

The Trend Letter

Monday, November 1, 1982

MARKET TRENDS

Depending upon who you talk to, the market of the past two weeks has either gone about as expected, or has started to become something of a disappointment. Those who are apt to be a bit disappointed at this stage are likely among the throng who bought wildly during the week of October 8th through the 15th in anticipation that the upward spiral in prices would continue. It hasn't and this is the cause of the disappointment. Positions taken at rather lofty levels are fine if those prices move on to still loftier heights. When they don't, some people start to get nervous. If this spreads to enough individuals, there could be some trouble ahead.

Those who are not disappointed, and this should include all serious students of the Wyckoff method, knew two weeks ago when the buying frenzy was at its peak that sustained high volume that fails to lift prices higher after an advance means the advance is over. It is at least time for a new trading range and perhaps nearing time for something somewhat more negative like a correction. A trading range has taken hold now and the preparation for the next important step is underway. It is time to pay especially close attention to what the market is saying. When it seems to say something that warrants action, the action should be taken. If it changes its mind and says something else later, action should be taken accordingly. The market knows all. We only know what it tells us. If we choose not to listen, we know nothing.

At the moment, the market is telling us that it has encountered an obstacle to additional upside progress. In September when this happened, it could be seen as a sign of momentary fatigue resulting in a short lived resting spell. This time, we can also suppose some fatigue in view of the tremendous upside effort expended recently, but the problem may go somewhat deeper than that. Some of the specifics can be seen on the weekly chart.

The weekly chart of the Wyckoff Wave indicates that the market wants to turn the 1980's, or at least part of them, into an important uptrend. The uptrend channel is in place. This will serve to take the market to whatever height it is going to reach. For now, the trend channel suggests we have seen the highest point that we are going to see for a while. Or, if we are going to see higher levels very soon, they will be the result of a hard fought battle. Often, these do more long term harm than good.

The week that saw the market start to move into a trading range also saw it run into the major overbought line. This can be seen as an important reason behind the development of the trading range. In the past two weeks, the market has tried to pretend that the overbought line is not there and has failed. In addition to the overbought line, the market has experienced weekly Technometer readings above forty-eight. These are not clearly overbought readings, but similar numbers in the past have brought meaningful corrections. They tell us the market is vulnerable.

If the market is vulnerable to a correction, the next question is how big can it be? The answer is that it can be pretty big. The market's primary uptrend is so wide and gradual that it can weather a substantial setback and still be totally intact. It may have to do that. Both the fifty point and the twenty-five point figure chart already indicate three to four hundred point potentials. If the third phase of the advance is going to be very sluggish, these points could be consumed on the upside. However, the presence of the major overbought line and the relatively overbought condition appear to indicate otherwise.

Speculation on which direction the market will use the potential indicated on the longer term figure charts and confirmed by the ten point chart is really meaningless until the market's own action begins to provide some clues. The action of Friday, October 22 put the market in an upthrust position. Last Monday, it broke sharply back into the trading range, which is what would be expected from an upthrust. The volume, however, contracted rather than remaining strong. This creates a problem that must be resolved. The means of providing the resolution is the test of the upthrust, which appears to be underway at the present time.

We tend to think of important actions such as upthrusts, springs, and their tests as being one day occurrences. Often they are, but not always. For example, the upthrust on October 22 was actually a three day penetration. On Wednesday of last week, we saw one day action that provided a convincing indication of a test. On Thursday, the market began moving down in response to the potential test. There was a problem, however. Volume did not come in on the downside. Friday, the market met support and made an attempt to rally. Again volume failed to come in. This tells us that the market has not completed its testing of the upthrust. It also tells us that the upthrust has not been confirmed. Confirmation does not exist until the test holds.

An extended testing process is something of a mixed blessing. In the case of a one day test, shorting activity must be concentrated. There is little time to act or think. The reward for swift action is a speedy profit. The problem is that it is often difficult to act this quickly, which can lead to lost opportunities. In an extended test, there is more time. There is more time to think, to take positions, and unfortunately for things to go wrong. This is where we find ourselves. We are looking for places to take shorter term short positions in anticipation of a successful test. We are being given time to search. Unfortunately, when an opportunity is found and exercised, we must wait for the entire testing process to end before meaningful profits are achieved. During this waiting period is where we need to be most cautious and be ready to relinquish our positions if the need arises. Assuming the test is successful, the next critical point will be at the bottom of the trading range. Will the market spring again or not? After the test of the upthrust, a spring will become our next concern.

STOCK TRENDS

It should be noted that the potential short selling opportunity that appears to be developing has been mentioned as a short term possibility. There are two reasons for this. The market and the stocks are still in important uptrend channels. In addition, the stocks do not have the twenty-percent potentials usually seen as the minimum needed for a worthwhile intermediate move. Therefore, any action that is going to be taken here is going to have to be restricted to options.

Exxon appears to be a good candidate for a short term short position. (Position in January 30 puts suggested Oct. 27.) The stock is well below its high and has shown no ability to rally as the market tests the upthrust. These are the factors that justify considerations on the short side. Also, notice the enormous effort on the second phase of the advance. This did not produce an expanded gain.

The problem with Exxon is that its figure chart does not indicate a downside objective. Therefore, we must watch previous support levels closely. This makes the area around 26.4 a likely target. In order to get there, though, the stock will have to get through the support line of the uptrend, which may not be easy. Natural support and even a rally as the price approaches the support line is normal. However, a rally above 31.1 would not be, so it represents a good level for a stop order.

General Electric cannot be considered a good short term short candidate. The reason is a lack of any signs indicating relative weakness. There is a count building that can already be measured as being ten points. However, without any clear indication of weakness, it would be wrong to assume that it is for the downside. The stock may remain strong as the market corrects and then use the count for a resumption of the advance some time in the future. To do this, it will need the potential that is building because all reasonable upside objectives appear to have been met.

In the past week or so, there has been a great deal of attention given to the auto stocks. This has been due to an unusual amount of attention getting action among the stocks in the group. New highs and large volumes have been common. Has all this been done to attract the attention of the public to something that is just beginning? The market seldom works that way unfortunately. Normally, the wide spread attention comes as something important is building to a climax. The upside objectives in General Motors suggest that this is what is happening in this stock. At most, we can see a move to fifty-nine, which is only another two points. After that, there will have to be new preparation for a possible third phase. With only two points left to go on the upside and with a general market picture that mildly favors the downside, new long positions in General Motors make no sense. The same is true of shorter term short positions. A stock that is still showing considerable strength after that of the general market has faded cannot be considered for a short position.

I.B.M. is a once strong stock that has started to show some signs of fading. The reason for this is that the aggressive advance of the past few months has gotten the stock badly overextended. This is especially evident on the weekly chart, where the overbought position can be seen to be dangerous. There is a higher objective well into the nineties, but it is not likely to be reached soon with such an overbought position present. The stock needs to get back into its long term uptrend. The one point figure chart indicates that the potential to accomplish this is building and the vertical line chart reflects a weakening following the overbought position that developed on the intermediate uptrend.

From a shorter term perspective, I.B.M. is at an important crossroads. The intermediate overbought position set in motion a series of events that have led to a trading range. The action of the past week, while more negative than that has created a potentially positive position. After Friday, we find the stock on the verge of a spring position and up against an important support line. Certainly, this is not the place to go short. If we could be more positive about the market's near term future, it would be a place to buy. Since this is not possible, we need to wait and watch the response of the next few days. Anything less than a return to the top of the trading range should produce a shorting opportunity if the market can move closer to an overbought condition. In view of this and the stock's ability to move quickly, it should be watched closely as a potential candidate.

If there is any stock that should be vulnerable to some type of short term correction, it is Merrill Lynch. Had the Wyckoff Wave moved as much as this stock in the past two months, it would now be over five thousand. Because of this total loss of touch with reality, there might be a tendency to want to go short. This would be an error at this point. It is true that the stock has been in an overbought position. It is also true that this position needs to be corrected. However, the strength suggests an unimpressive downside correction and the figure chart confirms this. This stock has nowhere to go on the upside without a new buildup of count. The same problem keeps it from having any place to go on the downside. Therefore, it is not a good vehicle for new positions at this time.

The potential danger in a dangerously overbought position can be seen in Pepsico. Here we have a very strong stock that tried to outdo itself. When reality finally set in, it hit hard. This is a potential problem for many other stocks right now and is why the risk on the long side is so great. Due to its obvious weakness during the past two weeks, the stock has to be considered a potential short candidate. Before, it is shorted, however, it needs to prove itself.

The recent move down to forty-one has all the earmarks of a sign of weakness, but the price did meet support near an important halfway point. Is this just a normal correction accomplished in a somewhat unorthodox manner? The next attempt to rally should provide the proof. Resistance in the forty-five to forty-six area would be negative and should serve to indicate a shorter term short side opportunity.

UAL, Inc. is similar to General Motors. It has shown good strength in recent days, but has rallied to the previous high on lower volume. It is now entering an overbought position and is only two points from an important upside objective. Buying it now makes no sense and shorting it is equally questionable in view of the recent relative strength.

Union Carbide may be considered as a short candidate. It has become overbought and used up its potential. A trading range has developed and been upthrust. That upthrust has had one convincing test. With the market apparently in need of additional testing, another one may develop here as well. If it does, a shorting opportunity will be at hand and likely with a respectable downside potential.

S&P INDEX FUTURE

It is common to find investors and traders who can interpret the general market very well and then make a poor stock selection. For these people and those who just want to out perform the general market, there are now index futures. These relatively new trading vehicles provide enormous potential for a small to moderate price. The best appears to be the S&P Index Future.

Potential is the key word when it comes to index futures. Someone who bought a contract in August and held on could have made forty-one points profit where one point equals five hundred dollars. We might think that nothing can have this much potential. There must be a catch. There is. Potential in index futures works both ways. To go along with the virtually unlimited potential for profit, there is an equal potential for virtually unlimited loss. In options, the loss is limited, but in index futures it is not. Therefore, this is a vehicle for only the most disciplined Wyckoff student. Carefully placed stops are a necessity. No chance to let an error go unrecognized or unadmitted can be allowed to exist.

The S&P Index Future is highly leveraged. This makes it possible to profit rather well from a very small move. Many people fall into the trap of trying to do this. It is a trap because it requires entering the market very frequently. Every time the market is entered, the trader is put at risk. Risk is something we want to control as much as possible. Therefore the way to trade these futures is to go after the big moves. If we do this, only a few trades will be needed to generate a large return, which is the ultimate goal.

These discussions will be aimed at the types of moves that the enclosed three point figure chart indicate are possible. Most of the time these will be major moves. Sometimes, however, especially obvious shorter term indications will be highlighted. This will be done not so much for taking advantage of the present opportunity, but to make similar opportunities stand out more clearly. One of these shorter term opportunities appears to be developing now.

Last Tuesday, the price entered a spring position on very high volume. This needs to be tested and it is on lower volume. The indication here is that the future is going to try the upside again. This is in keeping with the market's need for additional testing of the upthrust. The index futures will almost always overdo what the market does. Therefore, a successful testing of the upthrust leading to shorting opportunities in stocks could produce a worthwhile advance in the future. From what we can see right now, that could take the price back to the 141 area.

Caution is extremely important here. When the market has completed a successful test to the upthrust, the move in the future will be over. This is true whether the price makes it to 141 or not. Given a weakening stock market it may not. A natural resistance level exists around 137. Unless volume comes in to push the price through this area, it will likely be stopped. In this case, it would be foolish to hold out for the higher level. It is at this point that the next significant opportunity may develop. It will be for the short side. If the potential is there for a move back into the trading range that followed the first phase of the advance, it will be worth pursuing.

HYPOTHETICAL ACCOUNT

In an effort to better monitor the suggestions made on the recorded updates, a hypothetical account in the amount of \$50,000 is being established. It is divided into a speculative fund (20%) and an investment fund (80%). Speculative funds will be traded in options and investment funds will be traded in stocks with potentials of at least twenty percent.

A round of speculative trades will consist of a maximum of three positions taken in the options of three stocks. Each position will use approximately one third of the available funds. No more than one position will be taken at any one time. A round of investment positions may include nine trades. The funds will be divided into thirds. One third will be earmarked for one stock. Therefore, the maximum number of stocks traded will be three. When a position is taken in a stock, only one third of the dollars earmarked for it will be used. Therefore, three positions may be taken in a stock, but at three different times. More than one position may be taken at a particular time, but they will be in different stocks. All positions in both funds will have stops and objectives.

Hypothetical Account

Investment Fund		
	Initial funds	40,000.00
Speculative Fund		
	Initial funds	10,000.00
Oct. 28	Buy 20 XON Jan. 30 puts	(2,750.00)
	at 1.3	(65.00)
	Commission	
	Close out position if stock trades above	
	31.1 Anticipated objective 27.4	
	Balance	7185.00



INDEX CHARTS

STOCK MARKET INSTITUTE, INC.

OCTOBER 27, 1982.

SMI/WYCKOFF INDEX CHARTS

This set of SMI Index Charts is published weekly and is available only to subscribers of SMI's DAILY STOCK REPORT / PULSE of the MARKET or SMI's CHARTING SERVICE. It contains the following charts:

Weekly Wyckoff Wave

50-Point Modified Wyckoff Wave

25-Point Modified Wyckoff Wave

3-Point of the 10-Point Modified WW

10-Point Modified Wyckoff Wave

Two Point Modified O-P

1/2-Point Time Index

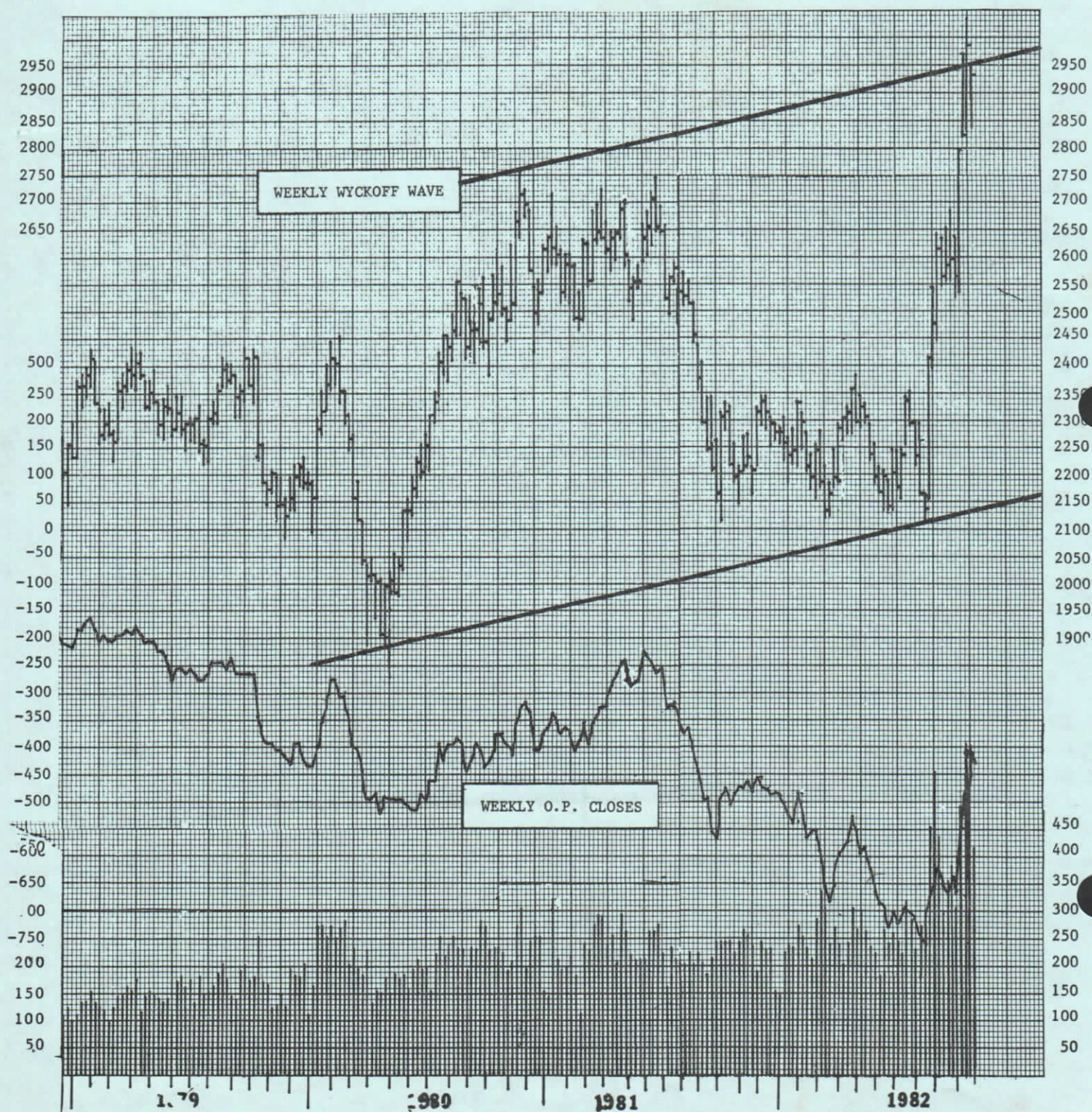
Trend Barometer/O-P

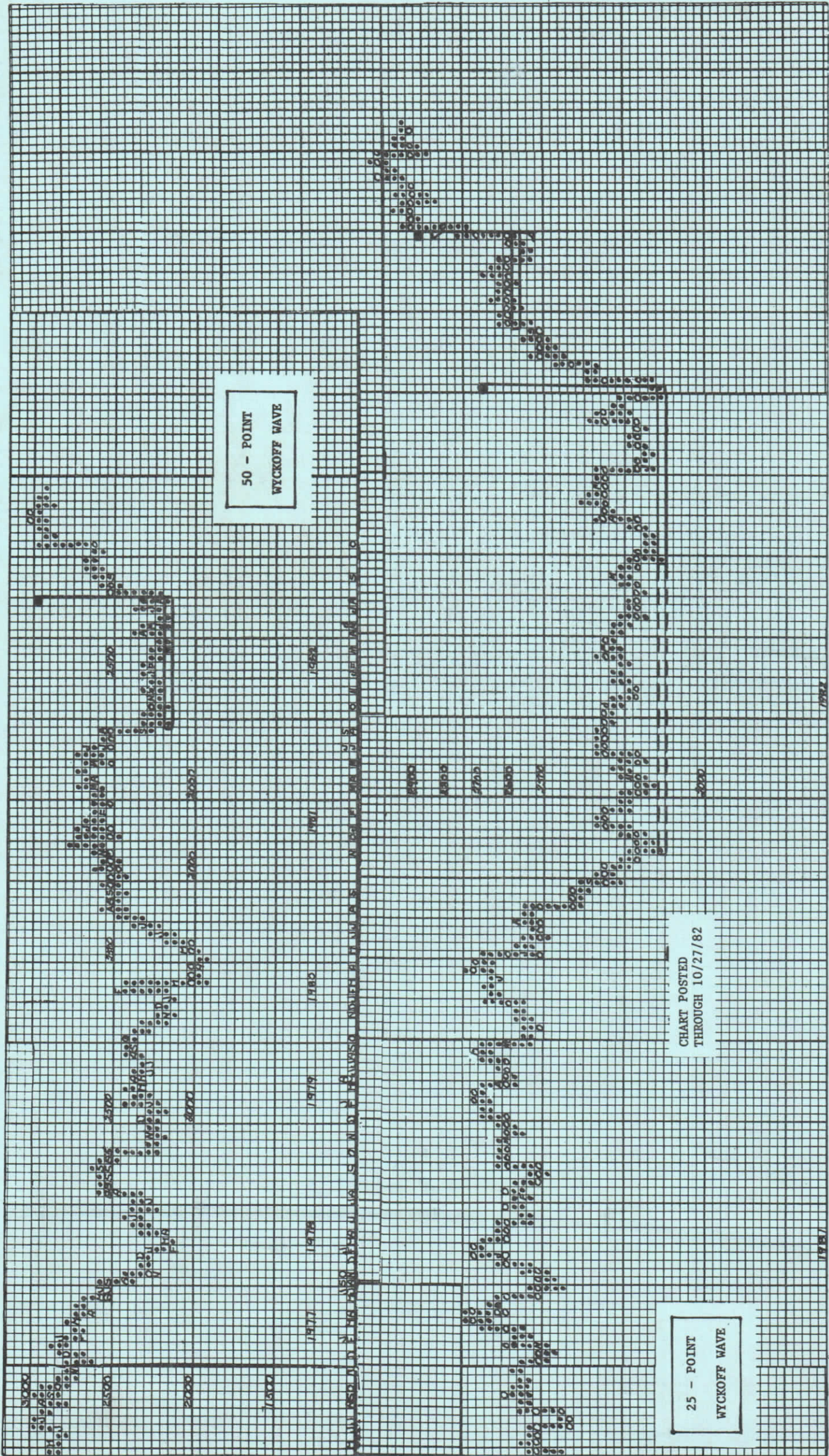
Intra-Day Wave Chart

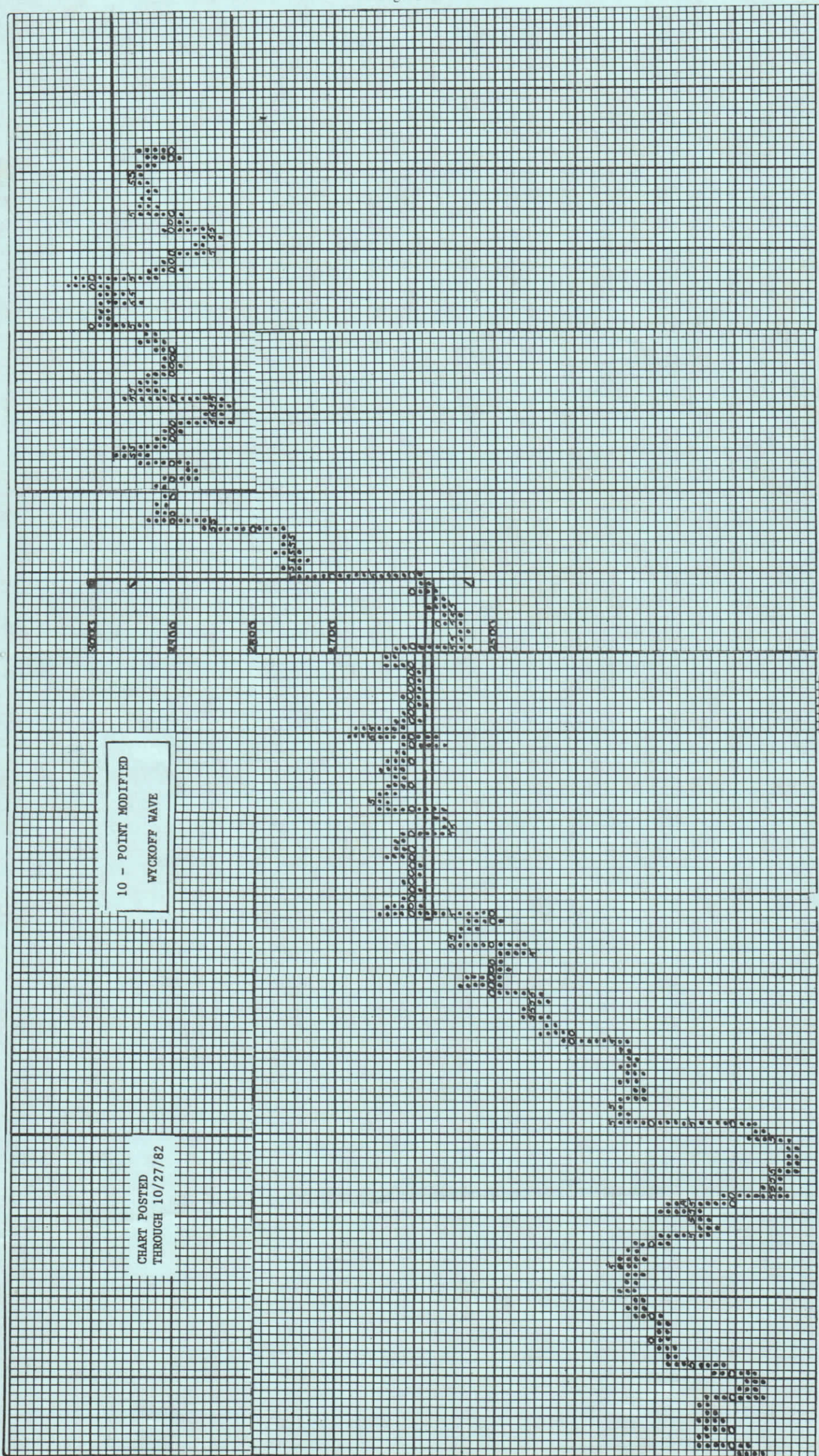
5-Point Modified Wyckoff Wave

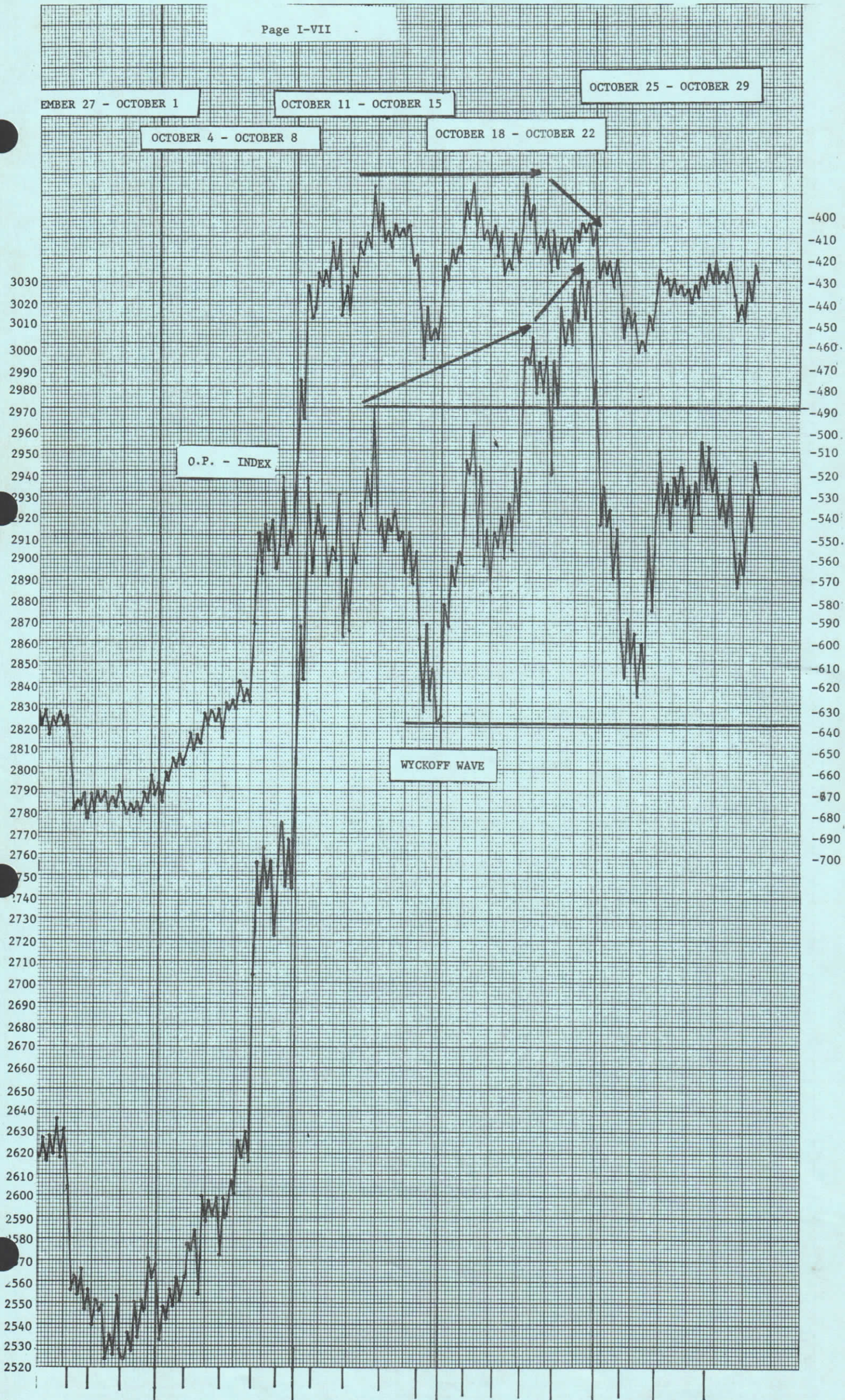
Group Indexes

In our desire to insure the accuracy and reliability of these charts all statistical data is checked and cross-checked. However, even with this care, the completeness and accuracy cannot be guaranteed.







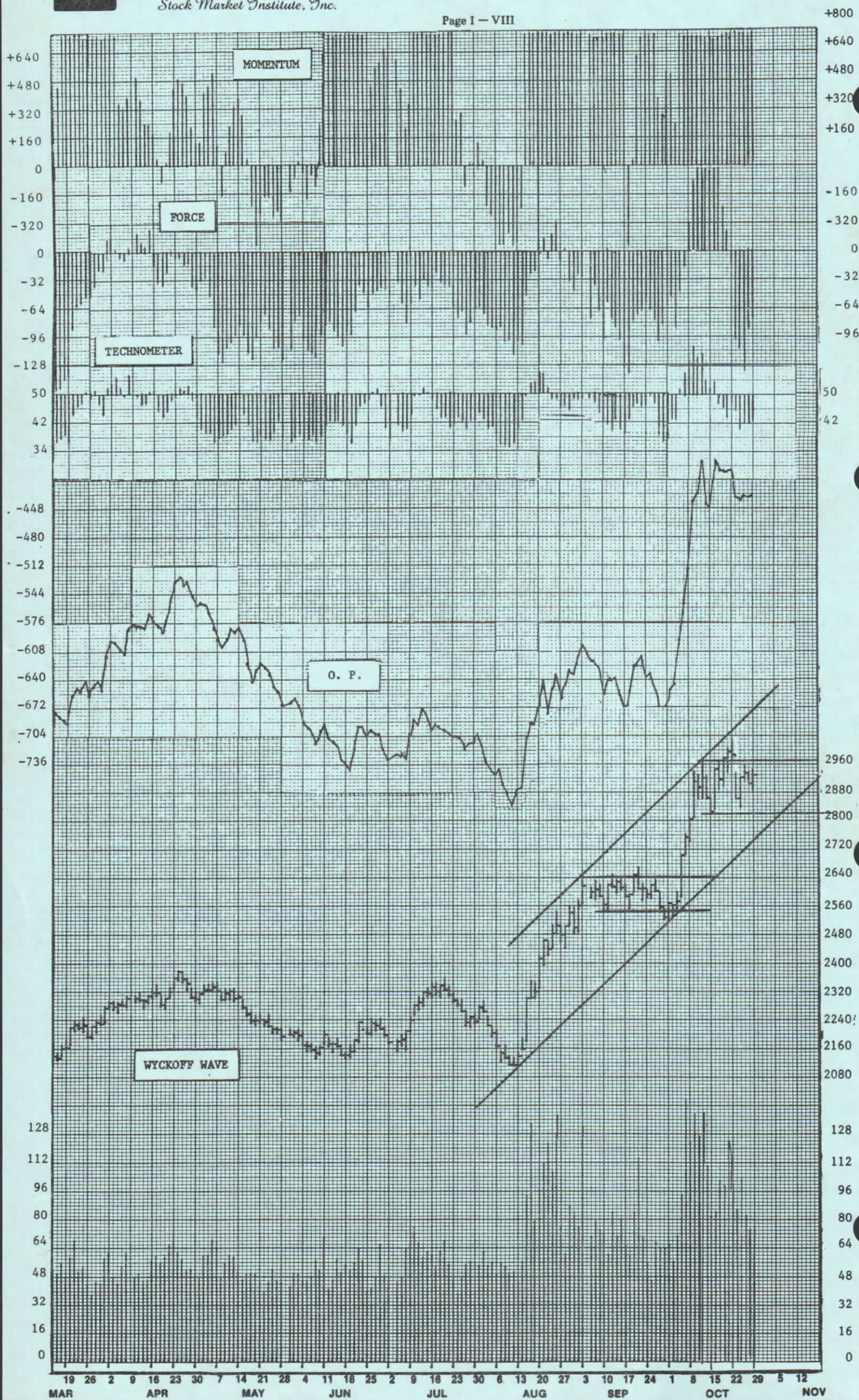




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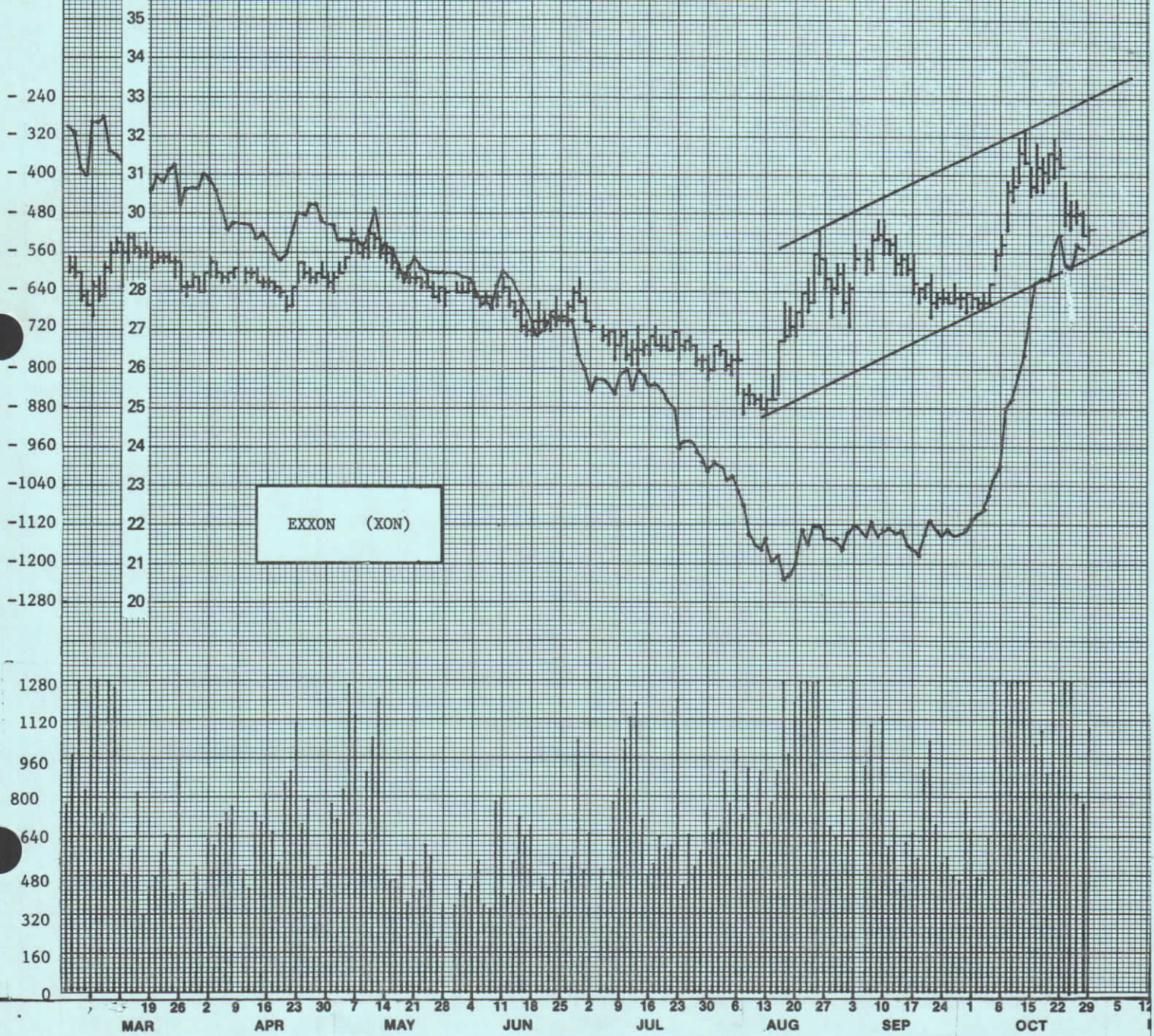
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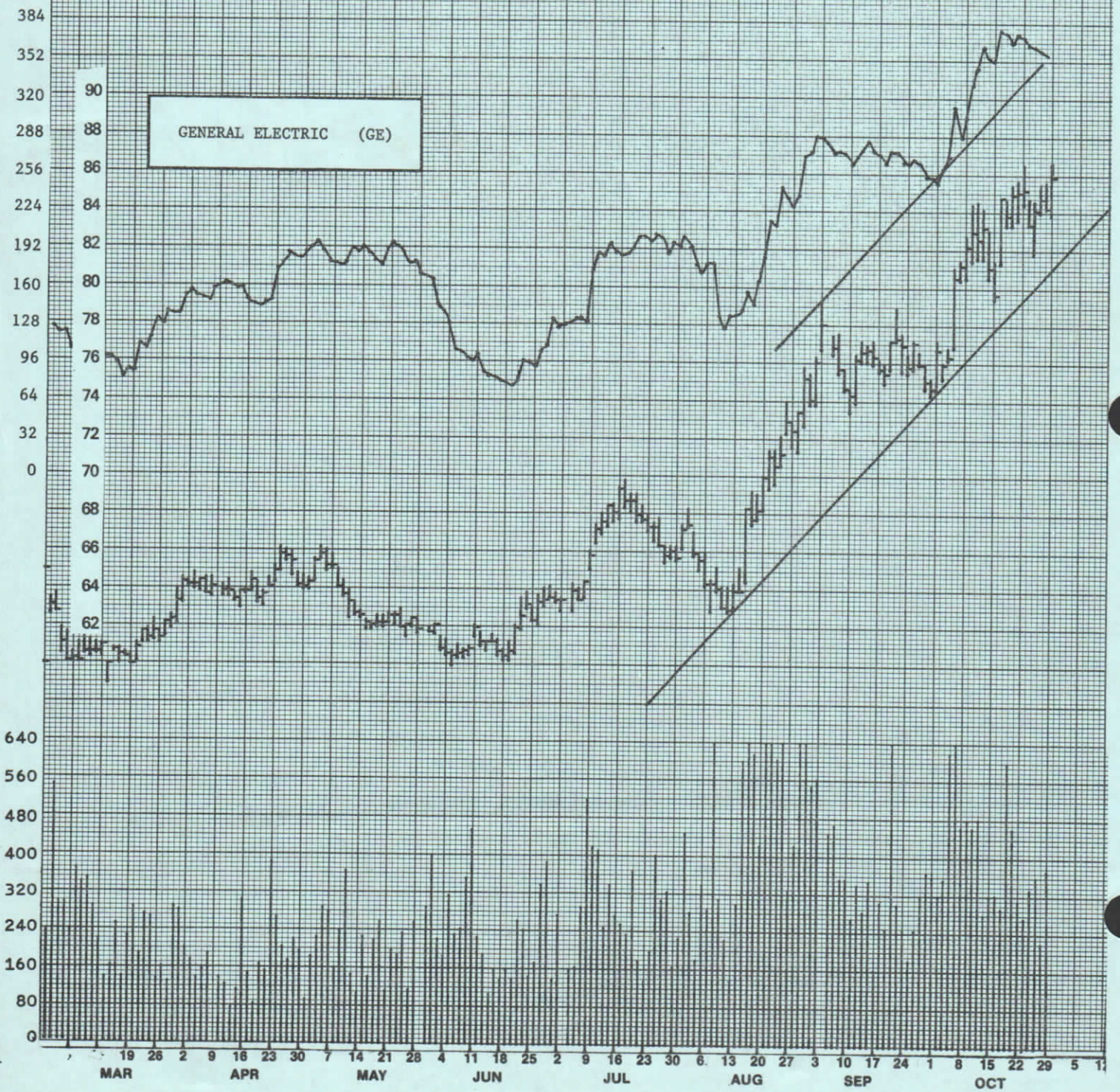


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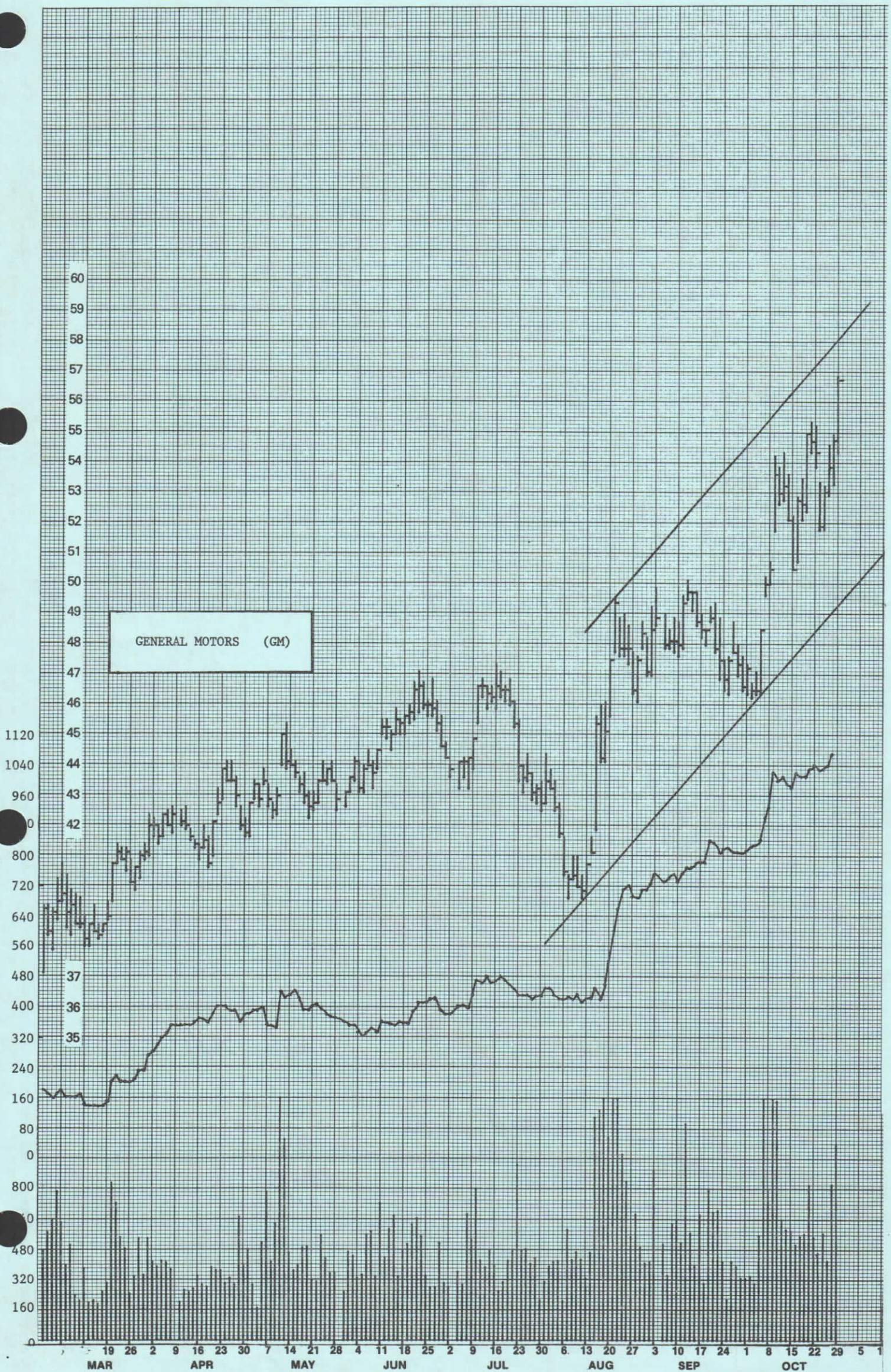


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