CHART PATTERNS	SECTORS	MARKET UPDATE
Dow's Dragonfly Doji And Divergences	Utilities Moving Sideways	Is Gold Losing Its Luster?

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GOLD, BIG PICTURE VS. CLOSEUP

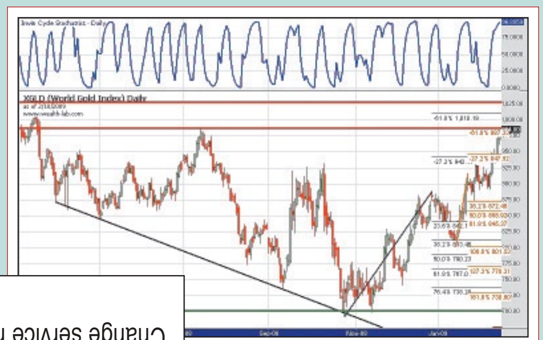

FIGURE 1: XGLD, DAILY. Here's a big-picture view of gold.

FIGURE 2: XGLD, DAILY. This closeup view shows gold right at major resistance.

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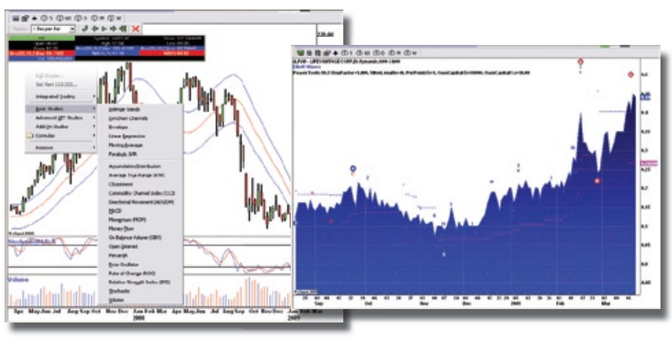

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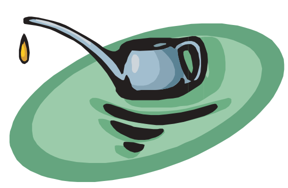

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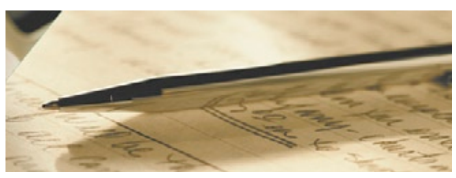

May/June 2009 • Volume 7, Number 3

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TRADING NOW

It is well known that markets move in cycles. We saw it with Tulipmania, we saw it with the dotcom bubble, and we saw it with the South Sea bubble, among others. The markets did reverse after these cyclical troughs, and it is likely that the present economic crisis will follow the same path. I am, however, concerned that this time around, the recovery may be relatively slow.

We have a situation where the individual consumer has been severely affected. This has brought down consumer sentiment drastically to the point where consumers have actually become very conservative in their spending. Add to that the sharp decrease in lending by banks, and you have a situation that is far away from the spending–lending equilibrium. And it will take a few years to stabilize this scenario. Then, of course, there are the mounting losses in the private sector, especially financials. It looks like they may need further stimulus to get things moving. Mind you, the stimulus merely replaces lost capital. It doesn't add to it, and it'll be a while before we really see capital being added to the economy.

So although the markets may look like they have started to rally, it would be in your best interest to look at the trend. Ask yourself if we are still in a bear market because, don't forget, there are rallies in bear markets. Keep an eye on the global indexes, the various sectors, chart patterns, and any indicators to get any sort of confirmation that the markets are indeed reversing. And most important, don't be influenced by what others are saying. Keep an open mind, but make your own decisions based on your knowledge.

In this issue of **Traders.com**, we have included articles to look at the market with a clear eye. There's "Measuring Your Trading Temperament," by Donald Pendergast; whether we are seeing circumstances uncomfortably close to those in the early 1930s in "DJ Vu" and "DJ Vu II," by James Kupfer; "Spotting Tomorrow's Leaders" by Mike Carr; and pondering "Dow's Direction," again by Kupfer. And there's a whole lot more.

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Jayanthi Gopalakrishnan

Jayanthi Gopalakrishnan,
Editor

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TRADING SYSTEMS

Measuring Your Trading Temperament

by Donald W. Pendergast Jr.

A well-tested trading system can help make the decision-making process less stressful, but every trader needs to determine his or her tolerance for risk and drawdown before committing to a mechanical trading process.

Tradable: NEM, AKS, HAL, APA, more

Name the trading style, and there's probably a trading system designed to take advantage of specific kinds of market behavior. Daytraders might prefer a scalp or opening gap reversal system, while long-term trend-followers might be more comfortable with a breakout system that trades commodities or sector funds. The main thing is that the trading system chosen fits well with the personality and the financial goals of the trader using it. I'll show details of a long-term trend-following system, one that was tested with a basket of mining, steel, and energy/energy services stocks over a 7-3/4 year period beginning on January 1, 2001. Stocks like HAL, AKS, APA, and NEM are typical of the equities used in testing. Only long trades were taken, no margin was used, and the starting hypothetical account balance was $50,000. The commission rate was a penny per share both for the entry and the exit.

Although this system was very profitable, there were extended periods of time that a trader's patience would have been tested. My intention is to highlight those troublesome, faith-testing periods of drawdown and reversal, contrasting it against the backdrop of profitable systems that generated both the profits and the inevitable drawdowns.

In Figure 1 you see the equity line for the system's nearly eight-year run; it's very profitable, returning at an average annual compounded rate of more than 19%, even though it boasts more losing trades than winners. Here's the big idea, one that you need to consider before launching into the world of systems trading with a big bankroll and stars in your eyes — this system earned more than $151,000 in net profits, yet it spent the first two and a half years completely under water! Look at the graph — right off the bat, you would have had to watch your initial $50,000 in account equity shrivel down to less than $38,000, even though you were following a well-tested system, using stop-losses, sizing positions wisely, and so on. Could you really have maintained your composure after a quarter decade of running this system, with nothing to show for it but red ink, or would you have cast it aside after the first series of losing trades, running to yet another system?

At one time, that's exactly what I would have done, and if you're honest, you probably would have, too. But now, let's look at the performance of this system, pretending that we're analyzing backtested results and want to know if we should risk our trading capital on this system going forward (Figure 2).

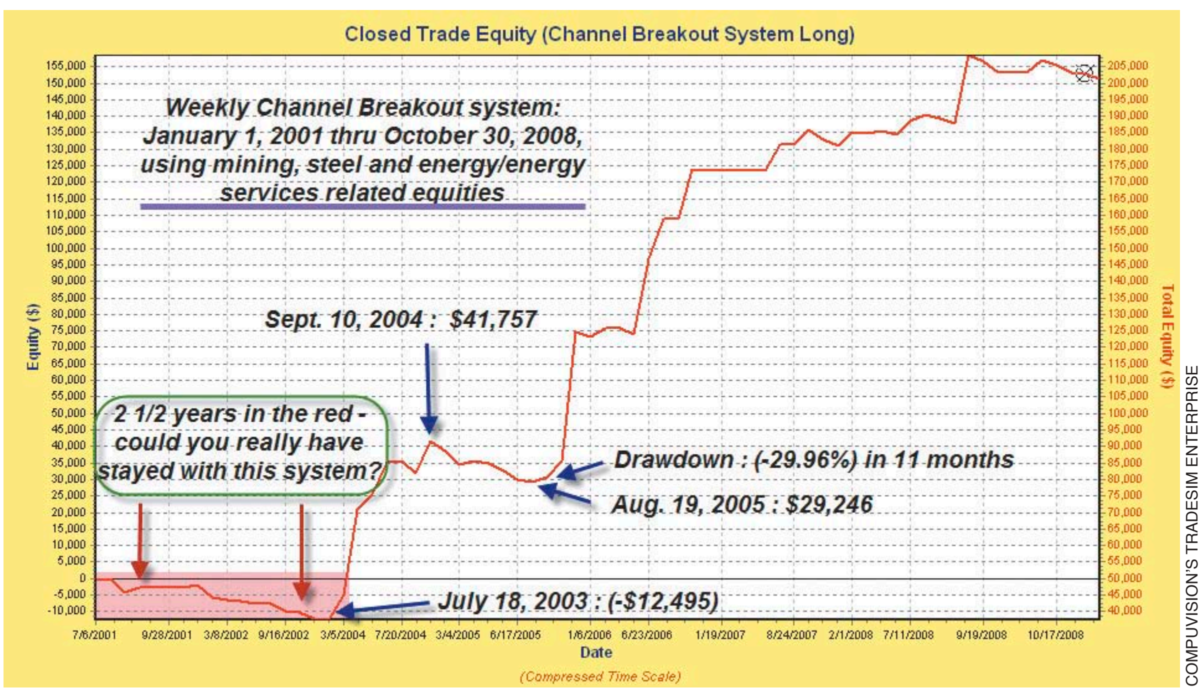

FIGURE 1: WEEKLY CHANNEL BREAKOUT SYSTEM. While this system made good money during its 7-3/4 year back-test, note how long and deep the initial drawdown was. Could you really have stayed with this trend-following system?

Profit Summary	
Profit Status:	PROFITABLE
Starting Capital:	$50,000.00
Finishing Capital:	$201,190.92
Maximum Equity/(Date):	$158,480.93 (9/12/2008)
Minimum Equity/(Date):	($12,495.18) (7/18/2003)
Gross Trade Profit:	$208,225.09 (416.45%)
Gross Trade Loss:	($57,034.17) (-114.07%)
Total Net Profit:	$151,190.92 (302.38%)
Average Profit per Trade:	$2,159.87
Profit Factor:	3.6509
Profit Index:	72.61%
Total Transaction Cost:	$6,191.17
Total Slippage:	$0.00
Total Trade Interest:	$0.00
Daily Compound Interest Rate:	0.0490%
Annualized Compound Interest Rate:	19.5788%
Trade Statistics	
Trades Processed:	1761
Trades Taken:	70
Partial Trades Taken:	0
Trades Rejected:	1691
Winning Trades:	32 (45.71%)
Losing Trades:	38 (54.29%)
Breakeven Trades:	0 (0.00%)
Largest Winning Trade/(Date):	$39,216.69 (12/23/2005)
Largest Losing Trade/(Date):	($4,162.20) (9/28/2001)
Average Winning Trade:	$6,507.03
Average Losing Trade:	($1,500.90)
Average Win/Average Loss:	4.3354

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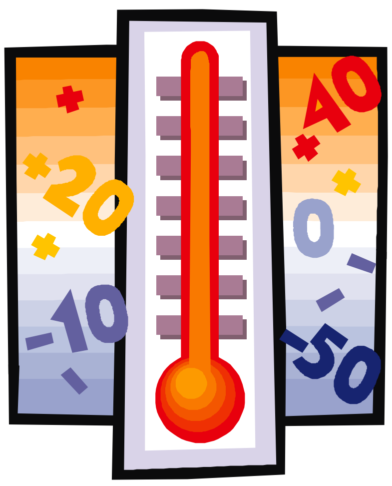
FIGURE 2: PROFIT SUMMARY AND TRADE STATISTICS. This weekly channel breakout system (long only) produced good backtested results on a mix of mining, steel, and energy/energy service stocks from January 2001 through October 2008. Note how high the profit factor is: 3.65.

Consecutive Trade Statistics	
Maximum consecutive winning trades:	5
Maximum consecutive losing trades:	9
Average consecutive winning trades:	1.88
Average consecutive losing trades:	2.11
Relative Drawdown	
Maximum Dollar Drawdown/(Date):	$10,206.45 (7/18/2003)
Maximum Percentage Drawdown/(Date):	21.4400% (7/18/2003)
Absolute (Peak-to-Valley) Dollar Drawdown	
Maximum Dollar Drawdown:	$12,609.91 (25.2200%)
Capital Peak/(Date):	$50,000.00 (-)
Capital Valley/(Date):	$37,390.09 (7/18/2003)
Absolute (Peak-to-Valley) Percent Drawdown	
Maximum Percentage Drawdown:	25.2200% ($12,609.91)
Capital Peak/(Date):	$50,000.00 (-)
Capital Valley/(Date):	$37,390.09 (7/18/2003)

FIGURE 3: DRAWDOWNS. Not a system for those who need instant gratification, the drawdowns have been substantial at times. Losing streaks last about 80% longer than winning streaks, too. Could you handle this, emotionally?

The stats look great — the average trade returned $2,160, the profit factor is 3.65, and the average win/average loss ratio is well above 4.30. While the system only wins about 46% of the time, that's a very typical win rate for a trend-following system like this. The 19%+ annual average return sure beats the return on a passbook savings account, too.



All of this is wonderful, but if you hadn't also looked at some other stats like maximum peak to valley drawdown, for example, you might have overlooked the possibility of a huge and disturbing period of drawdown, and that right off the bat, no less.

In Figure 3 you can see some of those other stats, the ones that reveal that trading this system will likely require a large dose of patience and foresight. Note how long the string of winning trades (five) versus losing trades (nine) is, along with the average number of winning trades (1.88) versus losing trades (2.11) is. Clearly, if you constantly need the emotional gratification that comes from a high win percentage system, you're going to be disappointed if you choose to trade this method. And once again, there are those drawdown stats, too — a 25% drawdown right from the start, not to mention the 2004-05 drawdown that loppped another 29% off that rapidly rising equity line.

So that was then and this is now. What about launching with this system right now? After all, it has a profitable track record, healthy stats, and it trades stock with a penchant for dramatic trending moves — what's to be concerned about? Nothing, really, except for the fact that the future is unknowable and you could start trading this system tomorrow and go right into a three-year long drawdown. It could happen, and you would need to be mentally and financially prepared for such a possibility. Always make sure that you make a full and thorough investigation of the performance and drawdown characteristics of any system you are considering before you part with your cash. That would be a wise investment of your time.

This system could also be configured to take short trades. I have tested it as such, but the results are much more modest than the long-only version described. The combined equity curves are only marginally more profitable, and since selling stocks short involves margin costs, dividend payment liabilities, the danger of violent short squeezes, and higher commission costs (versus a long-only system), trading this channel breakout system on the short side may not be worth the hassle. Regardless, it's nice to know that such old-line systems as the channel breakout can still hold their own in today's trading arena. ■

INDEXES

TECHNICAL ANALYSIS

30-Year US Treasury Bonds Uptrend Losing Strength

by Paolo Pezzutti

Prices may have initiated an A-B-C correction.

Tradable: US.P

Several analysts are warning about the next big asset bubble — US Treasuries. In fact, yields have plunged to lowest levels in decades as investors, in a typical flight-to-safety approach, fearful of a sustained recession and deflation, have purchased government-issued debt.

Since the beginning of November and quite impressively, prices of the 30-year US Treasury bonds future contract (US.P) have moved from about 112 to a high above 140 in December. The warning is coming after the surge of prices, but if you look at the longer picture (Figure 1), you can see the long uptrend started in the 1980s. Treasuries have been quite a good investment so far.

I used the force index indicator, which is an indicator measuring the force of bulls during uptrends and the force of bears in downtrends. It takes into account price and volume. I applied a 13-day exponential moving average (EMA) of the force index to help track the trend. When the trend is positive, the color is blue; when the trend is negative, the color is red.

I applied also the %b indicator, which is derived from the Bollinger bands. It measures where the last price is in relation to the bands and it is used to tell us where we are within the bands.

In the weekly time frame (Figure 2), the trend according to the force index is still positive. The %b left the overbought level and prices after a bearish candlestick pattern printed at the top. At the daily level (Figure 3), the force index indicates a continuing uptrend, while %b has printed a negative divergence in coincidence with the December top and toward the oversold level. The gap printed on December 17 has proved to be an exhaustion gap. In fact, days immediately after the gap, the Treasury futures contract developed a congestion, then closed the gap and printed a first leg to the downside that retraced about 30% of the steep up move. Prices had a rebound from January 7 to January 15, retracing more than 55% of the first correction. Note that the rebound lasted so far seven bars while the leg to the downside were developed in only five bars. The longer move developed about half the distance in price. This shows that bulls are still trying to push prices higher, but their action is losing effect. Moreover, the rebound reached the level from where prices gapped on December 17. The

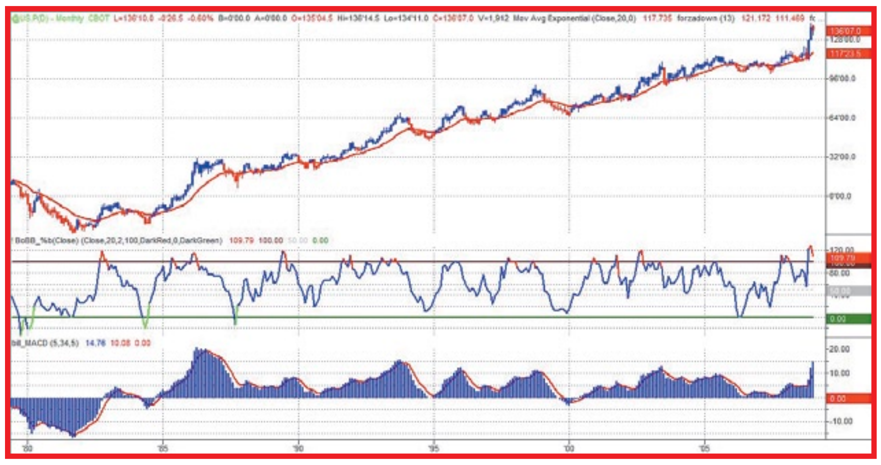


FIGURE 1: 30-YEAR US TREASURY BONDS, MONTHLY. Bonds have been in an uptrend for many years.

FIGURE 2: 30-YEAR US TREASURY BONDS, WEEKLY. Bonds printed an impressive up move between November and December 2008.

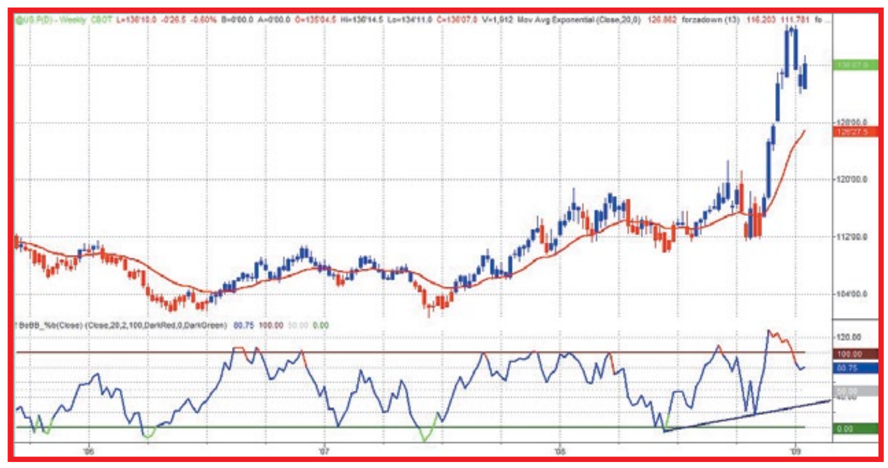


FIGURE 3: 30-YEAR US TREASURY BONDS, DAILY. The closure of the exhaustion up gap has inititated a correction.

area of the gap represents a resistance, and a closure of the gap would imply a likely retest of the top.

Assuming that the medium-term uptrend in bonds is still ongoing, the present correction could develop in an A-B-C pattern. The futures contract in this scenario could have printed waves A and B and could be about to develop a second leg to the downside in the form of wave C. I would not open a long trade on Treasuries, although in this moment both the weekly and daily time frames indicate that an uptrend is ongoing. I see too much risk to the downside. Instead, to open a short trade there are several options. A bearish pattern in the coming days could provide the trigger with a stop-loss above 137. Or it is possible to anticipate and sell short next to resistance levels, should prices continue to move up in the next sessions? ■

The force index measures the force of bulls during uptrends and the force of bears in downtrends.

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TECHNICAL ANALYSIS

DJIA Resumes Downward Trend

by Alan R. Northam

The corrective rally off the late November low came to an end in mid-January 2009, and on February 2, 2009, the DJIA officially resumed its downward trend.

Tradable: $INDU

In late November 2008, the Dow Jones Industrial Average (DJIA) put in a market bottom and then rallied during December (see Figure 1). Looking at the wave structure, note that during the course of December, the DJIA made a series of overlapping waves as it rallied into the new year. Overlapping waves signal a struggle to make upward progress. According to the Elliott wave theory, overlapping waves occur during market corrections. The Elliott wave theory therefore marks the rally from late November to the beginning of the new year as a market correction.

In early January 2009, the DJIA started to sell off and moved below the support shelf drawn off the December 12th low. The breaking of this support shelf signaled the end of the corrective rally that started last November. Market rallies are made up of a series of waves that form higher peaks and higher valleys, and market selloffs by a series of waves that form lower peaks and lower valleys. The breaking of the support shelf in mid-January signaled a breakdown in the series of higher valleys and signals the making of the first lower valley. Six trading days later, after breaking below the support shelf, the DJIA put in its first lower valley. However, the DJIA still needed to make a new lower high to signal the beginning of a new downward trend. The breaking of the support shelf signaled the end of the corrective rally but does not necessarily signal a new downward trend. It could simply mean that the market trend is changing. This change could be in the form of a more shallow upward trend or even a trading range.

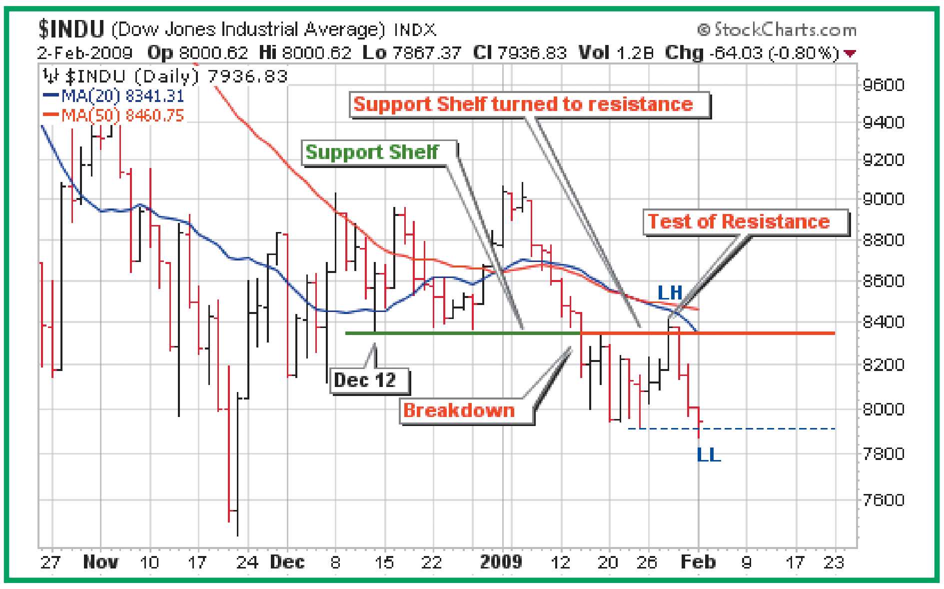

FIGURE 1: DJIA, DAILY. Here's how the DJIA has appeared over the last four months.

Three trading days later, after putting in a lower low, the DJIA challenged the support shelf, which has now turned into resistance. The test of resistance held and the DJIA turned back down. The failure of the DJIA to move above this line of resistance ended up forming a lower high. This lower high then signaled that a new downward trend was developing. Three days later, the DJIA made another lower low, confirming that the new downward trend is now in progress.

In support of this analysis, note that price is below the 20-day short-term moving average and the 50-day moving average. As long as price continues to remain below these two moving averages, the trend will remain downward. ■

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OVERBOUGHT OVERSOLD

Oversold Markets

by Mike Carr, CMT

"Oversold" does not mean "Buy now."

Tradable: DJIA

Technical analysts often talk about a market being oversold or overbought. "Oversold" means the price has fallen so much that it is now severely undervalued and should represent a buying opportunity for investors. "Overbought" markets are those in which price has run up too fast and there is likely to be a shortage of new buyers. These conditions represent extremes and should occur rarely.

Figure 1 shows an example of an oversold market condition. Over the past 12 months, the Dow Jones Industrial Average (DJIA) has declined by more than 36%. In the brutal bear market that began in 2000 and ended in 2002, the rate of change never exceeded 25%. The severity of this bear market is unusual.

Looking to history as a guide of what to expect next, we find that the market reached this level of extreme downward movement in 1974, very close to the ultimate bear market bottom (Figure 2). After declining by 35.8% in the 12 months ended in September 1974, the market rose by 70% over the next 15 months.

Looking further back in history, we see that the market became this oversold in August 1930 as well (Figure 3). But that time the market stayed oversold until March 1933, falling another 75% after becoming oversold.

While history offers a guide as to what we can often expect the market to do, it is more often than not an inconclusive guide. Stocks may turn higher from this oversold level, or they may remain oversold and decline further. Time will tell, and technicians touting a once-in-a-lifetime buying opportunity on cable news should be ignored. ■

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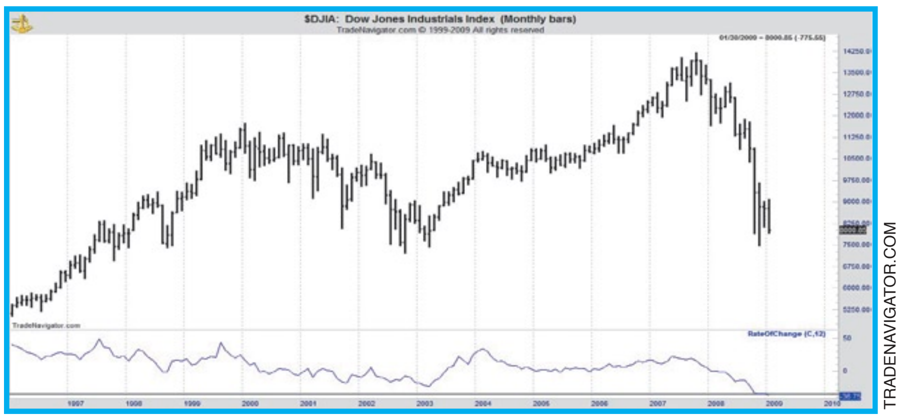
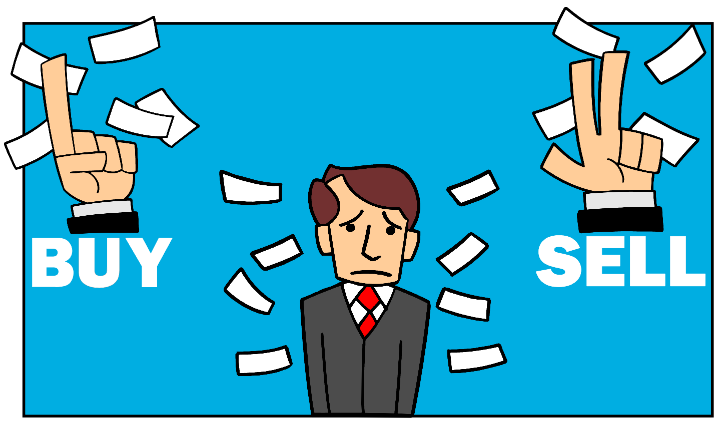


FIGURE 1: DJIA, MONTHLY. The DJIA appears to be oversold.

FIGURE 2: DJIA, MONTHLY. The 1974 bear market bottom occurred after the market became oversold, reaching a level almost as severe as the current reading.

FIGURE 3: DJIA, MONTHLY. Oversold markets can stay oversold, as the DJIA did in the 1930s.



TREND CHANNELS

CRB Doldrums

by James Kupfer

What is going on in the CRB?

Tradable: CRB

At the beginning of January 2009, I suggested to readers that the Commodity Research Bureau Index (CRB) might well have hit an intermediate-term bottom. Since then, the CRB has traded in a relatively tight range, neither rebounding after its tremendous fall nor increasing in value to any appreciable extent.

As can be seen in Figure 1, both price and the relative strength index (RSI) are very flat. On the bearish side, the RSI has been unable to break above 50, thus indicating a continued level of weakness in the CRB. On the bull's side is the fact that the CRB has continued to remain above the slightly upward-sloping purple trendline.

Now, however, we are at an important juncture. For the CRB to have any chance to rebound, it must successfully test the support line. Failure to hold the line would likely lead to a retest of the December 2008 lows. Failure to hold that low would likely mean a resumption of the previous downward trend and a continuing series of fresh new lows. ■

FIGURE 1: CRB, DAILY. The CRB index lacks any clear direction other than sideways.

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Adam Hewison, co-creator of MarketClub, was one of the first currency traders on the International Monetary Exchange. He was also a member of the Chicago Mercantile Exchange's Index and Options Market, the New York Futures Exchange, and the London International Financial Futures Exchange. He has been widely featured in the media including CNBC, Bloomberg, ABC News, Washington Post, Forbes, Futures Magazine, Marketwatch.com, Chicago Daily Herald, and USA Today. – **Adam Hewison**

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CYCLES

DJ Vu

by James Kupfer

Looking back in history may show us what the future will look like for the Dow Jones Industrial Average.

Tradable: DJIA

The combined chart in Figure 1 is a weekly view of the Dow Jones 30 from two different time periods. Blue lines have been drawn between relative tops and purple lines have been drawn between low points. As can be seen, highs and lows occur within close proximity with one another. While the similarities are obviously not perfect, we could be forgiven for thinking that the charts shown here are from two correlated stocks over the same time period.

In fact, the charts are almost 80 years apart. The chart on top starts at the 2007 market top. The chart beneath starts at the 1929 market top. Before dismissing this as a coincidence, keep in mind that the stock market is cyclical in nature, and therefore it is not at all surprising that the charts from so long ago are eerily similar to what is happening now.

If we accept 1929 as a generalized guide as to what may happen in the DJ30 going forward then, the picture is bleak indeed. It is also interesting to note that from the 2007 high until today the market is down 44.7%; from the 1929 top until where in the corresponding cycle we are (based on my rough estimate) the market of 1929-30 was down 43.7%. From October 1930, the Dow fell another 81% over another year and a half. For us today, that would equate to a Dow low of about 1500 sometime in 2010–11.

While it may seem impossible to us now to comprehend a Dow Jones 30 of 1500, I'm sure it seemed equally unlikely to a stock jobber in 1930 that the market would eventually hit a low of 40 from a high of 380. This forecast certainly may not happen — and hopefully won't — but it may be worth keeping in mind. See Figure 2; is the red line an indicator as to where we are today relative to 1930? ■

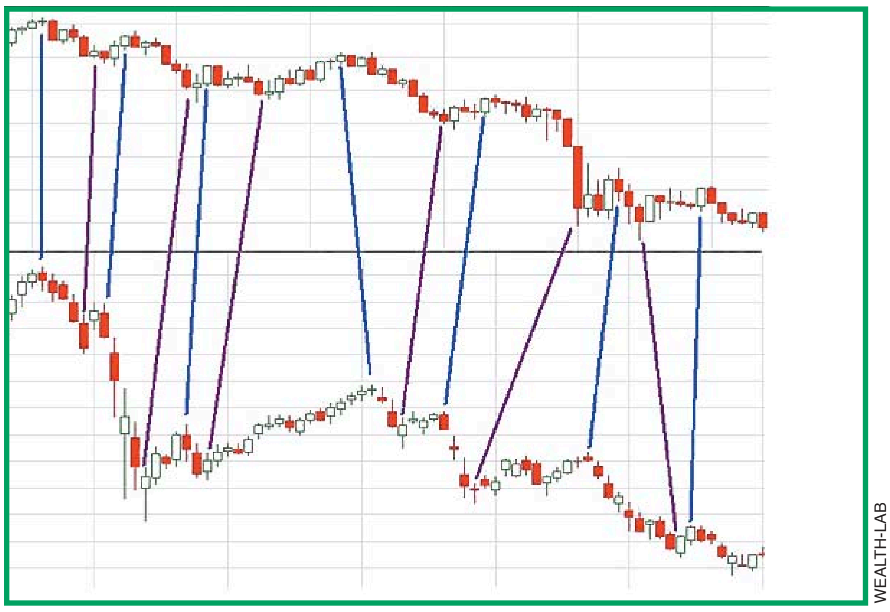

FIGURE 1: DOW JONES INDUSTRIAL AVERAGE, 2007 AND 1929. Blue marks cycle highs, purple cycle lows.

FIGURE 2: SIGN OF THINGS TO COME? Is the red line an indicator of where we are today relative to 1930?

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The stock market is cyclical in nature, so it is not at all surprising that the charts from so long ago are eerily similar to what is happening now.

CYCLES

DJ Vu, Part II

by James Kupfer

History may be happening again in more ways than one.

Tradable: DJ 30

On February 18, I wrote in an article titled "DJ Vu" about some of the apparent cyclical relationships between the current bear market and that of the early 1930s. After writing that article, I decided to see if there were any other apparent relationships that might be of interest. There are.

There have thus far been four major down moves from the market top in 2007. These are labeled on the bottom chart. The bear market of the early 1930s consisted of seven major down moves, of which I have shown the first four for comparison. There are more comparisons that may come into play in the future, but for now let us focus upon two relevant comparisons between these bear market moves. See Figure 1.

During the Great Depression, move 1 lasted 11 weeks as did move 2, while moves 3 and 4 were both 15 weeks in length, for an average of 13 weeks per move. In the recent bear market, move 1 lasted 16 weeks, move 2 lasted 12 weeks, and move 3 was 15 weeks, while the current move 4 down has currently lasted nine weeks. Should move 4 end this week (week 10), the average length for each move down would be 13.25 weeks. While this is not a very large sample group, it is apparent that there are great similarities between the lengths of time that each move has taken. If the similarities hold, we should expect the current move to end this week.

Fibonacci ratios were good predictors of future price action during the bear market of the Great Depression. The bottom of move 3 was near 161.8% of move 2, while the bottom of move 4 was near 127.2% of move 3. Similarly, the bottom of the 2008 move 3 was near 200% of move 2, while move 4 is approaching 127.2% of move 3. That price target would be

Fibonacci ratios were good predictors of future price action during the bear market of the Great Depression.

6247. However, as I stated on February 20, there are two other Fibonacci support levels right around 6430.

In summary, there are interesting similarities between the downward moves of the 1930s and today. These include the time duration of the moves as well as the Fibonacci relationships between the moves. This coupled with the price action previously described in "DJ Vu" lends further credence to the idea that what is happening now is similar in structure to what happened in the 1930s, and as such can serve as a guidepost as to what may come. Should these relationships continue to hold, the Dow Jones 30 would be expected to bottom on an intermediate-term basis in the next week around 6247. ■

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FIGURE 1: DJIA, WEEKLY. Although the moves vary in magnitude, there is a strong similarity between the price action in the 1930s and today.

SECTORS

TECHNICAL ANALYSIS

Financial Sector Leads Broader Stock Market

by Alan R. Northam

There are many ways to determine if the stock market is at or near a major market bottom. One way is by looking at the financial sector. Turns in the financial sector normally lead turns in the broader stock market.

Tradable: XLF

Before the stock market can make a significant recovery, at least three things need to occur. First of all, there needs to be consumer confidence before those consumers start to loosen their purse strings. On January 27, I wrote an article discussing how comparing the consumer staple index to the consumer cyclical index can help in determining this confidence by consumers. Second, retail spending needs to increase. On January 29, I wrote an article that showed that the retail market sector still had further to go on the downside. And the third thing that needs to happen is that the financial market sector needs to turn upward. The financial market sector typically leads the broader stock market. Therefore, if we can determine that the financial sector has turned upward, we then know that the stock market is not far behind in turning upward as well. Today, I'm looking at the current technical situation of the financial market sector.

Figure 1 shows the daily bar chart of the Financial Select Sector SPDR (XLF). This chart shows that over the last four months, XLF has been in the process of forming a falling wedge trading pattern. Falling wedges are rare and normally occur at or near the end of a trend. As such, this falling wedge is foretelling the end of the current downward trend for the financial market sector. In terms of the Elliott wave theory, these falling wedges are called ending diagonals. The Elliott wave theory suggests that there will be a final leg downward that will penetrate the lower support boundary line of the ending diagonal. By looking at the chart, we can see that XLF is currently testing this lower support boundary line.

FIGURE 1: XLF, DAILY. This chart shows a falling wedge trading pattern that normally occurs at the end of a trend. This chart also show the accumulation/distribution indicator below the price chart.

To determine just how low we should expect XLF to fall if it successfully breaks out below the lower support boundary line of the falling wedge formation, note that the symmetrical triangle that has formed within the boundary of the larger falling wedge. Note further that XLF has broken out to the downside of this symmetrical triangle.

To measure the extent of the move down from the breakout of a symmetrical triangle, it is normal to project the widest distance of the triangle from the breakout point. I have identified that the widest price difference of the symmetrical triangle with two red arrows. Projecting this price difference from the breakout price of the symmetrical triangle yields a price target of $6.00. This, then, is the expected price target of the complete move downward for XLF.

To further help support the analysis that XLF is on the verge of completing its move downward, I have shown the accumulation/distribution indicator. The accumulation/distribution indicator measures volume. The basic premise behind this volume indicator is that volume precedes price. Many times before price starts to advance, there will be a period in which volume increases just prior to price. Looking at the accumulation/distribution indicator with respect to XLF, as price continues to move lower, the accumulation/distribution indicator has been moving upward by forming higher lows. This indicator is informing us that volume is increasing and we should expect price to follow suit in the not-too-distant future. From a technical analysis viewpoint, this is called a bullish divergence. Bullish divergences are often found at the end of a trend and in themselves forewarn of a pending change in the direction of the trend.

In conclusion, XLF looks to be forming a falling wedge trading pattern that is foretelling the end of the downward trend in the financial market sector. A final leg downward to the price target of $6.00 is expected and will mark the end of the trend. Once the financial sector has bottomed and turned upward, we can then expect the broader stock market to follow suit within the next several months. ■

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TECHNICAL ANALYSIS

Utilities Moving Sideways

by Paolo Pezzutti

Trading a breakout of the long consolidation is an option.

Tradable: XLU

In June 2008, when I wrote an article about utilities, the price of the Utilities Select Sector SPDR (XLU) was about $40. Prices were in a trading range and after the breakout to the downside, they moved to print a new low at $23.28 in October. Since then, XLU has started a long consolidation. If you see the weekly chart in Figure 1, it looks as if a congestion with prices contained within the wide-ranging bar printed during the first week of October. Basically after the panic selling, XLU has managed to build a base and move slightly higher to the present value of $28. If this is the premise for another leg to the downside, it is difficult to say. In this time frame, the force index indicator, which I used to indicate the trend, is still negative. This indicator takes into account price and volume. A 13-bar exponential moving average (EMA) of the force index is used to track longer-term changes in the force of the market's participants. In the figure you can also see the %b indicator, which is derived from the Bollinger bands. It measures where the last price is in relation to the bands. The %b moved up from the oversold level; its value is about 40 and it does not provide useful indications. Prices are in the middle between the bands, which are converging quickly as a result of the ongoing sideways phase.

Moving to the daily time frame (Figure 2), the formation is more evident and it displays the interesting feature of having higher lows. The resistance at $30 has been tested many times and its breakout to the upside would be a very reliable signal. To the upside, XLU would have a potential to reach the area at $32–33. Prices are now testing the rising trendline. The force index indicator is negative also in this time frame. The %b indicator after printing a negative divergence in coincidence with the last test of the resistance at $30 has managed to break out its trendline to the downside. It is difficult to say if the indicator is anticipating a price move. The Bollinger bands are parallel and narrow; the price is close to the lower band, which has acted as a support in the past.

It is hard to predict on which side the breakout will occur. The higher lows in the formation indicate that chances are that we will see an exit to the upside. But I would not bet on it. There are different options on how to open a trade; one is trading the breakout on either side, while the other is trying to anticipate the exit based on a pattern or risk-reward considerations. ■

FIGURE 1: XLU, WEEKLY. Prices are developing a long congestion. The Bollinger bands are still converging in this time frame.

FIGURE 2: XLU, DAILY. Higher lows of the long formation indicate that prices could break out to the upside. You can see that the $30 level has been tested many times and a breakout would be a reliable signal.

Health Care Index Declines

by Chaitali Mohile

The reversal patterns are likely to drag down the Health Care Index to the immediate support level. Is the correction only a reaction to bearish formations?

Tradable: $RXP

The positive divergence on the relative strength index (RSI) (14) of the Health Care Product Index ($RXP) gave birth to a bullish rally. The average directional movement index (ADX) (14) in Figure 1 surged above 40 levels, indicating an overheated downtrend. And the bullish crossover of the moving average convergence/divergence (MACD) (12,26,9) strengthened the new upward move. $RXP witnessed a robust rally of about 150 points from 1100 to 1250 levels and entered a sideways consolidation period. But in Figure 1 we can see the consolidated move was not healthy as more than one hanging man candle appeared. The hanging man candlestick pattern indicated a reversal rally and reluctance in carrying the upward rally higher.

However, $RXP broke upward on the weak candlestick pattern. The declining RSI (14) added the bearish pressure on the breakout. The RSI (14) indicated lack of strength to move the price rally higher (see the market circle in Figure 1). Currently, the ADX (14) is indicating a developing downtrend. For undergoing a bullish breakout rally in the downtrend, the stock/index requires robust strength and positive momentum. Figure 1 shows another hanging man formation after the bullish week. As a result, the index began descending. Currently, $RXP is near the breakout support. But the weak indicators suggested a further descent toward the next support at 1200 level.

Figure 2 shows the rising wedge formation on the price chart. The rising wedge is a bearish reversal pattern that breaks in a downward direction. $RXP formed this pattern during the relief rally in a bear market. As seen in Figure 2, $RXP has already broken down. The RSI (14) has declined vertically and has marginally moved below 50 levels, suggesting a downside rally. The bearish crossover of MACD (12,26,9) in the positive territory and the weak ADX (14) would drag $RXP to the 50-day moving average (MA) support at 1239 level.

Thus, the current descent in $RXP is only the reaction of the bearish formations on the charts. But if the 50-day MA support is breached, the index would resume its downward journey as the main trend remained bearish. ■

FIGURE 1: $RXP, WEEKLY. Here's the cluster of hanging man candlestick patterns.

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FIGURE 2: $RXP, DAILY. The rising wedge has broken downward. The 50-day MA is the immediate support for the declining rally.

RELATIVE STRENGTH COMPARATIVE

Fidelity Sector Funds Leaders And Laggards

by Donald W. Pendergast Jr.

Comparing the track records of the Fidelity Select Sector funds on a short-, intermediate-, and long-term basis may help identify industry group rotations.

Tradable: FSBIOX, FSAVX

Fidelity offers one of the most comprehensive array of sector funds; these 42 funds cover all of the key sectors and industry groups in the broad US markets. Although not as flexible to use as comparable exchange traded funds (ETFs) (no shorting available and only end of day trading permitted), for longer-term traders and investors, they remain a popular means of latching onto the strong trending moves that result as vast amounts of institutional money hurtle though the markets, seeking out the sectors with the best chances of long-term growth. While a discussion of all of the various ways to effectively trade Fidelity Select Sector funds isn't possible here, there are a few basic ways to determine which sector funds are strengthening or weakening on both a short-term and a long-term basis. We'll examine a simple price comparison method here, one that measures the percentage increase/decrease in a fund's price on a one-, five-, 10-, 20-, 30-, 60-, 120-, and 240-trading day basis, complete with the appropriate MetaStock exploration code to enable you to determine which sector funds are likely to be favorable places to deploy your investment capital.

In MetaStock's Explorer, create the following exploration (same as in Figure 1):

Name: Fidelity Daily Performance
Exploration notes: One-, five-, 10-, 30-, 60-, 120-, 240-day performance, sorted on one-day performance.

For those with MetaStock, entering the exploration code (in the graphic) should be second nature by now; the leftmost text indicates the name of each particular column that will be displayed atop the exploration output, while the capital-lettered text on the right side is the actual code to be pasted into the formula box for each column. No filter is used.

Now, paste each line of the code into its appropriate formula box in Explorer. Under "Options," make sure you select "Most recent date" and "Daily" under "Exploration Periodicity." Click OK when you've done that, highlight the new exploration you just created, hit Explore and then load your list of Fidelity Select Sector mutual funds.

Hit OK, let it rip through all the data (takes about two seconds) and then click Reports to bring up the same exploration output grids shown in Figure 2.

The idea of the exploration is to track the long- and short-term rotation of the funds, paying particularly close attention to those funds that are exhibiting strength across a range of time frames as well as those that are manifesting weakness across multiple time frames. Once you've identified the persistently strong and weak funds, you may be better able to make wise decisions as to which funds you want to deploy cash into. Another way to use this information is to find the strongest funds (particularly those with the strongest 240-day reading, which covers about a year's worth of market action) and then drill down to the component stocks within those funds (Fidelity posts partial listings of each sector fund's holdings on their website), looking for key support/resistance levels and/or pullbacks in a strong trend that may provide low-risk entry points.

Exploration notes	1,5,10,30,60,120,240 day performance, sorted on 1 day performance.
Col A: Close	CLOSE
Col B: 1 Day	ROC(CLOSE,1,percent)
Col C: 5 Day	ROC(CLOSE,5,percent)
Col D: 10 Day	ROC(CLOSE,10,percent)
Col E: 30 Day	ROC(CLOSE,30,percent)
Col F: 60 Day	ROC(CLOSE,60,percent)
Col G: 120 day	ROC(CLOSE,120,percent)
Col H: 240 day	ROC(CLOSE,240,percent)
Filter enabled	No
Periodicity	Daily
Records required	5000

METASTOCK

FIGURE 1: SECTOR FUNDS PERFORMANCE. Tracking the performance of sector funds on a short-, intermediate-, and long-term basis may prove useful in spotting sector rotations and trend persistence.

For the bottom fishers of the world, daily monitoring of the weakest sector funds could also prove beneficial, particularly when the broad markets are showing signs of major downside exhaustion. Some sector fund analysts have posited that most sectors hit bottom two to three years after crashing from substantially higher levels, and that these devastated sectors (if down 70% to 90%) can frequently turn into the next market cycle's outperformers. Consistent monitoring of the sector funds on a regular basis should prove useful to a variety of traders and investors.

Figure 2 displays today's' results on all 42 Fidelity Select Sector funds. Fidelity Select Biotechnology (FBIOX) has had the best 240-day performance, only down by -3.41%, no small feat given the devastating bear market since late 2007. We also note that although FBIOX is down by -18.28% during the past 120 trading days, its one-, five-, 10-, 20-, 30-, and 60-day performance has been relatively flat to slightly down. In fact, just by glancing at the performance figures for trading periods 1-30, a trader could determine that FBIOX was either in a period of consolidation and/or a very weak trend, which indeed happens to be the case.

Now let's examine the worst performing sector fund over the past 240 trading days — Fidelity Select Automotive (FSAVX). Down a mind-shattering -67.84%-, this fund is also the weakest in the 120-, 60-, and 30-day columns as well. Incredibly, this fund is also in the red in the shorter-term one-, five-, 10-, and 20-day columns, too. At first glance

"Fidelity - Performance, Daily" Explored 2/26/2009 20:40

Results | Rejects | Exploration

Security Name	Close	1 Day	5 Day	10 Day	30 Day	60 Day	120 day	240 day	Ticker...
Fidelity Select Biotechnology	56.8500	-4.2768	-5.0918	-7.1382	-4.6301	4.3502	-18.2837	-3.4149	FBIOX
Fidelity Select Pharmaceuticals	7.8200	-3.0979	-6.0096	-8.6449	-9.5954	-6.0023	-22.3137	-18.8447	FPHAX
Fidelity Select Medical Equipment and Systems	18.1100	-4.3823	-6.9373	-7.6962	-0.8215	3.1631	-29.4021	-19.5885	FSMEX
Fidelity Select Health Care	76.0500	-4.6754	-7.7511	-9.5181	-5.2100	-0.3221	-27.3188	-24.5985	FSPHX
Fidelity Select Retailing	26.1800	0.0382	-0.6829	-3.9618	-5.6577	-1.1970	-32.9075	-24.6624	FSRPX
Fidelity Select IT Services	10.5800	-1.2138	-1.8553	-5.2820	-7.1930	-1.7642	-34.4486	-24.9645	FBSOX
Fidelity Select Consumer Staples	44.2900	-1.9048	-4.6707	-5.4441	-10.0893	-10.4929	-26.2658	-28.7209	FDFAX
Fidelity Select Leisure	46.3500	-2.2564	-2.0913	-6.6841	-9.6843	-4.5279	-28.4069	-30.2754	FDLSX
Fidelity Select Telecommunications	26.9100	-0.8840	1.8932	2.6707	1.0514	4.4542	-31.6730	-31.0794	FSTCX
Fidelity Select Software and Computer Svc	44.4900	-1.7664	-3.6387	-7.1965	-6.6317	-3.8885	-31.8683	-31.2152	FSCSX
Fidelity Select Wireless	4.4800	-1.3216	0.9009	0.6742	2.0501	9.8790	-31.2841	-32.1046	FWRLX
Fidelity Utilities	11.5100	-0.6045	-1.3710	-7.1774	-9.0119	-11.9511	-28.9477	-32.9944	FIUIX
Fidelity Select Medical Delivery	26.1300	-8.3158	-15.6008	-16.7039	-9.0814	-0.3052	-34.7891	-33.0421	FSHCX
Fidelity Select Networking and Infrastructure	1.2100	-1.6260	0.0000	-6.2015	-2.4194	0.8333	-37.9487	-34.2391	FNINX
Fidelity Select Environmental	11.0100	-2.4801	-6.0580	-9.3827	-12.8956	-13.4175	-35.4668	-34.4739	FSLEX
Fidelity Select Gold	30.7700	0.7531	-6.2748	-6.7858	9.5018	23.7234	6.4338	-35.5751	FSAGX
Fidelity Select Utilities Growth	35.4000	-1.1173	-4.0650	-10.8537	-10.3116	-13.8757	-29.9334	-36.9632	FSUTX
Fidelity Select Consumer Discretionary	11.6200	-1.4419	-1.9409	-7.3365	-12.1029	-9.7926	-38.8872	-37.8488	FSCPX
Fidelity Select Construction and Housing	18.2100	-0.2192	-1.9914	-13.7784	-20.7227	-18.1023	-42.2140	-39.8674	FSHOX
Fidelity Select Computers	23.5600	-1.0915	-2.4431	-9.2799	-6.7669	-6.5450	-39.4967	-40.2637	FDCPX
Fidelity Select Communications Equip	10.8100	-1.0073	0.0000	-5.5070	-6.9707	-2.6225	-44.0907	-40.7983	FSDCX
Fidelity Select Technology	37.3000	-1.0872	-0.6922	-7.2370	-5.8794	-1.5055	-41.7408	-40.8192	FSPTX
Fidelity Select Transportation	24.1900	-2.0648	-5.6184	-13.9452	-20.0066	-24.7281	-43.8414	-41.2146	FSRFX
Fidelity Select Air Transportation	18.1200	-1.7886	-6.9815	-14.1232	-29.6584	-21.9638	-38.9282	-41.5770	FSAIX
Fidelity Select Electronics	21.2700	-1.3908	1.3823	-6.9147	-3.4060	-1.1415	-37.1611	-41.6678	FSELX
Fidelity Select Defense and Aerospace	40.3400	-2.0636	-10.1359	-13.7297	-17.0812	-11.4276	-40.1133	-43.1052	FSDAX
Fidelity Select Multimedia	18.2900	-2.7128	-0.7058	-7.4393	-14.3326	-13.0249	-43.1928	-44.2359	FBMPX
Fidelity Select Chemicals	42.7500	-0.8351	-5.8785	-10.3774	-10.7516	-10.2675	-44.6495	-45.2488	FSCHX
Fidelity Brokerage & Investment Mgmt	28.0300	1.3743	-2.7074	-11.7165	-10.3040	-5.2011	-42.5788	-45.8491	FSLBX
Fidelity Select Industrial	10.3200	-1.8078	-7.3609	-14.6402	-18.8679	-17.7411	-46.9460	-47.9369	FCYIX
Fidelity Select Insurance	25.1600	-0.2379	-2.2913	-12.5478	-20.2283	-15.6531	-42.7579	-48.5391	FSPCX
Fidelity Select Materials	27.7400	-0.6447	-4.2127	-9.9643	-9.3760	-6.0402	-45.0330	-50.7072	FSDPX
Fidelity Select Paper and Forest Products	13.0300	0.5401	0.3852	-9.7020	-13.3067	-16.3497	-52.0615	-51.0159	FSPFX
Fidelity Select Banking	9.7400	4.7312	15.2663	-7.5024	-24.7295	-35.0036	-47.5343	-52.2149	FSRBX

FIGURE 2: FBIOX, DAILY. Any mutual fund that's down by only 3.4% in the past 12 months must certainly qualify for the term "survivor."

this fund might appear like a potential buy from a bottom-fisher's point of view, but extreme caution is warranted since the broad markets still have not made a confirmed low yet. If we do see that major low confirmed, then prudent investors might want to deploy a small amount of cash into either FSAVX or the most recently listed component stocks within, names like Johnson Controls (JCI), Ford (F), and Goodyear Tire and Rubber (GT).

In the meantime, shorting such component stocks on bear market rallies might be the sanest way to engage the heavily wounded automotive sector until the broad markets finally sound the all-clear signal that so many burned traders and investors are longing for.

Whether you prefer sector mutual funds or ETFs, the fact remains that identifying sector rotation and relative strength can add an edge to those traders seeking to deploy funds on the right side of any given market. Spend some time with the exploration presented in this article and see if it doesn't shed some light on the origin of the powerful trend moves we see in the various industry groups. ■

"Fidelity - Performance, Daily" Explored 2/26/2009 20:40

Results | Rejects | Exploration

Security Name	Close	1 Day	5 Day	10 Day	30 Day	60 Day	120 day	240 day	Ticker..
Fidelity Select Automotive	10.3000	-0.1938	-3.8282	-14.7351	-25.8993	-28.3774	-62.5685	-67.8389	FSAVX
Fidelity Select Home Finance	8.5600	2.0262	3.5066	-7.6591	-18.9394	-23.4294	-50.7127	-61.0662	FSVLX
Fidelity Energy Services	34.0600	2.1902	-1.6460	-8.3916	-8.6618	-16.2528	-60.3631	-61.0479	FSESX
Fidelity Select Natural Gas	19.4000	0.1032	-2.2177	-10.0186	-6.6859	-8.6629	-50.2181	-59.1559	FSNGX
Fidelity Select Energy	27.8200	1.1269	-2.0423	-9.9676	-9.1147	-12.7079	-48.7567	-54.8427	FSENX
Fidelity Select Industrial Equip	14.2800	-1.1080	-7.2125	-14.5422	-20.3125	-20.1797	-50.6920	-53.8713	FSCGX
Fidelity Select Natural Resources	17.4200	1.4560	-2.1898	-8.9388	-6.6952	-9.2236	-46.6789	-53.7390	FNARX
Fidelity Select Financial Services	35.6900	1.7679	5.1252	-10.2138	-18.6275	-21.5921	-47.4541	-53.0824	FIDSX
Fidelity Select Banking	9.7400	4.7312	15.2663	-7.5024	-24.7295	-35.0036	-47.5343	-52.2149	FSRBX
Fidelity Select Paper and Forest Products	13.0300	0.5401	0.3852	-9.7020	-13.3067	-16.3497	-52.0615	-51.0159	FSPFX
Fidelity Select Materials	27.7400	-0.6447	-4.2127	-9.9643	-9.3760	-6.0402	-45.0330	-50.7072	FSDPX
Fidelity Select Insurance	25.1600	-0.2379	-2.2913	-12.5478	-20.2283	-15.6531	-42.7579	-48.5391	FSPCX
Fidelity Select Industrial	10.3200	-1.8078	-7.3609	-14.6402	-18.8679	-17.7411	-46.9460	-47.9369	FCYIX
Fidelity Brokerage & Investment Mgmt	28.0300	1.3743	-2.7074	-11.7165	-10.3040	-5.2011	-42.5788	-45.8491	FSLBX
Fidelity Select Chemicals	42.7500	-0.8351	-5.8785	-10.3774	-10.7516	-10.2675	-44.6495	-45.2488	FSCHX
Fidelity Select Multimedia	18.2900	-2.7128	-0.7058	-7.4393	-14.3326	-13.0249	-43.1928	-44.2359	FBMPX
Fidelity Select Defense and Aerospace	40.3400	-2.0636	-10.1359	-13.7297	-17.0812	-11.4276	-40.1133	-43.1052	FSDAX
Fidelity Select Electronics	21.2700	-1.3908	1.3823	-6.9147	-3.4060	-1.1415	-37.1611	-41.6678	FSELX
Fidelity Select Air Transportation	18.1200	-1.7886	-6.9815	-14.1232	-29.6584	-21.9638	-38.9282	-41.5770	FSAIX
Fidelity Select Transportation	24.1900	-2.0648	-5.6184	-13.9452	-20.0066	-24.7281	-43.8414	-41.2146	FSRFX
Fidelity Select Technology	37.3000	-1.0872	-0.6922	-7.2370	-5.8794	-1.5055	-41.7408	-40.8192	FSPTX
Fidelity Select Communications Equip	10.8100	-1.0073	0.0000	-5.5070	-6.9707	-2.6225	-44.0907	-40.7983	FSDCX
Fidelity Select Computers	23.5600	-1.0915	-2.4431	-9.2799	-6.7669	-6.5450	-39.4967	-40.2637	FDCPX
Fidelity Select Construction and Housing	18.2100	-0.2192	-1.9914	-13.7784	-20.7227	-18.1023	-42.2140	-39.8674	FSHOX
Fidelity Select Consumer Discretionary	11.6200	-1.4419	-1.9409	-7.3365	-12.1029	-9.7926	-38.8872	-37.8488	FSCPX
Fidelity Select Utilities Growth	35.4000	-1.1173	-4.0650	-10.8537	-10.3116	-13.8757	-29.9334	-36.9632	FSUTX
Fidelity Select Gold	30.7700	0.7531	-6.2748	-6.7858	9.5018	23.7234	6.4338	-35.5751	FSAGX
Fidelity Select Environmental	11.0100	-2.4801	-6.0580	-9.3827	-12.8956	-13.4175	-35.4668	-34.4739	FSLEX
Fidelity Select Networking and Infrastructure	1.2100	-1.6260	0.0000	-6.2015	-2.4194	0.8333	-37.9487	-34.2391	FNINX
Fidelity Select Medical Delivery	26.1300	-8.3158	-15.6008	-16.7039	-9.0814	-0.3052	-34.7891	-33.0421	FSHCX
Fidelity Utilities	11.5100	-0.6045	-1.3710	-7.1774	-9.0119	-11.9511	-28.9477	-32.9944	FIUIX
Fidelity Select Wireless	4.4800	-1.3216	0.9009	0.6742	2.0501	9.8790	-31.2841	-32.1046	FWRLX
Fidelity Select Software and Computer Svc	44.4900	-1.7664	-3.6387	-7.1965	-6.6317	-3.8885	-31.8683	-31.2152	FSCSX
Fidelity Select Telecommunications	26.9100	-0.8840	1.8932	2.6707	1.0514	4.4542	-31.6730	-31.0794	FSTCX
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METASTOCK

FIGURE 3: FSAVX, FSVLX, DAILY. Conversely, FSAVX has the worst overall persistence of trend of any Fidelity Select Sector fund, down significantly in each column. Fidelity Select Home Finance (FSVLX) comes in a close second in terms of overall weakness.

Playing The Commodities Rebound With Options

by Donald W. Pendergast Jr.

Potash Corp. of Saskatchewan's dramatic decline appears to be over. Here's an interesting option play on this agriculture sector giant.

Tradable: POT

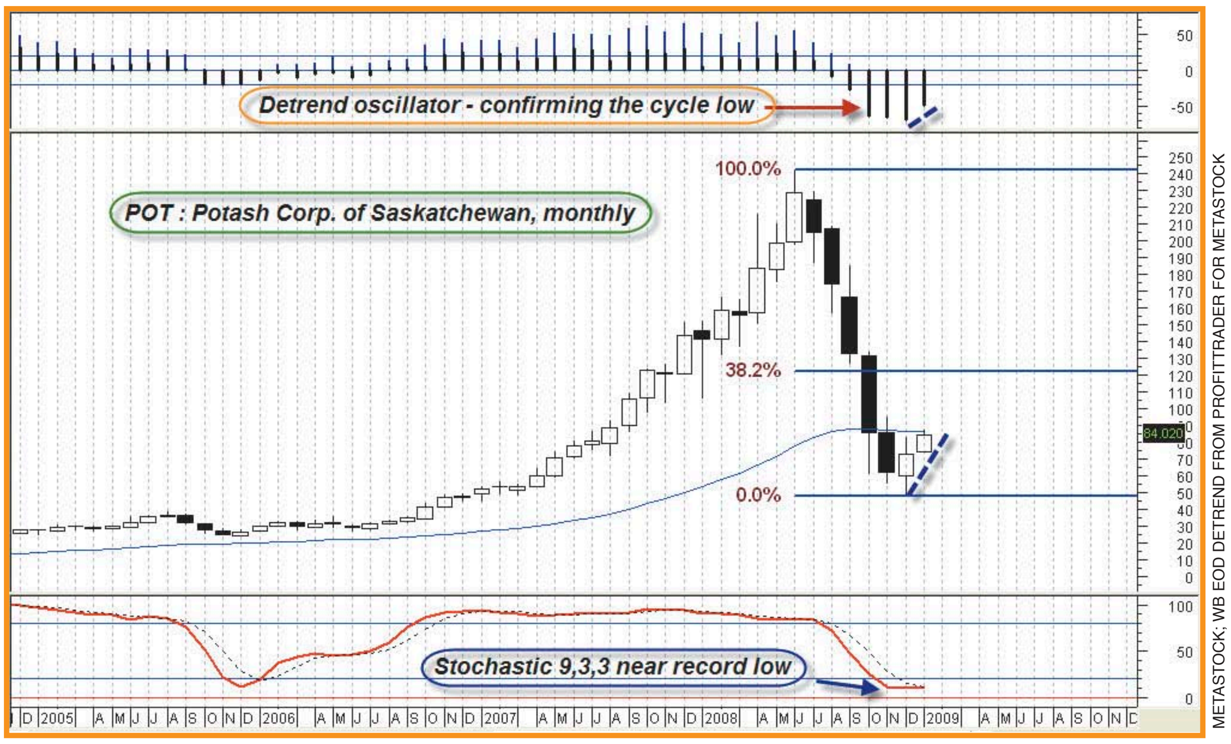

FIGURE 1: POT, MONTHLY. With worldwide demand for fertilizer and animal fee remaining strong, opening a bullish option spread in POT for a credit could be an appropriate strategy.

Unless you've been living in a bomb shelter for the past seven months, you're more than aware of the massive slide in commodities and commodity-linked equities. Potash Corp. (POT) also got caught in the landslide, shedding about 80% of its value from the June high to December's low. Let's look at a monthly chart (Figure 1) and see if we can craft a low dollar outlay bullish option spread, one designed to gain through a unique blend of time decay, bullish price movement, and falling implied volatility.

As of this writing, the monthly cycle appears to have bottomed, based on the action in the stochastic (9,3,3) and detrend oscillators. Similar patterns are printing across the basic materials and energy sectors, lending extra confidence in this cyclical low assessment. The last time the monthly stochastic was this oversold was in December 2005; prices then proceeded to rise nearly 100% over the following 14 months before the stochastic leveled out in February 2007. Currently, POT is rising strongly from a major low, with the first major resistance (the Fibonacci 38.2%) level coming in at $122. For those who may be interested in playing the apparent recovery in POT with a zero-cash initial outlay, the following option spread might be attractive.

A little background first. Option implied volatility is slowly declining on POT, which means that selling options can be very beneficial. A strategy called a reverse diagonal call calendar spread involves buying a near-month, near-the-money call and then selling an out-of-the-money call in a deferred month:

Buy: 1 June 2009 $80 call at $18.40
Sell: 1 January 2010 $95 call at $19.40

Net credit: $1.00

The intention is to hold the trade until just before June expiration (when the long call expires), hoping that implied volatility will decline on the short call by then even as the price of POT shares continue to move higher on the strength of the bullish monthly cycle. (The spread needs to be closed out then or a trader will be still be short a naked January 2010 $95 call.)

Here are some reward/risk stats to consider before putting this option spread on, understanding that the greatest risk to this trade is that the price of Potash stock remains within a few dollars of its current price at expiration. Another risk is that implied volatility begins to rise again, inflating the value of the longer-term short call.

Date	Stock price	Volatility	Gain/loss
6/19/09	$122.00	Drops by 12 pts.	$781
6/19/09	$84.02	Drops by 12 pts.	($570)
6/19/09	$47.54	Drops by 12 pts.	$24
6/19/09	$122.00	Stays the same	$454
6/19/09	$84.02	Stays the same	($866)
6/19/09	$47.54	Stays the same	($64)

That's quite a range of profit outcomes, but there are some simple rules that can be applied to keep the risks to a reasonable minimum. For example, if the price of POT stock becomes range-bound, not much beyond $80–90 by late April, a prudent trader would probably just close the spread out then rather than risking the maximum possible loss at June expiration. Here are some breakpoints that might make it easier to comprehend the wisdom of an early close out in a range-bound market:

Date	Stock price	Volatility	Gain/loss
4/19/09	$90.00	Stays the same	($242)
4/19/09	$80.00	Stays the same	($332)
4/19/09	$90.00	Increases by 6 pts.	($344)
4/19/09	$80.00	Increases by 6 pts.	($419)

Losses are no fun, but if the trade doesn't kick into bullish mode and is still in a range by April expiration, closing the spread for a modest loss make a lot more sense than hoping for a turnaround by June expiration, when the loss could be twice as much ($866).

The monthly cycle appears to have bottomed, based on the action in the stochastic (9,3,3) and detrend oscillators.

Reverse diagonal call calendar spread

Interesting, isn't it? This is a trade that is initiated with a $100 credit to a trader's account, and yet, if the trade doesn't pan out and appropriate risk control measures aren't implemented, a trader could lose nearly $900 (or even more if implied volatility spikes sharply higher). The keys to success with a reverse diagonal call calendar spread are simple:

- ♦ Identify a high-probability bullish trend in a market with very high implied volatility.
- ♦ Buy an at-the-money call and sell an out-of-the-money call in a deferred month, making sure the bid-ask spreads and volume/open interest figures are attractive.
- ♦ If the trend stalls and goes into a trading range, one that negates the original trending trade scenario, close the trade early for a modest loss.
- ♦ If the trade trends as desired, close the spread just before the long call expires.

If an option trader follows those simple rules, his/her odds of success should be greatly increased with this kind of option spread. ■

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METALS & ENERGY

CYCLES

Two Ways To Play Hecla Mining

by Donald W. Pendergast Jr.

After forming a solid-looking nine-week base, Hecla Mining may be forming a cycle low, one that short-term traders may wish to investigate.

Tradable: HL

Hecla Mining (HL) has been mining silver in northern Idaho's Silver Valley since 1891 and also has mining operations in Alaska, Colorado, Mexico, and Venezuela. The stock of the company, the oldest US precious metals mining company (and the lowest-cost primary silver producer in North America), has been trading on the NYSE since 1964. Apparently, longevity and stability have little to do with the wild price action of this miner over the past nine months; after peaking at \$13.14, HL shares took a toboggan ride off the south side of Mt. Everest before finally cratering to \$0.99 this past November. What's the technical state of this stock right now, and how might traders and investors choose to engage the shares of this senior player in the mining industry?

Hecla's weekly chart (Figure 1) offers a few clues that may suggest that the recovery move higher could still have some room to run. First, there is the rising B-line oscillator, a very reliable cyclical confirmation tool. Then there's the widening spread on the weekly moving average convergence/divergence (MACD) indicator in conjunction with the most recent bullish reversal candle. Prices have initially been turned back by the smaller-degree trend's 23.6% Fibonacci retracement, but given the other three bullish technical factors, the bias appears to favor higher prices in the near term, with the higher-degree trend's 23.6% Fib level (near \$3.85) as the most logical initial target.

Dropping down to HL's daily chart (Figure 2), we can get a better idea of the last nine weeks' worth of bottoming/basing action. Here, the imagery is even more bullish, especially for longer-term daily based traders/investors. Prices finally closed above the 50-day exponential moving average (EMA), only recently pulling back. The close proximity of both a relatively flat 20-day and 50-day EMA also confirms the consolidating/basing pattern. A nice series of higher highs/higher lows has also printed, and now the stochRSI indicator is turning higher; if it breaks above its blue signal line, the chances of a continued cycle move higher is probable, especially considering the rest of the technical evidence. Finally, the Chaikin money flow index (CMF) (34) is well above its zero line, confirming the fact that the stock is under sustained accumulation. If you go back in time, you can confirm the strength of the up- and downtrends in this (or any) stock by looking at the general long-term slope of the CMF 34 and its relationship to its zero line. Sustained periods of time spent above (below) the zero line by the CMF 34 almost always confirms the existence of a strong uptrend (downtrend). Check it out on your favorite stocks.

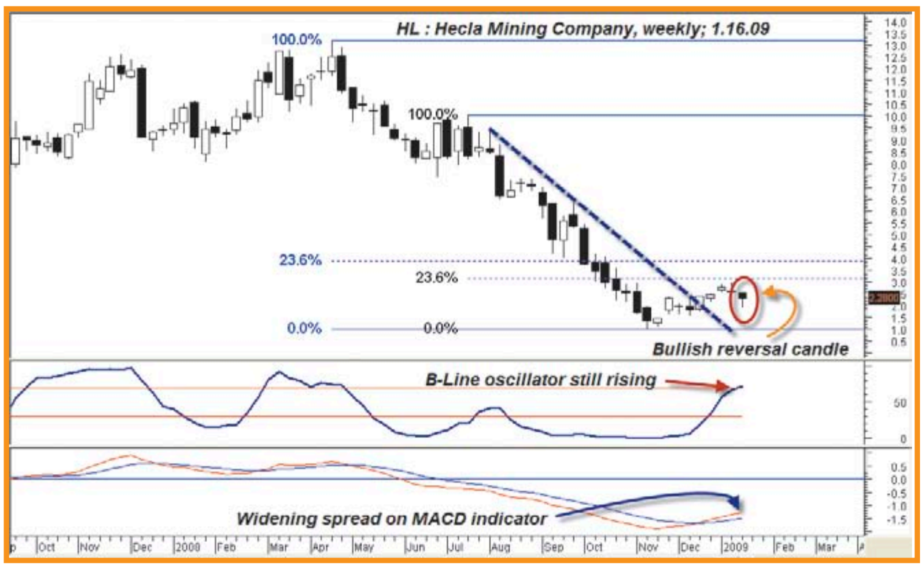

FIGURE 1: HL, WEEKLY. After completing a major trendline break, the combination of a widening MACD spread, rising price cycle, and bullish reversal candle all seem to imply the possibility of further gains.

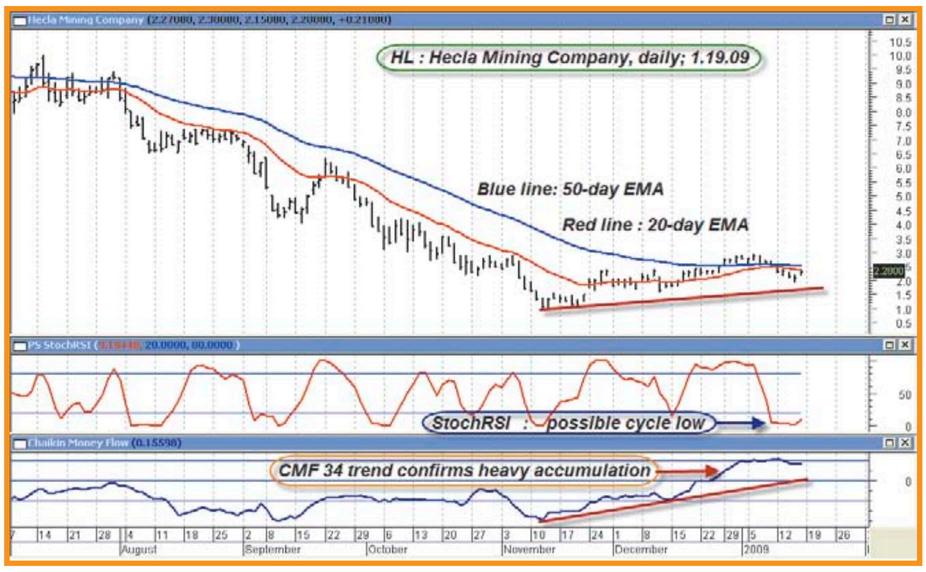

FIGURE 2: HL, DAILY. Higher highs and lows, a strong CMF 34, and a rising stochRSI indicator each add a bullish tone to this daily chart.

So, how to play a potentially bullish continuation move in Hecla Mining stock? Daily based swing traders might want to put half their position on if the January 16th high of \$2.30 is taken out, waiting for a pullback on the 30-minute chart to enter the second half of the position. A stop-loss near \$2.10 looks like a good make-or-break for this trade.

Taking half of the position off if the 50-day EMA (approximately \$2.51) is pierced and then trailing the balance with a three-bar trail might also be a good idea; if prices approach the last swing high of \$2.95, the stop should be tightened further.

Longer-term traders with a firm bullish conviction for HL's future might consider buying one March 2009 \$2.50 covered call (buying 100 shares of HL and selling one call against it) for \$0.30 or \$0.35; if the shares are called away at \$2.50 at March expiration, the trade will generate approximately \$52-57, which equates to an annual return of close to 100%. If the shares can't stay above \$2.50 at expiry, the trader keeps the shares and can sell another call against them, if desired.

Given the strong global appetite for investor silver, the downside potential on Hecla stock appears to be minimal in relation to its potential upside, especially now that solid bullish technical patterns are suggesting higher prices in the weeks ahead. Choosing to play Hecla shares on a swing trade or covered call basis offers enterprising traders a sound way to play these probabilities. ■

TRIANGLES

Energy Select SPDR Forming Triangle?

by Chaitali Mohile

After a huge decline, XLE is consolidating in a converging range. Which pattern is being built?

Tradable: XLE

The Energy Select SPDR (XLE) is consolidating near its low at 38.84. The stock is moving in a narrow range, forming the shape of a symmetrical triangle (cone) in Figure 1. Although XLE entered consolidation after the large descending move, the pattern is not a bearish flag & pennant. The continuation pattern is a short-term formation that can last for one to 12 weeks. The pennant that is more than 12 weeks old can be seen as a symmetrical triangle. The pattern in Figure 1 has been in place since October 2008 (that is, more than 12 weeks). Therefore, the pattern is a symmetrical triangle and not a bearish flag & pennant. The volume in Figure 1 is diminishing due to the converging consolidation range. The duration of patterns is equally important to identify their reliability.

The average directional movement index (ADX)(14) indicated the developed downtrend. The moving average convergence/divergence (MACD) (12,26,9) shows a bullish crossover in negative territory. The full stochastic (14,3,3) has surged from an oversold area and has hit the bullish level at 50 (see Figure 1). Therefore, the indicators are indicating bullish momentum in the developed downtrend. On these mixed messages, we can anticipate a rally from the lower ascending range to an upper descending one. But I would not recommend traders to go long, as the narrow range may whipsaw and catch any market participants unawares.

The breakout direction for the symmetrical triangle is uncertain. Although this triangular formation is a continuation of the current bearish trend, the downward breakout cannot be anticipated. A low-risk and safe-entry point will occur only after the confirmed breakout of a symmetrical triangle. The pattern in Figure 1 has almost matured as both trendlines have moved closer. After the breakout on increased volume, we can measure the potential target by calculating the widest distance of the triangle. If the breakout happens upward, then the trader should add the breakout level to the length of the triangle and subtract the breakout level if the breakout direction is bearish.

FIGURE 1: XLE, DAILY. XLE is forming a symmetrical triangle. Due to the converging range, the volume has decreased.

If the pattern is identified correctly, we can trade successfully. Thus, every aspect of the pattern formation should be understood. ■

CHART ANALYSIS

Crude Oil Triple Bottom Close To Completion?

by Donald W. Pendergast Jr.

Can it be? Is the developing triple-bottom pattern on the crude oil daily chart for real? If so, how far might crude prices rise?

Tradable: CL

The action over the past few months in the crude oil market has been generally unpredictable, yet when looked at from a long-term perspective, it's been exactly the kind of "back and fill" price action that might be expected at a major cyclical bottom. How much more consolidation needs to take place before price begins to move strongly

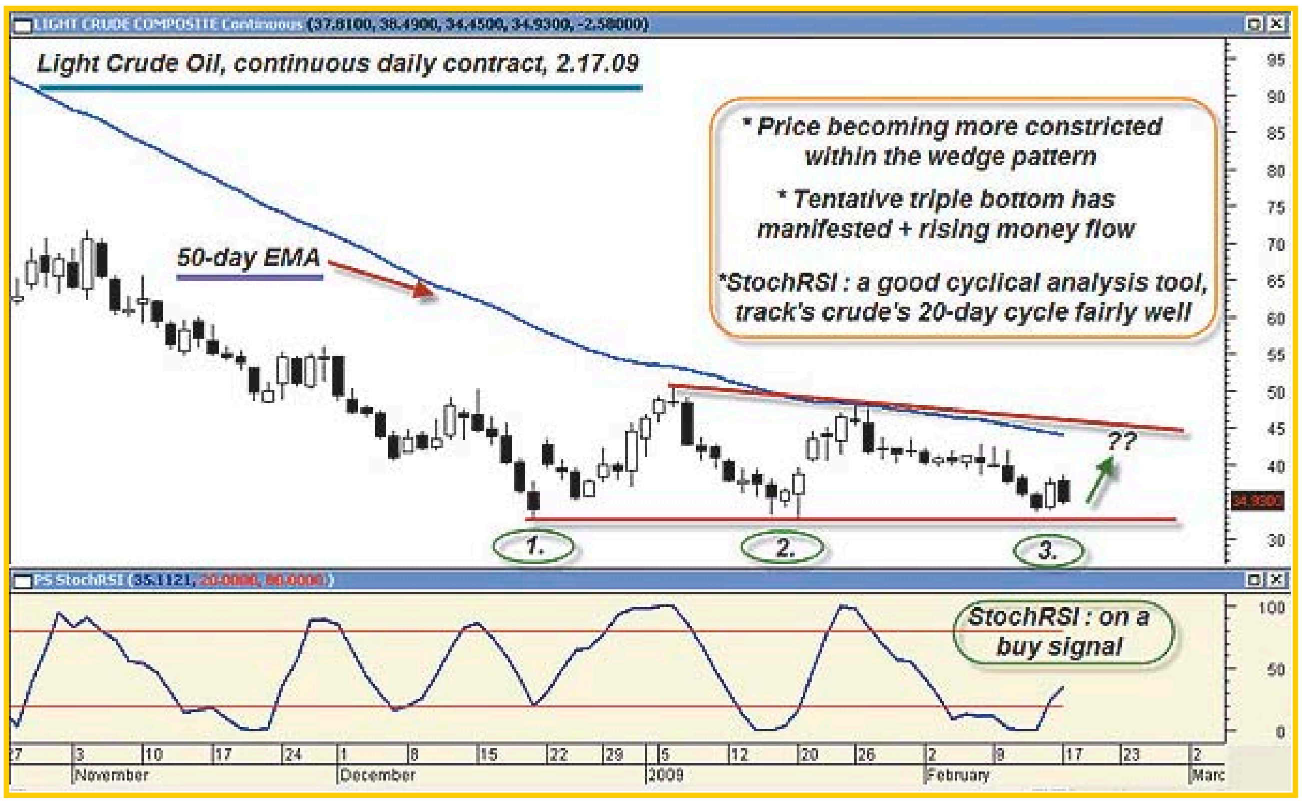

FIGURE 1: CL, DAILY. A triple bottom, coiling price action within a wedge pattern, and a stochRSI buy signal appear to bode well for some sort of a crude oil swing move.

in either direction?

The daily graph of the continuous crude oil contract (Figure 1) depicts the slow, steady period of consolidation that commenced in mid-December 2008. A triple bottom is close to being confirmed, and if a new upswing develops, there could be quite a bit of renewed interest in this vital commodity market. Anytime you have three tests of a support level, particularly when a stock or commodity is extremely oversold on a monthly basis, many traders will be watching, preparing to initiate new long positions (all else being equal) on the successful test of the pattern.

Price is becoming more constricted within the wedge pattern even as the stochRSI indicator has flashed a fresh buy signal. The risk-reward on this signal isn't all that great; a buy-stop order could be placed at $38.50 with an initial stop just below the recent low near $33.52. The first swing target would be near $44, which is the 50-day exponential moving average (EMA) price. The upper channel line of the wedge is near $45 so, all told, the RR ratio comes in at about 1.30 to 1. Given the tremendous leverage involved in futures contracts, that's a fairly poor RR ratio. More adventurous types might try to wait for a possible pullback toward the lower support level, using a 30- or 60-minute chart to time an entry.

Traders with a longer-term bullish outlook, those who feel that the triple-bottom pattern is going to hold on a possible retest, might want to take the lazy man's way out. Instead of trying to time an exact entry into a long crude oil position, they could just sell an out-of-the-money put option. Right now (Tuesday, February 17, 2009), a trader could collect $180 in cash for selling a May $25 crude oil put option. May 2009 crude closed at $40.98 today, meaning that crude prices would have to drop 39% by April 16, 2009, before the option would close in-the-money. If the May contract closes at $25 or below, the trader would be assigned a long crude oil contract with a basis of $25. Given the steady global demand for crude oil, that's an assignment risk that some traders might be more than willing to accept.

Figure 2 is the Chaikin money flow (CMF) (34) for the daily crude (continuous) contract. It's very effective at spotting divergences between money flow and price action. The CMF (34) peaked nearly three months (in April 2008) before crude oil hit its all-time price in July 2008. We all know what happened after that divergence played out. Right now, a different kind of CMF (34) divergence is printing, the kind that shows progressive amounts of accumulation during sideways or consolidating price action. This money flow evidence, coming at a time of a daily triple bottom and a major monthly cycle low, should be enough to rekindle the flame of hope in energy market bulls everywhere. Whether you choose to sell a put or time a swing trade, the probabilities seem to favor some sort of a bullish move by crude oil in the weeks ahead. ■

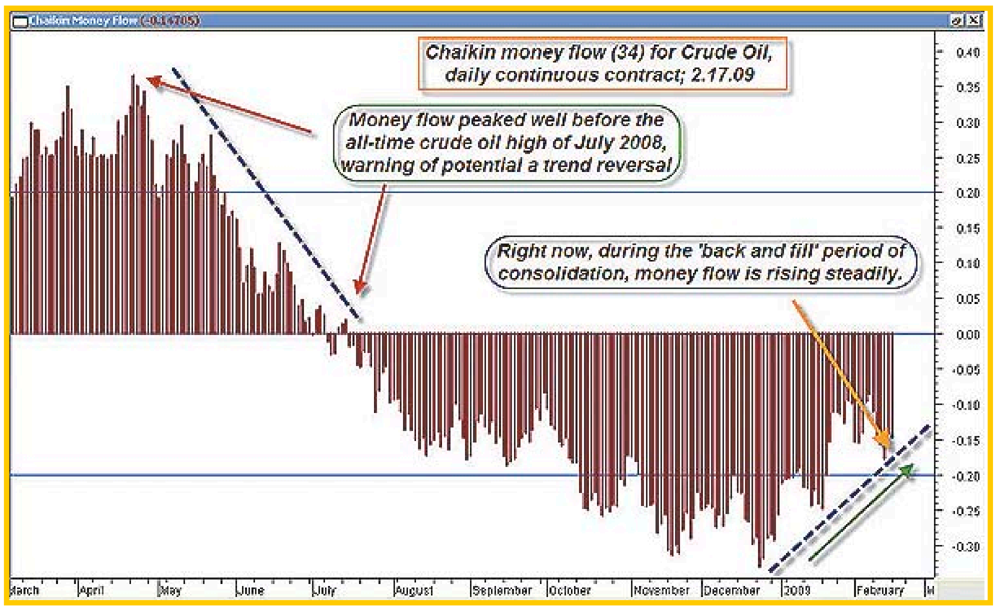

FIGURE 2: CMF, DAILY. The CMF (34) indicator is very useful at spotting meaningful divergences in stocks and commodities. Crude oil is apparently being accumulated during the past two months of consolidating price action.

RESISTANCE LINE

Is Gold Losing Its Luster?

by James Kupfer

Gold has been on a tear recently. Where are the primary resistance points?

Tradable: XGLD

The shiny metal has moved higher over the last few months, breaking through some major resistance levels and out of its old channel. Given its recent strength, is gold likely to move higher or hit resistance and turn back down?

Is gold likely to move higher? To answer this, let's first establish, cyclically speaking, that gold seemingly has yet to make its nine-year cycle bottom, which means that the move from the November bottom is a countertrend bounce. Assuming that gold has yet to make this bottom, we should be searching for a top to the price of gold rather than looking to go long.

Looking at Figure 1, it now appears that gold is in a prime spot to potentially halt its upward move. First off, gold is now very close to its July 2008 high of $988.50. In addition, $987.23 is 161.8% — a Fibonacci ratio of the move between two pivot points in the recent move shown in orange. Last but not least, gold is significantly overbought on daily, weekly, and monthly time frames, according to Irwin Stochastics.

Should gold make it above the $988 region, there is further resistance at the $1,010 and $1,025 levels, the latter being the March 2008 highs (Figure 2). In the unlikely event that gold were to break above $1,025 to new highs, it would almost certainly invalidate my premise that gold has yet to make its nine-year cycle bottom. In this case, gold would be near the start of a multiyear upward move. ■

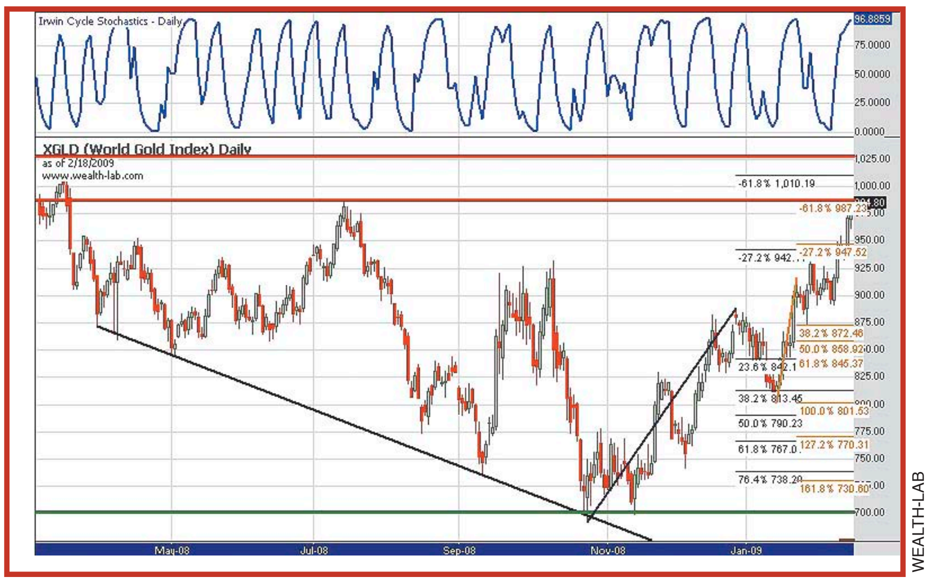

FIGURE 1: XGLD, DAILY. Here's a big-picture view of gold.

FIGURE 2: XGLD, DAILY. This closeup view shows gold right at major resistance.

Gold Breaking Out From Weekly Flag

by Donald W. Pendergast Jr.

Gold's corrective move may finally be over, and a bullish breakout from its weekly flag pattern may imply substantially higher prices.

Tradable: GC

When gold finally topped $1,000 an ounce last March, some analysts within the gold bug community were making bold predictions including forecasts of $3,000 an ounce, and other kinds of weighty pronouncements that frequently coincide with a major monthly cycle high of a given stock, index, or commodity. Of course, since many analysts don't even consider the existence of price cycles, the ensuing collapse of gold back toward $680 came as a complete surprise to many otherwise talented market technicians and newsletter writers. Has the situation changed? Are we in for a repeat of the March 2008 scenario, in which we need to prepare for a sudden selloff in this emotionally charged commodity market? Or should we expect significantly higher prices in the months ahead? Our first reality check is the monthly gold chart (Figure 1).

The nine-year-old bull market in gold (literally; it began on February 23, 2001) has had enormous staying power, providing buy & hold investors with an average annual rate of return that's been far beyond that offered by any other asset class. Of course, the longer a bull run continues, the larger the proportional corrections against the major trend usually are. Note how each corrective phase was larger than the one preceding it; of the four significant corrections, the latest one (2008) absolutely dwarfed those that occurred in 2003, 2005, and 2006.

Does this mean that this bull run is finished, due to the size of the 2008 correction? Not necessarily. In fact, there are a number of factors that suggest that the March 2008 high of $1,014 may soon be taken out on the way to higher levels. First, all three major uptrend lines are still intact, with prices well above each one. Next, the stochRSI indicator, one of the more reliable momentum-based tools, has made a convincing turn above its signal line. In the gold market, this indicator has done a good job of identifying most of the major cyclical lows since 2001, so its current action is fairly convincing. Of course, nothing is more important than raw price action on the chart, and the strong monthly breakout from the broadening wedge pattern suggests that the March 2008 high at $1,014 should be challenged very quickly. The current monthly candle almost completely fills the area between the March 2008 high and the top channel line of the wedge. Given this constricting technical framework, it will be interesting to see which of these support/resistance lines will prove victorious. We'll drop down to the weekly chart now, digging a little deeper for more specific understanding (Figure 2).

Here, we note that not only has price broken out of the monthly wedge, but it also busted above a significant weekly flag pattern, too. If we use the June 2006 low of $555 as the base for the run to the $1,014 high, this weekly flag pattern has a nominal terminus area near $1,140. Given that the weekly Aroon 14 confirms the strong uptrend, if the $1,014 high can be taken out on a weekly close, the projected flag may very well hit $1,140 sometime in the coming weeks. Of course, the area adjacent to $1,014 could be a major battleground, and it's entirely possible that the breakout could fail. A sharp pullback from the $1,1014 resistance line might even open up the opportunity for daily-based swing traders to take a shot at a retracement entry.

Regardless of what happens, this is going to be a fascinating market to watch.

There is no way I'm going to attempt to predict a price target (up or down) for gold. What I can do is attempt to ascertain where the price of gold isn't likely to go in the next few months. That said, here's a trade idea for those with a little adventure in their margin accounts. Here's the setup, a June 2009 gold $670/$2,400 short strangle:

Sell 1 June 2009 gold $2,400 call option for $380 or better

Sell 1 June 2008 gold $670 put option for $180 or better

Net credit: approximately $560

FIGURE 1: GC, MONTHLY. A major uptrend in progress; the corrective moves grow proportionally larger as the trend moves higher.

FIGURE 2: GC, WEEKLY. A breakout from both a weekly flag and wedge pattern is soon to meet with major resistance near $1,014, the March 2008 high. The strong Aroon (14) reading appears supportive of more upside progress.

Note how the futures options are priced — they're definitely biased toward a bullish sentiment among option traders. Even though gold would have to rise by 139% by May 26, 2009, in order for the $2,400 call to go in-the-money, it's priced at more than double the $670 put, which is only 33% out-of-the-money. This could also be taken as a contrarian indicator, one that suggests that any overexuberance in any given trend direction is an early warning that a correction or reversal is approaching. Regardless, this short strangle seems to offer a reasonable compromise between risk and reward. The major October 2008 low at $681 is above the short put strike and there is also another significant support level near $805. Both support levels could offer interference, should gold decide to move lower from here. As far as the short call at $2,400 goes, although it's possible that gold could rocket that high in the next three months, it does seem far-fetched that such a far out-of-the-money option (with a very tiny delta value) would pose any near-term threat to a $670/$2,400 short strangle seller.

This is going to be a fascinating market to watch.

As long as the price doesn't close at or above either short strike at June expiration (May 26, 2009) the entire spread will expire worthless, allowing the seller to walk away with the entire $560 in premiums. If price begins to move quickly toward either strike and the spread doubles in value, conservative traders should buy the spread back at a loss. More aggressive traders could simply buy back the option that has moved too quickly toward the in-the-money zone, letting the other option ride, possibly even rolling into a new spread by selling a further out-of-the-money option than the one bought back at a loss.

Check with your broker regarding margin requirements, option bid-ask spreads, and open interest figures before considering a short strangle in gold or any other commodity. ■

FAN LINES

Oil All Dried Up?

by James Kupfer

Shares of USO may be breaking out of a Fibonacci fan pattern.

Tradable: USO

Along with the global economy and perceived demand, shares of the oil tracking exchange traded fund (ETF), USO, have fallen precipitously since July 2008. The downward slope of the decline has been very steep indeed. Now, however, there is a glimmer of hope that USO may be starting to put in some type of bottom.

Looking at Figure 1, you can see that I have drawn a Fibonacci fan between the July 2008 top and the August 2008 reaction low. There are other obvious points that the Fibonacci fan could be drawn with that could well hold importance in the future, but seeing as how USO has stayed nicely below the fan, I think it is valid to ascribe importance to it at this time. On four instances, USO has tested the 38.2% Fibonacci level, only to turn back down. In only one period did USO manage to close above, albeit briefly, the Fibonacci level.

Now, however, USO has managed to close for three consecutive days above the fan line. Price movement over these days has been flat, but a close above the fan line, nonetheless. This signals a potential short- to intermediate-term bottom. Should we get a bounce here, it would likely be a very mild one, perhaps even move along the lines of a consolidation phase rather than an outright bounce.

FIGURE 1: USO, DAILY. A Fibonacci fan shows the extreme downward movement of USO since the market peak.

Keep in mind that this only signals a potential bounce; price movement to the upside is needed before we can say that the strong bear market in oil is ready for a rest. ■

CANDLESTICK CHARTING

Evening Star Patterns In Light Crude?

by Chaitali Mohile

The Light Crude Oil Index is likely to lose its past week's gains under the bearish shadows.

Tradable: $WTIC

The Oil Light Crude Continuous Contract Index ($WTIC) has formed lower highs. The lower high formation indicates weakness prevailing in the stock/index. In Figure 1, $WTIC formed lower peaks, and at every peak we can see an evening-star candlestick pattern. The lowering trendline shows the declining tops and the boxes show the candlestick pattern. Among the first four boxes, 1, 3, and 4 are the evening-star candlestick patterns. This pattern is a bearish reversal, suggesting downside rally. Figure 1 shows the descending rally after the bearish candlestick pattern. The index had deep cuts of about 10/15 points from every lower top. But the rally following box 2 is the deepest.

The candlestick pattern in box 2 is not the evening star. Instead, we can see two different single candlestick patterns. The first candle is completely bullish, the second candle in the box resembles a hanging man with a small upper shadow, and the third looks like a shooting star (see Figure 1). Both the patterns are bearish reversals. As a result, $WTIC witnessed a robust bearish rally of 23 points approximately. Therefore, the lower tops and the bearish candlestick formations together have strengthened the bearish hold on the index. But the relative strength index (RSI)(14) and the moving average convergence/divergence (MACD)(12,26,9) in Figure 1 reflected the different story.

The RSI (14) and the MACD (12,2,9) are indicating positive divergence toward the declining price rally. This divergence gave birth to the three-day bullish rally in the last week. Since early 2009, the average directional movement index (ADX)(14) has been descending below the 15 levels. The positive directional index (+DI) and the negative directional (-DI) have converged, indicating

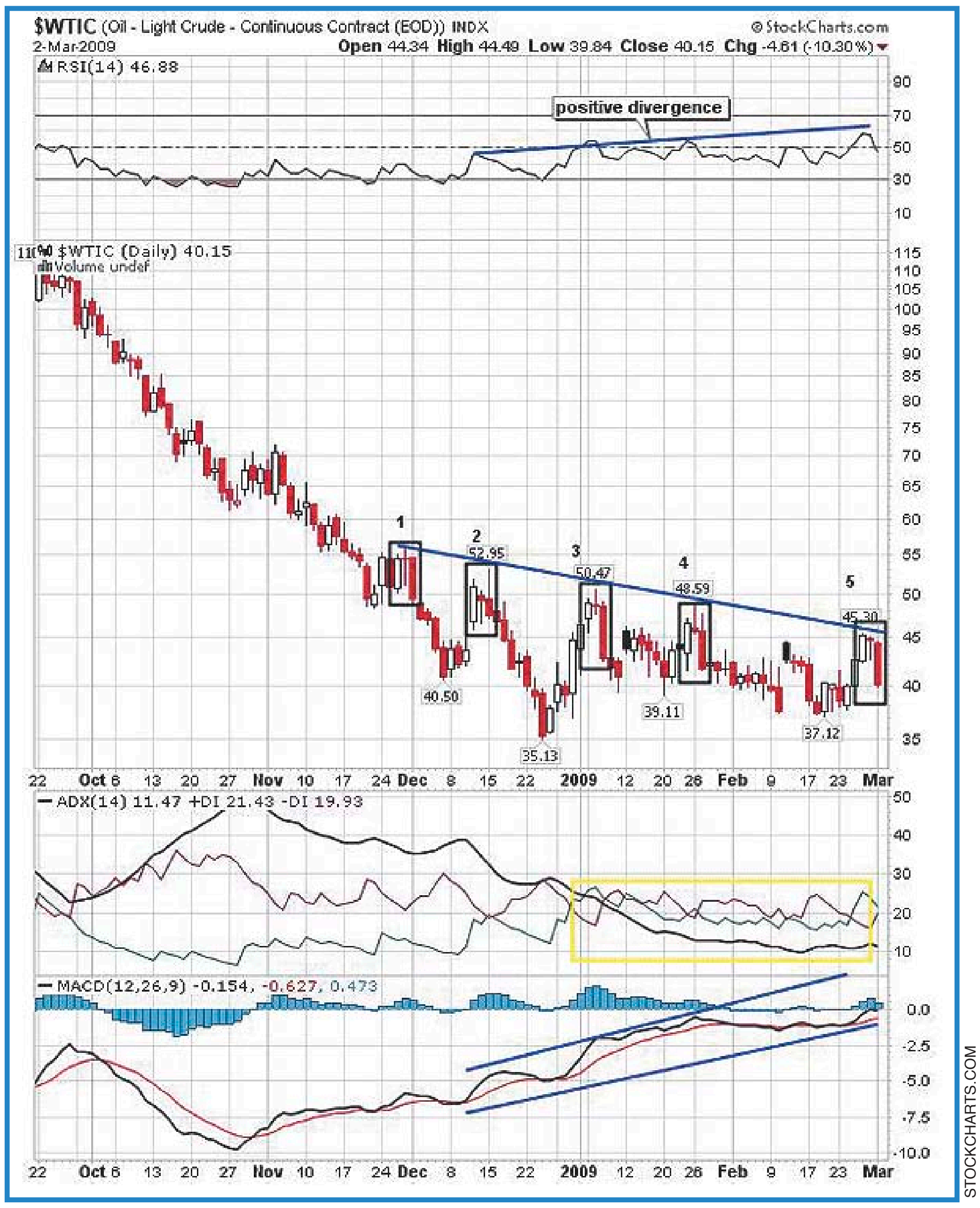

FIGURE 1: $WTIC, DAILY. The boxes shows candlestick formations and the declining trendlines indicate lower highs. The evening star candlestick patterns are marked in boxes 1, 3, 4, and 5.

volatile consolidation. But due to the weak trend indicated by ADX (14) the bullish rally failed to surge. Currently, $WTIC is forming another evening star bearish reversal candlestick pattern (see box 5 in Figure 1). The RSI (14) is ready to drift below the 50 levels, and the MACD (12,26,9) is reluctant to move into positive territory. This suggested the lack of bullish strength. So the series of evening-star candlesticks supported by diminishing bullish strength would drag the index to the previous lows of $37 and $35.

Figure 2 shows the robust support zone for $WTIC. Apart from the previous highs that are currently strong support areas, the 200-day moving average (MA) is the additional support for the descending rally. The long-term trend indicated by the ADX (14) is down. Though the indicator has declined from the highly overheated levels, the trend currently is well developed and robustly bearish. The RSI (14) is still not oversold, but the support level at 30 may be challenged. The long-term indicators show more space for a downside rally.

Therefore, $WTIC may retrace back to the previous lows and subtract the minor gains on the relief rally. ■

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FIGURE 2: $WTIC, MONTHLY. The index is heading toward the strong support zone.

ELLIOTT WAVE

Gold Turns Down

by Alan R. Northam

GLD made a bull market top in March 2008. Since then, GLD has been consolidating its gain from its 1999 runup. The target price for the completion of the consolidation in GLD is calculated at $66.

Tradable: GLD

In my last article entitled "Gold Turning Down" published December 23, 2008, I reported that gold had completed an ABC corrective Elliott wave pattern and gold was set to move lower. However, as sometimes happens, the corrective wave structure extended to form a double ABC corrective wave structure to complete the larger B wave that ended in late February 2009. In some instances, a corrective wave pattern can extend three times before being complete; Elliott wave theory calls these "combinations." Combinations are rather rare, and as such, the probability of the market correction in gold extending again is low, but is still a possibility. If gold does extend for a third time, I will address the alternate Elliott wave structure at that time. However, here is what I expect is developing:

Figure 1 shows the daily bar chart of GLD. This chart shows that GLD made a major bull market top in March 2008. Since then, GLD moved lower, forming an Elliott wave ABC zigzag corrective wave structure that ended in early September 2008. From early September to the end of September, GLD formed an X wave. X waves are connecting waves that connect multiple corrective waves together. From late September to mid-November 2008, GLD formed wave A of an extended flat corrective wave. From mid-November to late February 2009, GLD formed wave B of the extended flat correction. Wave B itself was formed by two smaller abc zigzag corrective waves connected by an x wave. With wave B now complete, the final wave C down of the extended flat is now under way. Wave C of extended flat corrective wave structures are normally 1.618 times the length of wave A. This then calculates to $66, the target price for the completion of wave C.

FIGURE 1: GLD, DAILY. This chart shows the Elliott wave count and points to a price target of $66.00 per share.

In conclusion, gold has now completed a double abc zigzag corrective wave structure off the mid-November 2008 price low. These two completed wave structures satisfy the Elliott wave requirement for the completion of the B wave of an extended flat corrective wave structure. This then signals that wave C of the extended flat should now be under way. According to the Elliott wave guidelines, wave C of extended flat corrections are typically 1.618 times the length of wave A, marking the target price for the completion of wave C and the extended flat corrective wave structure at $66. ■

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This article was first published on 3/6/2009.
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ELLIOTT WAVE

Are The Dollar And Gold Decoupling?

by Alan R. Northam

Normally, the US dollar and gold move in opposite directions. However, in recent days they moved in the same direction. Is this a sign that the dollar and gold are decoupling, or is this just an anomaly?

Tradable: $USD, GLD

The dollar and gold normally move in opposite directions, but in recent days both the dollar and gold have fallen. This has led to some confusion among analysts, and they rationalize the event by saying that it appears that the dollar and gold may be uncoupling, or that these two markets appear to be forming a divergence. However, among Elliotticians this phenomenon is not confusing at all. I don't claim to be such an Elliottician, but I do like to use the Elliott waves in my technical analysis of the markets. Therefore, I present my technical analysis of these two markets.

Figure 1 shows the daily price chart of the US Dollar Index. As can be seen, the dollar has moved upward from July in five nonoverlapping waves. These waves are impulsive and Elliott wave theory says that impulse waves define the direction of the next larger trend. Simply stated, the direction of the major trend is upward. This is verified by the 200-day moving average. When the dollar is trading above the 200-day moving average and the 200-day moving average is moving higher, the long-term trend is known to be in the upward direction. However, since late November the dollar has been trading down. According to Elliott wave theory, an impulse five-wave move is followed by a three-wave counter move. From November 2008, the dollar has fallen in a three-wave countermove labeled waves A, B, and C. Once the countertrend move is complete, the major trend resumes and this is what the dollar is doing. Since mid-December, the dollar has

FIGURE 1: US DOLLAR, DAILY. Daily price chart of the US Dollar Index shows the Elliott wave count and 200-day simple moving average.

FIGURE 2: GLD, DAILY. This chart shows the Elliott wave count and 200-day simple moving average.

started to resume its upward trend and has traced its first two waves out of the first five-wave impulse. Note also that the fall in the dollar was stopped in mid-December by the 200-day moving average acting as support. Thus, the long-term direction of the dollar is upward.

Figure 2 is the daily price chart of gold. As can be seen, gold made a major bull market top in March 2008. Since then, gold has been in a countertrend correction. Elliott wave theory states that following an impulse upward move, the market will correct itself in a three-wave corrective move. However, the theory also states that these market corrections can become more complex. This is the case with gold. Instead of a simple three-wave ABC countertrend correction, gold looks to be forming a double ABC countertrend corrective wave pattern. As can be seen, there are two ABC wave patterns connected together by an X wave. The second ABC wave pattern is still incomplete. Waves A and B look to be complete, but not wave C. In addition, with the beginning of 2009 it looks like wave C down is now starting to unfold. From Elliott wave theory I have shown the expected target price for the completion of wave C to be $65 for GLD. Further, note that GLD is trading below its 200-day moving average and the 200-day moving average is pointing downward. This is confirmation that the long-term trend is down for gold.

Further analysis indicates that no trend, whether up or down, moves in a straight line. All trends have days in which the market moves upward and days in which the market moves downward. What distinguishes an uptrend from a downtrend is that in an uptrend there are many more days in which the market moves upward than downward, and in a downtrend, just the opposite occurs.

In conclusion, when we analyze the dollar and gold using Elliott wave theory and moving averages, we can see that the US dollar is still in a long-term upward trend, whereas gold is still in a long-term downward trend. As for what happened with gold and the US dollar, perhaps the dollar simply had a down day, whereas perhaps the gold market traded in the direction of its trend. The US dollar and gold are not uncoupling or showing a divergence. They are simply doing what they are suppose to be doing, and that is moving in opposite directions over the longer term. ■

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TREND CHANNELS

The Dollar Conundrum

by James Kupfer

The US dollar looks poised to continue its ascent — or does it?

Tradable: $US

When you look at a daily chart of the US Dollar Index (Figure 1), there seems to be credible evidence to support the conclusion that the dollar should continue to rise. First, on a closing price basis the dollar has a nice upward-sloping trendline. It has previously tested prices at three locations and can thus be considered to be a valid line. In recent days, prices have deviated too far above the trendline and have since come back to retest the line. With the daily stochastics oversold it would present a logical buying opportunity.

Switching to the weekly chart (Figure 2), however, presents a very different picture. First, note the dotted blue line cutting through prices after October 2008. That is the top channel of a downward-sloping linear regression channel formed between the January 2002 top and the recent 2008 lows. While prices were able to break slightly above the channel in November 2008, in December they had clearly failed and dropped significantly. Over the last two weeks, prices have again attempted to clear the channel, with no success thus far.

These conflicting daily and weekly views point to major indecision in the dollar. At this point, it is probably best to sit back and wait for the dollar to present a clearer picture of where it may go. Traders wishing to go long the dollar based on the daily chart should keep tight stops. However, the better trade might be to see if the dollar breaks below the trendline displayed on the daily chart, in which case the daily and weekly charts would be more in sync with one another. ■

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FIGURE 1: US DOLLAR INDEX, DAILY. The dollar has had a strong runup over the last few weeks.

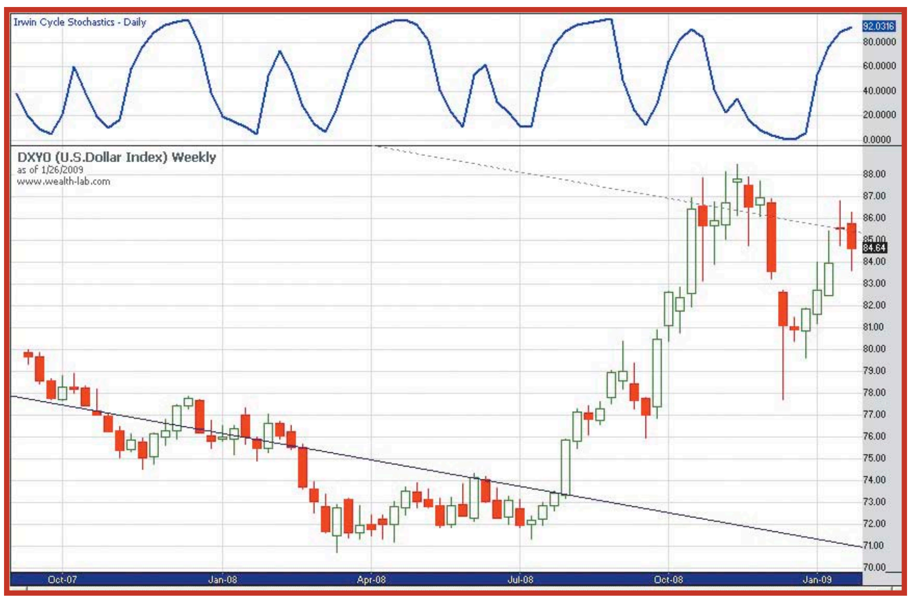

FIGURE 2: US DOLLAR INDEX, WEEKLY. The upper boundary of the linear regression channel is proving hard to move above.

Is A Breakout For The US Dollar Index In The Cards?

by Chaitali Mohile

The US Dollar Index is consolidating after an extensive advance rally.

Tradable: $USD

The US Dollar Index ($USD) has entered a sideways consolidation after a robust bullish rally. Figure 1 shows a bullish flag & pennant continuation pattern that breaks upward. But the stability of the breakout must be questioned in the current economic crisis. The relative strength index (RSI) (14) has established a support at the 50 levels, indicating bullish strength. However, the average directional movement index (ADX) (14) has declined from the comfort zone that indicated a coming downtrend. This means the index is stronger only because the US economy is doing better compared to that of Europe and Japan. In such a scenario, anticipating a successful breakout for the $USD would be incorrect. The previous high resistance at $88.46 may resist the future breakout rally.

Below are the daily charts of the Euro Index ($XEU) (Figure 2) and the Japanese Yen Index ($XJY) (Figure 3). $XEU in Figure 2 is highly volatile compared to the yen index. $XJY had a robust bullish rally for a longer period. Currently, $XJY in Figure 3 is consolidating at a higher level. Comparing Figures 1, 2, and 3, $USD and $XJY are better performers than $XEU. But the dollar index seems stronger than the other two.

Due to the weak trend indicated by the ADX (14), the dollar index is likely to remain range-bound in the near future as well. If the flag & pennant pattern breaks upward, then the rally would hit the resistance at $88.46. The trendline from the bottom shows the support at $83. So if the pattern breaks down, $83 would be the strong support. In addition, the 50-day moving average (MA) is the immediate support at $84.

FIGURE 1: $USD, DAILY. The index is consolidating, forming a bullish flag & pennant continuation pattern.

FIGURE 2: $XEU, DAILY

FIGURE 3: $XJY, DAILY

Figure 4 would give us a long-term view for $USD. ADX (14) shows a significant downtrend since 2003. The index consolidated at a new low below $72 in 2008 and entered an intermediate uptrend. Therefore, $USD surged from $72.50 and formed a lower high at $87.50 level. Currently, $USD is consolidating near the newly formed support of the 50-day MA. But the intermediate uptrend is declining, so the index may not break out. The RSI (14) in Figure 2 ranged between 50 and 70, indicating bullish strength during consolidation. Thus, $USD is likely to continue to consolidate.

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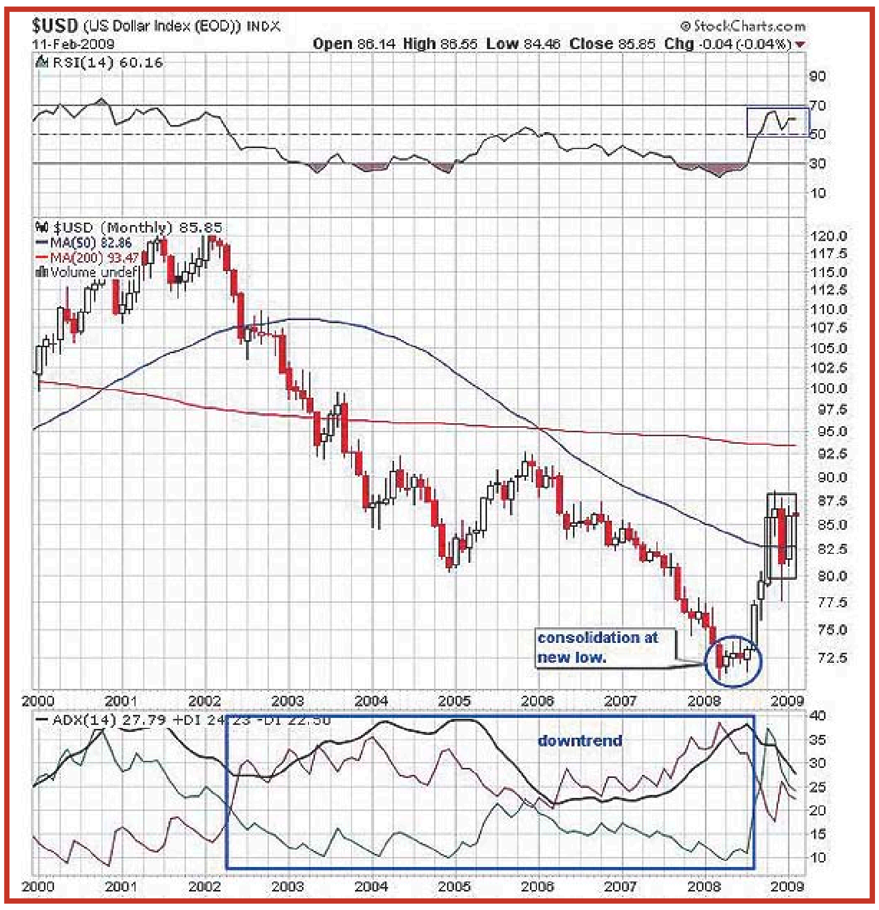


FIGURE 4: $USD, MONTHLY. The index has moved sideways after a prolonged bullish rally.

TRADING SYSTEMS

The QQQQ Tests Its Secondary Trendline

by Ron Walker

After a recent encounter with the rising minor trendline, the bears managed to run roughshod over the bulls, puncturing a hole in the minor rising trendline on the QQQQ's hourly chart. But a secondary trendline may be just the springboard needed to bolster the bulls.

Tradable: QQQQ

The exchange traded fund (ETF) QQQQ has been in an uptrend since its bottom on November 21. In Figure 1, you will note that once that bottom formed on the hourly chart, prices swiftly rallied up to the $29 dollar level that formed a downward-sloping trendline. After that move, prices threw back to $26.80, then QQQQ attempted another go at moving above that trendline. But prices stalled there once again a few days later. Finally, during its third attempt, the QQQQ was successful in taking out the trendline of resistance. That sloping trendline that appeared on the QQQQ hourly chart formed the neckline for a inverse head & shoulders pattern.

Prices then backtested the neckline of the pattern successfully and proceeded to move sideways, carving out a symmetrical triangle pattern. And on January 2, the QQQQ broke out of its triangle pattern. Shortly after the breakout, negative divergence formed between the price chart and the relative strength index (RSI) (14), causing prices to drift back down into the triangle near its apex. A divergence has formed between price and the moving average convergence/divergence (MACD) histogram at that level of support, which may allow a bounce to occur off these levels.

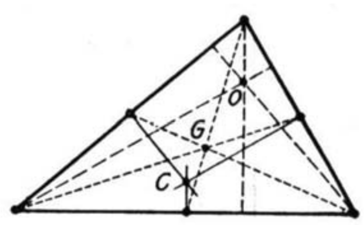
In Figure 2, a minor trendline was previously erected on the 60-minute chart of QQQQ that connected the last minor low with November 21. However, the QQQQ stumbled below its minor trendline on the hourly chart, causing prices to creep back down to a secondary trendline of support. The lower boundary of the symmetrical triangle is that secondary trendline of support. Now, even though the minor trend has been taken out, we still have higher lows on the price chart. As long as the prices do not make a lower low, the uptrend remains in full force. The uptrend can only be officially broken if prices make a lower low. So far, the hourly chart still has higher highs and higher lows, the character traits of an uptrend.

The QQQQ is at a crucial level of support. If the secondary trend is punctured, then prices will fall to test the last minor low at $28.46 made on December 29. If prices tumble below that last minor low, then the odds favor that the QQQQ will revisit its November low. Remaining above its secondary trendline will isolate it from further erosion and perhaps rejuvenate the advance, bringing about price stability. Right now, prices continue to struggle and limp along, inflicted by the technical damage done to the previous minor trendline. The QQQQ needs to gain some traction off either the secondary trendline or at its last minor low if the bulls expect to stay in power. If the QQQQ gets the traction it needs, a redraw of trendline will be in order off the November lows.

I am giving the uptrend the benefit of the doubt and anticipating that the advance will continue once prices have put yet another higher low. Should buyers support this secondary trendline, then we should get another attempt at a higher high. Assuming that the secondary trendline holds, and that price goes on to make higher highs, then prices may ultimately be carried up to the November 4 high near $34 or another barrier of resistance just above it near $35 (Figure 2). This is a major resistance zone for the QQQQ, and in all likelihood it will extinguish the advance. I don't think price will have the perseverance to move much higher than the resistance zone. The price target is arrived on the triangle by subtracting the lowest point from highest point in the pattern, and then by adding it to the pivot point where prices break out, a target can be calculated. Interestingly, the triangle measures $3.98, and when you add that to the pivot point at $30.20, we arrive at a minimum projected target for the pattern of $34.18. That is right in line with key resistance. ■

FIGURE 1: QQQQ, HOURLY. The QQQQ broke out of a symmetrical triangle pattern on January 2. Shortly after that a bearish divergence formed, throwing prices back into the triangle to test its lower boundary once again.

FIGURE 2: QQQQ, HOURLY. Here we see that the minor trendline has been fractured. But a secondary trendline is now being tested, with horizontal support just below that at $28.46. If support holds, prices will challenge the last minor high of $31.63, and if successful, they could rise to the resistance zone.



The Dow's Dragonfly Doji And Double Dose Divergences

by Ron Walker

Technical analysis can offer us a glimpse into the future when we spot a divergence or candlestick reversal patterns and they offer clues to potential price swings and fluctuations. Either signal has credibility on its own merits, but when they have a bullish divergence on more than one intraday chart, while the daily chart puts in a reversal candlestick, it could be a winning combination for a successful trade.

Tradable: $INDU

After the Dow Jones Industrial Average (DJIA) peaked at 9087 in early January 2009, the floor fell out as it put in its worst January performance in history. For January 2009, the DJIA lost 775 points or 8.84%.

THE FIRST DIVERGENCE

The Dow Jones Industrial Average (DJIA) broke the sound barrier on its steep ride down from its January high and moved on to February with a series of lower lows. In Figure 1, a divergence appeared on the DJIA hourly chart in early February that gave prices a short-term pop back up to resistance near the 8400 level, which was the minor high made in late January. Braced for another impact at resistance, the DJIA was dealt another severe blow that sent it crashing back down, falling below the cracks and crevasses of support to make yet another lower low. The moving average convergence/divergence (MACD) (12, 26, 9) was unsuccessful in moving above its previous peak, bringing about a lackluster rally. The moving average convergence/divergence (MACD) couldn't break above its previous peak, subsequently stalling the rally. It also revealed that momentum to the upside was flat, and that it would be difficult to gain any traction here at resistance.

Needless to say, the DJIA retreated, and fell below the lows it made in early February, on its way down to test the November low. But while prices were busy making lower lows, the MACD held above its prior low, forming a much larger divergence than one that formed in early February. In addition to the divergence, the MACD has a long-term trendline off the November lows, killing two birds with one stone. Moreover, the formation of the divergence has allowed a very large bullish falling wedge pattern to form on the hourly chart. Prices need to move above the 8100 area in order for the pattern to break out. But the fact that the pattern hasn't broken out yet is irrelevant; the important thing here is that the 60-minute chart has a bullish divergence.

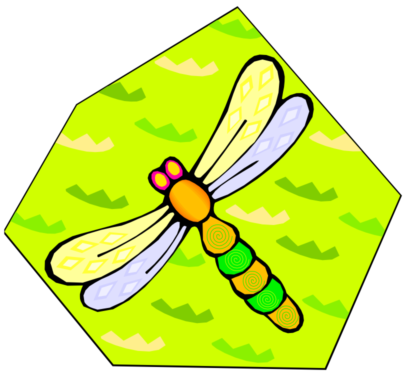
FIGURE 1: DJIA, 60-MINUTE. Note how the first divergence completed in early February (black dotted line on the price chart) with the MACD. But the MACD failed to push above its previous peak made in late January, causing prices to make new lows. The new lows completed a larger divergence (solid blue lines) while simultaneously testing the support of the rising MACD trendline off the November 21st lows.

THE SECOND DIVERGENCE

Now we also have a divergence on the 15-minute chart. On the DJIA 15-minute chart, we can see on a larger scale, the rally that occurred from the early February lows. In Figure 2, we can see that prices rallied up to 8314 on February 9, but then the rally stalled and prices rolled over and began to decline once again. Over the course of the next three trading sessions, prices forged lower, forming a bullish falling wedge, just like the hourly chart. Note that both the MACD and the relative strength index (RSI) formed a divergence with the price. This bullish divergence led to the pattern's breakout on February 12 where the DJIA embarked on a journey back up to overhead resistance near the 7975 area. With both 15- and 60-minute intraday charts sporting a bullish divergence, examine the candlesticks on the daily chart for evidence of a reversal. That will help us gauge what kind of odds we are up against for the divergences to play out. If a potential reversal pattern has formed, the odds significantly increase that the divergences will play out.

FIGURE 2: DJIA, 15-MINUTE. The DJIA has a divergence with the MACD, TRIX, and the RSI. The divergence forced the breakout of the bullish falling wedge, which was so powerful that a bullish three white soilders candlestick pattern appeared at the breakout (circled in black).

FIGURE 3: DJIA, DAILY. With a reversal dragonfly doji candlestick on the daily chart, the DJIA has formed a orderly rising minor price channel. A dragonfly doji is usually associated with a turning point in price. So it is very possible that the DJIA could begin a journey back to the upper boundary of this channel toward the 9200 level.



The Dragonfly Doji

In Figure 3, we can see that a dragonfly doji candlestick has formed on the DJIA daily chart, which is a reversal one-day candle pattern. A dragonfly doji occurs when the open and the close are at the high end of the day. This doji signifies a turning point for the DJIA. Note that a progressive rising channel has been completed with the appearance of the dragonfly doji. In addition, note how the rising minor trendline runs parallel with the upper level of rising resistance, which forms the upper boundary or a trend channel.

With a divergence on the 15-minute chart and on the 60-minute chart, the dragonfly doji will likely get a follow-through confirming the pattern, as prices close above the highest peak on the doji. This pattern must be confirmed by prices closing above the highest point on the pattern. Volume should increase on the confirmation, and once it is confirmed it should resurrect a rally and silence the bears. With the confluence of support in these multiple time frames, the DJIA may lick its wounds and begin the healing process. But keep in mind that not every divergence plays out; there is no sure thing. This market is volatile, and whipsaws have occurred frequently in this emotional trading environment. Whipsaws occur when a buy signal is given but quickly reversed. But the scales of balance are clearly shifting the odds in favor of the bulls for the short term. ■

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ELLIOTT WAVE

Is The A-B Base What The Bottom Will Look Like?

by Koos van der Merwe

Is this A-B base the future market bottom picture?

Tradable: OEX

FIGURE 1: S&P 100, WEEKLY

Readers have emailed me to ask whether I still believe that the stock market is near or at a bottom. To answer their question, I have chosen a weekly chart of the Standard & Poor's 100 to analyze (Figure 1). I have chosen a weekly chart because a daily chart offers too many waves and should be used for fine-tuning only, and a monthly chart is for long-term analysis only. My analysis will hopefully allow those readers to sleep better at night.

Figure 1 shows my Elliott wave count from 1999 to the present, a period of 10 years. I have shown the fifth-wave top as being March 2000 as the tech bubble burst. Wave A, as we all know by now, was in September 2002, with the top of wave B the start of the present recession in October 2007. Unlike the Standard & Poor's 500, the top of wave B is not higher than wave V, so the S&P 100, like the chart of the Dow Jones Industrial Average (DJIA), is not suggesting a flat wave C, which means that wave C will fall in a five-wave pattern and will fall beyond the low of wave A. The chart shows that this has occurred.

A positive sign that the end of the bear market is at hand is the wave count of wave C, which does appear to be nearing completion. The relative strength index (RSI) seems to be suggesting that a divergence buy signal is in the offing. The RSI has not been that successful as shown, where in March and September 2001, both buy signals were short-term buys only. However, in August 2002, the divergence buy signal was successful in calling a bottom, which suggests that when the present divergence does materialize — if it does — then it could also be a success.

If this is truly a C-wave bottom developing, then what about the future? In the chart I have drawn in what is called the "A-B base." In his book *Nature's Law*, Ralph Nelson Elliott twice referred to a structure called an "A-B base." He believed that after a major decline ended on a satisfactory count, the market would advance in three waves, and then decline in three waves prior to the commencement of the new bull market. This theory does suggest a rounding bottom, a period of burial for the bear's corpse.

The A-B base does have its detractors, the strongest being Robert Prechter (coauthor of *Elliott Wave Principle* with AJ Frost), who believes that Ralph Elliott invented this wave to "force his principle into the 13-year triangle concept." I admit that the A-B base would cause the wave count to fit beautifully into the Kondratieff wave theory (an earlier Traders.com Advantage article of mine).

Should we, however, stick to keeping a simple wave count, then we could argue that the A-B base is simply part of the wave I formation of the new bull market, which according to the Kondratieff wave theory should only start in 2012, give or take a year. In Figure 1 I have drawn in both suggestions, the A-B base in blue and the possible wave I formation in light green. Whatever the final outcome, it does suggest a long and slow recovery — a rounding bottom as the maggots on the bear's corpse slowly consume the rotting flesh.

To conclude: Yes, I do believe that the bottom is almost in place if not already in place. However, I also believe that the recovery will be slow, no "V" bottom recovery that most analysts hope for. That bear's corpse is truly a big one. ■

Further Reading

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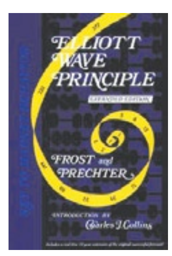
Frost, A.J., and Robert Prechter [1985]. *Elliott Wave Principle*, New Classics Library.



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S&P 500 To Thrust Lower

by Alan R. Northam

The S&P 500 is currently in a wave 2 market correction. Once this correction is completed, the S&P 500 will thrust downward to a new price low.

Tradable: $SPX

According to the Elliott wave theory, wave 3s are the ones that move the farthest in price and usually does so in the shortest period of time. Thus, wave 3s are the thrust wave. The Standard & Poor's 500 is now ready to start wave 3 downward, which should draw this index below its November 2008 low. Following the completion of wave 3, the index will undergo a small upward corrective rally, followed by a final move down to yet lower lows.

Figure 1 shows the weekly bar chart of the S&P 500. Note that in this chart there are three wave 3s. Further, note that wave (1) is made up of a sequence of waves labeled waves 1, 2, 3, 4, and 5. Of these five, wave 3 is the one that fell the furthest distance in price. Wave (3) is also made up of five waves. Of those five, wave 3 also fell the furthest in price. In addition, wave (3) itself fell further in price difference between it and wave (1). These examples then show that wave 3s are the ones that move the most when compared to the other waves in its wave sequence.

Looking closer at the price chart of the S&P 500, Figure 2 shows the daily price bars of this index. The daily chart shows that corrective wave (4) is complete and wave (5) down is under way. Wave (5) will also be made up of five waves — 1, 2, 3, 4, and 5. Of these waves, wave 1 is complete and wave 2 may also be complete unless it extends. Wave 2 is a corrective wave which, when complete, if it is not already, will ultimately draw price below the low of wave 1 (see blue horizontal line). A move below this blue line will be a signal that wave 2 is finally complete and wave 3 down is under way.

The S&P 500 is currently in the process of completing corrective wave 2, if it hasn't already done so. Once wave 2 is complete, wave 3 will thrust the S&P 500 downward quickly to a lower price than that formed in November 2008. Upon completion of wave 3, the S&P 500 will undergo a small upward price correction to be followed by a more gentle final wave 5 downward that will then lead to an even lower price that will then complete wave (5) downward. ■

FIGURE 1: S&P 500, WEEKLY. Weekly bar chart of the S&P 500 showing the Elliott waves from the market top in October 2007 to the present.

FIGURE 2: S&P 500, DAILY. This chart also shows that wave 1 of wave (5) is complete and wave 2 may be complete as well. A move below the lower horizontal blue line drawn off the low of wave 1 will confirm that wave 2 is complete and that wave 3 or (5) is under way.

These examples show that wave 3s are the ones that move the most when compared to the other waves in its wave sequence.

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ELLIOTT WAVE

How Low Can The Dow Go?

by Alan R. Northam

The Dow Jones Industrial Average has now moved below its November 2008 low. How low can the Dow go?

Tradable: $INDU

On February 3, I wrote an article titled "DJIA Resumes Downward Trend." On Friday, February 20, the Dow Jones Industrial Average (DJIA) made a new lower low price, confirming the downward trend. So how low can the Dow go?

In determining how low the DJIA can go, I find that the Elliott wave theory gives a very good indication of the price target for the completion of wave (5). The Elliott wave theory simply states that wave (5) is typically the same length of its wave (1). There are two ways to accomplish this: arithmetic and ratio. To determine a good price target for the completion of the downward trend for the DJIA arithmetically, we take 14,198 and subtract 11,635 from it and get the subtrahend (that is, the number to be subtracted) of 2563. We then take 2563 and subtract it from 9088 to get a price target of 6525. To determine the price target for the completion of wave (5) and the complete downward trend using ratios, we take 14,198 and divide it by 11,635 to get the quotient 1.22. This quotient is then divided into 9088 to arrive at a price target for the completion of wave (5) of 7450.

Combining these two different ways of calculating the completion of wave (5) and the complete move down from the October 2007 high, we arrive at a price target range of from 7450 to 6525. From the price chart, we can see that the DJIA entered into this price target range on Friday, February 20, when it made a new low price of 7249. (See Figure 1.)

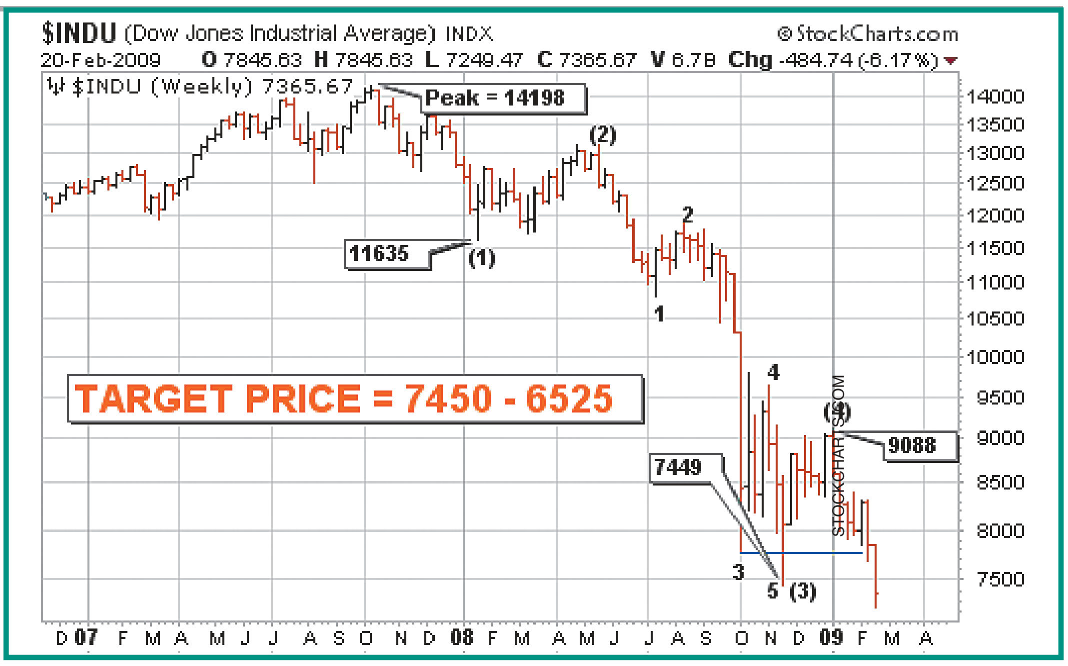

FIGURE 1: DJIA, WEEKLY. This chart shows the Elliott wave count and the target price range for the completion of the downtrend.

In conclusion, the DJIA has now entered into the price target range where we expect the DJIA to complete wave (5) down. Therefore, it is time to start looking for signs of a trend reversal signal to develop that will inform us that the Dow is in the process of reversing its trend from down to up. ■

FURTHER READING

Northam, Alan R. [2009]. "DJIA Resumes Downward Trend," Traders.com Advantage, February 3.

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See www.Traders.com for more.

The DJIA has now entered into the price target range where we expect the DJIA to complete wave (5) down.

CHART ANALYSIS

Dow 6000?

by Mike Carr, CMT

Technical patterns indicate the next 1,000 points on the Dow Jones Industrial Average is more likely to be down than up.

Tradable: DJIA

The Dow Jones Industrial Average (DJIA) has just broken long-term support, down from a descending triangle (Figure 1).

A descending triangle is a bearish chart pattern formed when a trendline connecting a series of lower highs and a second trendline that shows a strong level of support converge. On a break of the support, further downside is expected. Patterns provide measurement objective based upon the idea that symmetry exists in the markets. In the case of a triangle, the objective is assumed to be the same as the widest point in the pattern.

According to research done by Thomas Bulkowski, author of *Encyclopedia Of Chart Patterns*, this type of breakout ranks 10 out of the 21 patterns he tested. About half of the time the pattern objective is reached.

In this case, we have a price target of 6200 for the DJIA. Support for this target is found in the point & figure chart. These charts plot only price, ignoring the passage of time, which allows for a clearer picture of the price trend. The P&F chart of the Diamonds exchange traded funds (ETF), a proxy for the DJIA, can be seen in Figure 2.

By taking a count of the number of boxes across the base that the stock has completed, we can determine an objective from the breakout. In this case, we find a base of seven boxes at the price level of 81. We multiply that number by 3, which is the size of the reversal required to switch columns from X to O and find that the expected move is 21 points from the breakout. The sell signal occurred at 78, and subtracting 21 from that offers a price target of 57.

These two methods indicate that the DJIA may fall as low as 6000. There are bullish arguments to counter that, of course, but until the market moves back above 7900, the bears are in control. ■

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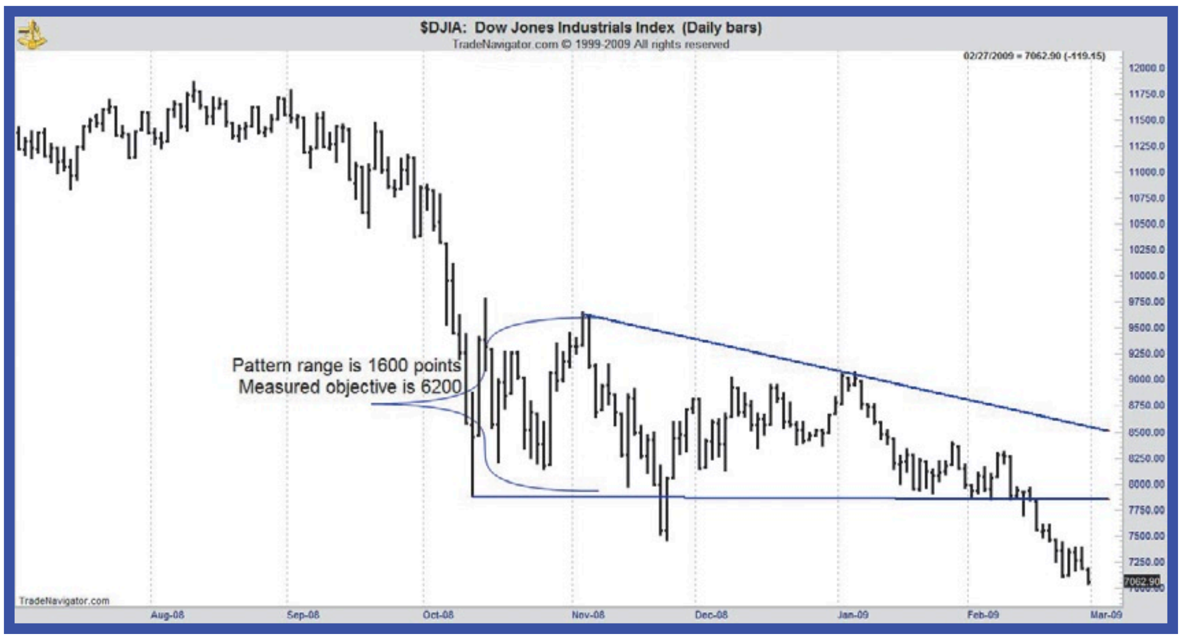

TRADE NAVIGATOR

FIGURE 1: DJIA, WEEKLY. The chart shows the triangle that formed since October 2008.

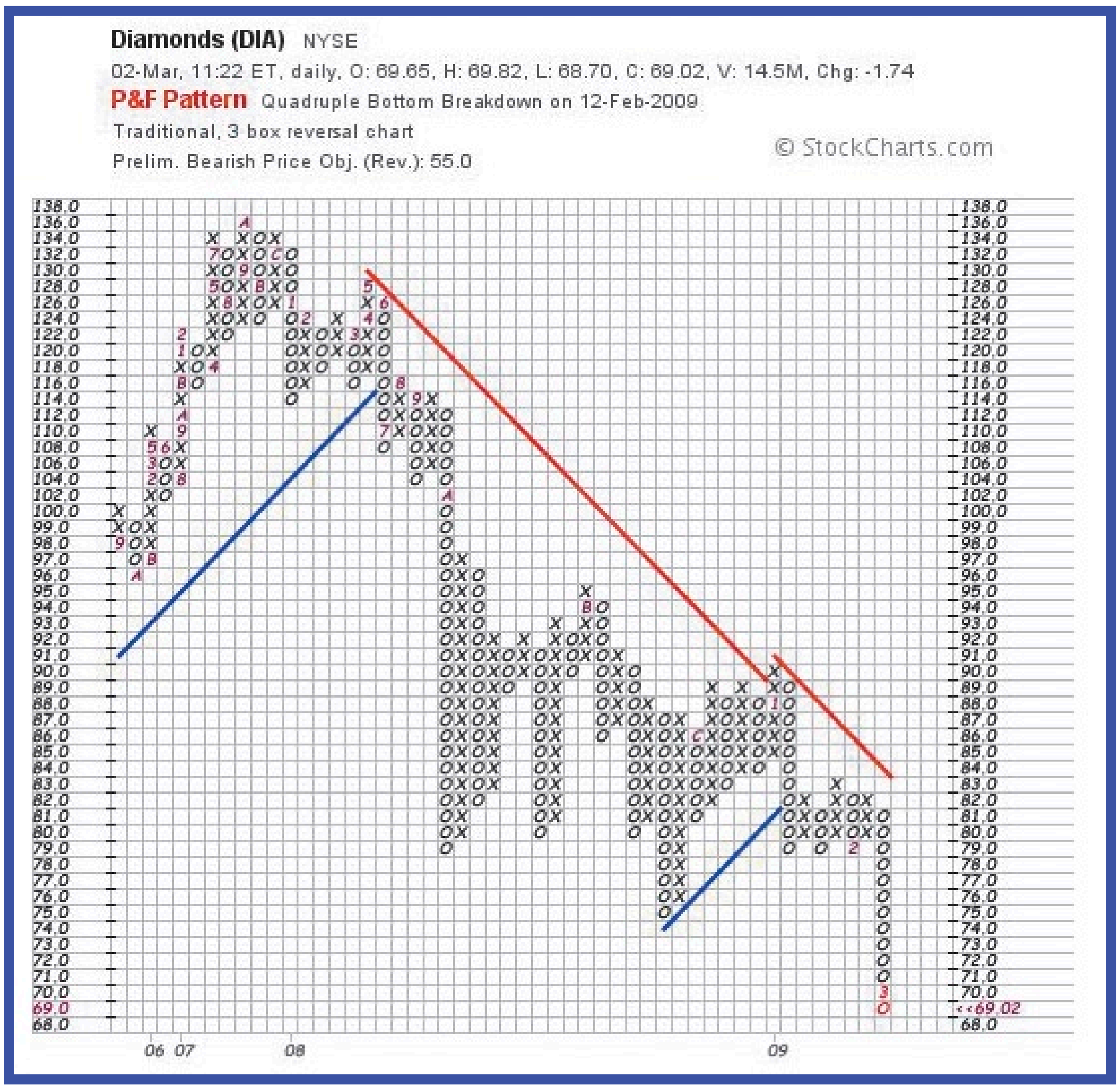

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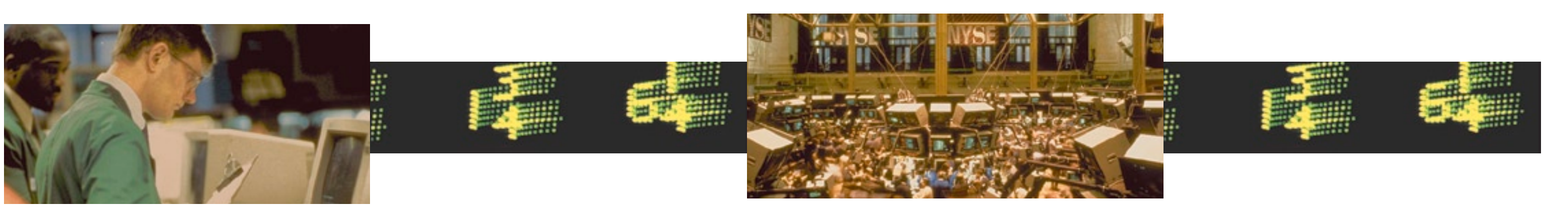
FIGURE 2: P&F, DIA. The P&F count supports the descending triangle objective, adding confidence to the analysis.



INDICATORS

RSI

Dow's Direction?

by James Kupfer

Are there any clues about which way the Dow Jones 30 is headed?

Tradable: DJ30

As the weakest of the three major equity markets, the Dow Jones 30 may be a good indicator for the rest of the equity markets. Let's look at some simple indicators to see what they may be telling us about the DJ 30's near-term future.

In the neutral category is the fact that the DJ 30 has remained in a relatively tight trading range for about the last month. It has not found the leadership to move significantly either up or down. After such a dramatic move downward in 2008, this might be construed as a possible long-term positive in that the market may be consolidating before a move back up. While I do not feel this is actually the case, it is worth taking a look at this as a possible scenario.

On the near-term bull side is that the DJ 30 has managed to hold the 76.4% Fibonacci retracement line indicated in purple. Each time the Dow Jones Industrial Average successfully tests this support zone, the stronger it becomes. In addition, the relative strength index (RSI) is displaying a potential divergence between price and the indicator. The RSI is making a series of slightly higher lows, while conversely, price is making a series of slightly lower lows. This demonstrates a potential underlying strength in the market.

On the bear side we have two items worthy of note. First, the RSI has been unable to break above 50 since the beginning of January. This is indicative of an underlying weakness in the market. Second, the DJ 30 has made a series of lower highs along with slightly lower lows.

All in all, there is no clear near-term direction present or developing. The evidence for both bulls and bears largely cancels one another out. At this juncture the most prudent alternative may be to wait for the market to present a clearer picture or trade with a downside bias as the market is still in the bear's grip and the long- and intermediate-term direction still appear to be down.

FIGURE 1: DJIA, DAILY. The RSI shows weakness as well as potential strength. Stochastics are neutral.

RELATIVE STRENGTH COMPARATIVE

Spotting Tomorrow's Leaders

by Mike Carr, CMT

As the market trades near key support, relative strength can show us where to look for potential winners if the market turns higher.

Tradable: QQQQ

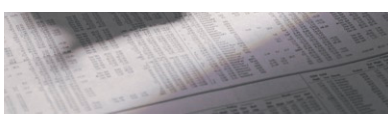
Countless academic studies have demonstrated that over the intermediate term, stocks trend. This means that the stocks that have gone up the most over the past three to six months are most likely to continue their winning ways in coming weeks. One way to measure past performance is to look at relative strength (RS).

The momentum of comparative strength (MoCS) indicator allows us to trade RS signals on an individual stock rather than using the more familiar portfolio rankings of RS. MoCS is a moving average convergence/divergence (MACD) calculation of the stock's performance compared to the Standard & Poor's 500.

Figure 1 shows the PowerShares QQQ (QQQQ) exchange traded fund (ETF), which tracks the NASDAQ 100. These are speculative stocks, and at past market bottoms, speculative stocks have tended to outperform value stocks.

This is confirmed by the small-cap indexes as well. The Russell 2000 Value Index (Figure 2) shows the same RS pattern as QQQQ. Although not shown, value stock indexes are on sell signals based on the MoCS.

Speculation is present when investors are optimismic and is a healthy sign in the stock market. The strength of growth stocks may be alerting traders to a bottom in the current, somewhat scary, market. ■



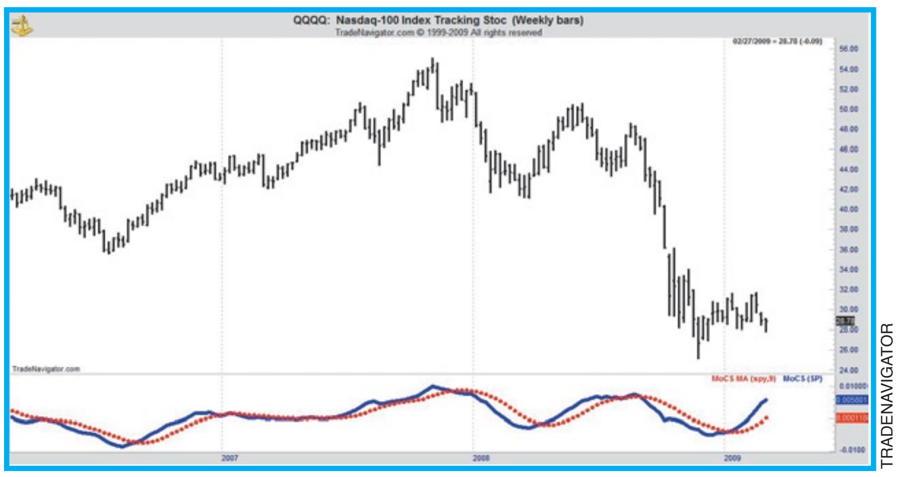


FIGURE 1: QQQQ, WEEKLY. The RS is showing a strong buy signal despite the choppy price action since the November lows.

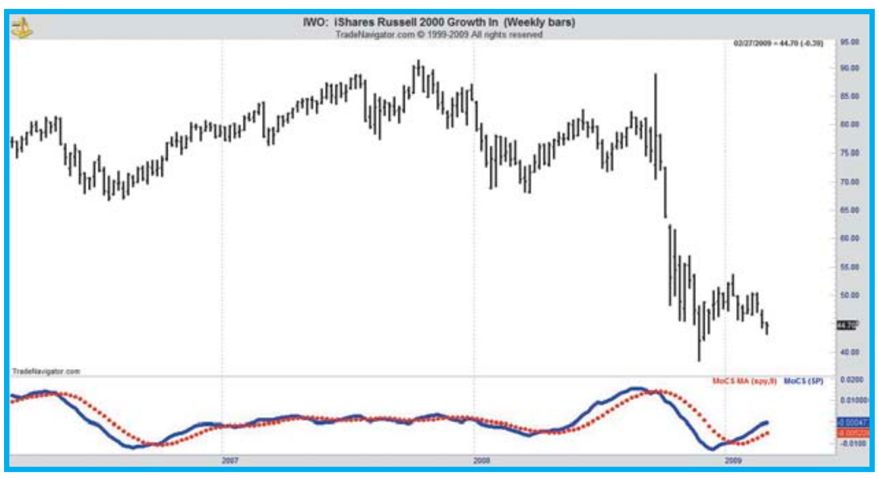


FIGURE 2: IWO, WEEKLY. This chart confirms the strength of growth stocks in the first weeks of 2009.

FIBONACCI

New Lows Approaching?

by James Kupfer

Where in support should the Dow Jones 30 break the November 2008 lows?

Tradable: DJIA

On February 17, 2009, the Dow Jones Industrial Average (DJIA) dropped almost 300 points to close at 7552. This close brings the DJIA within points of breaking the November 2008 lows. With any follow-through to the downside, the DJIA would trade at its lowest levels since 2002 when it reached a low of 7197.

Before breaking below 7200, the bears will have to break through significant support. As noted, it is the bottom of the 2000–02 bear market. Further, 7119 is the 50% Fibonacci retracement level from the lows of the Great Depression to the November 2007 market peak.

Since we are in the strong grip of a major bear market, I think it is almost inevitable that we will reach and, in the not-too-distant future, break below the 7200 level. Should that forecast come to fruition, where is the next major support level? We can use Fibonacci analysis to develop guidelines for where the market may be headed.

	October 1987 - October 2007	August 2008 - November 2008	November 2008 - January 2009
Major High	$ 14,198.10	$ 11,867.11	$ 9,088.26
Major Low	$ 1,616.21	$ 7,449.38	$ 7,449.38
Difference	$ 12,581.89	$ 4,417.73	$ 1,638.88
Fibonacci Ratio	61.8%	127.2%	161.8%
Fibonacci sub-value	$ 7,775.61	$ 5,619.35	$ 2,651.71
Fibonacci Target Level	$ 6,422.49	$ 6,247.76	$ 6,436.55

FIGURE 1: FIBONACCI TARGET LEVELS. Here are clustered Fibonacci support levels.

On Figure 1, you can see the major highs and lows of significant time periods for the DJIA — for example, the market bottom of 1987 and the market top in 2007. In this case, 61.8% of the difference between these market extremes leads to a price target of 6422. For the three examples noted, the average is 6369. This is not a hard and fast number, but if and when the DJIA approaches this level, it would be prudent to look to cover short positions and consider establishing long ones. ■

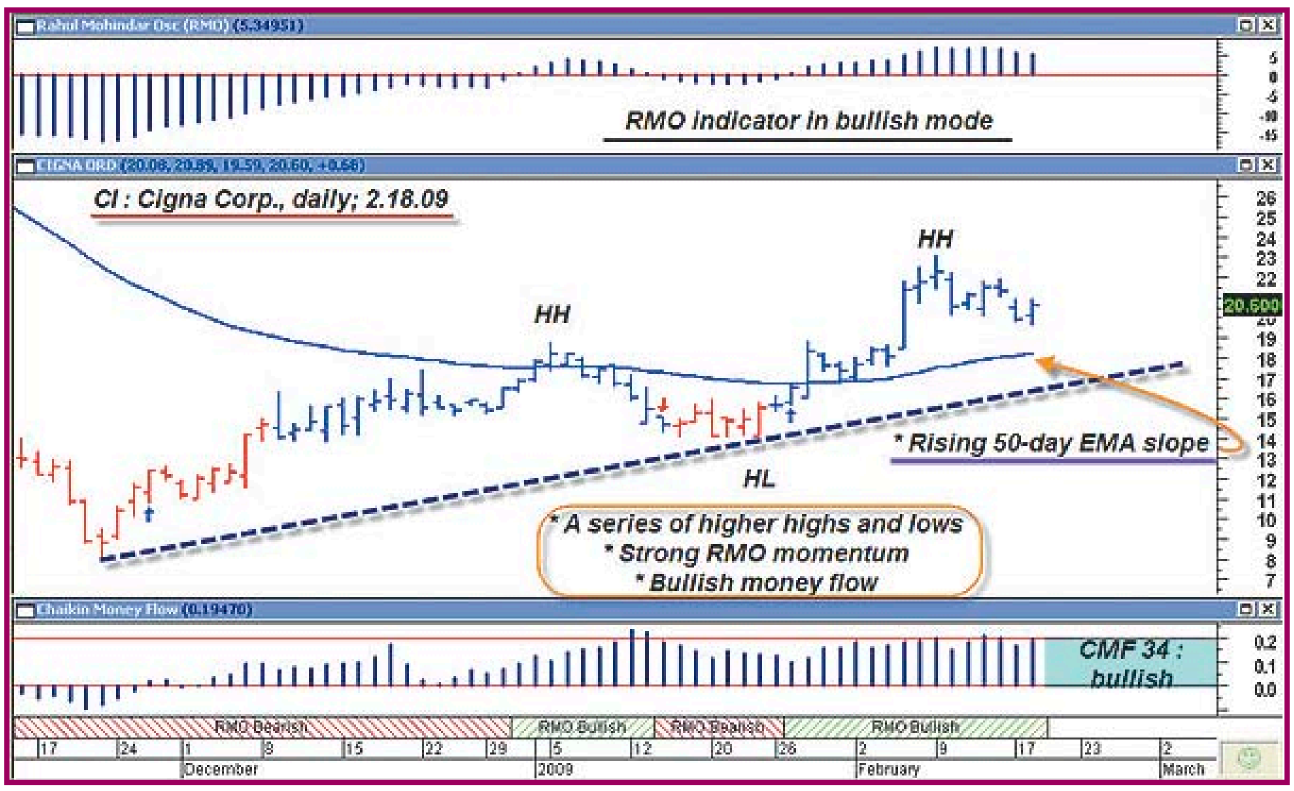
MOMENTUM

Cigna's High Relative Strength

by Donald W. Pendergast Jr.

Cigna Corp. has one of the highest 13-week relative strength rankings versus the Standard & Poor's 500. Is there an opportunity here for traders or investors?

Tradable: CI



METASTOCK; RAHUL MOHINDAR OSCILLATOR (RMO) FROM METASTOCK

FIGURE 1: CI, DAILY. High relative strength vs. the S&P 500, a solid uptrend and bullish momentum/money flow readings all combine to suggest more good times ahead for Cigna shares.

Not every segment of the US financial sector was creamed in the credit-crunched bear market wipeout of 2007–08. Although very few stocks (in any sector) emerged without suffering major setbacks in the price of their stock prices, some companies continued to earn profits and carry on in a relatively normal fashion. Cigna, the giant health insurer, appears to have been one of those fortunate companies. Its stock is up by more than 150% since the November lows and it keeps chugging higher, despite all of the increasingly negative economic news splattered all over the news media. What exactly is the technical state of this huge S&P 500 component stock?

Altogether, the technical image on the daily chart is positive (Figure 1). Price has finally managed to form a higher low that is well above its upsloping 50-day exponential moving average (EMA); in addition, a series of higher highs and lows has already printed. In the top pane of the chart is the Rahul Mohindar oscillator (RMO), a unique momentum indicator that helps keep a trader on the right side of the dominant trend. Buying pullbacks toward a significant support level (like a Fibonacci 38.2% or 61.8% retracement) when the RMO is on the positive side of its zero line is one useful way to utilize this indicator. Odds of success also seem to be enhanced by taking bullish trade setups that are on the north side of the 50-day EMA, particularly when the Chaikin money flow (CMF) (34) is also on the positive side of its zero line.

Such a setup may have just printed; price has pulled back approximately 38% of the last upswing's length, even as the RMO and CMF (34) are supportive of a long move.

Today's (February 18, 2009) bullish reversal bar could be used as the basis for a short-term swing trade; a buy-stop could be placed at $20.91 and, if filled, an initial stop placed just below Wednesday's low near $19.57. The initial target is the prior swing high of $23.06, yielding a nominal risk to reward ratio of approximately 1.6 to 1.

Since this stock has such great 13-week relative strength shrewd traders might attempt to take half profits if the $23.06 level were reached, letting the rest ride with a trailing stop. "Momentum precedes price," the old trader's saying goes, and this is one stock in which the benefit of the doubt should likely be biased in favor of higher prices. ■

A Major Low Soon For Altria And The .NYA?

by Donald W. Pendergast Jr.

Is the broad US market in a free fall, or are there some indications that a major low may be approaching?

Tradable: .NYA, MO

The recent breakdown through the November 2008 lows has caught the attention of traders and investors of every persuasion. While the Dow Jones Industrial Average's (DJIA) plunge below 7000 isn't good news, a closer look at the internal strength readings of the New York Composite Index may be enough to provide a few glimmers of hope that the long-awaited "major low" may be coming — and soon. The weekly chart of the .NYA is our first stop in our search for clues.

While the trend is still down, and long stock positions should generally be avoided right now, the internal strength indicator (a weighted mix of the advance-decline line, the ratio of new highs-new lows, the rate of change in price and the up volume-down volume ratio) is substantially higher than it was at the November 2008 lows. Technically, this is known as a nonconformation and may be viewed as a potential warning that the downtrend may be losing steam. Adding some extra power to this view is the fact that the weekly volume trend has been gradually declining for more than three months, another sign that the worst of the panic selling phase may be over for now.

Although price cycle measurements can be a subjective form of technical analysis, the Standard & Poor's 500, the DJIA, and the .NYA all tend to feature a 20-week (average) period between cycle lows. If the cycle remains on schedule, we may witness the next major weekly low within two to four weeks. Given the other technicals, there may be some reason to believe that the broad US indexes may be within reach of the elusive major low that everyone has been hoping and praying for. Let's look at another big S&P 500 component stock, Altria Group (MO), and see if its weekly chart is also suggesting that institutional money has begun to flow into some of these beaten-down mega-cap stocks.

Interestingly, Altria Group is also displaying very positive money flow action; it recently broke out of a two-year long Chaikin money flow (34) downtrend, and has even moved smartly above its zero line. This is a positive confirmation that there is renewed interest in this high-yielding (8.3%) S&P 500 component stock. Just as with the .NYA, look at how much stronger the money flow reading is now than it was at the November 2008 lows, even though price is only marginally higher. The "line in the sand" is now $14.34 in this stock; a break lower is probably an indication of further weakness, but if the November low holds and the CMF (34) stays strong, MO might be one of the early "recoverees" in this bear market bloodbath. Of course, the .NYA, DJIA, and S&P 500 all need to put in major lows too, for the balance of the market to regain its footing.

For those unsure as to how effective money flow analysis really is, I direct your attention to the left side of the Altria chart; note how the CMF (34) grew progressively weaker, even as the stock kept grinding higher. This was a visual display of the market phenomenon known as distribution. What that means is the smart money (pro traders and institutions) was gradually selling their positions to starry-eyed, profit-hungry, novice traders — the ones so sure that MO was destined for even higher prices. Whenever you see such a pronounced divergence between long-term money flows and price action, you can be pretty sure that the pros are either selling into strength or buying into weakness. I suspect that right now, the latter scenario is the correct assumption.

Maybe the rest of us can learn something from this, too, such as, "Dumb money chases price while smart money sells into strength." The converse is also true, too — "Smart money buys into weakness (if the underlying fundamentals are solid) while dumb money sells into weakness."

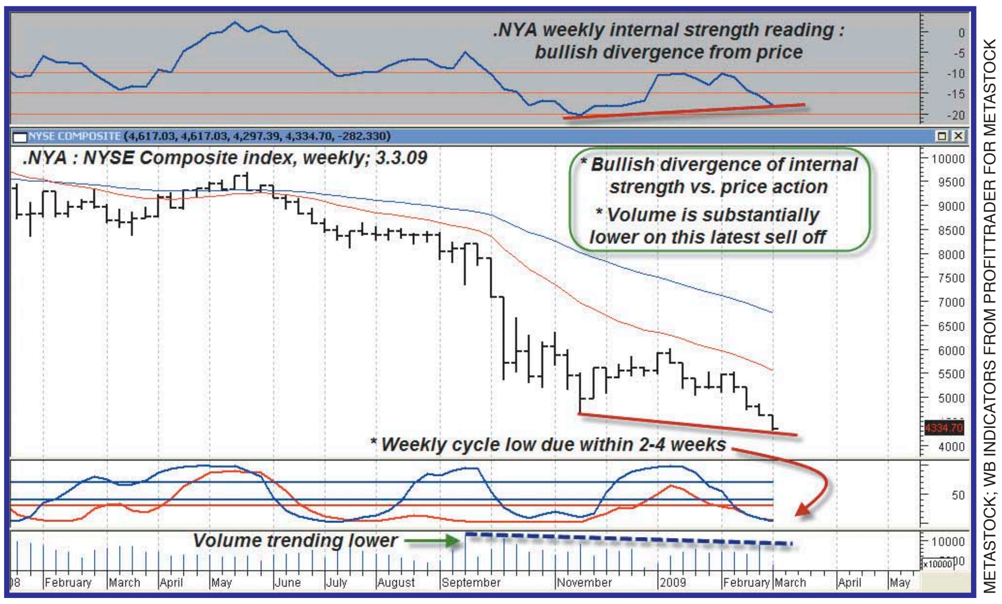


FIGURE 1: NYA, WEEKLY. An approaching cycle low, declining volume trend, and slightly bullish internal strength divergence may be suggesting a major low could be a possibility in the next few weeks.

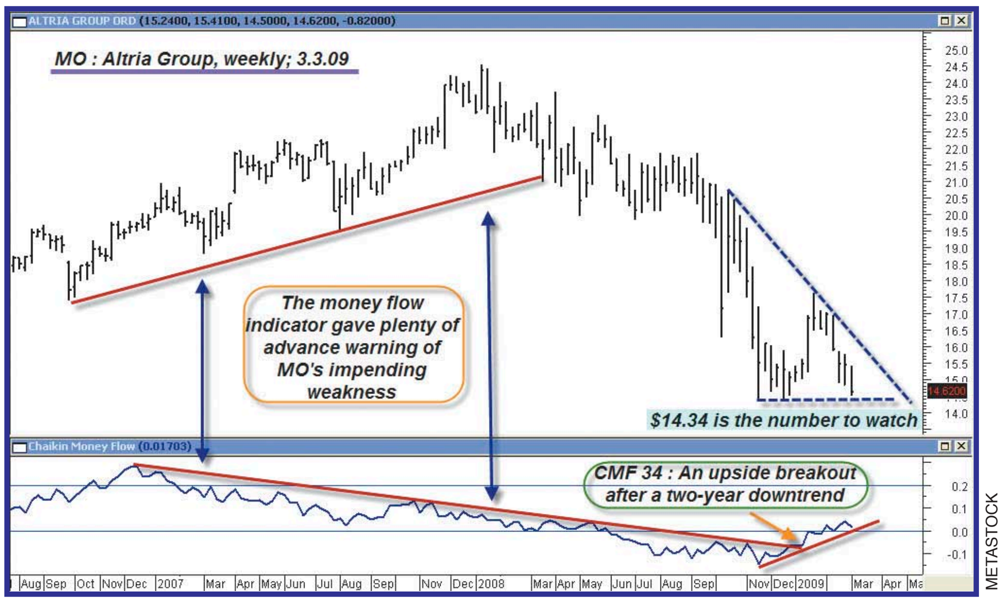


FIGURE 2: MO, WEEKLY. Altria Group's Chaikin money flow (34) breakout appears significant, given the duration and intensity of the previous long-term money flow trend.

There should be some incredible moves — either up or down — in the next few weeks, so keep close tabs on your investment and trading positions. The weekly price action in .NYA and MO may also be a good idea to watch, too. ■

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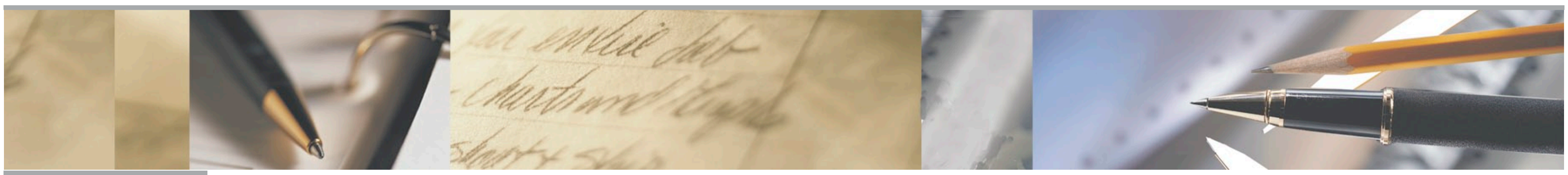

STRATEGIES

Can You Really Trade Economic News?

by Mike Carr, CMT

Government reports can move markets, but should they?

Figure 1 is a near-perfect stock market timing model. The logic is clear — when jobs are being created, the Standard & Poor's 500 moves higher. When job growth is negative, stocks decline. This is a relationship you'd expect to see since job growth is necessary in a healthy economy and stock price growth over the long-term is in line with GDP growth.

We could fine-tune this model with moving averages and catch tops and bottoms in the stock market within a month in almost all cases. With sound underlying logic, there should be no reason the model would ever fail.

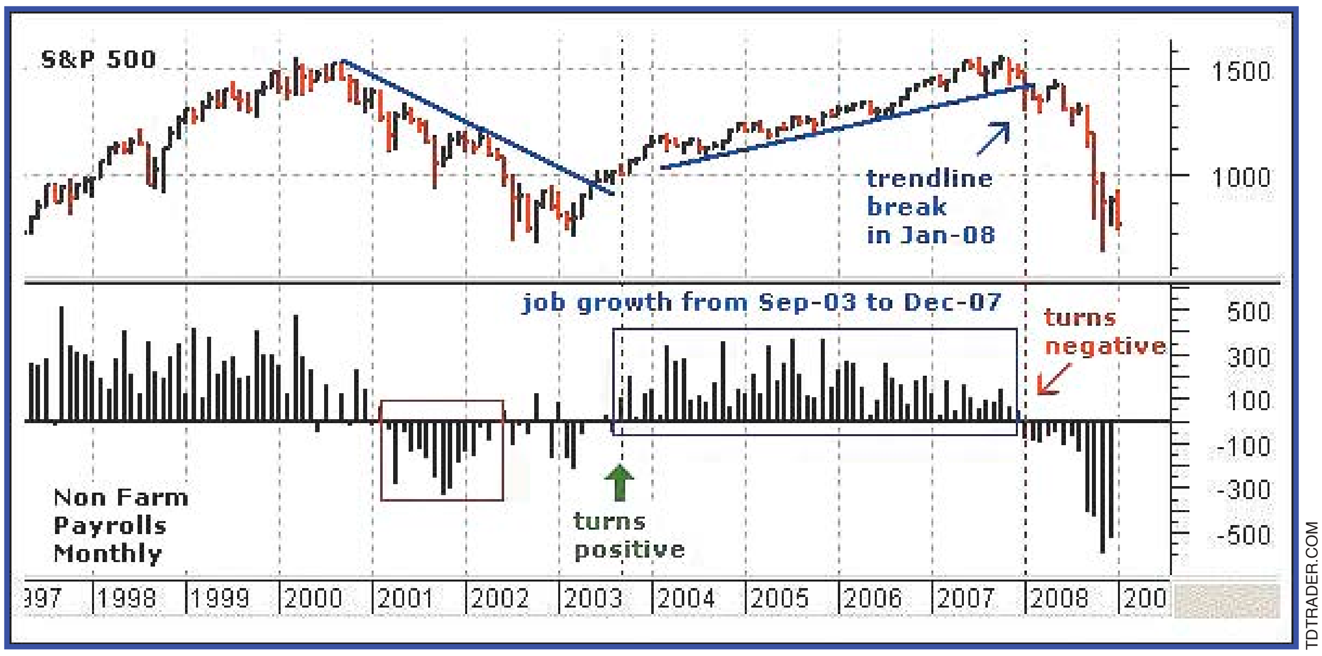

FIGURE 1: S&P 500. Perfect market timing with the US unemployment report.

The problem is shown in Figure 2. The official data is often changed repeatedly after it is first reported, meaning the historical test results shown in Figure 1 could not be achieved in real-time. As shown, the US economy has lost 3.6 million jobs since the start of 2008 with most of those losses, nearly 80%, coming during the last five months. While the sheer number of job losses is huge, each month it has been getting worse than it was the previous months. The unemployment report from January showed that employers cut 598,000 jobs during January. This number is likely to be revised in next month's report.

Economic statistics are almost always revised after their initial report. In Figure 2, Bespoke tracks the magnitude of these revisions in the unemployment report. The upper line is the reported figures on the day of the initial release as well as the most recently revisions. They wrote, "As shown, based on reported numbers, the US economy would have lost 2.48 million jobs since the start of 2008. However, once we take into account the negative revisions, the US economy has lost another 1.1 million jobs, representing a 44% increase in jobs lost."

Given the frequent and often drastic revisions to economic data, investors cannot rely on government reports for market forecasting. The best approach is to combine multiple data series to develop an indicator for the most likely direction of the economy and the market. This is the approach employed by the Conference Board's Leading Economic Indicator, one of the most reliable forecasting sources. ■

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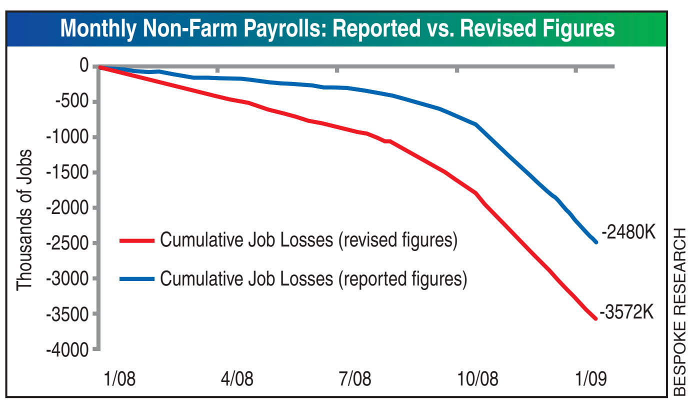

FIGURE 2: NONFARM PAYROLLS, MONTHLY. Revisions are constant and substantial.

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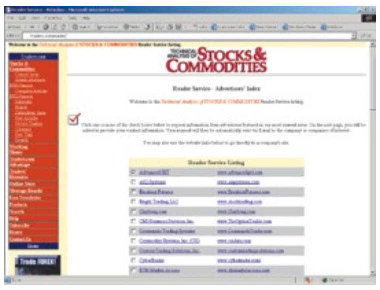

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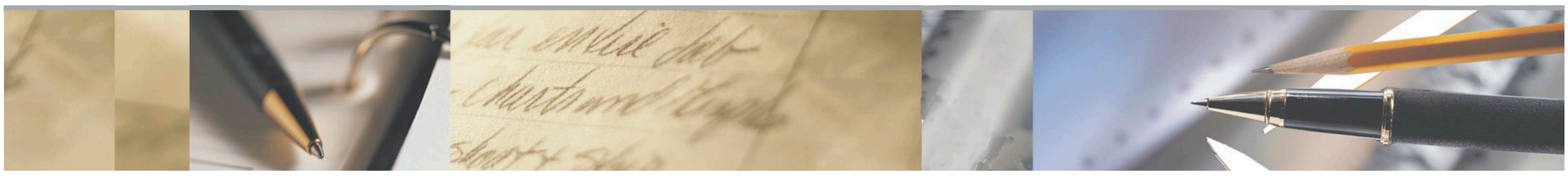

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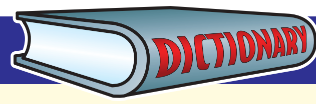
Ron Walker *is an active trader and technical analyst. He operates an educational website dedicated to the study of technical analysis. He is a video pioneer, having been one of the first to utilize the Internet for technical analysis videos.* ■

TRADERS' GLOSSARY



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

Average True Range — A moving average of the true range.

Breakaway Gap — When a tradable exits a trading range by trading at price levels that leave a price area where no trading occurs on a bar chart. Typically, these gaps appear at the completion of important chart formations.

Chaikin Money Flow — An oscillator that is used to determine if an equity is accumulating or distributing. It is based on the readings of the accumulation/distribution line and on the location of the closing price with respect to the price range.

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.

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

Exchange-Traded Funds (ETFs) — Collections of stocks that are bought and sold as a package on an exchange, principally the American Stock Exchange (AMEX), but also the New York Stock Exchange (NYSE) and the Chicago Board Options Exchange (CBOE).

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/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.

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

Relative Strength Index (RSI) — An indicator invented by J. Welles Wilder and used to ascertain overbought/oversold and divergent situations.

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.

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.

Stop-Loss — The risk management technique in which the trade is liquidated to halt any further decline in value.

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

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

Trading Bands — Lines plotted in and around the price structure to form an envelope, determining whether prices are high or low on a relative basis and forewarning whether to buy or sell by using indicators to confirm price action.

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.

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.

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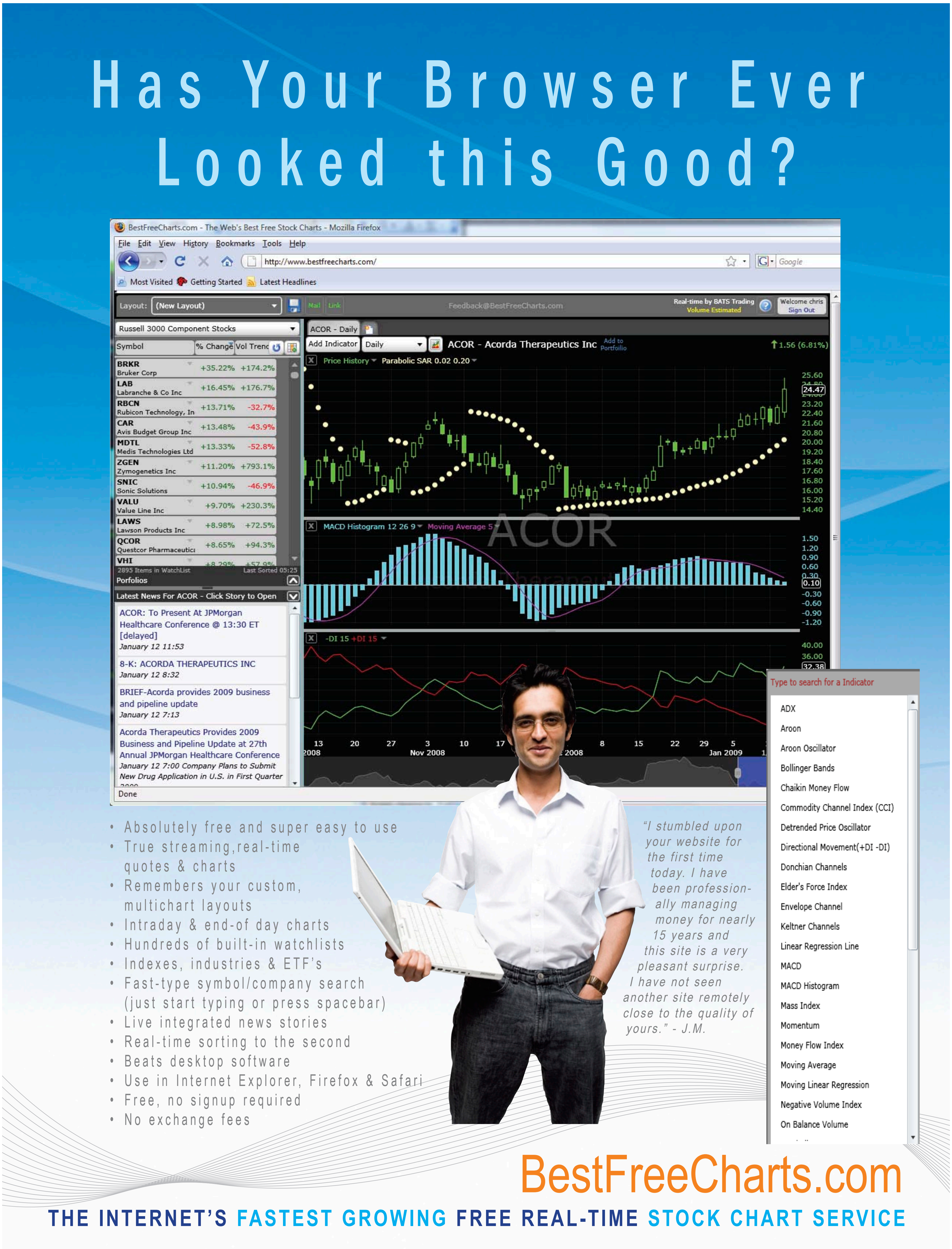
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