Books & Trades #214
August 22, 2014

One-Way Road Ends … Meetings … Specials … Italy

Dear Trader,

I aim to send these letters once a month, but skipped June and July – was up to my ears finishing a major project (more on it below).

As I look at the charts I showed you in May, S&P has risen from 1900 to 1980 (up 4+%) and All-Ords from 5490 to 5560 (up 1+%). Marketwise, we didn't miss very much.

A long-term client sent me a letter:

"*Hi Alex*

I did one of your courses in Sydney. I notice that the emails I occasionally receive from you now no longer have your commentary on the markets.

Cynically I was thinking that because they were wrong, you have stopped doing it (your analysis by the way was correct!)

You must be frustrated, as I am. In my retirement account, the money manager and I dutifully hedged the account several times this last year. All for losses. And this was using signals which in the past had worked well.

The consistently bad record in hedging - what should have worked at least 2 out of 3 times tells me that something is different with the markets. Completely different from the past few years and different from the bull market from 2003 to 2008.

No doubt things will revert back at some stage. All I can say is that when they do it will be very savage and a lot of money will be lost from those who gave up hedging or just bought the dips continually....

Chris"

Frustrating indeed – but that's not why I go easy on current market commentary. The monthly format of these letters doesn't lend itself to precision timing, while I have the luxury of daily adjustments in www.spiketrade.com There we've been on a buy signal since August 8).

This relentless rise doesn't fit into any historical model. The multi-year bullish trend looks too good, too orderly to be true. It reminds me of Bernie Madoff's "equity curve." The few people who attempted to blow the whistle on him became suspicious that his track record was too positive and too orderly to be real. His investors had a long good ride but a very sharp and sad end.

Madoff was ‘painting’ his curve while he and his group looted investors. The stock market is not being ‘painted’ – it’s rallying for real. What’s behind its unnaturally smooth and persistent rise?

I think it’s the Fed, pushing money into the economy, and most of that money flows into stocks.

There was an revealing profile of Janet Yellin in a recent issue of The New Yorker. Both she and her husband grew up with parents who experienced unemployment and privation during the Great Depression of the 1930s. Both see the main role of the government as reducing unemployment. Both are quite left-wing – Janet Yellin is cautious about what she says, that’s helped her get the job – but her husband and collaborator is quite open – to the point of giving an interview to a German magazine after George Bush’s re-election calling for civil disobedience. That’s not what we do in this country after elections.

As the Fed keeps pumping money, unemployment keeps dropping. The Fed wants to continue pumping because the person at the top is keenly aware that every fraction of a percentage drop of unemployment reduces the amount of human misery that she experienced as a child. She’s going to pump longer than most expect.

But remember: she is no great fan of Wall Street. When the unemployment falls low enough for the Fed to stops pumping, as the market begins to drop, it’ll have little sympathy and support. Just as the rise has been longer and smoother than ever, the coming slide is likely to be sharper and uglier than many expect.

Click here to enlarge this chart (only when you’re online)

I believe that the New High – New Low Index is the best leading indicator of the stock market. The weekly chart on the left shows that the weekly NH-NL hasn’t reached the typical bull market level of +2,500 since the beginning of 2014. It is building a massive bearish divergence. With the S&P at a record high, the weekly NH-NL was at a feeble 613 yesterday.

The daily chart on the right shows pronounced bearish divergences between prices and NH-NL in all three daily time windows that we track in SpikeTrade. The market is higher, but NH-NL is lower. It means that buying is becoming concentrated in a diminishing number of stocks. It is becoming increasingly hard to match market's performance buying individual stocks , with money flowing into index funds.

The green arrow shows the latest SpikeTrade buy signal – but keep your hand on the exit handle. I think this market is approaching the Bernie Madoff stage of bullishness.

Traders' Education

Please visit our website for more information on these events

ONLINE: August 27 at 6pm ET - Webinar –"Current markets with Dr Elder." Enter Dr. Elder's trading room from your own computer and watch him review stocks and futures. Send your picks to him and ask him to review them. **An ongoing bonus for all webinar participants – receive an email each weekend giving you the results of bullish and bearish scans of the S&P500**.

ALABAMA: September 20-21, Live Trading workshop (with Kerry Lovvorn) – sold out.

LONDON: October 11, at the IFTA conference: "Tuning your emotions for better trading".

Best wishes for successful trading from all of us at elder.com
Dr. Alexander Elder & staff