low of 4032 to a closing high of 4826, jumping up by 794 points.

In late February, just two days after reaching its latest minor closing high of 4826.31, the transportation index closed below its 20-day simple moving average for the first time since the confirmation of its reversal on January 22. From there prices sifted lower, putting in a new minor low. Four days later, buyers came back into the market, breaking the three-day losing streak, but severe technical damage had already resulted in a lower low. Then prices rose for next three days but found resistance at the 20-day simple moving average. The following day, prices plunged, giving back all the gains that had been made in the prior three trading sessions, producing a lower high. This setup was an interesting reversal pattern known as a bearish mat hold. It is a five-day candlestick pattern where the first day begins with a long black day. The next three candlesticks are bullish white bodies, with each closing higher than its predecessor the previous day. On the fifth day, a long black candlestick emerges that closes below the open of the second day. The transports had three strikes against it, with a lower low and a lower high in place, and prices finding resistance at the 20-day simple moving average, and now a bearish candlestick pattern. Confirmation of the pattern came the following day as prices closed below the low of the pattern. Prices continued lower for two more days, until a bullish engulfing candlestick made an appearance.

With a reversal in place, a broadening formation was now under construction, which is right-angled and descending. The pattern looks like a backward ascending triangle. This pattern is chronicled in Thomas Bulkowski's masterpiece, *Encyclopedia Of Chart Patterns*. In this work, Bulkowski classifies it as a "short-term bullish continuation" pattern. If this broadening formation is acting as a continuation pattern, then three important events will take place as seen in Figure 2. First, prices will once again rise to test resistance at the 4826 level, which is the upper boundary of the pattern. Second, if that occurs, prices will break out of the long-term falling price channel that has evolved since last summer. Finally, the broadening formation may be setting up a right shoulder in a huge inverse head & shoulders pattern, which has been setting up since mid-October. This pattern could bring about a complete reversal.

The odds of a test to the upper part of the broadening formation are likely, given that the engulfing candlestick allowed for a higher bar to develop on the moving average convergence/divergence (MACD) histogram, confirming long-term positive divergence on that same indicator. Broadening formations, right-angled and descending, are prone to failure, so the pattern isn't a sure thing. But in scoring the pattern, Bulkowski's research showed that "patterns acting as reversals occur 143 times, and 131 act as continuations of the prevailing price trend." So there is almost a 50/50 chance here with odds at 14 to 13. ■

SUGGESTED READING

Bulkowski, Thomas [2000]. *Encyclopedia Of Chart Patterns,* John Wiley & Sons.

FIGURE 1: DJTA, DAILY. In late January, the transportation index accelerated higher, finding resistance in February at the closing high of 4826. Prices broke down in late February as a bearish mat hold candlestick pattern developed, which continued to push prices lower, forming a broadening formation, a continuation pattern.

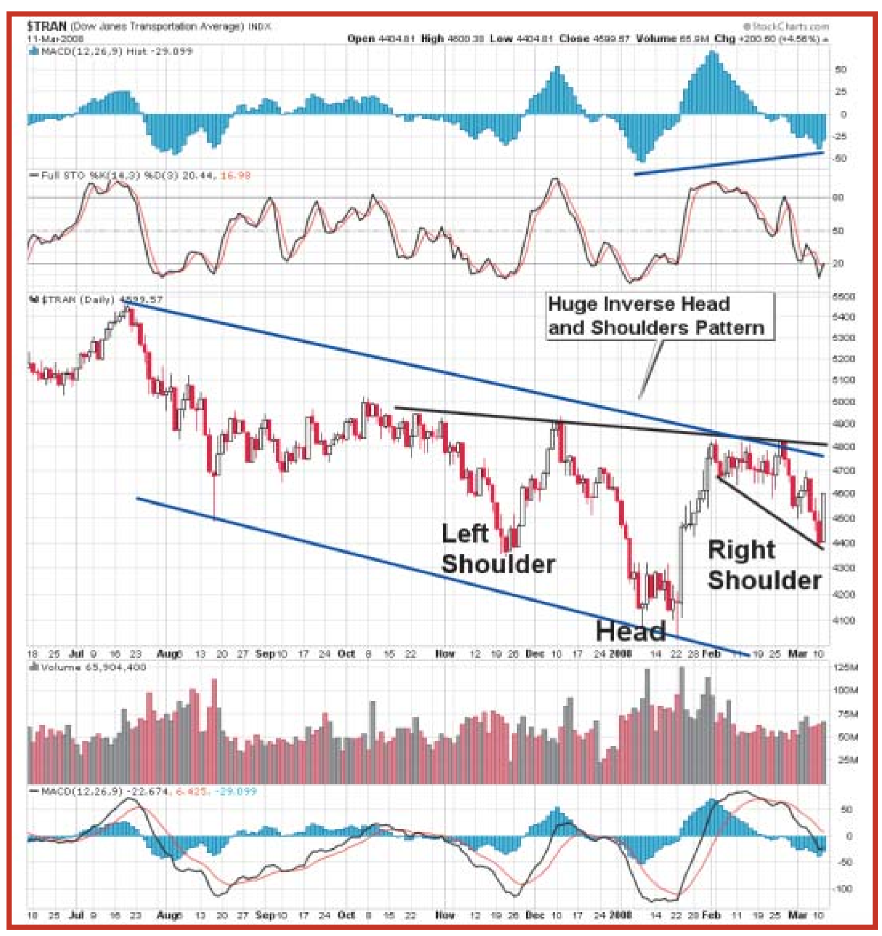

FIGURE 2: DJTA, DAILY. Watch for a breakout confirmation of the broadening formation pattern and the falling price channel. A breakout of the broadening formation could set up a right shoulder on a huge inverse head & shoulders pattern.

FIBONACCI

Financial Market To Lead Broader Market Up

by Alan R. Northam

The financial market looks as if it is ready to turn higher, indicating that the broader stock market could turn higher as well within the next few months, if not sooner.

Tradable: XLF

Financial stocks are known as leaders of the broader stock market and usually form a market top or a market bottom ahead of the broader stock market. Figure 1 illustrates this point. This figure shows a daily stock price chart of financial stocks, represented by an exchange traded fund (ETF) with the stock symbol of XLF, and the Standard & Poor's 500 representing the broader stock market. As you can see, financial stocks made a market top a little more than four months ahead of the S&P 500.

Below the price chart is a ratio chart of XLF divided by S&P 500. When the chart slants downward, it is an indication that financial stocks, represented by XLF in the numerator of the ratio, is falling at a faster rate than the S&P 500 in the denominator. This is what we would expect to see if financial stocks were truly leading the broader stock market lower. The question now becomes, "Will financial stocks continue to lead the broader stock market lower in the days, weeks, and months ahead?" To answer this, we must analyze XLF to determine if it still has room to move to the downside.

Figure 2 shows the daily bar chart of XLF. To determine if XLF still has room to move to the downside or if it is ready to turn higher, I have employed the use of Elliott waves and Fibonacci. Note that XLF has formed five waves down. Is wave 5 down complete? If so, XLF could be ready to enter into a correction. Corrections following the first five waves down from a market top are usually deep and could retrace as much as 62% of the distance traveled by the total of the five waves down. I show a chart of possible Fibonacci retracements in Figure 3.

Let's look at wave 5 to see if we can determine that it is complete. First I look at the wave structure of wave 5. Here I see that it further divides into five waves, wave (i), (ii), (iii), (iv), and (v) so all five subwaves are present. This is the first piece of evidence that the five waves down from the market top could be complete. Next, I look at the length of wave 5 and compare it to the length of wave 1. Wave 5 starts at a price of $29.93 and ends at $22.29 for a difference of $7.64. Wave 1 starts at $37.47 and ends at $31.00, a difference of $6.47. One of the Fibonacci relationships is that waves 1 and 5 are often equal in length. On our price chart in Figure 2, wave 5 is actually just slightly longer than wave 1. This is further evidence that wave 5 down could be complete. For a third piece of evidence, I looked for other valid Fibonacci relationships and found that the price difference from the market peak to the top of wave 4 equaled $7.54 and that the price difference from the peak of wave 4 to the bottom of wave 5 equaled $7.64. Comparing these two amounts to the complete price range from the market top to the bottom of wave 5, we get 0.50 or 50% (7.54/37.47 - 22.29) and (7.64/37.47 - 22.29). The fraction 0.50 is also a valid Fibonacci ratio and lends further evidence that wave 5 down could be complete.

As one final piece of evidence that wave 5 could be complete, I have also shown the moving average convergence/divergence (MACD) momentum oscillator in Figure 2. From late November 2007 through mid-March 2008, the MACD has been printing out a bullish divergence. A bullish divergence occurs when the MACD makes higher lows while the price chart makes lower lows. A bullish divergence warns that an important trend change is about to take place.

All the evidence points to a high probability that the financial market is about to change direction from down to up. If and when this change in direction takes place, it will most likely do so as a market correction and not the beginning of a new bull market. What this means is that we can expect the financial markets to retrace up to about 62% of the ground it has lost since it peaked in late May of 2007. Once this retracement is complete, then the financial market should turn back down once again and head for a new lower low in price.

With the evidence pointing to an upturn in the financial markets, we can expect a bottom in the broader stock market to occur within the next few months, if not sooner. Further, a bottom in the broader stock market does not indicate a change from a bear market to a bull market but that the broader stock market will most likely undergo a significant market correction before turning back down. ■

FIGURE 1: RATIO OF XLF VS. S&P 500

FIGURE 2: XLF, DAILY. Elliott waves and Fibonacci relationships can be seen here.

FIGURE 3: XLF, DAILY. Here's the price chart of XLF showing Fibonacci retracement levels. After the initial five waves down from a market top, the highest probability of a retracement is 61.8%.

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FIGURE 1: XLF, WEEKLY. The long bullish candle has covered two small bearish candles, and thus suggesting a fresh upside rally. However, the rally need not be too aggressive on bearish notes.

FIGURE 2: XLF, DAILY. The moving average resistance may get converted to support very soon, and thereon the sector may consolidate on new support.

Does The Financial Sector Have The Strength To Recover?

by Chaitali Mohile

After a long time, the Financials Select Sector SPDR is showing signs of recovery. Will it carry the rally ahead?

Tradable: XLF

Since mid-2007, the Financials Select Sector SPDR (XLF) has been hammered and dragged down to lower levels. In addition, every recovery has seen the lower lows, tracing the highs instead. The sector has lost its hold in the last seven to eight months as a result of the current financial crisis.

During a recent session, some interesting moves were visible, indicating strength. The sector has gained nearly $4, forming a huge bullish candle that covered two bearish candles. This bullish engulfing pattern shows a stronger reversal pattern, as one single bullish candle has completely engulfed two bearish candles. But the candlestick charting is better followed by more confirmation than isolation. In addition, what worries me is the lack of confidence eventually leading to the lack of participation, possibly weakening the bullish rally.

If we decide to keep aside the negative sentiment for the time being, the indicators that have been plotted are showing volatile recovery sessions. The stochastic (14,3,3) is constantly forming lower highs and somewhat stable lows. But probably this time the upper trendline is likely to turn to support, resulting in an upward rally. The rally is not going to be smooth for the sector, as the moving average convergence/divergence (MACD) (12,26,9) is deep in negative territory. Yes, the bullish crossover is visible here in Figure 1, but the indicator has to travel a long way to touch the hearts of bullish buyers and to bring the confidence back. Again, the optimistic view is that the downtrend is close to its overheated levels.

The average directional movement index (ADX) (14) shows overheated trend levels at 40 and above. This sometimes leads to a trend change. In Figure 1, the indicator is not yet declining to indicate the possibility of a trend change, but the existing downtrend may soon get exhausted or slow down. So though the downtrend may not change, some buying opportunities can appear during the relief rally. Traders therefore can trade between support and resistance levels.

On the daily chart (Figure 2), the sector's upside swings were suppressed by the 50-day moving average under the strong bearish shadows of the 200-day moving average. The sector has bounced back from this resistance to new lows. XLF once turned down this resistance to support but failed to sustain the support and tumbled even lower. The stock is trying its next attempt to cross the moving average resistance on marginally stronger notes. The stochastic (14,3,3) has moved to an overbought area, and therefore some more room is visible for an upward rally. Earlier, the oscillator could sustain these levels, so we need to be cautious this time.

But the trend is still down even though the ADX (14) is declining. The conflict between seller's and buyer's pressures, indicated by -DI and +DI, respectively, can result in consolidation during the relief rally. XLF can consolidate on the freshly formed support of 50-day moving average (MA). The consolidation is more likely to be highly volatile on a bearish background. The MACD (12,26,9) has turned upward in negative territory and could support the relief rally.

Thus, XLF may undergo a slow recovery under the resistance of a 200-day moving average. The rally seems to be volatile due to bearish sentiments across the financial markets. ■

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This article was first published on 3/28/2008.
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Homebuilders Recovering?

by Alan R. Northam

According to an analysis using moving averages to determine the future direction, XHB is now in an established intermediate-term uptrend. However, based upon an analysis using Elliott wave rules and guidelines, this uptrend is nothing more than a retracement.

Tradable: XHB

I've heard quite a bit lately about how homebuilder stocks are recovering, so I decided to do my own investigation and see what the media is talking about.

Looking at Figure 1, a daily price chart of XHB, a Standard & Poor's 500 Homebuilders Index ETF, three things pop out that I can immediately see. First of all, I see that XHB is trading above its 50-day moving average and that the moving average has been pointing upward since February. When a market is trading above its 50-day moving average and the moving average is pointing upward, technical analysts say that the market is in an intermediate-term uptrend. But what they fail to say is that intermediate-term trends last from approximately three weeks to six months. As you can see from the chart, this intermediate-term uptrend is now over eight weeks old and has fulfilled the minimum requirement in time to be classified as an intermediate-term uptrend. This also means that this intermediate-term uptrend can turn back down any time between now and July, when this intermediate-term trend would become six months old.

Second, I see that XHB is now trading at its highest level over the last six months. Again, technical analyst view this as a positive indication that a recovery is underway.

Third, technical analysts will also recognize that although this market is now trading above its 200-day moving average as well, this average is still pointing downward. Technical analysts will now be looking for a test of the 200-day moving average to see if it has changed from a line of resistance to a line of support and they will be looking for this moving average to turn upward. Once the 200-day moving average turns upward, technical analysts will view this market as being in a long-term uptrend. Long-term uptrends normally last from six months to two years. So everything looks rosy. XHB is now in an intermediate-term uptrend and could establish itself in a long-term uptrend within the next few months.

However, when I analyze XHB using the rules of Elliott wave analysis, I see a completely different picture. I prefer to use the Elliott wave rules in my market analysis because they have withstood time over the last 70 years or more. Over this period, Elliott's rules have only been violated a couple of times, which gives them a long history of being able to predict the future direction of the markets very accurately. According to Elliott, the rules used in market analysis are exact and followed exactly and are not subject to interpretation. More traditional methods of technical analysis such as the average directional movement index (ADX), the moving average convergence/divergence (MACD), the relative strength index (RSI), stochastics, and others do not have the same long history, nor the accuracy of predicting the future direction of the markets, having only been around for 30 years or less. Nor do they have exact rules to follow in using them and as such are open to differing views of interpretation.

FIGURE 1: XHB, DAILY. This chart of XHB shows 50-day and 200-day moving averages.

FIGURE 2: XHB, DAILY. This price chart of XHB shows Elliott wave count and price and time targets.

FIGURE 3: XHB, DAILY. This price chart of XHB shows Fibonacci retracement levels.

Looking Figure 2 from an Elliott wave perspective, I see five waves in the downward direction from that market top in early February 2007. There are exact rules that must be followed in determining these five waves that we will not go into here. According to R.N. Elliott, when a market makes a five-wave move those five waves determine the direction of the market. Elliott calls these five waves an *impulse wave* and impulse waves make progress in price.

In the case of XHB, these five waves down are predicting that the future direction of this market is down. Elliott's rules also state that after a five-wave move down, the market will retrace a portion of the total move of those five waves. This is also known as a *market correction*. Elliott's rules also state that after the initial five-wave move down from a market top, the retracement will be in the form of a three-wave ABC pattern called a *zigzag*.

Looking at Figure 2 again I see that XHB has now completed wave A and wave B and is working on the completion of wave C of this zigzag retracement pattern. Through the use of other Elliott wave rules and guidelines I have determined that wave C should complete somewhere in the vicinity of $26.51 and should be complete by May 19. Elliott also has a series of guidelines to follow in predicting the future price of a market. Guidelines are just that and are not as exact as the Elliott rules.

In Figure 3 I have added the Fibonacci retracement lines. According to the Elliott wave guidelines, the first retracement, after the initial five waves down from a market top, usually retraces 61.8% of the total move of those five waves. As you can see, our price target is just shy of a 50% retracement. What this is telling me is that there exists a possibility for the current retracement to morph into a more complex retracement pattern other than a simple zigzag that would allow the retracement to continue on to higher levels. This is all within the context of Elliott's guidelines, so we will have to see what this market does once it reaches our target price level. Once the total retracement is completed, then the next five waves down will commence.

In conclusion, using an analysis based upon moving averages, the Homebuilders Index has entered into an intermediate-term uptrend. However, according to Elliott wave analysis this intermediate-term uptrend is nothing more than a retracement of the downward trend, and once this retracement is completed, the downward trend will resume. ■

HEAD & SHOULDERS

Could Transports Climb A Wall Of Worry?

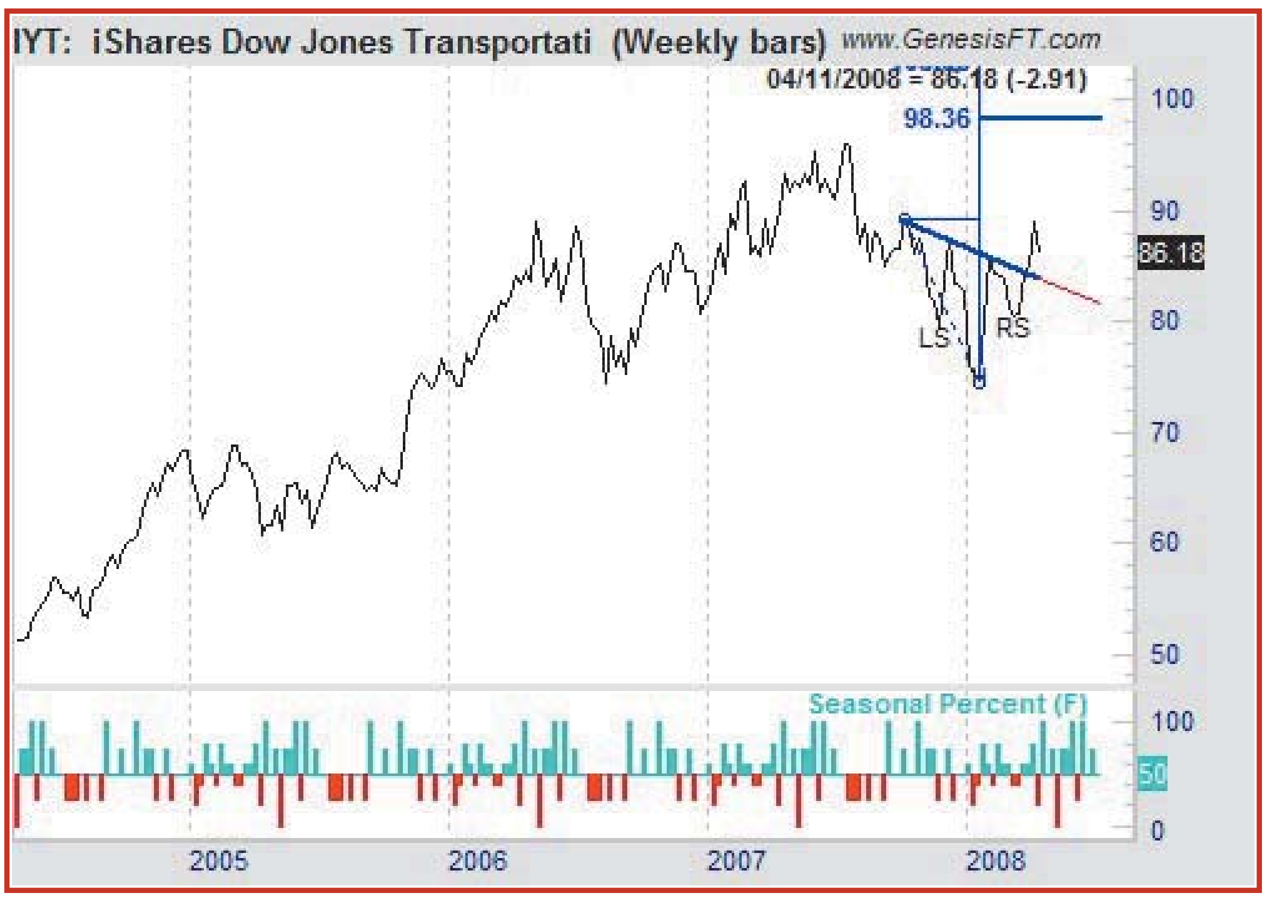
by Mike Carr, CMT

With the news dominated by airlines entering bankruptcy and oil stubbornly clinging to record levels, this may be a good time for contrarians to look at transportation stocks.

Tradable: IYT

It would be difficult to imagine the news getting much worse for transportation companies. And all of this bad news may provide the proverbial "wall of worry" for these stocks to climb higher in the coming months. Fundamentals are showing value in this sector, with the average transportation stock trading at 0.84 times sales, compared to a market multiple of 1.33. These stocks should also do well in a recovering economy, since industrial output would pick up, which means more shipments.

Despite the promising fundamentals, there is a great deal of risk within this sector. As Frontier Airlines demonstrated, business conditions can change quickly in the current environment. The best way to guard against unique company risks is through diversification, and iShares Dow Jones Transportation Average (IYT) offers that by owning 20 stocks. The chart of IYT (Figure 1) is bullish.

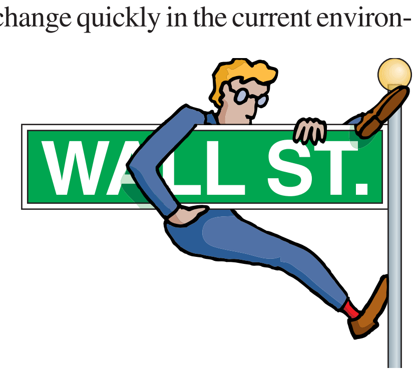


TRADE NAVIGATOR

FIGURE 1: IYT, WEEKLY. Here, IYT has completed an inverted head & shoulders and has a very favorable seasonal tendency at this time of year.

We can see that IYT is testing the neckline of an inverted head & shoulders pattern. A throwback after a breakout is normal, and healthy. The measured objective of this pattern, at 98, sits just above old highs. An additional factor is the bullish seasonal trend for IYT. Since it began trading, this exchange traded fund (ETF) has traded up 100% of the time in the 16th trading week of the year, and May is seasonally the strongest month for this stock. Combined with the recent breakout, this is an ideal time to buy IYT.

At the current level, IYT offers a low-risk entry with good upside potential. A close below 84 would put prices back into the pattern and indicate that this trade setup has failed. ■



Biotechnology Index Crushed In Crucial Areas

by Chaitali Mohile

The pullback rally has turned sideways in between the two Fibonacci retracements levels for the biotech index. This support-resistance area is also intercepted by the moving average hurdle.

Tradable: $BTK

Between May and July, 2006, the Biotechnology Index, was moving in the 620-680 range with high volatility. Various attempts were made to violate the upper resistance, but due to lack of strength and high volatility, the index consolidated at lower levels and formed a strong bottom. The stochastic (14,3,3) was indicating that a bullish rally may lie ahead, since the indicator had already begun its upside move from the oversold area. The moment the resistance was converted to support, a strong bullish rally was initiated that made new highs. At the same time the stochastic was hitting the overbought areas. The price chased the exponential moving average. On the breakout, price retraced toward the EMA 50, and as a result, every upside swing was followed by a vertical correction, which lost most of the gains from the bullish rally. This action was repeated twice, but the EMA proved to be a boon for the rally, and $BTK surged back to previous highs.

The stochastic also reached overbought levels as the price made new highs and slipped with equal speed, resulting in a declining price from the top. But the plunge from the 838-840 area failed to respect the EMA 50 support and slipped even further to kiss the 200-day EMA. The support-resistance line showed in Figure 1 and the 200-day EMA have the same collision points, creating the strong support-resistance zone. Thus, a fresh pullback rally was born from the same zone, with stronger bullish pressure. The average directional movement index (ADX) (14), though, shows a developing uptrend, and we can see a sudden rise in buying pressure. So even in a downtrend, the bulls try their hands, pulling the index higher.

FIGURE 1: $BTK, WEEKLY. The Fibonacci retracement level and the 50-day EMA together has compressed the index movement. Sustaining between this support-resistance zone by consolidating is healthy for the bullish rally ahead.

The index has now recovered almost 64.8% retracement levels and turned sideways. However, the 50-day EMA now stands as support as well as resistance for the rally. The moving average convergence/divergence (MACD) (12,26,9) is trying to sustain above the trigger line, whereas the MACD histogram has already moved above the zero line. Thus, this indicator leaves a positive view for a temporary phase. And the stochastic (14,3,3) is in the bullish area. As long as the retracement levels' support of 50% and resistance of 64.8% along with the 50-day EMA is held, bullish sentiments will sustain. But the index price will be crushed between the support and resistance. The sideways move in this narrower range will be healthier than slipping below the mentioned supports. ■

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This article was first published on 4/21/2008. See www.Traders.com for more.

INDICATORS

STRATEGIES

Profiting From Volatile Markets With OOPS

by Mike Carr, CMT

This famous Larry Williams trade setup can be especially profitable when markets are making wide intraday swings.

"Oops" is a trading strategy that market expert Larry Williams has written about extensively. The Oops signal trades gaps, going against the direction of the opening gap. It is called thus because, according to Williams, when a market reverses an opening gap, many traders with losing positions say "Oops" and exit with a small loss.

The rules are simple. For long positions, when a market opens lower than the previous day's low, place a buy-stop at the previous day's low. Shorts are initiated when a market opens higher than the previous day's high by placing a sell-stop at the previous day's high. Trades can be exited on the close, or held overnight to maximize profits. A stop-loss should always be used.

The Oops signal is based on market psychology. Often, news will cause a market to open with a gap. If there is no momentum behind the market, there won't be any follow-through action on the news, and prices will reverse. Traders often insist that most of the time the opening price will be near the high or low of the day at least 70% of the time. This means the Oops trade should offer an excellent reward/risk ratio.

Can something this simple really work? Williams found the strategy to be very successful in the futures markets. The leverage of futures helps increase profitability, but it can be employed in any market. We tested against the Spy exchange traded fund (Etf), since that is the trading vehicle of choice for many readers. With a stop-loss of $1,000 and using Williams' first profitable opening exit strategy, the trade delivers 81% winners, and it is equally successful from the long and short side. Testing with Qqqq is equally successful with startlingly similar numbers.

With large intraday swings becoming common in the stock markets, the Oops strategy is a great starting point for traders to look for profitable trading ideas. Variants of this strategy can be developed to personalize the idea, and few strategies can reliably help identify the market bias 80% of the time. ■

The OOPS signal trades gaps, going against the direction of the opening gap. The OOPS signal is based on market psychology.

Suggested Reading

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This article was first published on 3/12/2008.
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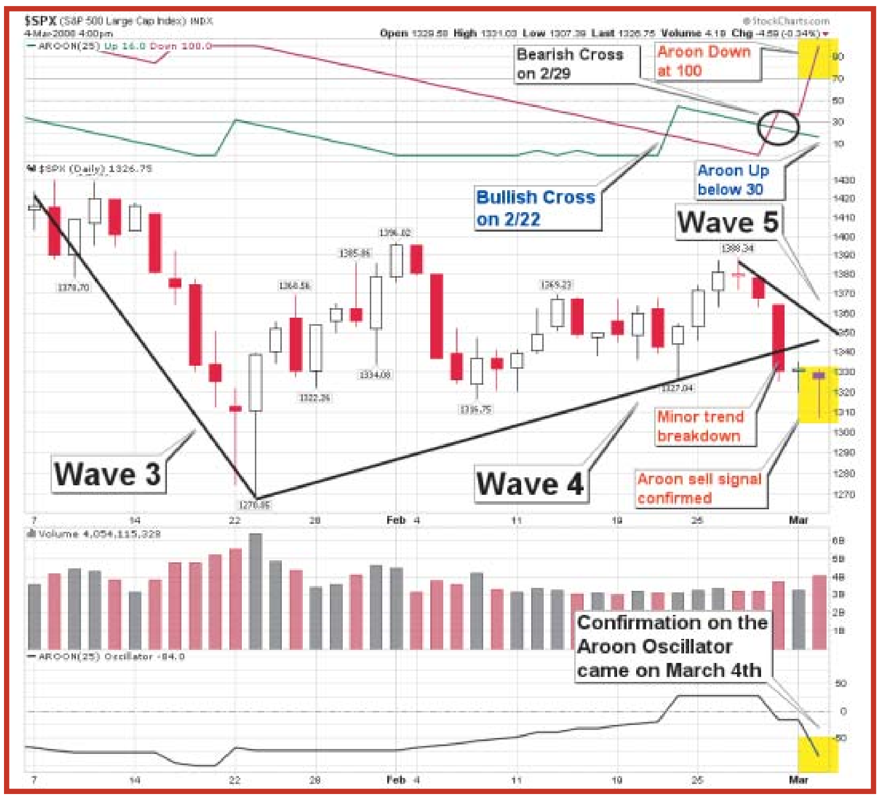

FIGURE 1, S&P 500, DAILY. The trend breakdown on the price chart on February 29 corresponds with the Aroon down moving above Aroon up, signaling a bearish crossover. Two trading sessions later, on March 4, Aroon down rose above 70, signaling a strong downtrend to come. That signal was confirmed by the Aroon oscillator.The bullish cross, which came on February 22 on the Aroon up, never got a follow-through during the minor trend that developed over January and February; nor did it move above the value of +50. The move quickly reversed as the Aroon down crossed above it on February 29.

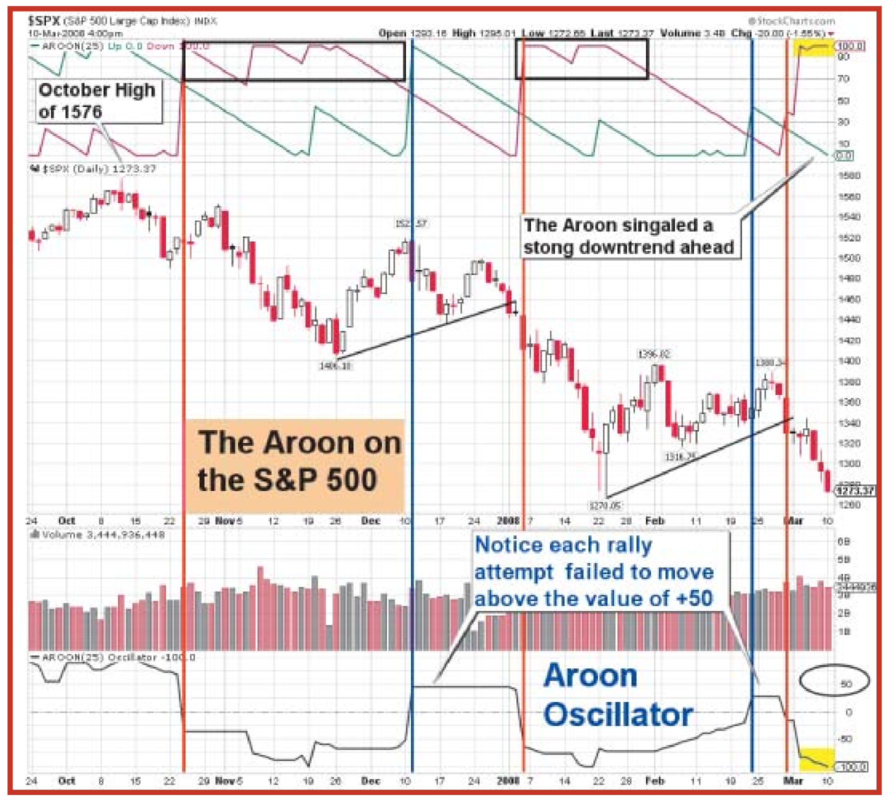

FIGURE 2, S&P 500, DAILY. The S&P 500 generated three sell signals from the October highs, one buy signal, and one false buy signal given by the Aroon. The two buy signals were given each time that the market was in a contratrend. In both December and February as the minor trends developed they were quickly violated as the prior trend reemerged. The minor trend that developed off the January low was never confirmed by the Aroon. A false buy signal was produced because the Aroon up did not move above the value of 50.

ELLIOTT WAVE

The Aroon : A Case For The Bears

by Ron Walker

The Aroon recently flashed a bearish signal. Could we be headed for a bear market?

Tradable: $SPX

The Aroon is a trend-based indicator that is plotted horizontally on a vertical scale from zero to 100. There is an Aroon up line and an Aroon down line. When the trend is bearish, the Aroon down line (a bearish indicator) moves above the value of 70, signaling a strong down trend, while the Aroon up line (bullish indicator) has a movement below 30.

And that is exactly what occurred on the daily Standard & Poor's 500 chart in Figure 1.

On February 29, the minor price trend was violated while simultaneously the Aroon down crossed above the Aroon up (a bearish signal), but it remained below the value of 70. Two trading sessions later, the Aroon down moved above the value of 70 to 100. The Aroon's behavior signaled that a strong downtrend was under way, which suggests that the S&P 500 has begun the next leg down, which is likely the Elliott wave 5. In Figure 1, the S&P 500 pushed lower, producing four Elliott waves from the October 11th high until the minor peak that was made on February 27 at 1388.

In Figure 2, the S&P 500 generated three sell signals from the October highs, one buy signal, and one false buy signal given by the Aroon. The blue and red lines mark each candlestick, the day the buy/sell signal occurred. The two buy signals (marked with blue lines on Figure 2) were given each time the S&P 500 was in a contratrend. The first buy signal in December had confirmation as Aroon up catapulted above 70, but the second buy signal in February 22 was false. This was because the Aroon up failed to confirm the crossover by not rising above the value of 50. The move quickly reversed as the Aroon down crossed above it on February 29. Shortly after the minor trends were starting to develop, they were quickly violated in December and February as the prior trend reemerged. The Aroon flashed a sell signal immediately after both of the minor trends brokedown.

The three sell signals (marked with red lines on Figure 2) that were given all received confirmation as the Aroon down rose to extreme levels above 70. The first sell signal was given in the early stages of the downtrend, while the latter two signals were very timely, coinciding around the time of the breakdown of each of the minor trends.

The Aroon oscillator works well with the Aroon. When the oscillator moves above +50, it indicates the early stages of a new trend. When it hovers near the zero line, prices are trendless. If the oscillator breaks below the value of -50, it signals that a bearish trend is developing. Note in Figure 2, how each rally attempt failed to move above the value of +50. The Aroon oscillator presented a short opportunity when it moved below the value of - 50, shortly after each of the contratrends failed, as prices broke the minor trendlines. ■

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This article was first published on 3/14/2008.
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SHORT SQUEEZE

Supply And Demand Always Drive Price

by Mike Carr, CMT

Being added to the Standard & Poor's 500 while a large short interest exists creates demand and can drive prices higher.

Tradable: HCP

Occasionally, stocks are added to or removed from the major indexes. With billions of dollars invested in index funds, these announcements trigger buying and selling that is completely disconnected from the underlying fundamentals of the stock. Usually, there is little that technical analysis can add to these news announcements. But smart traders will still read the reports and spend a few moments analyzing the stock, looking for clues as to whether the price changes are an indication of a coming trend.

On March 24, 2008, S&P announced that Health Care Property Investors (HCP) would be added to the S&P 500 at the close on March 28. That means funds will need to own that stock when trading begins on March 31. Buying will be forced upon the index fund managers, and we should see the stock trade higher. The question is: Will the stock continue higher?

HCP is a real estate investment trust that invests in health care-related properties and provides mortgage financing on health care facilities. Although real estate is in a slump, this is a niche company in a growth sector. Acquiring health care facilities and leasing them to health care providers is a business model that should do well over the long term. HCP has interests in more than 500 facilities. The business supports a long-term bullishness in this stock.

In Figure 1 we can see that the announcement caused a gap, which drove the stock up to old resistance levels. Several moving average cross signals were triggered by this action. The 10-day rose above the 200-day moving average, indicating short-term bullishness. This chart shows the 18-day moving average about to cross above the 40-day average, an indication of intermediate-term strength. The chart shows a low-risk buying opportunity at this level. A stop at the close before the gap represents less than three points of risk, while the pattern shows a measured move of nine points.

FIGURE 1: HCP, DAILY. The news-generated gap puts HCP near the top of a year-long trading range.

One indicator to check for potential bullish support is the large short interest in HCP. Buyins.net reports that shorts will need more than eight days of normal trading volume to cover their positions in this stock, representing a lot of potential demand in a stock that must be bought by fund managers. The squeeze trigger represents the average price level where short positions were initiated. At this level, many shorts are likely to cover their trade and find a more profitable opportunity in the market. Buyins.net calculates that the average short is now losing money since the squeeze trigger is 30.62. The news also creates a short-term floor for the price and the gap offers a new support level. Shorts are undoubtedly feeling squeezed. HCP represents a strong buy based on this potential demand. ■

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This article was first published on 3/27/2008.
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RELATIVE STRENGTH COMPARATIVE

Using Relative Strength To Avoid Losers

by Mike Carr, CMT

While Frontier Airlines surprised investors with a bankruptcy announcement, relative strength investors would have steered clear of this disaster in the making before then.

Tradable: FRNT

Recently, Frontier Airlines (FRNT) joined three other small airlines in filing for bankruptcy. The stock opened the week of its filing trading at $2.15 a share, a price level that marked multiyear lows. This is the level that many value investors look to buy at, reasoning that the stock is probably as low as it can go. FRNT proved them wrong, closing the week at $0.48 a share. This demonstrated the problem of the value trap that confronts investors, which involves knowing which companies will continue falling and which are likely to rebound.

Technicians can rely on relative strength to avoid the value trap. The idea behind relative strength is to buy stocks that are going up and sell them when they are going down. Numerous approaches to this methodology exist. Among the most popular ways to apply relative strength is to rank each stock the way *Investor's Business Daily* does, assigning a rank of 99 to the strongest stocks and 1 to the worst performers. This requires software to score each stock in the markets, something that may be beyond the capabilities of many small investors.

A simple approach to evaluating a single stock is to chart the ratio of the stock's price changes to the change in a market average such as the Standard & Poor's 500. A rising line means the stock is stronger than the market, while a declining line indicates it is lagging the market. This ratio can also be charted as a point & figure chart (Figure 1).

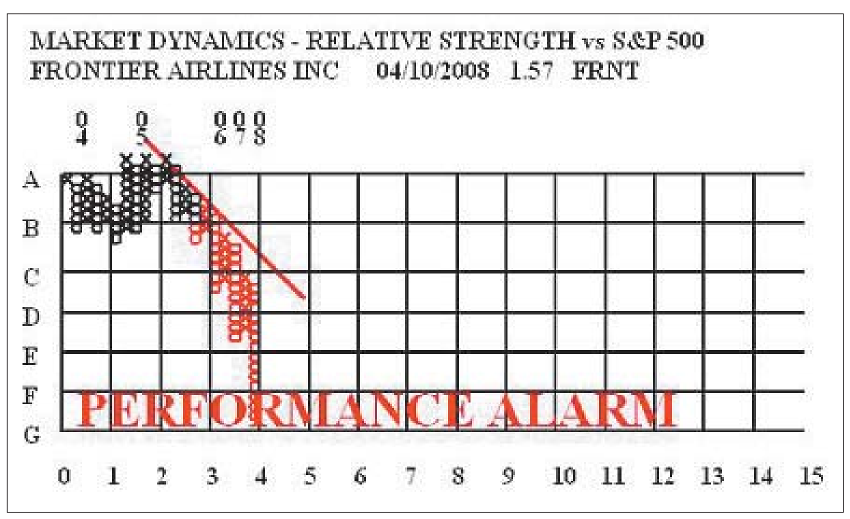

FIGURE 1: FRONTIER AIRLINES, P&F. The point & figure chart of relative strength for FRNT has been on a clear sell signal since late 2005.

The advantages of point & figure charts include the fact that there is always a clear buy or sell signal and the daily market noise is removed

The advantages of point & figure charts include the fact that there is always a clear buy or sell signal and the daily market noise is removed, allowing traders to focus on the long-term trend. For FRNT, the chart shows that the trend of relative strength has been down for more than two years, making this a poor candidate for long positions in a portfolio.

Another approach to evaluating relative strength for a single stock is

> **Technicians can rely on relative strength to avoid the value trap. The idea behind relative strength is to buy stocks that are going up and sell them when they are going down.**

shown in Figure 2. The momentum of comparative strength (MOCS) indicator applies the moving average convergence/divergence (MACD) calculation to relative strength. The result? Clear signals have shown that FRNT should be avoided for all but very short trades since the middle of 2005. To increase the probability of winning trades, traders should avoid MOCS buy signals for stocks like FRNT when they are below long-term down trendlines.

Applying relative strength analysis to any trade can help investors get on the right side of trades more often. This simple tool can be applied as a filter to both long and short strategies. ■

FIGURE 2: MOMENTUM OF COMPARATIVE STRENGTH (MOCS). The MOCS indicator offers clear buy & sell signals and works very well when combined with simple trendline analysis to avoid potential losing trades.

ELLIOTT WAVE

QQQQ On Last Leg Up

by Alan R. Northam

QQQQ is now on its last leg upward of its ABC zigzag bear market corrective rally. Once the market correction has completed, look for the next lower price target for QQQQ to be around 24.77.

Tradable: QQQQ

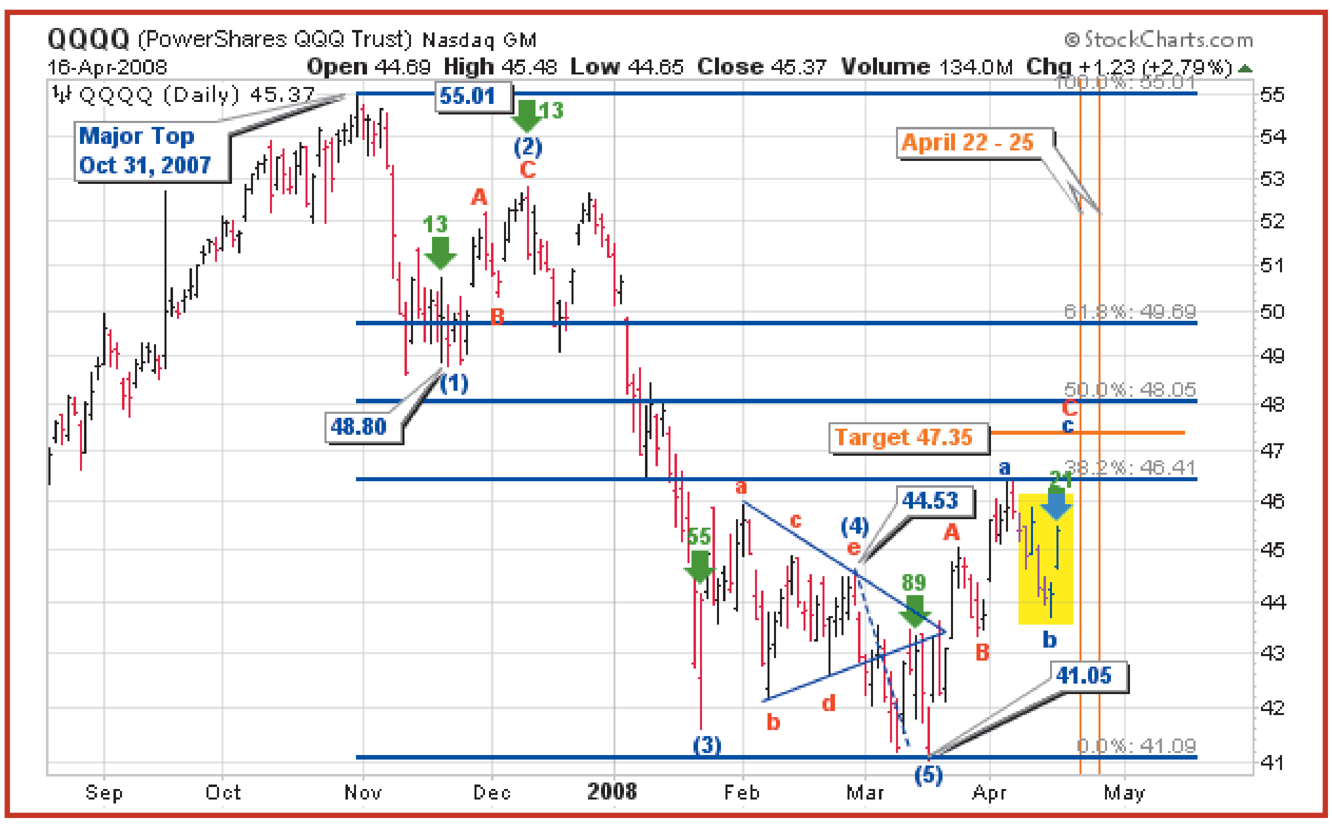

FIGURE 1: QQQQ, DAILY. The price chart shows an Elliott wave count and Fibonacci retracement levels.

In Figure 1, I have updated the price chart of QQQQ from that of my previous QQQQ article, dated April 4, 2008. The price bars highlighted by the yellow rectangle box is the price action that has taken place since that article.

In my previous article, I mentioned that wave C of the ABC zigzag corrective wave structure was most likely in progress and that wave C could develop into an a-b-c zigzag wave structure itself. That apparently is what is unfolding. I urge you to read my last article, "QQQQ Update," for the details of that discussion. To date, wave a of wave C and wave b of wave C are now complete with wave c of C now in progress. Once wave C is complete, then the next leg down for QQQQ will start. If wave C is complete at the target price of 47.35, then the target price for the next wave down should be around 24.77. However, if wave C ends at a different price than our price target of 47.35, the price target for the next wave down could be different.

> **Once wave C is complete, then the next leg down for QQQQ will start.**

Last time, I also mentioned that I thought wave C would end on April 16, which did not happen. I have now modified the date target to be somewhere between April 22 and April 25. In addition, in my previous article, I defined a price target from 46.41 to 48.05.

Overall, we still look in pretty good shape for the end of the correction to occur within the next five to eight trading days and should hit a price target from 46.41 to 48.05 before turning back down and heading to new lower low prices. ■

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TRADER'S NOTEBOOK

Using Bollinger Bands With Parabolic SAR

by Brian Twomey

Parabolic stop and reverse used in conjunction with Bollinger bands work well to catch a trend. Here's how.

This year marks the 25th anniversary of Bollinger bands. Facing a limited number of indicators in use back then, John Bollinger built on the concept of trading bands and devised his own, set at standard deviations to measure volatility of prices. What this measures is bandwidth — that is, where the bands will be located above and below prices. So each band is set above and below a 20-day simple moving average with a standard deviation of 2.0.

These days, setting bands at 20-day simple moving averages with a standard deviation of 2.0 is standard and the norm for charting this indicator. A misconception comes into play when traders don't adjust the bands to match their trading objectives.

Short-term traders may consider a 10-day simple moving average, while longer-term trend traders may employ a 50-day simple moving average. Standard deviations must be changed to reflect the average of prices, of which simple moving averages are nothing more. This doesn't give traders specific direction, only where prices are at any given time.

John Bollinger recommends two standard deviations with a 20-day simple moving average, 2.1 standard deviations with a 50-day simple moving average, and a 1.9 standard deviation with a 10-day simple moving average. This reflects where upper and lower bands will be set (the bandwidth). What traders want to capture is the volatility of prices to determine where prices have been and where prices sit at present, not where they are going. The upper and lower bands will do this. So the bandwidth is set in relation to volatility of prices.

For the most part, prices trade within the bands. The original theory was that when prices hit the upper band, this signified an overbought market so a sell position would be employed. Conversely, if price hit the lower band, this represented an oversold situation and a buy position would be instituted. But if traders were to rely on this concept alone, traders would find themselves in trouble every time.

The overbought and oversold situations may be nothing more than continuation patterns, so a retracement or consolidation may be needed before the next leg of the pattern ensues. In this instance, the bands would expand or contract based on volatility alone.

Remember, the purpose of Bollinger bands is to measure volatility. The bands will expand and contract based on volatility of prices and volatility only. Prices become volatile due to a new high or low or due to an economic announcement that may be out of sync with market expectations. In this instance, the bands would expand to reflect volatility. The lower and upper bands would follow this volatility. Bollinger bands may remain stable in normal market conditions, but volatility may also mean the next leg of price patterns is consolidation, so the bands will contract.

To generate buy and sell signals, John Bollinger recommends using Bollinger bands with another indicator, such as J. Welles Wilder's relative strength index (RSI). The RSI would have confirmed a buy or sell signal, or an overbought or oversold market when prices hit the upper or lower bands.

Traders may find themselves struggling with Bollinger bands because many believe that statistically, the price is two standard deviations away from price and price must revert back to the mean, the average. This is a false assumption.

Since the introduction of Bollinger bands, many traders have become quite creative with its many uses. Some will use 10- and 20-day simple moving averages within the bands, while others will use moving average convergence/divergence (MACD) in lieu of RSI. This can be done because Bollinger bands can be used accurately in any market and time frame.

PARABOLIC SAR

My preference is to use double Bollinger bands with a *parabolic stop & reverse* (SAR). Parabolic SAR is another indicator devised by Wilder and highlighted in his classic *New Concepts In Technical Trading Systems*. The term "parabolic" comes from the curved dots that look like weird-shaped parabolas.

With double bands, the first band is set at the standard 20-day simple moving average with two standard deviations. The second band is set at the

FIGURE 1: BOLLINGER BANDS AND PARABOLIC SAR, DAILY. Here, the euro has been in a long-term uptrend since March 2007. Bollinger bands are set at the normal 20-day simple moving average with a 2.0 standard deviation. The second set of Bollinger bands are set at the 20-day simple moving average with a 3.0 standard deviation. The parabolic SAR has forecasted this trend every step of the way. Note the dots in the uptrend and their behavior within corrections.

eSIGNAL

FIGURE 2: APPLIED TO A LONGER-TERM CHART, WEEKLY. On this chart of the GBP/JPY, the parabolic SAR has forecast the long-term downtrend. The downtrend began in July 2007 when the price of GBP/JPY touched 240. The trend is still intact as the GBP/JPY falls below 198. Note how many times price traded outside the Bollinger bands. Those instances were either small corrections or resumption of trading.

normal 20-day simple moving average with three standard deviations. Traders may want to employ the second band at a 10-period simple moving average with a 1.9 standard deviation. Either way, what traders want to capture is the full volatility of the market on short and longer time frames.

Normally, if prices fall outside of the first band and hits the second band on longer time frames, what may be occurring is an oversold or overbought market. But confirmation is needed, as well as where a likely entry or exit point would be. Bollinger bands are not equipped to point to an entry or exit area, nor will they give an indication as to where support and resistance levels are. It is difficult to catch a trend with Bollinger bands as a standalone indicator.

This is where parabolic SAR comes in. Using the curved dots of the parabolic SAR that follow prices, if the dots are above the price, traders go short because it indicates the market is overbought. If prices are below the price, it means you should consider going long because the market is oversold. When the dots change from an upper to a lower or vice versa, you should consider taking profits. You can now stop and reverse your position.

As long as the dots move in the same direction as the trend, traders should ride the trend until a reversal is evident. Used correctly, parabolic SAR is a useful and reliable indicator, especially useful for catching and riding long trends (Figure 1).

Parabolic SAR works well with short positions as long as the dots follow prices down; dots should always follow prices up on long positions. Note this up/down scenario. Trends occur only when the dots have angles either up or down. This is represented by small dots with an angle; be careful with thick horizontal dots. This usually represents a rangebound market, a weak trend, or indecision. At times, these horizontal dots may serve as strong support or resistance.

Traders should exercise caution until the trend is evident. Trending markets have small dots close to prices and are angling up or down. Dots that are far away from prices may not indicate a trend, showing indecision in the market. Parabolic SAR works best on longer-term charts such as a weekly chart (Figure 2), but it is still useful on hourly charts coordinated with a daily chart as long as the trend is identifiable.

SAR works best on longer-term charts such as a weekly chart (Figure 2), but it is still useful on hourly charts coordinated with a daily chart as long as the trend is identifiable.

A discrepancy may occur when the daily chart has an up dot and the hourly chart has a down dot. In such a case, traders would be better served to wait for the hourly chart to confirm the daily. You would do the same when coordinating between a daily and weekly chart. The far time frame of the weekly does not always have to correlate with the daily, but it does help. Keep in mind that when a trend reversal is seen, prices will accelerate toward the dot. This may not necessarily mean a change in the direction of the trend; that will only happen when the dots change. When this happens, it is time to bail out and take profits.

CATCH THE TREND

Parabolic SAR used in conjunction with Bollinger bands are a great combination with which to catch a trend. When these indicators are used together, what you have is trend and volatility, with parabolic SAR determining trend while Bollinger bands measuring price volatility, or how fast and how much prices are traveling.

Bollinger bands and parabolic SAR can be used in rangebound markets as well as trending markets, but the criticism regarding parabolic SAR is that it is least effective in rangebound markets.

Dots move in relation to price. If there is no price movement, there are no dots, but Bollinger Bands will find contractions of the bandwidth in rangebound markets. So some validity is evident with this argument. Note, however, that these two indicators can be used in any market on any time frame and can be quite effective. ■

This article was originally published on 4/30/2008.

SUGGESTED READING

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Wilder, J. Welles [1978]. *New Concepts in Technical Trading Systems,* Trend Research.

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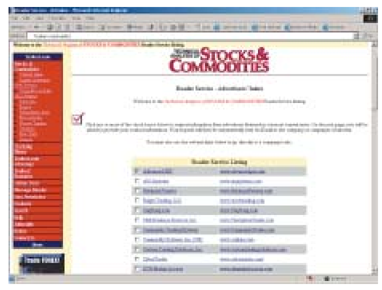

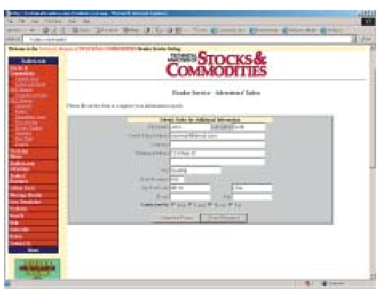

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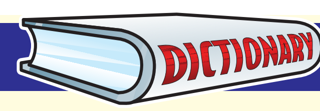
TRADERS' GLOSSARY



Average Directional Movement Index (ADX) — Indicator developed by J. Welles Wilder to measure market trend intensity.

Breakout — The point when the market price moves out of the trend channel.

Convergence — When futures prices and spot prices come together at the futures expiration.

Divergence — When two or more averages or indices fail to show confirming trends.

Directional Movement Index (DMI) — Developed by J. Welles Wilder, DMI measures market trend.

Exponential Moving Average — A variation of the moving average, the EMA places more weight on the most recent closing price.

Fade — Selling a rising price or buying a falling price. For example, a trader who faded an up opening would be short.

Flag — Sideways market price action that has a slight drift in price counter to the direction of the main trend; a consolidation phase.

Head and Shoulders — When the middle price peak of a given tradable is higher than those around it.

Lag — The number of datapoints that a filter, such as a moving average, follows or trails the input price data. Also, in trading and time series analysis, lag refers to the time difference between one value and another. Though lag specifically refers to one value being behind or later than another, generic use of the term includes values that may be before or after the reference value.

Moving Average Convergence/ Divergence (MACD) — The crossing of two exponentially smoothed moving averages that are plotted above and below a zero line. The crossover, movement through the zero line, and divergences generate buy and sell signals.

Overbought — Market prices that have risen too steeply and too fast.

Overbought/Oversold Indicator — An indicator that attempts to define when prices have moved too far and too fast in either direction and thus are vulnerable to a reaction.

Oversold — Market prices that have declined too steeply and too fast.

Pairs Trading — Taking a long position and a short position on two stocks in the same sector, creating a hedge.

Relative Strength — A comparison of the price performance of a stock to a market index such as the Standard & Poor's 500 stock index.

Resistance — A price level at which rising prices have stopped rising and either moved sideways or reversed direction; usually seen as a price chart pattern.

Retracement — A price movement in the opposite direction of the previous trend

Simple Moving Average — The arithmetic mean or average of a series of prices over a period of time. The longer the period of time studied (that is, the larger the denominator of the average), the less effect an individual data point has on the average.

Smoothing — A mathematical technique that removes excess data variability while maintaining a correct appraisal of the underlying trend.

Stochastics Oscillator — An overbought/oversold indicator that compares today's price to a preset window of high and low prices. These data are then transformed into a range between zero and 100 and then smoothed.

Support — A historical price level at which falling prices have stopped falling and either moved sideways or reversed direction; usually seen as a price chart pattern.

Trading Range — The difference between the high and low prices traded during a period of time; in commodities, the high/low price limit established by the exchange for a specific commodity for any one day's trading.

Trend Channel — A parallel probable price range centered about the most likely price line. Historically, this term has been used to denote the area between the base trendline and the reaction trendline defined by price moves against the prevailing trend.

Trendline — A line drawn that connects either a series of highs or lows in a trend. The trendline can represent either support as in an uptrend line or resistance as in a downtrend line. Consolidations are marked by horizontal trendlines.

Underlying Security — In options, a stock subject to purchase upon exercise of the option.

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