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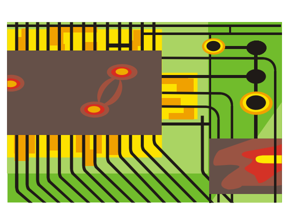

May/June 2008 • Volume 6, Number 3

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TRADING NOW

In the early part of the financial crisis, we already saw the first wave of "recovery" funds flooding into institutions that were hurt in the mortgage crisis. Now we are seeing the second wave of capital coming in to help companies such as Lehman, UBS, and Washington Mutual.

Given that so much capital is currently being flushed into the financial companies, it is easy to be tempted to buy into the sector, given that they seem relatively cheap and on the road to recovery. But there is still uncertainty in the economy and the housing market. We are, at the moment, in an inflationary period with high gas and food prices, and the housing market is still weak. And for as long as this scenario is here to stay, there will be more waves of financing.

If you do happen to jump into the financial sector, keep a close eye on the big picture. In this issue of **Traders.com**, we have included articles on the financial sector such as Paolo Pezzutti's "With Financial Select Sector SPDR ETF, The Downtrend Continues" and Mike Carr's "Betting On Financials," and many more. You'll find that when the US economy is likely to be in a recession, most sectors will be following a similar downward spiral. As you can see from our lineup of articles this time, many indexes and sectors are following suit: "Koos van der Merwe's "Tough Times Ahead For The Dow, Updated," as well as Arthur Hill's "Dow Fails At Broken Support" and "A Major Breakdown For The DAX."

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.

There's no denying we must always watch what the market does, considering the gloom in the financial sector is likely to continue, given the magnitude of losses resulting from the credit crisis. Now more than ever we should keep a wary eye on the financial landscape, because the bad news we have been watching spread like an oil slick could very well spill over to other forms of lending.

Jayanthi Gopalakrishnan

Jayanthi Gopalakrishnan,
Editor

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INDEXES

FIBONACCI

Dow's Dangerous Doji

by Gary Grosschadl

The Dow Jones Industrial Average is not reflecting a happy new year. Here's why.

Tradable: $INDU

As the main indexes are off to a shaky start in the new year, let's take a look at a long-term chart for some direction. In Figure 1, this long-term monthly chart shows a potential top in the form of a long-legged doji. Any doji (normally a small cross indicating the same open and close) at a possible top or bottom often points to a strong reversal signal. This form of market hesitation usually points to a shift in momentum, in this case a shift to bearishness. This harbinger to a possible serious down leg was verified by a close below the doji in the next two months. Note the current candlestick is an interim one as the month just started, but it is a bearish start so far.

To ponder on where a down leg might go, we should plot on Fibonacci retracement levels. The most common levels are retracements to 38.2%, 50%, and 61.8%. If minor support at 12,500 does not hold, these Fibonacci levels likely come into play. Note how the 38.2% level coincides with the 50-period exponential moving average (EMA) (currently 11,648) giving this level more credence. Should this level be breached, observe how the 50% level coincides with the long-legged tweezer-like bottom of the 2006 brief retracement. Note how even a large retracement to 61.8% still would have a 200-day EMA support, meaning the ultra long-term view holds that the bull is still intact. Most traders, however, would prefer not to suffer such a potentially large correction without taking some defensive action.

Several indicators are displayed. At the top of the chart, the ADX (average directional movement index) has peaked and is coming down. This portends a shift toward bearish power. This would be confirmed with a crossover of the DI's (directional indicators), which looks soon to occur. The moving average convergence/divergence (MACD) has just bearishly crossed and this would be a major signal if it holds with a January monthly close below 13,000. The relative strength index (RSI) shows a topping pattern of its own in the form of a triple top. Meanwhile, the stochastic oscillator shows a down leg under way now that the 80 level is broken to the downside.

In summary, a doji top means a significant reversal could be shaping up. If minor support at 12,500 does not hold, expect a move to at least near 11,500. Failure there brings the bigger Fibonacci levels into play.

FIGURE 1: $INDU, MONTHLY. The Dow Jones Industrial Average shows possible retracement levels should the bears prevail.

CYCLES

Yes, The US Is In A Recession

by Koos van der Merwe

So when will the Dow Jones bottom?

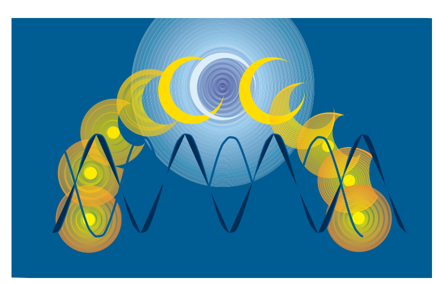
Tradable: DWIX

One of the most interesting discoveries in cyclical trading is what J. Welles Wilder has called the delta phenomenon. The cyclical count is mystified and tied to astronomical forces and advertised as being a "hidden order," but in 1975, a man named Roger Paget spent two hours in my office in Pretoria, South Africa, discussing his cyclical observation. The only difference between his cyclical research and that of the delta phenomenon is the inversion, where a rotation of 11 points is always a high point followed by a high point. In Figure 1, the chart of the Dow Jones Industrial Average (DJIA) has only six points, so the inversion theory does not apply.

The strategy of Roger Paget, who has since our meeting passed away, was far from astronomical. He had his own system of counting cyclical turning points, and where the delta strategy applies an inversion with varying counts, Paget would invert the chart from that point forward for 40 periods. Sounds simple, but in the days before a computer, that took time, with tracing paper and a 10B soft pencil.

In the years that I have used delta, I have found it remarkably accurate. It is not the Holy Grail of trading, but it is one of the best arrows in my cycle-quiver.

In this article I shall not discuss the delta phenomenon in depth; that I leave to DeltaSociety.com, but I will



present a weekly chart of the DJIA, which is almost self-explanatory.

Roger Paget divided a year into four equal parts as shown by the colored vertical lines. The delta phenomenon, on the other hand, divides a year into phases of the full or new moon, which is probably more accurate, but for this chart, we leave it as is.

Figure 1 shows the year divided into red, green, blue, and maroon vertical lines, which are then repeated each year. I have divided each year into six turning points as shown.

Starting from the red vertical, the start of 1999, I looked for major turning points in the DJIA. I found six and numbered them accordingly. I then projected those turning points forward in approximately the same position between the colored vertical lines. The delta moon points could probably account for a more accurate picture simply because the number of days of a lunar cycle is constant, where a month of days varies between 30 and 31 with February having only 28 days.

Note how repetitive the turning points are; for example, "1" is always a high point leaning to the vertical maroon line, while "2" is a low leaning to the green vertical line, and so on. Difficult counts are where no highs or lows occur when the market is extremely bullish or bearish. In this instance, you place the number in the position that is expected of it.

Projecting forward for the DJIA therefore, we should look to a low in the DJIA around about April 2008. Gann and Elliott charts will offer an approximate target in price. ■

FIGURE 1: DJIA, WEEKLY. This chart shows major cyclical turning points. The year is divided into red, green, blue, and maroon vertical lines, which are then repeated each year. I have divided each year into six turning points as shown.

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Where the delta strategy applies an inversion with varying counts, Paget would invert the chart from that point forward for 40 periods.

DOUBLE TOPS

A Big Double Top For The FTSE

by Arthur Hill

The FTSE has gone nowhere for over a year and a big double top is taking shape. Waning momentum suggests that this pattern will soon be confirmed.

Tradable: $FTSE

Figure 1 shows weekly bars for the FTSE 100 and extends back to early 2005. The FTSE advanced over 1,600 points from May 2005 until July 2007 — not a bad run at all. Things started going pear-shaped after the July peak. The index declined sharply and broke a multiyear trendline. This trendline is valid because it was touched three times (blue arrows). The break was the first warning sign for the bulls.

The index managed to find support around 6000 and bounced after the trendline break. However, the bounce met resistance at the July high to form a second top. Hence, we now have a double top working. The FTSE bounced off support at 6000 again in November and has yet to confirm the double top. Support at 6000 is quite strong because the index bounced off this level four times in the last 15 months. A clean break below support would confirm the double top and project further weakness toward the next support zone around 5500 (gray line).

The bottom indicator window shows the moving average convergence/divergence (MACD) with waning momentum. After breaking down in the second half of 2007, the MACD rebounded with a move back into positive territory in November 2007. However, this rebound proved short-lived as the MACD inched back into negative territory over the last two months. With the MACD below zero and below its signal line, momentum favored the bears, and this favors a support break in the index. ■

A clean break below support would confirm the double top and project further weakness toward the next support zone around 5500 (gray line).

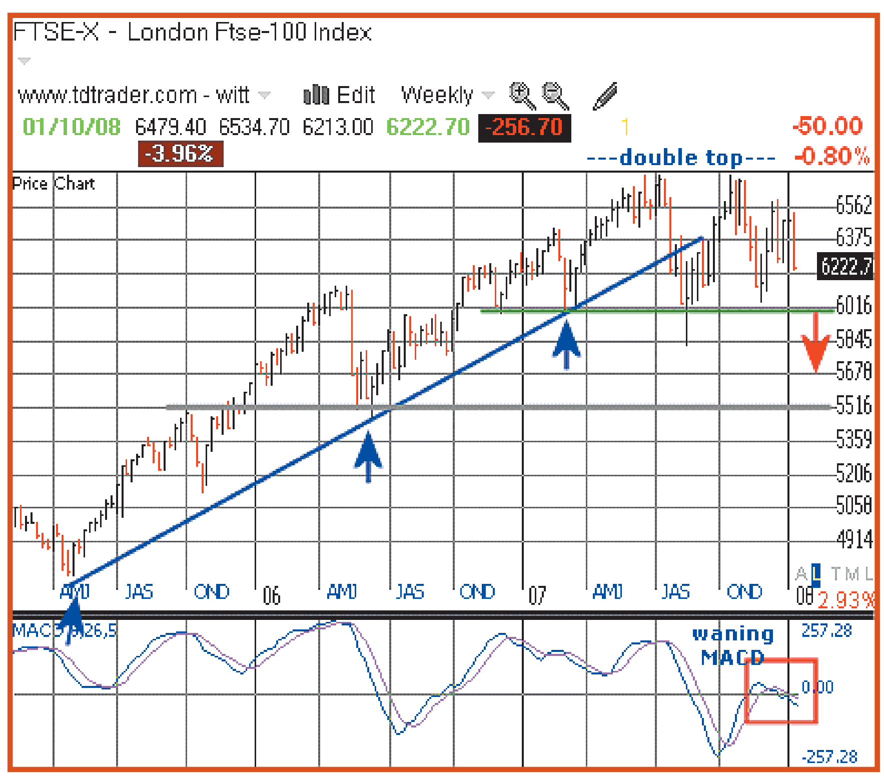
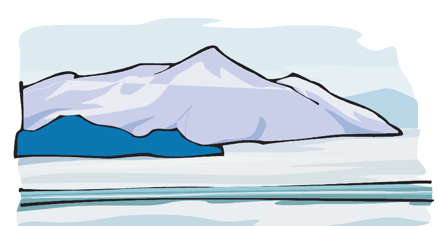


FIGURE 1: FTSE, WEEKLY. The FTSE 100 advanced more than 1600 points from May 2005 until July 2007 — not a bad run at all.



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ELLIOTT WAVE

Tough Times Ahead For The Dow, Updated

by Koos van der Merwe

My question for November 11, 2007: "Was last week the start of the meltdown?" Looks like it was.

Tradable: DWIX

The K-wave was spot-on in its forecast, telling all investors that 2007 was a time to take profits and prepare for the meltdown. But how many investors took that advice? Not many, I am sure. Now, on January 17, 2008, some economists are beginning to accept that the US economy, and for that matter the world economy, has slipped into a recession. Many, however, still will not accept that fact, and I will bet my bottom dollar that the correction upward that should start any day now will be manna from heaven to them, and justify their arguments against a recession. Investors who believe in the K-wave will use the opportunity to offload.

Figure 1 is a chart of the Kondratieff wave count, from 1985 to 2039, while Figure 2 is a monthly chart of the Dow Jones Industrial Average (DJIA) and shows how the DJIA has fallen from the high of October 2007 and is close to testing the high reached in January 2000 of 11908. This level should prove a strong resistance level, and we could expect a retracement to 13136, the 50% retracement level, or any of the other two Fibonacci levels shown, 13423 (61.8%), or 12921 (32.8%). I have shown the present fall as a wave A, but here I am guessing, because it could be a wave a of wave A. Time will tell.

Figure 3 is a weekly chart and shows how the DJIA has broken below the 28-period exponential moving average (EMA) and is now testing the pivot point support level at 11945. The relative strength index (RSI) suggests that this level should not hold because a buy signal has not been given, so we could expect a break below the level possibly to test the downward trendline. The Elliott wave count is suggesting that a fourth wave has been completed, and that a fifth wave up should follow. The probability index of this occurring is at 70%.

The daily chart, however, is suggesting that the DJIA could find support around about 11739 (Figure 4). The head and shoulders pattern is showing a target of 11224, and where extending this level to the downward sloping support line, we get a date of March 26.

The K-wave is showing a downtrend into 2012. This is confirmed by the monthly chart, although the final date could be earlier or later. Weekly charts are suggesting that a correction upward should occur, allowing us an opportunity to sell into strength. Daily charts are suggesting that the DJIA has further to fall before the correction, although the RSI is looking for the correction to occur now. Whatever the final outcome, do not believe the bear market is over, just look for any and all corrections to offload. Cash is king at the moment. The opportunity to buy into oversold blue chips is still far in the future. ■

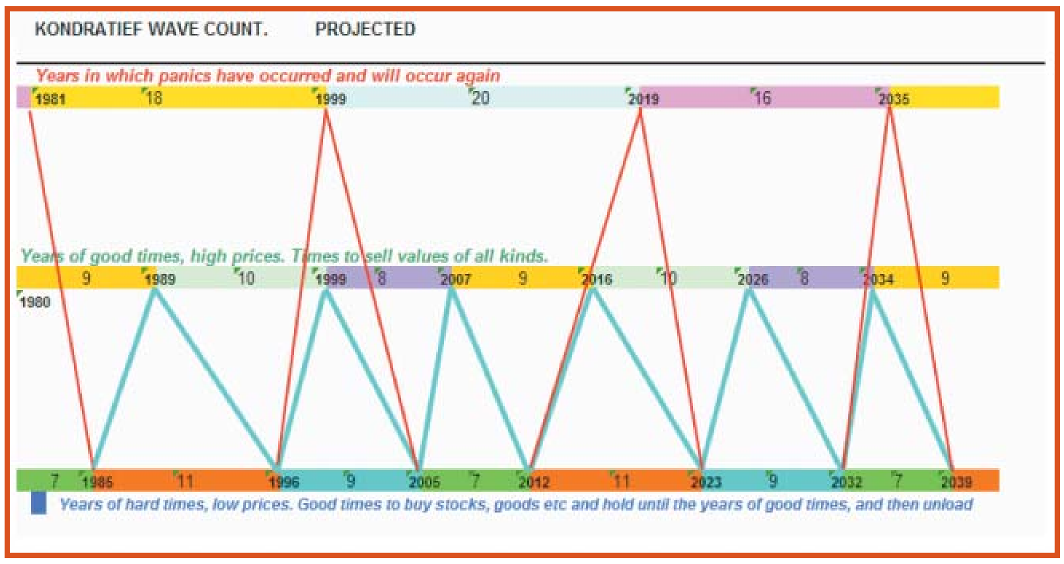

FIGURE 1: K-WAVE. K-wave is suggesting here that the bear market will end, and it will be time to buy stocks in 2012.

FIGURE 2: DOW JONES INDUSTRIAL AVERAGE, MONTHLY

FIGURE 3: DOW JONES INDUSTRIAL AVERAGE, WEEKLY

FIGURE 4: DOW JONES INDUSTRIAL AVERAGE, DAILY

CCI

Is The Wilshire 5000 Daily Index Giving Us Good News?

by Koos van der Merwe

A look at the divergence of the commodity channel index on the Wilshire 5000 is telling us something important.

Tradable: WLS

Figure 1 is the Wilshire 5000 daily index, with the commodity channel index (CCI) 20-period and a JM internal band indicator. The chart shows how the index broke all support levels falling to 13308.45 on January 18 to give sell signals. But —

FIGURE 1: WILSHIRE 500 INDEX, DAILY. The index is showing various buy and sell signals.

ADVANCEDGET

1 The index broke below the lower boundary of the JM internal band on December 14. It recovered but did not give a buy signal by breaking convincingly above the upper JM band. It then fell to present levels. The JM internal band is a 15-period simple moving average offset by 2% positive and 2% negative.

2 With the CCI 20-period indicator, divergence as shown by the green line has been excellent in predicting a recovery of the index. The buy signals given have been ahead of the JM internal band buy signals. Sell signals as shown by the red vertical line, however, have not been as successful.

The divergence buy signal of the CCI-20 period indicator is suggesting a recovery in the market after the recent tumble. How far will it rise? Possibly to test either trendline, the fact that the index forecast that the market would not collapse on January 22 in line with the dramatic fall in Europe and Asia on January 21, Martin Luther King Day, is interesting, and suggests that the indicator could be a leading indicator as far as buy signals are concerned. ■

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GAPS

A Major Breakdown For The DAX

by Arthur Hill

The German DAX Index held out longer than most, but finally succumbed to the bear with a breakdown and major trend reversal.

Tradable: $DAXI

Figure 1 shows monthly bars for the DAX and the last 12 years of trading. The index peaked in March 2000, bottomed in March 2003, and peaked again in July 2007. The advance to the 2007 high recouped the entire loss and met resistance from the 2000 high. This is a mighty resistance level for the index.

The blue trendline extends up from the August 2004 lows and has been touched at least three times. It takes two points to draw a trendline and one more to validate it. With the decline over the past week, the index broke this trendline and a big trend change is afoot.

Figure 2 shows weekly candlesticks. The index hit resistance in July 2007 and then consolidated for the next six months (July to January). The DAX held this consolidation while other stock markets fell apart but could not take it any longer last week and broke support with a big gap. This breakdown reverses a long uptrend and starts a new downtrend.

Momentum confirms the breakdown. The moving average convergence/divergence (MACD) turned flat from October to January and the indicator is on the verge of turning negative. The MACD peaked in July when the index was strong. As trading turned flat in the index, the MACD moved back to the zero line and moved sideways. There was no upside momentum so the MACD hovered around the zero line. A move into negative territory and below prior low would turn momentum bearish and likely coincide with another drop in the index. ■

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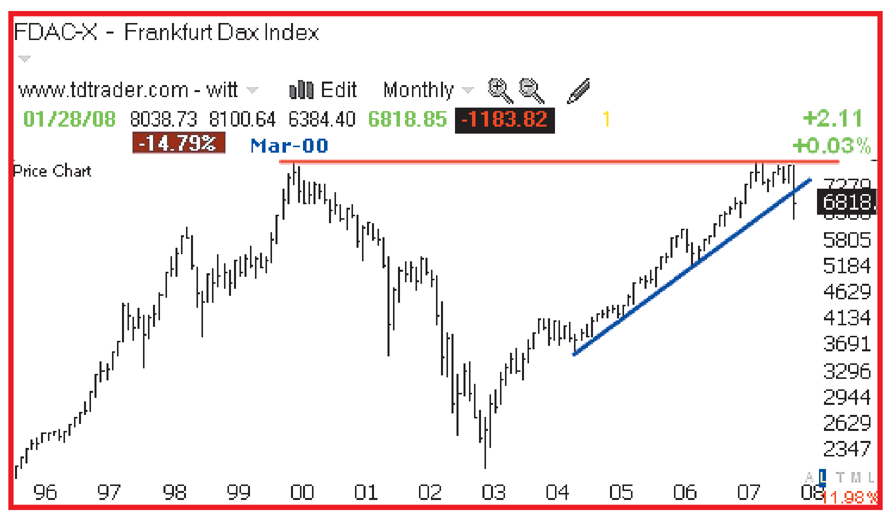

FIGURE 1: DAX, MONTHLY. The index peaked in March 2000, bottomed in March 2003, and peaked again in July 2007.

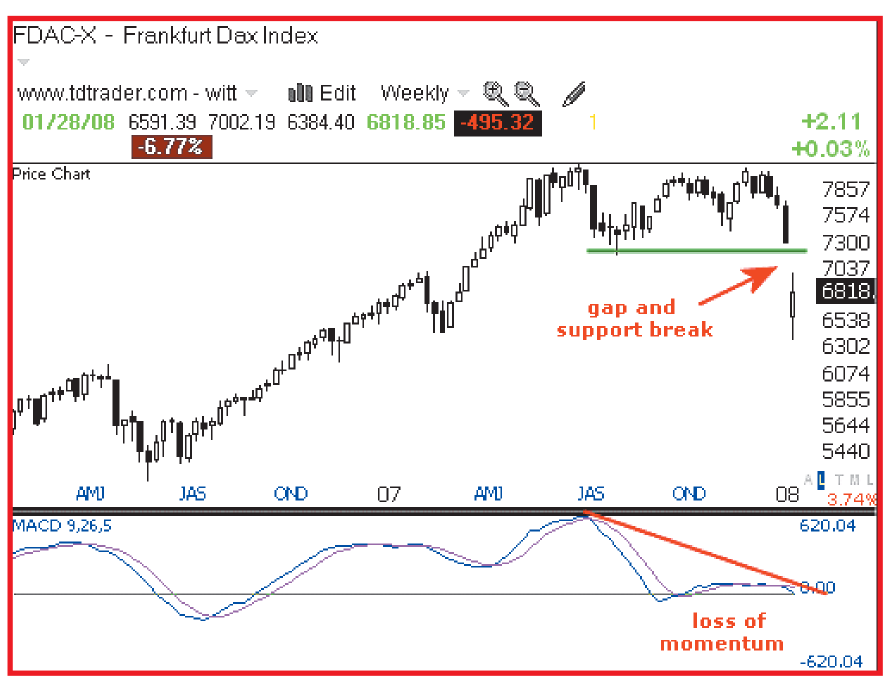

FIGURE 2: DAX, WEEKLY. Here, the index hit resistance in July 2007, then consolidated for the next six months (July to January).

BREAKOUTS

Taiwan iShares Back At Crossroads

by Chaitali Mohile

Taiwan iShares is tangling around the resistance area — which direction should it move now?

Tradable: EWT

The cup-with-handle breakout failed and the Taiwan iShares entered in significant downtrend for quite some time. The cup with handle is a continuation pattern where the uptrend pauses, trades lower, and ultimately continues in an upward direction on completion of the pattern. The breakout should have rallied the security much higher, precisely 2.5 points above the breakout level (17.25 - 14.75 = 2.5 + 17.25 = 19.75), with 19.75 the measured estimated level. The volume was not so enthusiastic to pull up the stock at target level and thus was dragged below. The breakout failed and a new downtrend was born. See Figure 1.

The support of the 200-day moving average was turned off, with a gap down powering the bears. Till then, EWT had a difficult trading session with lower lows and lower highs; after a gap down within a few sessions, EWT successfully established support around 13.50 levels. With this support, EWT was thrusting a 50-day moving average resistance after bearish moving average crossover. The downward-sloping trendline and a trendline at the support area forms an ascending triangle, so now the question is whether the breakout would occur now, or if EWT would continue forming a lower high till the range is narrowed further.

Earlier, the two DIs (positive and negative directional index) had moved closer, with the possibility of a downtrend changed to an uptrend. But the trend indicator surprised traders, and both DIs parted, leaving the downtrend intact. Similar conditions are appearing now; both the DIs are likely to collide. If history is not repeated, then a new beginning can be expected. EWT may enter in a new uptrend, with the other two indicators, the moving average convergence/divergence (MACD) (12,26,9) and the stochastic (14,3,3), showing some bullish bias.

Earlier, the MACD (12,26,9) was highly negative with large volatility that increased bearish pressure on the stock. And the stochastic (14,3,3) found it difficult to sustain above the 50 level, with eventually the lower high and higher low forming a symmetrical triangle. The stochastic movement is narrowed and indicates almost a breakout above the upper trendline. So this again extends positive notes bringing in buying pressure.

The stock is likely to be at a crossroad, deciding whether to be in a new uptrend or to remain under bearish control. ■

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FIGURE 1: EWT, DAILY. The cup-with-handle breakout failed, giving a major trend reversal indication, and thereafter the EWT was engulfed by a bearish trend. The breakout going upward would be the perfect path from the crossroad.

MOMENTUM

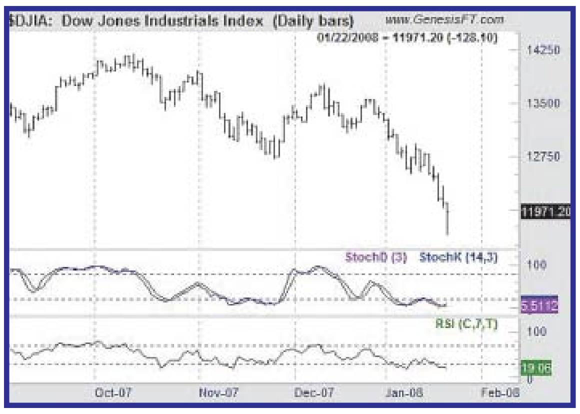

FIGURE 1: DJIA, DAILY. Currently, stochastics and RSI are reaching lower lows along with price and pointing toward lower prices.

FIGURE 2: DJIA, DAILY. In the 1972–74 bear market, momentum remained oversold for a month or more on several occasions.

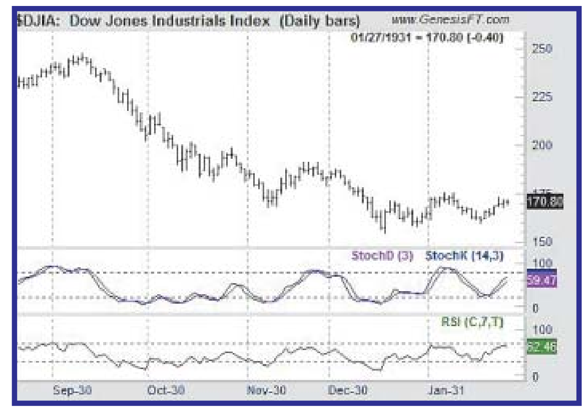

FIGURE 3: DJIA, DAILY. Further back, there were month-long periods of oversold conditions occurred in the 1929–32 bear market.

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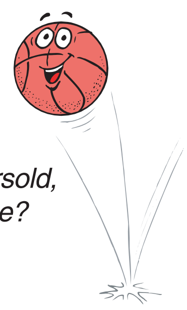
Oversold Markets Can Stay Oversold



by Mike Carr, CMT

With momentum indicators oversold, isn't the market due for a bounce?

Tradable: DJIA

With the market down so much, so quickly, many traders will look for a long entry point. They rationalize that the market is oversold and is due for a bounce. Even if it turns out to be a dead-cat bounce, they are certain that the market should offer a relatively low-risk long trade after a rapid decline. But the charts show that right now, stochastics and the relative strength index (RSI) are reaching lower lows along with price and pointing toward lower prices (Figure 1).

History shows that the market can remain oversold for an extended period of time. While momentum indicators have been oversold for nearly three weeks now, in bear markets, it is not uncommon to see this level sustained for a month or longer. In the 1972–74 bear market, momentum remained oversold for a month or more on several occasions (Figure 2).

Reaching further back in history, we see month-long periods of oversold conditions occur several times in the 1929–32 bear market (Figure 3).

While prices may be due for a bounce, traders should await price confirmation of that higher prices are more likely than lower prices before initiating new long positions. John Maynard Keynes was fond of saying that markets can remain irrational far longer than traders can remain solvent. This wisdom is usually applied on the upside, but is just as meaningful in bear markets. ■

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History shows that the market can remain oversold for an extended period of time.

ELLIOTT WAVE

QQQQ Set To Fall

by Alan R. Northam

According to Elliott wave theory, a stock or market trends in a certain direction in five waves with symmetrical triangle patterns forming as wave 4. Once wave 4 is complete, the stock or market continues in the direction of the trend to complete the final wave, a fifth wave.

Tradable: QQQQ

According to the Elliott wave theory, when a stock or a market is trending in a certain direction, it does so in five waves. Wave 1 will move in the direction of the trending stock or market, wave 2 will be a corrective wave, wave 3 will be a trending wave, wave 4 will be a corrective wave, and wave 5 will be the final trending wave. In addition, corrective wave 2 usually forms an ABC corrective wave pattern and corrective wave 4 usually prints out a different pattern on the chart from that of wave 2. Further, when a symmetrical triangle wave pattern appears on the chart, it usually forms as part of a wave 4 corrective pattern. One hard rule according to the Elliott wave theory is that the low of wave 1 and the high of wave 4 cannot overlap.

In Figure 1, I have shown the price chart for the technology ETF (QQQQ). QQQQ has printed out a textbook example of the first four Elliott waves. Wave 2 has formed a classic ABC corrective pattern and wave 4 has printed out a classic symmetrical triangle waveform. Elliott wave theory defines a symmetrical triangle as having five waves (a, b, c, d, and e). It now looks as if the symmetrical triangle waveform is complete and completes corrective wave 4. With wave 4 now complete, wave 5 down should now be under way. Therefore, I would expect QQQQ to immediately break down below the lower upward-sloping support line of the triangle formation and continue to move lower.

Once QQQQ breaks down below the triangle pattern, this ETF should then continue to sell off to around the $38.00 area. This target price is calculated by subtracting the low of wave 1 ($48.80) from the late October high of $55.01. This difference is then subtracted from the high of wave 4 ($44.53) that results in a price target of $38.32. Another way to visualize this target price for wave 5 is that wave 5 falls in price by the same amount as wave 1. According to Elliott wave theory, there are other price targets for wave 5 as well. In some instances, wave 5 may only fall by 0.618 times that of wave 1 and at other times it may fall 1.618 times that of wave 1, among others. It is even possible that wave 5 could extend into five waves itself and that would take QQQQ to a much lower price. However, in the majority of cases the price change during wave 5 is equal to that of wave 1, and this is the highest probability of a price target for wave 5 until proven otherwise.

In conclusion, it appears that QQQQ has now completed four out of five waves, according to Elliott wave theory. Wave 5 now appears to be under way and is confirmed by a break down below the symmetrical wave formation. The expected target price for QQQQ is $38.32. However, the markets seem to like round numbers, so I would modify this target price to $38.00. ■

FIGURE 1: QQQQ, DAILY. This chart shows a symmetrical triangle pattern.

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SUPPORT & RESISTANCE

Dow Fails At Broken Support

by Arthur Hill

After a sharp decline late last week, the Dow Jones Industrial Average failed to reclaim broken support, and the downtrend looks set to continue.

Tradable: $INDU

First and foremost, the overall trend is down for the Dow industrials. The average formed a lower high in December and broke below its November low in January. A lower high and a lower low define a clear downtrend. In addition, the 50-day moving average moved below the 200-day moving average in January. The 200-day moving average is also falling now and the January support break occurred on expanding volume. The bulls are looking mighty weak.

Broken support turned into resistance around 12700 and this support break held. The average tried to move back above the support break at the end of January and again in February. Both attempts failed and 12700 is the level to beat. The overall trend is clearly down as long as this level holds. With a downtrend in place, the odds favor another lower low and this implies a break below the January low.

The stochastic oscillator confirmed resistance with its second overbought reading (Figure 1). The indicator becomes overbought when it is above 80 and oversold when below 20. Both moves above 80 corresponded with the February highs. The oscillator crossed below 80 and below its signal line over the last three days. This acts as a sell signal and a move toward oversold levels is expected (<20). ■

FIGURE 1: DJIA, DAILY. The stochastic oscillator confirmed resistance with its second overbought reading.

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See www.Traders.com for more.

CHART PATTERNS

STRATEGIES

Buying 52-Week Lows

by Mike Carr, CMT

With the S&P 500 hitting a new 52-week low, bears have the upper hand in market action.

Tradable: SPY

On March 6, 2008, the Standard & Poor's 500 dropped to its lowest level in a year. Looking at the S&P 500 exchange traded fund (ETF) (SPY), we found that this has happened 13 times since 1990. If we had bought each time that occurred and held our investment for periods from one to 52 weeks, the results would have been mediocre, at best. The net profits from buying new lows and selling at the end of each time period are shown in Figure 1.

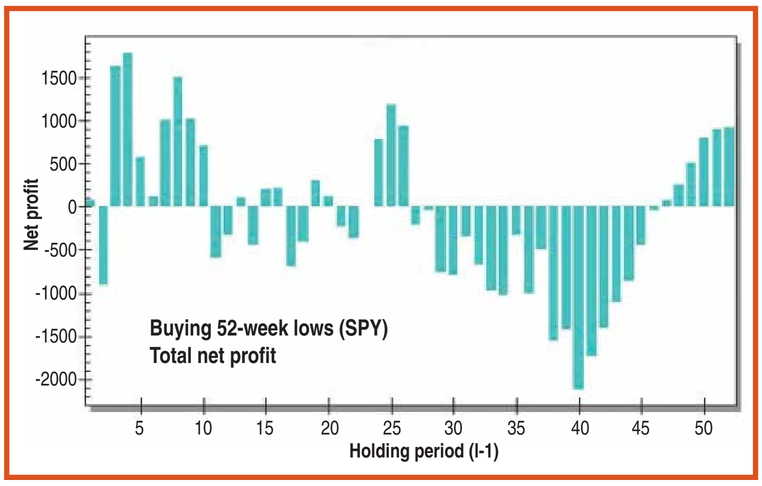

FIGURE 1: SPY. Buying new 52-week lows and holding for periods from one to 52 weeks shows a mix of winning and losing time frames.

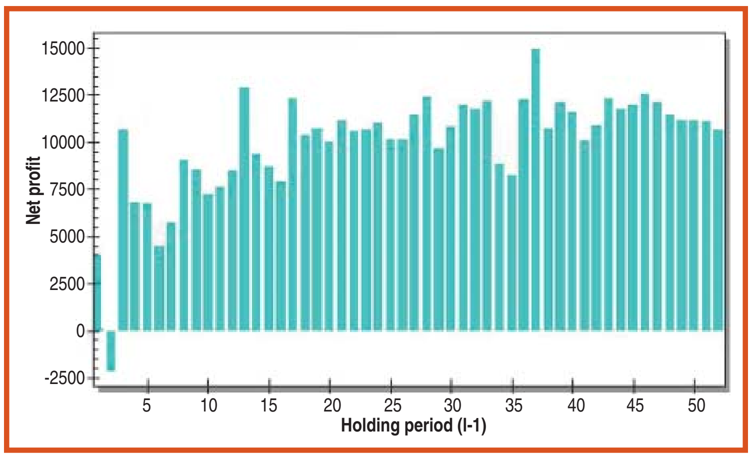

FIGURE 2: SPY. Randomly buying the SPY is usually profitable for holding periods up to a year.

For comparison, we tested buying SPY at a random time and holding for the varying time frames illustrated in Figure 1. These results are shown in Figure 2.

The results are dramatically different. A random buying decision is likely to have been a profitable trading strategy since 1990. This simple test indicates that the current market environment is a high risk time for stocks. Long-term investors should consider increasing cash. Traders should look first for short opportunities. Shorting SPY is a high-probability trade at this point. ■

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This article was first published on 3/7/2008.
See www.Traders.com for more.

POINT & FIGURE

Analyst Upgrades Aren't Always Buy Signals

by Mike Carr, CMT

When an analyst upgrades a stock, he or she is usually recognizing a company's improving fundamental conditions. Technicians can take short-term profits from recommendations by digging deeper.

Tradable: GYI

Last week, analysts upgraded Amdocs (DOX) and Getty Images (GYI), along with a host of other companies. Lists of upgrades and downgrades are available on many websites and offer the technician an overlooked screening tool. Analysts' reports put the company in the limelight, and many institutional managers looking for actively trading stocks scour the news, hoping to get in ahead of the competition.

In this case, both companies have suffered significant declines over the past six months; DOX has lost about a quarter of its value and GYI has lost nearly half. Pattern analysis of their charts is inconclusive, and standard indicators such as the relative strength index (RSI) and the moving average convergence/divergence (MACD) are neutral. Using the regular tools, the technician has no guidance on possible moves by either of these stocks in the news.

Relative strength analysis, however, offers a potential clue as to which one is likely to bounce. Looking at relative strength plotted in a point & figure chart removes the day-to-day market noise from the chart and provides a clear picture of the trend. DOX is shown in Figure 1. From this chart we can see that relative strength has just broken out of a small consolidation pattern, is giving a triple bottom sell signal, and is likely to head lower. Price performance of DOX should be expected to lag the market in the intermediate term.

In contrast, the chart of GYI's relative strength (Figure 2) looks to be severely oversold. It is significantly below its trendline and has shown serious underperformance for nearly two years. Given a choice between the two stocks, GYI is more likely to get an upward bounce from the upgrade based on this chart. It should not be thought of as a long-term hold given this chart, just a quick trade.

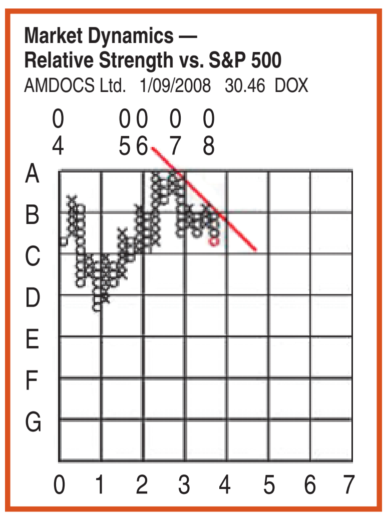

FIGURE 1: DOX. Amdocs was upgraded at the same time that the stock's relative strength was deteriorating. This stock is unlikely to match the performance of the stock market in the near term.

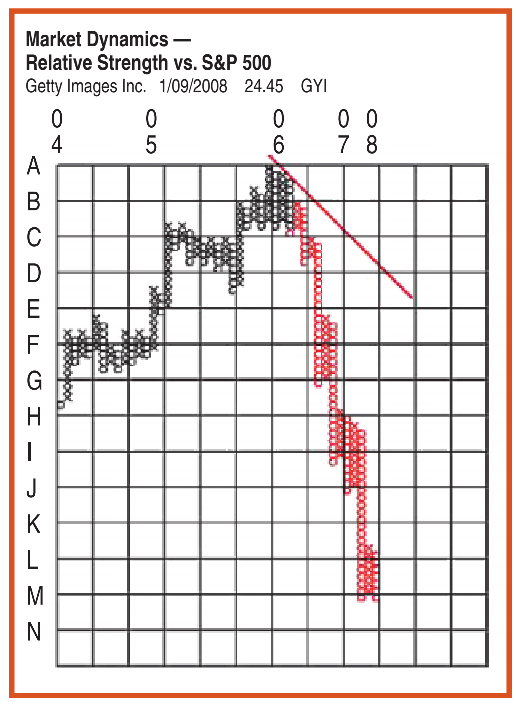

FIGURE 2: GYI. The relative strength of Getty Images is looking very oversold and the stock is likely to get an upward bounce from the announcement of an upgrade.

With the market moving sharply higher the week after the upgrades, GYI outperformed the market, while DOX experienced a small decline. Technicians should consider looking at a listing of analyst upgrades for trading ideas. Finding a strong oversold condition should lead to profitable short-term plays. ■

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This article was first published on 1/16/2008.
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Hang Seng Makes A Descending Triangle

by Chaitali Mohile

The index broke away from the descending triangle with a gap down. The Hang Seng Index has immediate support that may prevent further fall, and the breakout may fail.

Tradable: $HSI

With reference to my earlier article at Traders.com Advantage about the Hang Seng ($HSI) dated November 9, 2007, with a gap down, a new intermediate downtrend was developed that never turned back. The index has been hammered badly and lost huge amounts of money.

The index has formed a descending triangle while going through the correction. A descending triangle is a bearish continuation that appears in a downtrend and indicates distributions.

The trendline joining lower highs in Figure 1 is known as a *supply line* or a *sellers' line,* while the straight horizontal line is called *demand line* or *buyers' line.* With a bearish pattern, the breakout happened in a downward direction. Figure 1 shows that the index has already broken below the demand line, which means we can expect more downside.

The breakout from the bearish pattern has immediate support of the moving average, which may offer strong support and prevent the index to test lower levels. Earlier, when the index was in a strong uptrend, a bullish rally had started from the same support line.

But if history repeats, the upside rally would not be easy for the index. The demand line would be at first resistance and could move in a narrow range as the indicators are bearish too. The average directional movement index (ADX) (14) shows a developing downtrend so surges above the resistance would be difficult.

The relative strength index (RSI) (14) is suggesting the bullish move with the support of 30, but the rally would accumulate strength only above 50. The moving average convergence/divergence (MACD) (12,26,9) indicates the high volatility even during the recovery. So the breakout of a descending triangle may fail, but an upside move would also be volatile.

On the weekly chart (Figure 2), the steep descending triangle looks like a right angle. Here, if we look for support after the breakout, then the level of consolidation during the previous uptrend would offer some stability. This support will be an important level for $HSI, but if the support is taken off, the index might enter a serious downtrend. But the possibility of violating this support is very thin, considering the levels of RSI and MACD, while the ADX (14) shows a developing bearish trend.

The RSI (14) in Figure 2 had an upward rally from the bullish support at 50 earlier under bullish sentiments. Currently, the indicator has established support at the same level, but the situation is different now. This time, the index might witness shaky moves while moving in an upside direction. For MACD (12,26,9), there is a bearish crossover in positive territory.

So both indicators are currently in bullish areas that might give birth to a volatile pullback, ignoring the descending triangle breakout. ■

SUGGESTED READING

Mohile, Chaitali [2007]. "Hang Seng Likely To Face Turbulence," Traders.com Advantage, November 9.

Traders.com ADVANTAGE™
This article was first published on 1/22/2008.
See www.Traders.com for more.

FIGURE 1: $HSI, DAILY. A descending triangle breakout may fail due to the 200-day moving average support (the long-term moving average). In addition, the relief rally with this support may see high volatility because of a bearish trend.

FIGURE 2: $HSI, WEEKLY. The RSI (14) and MACD (12,26,9) have bullish support that may help the index to recover. But the developing downtrend and bearish sentiments will make the upside rally difficult.

VOLATILITY

VIX Breakout Could Signal Further Market Weakness

by Kevin Hopson

Even though the VIX is finding resistance around last August's high, the recent pattern breakout could act as a catalyst for higher prices.

Tradable: VIX

The Chicago Board Options Exchange Volatility Index (VIX) measures investor fear/volatility via options trading for the Standard & Poor's 500. The VIX tends to move in the opposite direction of the S&P 500, which means it can act as a contrarian indicator when volatility reaches extreme levels. Unfortunately for the bulls, the VIX may have higher to go before signaling a bottom in the market.

If you look at the six-month chart (Figure 1), you will see that the VIX has broken out of a symmetrical triangle pattern. By taking the base of the triangle (high point - low point) and adding this figure (37 - 16 = 21) to the breakout point (25), you come up with a potential price target of 46.

In addition, it appears that the VIX has broken out of a reverse head & shoulders pattern, which formed within the symmetrical triangle. If this pattern is accurate, it would coincide with the price target I mentioned. For example, if you measure the distance from the completion point of the left shoulder (29) to the bottom of the head (16) and then add this number (29 - 16 = 13) to the neckline breakout point (34), you come up with an estimated price target of 47. In other words, the two patterns indicate a target range of 46–47.

Since the VIX met resistance around last August's high (as illustrated by the red line), the index could pull back in the near term, possibly to the mid-20s. The reason I say this is because broken resistance tends to act as support and the triangle breakout point (prior resistance) comes into play around 25. If a pullback of this magnitude does occur, it could create an attractive trading opportunity. More specifically, to hedge against another market downturn, traders might consider buying inverse S&P 500 exchange traded funds (ETFs). ProShares, ProFunds, and Rydex are just a few companies who offer these investment vehicles. ■

FIGURE 1: VIX, SIX MONTHS. Note that the VIX has broken out of a symmetrical triangle pattern.

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This article was first published on 1/24/2008.
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HEAD & SHOULDERS

A Pattern Completion For The Weekly Dow Chart

by Gary Grosschadl

When the DJIA plunged 2,000 points in four weeks, it fulfilled a topping pattern.

Tradable: $INDU

This multiyear weekly chart clearly shows a topping pattern that went all the way to pattern completion. After hitting a new high of 14,000 last summer, it not surprisingly consolidated those gains by retracing to the 13,000 level for several weeks. This established a potential trendline for the coming pattern. This left shoulder was followed by another thrust beyond 14,000, which became the potential head of the pattern. Finally, the right shoulder was established last December.

There was a good indication that a topping pattern was coming even before the trendline was broken with a close below 13,000 late in the year. This came via two negative divergences shown. As the chart made a higher peak breaking above 14,000 (the "head" of the pattern), the moving average convergence/divergence (MACD) and the relative strength index (RSI) both went the other way. When price charts move higher while indicators fail to follow, trouble often signals. Any traders taking proactive action did well in avoiding a 2,000-point correction.

Note that the pattern completion target (downside move below the trendline equal to the distance from top to trendline) also related to a support level near 12,000 (the dip back in the winter of 2007). This level was further enhanced by close proximity to the ever-important 200-period moving average. So a bounce here is no surprise.

With the displayed indicators all in oversold territory including the stochastic oscillator, a bounce is expected by technical traders. Now the question is, How high? I expect major resistance back at the trendline of 13,000, which closely relates to the 50-period exponential moving average (EMA) currently 13,014. What happens at that level is telling.

In the bear camp, we have the possibility of this being a bear rally to upside resistance and then renewed downside action. Another test of the 200-day EMA then becomes likely. Should bulls prevail at the coming 13,000 test, a possible retest of 14,000 is in the cards. Either way, the next big move could be triggered by breaking either of the two depicted moving averages.

Two lines in the sand are clearly drawn by the 200- and 50-period EMAs. ■

FIGURE 1: DJIA, WEEKLY. The head & shoulders topping pattern comes to completion with the spike below 12,000 on this chart.

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This article was first published on 1/31/2008.
See www.Traders.com for more.

CONSOLIDATION FORMATION

Transportation Index Surges From Bearish Pattern

by Chaitali Mohile

The bearish flag & pennant pattern saw upside breakout, and the technicals suggest consolidation following.

Tradable: $TRANQ

According to Figure 1, the transportation index ($TRANQ) reached its top during October-November 2007, where it consolidated before lowering. The index formed a rounded top about this time; though the pattern was formed in a short span of about four weeks, the breakdown from moving average reversed the previous uptrend.

The overbought stochastic (14,3,3) turned oversold with the loss of 300 points in the index. However, the declining indicator showed the volatile downside. The stochastic showed shaky moves at oversold levels, indicating a temporary pause to correction. Meanwhile, the price enters a small consolidation at the first low of 2550. The oversold levels and price consolidation both put together accumulated strength for a pullback.

The pullback of approximately 300 points (2550-2850) faced the resistance of a 200-day moving average and a 50-day moving average. In addition, the moving averages had a bearish crossover, weakening the pullback further. The stochastic and price were dragged down and lower lows were formed.

After the second plunge from 2750 to 2350, the index consolidated in the range of 50-75 points. The spikes violated the lower range and formed a lower low at 2300 and 2350. The huge correction followed by a lower consolidation formed a bearish flag & pennant pattern that broke out downward, and continued the descending move.

In Figure 1, the index has broken in the opposite direction in a single trading session. Therefore, the bearish pattern failed and now new bulls are about to come back into the transportation index. The index is consolidating while the entire market drifted to lows.

Will the consolidation sustain or the index slump to upper range resistance turned support? The stochastic (14,3,3) has rallied in the bullish area, therefore indicating the strength in the consolidation. The moving average convergence/divergence (MACD) (12,26,9) shows a bullish crossover in negative territory and the histogram has already moved above the zero line so the moderate bullish force can be seen in the index with volatility coming from other markets, domestic as well as foreign. In contrast, the average directional index shows declining downtrend and the positive directional index (+DI), negative directional index (-DI) are moving closer to each other. So the consolidation may continue.

The index has been rallying since August 2006 from lows at 2300 and approached an all-time high at 3100 in July 2007. The index tumbled as a double top was formed at these high levels. The recent data shows that the index is back to its potential support area, so it is likely to establish strong support here. The stochastic is highly overbought and therefore ready to bring bulls. The average directional movement index (ADX) (14) is turning on the developing trend, but the fight between -DI and +DI may decide whether the trend is up or down. The MACD (12,26,9) is still negative and therefore needs confirmation.

Figure 2 shows the possibility of sustaining the support, but volatility would be more if the rally begins. Consolidating at current levels would increase the strength to a bullish breakout from a bearish pattern and the index may weather the storm. ■

FIGURE 1: TRANSPORTATION INDEX. This index reached its top in the October–November period.

FIGURE 2: TRANSPORTATION INDEX, WEEKLY. Will the support level be sustained?

TRIANGLES

Triangle Patterns Signal Continuation

by Alan R. Northam

Triangle patterns signal the continuation of the current market or stock trend and provides a method of measuring the minimum expected extension of that trend.

Tradable: $UTIL

Triangle patterns often show up on stock price charts and are formed over a period of several weeks when price peaks form a downward sloping trendline and price lows form an upward sloping trendline. To be a valid triangle pattern, volume must decrease as the triangle pattern is formed. Figure 1 shows such a pattern.

Figure 1 shows a price chart for the Dow Jones Utility Average (DJUA). In early December 2007 through early January 2008 the DJUA formed a double-top reversal pattern. Subtracting the lowest low price between the two price tops from the highest high price of the two price tops, and then subtracting this difference from the lowest price between the two price tops a minimum lower price target for this market is calculated. On January 22, 2008, the price target was hit as the market traded downward and went on to make a lower low for that day. Since hitting the price target, the DJUA went on to consolidate its losses over a four-week period, forming a symmetrical triangle.

Symmetrical triangles also forecast the minimum price objective for the next leg up in a bull market and the next leg down in a bear market. This price objective is calculated by taking the highest price in the symmetrical triangle formation and subtracting the lowest price in the formation from it. This difference is then subtracted from the breakout price. The result is the minimum price distance that the market is expected to move in the direction of the breakout.

According to trading analyst and author Thomas Bulkowski (*Encyclopedia Of Chart Patterns*, copyright 2005, John Wiley & Sons, publisher), symmetrical triangles forecast the continuation of the current trend 55% of the time and forecast a reversal of the trend 45% of the time. Further, Bulkowski has determined that symmetrical triangles in bull market trends meet price objectives 66% of the time, a good statistic, while symmetrical triangles in bear markets only meet their price objectives 57% of the time, not quite as good. According to these statistics, symmetrical triangles are somewhat overrated as continuation patterns but do tip the balance between a continuation pattern or a reversal pattern in favor of continuation.

In Figure 1 the symmetrical triangle made a price minimum of 477.82 on January 22, 2008, and a price peak of 521.20 on February 4, 2008. After consolidating for another two weeks, the symmetrical triangle formation was completed when the market broke out to the downside on February 21, 2008. By subtracting the price peak from the price minimum a calculated difference of 43.38 is obtained. This difference is then subtracted from the breakout price of 496.34 to determine the minimum expected price objective to the downside of 452.96. However, since price objectives are statistically met only 57% of the time, the market must be monitored closely to determine if the price objective will be met before turning back upward. To monitor the DJUA to see if it will continue downward and meet its price objective, a momentum oscillator such as the stochastic, the relative strength index (RSI), or rate of change indicator should be used. By monitoring one of these momentum indicators, traders will be able to determine if the momentum continues to remain strong during the move down or if momentum starts to weaken. Weakening momentum could be a sign that the DJUA may turn back upward before hitting its price objective. ■

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This article was first published on 2/22/2008. See www.Traders.com for more.

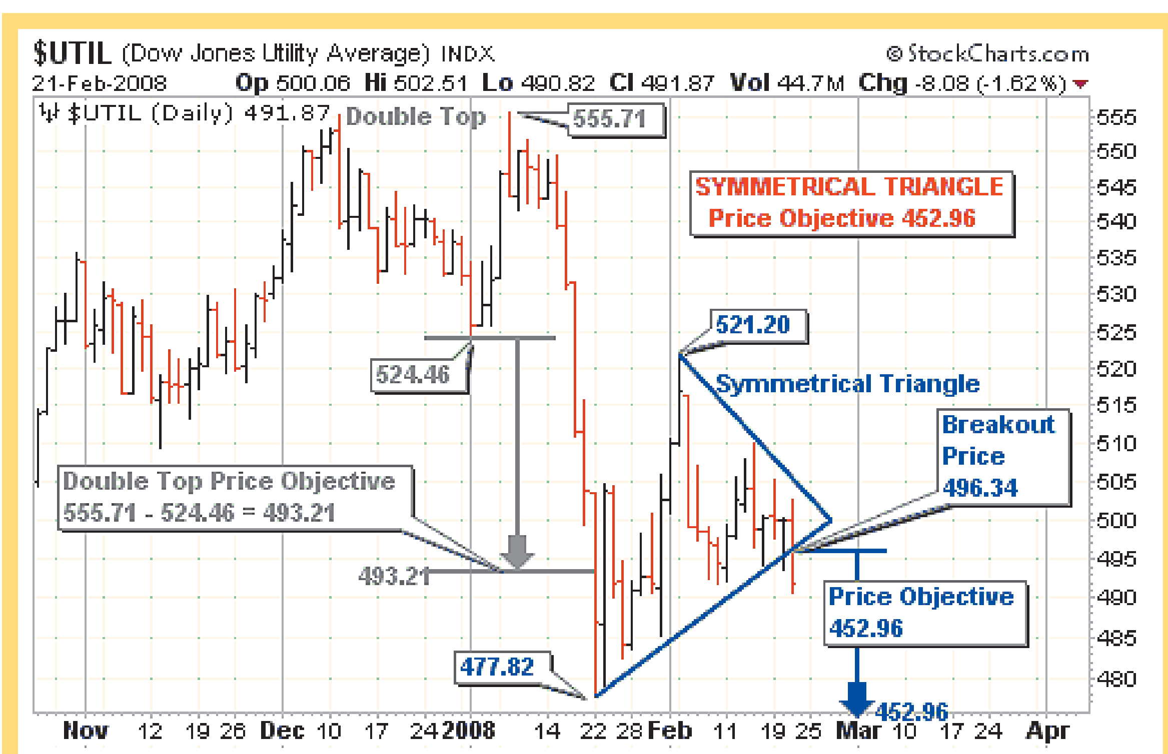

FIGURE 1: DOW JONES UTILITY AVERAGE. Here's a symmetrical triangle continuation pattern.

METALS & ENERGY

TRIANGLES

Two Bullish Patterns For TXCO Resources

by Kevin Hopson

Bullish patterns on both the short-term and long-term charts could signal much higher prices for TXCO Resources.

Tradable: TXCO

TXCO Resources is showing bullish patterns on both the short-term and long-term charts. Let us start with the six-month chart (Figure 1). As you can see, TXCO formed a symmetrical triangle after October 2007's sharp runup. Symmetrical triangles tend to be continuation patterns, which means the breakout should be in the same direction as the move prior to the pattern. Since the triangle formed after a substantial rally, the breakout should be to the upside. Right now, if TXCO were to break out, a short-term target of \$15.25 would be likely. I calculated this by taking the base of the triangle (high point of \$14 minus low point of \$11.25 = \$2.75) and adding this number to the potential breakout point, which is roughly \$12.50.

You will also note that during the formation of the triangle, the accumulation/distribution (A/D) line has been trending lower. This may appear to be bearish at first glance but if you look at the Chaikin oscillator (money flow), you will see the opposite occurring. This means the stock is seeing a positive divergence in money flow. If the Chaikin oscillator can continue this divergence and move above zero, it will give a buy signal.

Meanwhile, the long-term (three-year) chart shows a defined trading range over the past two years (Figure 2). The bottom of the trading range comes into play around \$9.00, while the top of the trading range is approximately \$13.00 – \$14.00. For the purpose of calculating a long-term target, however, we will use \$13 as the top of the trading range, the reason being that this price level has been tested the most. Like symmetrical triangles, trading ranges tend to be continuation patterns so the logical break would be to the upside.

If you count the number of times that prices have tested the top channel line in alternate sequence (as illustrated by the green circles), multiply this figure (4) by the width of the trading range (\$13.00 - \$9.00 = \$4.00) and then add this number (4 x \$4.00 = \$16.00) to the bottom (\$9.00) and top (\$13.00) channel lines, you come up with a long-term price target of \$25.00 – \$29.00. Conservative traders may want to wait for a confirmed breakout from either of these patterns before buying. However, high-risk/high-reward traders should consider accumulating on weakness. ■

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STOCKCHARTS.COM

FIGURE 1: TXCO, SIX MONTHS. TXCO has formed a symmetrical triangle after October 2007's sharp runup.

FIGURE 2: TXCO, DAILY. This long-term chart shows a defined trading range over the past two years.

TRADING SYSTEMS

Have Long-Term Rates Bottomed?

by Mike Carr, CMT

With the Federal Reserve pushing down short-term rates, the bond market seems to be worried about inflation and is resisting the Fed's efforts on the long end of the yield curve.

Tradable: TLT

With an economic slowdown on the horizon in an election year, the Federal Reserve, Congress, and the President are all doing something. While their actions may drive down short-term interest rates, the government has surprisingly little control over long-term rates. These rates are established by the markets, and market participants may be showing signs of nervousness. Fiscal stimulus in the form of tax rebates, combined with low interest rates engineered by the Fed as monetary stimulus, could be inflationary. And inflation concerns will put upward pressure on long-term rates.

On a weekly chart, the 10-year Treasury note interest rate seems to have exhausted its movement to the downside. In Figure 1, we see that the Bollinger bandwidth (bottom panel in the chart) has moved sharply higher, indicating that volatility has spiked. Volatility has been shown to be very cyclical, with high-volatility periods usually being followed by low-volatility trading ranges. With the interest rate testing its lower Bollinger Band, it is likely that it will consolidate at this level, and trade upward toward its 20-day moving average.

Figure 2 shows an indicator widely followed by professional traders. The DeMark sequential is an overbought/oversold indicator developed by Tom

FIGURE 1: BOLLINGER BANDWIDTH. With Bollinger bandwidth at a four-year high, volatility is likely to subside and interest rates are likley to move toward the 20-week moving average.

FIGURE 2: 10-YEAR T-NOTE. The last two DeMark sequentials correctly identified market turning points. On January 25, the countdown reached 13 and will give a buy signal the next time the market closes higher on a weekly basis.

DeMark that seeks to identify tops and bottoms. The logic is very detailed, but basically it consists of a setup, a countdown, and a signal. The setup criteria for a buy signal requires nine consecutive daily price closes that are lower than the close four days earlier. This indicates the trend has reversed. Then the countdown begins where we look for 13 closes that are lower than the close two days earlier, and these need not be consecutive. The buy occurs when there is an up close after a 13 has been recorded and would occur this week if the market closes higher.

The signals are rare, but usually profitable. Last week, the 10-year interest rate completed a 13 on the buy countdown. Being this oversold, the market has most likely put in a bottom and traders should prepare for higher long-term rates. One way to do this is shorting ETFs like iShares Lehman 20+ Year Treasury Bond (TLT). ■

The DeMark sequential is an overbought/oversold indicator that seeks to identify tops and bottoms.

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See www.Traders.com for more.

OSCILLATORS

Is Silver The Shine That Is Golden?

by Koos van der Merwe

With Silver Wheaton, it appears so.

Tradable: SVM-T

Silver Wheaton is a mining company with 100% of its revenue from the sale of silver. The company plans to sell 25 million ounces of silver by 2010, purchasing all or a portion of the silver production from Goldcorp mines in Mexico, Lundin Mining's Zinkgruvan Mine in Sweden, Glencore's Yauliyacu Mine in Peru, and European Goldfields' Stratoni Mine in Greece. Silver Wheaton's unique and simple business model is designed to create long-term shareholder value, providing for strong upside potential with downside protection. The company is unhedged.

Having found out all this, you can see why I like the company. With gold at a new high almost every day, silver jewelry, popular with the young because of its acceptable price, is now becoming popular with older mature women. Weddings in India, where brides are adorned with their weight in gold, are starting to show less gold and more silver, either in a lower carat for gold, or a greater display of silver.

Of course, Figure 1 shows how Silver Wheaton Corp. has prospered, either on good management or as the price of silver has increased alongside the price of gold. The price increased from a low of $3.06 in January 2005 to a high of $18.97 by January 2008, an increase of 520%. Not bad at all. So what does the future hold?

Here I turn to Figure 2 for a short-term evaluation. The daily chart shows that Silver Wheaton is very possibly a buy at present levels:

FIGURE 1: SILVER WHEATON, WEEKLY. This tradable is showing tremendous gains.

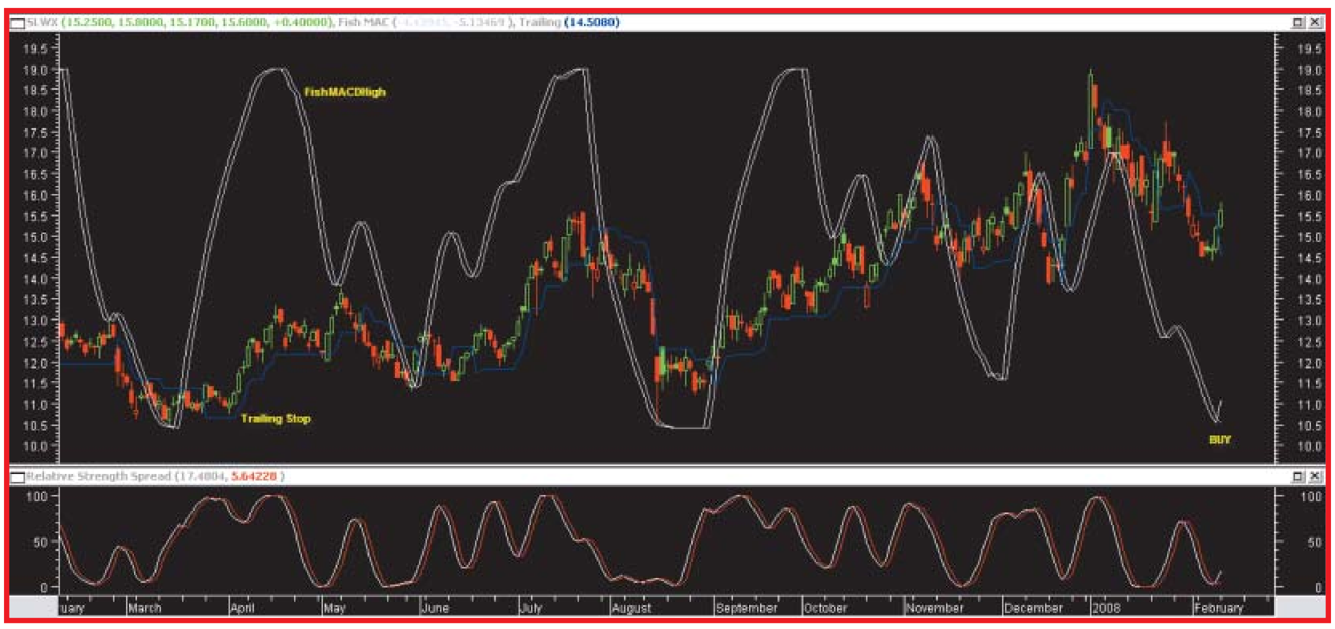

FIGURE 2: SILVER WHEATON, DAILY. A very possible buy at present levels for this stock.

a. The relative strength spread indicator has given a buy signal.

b. The Fisher transform of the MACD of the highs has given a buy signal. Note that this indicator should be used as a confirmatory indicator.

c. The price has broken above a 3% trailing stop, suggesting a change in trend.

With the United States entering a recessionary phase, and the world in general following this trend to a greater or lesser degree, investing in the royal metals could be advantageous. Companies that deal in those metals, that are well run, and under good management are definitely to an investor's benefit, far more so than an investment directly in the royal metal itself, either through an iShare or otherwise.

With the United States entering a recessionary phase, investing in the royal metals could be advantageous.

So is silver a buy? A very definite yes, and Silver Wheaton is an alternative to owning the metal outright. ■

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This article was first published on 2/19/2008.
See www.Traders.com for more.

CHART ANALYSIS

Crude's Trading Range

by Kevin Hopson

Crude oil is once again testing key resistance at the $100 level, but market sentiment and the long-term uptrend may point to an eventual breakout.

Tradable: $WTIC

Some traders may have been shocked to see crude oil approaching $100 a barrel early last November. However, what may be even more surprising is that oil prices have failed to back off from this level in recent months. As you can see in the six-month chart (Figure 1), the crude oil continuous contract has been stuck in a trading range ($86.00–$100.00) the last three and a half months. The reason crude has been finding stiff resistance at the $100 level is due in part to option open interest.

For example, if we look at call option open interest for the April 2008 contract, which will be the new front-month contract on February 21, the largest position (19,246 contracts) currently resides at the $100 strike price. Because there are only 250 put contracts open at this strike price, there is a net call position of 18,996 contracts. This is by far the largest net call position at any strike price for the April 2008 contract. Since the sellers of these call options have incentive to keep prices below $100 (by selling or going short), they can effectively put a cap on prices. We are seeing a similar pattern with the May contract as well.

That being said, market sentiment is not indicative of a significant top here. The *Commitments Of Traders* report, which measures the weekly trading activity of commercials (usually considered the smart money) and noncommercials (large speculators) shows some pessimism creeping into the marketplace. Over the last four weeks, the bullish percent (long positions as a percentage of total positions) for commercials has been steady around 49%.

However, the bullish percent for noncommercials has dropped from 61% to 55%. Noncommercials tend to have a herd mentality, which means they will buy into strength and help fuel rallies. When these traders start to turn more bearish, it creates more potential buying pressure in the marketplace (much like short-covering), as noncommercials will rush to buy once prices break out.

In addition, because trading ranges typically act as continuation patterns and the trend was positive prior to this formation, there is a good chance that prices will break to the upside. If so, the trading range pattern currently indicates an upside target of $128–142.

FIGURE 1: $WTIC, DAILY. The crude oil continuous contract has been stuck in a trading range the last three and a half months.

Please refer to my recent article on TXCO Resources for information on calculating trading range price targets. As of right now, nothing is certain, but the developing situation warrants watching. ■

OPTIONS TRADING

Coal: Volatility And Strength

by Mike Carr, CMT

With coal companies continuing to surge higher, now might be a good time to explore using covered call strategies.

Tradable: ACI

Covered calls are an options strategy where you hold a long position in a stock and write, or sell, call options on that same stock to generate increased income from the stock. This strategy is often employed when an investor expects the stock to have little upside over the short term. This idea is also known as a "buy-write."

Coal stocks were recently downgraded by analysts at Goldman Sachs, suffering significant one-day declines in reaction to the news. The next day, prices recovered and two days after the downgrade hit, some companies were trading at new all-time highs. This shows strength in an industry likely to enjoy long-term steady growth in profits. With macroeconomic factors supporting the stocks, there are good reasons to think the downgrade reflected little more than caution on the part of the analysts.

Arch Coal (ACI) has been one of the strongest coal companies over the past year. Figure 1 shows that the stock took a sizable hit on the downgrade but is now back to new high ground. Prices have moved up strongly in the past several months, and now look a bit overextended. The unusually wide Bollinger Bands mean that volatility has recently increased. In *Bollinger On Bollinger Bands*, John Bollinger writes, "High volatility begets low volatility, and low volatility begets high volatility." It is likely that we will see volatility in ACI decrease soon.

That means ACI will probably need to consolidate gains at this level. Buying the stock and selling a call will allow traders to be paid while they wait for the breakout. Increased volatility means that options are steeply priced, and now is a good time to sell. Calls with a strike price of 65 offer a nice premium, and going out as far as July 2008 could mean earning as much as $3 a share for holding a stock with high relative strength.

If price rises above 65, the stock would be called away, leaving traders with a 23% gain in less than six months. Any decline is offset by the options premium, and the call can be sold when the stock is sold, adding to any profits taken or decreasing any realized losses. As volatility increases, options offer aggressive traders an opportunity to increase profits. ■

FIGURE 1: ACI, DAILY. Volatility expansion, as shown here with Bollinger Bands, can be used to identify covered call trading candidates.

ELLIOTT WAVE

Gold Rush Playing Out

by Alan R. Northam

Expanding diagonal formations often show up on the price chart after a substantial price rally or at the end of a correction and are known as ending formations that signal a forthcoming reversal in trend.

Tradable: GLD

Some 70 years ago, Ralph Nelson Elliott studied the movements of the stock market and discovered that certain repetitious wave patterns existed much as Charles Dow had previously discovered. However, the work of R.N. Elliott went beyond that of Charles Dow. Among these repetitious waves, Elliott discovered that expanding diagonal patterns show up on the price chart after a substantial price rally or at the end of a correction and are known as ending formations that signal a forthcoming reversal in trend.

However, price rallies and corrections do not always end with an expanding diagonal formation. Expanding diagonal patterns are made up of five overlapping waves, waves 1, 2, 3, 4, and 5. In a bull market the lower price minima of waves 2 and 4 form an upward sloping support line while the price peaks of waves 1 and 3 form an upward-sloping resistance line, sloping upward at an angle greater than that of the support line. During the final stage of wave 5, the price will usually break through the upward-sloping resistance line of the expanding diagonal pattern, but this is not a requirement. When price does break through the upward sloping resistance line, it is called a "throwover." Volume tends to diminish as the formation progresses and will usually spike during the throwover. Following the throwover, price normally turns back downward. The expanding diagonal pattern is completed when price breaks below its upward-sloping support line, signaling the beginning of the trend reversal.

FIGURE 1: STREET TRACKS GOLD TRUST SHARES, DAILY. Here's the price chart of GLD showing the expanding diagonal pattern.

FIGURE 2: STREET TRACKS GOLD TRUST SHARES, DAILY. Here's a chart of GLD showing support price levels.

Figure 1 shows the price and volume chart of streetTRACKS Gold Trust Shares, with the stock symbol "GLD," which has been forming an expanding diagonal pattern since the beginning of the year. This expanding diagonal pattern is forming after a long substantial price rise, most of which has occurred off the left side of the chart. The expanding diagonal formation is not yet complete as prospectors (buyers) are still seeking their fortune (profits) in gold. To date, waves 1, 2, 3, and 4 have been completed, with wave 5 still in progress. The real gold rush comes near the end of wave 5 when price approaches the upward-sloping resistance line. At this time price will normally break through this line of resistance, "throw over," in a rush for immediate higher prices as volume spikes. It's the last rush for gold as everyone panics to buy as much gold as they can, thinking that gold will go much higher following the breakout. But once everyone has spent all their money panic buying gold, buying power dries up and the gold rush is over. When there is no more money to buy gold, the price of gold hits a peak in price as it cannot move any higher. Once buying power has dried up, profit-taking steps in and drives the price of gold back down, reversing the trend. See Figure 1.

Once gold starts to sell off and breaks through its lower upward-sloping support line, the first area of support will be the price level of the beginning of the expanding diagonal formation. However, if this support line does not hold, gold could fall to lower support levels. I have shown these support levels in Figure 2.

In Figure 2, I have shown what I believe are the major areas that could provide support for GLD. Support 1 is taken off the price level at the beginning of the expanding diagonal formation. Support 2 is taken from the November price high and support 3 the November price low. In addition to these support levels, the 50-day moving average could provide some intermediate-term price support, while the 200-day moving average could provide long-term support. Should GLD move significantly below its 200-day moving average, then expect a long-term bear market for gold.

Everyone panics to buy as much gold as they can, thinking that gold will go much higher following the breakout.

A wise trader will not try to outguess the formation by taking a position during its creation but will patiently wait for its completion before taking action. Once price breaks out below the upward sloping support line of the expanding diagonal pattern, the trader will know that the trend is reversing and can then take action. However, if price does not reverse its trend, the trader will know that the expanding diagonal pattern is a false formation and prices will most likely continue higher.

Although the gold rush in GLD has not played itself out yet and prospectors (buyers) are still buying gold in hopes of making a profit in the future, the expanding diagonal formation is letting traders know that there is a high probability the rush to buy GLD could be coming to an end. ■

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CURRENCIES

MACD

US Dollar Index Perks Up

by Arthur Hill

After holding above its November low, the US Dollar Index looks poised for a run toward long-term resistance.

Tradable: $USD

Figure 1 shows the US Dollar Index ($USD) over the last five months. The index found support around 75 in November 2007 and surged in December 2007. This was followed by a pullback, but the index found support above the November low. This makes for a higher low and a potential trend change could be afoot. I am marking resistance at 76.5 and a break above this level would open the door for a run toward 80.

The bottom indicator window shows the moving average convergence/divergence (MACD), but a faster version than the traditional MACD. Instead of using 12- and 26-day moving averages, I am using five- and 35-day moving averages. This makes the indicator more sensitive. A higher low is also possible in the MACD, and a break above the signal line (pink) would be quite positive for momentum. Further strength into positive territory would turn medium-term momentum bullish.

Despite the potential for a modest rally, the long-term trend remains down. On the weekly chart (Figure 2), the index is well below its November 2005 trendline. This is the trendline extension and broken support mark resistance around 80. The 40-week moving average also marks resistance around 79. Taken together, a modest rally on the daily chart could meet stiff resistance on the weekly chart. ■

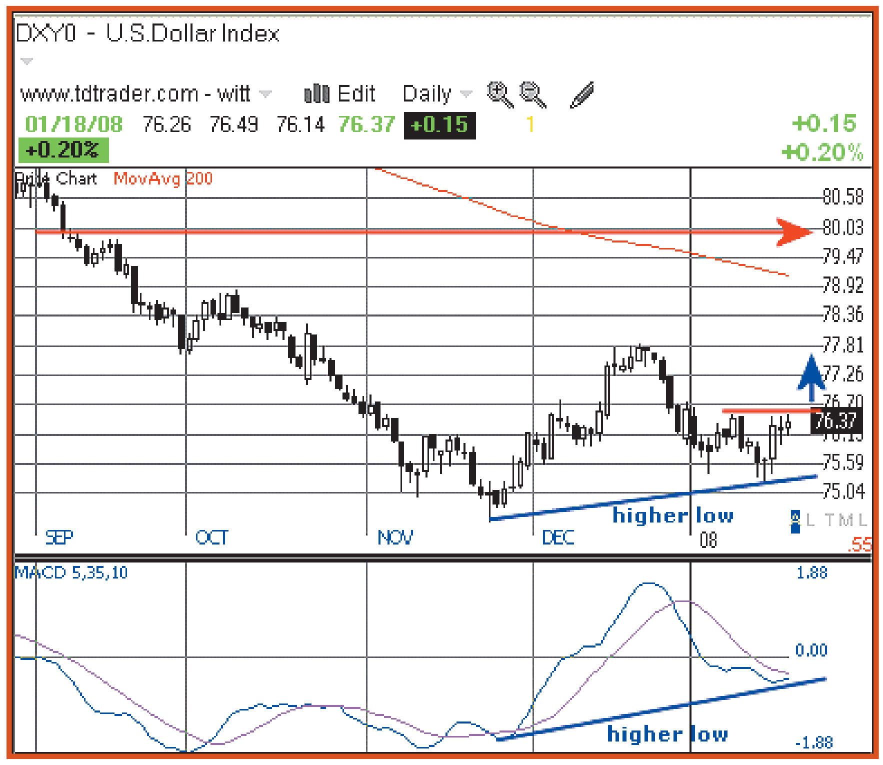

FIGURE 1: $USD, DAILY. The index found support around 75 in November and surged in December.

FIGURE 2: $USD, WEEKLY. Despite the potential for a modest rally, the long-term trend remains down.

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This article was first published on 1/23/2008. See www.Traders.com for more.

Not For Much Longer

by Koos van der Merwe

Previously, peanut farmer Jimmy Carter had been regarded by some as the worst US President. Not for much longer.

Tradable: UDX, CUCDX

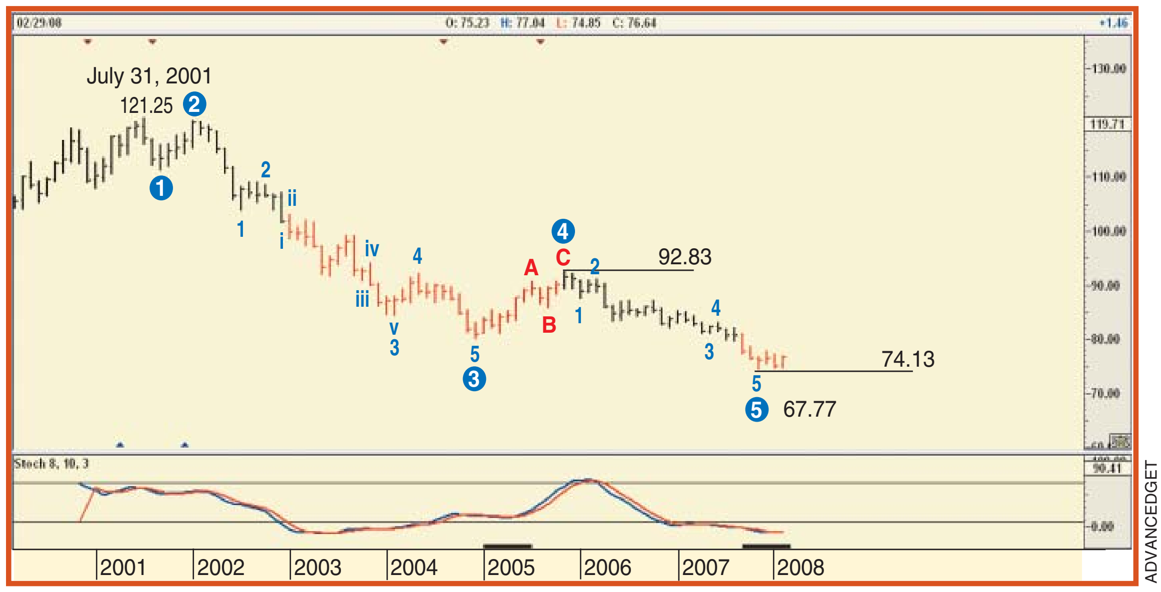

FIGURE 1: US DOLLAR INDEX, MONTHLY. See how the index fell from a high of 121.25 to the current low, a drop of 38.86% in seven years.

FIGURE 2: CANADIAN DOLLAR INDEX, WEEKLY VS. US DOLLAR INDEX. Here's a comparison of the Canadian dollar to the US dollar.

In the late 1970s, President Jimmy Carter was blamed for the high inflation rate in the US, and voters expressed their anger by not reelecting him in 1980. Paul Volcker, the chairman of the Board of Governors of the Federal Reserve System, was credited as having placed the United States back on a sound footing economically, giving the presidents who followed a successful economy until recently with the start of the Iraq war with its huge costs, the subprime crisis being the icing on the cake.

Over this period the US dollar has fallen dramatically as shown by the monthly chart of the US Dollar Index.

Figure 1 shows how the US Dollar Index fell from a high of 121.25 on January 31, 2001, to the current low of 74.13, a drop of 38.86% in seven years. With these figures two thoughts immediately come to mind:

A. The 38.86% drop is close enough to the Fibonacci level of 38.2% to be significant as a turning point.

B. WD Gann believed that a trend followed a 7-3-7-3 pattern. This means that now that we have seen a seven-year decline in the US Dollar Index, we should see a three-year recovery, starting from 2008, finishing in 2011.

Will there be a further seven-year decline from 2011 to 2018? That at the moment is anyone's guess, but common sense dictates otherwise because were this to occur, the US dollar would become valueless. There is talk at present of the US dollar being supplanted either by the euro or a basket of Asian currencies as the world's basic currency but so far this is just idle chatter by economists, who as we all know have two hands.

What should also be remembered is that the dates I have given coincide with the US Presidential cycle, with 2011 as the third term of office and 2012 being the start of a new Presidential cycle. The chairman of the Fed is independent of the President, of course, and is expected to act independently of the President, but this is not necessarily so. Wars cost money. Banks, the holders of a country's wealth, have over the years become financial institutions onto themselves. They create financial products, and the banks' financial advisors then sell those products to investors who have placed their trust in the hands of the banks. They are also risktakers with bank (investor) capital, as many banking crises (the latest one in France) has shown us.

So what now for the US dollar? The weakness of the dollar appears to be approaching an end. Nowhere can this be better seen than when we look at the Canadian dollar. Why the Canadian dollar and not the Australian dollar, New Zealand dollar, or any of the Asian currencies? Asian currencies are becoming more and more linked to the Chinese yuan, which as we all know is not a floating currency. Canada is inexorably linked to the United States, its largest trading partner. However, the Canadian dollar does float and was allowed to appreciate against a falling US dollar to the extent where industries in Canada are starting to suffer as prices of their manufactured goods are become less price-competitive.

Figure 2 is a weekly chart (inverted) of the Canadian dollar and suggests that the loonie will strengthen further against the US dollar for the short-term. This is confirmed by the stochastic indicator, which is oversold and showing strength. This is contrary to the US dollar index shown, which is looking for support at present levels, although a drop to 67.77 is yet possible. The green trendline drawn on the Canadian dollar chart does suggest a higher target based on time for the loonie — the further out the time, the stronger the Canadian dollar.

So is President George Bush leaving a legacy where historians will say "the worst President the United States has ever had"? Unlike President Carter, though, President Bush has served two terms. Will the next President be elected to only a four-year term, with the President to follow being the one to clean up the financial mess the United States is currently suffering? The charts seem to think so.

Whatever the outcome, the US Dollar Index does appear to be looking for a bottom. Any weakness in the future stock market that occurs does offer an opportunity to buy US assets at low prices in itself, causing the US dollar to strengthen. However, a negative is that with interest rates in the United States as low as they are, and possibly dropping further in the months ahead as Fed chairman Ben Bernanke shores up a recessionary economy, the US dollar is the currency that could become the brunt of the carry trade — sell at low interest rates and use the funds to purchase another currency at a higher interest rate.

We must remember, however, that the trader must borrow the US dollar first before they can convert it to the other currency with which to buy a higher interest-bearing bond. This strategy will start the trend toward a stronger US dollar, so those playing the US currency carry trade should beware — as charts are saying, "Not for much longer." ■

A Sure Thing In Forex?

by Mike Carr, CMT

Seasonal trading strategies have long been used to identify trades in stocks and commodities. They work in foreign exchange markets also.

Tradable: EUR-CAD

Seasonal trades seek to profit from economic changes that occur with some predictability at given times of the year. Even when we don't understand the causes of the patterns, seasonality is a useful analytical tool, one that every technician should consider employing. It is best used with technical analysis instead of as a standalone strategy.

Trades based on seasonality alone tend to show a high degree of profitability and reliability in backtesting. But markets change over time and these tendencies can disappear unexpectedly. Combining seasonal ideas with a strong technical basis for a trade can lower risk for traders.

In March, the euro/Canadian dollar pair shows a very strong seasonal bias. About 80% of the time, shorting the euro against the Canadian dollar is profitable for the month. The average trade results in profits of more than $1,200, but drawdowns are high and in foreign exchange trading, drawdowns are a primary consideration. The seasonal tendency tells us we should watch this pair throughout the month, even if we don't normally trade it.

Optimizing the seasonal trade, we find that shorting the euro on the 10th trading day of the month and holding for three to four weeks leads to 100% winners and very low drawdowns. This is a time that forex traders need to be very alert to possible setups. The best short-term trade in the month occurs on the 14th trading day and holds the position only four days. This trade has shown average profits of about $250 per day with low drawdowns over the past nine years.

Looking for a technical setup, the daily chart shown in Figure 1 is bearish on balance. Price is right at its 20-day moving average, an indicator that has been useful for timing trades. The moving average convergence/divergence (MACD) is confirming the failure to reach a new high in price and is very likely to turn negative.

FIGURE 1: EUR/CAD, DAILY. A break of the 20-day moving average is likely to be followed by a significant move in EUR/CAD.

Forex traders can easily monitor this currency pair and now know that shorts are likely to be profitable over the next month. Stock traders can use exchange traded funds (ETFs). Buying CurrencyShares Canadian Dollar Trust (FXC) and shorting CurrencyShares Euro Trust (FXE) will offer the same result, but dramatically lower profits since there will be no leverage. ■

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This article was first published on 2/29/2008. See www.Traders.com for more.

In March, the euro/Canadian dollar pair shows a very strong seasonal bias.

Forex Trading With ETFs

by Mike Carr, CMT

A limited number of ETFs offer new opportunities to stock traders.

One advantage of forex trading is a high degree of leverage. Many brokers offer leverage of 100 to 1, and some even more. This means great gains are possible on small investments. But what some see as an advantage, others see as a disadvantage. With a small move against the trader, visions of great gains can quickly become the reality of great losses. With full leverage, a very small move can wipe out an account.

Many brokers advocate paper trading, but trading legend Jesse Livermore thought it was a waste of time. He thought that until you won or lost real money with your ideas, there was no way of knowing the value of any trading idea or strategy. CurrencyShares ETFs offer traders a chance to test their ideas with real money, without a high degree of leverage. Although only four currencies are currently offered, spread analysis allows you to build synthetic pairs and create a roster of 12 additional trading candidates.

Although forex traders have a large number of options available to them, at times they still need to turn to synthetic pairs. If a trader thinks the worst currency in the world is the Icelandic krona (ISK) while the strongest is the Australian dollar (AUD), they want to go long AUD and short ISK. If this pair is not available, they can build a synthetic pair using a common base currency like the US dollar. By buying the dollar–AUD pair and shorting the dollar–ISK pair, they have created the position they wanted.

In Figure 1, we see a chart of the CurrencyShares Australian dollar ETF (FXA) with the relative strength compared to the CurrencyShares British pound ETF (FXB) in the lower half of the chart. We generate trading signals from the relative strength. After bottoming in August 2007, we would have been long FXA/short FXB until October. We could reverse the trade at that point, going long FXB and shorting FXA. In January 2008, the relative strength broke out of a rectangle, and we would be long FXA/short FXB again.

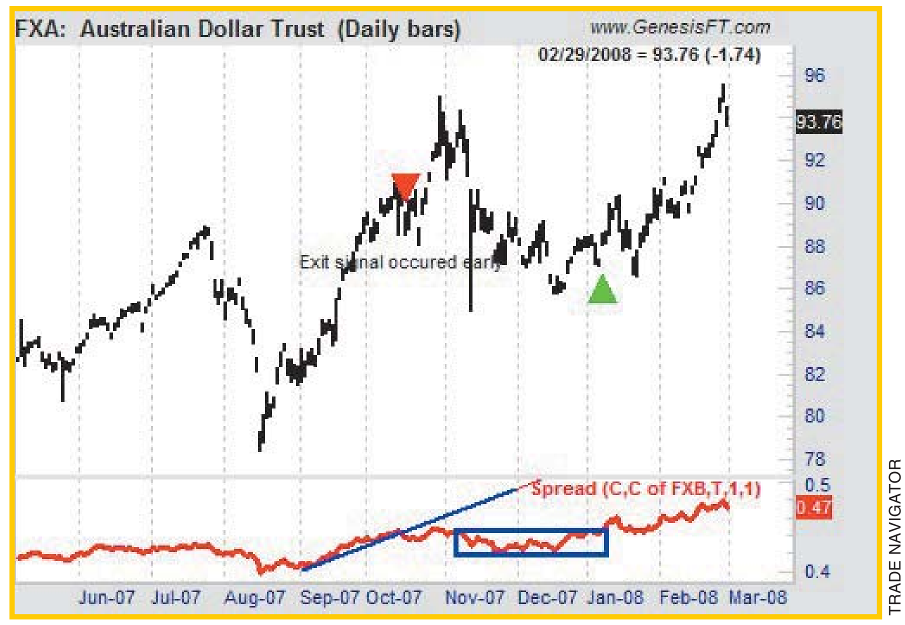

FIGURE 1: AUSTRALIAN DOLLAR TRUST. In this chart, all signals are generated using the relative strength line in the lower portion.

Using just these ETFs, traders can easily build a relative strength matrix in Microsoft Excel and monitor trading opportunities. With real money on the line but with limited risk, this technique offers traders an opportunity to develop skills in forex trading with real money but less risk. ■

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Does RSI Work?

by Mike Carr, CMT

Well known but rarely tested, technical tools like the relative strength index can be profitable if used properly.

Price oscillators are commonly added to charts and are useful for assessing whether a price trend is likely to continue. A well-known oscillator is the relative strength index (RSI), which was developed by J. Welles Wilder and introduced to the world in 1978. This oscillator compares the size of recent gains to recent losses in an attempt to determine overbought and oversold conditions of an asset. The formula is relatively simple:

$$RSI = 100 - [100/(1 + RS)]$$

where RS represents the average of x days' up closes divided by the average of x days' down closes.

Although it's a relatively simple formula, it can use some explanation. This calculation will always return a value between zero and 100, giving it clear boundaries. We will use a 14-day RSI for this example. The RS value averages the daily change on up days during that time and divides it by the average change on down days over the past 14 trading days. If there were 10 up days, the net gains are added and divided by 10 for the numerator; the net changes for the remaining four days are summed and divided by 4 to derive the denominator of RS.

Oscillators build on the idea that price movement is like a rubber band and will snap back if pulled too far. As RSI approaches 100, it is said to be overbought, indicating that everyone looking to buy has already bought. At the other extreme, near zero, RSI is oversold. Any oscillator, including RSI, works best during trading ranges, when a clear trend cannot be easily identified.

Usually, traders will consider the overbought level to be 70 and will look at selling when it reaches this level. An RSI reading of 30 is an indication that price has gotten oversold and is likely to be undervalued. This idea is shown in Figure 1, a daily chart of the euro/Canadian dollar currency pair.

Some signals work, while others are early or late. Because markets can appear to be irrational at times, a better strategy is to buy when the oversold or overbought condition reverses, signaling the trend has run its course. Testing against the euro/Canadian dollar currency pair shows that this simple RSI strategy can work surprisingly well. Selling short when RSI falls below 70 and buying when RSI breaks above 30 led to 20 consecutive winning trades since 1999, with an average profit of $536. We exited on the first profitable open or with a $2,700 stop-loss.

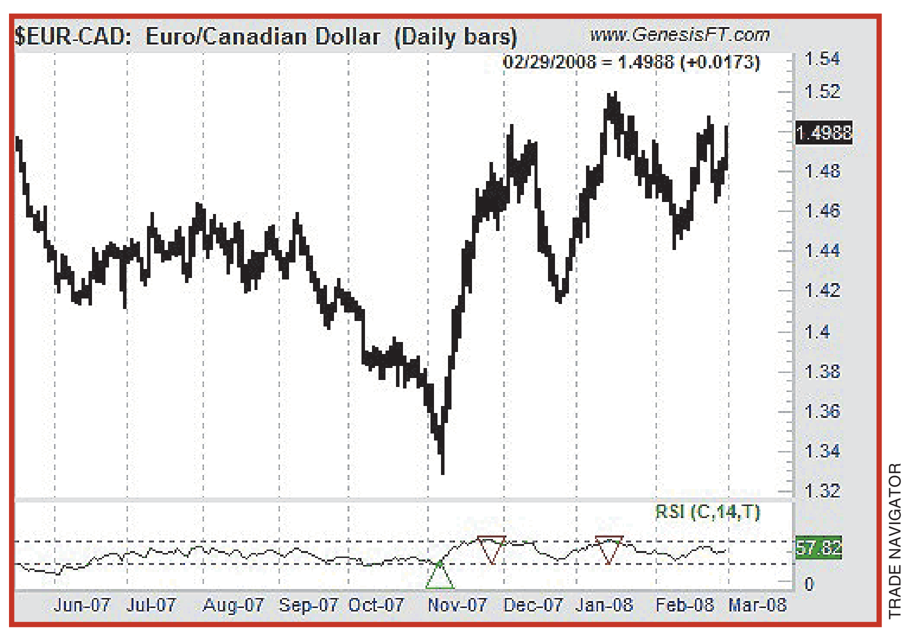
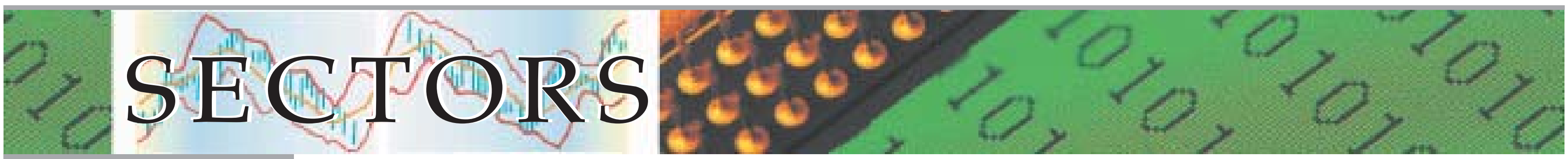


FIGURE 1: EUR/CAD. Some signals generated with RSI can be extremely profitable, such as the November 2007 buy signal in the EUR/CAD currency pair.

RSI can be used as a standalone trading system, or as confirmation of other signals. Traders can use this oscillator to significantly improve their profits. ■



BULL/BEAR MARKET

Semiconductor Index Is Losing The Support

by Chaitali Mohile

The index after consistent bearish breakouts is retesting the supports in a strong downtrend.

Tradable: $SOX

In prevailing market conditions, the stocks under bearish pressure are more than those in a bullish mood. Similarly, few sectors — industrial indexes, some major indexes — are either close to or have violated their nearest support. So now traders can find many bearish patterns on the charts; same is the case of the semiconductor Index. In Figure 1, the weekly chart, the index was at the highest level of 550 in early 2006 before it gradually turned lower to 384 by mid-2006. The moving average convergence/divergence (MACD) (12,26,9) moved to positive territory but showed some fresh volatility coming in. In addition, the average directional movement index (ADX) that declined to 15 established the support and tried to move upward with weak buying pressure. As result, the index took longer to recover to its previous high of 550.

Under this weak bullish strength, the index failed to climb above the prior high and began its downside journey. After the first bearish flag & pennant formation, the index dropped below its 200-day moving average support. This was the first bearish signal. Then was the second lower consolidation in the range ~ 430-410. Meanwhile, the weak indicators turned weaker, and bears became stronger.

The ADX (14) crossed 20 with selling pressure so the downtrend was developing here. The MACD (12,26,9) also gave a bearish crossover and rallied below its zero line. The relative strength index (RSI) (14) that hardly touched 70 had a nosedive to 30. The entire picture is highly bearish now.

FIGURE 1: $SOX, WEEKLY. After two bearish flag & pennant breakouts, the RSI (14) reached an oversold area, the MACD (12,26,9) is deeply negative, and the ADX (14) shows a well-developed downtrend.

FIGURE 2: $SOX, DAILY. The index has lost its support of 380 and the indicators are highly bearish, therefore leaving no space for bulls to come back.

No wonder the breakdown from the second bearish flag & pennant saw the index move below the previous low pivot of 384. The possibility of a pullback in $SOX is very dull under the present volatility in the entire global market.

On the daily chart (Figure 2), the index was consolidating with the support of a 200-day moving average with the RSI (14) finding it difficult to move above 50, and the MACD (12,26,9) showed no fixed direction to rally. In addition, -DI and +DI moved at an equal pace with a weak ADX (14) that tested 10. The situation therefore was not favorable for bullish breakout. The downward breakouts resulted in a huge plunge, losing almost 90 points in a month and a half. The bears continued their rally even below the lower consolidation in the range of 430-410.

The ADX (14) shows a well-developed downtrend. The MACD (12,26,9) has a bearish crossover in the negative territory. In addition, the RSI (14) is oversold at 20 levels; this indicates that the indicator still has room left below. And the RSI can remain oversold or overbought for longer so an overall scenario shows no signs for bulls.

Therefore, the bears are likely to continue in the semiconductor index. As a result, the support even below 370 is likely to get tested. ■

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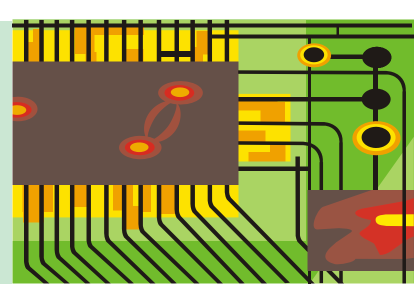
The RSI can remain oversold or overbought for longer, so an overall scenario shows no signs for bulls.



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TECHNICAL ANALYSIS

With Financial Select Sector SPDR ETF, The Downtrend Continues

by Paolo Pezzutti

There are no indications of a reversal; bad news and the generally negative sentiment could bring prices excessively lower.

Tradable: XLF

Writing about financial stocks can be compromising. Volatility is so high and news is affecting the performance of this sector that trying to forecast a scenario can be difficult.

The instabilities of last summer were triggered by losses through sub-prime mortgage lending in the US and have developed adverse global economic impacts. More than 86,000 mortgage jobs were cut in 2007 and the mortgage industry is facing a very difficult year in 2008 as housing prices declined and delinquencies and defaults rose rapidly. On the financial side, the Financial Select Sector SPDR ETF (XLF) fell to the lowest price seen since 2003, with most of its heavily weighted components contributing to losses. The financial instability and the credit crunch are still ongoing and their consequences will likely continue to affect markets. Bad news continues to hit markets and negatively impact stock prices. You shouldn't be surprised if a big player comes up with bankruptcy news. The crisis is not over and it will continue for quite some time, especially since everybody is talking about a recession in the US. And this is in spite of the Fed displaying its intention to intervene aggressively by lowering interest rates.

The XLF is a nice instrument for those who do not want to take positions on a single stock.

My view is that bad news and emotions will drive prices excessively low, creating buying opportunities. Timing the peak of the crisis will not be easy, although you may want eventually to be a buyer of this sector, which represents the heart of the economic system of any nation.

The XLF is a nice instrument for those who do not want to take positions on a single stock but want to diversify their investment. The XLF provides a good opportunity in this regard. Some of the companies composing the XLF are very important companies, such as Bank of America, Citigroup, JPMorgan Chase, Goldman Sachs Group, Morgan Stanley, and Merrill Lynch.

Let's focus now on the technical side to try and not take into account the negative sentiment that is surrounding these stocks.

In Figure 1, you can see the weekly chart of the XLF. After the double top printed in June last year in coincidence with a negative divergence of the moving average convergence/divergence (MACD), prices started a steep downtrend, losing about 30% so far. Prices are moving within a diverging channel and have engaged repeatedly in the lower trendline. You can also see that the MACD continues to print new lows, indicating that for the moment we cannot expect much in the medium term. The trend remains negative. At the same time, it is quite impossible to try and spot the low of this down move.

FIGURE 1: XLF, WEEKLY. The MACD is confirming the new lows of prices. So far there is no indication of a reversal in this time frame.

FIGURE 2: XLF, DAILY. The XLF is printing a slight positive divergence of the MACD. There are no indications of a reversal unless prices reenter the trading range within the descending channel and break out the resistance levels at $26 and $28.

In Figure 2, you can see the daily chart of XLF. In this time frame, the XLF is trading below the lower trendline of the descending channel, indicating the extremely difficult situation of the sector. Note that when prices attempted a rebound in November and December, they did not manage to break out of the static resistance level at $32, which was in the middle of the channel. This was a sign of weakness before prices resumed the downtrend. The MACD is printing a slight positive divergence, but the general situation is very negative. The length of the ongoing down leg will be very important to understand the strength of the downtrend. There could be also an acceleration of the move and a final climax. There is, in fact, the possibility of additional bad news, the emotions of which would hit the market in an excessive way. All you can expect is a rebound, but so far there are no elements. Key levels for a rebound, should it occur, are $26 and $28. To the downside, the first support and objective is at $24.

I would monitor the XLF to eventually be a buyer. Timing is very difficult and risky. Neither on the weekly and daily time frames are there indications of a reversal in the medium and short term. You have also to be aware that bad news and a general negative sentiment toward the sector could push prices too much to the downside. Instead of attempting to buy new lows, I would await a technical reversal pattern that would help identify a good risk-reward opportunity and a defined stop-loss. ■

STRATEGIES

Betting On Financials

by Mike Carr, CMT

If the market continues higher, and the financials move with it, Washington Federal would be a smart way to play the rebound.

Tradable: WFSL

Washington Federal Savings (WFSL) has more than 100 full-service branches located in Washington, Oregon, Idaho, Arizona, Utah, Nevada, New Mexico, and Texas. With the exception of Nevada, these states have strong economies. Washington Federal's loan portfolio offers exposure to all areas of real estate. It has been around since 1917, when it began as a small bank in Seattle.

This is a boring company with steady earnings and a small dividend. Earnings were $1.53 per share last year and are expected to be flat in 2008 before growing by 12.5% in 2009. The stock offers a dividend yield of 3.60%. It trades at a premium to its peers as measured by fundamental ratios, recognizing the solid management of this bank.

Figure 1 shows a recent breakout through a down trendline. Momentum and the moving average convergence/divergence (MACD) confirm the breakout, and this stock is very likely to move higher with the market. The October highs, more than 25% above current prices, offer the first significant resistance level. The breakout occurred at an old support level of 22, which offers a low-risk

The squeeze trigger represents the average price level where short positions were initiated.

stop location for this trade. More aggressive traders can use the trendline to set a stop, which increases the risk by point and a half. Another factor limiting risk is the low beta of 0.85, which means WFSL is likely to fall 15% less than the market if stocks resume their bear market.

Buyins.net reports that shorts will need almost 7 days to cover their sizable positions in this stock, and they calculate that the average short is now losing money since the squeeze trigger is 22.54. 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.

With a 2-to-1 reward-to-risk ratio, WFSL offers traders a great opportunity to profit in a rallying stock market. The stock also offers exposure to a financial stock that is not overexposed to the subprime mortgage market. ■

FIGURE 1: WFSL. WFSL broke through a trendline last week on a strong momentum and high volume.

REVERSAL

Is The Airline Index Ready For Takeoff?

by Gary Grosschadl

The airline index plunged 50% in the past year. Now there are signs of a bottom.

Tradable: $XAL

In the last quarter of 2006, things were looking up as the airline index ($XAL) rose above its 200-period moving average. This rise hit major turbulence at 65 as a warning candlestick appeared via a spinning top. This small-bodied candlestick often seen at market tops hints at a shift in momentum by way of market hesitation. When the bulls weaken after a rise, the bears like to assert themselves. And so they did in this case, with a 50% loss. When the index moved back under its 200-period moving average, smart traders ran for the hills. See Figure 1.

Note how the index's 20-period moving average kept a firm lid on any attempt to rise beyond several weak bear rallies. Thus, the first challenge for this index is to rise above this "boss" resistance, currently at 39.

A bottom is a possibility for several reasons. The doji candlestick (long-legged doji in this case) often marks market turning points at tops and bottoms. Several indicators lend credence to this assertion. At the top of the chart, the average directional movement index (ADX) line is considered overheated, being above 40 and both DIs (directional indicators). This hints at a coming shift to bullish power. Below the chart, we see deeply oversold conditions in the moving average convergence/divergence (MACD) and the relative strength index (RSI). Meanwhile, the stochastic oscillator shows early signs of an up leg developing as it rises above its 20 level.

To determine an upside target, an Andrews pitchfork is plotted using three turning points on the chart (low, high, low marks). The charting software then plots lines of support and resistance. Pitchfork theory has a move to the center median line as a likely event. As long as the lower median line holds support, this upward pointing pitchfork remains bullish in this pitchfork view. The target then is roughly 50. Note the previous congestion area between around 47, as this could also be a factor. In addition, note the falling overhead 200-period exponential moving average (EMA). This also needs to be taken into consideration. Chances are this ever-important moving average line will be very close to the median line by the time the index rises further. This likely makes this area very formidable resistance.

In summary, a bounce is expected here but will be likely halted by a confluence of resistance offered by the pitchfork median line, the 200-day EMA, and a previous congestion near 47. But first, should takeoff be aborted by current resistance at the 20-day EMA, then all bullish bets are off and it's back to the hangar. ■

FIGURE 1: $XAL, WEEKLY. The airline index looks like it may try to bounce on this weekly chart. Boarding passes for intrepid traders only!

The average directional movement index (ADX) line is considered overheated. This hints at a coming shift to bullish power.

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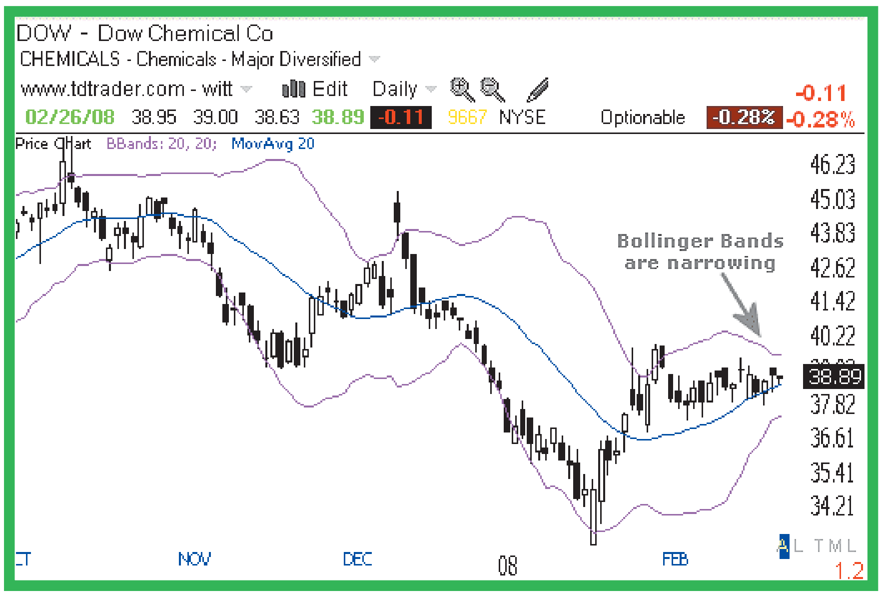

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FIGURE 1: DOW CHEMICAL, DAILY. Shown are daily candlesticks with the Bollinger Bands indicator. The middle line is the 20-day moving average (blue), and the upper band is two standard deviations above and the lower band is two deviations below (pink lines).

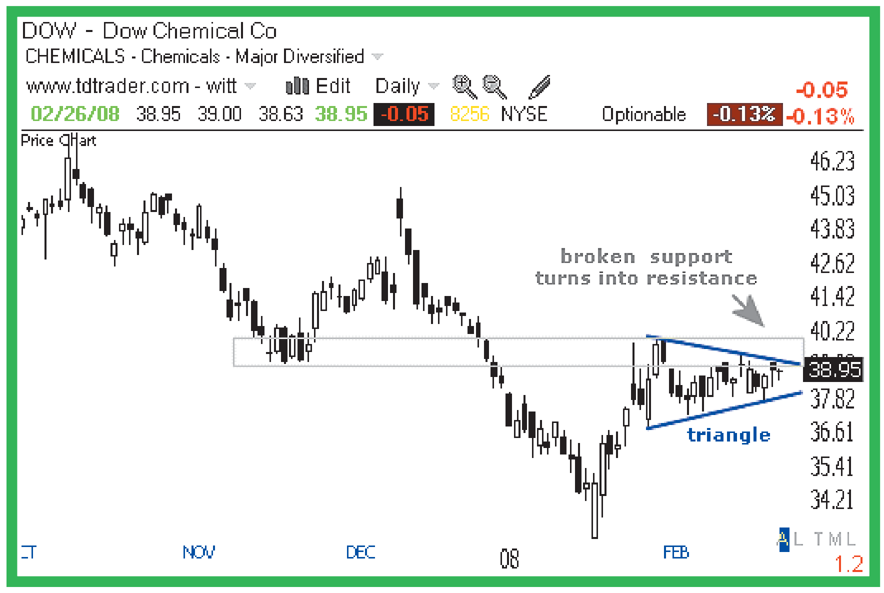

FIGURE 2: DOW CHEMICAL, DAILY. Here's a triangle consolidation at resistance. The stock broke support with the January decline and broken support turned into resistance in late January (gray rectangle).

Dow Chemical Is Wound Tight

by Arthur Hill

After a big surge at the end of January, Dow Chemical moved into a trading range that has tightened over the last few weeks. This volatility contraction could precede a volatility expansion and a significant move.

Tradable: Dow

Figure 1 shows daily candlesticks with the Bollinger Bands indicator. The middle line is the 20-day moving average (blue). The upper band is two standard deviations above and the lower band is two standard deviations below (pink lines). These bands reflect underlying volatility. They expand when volatility increases and contract when volatility decreases.

The Bollinger Bands expanded in January as the stock fell sharply. A rebound followed this decline and the exchange traded fund (ETF) then moved into a trading range. Volatility contracted during this trading range and the Bollinger Bands narrowed considerably (gray arrow). This narrowing acts as the calm before the storm and we must now look for a range break.

Figure 2 shows a triangle consolidation at resistance. Dow broke support with the January decline and broken support turned into resistance in late January (gray rectangle). The stock stalled at this resistance area over the last four weeks and formed a triangle. These boundaries hold the clue to the next signal.

A break above the February high would be bullish, while a break below the February low would be bearish. An upside breakout would signal a continuation of the January surge and target further strength toward the next resistance area around 45. A downside breakout would target a move back toward the January lows. ■

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TRADING SYSTEMS

Brazil iShares Has Strong Breakout

by Chaitali Mohile

Brazil iShares has moved above its previous high resistance on its third attempt on strong volume and may develop a fresh uptrend with this breakout.

Tradable: EWZ

Brazil iShares (EWZ) had a prior high resistance at 86. In mid-December 2007 the resistance was retested and the attempt to break out failed due to high volatility and low volume. As a result, EWZ plunged even below the support-resistance area of the 50-day moving average, thrusting deep below the long-term support.

Any downfall below this support would have adversely affected the long-term trend of EWZ. However, with the bullish indications by the stochastic (14,3,3), the moving average convergence/divergence (MACD) should overcome the fear of further correction.

As you can see in Figure 1, the stochastic has formed a double bottom, which indicates that a fresh bullish rally may begin soon. And the MACD (12,26,9) had a bullish crossover, while the histogram shifted above the zero-line. This boosted the new upward move and thereafter there was no turnback for EWZ. The security went through a one-sided rally till the previous high resistance was hit back. Though a steep upside rally without a halt is risky, this rally was well-supported with healthy volume to continue its journey. The rally therefore had few strong supports below along with positive technical indications.

So traders can initiate a fresh long posi-

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FIGURE 1: EWZ, DAILY. This chart of the Brazil iShares shows that the breakout has healthy signs to sustain. The MACD (12,26,9) is positive and ADX (14) is indicating a developing uptrend. The volumes are expanding as well, though the stochastic (14,3,3) is highly overbought.

tion on this breakout with a stop-loss of 84. I would also like to grab your attention to the three white soldiers candlestick formation, which is likely to appear soon. The last two-day bullish session has formed two bullish candles and if EWZ goes through a strong upside rally on February 28, it would complete the formation and you may see trend reversal conditions. In addition, note that the average directional movement index (ADX) 14 has moved to 20 with the positive directional index (+DI), and therefore the uptrend is developing as well.

Those who are already on board can move their stop-loss to 82 to protect their profits and carry the position further. To measure the estimated level, we can calculate the approximate length of the steep rally; 86 - 70 = 16 is the length, and therefore, 86 + 16 = 102 would be the minimum level on the breakout. With the stochastic (14,3,3) being highly overbought, some shaky moves can be expected on the indicator and subsequently, the price may give some jerks. So traders should keep shifting the stop-losses and protect the profits. ■

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This article was first published on 2/29/2008.
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STRATEGIES

Profiting In Commercial Real Estate

by Mike Carr, CMT

If the time to buy is really when there is blood in the streets, it's time to start looking through the real estate sector.

Tradable: CSGP

CoStar Group (CSGP) is a company that looks like it can profit from a real estate market that can only be described as difficult. The company provides information services to commercial real estate professionals in the US and the United Kingdom. Information on listings and sales becomes especially valuable when markets are tight, as buyers want to ensure they don't overpay.

The stock has suffered with the real estate market (Figure 1). Recent price action is indicative of a double-bottom price formation, and aggressive investors should consider taking positions at this level. The moving average convergence/divergence (MACD) histogram is supportive of higher prices, and risk is limited to the recent lows that are less than 10% away from current prices.

The weekly chart (Figure 2) indicates that prices can move much higher before encountering any significant resistance. With 15 points of potential upside, the trade offers a nearly 5:1 reward-to-risk ratio. Momentum is also very close to breaking out to the upside on the weekly chart. This is another indication that aggressive buyers should acquire position at this price.

Finally, the basic principles of supply and demand point to higher prices. According to Buyins.net, there is a large short interest in CSGP, which will create demand as prices move higher. Buyins.net tracks short interest in stocks and calculates the average prices on those shorts, providing a squeeze trigger price. At the squeeze trigger, shorts can be squeezed and stock prices can shoot higher as shorts scramble to cover their losing positions. The current squeeze trigger in CSGP is $43.18, right at the current price level. Shorts have built up a large position in this stock, nearly three weeks' worth of average volume, and on average, they are losing money right now.

Upward price moves in CSGP will deepen the losses of the shorts, adding to the bullish arguments for this stock. ■

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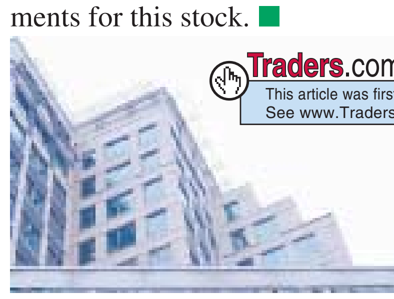

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FIGURE 1: GSGP, DAILY. Momentum confirms the recent price action on this chart of CSGP, shown here with the MACD histogram.

FIGURE 2: CSGP, WEEKLY. Momentum is about to give a buy signal on the weekly chart, meaning aggressive traders can initiate positions in anticipation of that signal.

TRADING SYSTEMS

How To Play Both Sides Of The Market

by Koos van der Merwe

Buy when the market goes up and buy when the market goes down. It's that simple.

Tradable: HXU-T, HXD-T

Horizon BetaPro ETFs are a unique series of alternative index exchange traded funds designed to help investors achieve their investment goals in all market conditions. They are designed to double the daily performance of the index they mimic — for example, the H&P Bear Plus Fund offers twice the daily return opposite to the direction of the index. As the index falls, the Bear Plus fund rises, and at twice the rate. Effectively and combined, the funds allow investors to profit in all market environments. See Figure 1.

The funds are offered across the index spectrum, and can be traded in Canadian dollars or US dollars and cover the entire US and Canadian spectrum. There are no trading restrictions, are extremely liquid with a 200% daily exposure and immediate settlement. Unlike a short sale, the risk is limited to the amount of capital invested. For Canadians, they are RRSP eligible, which means any profits made are nontaxable. A list of funds offered can be found on the website http://www.hbpetfs.com/.

Figure 1 is of the S&P/TSX 60 Bull Plus and Bear Plus ETF as they perform against the Canadian S&P/TSX 60 Index. The Index is in white, while the S&P/TSX Bull Plus is in green and the Bear Plus is in red. You can see how close the Bull Plus E ETF TF moves relative to the index, with the Bear Plus ETF is a mirror image, moving opposite to the Bull Plus ETF.

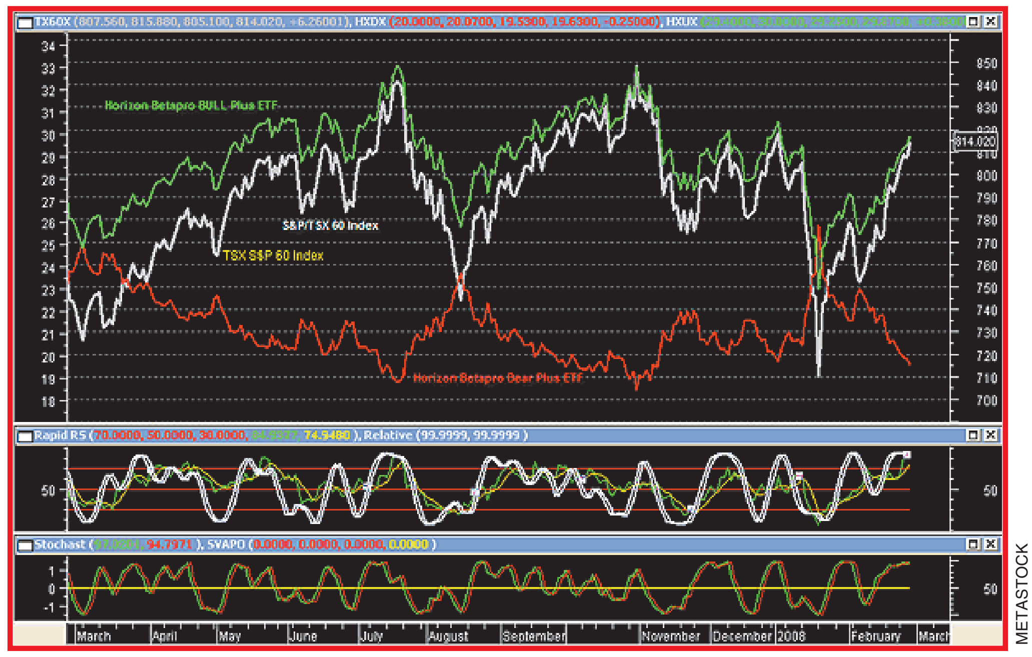


FIGURE 1: HXU-T, HXD-T. Here's a chart showing the S&P/TSX 60 index with the Horizon BetaPro Bull and Bear ETFs.

So... how to play it? Simple: Buy the S&P/TSX 60m Bull ETF (HXU-T) when the market is bullish, then sell it and buy the S&P/TSX 60 BEAR ETF (HXD-T) when the market is falling. The indicators shown on the chart are, in the upper box, the relative strength spread (white) and rapid RSI (green and yellow) lines. In the lower box the indicator is a stochastic RSI indicator. All the indicators are at oversold levels, suggesting that one should consider selling the HXU-T and buying the HXD-T. ■

RELATIVE STRENGTH COMPARATIVE

Millennium Bucks The Market

by Arthur Hill

While the broader market falls apart, relative strength and good upside volume point to higher prices for Millennium Pharmaceuticals.

Tradable: MLNM

Strong volume points to a breakout.

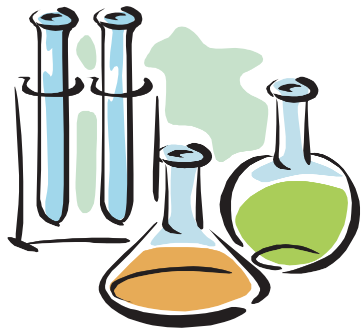
A glance at the price chart indicates that Millennium (MLNM) surged in October-November 2007 and then consolidated in December 2007-January 2008. Most of the gains are holding and the stock remains above its 50-day moving average. MLNM hit resistance around 16.25 twice and formed a higher low in early January. In connecting the dots, an ascending triangle appears to be taking shape and a breakout would signal a continuation higher. See Figure 1.

Strong volume points to a breakout. Volume began picking up back in mid-September when the stock gapped above its 50-day moving average. Volume continued at an above-average pace as the stock advanced in October. The 50-day moving average crossed above the 200-day in late October as the advance extended into November. Even though a consolidation unfolded in December, upside volume remained strong and this shows continued buying pressure (blue arrows).

A relative strength breakout opens the door to a price breakout. The bottom indicator compares MLNM against the Standard & Poor's 500 exchange traded fund (ETF). This indicator rises when MLNM leads and falls when MLNM lags. The indicator surged in November and then traded flat in December. The upswing continued with a surge in January and a break above the November high. This is bullish and increases the chances of a breakout in the stock. ■

FIGURE 1: MLNM, DAILY. Millennium surged in October and November 2007 and then has consolidated the following two months.

Millennium Pharmaceuticals Bouncing Off Strong Support



by Gary Grosschadl

After a big rise, stocks will often languish sideways or correct down before making another bull move.

Tradable: MLNM

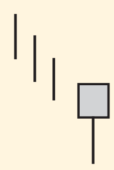
Figure 1 shows an admirable gain from last autumn, rising near 65% in only three months. Note the classic buy signal when the 50-day exponential moving average (EMA) crossed over the 200-day EMA. It languished sideways for about the same time frame, extinguishing the final bulls after a brief attempt at $17. The 50-day EMA held brief support until a convincing black candlestick closed beneath it.

The first sign of possible support came with the hammer candlestick just above $13. That mark held support in the next two trading days. Note how that level corresponded with a previous congestion level from last November. The other major consideration was the close proximity to the ever-important 200-day EMA. Stocks often respect that strong level of support or resistance.

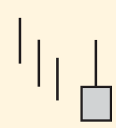
Below the chart, several indicators are considered. The moving average convergence/divergence (MACD) shows a strong buy signal. After a large decline to below the zero-line, a bullish crossover is one of my favorite buy signals. This indicator lags a little (by several days) so it is not meant to time the precise bottom. The relative strength signal (RSI) shows a similar move to a low level bouncing off 30. The move above the often key resistance area of 50 is another bullish sign. As expected, the stochastic oscillator shows a bullish up leg. A downturn from the 80 level usually points to some type of consolidation as the stock takes a breather, or possible reversal.

There are two considerations for an upside target. The first is a possible gap resistance near 15.50. The stock may balk at that point and have to reload before mustering a stab at the previous high near $17. A move beyond $17 is not ruled out, but there would have to be some bullish catalyst to bring in new bulls at that level — perhaps bullish news for the stock or the market in general. Should this drive turn sour, keep your eye on the 50-day EMA. This level must hold support or all bullish bets are off. Failure to hold support would likely bring another test of the 200-day EMA. ■

FIGURE 1: MLNM, DAILY. This chart shows a bounce near strong support.



Hammer (HA): The body (the color is not important) is small and at the upper part of the range. The shadow should be twice the height of the real upper body. It should have no or very short upper shadow. It is usually bullish after a selloff.



Inverted Hammer (IH): It is a shooting star–shaped candlestick. In a falling market, it could be a bullish signal. The inverted hammer signals the possibility of a bottom.

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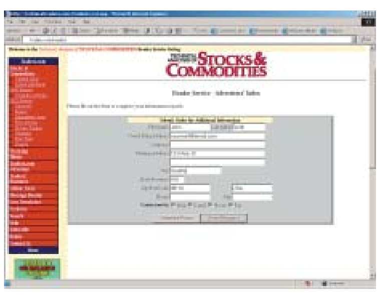

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Kim has done work for The New York Times, The New York Press, Honolulu, Good, Chronogram, Bust, The Stranger, and The Village Voice, *among others. Her work has been shown on The American Illustration website, in The Society of Illustrators Scholarship Show and in the Graphics New Talent Annual 2007. She has also participated in group shows in New York.*

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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.

Buy and Hold — The acquisition of a tradable for the long term rather than quick turnover.

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. The formula for calculating EMA is: EMA = (Today's closing price * k) + (Yesterday's moving average * (1-k)), where k = 2/(n+1); n = no. of periods.

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 — Simply, 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.

Swing Chart — A chart that has a straight line drawn from each price extreme to the next price extreme based on a set criteria such as percentages or number of days. For example, percentage price changes of less than 5% will not be measured in the swing chart.

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.

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