

Books & Trades # 207

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The first bell rings ... Classes ... Specials

Dear Trader,

A comment on the timeframe of these letters: I send them once a month, which works for expressing general ideas about the market, but not for precision timing. The site where I post up-to-date comments is SpikeTrade.com

For example, in my previous Books & Trades on August 14, I was bearish. Then on September 4, in SpikeTrade we turned strongly bullish, riding the rally to the new bull market peak.

With that caveat, today I'd like to share with you my SpikeTrade post from the latest Sunday.

Back in the 1980s I was practicing psychiatry full-time to support a family, while trading was an intense but a part-time interest. To make some extra money I began consulting at Phoenix House, a major drug rehabilitation facility in the city (Nancy Reagan was our patron saint). I'd drive there one or two evenings a week and do psychiatric interviews on new arrivals.

New York was in the grip of a heroin epidemic, and many of our arrivals had 'a \$200 habit,' meaning they needed to shoot \$200 worth of heroin into their veins each day, just to avoid withdrawal pains. To buy it, they had to steal \$2,000 worth of stuff every day, since fences paid them 10 cents on the dollar – they were virtual crime machines. They would do anything, absolutely anything, to get their \$200/day fixes.

I think of those days as I watch market's reaction to the Fed's QE program. I think it's pretty clear that this program cannot continue forever, that it'll end and the market will have to stand on its own feet or fall on its face.

Back in my Phoenix House days, the addicts didn't think about the long term. They only thought of their \$200 fix for today. The market's gyrations last week reminded me of those guys, for whom joy and despair alternated very quickly, with no long-term views. When the candidate for the Fed chairman who was perceived as slightly strict, withdrew, the market had a party. When Uncle Ben promised \$200 per day for a while longer, the market had an orgy. When it became clear that the decision about the \$200/day habit will be considered again in October, the addict broke down and cried.

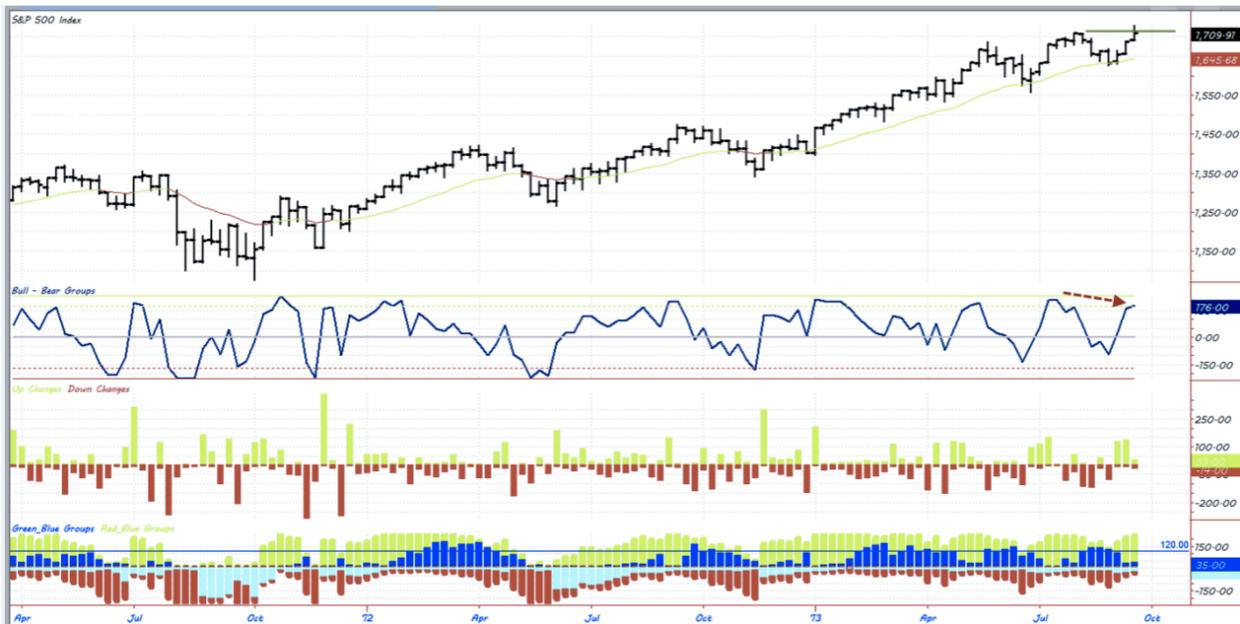
Addicts are at the center stage right now. Still, in the long run, logic will prevail, and we better be ready. Let's take a look at our charts...



The weekly charts of the Dow and the S&P have ugly bars at their right edges. They opened low, shot up very high, couldn't hold, and closed below their midpoints. Only the Nasdaq closed stronger, near its high.

Now, this alone is absolutely not enough to call a stock market top – we'll need a lot more evidence for that. Still, this is enough to ring the first warning bell on this rally. Just like at a Broadway show, they ring the bell once – you better start walking to your seat; they ring it twice – you better get there fast; they ring it three times – and in a moment the lights go out and the show begins. I would consider last week's action the first bell. You still have enough time to finish your drink at the bar, but the countdown to the show has begun.

The Impulse system is still bullish on the monthly and weekly charts of all indexes. The New High – Nnew Low Index is at bullish levels in all four time windows that we track. So far so good – but notice dashed arrows that point to potential bearish divergences. Those divergences aren't here yet, but they're starting to develop. NHL is at bullish levels in all of its for windows, but struggling below green lines that mark the July highs.



The chart of Industry Groups and Subgroups (unique to SpikeTrade) confirms that the rally is still in effect. Still, I could not resist drawing a dashed red arrow, indicating a potential bearish divergence.

Remember, the market time is much slower than our human time. Reversals take much longer than we would like. Let's not jump the gun. Still – forewarned is forearmed!

PS: For daily updates, please take a Trial membership in SpikeTrade.com

Best wishes for successful trading!
 Dr. Elder and Team at elder.com