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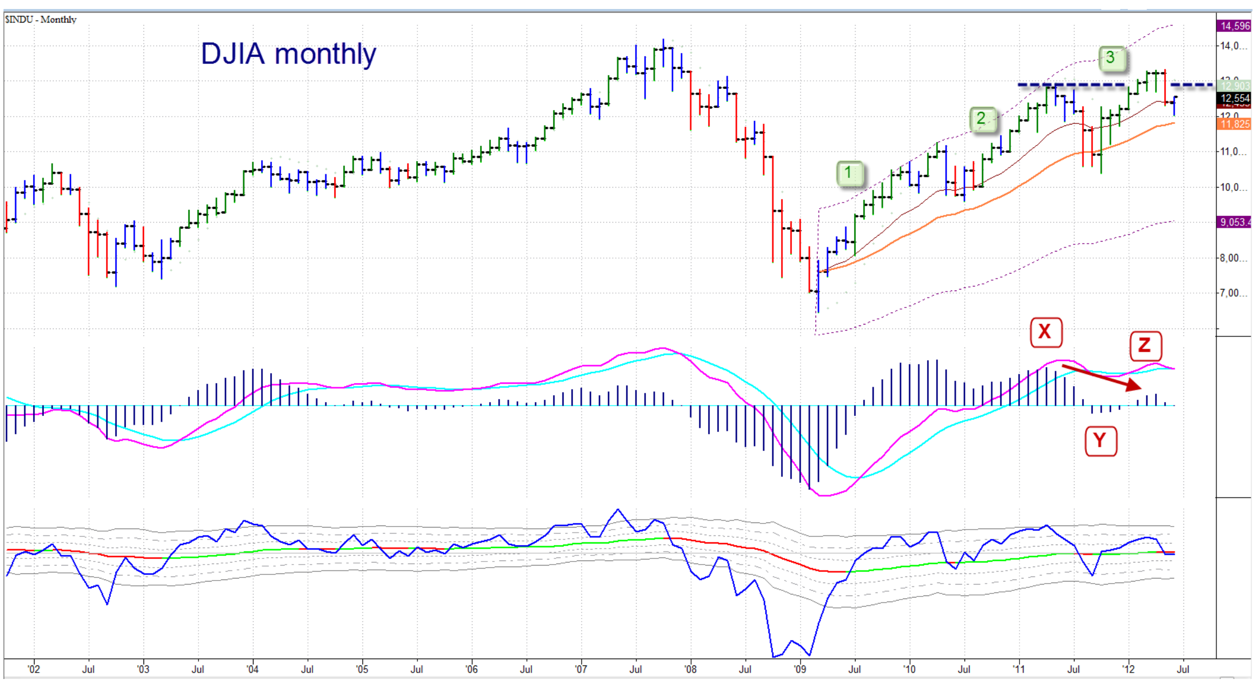
The market turns … January Camp … Special

Dear Trader,

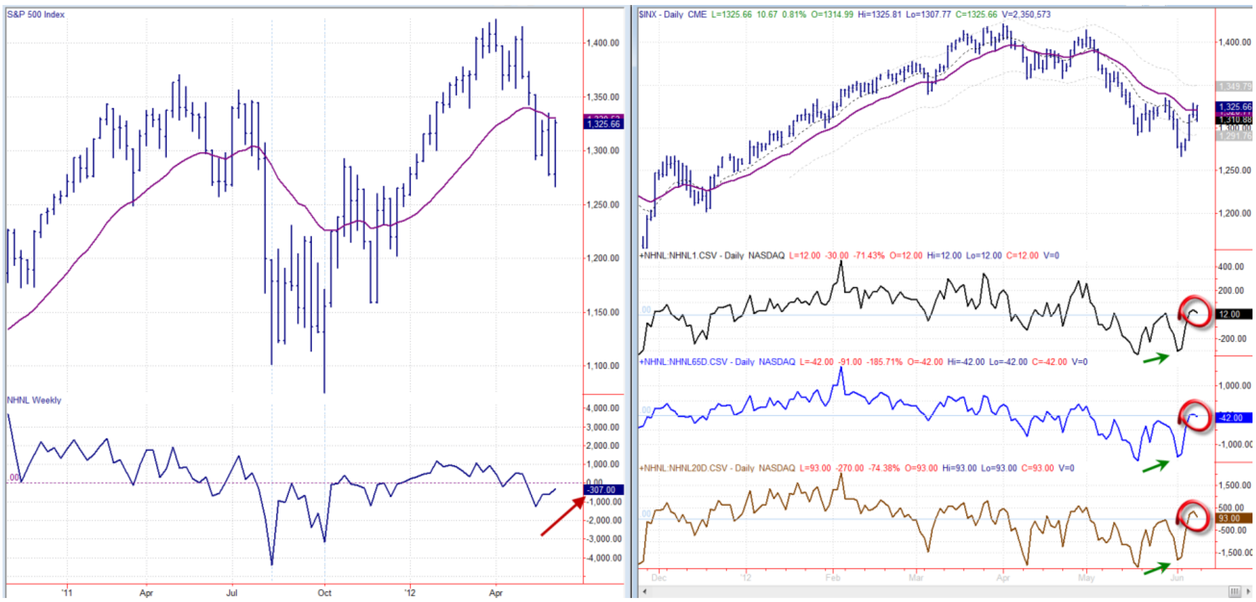
In my previous post on May 4 I invited you to look at the New High – New Low Index, which I consider the best leading indicator of the stock market. I showed you several charts and concluded: "… the bull is running on borrowed time, and the danger level is very high. … The New High – New Low Index is flashing bearish messages in all the timeframes that we track. … protect your profits on long positions with hard stops … look for opportunities to sell short."

Now, more than a month later and over 700 Dow points lower, let's take a fresh look at our updated charts.



Let's begin with the big picture, a monthly chart of the Dow. The bull market that began in March 2009 had three distinct upwaves, each shorter than the previous one. This is not a typical bull market behavior; normally, the third stage lasts the longest and rises the farthest. This shortening of the thrust looks like a sign of weakness, confirmed by the fact that the 'angle of attack' has become more shallow in each wave.

Last year monthly MACD-Histogram rallied into its peak X, confirming the power of bulls. It fell below zero last fall, ‘breaking the back of the bull.’ In spring 2012 the Dow rallied to a new bull market peak, but MACD-Histogram topped out at a much lower level Z and then ticked down, completing a bearish divergence. This, combined with the false upside breakout, is perhaps the most bearish combo in technical analysis.



As we turn to the New High – New Low Index, let’s keep in mind that no market move proceeds in a straight line – there is always some backing and filling. Last Monday I got back from China, saw a set of bullish divergences on the daily charts (marked with green arrows), and took profits on short positions the following day. I didn’t go long because I view the current environment on as a pressure-reducing rally in a bear market; once it ends, there’ll be new shorting opportunities.

Look at the weekly NH-NL on the left side of this chart: after a rally of 500 Dow points it is still negative. This leading indicator is displaying weakness, not strength. Look at the daily charts on the right (we track daily NH-NL on a yearly, quarterly and monthly basis). All of these charts rallied to their zero lines, basically reducing bearish pressure, and on Friday all three turned down, even as the market closed higher.

I would suggest to use this rally for profit-taking, protecting profits on long positions with hard stops, and for the more aggressive traders to look for new shorting opportunities. Of course, the monthly format of these letters is not suited for precision timing. For that I invite you to our sister website www.spiketrade.com – just take a Trial and see how you like it.

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

Dr. Alexander Elder & staff