CHART PATTERNS	SECTORS	MARKET UPDATE
Head & Shoulders Negative For DJIA?	Are The Industrials Outperforming?	What About The NASDAQ?

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Traders.com

THE MAGAZINE FOR INSTITUTIONAL AND PROFESSIONAL TRADERS™

SPX DAILY VS. SPX DAILY

SPX, DAILY. This figure shows a new higher peak being formed in June 2009, officially ending the bear market downtrend that began in October 2007.

SPX, DAILY. This figure shows the rally off the July 2009 low, showing that a series of higher troughs and higher peaks being formed that define an uptrend in progress.

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Introducing A Powerful Way To Differentiate Retracements From Reversals

You've entered a market and are holding a position. But now the market is moving against you. Is this current move a retracement or a reversal? If it's a retracement, it is a temporary pullback, where prices will bounce off support and resume the direction of the original trend. If it's a reversal, prices will break through the support level and continue to move against the original trend. Retracement or reversal? It's a typical question that traders face every day. They wonder:

1. Shall I surrender and take the loss?
2. If not, how much money am I willing to risk?
3. Should I set a stop-loss based on a percentage or dollar loss? How do I choose a percentage or dollar loss that will work?
4. What if I take the loss and then the market resumes the trend that I anticipated? Do I re-enter the market?
5. How about sticking with my original strategy? Maybe I should hang in there no matter how much drawdown I experience?
6. Is there a way that I can identify the support levels when I buy?

Yes, #6 is the most important question! If you knew the market support levels, you could use them to test market strength. When a market tests the support level, if it cannot penetrate that level but instead resumes the anticipated trend, that movement more likely is just a retracement. If you wanted, you could even add to your position at that time. On the other hand, if the market penetrates the support level and closes beyond it , it is likely a reversal. You would do well to exit the position and cut your losses short. Identifying an objective support level is the key to determining if the current move is a retracement or a reversal. So now we ask, is there a way to identify objective support levels?

And the answer is Yes! AbleTrend 7.0 T2 stops provide objective support levels by blue color dots placed below the price bars, so that well-defined support levels are at your fingertips. AbleTrend 7.0 T2 offers the following advantages:

1. T2 stops are defined by the market's own support levels and are therefore, 100% objective.
2. The scientific calculations behind T2 stops are universal, not curve-fitted.
3. T2 stops can be back-tested to reveal the characteristics of individual markets.
4. T2 stops are updated with each new tick so there are no delays.
5. T2 stops are proprietary, not shareware, and are for the exclusive use of software owners.
6. Successful AbleTrend users around the world have relied on T2. Their common conclusion: "Never fight T2 Stops."
7. Boost your confidence, because "you have seen it happen hundreds of times" in both historical and real time. Without confidence, no matter how great your systems are, they are of no practical use.
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Here is an example of how T2 stops work:

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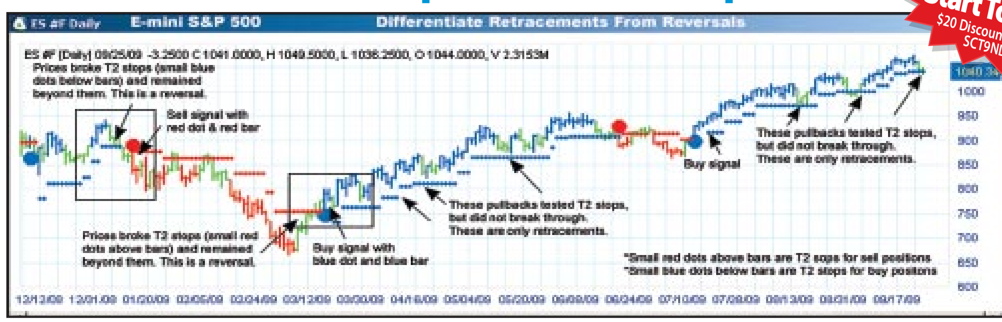

The market is always changing, but the way T2 works remains unchanged. Once you see it work time and time again, you will know that you can rely on it and utilize it. That's the value of the legendary T2 stops. The method is timeless. AbleTrend T2 stops can help you thrive in today's volatile markets.

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With The Higher Volatility And 300-500 Point Dow Moves In A Day, My Day Trading Profits Are Approximately 4 Times Higher Than In 2007

Interview Mr. Jim Kane – A Trader Using AbleSys Software

Mr. Jim Kane, How long have you been trading?
I have been trading, on and off, for 20 years. Several times I got so frustrated that I switched to mutual funds, but that never went well.

How long have you been using AbleSys software?
I have been using AbleSys software since early 2007.

What do you trade?
Stocks, ETFs, plus some time decay option trades.

What is your occupation?
I am a retired US Air Force dentist and am currently employed as a computer programmer.

How many other trading software programs did you use before using AbleTrend?
I used many other trading software programs as well as numerous newsletters. I currently use Zacks research wizard to help me pick stocks to trade. Zacks suggests what stocks to trade and AbleSys tells me how to trade them.

In your opinion, what are the main differences between other software programs and AbleTrend?
AbleSys software works in all markets, any time frame, long or short, without excuses.

What is the most important factor in trading? How does AbleTrend help?
Risk management. AbleSys T2 indicator provides excellent stops as well as entry points.

Were you able to find good trades during the current financial crisis? Could you give an example?
With the higher volatility and 300-500 point Dow moves in a day, my day trading profits are approximately 4 times higher than in 2007.

Do you have the confidence to use AbleTrend in trading for years to come?
Yes, if AbleSys software can handle the 2008 market, it can handle any market.

Could you share some of the exciting trades that you've made?
My best position trades were probably shorts in MTH, BC, and CC. They just kept going down. Stops based on the AbleSys T2 indicator were good and helped me move in and out of the stocks to maximize gains. My first year of using AbleSys, 2007, was the first year in 20 years of investing in which I made more money trading than at I made at my day job. On the long side, AbleSys T2 indicated trending stock behavior in WLT in Jan 2008. I had a good run in WLT until early June.

"The AbleTrend AutoScan Feature Enables Me To Quickly Roll Through More Than 200 Potential ETFs In Less Than 5 Minutes, As I Look For New Trading Opportunities"

Interview Mr. Gerry Wollert – A Trader Using AbleTrend 7.0

Mr. Wollert, how long have you been trading?
I bought my first five stocks back in 1964 after taking an evening stock market course at a local community college. I have been trading for over 44 years with very few interruptions.

What do you trade?
I trade ETFs (Exchange Traded Funds). I like the diversification that these trading vehicles provide. ETFs trade just like stocks. They have no minimum holding periods or early redemption fees which make trading ETFs much more attractive than trading mutual funds. ETFs can also be sold short. Lastly, there are a number of inverse ETFs that can be traded in an IRA during bear market periods.

How long have you been using AbleSys software?
I have been using eASCTrend from AbleSys for over ten years.

How many other trading software programs did you use before using AbleTrend?
Over the last couple of decades, I have purchased at least a dozen different software programs. Most of them are on the shelf of my closet gathering dust. Only AbleTrend has continued to be my primary trading tool. It truly helps me decide what to trade, when to trade it, and when to get out after I enter a trade

In your opinion, what are the main differences between other software programs and AbleTrend?
The AbleTrend AutoScan feature enables me to quickly roll through more than 200 potential ETFs in less than 5 minutes as I look for new trading opportunities.

AbleTrend provides its trading signals for all markets and for all time frames. Once you learn how to trade one market, you will know how to trade any other market with AbleTrend.

There is no data to download. I use eSignal data and there is a seamless interface between AbleTrend and eSignal. The buy and sell signals are clear and require little or no interpretation.

The T2 indicator moves up during a long trade in a stair step fashion. There is no need to calculate stops — T2 does this for you.

Were you able to find good trades during the current financial crisis?
Since I primarily trade in several different IRA accounts, I generally look for long candidates. Obviously, this has been a very difficult period to find attractive buy candidates. My buy discipline has kept the majority of my funds in the money market during this financial crisis. The key challenge now is to be patient and wait for opportunities to emerge. AbleTrend will tell me when it is "safe to go back in the water."

Interviewed by Grace Wang, Head of Customer Relations, AbleSys

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TABLE OF CONTENTS

NOVEMBER/DECEMBER 2009 • VOLUME 7 NUMBER 6

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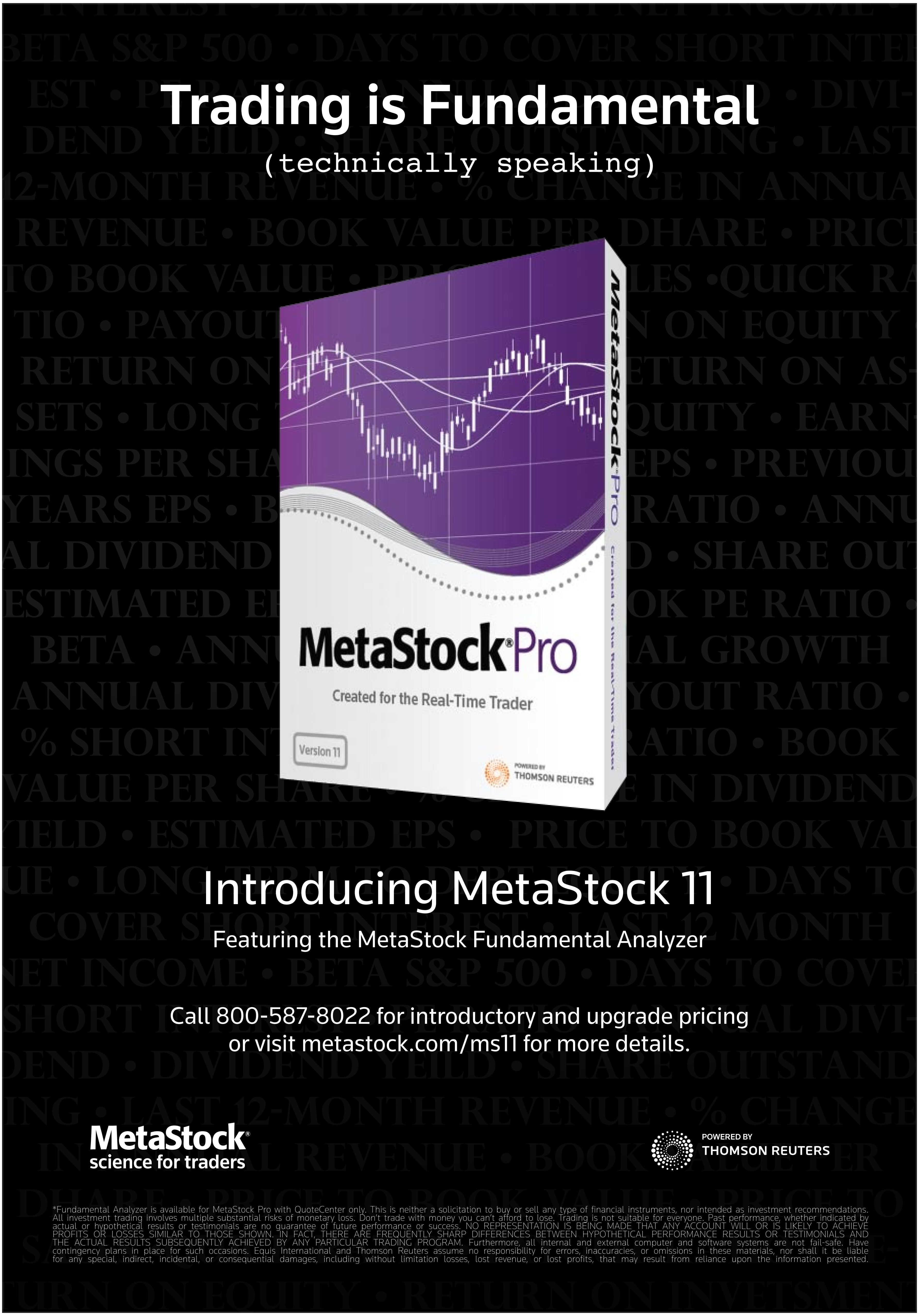
TABLE OF CONTENTS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TRADING NOW

Have the markets gone too far, too fast? It certainly seems that way, given that the markets have rallied quite sharply since March 2009 in spite of the lack of recovery in the economy. Although the recession may be close to its end, we haven't seen the typical signs of economic recovery just yet, and until we see those signs, I would remain very cautious about this market.

While equities are rallying, we are also seeing a vibrant rally in the gold market, which reached record highs in early October. This should come as no surprise in light of the weakening US dollar, which is sending investors scurrying to find an alternative to the greenback. For that matter, it's not just gold that is rallying; we are seeing a rally in most commodities as well. As we approach the end of 2009, I am sensing some euphoria in the markets, but as we all know too well, too much optimism can turn very quickly, especially in the financial markets. So keep an eye on these top-heavy markets and have plans in place based on various "what-if" scenarios.

The collection of articles in this issue of **Traders**.com will give you some idea of how to analyze various markets. We have covered various indexes and sectors and analytical techniques that can help you determine which way prices are likely to move. "Gold Approaching Possible Breakout/Breakdown" by Donald Pendergast, "Time To Buy Gold?" by Mike Carr, and "Gold Breaks Upward" by Chaitali Mohile all analyze the gold markets. Koos van der Merwe looks at indexes in his "What Now For the S&P 500?" and "What About The NASDAQ?" And "Are The Industrials Outperforming?" by Alan Northam takes a look at the Dow Jones Industrial Average, not to mention "The Big Picture For The S&P 500" by Ron Walker.

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

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- Visit our Subscribers' Area, where you'll find computer code that has been referenced in S&C articles; and finally,
- Visit our Message-Boards, where you can share your opinions of trading technical analysis, and most everything else you can imagine with other traders.

So what do *you* think? Are the markets going up anytime soon? Or are they going to sink a little bit more? These articles are going to give you some more insight, no matter which opinion you form, so however the markets go, you'll be prepared to trade. So trade well!

Jayanthi Gopalakrishnan

Jayanthi Gopalakrishnan,
Editor

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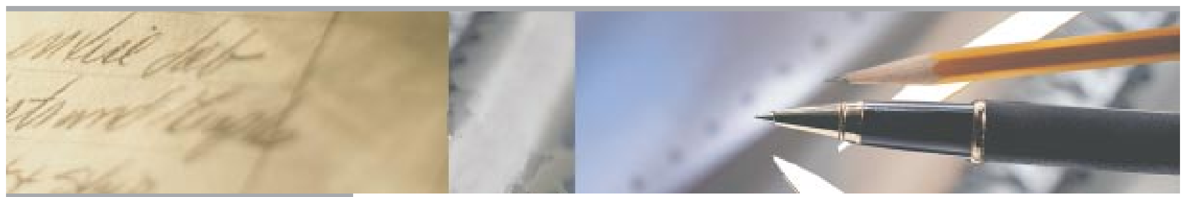

TRADING SYSTEMS

Designing A System To Survive A Bear Market

by Donald W. Pendergast Jr.

Designing a winning trading system, one that can survive a bear market as well as thrive during a bull market, takes a great deal of planning, testing, and self-examination.

Tradable: Various

You're going to be shown the essential building blocks of a trading system that looks like it's just too simple to be successful in the real world. It uses just one indicator, trades from the long side only, and has returned nearly 20% annualized since mid-July 2007, which was about the time that the Russell 2000 index peaked before the proverbial bottom fell out in the autumn of 2007. While it didn't return much profit during the bear market, it didn't lose much either, preserving trading capital for deployment during the powerful bull market rallies that have appeared since March 2009's historic market reversal. Here's what the real key to this system's success actually is.

For those of you who use MetaStock, here's a MetaStock exploration code to locate new long trading signals and/or long trade exit signals, exactly as used in this article:

```
Column name: Close Col A: CLOSE
Column name: Long Col B: Cross(
CCI(7),-100)
   Column name: Exit Col C: Cross(
CCI(7),100)
   Filter: none
```

I ran this simple MetaStock code on a diverse group of 150 mid- and large-cap stocks from every significant industry group, backtesting them from July 13, 2007, through August 17, 2009. While the system isn't the oft-searched-for holy grail, it lost very little money during the worst part of the 2007-09 market debacle and has demonstrated terrific performance characteristics since March 2009, when the bull market came back to life again.

For testing purposes, initial equity was set at $25,000, and commissions were set at $0.008 per share of stock. A maximum of nine stock positions could be held at any time and only one new position could be added on any trading day, no matter how many trading signals were generated. An 11% fixed initial stop was used on every trade; no trailing stop was employed. Using this simple trade-sizing/money management plan ensured that the maximum account risk per trade was kept at approximately 1.25%, including commissions. In Figure 1, you can see how this simple momentum system performed on a monthly percentage returns basis. Despite taking major hits during January 2008 and then again in October 2008 (-9.84% and -11.09%, respectively), the system made money overall. The best month was March 2009, generating a 16% monthly gain; several other months

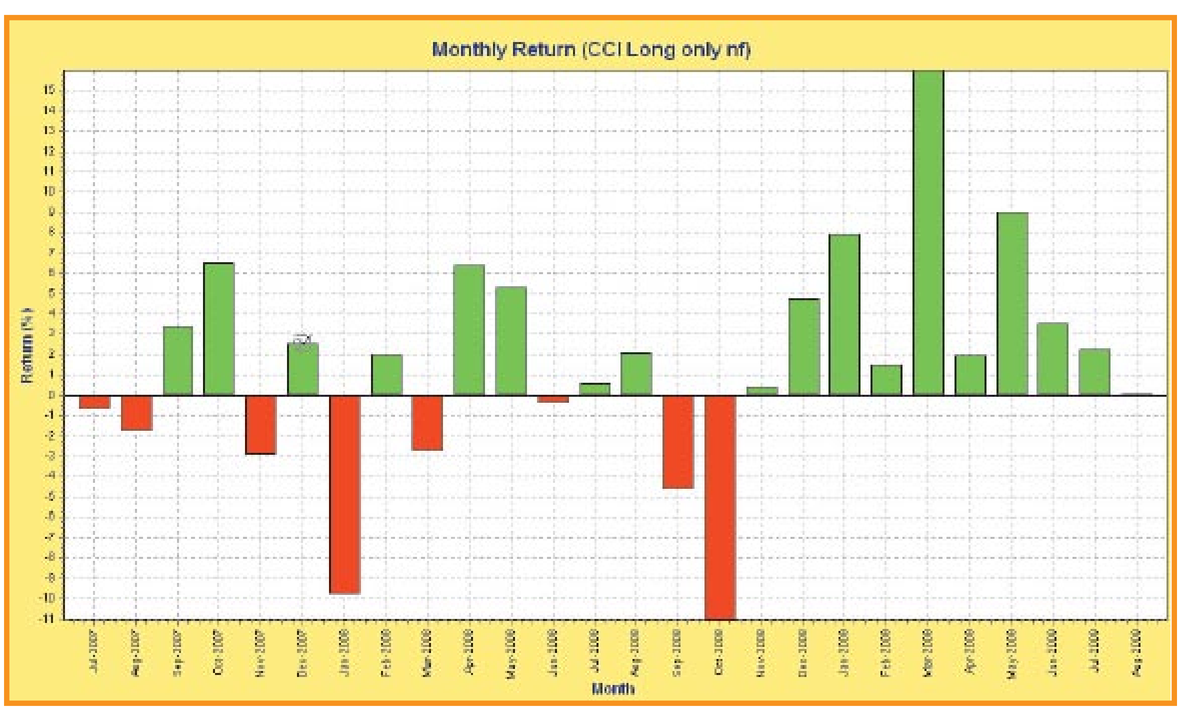

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FIGURE 1: MONTHLY HISTOGRAM. Here's a monthly histogram (percentage returns) for a simple CCI-based, long-only stock trading system. The use of a simple market timing filter would likely have reduced the extreme drawdowns experienced in January 2008 and October 2008.

also posted very healthy returns. Drawdowns were modest (coming in at only -12.23%, during January 2008), especially considering the severity of the recent bear market, which was the worst one since the Great Depression of 1930-33. All in all, a remarkable performance from a system that is deceptively simple.

Are you're wondering why I didn't test the system in reverse (to allow short trades)? Here's why. I have yet to meet a nonprofessional trader who can consistently make money shorting stocks using a mechanical system over the long term. Not that it can't be done, I'm sure it has, but it is a rare individual who can keep it all together to enable such an atypical outcome. The reasons for not shorting stocks are many — dividend liabilities, short-squeeze panics (watch out at earnings season for these), the natural bias of higher equity prices due to the long-term inflationary effects of the monetary system, and so forth. For most average traders, it's much wiser to just go to cash during confirmed bear markets, leaving the short-selling heroics to those with much deeper pockets.

In Figure 2, you can see the vital stats for this system; there were 437 trades (yes, this is a very short-term system), the win ratio was 53.55%, the profit factor was 1.37, the average winner was $182.07, and the average loser was $153.54. Maximum percentage drawdown was 12.23%. The system also had 11 consecutive winning trades and 17 consecutive losing trades; 314 of the 437 trades exited using the normal exit trigger, and 123 were stopouts (the stop was fixed at 11% on every trade).

Finally, here's the actual equity curve for the backtest run just described — yes, it chopped around for many months (during the worst phase of the bear markets from July 2007 to December 2009), but again, the drawdowns on this hypothetical $25,000 trading account were very modest, given the severity of the selling panics in 2007-08 (Figure 3). The real selling point for this system is the powerful rise of the equity curve from December 2008 through early August 2009; this short-term commodity channel index (CCI)-based method is apparently well-suited to bull phases in the broad market, gaining about $13,000 (more than 50%) in eight months.

So, here's your job: improve this system. Consider adding a market timing filter, one designed to keep you out of confirmed bear markets altogether. Maybe look at the volume characteristics of the stocks you wish to include in the system, particularly focusing on those from strong relative-strength sectors and industry groups. Maybe you could create a trailing stop, one that could lock in a higher amount of profits, or try adding two new stock positions a day instead of only one. The possibilities are endless; those who have MetaStock, TradeStation, or AIQ Trading Expert Pro should have little problem improving upon this basic momentum system, given the amazing amounts of technical firepower available in each program.

(PS: I do believe there is a place for short-selling stocks and futures on a case-by case discretionary basis; I do that on occasion, and usually with good success, but almost never with a mechanical system.)

Here's a final thought for those endeared with the idea of creating and deploying a winning trading system — the money management and trade-sizing aspects of the system are actually more important than the raw technical trading signals. Did you note that this system only adds one new long position on any given day, regardless of how many long signals the system fires (it tracks 153 stocks, so a day with 10 or even 20 signals isn't that unusual)? Do you see how adding new positions at a conservative rate can help keep your trading account protected from a sudden reversal that could wipe out a large chunk of your trading capital, particularly during bear markets? What if you added nine new long trade entries in one day, a day in which the broad market sees you coming and says, "Let's drop everything by 5% today, to punish Smedley the System Builder?" Would you rather have only put on one long position that day or have suffered a major drawdown as all nine of your stock positions took a major hit? Having the smaller position, one that you gradually build over time as additional long trade signals are developed, is the preferred course of action in virtually all cases.

So there you have it — playing a good defense (conservative position sizing and portfolio management) is even more important than uncovering a magic oscillator or even a top-secret trade entry strategy. ■

Profit Summary	
Profit Status:	PROFITABLE
Starting Capital:	$25,000.00
Finishing Capital:	$36,476.55
Maximum Equity/(Date-Time):	$12,060.71 (8/12/2009)
Minimum Equity/(Date-Time):	($1,974.32) (10/22/2008)
Gross Trade Profit:	$42,605.12 (170.42%)
Gross Trade Loss:	($31,128.57) (-124.51%)
Total Net Profit:	$11,476.55 (45.91%)
Average Profit per Trade:	$26.26
Profit Factor:	1.3687
Profit Index:	26.94%
Total Transaction Cost:	$1,438.37
Total Slippage:	$0.00
Total Trade Interest:	$0.00
Daily Compound Interest Rate:	0.0493%
Annualized Compound Interest Rate:	19.7240%
Trade Statistics	
Total Trades Processed:	18641
Trades Ignored:	0
Enabled Trades Processed:	18641
Trades Executed:	437
Partial Trades Taken:	0
Trades Rejected:	18204
Winning Trades:	234 (53.55%)
Losing Trades:	203 (46.45%)
Breakeven Trades:	0 (0.00%)
Largest Winning Trade/(Date-Time):	$2,470.64 (3/16/2009)
Largest Losing Trade/(Date-Time):	($640.68) (8/24/2007)
Average Winning Trade:	$182.07
Average Losing Trade:	($153.34)
Average Win/Average Loss:	1.1874

FIGURE 2: VITAL STATS. Any long-only equity system that can survive the bear markets of 2007-09 and still produce a set of trade stats like this is deserving of further consideration by aspiring system builders and traders.

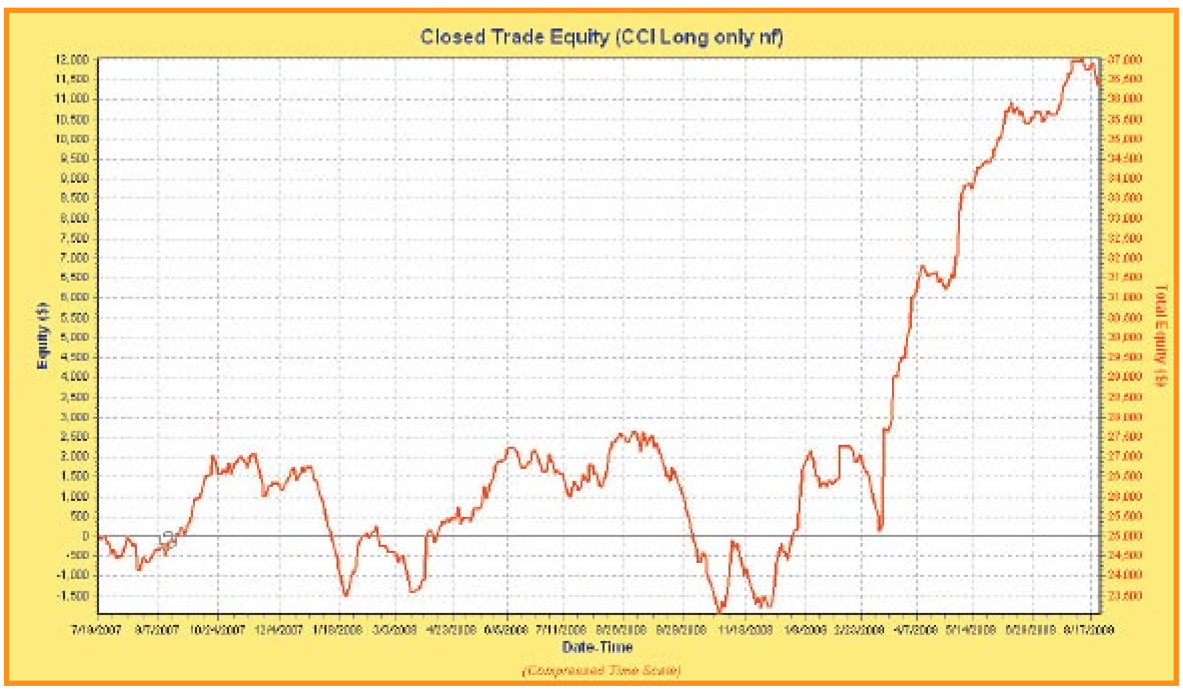

FIGURE 3: TRADE EQUITY. Bear markets can be tough on any long-only system, but this one survived with only modest drawdowns. Note how rapidly the system made up those bear market losses once the markets finally began the reversal process between December 2008 and March 2009.

INDEXES

ELLIOTT WAVE

What Now For The S&P 500?

by Koos van der Merwe

There is now no doubt that the S&P 500 is in a new bull market, but ...

Tradable: SPX

When we listen to CNBC debates, there are many market participants who believe that the bear market in the US will continue, and that the recent upward move in the indexes was an upward correction in a bear market. That is what they believe, and they put their bets on it. Charts, however, suggest otherwise.

Figure 1, which is a monthly chart of the S&P 500, shows the following:

- A move to a fifth-wave high in July 2000.
- A correction of wave A to 814.41 on October 2002.
- A rise in a B-wave to 1547 on April 30, 2007.
- The fall in wave C to 735.50 on February 2009.
- From the low of February 2009, the index rose in a new bull market in what could be a wave 1 of wave I. In other words, a new bull market appears to be forming that could last into the year 2026 (see my article on Kondratieff wave elsewhere in Traders.com Advantage).

FIGURE 1: S&P 500, MONTHLY

- This is confirmed by the moving average convergence/divergence (MACD), which has turned and could finalize a buy signal at the low of wave 2 of wave I.
- The chart is suggesting that the low of wave 2 of wave I could occur in September 2009. This date is determined by the Gann lines shown. Wave 2s are usually a 72% retracement of the rise of wave 1. This correction will definitely have the bears shouting "hallelujah" from the rooftops.
- WD Gann's wave analysis is a study in itself. Needless to say, Gann's charting techniques led him to become one of the greatest chartists of the 20th century with many followers.
- The chart suggests a wave 2 correction to 800.49 by approximately September 2009. This will bolster bear market pundits, and give wonderful buy opportunities for bull market believers.

To conclude, we could expect the S&P 500 to correct in a wave 2 of what I believe is a wave I of a new bull market, probably finding a low in September/October 2009. This will give us the opportunity to look for lows in the stocks we would like to own. For the next few months, therefore, be prepared for a down market, or with luck, more of a sideways correction as the Obama/Geithner financial strategy takes effect. ■

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This article was first published on 7/8/2009. See www.Traders.com for more.

FURTHER READING

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

Prechter, Robert R., Jr., ed. [2004]. *R.N. Elliott's Masterworks: The Definitive Collection*, New Classics Library.

ELLIOTT WAVE

What About The NASDAQ?

by Koos van der Merwe

When the technology sector crashed in 2000, the NASDAQ index crashed heavily along with it. But in the recovery phase, the Elliott wave B-wave, the index rose only as far as the 38.2% Fibonacci correction.

Tradable: OTC

With the bursting of the technology bubble, the NASDAQ index fell from the fifth-wave high of 5132.52 to a low of 1107.44, a fall of 78%. This collapse was horrific, and many small startup companies that climbed on the back of the floating bubble vanished.

Since that date, NASDAQ has recovered, but cautiously, as though testing each step before putting its full weight on it. Figure 1, a weekly chart of the NASDAQ, shows how the B-wave rose gradually in an abcxabc wave count, and gradually, from the low of 1107.44 to the high of 2862.88 by November 2007. This high was slightly above the 38.2% Fibonacci level, showing how cautiously the index corrected. (By comparison, the Standard & Poor's 500 corrected over 100% in its B-wave.) The index then fell in a C-wave to 1266.07, not the 1107.44 of the low of wave A. This does suggest a C-wave failure, which means that in the years ahead, the NASDAQ will rise to exorbitant levels. The chart does suggest that the index has moved into a wave I upward, but the moving average convergence/divergence (MACD) indicator suggests that further strength lies ahead, and that the wave is not complete. For this reason, I turn to Figure 2.

Figure 2, a daily chart, suggests a change in the Elliott wave count. The count suggests that the Index bottomed in a C-wave in November 2008 at 1294.48, and that the low of 1265.52, although lower than the low of the C-wave, is the bottom of a wave 2 of a wave I in the new bull market. If this is so, we can then expect a correction to one of the Fibonacci correction levels shown on the chart, the most likely target being 1742.79, the 38.2% level that acted as support for the wave 4 of wave I correction. The relative strength index (RSI) supports this count, and has given a sell signal, suggesting that a correction is on the cards.

The NASDAQ is due for a correction, which should see it test the 1742 level, a level that previously gave support to a fourth-wave correction of wave I. ■

FIGURE 1: NASDAQ, WEEKLY. This chart suggests a wave count.

FIGURE 2: NASDAQ, DAILY. This chart suggests a different wave count than the weekly chart.

CYCLES

What's Next, More Rally Or A Major Stall?

by Donald W. Pendergast Jr.

Even the strongest bull market rallies need time to pause and regroup before continuing higher. Is the current action in the broad markets a consolidation or a major top?

Tradable: .RUT, .NDX, .SPX

I was surprised to learn that many investors aren't yet convinced about the validity of the historic March-August 2009 bull market rally; many are still on the sidelines, earning 1% in the safety of cash. As we analyze these charts, keep in mind that at some point, many of those investors are likely to plow their funds back in to the markets, most likely after the market has already embarked on another upleg. Given the long-term cyclical patterns in the broad markets, consider the possibility that such a major flow of money may be the factor that allows the markets to reach the anticipated weekly cycle highs that are projected for mid- to late September 2009.

Figure 1 is the daily chart of the Russell 2000 index (.RUT). I like to look at .RUT before analyzing the .NDX or .SPX, m ostly because of the vital importance of small-cap participation in any sustained long-term market move. The R2K typically makes more dramatic moves (up and down) than either the .NDX and .SPX. We've already ascertained that the R2K made a major weekly cycle low on July 10, 2009, and according to its internal strength readings (new highs/new lows, upside volume/downside volume, advancers/decliners, and rate of change of the index itself), the index appears to be in an extremely bullish posture, with plenty of upside potential. On this daily chart we now examine the daily cyclical action of the index. By most measures, the R2K has already formed a complete daily cycle (measured on a low to low basis) and may actually be poised to start the next phase of a fresh up cycle. The curved blue line traces out the shape of this bull market cycle. The big question: Is this implied cyclical action going to fade into a more sustained period of consolidating price action first? Or might the index instead embark on a major retracement move — as in lower prices?

Of these three basic directions, up, sideways or down, here is what appears to be the line of least resistance for the R2K. First off, the internal strength readings are still in major bullish territory. For the uptrend to demonstrate staying power, however, the internal strength readings need to move above the red downtrend line, confirming any future upthrusts in this index. Note also that the stochRSI (10) indicator (bottom of chart) is also implying that the daily cycle low may already be in; the real key is to watch the daily bars. If you see a daily close below the trailing volatility stop (black dots on chart set at 2 * ATR10), you may be fairly sure that the index is either going to put in a more significant period of consolidation and/or is going to move lower, retracing a portion of the astounding gains made since early July 2009. Until the chart pattern changes substantially, however, the line of least resistance still appears to be higher for all the big three — the .RUT, .NDX, and .SPX.

Right now, the strongest Fidelity Select Sector funds (based on a 13-week rate of change calculations versus the Russell 2000 index) are hailing from the automotive, electronics, brokerage/investment management, transportation, and computer industry groups (Figure 2). The five weakest sector funds are found in the following groups: gold miners, wireless, telecommunications, utilities, and defense/aerospace (Figure 3). Depending on the ultimate path of the R2K in the coming days, you may wish to deploy a portion of your funds into the top-rated industry groups on a bullish continuation move. Conversely, if the index breaks down (a daily close below the volatility stop, as mentioned before), consider going short the weakest stocks in the weakest industry groups. Believe it or not, going short the gold mining stocks may actually be a very sound strategy (short term, of course, and for reasons generally unrelated to the price action in any of the broad market indexes) in the weeks ahead, but that's another article for another day. ■

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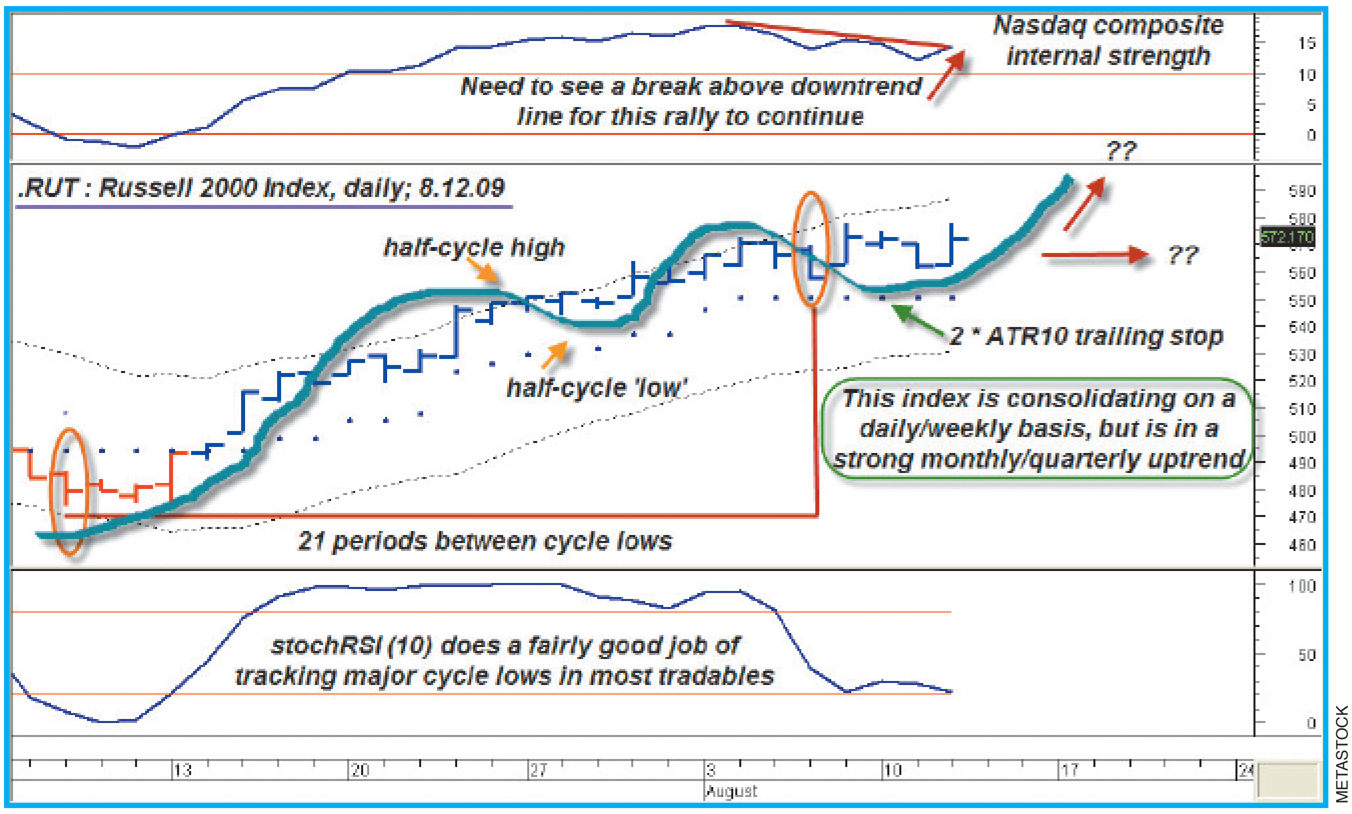

FIGURE 1: RUT, DAILY. Given the weight of the cyclical and internal strength evidence, the line of least resistance still appears to be up for this index, at least until sometime in September 2009.

Security Name	13wk ROC	Ticker...
Fidelity Select Automotive	3.5770	FSAVX
Fidelity Select Electronics	2.0861	FSELX
Fidelity Brokerage & Investment Mgmt	2.0444	FSLBX
Fidelity Select Transportation	1.9309	FSRFX
Fidelity Select Computers	1.8831	FDCPX

FIGURE 2: STRONGEST FIVE SELECT SECTOR FUNDS. The strongest five Select Sector funds, based on a 13-week rate of change calculation versus the .RUT.

Security Name	13wk ROC	Ticker Symbol
Fidelity Select Gold	0.3989	FSAGX
Fidelity Select Wireless	0.5084	FWRLX
Fidelity Select Telecommunications	0.5559	FSTCX
Fidelity Utilities	0.5942	FIUIX
Fidelity Select Defense and Aerospace	0.6492	FSDAX

FIGURE 3: WEAKEST FIVE SELECT SECTOR FUNDS. The weakest five Select Sector funds, also based on a 13-week rate of change calculation versus the .RUT.

TECHNICAL ANALYSIS

Swiss Cheese Rally?

by Austin Passamonte

Measuring price-action potential direction in the S&P 500 futures market.

Tradable: S&P 500 futures (ES)

The summer stock market rally of July– August 2009 (and counting) has reached new yearly highs. It accomplished this in dramatic fashion, rallying from the 870 levels to nearly 1020 peak highs in about 20 trading sessions. See Figure 1.

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FIGURE 1: S&P 500 FUTURES, DAILY

FIGURE 2: S&P 500 FUTURES, WEEKLY

Along the way, it has left behind no less than four remaining open gaps (purple dashed lines) in the process. Now it's not unusual for a strong market turn to spin away from an island reversal or similar open gap formation. But four open gaps in the span of one trading month? That leaves support below looking much like a block of premium Swiss cheese rather than blocks of concrete for foundation.

The November 4, 2008, highs near 1000 were also a pivotal price magnet through October last year as well. Prior resistance has currently turned to support, much like the triple-top high near 973 from January, June, and July 2009. Those two levels are highly probable to magnetize price on any subsequent pullback from (ultimate) peak highs through retracement back and fill.

But before that happens, it is entirely possible for a continued light-volume push toward ES 1100 level where a big open gap remains since September–October 2008. The 960-1000 price channel is clearly visible on its weekly chart (Figure 2). Back down to the bottom of that measure would fill two open gaps and confirm prior resistance as solid support. A rapid push to the 1100 levels before that back and fill would leave this market grossly extended on spindly legs beneath. ■

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TECHNICAL ANALYSIS

Stock Market Corrects

by Alan R. Northam

The stock market has now entered into a market correction. There are those market participants that are calling for the end of the upward rally at this price juncture and those who forecast the market will continue higher. Let's look at the technicals to see what the market is saying.

Tradable: $INDU

Figure 1 is that of the daily bar chart of the Dow Jones Industrial Average (DJIA) over the last two months. The chart in this figure shows the latest short-term rally that started in early July when the price bars broke out above the 13-day exponential moving average (EMA). Short-term rallies normally last from a few days to a few weeks, with this rally lasting 24 days or almost five weeks from breakout to breakdown.

On August 17, 2009, the DJIA broke below the support shelf it had been building over the last nine days, signaling that the DJIA had now entered into a downward trend. The DJIA also broke below its 13-day exponential moving average (EMA), signaling that this new downward trend is short term in nature. The next level of support comes at the 9000 level, where the DJIA will meet up with a horizontal support line as well as support from the 34-day EMA. In addition, there is further support just below 9000 at 8900, where the Fibonacci 38.2% retracement price level comes into play. When multiple lines of support all converge on a common price point, a stronger wall of support is built up over single lines of support. Thus, 8900 to 9000 could be a good price range for the current short-term correction to end.

Below the price chart is the volume bar chart. This chart shows that selling volume was below volume resistance over the last six trading sessions. This signals weak selling volume. The significance of this weak volume is that it signals the downward breakout in price as most likely being corrective in nature and not the beginning of a larger downward trend.

FIGURE 1: DJIA, DAILY. This chart shows moving averages, horizontal support levels, and the Fibonacci retracement levels.

In conclusion, the stock market as measured by the DJIA has entered into a short-term market correction. This market correction should terminate somewhere around 9000, if not at a higher price level. As long as the DJIA remains above the 34-day EMA, the correction should be short-lived. However, a break below the 34-day EMA will signal a much deeper market correction. ■

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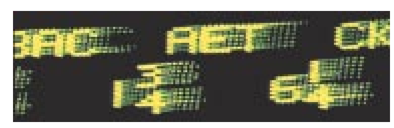

TECHNICAL ANALYSIS

Time For 10K Hats?

by Austin Passamonte

Near-term outlook for DJIA.

Tradable: INDU

Those of us who were around back in the dinosaur days of 1999 recall that silly period in time where CNBC pundits donned party hats and horns as the DJIA marched relentlessly toward 10,000. See Figure 1.

It's been a decade since then. Over that period, they tacked on another 4,000+ index points to all-time highs in late 2007, then shaved off more than half that total value by early 2009. Quite the volatile ride, indeed. The most recent +3,500 index point rise from March lows has been no less impressive than any prior period in time. You just can't keep the big index down for long. Two major trendline breaks (purple) and successful northward navigation of last autumn's upper congestion leaves nothing but blue skies from here to 10,000 or beyond. See Figure 2.

But before they fly any higher, the Dow Jones Industrial Average (DJIA) stocks need to collectively thwart some projected resistance levels right here. Do that, and 10,000 or even 10,500 come into play for the medium future ahead.

Backward to 9400 is a one-day pullback to retest prior resistance, now-presumed support. Back to 9200 does nothing more than solidify a rather airy ascent from the last time down there a few sessions ago.

Full-bull ahead from 9200 or higher, especially if they take out 9600+ with emphasis on volume. Sideways magnetism may be the seasonal outlook, and that may come to fruition with all major stock indexes near or right at key layers of resistance. Resolutions are coming soon, with breakouts above or reversals below being the inevitable choice of outcome. ■

FIGURE 1: DJIA, WEEKLY

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FIGURE 2: DJIA, DAILY

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This article was first published on 9/1/2009. See www.Traders.com for more.

SECTORS

RELATIVE STRENGTH COMPARATIVE

Are The Industrials Outperforming?

by Alan R. Northam

Relative strength analysis compares one stock or market to another to determine if that stock or market is out- or underperforming the stock or market it is being compared to. Here the industrial market sector is compared to the S&P 500 to determine if it is out- or underperforming the market index to which it belongs.

Tradable: XLI

The Standard & Poor's 500 is a large basket of 500 stocks representing a cross section of market sectors that make up our economy. These stocks have been divided up into nine basic market sectors known as Select Sector SPDRs, of which the industrial market sector is one. These nine basic market sectors each complete their own individual bull market and bear market trends at different periods of time, during which they either out- or underperform the S&P 500, of which they are separate and when taken together form the sum total of the S&P 500. Several of the individual market sectors are currently in bull market trends and are outperforming the S&P 500 itself. This article takes a look at the industrial market sector (XLI) to determine if it is among those sectors.

One of the most basic and most powerful techniques of determining in which direction a market is trending is called peak and trough analysis. When a stock or market is forming a series of lower troughs and lower peaks, that market is said to be in a downtrend. Such is the case for the industrial market sector from October 2007 until March 2009 (see Figure 1). However, when this series of lower peaks and lower troughs is broken, the downward trend is also broken and a new trend begins. In Figure 1 note that at the end of June XLI made a new higher low and at the end of July it made a higher high, thus breaking the string of lower peaks and lower troughs, ending the downtrend. An uptrend is defined as a stock or market that is making a series of higher peaks and higher troughs. From Figure 1 we can see that XLI has made its first higher low and higher high, putting this market sector in an upward trend.

While XLI is now in a new uptrend, its relative strength is not. Relative strength is a form of analysis that compares one stock or market to another to determine which is the stronger. The relative strength analysis used here is a comparison of the industrial market sector to the S&P 500. The result of this comparison is shown in the line chart directly below the price chart. When the relative strength line moves higher, it signals that XLI is stronger than the S&P 500 and when it moves lower, it signals that XLI is weaker than the S&P 500. From Figure 1 note that the relative strength line has made a higher low but has not yet made a higher high. As a result, the relative strength line is still in a downtrend, signaling that XLI remains weaker than the S&P 500. As long as a stock or market is weaker than the stock or market it is being compared to, it signals underperformance and should be avoided.

While XLI continues to underperform the S&P 500 to which it is a part of, its price continues to move higher at an accelerating rate. The moving average convergence/divergence (MACD) is used to measure the acceleration or deceleration of price movement. When price is accelerating upward, it signals that price is in a strong upward trend and when price is decelerating, it signals that the upward trend is tiring and a tiring market further signals a trend reversal ahead. When the MACD line is moving upward, it is an indication that price is accelerating and when it is moving lower, it indicates that the rate at which price is moving higher is decelerating or slowing down. The MACD line is plotted in Figure 1 above the price chart. Note that it has been making a series of higher lows and higher highs since March 2009, indicating that price momentum is in an uptrend. This indicates that price is in a strong uptrend.

The Industrial market sector is now in a new uptrend. However, the industrial sector continues to underperform the S&P 500 and should be avoided at this time. While the industrial market sector continues to underperform, it is in an accelerating uptrend, which suggests that it is just a matter of time before it starts to outperform the S&P 500. Therefore, watch XLI in the days and weeks ahead for its relative strength line to break out to a new higher high to signal that it is beginning to outperform the S&P 500. ■

FIGURE 1: XLI, WEEKLY. This figure also shows the MACD indicator above the price bar chart and the relative strength comparative line below.


Possible Index Change
Key Interest Rate Levels
JPY Pairs Moving Fast
Earnings Congestion Ahead
Leading Sector Mover Breaking Down
Emerging Market Development
Takeover Chatter
Surprise Merger Deal Event
Negative Same Store Sales

RELATIVE STRENGTH COMPARATIVE

Health Care Determines Market Direction

by Alan R. Northam

There are many ways to measure the expected future direction of the overall stock market. One way is to determine what the defensive market sectors are doing.

Tradable: XLV

Since March 2009, the stock market has come a long way in retracing its losses from the October 2007 stock market top. As a result, some market technicians are calling for a market top and the resumption of the bear market. There are also other market technicians forecasting a higher stock market going forward. Which camp are we to believe, those who are bullish or those who are bearish? One way to determine what the stock market is going to be doing in the days, weeks, and months ahead is to keep an eye on what the defensive market sectors are doing. When the defensive stock market sectors start to outperform the overall stock market, it is a signal that traders and investors are worried about the future of the stock market and they are heading for cover.

The Standard & Poor's 500 is made up of 500 individual stocks representing a cross-section of market sectors that make up our economy. These 500 stocks have been divided up into nine basic market sectors known as the Select Sector SPDRs, of which the health-care market sector is one. Of these nine market sectors, three are defensive market sectors and include Healthcare (XLV), Utilities (XLU), and the Consumer Staples (XLP). Defensive sectors represent those products and services that consumers cannot do without no matter what the economy is doing. In particular, the health-care market sector represents those health-care products and services that consumers cannot do without.

Figure 1 shows the weekly closing price line chart of XLV. This figure shows that the health-care market sector has been moving higher since March 2009 right along with the broader stock market as well as other market sectors. Since this market sector started rallying off the March low, the health-care market sector continues to trade above its intermediate-term trendline, but it remains below its long-term downtrend line.

FIGURE 1: XLV, WEEKLY. This shows the closing price line chart of the Health Care Select Sector SPDR. This figure also shows the on-balance volume as well as the price relative line chart.

On-balance volume (OBV) is an indicator that measures volume by adding up volume and subtracting down volume and the result is an accumulation of volume. When the OBV line is moving higher it tells us that buyers are in control of the market, and when it is moving downward sellers are in control. Looking at OBV, note that it has been in a downward trend since February, while price continues to move higher, signaling a lack of commitment by the buyers. When price moves upward while volume moves downward, it creates a negative divergence, which is a bearish condition.

Below the OBV chart in Figure 1 is the price relative chart. Price relative is derived by dividing the Consumer Staples market sector by the S&P 500. This then compares the market sector to the overall stock market. From this comparison, it can be determined if the market sector is outperforming or underperforming the overall stock market. When the price relative line is moving upward, it signals that the market sector is outperforming the broader stock market, and when it is moving downward, it is underperforming the broader stock market. Note that the price relative ratio line has been forming what looks to be a head & shoulders topping signal since October 2008. However, this topping pattern is incomplete. To complete the head & shoulders topping signal, the ratio line needs to break down below the neckline of the H&S pattern.

While XLV continues to move higher in price, volume continues to wane, signaling a lack of commitment by the buyers to this market sector. In comparing the health-care market sector to the S&P 500, it looks like a head & shoulders topping signal is in the making, warning that the health-care market sector may not start to outperform the broader stock market going forward. As a result of this analysis of the health-care market sector, it does not appear that traders and investors are starting to heading to the defensive market sectors to reduce the risk of their market exposure. Therefore, there is no reason to expect a broad stock market top at this time and higher prices should prevail. ■

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RELATIVE STRENGTH COMPARATIVE

Are Utilities Signaling A Higher Stock Market?

by Alan R. Northam

The utilities market sector continues to underperform the Standard & Poor's 500. Does this signal higher prices ahead for the broader stock market?

Tradable: XLU

The bull market came to an end in October 2007 and began a bear market selloff that lasted until March 2009, dragging all market sectors down with it. Since the market bottom in March 2009, the stock market has been working its way higher and has established itself in a new bull market uptrend. However, the stock market is now overbought and ready to reverse direction. The question is now whether the next reversal will be corrective in nature, or will it signal the resumption of the October 2007 bear market? To answer this question, all we have to do is to look at the defensive market sectors. When traders and investors become worried about the future of the stock market, they start reducing their stock market positions and increasing their positions in defensive market sectors as they run for cover to reduce risk. By determining the trend of the defensive market sectors, it becomes possible to determine if the broad stock market is simply overbought and ready for a corrective pullback, or if the stock market is topping and the bear market is about to resume.

Figure 1 shows the weekly closing price line chart of one such defensive market sector, the utilities market sector (XLU). This chart shows that from 2007 until early 2009, the utilities market sector has been in a downtrend, making lower highs (LH) and lower lows (LL). From March 2009 to date, the XLU has been working its way higher by making a series of small higher lows (hl) and higher highs (hh), signaling that the utilities are now in an uptrend. However, XLU remains below the November lower high (LH) as measured by the overhead resistance line drawn off the November high. Until this line of resistance has been violated, XLU's series of lower highs and lower lows from the October 2007 market top still has not been broken, and thus, the long-term trend remains downward and the series of smaller higher lows and higher highs since March are simply corrective in nature.

On-balance volume (OBV) is an indicator that measures volume by adding up volume and subtracting down volume and the result is an accumulation of volume. When the OBV line is moving higher, it tells us that buyers are in control of the market, and when it is moving downward, sellers are in control. Looking at OBV, we observe that volume has been up against overhead resistance since February 2009. This is a signal that volume is not expanding. One of the characteristics of a bull market is expanding volume. With volume being in a trading range since April 2009, its characteristics are more in line with a market correction than a new bull market.

Below the OBV chart in Figure 1 is the price relative chart. Price relative is derived by dividing the utilities market sector by the S&P 500. When the price relative line is moving upward, it signals that the market sector is outperforming the broader stock market, and when it is moving downward, it is underperforming the broader stock market. Note that in the price relative ratio line, two downsloping trendlines can be drawn. The first trendline is drawn off the mid-November 2008 and mid-January 2009 peaks. The second trendline is drawn off the January 2009 and June 2009 peaks. The second trendline is steeper than the first trendline, signaling that the price relative ratio line has been accelerating in the downward direction during the complete price rally since March. This downtrend signals that the utilities market sector has been underperforming the S&P 500 at an accelerating pace.

While the utilities market sector continues to trend higher, volume is not expanding to keep pace. In addition, the utilities market sector has been underperforming the S&P 500 during the complete rally off the March low. These technical factors are more characteristic of a market correction than a new bull market uptrend. Therefore, there is no reason to expect a broad stock market top at this time and we should expect higher prices ahead. ■

FIGURE 1: XLU, WEEKLY. This figure shows the utilities in a new upward trend but remain below overhead resistance. This chart also shows OBV and the price relative ratio line.

TECHNICAL ANALYSIS

XLU Has More Upper Space

by Chaitali Mohile

Ever since the Utility Select SPDR began its bullish journey, the sector moved in a steady rhythm in an ascending channel. The movement within the channel has allowed perfect entry-exits for traders. Let's look at the current one.

Tradable: XLU

The years 2007-08 saw one of the worst corrections in the global financial markets. Most of the indexes and the sectors plunged to their make-or-break supports. One was the Utility Select Sector SPDR (XLU). XLU turned down the ascending triangular formation that is seen as a trend reversal pattern in a downtrend. In Figure 1, the ascending triangle was formed at the end of 2008. Since the pattern took almost three months to get built up, it is considered a long-term pattern and therefore most reliable. But the power of the bears was stronger and intense than the pattern, and as a result, the reversal pattern failed and XLU resumed its prior declining rally. The bearish breakout witnessed a steep vertical fall without giving buyers any time to think. The selling pressure increased dramatically.

The average directional movement index (ADX) (14) in Figure 1 at the end of 2008 indicated consolidations by moving much below the 20 levels and the positive directional index (+DI) and negative directional index (-DI) undergoing a tough battle. The blue oval in Figure 1 reflects the consolidation phase of XLU. Later, the -DI conquered over the +DI and the trend surged in a bearish fashion (see the red arrow). Due to the overheated downtrend above 45 levels, XLU witnessed a sharp V-shaped recovery and gradually formed higher highs and higher lows. These rhythmic movements initiated an ascending channel — a bullish formation that shields not only the buyers but also the sellers.

However, the entry points (B1, B2, B3) from the lower trendline are considered genuine and prominent as there was steady upward price action, whereas the downside rally from the upper trendline was more volatile as they changed the directions before hitting the lower trendline (see the yellow block). According to Figure 1, XLU has recently surged from the lower trendline, offering one more low-risk entry point (B4) for traders. The upper trendline intercepts at 30 levels, marking it as the potential target for the current rally. The closer look of the daily chart would provide the details for the trade.

We have already seen that XLU has surged from the lower trendline. Figure 2 shows a bullish reversal candlestick pattern at the bottom, a bullish engulfing pattern (probably with the support of the lower trendline) that has initiated a breakout rally. XLU has converted the prior peaks to the support and moved sideways with a marginal descent. As a result, a pennant has been formed. The bullish consolidation pattern — a flag pennant pattern is already on the verge to break out upward. In Figure 1, the full stochastic (14,3,3) formed a bearish channel due to the lower lows and lower highs from an overbought area. Currently, the oscillator shows the possibility of a fresh bullish rally by moving above the 50 levels.

The ADX (14) is indicating a steadily developing uptrend, and the moving average convergence/divergence (MACD) (12,26,9) has been rallying in positive territory. Therefore, the bullish scene might soon signal a confirmed breakout of the bullish flag & pennant pattern in Figure 2. The only thing that is worrisome is the declining volume. The shrinking volume might slow down the breakout rally or might induce high volatility as well. Thus, a high-volume breakout is the most essential feature for the XLU's breakout. The sector has a large upper space for the rally to move ($30 target), and therefore, traders should not miss the opportunity to enter this sector. Hence, the big picture of XLU is positive and reliable.

FIGURE 1: XLU, DAILY. The ADX (14) signifies the developing uptrend during the recent upward journey from the lower trendline. The chart shows only two accurate selling points, S1 and S2.

FIGURE 2: XLU, DAILY. The support-resistance tool line shows strong support established by converting the previous high resistance to the support.

The big picture of XLU is positive.

The Declining Indicator

by Chaitali Mohile

The bank index and the related stocks have been rising as the RSI was descending. What does that suggest?

Tradable: $BKX, BAC, GE, C

The bullish rally of the bank index ($BKX) turned sideways for a longer period under the resistance of the 200-day moving average (MA). The descending path moved in a highly narrow range. The volatility was at its peak during the descent as the buying and the selling pressures converged. The average directional movement index (ADX) (14) in Figure 1 shows the positive directional index (+DI) and the negative directional index (-DI) coming together and the indicator turning weaker. Therefore, the bearish consolidation was very well indicated by the ADX (14). Another reason for the volatile sideways action was the shaky relative strength index (RSI) (14).

The RSI (14) managed to stop further descent by establishing support near the 30 levels and simultaneously forming a higher low, indicating bullish sentiments for the possible breakout of the descending channel. As a result, the price surged above the upper range but struggled to violate the 200-day MA resistance. Later, the breakout rally gained strength and $BKX rushed to the higher levels. With this breakout, the weak trend reversed in a bullish direction, adding buying pressure on the rally. In Figure 1, we can see that the index is again consolidating but horizontally, forming a bullish flag & pennant pattern. Since the overbought

FIGURE 1: $BKX, DAILY

FIGURE 2: BAC, DAILY

FIGURE 3: GE, DAILY

RSI (14) formed a lower high, $BKX entered the sideways consolidation. Now the point of concern is whether the bullish continuation pattern will break out or fail due to the negative divergence by the RSI (14).

If you consider the depth of the lower highs of the RSI (14), you can see that the indicator is still in an overbought area above the 60 levels. Currently, the oscillator is not indicating any further bearish move. In addition, the ADX (14) is signifying a well-developed uptrend. Therefore, $BKX would definitely undergo a bullish breakout but it might be a little slow. The fresh volatility in the global market might hold back the fast movement of the certain indexes. In addition, $BKX is directly related to the rallies in financial markets.

Financial stocks such as Bank of America (BAC), General Electric (GE), and Citigroup (C) should be watched during the index breakout.

BAC is a perfect image of the $BKX, but the other two are pretty volatile stocks. The index breakout would bring robust demand for BAC. The similar flag & pennant bullish continuation pattern is formed in Figure 2. The target of the breakout can be measured by adding the length of the flag pole to the breakout level. But the breakout should be confirmed before initiating any long trades.

GE witnessed a steep fall (Figure 3) with the gap down acting as a catalyst to the fall. Earlier, the stock gapped up, converting the 200-day MA resistance to support and rallied higher. The RSI (14) showed robust bullish strength in the rally and reached an overbought zone. The price movement of GE turned bearish immediately after the lower highs of the RSI (14). Currently, the momentum oscillator has surged establishing support at 50 levels, indicating a

FIGURE 4: C, DAILY

fresh bullish rally and offering new long positions. The ADX (14) moved steadily above 25 levels, indicating a developing uptrend. The uptrend remained intact during the reactive movement of the GE.

C is the weakest of all, as it has hit two strong resistance points, the 200-day MA and the previous high (see Figure 4). This stock has also formed higher highs, while the RSI (14) formed lower highs. Although the trend is bullish and the RSI (14) has sustained in an overbought region, traders should wait for the confirmed breakout above various resistance on the daily chart in Figure 4. Thus, traders might get safe entry points after the $BKX breakout. ■

Technology Leading Broader Stock Market Higher

by Alan R. Northam

There are two market sectors that lead the broader stock market higher. By knowing the current trend of these market sectors, it is possible to know what the future trend of the broader stock market is. One of these market sectors is the technology market sector.

Tradable: XLK

All the individual stocks that make up the total of the stock market can be and has been divided into market sectors. These various sectors each go through their own bull and bear markets at differing times as they lead the economy through the various stages of the business cycle. During economic uncertainties such as a recession, the consumer staples, health care, and utilities market sectors outperform all others as well as the overall stock market. By measuring the performance of these three market sectors compared to the Standard & Poor's 500, it is possible to determine when the stock market is predicting uncertain economic times ahead.

Recently, I wrote three Traders.com Advantage articles highlighting those three market sectors that normally do well during economic uncertainties. These sectors are known as defensive market sectors. These three articles are "Traders Remain Confident In The Stock Market," "Health Care Determines Market Direction," and "Are Utilities Signaling A Higher Stock Market?" I highlighted how you can forecast the future direction of the broader stock market based on what these three market sectors are currently doing.

Just as there are three sectors that outperform the broader stock market during economic uncertainties, there are two market sectors that start to outperform the broader stock market and all other sectors during the beginning of a new bull market of the overall stock market. Here, I highlight one of these market sectors.

One of the two market sectors that lead the economy out of bad times is the technology sector. If we can determine that the technology market sector is recovering and starting to trend upward, we can determine that traders and investors are predicting that the economy is about to recover. It is from this relationship that we hear the phrase "In a healthy bull market, the technology market sector leads the broader stock market higher." As this and other market sectors start to trend higher the overall stock market also starts to move higher, as it is made up of these various sectors.

FIGURE 1: XLK, WEEKLY. This chart shows XLK basing or forming a double bottom in late 2008 to early 2009. This chart also shows XLK breaking out of the double-bottom formation and starting to trend upward. Currently, XLK is up against long-term overhead resistance.

In Figure 1, the technology market sector as measured by the Technology Select Sector SPDR (XLK) started to recover from November 2008 to March 2009 when it went through its basing period by forming a double bottom. XLK broke out above its double-bottom basing pattern in early April, signaling that XLK was starting to trend higher. Shortly thereafter, XLK broke above its 34-week exponential moving average (EMA), signaling that the technology market sector was entering into a long-term upward trend. This long-term upward trend was then confirmed when the 34-week EMA started moving upward.

In addition to the technology market sector being in an established bull market trend, it is also necessary for the tech sector to show strength by outperforming the broader stock market. To make this analysis, I use relative strength comparative. Relative strength comparative analysis is performed by dividing the technology market sector by a stock market index such as the S&P 500. The result is a ratio line that climbs when the technology market sector is moving higher at a faster rate than its index and declines when the market sector is moving lower at a faster rate. When the ratio line is climbing higher, it shows sector strength and when it is falling, it shows weakness. In Figure 1, the relative strength comparative ratio line is shown below the price chart. The analysis shows that the technology market sector started showing market strength in early 2009 when it broke out above overhead resistance.

In conclusion, the technology market sector established itself in a long-term bull market upward trend around the May 2009 time frame and has been showing market sector strength since early 2009. Long-term trends normally last from several months to several years. From a timing standpoint, the long-term upward trend in the technology market sector is still quite young and should continue upward for several months. Unfortunately, XLK is now up against resistance from a long-term downward-sloping trendline, which could temporarily stall the upward advance. Until proven otherwise, the technology market sector remains in a bull market uptrend and continues to signal that the broader stock market is in the early stages of a new bull market uptrend.

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This article was first published on 8/28/2009.
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METALS & ENERGY

RESISTANCE LINE

Gold Approaching Possible Breakout/ Breakdown

by Donald W. Pendergast Jr.

Gold quadrupled in price from late 2001 until early 2008. Since then, gold is still about 7% below the highs attained early last year, but the chart suggests that big changes may soon occur in this market.

Tradable: Gold, GC, GLD

FIGURE 1: GOLD, MONTHLY. The presence of a pennant formation within the larger triple-top buy pattern lends a modestly bullish air to this chart.

Gold, along with silver, tends to do very well during periods of high consumer price inflation (1968-80 being one such time period) and during long-term commodity bull markets (again, from 1968 to 1980, and 2001 until today). Demand for gold comes from several sources: industrial, investment, and speculation interests all play a major role in determining the price direction of gold. Industry needs the metal for a variety of manufacturing purposes in the defense, electronics, jewelry and dental care industries, investors want gold as an inflation hedge, and speculators want to trade the various moves in the metal, up and down, frequently using futures contracts to do so. Right now, the gold market is consolidating in three separate time frames (daily, weekly, and monthly), but the price action on the monthly chart may be the most interesting of all.

Figure 1 is the Handy and Harmon chart for monthly gold; even an untrained eye would likely realize that this particular commodity has been in a major trending move for nearly eight years. Skilled technicians would also note the increased depth of each proportional pullback (large green and red circles on the chart) against the major uptrend; note how much larger the 2008 retracement move was than the one that preceded it in 2006. The big question now, of course, is, "What's next?"

If we step back from the chart for a moment and take in the big picture, we may at least be able to whittle down the number of possible outcomes. First off, the long-term uptrend lines are still intact; if gold breaks down from the triangle/pennant pattern, it could drop as low as $725 without violating the symmetry of the long-term uptrend. The gold rectangle on the chart highlights the most pronounced areas of support, all residing between $725 and $840. (Please remember this is the cash-equivalent price of gold, and not the price of any particular gold futures contract.) Note how the Keltner bands have helped delineate the massive uptrend in gold since 2001; since early 2002, the price of gold has remained above the Keltner band midline (thin blue line at the center of the Keltner bands), never once falling below that critical support/resistance line.

Even on the big 2008 selloff that saw gold plummet from $1,011 all the way down to $713, the line was never touched — and the line is still rising. If gold can manage a monthly close above the upper boundary of the green triangle pattern, it could be the tipoff that the run in gold is destined to carry to higher prices. Most technicians realize that a triple-top breakout is a very powerful pattern, one that frequently leads to a major trend-following move, and that's exactly what's shaping up here. While these patterns can and do fail (trading being a game of probabilities, after all), the fact that the triangle pattern is also integrated within the triple-top buy pattern makes it of special interest to gold bulls everywhere. Be sure to put this monthly chart on your watchlist to see how all of this plays out — the moves up or down could be hard and fast.

Perhaps the best way to play a monthly breakout/breakdown of gold is to let the anticipated break happen and then move down to your weekly and daily charts looking to capitalize on pullback against the trend type moves — either up or down. ■

TRADING SYSTEMS

Oil Services Industry Group Flashes Buy Signal

by Donald W. Pendergast Jr.

Now that the S&P 500 has finally cleared the magic 1000 level again, the odds are that the broad markets will continue to move higher. Here's a look at one of the strongest ETFs, one that has just issued a strong buy signal.

Tradable: IEZ, NTG

The crude oil prices have staged quite a turnaround since March 2009, and the energy services industry group stocks have also risen sharply as well. Right now, the Dow Jones US Oil Services and Equipment Index fund (IEZ) has just offered a convincing buy signal, one occurring after a significant test of support. Let's take a look at Figure 1.

If you have MetaStock, you can simply pull up a clean chart of whatever tradable you're interested in and apply the Profitunity (Bill Williams) Expert Advisor. Next, apply the ParaSar indicator to the chart (from the indicator Quick List) and then add a pair of moving averages (the 20- and 50-period exponential moving averages [EMAs]). Save the template under whatever title catches your fancy, so it's easy to remember if you have dozens and dozens of templates already saved.

Now that you have a chart with this particular set of indicators and expert advisors, you need to know what to look for. First of all, ParaSar is more than an indicator; it actually is a self-contained trading system. According to its original design, you'd be long anytime prices are above the lower set of ParaSar dots and short any time prices are below the upper set of ParaSar dots. And that's exactly the setup we have here on the IEZ daily chart for August 3, 2009 — a fresh ParaSar buy signal. You'll also note that IEZ is moving higher after having successfully completed a proportional retracement test of support near its 50-day EMA (blue line) at the same time that the Bill Williams Profitunity Expert is indicating that a strong uptrend is starting to develop in this particular ETF. Also worthy of note is that the Chaikin money flow (CMF)(34) is also well above its zero line, another tipoff that prices may have some room to run higher with this new buy signal.

All in all, this appears to be a low-risk long trade setup, given the incredible strength in the both the crude oil market and the S&P 500. The trade entry is very basic — either enter at the next session's open or wait for the signal bar's high price to be exceeded on a buy-stop order. Place an initial stop near $34.25, the current ParaSar exit trigger price, and then let the trade run. The ParaSar dots will rise a little every day as the trade progresses, and if you set your stop-loss at or just below that price every day, you'll automatically be taken out of the trade. This is a great way to trail a stop, as it takes all of the stress out of trying to figure out where to place the stop, trying to second-guess the market, and so on. ParaSar can be a really fun system to trade, especially when the market giving the signal has strong (weak) relative strength versus the broad markets.

For a chance at higher profits, consider drilling down to the component stocks that make up an ETF or index, choosing the strongest (weakest) stocks from any index or ETF issuing a fresh ParaSar buy (sell) signal. Wondering what stocks in the oil services industry group are also firing ParaSar buy signals? Let's find out.

Figure 2 shows the output of the MetaStock ParaSar exploration that I constructed, this time using the stocks from Metastock's Oil Well Services & Equipment data folder. The highest-priced stocks are at the top of the sort for ease of analysis. But maybe we need to try and whittle this list of stocks down a bit. But how?

Here's how (see Figure 3). If you'd like to know which of these stocks have had the highest performance over the past three-, six-, and 12-month time frames, we can run another exploration to pick the strongest of these particular oil services group stocks that are also flashing ParaSar buy signals. Note that the strongest ParaSar buy stock in terms of relative strength is very inexpensive (PDRT), selling for only $0.26 per share, so you may wish to deploy your funds into something a little meatier, like the second stock on the list, NATCO Group (NTG), which is going for about $38.15. It has an exceptional chart pattern and has all of the same bullish attributes as its ETF parent, IEZ. Of course, buying 100 shares of PDRT just for fun (all you can lose is $26 plus any commissions!) might also result in a gain — who knows? Even the mighty Microsoft was once a lowly penny stock, and look what happened. And, of course, any stock whose stock ticker can be loosely translated as Paydirt (PDRT) might be worth a second look, right? At $0.26 a share, sign me up.

Combining the basic ParaSar trading triggers with a few other technical tools can help you fine-tune your trading strategy, especially when you learn to harness the power of relative strength rankings. Trading the strongest stocks from the strongest industry groups at a time when the broad markets are in the midst of a powerful bull run is a very wise, relatively low-risk strategy. Try it, and you'll probably be amazed at how much better your trading results will become. ■

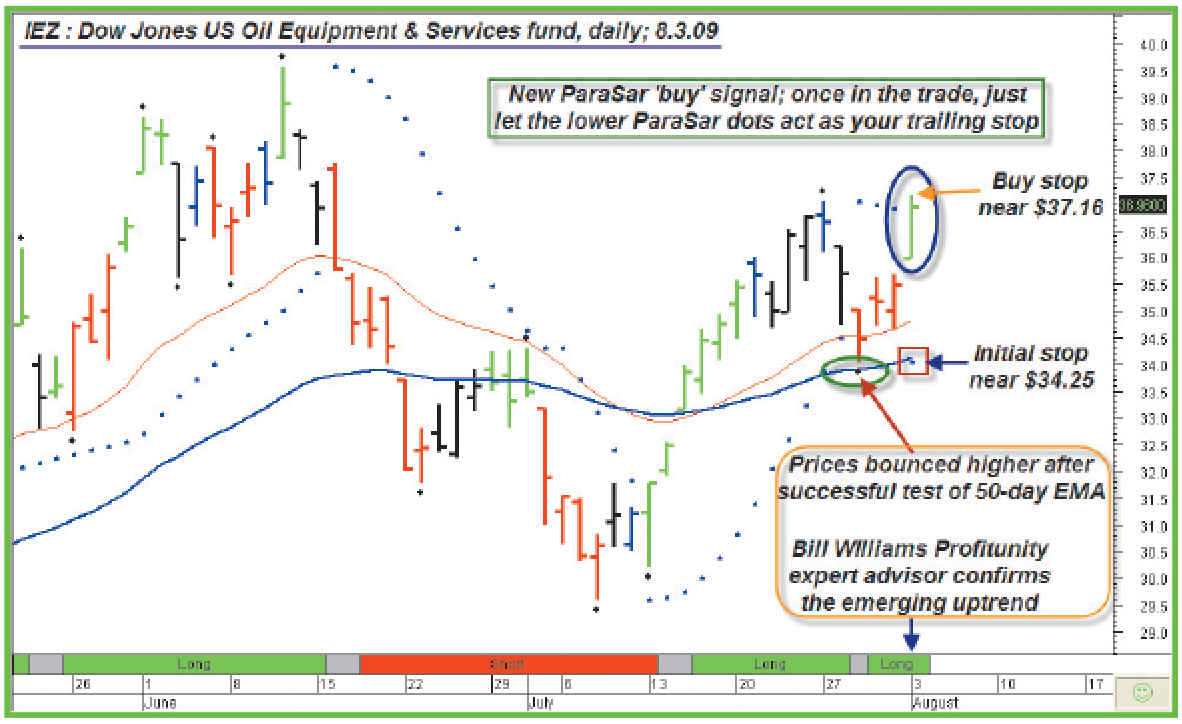

FIGURE 1: IEZ, DAILY. Building your own MetaStock templates can help you design the trading system that best suits your trading temperament and belief system.

Security Name	CLOSE	Above	Below	Ticker Symbol
Core Laboratories N.V.	89.7300	1.0000	1.0000	CLB
Transocean Inc.	82.0600	1.0000	1.0000	RIG
Dril-Quip, Inc.	43.8800	1.0000	1.0000	DRQ
Baker Hughes Incorporated	42.2700	1.0000	1.0000	BHI
NATCO Group Inc.	38.1500	1.0000	1.0000	NTG
National-Oilwell Varco Inc.	38.0400	1.0000	1.0000	NOV
Helmerich & Payne, Inc.	35.1200	1.0000	1.0000	HP
Atwood Oceanics, Inc.	30.0800	1.0000	1.0000	ATW
Smith International, Inc.	26.6100	1.0000	1.0000	SII
Weatherford International Ltd.	19.5500	1.0000	1.0000	WFT
Nabors Industries Ltd.	18.1000	1.0000	1.0000	NBR
Willbros Group, Inc.	14.6200	1.0000	1.0000	WG
Particle Drilling Technologies, Inc.	0.2616	1.0000	1.0000	PDRT

METASTOCK

FIGURE 2: IEZ STOCKS. Here are the Oil Well Services & Equipment stocks flashing new ParaSar buy signals.

Security Name	Close	3 month	6 month	12 month	Total	Ticker Symbol
Particle Drilling Technologies, Inc.	0.2616	127.4782	86.8571	-90.6571	83.7188	PDRT
NATCO Group Inc.	38.1500	45.7219	112.6533	-17.5313	62.1886	NTG
Atwood Oceanics, Inc.	30.0800	26.8128	73.7724	-24.8376	34.1868	ATW
Dril-Quip, Inc.	43.8800	18.8194	80.6505	-21.1217	32.3892	DRQ
Willbros Group, Inc.	14.6200	32.0687	45.1837	-64.3762	14.9816	WG
Weatherford International Ltd.	19.5500	6.8306	75.3363	-46.7448	14.0843	WFT
Helmerich & Payne, Inc.	35.1200	6.5857	56.6458	-33.4092	12.1360	HP
Nabors Industries Ltd.	18.1000	6.7217	66.6667	-46.6391	11.1570	NBR
Transocean Inc.	82.0600	12.5497	38.4745	-35.3604	9.4045	RIG
Core Laboratories N.V.	89.7300	3.5545	40.6426	-26.2816	7.1567	CLB
National-Oilwell Varco Inc.	38.0400	12.0141	33.9908	-45.5872	4.1440	NOV
Baker Hughes Incorporated	42.2700	10.8867	22.4153	-46.2487	-0.6867	BHI
Smith International, Inc.	26.6100	-10.7346	15.2946	-62.8870	-23.0206	SII

FIGURE 3: IEZ STOCKS. Here are the same stocks, this time ranked in terms of their weighted three-, six-, and 12-month relative strength rankings. Note that institutional investors don't usually buy many sub-$5 stocks.

Natural Gas Issues New Buy Signal

by Donald W. Pendergast Jr.

Can it be true? A tentative bottom in the natural gas market may finally be here, and a convincing long-trade setup is now beckoning.

Tradable: UNG, NG

What a long, strange trip it's been for natural gas bulls during 2008-09. The ride south has been steeper and more treacherous than the most challenging ski slope at Taos, almost seeming at times as if the entire nat gas market had lost all sense of sanity in regards to underlying commodity values. With the front-month contract having actually dropped into the $3 price bracket (earlier this year), it was hard to believe that a meaningful reversal could ever take place during 2009. In this article we'll examine the daily chart of the United States Natural Gas Fund LP (UNG), an exchange traded fund that deals in various natural gas futures contracts, offering retail equity investors/traders the opportunity to participate in the action in the nat gas market with more manageable risk exposure. See Figure 1.

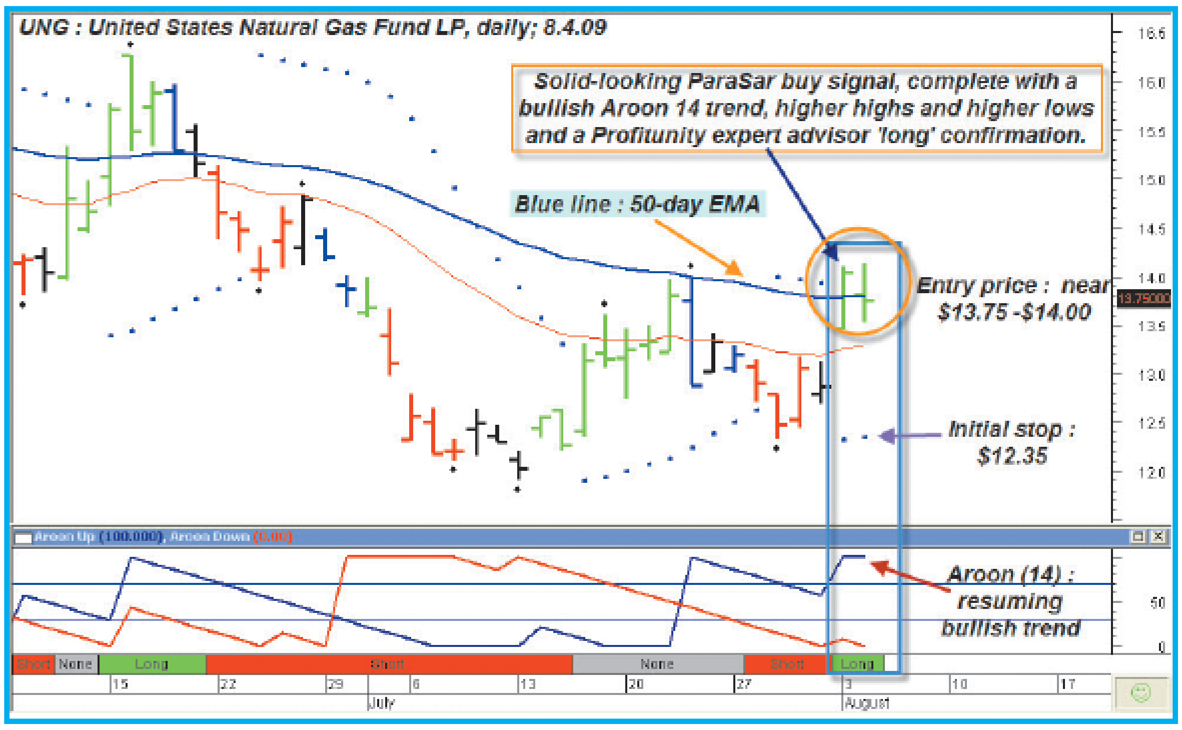

FIGURE 1: UNG, DAILY. Favorable technicals combined with bullish seasonal characteristics help make this a long entry signal worthy of consideration.

To begin, let's get a better grasp on just why this new buy signal in UNG is any better than the past three ParaSar buy signals, most of which wiped out all of the gains from the successful buy signal that printed in late April (good for a 14% gain in two and a half weeks). This particular buy signal appears to carry more weight because of two technical measures and one unusually important fundamental factor:

1. The long-term Chaikin money flow (CMF) (150) indicator trend appears to have found solid support above its zero line, building a flat base.

2. The Aroon (14) trend intensity indicator (bottom of Figure 1) has completed a successful test of support in its own right; look at how it briefly dipped beneath the 70 line before snapping right back up to the 100 area, where it is situated right now.

3. The seasonal price cycle for natural gas is favorable for bulls right now, as this energy commodity typically makes a seasonal low during late July to early August.

Even better, to have these three factors manifest even as the MetaStock Profitunity (Bill Williams) expert advisor moves into long mode (see green rectangle near lower right corner of chart) as price takes out the July swing high at $14.00 seems to be telegraphing the intentions of this market to begin another move back up from the gutters of its long-entrenched bear market.

Trade management is easy; to risk 1-2% max of your account equity, consider entering at a price somewhere between $13.75 and $14.00, maybe waiting for a 30-minute chart pullback to get a slightly better entry price on at least part of the position. Once filled on your entire position, place your trailing stop-loss near $12.35, the current lower ParaSar dot. Then do nothing! Just let the ParaSar indicator take you out of the trade (either at a profit or loss) as you adjust your trailing stop with each upward movement of the lower ParaSar dots, which will automatically rise each trading day (be sure you have accurate data for your evening download, of course), and your trade will be plotted on your chart by your software. You might want to place your stop a few pennies below the ParaSar to avoid a premature stopout, but it's really up to you.

For those of you who are able to trade NYMEX natural gas futures options, you might also be able to sell a far out-of-the-money January 2010 $4.30 natural gas put for almost $1,400 (based on a settlement price of 0.139 as of August 4, 2009). January 2010 natural gas settled at $5.951 on August 4, 2009, so you'd have a very nice price cushion (of almost 28%) by selling this far out-of-the-money put set to expire in mid-December 2009. That $1,400 in premiums you'd receive for selling the $4.30 put doesn't come without risk, of course, but given all of the bullish technicals and seasonals, this put sale is about as low risk as they come. Just make sure to buy the put back if it doubles in price, should natural gas decide to head back down south in a hurry. Better safe than sorry, unless you wouldn't mind being put a long natural gas contract at $4.30.

Overall, this technical setup looks outstanding, especially in light of the favorable seasonal characteristics of the natural gas market. However, even the best technical setups can go awry, causing unanticipated losses for inexperienced traders. Always predetermine the maximum amount of capital you're willing to lose before you actually place your trade; most professional traders try to limit their risk to 1-2% of their account size, depending on market conditions. Doing so will help you to not only survive a string of losing trades, it may also help you build your account equity at a more rapid pace than you may have thought possible. ■

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This article was first published on 8/5/2009.
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TECHNICAL ANALYSIS

Crude Cruise

by Austin Passamonte

Measuring the long-term view of crude oil futures market.

Tradable: CL

In retrospect, the 2008 peaks of $140-plus per barrel crude oil (CL) prices from the levels which they rapidly rose was blatantly unsustainable. It was not a matter of if they would correct, but only from where and when. The subsequent plummet to sub-$40 prices in early 2009 was equally unsustainable. Somewhere in the middle of that $100-span barrel price range lies fair value. But where?

Since the peak lows earlier this year, price action has stairstepped upward to the $70 zone. We see where the $75 area that was hit was a three-week pause late last year, and served as the recent double-top test this summer. Barely above that is the +162% projection off the initial 1-2-3 lows ascent.

CL may hang around and bang around the $70+ to $80 price zone for a while. Crude oil futures need to drain off sell-stops clustered on the lower side of congestion and begin tapping into the buy-stops clustered above. Yes, those stops are clustered there, and the marketplace itself exists to find and test them for validity.

It is no real coincidence that the upper levels of 233% and then 377% Fibonacci projection measures happen to overlay prior congestion zones. The CL $90 zone and the $115 zone (give or take a $1pbl) are the magnetic attractions. We could and probably will see crude oil prices testing those levels in the not-too-distant future. From the high $70s to high $80s and then $115 or so are the stepping-stones above. Retracement to the $60 levels should find firm footing below. ■

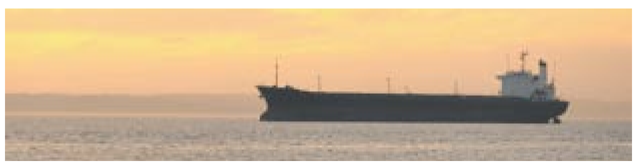

FIGURE 1: CRUDE OIL FUTURES, WEEKLY

RSI

Time To Buy Gold?

by Mike Carr, CMT

Traders seem obsessed with timing buys in gold. But there might be better investment opportunities in the metals that get overlooked.

Tradable: HG

Gold has a certain mystique and a reputation as an inflation hedge. The truth is, traders can profit from large swings in the price of gold, but investors should probably look elsewhere. We see in Figure 1 that gold has been in a broad trading range most of the year. In addition, the relative strength index (RSI) has remained below 60 on a weekly chart. In a true bull market, the RSI will generally move above 60.

Meanwhile, copper has clearly been in a bull market this year (Figure 2). This metal is up almost 100% since the RSI broke above its long-term moving average. The RSI has also been above 40 all year, such behavior most often associated with bullish moves.

These two charts illustrate the idea that rather than watching the news for trading ideas, traders should look at their charts. Copper can be traded as an exchange traded fund (ETF), in the futures market, or through the shares of mining companies. ■

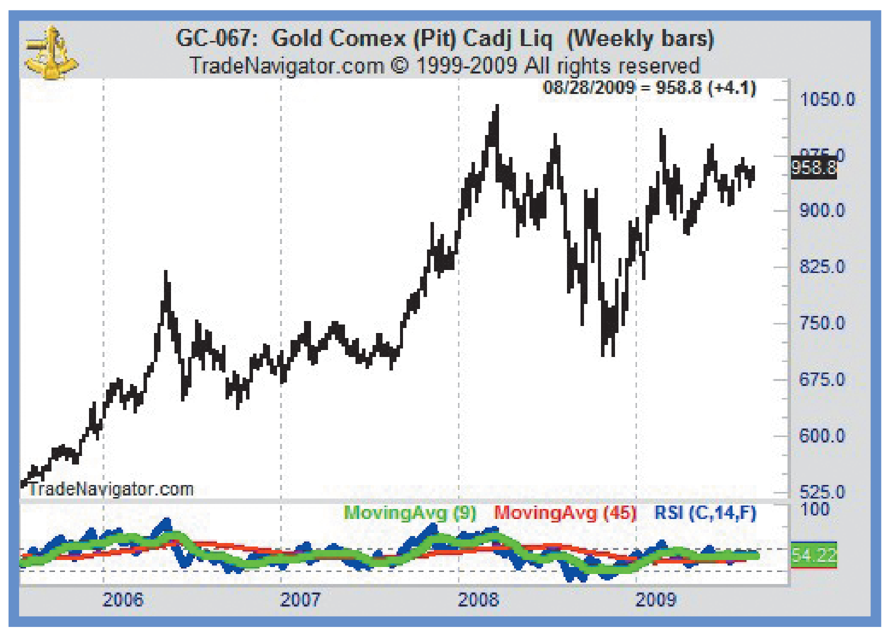

FIGURE 1: GC, WEEKLY. Other than large moves that allow traders to profit, there is really nothing bullish in this chart of gold despite the widely heralded move toward a price level of $1,000 an ounce.

FIGURE 2: HG, WEEKLY. Little noticed in the media, copper has delivered big profits to traders.

Gold Breaks Upward

by Chaitali Mohile

The Gold Index has veered downward in a narrow range over the past few months. The bullish breakout has brought back the lost glitter of the precious metal. How long can we stay positioned on gold?

Tradable: $GOLD

In Figure 1, the gold continuous contract ($GOLD) made lower peaks from 1007 levels and formed consecutive higher bottoms. The range for $GOLD narrowed even more, forming a symmetrical triangle pattern on its daily chart. When upper and lower trendlines converge, a symmetrical triangle appears on the chart. Due to the converging trendline, identifying the breakout direction is very difficult. This triangle is the continuous pattern in an uptrend as well as in a downtrend. These are some important features that differentiate the symmetrical triangle from ascending and descending triangle patterns.

The narrowing range induced high volatility in $GOLD. The equal buying and selling pressure indicated by the average directional movement index (ADX) (14) reflects the volatility in the index. As a result, the ADX (14) was unable to sustain above one particular level (see Figure 1). The rate of change (ROC)(14) also formed the symmetrical triangle in the past few days. After the recent bullish breakout, $GOLD's direction is clear and has opened a fresh buying opportunity. Along with the price breakout, the ROC (14) has surged and the ADX (14) indicated a developing uptrend. Therefore, traders can trigger long positions for an intermediate term.

FIGURE 1: $GOLD, DAILY. The symmetrical triangle has breached upward. The resistance at 1007 and 1033 would act as the intermediate- and the short-term target, respectively. However, the potential target of the symmetrical triangle breakout would be the long-term target.

Since the breakout has moved $52, I would watch the previous high at 1007 as an intermediate target. As such, the potential target on the symmetrical triangle is measured by adding the length of the triangle to the breakout level. Thus, the minimum estimated level after a breakout would be 1007 - 860 = 147 + 950 = 1097. But this level could be observed as a long-term target for $GOLD. After 1007, the second resistance is the 1033 level, which might suppress the breakout rally, leading to either consolidation or a short-term correction.

Therefore, traders can set up a buy with the intermediate target of 1007 and a short-term target of 1033. ■

CHARTPATTERNS

HEAD & SHOULDERS

A Head & Shoulders Negative For The DJIA?

by Koos van der Merwe

The pattern is there, a very obvious head & shoulder pattern.

Tradable: DWIX

The Elliott current wave count is a very definite Elliott wave 1 in a new bull market. After a wave 1 comes a wave 2, which history has shown can be anything from a small correction to 100% correction, if not greater. Looking at the daily chart of the Dow Jones Industrial Average (DJIA), however, we see a very possible head & shoulder pattern, which gives us a clue as to where the wave 2 correction should bottom.

Figure 1 is a daily chart of the DJIA showing the wave count of wave C; the wave I start of the new bull market and the start of the wave 2 correction, with possible target levels for the low of the wave based on Fibonacci retracement levels of the range of wave 1. The relative strength index (RSI) gave a divergent sell signal confirming the start of the wave 2 correction.

Figure 2 is an enlarged daily chart of the DJIA, which shows the head & shoulder pattern that has developed. The neckline suggests that should the DJIA fall below 8256, then it should fall to a target of 7607. So is this indeed the low of the wave 2 correction? Until proven otherwise, we must assume that it will be. But we should keep in mind the Fibonacci retracement levels, should the head & shoulder target be a temporary support level only. Do note that the closest Fibonacci level to the target level of 7607 is the 50% retracement level at 7684.

Finally, do note the divergent sell signal given by the RSI, which is showing further weakness ahead. The indicator is not yet at oversold levels. The DJIA appears to be forming a head & shoulders pattern with a target of 7607. Whether or not the pattern is a certainty, it should affect a large number of technicians causing them to either sit on the sidelines or sell their holdings. Either way, we can expect weakness ahead for the DJIA as a very defined wave 2 correction develops. ■

FIGURE 1: DJIA, DAILY. Here's a detailed chart of the DJIA showing a wave count.

FIGURE 2: DJIA, DAILY. Here's an enlarged chart of the DJIA showing a possible head & shoulder pattern.

REVERSE HEAD & SHOULDERS

The Big Picture For The S&P 500

by Ron Walker

How will the head & shoulders pattern play out in the days ahead for the S&P 500?

Tradable:$SPX

As of this writing in July 2009, the Standard & Poor's 500 is in the process of forming a head & shoulders (H&S) pattern of the complex class in the daily time frame (see Figure 1).

If the pattern runs its course and prices close below the confirmation of 879, it would allow a much larger pattern to set up on the S&P 500.

A very large inverse head & shoulders pattern has been setting up since last November. In Figure 1, the left shoulder can be seen at the November 21st low. The market rallied off those lows to January, where prices stalled at 944. Things really got ugly for the next two months until prices bottomed on March 6, 2009, putting in a momentous low of 666. The S&P 500 staged an impressive comeback, racking up one of the largest bull runs in history.

Eventually, prices broke down from a bearish rising wedge. From there, the index drifted sideways, forming a 10-week head & shoulders topping pattern. If the pattern breaks down and prices begin to freefall, we could see the right shoulder of the larger pattern form.

The first possible target where prices might be contained if a sell-off occurs is at the measurement of the H&S top. By taking the peak of the pattern (the highest point on the head) and subtracting it from the neckline at 879, we get a measurement of 77 points with an objective target of 802.

The target is calculated by subtracting the measurement from the neckline (879 - 77 = 802).

Another target is the 61.8 % Fibonacci percent retracement from the March 6th low at 666. If prices retraced 61.8% of the run from 666 to 956, it would retrace to 777. These Fibonacci retracements can be seen in both Figures 2 and 3.

Figure 2 shows the weekly chart and a silhouette of a very large right shoulder. Note the resistance from the primary trendline that prices are encountering, as the second right shoulder tries to form on the smaller H&S top pattern. That level of resistance may allow the H&S top to play out and set up the right shoulder on the larger inverse H&S pattern over the summer and early autumn. Then once the correction is done, prices can rise to break the primary trendline and move higher to test the neckline of the pattern near 944. If prices can break above the neckline of this pattern, it would likely end the bear market.

A third possibility is that prices put in an equivalent intraday low in proportion to the left shoulder made back on November 21, 2008, at 741.

All three targets have credibility, but we must first see the smaller head & shoulders top-reversal pattern break down in order for the big picture pattern to come into play. This bullish long-term scenario is predicated on the assumption that a higher low

FIGURE 1: $SPX, DAILY. There is a head & shoulders top-reversal pattern brewing over SPX. If we close below 879, a right shoulder will likely form in a much larger inverse H&S pattern.

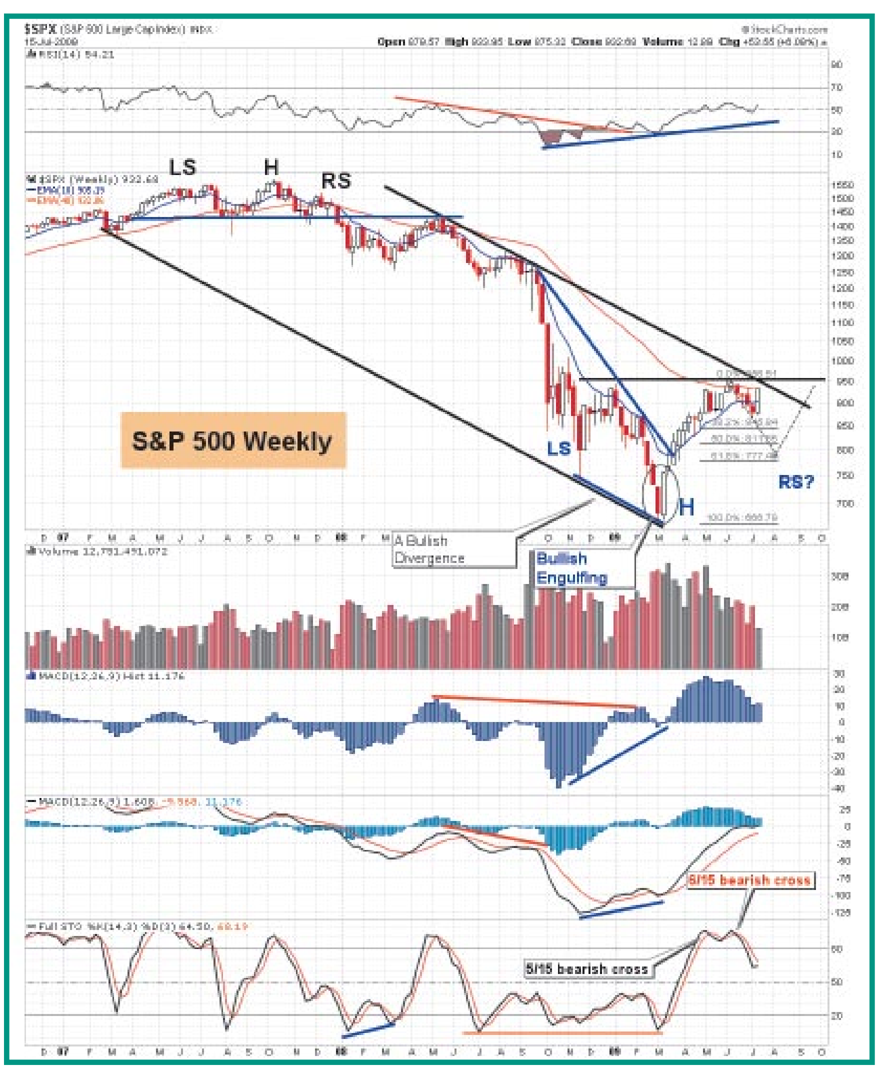

FIGURE 2: $SPX, WEEKLY. The weekly chart shows that the current rally will soon run into resistance at the primary downward trendline. This increases the odds that a second right shoulder will form on the H&S top, resulting in a summer selloff. Note the 61.8 % Fibonacci retracement coming in at 777.

FIGURE 3: $SPX, DAILY. In this closeup of the daily chart, we see the moving average convergence/divergence (MACD) turning bullish below zero and the stochastic clearing 50 as SPX slams into resistance. If a second right shoulder forms, the S&P 500 will be ripe for reversal. The 61.8% Fibonacci at 777 is just underneath the target of the price pattern.

forms on the weekly S&P 500 chart to complete the pattern, and that higher highs will follow, ultimately confirming the pattern's validity. So let's see if the head & shoulders top plays out in the days ahead and whether prices can be contained at one of the support levels discussed. ■

A very large inverse head & shoulders pattern has been setting up since last November.

CHART ANALYSIS

Saucer Bottoms And Trend Reversals

by Donald W. Pendergast Jr.

Traders can learn to profit from major trend reversals by employing visual analysis techniques along with a few simple technical tools.

Tradable: TEN

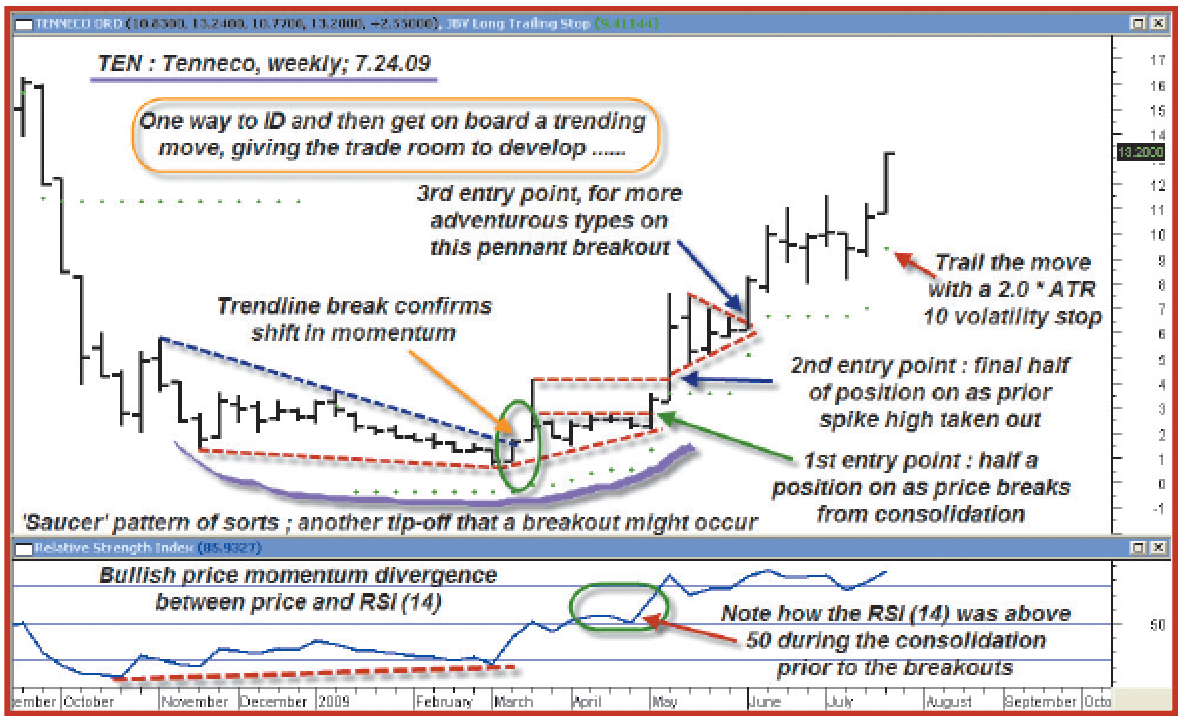

FIGURE 1: TEN, WEEKLY. Saucer bottoms and the bullish breakout moves occurring in their wake can frequently lead to profitable trend-following moves.

Tenneco's wild ride south took the stock from $37.73 in August 2007 all the way down to $0.67 in March 2009. By most conventional measures, most investors and traders probably wouldn't have considered touching this beaten-down stock with the proverbial 10-foot pole. Yet, look at the astounding reversal that occurred after the final lows were made; the stock has recovered a third of its former high in less than five months. Let's look at some of the tell-tale clues that were hinting that Tenneco (TEN) might have been a fairly low-risk long trade entry, especially as the broad markets reversed higher in sympathy.

Figure 1 is TEN's weekly chart, detailing the technical journey of the automotive industry group stock over the past 10 months or so. Obviously, the stock wasn't a favorite of institutional money managers once it plunged into the "sub-$5 a share" bin, but the pronounced bullish price-momentum divergence that showed up when the relative strength index (RSI) (14) was compared to the weekly action in the stock itself must have caught the attention of some deep-pocketed bottom-fishers, who put the stock on their radar screens. This was about the same time that the broad US markets bottomed and reversed sharply higher, also pulling up TEN in its wake.

As the stock caught a bid, it proceeded to break above the downtrend line that formed the top of the descending wedge pattern, causing even more traders to take note. A spike high printed in mid-March, followed by a six-week long consolidation platform pattern, the kind typically seen after a stock has completed a major reversal.

Now the setup was in place; traders looked for the breakout above this weekly platform, and they got what they wanted during the week ended May 1, 2009. At this point, there was no question that this stock was on its way higher, but as usual no one could have accurately called the incredible multimonth trend move that has emerged from such a humble price level.

This first breakout (see the short red dashed horizontal lines) would have been an ideal place to put on half of a position, trailing the anticipated move higher with a 2 * ATR 10 volatility trailing stop (green dots on chart). Also worthy of note is that the weekly RSI(14) never dropped below 50 level as the platform developed, a major tipoff that a bullish breakout of the pattern would likely have some staying power. (The reason for this, of course, is that an RSI(14) reading above 50 implies that a strong trend may be developing, all else being equal.)

The following week (ending 5/8/09), the stock followed through with a 95% gain, again offering trend-followers a second entry point (see the red dashed lines again) to add the second half of their positions. You can bet that the mutual funds were really getting interested, what with the stock roaring higher out of the cellar and thousands of momentum players jumping on board the powerful move. Those who entered somewhere between $3 and $4 and who also elected to use the trailing volatility stop (green dots) were already near breakeven by this time, allowing them the luxury of riding the trade out in hopes of more substantial gains — and with limited risk.

Price consolidated for a few weeks after that massive range bar, forming a well-defined pennant, one that also could be categorized as a continuation pattern. A bullish continuation pattern implies that an upward breakout from the pattern will result in a substantial continuation of the initial move up to the point of pattern formation.

Well, all the lucky charms were working on this one, because that's exactly what happened — as TEN broke from the pennant (also known as a triangle), it proceeded to gain 95% in less than two months, which is precisely where this high relative strength stock is right now.

There is another technical clue on the chart; note the purple curved line at the bottom of the chart. It basically traces out what some technicians refer to as a saucer bottom formation. Identifying chart patterns can be difficult at times, and no two are exactly alike, but this weekly price action in TEN between November 2008 and May 2009 certainly does seem to meet the definition of a saucer or rounded bottom pattern. You would still have needed to rely on the other technical tools discussed in order to time an entry, but the saucer pattern would have been a wonderful secondary confirmation, adding an extra dose of confidence to those who actually went long on TEN between May and June 2009.

Finally, trend-followers and momentum traders would also do well to examine the relative strength rankings of the stocks they intend to trade prior to actual entry. In this case, TEN had excellent relative strength (based on a 13-week rate of change) versus the Standard & Poor's 500 during May and June 2009, the period in which all three hypothetical long entries would have been made.

Taken as a whole, using all of the technical tools and evaluation techniques described here would have allowed an industrious trader to make a nice profit on this particular stock. Now that you know what to look for the next time the broad market makes a major low, see if you can apply some of these techniques to the stocks and exchange traded funds (ETFs) that you normally trade. ■

QQQQ's Ascending Broadening Wedge

by Ron Walker

The QQQQ has formed two bearish patterns during its recent runup. But even though bearish forces are at work, how far could prices drop? An ascending broadening wedge pattern might hold the answer and reveal where the correction might be contained.

Tradable: QQQQ

After the daily chart of the PowerShares QQQ Trust (QQQQ) peaked in May, prices began to trade within the boundaries of two trends that sloped higher and that broadened out over the next several months (Figure 1). Prices fluctuated between these two rising trendlines; the grade of the lower boundary has been gradually sloping higher, while the upper boundary has been rising at a much steeper and elevated angle of ascent. These trendlines are not parallel like a rising price channel, but they broaden similarly to a traditional broadening formation. However, unlike a broadening formation, which makes lower lows, this pattern continues to produce higher lows, which gives it a wedge shape. It looks like a backward falling wedge pattern.

More often than not, this pattern has bearish ramifications and could lead the march to a broad-based stock market retreat. Trader and author Thomas Bulkowski notes the bearish overtones of this pattern in his Encyclopedia Of Chart Patterns that "the breakout direction is downward the vast majority of times, but an upward breakout is not unheard of." The measurement of this pattern is calculated differently from the usual modus operandi that accompanies technical analysis, of taking the difference of the length of the pattern. The target of an ascending broadening wedge is simply the lowest low in the pattern. In this case, that would be the May low at $32.92. That target is just above the 200-day SMA (Figure 1).

In Figure 1, a powerful rally in July carried the Qs right up to rising resistance for a third touch of the

FIGURE 1: QQQQ, DAILY. The target of the ascending broadening wedge (trendlines marked in blue) measures to the lowest point in the pattern at $32.92. Meanwhile, the oscillators are unwinding.

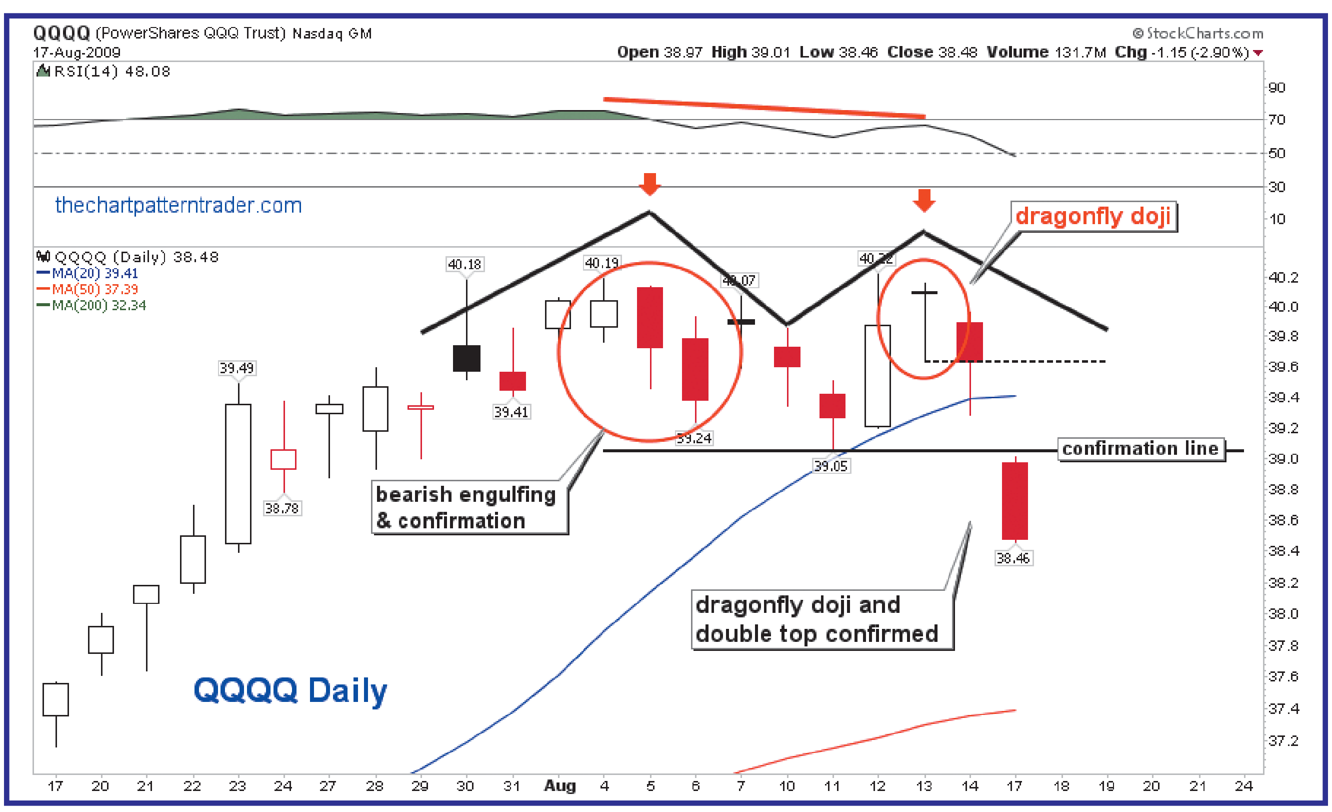

FIGURE 2: QQQQ, DAILY. The day after the dragonfly doji appeared, QQQQ closed one penny below the doji's intraday low of $39.64. That wasn't a decisive penetration, and therefore, the reversal candle pattern remained unconfirmed until the next session. There, the Qs also broke below the last minor low, confirming a double-top pattern and fell below the 20-day SMA.

upper trendline, which was soon met with a test back to the 20-day simple moving average (SMA). Remarkably, from the July intraday low $34.30 to the recent intraday peak of $40.22, the Qs have swung higher by 17.25%. The pendulum may have swung too far in one direction and could soon swing the other way.

A broad spectrum of indicators on the daily chart underscore the bearish nature of this pattern. The relative strength index (RSI) (14) has put in successive lower peaks, while prices continue to make equal peaks near the $40.20 area, resulting in a sharp reversal. The average directional movement index (ADX) (14) has peaked and is now sloping down, weakening the spread of the directional indicators (+DI and -DI) as they converged closer together. The moving average convergence/divergence (MACD) (12, 26, 9) got a bearish crossover on August 8, but remains above its zero line. Bullish momentum has run out on the stochastic (14, 3, 3), which has hooked lower after a bullish cross attempt failed to regain traction. The stochastic has moved below its median line at 50. There are a lot of insurmountable obstacles that lay ahead of the QQQQ that as a serious analyst I cannot ignore. All this information keeps drawing me to one conclusion: this tech-heavy fund is about to be whacked upside the head.

On August 13, a dragonfly doji candlestick appeared on the QQQQ daily chart (Figure 2). This pattern occurs when prices open and the close at the high of the day, and it is usually associated with turning points. The next session produced a reversal, but prices only closed one cent below the $39.64 low of the doji, failing to confirm the pattern. In the following session, the pattern received confirmation plunging below the doji, while simultaneously dropping below the 20-day SMA. This caused further technical damage, because from late July to mid-August, a bearish double-top pattern set up during the final runup of the ascending broadening wedge (Figure 2). As prices collapsed, it not only confirmed the dragonfly doji, but the double top as well. The confirmation line was at $39.05, the momentum low that separated the two distinct peaks. The pattern measures $1.17 with a target of 37.88, which is very close to the current rising trendline (seen in Figure 1) and the 50-day SMA. This is the third rising trendline since the March lows. If this trendline is violated, the price target of the ascending broadening wedge will likely play out, ultimately testing the 200-day SMA. ■

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BROADENING FORMATION

The Broadening Formation On The S&P 500

by Ron Walker

In an article I wrote in July 2009, I addressed the need for closure in order to confirm the complex head & shoulders pattern that was setting up. That pattern failed due to an 11th-hour decision to change course by the bulls. So the deal was never officially sealed on that particular reversal pattern. But since then a new bearish pattern has formed. Or has it?

Tradable: $SPX

From the July low of 869, the Standard & Poor's 500 has aggressively risen by 17.25%, causing the potential complex head & shoulders pattern to fail. This runup has allowed another bearish pattern to set up, a five-point broadening formation (Figure 1). Often, when a head & shoulders pattern fails, it signals the end of an advance approaching.

Analyst and author John Magee made an important observation about head & shoulders topping patterns: that a head & shoulders formation that does not work is a warning that even though there is still some life in the situation, a genuine turn is near. The next time something in the nature of a reversal pattern begins to appear on the charts, it is apt to be final.

That could be the case here on the S&P 500. The head & shoulders pattern may have been negated, postponing judgment until the broadening formation had a chance to conclude.

Many investors are now wondering if the long overdue correction will manifest itself, questioning if a top has truly been made. The bears have been asking in unison, "Are we there yet?" That in itself suggests a certain amount of complacency at these levels.

Keep in mind that from the June high of 956 to the July low of 869 was only a 9% correction for the S&P 500 (see Figure 1). This is not much of a correction, considering that from the March lows to the August highs, the S&P 500 climbed 53% in less than six months. That gives our broadening formation a heightened sense of importance because it can bring a possible long-term correction.

FIGURE 1: SPX, DAILY. The third peak on this broadening formation reveals that prices could not push above the rising trendline of resistance. Shortly after the MACD got a bearish cross, a reaction was produced that led to a lower low as prices fell below the 20-day SMA. In addition, note the 9% correction from the prior peak of 956.

In Figure 1, the S&P 500 is sporting a five-point orthodox broadening formation, clearly with three peaks, each higher than the next, and two bottoms with the second lower than the first. After the reaction began from the third peak, prices began to drift sideways. But on August 14, the moving average convergence/divergence (MACD) (12,26,9) crossed below its signal line, and the following trading session prices broke below support and put in a lower low, confirming that bearish signal. The daily chart now has a lower high and a lower low, which is what defines a declining trend.

However, the appearance of the broadening formation presents a bit of a quandary. This pattern can actually act as a continuation or a reversal pattern. And it is too early to know which path the pattern will take.

If the broadening formation is a continuation pattern, the lower trendline of the pattern should contain this next correction either near the 950 level or above the lowest low of the formation near 869 (the pivot point). If either one of those levels of support holds up, prices will gradually begin to rise back up to the highest high of the pattern, then eventually go on to make new highs.

But if the broadening formation is a reversal pattern, then look out below. The pattern measures 149 points to a target of 720, which will give back most of the gains that have been made from the March low. That target would also move prices well below the 61.8% Fibonacci retracement from the March low coming in at 801, as seen on the S&P 500 daily chart in Figure 2.

For downward breakout of this pattern, take the difference between the highest high (1018) and the lowest low in pattern (869). By taking the difference (149 points) and subtracting it from the lowest low of the pattern, we get the minimum price target.

Here's the math if the pattern turns out to be a reversal:

1018 (highest high) - 869 (lowest low) = 149 points

869 (lowest low) - 149 (difference) = 720 (minimum price target)

Assuming that prices are in the early stages of a correction, we should focus our attention on the rising trendline that has formed in the July lows (Figure 2). If it holds, it will be the third touch of the rising trendline and possibly establish a new intermediate trendline. The trendline is hovering near the 50-day simple moving average (SMA), which is an important level of support. If prices bounce off the trendline, the broadening formation may turn out to be a continuation pattern. But if the trendline is fractured, the bearish repercussions of the broadening formation will prevail over the market during the autumn, which would add credibility to the reversal scenario.

Even if the rising trendline breaks, and prices skid down to the lower boundary of the pattern, it still could act as a continuation pattern. However, the lower boundary must remain intact. In Figure 2, the 200-day is fairly close to the lower boundary, which could also halt the selloff.

If the lower boundary of the pattern fails to stop the selling, the bearish forces of the broadening formation will begin to take root and reverse much of the advance that has occurred. So if this pattern proves to be a reversal, it will activate an autodestruct sequence in the market.

In conclusion, should prices dip below the lower boundary of the formation, seasonal trends could take over. Periods of distribution often occur in the autumn months of September and early October, which might further exacerbate the situation. ■

FIGURE 2: SPX, DAILY. This chart shows a series of support levels. The 50- and 200-day SMAs are candidates were buyers to come in. The rising trendline is the key level of support. If it breaks the 200-day SMA, the lower boundary of formation and the 61.8 % Fibonacci retracement offer the next levels of support.

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STRATEGIES

A Rectangle In The Broad Market

by Mike Carr, CMT

The Value Line Index is understudied but one of the broadest measures of the stock market. Right now, it seems to be breaking out of a rectangle.

Tradable: $XVG

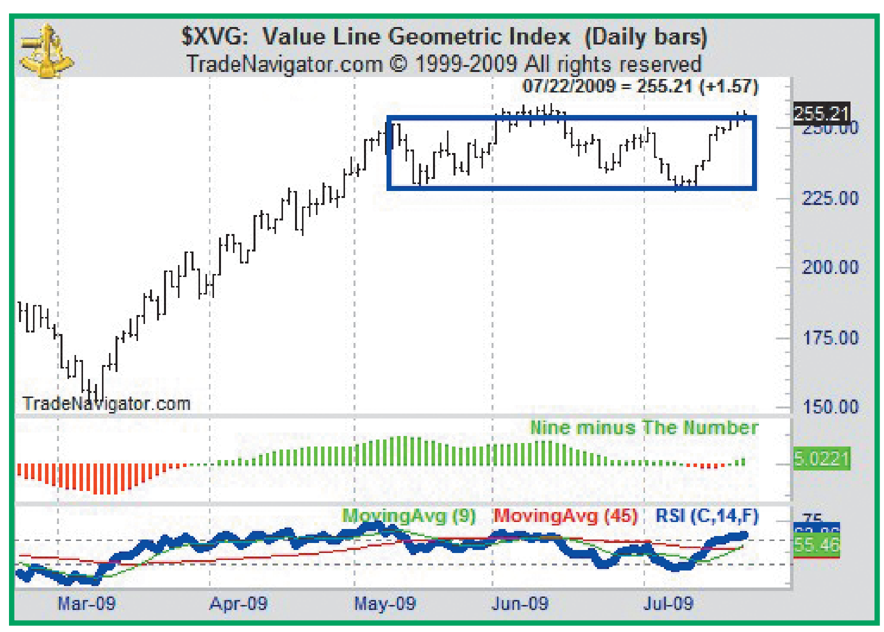
Rectangles are useful price patterns that can signify a reversal or a continuation. After the market's rapid rise from the March lows, a consolidation pattern was the best-case scenario for the market bulls. Looking at Figure 1, we can see that a rectangle has contained the price action for almost two months in the Value Line Geometric Index ($XVG).

While not as commonly used as other indexes as the Standard & Poor's 500 or Dow Jones Industrial Average (DJIA), $XVG is monitored by many traders. It is intended to offer a rough approximation of how the average stock in the Value Line universe is performing and offers exposure across market capitalizations. It is usually thought of as more representative of a typical investor's portfolio.

The middle frame in Figure 1 shows the relative strength index (RSI) after applying a moving average convergence/divergence (MACD)-style calculation. This is a technique pioneered by Andrew Cardwell, who has done a great deal of innovative work with the RSI. We see that it is currently indicating upward momentum in the indicator, a good sign that higher prices are ahead.

We can also see the RSI in the bottom part of the chart is bullish. Cardwell advocates putting moving averages on the RSI. In this case, we see that the nine-day moving average is just crossing above the 45-day moving average, another sign that the market should move higher.

Overall, this is supportive of higher prices for the broad market. ■



TRADE NAVIGATOR

FIGURE 1: $XVG: DAILY. Prices are at the upper boundary of the rectangle and the RSI points to an upside breakout.

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INDICATORS

STRATEGIES

Commitment Of Traders Report Turns Bullish

by Mike Carr, CMT

Commercial traders have turned bullish on the S&P 500.

Tradable: SPY

The Commitment of Traders (COT) report is released every Friday by the Commodities and Futures Trading Commission. It reveals the relative positions of hedgers (usually thought of as food and energy companies and producers) and speculators (hedge funds and individuals). Most analysts believe that hedgers will be right more often than not and speculators, especially individuals, are doomed to failure.

In last week's report, we saw that hedgers increased their positions in the Standard & Poor's 500 (Figure 1). The middle pane of that chart shows the commercials as the red line. The black line indicates that large speculators have decreased their positions in the past week, while small speculators have been decreasing their positions since the March bottom.

Last week, there was a large spike in the relative size of the hedgers' position. The bottom line in Figure 1 shows their position as a percentage of its value over the past six months. This is similar to the idea of a stochastic indicator. In the chart, we see that they now have their largest long position in some time.

Testing indicates this relative shift is significant. We looked at how the market performed after the indicator rose above 90. One week later, the market is higher 68.2% of the time. A month later, the market shows a gain 69.0% of the time. ■

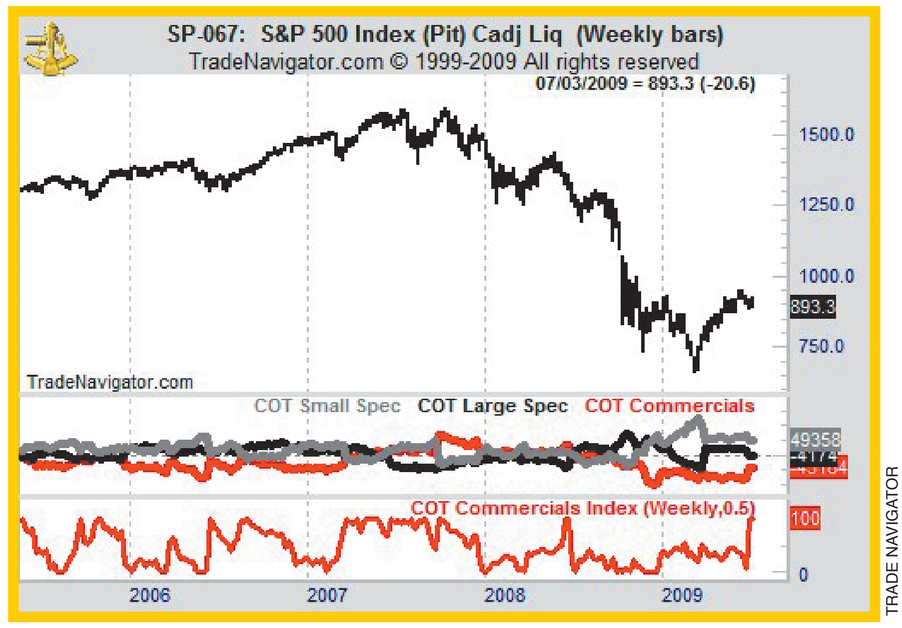

FIGURE 1: S&P 500, WEEKLY. The S&P 500 with COT data supports the idea that recent market action is a consolidation in a bull market.

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This article was first published on 7/9/2009. See www.Traders.com for more.

Don't Underestimate The Power Of The VIX

by Ron Walker

The recent runup in the stock market since the March lows still has the bulls giddy. But their bearish cohorts can make a pretty persuasive argument for a summer selloff in the stock market. Over the past couple of months, the S&P 500 has been busy chiseling out a top-reversal pattern while the VIX has been quietly waiting in the wings, positioning itself for a breakout.

Tradable: $VIX

FIGURE 1: $VIX, DAILY. The VIX daily chart has set up a bullish divergence with the MACD, but the bearish crossover on the stochastic shows that short-term momentum has postponed the breakout of the pattern. The relative strength index (RSI) has also formed a bullish divergence.

FIGURE 2: $VIX, HOURLY. The recent attempt made to break out on the daily chart failed as a head & shoulders reversal pattern set up on its 60-minute chart. Once the MACD turns bullish again here on the hourly chart, the VIX will likely make another stab at a breakout.

The volatility index (VIX) is a contrarian indicator. It moves in the opposite direction of the overall market. It is used by traders to help spot places of capitulation and complacency, offering clues of market volatility and sentiment. When the VIX is moving higher, the stock market is likely to be declining. In contrast, when the VIX is moving lower, the stock market should be rising. The indicator gives its best signals when it reaches extremes. When VIX climbs steadily higher it exposes weakness in the market by pressing and pushing prices lower, as investors vacate the premises.

Currently, there are many bullish hopefuls betting that the stock market has concluded its corrective move in a sideways correction. But chart watchers have been eyeing the VIX's nine-month bullish falling wedge with extreme interest (Figure 1). The pattern has been forming ever since the VIX peaked at 89.53 back in October 20, 2008.

Figure 1 shows that on July 1, 2009, the VIX bottomed out at 24.80, bouncing off the lower boundary of the wedge pattern before turning and making its way back up to test the trend. On July 8, the VIX attempted to break above the long-term trendline but was unsuccessful. The VIX quickly retreated from the trendline and sank back into the falling wedge pattern by the end of day. The VIX has now pulled back to test the July 1st low at 24.80. What happened? Why didn't the VIX break out?

By studying the VIX's 60-minute chart in Figure 2, we can see what went wrong. Here we see that the VIX formed a short-term, bullish falling wedge in late June. The pattern attempted to break out in early July as price snapped back to prior resistance near 33. Then the VIX skid back to support at the 50-period exponential moving average (EMA), trying to gain traction. The bounce produced a lower high and completed the right shoulder of the head & shoulders top. In the following session, the pattern broke down from the H&S top. So should we now write off the bullish wedge pattern on the daily chart? Not at all! Often, prices will attempt to blast off out of a reversal pattern, only to find the launch temporarily postponed in order to find the perfect timing and conditions so that the breakout can thrive.

Recently, NASA had to delay the launch of the

FIGURE 3: $VIX, WEEKLY. The weekly chart shows the VIX testing long-term support with a bullish divergence on the MACD histogram. The bullish MACD histogram should ignite the VIX. Once that occurs, the MACD should turn bullish as the stochastic moves out of oversold territory.

FIGURE 4: S&P 500, DAILY. The VIX has pulled back in order to build some momentum; meanwhile, the S&P 500 is busy setting up the second right shoulder in a head & shoulders top pattern. Once the shoulder is completed, the VIX gains traction. If the S&P 500 closes below the confirmation line of the pattern at 879, the VIX is likely to break out of its falling wedge pattern.

space shuttle Endeavour five times due to technical issues and unfavorable weather conditions. The conditions just weren't quite right for the space shuttle to have a successful liftoff and the mission had to be temporarily scrubbed. But sooner or later, the technical problems will be corrected, the unfavorable conditions will go away, and the Endeavour will blast off on its way to fulfill its mission at the space station. The same is true for the VIX. The bearish head & shoulders pattern on the 60-minute chart has delayed the breakout on the daily chart. But eventually the technical issues on the hourly chart will be repaired and corrected and the unfavorable conditions will disappear, as the bullish falling wedge on the daily chart ultimately rockets higher. Very soon the hourly, daily, and weekly chart of the VIX will begin to move in sync in a coordinated effort to drive down the stock market.

The weekly chart in Figure 3 shows yet another bullish scenario looming over the VIX. Note the falling wedge pattern that we looked at on the daily chart has come to rest on the primary trendline from late 2006, where there is a groundswell of support. The moving average convergence/divergence (MACD) histogram (12,26, 9) has formed a bullish divergence, as the MACD has flattened out and moved closer to its trigger line. The stochastic (14, 3, 3) has been inching up toward the 20 level. All three indicators suggest that the VIX will likely do a 180, while the prospects look dim for the stock market. This ticking time bomb will likely explode after the current rally in the stock market has concluded. The VIX is ready to explode higher, while the bears are preparing to oust the bulls and regain lost ground.

Figure 4 shows that the Standard & Poor's 500 has been carving out a complex head & shoulders pattern on the daily chart, looking ripe for a reversal. Once the second right shoulder has concluded, the odds favor that VIX turns to take another shot at breaking out of the falling wedge. Apparently, its delay occurred so that the S&P 500 could finish grinding through a top-reversal pattern.

Don't underestimate the dynamic power of the VIX. Its contrarian predictive powers suggest that the bears will make a roaring come back during the summer, in a flagrant act of disobedience against the bulls. ■

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Ford Motor In High Spirits

by Chaitali Mohile

After struggling for almost nine years, Ford has surged into a bullish region.

Tradable: F

FIGURE 1: F, MONTHLY. The stock drifted even below the historical low. The descending channel broke upward, generating fresh demand in the market. The fresh uptrend was developed after a long period.

According to the monthly chart in Figure 1, Ford Motor Co. (F) began its bullish journey in 1993 from $5 and made an all-time high in 1999-2000 at $32.50. Thereafter, the stock lost its entire gains of the past few years. The corrective rally dragged F back to its original level at $5, but the bloodshed continued. The stock formed lower lows and lower highs, forming a descending channel in Figure 1. The average directional movement index (ADX) (14) was highly overheated in 1999-2000, when the stock was at its peak. The overheated uptrend thus reversed, generating a bearish rally. Since then, the downtrend turned stronger. The descending channel's bullish breakout gave birth to a fresh uptrend after a period of nine years (see the green arrow). We can see that the channel broke at $5 and soon reached the $7.50 level. This robust breakout cannot be ignored.

On the weekly chart in Figure 2, the stock has surged above the 200-day moving average (MA) resistance. Earlier, F failed to breach the same resistance in 2008 due to the weak bullish trend. The relative strength index (RSI) (14) that was unable to move above 60 levels plunged to an oversold zone. But the current situation is different; the RSI (14) slipped into an overbought area during the 200-day MA breakout. The momentum indicator is likely to move straight in the bullish zone. The ADX (14) is suggesting a developing uptrend above the 25 levels. Thus, fresh buying opportunities have been opened for long-term traders.

Before the actual breakout, F consolidated under the 200-day MA resistance and formed a short-term bullish continuation pattern. The consolidation, after an exclusive advance rally, constructed a bullish flag & pennant pattern in Figure 2. The pattern has already broken in the bullish direction and hit a 52-week high as well, and thus the breakout is highly reliable. The minimum estimated level for the breakout rally would be 6.50 - 1.50 = 5 + 6.50

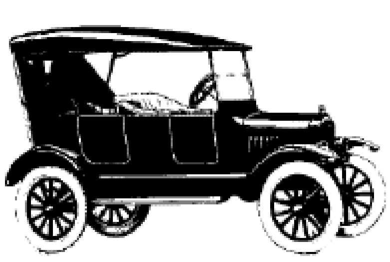

FIGURE 2: F, WEEKLY. The black arrows show the two lower lows and a higher low.

FIGURE 3: F, DAILY. The bullish flag & pennant pattern breakout.

= 11.50. The long positions could be held till it hits the target of $11.50.

Similarly, on the daily time frame in Figure 3 the flag & pennant formation is visible, which has already broken upward. The bullish moving average crossover, the marked circle, strengthens the prebreakout rally. The crossover gathered the bullish sentiments required for the pattern breakout. The RSI (14) sustained above the 50 level, indicating bullish force, and the ADX (14) that turned weak during the consolidation phase ultimately developed an uptrend. Currently, F is marginally moving sideways after the breakout, but the bullishness of the rally would be sustained.

Thus, the trading setup in F for long-term as well as short-term investors is most suitable and reliable. ■

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This article was first published on 8/12/2009.
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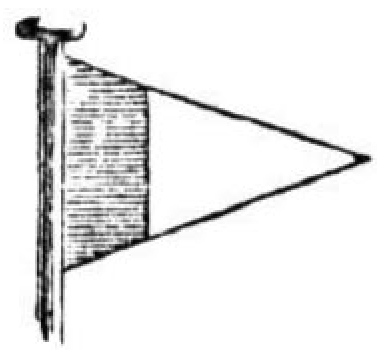

VOLATILITY

Bullish Belt Holds Bolster The Bears

by Ron Walker

A series of bullish belt hold candlesticks have materialized on the daily chart of the VIX reinforcing a new base of support. But will these bullish belt holds bolster the bears?

Tradable: $VIX

The Chicago Board Options Exchange Volatility Index (VIX) measures the implied volatility of the Standard & Poor's 500 index options. When the index climbs higher, volatility in the stock market greatly increases. This index is used to gauge fear. The VIX is quoted in percentage points and estimates the movement of the S&P 500 over the next 30 days on an annualized basis. The current reading of 26% suggests that option traders in the S&P 500 (SPX) options anticipate SPX to move to the 26% range over the next 12 months. However, the VIX looks poised to move much higher in the coming weeks ahead. If the VIX begins to move higher, it would usher in an overdue correction in the stock market.

Figure 1 shows the VIX bottomed out at 23% in late July, and then sidestepped through August in a tight contained price range, all the while closing above 24%. In mid-August, the VIX clambered to a slightly higher high, but quickly lost steam and retested support. Regardless of a failed rally on the VIX, it still has successfully produced a higher low, with a groundswell of support at the 24%

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FIGURE 1: VIX, DAILY. Circled in black are three bullish inverted hammers that formed at key support near 24%. Each inverted hammer was followed by a long bullish belt hold candlestick. The MACD, stochastic, and RSI each have confirmed the higher lows that formed a base of support at 24%. That may allow the VIX to clear the 50-day SMA.

FIGURE 2: VIX, DAILY. If the current belt hold produces a higher high, we will see the long-term downtrend broken here on the daily chart. Both the RSI and the MACD have long-term bullish divergences that are now beginning to build momentum on the VIX.

FIGURE 3: VIX, WEEKLY. The MACD on the VIX finally got a bullish cross on August 28. Bouncing off the long-term trendline should give the VIX the traction it needs to break out of the bullish falling wedge pattern.

level (Figure 1).

A series of bullish belt hold patterns have cropped up each time that support touched near the 24 level. The bullish belt hold pattern occurs when the candle for that session opens at its low, then rallies hard against the previous trend and manages to finish the session near the highs of the day. The belt hold candle is a long wide range bar representing a reversal. The belt hold one-day reversal pattern is unique in that it has no lower shadow at the lower end. Ironically, each time a bullish inverted hammer appeared at support it was followed by a bullish belt hold pattern (see that candle combinations circled in Figure 1).

In Figure 1 we can see that the VIX has had some trouble getting above both the 20- and 50-day simple moving averages in July and August. Both attempts failed. But the sequel of bullish belt hold candles might give the VIX the boost it needs to clear those two moving averages.

Figure 2 shows the daily activity of VIX over the past year. At the hard right edge of the price chart, you will see that the most recent belt hold candle nudged right up to the long-term declining trendline. The closeup of the daily chart in Figure 1 shows some very bullish signals that may cause the VIX to explode soon. The moving average convergence/divergence (MACD) (12, 26, 9) has confirmed a higher low and is creeping up to the zero line. The stochastic (14, 3, 3) and relative strength index (RSI) (14) also have higher lows. The stochastic got a bullish cross and is firming up above 20 (oversold levels); meanwhile, the RSI snapped above its median line of 50.

The weekly chart of the VIX in Figure 3 also looks to be revving up. The MACD histogram moved above the center line after it completed a long-term bullish divergence with the VIX. Currently, the slope of the MACD histogram bars is up (rising bars) in the weekly time frame and shows that bears are now back in the driver's seat. The MACD got a bullish cross on August 28, while the stochastic sprang above 20. A bullish falling wedge price pattern has formed off the primary trendline from the end of 2006. All these signs suggest that it is a favorable environment for short positions.

The current bullish belt hold needs a confirmation itself by a close that is above the high of the highest point in the candle pattern. In this case, we would need to see a close above the wick peak in the belt hold candle at 27.01%. That would push the VIX to a new high and break the downtrend, energizing the bears. ■

TRADING SYSTEMS

Will ParaSar Be On Target?

by Donald W. Pendergast Jr.

The tried-and-true ParaSar system is at it again, churning out yet another low-risk buying opportunity, this time in Target Corp., the Minneapolis, MN-based retail giant.

Tradable: TGT

Perhaps J. Welles Wilder wasn't aware of how successful his ParaSar trading system would become, way back in June 1978 when he first introduced it to the trading community in his classic New Concepts In Technical Trading Systems. It's an amazing system, one that can easily be tweaked to improve its bottom-line performance. Even better, this system has just issued a new buy signal for Target Corp. (TGT), a stock with superior relative strength versus the Standard & Poor's 500. See Figure 1.

Not only do we get a new ParaSar buy signal, but this long entry signal

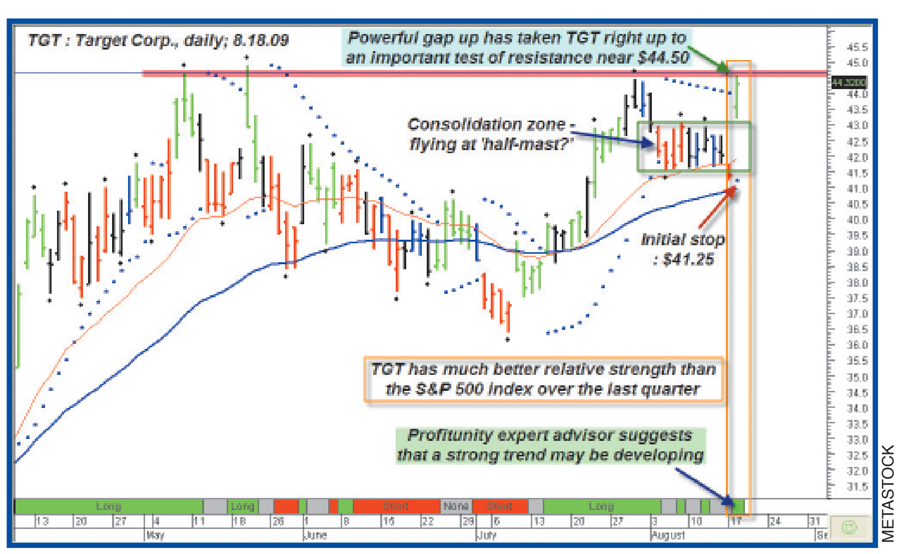

FIGURE 1: TGT, DAILY. A momentum players dream? A ParaSar buy signal occurring in the wake of a powerful gap higher into a triple-top resistance zone, launched from a consolidation zone that may be the proverbial flag flying at half-mast?

arrives in the wake of a powerful gap higher by TGT, one that takes it smack-dab into a strong area of overhead resistance near $44.50. This is the fourth time in less than four months that this price zone has been challenged by TGT and, given that the stock has very strong relative strength versus the S&P500 (based on a 13-week rate of change calculation), such powerful advances shouldn't be taken lightly. Even the reliable Profitunity (by Bill Williams) MetaStock Expert Advisor is chiming in with a green long confirmation color bar near the bottom. If you already own MetaStock, be sure to use the wealth of Profitunity expert advisors contained within; you'll gain insights about the nature of trading that will alter your worldview about how the financial markets really work.

Trade implementation on this TGT setup is very simple; if you're the aggressive type, a buy-stop at Tuesday's high near $44.60 in anticipation of strong follow-through should the major resistance line (as discussed) be taken out on heavy volume. Mild-mannered, "Walter Mitty" types might instead wait for an intraday pullback (a real possibility after a gap move up into major overhead resistance) entry, hoping that TGT may dip lower (attempting to fill the open gap) before snapping back higher. Once in the trade with your desired number of shares, simply place an initial stop-loss at about $41.25, the location of the lower ParaSar trailing stop (blue dots below the price bars on the chart). As each new daily bar prints, the ParaSar stop will adjust upward according to the formula programmed into MetaStock (or whatever charting program you actually use). Then all you need to do is adjust your trailing stop to match the price of the ParaSar trailing stop and you'll be all set. Eventually, you'll be stopped out for either a profit or a loss automatically.

While no one knows how this particular trade signal will fare, at least we know that the odds are in favor of a long entry at this time, given the weight of the technical evidence on the chart. ParaSar has been cranking out trading signals for more than three decades now, and it appears to be destined to be around for at least as long as the stock and commodity markets are. Give this system a try, paper-trading it on the stocks and futures you normally follow, and see if you can't learn a thing or two from it. You'll be pleasantly surprised. ■

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TRADING SYSTEMS

SanDisk Long Breakout And ParaSar Buy

by Donald W. Pendergast Jr.

The entire technology sector has been extremely strong over the past few months, offering a steady stream of long trading opportunities. Here's a look at another promising long setup in the tech sector.

Tradable: SNDK

SanDisk (SNDK) offers a full array of memory/storage products and has been a consistent innovator within its own industry group for some time. Its stock has had its share of thrilling ascents and frightening plunges along the way, but that's not a major surprise to anyone who's been trading tech-related stocks for any length of time. More recent price action in the stock has been very bullish; the stock nearly quadrupled off of its November 2008 lows and remains in a very bullish mode on both a technical and fundamental level. Right now, SNDK is offering a very interesting buy setup that combines the synergy of two powerful technical measures — a bullish breakout from a triangle/pennant pattern that occurs in conjunction with a mechanical ParaSar buy signal. Let's examine the chart and see if this is a trade setup worth considering (Figure 1).

There's a lot here, so let's begin with the basics. First off, SNDK has very good relative strength (based on a 13-week rate of change vs. the Standard & Poor's 500) as compared to the broad market. Second, the stock has exceptionally good long-term money flow, depicted at the bottom of the chart by the Chaikin money flow (CMF) (100) indicator. Next, note how SNDK experienced a bullish breakaway gap (purple square on chart) in mid-July 2009 after which the stock rocketed up toward the $19.00 area; SNDK then retraced nearly 50% of the entire July upthrust but never did fill the open breakaway gap near $15.50-$16.00. Instead, the stock began a modest "incoiling" process, gradually forming a pronounced pennant or triangle pattern. In the process of doing so, the 50-day exponential moving average (EMA) (blue line) also acted as solid support as the stock reversed higher after meeting it. Note that the reversal off of the 50-day EMA was the second successful test of gap support, encouraging a fresh wave of buying that still appears to be in process.

Finally, the recent bullish breakout of the pennant occurred in tandem with a new parabolic stop and reverse (ParaSar) buy signal. Overall, the technicals couldn't be much better than what we see here, although that still doesn't guarantee the success of a long trade entry at this point. However, the probabilities certainly favor the trader choosing to take this particular buy signal at this time. Remember that the ParaSar system is essentially a trend-following method, one that will always ensure that you can get in on any significant trend move that may materialize. It is not particularly well-suited to those who prefer to enter a position close to a significant swing low (high) as the system does tend to miss out on the early part of many significant market moves.

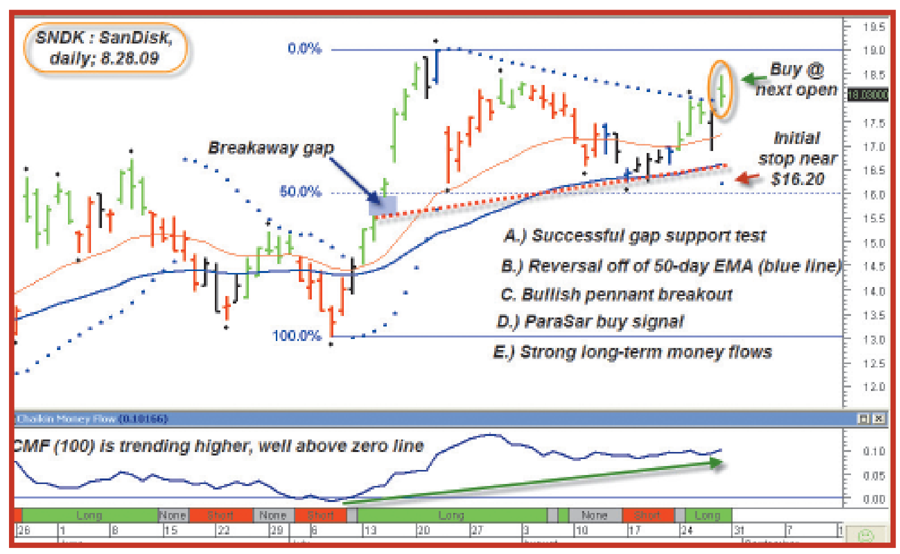

FIGURE 1: SNDK, DAILY. The technicals suggest that the current breakout/ParaSar buy signal may be worth considering. SNDK also boasts very good relative strength vs. the broad market indexes.

Therefore, it is essential to do a little technical and fundamental filtering (as we've already done) to ensure that you're not entering a ParaSar long signal during a confirmed bear phase in the stock, exchange traded fund (ETF), or commodity in question, nor entering a ParaSar short signal during a confirmed bull phase.

Trade management is simple: being sure to risk no more than 1-2% of your account equity, enter a long SNDK position at the next market open; when filled, immediately place a stop-loss near $16.23, the ParaSar trailing stop (blue dot on chart). Download your data and/or update your chart every evening and then adjust your stop-loss to the new level attained by the ParaSar stop — on long trades it will move up a little every day the trade remains open (and vice versa for short trades), allowing you to remain in the position without having to fret over where to place your stop for the next session. At some point, the trade will stop out automatically and you'll either chalk up another winner or loser, depending on how the trade plays out.

Traders hoping to obtain a better fill might want to buy half a position at the open, in anticipation of an intraday pullback on a 15- to 30-minute chart that might enable a better fill price on the final half of the position.

ParaSar, while appearing to be too simple to be effective in today's world of intermarket analysis and neural network trading algorithms, is nonetheless a very effective and straightforward means of trading the financial markets. Knowing when to deploy this system remains one of the keys to greater profitability, of course. Hopefully, this article has helped further enlighten your understanding so you'll know just when the best time to deploy this unique system actually is. ■

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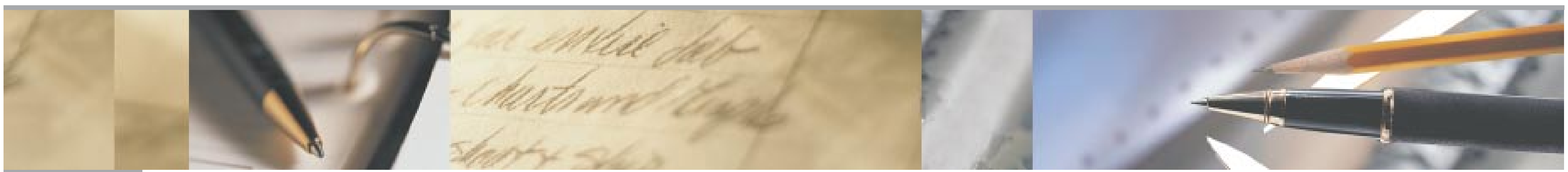


CYCLES

When Did The Bull Market Officially Begin?

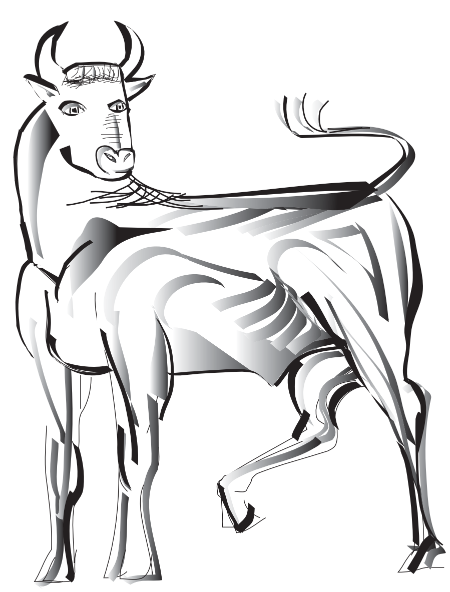
by **Alan R. Northam**

The market rally off the March low began as a market correction in an ongoing bear market. Later it started to be called a bull market. When did the bear market officially end and the bull market begin?

Tradable: $SPX

In a previous article published on June 8, 2009, titled "S&P 500 Breaks Series Of Peaks And Troughs," I explained how peak and trough analysis defined the bear market that started in October 2007. The emphasis of that article was to explain that when the market breaks the series of lower peaks and lower troughs, the bear market downward trend was terminated. I then went on to explain that the termination of a bear market downtrend does not automatically signal the beginning of a new bull market uptrend but could simply be signaling the beginning of a trading range followed by the beginning of a new downward trend. I recommend rereading that article for background information.

Figure 1 shows the daily bar chart of the S&P500 Index. This figure shows that the Standard & Poor's 500 broke the series of lower peaks and troughs in mid-June 2009 by forming a higher peak (labeled HP on the chart) to end the downward bear market trend. This figure is similar to the one in the previously mentioned article except the actual peak has been moved out about one week due to having the extra daily price bars available since the posting of the previous article. I have shown that a higher peak was made in mid-June by drawing a red horizontal resistance line off the last lower peak of the bear market downward trend made in early January. I call this line of resistance the "key resistance line" as the breaking of this resistance line is key to ending



So officially, based on Charles Dow's rule, the upward rally off the March low became a new bull market upward trend in late July. Up to that point, the rally was considered to be corrective.

the downward bear market trend.

In Figure 2, I zoomed in on the upward rally that started in March 2009. I have also removed the key resistance line for clarity of the chart. In the early 1900s, Charles Henry Dow determined that a new bull market trend was established when a market formed a new higher trough followed by a new higher peak. Figure 2 shows that in early July the S&P 500 formed a new higher trough (labeled HT on the chart). I have also drawn a red horizontal resistance line off the mid-June higher peak. The breakout above this resistance line constituted a new higher peak, thus fulfilling Charles Dow's rule for a new bull market upward trend. So officially, based upon Dow's rule, the current upward rally off the March low became a new bull market upward trend in late July. Up to this time, the rally was considered to be corrective.

Figure 3 zooms in on the current rally off the July lower trough. With a new bull market upward trend now having been established, any further pullbacks are considered to be corrective until proven otherwise. Figure 3 shows that in early August, the S&P 500 formed a new higher peak followed by a higher trough. Then on Friday, the last price bar on the chart, the market broke out above the higher peak made in early August, thus forming a new higher peak in progress. The higher peak in early August and the higher trough in mid-August then continued the series of higher peaks and troughs, signaling that the uptrend remains intact and the S&P 500 is now continuing to rally higher.

In conclusion, the peak and trough analysis shown in this article and the previous one along with Charles Dow's rule for determining when a new bull market trend begins became known as part of the Dow theory in later years after Charles Henry Dow's death. While there are many other parts that when combined form the complete Dow theory, here is what we have covered in this and the previous article: A bull market trend is defined as a series of higher troughs and higher peaks. A bear market trend is just the opposite, a series of lower peaks and lower troughs. In addition, a new bull market trend is said to have begun once a market makes a new higher trough followed by a higher peak and a new bear market trend is said to begin once a market forms a new lower peak followed by a new lower trough. ■

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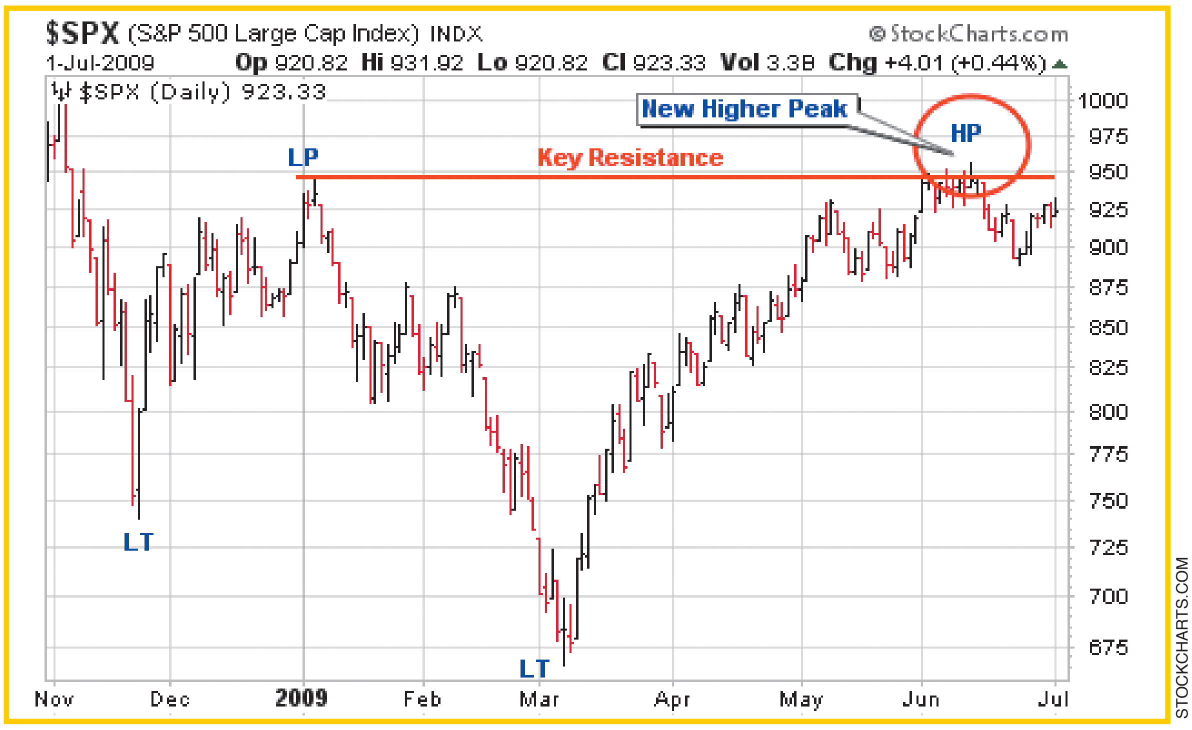

FIGURE 1: SPX, DAILY. This figure shows a new higher peak being formed in June 2009, officially ending the bear market downward trend that began in October 2007.

FIGURE 2: SPX, DAILY. This figure shows the rally off the March 2009 low, showing that a new bull market upward trend began in late July 2009.

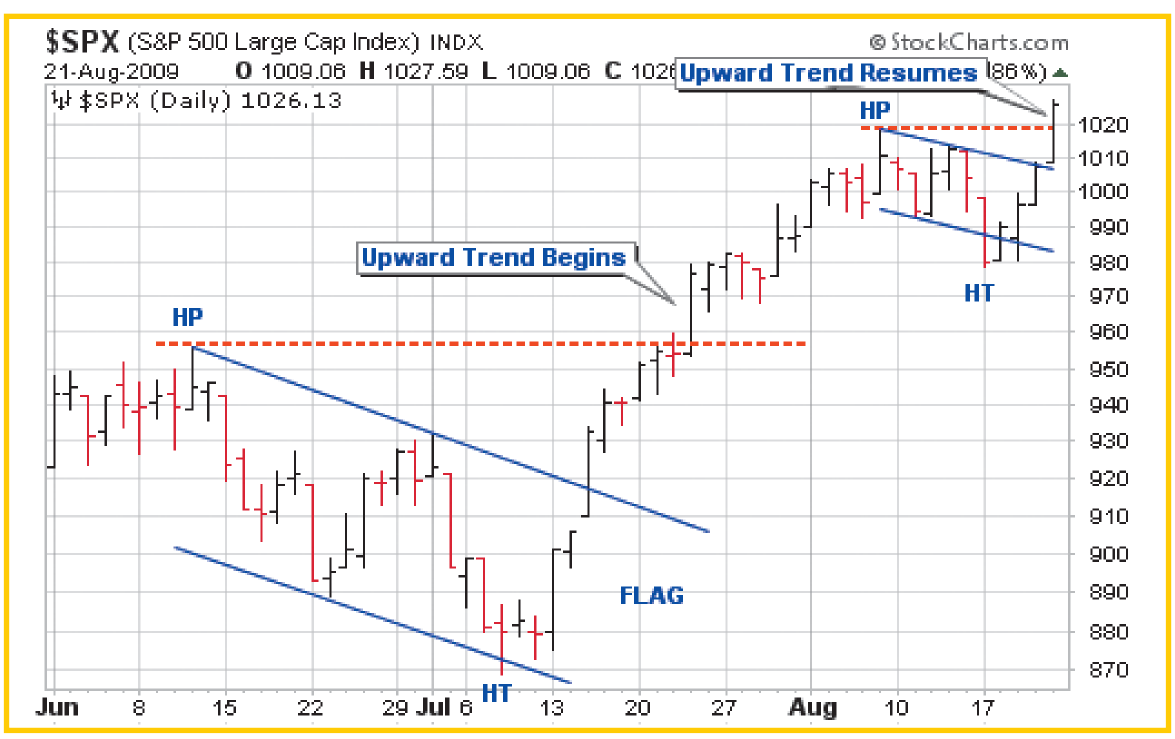

FIGURE 3: SPX, DAILY. This figure shows the rally off the July 2009 low, showing that a series of higher troughs and higher peaks being formed that define an upward trend in progress.

FURTHER READING

Northam , Alan R. [2009]. "S&P 500 Breaks Series Of Peaks And Troughs," Traders.com Advantage, June 8.

Rhea, Robert [1962]. *The Dow Theory*, Rhea, Greiner & Co.

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TRADERS' GLOSSARY

DICTIONARY

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.

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

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.

Signal — In the context of stock or commodity time series historical data, this is usually daily or weekly prices.

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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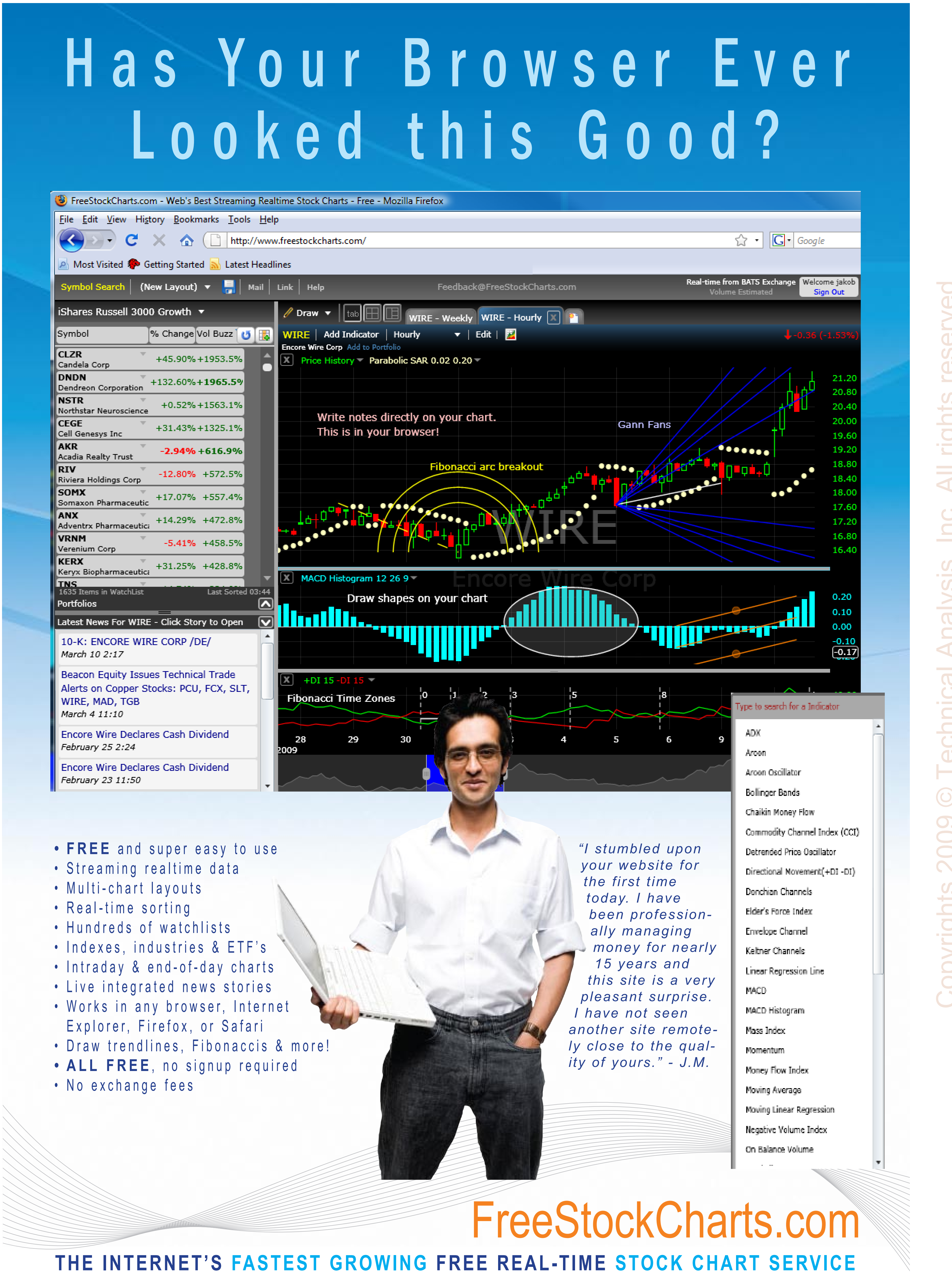
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