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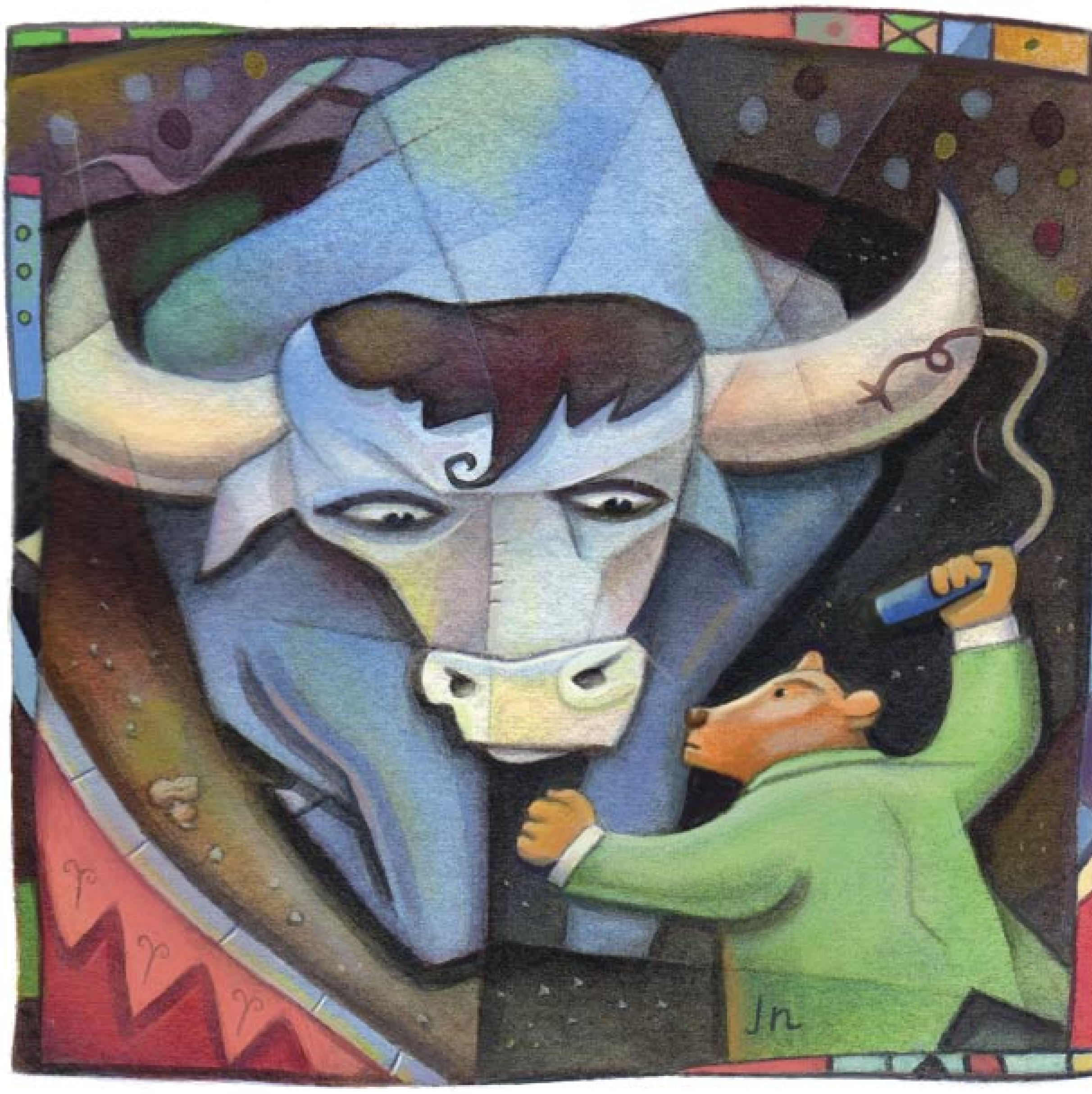

S&P 500 DAILY VS. DAILY

FIGURE 1: S&P 500 DAILY, 200-DAY MA

FIGURE 2: S&P 500 DAILY, 20-DAY MA

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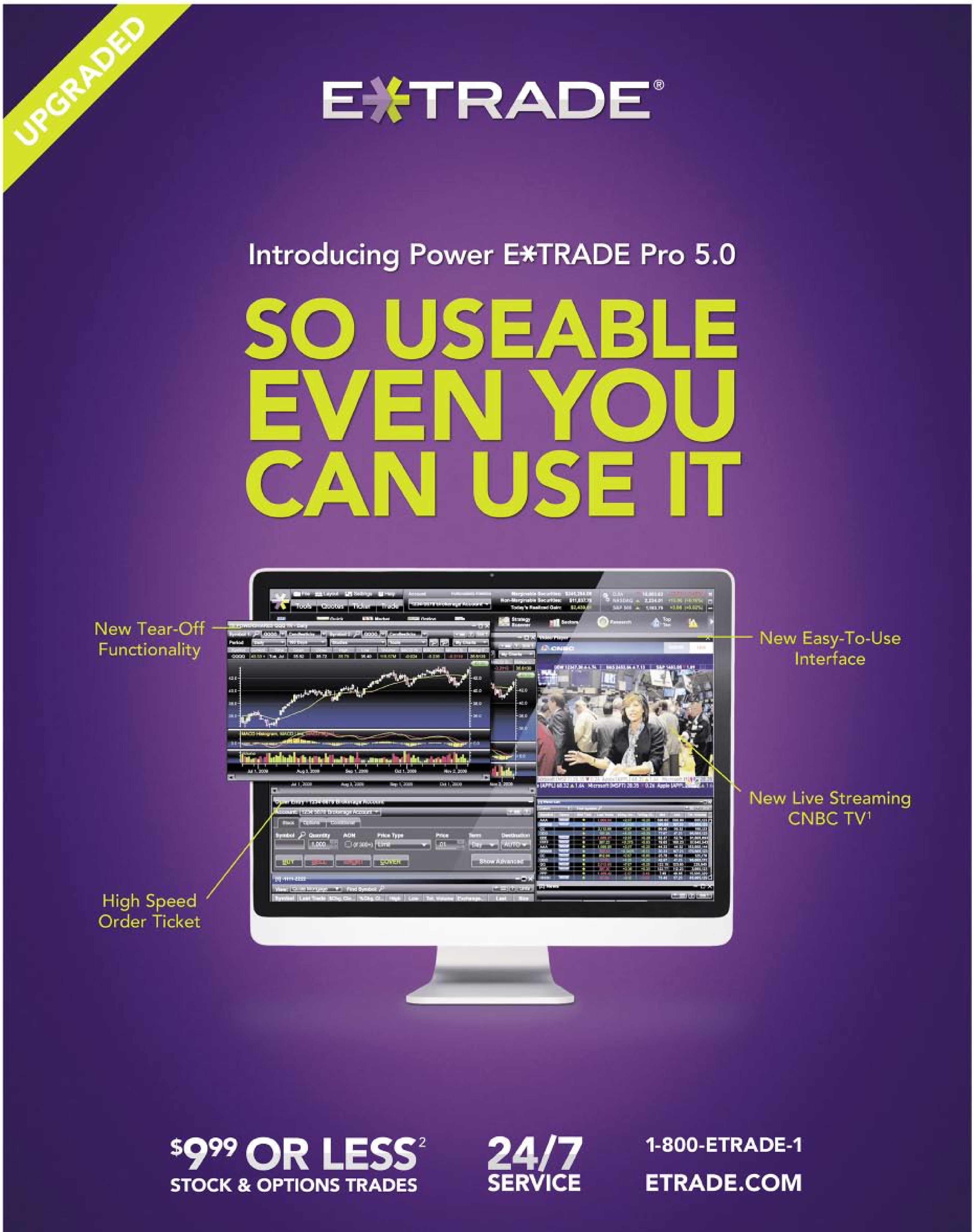
MAY/JUNE 2010 • VOLUME 8 NUMBER 3

Traders.com™ is published by Technical Analysis, Inc., 4757 California Ave. S.W., Seattle, WA 98116-4499. 1 206 938-0570 or 1 800 832-4642. Printed in the U.S.A.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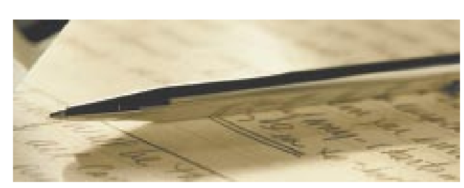

May/June 2010 • Volume 8, Number 3

Traders.com

THE MAGAZINE FOR INSTITUTIONAL AND PROFESSIONAL TRADERS™

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TRADING NOW

It's critical to keep in mind that when markets appear to be rebounding, they could quickly change direction. It is well known that markets are interrelated. When there's a crisis in Asia, an investor in the US could wake up in the morning with the discovery that they have lost several months of profits in a matter of minutes overnight. You want to avoid such scenarios as much as possible, which is why you should make the effort to analyze the cyclical behavior of various markets. If you focus on equities trading, try looking at the currencies or commodities. With the availability of exchange traded funds representing different asset classes, diversifying your assets among these different classes is much more accessible and less risky than buying futures contracts or trading in the spot market.

In this, the final issue of **Traders**.com, we expose you to the different asset classes so you can analyze their behavior and observe how they are interrelated. For example, if you think that putting your money in equities is like jumping on a fast train that has almost reached its destination, then look for other markets that are starting their ascent. Not only that, studying different markets exposes you to a lot more options. Articles such as "A Head & Shoulders Top On The NASDAQ A/D Line?" by Ron Walker and "S&P 500, Bull Or Bear?" by Alan Northam look at the broader equity indexes. We also look at energies and metals markets as well as various sectors, with articles ranging from "Two Bearish Reversals Of XLB" by Chaitali Mohile, "Why I Am Not A Bear" by Koos van der Merwe, and "Gold Falling Like A Ton Of Lead" by Donald Pendergast, and much more.

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Understanding how the different asset classes are interrelated will make you a more knowledgeable trader, and with more knowledge comes better results. That additional knowledge will have to come from our flagship publication, *Technical Analysis of* STOCKS & COMMODITIES, or from our online publications, Traders.com Advantage and Working-Money.com, from now on, however, as we are suspending print publication of Traders.com. But you will still be able to study at our Traders.com website, helping you become the best trader you can be. Good luck!

Jayanthi Gopalakrishnan

Jayanthi Gopalakrishnan,
Editor

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REVERSALS

Three Signals Are Better Than One

by Ron Walker

Correlating signals in multiple time frames increases the odds of a successful trade. Selecting a quality setup, like a reversal chart pattern in a micro time frame along with it, offers a trader endless opportunities to create wealth and protect capital.

Tradable: IWM

After a robust recovery in 2009, the Russell 2000 iShares (IWM) looks to be overheating. Unfortunately, IWM is up against heavy resistance in the weekly time frame, where a long-term downward trendline is sloping, which increases the odds of stalling the advance (Figure 1). The problem is that prices have risen right into resistance and have hesitated as several bearish divergences have emerged on the scene of the weekly chart. The relative strength index (RSI) (14), the moving average convergence/divergence histogram (MACDH) (12, 26, 9), and the MACD (12, 26, 9) are each chiseling out lower peaks. Once the MACD histogram is finished etching out a lower tower, it could complete the bearish divergence by turning lower and changing the slope. Once it moves below the zero line, the MACD will get a bearish cross, completing its bearish divergence.

Conditions on the daily chart are starting to show some signs that prices are beginning to weaken, which may spill over into the weekly time frame completing the bearish divergence. Figure 2 exhibits that IWM had made several erratic price moves centered around the 20-day MA from September to November, followed by a Santa Claus rally that got under way after prices slipped back below the 20-day moving average (MA) for a quick dip in late November. In early December, IWM managed to leap back up above the 20-day MA. This produced a higher low on the daily chart in the mid-$56 area. IWM then went on to catapult above the 50-day and to tackle some resistance just above $60. After hopping over that hurdle, prices went ballistic and rocketed higher, furthering the price acceleration as prices evolved into a rising wedge pattern.

This accelerated trendline is an important trendline because it touches at four points. So when it was violated on January 12, it was a significant event. The bears managed to pound prices lower, causing IWM to skid below the trendline. After penetration of the accelerated trendline, prices revived and began traveling upward, approaching the previous high. A successful backtest of the trendline would make way for a lower high to be established because the accelerated trendline already broke down, thereby eroding rising support. Thus, the trendline can now reverse roles by becoming resistance on the subsequent rally attempt. Immediately after the prices pierced through the trendline, in the next session, a half-hearted rally with mediocre volume drove prices back up to test the trendline (Figure 2). So far, the bulls have been unsuccessful in pushing prices back above the broken trendline. This tells us that IWM might be exhausted, for now, anyway.

Figure 2 also shows that momentum has shifted to the downside on IWM's daily chart, which may allow the bears to inflict technical mayhem into the situation. The MACD histogram is now sloping down, forming a bearish divergence. Even though during the throwback rally, the slope on the histogram did not change. Again, if the histogram bars move below the zero line, it will result in a bearish MACD crossover on the daily chart.

The stochastic is in agreement with the histogram, rolling over after completing a bearish divergence, followed by %K, flying sharply away from %D. The widening spread suggests further price chaos. So momentum is down on the daily chart and may allow the weekly chart to peak at its primary trendline in order to complete its divergences.

Momentum indicators are a derivative of price. So when momentum shifts, it gives a sneak preview of what is likely coming down the pike. But volume is independent from price and needs to confirm any price movement. That means if a reversal is under construction it needs to be backed up by an increase in volume as prices move lower, a sign that distribution is taking place.

The hourly chart also reflects a bearish tone (Figure 3). Looking through the microscope on the 60-minute chart, we can see that the breakdown of the trendline was the result of bearish divergences that set up the RSI (14), MACDH (12, 26, 9), and the MACD (12, 26, 9). The trendline is acting as potent resistance to the rally in play. The hourly chart could be grinding through a head & shoulders topping pattern, with a neckline of support slightly above $63. The backtest to the trendline could create a right shoulder, completing

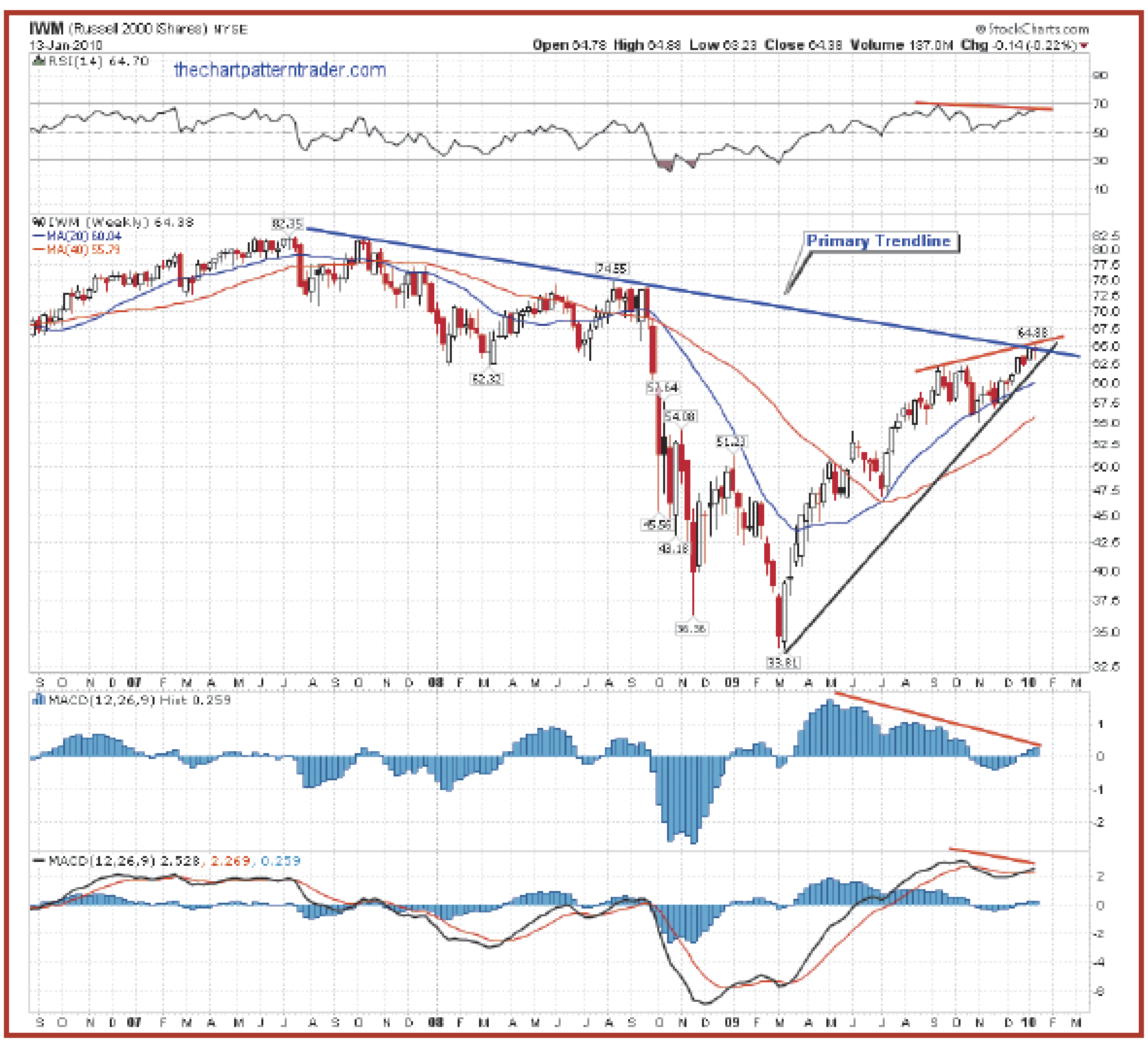

FIGURE 1: IWM, WEEKLY. Several bearish divergences are forming at the primary trendline. A lower peak on the histogram turned the MACD down.

FIGURE 2: IWM, DAILY. The bearish divergences the RSI, histogram, and stochastic may result in the MACD finally tipping over below its signal line.

FIGURE 3: IWM, 60-MINUTE. After penetration of the trendline, it reversed roles, and what was once support now becomes resistance. It was negative divergence that broke the trend, but a head & shoulders may produce a full-fledged reversal.

Momentum indicators are a derivative of price. So when momentum shifts, it gives a sneak preview of what is likely coming down the pike.

the pattern. But prices must establish a lower high and then move beyond the low that was made after the trendline broke. That would produce a miniature 1-2-3 trend reversal on the hourly chart. Keep in mind that this entire move is likely only a larger part of a 1-2-3 trend reversal on the daily chart. This miniature 1-2-3 reversal would set up the "1" on the daily chart. (I explained the 1-2-3 trend reversal in an article I wrote for Traders.com Advantage titled "Starbucks Undergoes A Test," on January 11, 2010).

Since prices rose at such a steep angle over the last several weeks, they became extended and overbought as IWM slammed into resistance on the weekly chart. Common sense indicates to exit a long position and/or try to find a new short entry. Here are two possible entry points to play the short side, should a lower high develop. As prices rally back to test the broken trendline, watch for a pivot reversal to occur that would be evident by some type of a reversal candle pattern setup. If a pivot reversal doesn't manifest itself, the head & shoulders chart pattern will fail. Just like the dark cloud cover candle pattern that formed on the head on the hourly chart.

Two low-risk trades can be taken here. A trader can choose to sell short at the pivot reversal as a lower high is being established or wait until IWM falls down and collapses through the neckline of support. A protective stop (around $0.25) can be placed above the last minor high at $64.88. If the chart pattern fails, you will be stopped out of the trade. Keep in mind that every signal doesn't always pan out in technical analysis, but having three sell signals in three different time frames heightens the odds of a successful trade. ■

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INDEXES

A/D LINE

A Head And Shoulders Top On The NASDAQ A/D Line?

by Ron Walker

The A/D line is an effective gauge in determining the overall strength of the stock market. It is by far the most commonly used measure of market breadth.

Tradable: $COMPQ

The NASDAQ's advance/decline (A/D) line is the difference between the total number of advancing and declining issues on all the securities that make up the NASDAQ Composite ($COMPQ). If there are more advancing issues than declining ones, the A/D line reading for that day would be positive, and vice versa. The information, either positive or negative, is then added to the cumulative total, which we refer to as the A/D line. If advancers are outpacing decliners, the A/D line will rise and begin to trend higher. If declining issues prevail, the A/D line will decline and trend lower.

The A/D line is useful because it forms trends and divergences. Sometimes the A/D trendline will break prior to a trend break on the NASDAQ. However, it is very common that their trendlines break simultaneously, thereby validating one another. When the NASDAQ and the A/D line diverge, it forewarns of an impending reversal. Market breadth is considered healthy when the A/D line and the NASDAQ move in the same direction.

Note the divergence that appeared between the NASDAQ A/D line and the NASDAQ in late 2008 to early 2009 (Figure 1). The NASDAQ moved to a lower low in March 2009, but the A/D line failed to make lower lows, meaning that the advancing issues are increasing. As a result, the NASDAQ bottomed out that March. That same month, the A/D line pushed above its 50-day exponential moving average (EMA) and has been advancing ever since, save for a temporary breach in late October to early November 2009.

In addition to trends and divergences, the A/D line can also form chart patterns. In September and October, the A/D line began to carve out what appeared to be at the time a double-top pattern, with two individual peaks made during those months. But with the runup during November 2009 to January 2010, the A/D line is beginning to resemble the appearance of a head & shoulders top (see Figure 1).

Figure 2 shows both the A/D line and the NASDAQ have mature trends. After they moved to new highs, the indexes gravitated back toward the trendlines that originated from March 2009 lows. If

FIGURE 1: NASDAQ, A/D LINE, DAILY. After a bullish divergence completed in March 2009, after a robust advance, a head & shoulders top could be carving out on both the NASDAQ and the A/D line.

FIGURE 2: NASDAQ, A/D LINE, DAILY. Here we see both the NASDAQ and the NASDAQ A/D line have mature trends. If the NASDAQ breaks its trendline, the A/D line must validate the move.

Chart patterns are psychological maps of human behavior.

those trendlines break, it could allow the head & shoulders patterns seen in Figure 1 to complete.

Chart patterns are psychological maps of human behavior. Euphoria has pushed both the A/D line and the NASDAQ to new highs to form their respective heads. If this current run dissipates and breaks the rising trendlines in Figure 2, causing the A/D line and NASDAQ to fall back to their necklines of support marked in Figure 1, that would complete the head formations. Should both develop a right shoulder after that, the top reversal patterns will be complete. If both the NASDAQ and the A/D line complete a right shoulder and form a lower high, they will validate each other and confirm a reversal. Further, if the A/D line also falls below the 50-day EMA as it grinds through a head & shoulders formation, it will reinforce the reversal patterns.

Now take a look at the NASDAQ ($COMPQ) daily chart in Figure 3. The NASDAQ moved to a new reaction high in early January 2010, reversing off the upper boundary of the trend channel. If prices continue to display weakness, we could see the trendlines in Figure 2 break and the head & shoulders patterns in Figure 1 play out.

In Figure 3, after peaking at the upper boundary of the channel, prices fell back to the accelerated trendline to complete a bearish rising wedge pattern. If the accelerated trendline breaks, $COMPQ will fall to the corresponding lower channel line. Should prices penetrate that level, they could fall back to the neckline near the 2025 area, which was highlighted in Figure 1. If the head completely forms, it means that $COMPQ will fall by approximately 300 points from its recent peak, and break the lower channel line. ■

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FIGURE 3: NASDAQ, DAILY. The NASDAQ reversed off its upper channel line, testing the accelerated trendline. That formed a bearish rising wedge. A break in the accelerated trend may allow the lower channel line and potential neckline to be tested.

ELLIOTT WAVE

Why I Am Not A Bear

by Koos van der Merwe

All you hear and read nowadays is that the market is in a bear correction and it will test the low reached in March 2009, if not fall even lower. Here's why I believe otherwise.

Tradable: OEX

FIGURE 1: S&P 100, MONTHLY

Being a contrarian is not easy. Whether it is politics causing the market to correct or the yuan or President Barack Obama's State of the Union address, bears will look for any excuse to tank the market. I read newsletters and listen to CNBC talking to bears like Robert Prechter of Elliott wave fame. I simply go back to studying my charts, and I simply cannot see what they are predicting. So once again I must tell you what I see.

Figure 1 is a monthly chart of the Standard & Poor's 100.

Whatever the bears like Robert Prechter say, I still believe that the low of March 2009 was the C-wave bottom. Just a simple look at Figure 1 shows this. The chart shows the ABC correction ended in March 2009. Since then, the index has risen in a Wave I, which has reached a high of 530.43, a 50% retracement of the fall of Wave C. The chart shows two moving averages, a short-term seven-period exponential moving average (EMA), and a 28-period EMA. The index is above the seven-period moving average and testing the 28-period moving average. However, the relative strength index (RSI) is still bullish, suggesting that although there may be a correction, it will be a mild one. To see how mild, we must look at a daily chart (Figure 2).

FIGURE 2: S&P 100, DAILY

Figure 2 shows that the Wave I correction suggested in Figure 1 has only completed wave 4, with a fifth wave to follow. The chart suggests that wave 5 of Wave I should reach a high of 622.26. This figure is a guesstimate, because wave 5 should be equal to wave 1. Unfortunately, wave 5 can be less or greater than wave 1, but we do know that the nine-period RSI has suggested a buy signal.

Yes, there will be a correction, and possibly a 20% one at that. That will be with Wave II when Wave I is completed at the target of 622.66, if it does reach there and when it reaches there. The Wave II correction will fall to somewhere in Wave 4, the correction in the previous impulse wave. Assuming it reaches its target of 622 and then falls as low as 500, then 622 - 500 = 122/622 is 20%.

So who do you believe, the bears on the television who are running with the wind and coming up with any story to justify that wind, or your charts? You decide. Me? I go with my charts, and yes, there will be a correction, at a guess with the "Sell in May..." maxim, but at the moment, I am still bullish. ■

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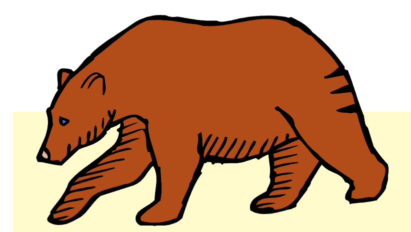
This article was first published on 1/29/2010. See www.Traders.com for more.



Could The Wave Count Already Be Completed?

by Koos van der Merwe

Recently, I wrote an article based on the S&P 100 about why I am not a bear [see page 14]. Here is a varying view on that Elliott wave count and market forecast.

Tradable: DWIX, SPX

ADVANCEDGET

FIGURE 1: S&P 500, DAILY

In the chart of the Standard & Poor's 100, I showed an Elliott wave count suggesting that a wave 5 top had yet to come. The daily chart of the S&P 500 suggests that the wave count could already be completed if not close to completion.

Figure 1 suggests that wave I is complete and that the index is in the process of completing wave II. I write "completing," because the wave II could end anywhere in the fourth wave of lesser degree, the highlighted area, which means that it could fall as low as 1031.32. The relative strength index (RSI), however, suggests that the bottom of wave II is close at hand as it is oversold, but with all the bad news about unemployment not easing in the United States, and the smaller countries in Europe like Greece, Portugal, and Lithuania only now facing financial difficulties, the last cockroach coming out of the woodwork, so to speak, the wave II bottom may be a complicated one and take many weeks to bottom, if not months.

Figure 2, a chart of the Dow Jones Industrial Average (DJIA), although the chart looks similar to the S&P 500 is currently suggesting that wave I is not complete and that the chart is currently tracing wave 4 of wave I with a target of anywhere between 10134 and 9714. Once again, the RSI is oversold.

Many analysts, however, believe that the wave shown in the monthly chart of the DJIA (Figure 3) is a B-wave in the major ABC correction of the DJIA and are therefore calling for a major collapse starting now. The chart shows their wave count with a projected C-bottom sometime in 2013 at the Gann 1 x 4 line of less than 5000. The chart looks acceptable, and possible, and could indeed occur.

Being an optimist, however, and finding that the last of the cockroaches are starting to appear, I prefer to believe in the monthly chart of the S&P 500 (Figure 4). What also talks to me in this chart is the RSI, which is in buy mode. Time will tell who is correct. ■

FIGURE 2: DJIA, DAILY

FIGURE 3: DJIA, MONTHLY

FIGURE 4: S&P 500, MONTHLY

The wave II bottom may be a complicated one and take many weeks to bottom, if not months.

FURTHER READING

Merwe, Koos van der [2010]. "Why I Am Not A Bear," Traders.com Advantage, January 29.

REVERSAL

A Shake Or Break For The S&P 500?

by Ron Walker

A fracture of the lower channel line on the daily S&P 500 may be nothing more than an attempt to shake out weak longs — or does this trend break signal more downside to come?

Tradable: $SPX

The Standard & Poor's 500 ($SPX) recently broke its intermediate trendline on the daily time frame (Figure 1), laying the ground work for a possible 1-2-3 trend reversal. This could be the early stages of a major market reversal. The breaking of the trendline is the first phase of three that is required to reverse a trend.

The S&P 500 is currently in the stage 1 process of a potential 1-2-3 trend reversal. Stage 1 occurred when prices broke down below the trend intermediate line on January 21 (Figure 1). Once a low is set by the post-trend break, stage 2 will allow prices to rise back up in an attempt to reestablish the uptrend in an effort to test the preceding high made in mid-January.

Stage 3 represents the move back down after a failed attempt to exceed the previous high, a move that takes prices beyond the low that was established during the initial breaking of the trendline.

Figure 2 shows that prices have come to the next important level of support, testing the lower boundary of a multimonth price channel. On January 29, the S&P 500 broke through the point where both horizontal support and the lower channel line intersect.

That prices failed to gain traction here may result in prices collapsing back to the 1030 level, which is where the potential neckline comes into play for a speculative head & shoulders (H&S) top. Incidentally, it is also where the 200-day moving average (MA) is hovering. The only way prices could rally back up is if the penetration proves to be a short-term bear trap.

The hourly chart of the S&P 500 chart in Figure 3 suggests that the breach in the lower channel line could be a short-term bear trap. Note that both the relative strength index (RSI) (14) and the moving average convergence/divergence (MACD) histogram (12, 26, 9) are attempting to chisel out bullish divergences, as prices test the lower boundary of the falling wedge pattern.

If prices do reverse course and a break to the upside occurs, it may lead an effort to begin stage 2 of the 1-2-3 trend reversal. The S&P 500 could then rally into the 20-day MA and halt at resistance, and then turn and retreat, providing another short opportunity for the bears. If prices are too feeble to rise through the 20-day MA, gravity will drag them back down through the channel line, where a stage follow-through to the downside will complete a 1-2-3 trend reversal. If a rally does occur, a redraw of the lower channel line would be in order.

It is uncertain if prices will attempt to complete stage 2 immediately, or if the move will be delayed now that the lower channel line has been broken. This could be a case in which prices refuse to pull back until the next level of support has been tagged. When fear permeates through the market, prices can rapidly decay. And since the rhythm of the channel has already been disrupted with the breaking the lower channel line, we could see some panic selling as prices fall to the potential neckline of the H&S pattern. Once there, prices would likely rise to form a right shoulder, thereby establishing a lower high and complete stage 2.

A bounce off the neckline will find resistance at the broken channel line, which could establish a lower peak and the right shoulder by completing phase 2. The broken channel line will act as resistance on any rally (Figure 2).

Whether or not prices bounce, getting a short-term pop, or continue to fall to test the neckline at 1030, traders should know that with either scenario, the H&S pattern could be a potential top that could lead to a major correction. The H&S top measures approximately 120 points. Subtracting that from the neckline at 1030 area gives a minimum objective target of 910.

FIGURE 1: S&P 500, DAILY. After a breakdown of the intermediate trendline, prices fall and collapse below the lower channel line. The 200-day MA is just below the potential neckline of a H&S pattern, offering a springboard in which prices could bounce to form the right shoulder.

FIGURE 2: S&P 500, DAILY. A break in the lower channel line may be a shakeout before prices test the 20-day MA. But with a breach in horizontal and rising support, prices could continue to plunge in order to complete the head of a potential head & shoulder top.

The weekly chart of the S&P 500 (Figure 4) has also recently had some very bearish events with prices reversing hard off the primary trendline, while the moving average convergence/divergence (MACD) histogram dipped below its centerline. When the histogram moves below the zero line, it identifies that the bears are becoming a stronger, more dominating force. This suggests that the S&P 500 is in the early stages of a major correction. As long as prices and the MACD histogram continue to move in the same direction, it will confirm the downtrend.

Should the H&S top pattern in a daily time frame tag the minimum target of 910, it would result in a test to the neckline of the inverse head & shoulders pattern on the weekly chart to the 875-900 area (Figure 4). Figure 4 shows a parallel line drawn with rising resistance on the weekly chart that forms a speculative channel. The speculative lower channel line (gray line) intersects with the neckline of the inverse H&S top pattern and the horizontal support that marked the low of the right shoulder. In geometry, when three or more lines intersect at a single point, they are said to be concurrent. This will be an area of crucial support if this turns out to be a deep correction.

If the S&P 500 slips below this support zone, there is one last safety net of support left. That is the closing low that was made while the left shoulder formed on the weekly chart's inverse head & shoulders pattern. That comes in at about 800. There is a very thin amount of support at that level, and if it was penetrated, the consequences would result in a test of the March lows. ■

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If prices do reverse course and a break to the upside occurs, it may lead an effort to begin stage 2 of the 1-2-3 trend reversal.

FIGURE 3: S&P 500, HOURLY. A bullish falling wedge appears as bullish divergences forming on the indicators, suggesting that prices could rally for the short term. Note the deep histogram extreme on the histogram. If the histogram completes a higher trough low, the bullish divergence will be complete.

FIGURE 4: S&P 500, WEEKLY. The reversal off the primary trendline on the S&P 500 weekly chart suggests that prices might backtest the inverse H&S patterns neckline, which intersects with a lower imaginary channel line drawn parallel to rising resistance.

S&P 500, Bull Or Bear?

by Alan R. Northam

Many methods are used to determine if the stock market is in a major upward trend or a major downward trend. One method compares price to its 200-day moving average. The method used here analyzes each stock within the S&P 500 to make this determination.

Tradable: $SPX

To determine how many stocks within the Standard & Poor's 500 are in bull market trend and how many are in a bear market trend, the following filters are used to perform a scan of all 500 stocks within the index:

FILTERS

1. To determine which stocks are in an upward trend and which are in a downward trend, a 20-day exponential moving average (EMA) is compared to a 50-day EMA. If the 20-day EMA is above the 50-day EMA, the stock is considered to be in an uptrend; otherwise, it is considered to be in a downtrend.

2. To determine which stocks have positive price momentum and which have negative price momentum, the moving average convergence/divergence (MACD) indicator is used. The moving averages used with the MACD are the 20-day and 50-day EMAs. If MACD is above its nine-day signal line, then price momentum is in an upward trend; if not, it is in a downward trend.

3. To determine which stocks have positive volume momentum and which have negative volume momentum, a 20-day EMA and a 50-day EMA of the on-balance volume (OBV) indicator is used. If the 20-day EMA of the OBV indicator is above the 50-day EMA of OBV, then volume is considered to be in an upward trend; otherwise, it is considered to be in a downtrend.

4. The final filter determines if each stock is outperforming or underperforming the S&P 500 to which it belongs. To perform this analysis, each stock is divided by the S&P 500. If the resulting ratio is above a 50-day EMA of the ratio, then the stock is considered to be outperforming the S&P 500.

The result of a scan using these filters is as follows:

1. Of all stocks within the S&P 500, 54% are in uptrends based upon filter 1.

2. Of all stocks within the S&P 500, 65% have positive price momentum based upon filter 2.

3. Of all stocks within the S&P 500, 51% have positive volume momentum based upon filter 3.

4. Of all stocks outperforming the S&P 500, 57% are based upon filter 4.

In a previous article titled "Is The Top At Hand?" published on January 18, 2010, a similar analysis was performed with the following results:

1. Of all stocks within the S&P 500, 87% are in uptrends based upon filter 1.

2. Of all stocks within the S&P 500, 55% have positive price momentum based upon filter 2.

3. Of all stocks within the S&P 500, 77% have positive volume momentum based upon filter 3.

4. Of all stocks outperforming the S&P 500, 55% are based upon filter 4.

In conclusion, the S&P 500 is considered to be in a bull market if the majority of individual stocks within it are in uptrends, if the majority of stocks have positive price momentum, if the majority of stocks have positive volume momentum, and if the majority of stocks within the S&P 500 are outperforming the S&P 500 itself. It is the result of a scan performed on all 500 stocks within the S&P 500 that reverses the majority of the stocks that meet these conditions. Based upon these results, it is concluded that the major trend of the overall stock market, as measured by the S&P 500, is still in an uptrend as of this writing on March 3, 2010. However, when compared to a similar study done over a month ago, it can be seen that the major uptrend is weakening and is close to turning down. ■

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This article was first published on 3/3/2010.
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FURTHER READING

Northam, Alan R. [2010. "Is The Top At Hand?", Traders.com Advantage, January 18.

Prepare For A Slow Bull

by Koos van der Merwe

The bull is definitely there. The matador, however, is frustrated by the lack of action as the bull just yawns and relaxes. What can he do to get it moving?

Tradable: OEX

Figure 1 is almost self-explanatory. It is a Standard & Poor's 100 weekly chart and shows quite clearly that the index is currently in a Wave 5 Of a Wave I. The bears out there, calling for a double-dip recession, have probably given the bull a sleeping pill, but they simply cannot find the key to open the lock and let the bear in. All they have done is slow the bull down, and forced you, the matador, to the limits of your frustration as the market moves up slowly in its Wave 5 of Wave I. Why am I so convinced of my forecast? Well, look at the chart:

FIGURE 1: S&P 100, WEEKLY

FIGURE 2: S&P 100, DAILY

- The first rule in Elliott wave theory as theorized by Robert Prechter in his book *Elliott Wave Principle* is that the wave count must look right, something the bears appear to have forgotten. The wave count in the chart does look correct, and above all, it is a simple count.

- The relative strength index (RSI) is bullish after a divergence buy. Note how obvious the previous sell signals were and the RSI has not given a sell signal.

- The Fibonacci retracement levels of the fall from the high of Wave B to the low of Wave C. Note how Wave 3 of Wave I tested the 50% retracement level and corrected to the 38.2% retracement level. This suggests that the target for wave 5 of Wave I is 574.42, unless wave 5 rises in a pennant, when it could be higher.

The chart does suggest a wave 5 lower, but the probability index (PTI) is 25. Any PTI less than 32 is a no-go.

Figure 2 is a daily chart of the S&P 100, with an Elliott wave count as suggested by the algorithms of the Advanced GET program. The chart does suggest a wave 5 lower, but the probability index (PTI) is 25. Any PTI less than 32 is a no-go.

No matter how hard I try, I simply cannot see a double-dip recession happening. Yes, there will be a Wave II correction after Wave I, but it should only bring us back to present levels. ■

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This article was first published on 3/4/2010.
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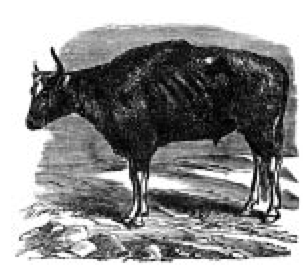


SECTORS

HEAD & SHOULDERS

The Paper Index Forms Neckline Support

by Chaitali Mohile

After consolidating for about a month and a half, the US Paper Index rallied higher. The index turned downward without hitting the potential target. What's next for the index?

Tradable: $DJUSPP

I mentioned a slowdown in the Dow Jones US Paper Index ($DJUSPP) in my previous article dated September 22, 2009. After an exclusive rally from 55 to 90 levels, $DJUSPP witnessed a volatile consolidation for almost a month and a half. The yellow block in Figure 1 shows the consolidation in a perfect range. You can see that the rally within the range was sharp and formed a bullish flag. The breakout journey from 90 levels surged to reach a target of 90 - 55 = 35 + 90 = 125; however, a declining uptrend unnerved the bullish rally. As a result, $DJUSPP reversed significantly from 105 levels forming a higher low. This formed an ascending neckline support for the left shoulders and the head.

The previous peak formed during consolidation is the left shoulder of the head & shoulders top pattern in Figure 1. The sharp vertical movement of the full stochastic (14,3,3) turned shaky, affecting the breakout journey of $DJUSPP. The descending rally formed the head. In addition, the average directional movement index (ADX) (14) drifted from an overheated uptrend region. Further decline in the trend indicator developed a new intermediate downtrend for $DJUSPP.

Back to the price chart, the index is likely to form a right shoulder with the support of an ascending neckline. The volatile stochastic oscillator in an oversold region below the 20 levels, and the developing downtrend in ADX (14) would restrict the upward price action. Hence, the head & shoulders pattern would succeed without any hurdle. But the pattern completion would add the bearish strength, breaking the index downward. The head & shoulders top is a bearish reversal formation, indicating the end of an existing uptrend.

The blue dotted line is an immediate support after the breakout. If the right shoulder is formed with this support (blue dotted) in Figure 1, then it could be observed as a neckline as well.

On the weekly time frame in Figure 2, the bullish flag & pennant formation is clearly visible. After the breakout, $DJUSPP rapidly surged, breaching the 50- and 100-day moving average (MA) resistance. Later, the 200-day MA resistance suppressed the bullish rally, resulting in the bearish move from the higher levels (105). Thus, the head & shoulders top reversal pattern is being constructed. The right shoulder is yet to be formed on the weekly time frame. During the entire price action (starting from the bullish flag & pennant formation till the head & shoulders pattern) the stochastic in Figure 2 was comfortably moving in an overbought zone above 80 levels. Here, the oscillator formed the similar head & shoulders pattern that has already witnessed a bearish breakout. The breakout, therefore, reconfirms the formation on the price chart. The indicator is on the verge of breaching the center line (50 level) support that might weaken the index further. However, to form the right shoulder, the full stochastic has to bounce in the bullish area. Although the uptrend is declining from an overheated region above 40 levels, the ADX (14) is currently indicating the developed uptrend. The green line in the ADX (14) shows that buying pressure is lowering and the selling pressure is picking up (see the red line).

Thus, the right shoulder is likely to develop with the support of an ascending neckline and the head & shoulders pattern would be completed. Therefore, the paper industry is likely to enter the short-term downtrend. The index is likely to plunge to (100 - 80 = 20 - 80 = 60) at 60. There are two moving average supports. One is the 100-day MA at 73 and the second is the 50-day MA at 65 for $DJUSPP before hitting the target. Hence, $DJUSPP would undergo a steady bearish rally and not a steep vertical decline. ■

FIGURE 1: $DJUSPP, DAILY. The oversold stochastic and the developing downtrend would discourage the bullish strength in the upcoming rally and gradually form the right shoulder.

FIGURE 2: $DJUSPP, WEEKLY. The head & shoulders top formed by the full stochastic (14,3,3) has broken downward.

REVERSALS

Two Bearish Reversals Of XLB

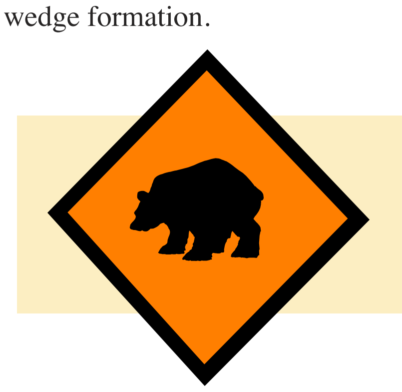
by Chaitali Mohile

Many indexes, sectors, and stocks may be facing tough trading sessions and huge volatility. XLB has the same challenge.

Tradable: XLB

The August 2009 rally of the Material Select Sector SPDR (XLB) offered healthy gains to traders. The sector moved with a steady speed and eventually violated the moving average (MA) resistance that is 100- and 200-day MA. By the time both resistances were converted to support, the picture on the weekly time frame in Figure 1 was clear. The upward movement of XLB formed a rising wedge formation, which discouraged position traders. The rising wedge formation was both shocking and heartbreaking for them. The wedge formation is a bearish reversal that drags prices lower. During the formation volume shrinks, indicating the discomfort among traders. Because of a bearish breakout, traders and investors preferred to stay on the sidelines.

In Figure 1, similar conditions appeared, turning the volume volatile. The doji candles with small real bodies show the uncertainty and indecision among traders and investors. The relative strength index (RSI) (14) ranged between 50- and 70-level bullish areas. The average directional movement index (ADX) (14) indicated a developing uptrend throughout XLB's bullish rally. These indicators reveal the reason for the rising wedge formation. The range-bound RSI (14) means the bullish force was not strengthening, and the ADX (14) failed to move above 25 levels, although the price surged. Hence, XLB lacked the required bullish strength, resulting in the rising wedge formation.



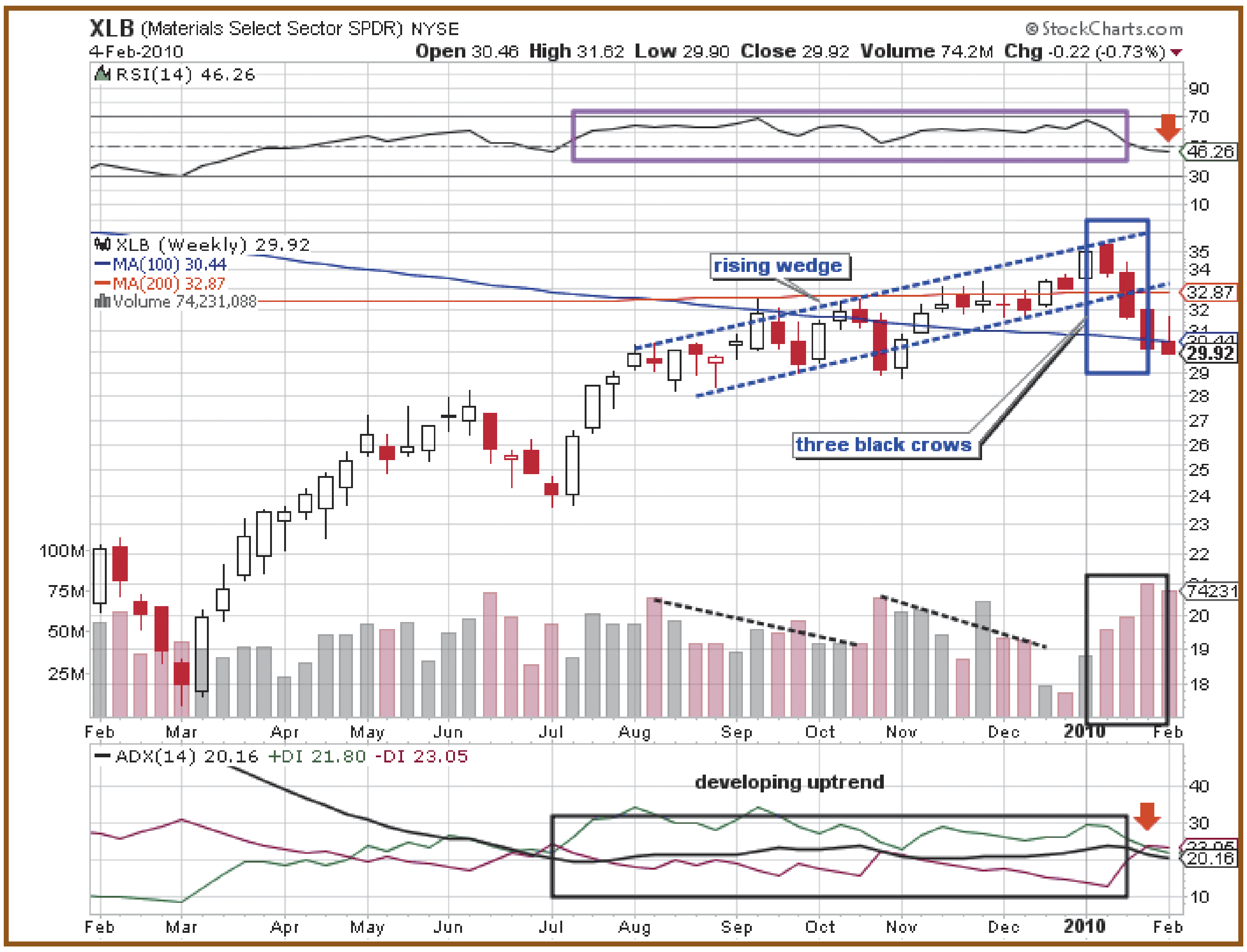


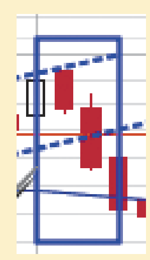
FIGURE 1: XLB, WEEKLY. The breakdown of the rising wedge formed the three black crows' candlestick pattern.

Later, the breakdown of the pattern was confirmed as the lower trendline was breached and the seller's volume increased (see the black rectangle). While breaking down, the second bearish candle (red) in Figure 1 opened near the previous close, creating the possibility of another robust bearish reversal formation, but this time a candlestick pattern. The second candle closed below the 200-day MA, highlighting the possibility of a major breakdown. Violating the 200-day MA support is considered to be a robust trend reversal signal. The RSI (14) slipped below 50 and selling pressure increased. The third candle opened marginally above the previous close (closing level of second candle), and thus, the three black crows candlestick pattern appeared on Figure 1.

The three black crows is a bearish reversal candlestick pattern. The group of three consecutive big bearish candles makes the formation one of the strongest candlestick patterns. The uptrend is about to be reversed; the selling pressure (red line) in Figure 1 has surged above the buying pressure (green line) in the ADX (14). This reflects that the downtrend for XLB is developing. The fourth bearish candle has reconfirmed the bearish breakout by opening below the previous close. The breakout would bring fresh selling pressure in the sector index and drag down the price levels. However, for the new short positions, traders should wait till the indicator turns healthily bearish, or look for the opening below or near the low of the current candle (fourth candle).

The two bearish reversal formations have weakened XLB. The big picture suggests the fresh bearish journey of the sector index. ■

The three black crows is a bearish reversal candlestick pattern.



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Correction Phase Of Utility Average Ends

by Chaitali Mohile

The Dow Jones Utility Average severely lost bullish strength in the past correction. The charts suggest that a gaining season for the index is under way.

Tradable: $UTIL

According to the daily time frame, the Dow Jones Utility Average ($UTIL) began its bullish journey in November 2009 from the low at about the 359 levels. After violating the 50-day moving average (MA) resistance, the upward move gained robust strength and reached the new high at 405 levels. However, the technical indicators could not sustain in the bullish region. The average directional movement index (ADX) (14) hardly reached the 30 levels. Although the positive directional index (+DI) of the trend indicator in Figure 1 shows huge buying pressure, an uptrend failed to surge in a well-developed area above 30 levels. The moving average convergence/divergence (MACD) (12,26,9) turned negative by slipping below the trigger line. The bearish crossover of the indicators shows the possibility of bearish momentum. This explains the bearish rally in $UTIL.

By early February 2010, the index lost all its gain from the previous bullish rally. We can see $UTIL is back at the 365 levels. The blue block shows a cluster of bearish candles with the long lower shadows and a bullish candle with a long upper shadow. Among these candles are the two hammers, one with a bullish real body and another with a bearish body (formed on February 12 and 15, respectively). If we consider the entire cluster of candles, then $UTIL seems to bottom out near the immediate support at 359.33 levels, and if we decided to watch just the hammer candles in the block, we can still anticipate a future bullish rally. The index has established support just a few points away from the previous low at 359.33 levels, so we can consider it to be a double-bottom formation.

The double-bottom bullish reversal formation is likely to initiate the fresh rally from current levels. The red dotted lines are marked to show the previous consolidation range that is likely to restrict the future bullish rally. Therefore, a fresh long position can be set above this level. Currently, the ADX (14) is tipping down, suggesting the declining downtrend, and the MACD (12,26,9) has yet to surge above the trigger line in negative territory. Thus, we need to wait for the confirmed bullish breakout.

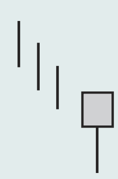
On the weekly time frame in Figure 2, $UTIL has two major supports: first, the 50-day MA support and second, the support-resistance area created by the previous highs and lows. The ADX (14) shows the possibility of consolidation for the index, and the MACD (12,26,9) is volatile in positive territory. Therefore, $UTIL is likely to recover slowly in the long term. Although support has been established, the technical indicators are not completely bullish.

Considering both technical charts, $UTIL is likely to pull back. ■

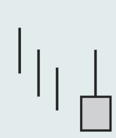
The bearish crossover of the indicators shows the possibility of bearish momentum.

FIGURE 1: $UTIL, DAILY. The bullish breakout would be confirmed if the index opens above the red dotted resistance line.

FIGURE 2: $UTIL, WEEKLY. The index has established strong support at the 50-day MA near 360 levels.



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



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

Semiconductor Index Breaks Down

by Chaitali Mohile

The Semiconductor Index was undergoing a steady bullish rally until an unanticipated breakdown appeared. Will the index resume its bullish path or will it drop further?

Tradable: $$SOX

A robust rally was initiated in the Semiconductor Index-Philadelphia ($SOX) in early 2009 (Figure 1). Prior to the rally was a sharp downtrend during which time the average directional movement index (ADX) (14) descended from the 50 level, reducing the bearish hold on the trend, and offered an opportunity for the buyers. $SOX surged to 231.25 from the new low at 167.55, and later retraced to 188 levels, forming a higher low. The upward rally from 188 levels slipped above the previous high at 231 and converted the 50-day moving average (MA) resistance to support. By joining these two higher levels, you can draw an ascending trendline and a parallel lower trendline, connecting the higher lows from 188 levels. Thus, an ascending channel is visible in Figure 1.

Trading within the channel is a good and safe strategy in any kind of market situation. Since you can anticipate the breakout and breakdown points of the channel, you can place appropriate stop-losses for your trades. The channel breaks upward if the upper trendline is breached and opens fresh buying opportunities. This buy setup could be escorted by a stop-loss that is marginally below the upper trendline, as the price may retrace back to test the newly formed trendline support. On the other hand, if price cracks the lower trendline support, it could be considered to be bearish, suggesting severe damage to the stock/index. So it may be wise to set your stop-loss a few points above the lower trendline. Since the ascending channel is a bullish pattern, the downward breakout damages bullish sentiments. To determine the breakout points, you need to stay watchful of price movements.

In Figure 1, you can see that $SOX moved closer to the upper trendline. This indicated that the index was ready to breach upward. However, the ADX (14) failed to develop in the bull's favor. The buying pressure was sluggish and the ADX (14) remained range-bound between 20 and 30 levels. The full stochastic (14,3,3) in Figure 1 frequently changed its direction in the bullish region of 80 and 50 levels. Due to lack of bullish strength in the rally, $SOX could not break upward; instead, the index retraced toward the lower trendline support. A minor bearish rally from the upper to lower trendline generated a short-term selling opportunity for the sellers. But $SOX bounced immediately without actually hitting the lower trendline. As the technical indicators did not improve, the rally again moved parallel to the upper trendline but failed to undergo the bullish breakout. Thus, the index continued moving within the upper and lower trendlines.

Although $SOX rallied 220 points from the low, the uptrend moved in the developing uptrend region, and the stochastic oscillator remained highly volatile. Due to these weak bullish notes, the index breached the lower trendline, suggesting major breakdown. Fortunately, the 40-day MA offered robust support to the bearish rally and prevented an additional fall. With the support of the MA, $SOX surged to challenge the lower trendline resistance. Such price movement is a common behavior of any stock/index. In this case, the price movement reveals the reason for positioning the stop-loss marginally above the lower trendline during the breakdown. Currently, $SOX is struggling to hit the new resistance line. The ADX (14) has turned weaker by moving below 20 levels and the stochastic oscillator is ready to move into the bullish area above 50 levels. Due to this mixed scenario, $SOX would be little reluctant to surge in the ascending channel. In addition, the current volatility and turbulence in the financial market across the globe would pour the bearish pressure in $SOX.

Thus, traders should be on their toes to trigger a short position whenever $SOX drops down from the trendline resistance. ■

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FIGURE 1: $SOX, WEEKLY. The ascending channel has been breached downward. The index has bounced with the 50-day MA support to challenge the new resistance line.

RELATIVE STRENGTH COMPARATIVE

Airline Stocks Remain High-Flyers

by Donald W. Pendergast Jr.

Of all the Fidelity Select Sector mutual funds, the air transportation fund is the one most substantially outperforming the S&P 500 over the past quarter.

Tradable: FSAIX, UAUA

Comparative relative strength analysis remains one of the best ways to help ensure that you deploy your trading and investing capital into the most favorable areas of the stock market. With the air transportation sector fund (FSAIX) doing so well right now in comparison to the broad markets, it might pay to drill down and take a closer look at the strongest component stocks within that fund, hoping to identify ways to turn such astounding momentum into tangible profits. See Figure 1.

Here's the weekly top-10 ranking of the strongest Fidelity Select Sector funds over the past 13 weeks, compared to the Standard & Poor's 500. FSAIX holds a commanding relative strength advantage over the rest of the highly ranked funds, boasting nearly twice the strength of the more generally focused transportation fund (FSRFX). It is interesting to note, however, that the top-10 ranking is populated by a variety of funds, hailing from the banking, retailing, home finance, construction and housing, biotechnology, electronics, and medical delivery sectors. This confirms that the recent minor advance in the market has enjoyed broad participation, but it does little to alert us to what the direction of the broad markets may be in the coming days and weeks. That said, let's identify the strongest stocks in the air transportation fund and then look for a trading opportunity or two. See Figure 2.

No question about it, based on 13-week rate of change versus its parent fund, FSAIX, UAL Corp. (UAUA) is the leader of this pack, far overshadowing lesser rivals such as Continental and Southwest. Since this stock is way past the "buy on a pullback" point, at least for now, how do we latch onto this ascending wide-body right here? By selling an at-the-money (ATM) covered call, of course. What a chart — Figure 3 has got it all:

- Strong money flow (bottom of chart)
- Powerful momentum (top of chart)
- A rising 50-day EMA slope (blue exponential moving average line)
- Stock is at post-crash highs
- Stock has incredible relative strength versus broad market and its parent sector
- Strong support levels that can help protect a short-term covered-call trade.

So, here's the trade setup:

For every 100 shares of UAUA that you acquire, sell one April 2010 UAUA $17 call option for a credit of $1.70 or better. If the stock is called away at expiration (46 days from now), the trade will generate an annualized return of nearly 70%, which is a nice return for such a short-term commitment of capital. If you set an initial get-out (stop-loss) point at $14.75 a share (major support), you stand to incur only a modest loss if the trade goes haywire, as ATM options like this have the most amount of time value, meaning that the short options' deltas will drop like a falling stone on any selloff in UAUA shares, greatly offsetting any losses in the price of the underlying stock.

Should you get in on this trade, a great way to trail a stop would be to simply use the 50-day EMA as your trailing stop, especially once it rises above $14.75, the current major support level. This will give the stock plenty of room to back and fill and allow you extra peace of mind between now and April option expiration.

Strong stocks tend to stay strong, sometimes for far longer than we might otherwise assume, and this setup in UAUA certainly looks about as low risk as they come. ■

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This article was first published on 3/2/2010.
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Security Name	ROC	Ticker Symbol
Fidelity Select Air Transportation	1.9356	FSAIX
Fidelity Select Transportation	1.1051	FSRFX
Fidelity Select Home Finance	0.8642	FSVLX
Fidelity Select Banking	0.7235	FSRBX
Fidelity Select Retailing	0.5986	FSRPX
Fidelity Select Electronics	0.5804	FSELX
Fidelity Select Construction and Housing	0.5754	FSHOX
Fidelity Select Biotechnology	0.5476	FBIOX
Fidelity Select Medical Delivery	0.5122	FSHCX
Fidelity Select Insurance	0.4912	FSPCX

METASTOCK; METASTOCK EXPLORER

FIGURE 1: TOP 10. While the top-10 rankings show plenty of diversity, the air transportation sector fund easily qualifies as the 800-pound gorilla in the room.

Security Name	ROC	Ticker Symbol
UAL Corporation	4.3397	UAUA
US Airways Group, Inc.	3.7230	LCC
AMR Corporation	1.4183	AMR
Atlas Air Worldwide Holdings, Inc.	1.1279	AAWW
Continental Airlines, Inc.	1.0790	CAL
Southwest Airlines Co.	0.4798	LUV

FIGURE 2: STRONGEST STOCKS. Drilling deeper, we find that UAL Corp. shares are the strongest stock within the airline sector, based on a 13-week rate-of-change (ROC) calculation.

METASTOCK; RAHUL MOHINDAR OSCILLATOR (RMO) FROM METASTOCK

FIGURE 3: UAL, DAILY. Finally, the chart for UAUA. Strong momentum, money flow, and new post-crash highs all suggest that selling an April $17 call option against every 100 shares of UAUA is a realtively low-risk trade setup, one offering an exceptional annualized return of nearly 70%, if successful.

METALS & ENERGY

CHART ANALYSIS

Gold Pennants, Breakdowns, Washouts, Reversals

by Donald W. Pendergast Jr.

Take an intraday trip through the gold futures market, using the three- and fifteen-minute charts as a road map.

Tradable: Gold, GC

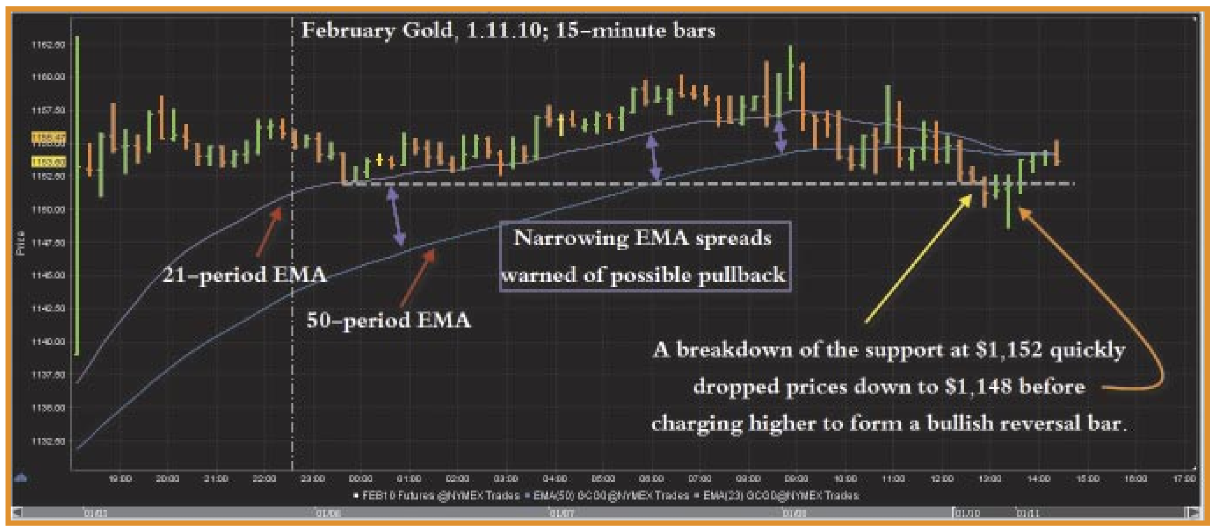


FIGURE 1: GOLD, 15-MINUTE. Narrowing EMA spreads and a strong intraday support level are some of the guideposts available to intraday gold futures traders.

FIGURE 2: GOLD, THREE-MINUTE. While the price action coming out of the pennant breakdown was widely anticipated, the wild wash & rinse reversal action at 1327–1330 was not.

During the overnight session, COMEX February 2010 gold experienced a major rally, rising by more than $20 from Friday's closing price; at one point gold made it past $1,163 before settling down during Monday, January 11's regular daily session. On a daily basis, the pattern may be some sort of an exhaustion gap into major overhead resistance — remember, February gold was at $1,226 in early December and then tumbled to $1,075 in less than three weeks. The area between $1,142 and $1,169 is rife with a variety of potential Fibonacci retracement and extension levels, so traders considering going long here might want to do so only on an intraday basis until February gold can make a convincing daily close above $1,169. Let's face it, gold is going to do whatever it wants to do, just like any other commodity, and the best we can do is to try to determine the lowest risk entry and exit points.

The ultimate path of gold aside, however, today's intraday action in the gold market was full of chart patterns and/or dynamics, three of which we'll cover in this article. For starters, we'll look at the 15-minute chart of the February COMEX gold contract (Figure 1).

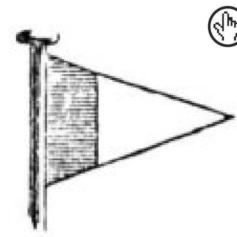
At the extreme left side of the chart you can see the massive 15-minute bar that brought gold up to the $1,163 area at about 7:00 pm ET on Sunday night; in the aftermath of that move, however, price simply meandered back and forth in a narrow range for the next 12 hours or so, failing to provide any real clues as to the next trend thrust. Wise technicians would also have been keeping an eye on the support level at $1,152 (dashed gray line), as a solid break below it might have initiated a substantial corrective move lower. Savvy chartists would also have noted that the spread between the 21- and 50-period exponential moving averages (EMAs) had narrowed significantly by the time of the morning session's open at 0930 ET; it was an early warning of a possible trend reversal and/or corrective move.

So, with the big picture in view, we'll take a look now at what went down on the three-minute gold chart.

Since we already know that the spread between the 21- and 50-period EMAs on the 15-minute chart were contracting by the time the morning session commenced, the completion of a near-perfect pennant formation at 12:15 pm was also of great interest to those interested in a possible short setup. Aggressive traders were able to jump in on a break (at 12:22 pm) below the lower pennant boundary and were able to pick up a couple of handles by the time 1:00 pm rolled around. The trade went short at $1,153.25 and then proceeded to take out that critical intraday support level of $1,152, too. So far so, good — a winning chart pattern trade that was in line with the higher time frame trend dynamics. The big question was, of course, this: Was this the first warning of a major trend reversal or just a minor pullback in a major bull rally in gold?

The sharp downthrust that commenced at about 1:28 pm was destined to answer that particular question, but only after it had faked out plenty of short-sellers who had already positioned themselves to pull the trigger at the $1.150 area. The downthrust triggered a wave of short sales that quickly dropped gold down to $1,148.60, but it only remained there for a few moments before it suddenly started to rocket back up to the $1,151 area, again triggering a fresh wave of buy-stop orders (to cover the short sales instituted near $1,150) that provided even more fuel to push the market higher. This amazing market reversal finally petered out near $1,155 at 2:16 pm.

If nothing else, trading events like this should help remind us that at times the market will respond in a way that we generally anticipate, the lovely three-minute pennant/15-minute support breakdown move being a prime example. At the same time, the unexpected and violent "wash & rinse" reversal bar (Figure 2) should also serve to warn us that the market can and will react in ways not normally able to be detected and/or anticipated by normal technical trading tools. If you were the unfortunate trader who shorted gold at $1,150 today, hopefully you had placed a buy-stop order to take you out of the trade with minimal losses. If you didn't, well, then you might have had to take a much larger loss. In futures trading, your best offense is a good defense — always use stops and modest position sizing. ■



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This article was first published on 1/12/2010. See www.Traders.com formore.

The Gold Miner And The Pitchfork

by Alan R. Northam

One of the useful aspects of the Andrews pitchfork is that it can be drawn from any series of three alternating high and low pivot points. With each pitchfork drawn, a story about the trend is told. With each of the pitchforks drawn as seen here, the story of the Gold Miners ETF is unraveled.

Tradable: GDX

One of the beautiful aspects of the Andrews pitchfork is that you can draw it from any three pivot points and it will tell a story about the trend under way. In Figure 1, I have drawn the Andrews pitchfork off the last three pivots of the current trend of the Gold Miners exchange traded fund (ETF)(GDX). Note that from late December 2009, GDX has been trading along the lower horizontal line of the pitchfork. Alan Hall Andrews called this lower pitchfork line the "lower median line horizontal" or "L_MLH" because it is drawn below the median line (ML) and horizontal to it (Andrews used the term "horizontal" instead of "parallel").

Andrews noted that 80% of the time, price would rally up to the median line of the pitchfork and then reverse down. When the price failed to move up to the median line before reversing trend, Andrews noted that the price reversal would most likely go further than it did on its approach to the median line.

The story that the pitchfork is telling is that the Gold Miners ETF is not moving up to the median line of the pitchfork as should be expected. This tells us that if price reverses trend before reaching the median line the price reversal will go further in the direction of the reversal than it would if price first reached the median line.

In addition, the story that the pitchfork is telling warrants the drawing of the Hagopian line (see my January 12, 2010, Traders.com Advantage

FIGURE 1: GDX, DAILY. Here are the pitchfork and the Hagopian line.

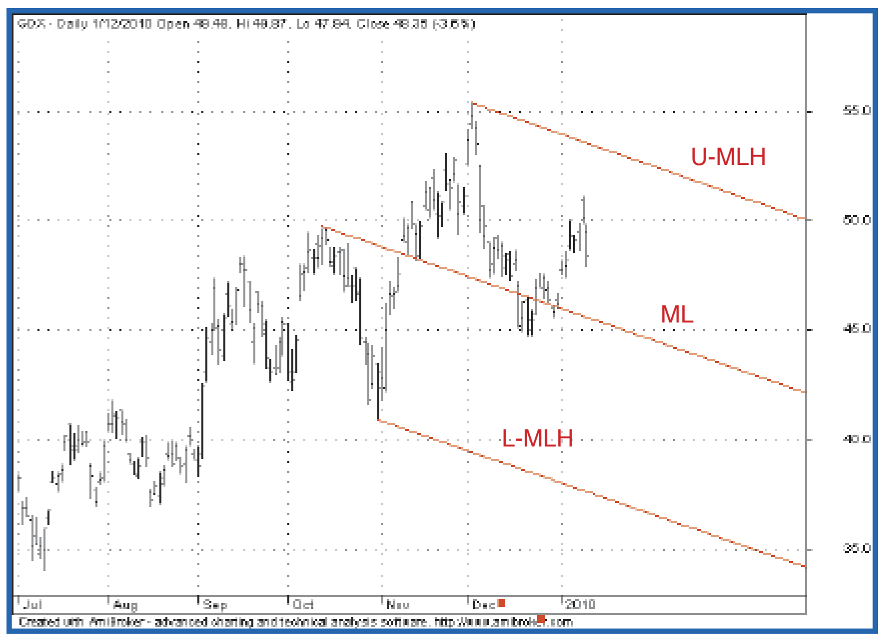

FIGURE 2: GDX, DAILY. Here's the pitchfork.

article). Whenever price continues to follow the lower horizontal line of the pitchfork, the drawing of a Hagopian line is warranted. The reason for this is because any market correction to the upward rally could more easily break below the Hagopian line, signaling a trend reversal than it would if price had moved closer to the median line. If price were to move upward at a steeper rate and toward the median line, any market correction most likely would not be severe enough to move below the path of the Hagopian line. Under those conditions, it would not be necessary to draw the Hagopian line.

Since Andrews pitchforks can be drawn off three pivots, I have drawn another pitchfork in Figure 2. The pitchfork tells us more about the story of the gold miners and the pitchfork. Note in Figure 2 price did manage to move down to the median line of the pitchfork and reverse directions. This indicates that price is now in an upward trend and headed for the upper horizontal line of the pitchfork, which acts as resistance. Therefore, for the uptrend in the GDX to continue, price must break out above this line of resistance. If price does not break out above the upper horizontal line of the pitchfork but instead reverses back down, it will indicate that GDX has reversed trends from up to down as signified by the down slope of the median line.

In conclusion, GDX is still in an upward trend, but failure of price to break out above the upper horizontal line of the pitchfork in Figure 2 will constitute a reversal in trend from up to down. ■

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This article was first published on 1/13/2010.
See www.Traders.com for more.

FURTHER READING

Northam, Alan R. [2010]. "Hagopian's Rule," Traders.com Advantage, January 12,

CYCLES

Gold Falling Like A Ton Of Lead

by Donald W. Pendergast Jr.

Despite a modest relief rally, gold has resumed its major monthly cyclical downtrend. At what support level might this metal finally bottom out?

Tradable: GC, GLD

The December 2009 high in gold was projected by various market technicians to coincide with the $1,200 price level (based on a variety of cyclical, Fibonacci, and resistance studies), and once it headed south it did so with little hesitation, dropping down to $1,075 in only three weeks. The bear market rally that ensued was bullish enough to cause the faithful to believe that this was nothing more than a standard pullback against an intact uptrend, but nothing could be farther from the truth. In fact, basic cycle analysis confirms that gold is likely destined to fall at least another $50 to $100 (if not more) before it hits support levels strong enough to engender another round of base-building. Let's have a look at the monthly chart of gold (Figure 1).

As of this writing, monthly gold (continuous contract) is resting right at the Fibonacci 23.4% support level (calculated from the October 2008 to December 2009 upthrust), and as anyone familiar with trend reversal dynamics already knows, that particular Fibonacci retracement level is usually just a temporary stopping-off point before continuing with a move down to the Fibonacci 38% or 50% retracement levels. The main reason this appears to be what will come to pass is the current state of the DBS10 cycle oscillator (blue oscillator at bottom of chart); it's in "hard-down" mode, with plenty of room to run before it reaches oversold readings. Given the high reliability of this oscillator to follow through, it appears that shorting gold here, hoping for a move down to at least the Fibonacci 38% level at $1,025, is a reasonably sane course of action. Just below that level is the March 2008 high at $1,014, an area of support that will be a line in the sand as far as determining the health of the long-term uptrend in gold goes.

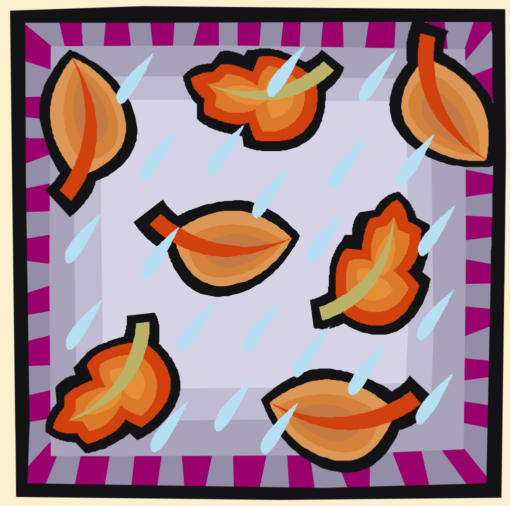
Now let's check out the daily chart of gold, noting other coincident support levels that might also help establish a rational price target for those already short gold and/or for those ready to take the plunge.

The daily Fibonacci levels (not shown here) tells a similar story; the 50% Fibonacci support comes in at $1,067, the 62% Fibonacci resides at $1,030 and the 200-day exponential moving average (EMA; see red line) sits near $1,010. With daily gold having made another convincing close beneath its 50-day EMA (yellow line on chart), there appears to be little support now other than the December swing low at $1,075 (see ellipse). If this low is taken out, expect another wave of selling that should make the trip down to $1,067 in record time. Every tick in the gold market (0.10) is worth $10, so this could be a way to pick up about $700 in a session or two if the selloff proceeds as anticipated. For those selling near $1,095 (the price of April 2010 gold as I write this), a drop to that first daily Fibonacci level would mean about $2,800 in pretax profits. If you use the 50-day EMA (near $1,114.50) as your stop-loss, your initial risk on the trade would be about $950 and the profit target would be almost three times that at $2,800.

Given the powerful downward pressure in the gold market, finding a trade setup with a risk-reward ratio of 3:1 is a wonderful thing, especially since the monthly cycle is likely to move substantially lower.

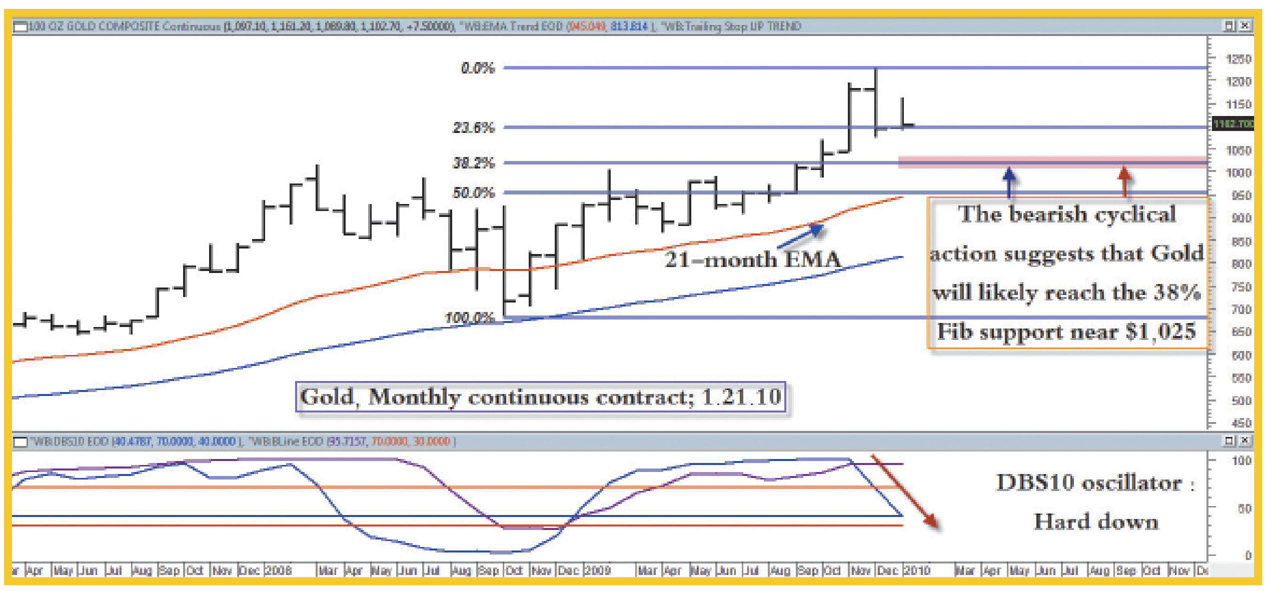
More conservative traders can configure the same basic trade using GLD or with minigold futures contracts. Run a three-bar trailing stop of the daily highs until the $1,067 to $1,070 area approaches and then close the trade down for a profit, especially if trading the full-sized COMEX gold futures (GCJ10) contracts. The February 2010 contract has much more liquidity than the April contract and should be the contract of choice.

This looks like a relatively low-risk trade, one that has plenty of technical and fundamental advantages in its favor. If your margin account can handle the action, this could be a memorable and potentially profitable daily trade setup.



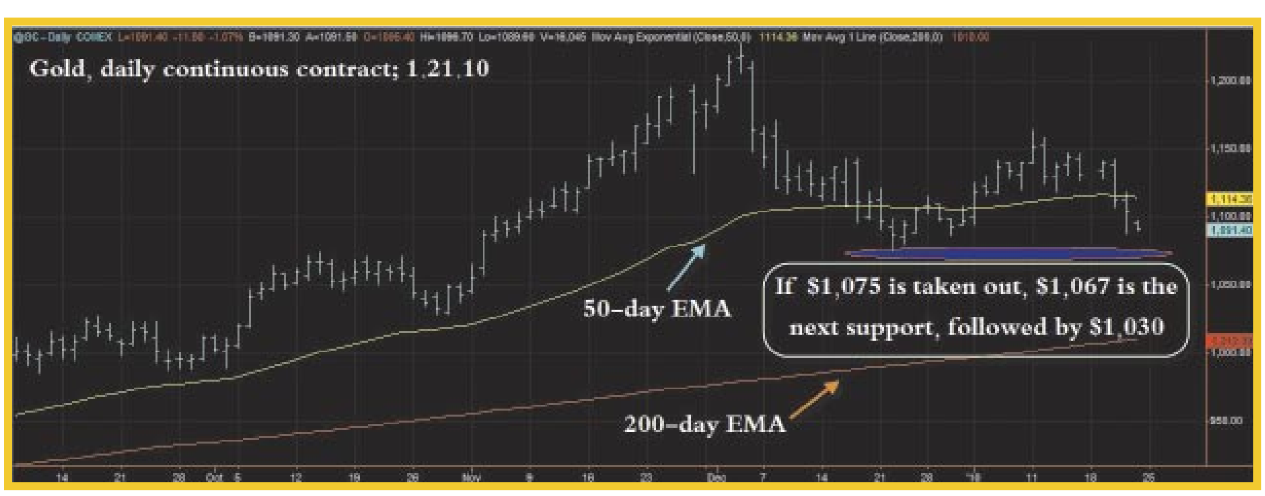
If this low is taken out, expect another wave of selling.

Bottom line, there is little to hold gold up on the way down to the daily Fibonacci 50% retracement level near $1,067, especially if the December low at $1,075 is taken out on a daily close. Beneath that price zone, various Fibonacci chart and EMA support spans the range from $1,030 to $1,010, with the March 2008 swing high at $1,014 being of major import in the overall scheme of things. Keep a close eye on price action, should it get that low; there should be volatile (and probably tradable) moves in either direction if it arrives there. ■



METASTOCK; WB DBS10 EOD FROM PROFITTRADER FOR METASTOCK

FIGURE 1: GOLD, MONTHLY. The strong downward thrust in gold's monthly cycle suggests that a move down to $1,025 — the Fibonacci 50% support level — is very probable.



TRADESTATION

FIGURE 2: GOLD, DAILY. If December's low of $1,075 is taken out, $1,067 is the next Fibonacci support zone, followed by various supports near $1,030, $1,025, $1,014, and $1,010.

FIBONACCI

Silver Downtrend Strengthens

by Donald W. Pendergast Jr.

As silver approaches an important support area, traders begin to take sides for the ensuing battle.

Tradable: SI, SLV

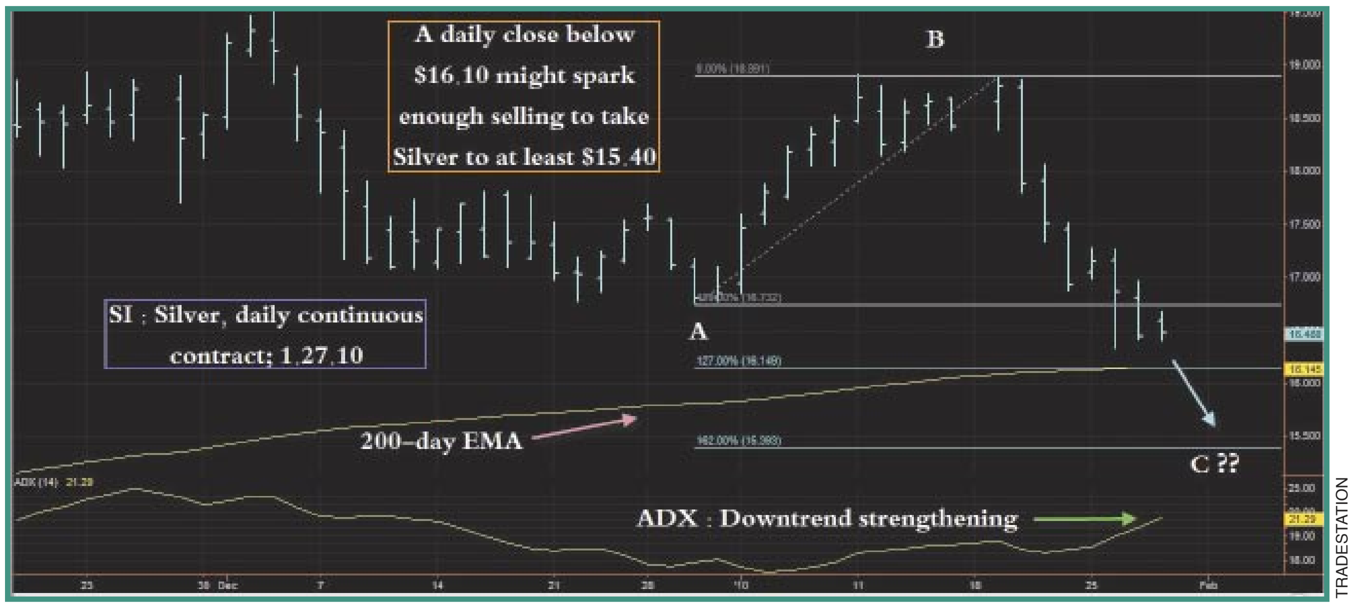


FIGURE 1: SILVER, DAILY. Silver is rapidly closing in on its major support level at $16.15; a daily close below that price could set the stage for more selling down to the next Fibonacci 162% extension level near $15.39.

Silver has been falling steadily for the past couple of weeks, shedding about 12% of its value since mid-January. The disparity between the commercial and large speculator interests in the silver futures market has finally begun to resolve itself in favor of the big money commercials -- for now. With two significant support levels right below the current price, will this be enough to put a floor under this market and, if so, will it hold? Let's take a look at the daily chart of the continuous contract for COMEX silver futures.

Figure 1 is a very simple chart, one featuring several technical tools that can help us identify potential support levels as well as the strength of the recent downswing. Note the A-B labeling of the most recent swing termination points over which a Fibonacci extension ratio grid has been overlaid. The big idea here is that swing C has already exceeded 100% of the length of swing A-B and appears to be on track to move to at least the next Fibonacci ratio of 127%, a support level that also exactly coincides with the 200-day exponential moving average (EMA) at $16.15. This is a major support level, and any significant breach of it is very likely to unleash another wave of selling pressure, one that might have little trouble dropping down to test the Fibonacci 162% support level near 15.39. Those of you who read my last two silver-related articles (in late December 2009 and early January 2010, respectively) already know there are several major daily and weekly support levels between $15.30 and $15.70 in this market, so there is a good chance that silver may finally land on more solid footing should it decline to these levels.

One reason silver appears to be destined to eventually break below the 200-day EMA is the strongly rising average directional movement index (ADX) (yellow line at bottom of the chart). This indicator measures the intensity of a given trend, with readings above 25 generally thought to be indicative of a strong trend in motion. It's still a few points shy of 25 right now, but it is still rising smartly enough to warrant further attention.

Again, the price action near the 200-day EMA will be critical for daily (and intraday) silver traders to monitor, as powerful reversal and/or breakdown moves are likely to be seen here, and soon. Silver's weekly price cycle is still in a mode that seems to favor a move down below the 200-day EMA/Fibonacci 127% expansion level toward the mid- to upper $15 range.

Shorting silver right here is probably a little south of sane, given that it's already down for five of the past seven sessions and the close proximity to the aforementioned major support area. However, depending on the strength of this downthrust, selling out-of-the-money silver put options might be a cash-generating play of interest for those able to trade futures options with their particular broker. Here are a couple of ideas for you to kick around:

Sell one March 2010 COMEX silver $15 put option for 0.120 or better (that's $600 cash that goes into your margin account, before commissions). This option expires on February 23, 2010, so it's on the fast track to extinction due to ever-accelerating time decay, and given all of the potential support areas that separate the current price of silver ($16.58 as this is written) from that $15 strike price (at which point the option goes in-the-money), this appears to be a modest-risk option credit strategy.

Risk control on the trade is simple — if the price of the option doubles, you bail out of the trade, no questions asked, buying your short put option back as soon as possible. If silver gets hung up around the 200-day EMA or even stages a minor bounce higher in the days after selling your put, you'll be in the cat-bird seat, able to enjoy the twin blessings of ever-increasing time decay and shrinking option deltas. And even if silver keeps declining after you sell the put, if the rate of descent is slow enough, you may be able to still hold the trade long enough to realize a relief rally commencing well before the $15 strike is reached.

Conservative traders should probably wait to see what happens in the next few sessions to see how silver reacts to the $16.15 support area before attempting to sell any silver puts; you won't get as much premium (because the option loses more and more time value every day) but you'll have more peace of mind due to a better understanding of the technical state of silver, all else being equal. Do some analysis work of your own and talk to your broker regarding some of the finer points of selling futures options before taking the plunge — it should be time well spent. ■

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This article was first published on 1/28/2010. See www.Traders.com for more.

Further Reading

Pendergast Jr., Donald W. [2010]. "Minor Pullback Due In March Silver," Traders.com Advantage, January 5.

_____ [2009]. "Silver, Make Or Break," Traders.com Advantage, December 22.

BULL/BEAR MARKET

Gold & Silver Index Enters Fresh Downtrend?

by Chaitali Mohile

The corrective rally of the gold & silver index has breached its trendline support. Will the index establish support or plunge further?

Tradable: $XAU

Since August 2009, the bullish rally of the Philadelphia gold & silver index ($XAU) has been very volatile. After every higher peak, the index corrected and formed a higher bottom. You can draw an ascending trendline by connecting all the higher bottoms. This trendline acts as a support for the rally. In Figure 1, one such trendline is drawn, and note that $XAU has bounced with the support of the trendline. The areas marked as 1, 1a, 1b, and 2, 2a, 2b in Figure 1 shows the price rally and the indicator status during the pullback rally from the trendline support. When the trendline support was challenged earlier (see no. 1), the full stochastic (14,3,3) was oversold (1a) and the selling pressure, reflected by the negative directional index (-DI), descended while the average directional index (ADX) (14) was weak (see 1b). The index surged along as did the stochastic oscillator and the buying pressure. The rally turned stronger, forming higher highs. Because of the high volatility of the rally, the indicators failed to sustain in healthy bullish areas. Thus, the overbought stochastic reversed and the buying pressure declined in Figure 1.

Therefore, $XAU retraced and formed another higher bottom that is our second trendline support (no. 2 in Figure 1). Once again, the full stochastic (14,3,3) was oversold (2a) and the selling pressure shrank (2b). The major difference in the situation was that both indicators sustained in particular areas for a few weeks and later changed direction. As a result, the pullback rally formed a lower peak above the 50-day moving average (MA) resistance. This indicated weakness in the index.

Soon $XAU corrected, and the bearish pressure was stronger than earlier conditions. The trendline support was breached for the first time, and the index continued drifting lower. This was the first robust bearish indication by the index. The 200-day MA support was under threat as the price dropped further. The full stochastic (14,3,3) is oversold and shows the possibility of reversing, but we need to stay watchful till the indicator actually surges above 20 levels. The selling pressure -DI has been traveling vertically upward. The significant increase in the selling pressure dragged the ADX (14) above 20 levels, developing a downtrend. Immediately, $XAU breached the robust support of the 200-day MA and entered an intermediate downtrend. Currently, the index is under the newly formed 200-day MA resistance. In addition, the ADX (14) has reached 22 levels, suggesting the developing downtrend.

Thus, $XAU is likely to plunge some more levels. Those already short can carry their positions; however, opening fresh short positions might prove risky, as the index has traveled down a long way. Under the 200-day MA resistance, the index might turn more volatile. ■

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This article was first published on 2/1/2010.
See www.Traders.com for more.

FIGURE 1: $XAU, DAILY. Due to developing downtrend, the index is likely to sustain below the 200-day MA resistance.

CHARTPATTERNS

TECHNICAL ANALYSIS

Dollar, Up Or Down?

by Alan R. Northam

The dollar has been in a downward trend since last March. However, in early November 2009, the dollar broke out above its downward sloping trendline. Once a trendline is broken the question becomes, "Has the market under study reversed its trend?" To answer this question, it is important to pay attention to what the market does following the breakout.

Tradable: UUP

Looking at the price chart of the US dollar exchange traded fund (ETF)(UUP) in Figure 1, the dollar broke out above the downsloping trendline that has been in effect since March 2009. The breakout above the trendline signals the end of the downtrend. The question now is, "Has the dollar reversed trends from down to up?" To answer this question, we must examine the technical situation.

The first thing I noticed when looking at the price chart is the gap formed in early September. I also saw that price has formed three peaks since the gap, none of which have moved above the gap. Therefore, this represents a strong line of resistance and a resistance line is drawn. Price is now moving in a downward direction. I have also drawn a line of support off the market low, as this is the lowest level that price attained in the current downward rally off the March high.

In downtrends, support levels are easily broken and resistance lines are respected. This can easily be seen in Figure 1 by looking at each lower low and lower high made during the downtrend from March. Each lower low represents a line of support that has eventually been broken, while each lower high represents a line of resistance that has not been broken. So on the one hand the downsloping trendline has been broken indicating a reversal in trend is occurring, while on the other hand the lower highs, which represent lines of resistance, continues to hold, signaling that a downtrend remains intact.

To determine if the dollar is reversing its trend from down to up, further price action is needed. Currently, price is moving in the downward direction. If price moves down to the support line and reverses back up, a strong line of support will have developed. We say a "strong line of support" because two touches of a support line is stronger than a single one, and three touches would represent an even stronger line of support. If price makes it down to the support line and reverses back upward, the market will have formed a strong line of support and a strong line of resistance. These strong lines of support and resistance will most likely indicate that the dollar is trapped in a trading range. The characteristic of trading ranges is that they are trend continuation patterns and would then call for a continuation of the downtrend.

In Figure 2, I offered an alternative analysis. It is possible for price to turn back upward before reaching the support line. If this occurs, a higher low price point will have developed, forming a new higher level of support. Further, if price then moves above the resistance line, this will be the first time a line of resistance has been broken since the downward rally in March began. An upward trend is indicated when support levels are held and resistance levels are broken. Therefore, the breaking of the resistance line will indicate that a new uptrend has started and will continue as long as each new level of support continues to hold.

FIGURE 1: UUP, DAILY. Here's a possible trading range developing and signaling a continuation of the downtrend.

FIGURE 2: UUP, DAILY. Here's a possible reversal in trend developing.

In conclusion, it is not yet clear if the US dollar ETF has reversed to the upside or will continue to move lower. To answer this question, we need to wait on the market to either develop a continuation pattern or a new higher level of support that is not broken and a breakout above resistance to signal that a new uptrend is under way. ■

CYCLES

Canadian Dollar Futures Descending Toward Support

by Donald W. Pendergast Jr.

Canadian dollar futures enjoyed a nice bull run in 2009, but the technicals now suggest that it may take a while for the loonie to meet or exceed its October 2009 highs.

Tradable: CAD, FXC

The only nice thing about a bear market is that there's always a bull market destined to follow in its wake, and perhaps that was the general feeling among long-position holders of Canadian dollar (CAD)–denominated assets during the long decline that commenced in November 2007. The loonie dropped all the way from 1.104 to 0.7635, finally making a lasting low in early March 2009. CAD futures then embarked on a seven-month-long bull rally, rising by more than 28%. Since October 2009, however, the recent swing high failed to take out October's high at 0.9798, causing a sharp selloff to occur. Will the loonie be able to recover and mount another attempt at the October swing high, or is a larger-degree decline in the cards for this major global currency? The weekly and daily charts may offer some useful clues, as always.

Figure 1 is the weekly chart — note the sideways action in the loonie since making that high in October 2009. In addition, the WB DBS10 oscillator (the red indicator at the bottom of this chart) does a fantastic job of calling cycle tops and bottoms, especially when they're in the direction of the dominant trend falling rapidly, suggesting that the CAD should easily make it to the 50-week exponential moving average (EMA) support level in this particular weekly swing move. The spread between the 21-week (red line) and 50-week EMA (blue line) has also flattened, confirming the previous period of consolidation. Now let's get more specific with an examination of the CAD daily graph.

One of the most important technical features on Figure 2 is the double-top formation (labeled as "1T" and "2T," respectively). January's swing high came within a few ticks of meeting the October high, but apparently most traders simply shrugged and said to themselves, "Close, but no cigar." The CAD is still in the downward move that resulted from that particular failure swing, but there are three significant areas of support that may help tone down the sharp rate of descent in this commodity currency. They are:

1. The November/December swing lows, near 0.9301/0.9303
2. The 200-day EMA, near 0.9212
3. The Fibonacci A-B 127% extension ratio near 0.9175

As we already know, the weekly cycle is falling sharply, so there is a high probability that these support levels will be hit, most likely within the next few weeks.

The US dollar's rally also appears to be the real deal, and as the CAD and US dollar generally move in inverse fashion, this is another powerful confirming factor that warns of further weakness in the loonie.

Playing the down cycle in the CAD offers some interesting choices in the option market; right now, you can sell a June 2010 0.8300 CAD put option for about 0.0034 or $340 before commissions. The option trades on the CME (Chicago Mercantile Exchange) and expires on June 4, 2010, a little more than four months from now. Here's a basic plan for those who are moderately bearish on the CAD between now and early June:

Sell 1 June 2010 0.8300 CAD put option for 0.0060 ($600) or better, but only if the currency bottoms and begins to turn higher at a price level of 0.9000 or higher.

There is a very significant chart support level at 0.8530, the July 2009 weekly swing low, and this should offer a reasonably good level of protection for this far out-of-the-money, deferred-month short option sale. As always, if you see the CAD drop sharply after you sell your put (per guidelines) and the option doubles in price, simply buy it back (buy to cover) before the situation gets out of hand. On the other hand, if the CAD does manage to make a solid low somewhere between 0.9000 and 0.9200 and then begins to retrace some of the recent losses, your short put will lose plenty of deltas (as it moves away from its 0.8300 strike price) even as it sheds ever-increasing amounts of time value.

So your job now is to simply keep an eye on the area between 0.9000 and 0.9200 to see if the CAD can find a base from which to launch higher in the weeks ahead. It may take a bit of faith and a good understanding of price cycles to time the perfect fill on this particular option sale, but since this is a long-term, way out-of-the-money option, you should still be able to obtain an attractive premium even if you're off a bit on your timing. ■

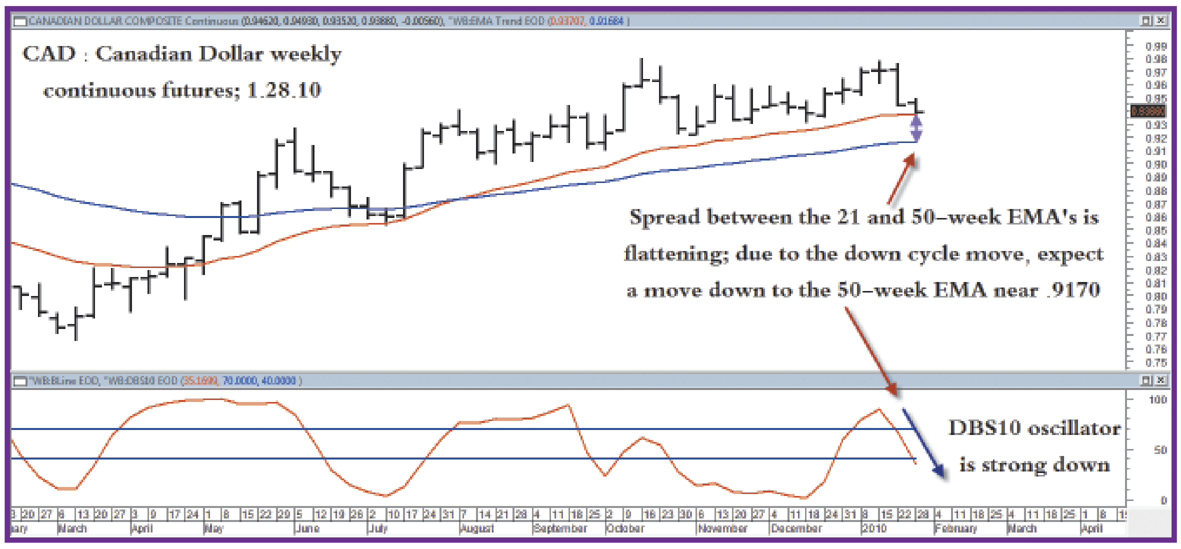

FIGURE 1: CAD, WEEKLY. With a very reliable cyclical indicator suggesting lower prices ahead, the 50-day EMA (blue line) near 0.9200 may still offer some support.

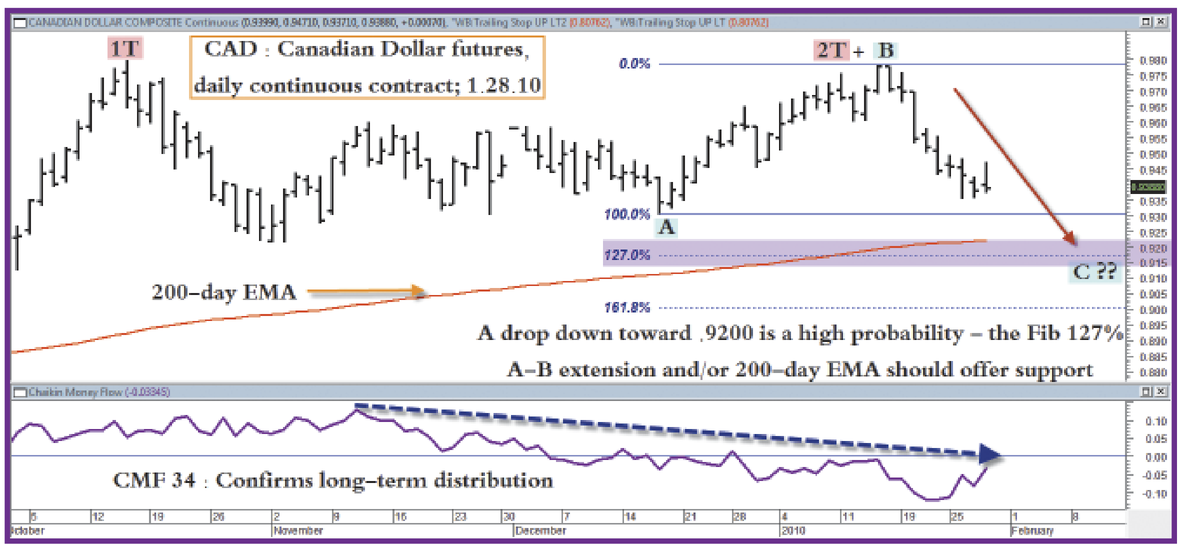

FIGURE 2: CAD, DAILY. If the CAD breaks below swing point A, expect a swift move toward major support between 0.9215 and 0.9175, the location of the 200-day EMA, and the Fibonacci A-B 127% expansion level.

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This article was first published on 1/29/2010. See www.Traders.com for more.

CANDLESTICK CHARTING

QQQQ's Falling Three Methods Candle Pattern

by Ron Walker

The bulls recently got a rude awakening as the bears revolted, sending QQQQ into a tailspin. But a bearish falling three methods candle pattern suggests that the selling may not quite be over yet.

Tradable: QQQQ

The PowerShares QQQ Trust (QQQQ) daily chart was on an unsustainable path as a multimonth accelerated trendline formed from the November low (Figure 1). Prices peaked in early January at $46.64 just as a bearish rising wedge pattern was developing. Just two sessions after prices peaked, the accelerated trendline ruptured, resulting in a bearish breakout of the rising wedge chart pattern as prices collapsed below the 20-day moving average (MA). QQQQ continued to drop through the 50-day MA as a precursor to testing the lower channel line.

Figure 1 reveals that by the end of January, the bears managed to shatter the lower channel line as QQQQ continued in self-destruct mode. But immediately after the channel broke, the selling temporarily halted as QQQQ filled the gap from November. The gap fill spurred a lackadaisical rally fueled by light volume, carrying prices back up to the broken lower channel line as the bulls tried to salvage the previous advance. But as prices tagged the broken channel line, the bears pounced on prices again, causing them to reverse course. That reversal resulted in the completion of a bearish falling three methods candle pattern. According to Greg Morris, in his marvelous book *Candlestick Charting Explained*, "The falling three methods pattern is the bearish counterpart of the rising three methods pattern" — a continuation pattern.

According to Morris, the falling three methods candlestick pattern begins with elongated candlestick forms in the direction of the current

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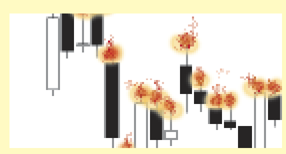
FIGURE 1: QQQQ, DAILY. The falling wedge continuation pattern formed after the channel broke, suggesting the pattern may carry prices lower to complete a neckline of a speculative head & shoulders top.

FIGURE 2: QQQQ, DAILY. After a break in trend and a drop below key moving averages, prices do the side-step to form a falling three methods continuation pattern. Note how the three-day rally sandwiched between the bearish bars and failed to clear the first day's bar.



That reversal resulted in the completion of a bearish falling three methods candle pattern.

trend. That's followed by three sessions of small real-bodied candles that rise in the opposite direction of the trend. The three bodies are usually contained within the high-low range of the first candle. The last day of the pattern produces another long candle that usually closes below the first day's candle of the five-day pattern.

In the example in Figure 2, the falling three methods pattern possesses all of these characteristics, from all three sessions staying within the trading range of the first candle to the last candle in the pattern breaking to a fresh low.

The bearish falling three methods continuation pattern will more than likely be the vehicle that will be used to continue to drive prices lower near the proximity of the $40.50 area, which is the neckline of a speculative large head & shoulders topping pattern. Once there, the bulls may try to spearhead an effort to take prices back up to form a right shoulder in order to complete the pattern. If the right shoulder is to have symmetry with the left shoulder, prices may peak just below the $44 area. ■

Further reading

Morris, Greg [2006]. *Candlestick Charting Explained*, McGraw-Hill.

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This article was first published on 2/8/2010. See www.Traders.com for more.

REVERSAL

Reversal Bars Signal Trend Change

by Alan R. Northam

Many methods can be used to determine the trend of the market. One such method is the use of one- and two-bar reversal patterns.

Tradable: !DJ30

Many methods can be used to determine the trend of a market. Most of these methods involve using moving averages or momentum indicators, both of which introduce a lag in determining the trend of a market and are therefore lagging indicators. Normally, lagging indicators are used to confirm a trend but are a poor selection when trying to identify a trend reversal. One method that can be used quite successfully is the one- and two-bar reversal patterns.

When trying to identify long-term trend reversals using one- and two-bar reversal patterns, the monthly bar chart is used. Figure 1 shows a two-day reversal bar pattern that identified the 2007 market top as well as the one-day reversal bar pattern that identified the 2009 market bottom. The 2007 market top was identified by a two-bar reversal pattern known

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FIGURE 1: DJIA, MONTHLY. The bar chart shows one- and two-bar reversal patterns.

as a pivot point reversal. A pivot point reversal is formed when a market such as the Dow Jones Industrial Average (DJIA) forms a high bar followed by a second bar with a closing price below the low of the highest bar.

Pivot point reversal patterns are the most common of the one- and two-day reversal patterns. Being the most common of the reversal patterns, they are the ones that normally fail as a reversal signal. Therefore, it is best to look for some confirmation before determining that a trend has changed. The most common method is to look for two following consecutive bars with lower closing prices: On the chart these are normally numbers 1 and 2.

The market reversal in early 2009 was identified by a single closing price reversal bar. Closing price reversal bars are formed when a bar opens below the low of the previous bar and closes in the top half of the bar and above the close of the previous bar. Closing price reversal bars are very reliable reversal signals, and the closer to the high of the bar the market closes, the stronger the signal. Thus, the closing price reversal bar made in March 2009 was a fairly strong reversal signal. Each bar following the closing price reversal bar that each bar made, a higher one indicating the strength of the trend following the strong reversal bar was made.

This brings us to January 2010, when a key reversal bar was made. A key reversal bar occurs when a market opens above the closing price of the previous bar and closes below the low of the previous bar. Key reversal bars do not occur very often but when they do, they are very reliable. Therefore, the key reversal bar that has formed on the monthly chart of the DJIA in Figure 1 is a very reliable signal that the long-term trend of the market has reversed from up to down.

Long-term trends normally last for a year or longer. Therefore, the key reversal signal that formed in January 2010 is a strong indication that the long-term trend has now reversed downward and should last for at least a year. As a confirmation, the next two months should produce bars with consecutively lower closing prices. ■

Closing price reversal bars are very reliable reversal signals.

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This article was first published on 2/2/2010.
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REVERSAL

The CRB Index In Wide Range

by Chaitali Mohile

The bullish journey of the CRB index was stopped by the two robust moving average resistances. The index has broken out of the rising wedge formation.

Tradable: $CRB

After hitting a new low at 200 levels, the CRB Index (end of day) index ($CRB) began a bullish reversal rally. The higher bottom moved in the shape of a bowl, gradually forming a rounded-bottom pattern. The formation is a bullish reversal, and a descending overheated downtrend reconfirmed it. The average directional movement index (ADX) (14) was highly overheated (at 50 levels) for about two months, suggesting a big reversal move for $CRB. The full stochastic (14,3,3) remained oversold for a much longer period, and the moving average convergence/divergence (MACD) showed a bullish crossover in negative territory. Therefore, the rounded bottom and the indicators were suggesting a significant up move in the near term.

The rounded-bottom's bullish breakout is confirmed after converting the moving average (MA) resistance to support. In Figure 1, $CRB surged after violating the 50-day MA resistance. Generally, the rounded-bottom breakout generates tremendous strength in the breakout rally. But the picture for $CRB was a little different. The breakout rally failed to move vertically upward.

FIGURE 1: $CRB, WEEKLY. Due to the 200-day MA resistance, the rounded-bottom breakout formed the rising wedge formation.

FIGURE 2: $CRB, MONTHLY. The index is ranged between the 200-day MA support and 100-day MA resistance.

After the rounded-bottom breakout, the stochastic oscillator soon moved in a wide range between the 50 and 80 levels. Although these levels are considered to be a healthy overbought area, the oscillator in Figure 1 frequently changed its direction, because of the high volatility in the rally. Hence, the trading range of the index narrowed as price levels moved closer to the 200-day MA resistance. Finally, a rising wedge was formed in Figure 1, highlighting a breakdown for $CRB.

The MACD (12,26,9) was likely to turn negative as the gap between the MACD line and trigger was narrowing. The declining downtrend weakened, however, and the uptrend could not develop. Thus, the weak trend, the volatile stochastic, and the negative MACD affected the bullish breakout rally, forming the rising wedge -- a bearish reversal formation. As the wedge hit the 200-day MA resistance, the pattern broke downward. The breakout drifted $CRB almost 40 points and settled near the 50-day MA support. Currently, we can see in Figure 1, a bullish candle with the MA support, suggesting the possibility of a pullback rally. The upward moving stochastic in an oversold area may confirm the relief rally. However, the ADX (14) has not developed any bullish sign. Hence, traders need to wait for more confirmation from the price chart as well as from the indicators. $CRB has moved in a strong support-resistance zone of 50-day MA and 200-day MA, respectively.

The monthly time frame gives a very long-term view of the stocks and indexes (Figure 2). $CRB is range-bound within the 100-day MA support and 200-day MA resistance. The lower and upper shadows of the bullish candles within the range reflected instability in the bullish strength. This shows that the index was unable to sustain near the highs and lows of the month. The full stochastic (14,3,3) is on its bullish path toward the overbought region, indicating the bullish move. The MACD (12,26,9) has a bullish crossover in negative territory below the zero line. The ADX (14) is consistently descending from an overheated area. Therefore, the trend indicator is currently suggesting the declining downtrend. This mixed picture provides the range-bound price movement for $CRB.

The lower and upper shadows of the bullish candles within the range reflected instability.

To conclude, $CRB would continue its movements between the support-resistance of the MAs. The path is likely to be tricky. ■

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This article was first published on 2/16/2010.
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REVERSAL

Will A 1-2-3 Trend Reversal Mark The Top For The S&P 500?

by Ron Walker

Identifying price shifts in the market at the earliest possible moment can lead to big profits and allow you to trade in the direction of the trend. By using the 1-2-3 trend reversal methodology, we can confidently know the exact moment a trend changes.

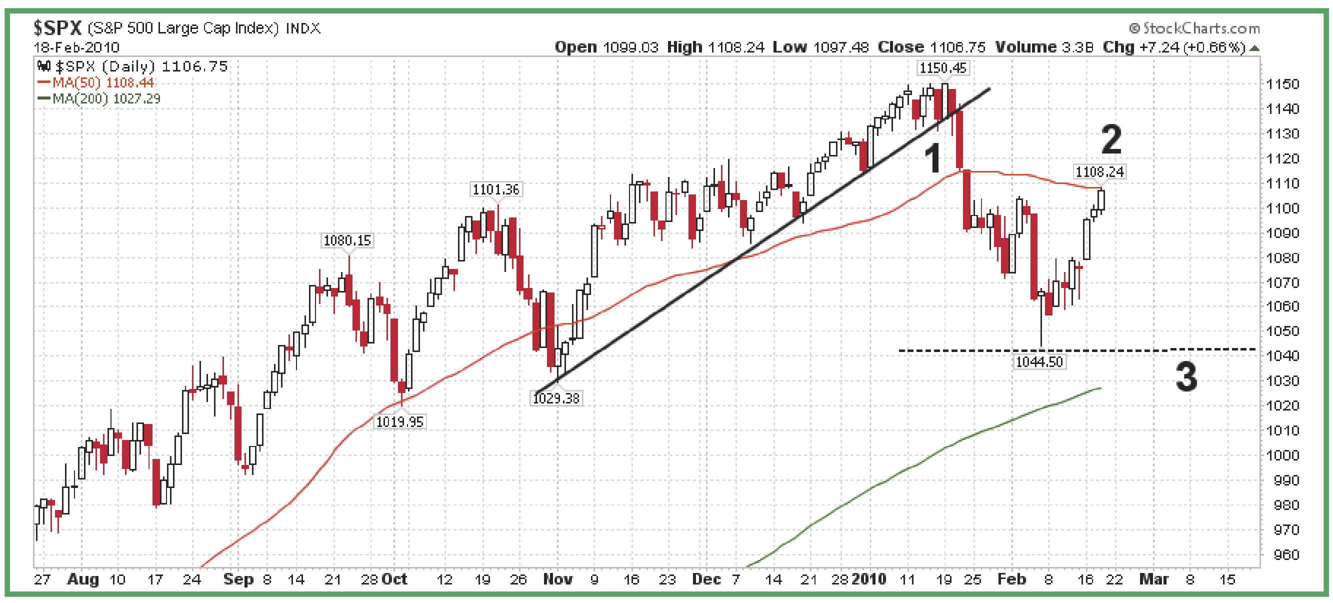

FIGURE 1: $SPX, DAILY. Here we see a potential 1-2-3 trend reversal. Prices may reverse off the 50-day MA to complete stage 2 of the pattern if the bulls fail to reestablish the previous trend. If prices complete stage 3, a lower high and lower low will establish an new downtrend.

Tradable: $SPX

One of the most certain ways of knowing if a trend is truly changing is described in Victor Sperandeo's book *Methods Of A Wall Street Master*. Sperandeo contends that in order for a change in trend to occur, three important changes in price movement must take place, which he has nicknamed the *1-2-3 trend reversal*.

Each of the numbers refer to a specific stage in the trend reversal pattern. For instance, the "1" represents the initial break in a trend. The "2" refers to a test back to the preceding high or low as the previous trend tries to reassert itself. If prices cannot move beyond the previous high or low, it opens the door for stage 3.

The third stage of 1-2-3 trend reversal occurs the moment prices move beyond the low (in the case of a previous uptrend) or high (in the case of a previous downtrend) that occurred after the initial trend break was established. All three stages must be completed in order to properly identify a change in trend.

In Figure 1, the daily chart of the Standard & Poor's 500 reveals that prices have already crossed below the trendline in mid-January. This trendline is actually taken from the March 2009 low, but I have magnified the chart so we can concentrate on the current price behavior. Following the trend break, the bears aggressively pushed the S&P 500 down to 1044, completing the first stage of the 1-2-3 pattern.

After finding a short-term bottom in early February, stage 2 began with a powerful rally back to the 50-day moving average (MA) to test the January high (Figure 1). Currently, prices have halted right at the 50-day MA, hesitating to move above. The reluctance to clear it well may bring another epidemic of selling. This rally will live or die on its ability to move above the 50-day moving average. Failure to do so will result in irreconcilable damage to this recovery attempt. The 50-day is a powerful point of resistance and will likely bring back sellers.

Now, in order for stage 2 to be completed and for a downtrend to begin, prices have to stop making higher highs and establish a lower high. Then they must turn back down and move below the 1044 minor low that occurred after the initial trend break. By speculating on a 1-2-3 trend reversal, we're looking for a price pop to the 50-day MA and then a drop back to the 200-day MA where support lies, thus completing phase 3 of the pattern.

In addition to the 1-2-3 setup in play, the S&P 500 also has a head & shoulders topping pattern carving out (Figure 2). If prices drop down to the neckline (near 1030) of the head & shoulders pattern and tag the 200-day MA, the head will be completed. Currently, the 200-day MA is hovering near the neckline on the S&P 500. Failure for prices to move back above the 50-day MA, will only increase the bearish stronghold surrounding

FIGURE 2: $SPX, DAILY. If prices reverse at the 50-day MA and drop, they will likely test the neckline and 200-day MA in order to complete the head of a potential head & shoulders topping pattern.

FIGURE 3: $SPX, DAILY. After prices peaked in the rising channel, they sharply declined until early February, forming a very steep falling price channel (dotted black lines). Prices then broke out of that channel, evolving into a less abrupt, more gradual incline (solid black lines).

Assuming that the 1-2-3 pattern is successful, we can speculate the measurement of the pattern using the swing rule.

the 50-day MA.

In Figure 2, we can see that a 10% correction on the S&P 500 would be at 1035, which is very close to the 1030 neckline. Once the S&P 500 has tested the 200-day MA, prices should rally up one last time to form the right shoulder and complete the pattern.

Given that bearish scenario, this current countertrend is likely nothing more than a charade, a pseudo rally forming so that the S&P 500 can expand its current channel. Figure 3 showcases several channels on the S&P 500 daily chart. Note that immediately following the January high at 1150, prices rapidly declined, forming a very steep falling price channel (marked with black dotted lines) that was unsustainable. Therefore, it was necessary for prices to rally higher in order to expand into a larger price channel that didn't have such a steep slope before beginning the next leg down.

Assuming that the 1-2-3 pattern is successful, we can speculate the measurement of the pattern using the swing rule. By taking the difference between the January high and February low that completed phase 1, we find a measurement of 106 points. By subtracting that amount from the February low of 1044, we get an objective target of 938. Should the S&P 500 reach that target, it would result in a correction of approximately 18.50%. Ironically, the head & shoulders pattern measures down 120 points to 910, very close to that price target, which would amount to a 20% correction.

Finally, looking back to Figure 1, we can conclude that a move above 1150 would be construed as bullish, while a move below the last minor low of 1044 would be quite bearish and signal a new downtrend, completing a 1-2-3 trend reversal. ■

1-2-3 TREND REVERSAL

❶ The "1" represents the initial break in a trend.

❷ The "2" refers to a test back to the preceding high or low as the previous trend tries to reassert itself.

❸ If prices cannot move beyond the previous high or low, it opens the door for stage 3.

—R.W.

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This article was first published on 2/19/2010.
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FURTHER READING

Sperandeo, Victor [1993]. *Methods Of A Wall Street Master,* John Wiley & Sons, Inc.

INDICATORS

HEAD & SHOULDERS

PMC-Sierra

by Koos van der Merwe

The DJIA is down, so why has PMC-Sierra given me a buy signal?

Security: PMCS

PMC-Sierra, a leading provider of broadband communications and storage semiconductors and offers worldwide technical and sales support, including a network of offices throughout most of the world. PMC-Sierra's fourth-quarter 2009 earnings will be released after the stock market closes on January 28, 2010. Is this the reason why I have gotten a buy signal?

Figure 1 is a monthly chart and shows how public enthusiasm at the time of the dotcom bubble pushed the share price from a low of $1.44 in August 1996 to a high of $247.26 by September 2000 — incredible for those who owned the stock. Note how the relative strength index (RSI) warned of the impending crash.

Figure 2 suggests a head & shoulders pattern and shows that the neckline has been penetrated, but the target of $6.67 has not yet been reached. The chart shows a JM inside band sell signal. A JM inside band is a 15-period simple moving average (SMA) offset by 2% positive and 2% negative. There is resistance at the pivot point 7.62.

Figure 3 is an OmniTrader chart of PMC-Sierra and is the chart that has given me the buy signal. This chart shows the following:

1. A candlestick chart with a trailing stop and Fibonacci support levels. The price is below the trailing stop level but is testing the Fibonacci support level at $8.01.
2. The MACD volume indicator has given a buy signal.
3. The vortex indicator written about in the January 2010 issue of STOCKS & COMMODITIES suggests further weakness.
4. The stochastic RSI cycle 8 period indicator has given a buy signal.
5. Finally, the vote line, which has given a buy signal with a backtest hit ratio of 100 (not shown).

To conclude, the stock has given a buy signal ahead of its financial report, and it is a strong one despite the head & shoulder pattern not yet reaching its target. With the Dow Jones Industrial Average down, we could put in a low ball bid. This is a stock that should be watched. ■

ADVANCEDGET

FIGURE 1: PMCS, MONTHLY

FIGURE 2: PMCS, DAILY

OMNITRADER

FIGURE 3: PMCS DAILY, OMNITRADER

FURTHER READING

Botes, Etienne, and Douglas Siepman [2010]. "The Vortex Indicator," *Technical Analysis of* STOCKS & COMMODITIES magazine, January.

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This article was first published on 1/21/2010.
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McClellan Summation Index 101: Divergences

by Ron Walker

The McClellan summation index for the NYSE just completed a bearish divergence, and traders got the confirmation as it crossed below the 10-day moving average triggering a bearish signal. Meanwhile, the summation index was also grinding through a bearish head & shoulders topping pattern.

Tradable: $NYSI

In 1969, Sherman and Marian McClellan developed the McClellan oscillator and its companion, the McClellan summation index, to help them improve market timing by spotting major market turning points. Since then, the McClellan summation index has become a popular market breadth indicator.

But what is the McClellan summation index? It is the cumulative sum of the daily McClellan oscillator figures. The McClellan oscillator (MO) takes the difference between two exponential moving averages (EMAs) of the daily NYSE advance-decline net values. The MO is the difference between the 19-day and the 39-day exponential moving averages (EMAs) of the daily net advance-decline figures. The MO is a market breadth indicator that helps us evaluate the money flow of the stock market. Its purpose is to help determine if money is entering or exiting the stock market, indicating whether overbought or oversold conditions are present.

The formula for the MO is derived by subtracting the 39-day exponential moving average from the 19-day EMA of net advances.

The MO is plotted vertically and fluctuates between +100 and -100, with zero acting as a median line. When the indicator is above zero, it is a favorable environment for long positions, but when the oscillator hovers below zero it signals that it is a better atmosphere for selling short (see the middle window on Figure 1).

When the shorter moving average (19-day EMA) moves above the longer moving average EMA (39-day EMA), it signals that the bulls are gaining momentum as advancing issues increase. This causes the MO to remain above the zero line. In contrast, when the 19-day EMA falls below the 39-day EMA, it signals that declining issues are prevailing and that the bears are in control, causing the MO to hover below zero.

The McClellan summation index (MSI) is a long-range version of the McClellan oscillator. It is calculated by adding each day's McClellan oscillator reading to the previous day's summation index reading.

There are now two ways of calculating the MO formula, but due to space constraints I will only give the original method.

Yesterday's summation index +
Today's McClellan oscillator
= Today's summation index

The MSI fluctuates between positive and negative territory with a median line of zero. A move below zero is undesirable and suggests price weakness. The MSI is better suited for longer position or trend trades, whereas the MO is ideal for providing short-term signals.

Figure 1 shows how the McClellan oscillator and the McClellan summation index work. The bottom window shows the 19-day EMA and the 39-day EMA of the NYSE advance-decline issues, and the middle window shows the ratio-adjusted McClellan oscillator line, and in the upper window is the McClellan summation index, which is the cumulative total of the McClellan oscillator. Figure 1 reveals that the 19-day and 39-day EMA crossovers correspond with zero-line crossovers on the McClellan oscillator.

Note when the MO moved above its zero line in early December and remained there until mid-January, with the exception of a few abbreviated tests to the zero line, that move coincided with the MSI rising above its 10-day EMA for an extended period. See Figure 2.

Like other market breadth indicators, the McClellan summation index can form trendlines, divergences, and chart patterns. Sherman McClellan suggests looking for tops when divergences develop with the market.

Figure 2 reveals that such a divergence occurred in January with the daily chart of the New York Stock Exchange (NYSE). Notice that it was a bullish divergence in late 2008 to early 2009 that created the March bottom in the market. During November the MSI tested the lows made during the summer correction,

FIGURE 1: $NYMO & $NYSI, DAILY. Note how the 19-day and 39-day EMA crossovers correspond with zero-line crossovers on the McClellan oscillator. The zero-line crossovers correspond with the summation index rising above and falling below its 10-day EMA.

FIGURE 2: $NYA & $NYSI, DAILY. Just as a bullish divergence completed in early 2009 between the NYSE and the McClellan summation index marking a bottom, the recent bearish divergence is likely carving out a top. The recent peak completed a higher high and the right shoulder of a head & shoulders topping pattern.

Like other market breadth indicators, the McClellan summation index can form trendlines, divergences, and chart patterns.

but then surged in December, forming a potential neckline for a head and shoulders top pattern. The MSI continued to rise until January, where a lower peak formed, completing a bearish divergence and creating a potential right shoulder (Figure 2).

If the MSI falls back and declines

below the clearly seen level of support just below +400, the head and shoulders pattern will play out. With the bearish forces of the divergence at work, there is a high probability that head and shoulders top will run its course. The bearish divergence, the MSI bearish crossover below its 10-day EMA, and the head and shoulders top all forewarn that the market is likely in the early stages of a major correction. If the Summation Index moves below the neckline of the pattern, it very well may be headed back below the zero line. That would be an extremely bearish sign. ■

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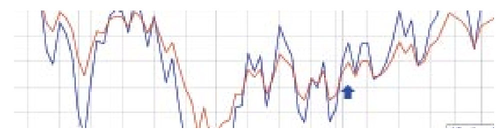

SUPPORT & RESISTANCE

Copper Approaches 200-Day EMA

by Donald W. Pendergast Jr.

No doubt, the copper futures market is in the midst of a substantial trend reversal, one that commenced four weeks ago. Might we get a tradable bounce higher in copper regardless?

Tradable: HG, JJC

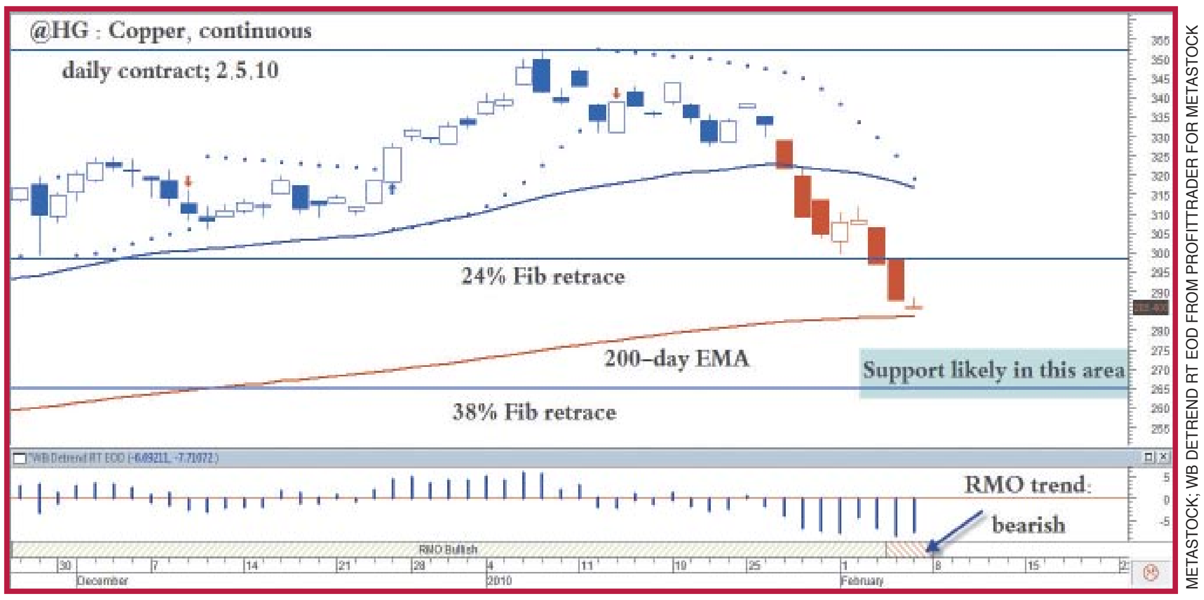

FIGURE 1: COPPER, DAILY. The 200-day EMA frequently acts as a major support/resistance barrier, particularly after a strong up or down move by a stock or futures contract. Experienced traders might wish to monitor for a suitable countertrend entry, should the area near 283.00 offer firm support.

Maybe, maybe not! With the metal firmly ensconced within a solid weekly down cycle, the probabilities still favor trading pullbacks against the dominant trend rather than looking for a countertrend entry. Nevertheless, shrewd and nimble daily and intraday traders may want to monitor copper for a tradable daily bounce higher. Let's take a look at the daily chart for copper (Figure 1).

We'll start with the continuous daily chart for COMEX copper; no question about the validity of the current downtrend, especially since the RMO system has a confirmed short entry and copper has also plowed right through the Fibonacci 23.6% retracement level with nary a bounce. Currently, copper is sitting just above its 200-day exponential moving average (EMA), a key moving average that frequently acts as a tradable support/resistance barrier, particularly after a sizable move up or down by the tradable in question. Given the major move south by copper so far, daily and intraday (30- to 60-minute time frames) traders should monitor the price action near 283.00 for possible long swing trade setups, bearing in mind that this kind of countertrend trade carries more risk than a trade that's in line with the main trend.

If you can time a countertrend long entry with a stochRSI(10) indicator, you may wish to run a close stop (near the 200-day EMA) and then run a two- to three-bar trailing stop, hoping to lock in a profit if the stochRSI clears its upper signal line before copper starts correcting lower again. The 50-day EMA in copper is near 315.00, so any retracement move getting above 300.00-310.00 might be a great place to close out a long swing entry and/or start looking to time a fresh short entry.

If such a short entry gathers steam, subsequently taking out the 200-day EMA on heavy volume, expect prices to fall to at least the 38% Fibonacci retracement near 265.00. Copper's 200-week EMA also resides in that same vicinity (near 264.00) and should also offer major support, for at least a while, depending on how vicious the selling may get by then. Currently, large speculators are still net long even as the commercial interests are heavily short, suggesting that there could be a lot more selling to come before the commercials (who buy and sell copper for their business needs rather than for speculation purposes) begin to step up to the plate and start to acquire more of this essential metal, building inventories in anticipation of this year's building season.

Bottom line is this: Copper may find a temporary low near its 200-day EMA, one that might afford sharp traders a reasonably tradable countertrend swing trade. Less experienced traders (that is, 90%-plus of all people now trading) would probably do better to wait for a lower-risk short pullback swing trade entry, especially if copper makes it back to the 300.00 price level or higher. Bear in mind that copper trades with much lower liquidity than the gold market does, making it essential that you have access to a top-flight broker with modest commissions. Even with that caveat, it is amazing to behold the trend and swing moves that this particular market can and does make from time to time. Be sure to size positions wisely, however, and to always use a real stop-loss order. ■

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Suncor Energy Heats Up

by Koos van der Merwe

Albert Einstein said that energy cannot be created or destroyed. The energy we use in our everyday life must therefore be released from wherever it is confined, whether in oil, or atoms. Right?

Tradable: SU-T

It will take at least 10 years for the nuclear power stations that President Obama has stated will be built in the US. It will take who knows how many years before all the automobiles in the world will no longer use petroleum or ethanol, but electricity... which will be generated by... who knows what. Until then it is oil..Oil...OIL, and of course methane gas.

Suncor Energy, which is listed on the Toronto Stock Exchange, is a company that pioneered the commercial development of Canada's Athabasca oil sands — one of the world's largest petroleum resource basins. Since then, Suncor has grown to become globally competitive, with a balanced portfolio of high-quality assets, a strong balance sheet, and significant growth prospects. It offers:

- Near Fort McMurray, in Alberta, Canada, Suncor extracts and upgrades oil sands into high-quality, refinery-ready crude oil products and diesel fuel.
- In Western Canada, Suncor explores for, develops, and produces natural gas.
- The international and offshore business focuses on operations in the North Sea (United Kingdom, Netherlands, and Norway) and the East Coast of Canada (where it participates in every major oil development project). Suncor is also building material positions in the growth areas of Libya, Syria and Trinidad and Tobago.
- Across Canada and Colorado, Suncor's downstream operations market the company's refined products to industrial, commercial, and retail customers. They have refineries in Edmonton, Alberta, Sarnia, Ontario, Montreal, Quebec and Commerce City, CO. Suncor is also investing in clean, renewable energy sources.
- Suncor has four windpower farms in operation. With a total capacity of 147 megawatts, these renewable energy sites serve as an alternative to hydrocarbon-fuelled generation.
- Suncor's ethanol facility located in the township of St. Clair, Ontario, has a current production capacity of 200 million liters per year. The ethanol is blended into the company's Sunoco and Phillips 66-branded gasoline and contributes to CO2 emission reductions of up to 300,000 tonnes per year.

METASTOCK

FIGURE 1: SUNCOR, WEEKLY

FIGURE 2: SUNCOR, DAILY

What do the charts tell us?

Figure 1 is weekly and shows how the price rose from a low of $7.31 on November 8, 2002, to a high of $74.27 by May 23, 2008. This movement was caused by a combination of the oil price bubble and growth in the company. When the bubble burst, the price dropped to a low of $14.53 by November 21, 2008. Since then, it has risen to a high of $39.62 by October 16, 2009, as the price of oil rose and it is currently trading at the $29.20 range.

On the chart, I have included oil services HOLDRS to show how the oil price is moving and how closely the Suncor Energy price is following it. The indicators shown on the chart are the Hawkins moving average convergence/divergence (MACD) and the rapid relative strength index (RSI) modified. Both are suggesting further downside, although a bottom does appear close at hand.

Figure 2, a daily chart, shows that a solid base is forming, suggesting a buy signal if any one of the following happens:

- **a** The price rises above the pivot point A'
- **b** The price breaks above the trailing stop at B'
- **c** The rapid RSI has given a buy signal by breaking above the moving average (green), but we can wait for the indicator to break above the 30 horizontal line and confirm the buy.
- **d** The Hawkins MACD turned green and gave an early warning buy signal. We can also wait for a movement above zero as confirmation.

Suncor Energy is a stock that moves with the oil price and can be bought when the oil price starts rising. The stock price is in oversold territory, suggesting a buy signal is in the offing. ■

MOVING AVERAGES

A Simple Trend Filter For Trend-Followers

by Donald W. Pendergast Jr.

Some moving averages do a better job than others when it comes to determining various degrees of trend. Here's a look at how to combine two simple technical tactics in order to stay on the right side of a given market.

Tradable: EUR/USD, various

The euro/US dollar (EUR/USD) currency pair has been a relatively trendworthy market over the last 11 years, making it a good candidate for various trend-following methodologies. Here's a strictly visual way to determine if this particular forex pair is offering a good trend-following opportunity. Let's take a look now.

Figure 1 is the daily chart of the EUR/USD forex pair from September 2008 through October 2009, plotted in TradeStation. I've applied only two indicators:

1. The 89-day exponential moving average (EMA)(yellow line).
2. The TradingAlchemy.com TrendCatcher, an average true range (ATR)-based indicator that changes color from violet to aqua blue (and vice versa) when a significant trend reversal is detected.

While the EMA comes standard in TradeStation, the TrendCatcher must be purchased seperately from Trading Alchemy.com. Working together, these two dissimilar indicators do an outstanding job of determining potentially profitable trend-following phases in most freely traded markets, as this 13-month depiction of the daily action in the EUR/USD plainly illustrates.

Note that even though no method of identifying trend can prevent a trader from being whipsawed during choppy, consolidating market phases, this TrendCatcher/89 EMA combo still does very well, enabling a trader to maximize trending gains that are likely to far exceed the losses that will be incurred during nontrending periods.

Your job now is to get even more specific, adding specific entry and exit parameters to this basic trading template, back- and forward-testing them nonstop until your computer's CPU starts to smoke like a Georgia barbecue pit on the Fourth of July. Only in that way can you actually trade a template like this with the rock-solid confidence that you'lll need to take every trade that passes muster.

Who knows? Maybe you'll make more than enough trading profits to fly to Hotlanta or Macon and buy a barbecue joint of your own. ■

The euro/US dollar (EUR/USD) currency pair has been a relatively trendworthy market over the last 11 years.

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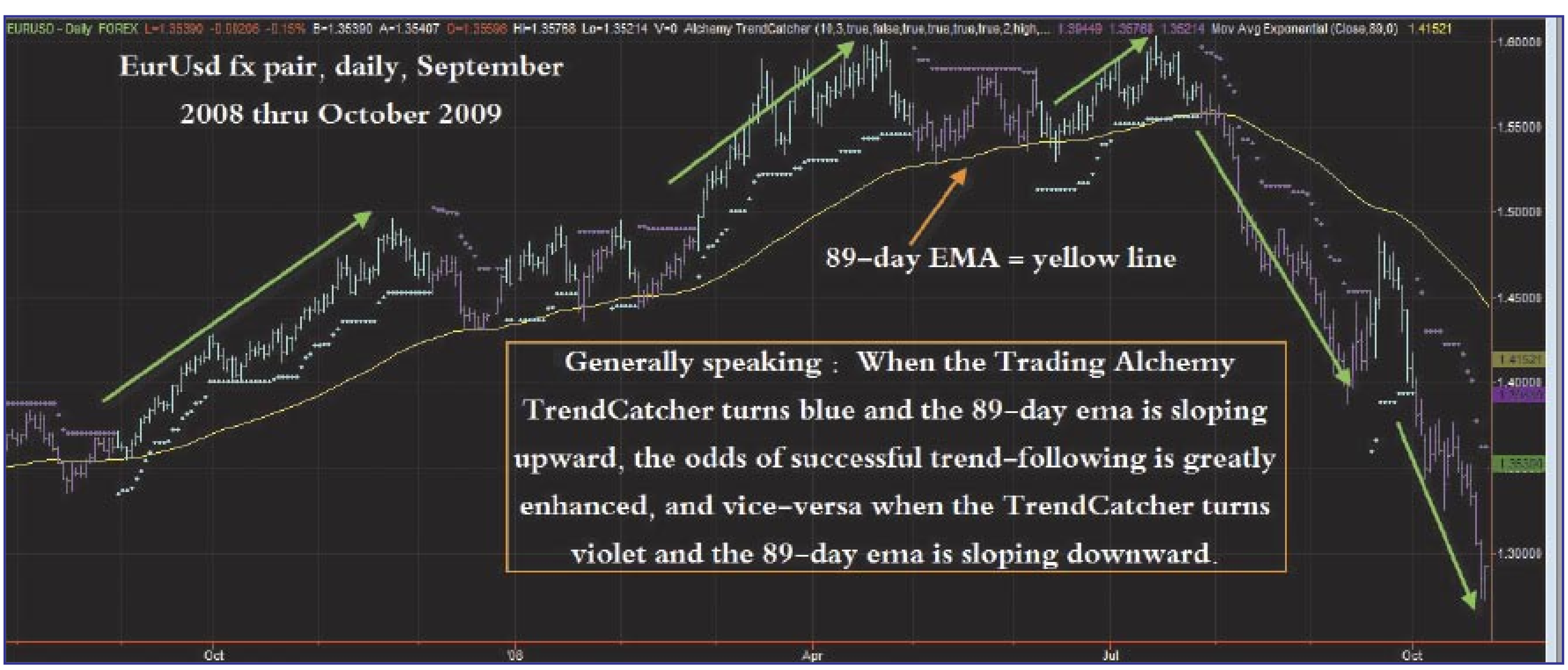
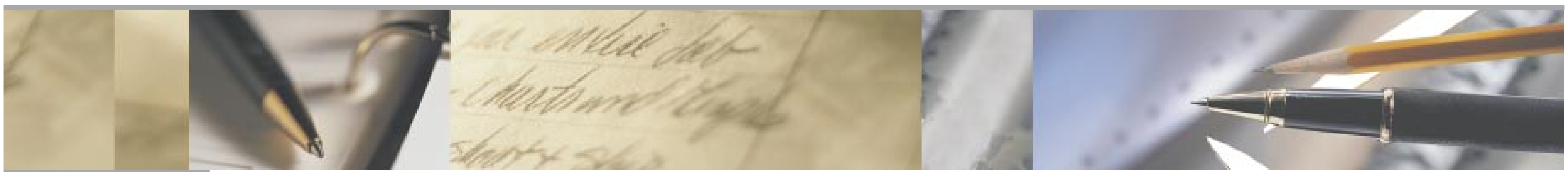


FIGURE 1: EUR/USD FX PAIR, DAILY. Keep It Simple, Stanley! The combination of Trading Alchemy's TrendCatcher and the 89-period EMA does a pretty good job of keeping aspiring trend-followers on the right side of most freely traded markets.



STRATEGIES

Entering The Trade

by Alan R. Northam

There are three steps a trader must make in entering a trade. The first is to identify the trend, the second is to determine when to place a trade, and the final step is to determine the risk involved.

Tradable: JBHT

The first step in placing a trade is to determine the trend of the security a trader is considering. There are many methods of technical analysis that can be used to determine the trend of a security, and one such is to use moving average crossovers.

Figure 1 shows the stock chart of JB Hunt (JBHT). In this figure, I have shown two moving averages. The 20-day exponential moving average (EMA) is used to measure the short-term trend and the 50-day EMA is used to measure the intermediate-term trend. The intermediate-term trend is defined as in a downward direction when the 20-day EMA crosses below the 50-day EMA. Intermediate-term trends normally last for several months and since these two moving averages crossed in late January, the intermediate-term trend is expected to move lower over the next several months.

With the trend of JB Hunt in an intermediate-term downtrend, the price of JBHT is expected to continue lower. However, price does not normally move lower in a straight line. On its way down, price will normally move lower in waves that form lower high peaks and lower low valleys or troughs. I have shown these lower high peaks and lower low valleys on the price chart. Note that in a healthy downtrend, each successive price peak will be lower than the previous peak and each successive price valley will be lower than the previous one. It is only near the end of a trend that these previous peaks and valleys will be violated.

The next step in placing a trade is to determine the entry point of the trade. The lowest risk point to enter a trade is when price is pulling back to its 20-day EMA as JBHT is doing as shown in Figure 1. However, the exact point to enter a trade during a pullback can vary. I like to wait for the high of the price bar to move above the 20-day EMA before entering a trade. However, there will be times when prices will continue to move up through the 20-day EMA and move all the way up to and even slightly cross the 50-day EMA before turning back down. Under these situations, a small loss would be incurred as price continued to move up before turning back down. (Recall that in a downtrend, price should not move back above a previously made lower high price peak and should turn back down before reaching such a price peak.) Under certain situations, price will not even pull back as high as the 20-day EMA before turning back down. Under these circumstances, as soon as a price reversal bar forms, signaling that price is reversing back down, it would be time to enter the market. It is virtually impossible to time the perfect entry point, so don't be disappointed if the entry is a little early or a little late, as this is simply part of trading.

After determining the entry point, it is time to decide whether to enter the market short or long. In a downtrending market such as shown in Figure 1 for JBHT, a short trade should be placed. Long trades should only be placed during uptrends. An uptrend can be determined by reversing the procedure as described on how to determine a trend.

Once the entry point has been determined, it is time to determine a stop-loss point. A stop-loss is a point at which a decision is made to exit the trade if the trade is going against the expected direction. Under such circumstances, a significant loss of capital would be incurred if the trade was allowed to continue. The best price area to place a stop-loss is just beyond a price point that price is not expected to go during a pullback. Such a place is slightly above a previous lower high in a downtrend as shown in Figure 1, where price made a lower high in late January. Recall that in a downtrend, a price pullback should not move higher than a previous price high or peak. Therefore, this previously formed lower price high is an ideal area in which to place a stop-loss.

The lowest risk point to enter a trade is when price is pulling back to its 20-day exponential moving average (EMA).

The last step in placing a trade is to calculate the risk of entering the market. The risk is calculated by dividing the entry price by the stop-loss price and expressing the result in percentages. In the case of JB Hunt, if a market order was set to enter the market at the last closing price of $31.68 and a stop-loss was placed at $33, the resulting risk of entering this trade calculates to be approximately 4%. Therefore, there is a possibility of losing 4% of the total dollar amount to be used in placing this trade. However, if the analysis is correct, the market will reverse back down before reaching the stop-loss point.

In conclusion, when deciding to place a trade, the first thing to consider is the main direction of the trend of the security being considered. The next step is to determine the entry point and the final step is to determine a stop-loss point. If the analysis is done correctly, price will turn back down in the area of the entry point and the stop-loss point will never be triggered. However, if the analysis is wrong, the stop-loss will trigger, resulting in a small loss and thus avoiding a large loss of working capital. There will be times when trades don't work out and losses incurred. However, there will also be times when the trade does work and profits result. Such is the life of a trader. ■

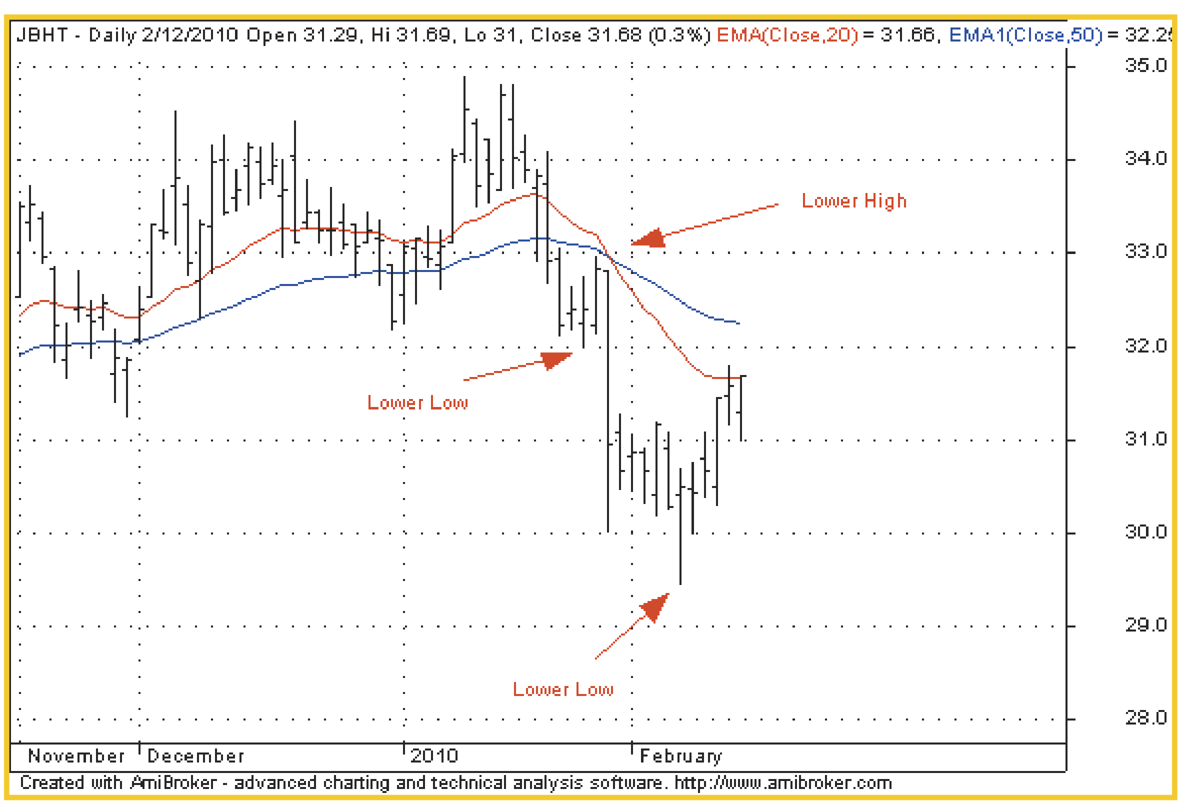


FIGURE 1: JBHT, DAILY. This shows exponential moving averages and price peaks and price valleys.

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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.

Backtesting — A strategy is tested or optimized on historical data and then the strategy is applied to new data to see if the results are consistent.

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 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.

Moving Average Crossovers — The point where the various moving average lines intersect each other or the price line on a moving average price bar chart. Technicians use crossovers to signal price-based buy and sell opportunities.

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.

Pin Risk — A risk that an option or futures contract faces when the price of the underlying asset closes at or near the exercise price of the contract upon expiration.

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.

S&P Emini — Electronically traded, smaller-sized ($50 times the S&P 500) contracts of the Standard & Poor's 500 index.

Simple Moving Average — The arithmetic mean or average of a series of prices over a period of time. The longer the period studied (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 transformed into a range between zero and 100 and 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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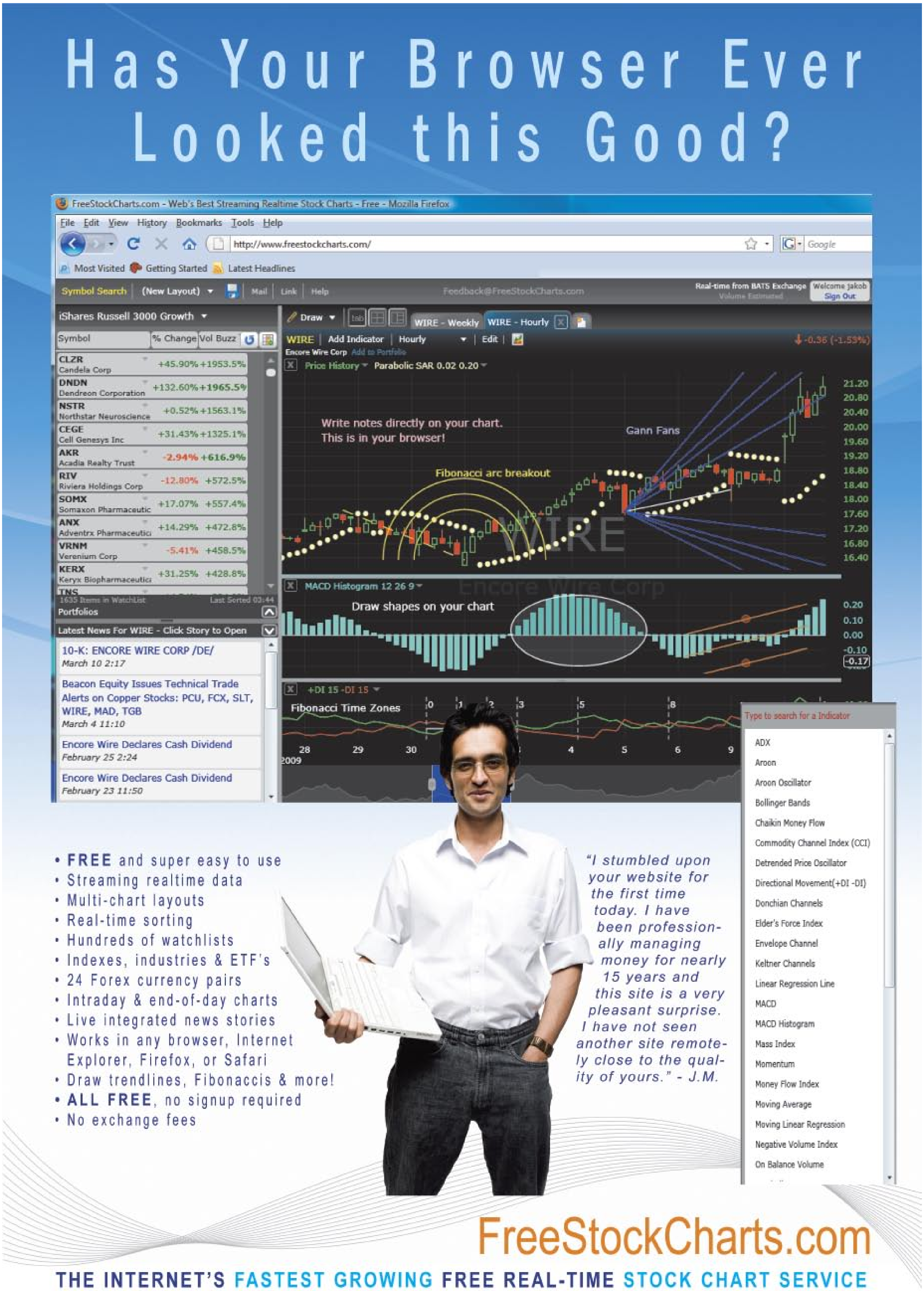
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