CHART PATTERNS	SECTORS	MARKET UPDATE
S&P 500 Flagging For Help	Gold Tests The Breakout	NASDAQ 100 At Support

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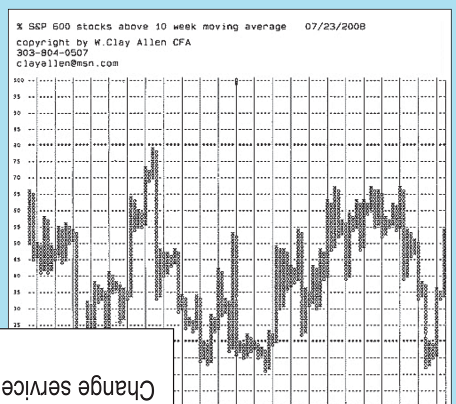
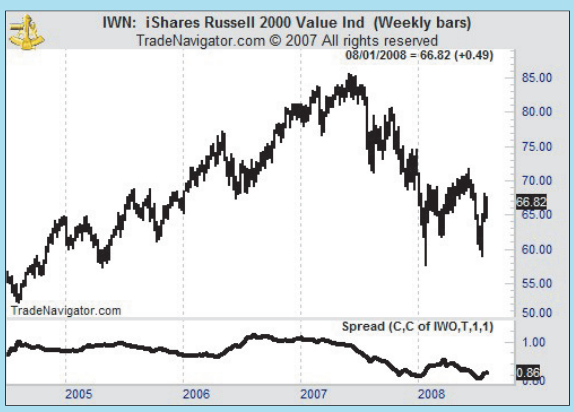
S&P 600 VS. IWN



MARKET DYNAMICS



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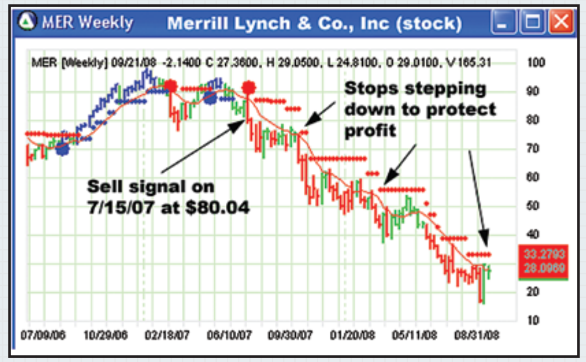

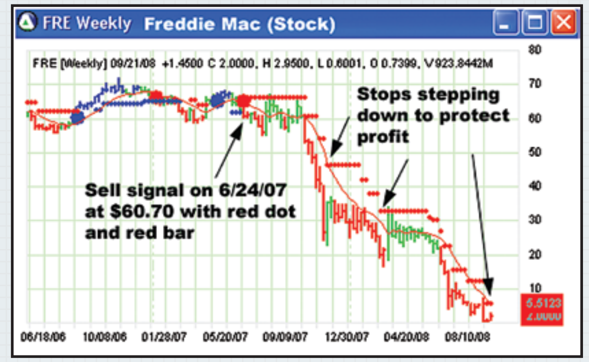

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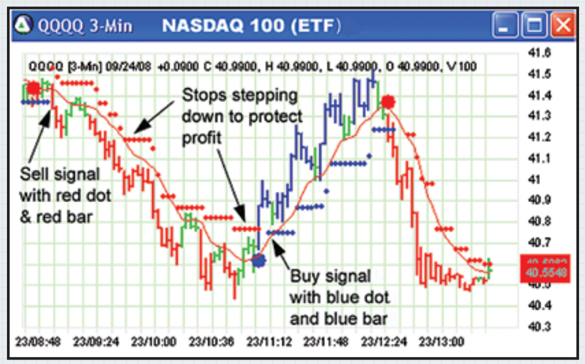

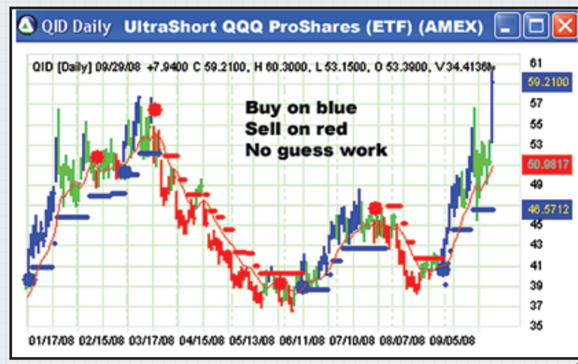

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CHART PATTERNS

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STOCKS — The Wizard called the stock market short on June 13th. Here are our short picks.

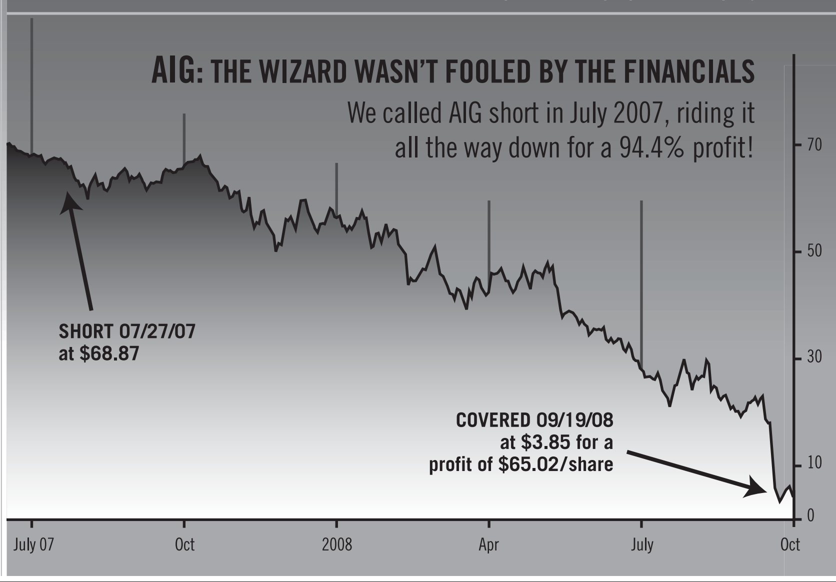
359 WINNING 27.42% avg loss	115 LOSING 5.73% avg loss	19.37% total profit	38.75% margin profit	113.28 avg days held

FUTURES — The Wizard called the big moves in oil, gold, natural gas and many more.

28 LOSING 11.07% avg loss	8 LOSING 0.72% avg loss	$210,073.60 total profit : 1 contract / trade	66.56 avg days held

FOREX — The Dollar's going to zero? The Wizard profited from the “surprise” USD reversal.

19 LOSING 5.277% avg loss	3 LOSING 1.48% avg loss	$105,877.78 total profit : 1 lot / trade	85.91 avg days held



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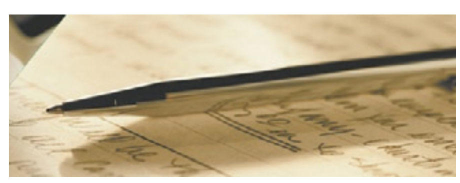

November/December 2008 • Volume 6, Number 6

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TRADING NOW

As I write this (in early October), all I can do is wonder how many consecutive down days we are going to have in the equity markets or even some of the commodity markets this month. October traditionally has not been a great month for the markets, and what we are seeing now goes to show how handing out easy credit can affect the markets at a global level. There is nothing positive in the markets, except for maybe the US dollar, which for some reason seems to have started showing bullish signs. In times like these, it is easy to see that a buy & hold strategy is not going to be in your best interest. Think of how long it will take to make up a loss of this magnitude. We have seen the housing market, equities, and commodities all crash and burn. In fact, the markets have been coming down so fast and so hard that even a recovery in the markets of a magnitude of 20% will be just a bounce. The panic has spread to all parts of the world.

In this issue of **Traders.com**, you will note that most of the articles suggest that we are indeed in a bearish period. Here's a list of some you'll find: "If The Bear Has Really Ended…," by Mike Carr (on page 12); "Second Market Crash Is Straight Ahead," Alan Northam (on page 14); "S&P 100 Has More Downside," by Chaitali Mohile (on page 20); "S&P 500 Flagging For Help," by James Kupfer (on page 24); and "QQQQ Crash Coming?" by Alan Northam (on page 49).

And we had to throw this one in: "A Head & Shoulders For Goldman" by Arthur Hill (page 21).

It's not just limited to equities. In our Metals & Energy section, you will see that the precious metals and oil followed the same path as equities, although the metals seem to be showing signs of recovery. But they are inversely correlated with the US dollar, which is just about the only market that is bullish at present.

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.

I would hope that you are out of your long positions by now and in cash. The best thing to do now is to wait for the markets to hit bottom and start reversing. Resist the temptation to bottom-fish. Wait till you are sure the market is reversing, and while that wait may be a long one, at least be happy you are preserving your capital. Let's hope that by the time the next issue comes out, the markets will be dancing to a different tune.

Jayanthi Gopalakrishnan

Jayanthi Gopalakrishnan,
Editor

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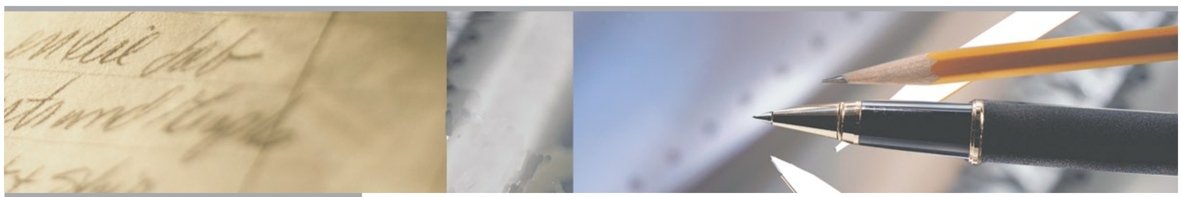

TRADER'S NOTEBOOK

Consider, If You Will, The Exchange Traded Note

by John Devcic

Here's what it is, and here's how to consider it.

You may have heard of the new investment vehicle that has become popular recently, the exchange traded note (ETN). If you have never heard of an ETN or may have heard of it but have no idea how they work, then read on; this article is for you. Here's what an ETN is and how it works, and here are some of the advantages and disadvantages about investing in ETNs. So what is an exchange traded note anyway?

What is an ETN?

An exchange traded note is an unsecured debenture first introduced as an investment in 2006. The best way to think of an ETN is to imagine if you were to combine the best points of a bond and an exchange traded fund (ETN). An ETN is a note and not a fund that holds a basket of securities. You have to look at ETNs as a bond first and foremost, and like any other bond, ETNs have an issuer.

Here's how an ETN actually works. An issuer will create a note with the express purpose of providing you with a return based upon an index or other investment strategy of the issuers choosing. This return will be somewhere in the future, which means these notes, like bonds, have a maturity date. These notes are openly traded on an exchange much like any other security and in particular like an ETF. Most ETNs have a maturity date some 20 or 30 years into the future.

ETNs will be traded on the open market, which means the value of a particular ETN will rise and fall daily. As an example, assume you purchased an ETN at $60 and that note matures in 20 years. Let's also assume that the ETN has had a nice rise of 400% in those 20 years. You would receive $240. Note that this figure does not include any expenses or fees.

It is important to remember that an ETN will never hold any security but rather guarantee the owner of the ETN a return based upon the performance of the index or strategy it is designed to track. Of course, I should mention that if the strategy or index does not perform well, the return of the ETN will be affected as well.

Advantages of ETNs

Access to markets and strategies: ETNs offer a fairly easy way to invest in what usually can be difficult markets for investors to get into. For example, commodity and currency ETNs are very popular. There are also ETNs that track the Indian stock market. Or if you would like to invest in a particular investment strategy like the Dogs of the Dow, you can with the "Dogs of the Dow" Dow Jones High Yield Select 10 Total Return Index created by Deutsche Bank. The Dogs of the Dow strategy may be too costly for most investors, and an ETN can step in and allow you to profit from the strategy without having to buy any shares of stock.

Liquidity: ETNs are openly traded on an exchange that allows an investor to be able to see daily what his or her ETN is worth. You can easily buy and sell ETNs without holding till maturity. Trading openly on the market allows an investor to quickly get in or out if he or she chooses to do so. This is why ETNs are often compared to ETFs. In this case, the comparison does make sense, as they are both openly traded on an exchange. Similarities between ETFs and ETNs stop there, however.

No more tracking errors: ETFs have had issues in properly tracking an index. There are many factors that can affect the ability of an ETF to track the performance of the underlying index. Some factors such as fees and expenses, redemption costs, and dividend reinvestment policy can all cause an ETF to not properly track the underlying index. These issues do not exist with ETNs because you have the issuer's guarantee to return an exact replica of the performance of the underlying index or strategy. You also have the advantage of an ETN not holding any securities so those factors that cause tracking errors in ETFs are done away with. This is why a lot of ETNs that track a commodity index are becoming popular.

Disadvantages

Credit risk: The biggest risk inherent with ETNs is the credit rating of the issuer. You have the guarantee of the issuer to replicate the return of the underlying index or strategy at maturity. This guarantee is as good as the credit rating of the ETN's issuer: the more creditworthy the issuer, the better their guarantee. This

You have to make sure that there is decent volume before you buy an ETN. If not, you may not be able to get out once you have gotten in.

is the most important part of understanding ETNs. Like bonds, you must first look at the creditworthiness of the issuer before you begin looking at a particular ETN.

Illiquidity: I know what you are saying. One of the benefits of an ETN is liquidity, so how can it also suffer from illiquidity? Illiquidity is the result of a lack of buyers and sellers, which would be the case if a new ETN does not garner enough interest.

ETNs are new and the success of any particular ETN will be decided by how much of that ETN is sold to the public. Investors, big and small, will decide the success of a particular ETN if they decide to purchase an ETN. You have to make sure that there is decent volume before you buy an ETN. If not, you may not be able to get out once you have gotten in.

TAX CONSIDERATIONS

Since the introduction of ETNs, one of their biggest benefits according to their issuers is their tax efficiency. As of right now, the Internal Revenue Service (IRS) has only made a decision on taxes regarding currency ETNs; it has not made a ruling about other ETNs, so investors should not regard an ETN as tax efficient until the IRS makes a ruling. You will still see some articles discussing the tax efficiency of ETNs, but until the IRS makes a ruling regarding taxes and ETNs, you should not assume it will be a benefit.

In December 2007, the IRS made a ruling regarding the tax implications of ETNs tracking currencies only. Those ETNs will be considered debt for tax purposes. This was to make sure that any gains in currency ETNs would be taxed the same way as any other currency investment. ETN holders will have to pay taxes on any interest earned without getting any of the money. Any interest earned is assumed back into the value of the ETN and will only be distributed when the owner of the ETN sells or the ETN reaches maturity.

ETNs are still new and only time will tell if they have a future. Right now they are being issued at a fast pace. Taking time to properly evaluate these investment vehicles is the most important step for any investor. Keeping an eye on the issuer's credit status is as important to an ETN holder as monitoring the performance of the strategy or index that ETN is tracking. You should also not assume that there will be any tax advantages to buying an ETN until the IRS makes a ruling. So keep an eye on any future tax rulings from the IRS This, of course, has not stopped ETN issuers from touting their perceived tax benefit. Investing in ETNs has its benefits, but be wary of their disadvantages as well. ■

This article was originally published on 8/13/2008.

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INDEXES

FIBONACCI

NASDAQ 100 At Support

by James Kupfer

The NASDAQ 100 is weak and just keeps getting weaker, but is it ready to turn? And if so, where might it go?

Tradable: NDX

Fibonacci retracement levels are a favorite tool of mine to indicate potential reversal levels and price targets. It is common to draw these retracement levels by calculating the popular Fibonacci levels between a stock's recent high and lows. Any decent charting package will do the calculations for you once you select the relevant endpoints.

On the weekly charts of the Nasdaq 100 (Figures 1, 2, and 3), you can see that I have already drawn the appropriate levels. As you can further see, the Nasdaq 100 is hovering right at the 61.8% retracement level and has been for about two weeks. This level is a significant one, and combined with the dramatically oversold stochastic indicator reading, this becomes a critical potential turning point. Although I think it will bounce here, if it does not it has no support until it reaches the March lows.

Assuming a bounce occurs, where can we expect the NASDAQ 100 to bounce to? Again, Fibonacci retracement levels can indicate a potential answer. Drawing Fibonacci retracement levels between the October 2007 market high and the March 2008 lows (long term, in orange), as well as the subsequent May highs and potential lows in July (short term, in black) leads to some interesting results. Specifically, there is a clustering of Fibonacci retracement levels at nearly identical value. At these clustering levels I would expect a significant amount of upward resistance.

Short-term support levels are:

61.8%: 1952
50.0%: 1953
38.2%: 1888

Long-term support levels are:

61.8%: 2021
50.0%: 1953
38.2%: 1886

Note that the support levels are very similar at 1952 and 1953, and again at 1888 and 1886. Those are the cluster levels I referred to earlier.

Of course, that doesn't mean the NASDAQ 100 will reach those levels or not even go higher, but they are worth watching closely.

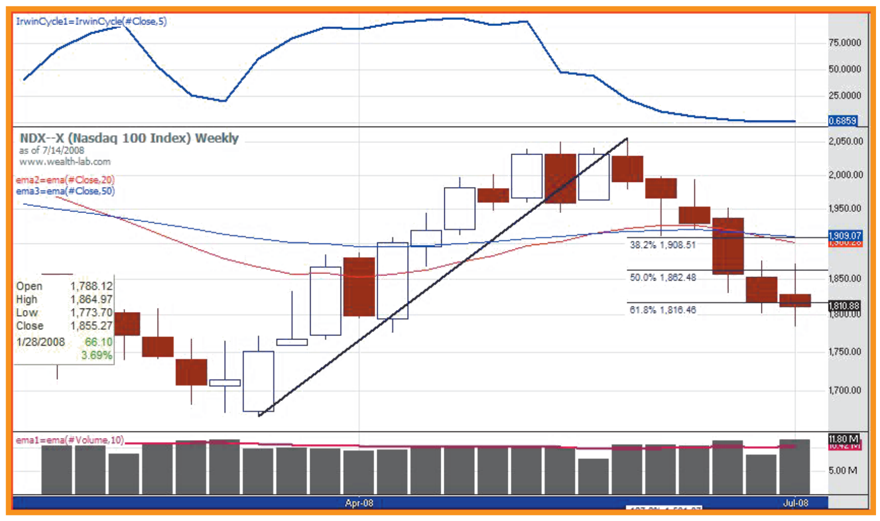


FIGURE 1: NDX, WEEKLY. The NASDAQ 100 is hovering around the 61.8% retracement level.

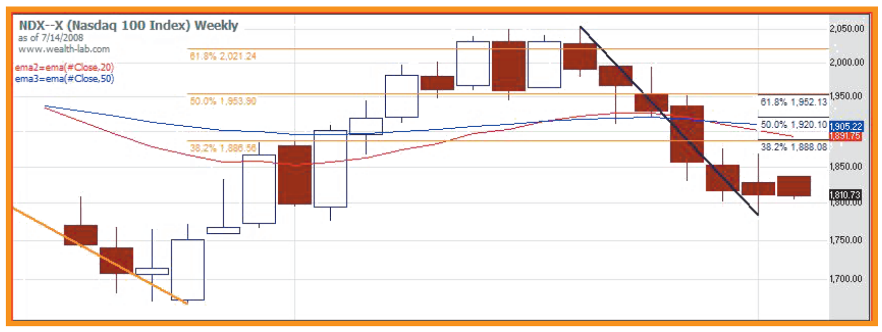


FIGURE 2: NDX, WEEKLY. Assuming a bounce occurs, where can we expect the NASDAQ 100 to bounce to?

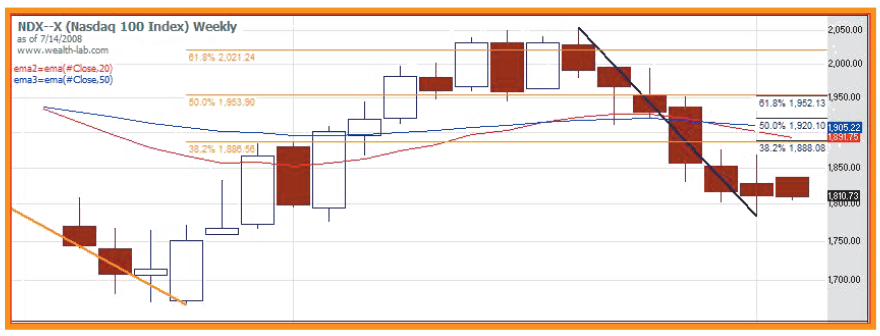


FIGURE 3: NDX, WEEKLY. Here's a closeup of retracement levels.

RELATIVE STRENGTH COMPARATIVE

If The Bear Has Really Ended...

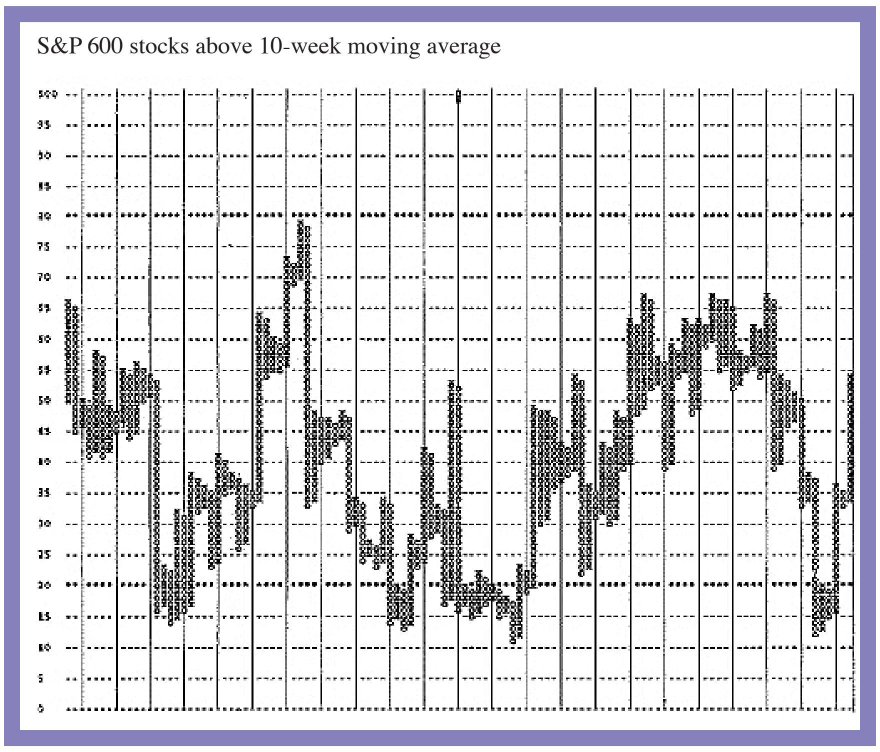
by Mike Carr, CMT

Early market leadership indicates small-cap value is the best area for new investments if stocks are headed higher.

Tradable: IWN

It's probably too soon to be certain, but with the market more than 5% off its July lows, media speculation has begun focusing on whether the bottom is in. Studying market action since that time, we find that small-cap stocks have been leading the market higher. Relative strength (RS) is a useful tool to identify the leading market segment. In Figure 1, we see a point & figure chart of the RS of the Standard & Poor's 600 index. This chart is created by plotting the percentage of stocks in an uptrend.

More than half (54%) of the stocks in the S&P 600 are trending higher. Only 36% of large-cap stocks and 42% of mid-caps are in confirmed uptrends. The stocks that make the sharpest move off a bottom have



MARKET DYNAMICS

FIGURE 1: S&P 600. The percentage of small-cap stocks trading above their 10-week moving average has risen sharply since bottoming in mid-July.

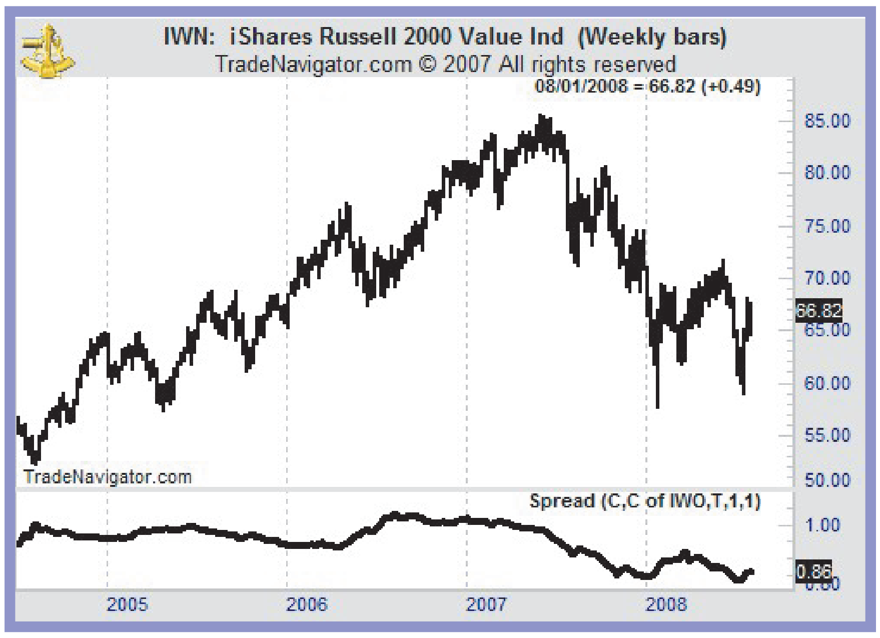


FIGURE 2: IWN. IWN seems to have successfully tested the January 2008 lows.

Relative strength (RS) is a useful tool to identify the leading market segment.

historically been the best performers in subsequent bull markets.

Looking deeper at RS, we find that small-cap value stocks have outperformed small-cap growth over the past few weeks (Figure 2). The indicator in the bottom of that chart shows the RS of the iShares Russell 2000 Value Index ETF (IWN) compared to the iShares Russell 2000 Growth Index ETF (IWO). We can see that IWO has outperformed IWN most of the time since late 2006. This changed in mid-July when the RS of IWN turned higher, coincident with the market bottom.

Conservative traders can simply buy IWN with a stop near 60, risking 10% from current levels but potentially profiting handsomely if the market has indeed bottomed. Aggressive traders should look within the components of the exchange traded fund for the potential best performers in a new bull market. ■

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This article was first published on 8/5/2008. See www.Traders.com for more.

Second Market Crash Is Straight Ahead

by Alan R. Northam

The NASDAQ completed its bull market runup in 2000 and is in a market correction that could last until 2010. It could fall to as low as 617.

Tradable: $COMPQ

Figure 1 is that of the NASDAQ monthly bar chart over the last 12 years. This chart shows that the NASDAQ bull market peaked in 2000. According to R.N. Elliott, after the completion of a bull market trend, the market will correct in three waves, labeled waves (A), (B), and (C). Wave (A) is a downward trending wave and is made up of five smaller waves. Wave (B) is a corrective wave that corrects the losses incurred during wave (A) and is made up of three smaller waves. And wave (C) is a downward trending wave also made up of five smaller waves. As can be seen in Figure 1, wave (A) down unfolded in five waves from its peak in 2000 to its low in 2002 as the market crashed and lost about 78% of its value. Wave (B) unfolded in three smaller subwaves labeled A, B, and C from the market low in 2002 to the high in 2007. Subwave A unfolded from late 2002 to the end of 2003. Subwave B unfolded during the first half of 2004, and subwave C took from mid-2004 until late 2007 to unfold. Figure 1 also shows that wave (C) down has not yet unfolded.

Figure 1 also shows that an ending diagonal pattern has developed during subwave C of wave (B). Ending diagonals normally show up in two places on the chart. The first place they typically show up is in wave 5 and the second is wave C. As you can see from the chart, this ending diagonal has shown up in wave C. This does two things for the market technician or the Elliottician. First, as an ending pattern, it tells the technician that wave (B) is over, and second, it builds confidence that the wave labeling is correct.

FIGURE 1: $COMPQ, MONTHLY. This chart shows Elliott wave count. This figure also shows an ending diagonal pattern indicating that the upward move from the 2002 low is over and the downward trend is about to resume.

With wave (B) now complete, wave (C) down has begun and is in its very early stage of development. To confirm that wave (C) down has begun, I have added a support line drawn off the low of subwave B. Confirmation of wave (C) will come when the NASDAQ decisively closes below this support level. What we want to do now is determine the target price for the complete move down of wave (C). Typically, the ratio of the high price to the low price of wave (A) and the ratio of the high price to the low price of wave (C) are equal, but the ratio of wave (C) can sometimes be 0.618 times that of wave (A). Since this calculation involves two different target prices, this then gives us a range of prices as a target. To determine this target price range, we first take a ratio of the high and low price of wave (A) and divide it into the high price of wave (B). The ratio of wave (A) is 5132.52 divided by 1105.96, which gives us a ratio of 4.64:1. Next, we divide 4.64 into 2862.51 and we arrive at an expected target price for the complete move of wave (C) to be 617. Second, we take the ratio of 4.61:1 and multiply it by 0.618 to arrive at 2.87. Then we divide this new ratio into the high price of wave (B) or 2862.51 to arrive at our second price target of 997. The result is a target price range of from 997 to as low as 617 for the complete move down of wave (C). This represents a minimum expected drop in price from today's price level of 60%.

To determine the time frame as to when the wave C down will be completed, all we need do is look back at wave (A). Typically, wave C unfolds in the same amount of time as wave (A). From wave (A), we should expect wave C to take approximately two and a half years to complete. This then suggests that the NASDAQ should continue to fall over approximately the next 18 to 20 months with an average annual rate of descent of 20% per year. This further suggests that the NASDAQ could fall to around 2100 by the end of 2008 or 14% lower from today's price level.

In conclusion, the NASDAQ market peaked in early 2000 and is in the process of correcting for the complete bull market runup in price. This market correction has currently completed waves (A) and (B) of a three-wave market correction. This leaves wave (C) down yet to be completed. Wave (C) down started in late 2007 and is expected to last for two and a half years or 30 months. Wave (C) has now been in progress for nine months, leaving approximately 21 months to go. This then suggests that the market correction for the NASDAQ will not be over until approximately the end of the first quarter of 2010. Further, the NASDAQ is expected to fall 60% over this time frame with a price target range of from 997 to 617. If this analysis is correct, then the second market crash is straight ahead. To confirm that wave (C) down has begun and that price can potentially fall into this target price range, the NASDAQ must close below the support line drawn off the low of subwave B. However, should the NASDAQ turn back up and move above the late 2007 high, then the complete move up from the low of 2002 is still unfolding and the second market crash has either been avoided or just postponed. ■

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TECHNICAL ANALYSIS

The Russell's Road To Recovery

by Ron Walker

The Russell 2000 (small cap stocks) has been on the road to recovery and is now testing the highs made in early June. It looks poised to clear June's overhead resistance in the near future, but might need a pullback to build the momentum to get the job done.

Tradable: $RUT

Since the July 15th lows several indexes have done exceptionally well, but there is one that stands out. The Russell 2000 has taken a leadership role, having risen approximately 18% from its intraday low made on July 15 to its intraday high made on Friday, August 15, having advanced 117 points since that intraday low. The Russell 2000 has risen for the past six consecutive weeks on its weekly chart. But on August 15, the Russell 2000 ran into key overhead resistance and could get a healthy pullback before the advance continues.

In Figure 1, the Russell 2000's daily chart reveals some very interesting things. First of all, during this advance the small-caps managed to close above their 50- and 200-day simple moving averages (SMAs) on the daily chart. That is a very strong sign. Previously in the early stages of the current advance, prices moved above the 20-day SMA. Currently, prices are well above the 20-day SMA. But during an uptrend, most reactions are contained at either the 20- or 50-day SMAs, so I do anticipate a pullback in the near future, especially because the Russell is running into overhead resistance near 764. That was the peak that was made in early June. We are likely witnessing an accelerated trendline; prices should pull back because the current angle of ascent is very steep. If the current rising wedge on the daily chart in Figure 1 breaks down, a reaction back to support could allow a new rising trend channel to develop.

In Figure 2, the Russell 2000's 60-minute chart exposes the current weakness in price. The price rose up to overhead resistance at 764, forming a divergence between price and the relative strength index (RSI). Moreover, the divergence is on the moving average convergence/divergence (MACD) as well. The Russell rallied up but couldn't close above overhead resistance. Simple divergence such as we see here on the 60-minute chart forms when prices have moved up too quickly. A simple divergence doesn't mean that the advance is over; it is just a warning that prices are likely to experience a corrective move.

On the weekly chart of the Russell 2000 (Figure 3), you will notice several bullish events have recently occurred in that time frame. The MACD made a higher low during the pullbacks in mid-July, confirming the higher low made on the weekly price chart. The MACD also looks poised to move above the zero line, which is very positive. The

FIGURE 1: $RUT, DAILY. The Russell is now above its 20-, 50-, and 200-day SMAs. If a pullback occurs, prices may find support where the 20-day SMA and 200-day SMA intersect near 722. The average directional movement index (ADX) is showing that the Russell is in a healthy rising trend, but the ADX line needs to rise above 20 for the advance to continue.

FIGURE 2: $RUT, 60-MINUTE. The Russell 2000 has had a 18% move from its intraday low on July 15 to its intraday day on August 15. That is a 117 increase in one month. But negative divergence is looming over the 60-minute as the Russell 2000 has formed a bearish rising wedge pattern.

MACD histogram has been in positive territory for the last three weeks, showing that the bulls have taken back control. But most important is that the falling price channel was broken as the week closed on August 15. The weekly chart also has a rising 13-week exponential moving average (EMA). It also appears that the 764 area of resistance is the confirmation line to a triple bottom (see red arrows on Figure 3). Prices need to ultimately close above the May highs (the 764 level) in order for the July lows to hold up.

The odds favor that Russell 2000 will continue to take a leadership role, but for the short term it looks like the bearish rising wedge on its 60-minute chart will break down due to the negative divergence. If that happens, the market should follow suit. So we might start seeing some selling pressure for the short term, but once prices pull back, the weekly chart suggests that the advance will resume. ■

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FIGURE 3: $RUT, WEEKLY. The aroon on the Russell weekly chart has signaled that the small-caps are in a new uptrend, as the aroon upline (green line) crossed above the aroon downline (red line) (highlighted in yellow) and then moved above 70, as the aroon down dipped below 30. That is what occurs during a healthy rising trend. This move has also been confirmed by the aroon oscillator moving above +50 (highlighted in yellow).

ECONOMICS CYCLE TRADING

Predicting The Future With Kondratieff Waves

by James Kupfer

If you believe in the theory espoused by the economist Nicolai Kondratieff, then you realize that the economic malaise in the United States is likely to last until at least 2010 and possibly all the way out until 2018.

If you believe in the theory espoused by the economist Nicolai Kondratieff, then you realize that the economic malaise in the United States is likely to last until at least 2010 and possibly all the way out until 2018. According to Kondratieff, there exists a roughly 50- to 70-year economic business cycle made up of four distinct phases: spring, summer, autumn, and winter. Given the US's economic symptoms, we are now in the painful "winter" phase.

Here is an abbreviated breakdown of how the cycles are delineated, with the primary focus being on autumn:

- Spring: Solid economic growth and mild inflation
- Summer: Stagflation/recession
- Autumn: Price stabilization or mild deflation, easy accessibility to cash, global stock market euphoria and boom, real estate prices soar.

The hallmarks of autumn should sound familiar enough, as they are the economic environment that has been in place basically since the mid-1970s and 1980s until recently. This brings us to the winter phase:

1. Stocks, commodities and real estate prices drop in a bear market

2. Interest rates eventually drop significantly, leading to a rise in bond prices

3. Economic growth limited.

It should now be obvious that all three of these conditions of the winter phase are occurring in the US, and generally across the globe. Both stock and commodity markets are now generally down more than 20%, since their peak and housing prices can be down significantly more than that. Interest rates have been dropping for the last few years. Finally, many pundits and economists have stated that the US is likely in the midst of a recession. As bad as things may seem for the economy and stock market right now, the forecast could be much bleaker. Here is a little bit of history for you: the last winter period began in 1929 with a little something called the Great Depression.

Assuming the theory is correct, then in the best-case scenario, the winter phase arguably began in 2000 and would likely last for a decade, bringing our economic woes to an end around 2010. Under the worst-case scenario, the winter phase began just this year with the recent peaks in stock and commodity prices, which could lead to another decade of economic turmoil that would not end until around 2018. Let us hope for the former. ■

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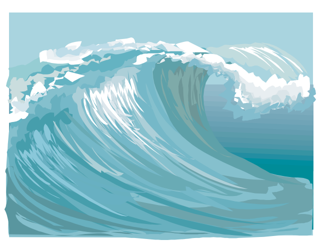

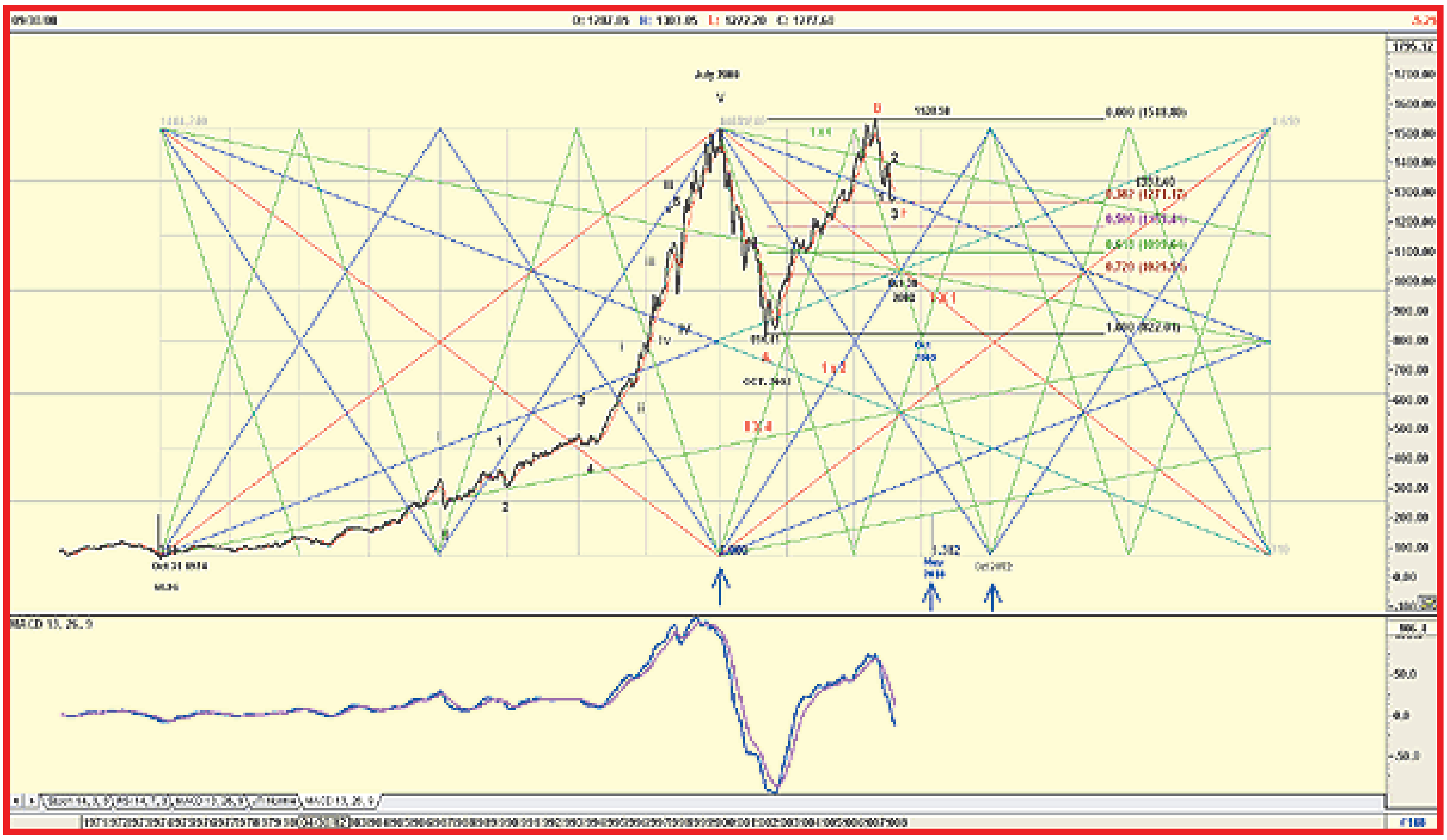

FIGURE 1: SPX, MONTHLY. Note the Gann lines.

Will The US Lead The Way To Recovery?

by Koos van der Merwe

How much farther can the Standard & Poor's 500 fall?

Tradable: SPX

Over the years, I have written articles on the Kondratieff wave and the Standard & Poor's 500. The K-wave is calling for an end to the present financial setback in the world by 2012. So will the US again lead the way and recover ahead of the K-wave forecast?

Figure 1 is a monthly chart of the S&P 500, with Gann chart lines superimposed. The chart shows the following:

a. The index fell and tested 1271.17, the 38.2% Fibonacci level before correcting upward. Should it break below this level, and it can, then its next support level is the 50% level at 1185.41.

b. The target date for testing this level is October 2008.

c. Should the 50% level be broken, the next support level is 1099.64, the 61.8% level.

d. The target date for testing this level is October 2009.

e. The chart shows a Gann date of October 2012, which coincides with the K-wave prediction.

f. The moving average convergence/divergence (MACD) is still very negative.

However, wave theory does say that a bear market is usually 38.2% the length of the bull market, which means that the bear market for the S&P 500 could end in May 2010. Whether this will be at the 1099.64 level or lower, below the 822.01 level — below the support level of wave A — is the question. However, a little-known rule of Elliott wave says:

- If wave 3 is less than wave 1, then wave 5 will be less than wave 3.
- The length of wave 1 of wave C is 273.58 (1530.58 - 1257)
- If the low of 1271.17 is the low of wave 3 of wave C, a drop of 134.71 (1405.88 - 1271.17), then wave 5 of wave C should be less than this — that is, not greater than 134.71. This means that the target of 1184.41 could well be the wave 5 of wave C target.

Unfortunately, the time factor does not agree with this count, so we can expect wave 3 of wave C to be either at the 61.8% level of 1099.64, the 72% level of 1025.51 (a level more conducive to a wave 2) or even lower.

One thing for sure is that wave 2 of wave C is a simple wave, and therefore we can expect wave 4 of wave C to be a complicated wave — which takes up time.

Forecasting the actual turning point for the bottom of the S&P 500 is very much in the air at the moment, and depends on the turning point of wave 3 of wave C currently in progress. The time for that turning point, however, could well be May 2010, which means that should the K-wave date be correct, then the US will lead the world in recovery. ■

S&P 100 Has More Downside

by Chaitali Mohile

The S&P 100 has retraced back to 38.2% retracement levels. The correction may hit the lowest level.

Tradable: $OEX

FIGURE 1: $OEX, WEEKLY. Here is the weekly bar chart with long-term data. The lower trendline of the falling wedge ends below the 38.2% retracement level. The chart shows a multiple head & shoulders formation.

FIGURE 2: $OEX, WEEKLY. The head & shoulders top reversal on this chart is a muchlarger formation and more reliable. The breakout of this formation would drag the index to the target of 416.

The Standard & Poor's 100 ($OEX) witnessed a strong corrective phase in 2000–03. The correction that began in September 2000 from the 850 levels stopped in April 2003 at the 400 levels. With newly formed support at 400, the pullback rally gradually moved in the direction of the previous high. But the recovery process was much slower than the fall itself, as it took almost five years to cross back up the 61% retracement level.

The Fibonacci retracement tool is used here in Figure 1 to measure the pullback levels. We can see that the index moved within the 38.2% and 53% retracement levels for the maximum period of recovery. Further, the index surged above the 61.8% level and soon reached the high at 734. With the support of the 61.8% retracment level in 2007, we can see a small head & shoulders top formation, with the head at 734 and the two shoulders at approximately at 720–715 levels (see Figure 1). As the neckline support was left behind, the oil price declined.

During the correction from the 734 levels, the index formed a falling wedge, with the lower trendline moving below the 38.2% retracement support. The falling wedge is a bullish reversal pattern with the potential breakout in the upward direction. The volume during the formation is highly volatile. The falling wedge in Figure 1 has not matured yet and shows the possibility of a lower trendline getting tested for the fourth time at the level of 525, so the short-term downside can find support at the 525 level.

In Figure 1, the bar chart also shows that the index is forming another head & shoulders top, which is likely to be completed in the coming trading sessions. This formation has a larger time frame with two shoulders at 660–650 levels, and the previous small head & shoulder forms the head. Here, the neckline would be 575. This is the classic example of the multiple head & shoulders formation. Similar patterns are explained by Robert Edwards and John Magee in their classic work *Technical Analysis Of Stock Trends*.

Let's refer to the same weekly chart with shorter data to understand the formation details and the prospective target levels.

The head & shoulders top formation in Figure 2 is a bearish reversal pattern. With the breakout below the neckline, the index may enter a long-term downtrend. At the present, the index is in an intermediate downtrend, indicated by the average directional movement index (ADX) (14). And the breakout can make the downtrend stronger.

The estimated downside target can be calculated by measuring the distance between the neckline support at 575 and the head at 734. The distance is 734 - 575 = 159, and by subtracting 159 from the neckline support of 575, we get the target of 416. Therefore, below the support at 525, the index may see the lowest level of 416 in the long term.

The relative strength index (RSI) (14) and the moving average convergence/divergence (MACD) (12,26,9) are highly bearish, supporting the present declining rally. The RSI (14) trendline joining the lower low shows the lowest possible support for the indicator at 10. Though the indicator ranges between 50 and 30, it is forming lower highs, indicating reducing bullish pressure. So all the three indicators together can drag $OEX to a lower trendline support of a falling wedge at 525. However, as the long-term head & shoulders top formation breaks down the neckline support at 575, the next downside target would be 416. Thus, $OEX is likely to see more downside below the 525 level. ■

CHART PATTERNS

HEAD & SHOULDERS

A Head & Shoulders For Goldman

by Arthur Hill

Goldman Sachs formed a large head & shoulders pattern over the last four months, and a neckline support break would have long-term bearish implications.

Tradable: GS

The long-term implications for this head & shoulders are clear on the weekly chart.

Figure 1 shows daily candlesticks with the head & shoulders pattern extending from March to June. There was a one-day spike below 150, but the stock recovered the next day. With such a quick recovery, I elected to ignore this spike and drew trendlines from the other March lows. As such, the left shoulder formed in March to April, the head formed with the May 2nd high, and the right shoulder is currently under construction. Neckline support resides around 160 and a break below this level would confirm the pattern.

Downside volume and momentum are picking up. The decline over the last few days occurred with expanding downside volume, which shows increased selling pressure. The bottom indicator window shows a -DI (negative directional indicator) and +DI (positive directional indicator), which are part of the average directional movement index (ADX) system from J. Welles Wilder. -DI moved above +DI in mid-June, and this shows that downside momentum is also picking up. The final straw would be a break below neckline support. Such a move would argue for a decline equal to the height of the pattern (~40 points) and project further weakness to around 120 (160 - 40 = 120).

The long-term implications for this head & shoulders are clear on the weekly chart (Figure 2). GS is trading near a trendline extending up from June 2004. A break below this major trendline would argue for the start of a long-term downtrend. There are already signs of a long-term reversal with the other trendline breaks (red arrows). A break below the third and final trendline would fully reverse the long-term uptrend. ■

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FIGURE 1: GS, DAILY. Here are daily candlesticks with the head & shoulders pattern extending from March to June.

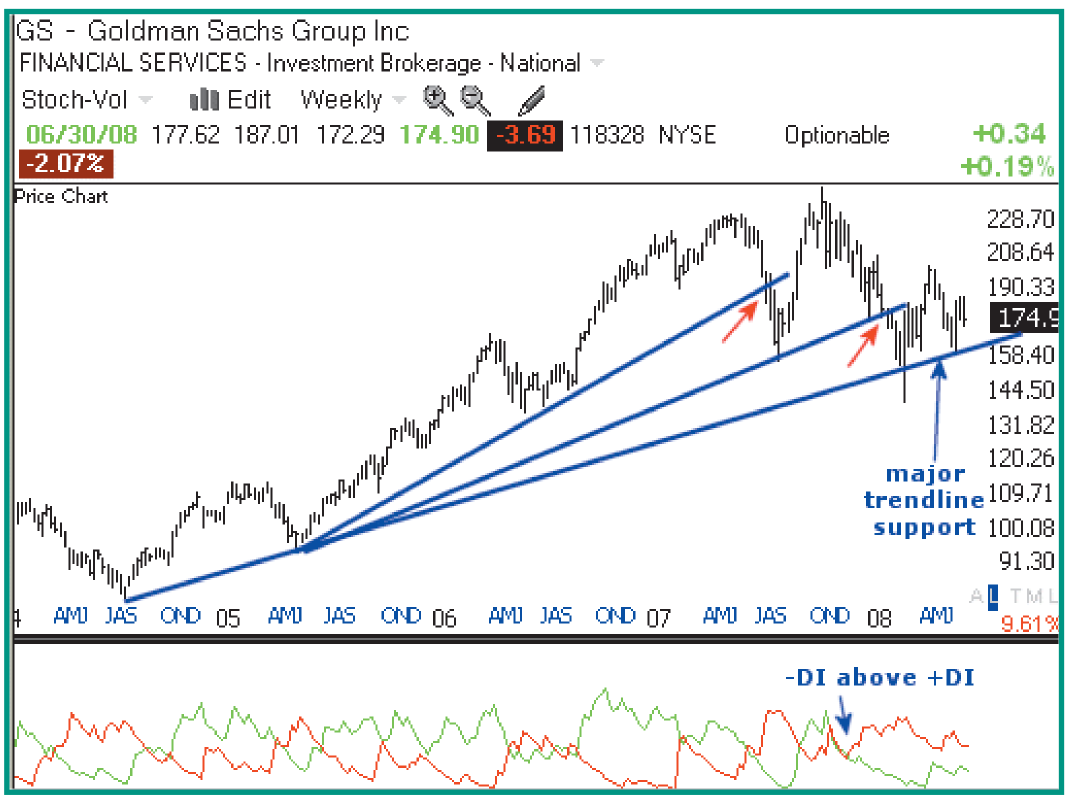

FIGURE 2: GS, WEEKLY. GS is trading near a trendline extending up from June 2004.

Material Select SPDR Trend Reversal

by Alan R. Northam

XLB has been in a long-term uptrend since 2002 but may be getting ready to reverse its trend. A symmetrical triangle has formed on the daily chart and has signaled a trend reversal.

Tradable: XLB

Figure 1 is that of a monthly bar chart for XLB. It shows the XLB has been in a long-term upward trend since 2002. All along its upward journey it has made a series of higher highs and higher lows, as is normal when markets are trending in an upward direction. Recently, XLB has made a new higher high and is in the process of a market correction as it moves downward toward its long-term trendline. Up until now, every time that XLB entered into a market correction it resulted in a new higher low followed by another rally to new highs. Will XLB break through the long-term trendline and establish itself in a new downtrend? For reference I have added the Standard & Poor's 500 in gray to show that the index, which XLB is a part of, peaked in 2007 and is now in an established downtrend. I also want to draw your attention to the average directional movement index (ADX) just above the price chart. This index moves higher as the momentum of the trend increases and moves lower as the market slows down. Note that the ADX peaked in mid-2007, indicating that XLB has lost its momentum and is now starting to slow down. A normal occurrence in a market that is getting ready to reverse its trend is a loss of momentum. However, a loss of momentum does not mean that a market must reverse its trend. Thus, we have two pieces of evidence that XLB could be about to reverse its trend. First, the S&P 500 has already reversed its trend, and second, XLB has lost its upward momentum and is starting to slow down.

Figure 2 is a weekly bar chart of

FIGURE 1: XLB, MONTHLY. Here's the monthly price chart of XLB showing a long-term trendline and the ADX above the price chart.

FIGURE 2: XLB, WEEKLY. Here's the weekly price chart of XLB showing the ADX above the price chart and the slow stochastic indicator below.

XLB. It also shows that XLB remains in an upward trend but that over the last several weeks it has been in a market correction that has not yet reversed itself. Again, I have shown the ADX above the price chart. Note that in October 2007, the ADX dropped below its 20 line. This is an indication that XLB is no longer in an uptrend even though price continues to drift higher. When the ADX is below the 20 level, market technicians no longer gauge a market's progress by using trend-following indicators but rely upon oscillator indicators to gauge the activity of a market. Oscillators are normally used in range-bound markets. Therefore, I have added the slow stochastic indicator below the price chart so we can measure the activity of this market on a weekly basis. The stochastic has recently fallen below its 50 line, indicating that market sellers have taken control of this market. As a result, we should expect to see this market continue to move lower in the weeks ahead. We now have more evidence that XLB

When the ADX is below the 20 level, market technicians no longer gauge a market's progress by using trend-following indicators.

could be on the verge of changing the direction of its trend. Our third piece of evidence is that XLB is no longer in an established upward trend on a weekly basis and is merely drifting higher, which should stop when XLB runs out of momentum. And our fourth piece of evidence is that this market is now being controlled by market sellers.

Figure 3 is a daily price bar chart of XLB. This chart shows that XLB put in a market top in mid-May and formed a symmetrical triangle during the following month. Triangle patterns are normally continuation patterns and in an uptrend the market normally breaks out to the upside. However, when the market breaks out to the downside, as has happened with XLB, the symmetrical triangle pattern becomes a reversal signal. Note that once XLB broke out to the downside, it continued to sell off until it hit its 200-day moving average. For three days, this moving average acted as support for the market, but then XLB broke down below the 200-day moving average, indicating that this market wants to continue to move lower. A break below the 200-day moving average spells trouble to a bull market, and when the 50-day moving average crosses below the 200-day moving average doom comes to a bull market. So right now it looks like the bull market is in trouble. I have again shown the ADX above the price chart. Note that ADX has moved above its 20 line. This is an indication that the downward price breakout is picking up momentum. If ADX continues to move upward and moves above its 30 line, that will be an indication that a strong downtrend has been established. The fifth piece of evidence that XLB could be changing the direction of its trend is that the market has broken out to the downside of a symmetrical triangle, signaling a reversal in trend. And the last piece of evidence is that momentum to the downside is starting to pick up.

Although the long-term trend in XLB remains in effect, all the evidence of the monthly, weekly, and daily price charts show that XLB could be in the process of changing its trend from up to down. What we need to watch at this point is the 50-day moving average. If the 50-day moving average moves below the 200-day moving average, that will most likely seal the fate of the bull market in XLB. As a trader, I am not quite ready to short this exchange traded fund (ETF) but will continue to watch it. I expect this market to bounce and retest the underside resistance of the symmetrical triangle. If this resistance holds and the market then starts to move back down, I will consider a short position in XLB. From a more conservative trading opportunity I would wait for the 50-day moving average to cross below the 200-day moving average, followed by a retest of resistance of the 50-day moving average. ■

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FIGURE 3: XLB, DAILY. Here's the daily price chart showing a symmetrical triangle and the ADX above the price chart.

STRATEGIES

Intermarket Analysis With Canadian Stocks And Gold

by Mike Carr, CMT

The Canadian benchmark index is showing signs of weakness, and potential weakness for gold.

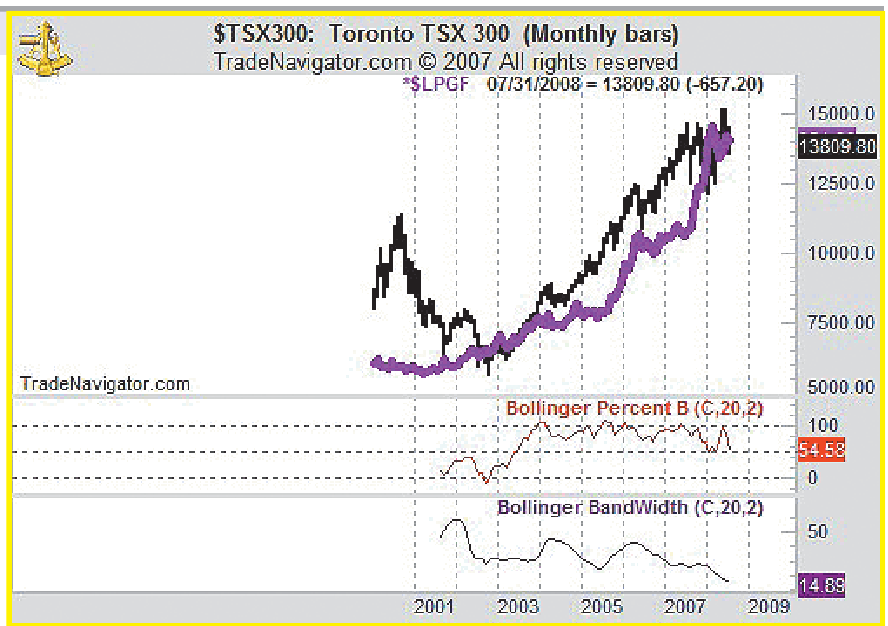
Tradable: TSX & Gold

The Canadian Toronto TSX 300 has shown signs of topping in recent days and has fallen slightly more than 10% over the past month before recovering somewhat. The market has been led lower by the metal and mining sub index, the largest sector in the market.

The monthly chart (Figure 1) shows the strong correlation between the TSX and the price of gold. Both have moved higher in lockstep over the past five years. The recent downward move in the stock index has been matched by an equally sharp move in the price of gold. In the bottom of Figure 1 we can see that volatility, as measured by the Bollinger bandwidth is at historic low levels. This means that volatility is likely to increase, and other indicators tell us that prices are more likely to decline than rise in the coming move.

The daily chart (Figure 2) supports the bearish case. Prices have completed a triple-top pattern and the stochastic has failed to confirm the recent highs. This bearish divergence in momentum was confirmed by the price break that occurred in the past few weeks. The current price is at a long-term support level and a move lower is likely to go to the 12,500 level.

With Canadian stocks heading lower, gold is likely to follow. This is an example of intermarket analysis using nontraditional markets like Canadian stocks to develop an opinion on the larger trends. In this case, traders should be prepared for commodities to head lower, led by gold. ■



TRADE NAVIGATOR

FIGURE 1: TSX, MONTHLY. The close correlation between the price of gold and Canadian stocks is easy to see in this chart. The cyclical nature of volatility is also evident in the bottom clip.

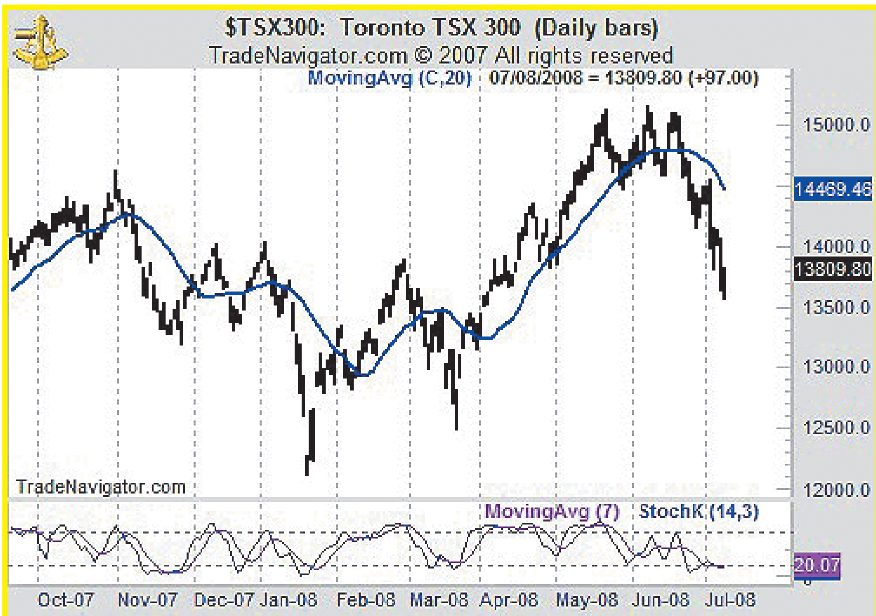


FIGURE 2: TSX, DAILY. The daily chart shows that the 20-day moving average has rolled over and prices have decisively moved into a downtrend.

FLAGS AND PENNANTS

S&P 500 Flagging For Help

by James Kupfer

The S&P 500 as well as the DJIA appear to be forming flag formations. What does this portend for the market?

Tradable: SPY

A flag formation is a short-term continuation pattern. Since the Standard & Poor's 500 and Dow Jones Industrial Average (DJIA) both appear to be forming very similar flag formations, they may be preparing to resume their downtrend. In addition, the flag formation allows us to define a price target for the indexes.

There are a few characteristics that define a flag. First, there needs to be an established trend up or down in place before the flag formation. The purple line clearly shows an established downtrend (Figure 1). Second, the flag needs to be formed within one to eight (some say 12) weeks. The flag shown below that (orange lines) is about three weeks old. Third, volume should be high during the initial trend (red line in the volume pane) and decrease during the flag formation (light blue line in the volume pane). Each of these three conditions has been met thus far.

Until such time as price breaks below the upward-sloping orange trend line the pattern will not be complete. Assuming this transpires, we can calculate a price target for the S&P 500 exchange traded fund (ETF) proxy, SPY, as follows: find the difference between the beginning of the flag and the start of the recent trend and subtract it from the flag breakout.

WEALTH-LAB

FIGURE 1: SPY, DAILY. What does the flag formation indicate?

Trend start: $139.50 (on 5/21/08)
Flag start: $120 (on 7/15/08)
Difference = $19.50

Since the flag has not yet broken out, it may happen around $125. Subtracting $19.50 from $125 leads to a rough price target of $105.50. ■

Technicals Can Help Traders Avoid Disaster

by Mike Carr, CMT

IndyMac, Fannie Mae, and Freddie Mac have cost investors billions, but technicians should have been out of the stock or short these high-profile losers.

Tradable: IMB

By the time the Feds took over IndyMac (IMB), the stock had already fallen to 0.62. Amazingly to technicians, people were still long this stock. Fundamental analysts had rated it "neutral" in May 2007, with the price above 35. Relative strength was strongly bearish by that time (Figure 1).

Relative strength never recovered in IMB (Figure 2), and neither did price. This single technical indicator would have kept investors out of a bad stock, and alerted aggressive traders to a possible short.

The traditional price chart was also bearish for IMB (Figure 3). Prices have been below their 20-month moving average since the beginning of 2007. Stochastics traced out a negative divergence in 2006, indicating that the next move was likely lower.

Interestingly, Freddie Mac (FRE) was showing a similar pattern (Figure 4). The long-term moving average and stochastics both warned traders of lower prices.

Fannie Mae (FNM) looks exactly the same. Those looking to enter long positions should look at a monthly, or at least a weekly chart. Stocks with prices below their long-term moving average may still be bought, but tight stops should be used to avoid holding stocks that ultimately collapse. ■

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Relative strength never recovered in IMB, and neither did price. This single technical indicator would have kept investors out of a bad stock.

MARKET DYNAMICS

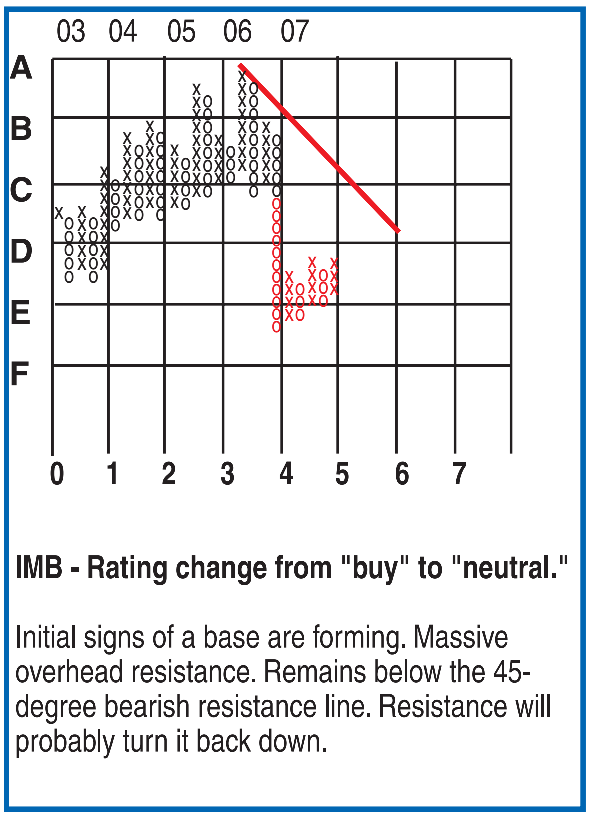

FIGURE 1: IMB, P&F. The point & figure chart of relative strength in IndyMac was already negative by the time fundamental analysts turned neutral.

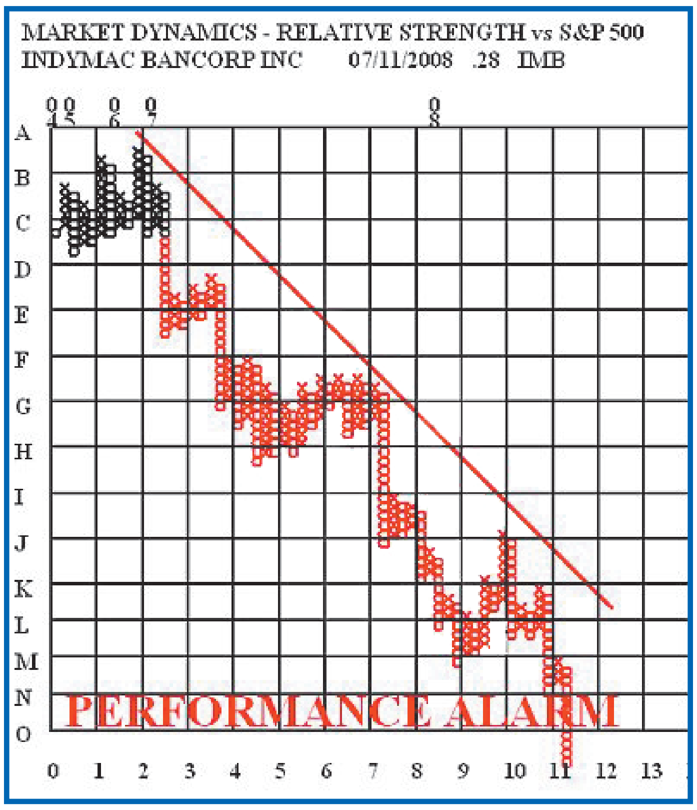

FIGURE 2: IMB, RELATIVE STRENGTH. Relative strength in IMB never turned bullish after the analyst downgrade in May 2007.

TRADE NAVIGATOR

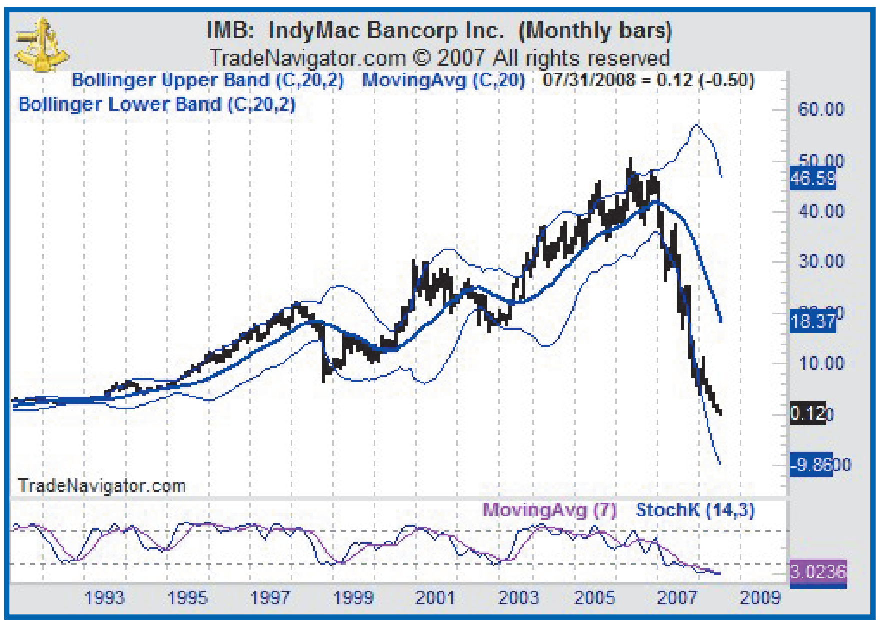

FIGURE 3: IMB, MONTHLY. The monthly chart of IMB shows that bears have been in control for more than a year and a half.

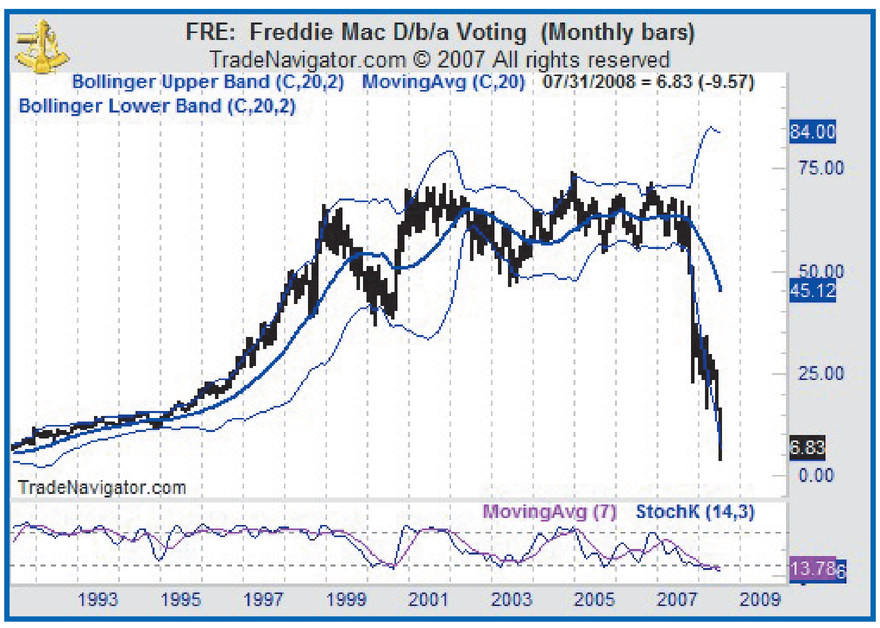

FIGURE 4: FRE, MONTHLY. Freddie Mac formed a topping pattern over a six-year period before collapsing at the end of 2007.

CANDLESTICK CHARTING

Ford's Piercing Line

by James Kupfer

Ford Motor has just completed the formation of a bullish piercing line candlestick pattern.

Tradable: F

A bullish piercing line is a reversal candlestick pattern. This pattern consists of two bars. After a prolonged downtrend, the first bar is a long black candle and the second bar is a long white candle whose opening is below the last day's low (that is, gap down opening) but closes above the midpoint of the last day's bar.

Here is the rationalization of psychology behind this pattern: Since the market is in a downtrend, the first black bar confirms the bearishness of the current market sentiment. The next day's gap down opening reinforces bearish sentiment. Suddenly, the bulls find this price level attractive. As the demand comes in, price closes above the midpoint of the last day's bar. This signifies a definite psychological shift from a complete bearishness to a hint of bullishness that may lead to a bottom reversal.

Ford Motor completed the formation of a bullish piercing line candlestick pattern. Ford's recent downtrend started in May 2008. The last two bars form a piercing line pattern (Figure 1, shown in the red box). Aggressive traders can now look to buy Ford above the last bar's high ($5.07), which would serve as confirmation of the trend reversal. Once entered, a stop-loss below the last bar's low ($4.40) or the early July low ($4.30) should be placed. All levels are on closing basis.

FIGURE 1: FORD, MONTHLY

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RELATIVE STRENGTH COMPARATIVE

Trading Relative Strength Instead Of Price

by Mike Carr, CMT

It is possible to profit from relative strength charts, basing buy and sell decisions only on this indicator instead of looking at price.

At the end of 2005, analysts upgraded Baxter International (BAX) based on the fundamental outlook. At that time, BAX was on a buy signal based on a point & figure chart of relative strength (RS), as shown in Figure 1. These charts eliminate the day-to-day noise inherent in any indicator and allow the analyst to focus solely on the longer-term trend. We can see that BAX had recently begun to outperform the market and had in fact broken a long downtrend in RS.

Another RS indicator, the momentum of comparative strength (MOCS), can be used to time buys and sells based upon movements of RS. MOCS applies moving average convergence/divergence (MACD)-type calculations to RS and allows us to obtain precise trading signals. Combining this indicator with the point & figure chart of RS leads to high-probability trading signals.

In this case, we buy BAX when MOCS crosses above its nine-period simple moving average. We sell when MOCS crosses below the moving average. With BAX on a RS buy based on the point & figure chart, there are four buy signals. Two gained more than 20%; one gained a little more than 5%; and the current trade is up by more than 15%. No trade suffered significant drawdown.

Without our even looking at price, these two RS indicators offer a powerful trading strategy that all traders should consider.

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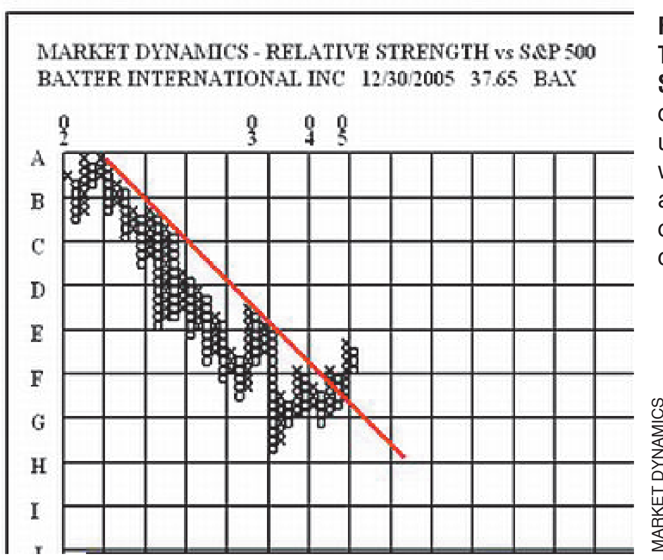

FIGURE 1: BAX, RELATIVE STRENGTH VS. S&P 500. As fundamental analysts upgraded BAX, RS was breaking out and signaling a buy on the point & figure chart.

FIGURE 2: BAX, WEEKLY. MOCS gives four buy signals, all winners with sells timed to allow the trader to keep the majority of the profits.

Utilities Select SPDR Head & Shoulders

by Alan R. Northam

XLU has been in a bull market trend since 2002, but that trend looks to be ending with a head & shoulders trend reversal pattern.

Tradable: XLU

Figure 1 is that of the weekly Utilities Select SPDR bar chart (XLU). This chart shows that the utilities sector has been in a bull market trend since October 2002.

From mid-2007 until August 2008, the utilities sector has been printing out what looks to be the formation of a head & shoulders reversal pattern. Head & shoulders patterns often appear on the charts after a long runup in prices during a bull market or a long selloff period during bear markets.

Head & shoulders patterns normally appear at the end of a trend and as such are reversal patterns. Head & shoulders patterns can also be continuation patterns that occur during market advances or declines.

However, in these cases, the head & shoulders patterns are typically reversed or upside down. In an upward trend, the continuation form of the head & shoulders pattern will normally be with the head & shoulders pointing in the downward direction instead of pointing upward. In a downtrend, the continuation form is with the head & shoulders pointing upward instead of downward. This makes it easy to identify the trend reversal form of the H&S pattern from the continuation form. In the present case, the head & shoulders are pointing up, indicating the reversal form.

Although it appears that a head & shoulders reversal pattern is developing, it has not yet been confirmed as a valid head & shoulders pattern. To be validated, the price must continue to trade on down and break down below the neckline of the H&S pattern. The neckline is drawn off the price minimum between the left shoulder and the head, and the right shoulder and the head. At times, the price minimum between the head and the right shoulder will not be the same as the price minimum between the left shoulder and the head. This will result in the neckline slanting either slightly up or down, whichever the case may be.

FIGURE 1: XLU, WEEKLY. This bar chart shows the head & shoulders reversal pattern and minimum expected price target of $27. This chart also shows support levels and the Fibonacci retracement levels.

In our case here, the neckline is horizontal. Some market technicians will accept any breakdown below the neckline to validate the head & shoulders pattern as a reversal signal while others wait for a confirmation of the breakdown. A confirmation of the breakdown below the neckline is typically set at 3%. In other words, some market technicians will wait for the market to move 3% below the neckline before accepting the breakdown as a valid breakdown. This helps to reduce whipsaws, where the market turns back upward and continues to trade higher. However, the 3% rule is not 100% perfect and the market can still turn back upward and make a new high.

The head & shoulders pattern also provides a forecast of the future minimum expected price target. This price target is calculated by taking the difference in the price of the lower of the two price minimums between the two shoulders and the head and subtracting it from the price maximum of the head. This difference is then subtracted from the breakdown price, which in the case of the utilities sector yields a price target of $27, or 27% lower than its current price. Keep in mind, however, that this is an expected minimum price target for XLU, and in reality, price could fall to much lower levels before reaching its ultimate low price.

There are, however, a few support barriers that price will have to overcome before reaching this expected minimum price target. One is the head & shoulders neckline itself. This support level must be clearly broken before expecting XLU to move significantly lower. The 3% rule for confirming a breakdown would be a good gauge to use for a clear breakdown of the neckline.

The second support line is the 200-day moving average.

The third support line comes in twos: First, there is the old resistance that was formed back in late 2005 and early 2006. This resistance barrier was broken, turning it into new support. At the same price level, we also have the 38.2% Fibonacci retracement level. When support levels cluster around a common price point, that support level becomes extra strong, so XLU could find it difficult to break down below this level. What could happen at this clustered support level is for price to come down to it and bounce off and then attack it a second time before breaking down below it.

But if the bull market trend for the utilities sector is truly over, then this clustered support level should eventually be broken. The next lower support level is the 50% Fibonacci retracement level. The 50% level is a typical place for the market to turn back up. So again, price may bounce off this level before eventually breaking down below it. And again, if the bull market for the utilities is indeed over, the 50% level should eventually be taken out. If price makes it through all these support levels, then expect it to hit the minimum price target for the move down.

Further, should XLU continue to move lower and make a clear break below the 78.6% Fibonacci retracement level, then expect the selloff to continue for quite some time. Look for a reversal trading pattern, such as an upside down head & shoulders pattern or a double bottom or some other reversal pattern, to determine the ultimate low price for XLU.

In conclusion, XLU looks to be making a head & shoulders reversal pattern. A clear breakdown below its neckline of 3% will validate this pattern as a true reversal pattern. Following the breakdown, expect the price to continue lower until it hits its minimum expected price target of $27. Keep in mind, however, that $27 is an expected minimum price target and price may actually continue lower before reaching its ultimate low price. Look for a reversal trading pattern to determine when the downward move is over. ■


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METALS & ENERGY

WILDER'S RSI

Investing In Energy

by Koos van der Merwe

With the price of oil reaching new highs, is investing in Energy Savings Income Fund the way to go?

Tradable: SIF.UN.TO

Energy Savings Income Fund is an open-ended, limited purpose trust. Its business involves the sale of natural gas and electricity to residential and commercial customers under a long-term, irrevocable fixed-price contracts. The company is currently paying a dividend of Canadian $1.48 per share, up from C$1.07 per share in 2007. At the current price of $13.25 this is an 11% plus return.

What are the risks involved? The trust plans to convert away from its current income-trust business structure within the next two years in response to the federal government's proposed legislation to tax cash distributions of income trust. However, the company is exploring several options for a new structure remaining a high income yielding investment vehicle. Constant payment is assured because the company's revenue stream comes from existing customers and is guaranteed under fixed price contracts.

Figure 1 shows how the price has dropped from $16.89 to $12.47 on the Halloween announcement by Canadian Minister of Finance James Michael Flaherty, and this after the Prime Minister of Canada, Stephen Harper, made a preelection promise that income trusts would not be taxed. The moral of this story is not to trust politicians, especially when they make preelection promises.

Of course, the price rose to fill the gap, and by November 2007 it reached a high of $17.66, higher than its price of Halloween eve. Note how accurate the relative strength index (RSI) has been in calling price movement.

Figure 1 also shows a head & shoulder formation with a target price of $10.66, but support line A-B does suggest support at $12.64. This is confirmed by the RSI, which is close to being oversold.

In today's market, the yield paid by the Energy Savings Fund is very attractive. One should not forget, however, that although "energy" appears in the name, the company is *not* involved with oil, and therefore will not benefit by a rising oil price. However, the chart does look promising as a future speculative investment, with an pleasant yield as a perk. At around $12.64, the stock price could be an attractive short-term buy. ■

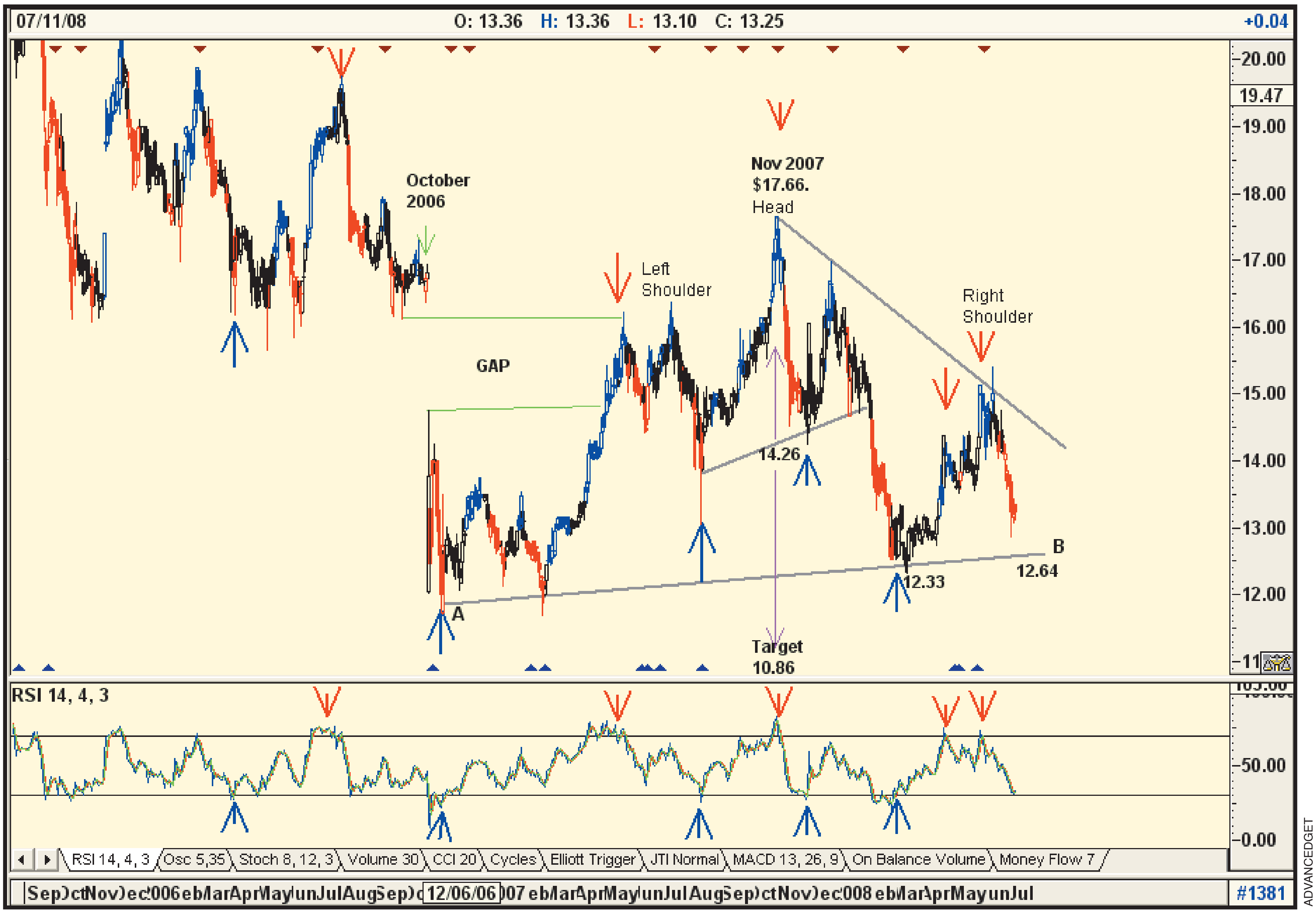

FIGURE 1: ENERGY SAVINGS INCOME FUND, DAILY. Note how the price dropped from $16.89 to $12.47 on the Halloween announcement.

Is Gold A Safe Haven For Your Money?

by Alan R. Northam

With the stock market now officially entering into a bear market, traders are looking to gold as a safe haven for their money. However, gold may not be the safe haven that traders think it is.

Tradable: $GOLD

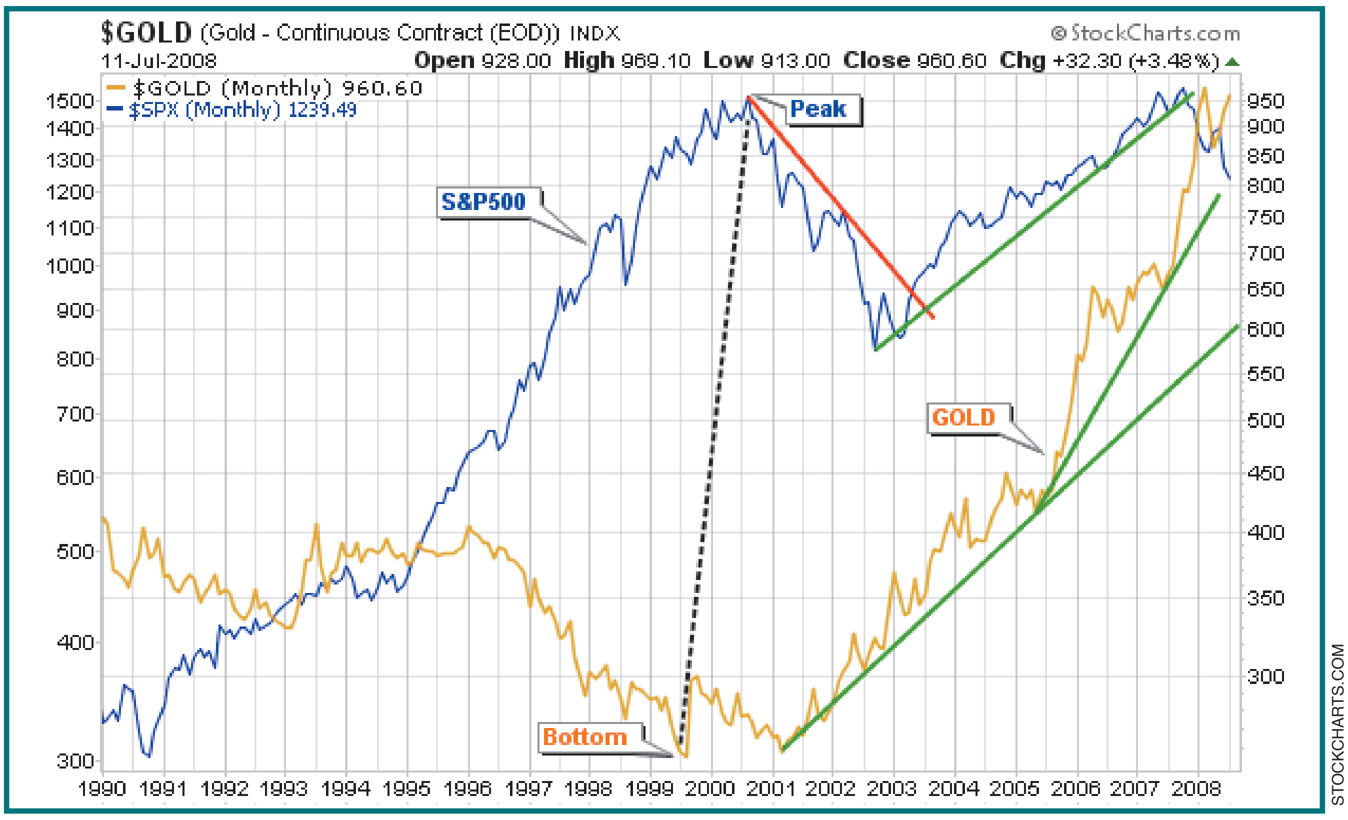

FIGURE 1: GOLD, MONTHLY. Here's the monthly line chart showing the market trend of both the S&P 500 and the gold index from 1990 to 2008. This chart shows that gold bottomed in 1999 and stocks peaked in 2000. This chart also shows that both the gold index and the stock market index are trending in the same direction together.

With the stock market now in a major bear market, traders are looking at gold as a safe haven to put their money. There has been a common belief for investors and traders throughout the years that the stock market and gold trend inversely with each other, such that when one market goes up, the other goes down. With this in mind, traders are automatically programmed to immediately look to the gold market for their investment dollars once the stock market has entered into a bear market. However, this belief is not valid, as the stock market and the gold market do not always trend in opposite directions. There is a period of time when both of these markets trend together.

The business cycle lasts for approximately four years and is divided into six stages. In stage 5, the stock market turns down and in stage 6, the commodity market turns down.

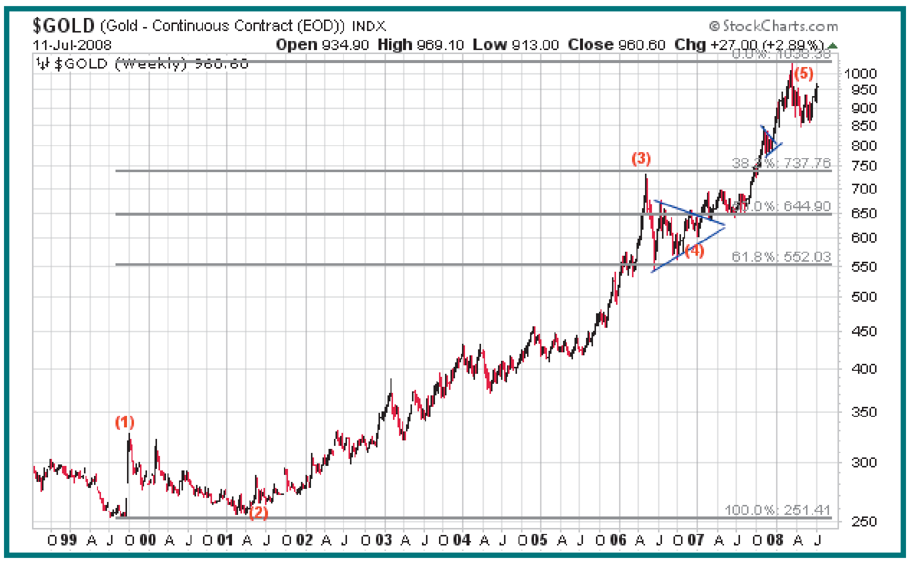

FIGURE 2: GOLD, WEEKLY. Here are the weekly price bars of the gold index. This chart shows a completed five-wave Elliott wave count signaling that the upward trend is complete. This chart also shows the early development of the market correction that normally follows the completion of an uptrend. The Fibonacci retracement levels have been added to the chart as typical price targets for market corrections. Also shown are two triangles whose apex are also possible price targets for market corrections.

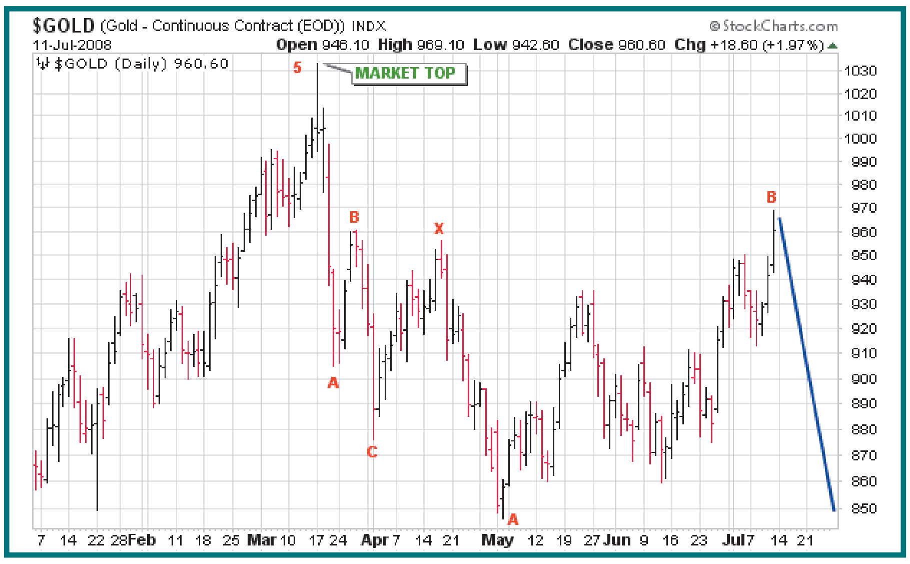

FIGURE 3: GOLD, DAILY. Here are the daily price bars of the gold index. This chart shows the corrective rally to date and is labeled with the Elliott wave count. This chart shows the completion of the first ABC zigzag corrective wave and waves A and B of a second zigzag corrective wave. Wave C of the second ABC zigzag is yet to unfold and its expected path is shown as a blue downward sloping line. This chart also shows that the first and second ABC zigzag corrective waves are connected together by an upward sloping X wave.

Gold is a commodity, and gold also turns down during this later stage. The stock market doesn't turn up again until stage 2 of the business cycle, and commodities don't turn back up until stage 3. So during the latter part of stage 6 and all the way till midstage 2, the stock market and the gold market normally move in the same direction. I believe that the stock and gold markets are now entering into that time frame within the business cycle when both the stock market and the gold market are now starting to trend in the same direction. The stock market peaked in 2007 and has entered into a bear market, while the gold market has now peaked in early 2008 and appears to be in the very early stages of a bear market. Let's look at the evidence.

In Figure 1, I have shown a line chart of both the Standard & Poor's 500 and gold. As you can see, from 1996 to 2000, the stock market and gold moved in opposite directions as the stock market moved higher and the gold market moved lower. Then in 2000, the stock market peaked and moved downward until 2002, while the gold market bottomed and started a long bull market upward. However, both markets continued to move in opposite directions. Then in 2002, things changed. The stock market turned back up and has climbed to make a new high in 2007. During this time frame, both the stock market and the gold market moved upward together and did not move in opposite directions. This dispels the theory that the stock market and gold always move in opposite directions. With the stock market and gold moving upward together since 2002, this could be an indication that the business cycle has entered into stage 6. If this is true, then the stock market and gold will most likely continue to move together until stage 2 of the business cycle. With the business cycle typically lasting four years, this could further mean that the stock market and gold could move together for the next year or two. As stage 6 of the business cycle moves along and all through stage 1, both the stock market and gold should continue to move together but in the downward direction.

It is becoming apparent that most investors and traders are starting to realize that the current downward trend in the stock market is more than just a market correction but a real bear market, yet there is still a large number of holdouts who believe that the stock market will turn back up and continue higher. In time, these stragglers will finally give in and join the bear camp. It is also apparent that traders still think the current downtrend in gold is nothing more than a bull market correction and gold will ultimately turn back upward to trend in the opposite direction of the stock market. I don't think so. Let's look at the telltale signs given to us by the trading log of the gold market.

Figure 2 is that of the trading log of the gold market. This figure shows the weekly price bars of gold since 1999. Note that from 1999 to 2008, gold has traded upward and has traced out five waves according to my Elliott wave analysis. The Elliott wave principles state that upon completion of five waves up, the market will enter into a market correction that will correct the entire move upward. The Elliott wave guidelines tell us that typically this correction will retrace from 38% to 62% of the upward price movement. I have placed these Fibonacci retracement levels on the price chart for reference. Other retracement areas, according to the Elliott wave guidelines, are the apex of triangles. Therefore, these other retracement areas could be at $800 or even $600 per ounce of gold. As we can see from the chart, gold has not yet approached any of these retracement levels. Therefore, the market correction in gold could have much further to go before it is complete. One point that should be noted is the $800 per ounce retracement level, which represents a 20% decline in price. Traders and investors typically recognize this percentage number as the demarcation line between a bull market correction and a bear market. Therefore, if gold does continue to trade downward to the $800 per ounce level, or even lower, we can begin to see that we are looking at a bear market in gold and not simply a bull market correction. I would now like to draw your attention to the details of the trading activity in gold since the beginning of this year. For this, I have included Figure 3.

Figure 3 shows the daily price chart of gold from the beginning of 2008. Note that the gold market peaked in March. During the month, gold traded downward and formed an ABC zigzag corrective pattern. During April, this market traded upward and formed an X wave. X waves connect multiple corrective patterns together. From mid-April to the present date, gold appears to be in the process of forming a second ABC zigzag pattern and looks to have either completed wave B or is very close to completing wave B of this second ABC zigzag corrective pattern. Once wave B is complete, we can expect gold to continue to sell off to complete wave C. We can also expect this selloff to continue down to the retracement levels.

In conclusion, we have also learned that the gold market completed five waves up from 1999. The gold market then peaked in 2008 and has entered into a market correction. This market correction looks to be tracing out a double zigzag corrective pattern that could draw this market down to $750 to $550 per ounce. This market correction could be of such proportions that it will appear to be more than just a bull market correction in gold, but will begin to feel like a real bear market. We have also learned that the business cycle lasts approximately four years and is divided into six stages. We have further learned that gold is a commodity and that commodities trend in the downward direction from midstage 6 to midstage 3 of the business cycle. Therefore, we can expect the current bear market in gold to last as much as half the length of a typical business cycle, or from one to two years. And finally, we have seen that the stock market and the gold market do not always move in opposite directions as is commonly believed but that they have been moving together in the same direction ever since 2002. ■

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CONSOLIDATION FORMATION

Gold Tests The Breakout

by Arthur Hill

After returning to broken resistance with a sharp decline in July, the streetTRACKS Gold ETF formed a small consolidation, and there is a big test at hand.

Tradable: GLD

Figure 1 shows the streetTRACKS Gold ETF (GLD) over the last five months. The ETF firmed in the mid-80s from late April to early June and then broke resistance with a surge in late June. The breakout featured a gap, a trendline break, and a move above the early June highs. This powerful breakout carried GLD above 95.

After becoming overbought in mid-July, GLD stalled and then declined with a sharp pullback. Despite such a sharp decline, the ETF is finding support near broken resistance around 90. This is the moment of truth for gold. A successful best would keep the June breakout alive and uptrend in play. Failure to hold support would negate the breakout and argue for a test of the May–June lows.

For an expanded view of the three-day consolidation, I am looking at a 30-minute candlestick chart. GLD broke support with a sharp decline in July and then firmed in the low 90s. The slight advance over the last few days looks like a rising flag, which is potentially bearish. Flags are corrective patterns that slope opposite the bigger trend. A bearish flag slopes up and a bullish flag slopes down. This rising flag looks like a corrective rally to alleviate short-term oversold conditions. A break below flag support would signal a continuation of the prior decline. ■

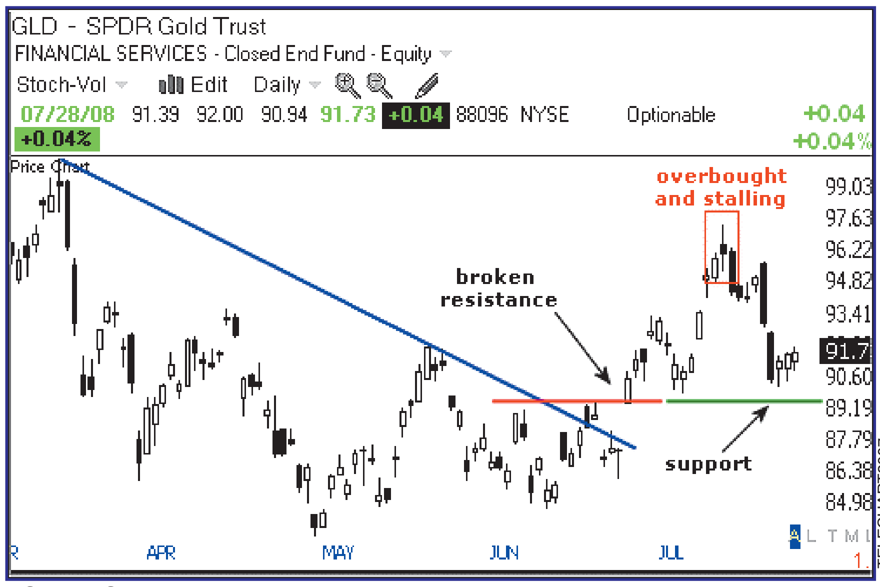

FIGURE 1: GLD, DAILY. This ETF firmed in the late 80s from late April to early June and then broke resistance with a surge in late June.

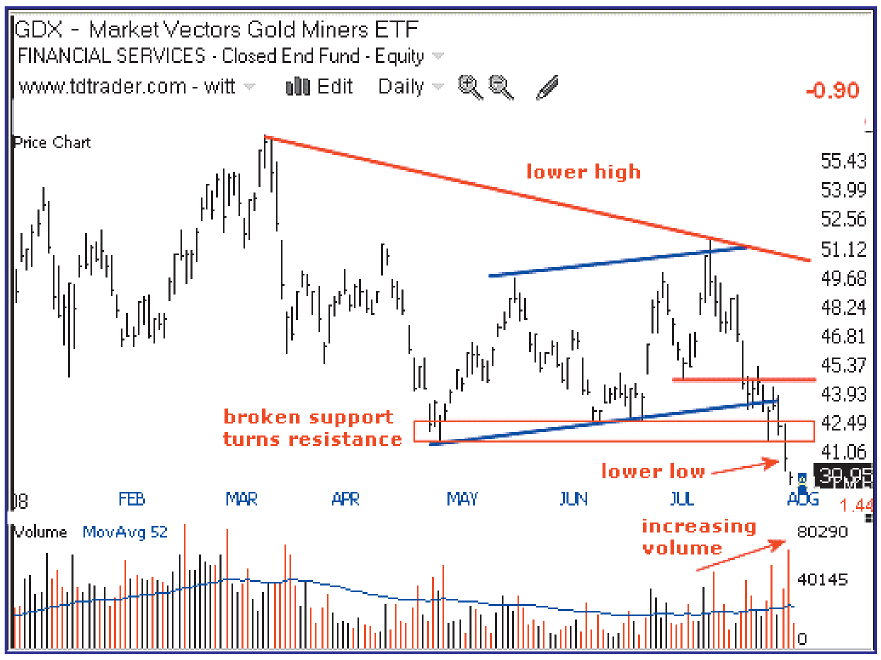

FIGURE 2: GLD, 30-MINUTES. Here, GLD broke support with a sharp decline in July and then firmed in the low 90s.

HEAD & SHOULDERS

A Big Support Break For GDX

by Arthur Hill

After forming a massive head & shoulders pattern, the Gold Miners ETF broke support to confirm the reversal and establish a long-term downtrend.

Tradable: GDX

On the weekly chart (Figure 1), the head & shoulders pattern for the Gold Miners exchange traded fund (ETF) (GDX) extends from October 2007 to July 2008. This 10-month period represents a massive distribution in which the bearish reversal pattern evolved. After forming the head high, GDX formed a lower high to trace out the right shoulder. This lower high showed less buying pressure, and the subsequent support break forged a lower low to reverse the uptrend. GDX now has a lower high in March and a lower low in August for a new downtrend.

High volume confirms the support break and pattern. The surge that formed the head occurred with high upside volume. However, upside volume was not strong when the ETF advanced to form the right shoulder. In addi-

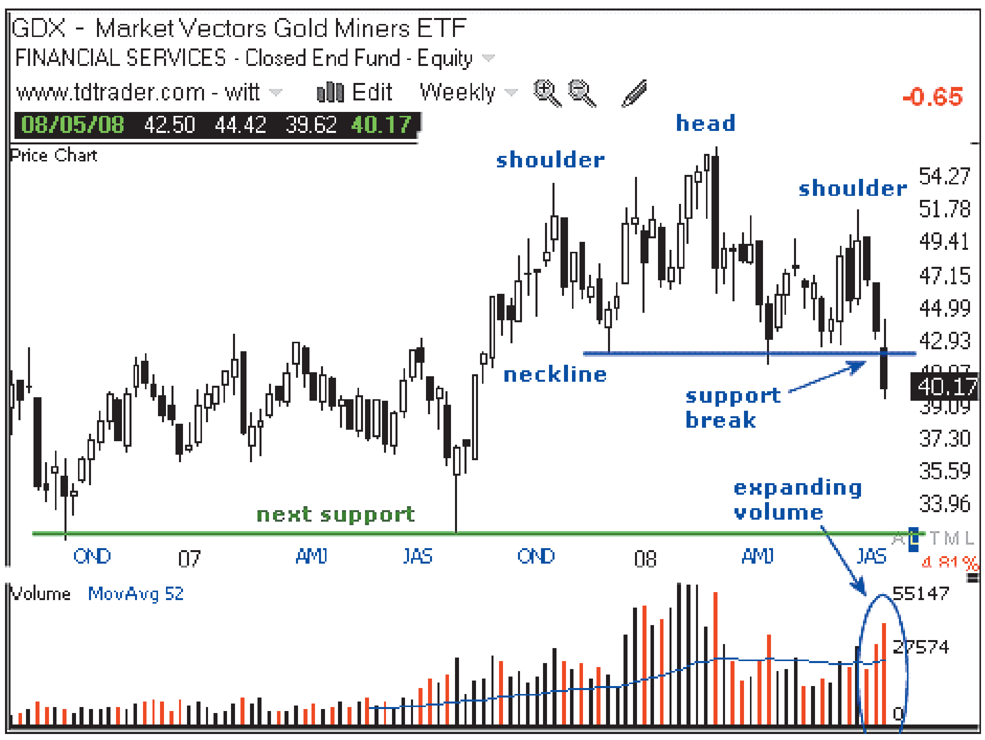

FIGURE 1: GDX, WEEKLY. The head & shoulders pattern seen here extends from October 2007 to July 2008.

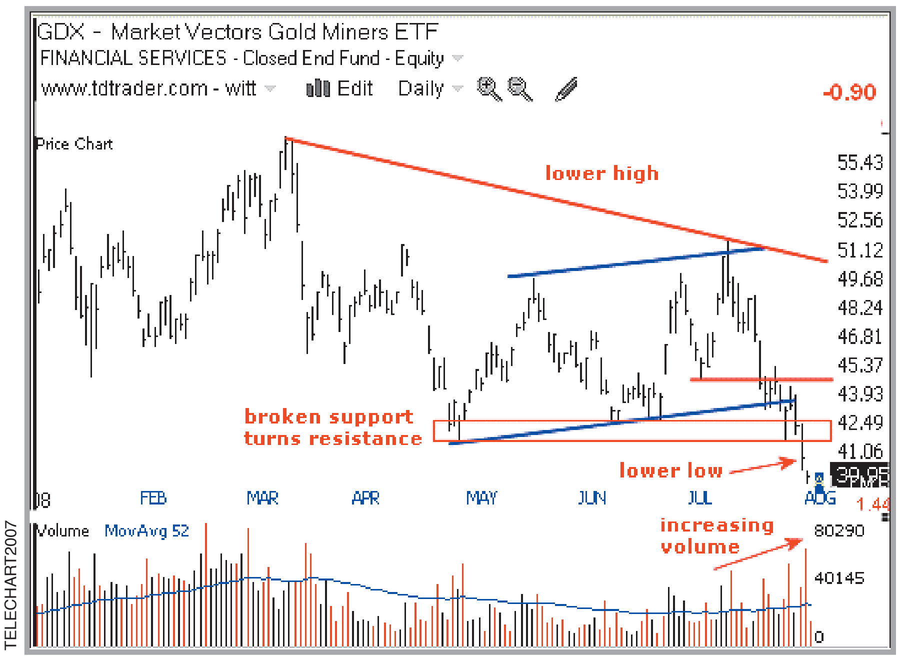

FIGURE 2: GDX, DAILY. Here, GDX broke the April–June lows with a sharp decline on high volume.

tion, downside volume expanded as the ETF broke neckline support with two sharp declines. Selling pressure is clearly expanding and the move below support broke the bull's back. The next support zone resides around 32–33 and this is the downside target.

On the daily chart (Figure 2), GDX broke the April–June lows with a sharp decline on high volume. Note how volume rose as the ETF declined. Broken supports around 42–45 turn into resistance and there could be a throwback rally if the ETF becomes oversold. A move back into this zone could also provide a second chance for new short positions. ■

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This article was first published on 8/6/2008.
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Selling pressure is clearly expanding and the move below support broke the bull's back.

FIBONACCI

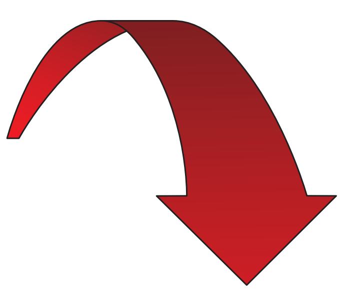
Gold's Fall From Grace

by James Kupfer

Gold's speculative bubble has burst. Where are we headed from here?

Tradable: GLD

I hope this won't come as a surprise to you, but it should be clear even to gold bugs that the yellow metal has been in a speculative bubble that started in 2001. Whenever an asset class rises from $250 to more than $1,000 in just a few short years, that is the mark of a bubble, akin to the fabled tulip stocks long ago and the technology stocks in 2000. Well, the gold bubble has burst.



If you study the history of market bubbles across multiple asset classes, you may note that the majority of those assets retreat approximately 90% of their gain since the bubble's beginning. That would indicate an eventual retreat of gold to around $325. This, however, will likely take a few years to come to pass, if ever.

FIGURE 1: GLD, WEEKLY. Note the three primary Fibonacci retracement levels.

In the meantime, let's focus on potential price targets that could happen over the next few months. Looking at Figure 1, you will see that I have drawn the three primary Fibonacci retracement levels on the chart. I used the 2001 bottom to this year's peak price.

While Fibonacci levels are significant by themselves, you'll notice that each major level also corresponds closely to a significant technical resistance level. I have circled those resistance levels on the chart. The 2006 price peak, marked in red, now acts as support and is very close to the 38.2% retracement level. The 2006 price lows, circled in blue (but also earlier in the year), correspond to the 61.8% retracement level. Finally, the lower prices from the period of price congestion from 2007 (brown oval) match closely to the 50% retracement level. In the same vein, if you take 161.8% of the price movement between the March 2008 top and the May 2008 price low, you will find that it indicates a price target of almost $730. The 161.8% figure is a Fibonacci value that can be used to calculate price targets. And, of course, the $730 value is almost identical to the 38.2% retracement level mentioned earlier.

Given the bursting of this bubble, I think it is likely that gold will eventually move to at least the $550 level, but first it will have some very strong support along the way at $730 and $640. Look for these to be significant price levels that gold must hold to have any chance of eventually moving back up above the $1,000 level. ■

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Silver Ready To Move Lower

by Alan R. Northam

Silver Standard Resources made a market top in late 2007 and has been trading lower this year. Over the last few months, SSRI has been in a narrow trading range that looks ready to break down and move lower.

Tradable: SSRI

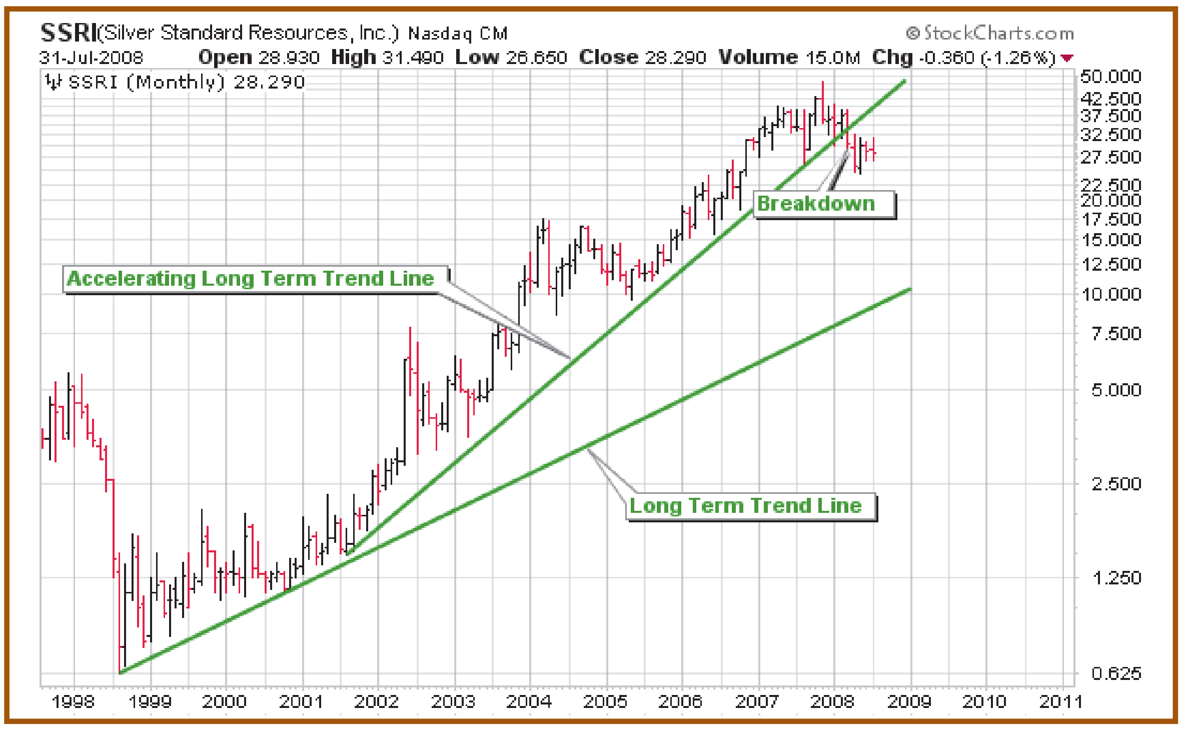

FIGURE 1: SSRI, MONTHLY. This price chart of SSRI shows long-term trendlines and a breakdown. A breakdown of a trendline signals the end of that trend and the beginning of a new one.

FIGURE 2, SSRI, DAILY. This figure shows the intermediate-term trendline and channel line as well as a narrow trading range. Trading ranges are continuation patterns and signal the continuation of the downward trend once the price breaks down below the trading range.

Silver Standard Resources (SSRI) has been in a long-term bull market since 1998. In Figure 1, you can see two long-term trends drawn on the monthly chart. The more shallow long-term trendline is the original trendline drawn off the first reaction low set in 2000. From 2000 forward, SSRI accelerated and formed a steeper long-term trendline.

This steeper trendline remained in place for six years without being penetrated, making it a strong line of support. However, early this year this strong line of support was broken when SSRI started to move lower. The breakdown of this trendline now signals that the acceleration period of higher prices for SSRI has ended and a new trend is now unfolding.

There are several scenarios that can unfold for this new trend. SSRI could enter into a trading range and move sideways for many months as it consolidates its gains. Trading ranges are typically continuation patterns, which means that eventually the upward trend will continue. However, I am a little skeptical of this scenario since the price has broken down below the price minimum set in 2007. The second scenario is for SSRI to enter into an intermediate-term downward trend to correct for its overall gain. This is a likely senerio that we will evaluate further. The third scenario would be for SSRI to enter into a long-term downward trend or bear market. This also is a likely scenario but will not be confirmed until price breaks down below the more shallow long-term trendline.

Figure 2 shows the daily price chart for SSRI over the last 18 months. This chart shows that the SSRI has been in an intermediate-term downward trend over the last several months following its price peak in November 2007. Figure 2 shows SSRI bouncing off its channel line in early May to move higher as it corrected for its losses from March. This corrective bounce has since morphed into a narrow trading range.

From June forward, SSRI has been trading within this trading range and is now up against the downsloping trendline. From mid-July to the present, it appears that SSRI is respecting the trendline by not breaking out above it. As a result, I expect SSRI to move lower in the days ahead to the lower edge of the trading range. The big question is, will SSRI eventually break out above the downward sloping trendline and retest the resistance of the upper edge of the trading range, or will it break down below the lower edge of the trading range and continue the selloff?

To answer that question, we have to look at two things. First of all, trading ranges are consolidation patterns, which are continuation patterns. Therefore, the higher probability is for a continuation of the previous trend, which is downward.

Second, we have to look at the relationship between the 50-day and the 200-day moving average. Here we see that the 50-day moving average is below the 50-day moving average, which indicates that the intermediate-term strength is to the downside. In addition, the 200-day moving average is moving lower, indicating that the longer-term strength of this market is also downward.

At this time there is no evidence of any market strength to the upside, so the higher probability is for SSRI to continue to move lower in the days, weeks, and months ahead. Therefore, I would look for a breakdown in price below the current narrow trading range in the days ahead to signal the continuation of the downward trend.

To establish a good target price for this downward move, all we have to do is look at Figure 1.

To establish a good target price for this downward move, all we have to do is look at Figure 1. The next major line of support is the more shallow of the two long-term trendlines. This line of support is a good price target for silver over the next year or so. ■

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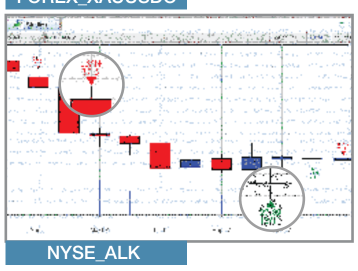
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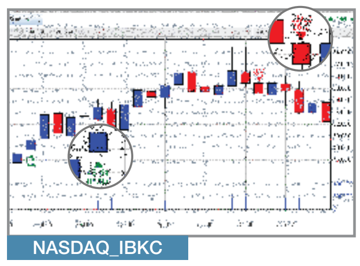
2008 Q1-Q2 Triangle Returns		
James River Coal Co.	JRCC	208.34%
Fuel System Solutions	FSYS	160.90%
Vision Sciences	VSCI	126.60%
Duvernay Oil Corp.	DDV	85.88%
General Motors	GM	52.89%
Heating Oil	HO	49.98%
Wheat	ZW	38.6%
Crude Oil	CL	35.29%
Sugar #11	SB	23.92%
Soybean Meal	ZM	23.73%

*Results using our suggested "Trade Triangle" technique.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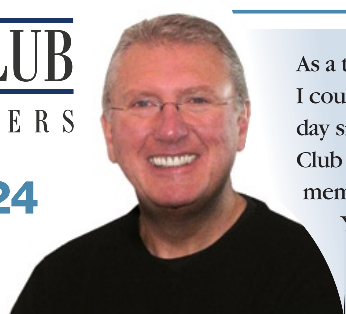

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TREND CHANNEL

Is The Oil Uptrend Over?

by Alan R. Northam

USO has been in an uptrend since 1999, but it now looks like the upward trend is over and a sizable correction in oil is at hand, one that could drop the price of oil to as low as $53 per barrel.

Tradable: USO

On June 2, I wrote an article entitled "Is USO Ready To Turn Lower?" I pointed out that the next target price for oil to end the rally was $118.20 per barrel. I encourage rereading this article for details as to how I arrived at this target price. Since that time, USO climbed higher and hit this price target on July 11. On that day, USO made a market high price of $119.17 per barrel and has been trading lower since (see Figure 1).

In Figure 1, I show the daily price chart of the current intermediate-term rally that began in February 2008. On this chart I have shown an upward trending intermediate-term trendline drawn off the first short-term rally reaction low in early April. As you can see, there has been three other short-term rallies since with the reaction of the first two short-term rallies holding above this intermediate-term trendline. However, the final short-term rally reaction failed to hold above this intermediate-term trendline and has broken down below it. This breakdown signals the end of the intermediate rally that began in February. I have also shown a support line drawn off the mid- to late June price minimums. Over the course of the last few days of trading, USO has also broken below support. Once price breaks down below a support line, that line of support changes its function and becomes a new line of resistance. Therefore, any rally attempts should find resistance at this new resistance line.

In Figure 2, I have shown the daily price chart from the beginning of the current intermediate rally. On this chart I have plotted the Fibonacci retracement levels of 38.2%, 50%, and 61.8%. These Fibonacci retracement levels are typical price levels of market corrections. The breakdown below the intermediate-term trendline has signaled the end of the intermediate rally that began in February and has ushered in a market correction that should see oil sell off to one of these three retracement levels. As you can see from Figure 2, USO is now approaching its first retracement level of 38.2%. Typically, market corrections form in a zigzag fashion. In other words, the market will trade down for several days, then move up for a few days, and then trade back down for several more. I do not see that a zigzag pattern has developed since the selloff from the July price peak began. As such, I would expect USO to continue lower to at least the 50% retracement level before launching a new market rally.

However, I believe that oil could fall much further. In Figure 3 I have shown the monthly price chart for USO from the beginning of the current bull market rally in 1999. In this chart I have shown that USO has completed five nonoverlapping waves. According to the Elliott wave rules, USO has now completed a long-term uptrend. Elliott also calls for an ABC zigzag market correction following the completion of a five-wave move up.

There is one exception to the rule that I must divulge at this point. Oil is a commodity, and waves 5s in commodities can extend. So once the current market correction is over, that corrects the just-completed intermediate-term rally (see Figures 1 and 2) and then wave 5 could extend higher. However, if wave 5 does not extend, then USO should continue to correct over the months ahead in a downward zigzag fashion and correct to one of the Fibonacci retracement levels shown here in Figure 3.

In conclusion, USO has completed five waves up and should now be entering into a downward market correction that could see oil fall to as much as $53 per barrel. Further, there exists a possibility that wave 5 could extend higher before any sizable market correction begins. However, when we look at the fifth wave in Figure 1, I have shown that the intermediate-term trendline, composing wave 5, has been broken, signaling the completion of wave 5. I believe that there is a higher probability for a significant selloff in oil than for the price of oil to continue higher. ■

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This article was first published on 7/23/2008.
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FIGURE 1: USO, DAILY. Here's a daily price chart of USO showing an intermediate-term trendline, support level, and price target.

FIGURE 2: USO, DAILY. Here's a daily price chart of USO showing Fibonacci retracement price levels.

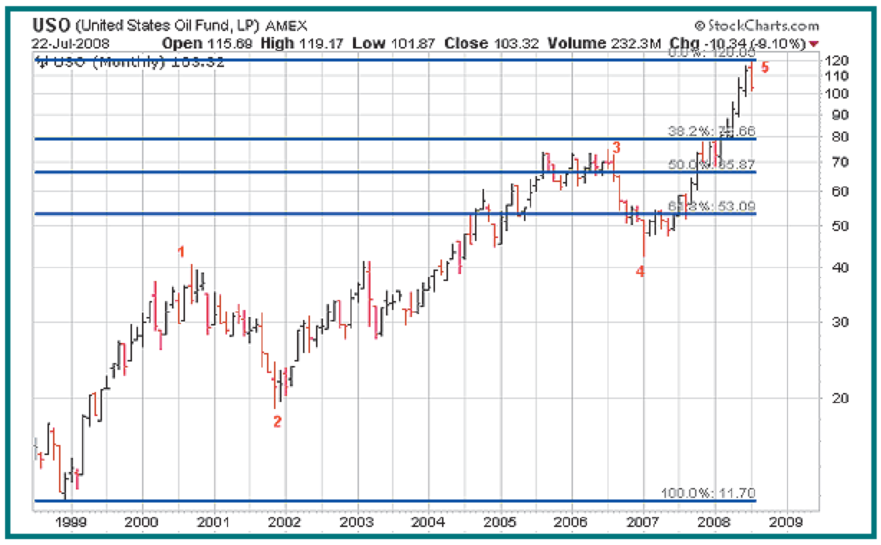

FIGURE 3: USO, MONTHLY. Here's a monthly price chart of USO showing the Elliott wave count. This chart shows five nonoverlapping waves that satisfy the Elliott wave rules, completing the bull market rally from 1999.

CONSOLIDATION FORMATION

The Alarming Oil-Light Crude Move

by Chaitali Mohile

After a long rally, crude oil is consolidating and is ready for breakout. This breakout may lead to a bloodbath in global financial markets.

Tradable: $WTIC

The breakout of the oil-light crude ($WTIC) at $100 left global financial markets in shambles. The price hike continued at a greater pace, and inflation levels worsened globally. When the price of crude oil was at $135 you can see from Figure 1 that a breakout was a strong possibility. Earlier in May 2008, $WTIC declined from $135 to $120, but within a few trading sessions, the commodity was back to the previous level of $135. This indicated strong upside and a willingness to surge higher. In Figure 1, we can see oil consolidating in the range of $140 on the upper side and $132 on lower. The pattern formed is a bullish flag & pennant continuation, which breaks in an upward direction. So with this breakout the oil prices may climb the next step on the ladder, worsening global economic conditions.

As we can see in Figure 1, the relative strength index (RSI) (14) has ranged in the 50-70 levels, indicating bullish strength throughout the rally. This rangebound movement can lead to the pattern breakout. The moving average convergence/divergence (MACD) (12,26,9) is bit volatile near the trigger line in positive territory. So under the present scenario, the bullish consolidation may soon violate the upper range. There is a possibility of crude oil dragging below $130 during the consolidation.

The breakout would meet the minimum level of $159. We calculate the target by measuring the length of the flag pole 140 - 121 = 19 and adding this number to the breakout level of 140. This estimated level is the next destination for $WTIC.

In Figure 2, the breakout rally from $100 to $140 was seen with three white soldiers. The first two candles after the breakout reflect the strength in the rally, but the size of the third candle is comparatively smaller.

FIGURE 1: $WTIC, DAILY. The flag & pennant pattern breakout may carry crude oil to new highs.

FIGURE 2: $WTIC, MONTHLY. The RSI (14) and the MACD (12,26,9) has reached extreme bullish levels. The ADX (14) is about to enter the overheated uptrend.

The third candle shows bullish consolidation. The average directional movement index (ADX) (14) has moved near the overheated levels, and the MACD (12,26,9) and the RSI (14) have reached the highest bullish levels. Therefore, the indicators may decline to create further space for the rally.

Figure 3 shows $WTIC in a strong uptrend since 2007. The RSI (14) surged above 50 and has sustained in those bullish areas, with minor declines from overbought levels of 70. At $141, the RSI (14) has again reached 70 levels and established strong support, so the indicator is likely to move in an overbought area.

The MACD (12,26,9) is highly positive in bullish territory, indicating a slow rise in the future. In addition, the ADX (14) is near the overheated levels. $WTIC is taking a steep upward move, so a sideways action is essential for accumulating bullish strength.

Thus, the present consolidation is a reaction to highly bullish indicators. This consolidation will soon undergo a robust breakout that will lead to a price hike of crude oil. This price hike may lead to a bloodbath in global financial markets. The range at both ends may be challenged till the breakout is confirmed. ■

FIGURE 3: $WTIC, WEEKLY. $WTIC has been in a strong uptrend since 2007.

FIBONACCI

Could Oil Fall Even Further?

by Alan R. Northam

Oil is now in an established downward market correction that could see oil drop to $81.50 per barrel. There exists a possibility that oil could fall even further.

Tradable: USO

On July 23 I published an article titled "Is The Oil Uptrend Over?" There I showed that the intermediate-term uptrend line had been broken, ending the intermediate-term upward trend. I also pointed out that once the intermediate-term trendline was broken, it ushered in a market correction in oil. I further mentioned that market corrections normally take the shape of an ABC zigzag wave formation. I encourage all to reread this article to better understand the details of my analysis on oil.

Since that article, oil has continued to fall in price as expected and has now fallen to just below the Fibonacci retracement level of 50%. This indicates that oil has now lost half of its price increase from the rally that started last February. In so doing, oil has also traced out waves A and B of the ABC zigzag correction that I pointed out should occur. With waves A and B now complete, this leaves wave C yet to be completed. (See Figure 1.)

FIGURE 1: US OIL FUND, DAILY. This figure shows that the intermediate-term uptrend has ended and oil is now in a market correction that could see oil fall to $81.50 per barrel.

With waves A and B now complete, it is possible to determine a target price for oil that could complete the market correction. To determine this price target, we simply take the length of wave A and subtract it from the price maximum of wave B. The result of this calculation then gives a price target for oil of $81.50 per barrel. Although $81.50 per barrel is a good price target, there exists the possibility that oil could correct even further. Allow me to explain: Corrective rallies are sometimes complex affairs and do not always print out a simple ABC zigzag wave pattern. Sometimes, these wave patterns can morph into more complex corrective waves, and therefore, we must be on guard for such an occurrence. Further, it is possible that the current wave pattern development is not an ABC corrective wave after all. It could turn out to be waves 1 and 2 of a downsloping impulse wave that, according to the Elliott wave theory, determines the direction of the next larger impulse wave. Should the waveform turn out to be an impulse wave, that will signal that the major trend in oil is in the downward direction and that the current selloff is not a correction but a new downward trend. Impulse waves are made up of five nonoverlapping waves: wave 1 down, a corrective wave 2, wave 3 down, a second corrective wave 4, and wave 5 a final wave down.

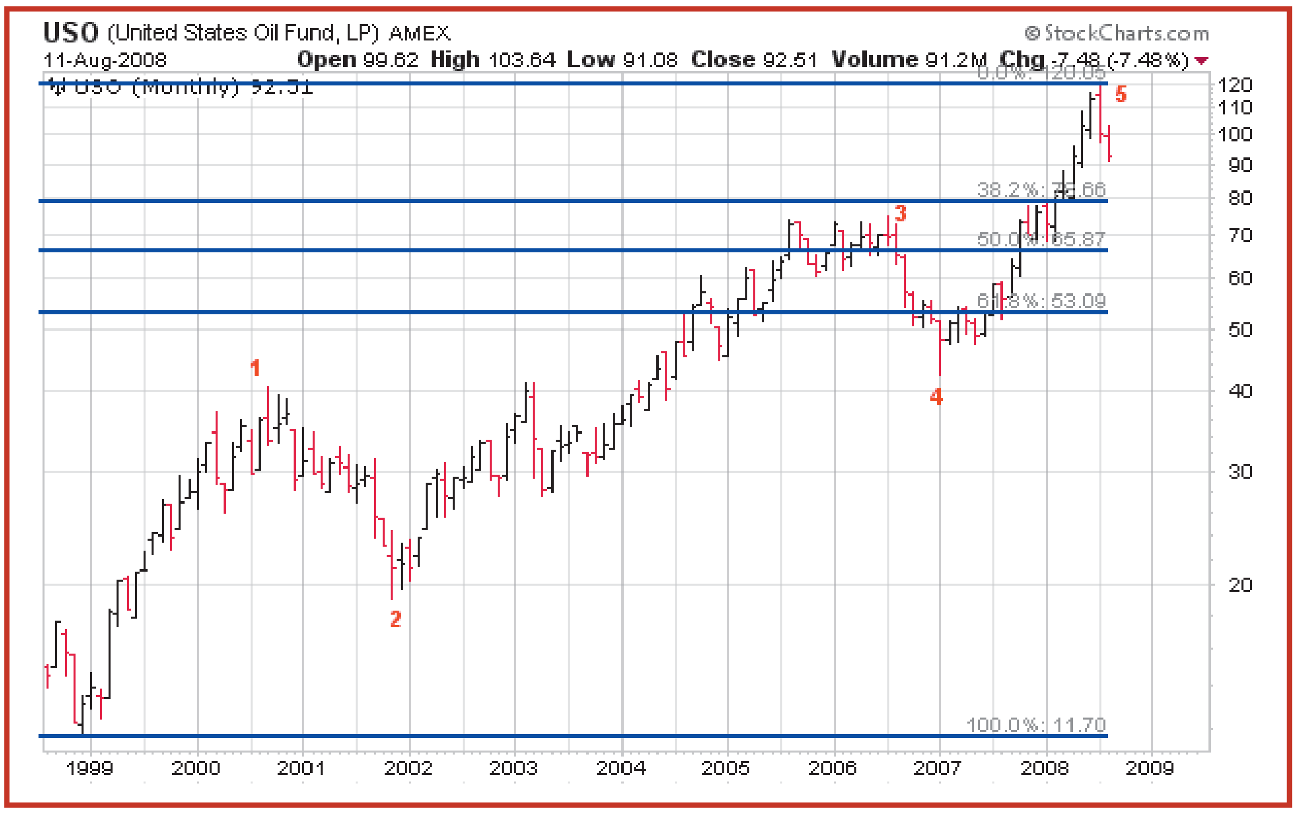

FIGURE 2: USO, MONTHLY. This chart shows the typical Fibonacci retracement levels for the complete bull market rally from 1999. This chart further shows that the price of oil could drop to as much as $53 per barrel before the market correction is complete.

Figure 2 is that of the monthly price chart of oil. This chart shows the Fibonacci retracement levels for the complete rise in price for the bull market in oil that started in 1999. Note that the $81.50 price target is right at the 38.2% retracement level. However, should the market correction morph into a more complex wave pattern, then expect the price of oil to possibly fall to either the 50% retracement level or even the 61.8% retracement level. This means that if oil does continue to sell off, it could fall to as low as $53 per barrel. As an additional note, according to Elliott wave, market corrections typically move into the price territory of the previous waves 3 and 4. This indicates that the price of oil should drop to around $40 to $75 per barrel before the correction is over.

In conclusion, the intermediate-term uptrend in oil that started in February has ended and the oil market has entered into a corrective phase. This corrective phase is expected to continue with a near-term price target of $81.50 per barrel of oil. However, there does exist the possibility that the current market correction could morph into a more complex form that could see oil continue to fall to as low as $40 to $70 per barrel. ■

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This article was first published on 8/12/2008.
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Betting On An Oil Rebound

by James Kupfer

With the recent drop in oil prices, is USO a good short-term buy?

Tradable: USO

For traders with a short-term focus, it looks like USO might be in position for a quick, albeit small tradable rebound. Granted, there is good cause to think that oil has made a long-term top, so don't expect any long positions to soar to new heights. That being said, here is why the chart seems to support a potential rebound.

Looking at Uso (Figure 1) over the last few months, you can see that it is in an obvious uptrend, just in case you couldn't tell from what it costs to fill up your car. Drawing a linear regression channel around the price action starting in August 2007, you can see that on multiple occasions, Uso has bumped against the upper boundary of the channel. Now Uso is at the lower boundary, which can be seen better in Figure 2.

Figure 2 is a close-up view of the same USO chart. There are a couple of thing worthy of note. First, as noted previously, USO is very close to hitting the lower linear regression channel (blue dotted line). Second, USO is at the significant Fibonacci retracement level of 38%. I calculated this using the bottom of the move beginning in 2008 until the most recent top. Finally, USO is near a support level (green line) formed in June of this year.

When multiple support levels converge, it lends credence to a potential bottoming, at least on a short-term basis. On Friday, I entered a long position of USO at $100. I have set a stop below the June lows. Again, this is a short-term trade, given that I think USO has made a long-term top, but the bounce, assuming it happens, will hopefully be good to at least about $107. ■

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This article was first published on 7/25/2008.
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FIGURE 1: USO, DAILY. Looking at the stock over a few months, it appears to be on an uptrend.

FIGURE 2: USO, DAILY. Two things to note. First, USO is very close to hitting the lower linear regression channel (blue dotted line), and second, USO is at the significant Fibonacci retracement level of 38%.

SUPPORT & RESISTANCE

US Dollar Index Hits Support

by Arthur Hill

After a decline during the last few weeks, the US Dollar Index hit a key support area that represents a big make-or-break level.

Tradable: $DXY

Figure 1 shows daily candlesticks with the stochastic oscillator. The index bottomed in mid-March and worked its way higher the last three to four months. Although the advance is not steep, a series of higher highs and higher lows remains in place. After the decline the last few weeks, the index is trading near support from the May–June lows and the March trendline. This support level holds the key to the medium-term uptrend. Failure to hold would reverse this uptrend and have long-term consequences.

The stochastic oscillator has yet to reach oversold levels, but is quickly approaching an area that inspired prior bounces. The green circles show where the stochastic oscillator moved from oversold levels (cross above 20). These crossovers coincided with bounces in the index, and traders should watch this indicator for support as it nears 20. A move above the magenta line would signal an upturn in momentum and a successful support test.

Figure 2 shows weekly prices and the long-term picture. Here we can see the long-term consequences of a support break. With the long-term trend down, the index bounced back to broken support over the last few months. Combined with the trendline extending down from June 2007 (blue), there is considerable resistance around 74.5. A break above this resistance area is needed to consider a long-term trend reversal.

On this weekly chart, the advance since mid-March looks like a rising flag, which is a bearish consolidation pattern. A break below support (May low) would confirm this flag and signal a continuation of the long-term downtrend. Needless to say, this would project new lows in the index. ■

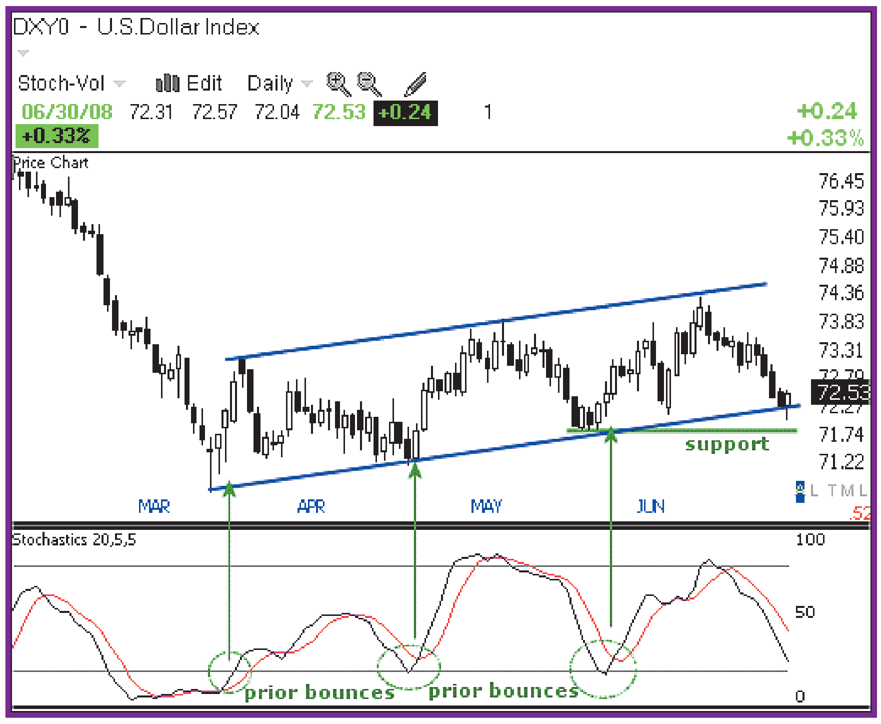

FIGURE 1: US DOLLAR INDEX, DAILY. Daily candlesticks are shown here with the stochastic oscillator.

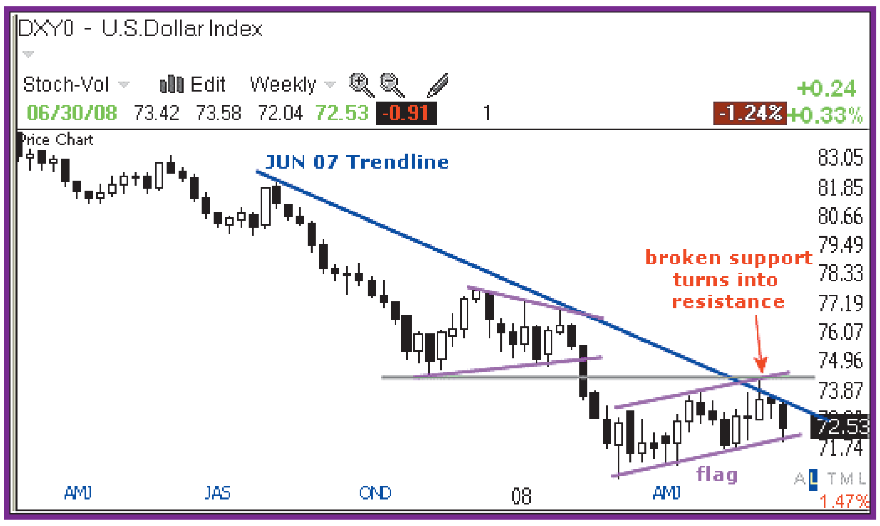

FIGURE 2: US DOLLAR INDEX, WEEKLY. Weekly prices are shown here in the long-term picture. The advance since mid-March looks like a rising flag.

STRATEGIES

Dollar Bottom?

by Mike Carr, CMT

While analysts have been calling for a bottom in the US dollar for some time, this time might be different.

Tradable: UUP

Global economies are linked together and a slowdown in one region will affect others. China's stock market is down about 50% year to date amid reports of economic slowing and inflationary pressures. Europe is seeing the same troubling signs and English monetary authorities are saying that a slowdown, and probably a recession, is inevitable. With weakening fundamentals in riskier nations, it seems likely the US dollar will return to its traditional role as a safe haven and this provides fundamental support for a higher dollar.

The long-term chart of the US Dollar Index (Figure 1) shows the magnitude of the price decline. All momentum oscillators are severely oversold as we would expect in a bear market. In oversold or overbought markets, Bollinger bands offer a useful analytical technique. In this case, Bollinger PercentB is showing a bull-

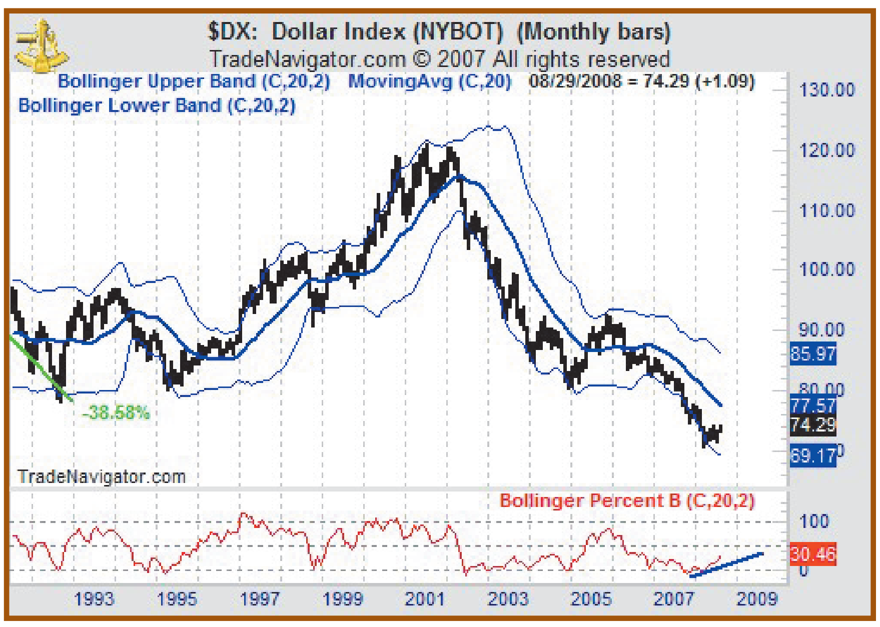

FIGURE 1: $DX, MONTHLY. The monthly chart of the US Dollar Index shows a deeply oversold condition after an extended bear market.

ish divergence. PercentB measures where price is relative to the Bollinger bands. A bullish divergence indicates that prices have moved higher on a relative basis and these divergences often precede price advances.

The daily chart (Figure 2) also offers bullish support. Prices have risen sharply since the July test of earlier lows. Prices have broken through 74, an area of past resistance. The stochastic is overbought and this is common in strongly trending markets. With prices just above the upper Bollinger band, a consolidation can be expected, which offers an opportunity to build positions.

Buying the dollar at current levels offers a low-risk entry point. The 20-day moving average offers a nearby stop loss for futures traders. Stock investors can use the PowerShares DB US Dollar Index Bullish (Uup) exchange traded fund, again using the 20-day moving average as a stop. ■

FIGURE 2: $DX, DAILY. The daily chart of the US Dollar Index shows signs that a bottom is in place.

LINEAR REGRESSION TREND

The Dollar Is At A Critical Juncture

by James Kupfer

While the US dollar has been undeniably strong recently, it is now at a critical juncture that may temporarily halt its uptrend.

Tradable: $

First off, I'd like to focus on a longer-term chart of the US Dollar Index. From the top in October–November 2005, I've drawn a linear regression channel (orange line is the center) that encompasses almost all of the price action through Friday's close. You can see that in four previous instances marked by orange circles that prices have touched the channel boundary and then bounced back to stay within the channel. There are two additional instances (black circles) that we could argue also constitute tests or part of the formation of the channel. Even ignoring these last two, it is clear that the dollar has been in an extended downward channel. The dollar has now risen to the top of the long-term channel. See Figure 1.

Figure 2 shows a slightly modified view of the same chart with a speed resistance line added. For this, I used the 2005 top and the 2008 bottom. The speed resistance line, in pink, is very close to the top of the linear regression channel. As of Friday's close, prices are now a few pennies above the SR line. This line may act as further resistance to any upward move in price.

Moving along to a closer view of the daily chart in Figure 3, you can see that prices have moved to within a few cents of the long-term down channel identified previously (top dotted line). I have also included another linear regression channel of the dollar that I first described on June 3. The regression channel has held up among multiple tests. Note, however, that it has been a countertrend channel up within the long-term down channel. On Friday, prices moved sharply above the short-term channel boundary. I would not yet classify this as a full breakout, but it is encouraging if you are long the dollar. Unfortunately, this also puts the dollar in a precarious position that must be resolved. The dollar is now in a position where it is trying to break through a long-term downtrend where it is overbought on both a daily and weekly perspective. In addition, it is up against a speed resistance line. If it fails this test now, it would likely return to the bottom of the up channel around $73–72.50 before making another attempt at new highs.

While I do think the dollar has made a long-term bottom, I'm not sure it is ready to break to new highs just yet. So trade with caution and consider that this might be a good opportunity to take profits. If prices do continue up and a breakout is made, look for the speed resistance line and linear regression channel to become the new support level of the dollar. ■

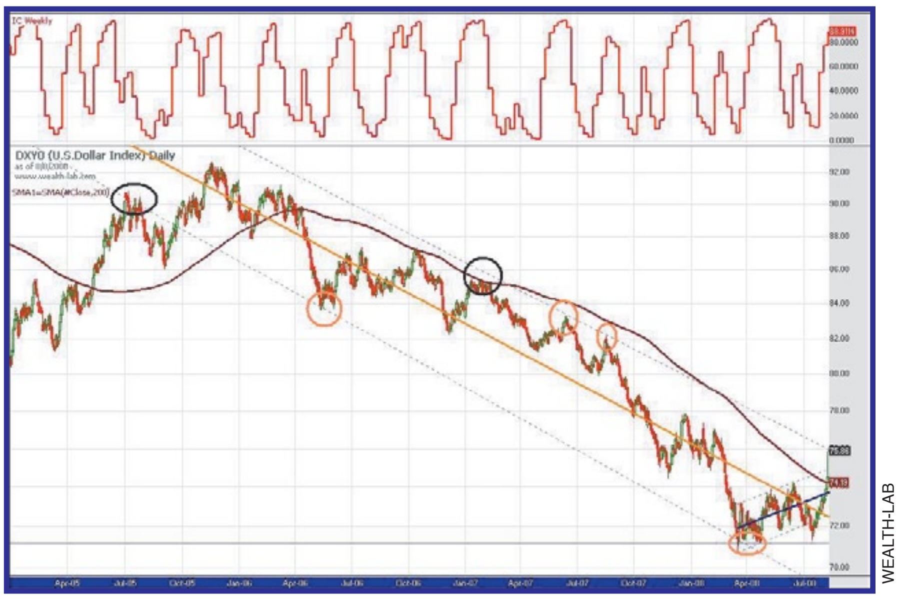

FIGURE 1: USD, DAILY. The orange line is the center that encompasses almost all of the price action.

FIGURE 2: USD, DAILY. The speed resistance line, in pink, is very close to the top of the linear regression channel.

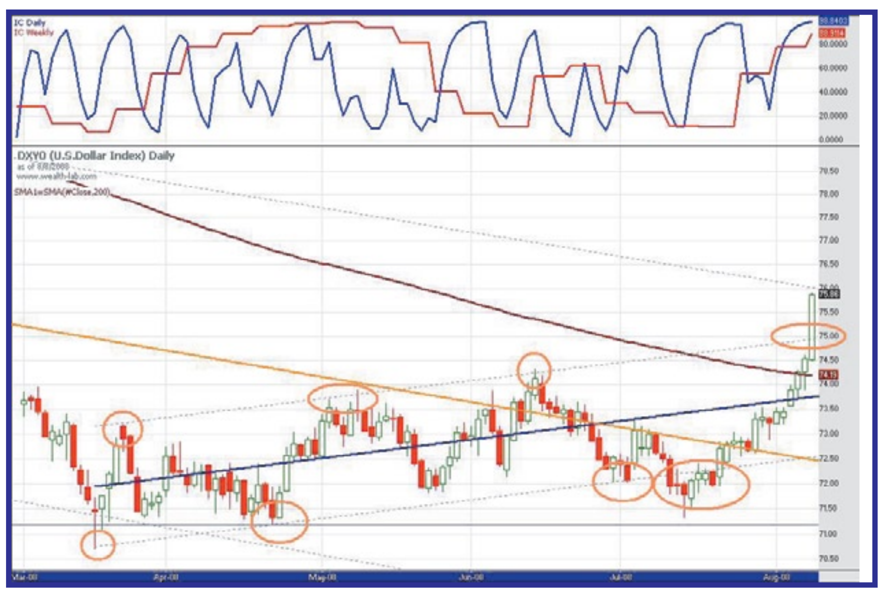

FIGURE 3: USD, DAILY. Prices have moved to within a few cents of the long-term down channel identified previously (top dotted line).

INDICATORS

RELATIVE STRENGTH OSCILLATOR

Air Products Hits An Air Pocket

by Arthur Hill

After hitting long-term resistance, Air Products suffered a momentum reversal and trendline break that point to weakness in the coming weeks.

Tradable: APD

Figure 1 shows weekly prices for Air Products (Apd). The stock met resistance around 105 in December 2007, declined to the 80–85 region in January 2008 and then moved back to resistance in June. Apd stalled the first three weeks of the month and then declined sharply with a long black candlestick below 100. It looks like resistance is going to hold.

The next support level is around 80–85 from the August 2007, January 2008, and March 2008 lows. I elected to ignore the spike below 80 in August because the stock established support around 85 on either side of the spike (blue arrows). With the stock recovering the same weeks, the spike looks like an overshoot.

Figure 2 shows APD with daily candlesticks. The stock formed an inside day or harami in early June. These are bearish candlestick reversals that require confirmation. The stock declined to 100, but bounced off trendline support in mid-June. This bounce did not last, as the stock declined below 100 with a high-volume move on June 27. In fact, note that downside volume has been high three of the last four days. Selling pressure is picking up and the harami has been confirmed.

In addition to increased selling pressure, momentum broke down as the relative strength index (RSI) moved below its support zone. The stock advanced from early March until June. During this time, the 15-day RSI broke above 50 in mid-March and held the 45–50 support zone. Momentum favored the bulls as long as this support zone held. The RSI broke the support zone and momentum now favors the bears. The next support area is around 80–85 and this is the first target.

FIGURE 1: APD, WEEKLY. The stock met resistance around 105 in December, then declined to the 80 to 85 region in January.

FIGURE 2: APD, DAILY. The stock formed an inside day or harami in early June.

WILDER'S RSI

The QQQQ Gets A Top Failure Swing

by Ron Walker

The relative strength index gave an early signal to the current weakness on the QQQQ by forming a top failure swing. Additional clues in other time frames suggest that there may be further downside to come.

Tradable: QQQQ

The PowerShares QQQ Trust (QQQQ) recently formed some traditional chart patterns on its hourly chart that astute traders were able to spot in the 60-minute time frame. The QQQQ formed an ascending triangle as prices moved back and forth in a narrow trading range between the $43 to $46 range during July.

In Figure 1, the QQQQ broke out of an ascending triangle on its 60-minute chart in early August. QQQQ rose sharply, but the advance stalled near $48.50. During the ascension, a bearish rising wedge emerged on the scene. On Friday, August 15, a divergence appeared between the RSI and the QQQQ on the 60-minute chart. Later, at the end of that trading session, the rising wedge broke down as prices penetrated through the rising trendline of the pattern.

The following trading session on Monday, August 18, the RSI added further evidence that the short-term trend was changing in the 60-minute time frame. Previously on August 15, a lower high appeared on the RSI, and then on August 18, the RSI broke below the previous trough low, forming a top failure swing. J. Welles Wilder, who developed the RSI, introduced the concept of a failure swing in his 1978 book, *New Concepts In Technical Trading Systems*.

When the RSI peaks above 70 and then proceeds to put in a lower peak on the RSI during the next rally, it is a sign of weakness. Usually, a divergence forms between the RSI and price. A top failure swing transpires when the RSI forms a second peak that cannot move above the first peak, which is followed by a downside break of the last trough low (Figure 1).

The QQQQ did get a break of the last trough low, confirming a top failure swing. The same day that the failure swing occurred, the RSI tested the broken confirmation line just under the value of 50, but it was unsuccessful moving back above it.

The following day, on Tuesday, August 19, the RSI drifted lower as the QQQQ penetrated below the previous minor low at $47.25. That was followed by weak rally back up to test the 50-day exponential moving average (EMA) on its 60-minute chart. That caused the RSI to rise and test the broken confirmation line once again.

It is noteworthy that the top failure swing on QQQQ was confirmed by other indicators. The direction movement indicators (DMI) got a bearish cross, the moving average convergence/divergence (MACD) had negative divergence as well, and then MACD proceeded to break below its signal line and move below zero.

In Figure 2, you can see on the QQQQ 15-minute chart that a price break occurred below the last minor low of $47.25, causing prices to move to the next level of support near the

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FIGURE 1: QQQQ, 60-MINUTE. Here on the 60-minute chart, negative divergence has appeared on the RSI, forming a lower second RSI peak. Shortly after the divergence, the RSI line breaks below the middle trough, marking the top.

FIGURE 2: QQQQ, 15-MINUTE. On the 15-minute chart, the QQQQ could be getting ready to rally back up and form the fifth-wave of a potential broadening top. Note how prices broke below the previous minor low of $47.25 and came to rest on the lower trendline of the pattern near the next level of support near $46.80. Positive divergence on the MACD suggests that the fifth-wave emerges.

$46.80 level. Thus, a broadening formation appears to be under construction in the 15-minute time frame. Key support level is just below that near $46. The QQQQ may attempt to form another way in a recovery, given there is a divergence forming on the full stochastic (14, 3, 3).

In addition to the broadening formation, the QQQQ has already broken down from a double-top pattern, with the confirmation line being $47.25. If prices rise boldly above the confirmation line, then greater weight should be placed on the broadening formation. At this time, the criteria of both patterns have been met but further breakdown will add credibility to a double-top pattern, while a short-term spike in prices give authenticity to the broadening formation.

Looking at the short-term bullish conditions on the 15-minute chart, I think the odds favor the bounce to complete the fifth wave on the broadening formation. Broadening tops have a tendency to form a five-pointer before a reversal occurs with three minor highs and two minor lows. A five-point reversal is not a mandatory requirement for a broadening formation, but it is a characteristic often associated with the pattern. If the top failure swing is to maintain its authority, then prices should put a lower high rather than moving to a new high and completing the fifth wave. This is known as a partial rise on a broadening formation, and it occurs when prices are too feeble to complete the fifth-wave formation.

In Figure 3, prices could move lower to test the rising trendline in the current price channel that originated from the July 15th low. That rising trendline is currently pointing toward $45.50, which could be hit should the $46 level of support be violated. Should $45.50 be tested and hold up, the QQQQs will have developed a new intermediate trend in its current rising price channel. In addition, the MACD histogram has a downward slope on the daily chart. If prices erode back to the rising trend, the MACD histogram should move below zero. If that takes place, watch for a higher trough to form on the histogram, and then for the histogram bars to start rising again in an upward slope. That would confirm support at the rising trendline. ■

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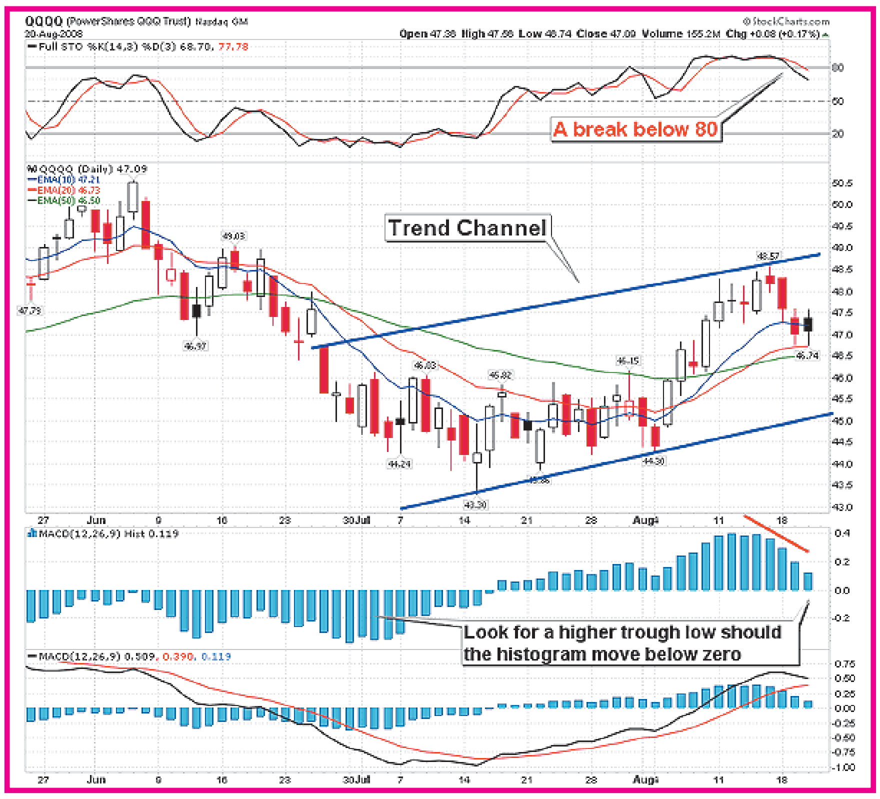

FIGURE 3: QQQQ, DAILY. If prices rise back up to form a broadening top on the QQQQ 15-minute chart, the pattern could break down and test the rising trendline in the daily time frame near $45.50. That would form a new intermediate trend and allow the current rising price channel to remain intact.

Crude Oil May Bounce Back

by Chaitali Mohile

The sharp plunge in oil prices since July brought great relief across the financial markets. The commodity has cooled almost $40 from the highs. Can the oversold stochastic result in a price bounce?

Tradable: $WTIC

In these charts, I have used the full stochastic since I find it more flexible. The additional parameter of the full stochastic is the smoothing factor of 14,3,3.

According to Figure 1, the oil light-crude ($WTIC) was at its peak at $147, and the stochastic (14,3,3) was overbought. The overbought indicator was unable to sustain above 80, resulting in a steep fall. Eventually, the price of oil began its downside trip from the lifetime high. As the price reached $132, the stochastic entered the oversold area below 20. Since then, the oscillator moved in the oversold zone, forming a higher low. However, $WTIC moved to a lower low and soon plunged to $117.50. Thus, the stochastic (14,3,3) showed positive divergence toward price movement. In Figure 1, we can see that the $WTIC is consolidating after the prolonged fall (see the marked square). Usually, the consolidation range after an advance/decline rally breaks in the direction of the existing rally. But in case of $WTIC, the breakdown possibility looks difficult due to two reasons, with first that the positive divergence and the stochastic has been in oversold territory for more than a month. The second reason is the strong 200-day moving average (MA) support at 111.50. Hence, the bullish breakout is possible under this scenario.

In Figure 2, the stochastic (14,3,3) remained highly overbought for more than three months. The entire breakout rally from $100 was carried by overbought stochastic. By the time crude oil reached $147, there was hardly any space left for the oscillator to move higher. As a result, the oil prices failed to move higher. The stochastic (14,3,3) had a nosedive from the overbought area and dragged $WTIC to lower support. The large red candles in Figure 2 shows that the fall in prices was stronger earlier. As the price moved nearer to the previous low at 110, the bearish force weakened, and the stochastic also slipped below 20 levels. This indicated limited downside for the correction, and hence the possibility of pullback rally arose. The downward rally was exhausted, and thus it moved sideways for two weeks in August 2008. Due to the highly oversold stochastic, the breakout of a sideways rangebound move is anticipated in an upward direction.

In the present volatile financial market, the stability of the breakout is more important. We cannot trade blindly just with an oversold oscillator, or in anticipation of a bullish breakout. The stochastic (14,3,3) has to move above 20 for a stable rally, and the price should eventually sustain above $122.

Considering both charts, the oil prices are likely to bounce. The breakout would be confirmed only above $120 to $122 levels. I would suggest that traders wait for this confirmation before initiating any position. ■

FIGURE 1: $WTIC, DAILY. The oversold stochastic (14,3,3) and the 200-day MA support may help crude oil bounce back.

FIGURE 2: $WTIC, WEEKLY. The stochastic remained highly overbought for more than three months and then had a nosedive to the oversold region. The small two candles marked in the circle reflect the losing bearish strength.

FIGURE 3: $WTIC, WEEKLY

ELLIOTT WAVE

QQQQ Crash Coming?

by Alan R. Northam

QQQQ has now entered into wave (3) of 3, the crash wave, just in time for the worst two months of the year for the stock market. Expect QQQQ to sell off rapidly from here on out.

Tradable: QQQQ

FIGURE 1: QQQQ, DAILY. This chart shows the Elliott wave count.

I have written several articles on the QQQQs, and I encourage those reading this article to refer back to them for background information. My last article entitled "QQQQ Rally Complete?" published on 5/22/08 describes the details of the Elliott wave analysis of the QQQQs from its market top in late October 2007 through early June 2008.

In the early 1900s, Ralph Nelson Elliott discovered that the stock market moved in identifiable waves. Basically, R.N. Elliott discovered that the major trend of the market moved in five waves and that corrective waves moved in three waves, but that these waves can take on more complex formations. From late October 2007 until early June 2008, Qqqq formed waves 1 and 2 of a five-QQQQ impulse wave that defines the major direction of this market as downward (as described in my "QQQQ Rally Complete?").

The completion of wave 2 in early June 2008 marked the beginning of wave 3 down. Wave 3 typically travels the furthest distance in price in the shortest period of time. Wave 3 is also the wave that is typically extended. By "extended," it is meant that wave 3 usually unfolds in five smaller waves. This means that we can expect wave 3 to unfold in five waves labeled wave (1), (2), (3), (4), and (5). Further, wave (3) can extend into five waves labeled waves (i), (ii), (iii), (iv), and (v). From Figure 1, note that wave 2 is now in the process of extending, of which waves (1) and (2) are now complete. With the completion of wave (2), I want to draw your attention to the fact that wave (3) down is now starting to unfold. Recall from above that wave 3 typically traverses the furthest distance in price in the shortest period of time. So looking at the complete picture, QQQQ is now in wave 3 of (3). Both of these waves travel the furthest distance in price in the shortest period of time. What this further implies is that from now to the end of wave (3) down, the downward movement in price could occur quite rapidly. This is called the crash wave.

I have calculated the expected target price for the completion of the crash wave. This is done by taking the low price at the completion of wave 1 and subtracting it from the high price at the market top in October 2007. This difference is then multiplied by a common Fibonacci number of 1.618 for wave 3. This product is then subtracted from the high price of wave 2 in early June 2008. This difference then calculates to be $28.03. This then is a practical price target for the completion of wave 3. However, as waves (3), (4), and (5) unfold, a more accurate price target can be calculated.

In conclusion, what I find interesting about QQQQ having entered into its crash wave is in its timing. On average over the years, September and October have been the two worst months of the year for the stock market. Therefore, I would expect that during these two months we are about to witness an acceleration in the price decline of this market. Will this market hit its price target of $28.03 during the next two months? It's hard to tell. Trying to pinpoint the date at which a market will hit its expected target price is not as accurate as the calculation of the target price, so I am not going to try and calculate an expected date as to when wave 3 will be complete. However, I do expect to see a significant selloff during the next two months. ■

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ELLIOTT WAVE

Financial Select SPDR Correction Ahead

by Alan R. Northam

XLF made a market top in May 2007 and has been trading lower ever since. Now it looks as if XLF is close to a market correction that could retrace from 38% to 62% of the ground lost in the decline.

Tradable: XLF

Financial Select SPDR (XLF) made a major bull market top in May 2007. Since then, XLF has been trading downward and has moved in five waves (1, 2, 3, 4, and 5) as shown in Figure 1. Waves 1 through 4 are complete, with wave 5 yet to be completed. I show wave 5 in gray to signify that it is not yet completed. Once wave 5 is complete, this market will enter into a correction that could rally upward and retrace as much as 62% of the ground lost during the May 2007 decline. Just how close are we to a market correction? Let's take a look.

Wave 5 normally ends when its price range is equal to that of wave 1 subtracted from the price maximum of wave 4. I show this target price in Figure 1 to be 21.55. As you can see, XLF has traded right through this target and is continuing lower. The next target occurs when wave 5 is equal to 1.618 times the price range of wave 1 subtracted from the price maximum of wave 4. This calculates to be at a price of 17.61. As you can see, the market is not quite there yet, but it is closing in on this target. Looking at the stochastic indicator below the price chart, we can see that XLF is oversold, supporting our analysis that this market could be close to entering a correction.

Figure 2 shows the daily price chart for XLF and the detail of wave 4 down. Looking at the wave count, we can see that wave (v) of wave (3) still needs to be completed. Once wave (3) is completed, then XLF will undergo a small wave (4) correction followed by the final wave (5) down. Once wave (5) down is complete, that will also complete wave 5 down (refer back to Figure 1).

In Figure 3 we zero in for a closer look at wave (5) down by looking

FIGURE 1: XLF, WEEKLY. XLF traded through the target of 21.55 and kept right on dropping.

FIGURE 2: XLF, DAILY. Looking at the wave count, we can see that wave (v) of wave (3) still needs to be completed.

at the 60-minute chart. Here we can see that subwaves i, ii, iii, and iv are now complete, with wave v yet to be completed. So all that has to be completed to finish wave 5 (from Figure 1) is to the final subwave, wave v.

Figure 4 looks at the detail of this final wave v. Figure 4 is that of the 10-minute chart of XLF. In this figure we can see that subwave (i) is complete and wave (ii), a corrective wave, is well developed and could be complete, but wave (iii) down has not yet started to confirm that wave (ii) is complete.

From this analysis, we can see that XLF should continue to move lower from its current price level as wave (iii) down, wave (iv), a small corrective wave, and a final wave (v) down are yet to unfold. These last three remaining waves are probably just enough to move XLF lower to our 17.61 target price.

In conclusion, XLF is close to completing five waves down, and once these five waves are complete, we can expect this market to correct from 38% to as much as 62% of the ground lost from its May 2007 decline. ■

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FIGURE 3: XLF, 60-MINUTE. All that has to be completed to complete wave 5 (from Figure 1) is to complete the final subwave, wave v.

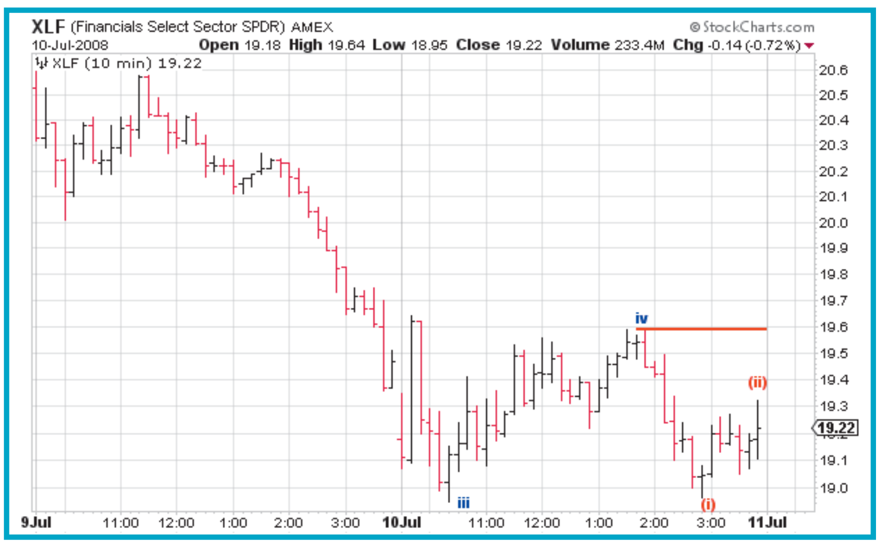

FIGURE 4: XLF, 10-MINUTE. Subwave (1) is complete and wave (ii), a corrective wave, is well developed and could be complete, wave (iii) down has not yet started to confirm that wave (ii) is complete.


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Can The GDP Move The Market Higher?

by Alan R. Northam

The latest GDP numbers are now out and they were better than expected. Investors are starting to get optimistic about the economy, but will the positive GDP data move the stock market higher?

Tradable: $INDU

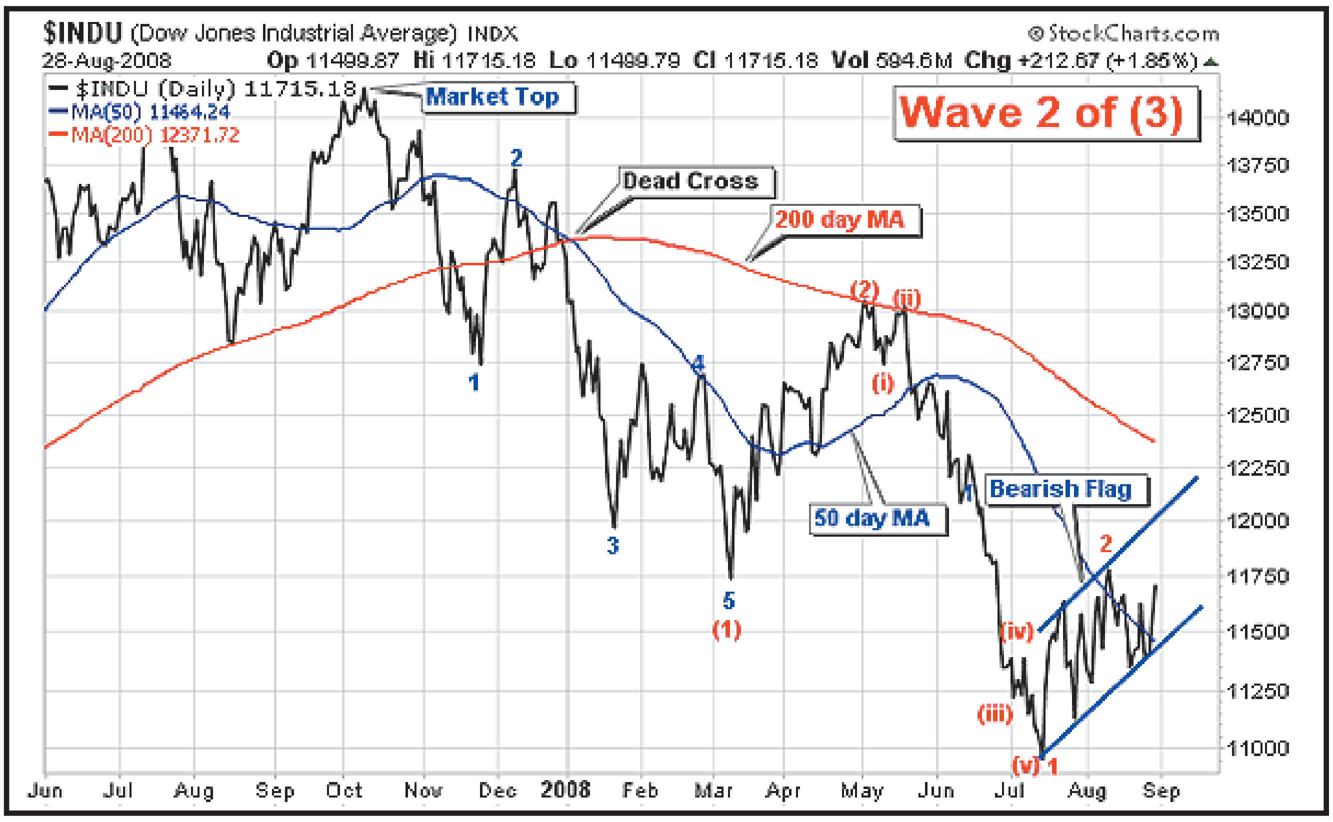

FIGURE 1: DJIA, DAILY. This chart shows the Elliott wave count and a bearish flag.

The US Commerce Department came out with its report on August 27 reporting that gross domestic product rose at an annual rate of 3.3% for the April–June 2008 period, leaving investors somewhat optimistic. It marked the economy's best performance since the third quarter of 2007, when GDP rose at a 4.8% pace. GDP is considered the best barometer of the economy's well-being and investors are looking for signs that the economy is starting to grow after being pounded by the credit crunch and the housing hassle. However, investors would do better to look in their own backyard for signals as to how the economy is doing, as the stock market is a leading indicator of the economy. So let's look at the stock market to see if this good news about the GDP has a chance moving the stock market higher.

Figure 1 shows the daily closing price chart of the Dow Jones Industrial Average (DJIA). From this chart, note that the DJIA made a bull market top last October and has traded downward, making a new low price in mid-July of this year. Since that time, the market looks to be turning back upward, and the optimism of investors is that the GDP report could be the fuel to continue to propel the stock market higher, but let's take a closer look at the data by analyzing this market using the Elliott wave principles.

Note that the market made five waves down — waves 1, 2, 3, 4, and 5. These waves form an impulse wave, and impulse waves move in the direction of the main trend of the next larger impulse, which in this case is down. The next larger impulse wave is made up of waves (1), (2), (3), (4), and (5). From the chart we can see that waves (1) and (2) of the next larger impulse wave is now complete. This also means that wave (3) down is now under way, to be followed by corrective wave (4) and a final wave (5) down. Note that wave (3) down is developing in five subwaves with wave 1 down complete and corrective wave 2 either now complete or still unfolding. Once wave 2 is complete, then waves 3, 4, and 5 will unfold to complete wave (3) down.

From mid-July to the present, the DJIA has been forming corrective wave 2. From a more traditional technical analysis point of view, a bearish flag has been developing. A bearish flag forecasts that the market will continue its downward trend following a breakdown of the flag formation. Wave 2 has now fulfilled the requirements of a market correction and is signaling that the market correction could be over. However, to confirm that wave 2 is complete, we need to see the DJIA break down out of its trading channel, or flag. However, corrective waves can morph into more complex structures and can retrace most of wave 1 down so I would not count the market correction complete until the market breaks below its trading channel.

So can the latest GDP figures continue to move the stock market higher? Since the stock market is a leading indicator of the economy, I might suggest that the stock market predicted the better-than-expected GDP numbers in mid-July and rallied higher. In this case, maybe the stock market has already made its move to account for the GDP numbers. But if wave 2 is not yet complete and is going to morph into a more complex corrective pattern, then the GDP numbers will probably get the credit for moving the market higher. However, over the longer term, the current GDP numbers will have no effect on the main trend of the stock market, which is down. ■

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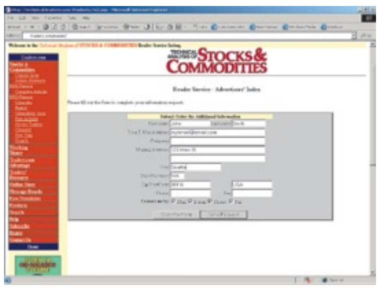

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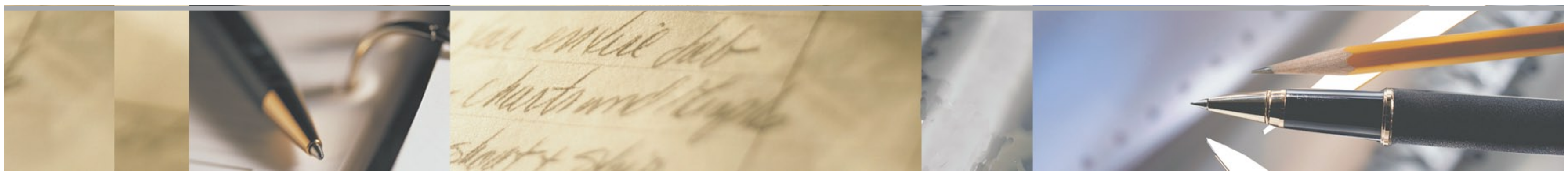

AUTHORS AND ARTIST IN THIS ISSUE

Kim Scafuro (cover art) *grew up outside of Philadelphia with a Corgi, two sisters, and her parents. She has always been interested in drawing, painting, eating, and jokes. To pursue these interests, she moved to Brooklyn, where she graduated from Pratt Institute with a bachelor's degree in fine arts in illustration and burrito making, in 2006.*

Scafuro 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.*

Mike Carr *is a member of the Market Technicians Association and editor of the MTA's newsletter,* Technically Speaking. *He is a full-time trader and writer.*

John Devcic *is a market historian and freelance writer. He may be reached at glatko@aol.com.*

Arthur Hill *is currently editor of TDTrader.com, a website specializing in trading strategies, sector/industry-specific breadth stats, and overall technical analysis. He passed the Society of Technical Analysts (STA London) diploma exam with distinction and is a member of IATF-ITFA Belgium. Prior to TD Trader, he was the chief technical analyst for StockCharts.com and the main contributor to the ChartSchool.*

James Kupfer *has more than a decade of experience as an active trader and was a contributing author to* Day Trading for Dummies. *Currently, he consults for institutional clients and trades for his own hedge fund.*

Chaitali Mohile *is an active trader in the Indian stock market. She may be reached at chaitalimohile@yahoo.co.in.*

Alan R. Northam *lives in the Dallas, TX, area and is a practicing electronics engineer. His ability to analyze the coming direction of the stock market has allowed him to successfully trade of his own portfolio over the last 30 years. You can reach him at info@tradersclassroom.com or by visiting his website at http://www.tradersclassroom.com.*

Koos van der Merwe *has been a technical analyst since 1969. He has worked as a futures and options trader with First Financial Futures in Johannesburg and for Irish Menell Rosenberg stock brokerage in the research department as a technician specializing in gold and gold shares.*

Ron Walker *is an active trader and technical analyst. He operates an educational website dedicated to the study of technical analysis. He is a video pioneer, having been one of the first to utilize the Internet for technical analysis videos.*

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TRADERS' GLOSSARY

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

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

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

Cubes (QQQQ) — Traded on the NASDAQ, cubes are ETFs that track the NASDAQ 100 index, which is made up of the 100 largest, most active NASDAQ nonfinancial stocks.

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.

Double Bottom (Top) — The price action of a security or market average where it has declined (advanced) two times to the same approximate level, indicating the existence of a support (resistance) level and a possibility that the downward (upward) trend has ended.

Engulfing Pattern — In candlestick terminology, a multiple candlestick line pattern; a major reversal signal with two opposing-color real bodies making up the pattern.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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