Tuesday, November 12, 2002

Market Commentary: Turnaround Here? Not All Counting Crows Are Created Equal

Round here we're carving out our names
Round here we all look the same
Round here we talk just like lions
But we sacrifice like lambs

Round here hey man got lots of time
Round here we're never sent to bed early
And nobody makes us wait
Round here we stay up very, very, very, very late

-- Counting Crows

In the nomenclature of candlestick charting, Black Crows are three consecutive negative bars with closes at/near the bottom of the day's range. In other words, three down days with each close near the low of the session.

These Black Crows, these three "birds on a wire of distribution," are supposed to be a warning of weakness with further downside to follow. Apparently, the thinking is that when three crows show up there is likely a flock not far behind. It makes sense on the surface, I suppose: Large moves, of course, begin with small moves. Three signs of distribution are *sometimes* a sign of a turn. But what if these three crows are just scouts checking out the conditions?

In my experience, if the intermediate trend is firmly up, it typically does not give more than three days down against the trend. This is how I define the concept of the 1-2-3 Pullback described in my first book, *Hit and Run Trading*. As you know, I key off of the price action in the **S&P** as program trading currently represents approximately 35% of all **NYSE** volume. As you also know, the S&P left a 1-2-3 Pullback buy setup on Monday's close. In my experience, the *first* 1-2-3 pullback from highs is one of the best risk-to-reward setups you can find. It does a good job of identifying when the move will resume ... if it is going to resume.

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It is too early to say with certainty if Tuesday's attempted turnaround will make the crow counters fly away. But the fact that some technicians are comparing the current Black Crows of last Thursday, Friday and Monday to the Black Crow pattern of Aug. 1, 2 and 5 is heartening for the prospects of the longevity of the rally phase. Apparently these bears indicate that the sell signal on Aug. 5 at 834 S&P "worked," but that it took a while to kick in.

I'll say. Thirteen trading days and 130 S&P points later! Interpretations like this we can do without. Moreover, it appears that there are more than a few technicians out there who choose to perceive the current Black Crow as bearish and are fearful of missing the next leg down. Consequently, as in August, they are now putting their face in the fire and shorting even if it means taking some heat. Can you say blowtorch?

Unless you feel you need to punish yourself for some reason, I do not recommend this approach to trading or this style of thinking. Psychotherapy has got to be cheaper. It's not necessary to get too far ahead of the curve; it's only important to follow the market. Don't stay up very, very late trying to outthink the market. That's not the point. The point of the game is to define the intermediate term and look for re-entry setups as the short-term trend pulls back, giving an opportunity.

The **Nazz** has been leading. And the Nazz has carved out an Outside Up month. In other words, so far in October the Nazz made a new swing low for the move but has already exceeded September's high, which was on Sept. 11. Of course, this Outside Up monthly pattern is not a pattern that should be easily faded. Neither is it a pattern that should fail, as a failure from this type of setup could be ugly indeed. Rather, this pattern should be given the benefit of the doubt until proven otherwise.

With such a big-picture dynamic the first pullback *must* be bought. The bulls must show their stuff here if they are out there. Tuesday, the bulls did show up and the techs took off. However, the rally was tarnished when an hour before the close **Philip Morris** (MO:NYSE) said it was "not in the position" to confirm its previous target of 8% to 10% earnings growth in 2003. If it is not in a position to confirm or deny, then who is? It is important to remember that one day does not a market make and that one stock (in this case MO) does not a market make.

Of course, the herd has been so burned buying the dips that it is on its heels at the first sign of any trouble and is squeamish at the first sign of blood on the tracks and a little red on the tape.

If the bullish bent to the near-term personality of the market is to persist, the correct posture will be to buy the dip when it's ugly. If the personality of the market has indeed changed, then buying the dip *will* work. If buying the dip does not work here then indeed the birds may be headed south.

Does that mean my nerves weren't raw on Monday? Hell no. But on these semiholidays, when the cat's away the mice love to play. As my associate Dave Reif suggested to me Tuesday morning: Isn't it easy for a few princes of darkness manning the big trading desks to buy cheap puts and then smash the market down when most of the big buy-side elephants are away? Very little resistance was offered to push the beach ball under water on Monday as the banks were closed.

Conclusion: As speculated last week, Monday/Tuesday should find a low. So far so good. The momentum with which this beach blanket Babylon bingo ball known as the market comes bouncing back

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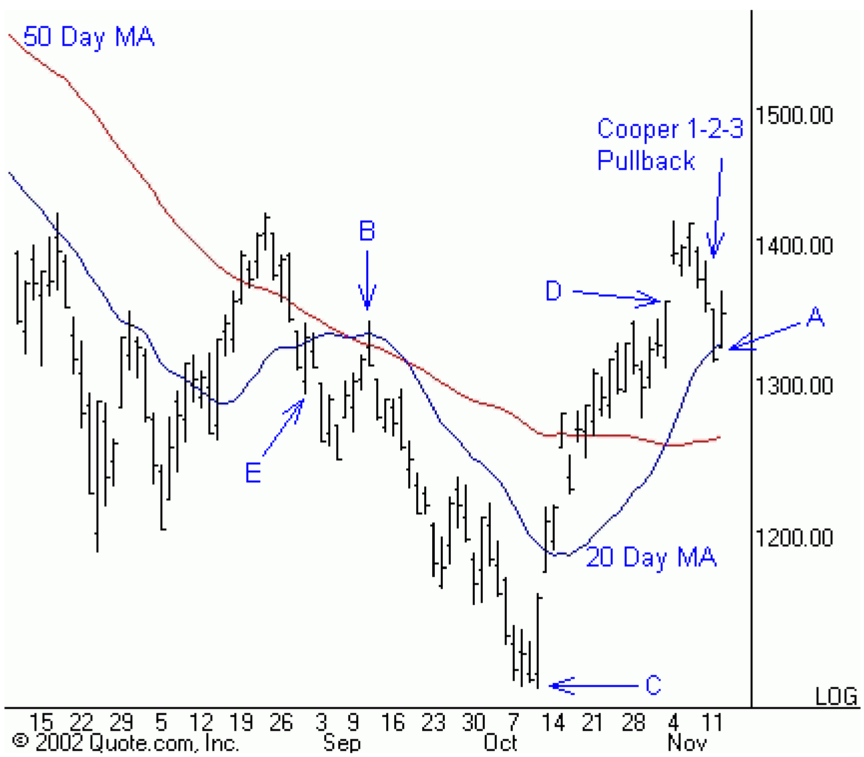
will tell the tail. However (there is always a however), as Dave Reif also points out, the percent of stocks above their 200-day moving average dropped to 19% again after generating a recent triple-top breakout on the point-and-figure chart. This is potentially troublesome. The market has got to pull itself up by its bootstraps here if the advance is going to continue. A strong move up accompanied by solid breadth and volume is required here or the advance could disintegrate.

Strategy: Note how the first bar up on the S&P on Aug. 6, after the Black Crows pattern, completely offset the prior day's decline as it kissed its 20-day moving average. Likewise, in order to remain constructive, the S&P needs to recapture its 20-day moving average now. Constructively, the volume on the decline from Thursday, Friday and Monday was moderate. Interestingly, the Nasdaq did hold its 20-day MA Monday following through on a Holy Grail buy signal and turning its daily chart up. That is the same behavior demonstrated by the Nasdaq on Aug. 29. The action this week will be critical as to the longevity of the advance. If the bulls are going to make the bears eat crow, the clock is ticking.

Nasdaq Combined Composite



(A) Primary Holy Grail buy signal generated on Nazz.
(B) September high
(C) New monthly low
(D) Turn up in monthly chart establishes outside up month as Nazz leads S&P
(E) Note outside day up at 20 day on way down in August. Follow-through to upside now would be a change in character.

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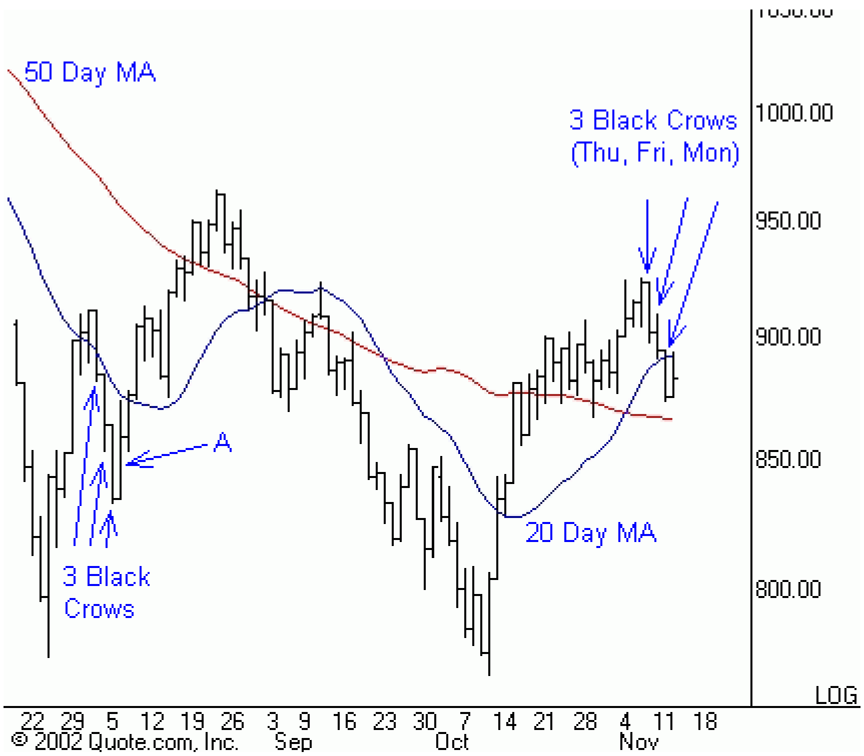
S&P 500 Daily



(A) Aug. 8, Black Crow offset similar to Tuesday's action.

THE DAYTRADING REPORT

Chart 1

Mentor
(MNTR:Nasdaq)
Long

Entry: **39.60**
Stop: **38.60**
Pattern: **Cooper 1-2-3 +1 Pullback / 180**

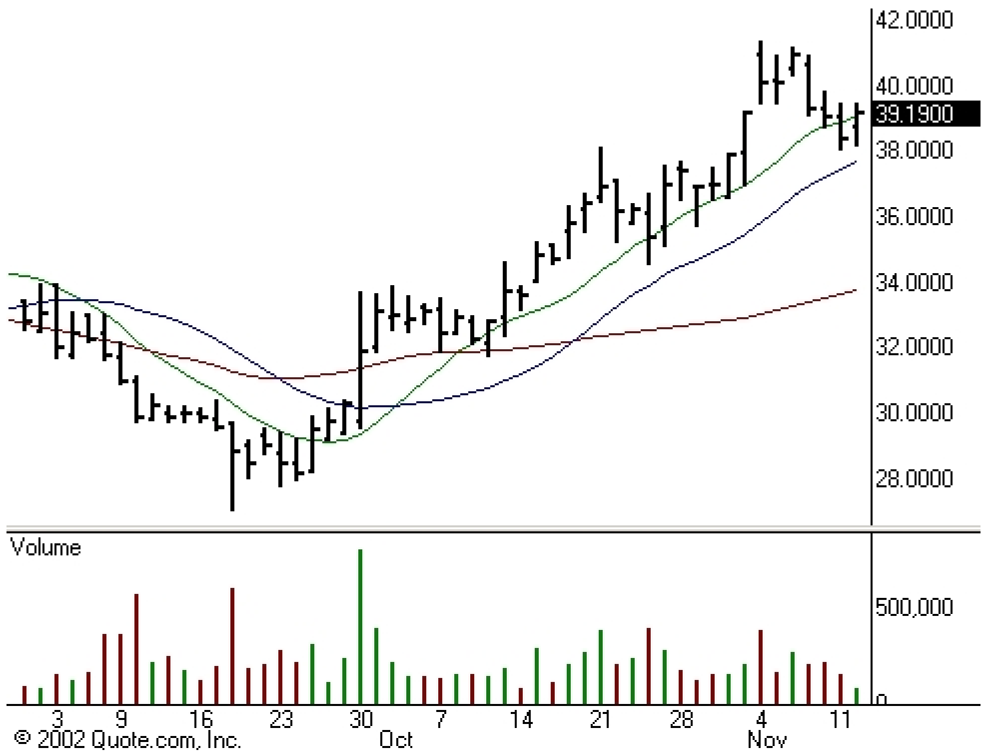


Chart 2

Adtran
(ADTN:Nasdaq)
Long

Entry: 27.00
Stop: 26.00
Pattern: 180 / Pullback Pivot

Chart 3

Adobe Systems
(ADBE:Nasdaq)
Long

Entry: Only on a pullback toward 26.00
Stop: Use a 1-point stop
Pattern: Volatility Jackknife / 180

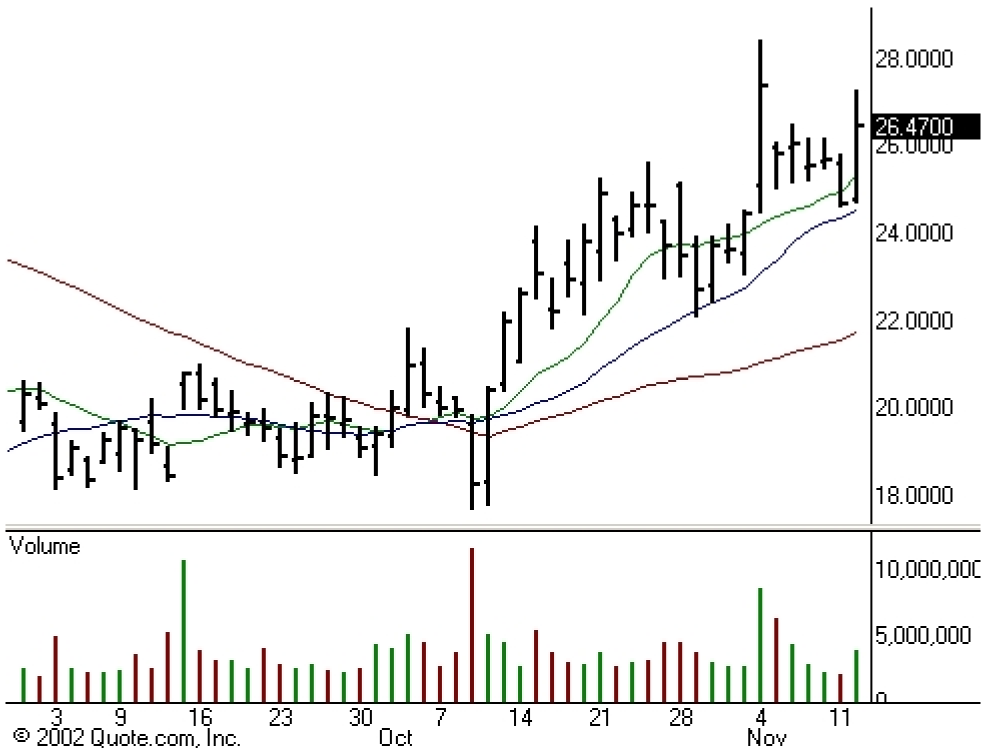


Chart 4

AFC Enterprises ▲
(AFCE:Nasdaq)
Long

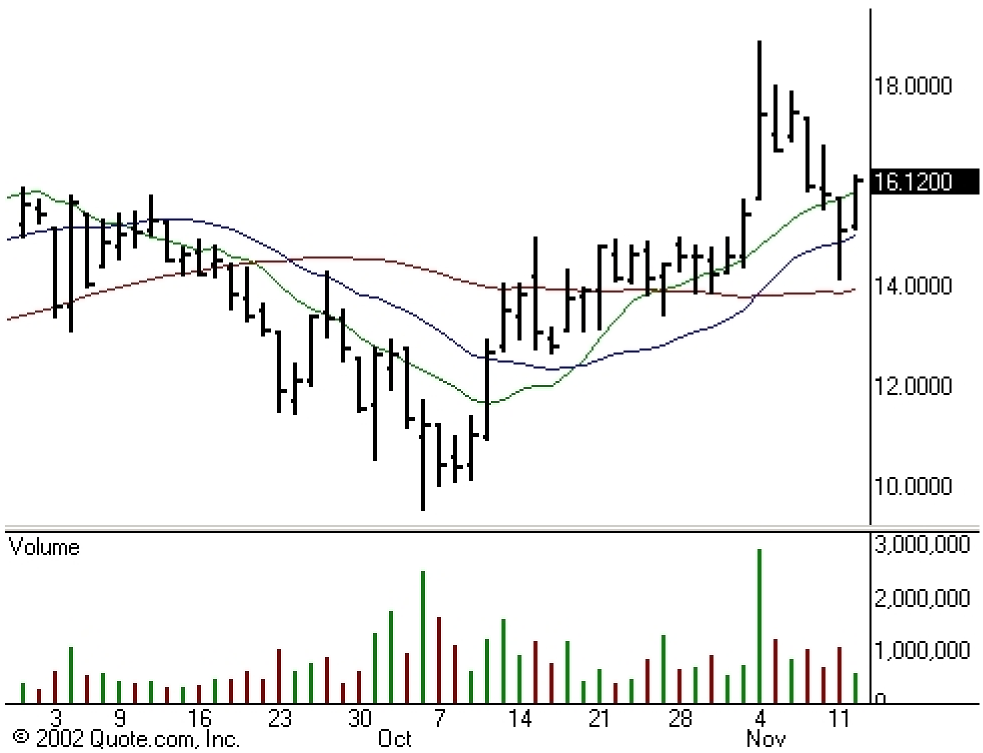
Entry:	**21.00**
Stop:	**20.00**
Pattern:	**Expansion Pivot**

Chart 5

Documentum
(DCTM:Nasdaq)
Long

Entry: **16.30**
Stop: **15.30**
Pattern: **Pullback Pivot**

Comments: Cheapie du Jour



THE SWING REPORT

Chart 1

Amerada Hess
(AHC:NYSE)
Short

Entry: 52.25
Stop: 54.25
Initial Target: 50.25

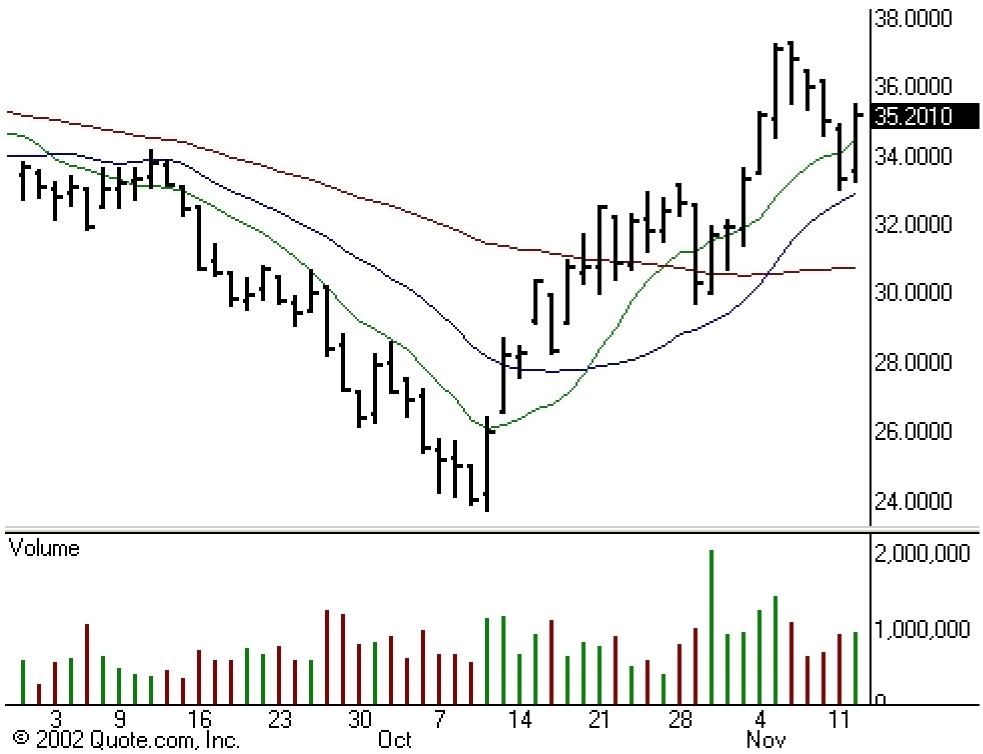
Pattern: Lizard / Volatility Setup

Chart 2

Tech Data
(TECD:Nasdaq)
Long

Entry: 35.65
Stop: 33.65
Initial Target: 37.65

Pattern: Cooper 1-2-3 +1 / 180



OBSERVATIONS AND TRAILING STOPS

-- Wednesday is day two in **IBM** (IBM:NYSE) (long). We are long from 78.45. Continue to look to exit one-half your position at 80.45. Raise your stop to 78.50.

-- Wednesday is day four in **Merck** (MRK:NYSE) (long). We are long from 56.10. Maintain the stop at 54.10. The initial target for one-half of your shares is 58.10.

-- Wednesday is day four in **Aetna** (AET:NYSE) (short). We are short from 38.90. Maintain the stop at 40.90 and look to sell one-half of your shares at the initial target of 36.90.

Notes and Guidelines

DayTrading Report:
Trades marked ▲ indicate stocks that are considered small-cap, trading 500K shares or less. As you know, thin stocks are generally more volatile and trade with a wider spread.

Trades marked * indicate patterns that don't conform to the original rules of the pattern but are defined as "in the spirit of" their namesakes.

The 1-Point Gap Rule: Any stock recommendation that opens 1 or more points above the listed entry price (for longs) or 1 or more points below the listed entry price (for shorts) should be ignored for the day. Please note that history suggests that entering a stock on a gap open increases your potential for a loss.

Reminders: A signal is not valid unless the stock trades at or above the listed entry price for longs and at or below the listed entry price for shorts. ***If a position moves 1 point in your favor in this choppy environment, it is a good idea to sell half the position and move your stop on the remaining position to break even.***

Charts: The green line is a simple 10-day moving average, the blue line is a simple 20-day moving average, and the red line is a simple 50-day moving average.

The Swing Report:
Trades marked ▲ indicate stocks that are considered small-cap, trading 500K shares or less. As you know, thin stocks are generally more volatile and trade with a wider spread.

Trades marked * indicate patterns that don't conform to the original rules of the pattern but are defined as "in the spirit of" their namesakes.

The 2-Point Gap Rule: Any stock recommendation that opens 2 or more points above the listed entry price (for longs) or 2 or more points below the listed entry price (for shorts) should be ignored for the day. Please note that history suggests that entering a stock on a gap open increases your potential for a loss.

Initial Target: Target price at which you should look to sell/cover half your position.

Reminders: A signal is not valid unless the stock trades at or above the listed entry price for longs and at or below the listed entry price for shorts. ***If a position moves 2 points or more in your favor in this choppy environment, it is a good idea to sell half the position and move your stop on the remaining position to break even.***

Charts: The green line is a simple 10-day moving average, the blue line is a simple 20-day moving average, and the red line is a simple 50-day moving average.

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