SMI
The Trend Letter
Thursday, December 10, 1981

MARKET TRENDS

On Thursday, November 19, the market began what proved to be the strongest rally of the trading range with the exception of the automatic rally. The advance failed to break the top out of the range. Does this mean that it was just another example of the impatience that has been displayed ever since the secondary test? That is one explanation, but it is not the only one.

Why did the rally fail to produce what appeared to be its intended result? There are a number of reasons. One has to do with the volume. The advance that began on the nineteenth could have developed into a jump across the creek if the volume had come in strong as the price started to make its upside progress. That did not happen. Instead, the volume pattern remained substantially flat. This alone would have been enough to doom the rally to failure, but there were other factors.

For example, the Wave and O.P. have been going their separate ways ever since the top of the automatic rally. This is something that should not be overlooked. Whenever the Wave and O.P. start doing different things, there is reason for concern. The likelihood of an important turn is increased and the likelihood of a sustained move is decreased. As the Wyckoff Wave approached the top of the trading range, it was not in harmony with the O.P. This important flaw at such a critical point could easily have prevented an upside breakout.

A third important factor in the markets failure at the resistance level can be found in the Technometer. It became clearly overbought just as the Wave was encountering the resistance level. This vulnerability to a reaction together with the other factors that seriously limited the upside possibilities could have been responsible for the end of the rally.

All these reasons why the rally was doomed to failure create the impression that the entire experience was in fact just another example of investor impatience. The reaction that has begun since the top of the rally would seem to confirm this. Before we write the rally off entirely, however, we should wait to see what type of character the reaction develops.

Although it stretches the concept a bit, the last rally could be seen as some type of sign of strength. The reason there is a problem with this goes back to the volume. A sign of strength should be an aggressive rally on increased volume. There is nothing wrong with calling the price action on the last rally aggressive, but it did not come on increased volume. Do we say that half a sign of strength is better than no sign of strength? No. That would be too dangerous. What we can do, however, is pay close attention to the level of volume as the current reaction progresses. If it will substantially contract as the middle of the trading range is approached, the market may be developing a last point of support and indirectly proving the sign of strength. At the very least, this type of action should provide the market with the opportunity to make another run at the resistance level.

There is another possibility that could develop from this point, which also could have a positive outcome. If we take a closer look at the top of the last rally, we can see that it made two penetrations of the resistance level that did not accomplish anything. These can be seen as an upthrust and a test, which leads to some negative possibilities. The worst thing that could happen would be for the Wave to drop back into the middle of the trading range without experiencing any decline in volume. This would tend to confirm the upthrust. There would still likely be another attempt to rally, but this would probably be a more important test of the upthrust action and could leave the market in serious trouble.

The worst case scenerio following the upthrust action does not have to happen. There is another possibility. If the Wave meets support very quickly well above the halfway point of the previous rally, it could be very positive. This depends on the level of volume. It must contract substantially and as quickly as the price meets support. This would represent a failure to respond to the upthrust and leave the market well positioned to resume its rally and break through the top of the range. This possibility would be aided by an oversold condition developing as the Wave meets support.

On balance, the possibilities for the future appear more positive than negative. Therefore, the objective of stock selection at this point should be to identify potential long candidates, but to hold off on actually taking them until the worst case scenerio mentioned above has been laid to rest.

STOCK TRENDS

In recent weeks, the eight stocks in the Wyckoff Wave have undergone a substantial rearrangement from the standpoint of those that are relatively strong and weak. If one of the positive possibilities outlined earlier develops, the issues most worthy of long commitments appear to be General Electric, Union Carbide, Exxon, and Pittston. Should the worst case scenerio start to take shape, the stocks to consider for short selling would be UAL, Inc., I.B.M., General Motors, and Merrill Lynch.

Trying to choose between GE and UK as being the strongest stock is difficult. Since the climax, both issues have made advances in excess of fifteen percent. However, the advance in General Electric has been a little larger and has managed to retrace half of the previous decline, which is something Union Carbide has not quite managed to do. This would seem to make GE the strongest of the stocks, but do not rush out to buy it immediately. There are additional factors that need to be considered.

Both stocks appear to be in need of corrections with the need seeming to be bigger in the case of General Electric. This stock has twice run into its overbought line and been turned back on both occasions. At this point a gradual return to the creek level at the top of the trading range would be very desirable. It would eliminate the overbought problem and probably add to the potential. At this point, the relatively small amount of additional potential is the biggest drawback in this stock.

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Upside potential is not as much of a problem for Union Carbide, but that which does exist could stand some expansion. A correction at this time could be very helpful with this, as well as eliminate the possibility of an overbought condition developing. A reaction in this stock could find support at fifty-one or could drop back as far as forty-nine without causing a problem.

The other two strong stocks, Exxon and Pittston, are not as attractive as the two just discussed, but they are worth considering. Exxon's position has improved considerably in recent weeks. The recent rally to thirty-three broke the trading range between thirty and thirty-two. Unfortunately, the volume of this rally was not impressive. This creates uncertainty and puts a great burden on the current reaction, which should meet support around 31.3. This would set the stage for a rally to the thirty-eight to forty level, but a position could only be justified if there was a great deal of confidence about the future of the general market.

Pittston, the last of the potential long candidates, is a relatively strong stock that has been confronted by significant resistance since early in the trading range. Therefore, it has not made any new progress for quite some time. However, it has been able to hold the progress that was made earlier. This is positive and when combined with the new potential that has developed forms the possibility of renewed upside progress.

The key to Pittston's future appears to be the outcome of the battle between the resistance level at 28.2 and the important support line constructed under the selling climax and the low of the last reaction. The victor in this fight should be known in a week or so and that will indicate whether this stock remains a potential long candidate.

If the market does develop into its worst case scenerio, a prime candidate for the short side should be UAL. The reason is not so much because of what it has done, but because of what it has failed to do with the potential that is available. The action within the trading range had been reasonably bullish. Then there was an obvious spring action followed by the expected positive response. Several weeks later there was a very constructive test to the spring. At that point, UAL should have been ready to make its move. It got off to a good start with a rally to twenty and then was promptly stopped while the market continued to rally strongly. This failure to respond eliminated the stock as a long candidate. The situation could improve given more time. However, the failure suggests the possibility of distribution. In view of the potential available in this stock, we would not want to be caught on the wrong side of it. Therefore, either monitor its short side possibilities or leave it alone.

Perhaps the best short candidate is I.B.M. It has a down trend going that just will not quit. This was proven earlier this week when the price reached the supply line and promptly turned around. This indicates that the climax of about six weeks ago at the least needs additional testing. If we can take this week's high of fifty-five as a count level and take that count back into a previous congestion in this area, we have a significant remaining downside potential. This in combination with that persistent down trend makes I.B.M. a good short sale candidate.

A stock that has paralleled the weakness in I.B.M. is General Motors, which should also be considered a potential candidate for the short side. Its position has improved somewhat recently. The down trend appears to have been broken, which puts this stock one step ahead of I.B.M. However, there is no indication as yet that the testing process has been completed. Consequently, GM remains a possibility for a short sale of at least a short term duration.

Finally, there is Merrill Lynch. This stock along with Pittston was the first to show strength following the climax. Even now, it is still holding half of its earlier gain, which makes it a relatively strong stock from an intermediate standpoint. However, there is a question as to how long that strength is going to last. As was mentioned earlier, the last rally in the general market was the best one thus far. It is reasonable to expect a strong stock to respond positively to such a rally. Merrill Lynch did not. Hence, the question as to whether this stock is undergoing an important change of character. A breakout on the upside by the market would likely get some type of positive response from the stock, but there is now serious question as to whether a new high could be reached. Should the market now turn negative, the weakness recently expressed would make this a good short sale possibility.

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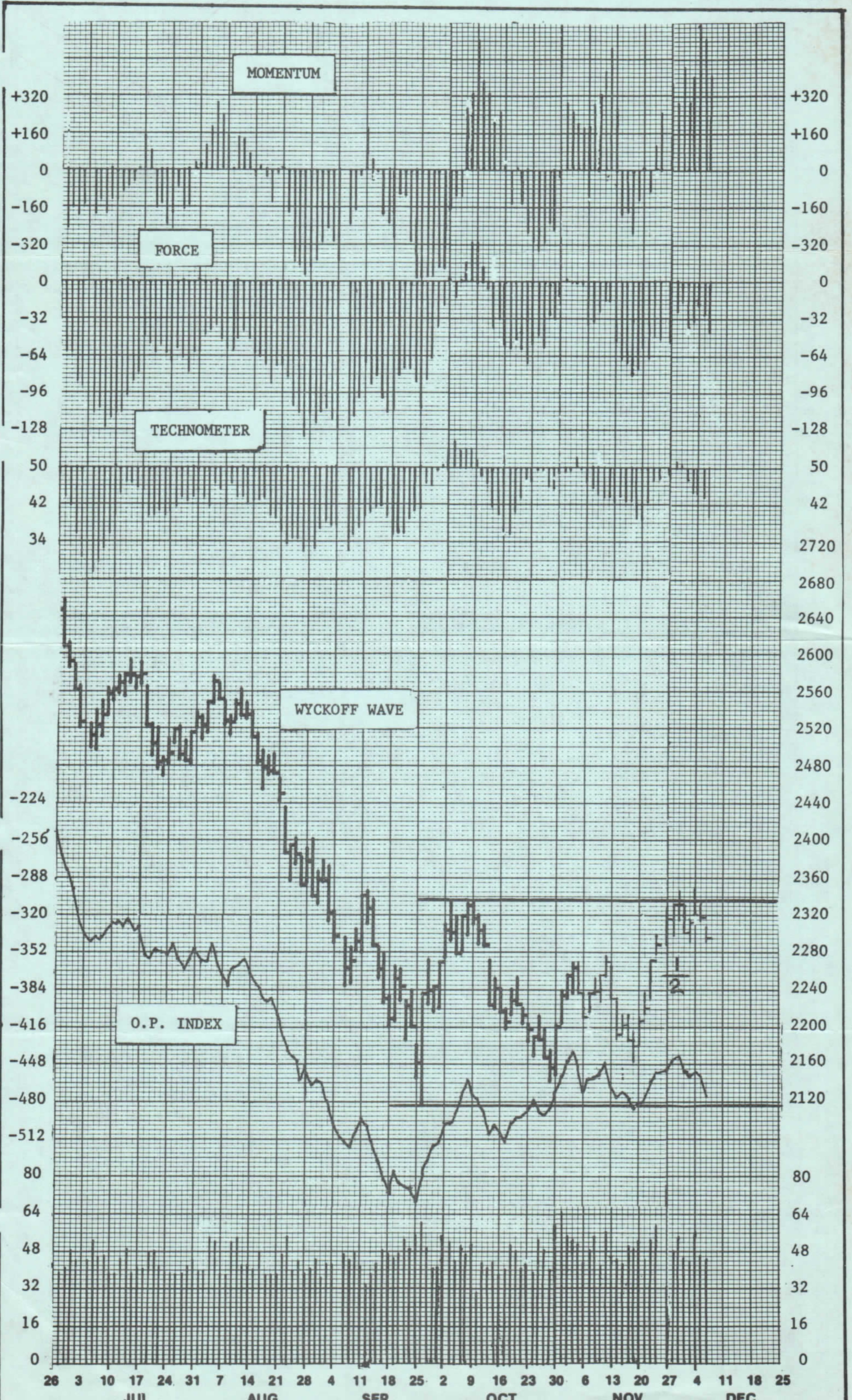
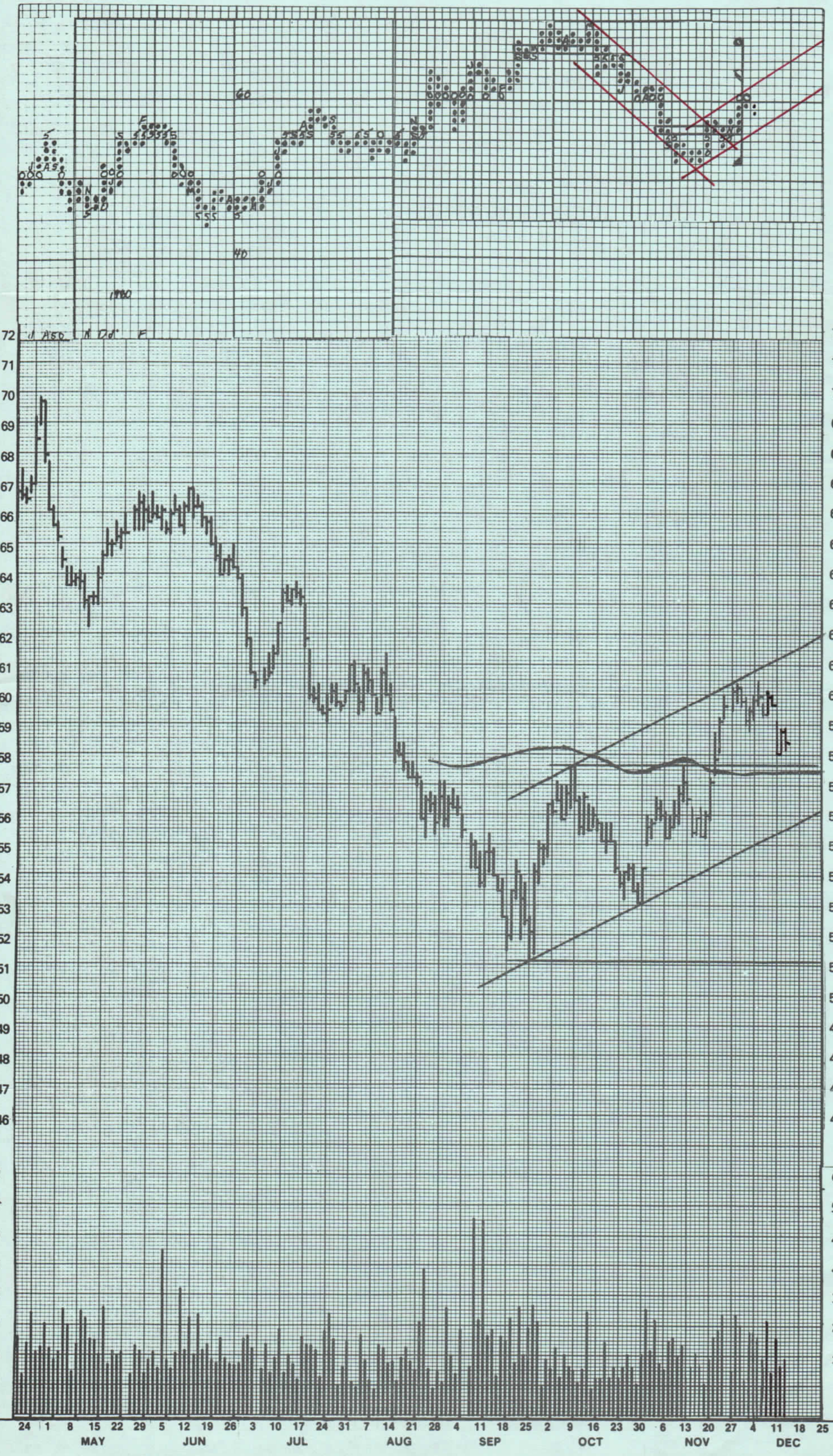
The Pulse of the Market

TUESDAY DECEMBER 8, 1981

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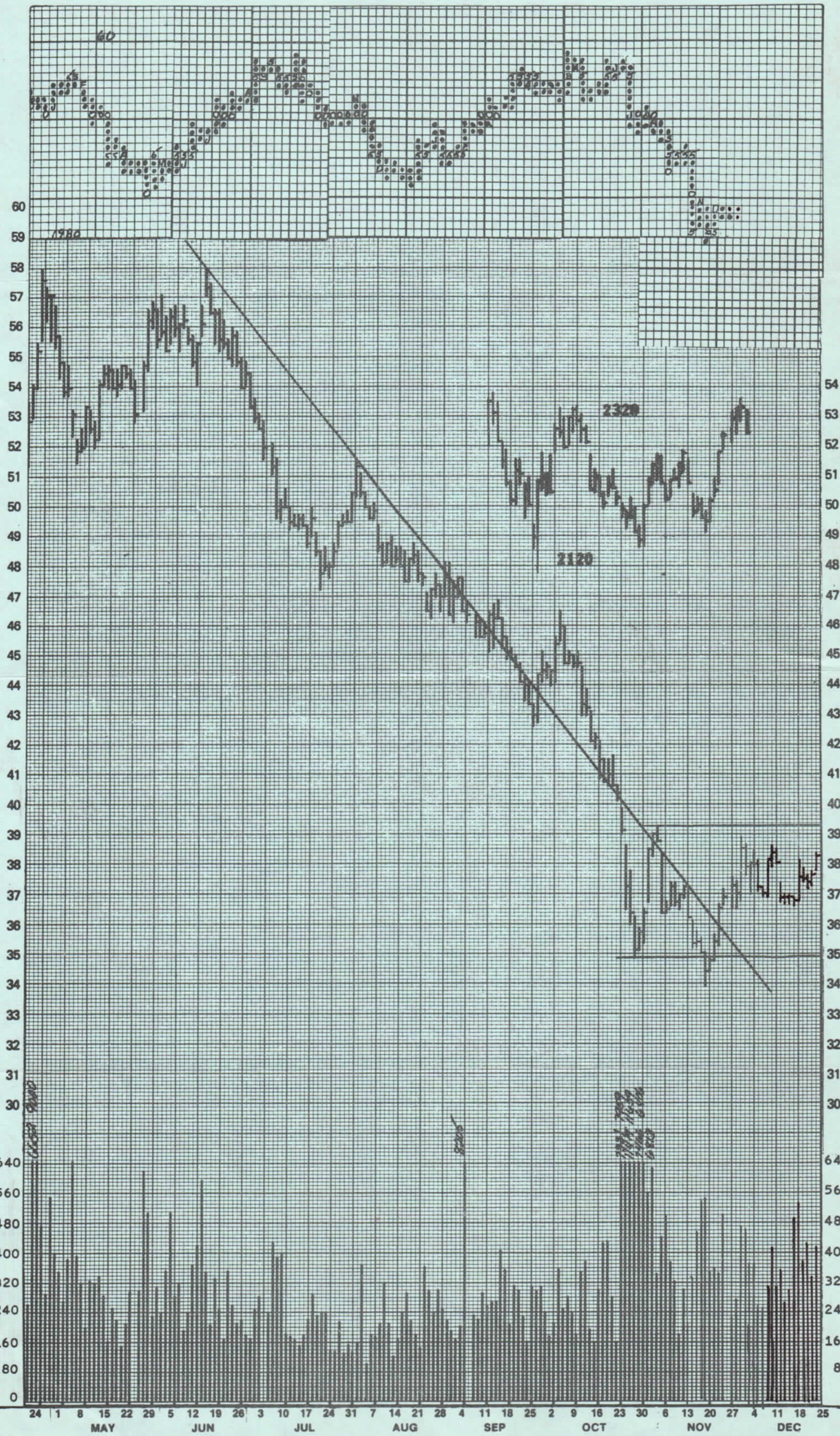
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IBM

COMPUTERS

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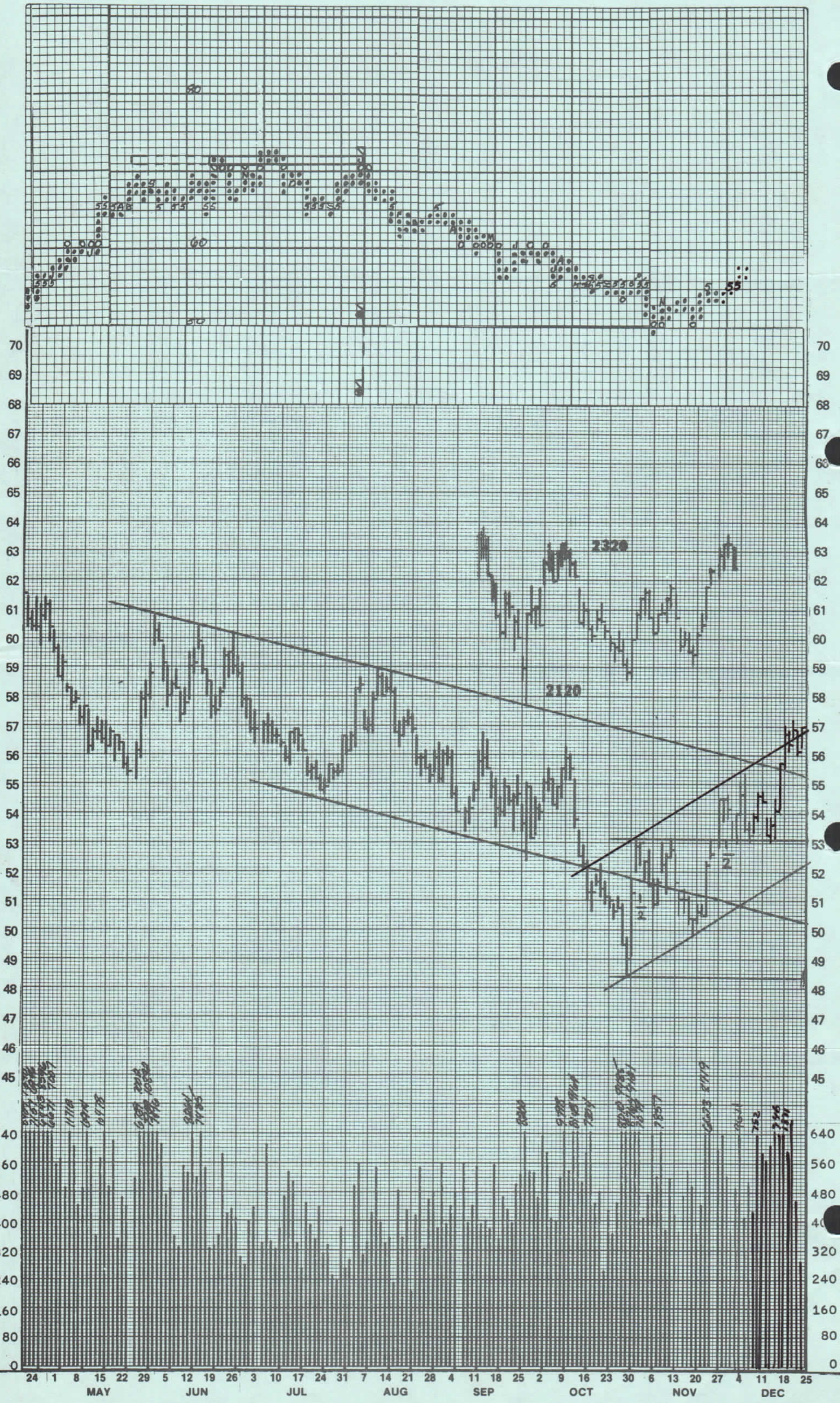

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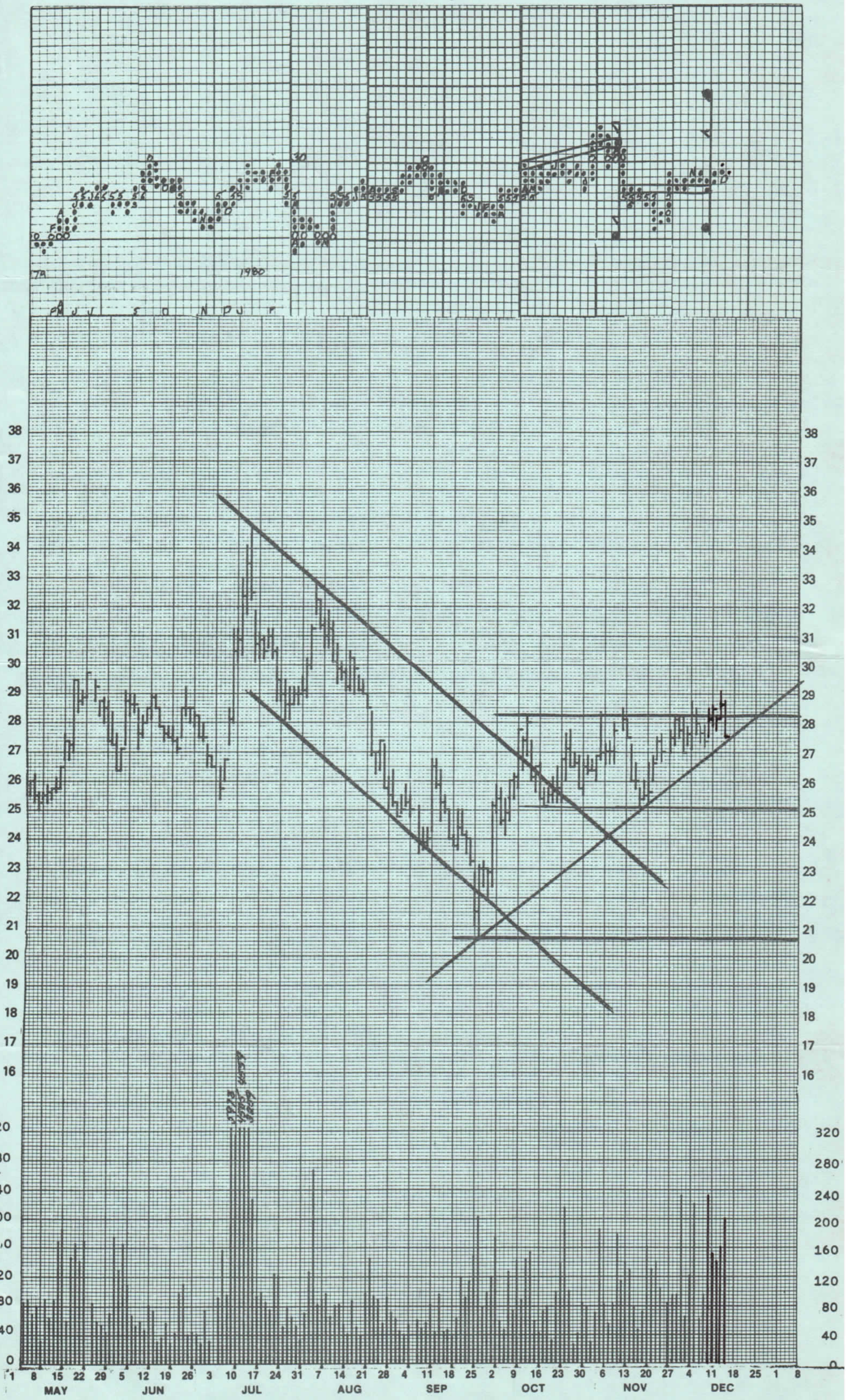
PITTSTON CO. (PCO)

STEEL/COAL P.B.W. (p&c)



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MERRILL LYNCH (MER)
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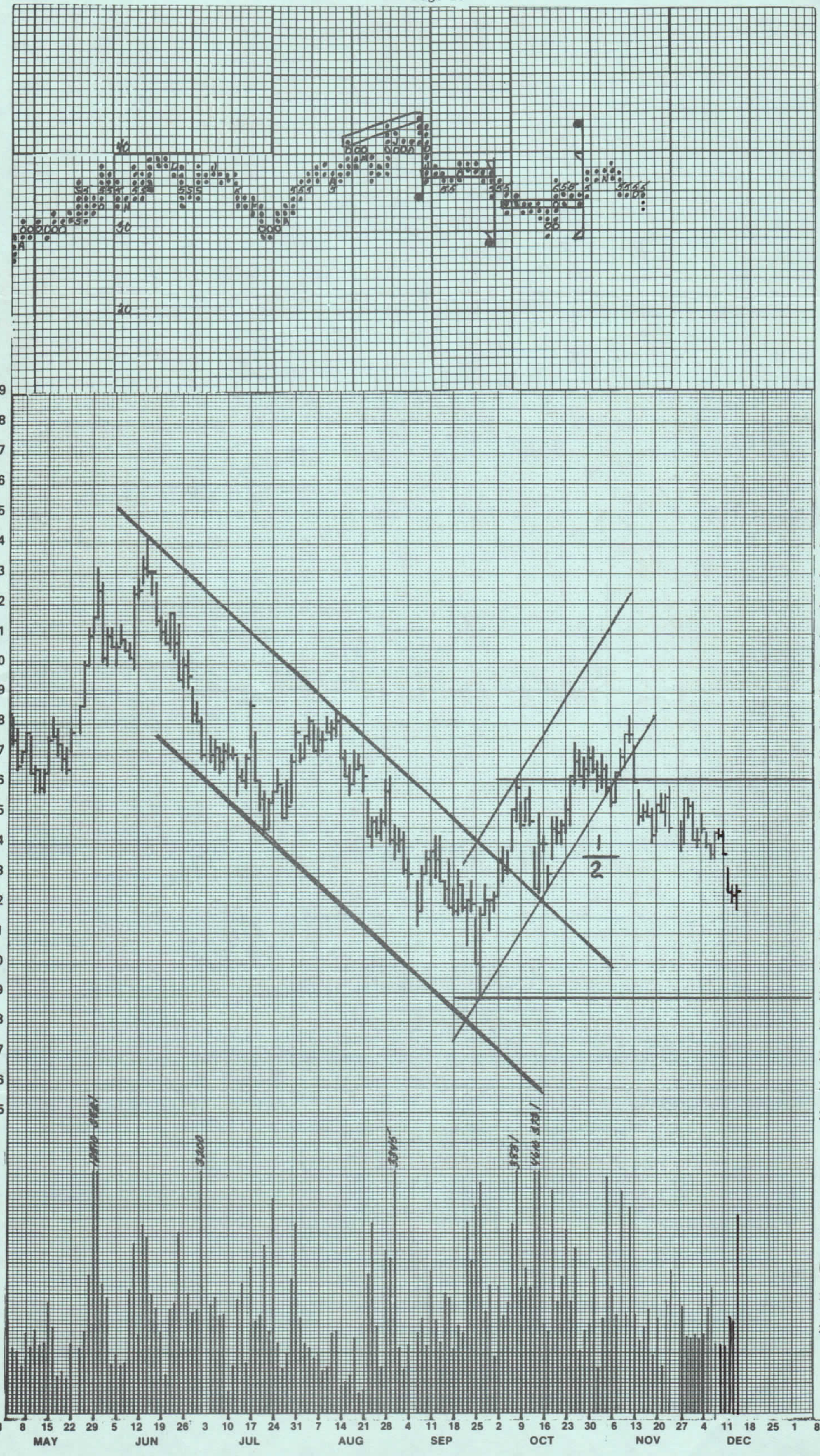

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UNION CARBIDE (UK)
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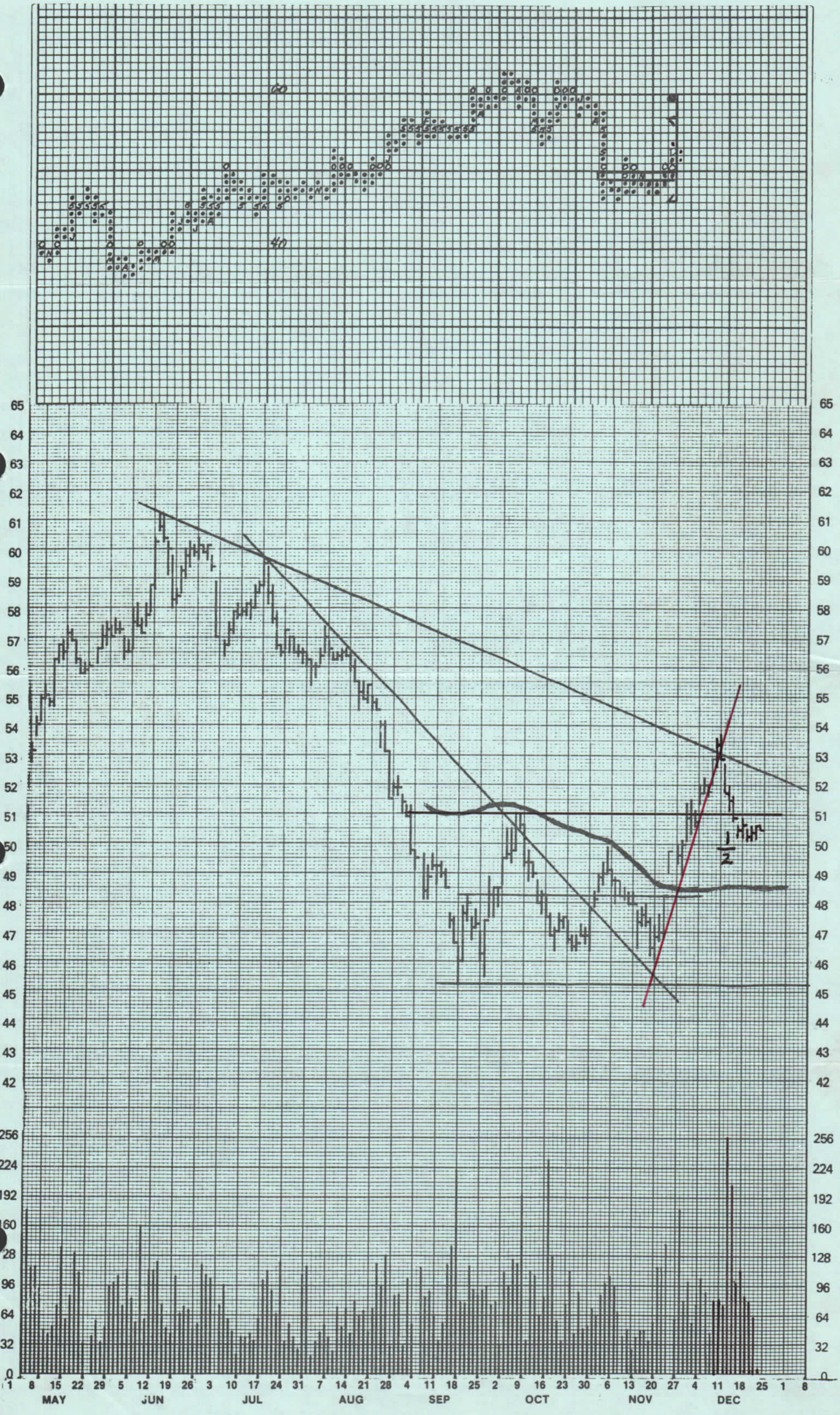

EXXON (XON)

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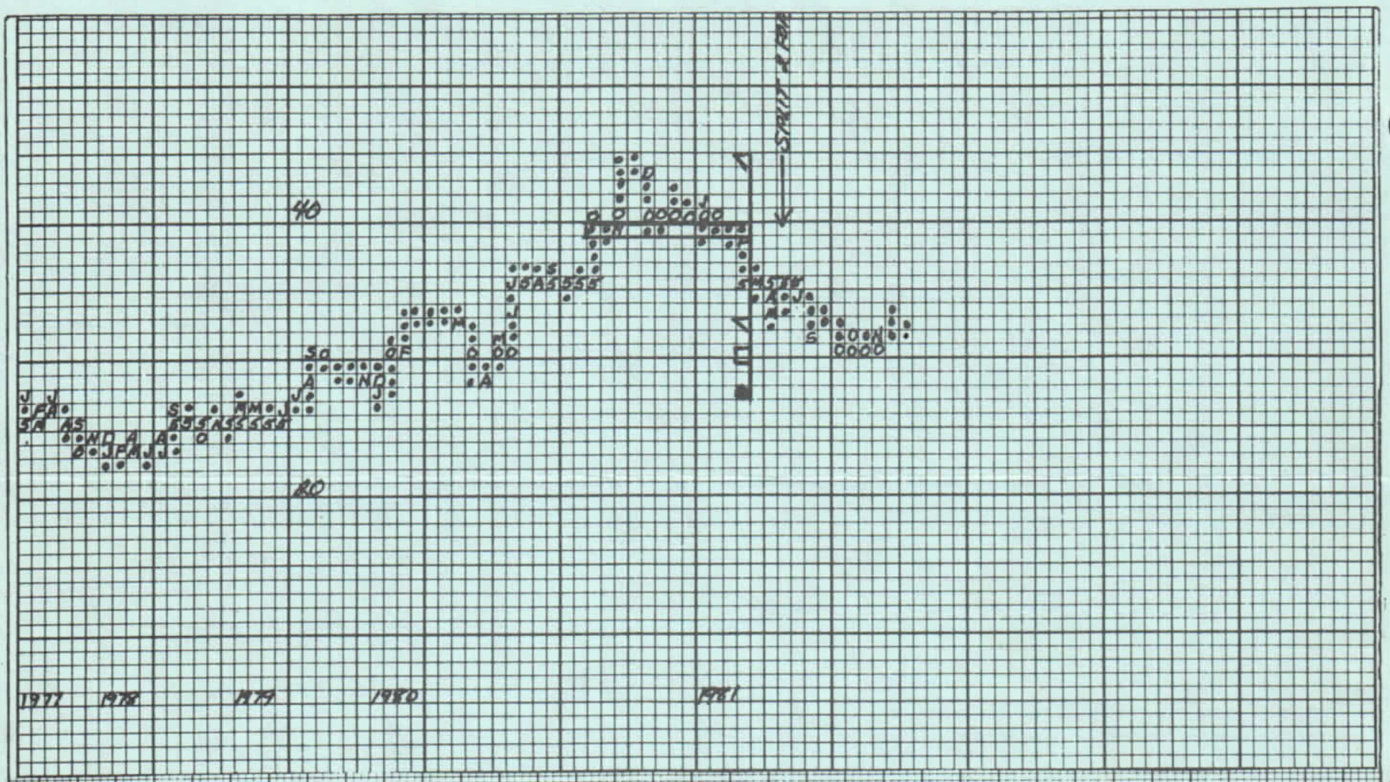

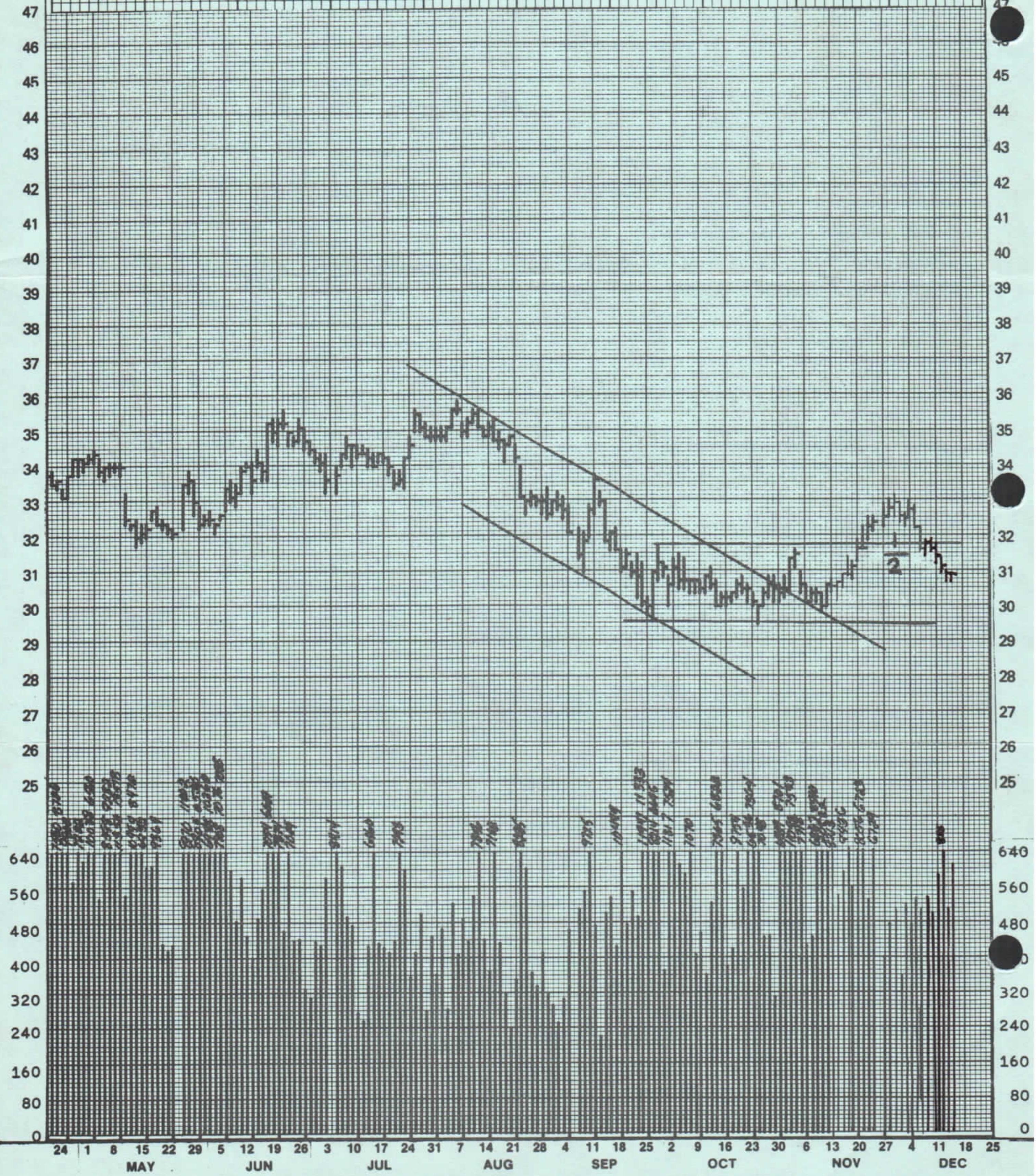

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U.A.L. INC. (UAL)

AIR TRANSPORT C.B.O.E. (p&c)