The Trend Letter

Thursday, January 6, 1983

MARKET TRENDS

Most investors have heard of the idea that the market's action during the first five trading sessions determines its course for the balance of the year. Generally, this is understood to apply only to direction. If the market is lower at the end of the fifth session of the year than it was at the end of the last session of the previous year, it will also be lower at the end of the last session of the new year. If there is a net advance during the first five sessions, there will be a net advance for the year. Historically, this generalization has worked over the years. Unfortunately, it gives no indication of the magnitude of move to expect. In addition and perhaps more importantly, there is nothing said about how to determine if the concept is not going to work in a particular year. For this reason, it is virtually a useless notion. Any idea that does not carry with it an element of protection should be dismissed.

Anyone who professes to be a follower of the above notion must be looking at the first two trading sessions of 1983 in a state of confusion. After a historically sharp decline on the first day of the year, the market turns around on the second day and almost completely erases the decline of the day before. What does this tell us? Does it say that 1983 will be a down year? Does it tell us that the market will be down only slightly for the year, but will follow an usually volatile path along the way? Or, does it say to refrain from making a long term appraisal at least for three more days? No doubt, the next three days will add important informaiton, but the last two have made some statements that should not be overlooked and the same is true of the past few weeks.

Beginning in mid August and lasting almost to the end of the year, the uptrend was the dominent influence on the market. That is no longer true. Now the focus of attention is the trading range. It holds the potential for the market's next important move. Until recently, we had been defining the trading range as being between 2960 and 3200 with preliminary supply having been experienced in October. This made the rally in early December an upthrust and the one that ended the year its test. Based on the action of this past Monday, it appears as though the test is going to hold. If so, we may now expect a move to at least the 2950 to 3000 area and perhaps as far down as 2650 if the count is extended to the area of preliminary supply. Since the test of the upthrust has already been accomplished, there is reason to look for an immediate fulfilling of one or both of these objectives.

The problem with the above is Tuesday's action. It is not consistent with a break down following the test of an upthrust. The magnitude of the advance was too great. In addition, the substantially higher volume is impossible to fit into a scenerio that counts on immediate substantial weakness. Does this indicate a problem with the market or with the scenerio? Obviously, the latter is the one that should be questioned.

It is normal for us to want to look at the market in a way that will produce a maximum amount of action in a minimum amount of time. However, the market's action over the past two years suggests that this is not how the market works. It is often content to spend long periods of time in preparation. Knowing this, we should perhaps take another look at the trading range in such a way that our desire for immediate action is not being thrust upon the market. There is an alternate trading range that is totally valid.

Instead of viewing the horizontal action in October as preliminary supply, we should perhaps look at the resistance experienced in November as being the first signs of important supply. This shifts the climax of the move to the rally in early December. We may then look at the rally at the end of December as being the secondary test of the buying climax. Since this rally is to a lower top and on less volume, it is convincing in this role. The result of this line of reasoning is a trading range between 3020 and 3320. It is not that much different than the one previously defined, but it makes a substantial difference in interpretation.

With this new trading range in place, the action of the past two days is no less unusual, but it is less confusing. It can be looked at as just being trading range activity. No indication of an immediate break from the trading range has been given so none is likely. The likelihood that the trading range is going to continue for some time may be the best thing the market can do because it should tend to disappoint the greatest number of people.

Since we are no longer focusing our attention on an upthrust and its test, we can perhaps be better able to see some of the finer points that might be missed in the expectation of an immediate collapse. For example, why was the market ready for a rally on Tuesday? It had not reached its downside objective as indicated by the ten point figure chart, but it was nearing it. Therefore, we had reason to expect relatively little in the way of additional decline. More importantly, however, were the divergence and oversold Technometer. Both point to a rally of some magnitude very soon and the market responded.

The divergence and oversold condition say nothing about the magnitude of the indicated rally. The figure charts also indicate nothing. Therefore, the expectation for the future should be a continuation of the trading range. A trading range may be traded coming and going. However, experience tells us that those who do the best in this type of operation decide to trade the range either coming or going, but not both. The reason is that the short term moves require rapid and total reversals in thinking. This is difficult to do and can lead to many needless errors. By trading only the rallies or reactions in a trading range, there is time to prepare and think through actions before they are taken. The result will be fewer trades, but they should be better trades.

The final question then becomes how to determine which side of the trading range to trade. Two possibilities seem to make sense here. One is to trade the side in harmony with the previous important move. In this case, that means trading the long side. The reasoning here is that the trading range resulted when the strength previously in the market began to rotate so evenly throughout the market that the advance could no longer be maintained. The strength is still there it has just become periodic rather than persistent.

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The other approach to one sided trading of a trading range is to concentrate totally on the action of the range itself and use its indications in selecting which side to trade. Here the volume on rallies and reactions is the best way to make the determination. In this case, however, there is no consistent pattern as yet, so there is a need to look elsewhere for a clue. A good alternate is to go with the flow of the interest. We can judge this from the Momentum. The pattern of lower tops on rallies suggests a declining interest in the upside, which in turn suggests that the reactions in the range should be traded. Either of the two approaches is acceptable. Whichever is selected, however, care should be taken so as not to become so totally caught up by the action within the range that an indication that the market is about to leave the range is overlooked.

STOCK TRENDS

Since the market is in a trading range all stocks become candidates for action. However, some favor the first approach mentioned above and others lean toward the second. A very small minority can take advantage of either. One such stock is Exxon.

The trading range in Exxon stretches approximately from twenty-seven to thirty-two. At this point, there is no indication that the stock is ready to leave the range. The present rally began after the low of 27.1 was successfully tested. The figure chart indicates that the objective of the rally is thirty-two, or the top of the trading range. The reason this stock can be traded both ways in the trading range is that it moves slow enough to allow for a change of thinking and a reversal in position.

General Electric, General Motors, IBM, and Merrill Lynch all favor an approach that trades in harmony with the prior trend, which is obviously up. This is especially true of General Motors where the uptrend has not as yet given way to a trading range. General Electric and IBM have both recently been in upthrust positions to which they appear to be responding with reactions to the bottom of the range. If they hold and are in harmony with the trading range action of the general market, they should be considered for short term trades on the long side.

The one doubtful stock in this group of four is Merrill Lynch. The problem here is the apparent lack of interest in the upside shown on the last rally. This developed on the initial response to the spring position that had developed. Since that spring can be seen as a number two, a test is in order. This may account for the unimpressive showing on the last rally. The stock should still be a good candidate for trading range rallies if the test holds. The verdict is not in on that as yet. A lower low has been made on the test, which is not positive and the volume on the test is inconclusive. Should the stock be unable to resume upside progress from the test, it will become a candidate for trading the reactions in the trading range based on continued decreasing interest in the upside.

Pepsico and Union Carbide are candidates for short positions on the reactions within the trading range. This is consistent with their previously established trends and with the decreasing interest in the upside being shown on the rallies. Both stocks may be going into trading ranges instead of continuing with substantial declines, but their previously expressed weakness should continue to favor short term short positions for some time to come.

UAL, Inc. is a situation something like Merrill Lynch. The previously established trend is obviously up. This favors action on the long side within the trading range. The problem here is a definite decline in upside interest on the last rally. This suggests that a change may be underway to a weaker condition. Therefore, the stock should be approached cautiously. If its next rally again makes a lower top, the stock should then be considered only for short positions within the trading range.

S & P INDEX FUTURE

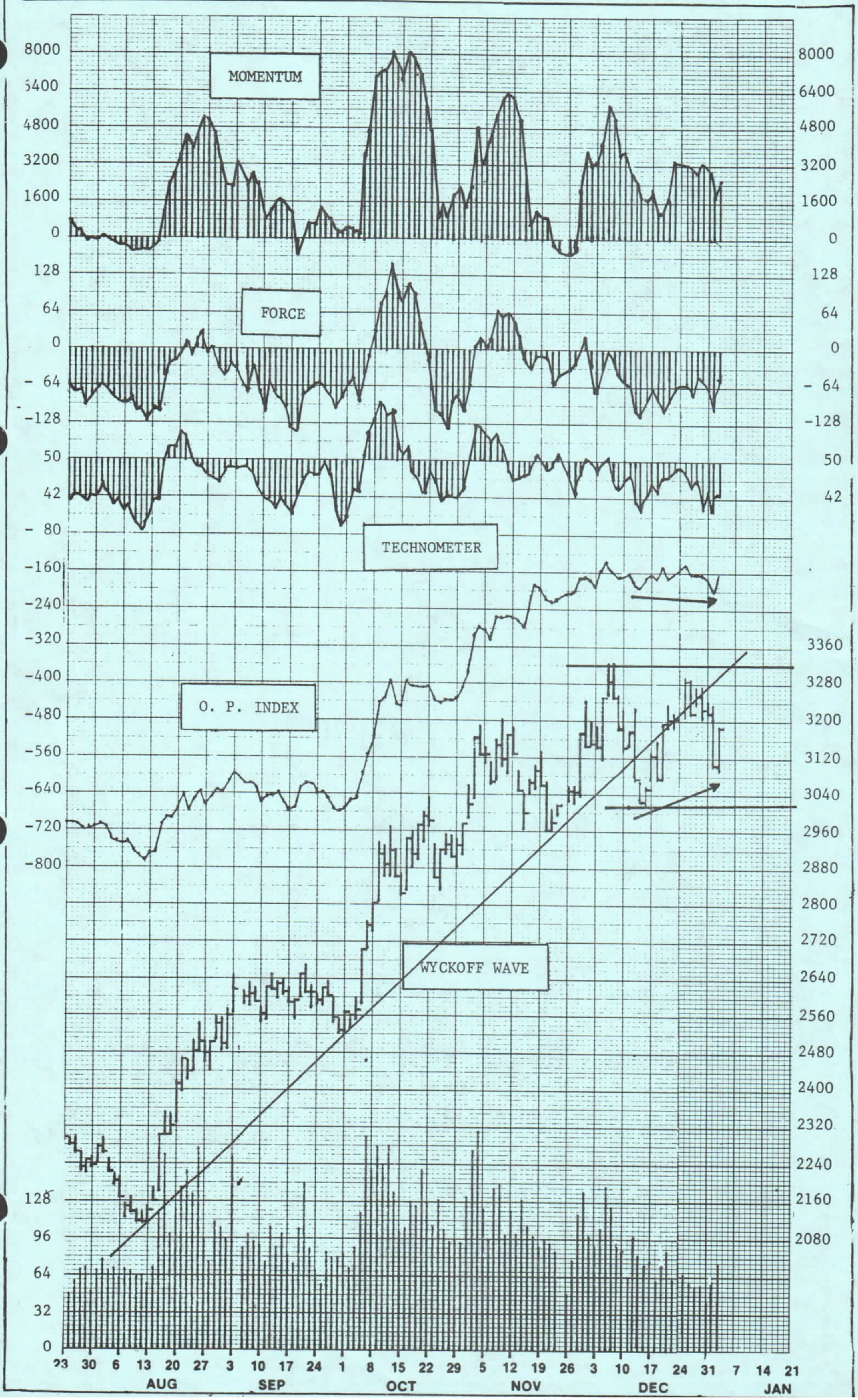
Not surprisingly the S & P index future is in a trading range as is the general market. More importantly, however, is the fact that the action within the trading range is developing into an apex. Within the next month, this apex should be broken with action that will be very important to the future course of the index future. A similar apex does exist in the general market, but due to the somewhat unusual trading range development the apex is not especially obvious on the Wave.

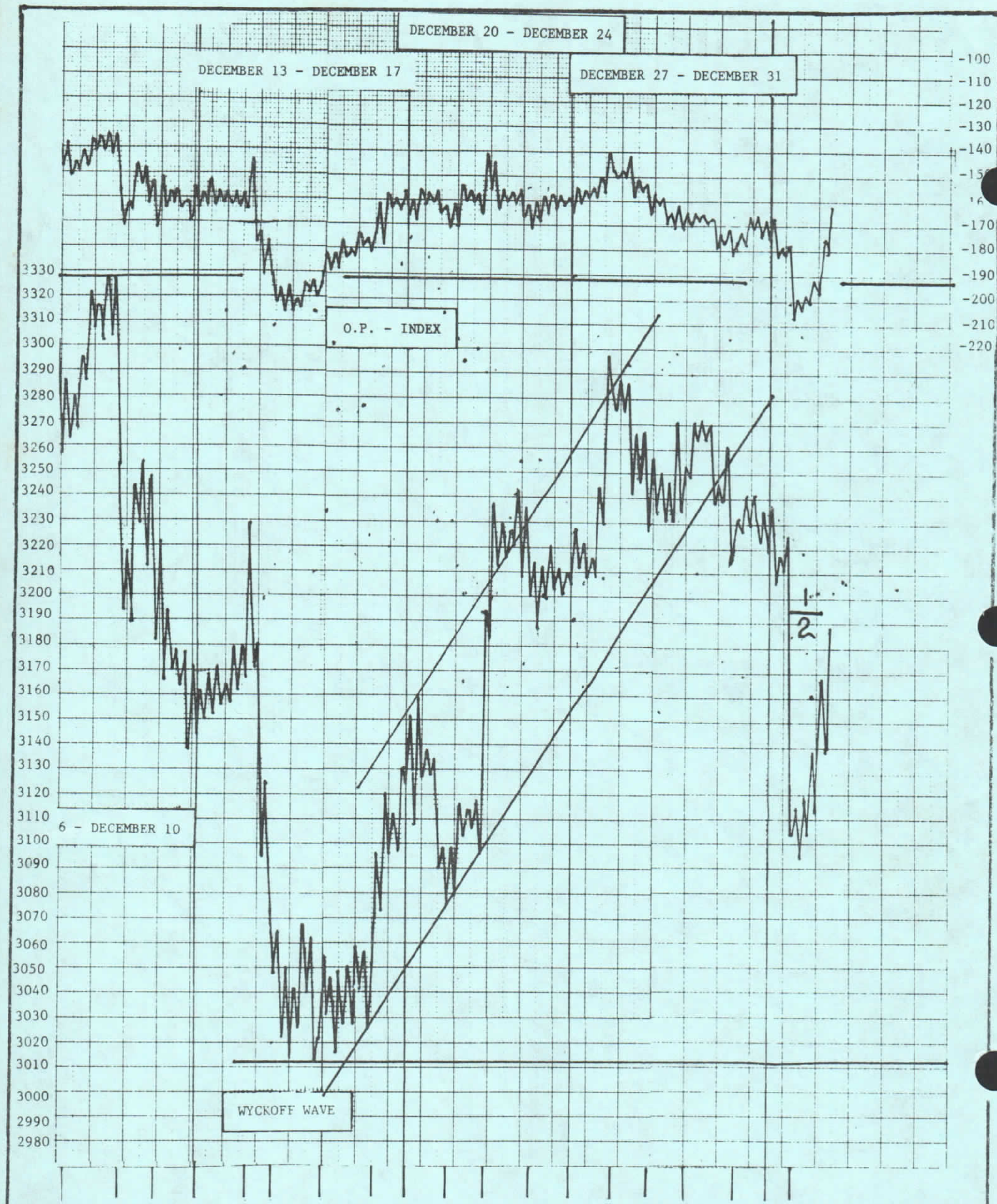
Trading of the future should be done very cautiously until the apex is broken. It should be noted that the future is weaker than the Wyckoff Wave. Therefore, viewing it as a stock, it must be considered as a good short candidate for reactions within the trading range. The next opportunity should come as the rally that began on Tuesday runs its course. Since the supply line of the apex has been well respected, it may be used as a guide in determining where to take a short position.

The Pulse of the Market

STOCK MARKET INSTITUTE

TUESDAY, JANUARY 4, 1983.

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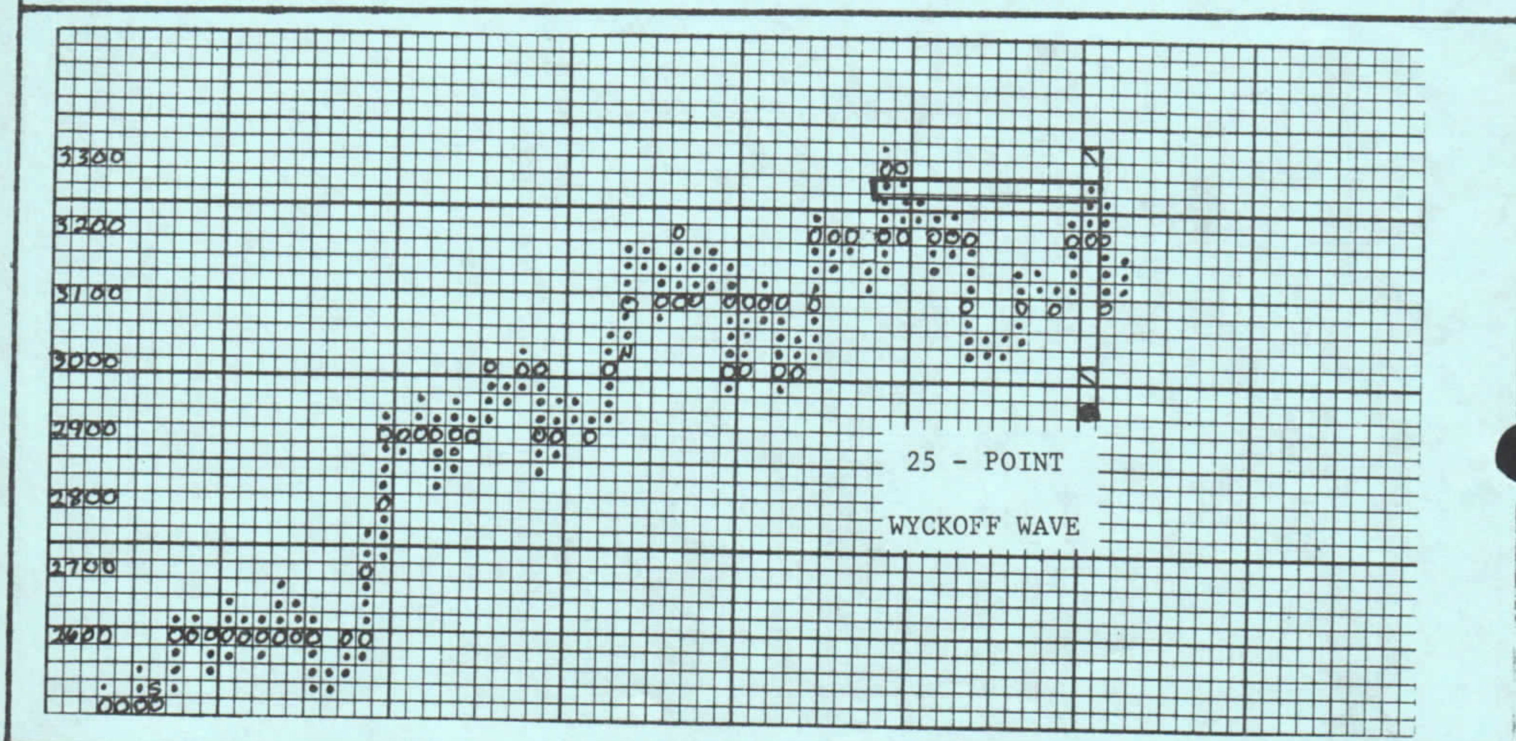
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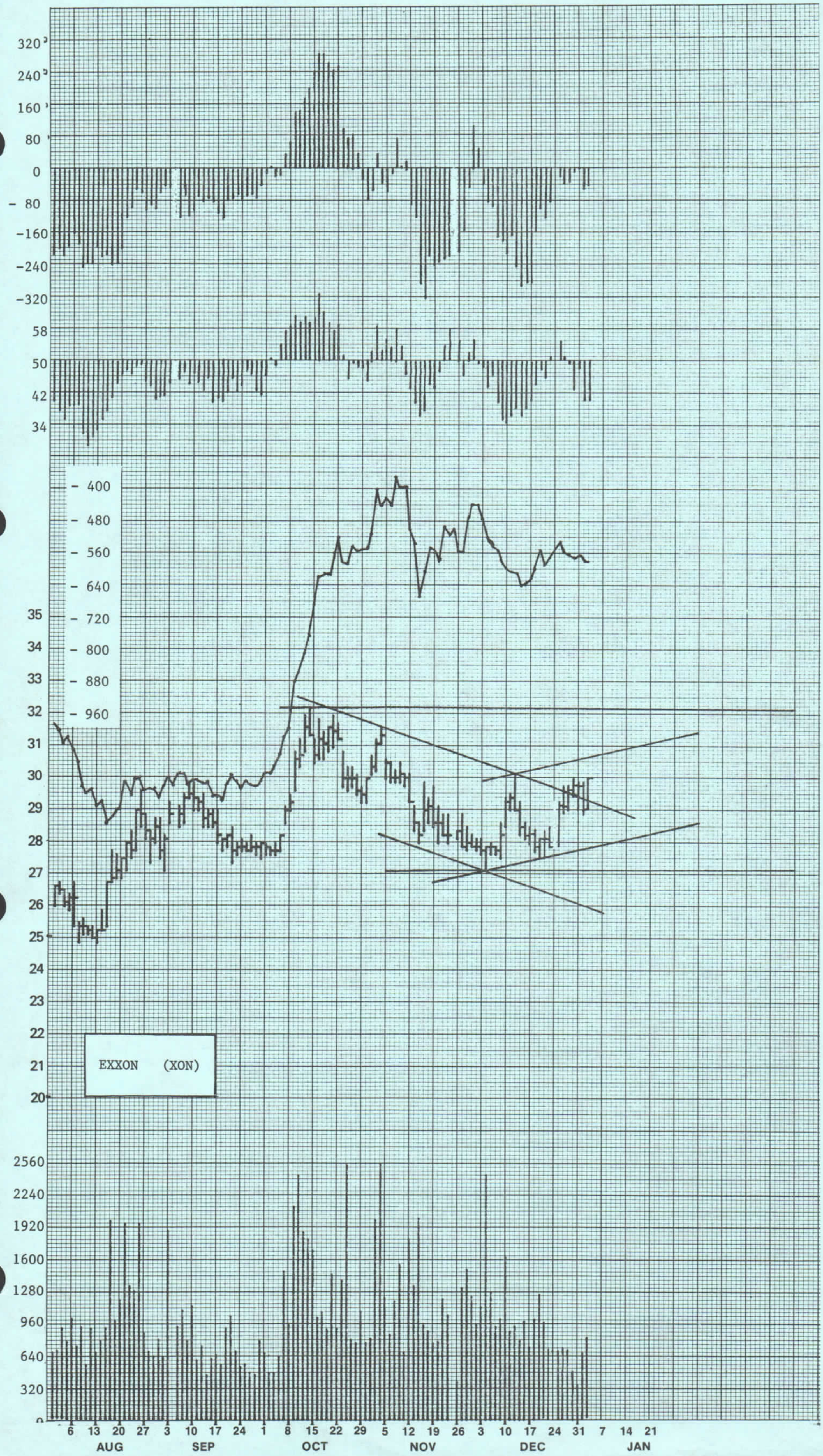

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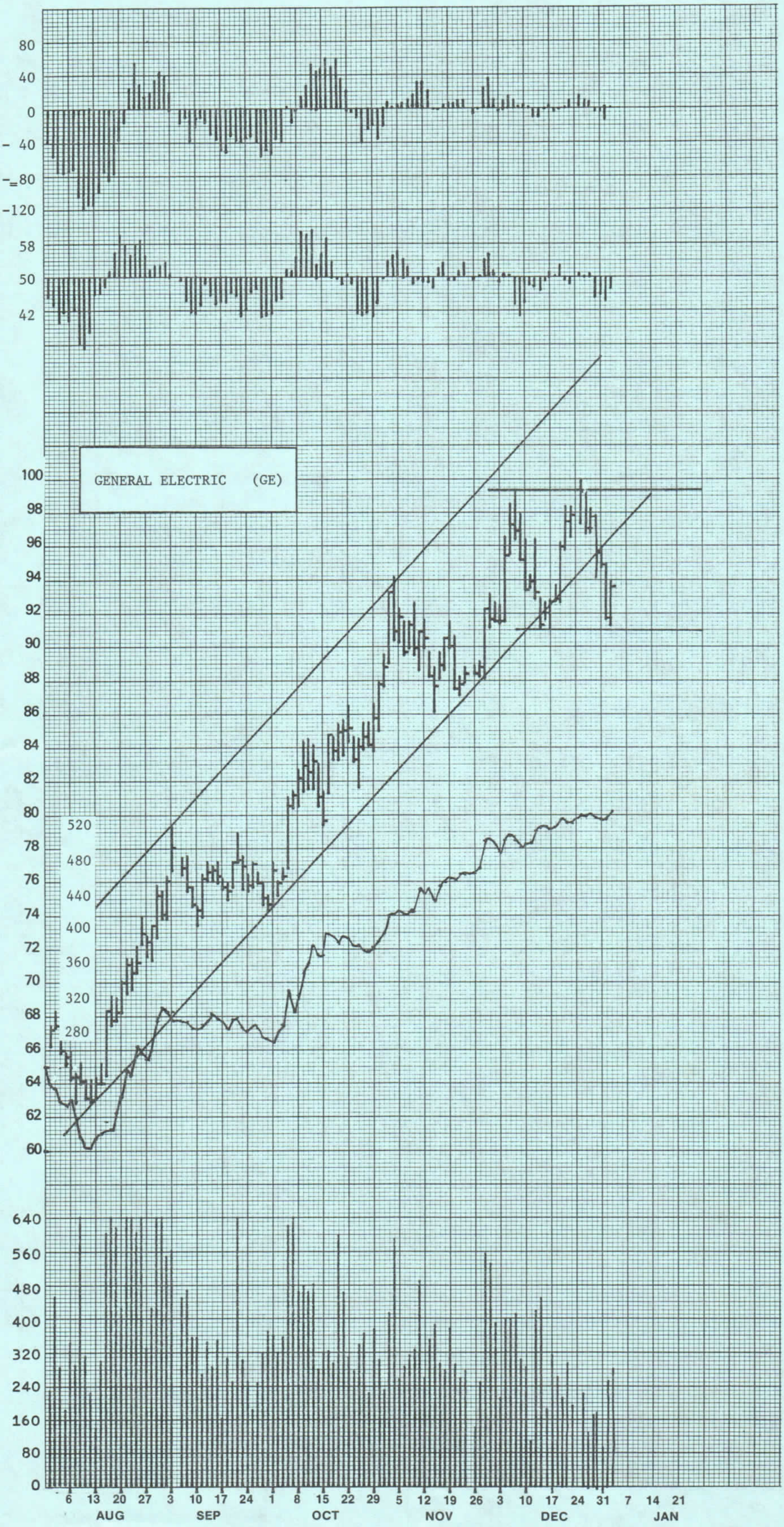
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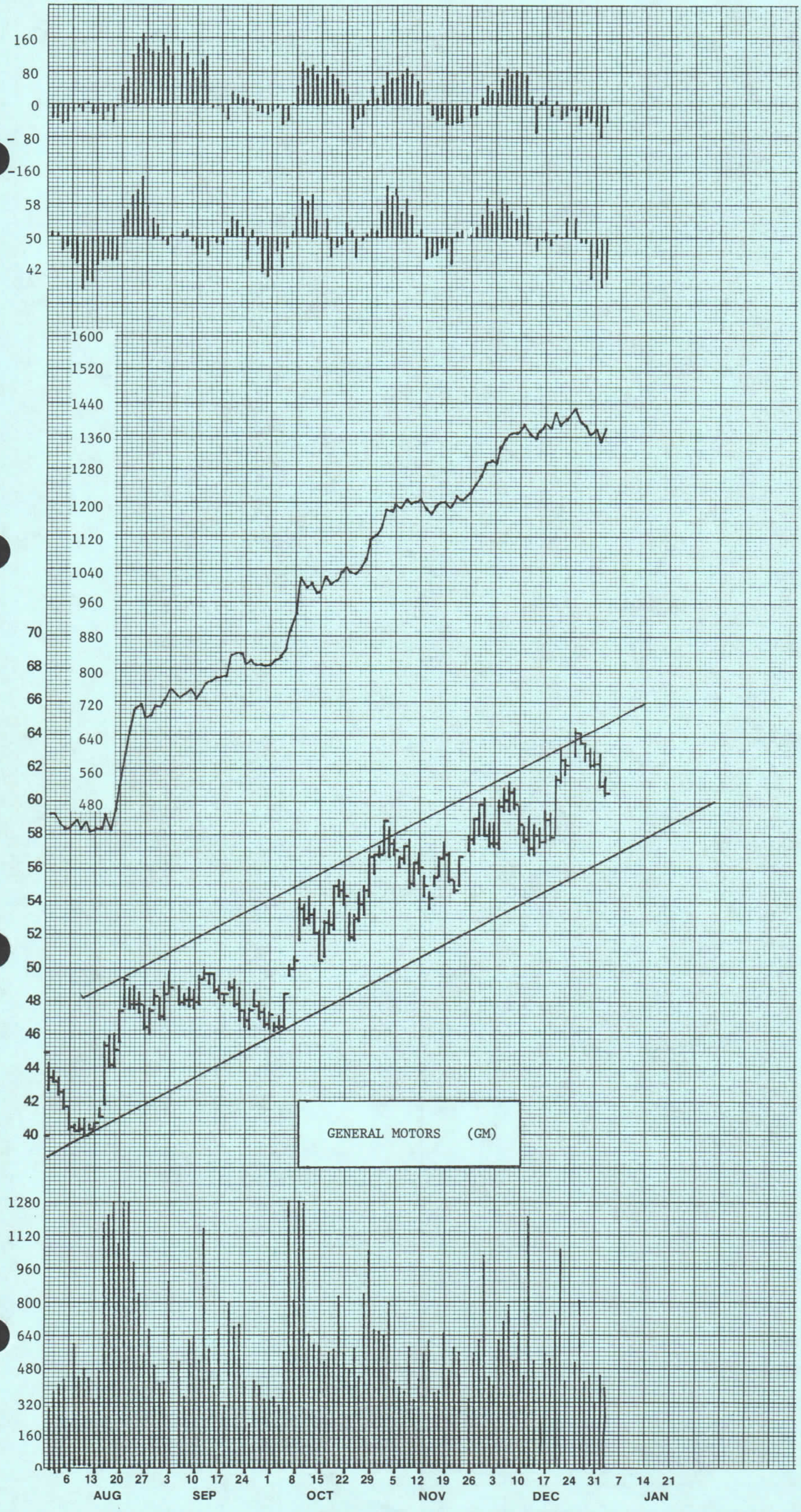

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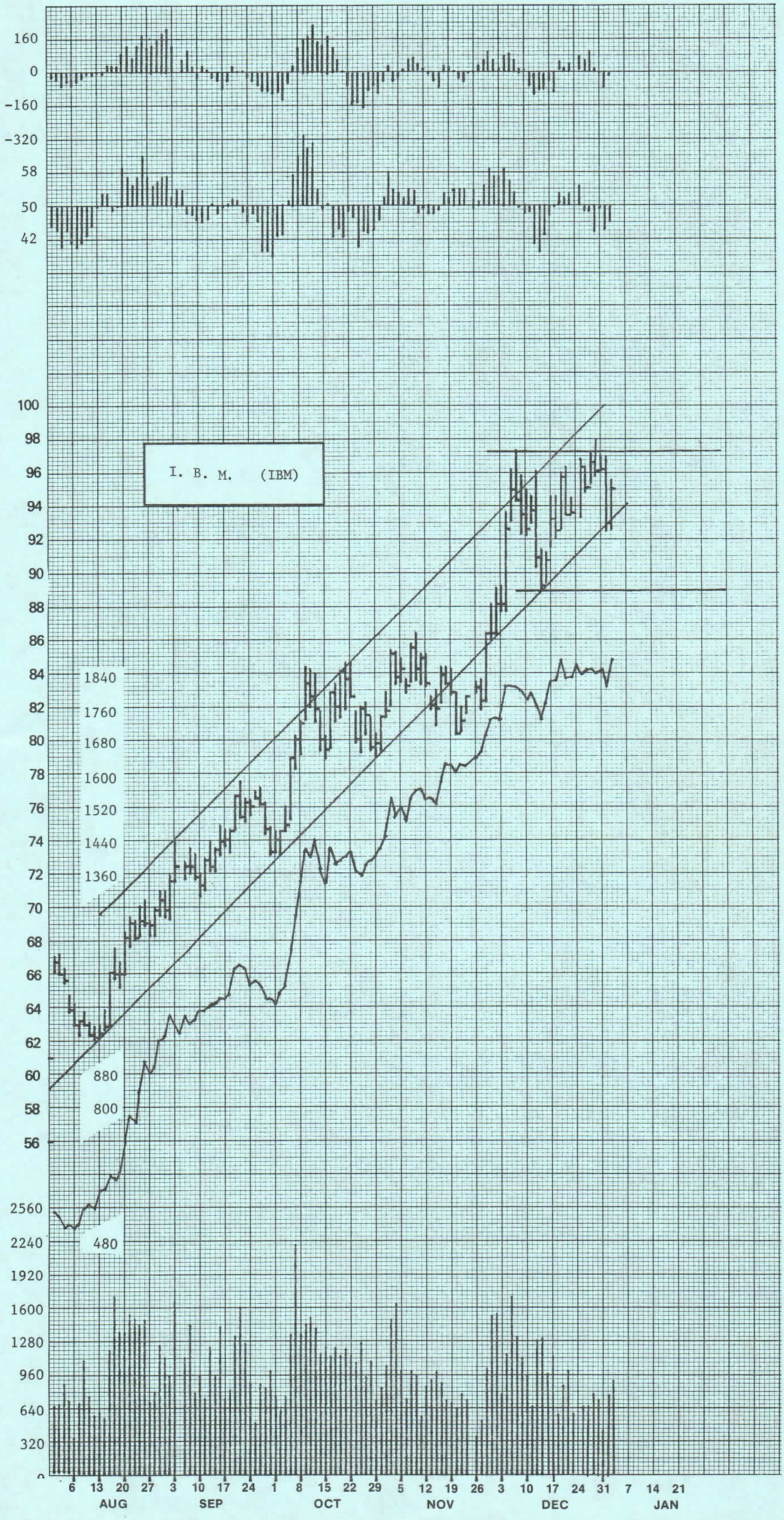

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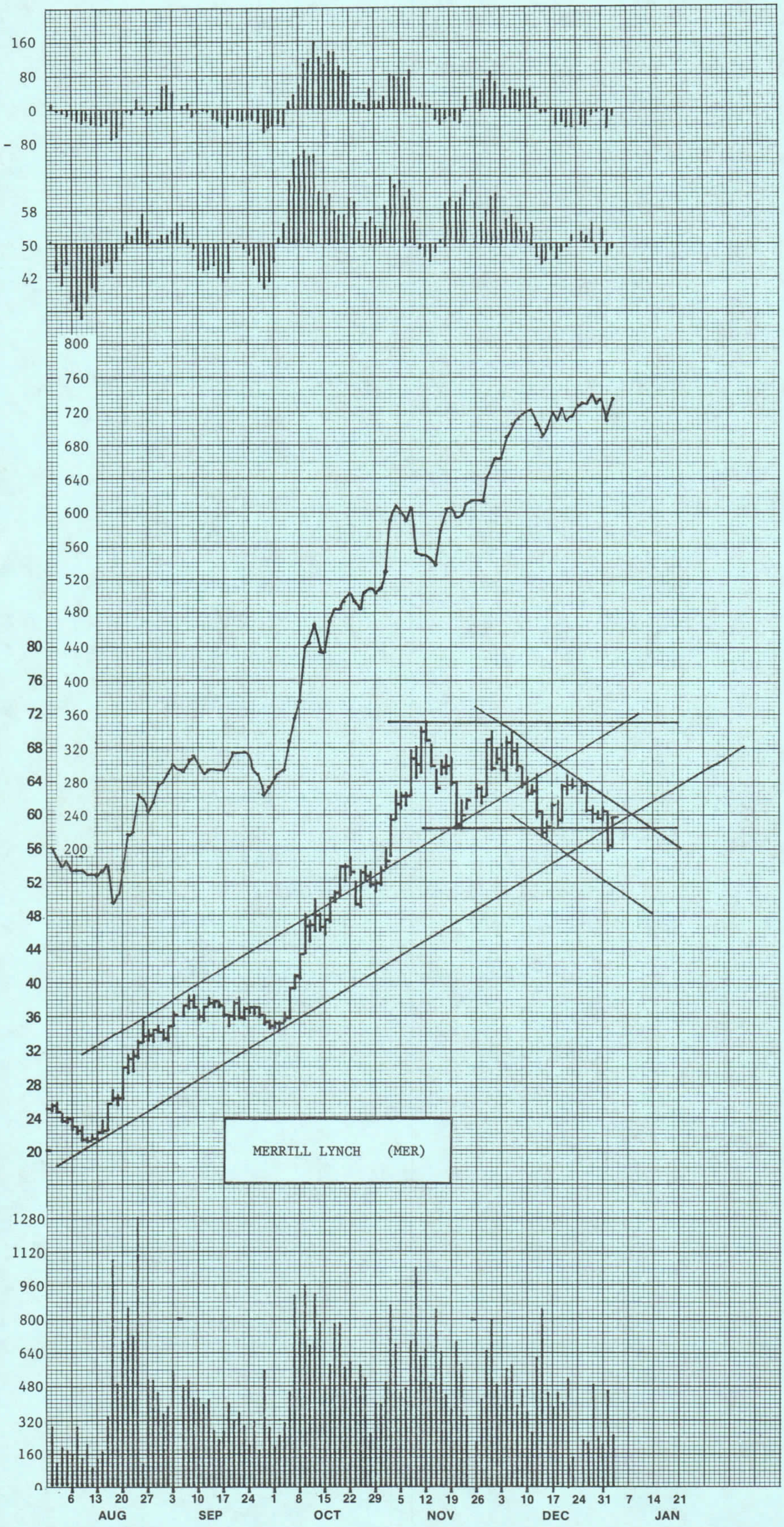
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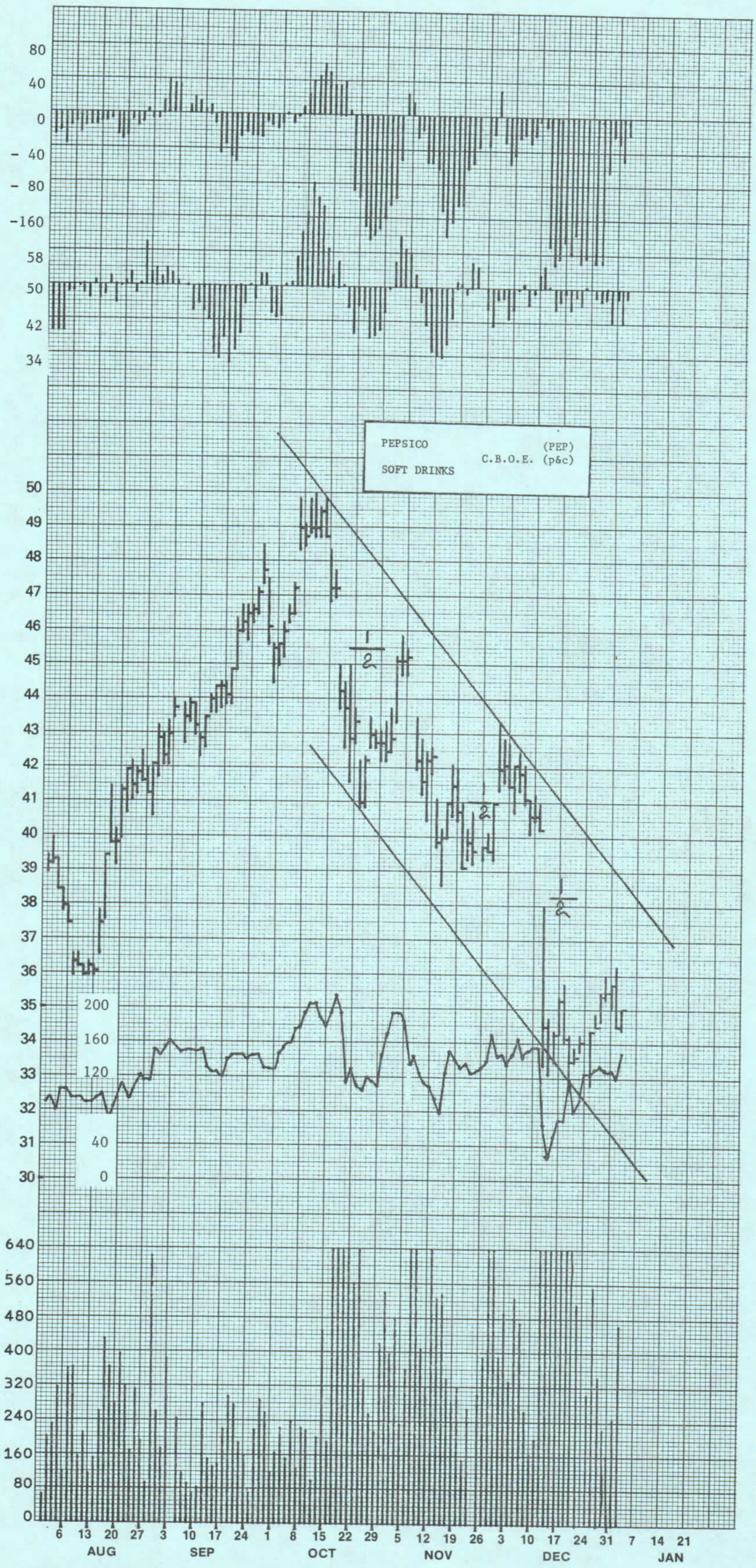

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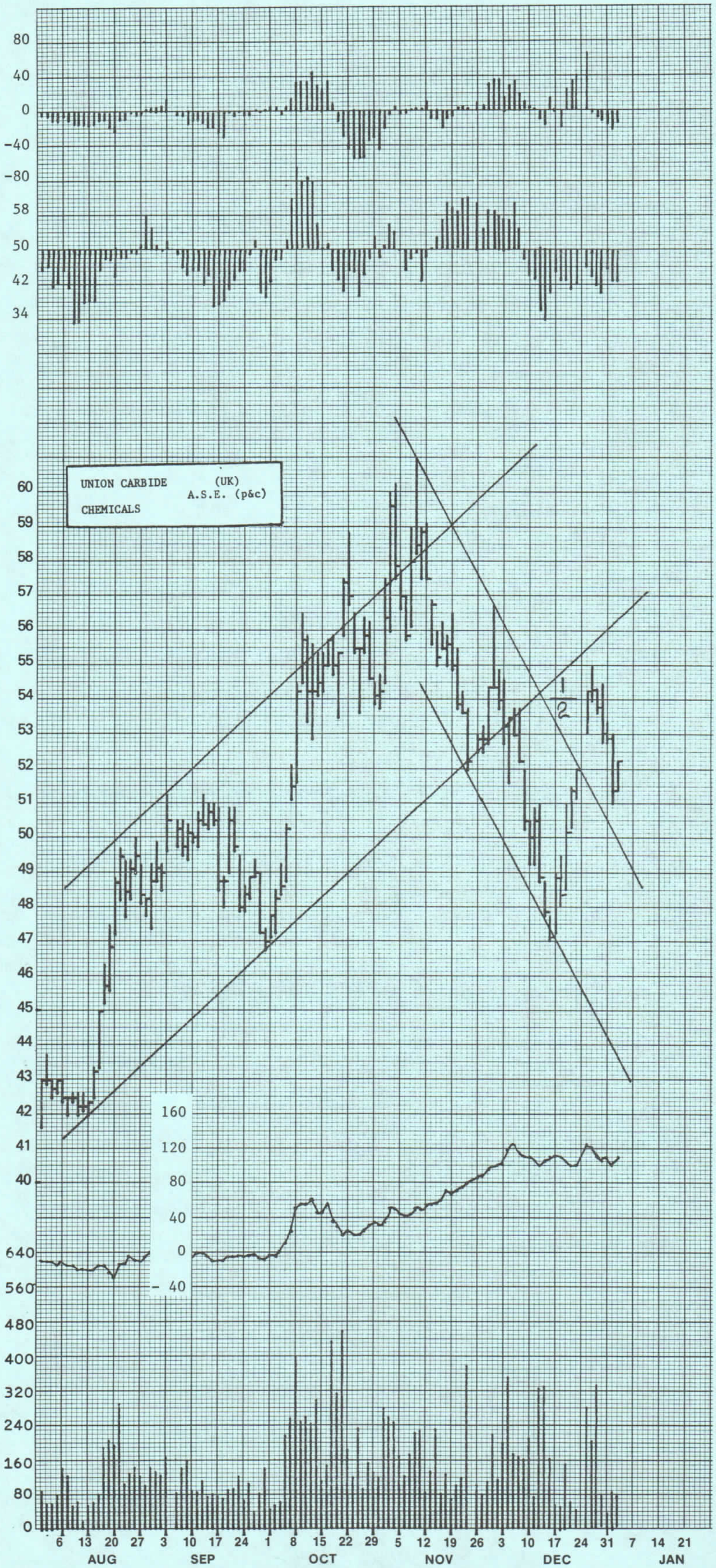

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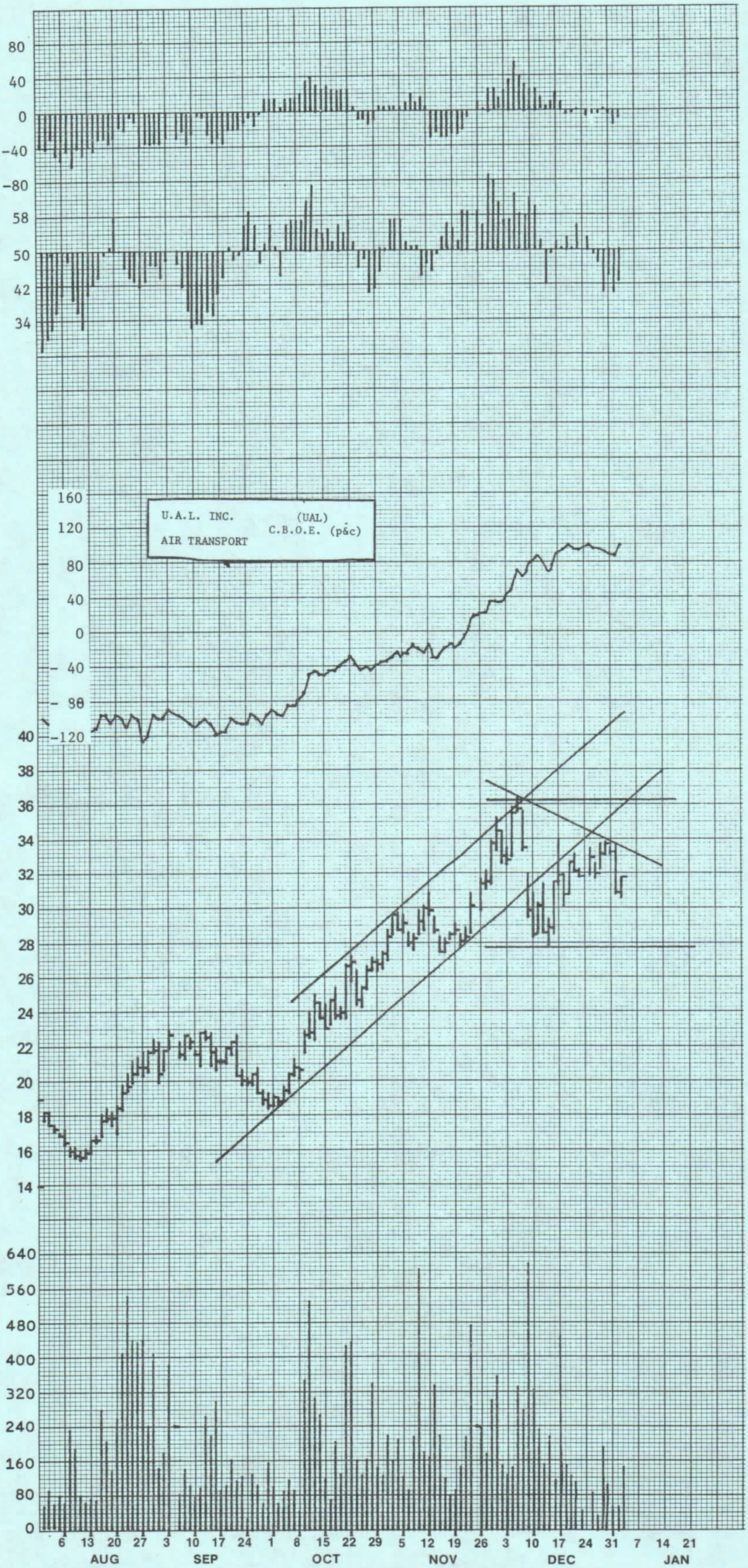

U.A.L. INC.
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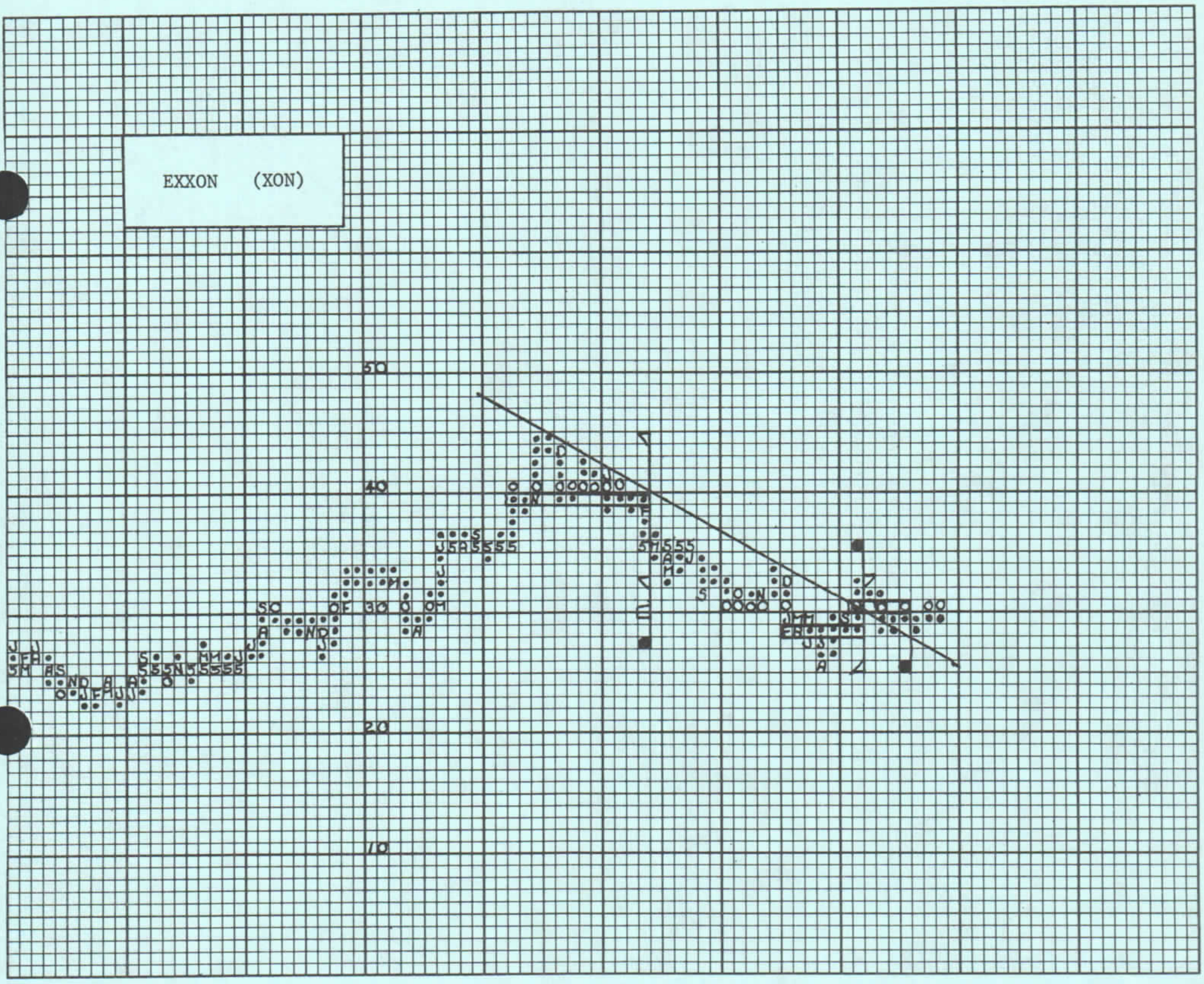
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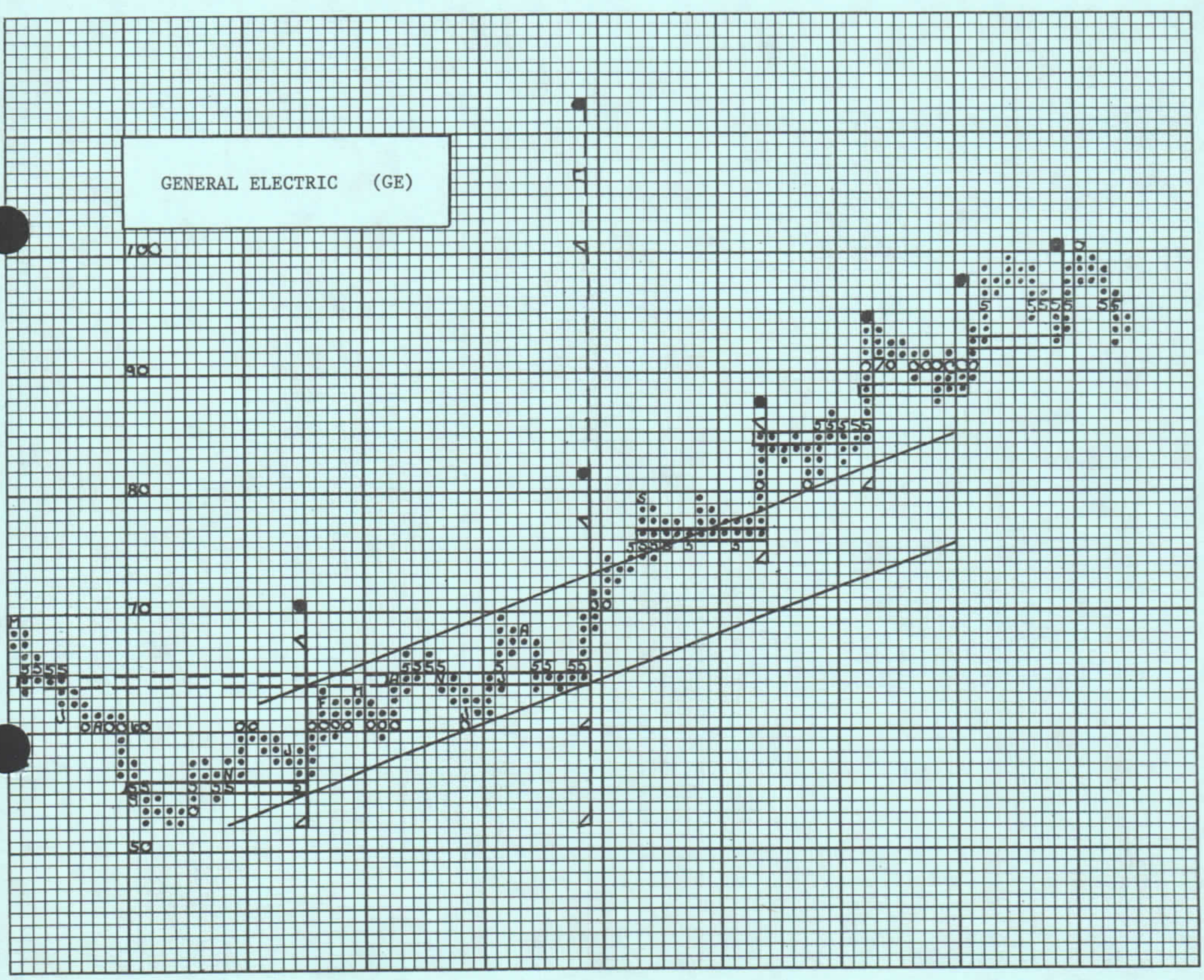
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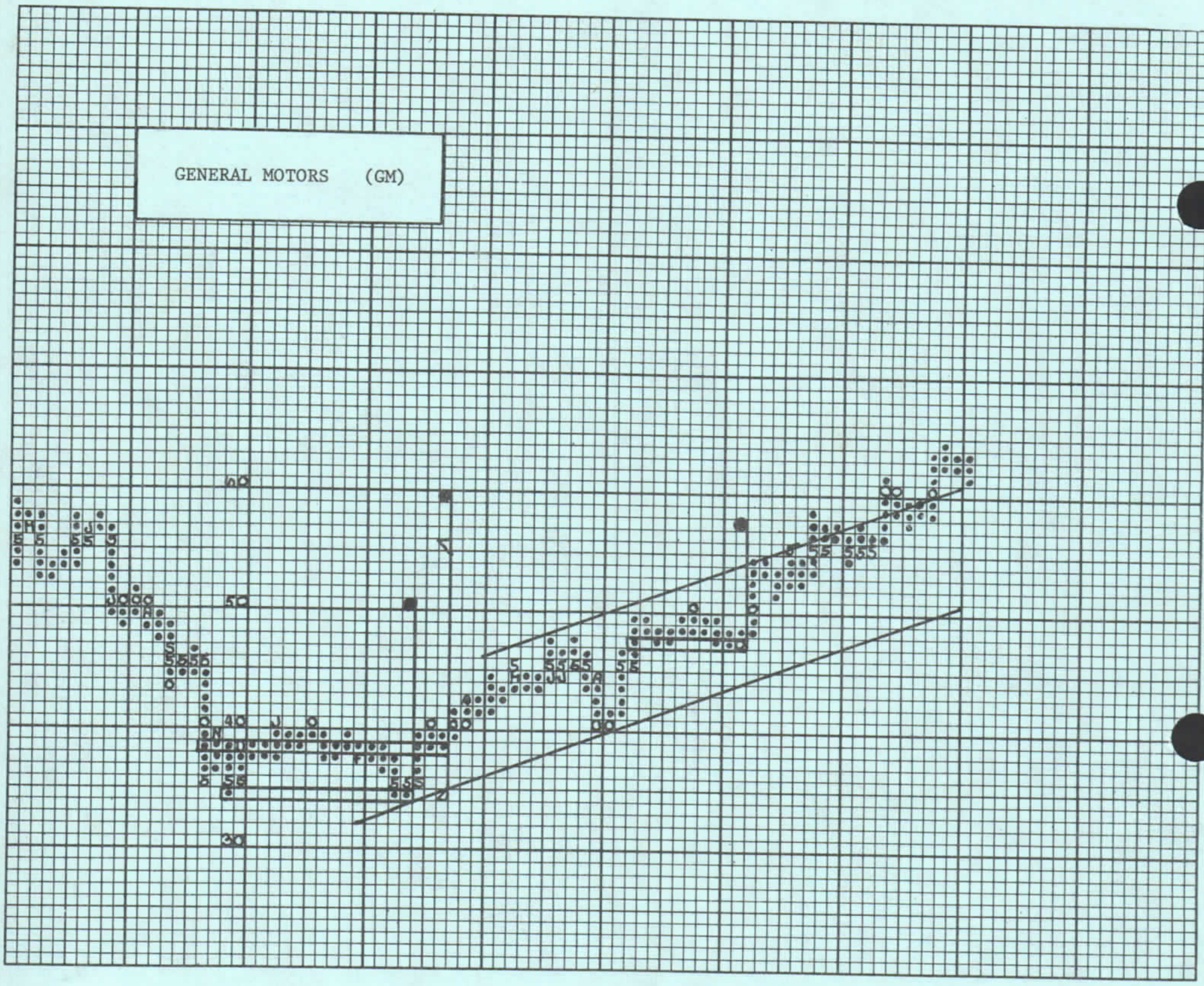
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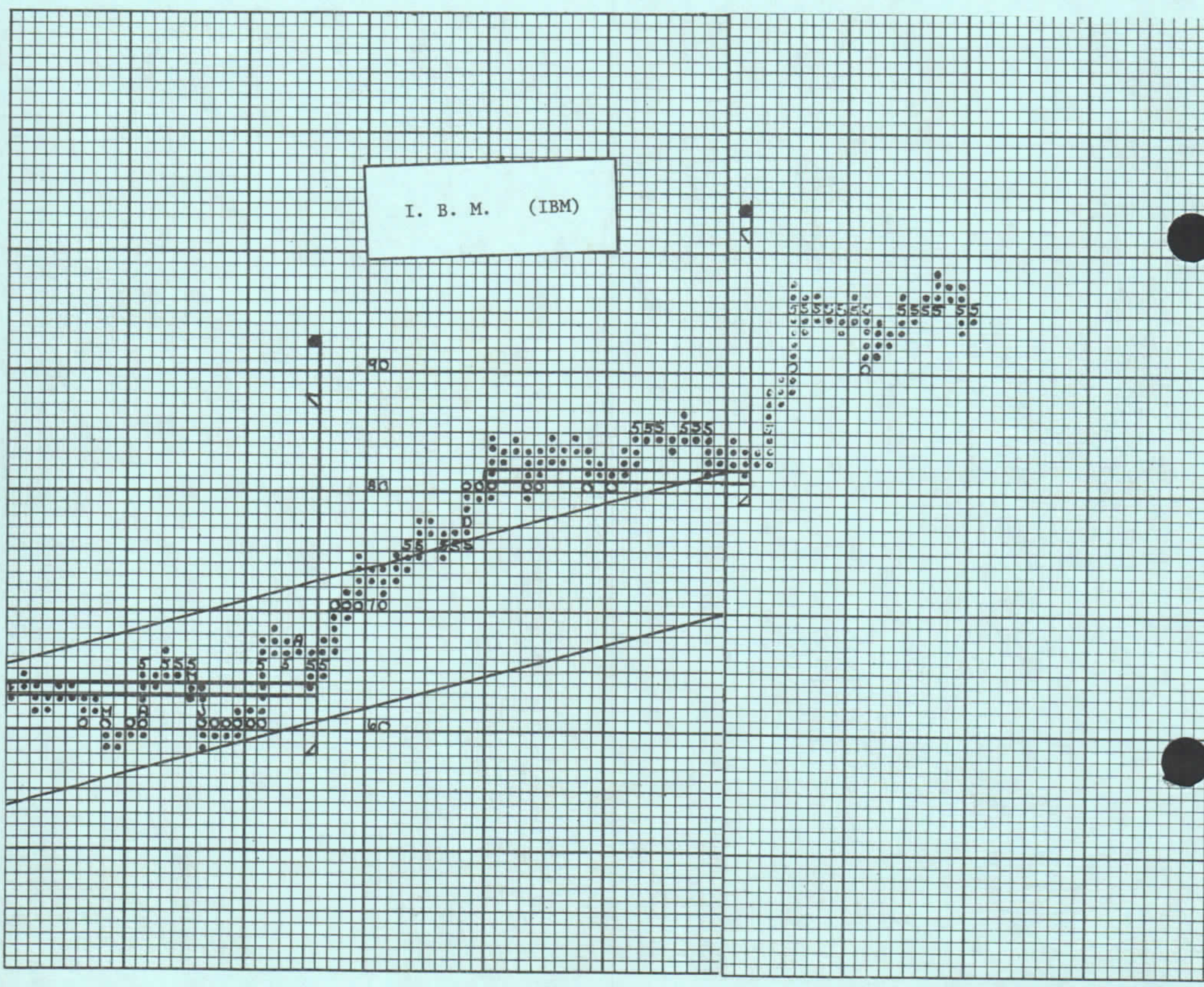
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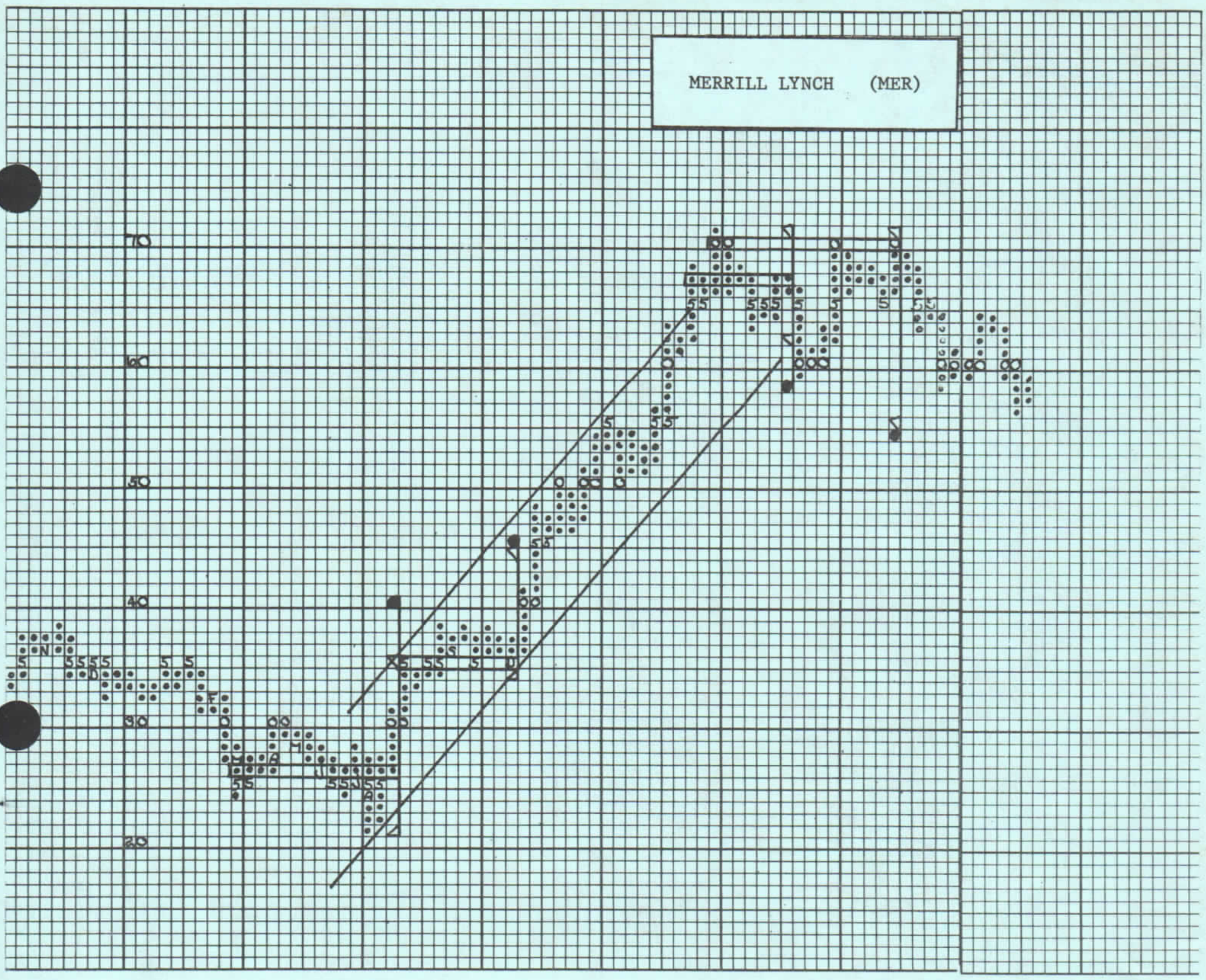
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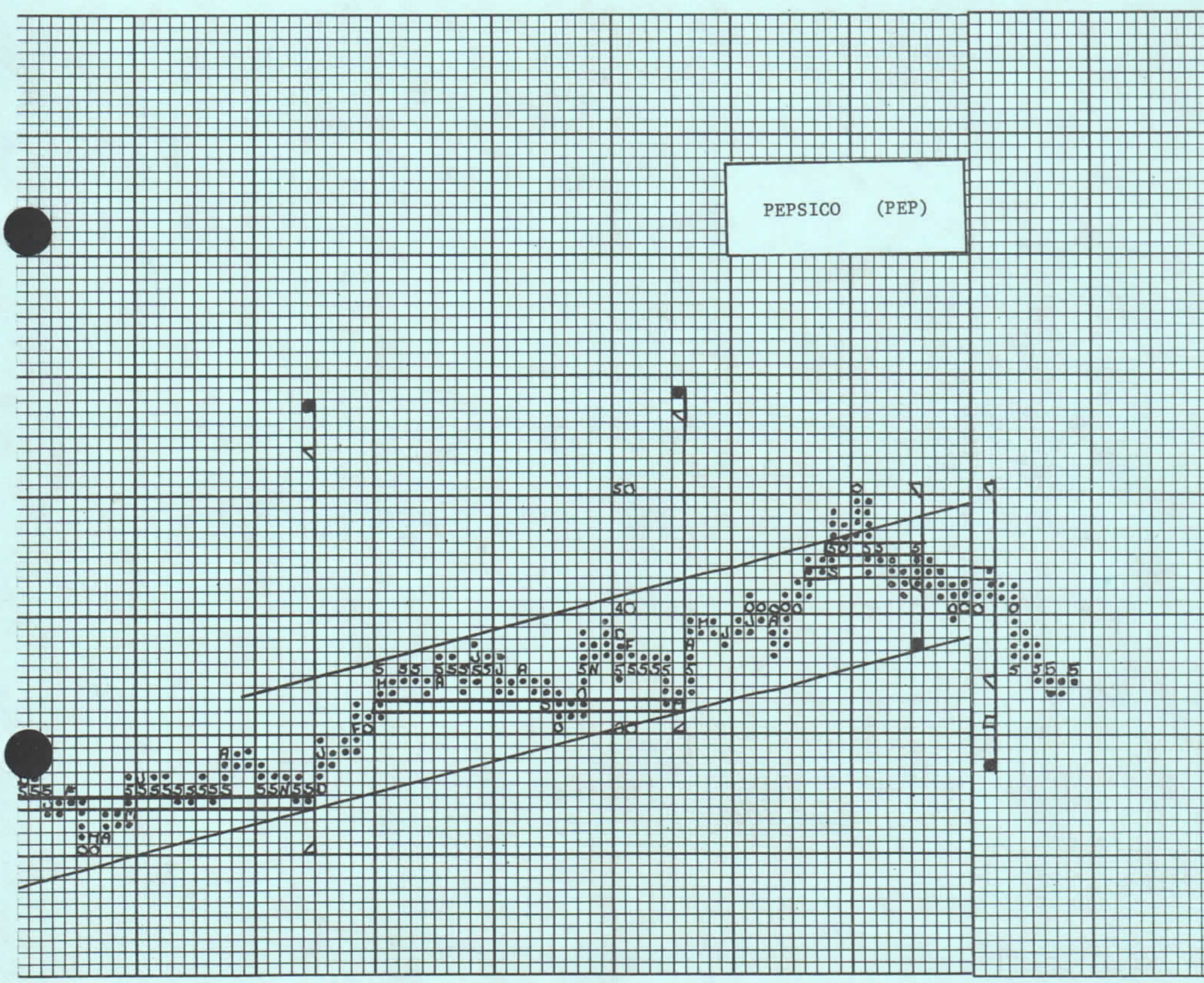
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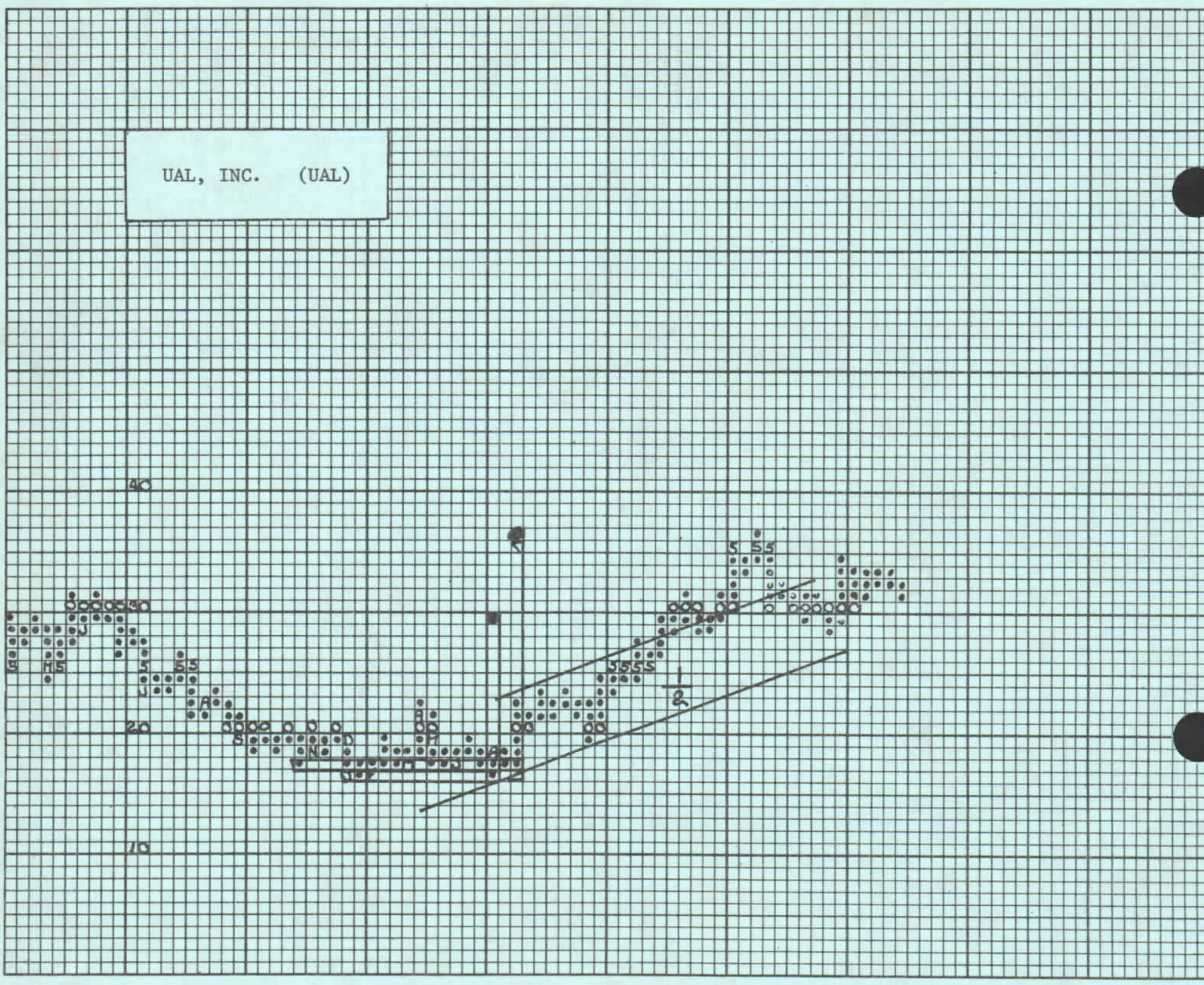
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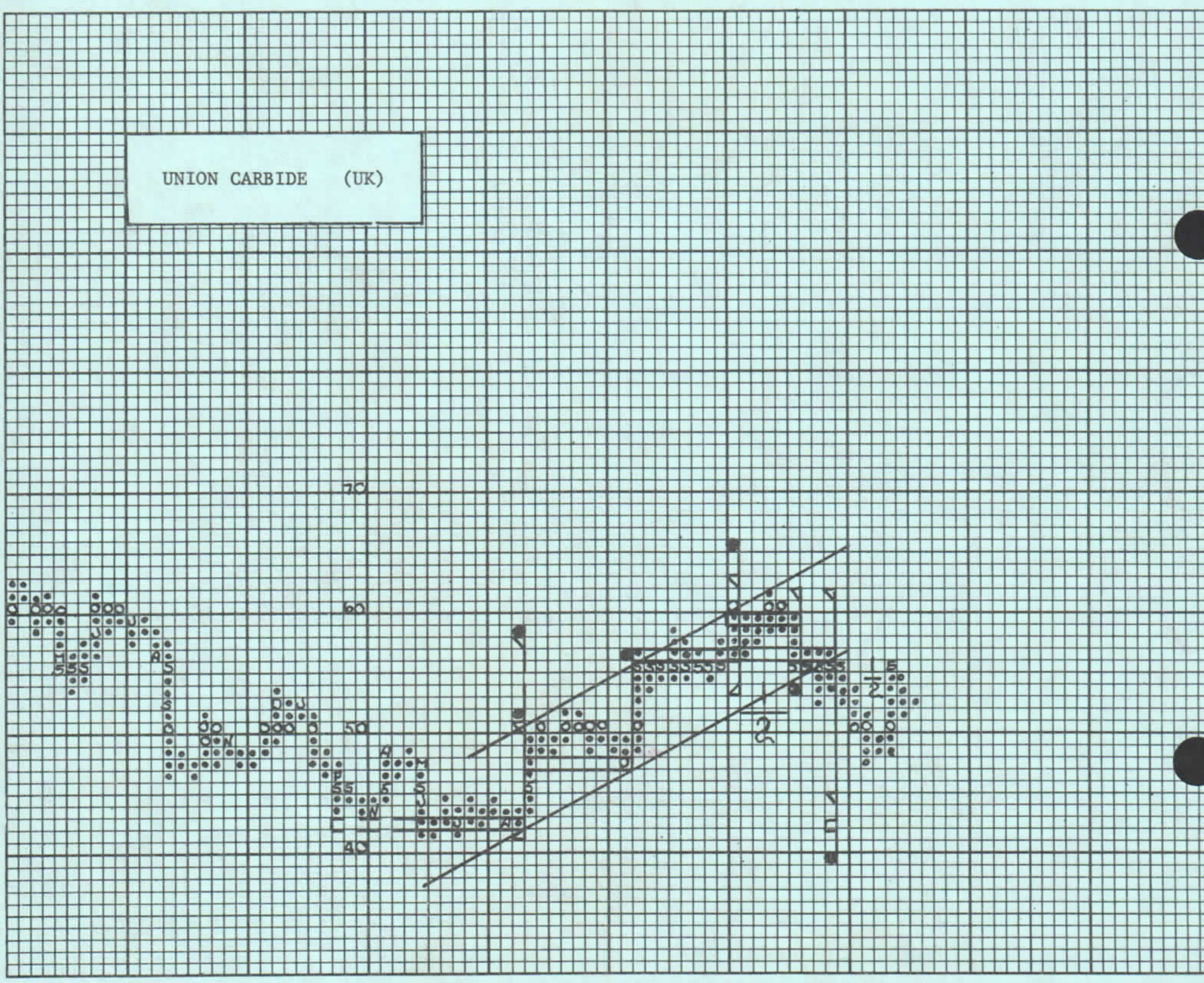
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