SMI
Stock Market Institute, Inc.

# TRENDS AND TRADING RANGES

**November 5, 1981**

One of the problems of the general investing public is that it tends to be in too much of a hurry. Consequently, they are almost invariably too early in the actions they take. As a result, these individuals are often exposing themselves to a greater degree of risk than they need to and certainly to more than can be justified. Although some will make substantial profits in spite of their premature actions, many more will be worn out or shaken out of their positions before the anticipated profit actually develops.

The primary reason for these problems likely can be traced to a failure to understand the cause and effect nature of the market. The public buys or sells for any number of reasons, but they all reduce down to an effort to tell the market that it should be or is ready to move. Of course, we know that this is not how the game is played. The market will move when it is ready. At best, the most the public can do is produce a minor distortion. When it is over, the market will resume its own plan. When the cause is built, the effect will occur and not before. An example that seems to prove this is the market's most recent action.

On September 28, when the market experienced what now appears quite clearly to have been a selling climax, a result was the creation of a long term divergence between the Wyckoff Wave and O.P. Index. This indicated an impending turn in the market. However it tells us very little about the nature of that turn or the magnitude of the advance that is likely to follow. All we know is that it was a long term divergence, which points to a long term result. The important thing to remember about long term results is that they do not develop out of nothing. They require a cause.

The lack of a cause is one of several reasons why the price has had to return to the support line constructed through the 1980 low and the September 28 low. The rally that preceded this took the market as far as it could. If a more meaningful rally is going to develop out of the long term divergence, there will have to first be a reason to expect it .At this point, neither the fifty point nor twenty-five point figure chart provide a reason to expect much of anything. The fifty point chart only indicates a move to 2250, which has almost been completed. The twenty-five point chart is a bit more generous in its measure of upside potential, but even it only indicates an objective of 2350 to 2375. This is only a little above the top of the trading range. The reaching of this objective could actually do more long term harm than good. This is because a reaching of the objective could be accomplished in an upthrust action.

Returning briefly to the vertical line chart, there is one other potentially positive point that is worth considering. It had been hoped that the big advance in 1980 would be just the first leg in a major advance. If the Wave had been able to hold at the halfway point on the way down, this hope would have been greatly reenforced. Of course, we know that no support was encountered. This tells us that the market is no longer as strong as it was in 1980 or perhaps that it was not that strong even then. We should not, however, conclude that the possibility of a long term advance has been eliminated. Although the resulting uptrend created from the two most recent important lows is not as steeply inclined as some might hope, its existence is a fact. In addition, the recent respect shown to that line on the test tends to strengthen its credibility. With the apparent need for additional testing, it is possible that this line will gain still more prominence if those additional tests also respect the support. Bear in mind, however, that if they do not provide this respect, the uptrend will likely be broken and that would have a major impact on expectations for the future.

The technical I.Q. of the investing public must be increasing, because as the market went down for the secondary test that shows up so clearly on the daily chart of the Wyckoff Wave virtually everyone seemed to know what was happening. In addition, most everyone seemed to expect the test to be successful. This second point may have been a guess, but it did turn out to be true. Such technical consciousness on the part of the public is encouraging, but there is still a great deal of learning to be accomplished. This is proven by the expectation that now seems to prevail.

For some reason, there appears to be an effort to equate the end of the successful secondary test with the beginning of an important correction to the big decline. There are instances when this is justified, but this is not one of them. The principle purpose of a secondary test is to confirm the creation of a new trading range. It does this by respecting the support generated by the climax. There is not necessarily any indication given as to the direction of the next move. There can be if the secondary test results in a spring action, but that was not the case in the current situation. Therefore, those who have been buying based on the successful completion of the test are taking a rather substantial risk and probably one of which they are not totally aware. They are vulnerable to a spring or shakeout action that may follow, or they may be buying in an area that will prove to be distribution.

It could be argued that the recent test represented a last point of support. There is a problem with this, however. In order to define a last point of support, we must first have a sign of strength. If the secondary test is the last point of support, that would make the automatic rally the sign of strength, which is something that it is not intended to be. Therefore, calling the October 29 low the last point of support cannot be justified.

Another possibility, and the one that seems to make the most sense, is that the positive performance of the past few days is nothing more than a response to the encounter with the oversold line that occurred on October 29. The fact that the market has become so sensitive about touching that line is a positive sign, but the rally that has followed is only normal corrective action and probably not the beginning of an important advance. It is possible that this correction could develop into a sign of strength, which would be followed by a reaction that could justifiably be called a last point of support. However, we need to see more action before making this conclusion. Until then, it seems advisable to expect another return to the bottom of the trading range. If this happens, it would be especially desirable to see the test end in a spring action.

Since it has been determined that no last point of support has yet occurred, it is premature to actually take an intermediate up count. We can, however, consider the type of building that has already been completed. If a count could have been justified at the recent low around 2150, the upside objective would be between 2480 and 2510, which should be an area of major resistance. This objective is significant because it is higher than the halfway point of the June to September decline. Reaching it would not fit the scenerio of major long term weakness that has seemed to make so much sense to this point. Considering that this count area is likely to develop further before any important up move, the ultimate objective could be considerably higher assuming that the move is not stopped at the end of any of its intermediate phases.

Those who have had the good fortune of participating in the current short term rally probably did not take their positions on October 28 or 29. They were more likely taken about a week earlier when the Technometer was indicating an oversold condition. Although the Wave moved lower after this, many of the relatively strong stocks did not and have since moved up a few points as the general market has rallied. This is a good example of why we should always buy relative strength and sell relative weakness.

Short term profits that are currently held should be watched closely. There are a couple of reasons for this. One is the divergent condition between the Wave and O.P. A great deal of upside effort has been used up in realizing the gain of the past few days. In view of the result, it seems reasonable to say that too much effort has been expended. Therefore, the market may have a problem holding its recent gains, making it desirable to take some of those short term profits instead of running the risk of giving them back.

Another reason to be expecting a short term pull back can be found in what the rally of the past few days has and has not accomplished. It has accomplished a breaking of the short term down trend. However, it has not confirmed that the trend has been broken. That will require a reaction, which will have a negative impact on short term profits. A final reason to expect a pull back is that what little upside potential that did exist on the five point figure chart has now been just about used up.

It is always uncomfortable to watch a rally or reaction of any proportion occur and to not have a position from which to profit by that move. The public tries to avoid this and usually ends up trading too early and too much. A better course of action is to thoroughly analyze the move that has been missed to determine how it fits into the overall picture. If it is not important to the perspective of operations being undertaken, then nothing has really been missed. If it is important, there will always be another move later. Analyze the missed move to determine the error in hopes of not repeating it. Above all, do not play the public's game. Most of them are losers.

## GROUP ANALYSIS

Since the market still appears to be in a period of accumulation instead of distribution the groups of primary interest should be those that are showing relative strength. One such group is the aerospace stocks, which have become quite strong since the September 28 climax. It has recently broken an important supply line, which puts it ahead of the general market. What it needs to do now is confirm that break. This means a reaction back to the support line, which should result in a second point for the defining of a longer term uptrend. After this has been completed, the group should be ready to resume its drive toward the indicated objective above 4700.

The airline group has not shown the quality of strength exhibited by the aerospace stocks, but it has remained in harmony with the market and can therefore be considered a potential candidate. The completion of the secondary test last week confirms the new trading range. What is needed now is the development of a good trading opportunity. This could come in the form of a spring action on the next general market reaction.

Another group showing a great deal of promise is the banking group. The problem here is that very little of this promise has been turned into performance. There was one rally effort previously that penetrated the top of the trading range, but this turned into an upthrust action. The current rally is again providing an upside promise. The high volume and good price movement suggests a sign of strength. That being the case, the next reaction should be watched closely for signs of developing into a last point of support.

There is often a connection between the banking stocks and the building material issues. This appears to be true now as well with the building stocks showing some promise. The important point to note with these stocks is the severity of the just completed test. Every effort was made to break the support and they failed. The index is now rallying strongly on greatly increased volume. This could easily evolve into a sign of strength making this another instance where the next reaction should prove to be especially important.

The other group whose action is often related to that of the banking group is the insurance group. In this case, it appears as though the insurance stocks are realizing the promise of the banking issues. The problem here is that too much of the promise has been realized. The upside potential that had been built up has been used up. Therefore, a corrective phase now seems likely. However, in view of the relative strength in this area, the correction should be watched closely for signs of developing into new potential for a renewed upward march.

There are two other groups that seem to have the same short term problem as the insurance group, they are the electronics group and the medical group. Both have shown amazing strength in view of their previous sharp declines. Unfortunately, this strength has been carried to the point where the upside potential has been used up. That means new preparation is needed as well as a correction to the recent gains. Both can be accomplished during the next reaction.

The oil exploration group and the semi-conductor group have also been the objects of recent strength. Both are in need of corrections before they can seriously be considered as buying candidates. The current rallies may turn into signs of strength, or perhaps even a jump across the creek in the case of the semi-conductor stocks. Here again then the next reaction becomes potentially very important. Count levels have been marked on both of these charts, but no counts have been marked. This is because it is hard to justify calling the points at the right of these areas last points of support. If the next reactions do meet the requirements of an LPS, then more meaningful counts can be taken.

# INDEX CHARTS

STOCK MARKET INSTITUTE, INC.

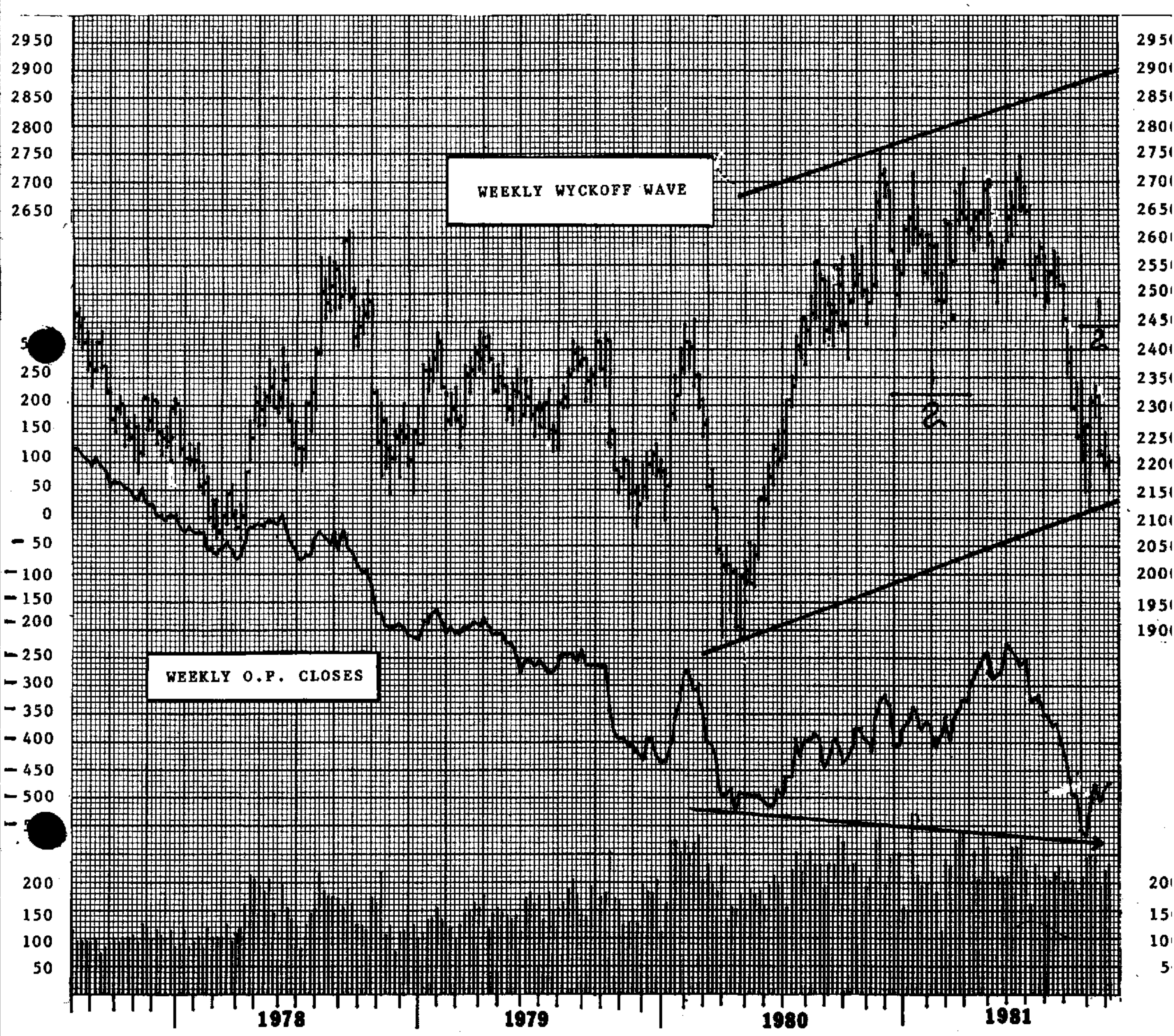
OCTOBER 28, 1981.

## 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.



# INDEX CHARTS

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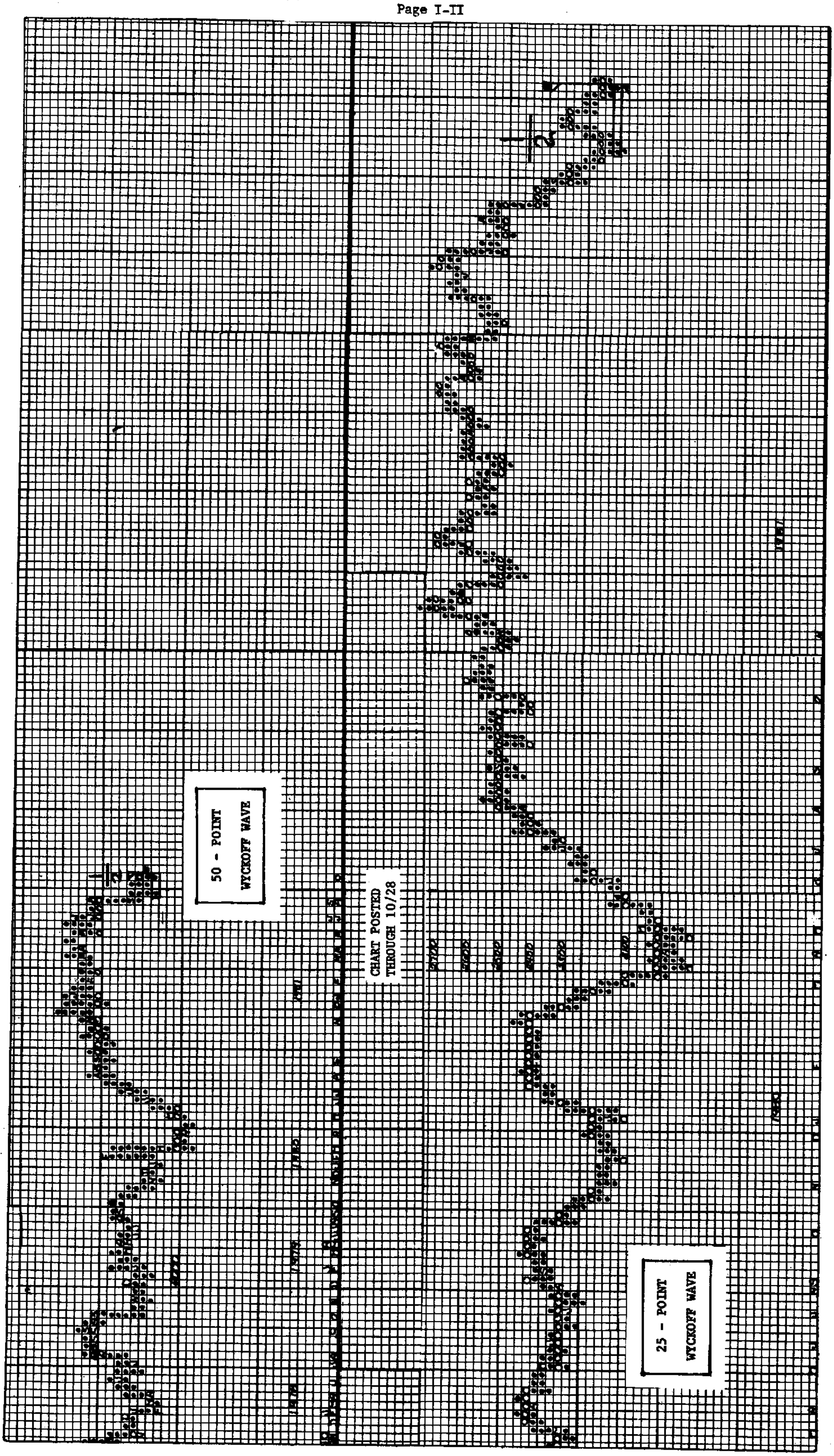

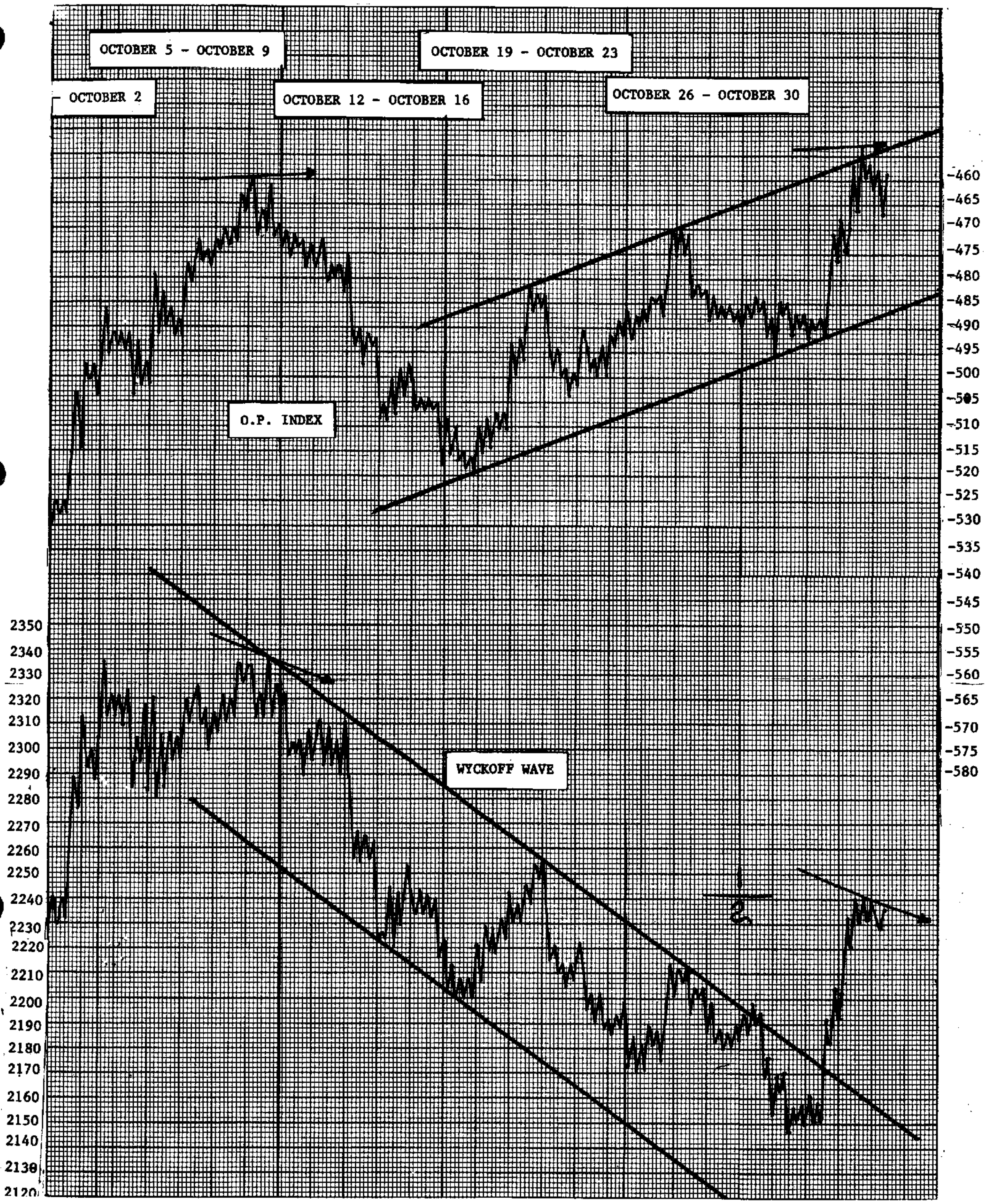
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OCTOBER 19 - OCTOBER 23
OCTOBER 2
OCTOBER 12 - OCTOBER 16
OCTOBER 26 - OCTOBER 30
O.P. INDEX
WYCKOFF WAVE
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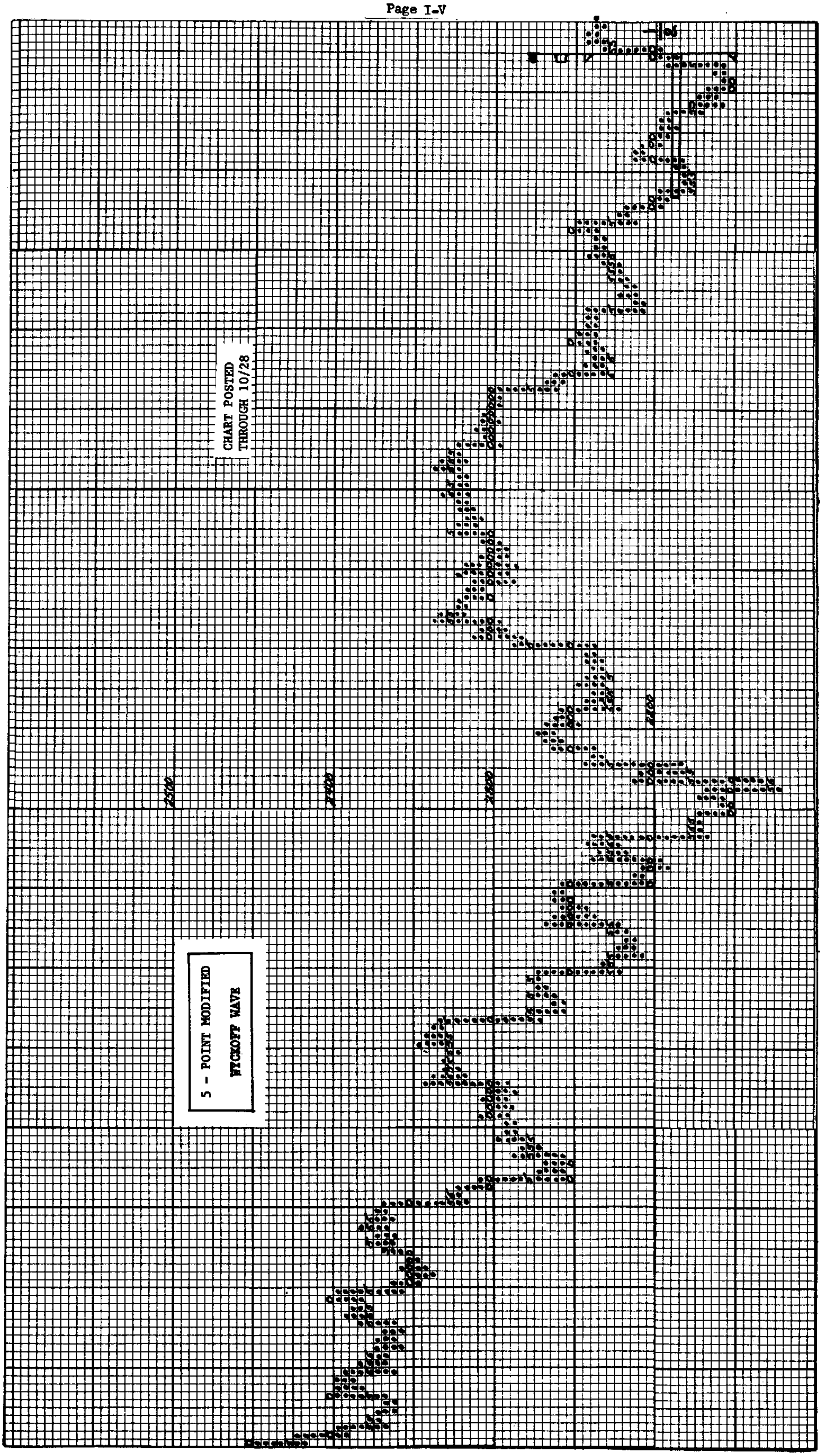
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THROUGH 10/28
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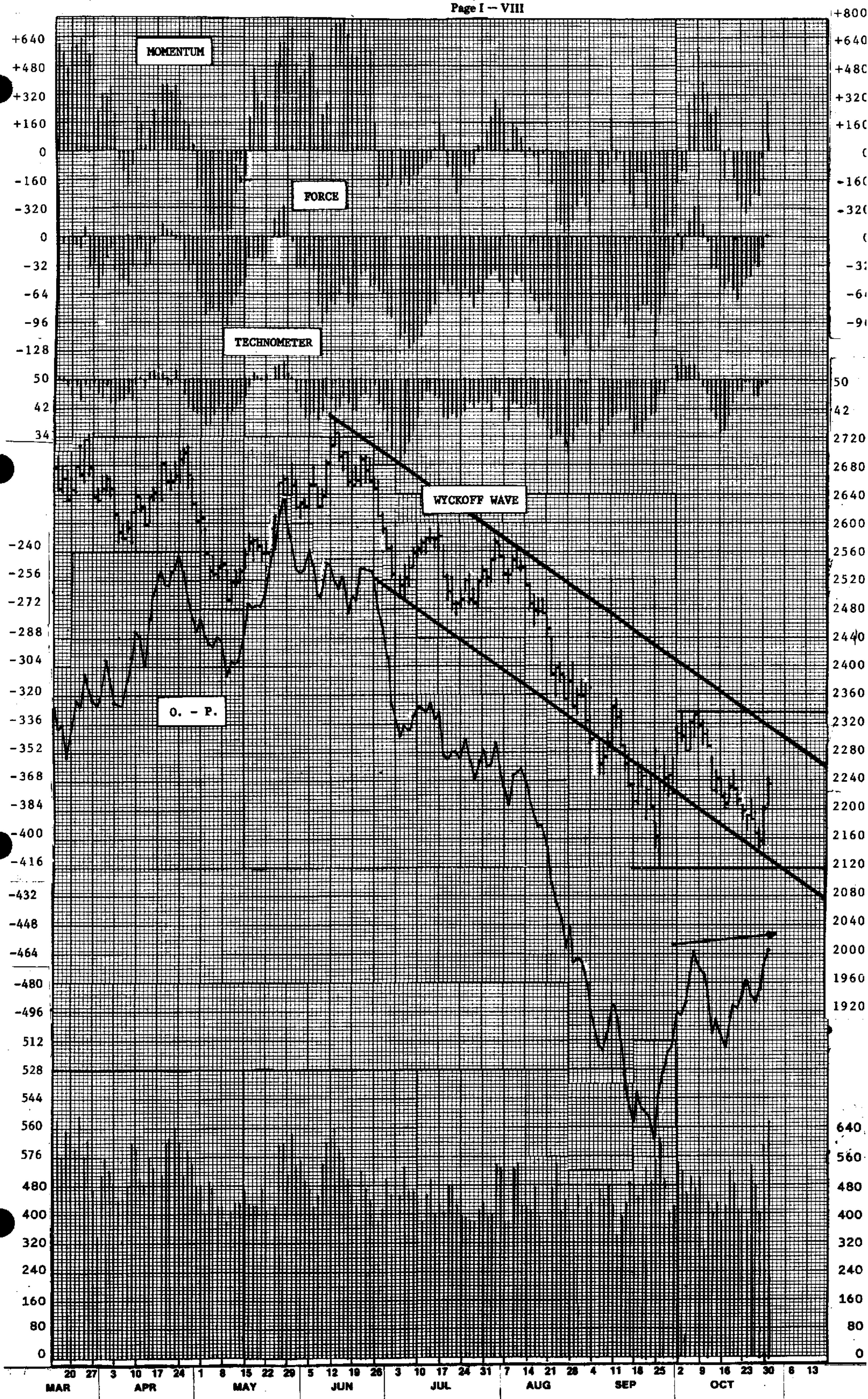
MOMENTUM
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TECHNOMETER
WYCKOFF WAVE
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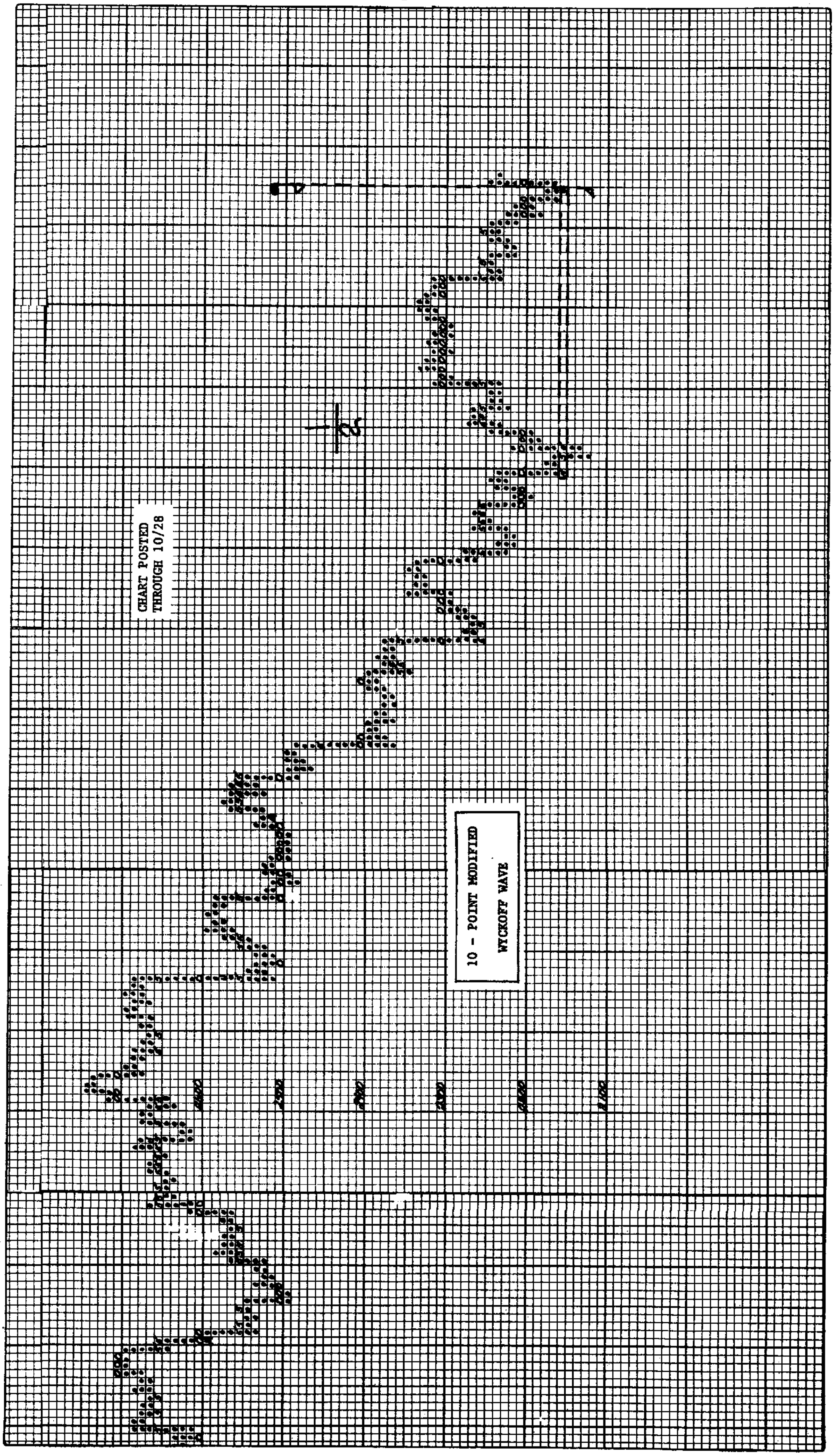

AEROSPACE GROUP
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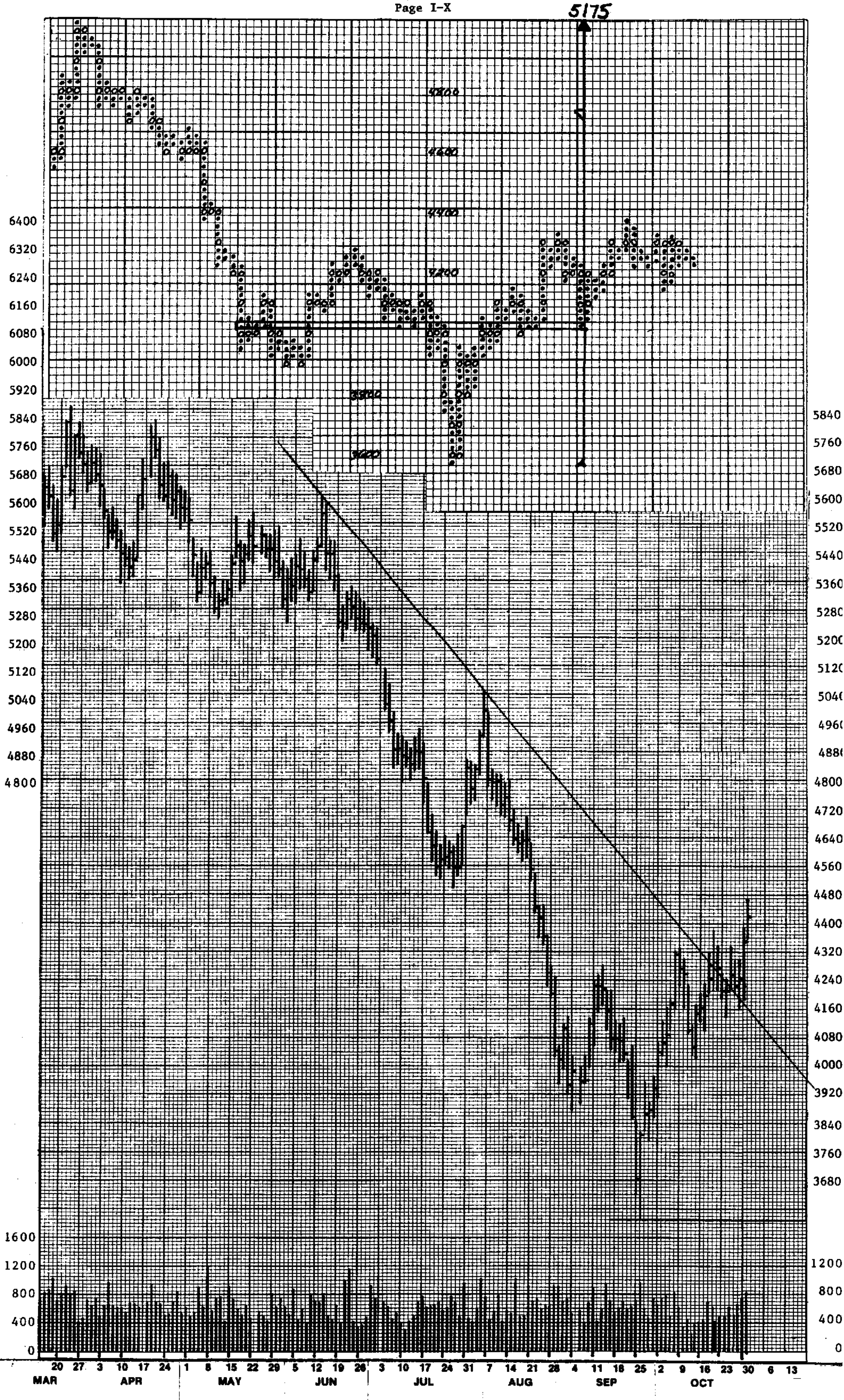

AIRLINE GROUP
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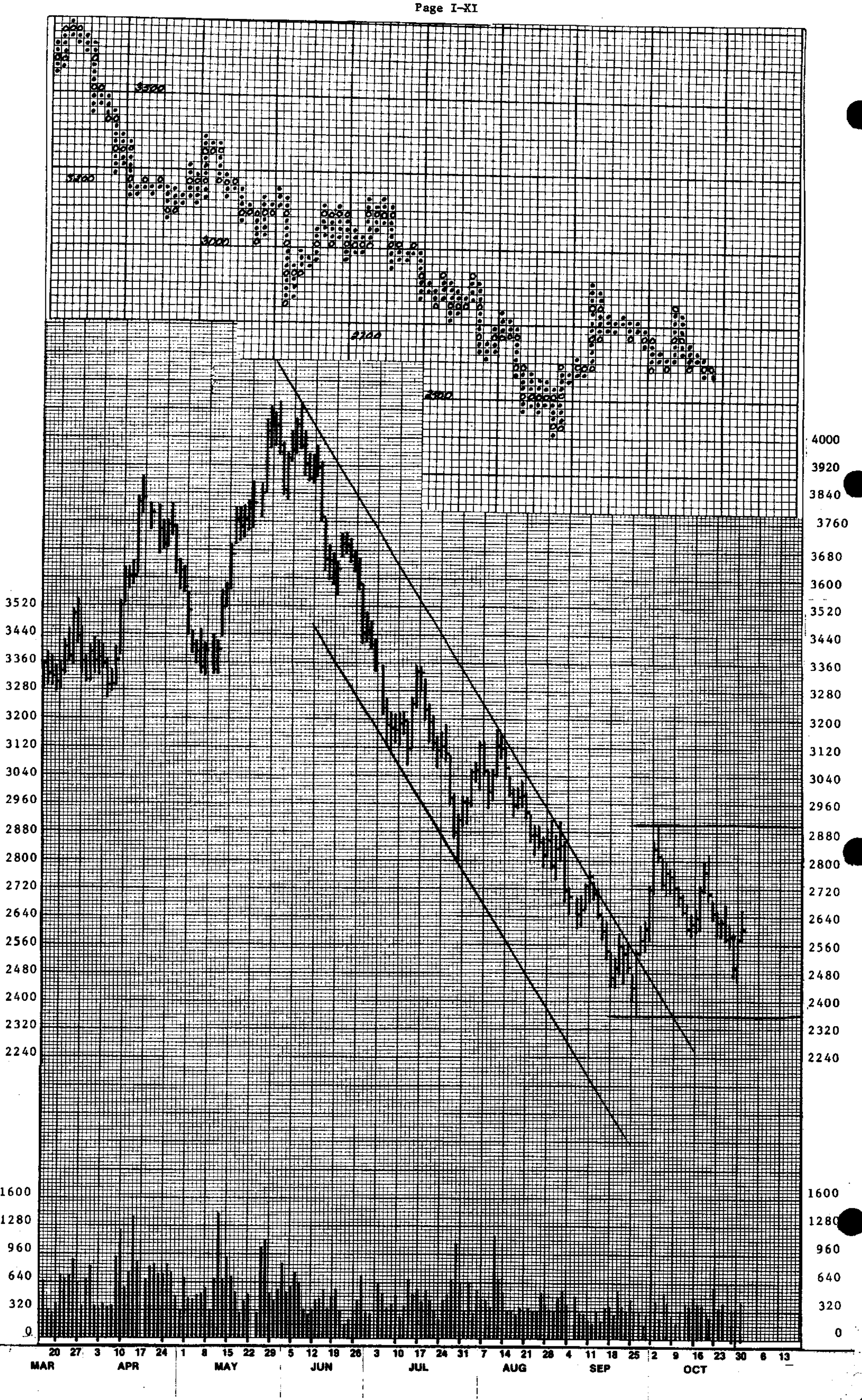

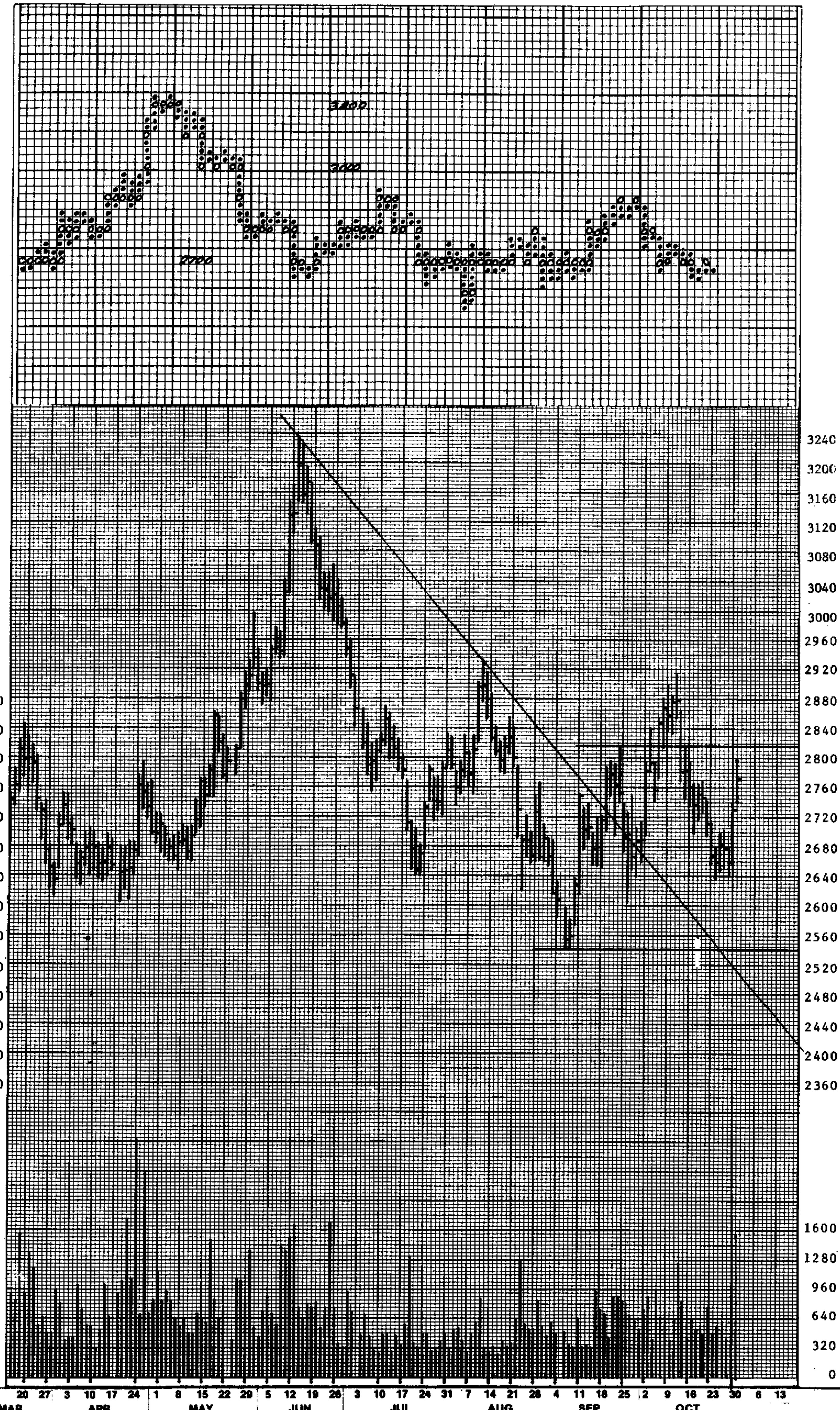
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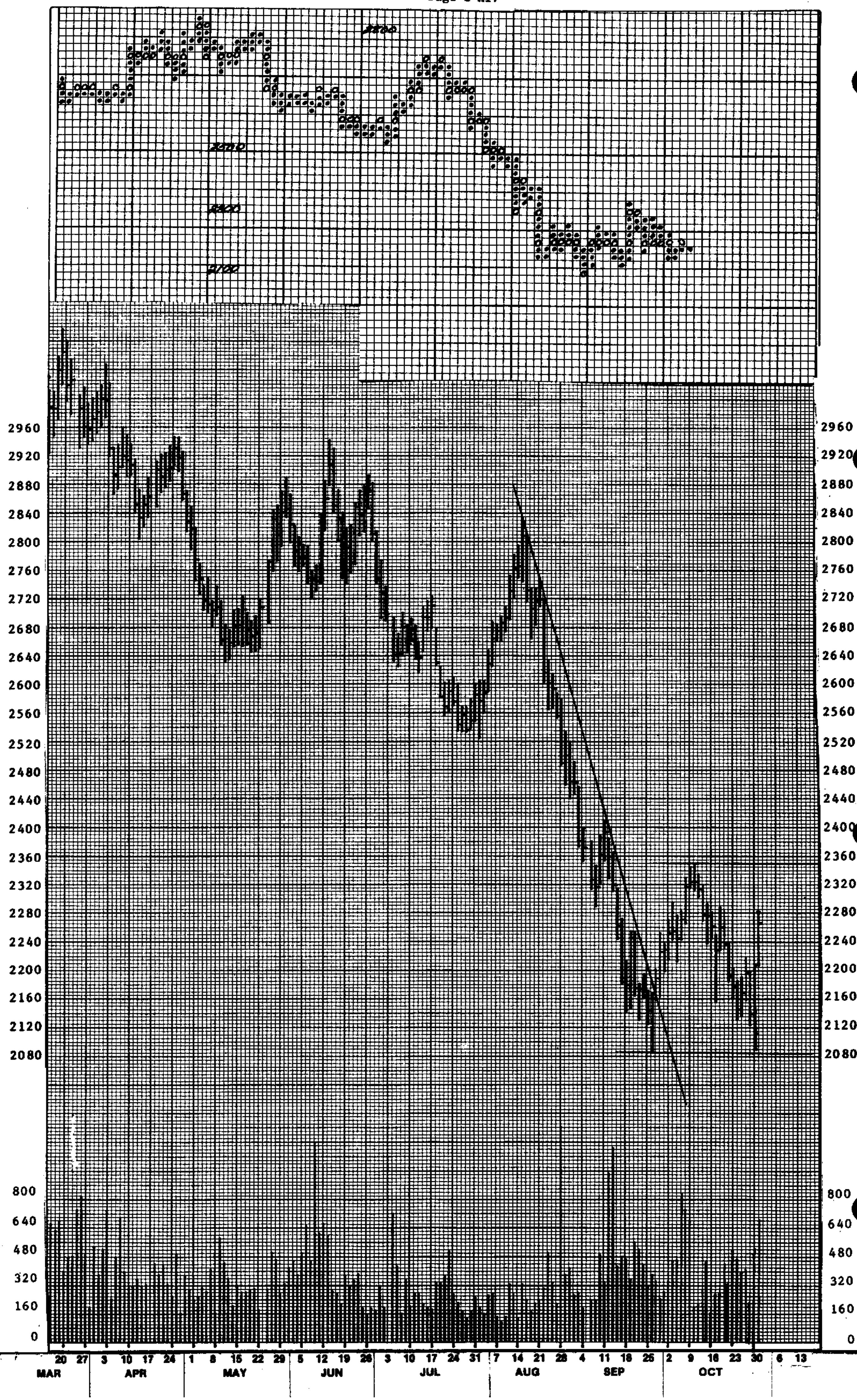
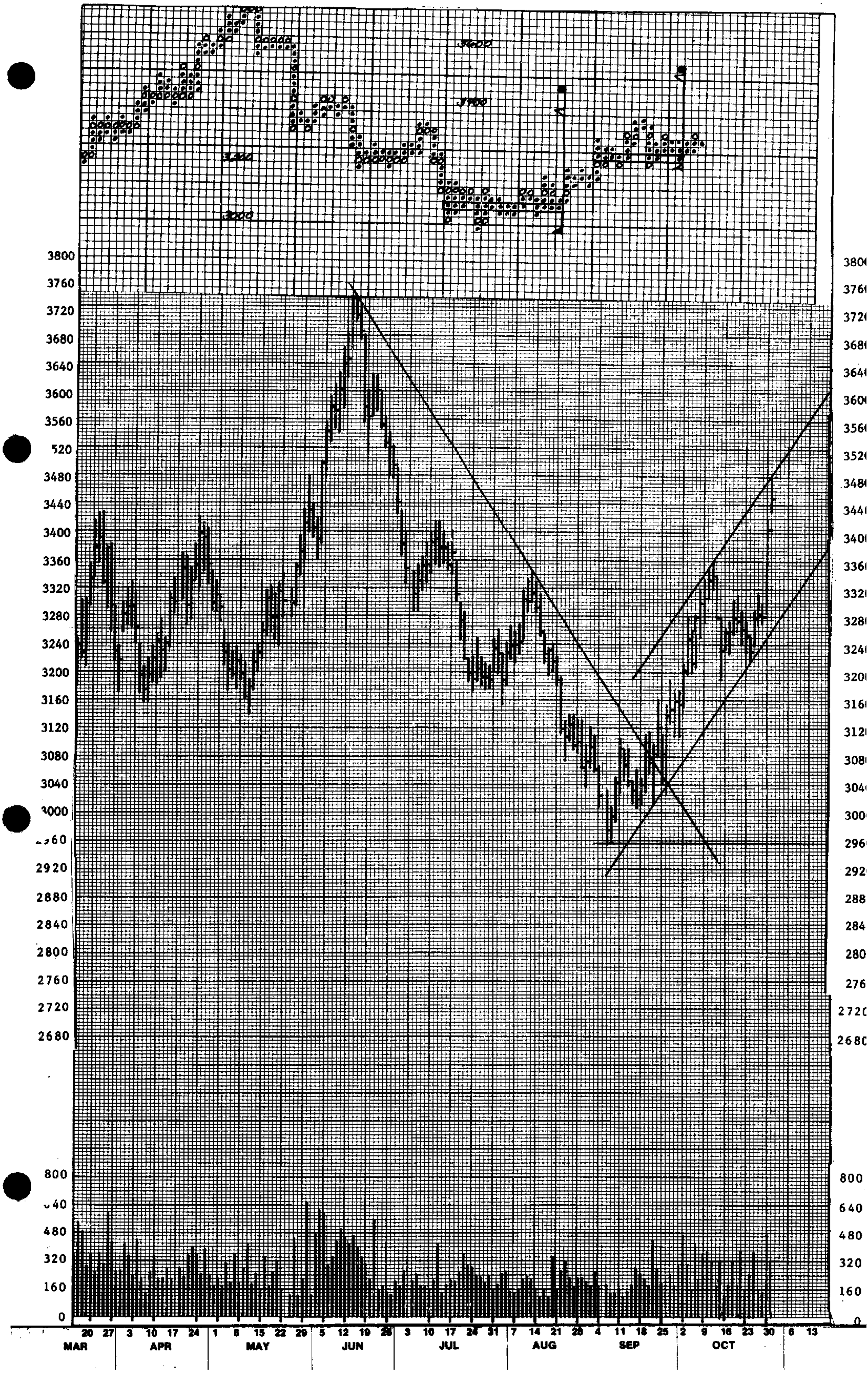
BUILDING MATERIALS GROUP
7(2GP+2JM+2JWC+4MNC+3WY),



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JUN
JUL
AUG
SEP
OCT

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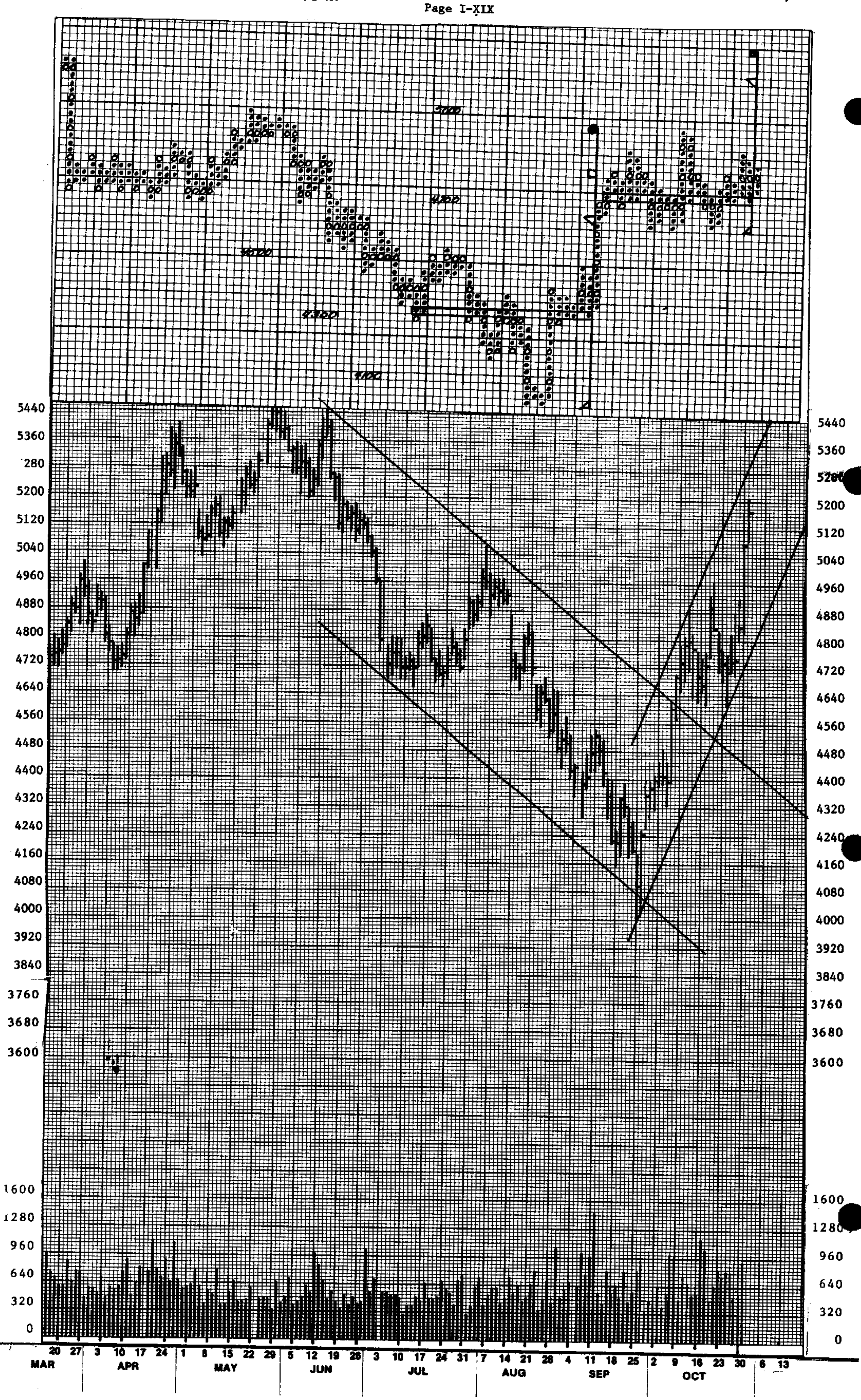
ELECTRONIC GROUP
5(2GE+5WX+3TRW+4RCA+12GRL)





# INDEX CHARTS

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MEDICAL GROUP
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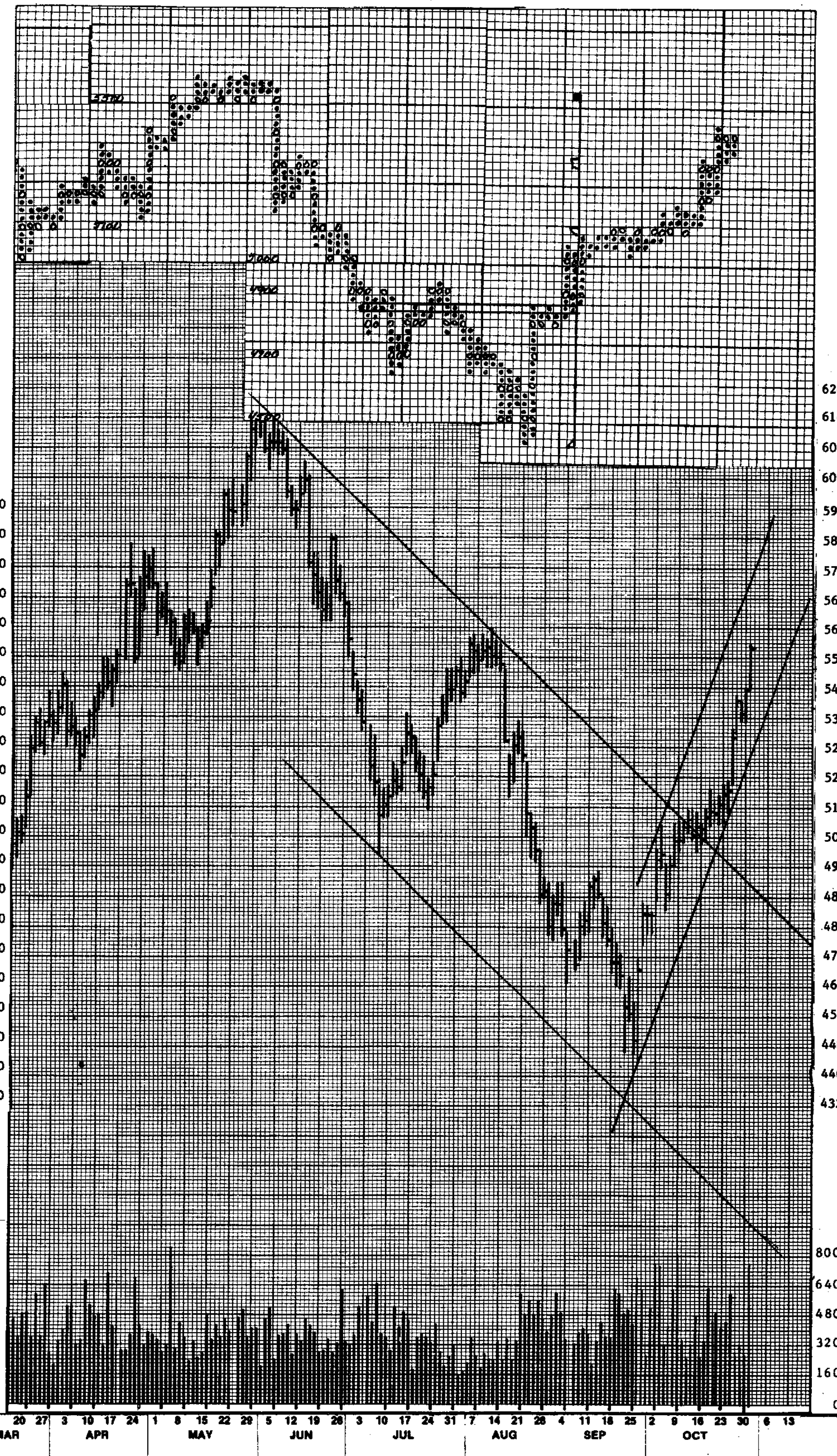

OIL EXPLORATION GROUP
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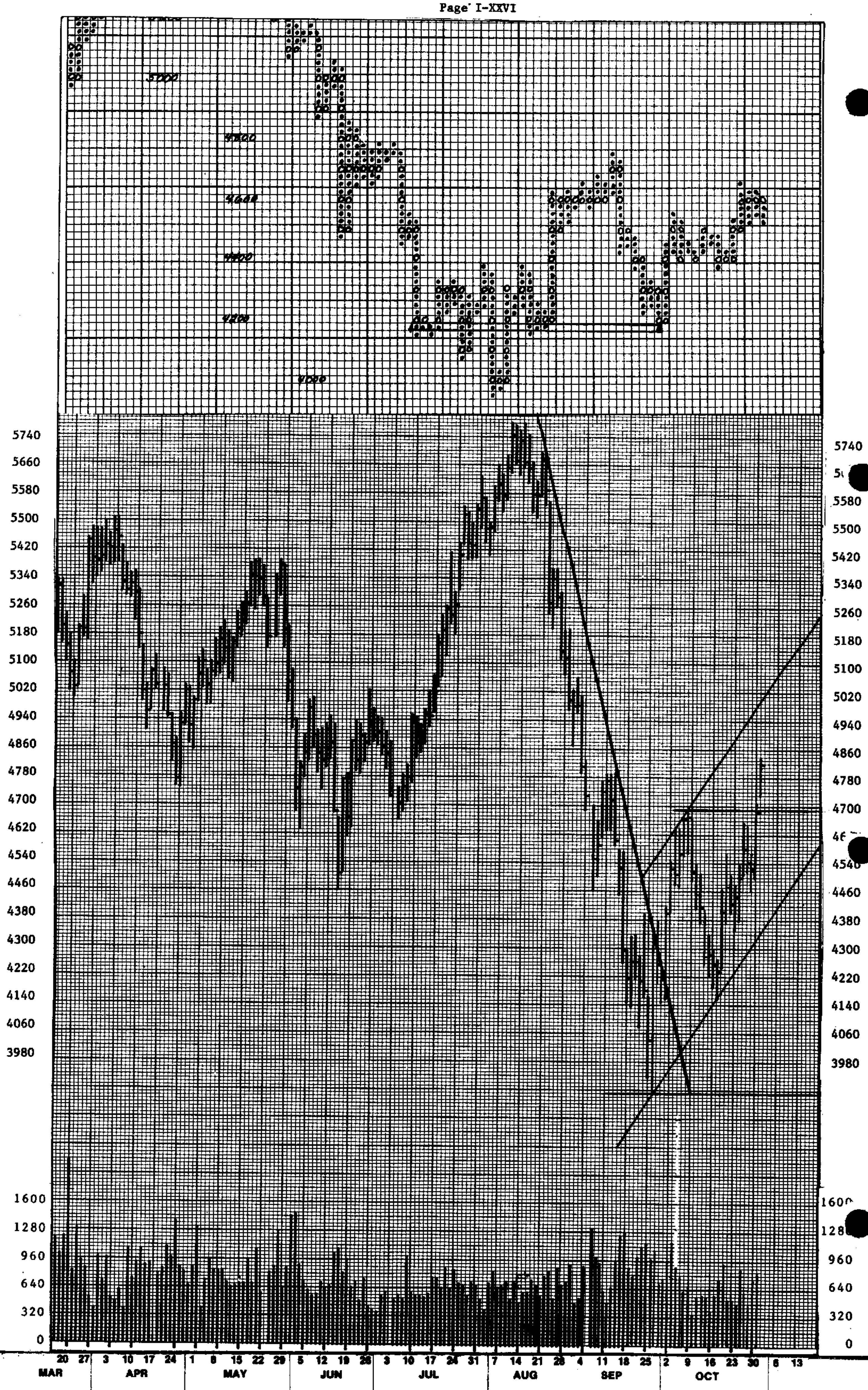

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SEMI-CONDUCTOR GROUP
3(7AMD+4MOT+12NSM+2TXN+24UTR)