SMI

The Trend Letter

Wednesday, July 21, 1982

MARKET TRENDS

Some market letters are now saying that the levels reached in June prior to the current rally represent a major market bottom. The market will not go that low again at least for the rest of this year. Those who are now saying this may be correct. However, the raging bull attitude that they have adopted is likely based more on a desire to sell subscriptions than on anything that can be justified by the market's own action. In other words, these new optimists are guessing. They do not have the necessary proof to confirm their conclusions. Trading ranges are full of indications most of which tend to contradict each other. At some point, however, an indication will be confirmed. Until then, pronouncements that this level or that level is the absolute top or bottom are worthless. The market will provide the confirmation when it is ready. All we can do is monitor the action so as not to miss that point when it comes.

Due to the failure of the market on the upside in April and the subsequent drop all the way back to the bottom of the trading range, an indication was given that the market was in a weak position and subject to being sold short. The confirmation of this as well as the opportunity to take the action was to come on the current rally. The question now is has it? The weekly chart of the Wyckoff Wave seems to be saying that the confirmation has not been given. Ideally, when the attempt to rally first ran into resistance around the halfway point in the 2250 area that should have been the end of it. However, ideal situations are rare. In this case, the market took advantage of extended upside potential that it had and pushed on through to the top of the trading range. By itself, this show of strength is not critical, but there is more.

Normally, the test of an upthrust action, which is what the April high was, will be tested by an advance that is unable to repenetrate the resistance level. This results in a lower top and proof that the door to upside progress that had been open is now locked. The top of the trading range is 2335. In recent days, the Wyckoff Wave has been in the 2345 area. This repenetration of the resistance level that had previously been upthrusted creates some uncertainty. However, the Wave has not moved above the April high, so the repenetration of the resistance is not critical, but there is more.

The test of an upthrust action absolutely must be accompanied by lower volume. This is the one way that the test has of providing proof that it is finding success and that the next move will be down. This is critical and on this point the current rally fails the test. The volume in the most recent week was higher than at the upthrust itself. This tells us that the market is either going to explode through the top of the trading range, or be forced to make another test of the upthrust. Which will it be?

The logical answer to this is that the market will tell us, but how can we be sure we understand what it is saying? The answer to this is through anticipation. What we see in the final posting to the weekly chart is an approximately equal spread on increased volume as the price approaches an area of former resistance. If the market is not going to pass its test of the upthrust and instead break through the top, it should come as a jump across a major creek. We know that a jump across a creek is a widening of the spread on increased volume as the price passes through an area of resistance. Therefore, what we have seen to this point does not qualify. If we now witness a distinct narrowing of the spread, we will know that the supply is still there. We will also have a second potential upthrusting action with a need to be tested. We could then hold off our longer term short selling in anticipation of the additional test. Of course, short selling would only be done if the anticipated test corrects the failures of the present one.

Assuming that there is now narrowing of the spread and sustained high volume at the top of the range, an alternate approach might be to sell short without the additional test. From an intermediate or short term standpoint this probably makes sense, but is somewhat questionable for the longer term investor. Such action would be based on the assumption that repeated upthrusts will eventually take such a toll on the market that it will have to give way. Although this sound logical there is not fact to back it up. It should be remembered that trading on the upthrust without waiting for the test involves a greater risk. The only way it can be justified is with a close stop.

For shorter term traders, the question is not so much one of whether to consider going short but rather one of deciding when. The April experience should serve as a good reminder that some rallies die hard. Therefore, there is wisdom in holding off on action as long as possible. This is especially true if the trading vehicle is very short term in nature. The fear of missing a move should not be allowed to outweigh the more justified fear of what will happen if a trade is too early.

The Wave has already started to run into trouble at the top of the trading range. We can see this in the three efforts to push through the resistance level that have all been turned back. The declining volume is also likely to work against the success of continued upside efforts as is the relatively overbought condition of the market.

Something else that is worth noting is the lack of harmony between the Wave and O.P. Although the Wyckoff Wave has rallied well above the halfway point of the move down from April, the O.P. has not. This suggests that there is relatively little support of any substance under this rally. It is this likelihood that points to the probability of a turn down. Therefore, the cumulative effect of these indications would likely be a decision to close out long positions taken in June or at the beginning of July that are now showing a good profit.

Although we can justify not being long for the short to intermediate term at the moment, it does not follow that we can therefore justify being short. As yet, there is nothing that can be seen as a clear downcount level. 2330 and 2345 are likely candidates for count levels, but the justification for taking those counts does not exist. If it did, the positions would be questionable because the counts would be too small. Another reason for not being short at this time is that the ten point chart indicates a higher objective that will challenge the previous top. Such a move from present levels could result in shorter term positions being stopped out just as the market was actually getting ready to begin the anticipated reaction.

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STOCK TRENDS

With the Wyckoff Wave now beginning to run into trouble at the top of its trading range and with the possibility that it could be in more serious trouble later, this seems to be a good time to start looking at the stocks with the idea of identifying potential short candidates. The prime candidates should be those that have been underperforming the market during its most recent rally. In addition, stocks that appear to be experiencing a change of character from strong to weak may be considered. Only those stocks most responsible for the rally in the Wave should not be seriously considered as short candidates.

Exxon would certainly qualify as a stock that has failed to participate in the market's upside efforts. Therefore, it should be a short candidate. However, relative weakness is not the only consideration. Other factors are volatility and potential. Since we are looking for a short to intermediate term decline, volatility is important. A stock that will not move just will not do. Exxon has still shown no signs of life following its split, so it cannot be seen as a good short term candidate. Its character does make it a long term candidate should a long term short selling opportunity appear to develop, but its maximum downside objective of twenty-three discourages any actual commitment.

General Electric is one of the stocks most responsible for the rally in the Wave. Therefore, it should not be seriously thought of as a short candidate. There is a tendency to think of the strongest stocks as being most vulnerable to a big correction, but that is often not the case. It is true that this stock is in an overbought position on its uptrend and has been in an overbought condition on its Technometer. Therefore, it should be subject to a correction. It could be a shallow correction, however, due to the relative strength. The figure chart indicates no downside potential and actually points to a somewhat higher objective. Therefore, the stock should be left alone.

General Motors appears to be a stock that is experiencing a chance of character. It had been a very strong stock, but is now beginning to flatten out. This suggests that the strength is beginning to slip away. This is demonstrated by how short the current rally has fallen from the overbought line of the uptrend. The previous rally had been able to almost reach the line. Also notice that the last reaction penetrated the support line providing a warning of an impending break in the trend. Another point of importance is the extreme upside effort required to produce the current rally, which has only resulted in a slight new high. All of this suggests that something is wrong. It is too early to look for a major decline, but a correction of the advance that has occurred is very possible and would be worth a short to intermediate term position.

I.B.M. is the second stock in the Wave responsible for the current summer rally. Therefore, it also cannot be considered an immediate short candidate. The most recent part of its rally has penetrated an important supply level. This will either develop into an upthrust for later action or a jump across the creek. In view of the fact that a reaction is anticipated for the general market, a jump across the creek for IBM does not seem too likely. IBM almost always participates in actions of the Wave.

Merrill Lynch can be seen as a potential short candidate. This is based on the fact that it has only been able to make up about half of what it lost from the April high and because the volume has been decreasing as this critical level has been reached. The stock is also near a major supply line which should provide some downward pressure. A short position in this stock now should be watched closely because of the spring position that occurred about two weeks ago. That being a number two spring, it needs to be tested. The next reaction will be that test. Obviously, any signs that the test is going to hold would have to be taken as reasons to eliminate short positions.

Since it has only been in the Wave for less than two months, Pepsico should probably still be viewed as a learning opportunity and not as a trading opportunity. This is because a stocks character should be thoroughly understood before it is traded. The recent action does appear to be an effort to jump an important creek around 39. The important action lies ahead, however, in the back up. Even so, just the possibility of a jump should eliminate the stock from consideration at this time. It may be considered later for the short side if the jump fails.

UAL should be considered as a short candidate. Like Merrill Lynch, it has only rallied about halfway back and has been experiencing decreasing volume. The stock is also showing signs of being quite overbought, which should make it vulnerable to a reaction. The one thing the stock has going for it is the short term uptrend, which will have to give way before good downside progress will be possible. Therefore, any short position taken now should be watched as the support line is approached. If no reason to cover develops, UAL should be able to fall back to the fifteen to sixteen area.

The final stock in the Wave, which is Union Carbide, can also be considered a short candidate. This is another situation where only half of the previous decline has been made up. A short term uptrend does exist, but the last rally fell well short of the overbought line and now the support line appears to be in jeopardy. It should also be noted that there was a spring position about four weeks ago with a test about two weeks ago. This is important because the price has failed to respond in a positive manner since. The conclusion has to be that something is wrong. Therefore, the stock presents itself as a short candidate for perhaps a move down into the mid thirties.

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INDEX CHARTS

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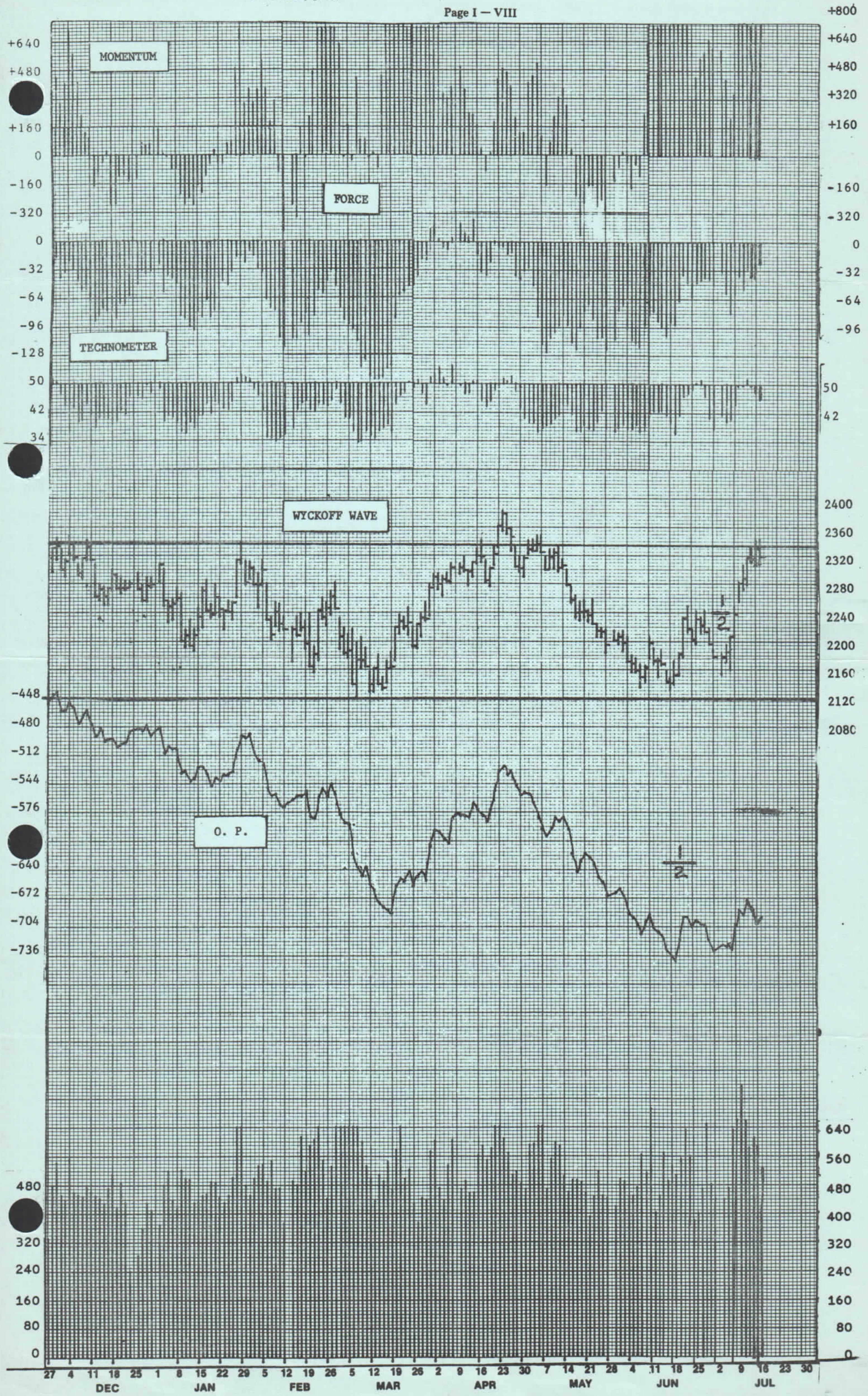

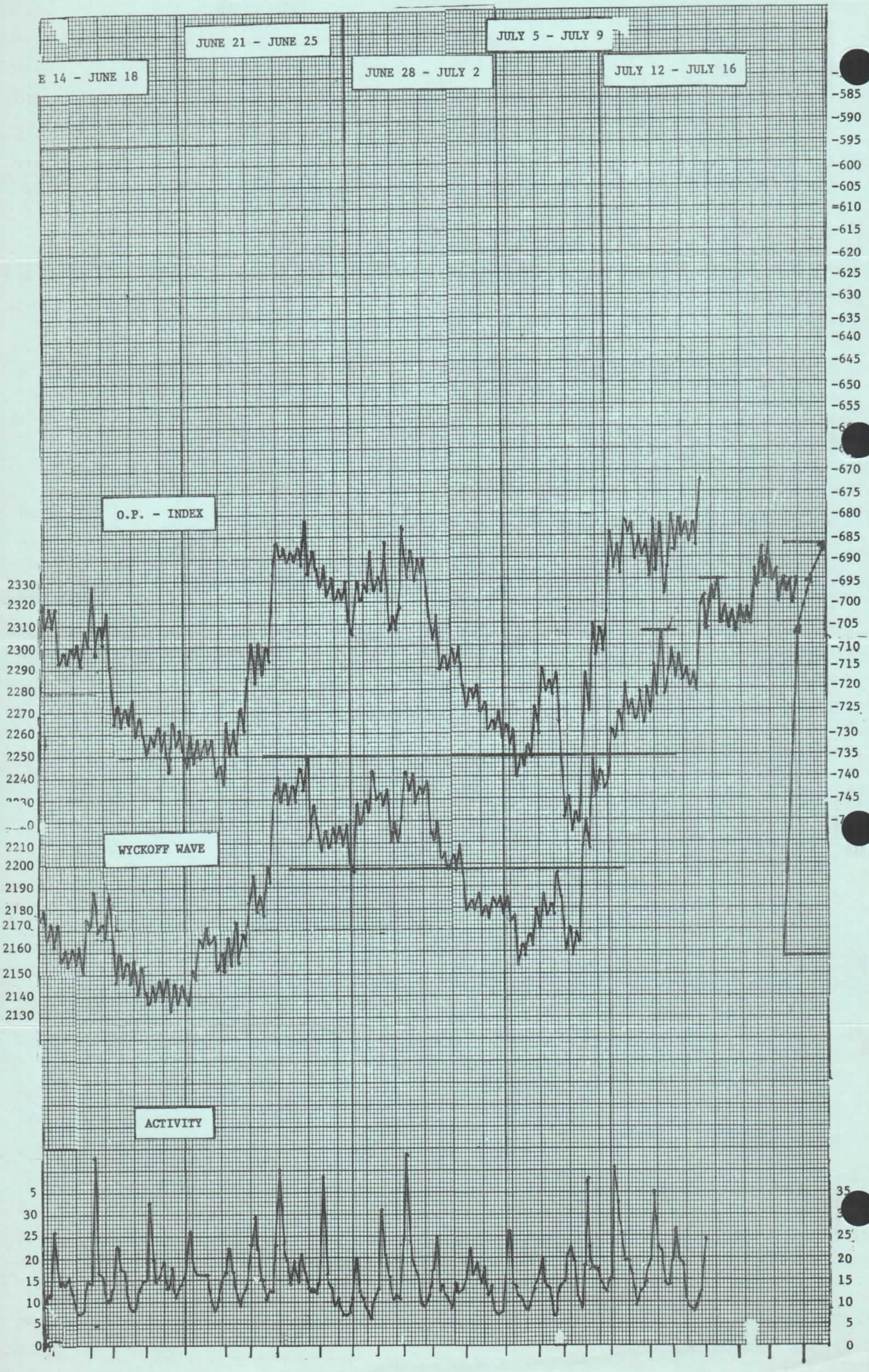
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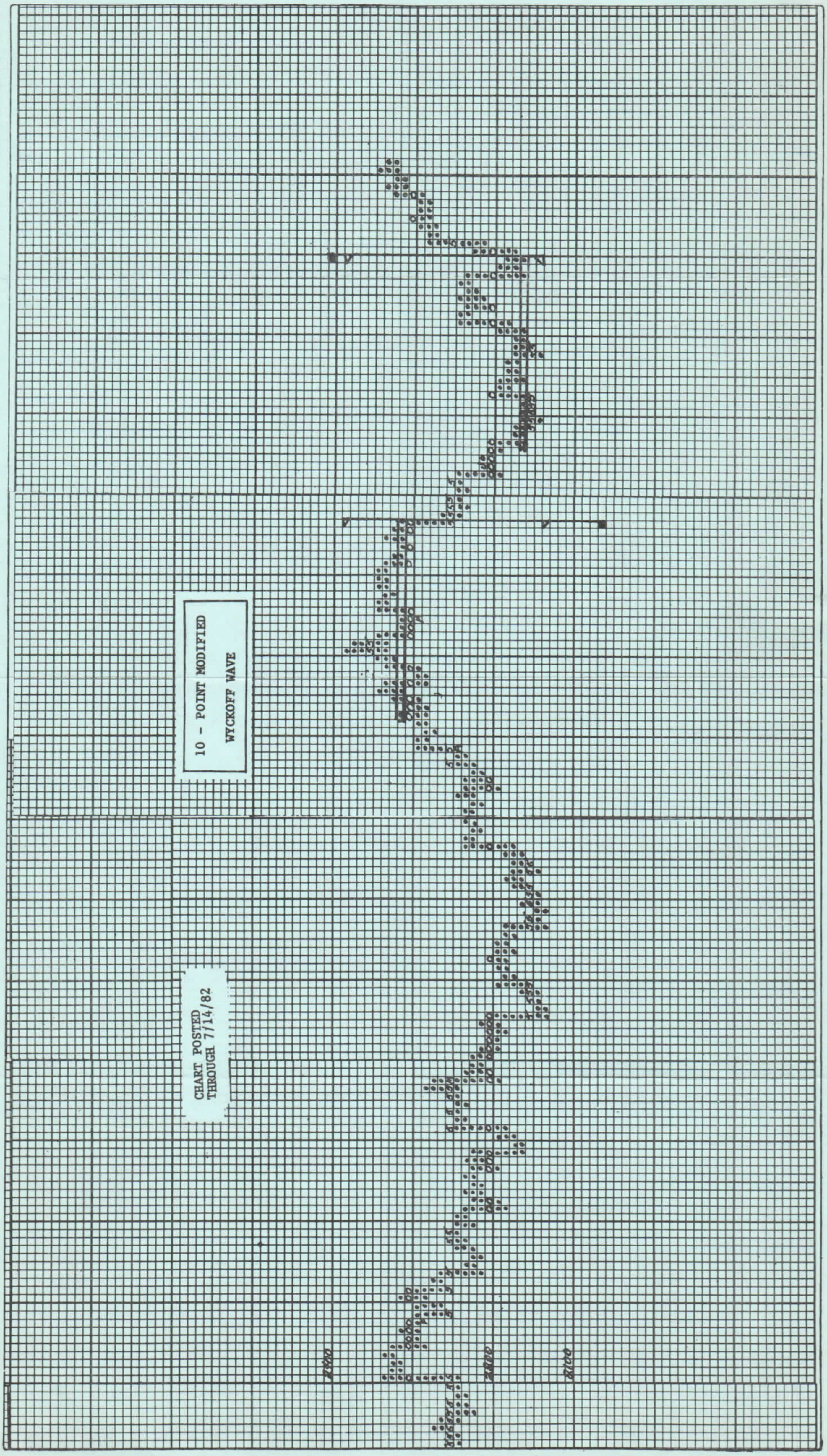
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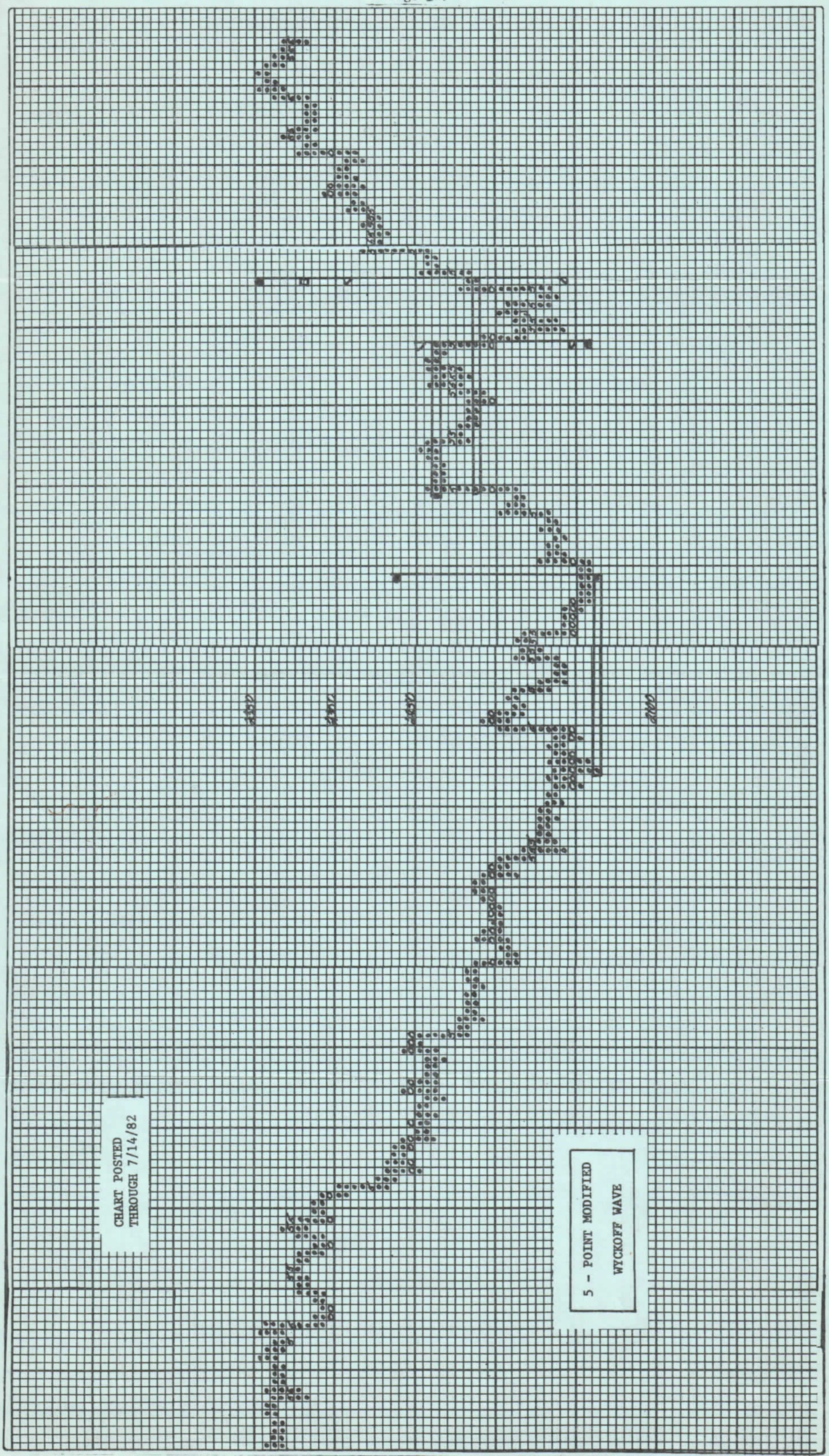
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INDEX CHARTS

STOCK MARKET INSTITUTE, INC.

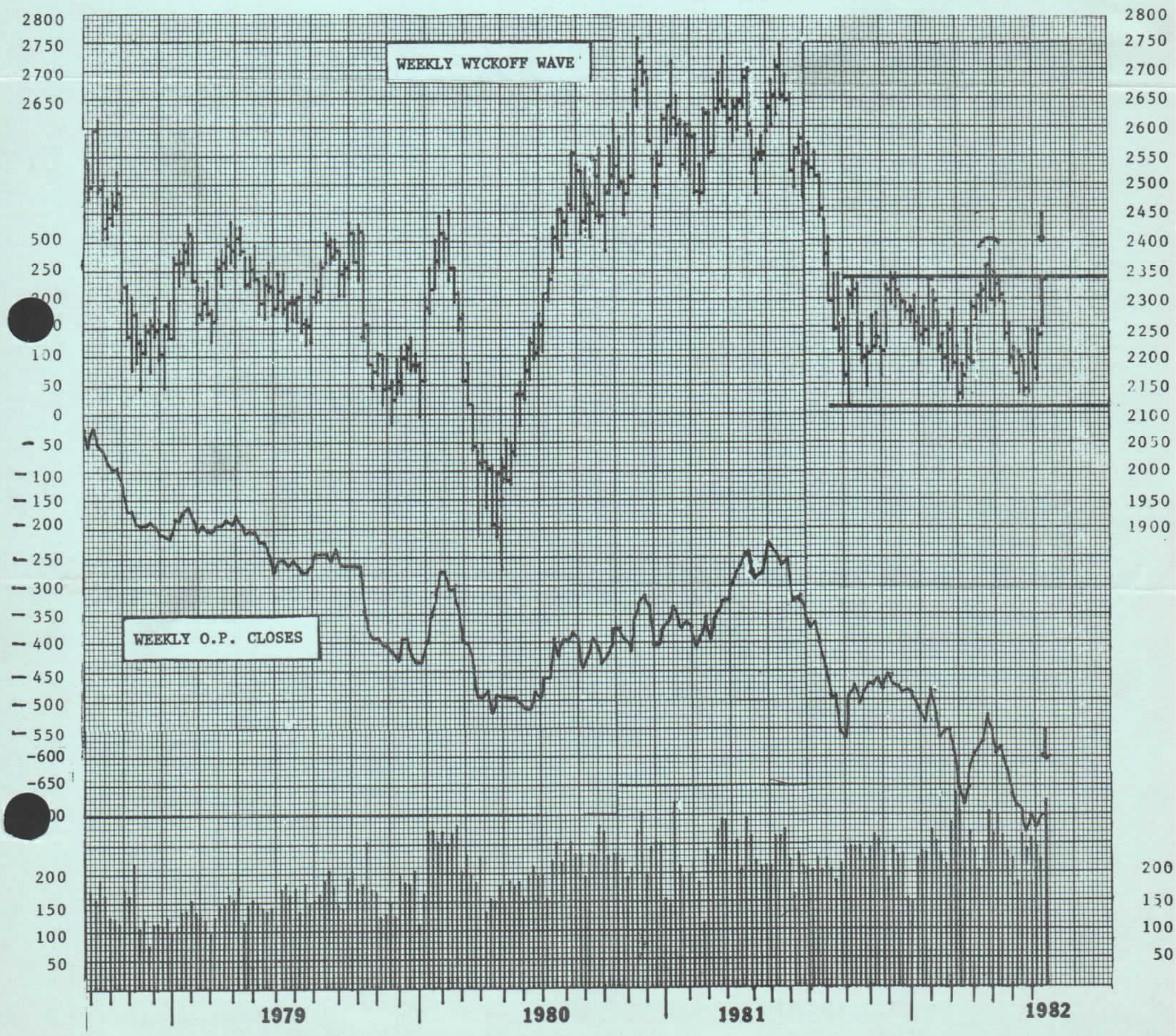
JULY 14, 1982.

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
- ½-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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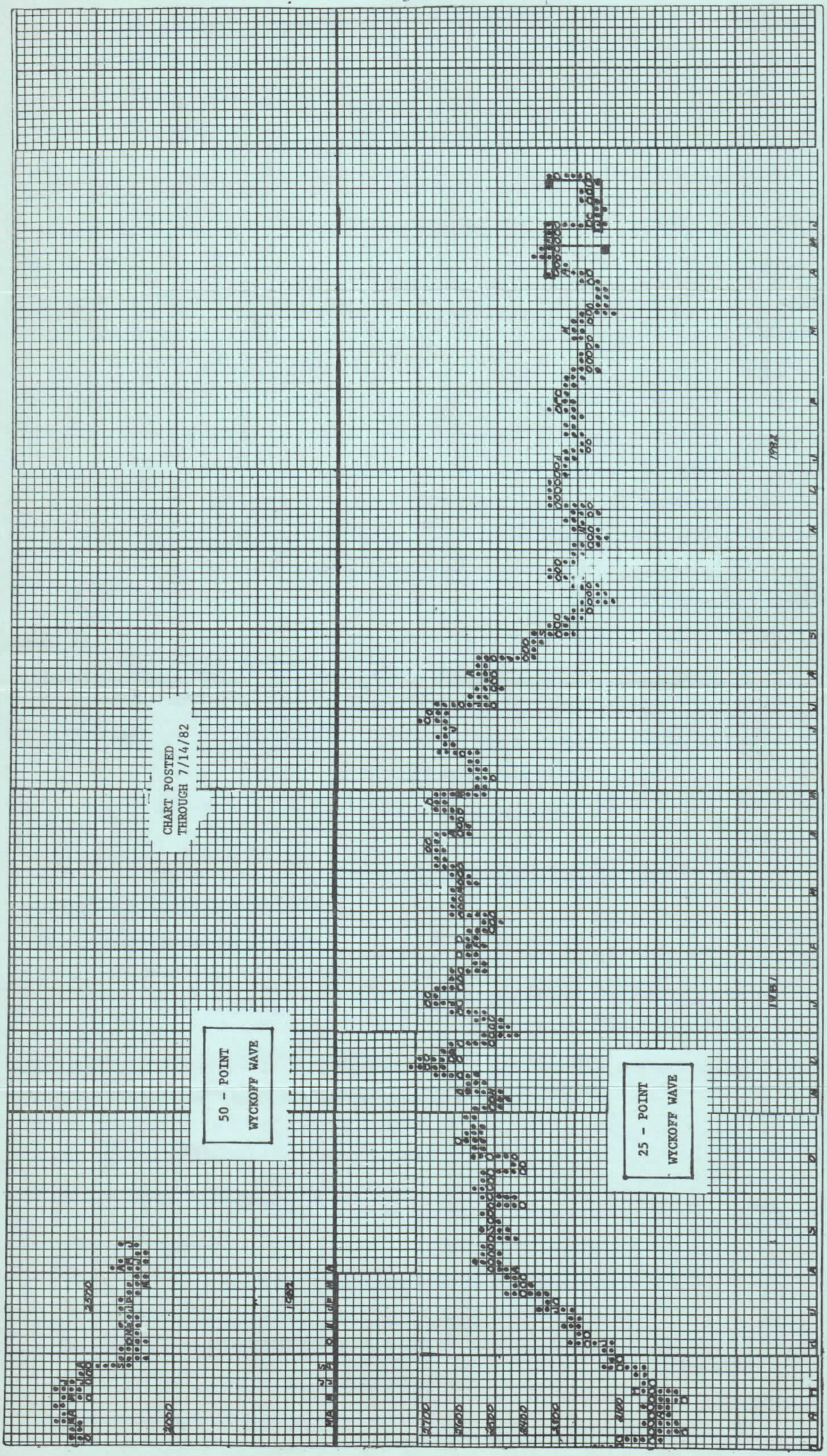

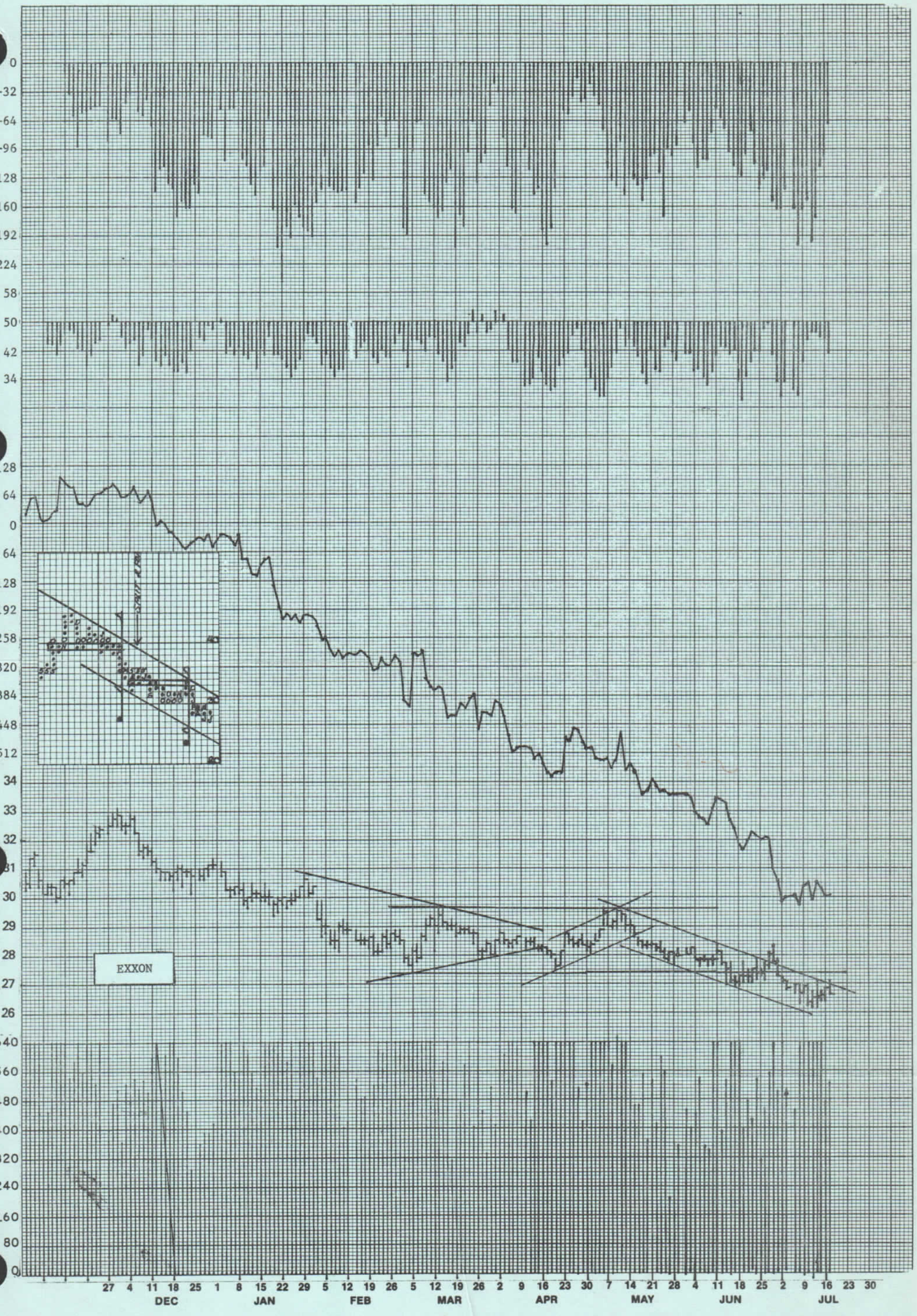
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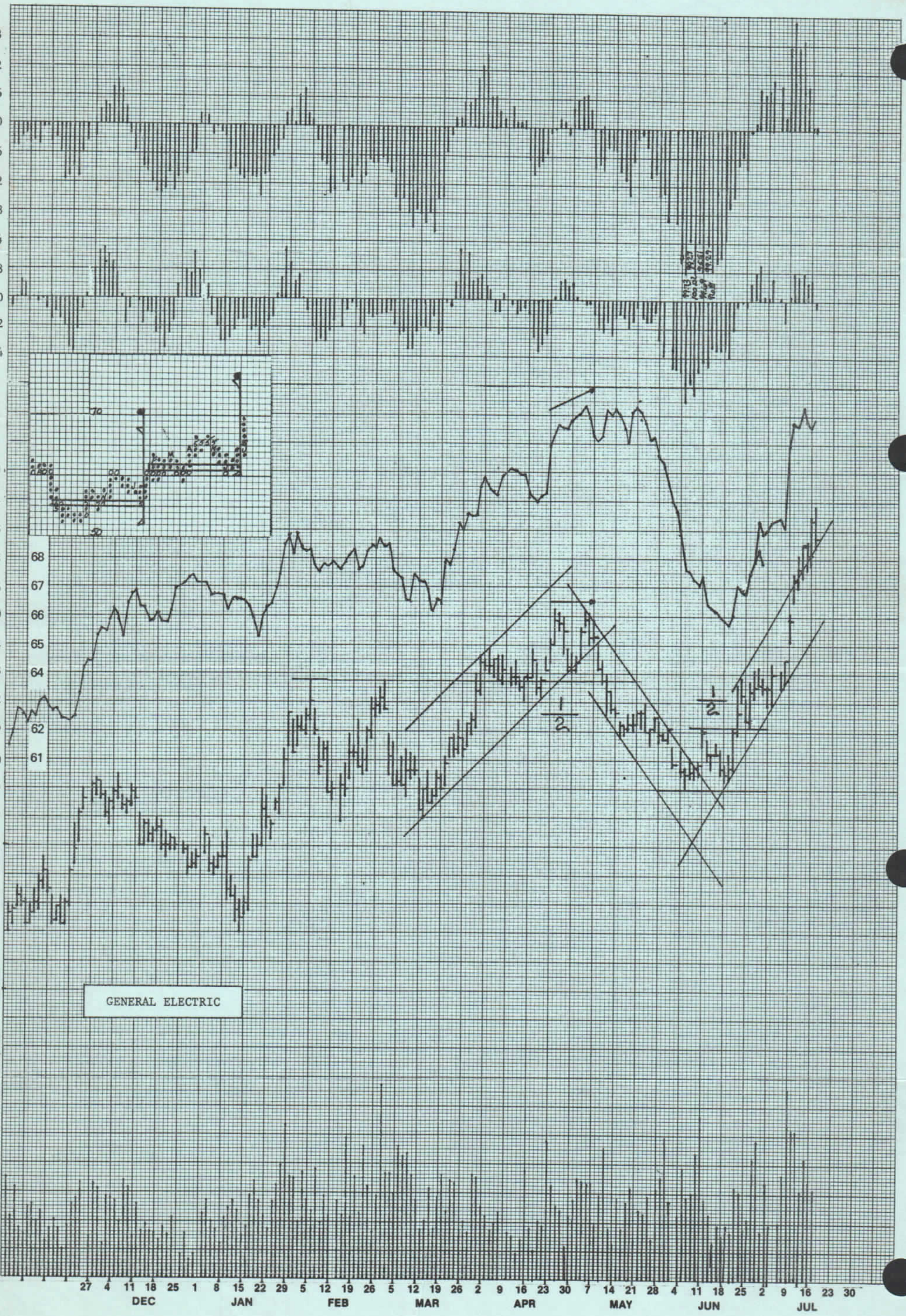
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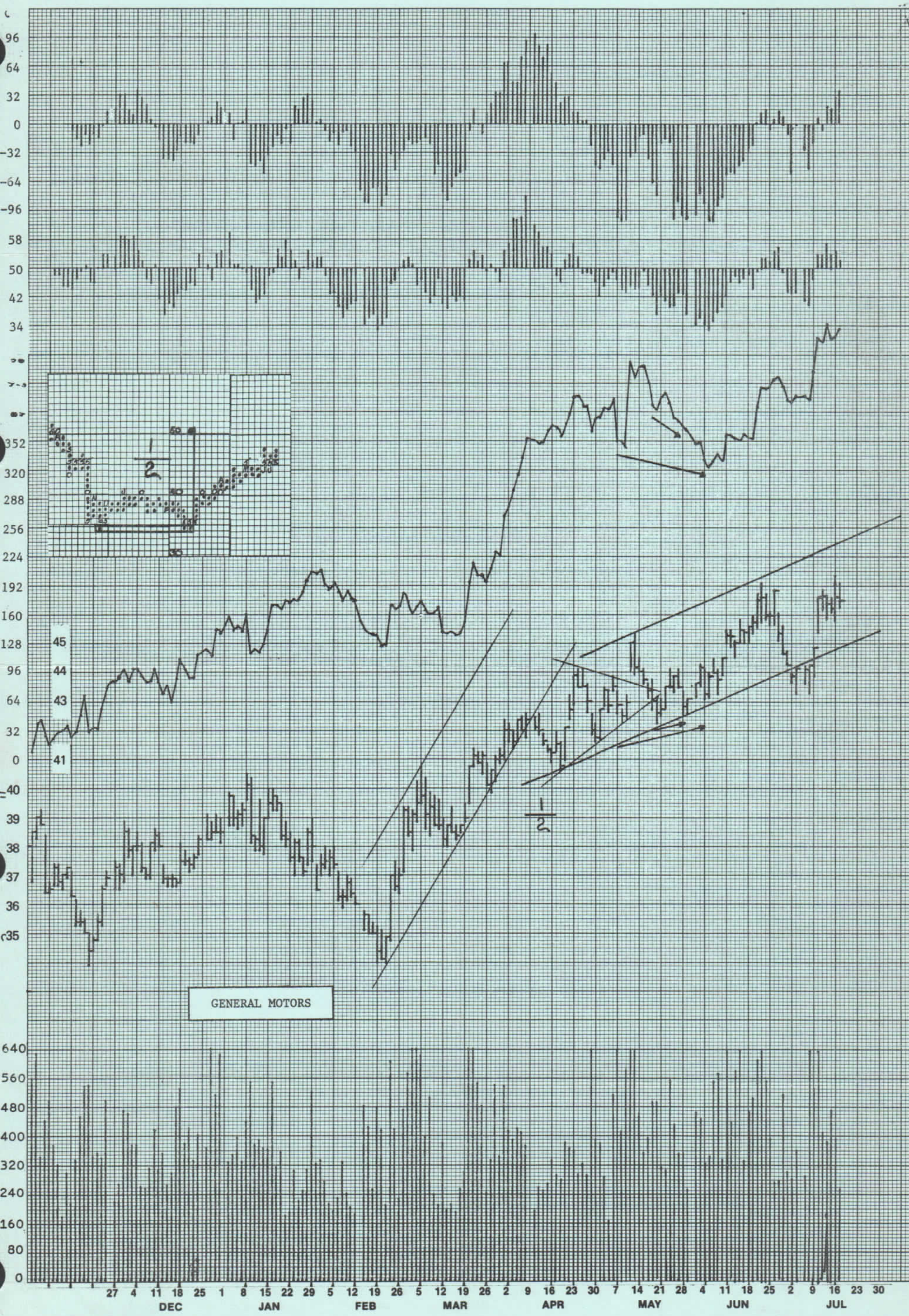
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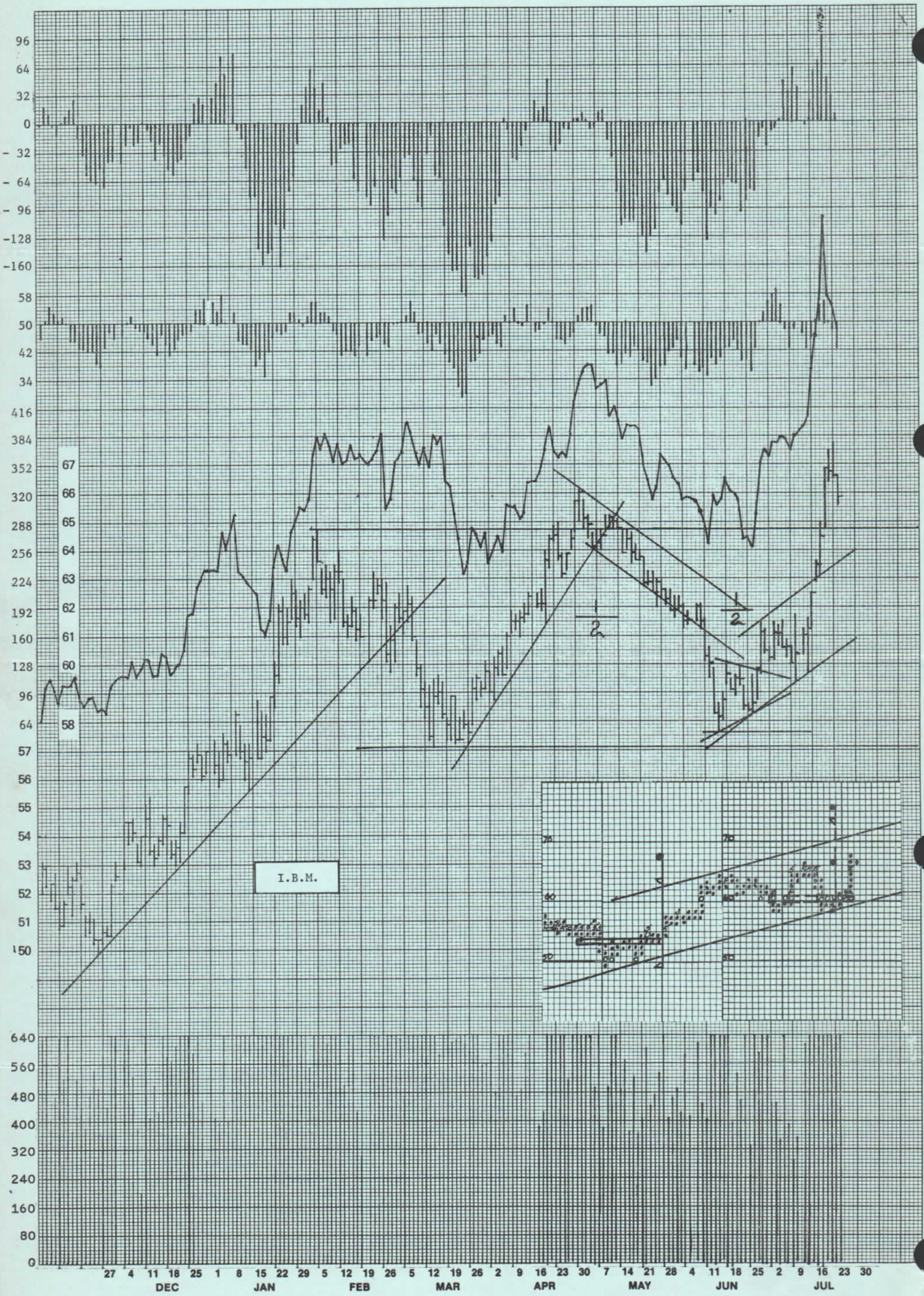
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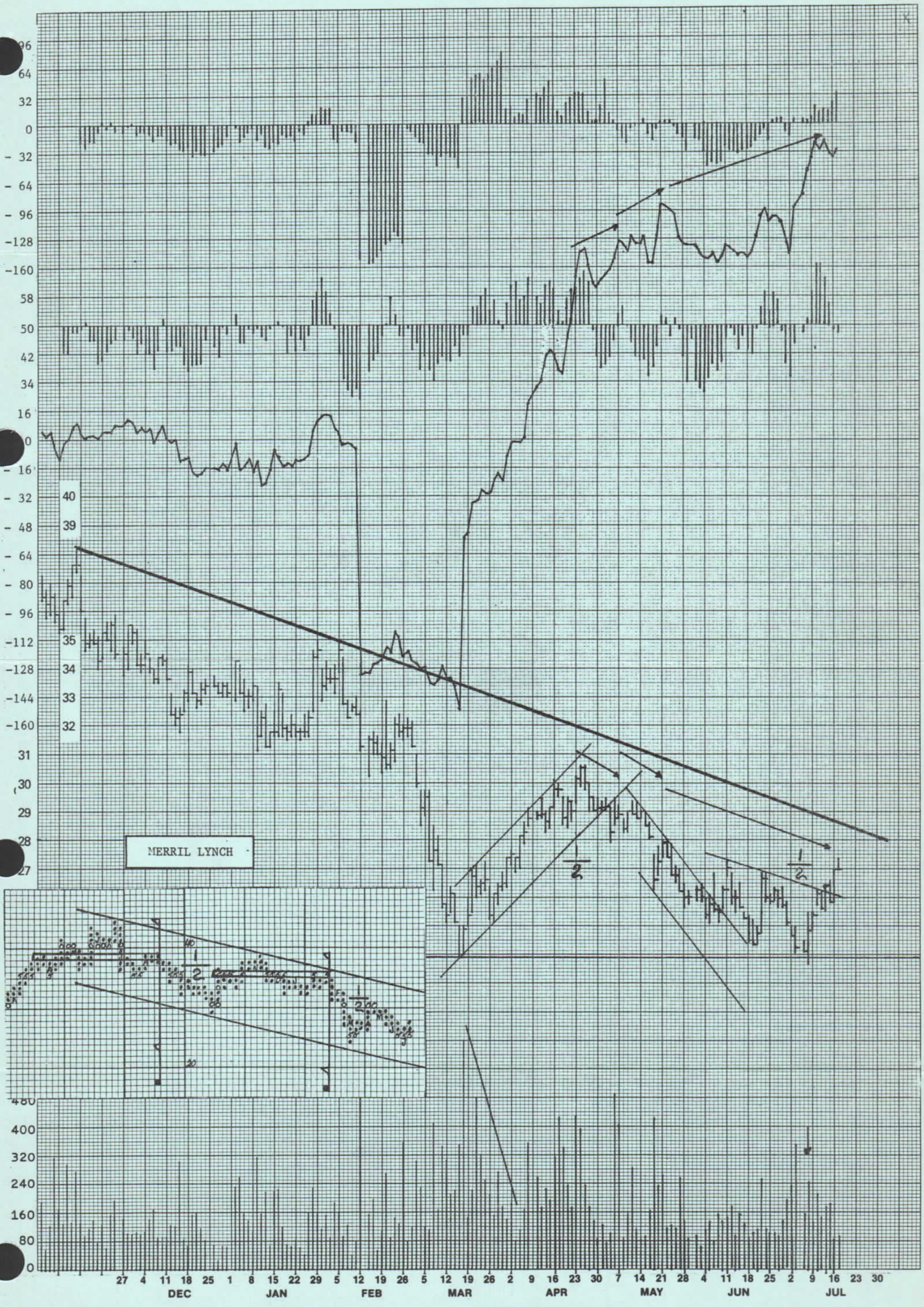
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PEPSICO

SOFT DRINKS

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

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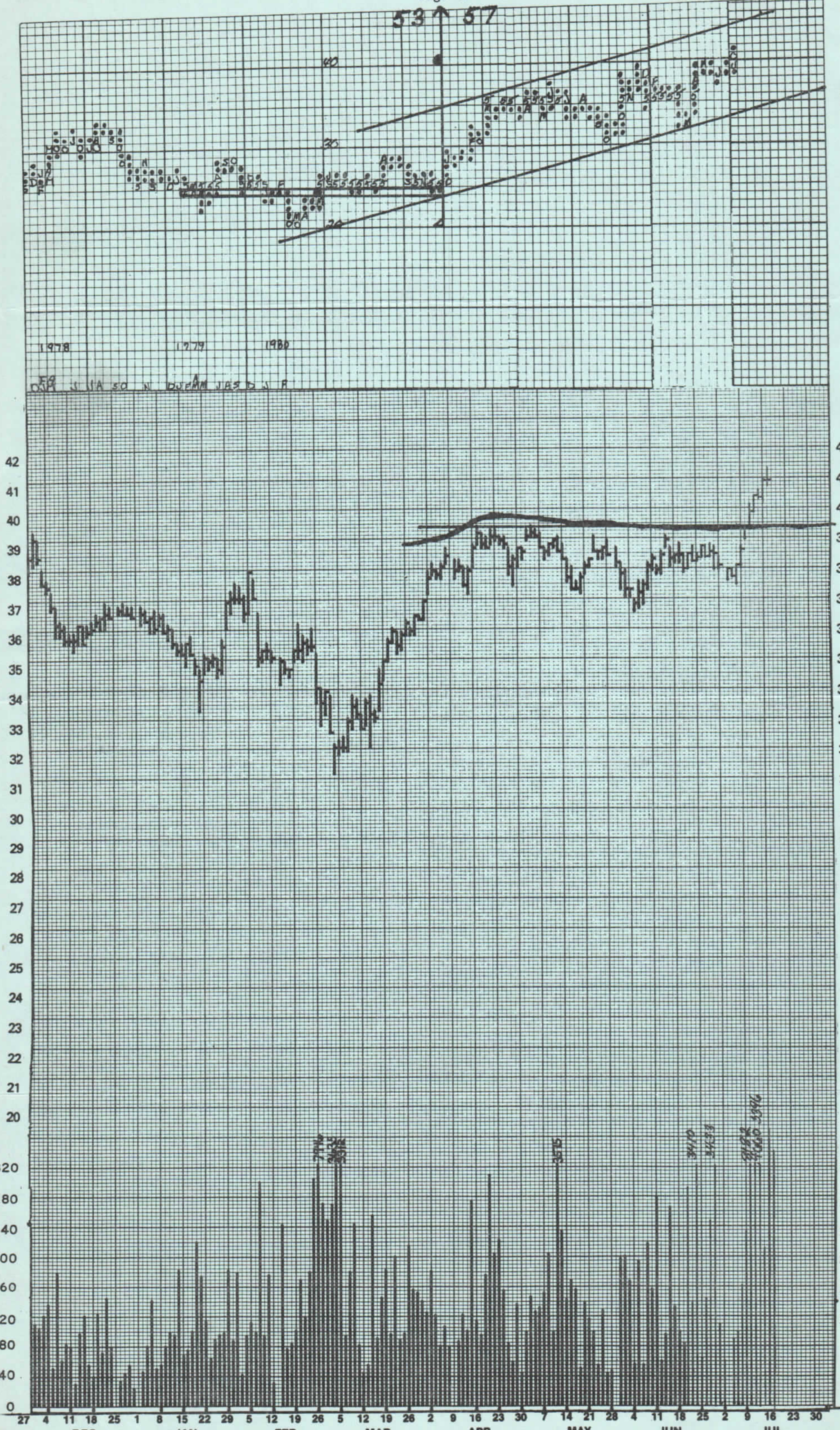

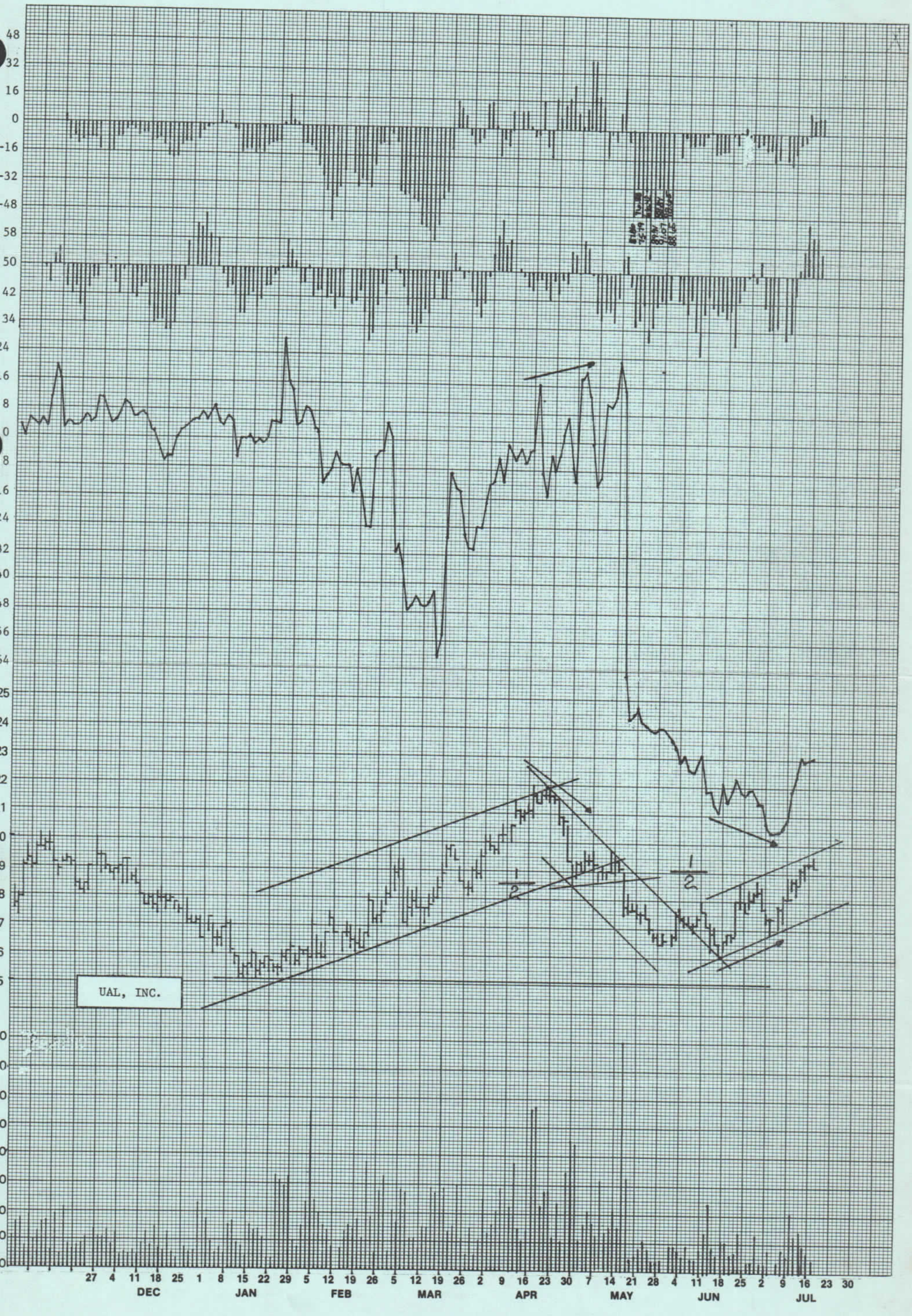
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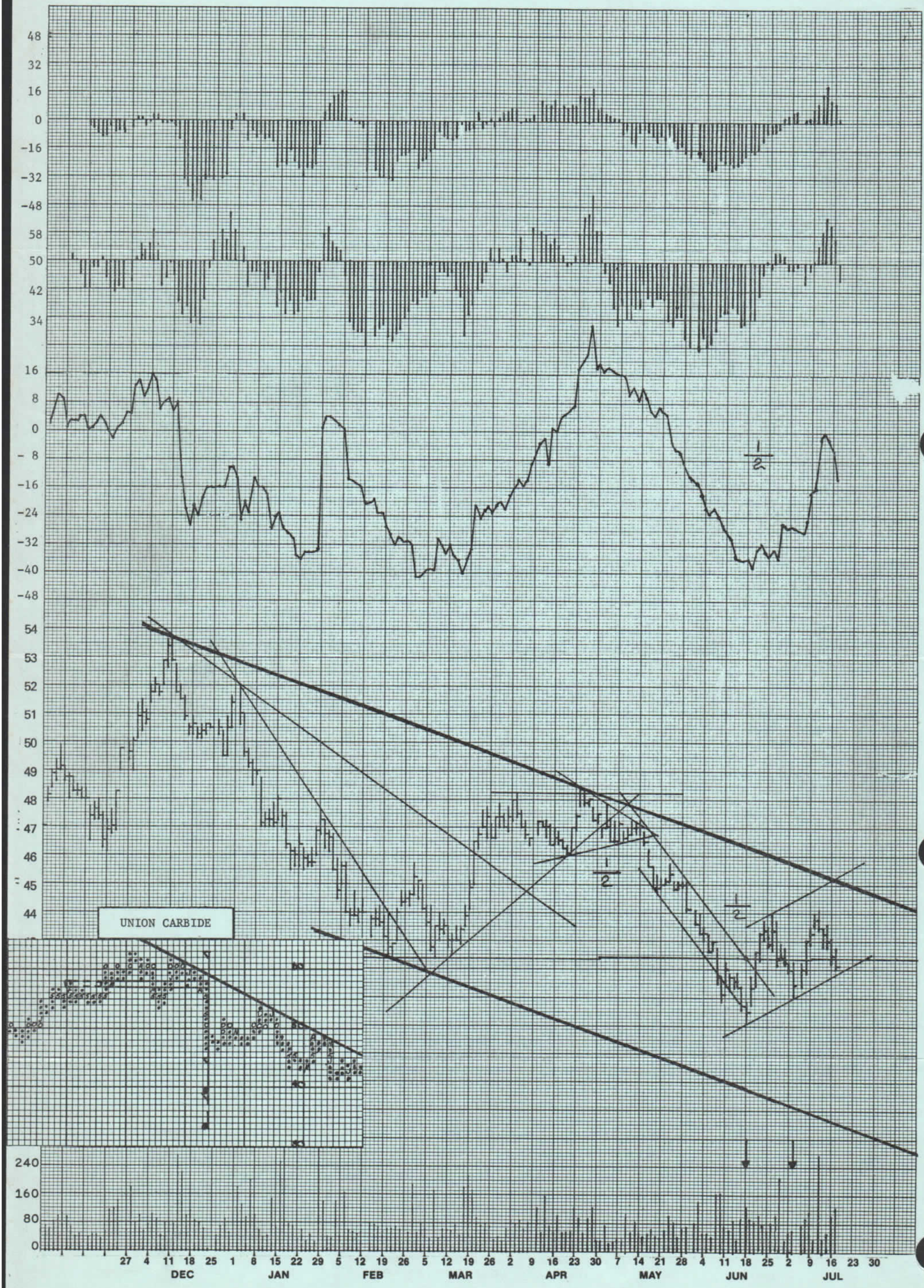
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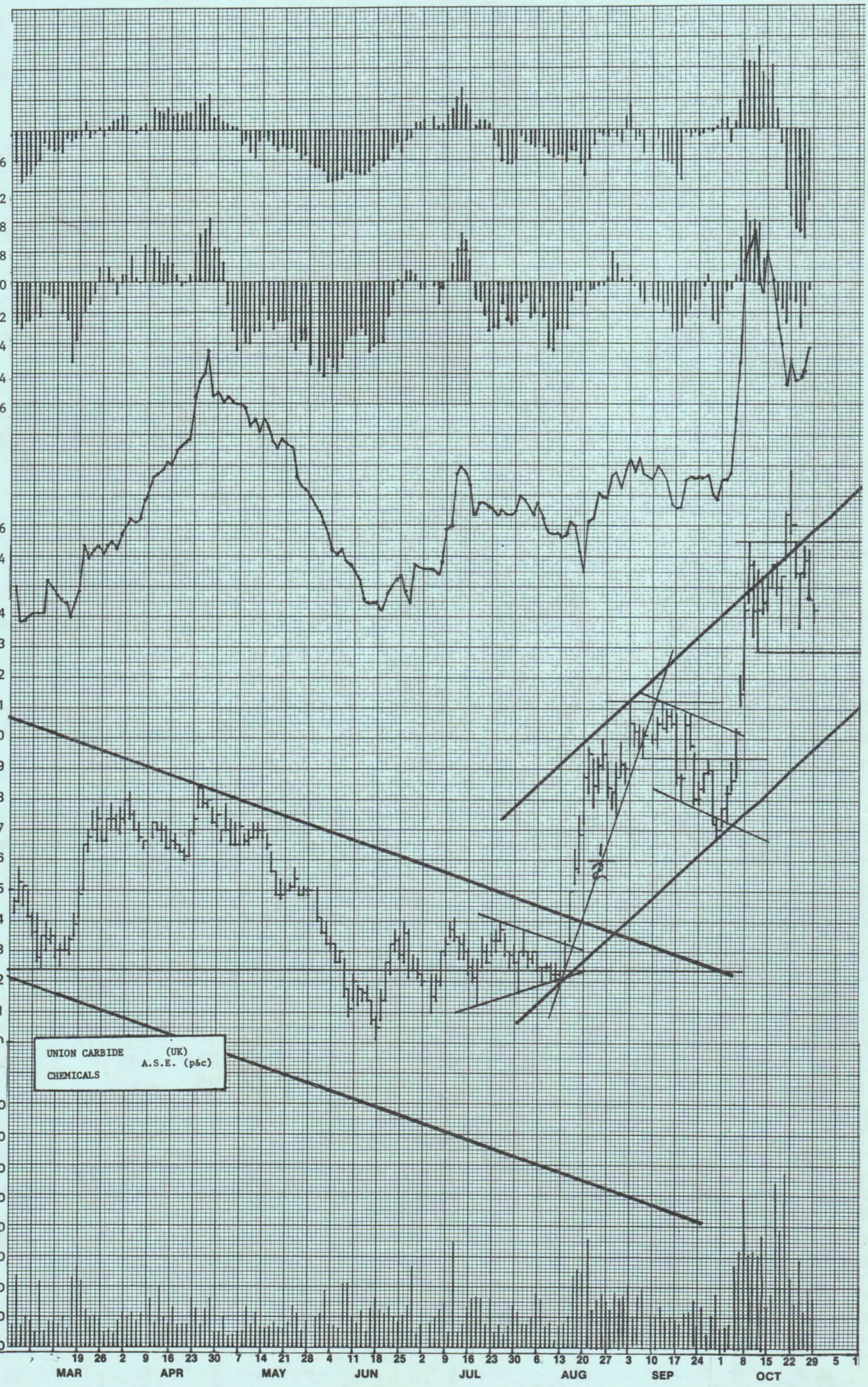

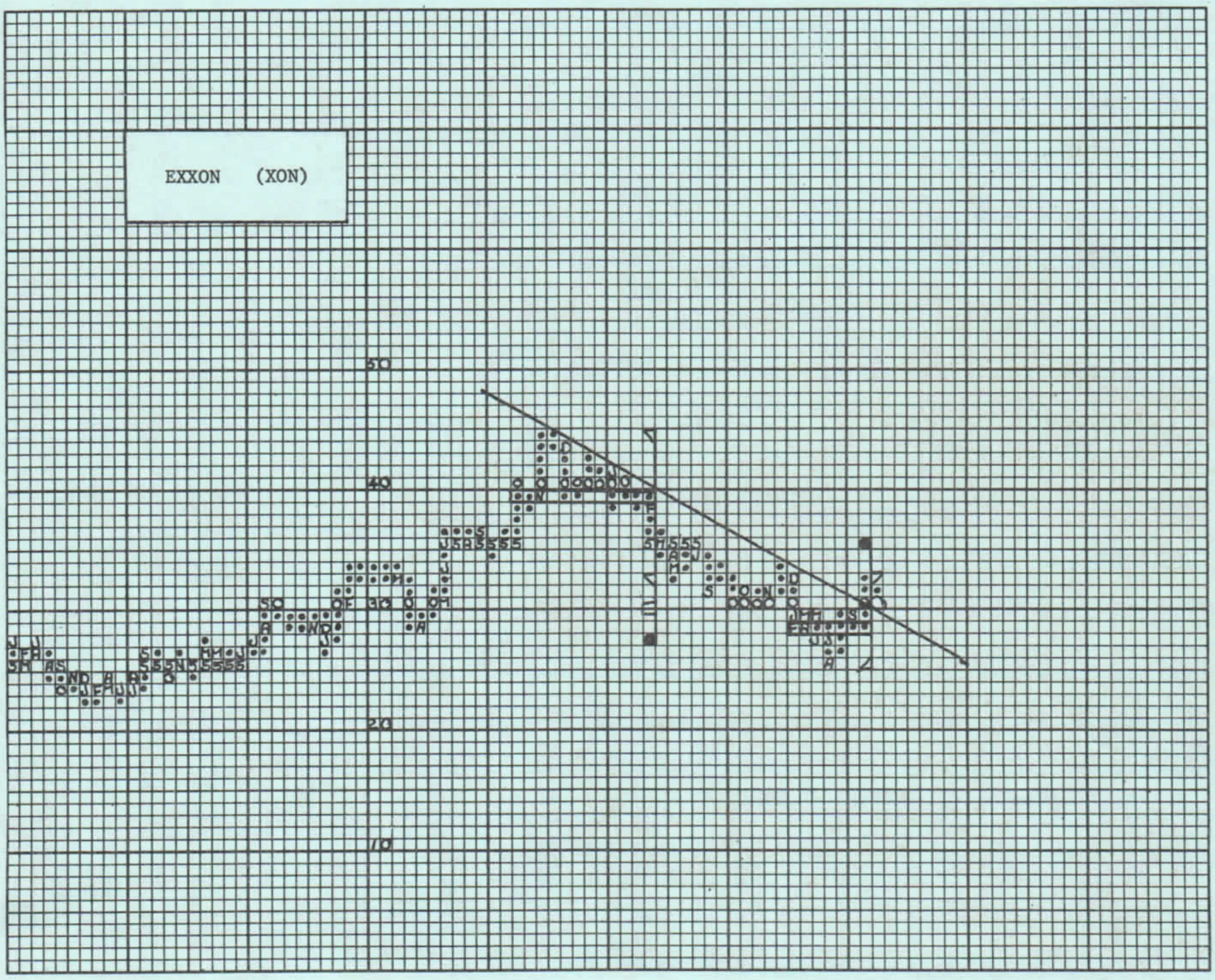
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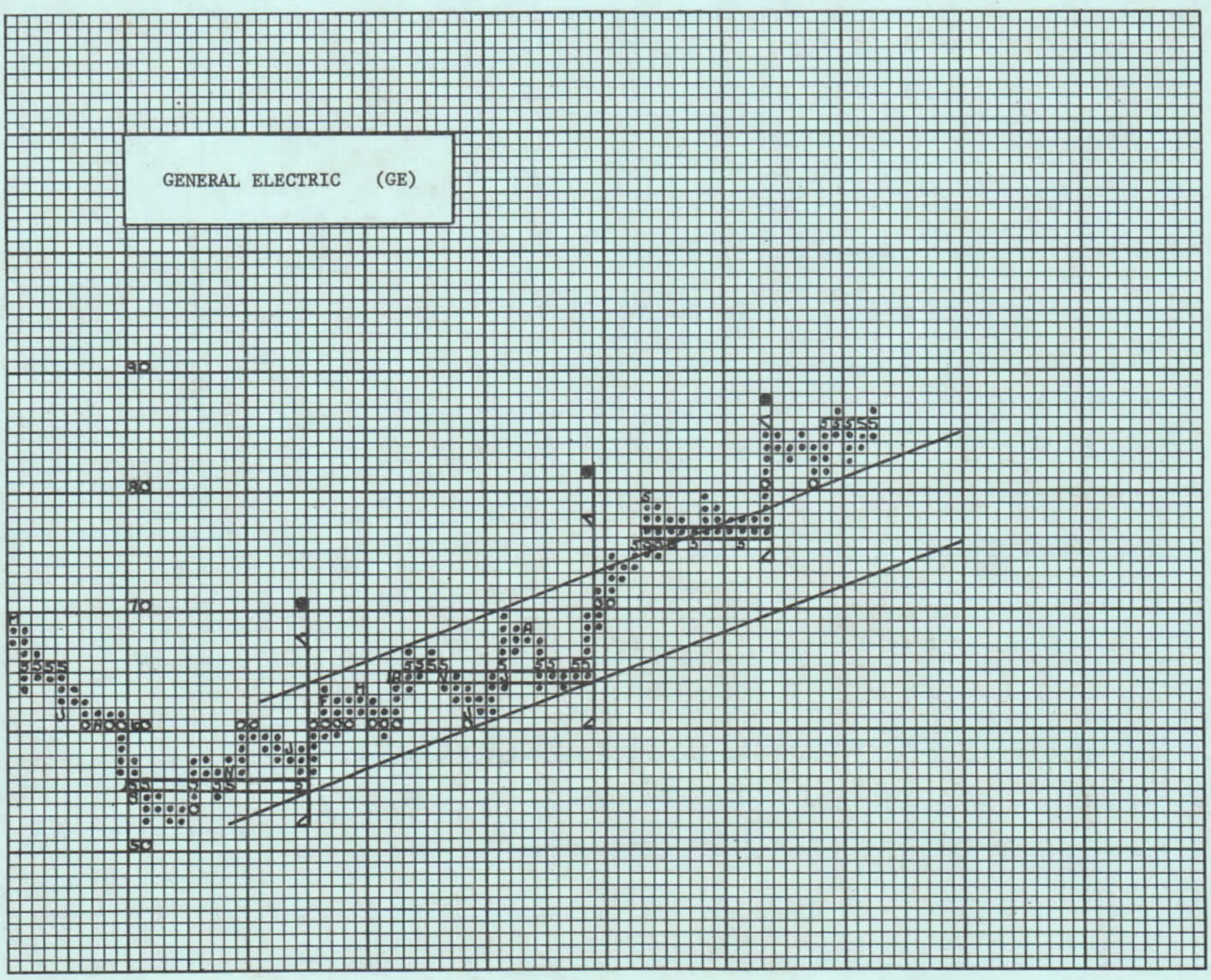
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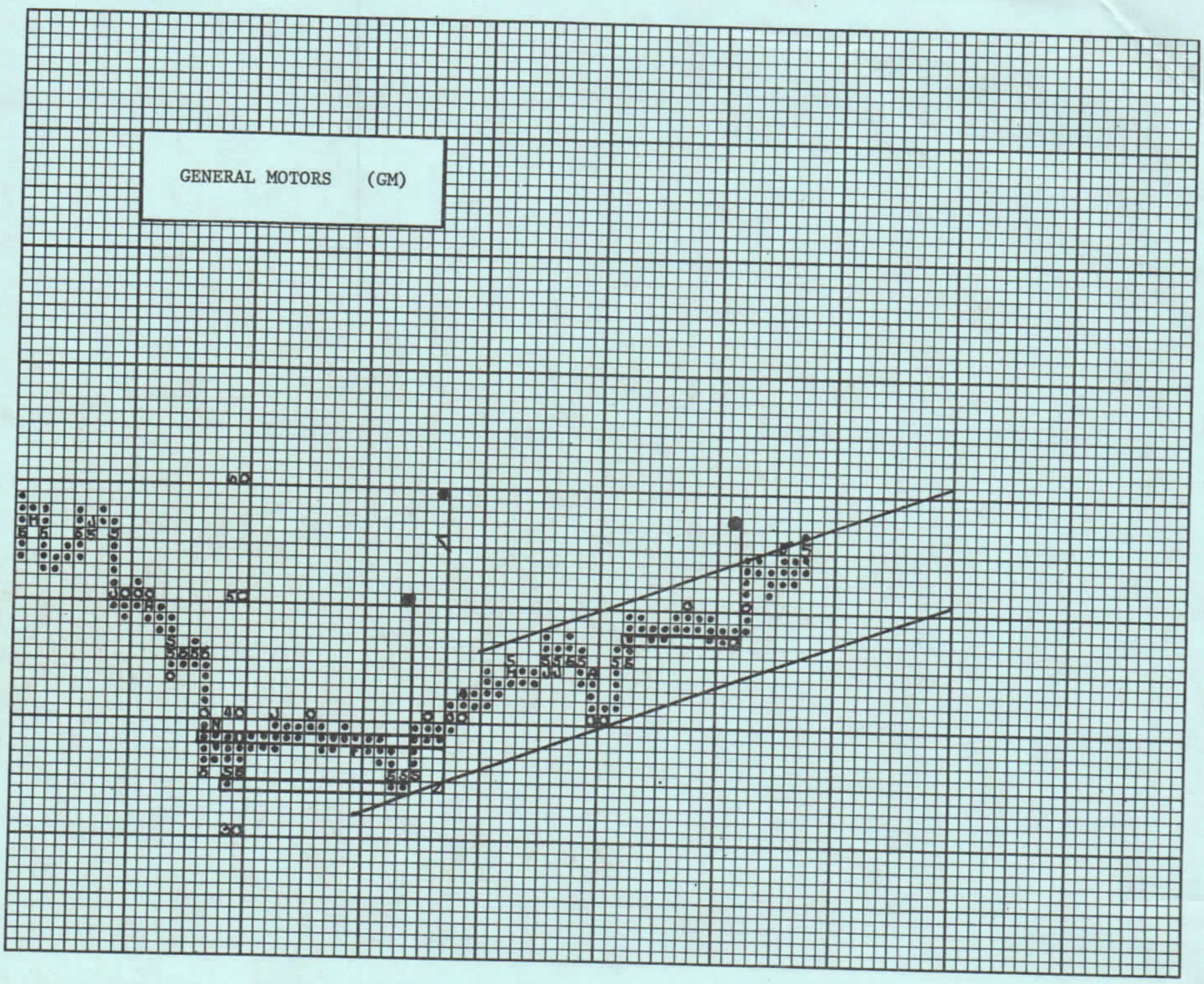
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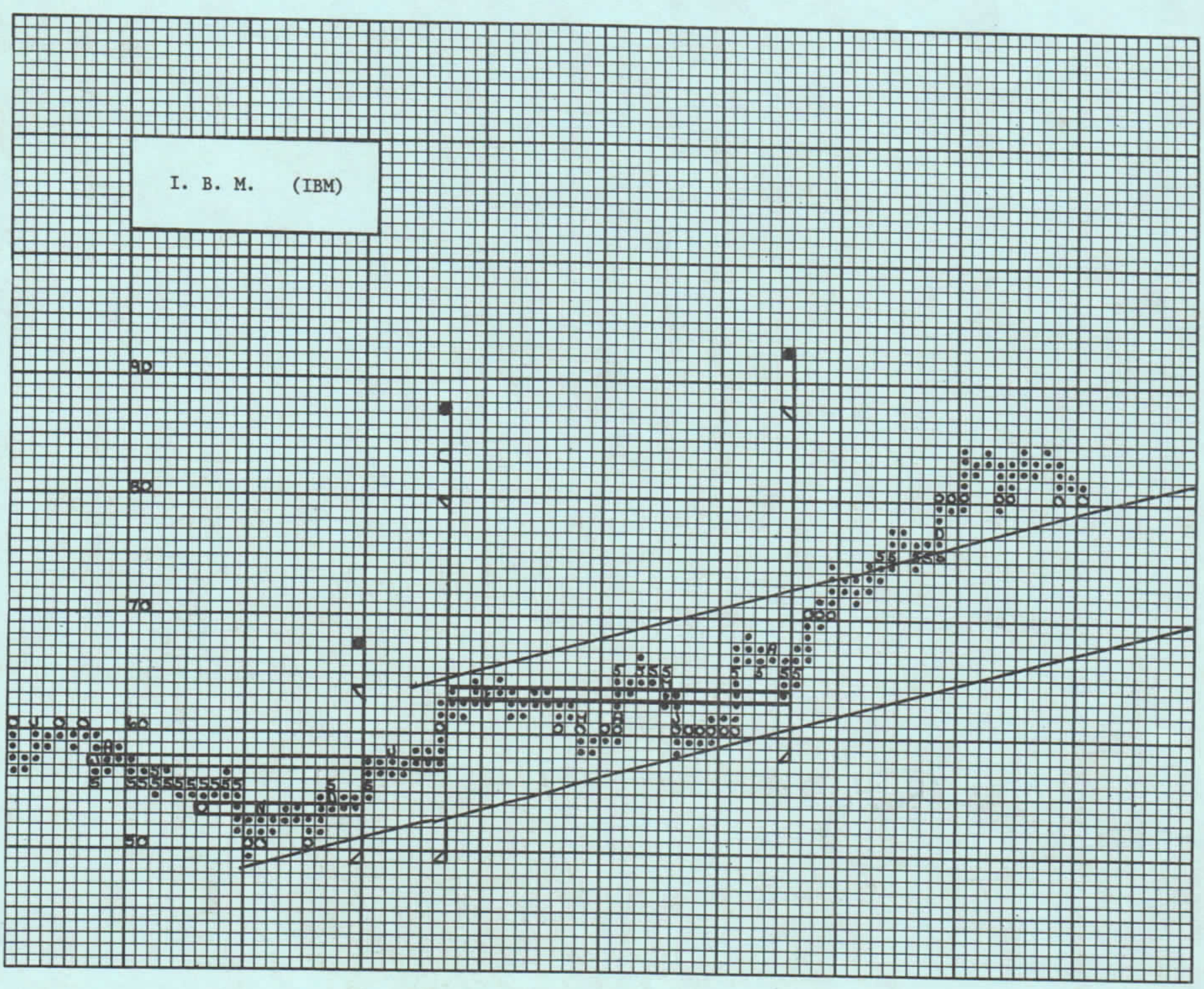
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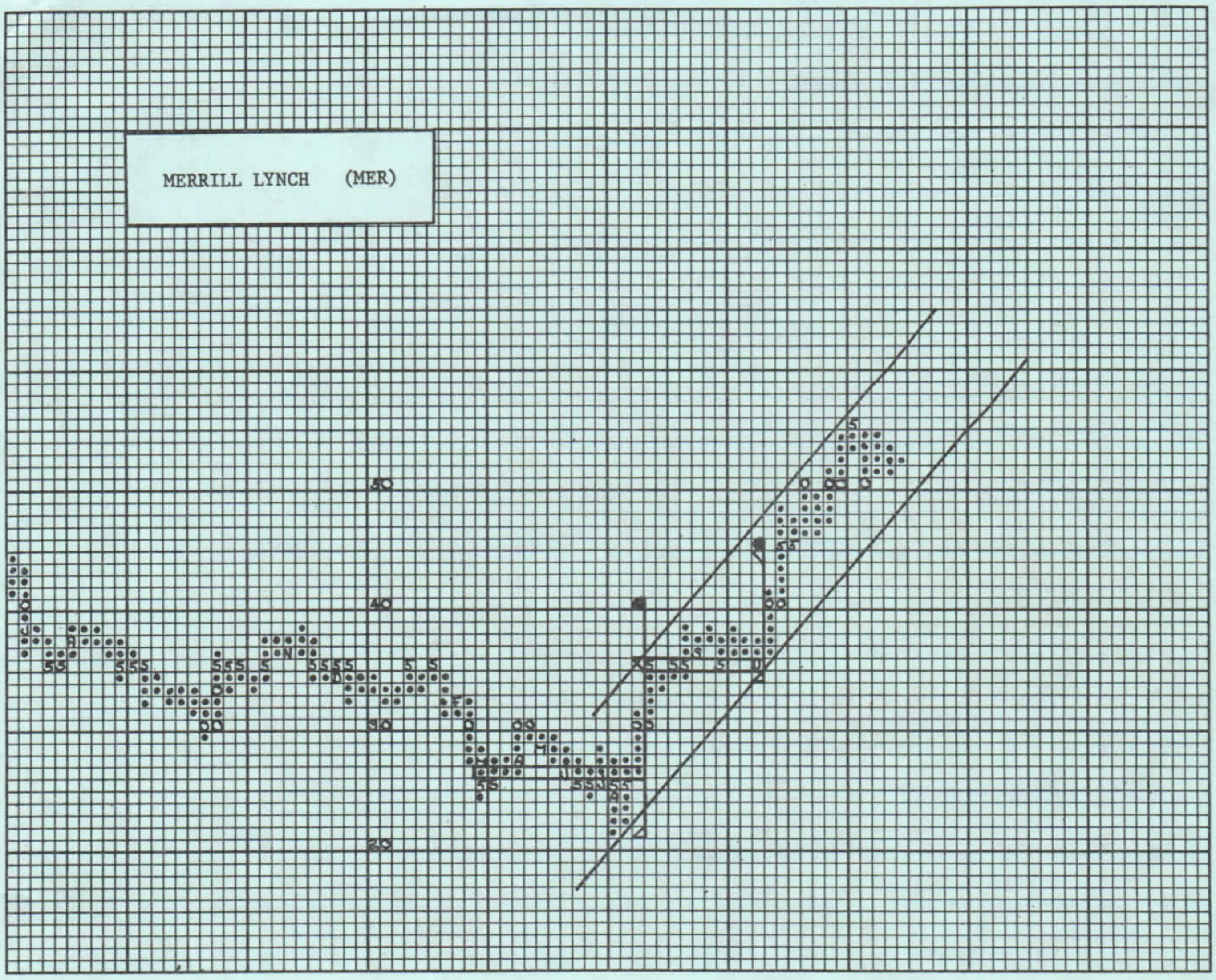
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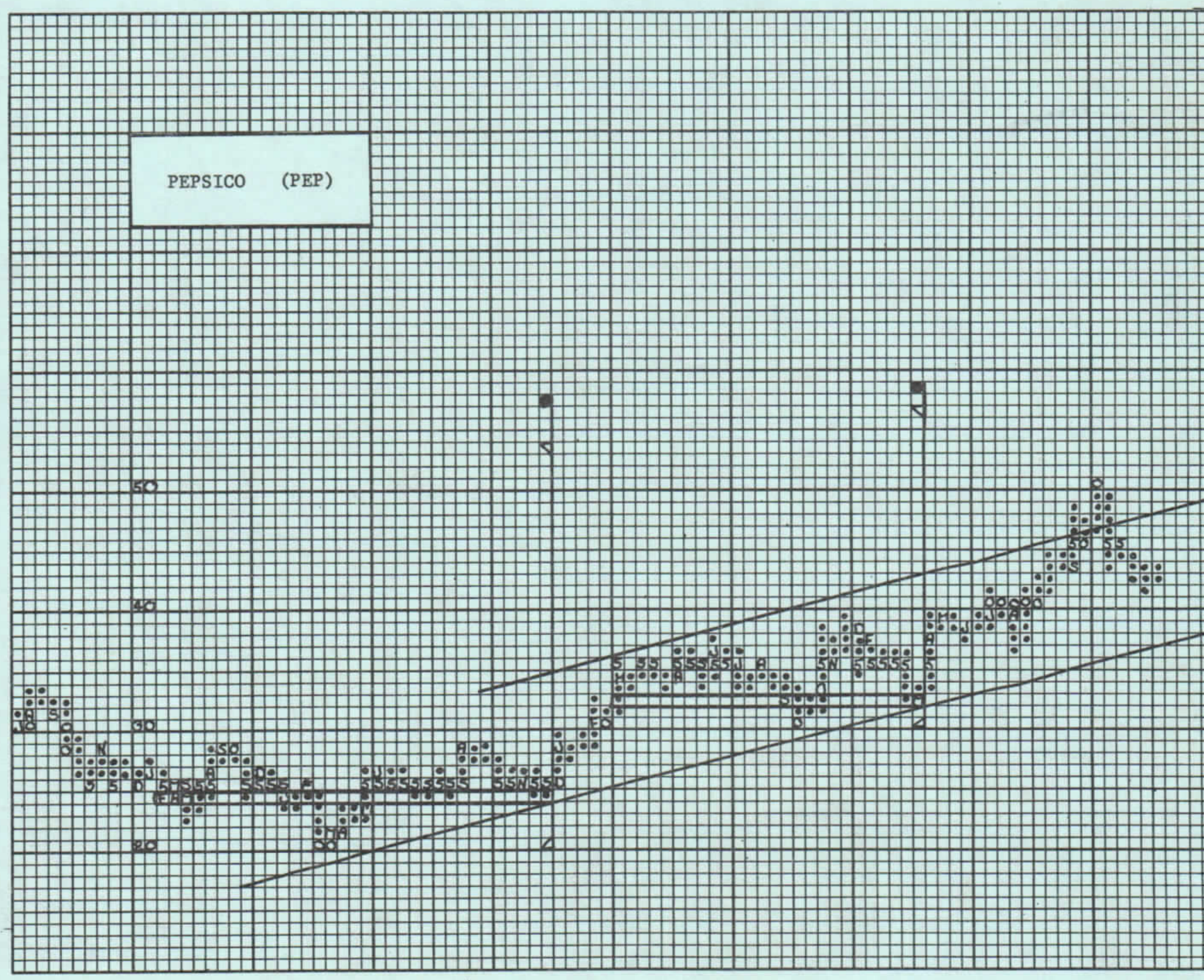
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