

Books & Trades # 192

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The New High – New Low Index ... A New book ... Education

Dear Trader,

Hello from Annapolis, this year's site our SpikeTrade Reunion. I drove here from New York a day early to make sure everything was ready for us, and since everything was fine I got a few free hours to write this letter.

With the Dow having reached a new bull market high a few days ago, it's the time to ask: are we in the midst of a healthy bull market or are we watching a distribution pattern at a bull market top.

To answer this question, let's use the New High – New Low Index. I consider it the best leading indicator of the stock market.

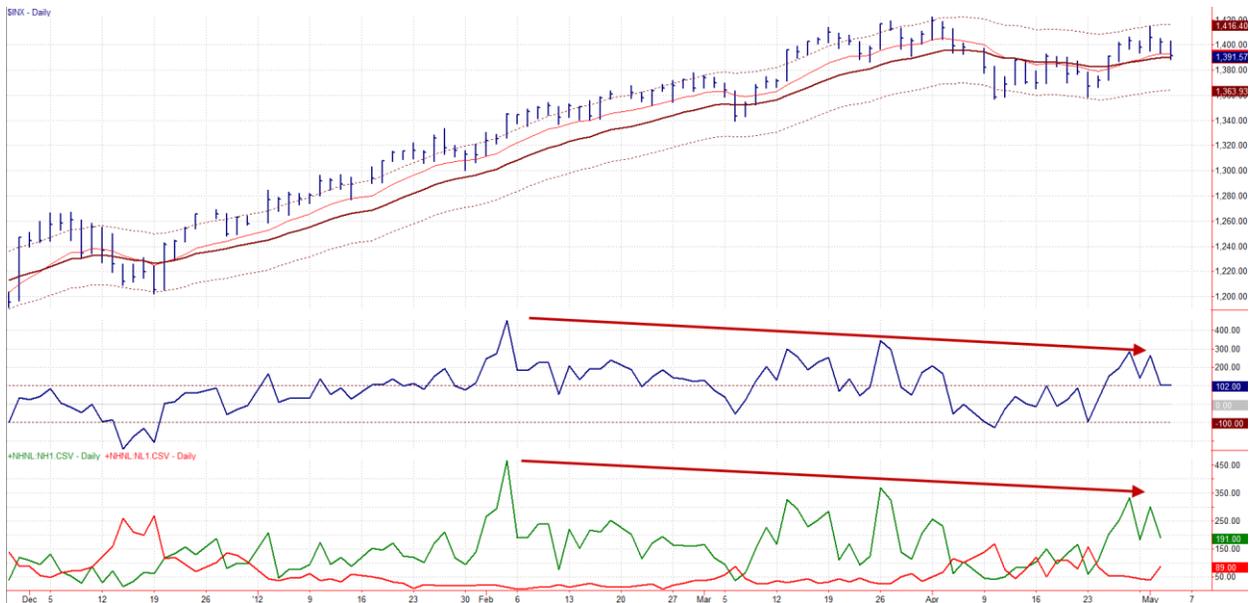
The New Highs are the stocks that rise to a new high for the year on any given day. These are the strongest stocks on the exchange, the bullish leaders. The New Lows are the stocks that fall to a new low for the year on any given day. These are the weakest stocks on the exchange, the bearish leaders. Crowds follow leaders in and out of the markets, which is why the New High – New Low Index allows you see which way the leaders are going and what the crowd is likely to do next.

Let's take a look at the charts...



This is a weekly chart of NH-NL. Notice two horizontal dashed lines. The green line is drawn at a minus 4,000 level. Whenever the weekly NH-NL spikes below that level and then rallies above it, it generates a “Spike” – a powerful buy signal. That signal is especially strong when it comes out of a bullish divergence, as happened in areas A and D.

A red dashed line is drawn at the plus 2,500 level of weekly NH-NL. This index rises to that level only during true bull markets and never during bear market corrections. You’ll notice that it confirmed the bull market in 2009 in area B. There have been several confirmations since that time, but what is shocking is that no confirmations occurred since November 2010. This tells us that the bull is running on borrowed time, and the danger level is very high.



This daily chart of the New High – New Low Index shows a growing bearish divergence. The New Highs (green line) and the daily New High – New Low Index (blue line) both reached their peaks in early February. They have been trending lower since that time, even as market indexes continued to rise (remember, the Dow reached its bull market high last week). The leaders are becoming weaker, even as followers press their attack. This is a setup for a reversal.

The New High – New Low Index is flashing bearish messages in all the timeframes that we track. What's a trader to do?

First of all, protect your profits on long positions with stops – with hard stops, not mental stops. Second, be extremely cautious about buying. Third, look for opportunities to sell short. Consider joining us at www.spiketrade.com where we update our NH-NL analysis on a nightly basis.

Best wishes for successful trading from all of us at elder.com

Dr. Alexander Elder & staff