The Trend Letter

Thursday, March 11, 1982

MARKET TRENDS

On Tuesday, March 9 at 12:10 PM Eastern Time, the market finally did what it has been in need of ever since the selling climax of September 28. It returned to the bottom of its trading range for a serious test of the support at the bottom of that range. This makes it an especially important day and one whose meaning warrants very careful study. The reason is that an incorrect analysis of this action could result in trading that is either wrong or seriously premature.

When the market reaches important points, most investors and traders have preconceived ideas as to what the outcome will be. It is almost impossible not to have such opinions. The important thing is that these be tested against the reality of the situation. On Tuesday with the market squeezed up against a critically important support level, opinions as to its future could be grouped into two important categories. One opinion is that the future looks very positive. Just about everyone is negative, but since the market has not rolled over and died, it probably will not. This should make the future very positive. The second opinion sees the market's future as being very negative. The market has been trying desperately for five months to get an advance going. In recent weeks, these efforts have been of increasingly poorer quality. There is now no more room for additional deterioration. The market is ready to break the bottom out of the trading range. Therefore, the future should be very negative.

These two opinions represent extreme positions. In addition, they are exact opposites of each other. One should be totally right and the other completely wrong. In the long run, this may prove to be true, but for now neither correctly reflects the reality of the present position.

Let us assume that we have adopted the positive opinion. How might we view the action of March 9? The most positive stance would be to say the action represents a selling climax. A selling climax comes after a sustained decline with especially rapid deterioration and high volume in the final stages of the decline. It can be expected in the area of a downside objective. The day of the climax will have a high volume downward thrust followed by a sharp snap back with the market closing at or near the high for the day. Does the action of March 9 qualify?

Since the market had started moving down on January 9, it can be said that a sustained decline was underway. The final phase of the decline began on March 2 and it is clear that it brought with it especially rapid decline and very high volume. Thus far, the case for a climax seems rather convincing, but now we run into a problem. In trying to find a downside objective, we find that the most conservative counts have been overrun, but that other lower objectives are nowheres near being fulfilled. Since we can see that some objective has been fulfilled, we will overlook this potential problem. As for the action of March 9 itself, there was a high volume downward thrust followed by a sharp snap back. The market closed nearer its high than its low, but there is some question as to whether this fits the definition of a climax.

If we look at the evidence critically, we can see that it is far from compelling. As to whether it is convincing, that is a matter of personal opinion. For the sake of argument, we will accept the evidence as being convincing. Therefore, we conclude that a selling climax has occurred, but what has been climaxed? Clearly, it is not a major down trend. It is only a relatively short term six week down trend totally contained by a more important trading range. At this point, the longer term investors should lose interest. The action is just not important enough for them to be excited. They need to see more, probably much more.

The shorter term trader has reason to remain interested, but that is all. Remember, a selling climax only says that the decline in progress has been temporarily halted. There are several additional steps that must be completed before a buying opportunity can be said to exist.

There is another way to put the action of March 9 into a very positive light. It can be done by calling the action a spring. The only problem with this is that it is not true. The low on March 9 did not penetrate the low of September 28. Therefore, no spring condition existed. Close does not count. Many market losses have come from acting on situations that were supposedly good enough.

Since we cannot reasonably justify holding the very positive opinion, should we adopt the very negative point of view? If we do, we see that the market is without a doubt in a down trend and on the verge of breaking a major support line. This in turn may trigger the second leg of a major decline. All this may be true in the long run, but in the short run it overlooks a very important point.

The first step of the Wyckoff method tells us to determine the trend and position. We trade in harmony with the trend from a position that suggests the likelihood of additional progress in the direction of the trend. We can see that the trend is down. Hence, there is justification for a negative opinion. However, we should also note that as the market hit its low on Tuesday it was in a very oversold position. This can be seen in the penetration of the oversold line and the Technometer reading. Therefore, the likelihood of immediate additional downside progress was small. The rally that set in at this point can be seen as an effort to correct the oversold condition. This is a perfectly normal development and does not change the fact that the trend is down.

If the extremely positive approach is wrong and the very negative view is equally wrong, that must mean that reality lies somewhere in the middle. This is how things are most of the time. We must remember that the intermediate trend of the market is down. Therefore, for those trading in that time frame, the emphasis should be on the short side. The market's recovery on Tuesday presents the possibility of another short selling opportunity. It also puts off the final decision as to whether a new major decline is about to begin. This additional time gives the market an opportunity to recover from its recent weakness, but that is only an opportunity and not a guarantee. At this point, there is no evidence of a recovery.

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STOCK TRENDS

Since the Wyckoff Wave is in a down trend, the weak components are the ones most worthy of short positions. These are Exxon, Merrill Lynch, Pittston, and Union Carbide. Merrill Lynch appears to possess the most clearly defined remaining downside potential. Therefore, it should be considered a prime short candidate if a new short selling opportunity develops. The other three would also be possible candidates based on a continuing pattern of relative weakness, but it is unclear just how much lower these stocks have to go.

The future of the Wave is more likely to be influenced by what happens to the relatively strong issues. Theses stocks are General Electric, General Motors, I.B.M., and UAL, Inc. The action of these four can be seen as the reason for the Wave continuing to hold on to its trading range in spite of a down trend. Therefore, deterioration in these four could signal a negative future. On the other hand, continued or renewed strength would point to an improved future.

When viewing the entire period since September 28, we find that General Electric has shown the most strength for the longest period of time. GE is also the most important stock in the Wave right now. Therefore its future and that of the Wave are closely related.

General Electric does have a previously defined higher objective between 67 and 70. This goal may be reached, but it will probably not be in the immediate future. The action of the past few days has penetrated the support line of the most recent short term uptrend. This means that the new trading range between fifty-nine and sixty-four has taken control. Although this is a change from the past action, it is not necessarily negative. The result of this action could be a confirming count for the higher objective. Time will tell. Until that time arrives, however, the trading range action should be watched closely for signs of distribution. Thus far, they are not present, but if they do appear, the future for the stock and probably the market as well will turn substantially more negative.

Another recently very strong stock that has fallen on hard times in the last week or so is I.B.M. The potential problems here are more serious than with General Electric. This is because there are clear signs of a downward break following some distribution. The downside objective built during this period is fifty to fifty-two. Considering the importance of this stock in the Wave, that much of a decline could turn into a very negative development.

The count that yields the objective of fifty can be broken into two phases. The goal of the first phase is fifty-six to fifty-seven. This approximates the halfway point of the advance from forty-nine to sixty-four, which is a logical place to expect support. The question is will the stock climax at the first phase objective and will the trading range that follows be an accumulation for a resumption of a longer term advance? These are questions that can only be answered by the trading range action. If we find the answers to be yes, this stock becomes an excellent possibility for the long side. Even if the answers prove to be no, there is a possibility here, but it would be on the short side. Either way, this stock deserves continued attention. Its recent retreat is not reason enough to look elsewhere.

Since we know that four of the stocks in the Wave are weak and since we know that the two strongest stocks have lost some of their strength recently, how is it that the Wave has been able to hold on to its trading range? The answer is that GM and UAL have presented important signs of strength over the past two weeks. For both stocks this represents an important change of character. A low volume reaction in each in the face of an improving market picture could turn into a signal to buy.

The future of the four strong stocks in the Wave is critical. It is unlikely that the weak ones will make 180° turns. Therefore, the future of the Wave rests on the four strong stocks remaining strong. These should be watched carefully. Sometimes, the next move of the Wave can be picked up in the action of the individual stocks before it becomes clear in the Wave.

The Pulse of the Market

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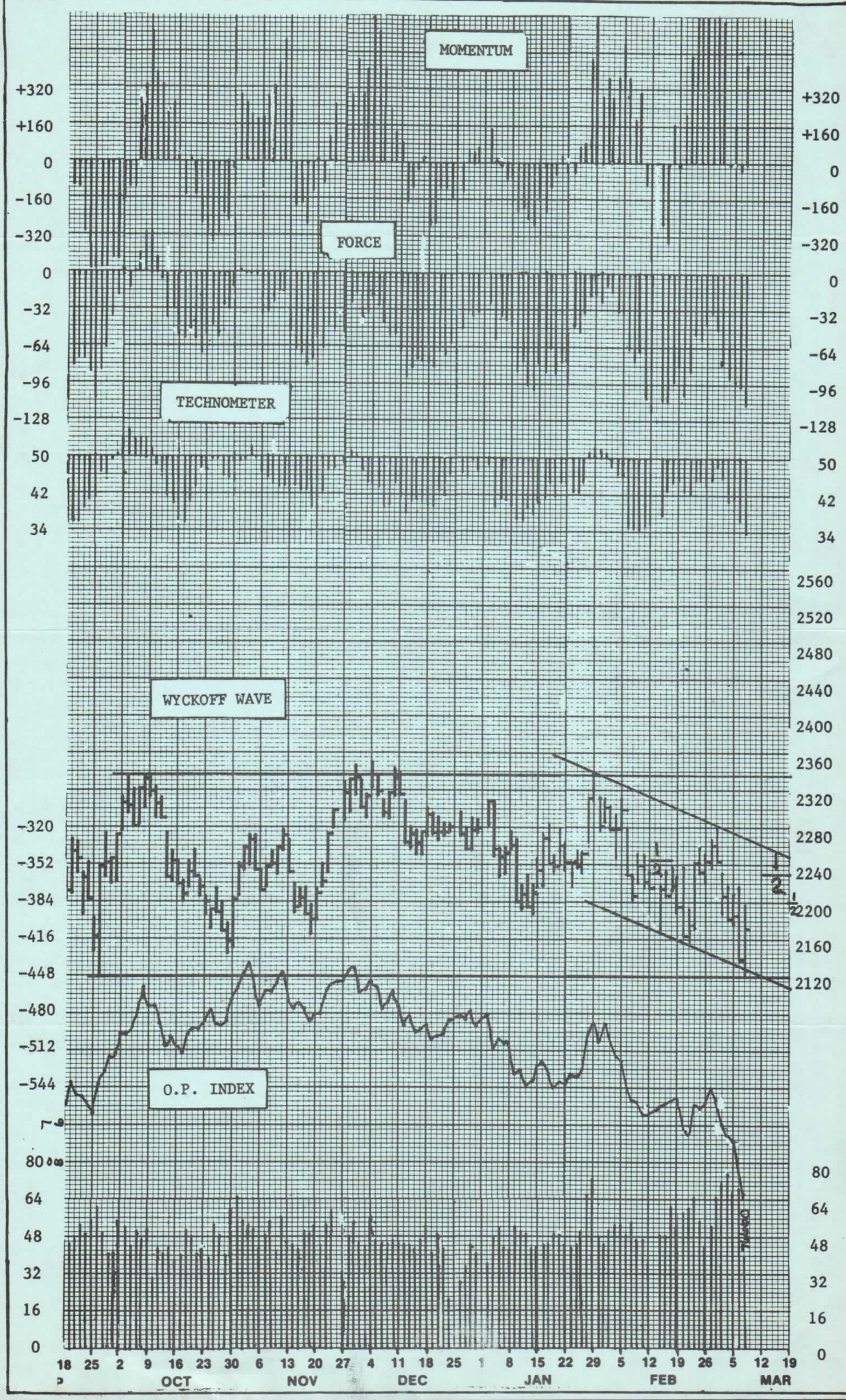

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GENERAL ELECTRIC (GE)

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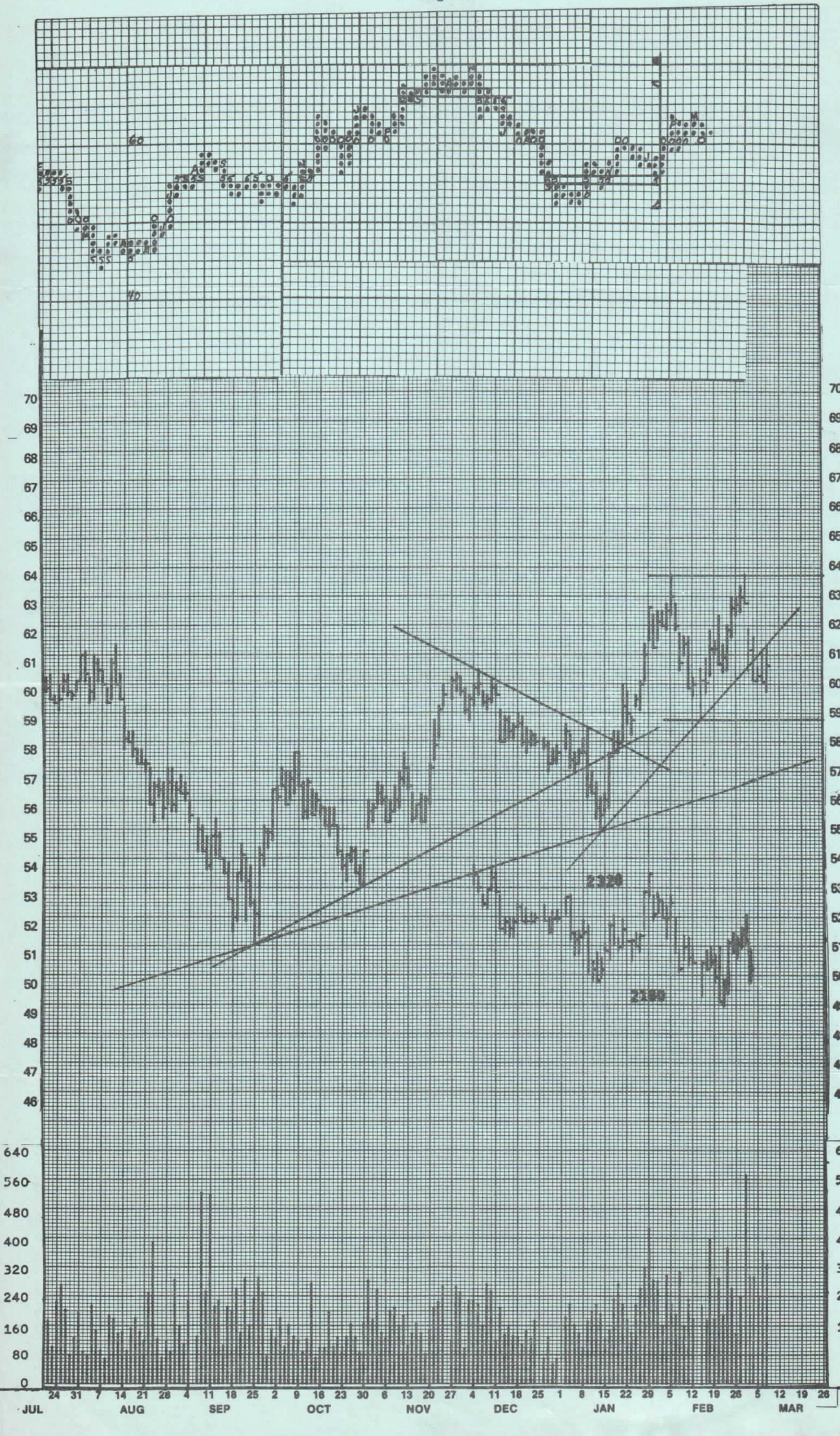

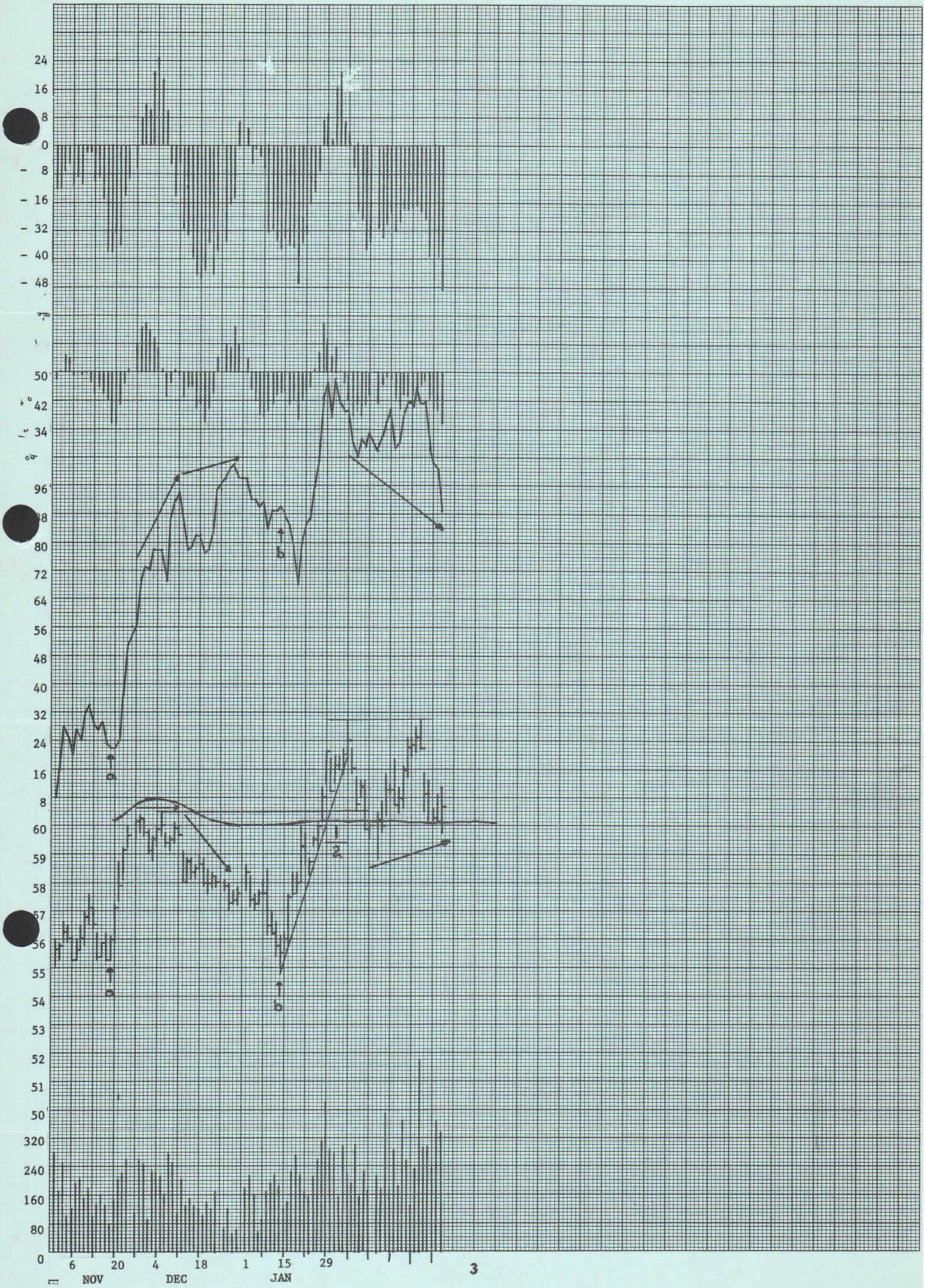
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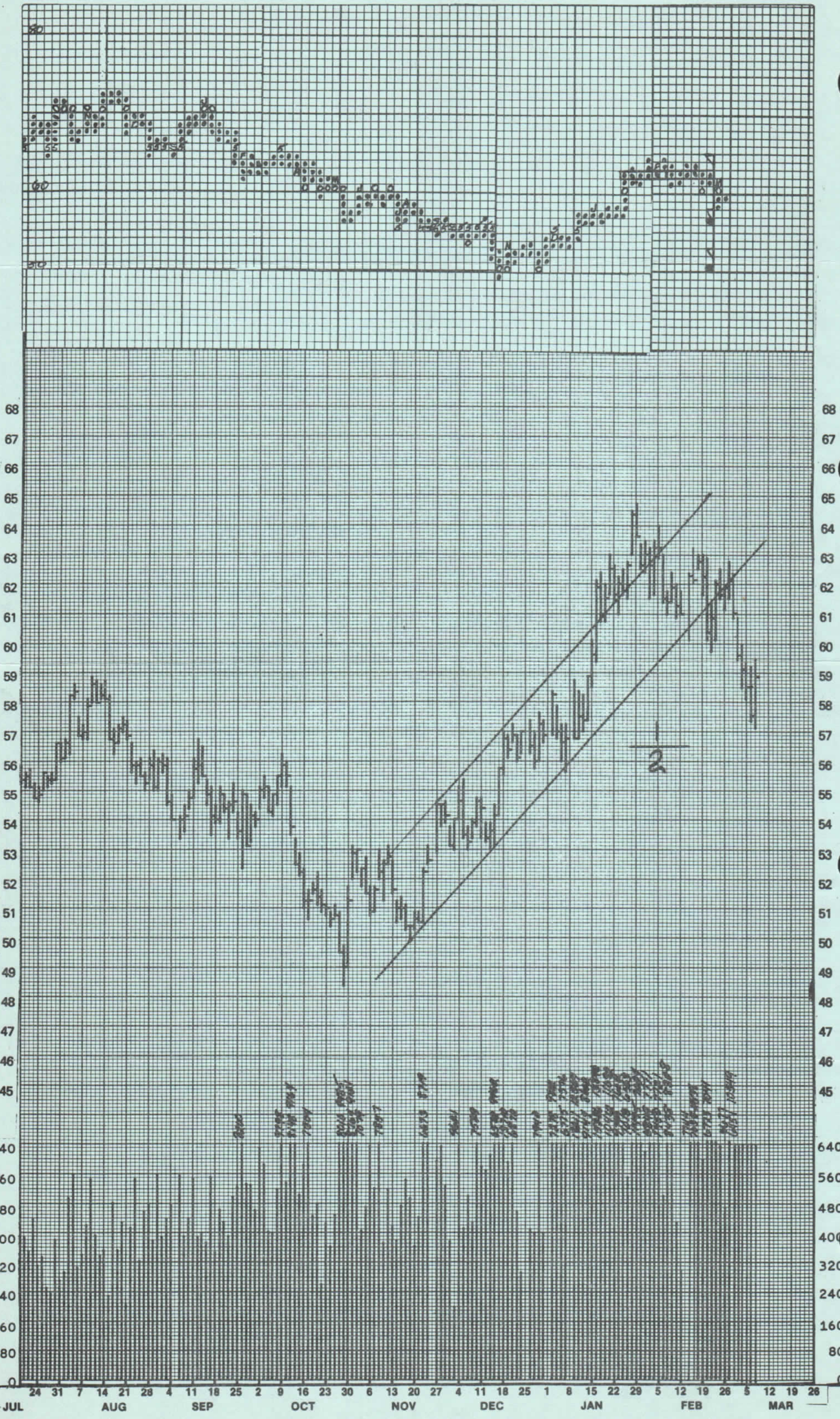
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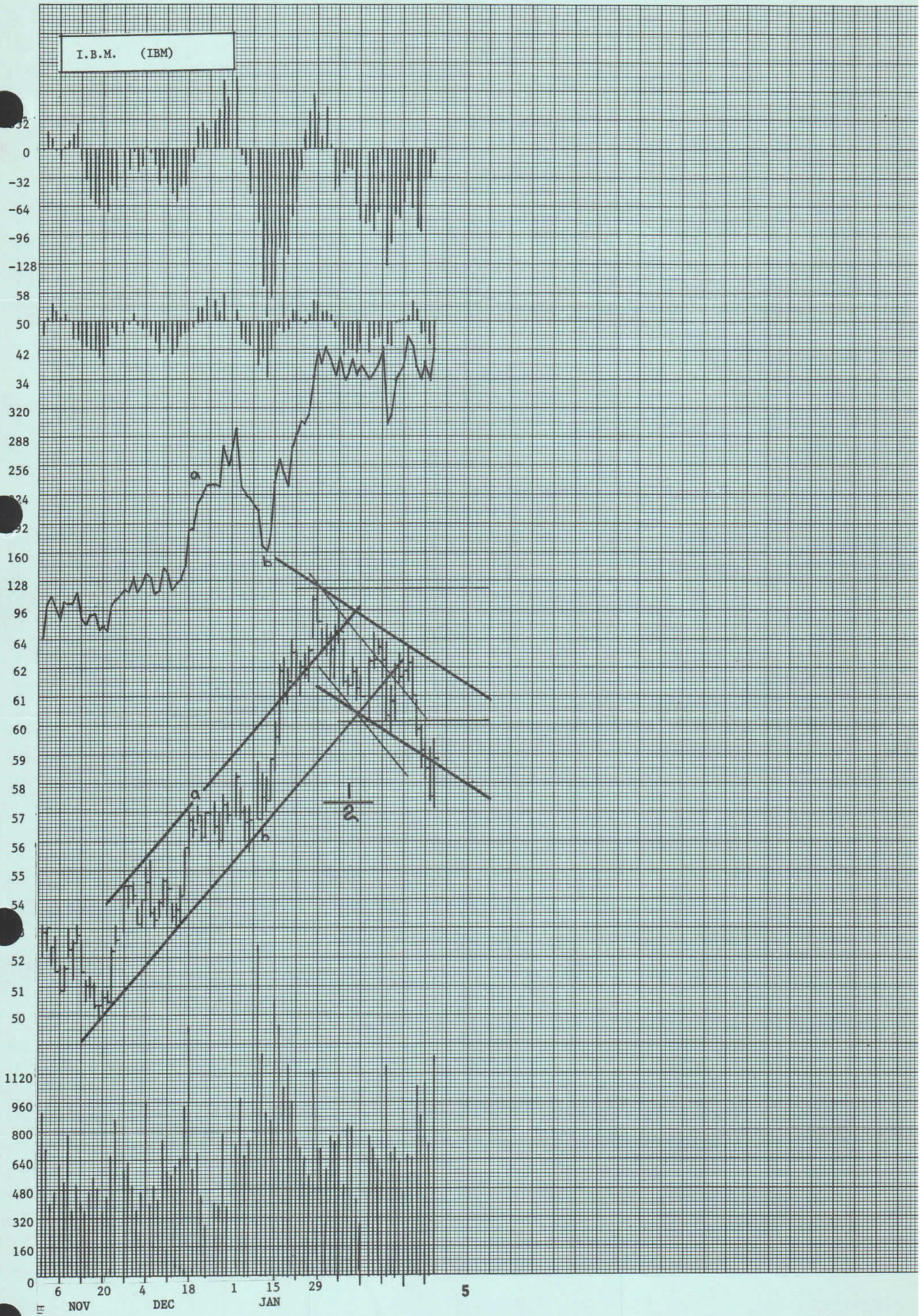
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GENERAL MOTORS (GM)

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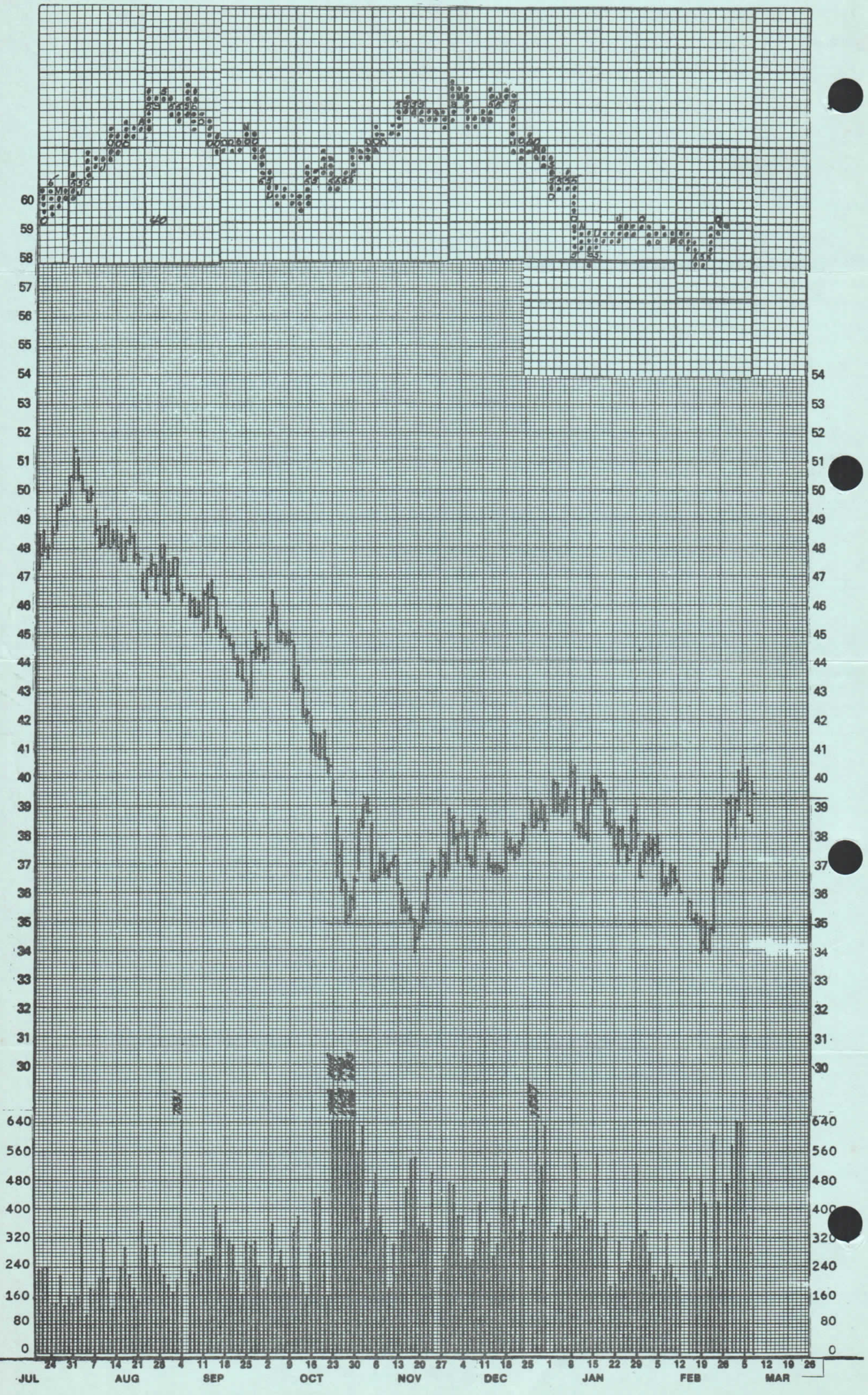

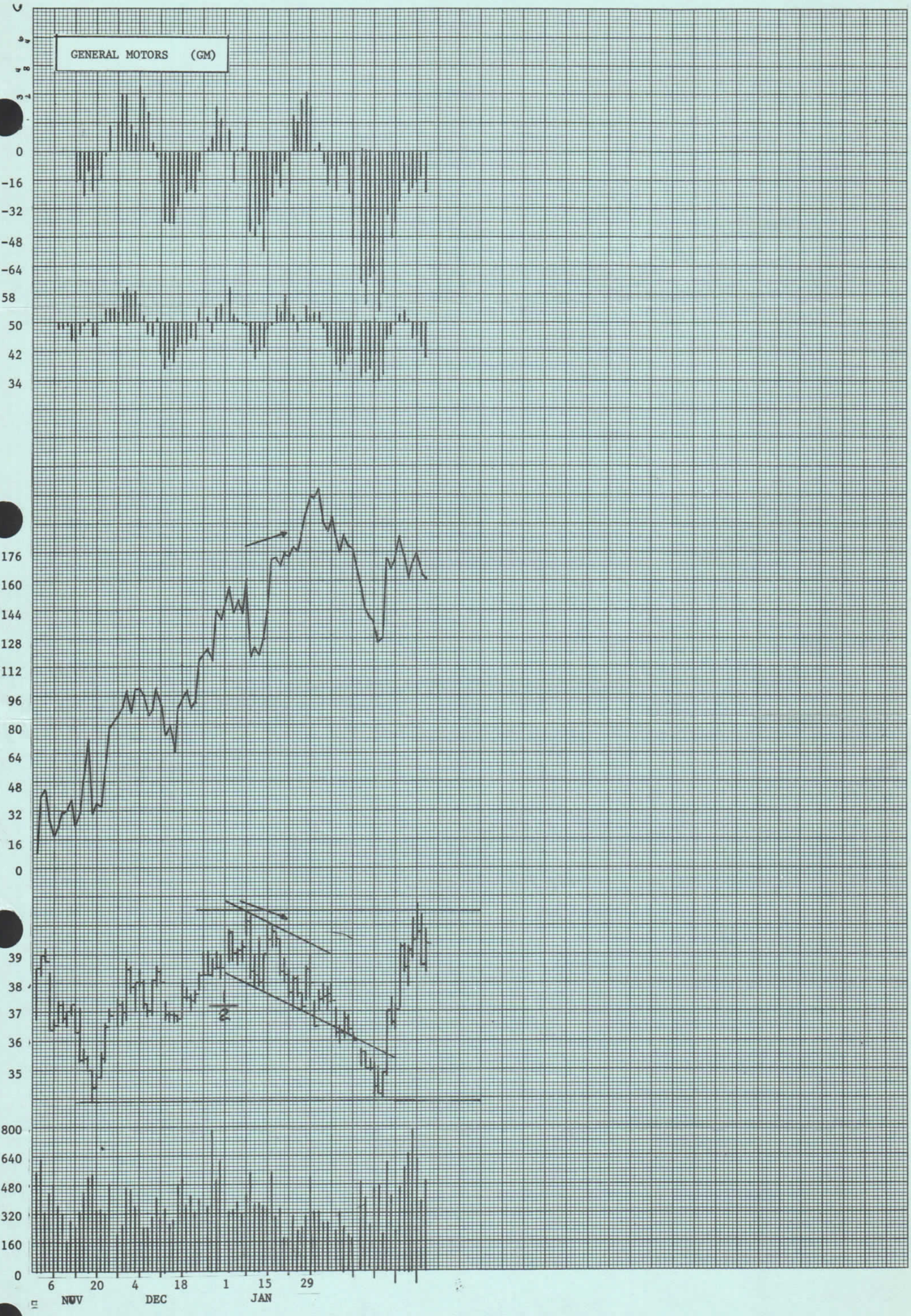
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U.A.L. INC. (UAL)

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