Wednesday, October 4, 2006

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Market Commentary: Things Not Always as They Seem

I wrote yesterday that the **S&P 500** was poised to rally out of a classic 1-2-3 Pullback pattern (this is a pattern I describe in my book *Hit and Run Trading* that identifies continuation entries out of pullbacks in strongly trending momentum moves), and that my long-outstanding 1340/1350 projection would be tagged.

In addition, the S&P also had traced out a Plus-one Minus-two buy setup on Tuesday's close, as shown in the daily S&P chart yesterday. This pattern sets up when a stock or index makes a new three-day high (for the Plus-one part of the equation) and subsequently pulls back, making two consecutive lower lows (for the Minus-two part of the equation). The result was that the S&P exploded out of the setup, closing at 1350.20.

The **Dow** broke to another new record high, but some poo-poohed the move, and in my opinion for good reason. It is what it is, but things are not always what they seem:

- The average Dow stock is 31% off its all-time high.
- The median Dow stock is 36% off its all-time high.
- The Dow's move to a record new high on Wednesday may yet prove that the emperor has no clothes.

Although the breakout is obviously affecting sentiment, and it is hard to tell how far sentiment can carry, it is also creating the kind of psychology emblematic of the optimism necessary for tops -- if that in fact is what the agenda is.

Although the Dow record is somewhat phony, the divergence between other broader indices, as well as the Dow Industrial and Dow Transportation indices, is real.

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Moreover, despite an ISM service sector report that came in weaker than expected on Wednesday, the market rallied. That raises some questions.

In addition, the market was quick to rally off **Fed** Chairman Ben Bernanke's comments on Wednesday about the housing market slicing 1% off GDP. The interpretation was that the Fed would be cutting rates sooner rather than later. The drop-off in housing is hardly news. It seems to me a stretch to interpret that simply because Bernanke mentioned it that he was somehow telegraphing a cut in interest rates.

Yet the market ran with the ball, and traders will ask questions later. That is the nature of bull runs. The market has its own internal agenda.

And one very good possible target for that agenda is 1350 S&P. The chart of the Square of Nine Calculator shows why this level is so important. The low in October 2002 on the S&P was 768. Because that low has scratched out a yearly low, it became what I call a Master Square. As long as that level holds, the S&P will vibrate off that number, as well as the all-time high on the S&P of 1552.

On the same axis but in opposition, or directly across from 768, is the number 1347. The S&P closed just 3 points above that on Wednesday. Interestingly, as the chart shows, 1347 is square of 90 degrees from the date of Oct. 4/5. At the same time, a complete 360-degree move up from last June's 1219/1220 S&P low equates to 1363.

In addition, a weekly chart of the S&P below shows the importance of the 1136 level, which was a key swing low from April 2005. I mention this because 1136 is also on the same axis as 768 and 1347. In other words, 1136 is also on the master square.

The move up from 1136 to 1347 is 540 degrees, or one full cycle of 360 plus another 180 degrees. In my course, "The New Swing Chart Method", I call this 540-degree move a Completion Move because in my studies of market history, I have noticed how many significant advances and declines culminate after a 540-degree move. I believe that a 540-degree move completes a major square in price because the market moves in 90-degree increments.

Therefore, a full three-dimensional square is not four-sided, but rather a six-sided cube. Ninety degrees times six sides equals 540 degrees. In addition, we may have a major time and price square-out this October from 540 degrees up in price from April 2005, because we are also 540 degrees in time up from April 2005. In other words, from April 2005 to April 2006 is 360 degrees in time. Another six months or 180 degrees in time takes us to October 2006.

Conclusion: The bulls put on a big show as buy programs were thrown at Bernanke like flowers at a diva. The big question is, of course, whether the fat lady is singing yet. Clearly, 1347/1350 to possibly as high as 1363 is a window of major resistance based on the above square-outs.

Strategy: Trade back below 1340 -- the last breakout point -- that follows through to the downside with momentum will give a Boomerang sell signal.

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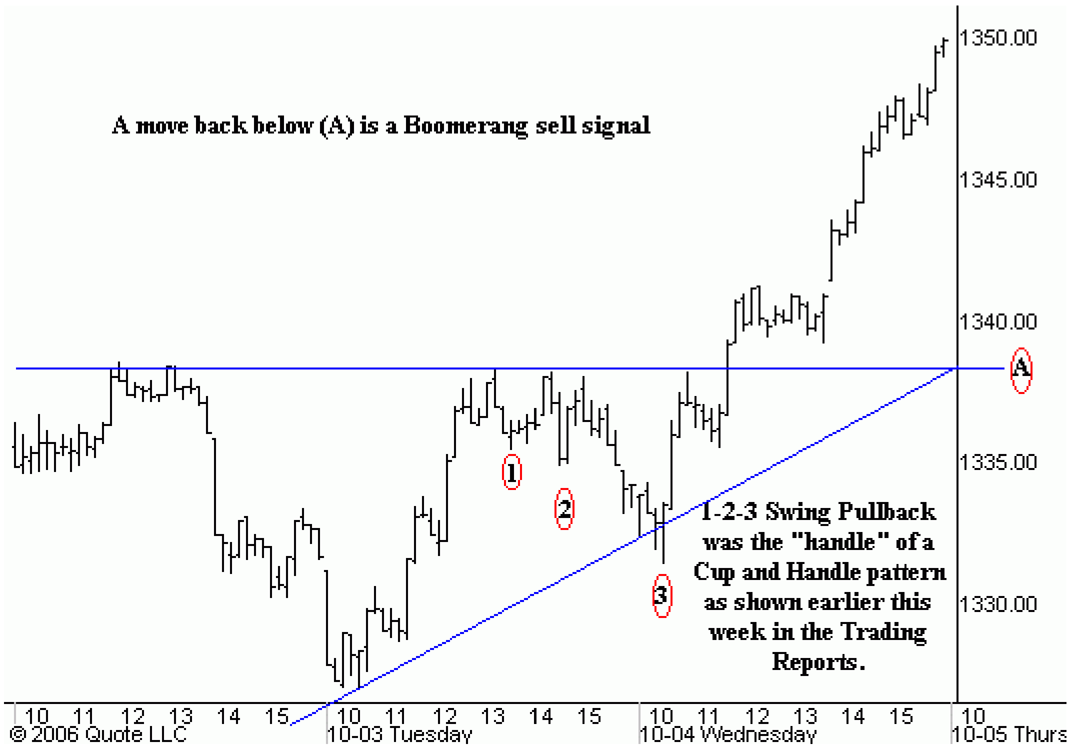
S&P 500 -- 10-Minute



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S&P 500 -- Daily

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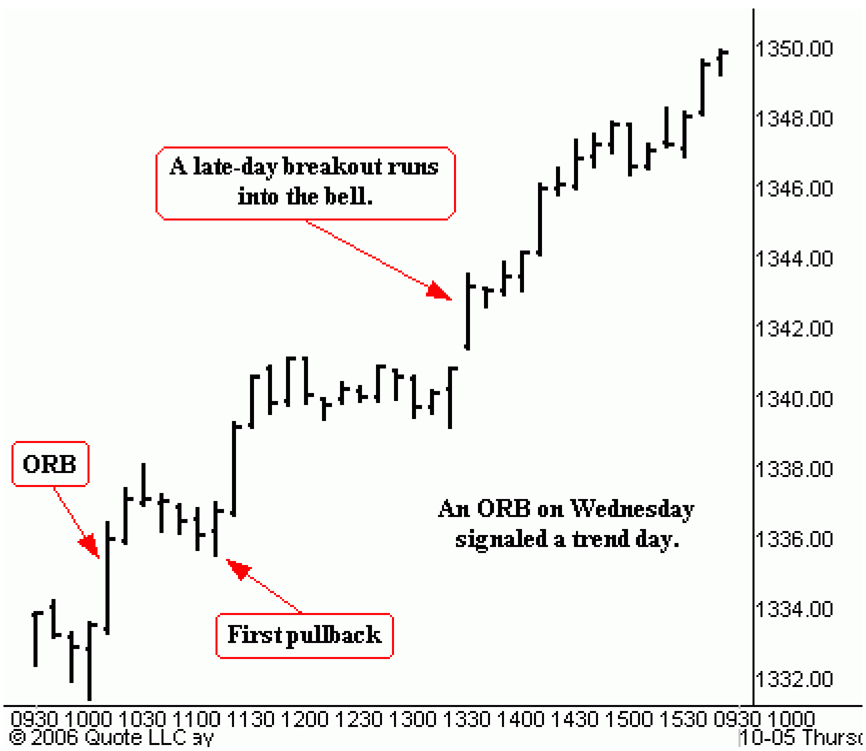
S&P 500 -- Weekly

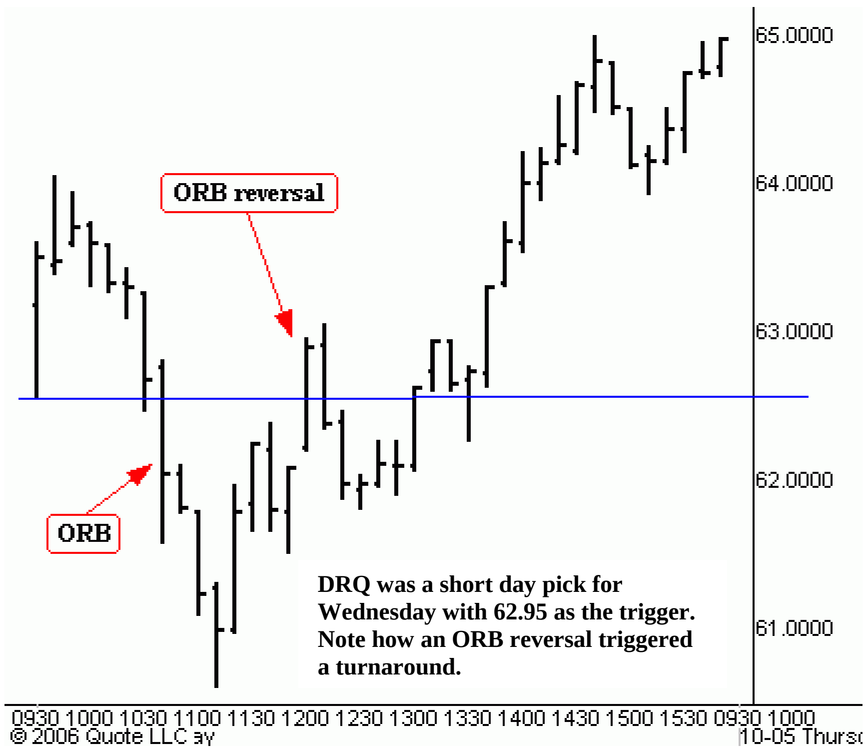
Pivot Points

S&P 500 -- 10-Minute



S&P 500 -- 60-Minute

Dril-Quip (DRQ) -- 10-Minute



THE DAYTRADING REPORT

Chart 1

Gymboree
(GYMB:Nasdaq)
Long

Entry: 44.35
Stop: 43.35
Pattern: Expansion Breakout / 180 / Reversal New High Method / LROD

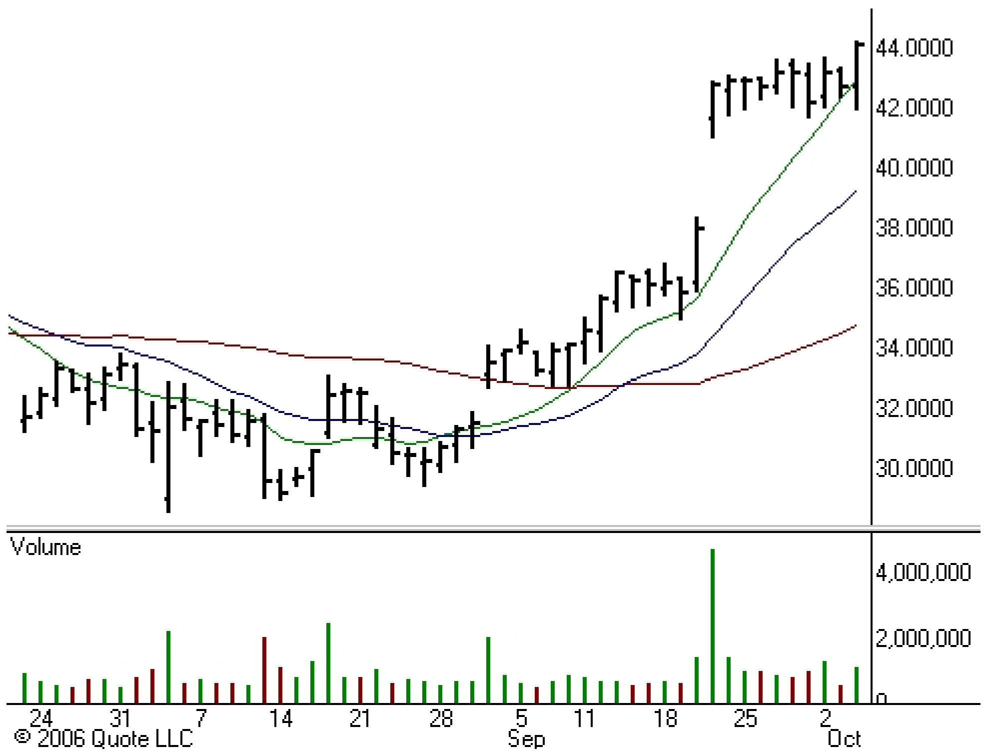


Chart 2

Fomento Economico Mexicano
(FMX:NYSE ADR)
Long

Entry: 99.50
Stop: 98.50
Pattern: V Thrust / Holy Grail

Comments: Heads up as this one is thin.

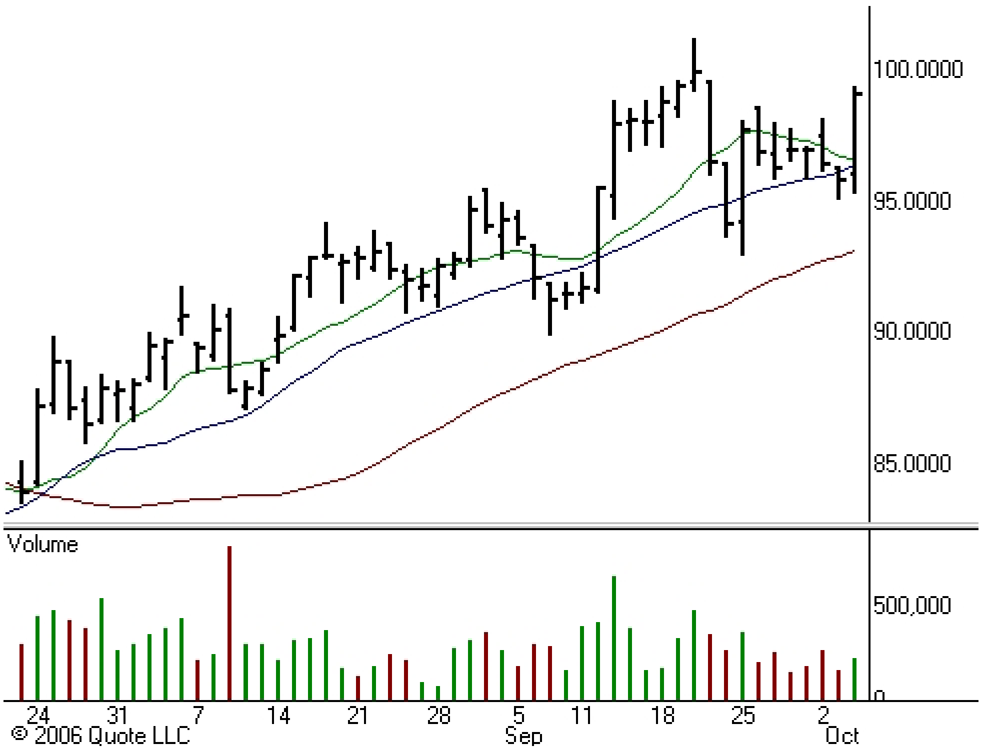
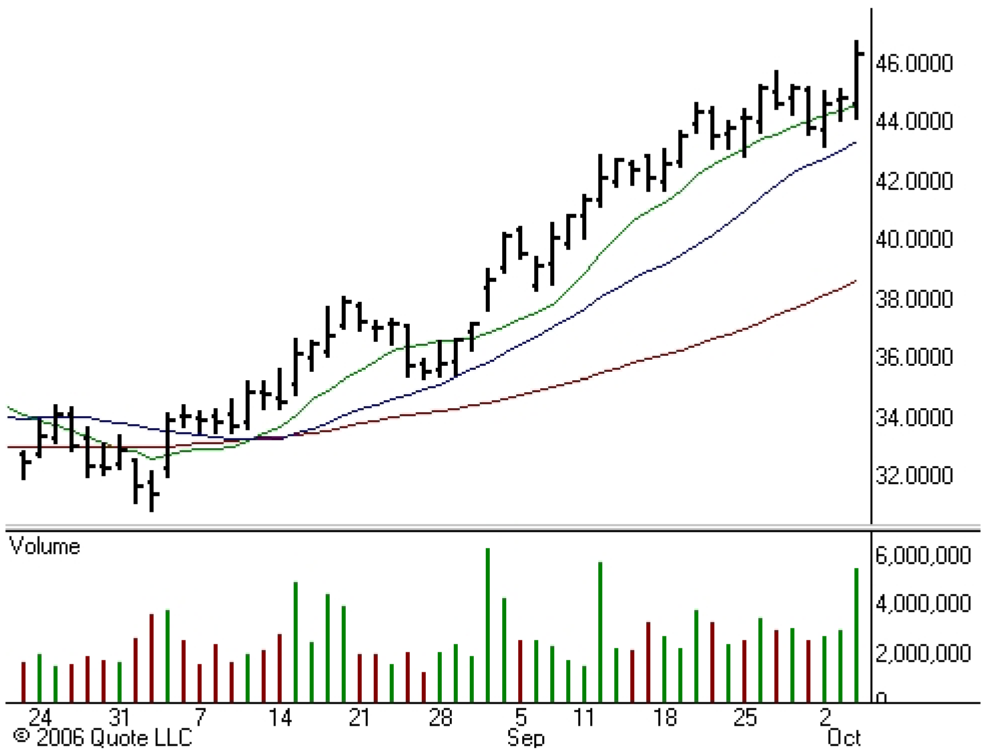


Chart 3

American Eagle Outfitters
(AEOS:Nasdaq)
Long

Entry: 46.90
Stop: 45.90
Pattern: Expansion Breakout



THE SWING REPORT

Chart 1

Devon Energy
(DVN:NYSE)
Long

Entry: **61.50**
Stop: **59.50**
Initial Target: **63.50 (trade toward)**

Pattern: LROD / *Soup Signal

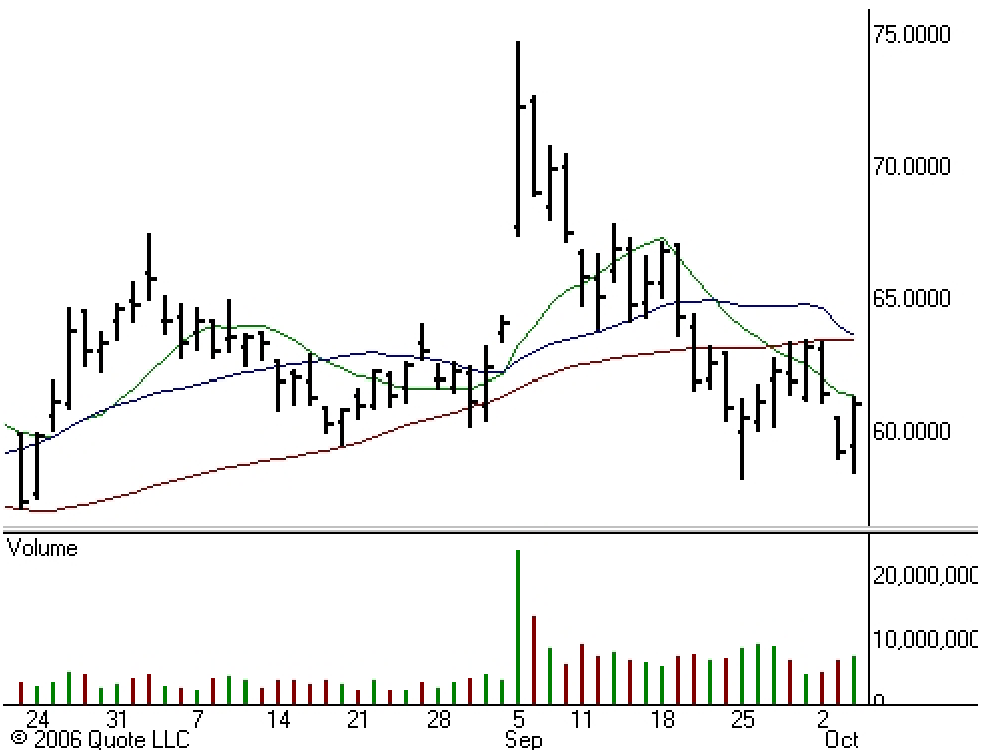


Chart 2

DivX
(DIVX:Nasdaq)
Long

Entry: **22.00 officially, but you may want to use an Opening Range Breakout (ORB) as it closed at 20.81**

Stop: **2 points from entry**
Initial Target: **2 points from entry (trade toward)**

Pattern: Cooper 1-2-3 Pullback / Hot IPO Pullback

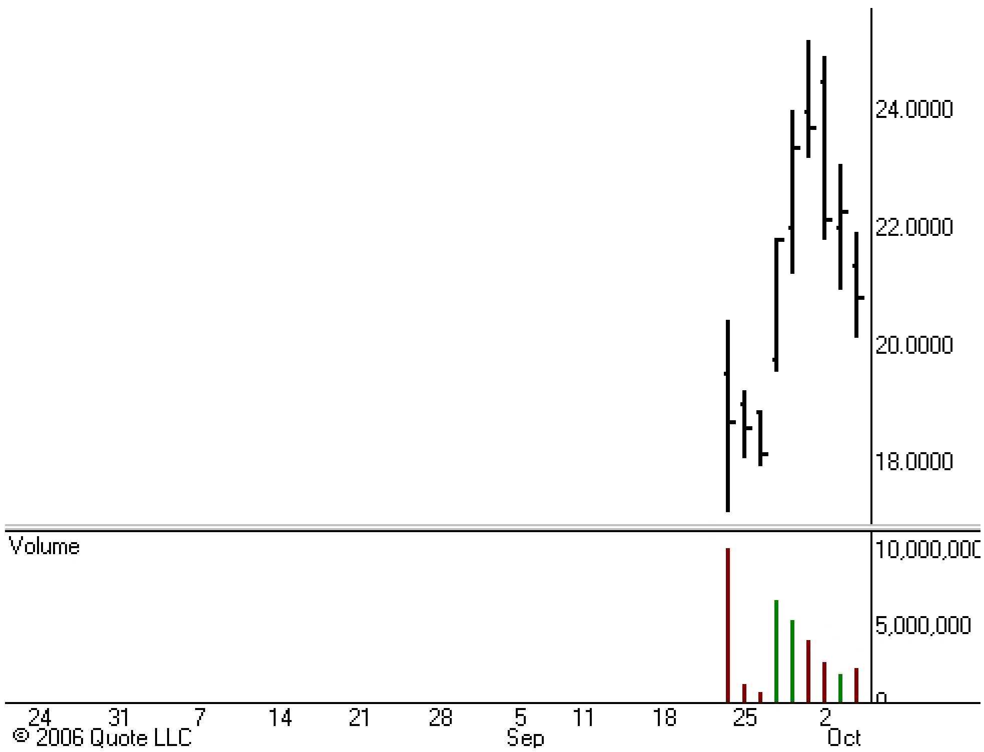


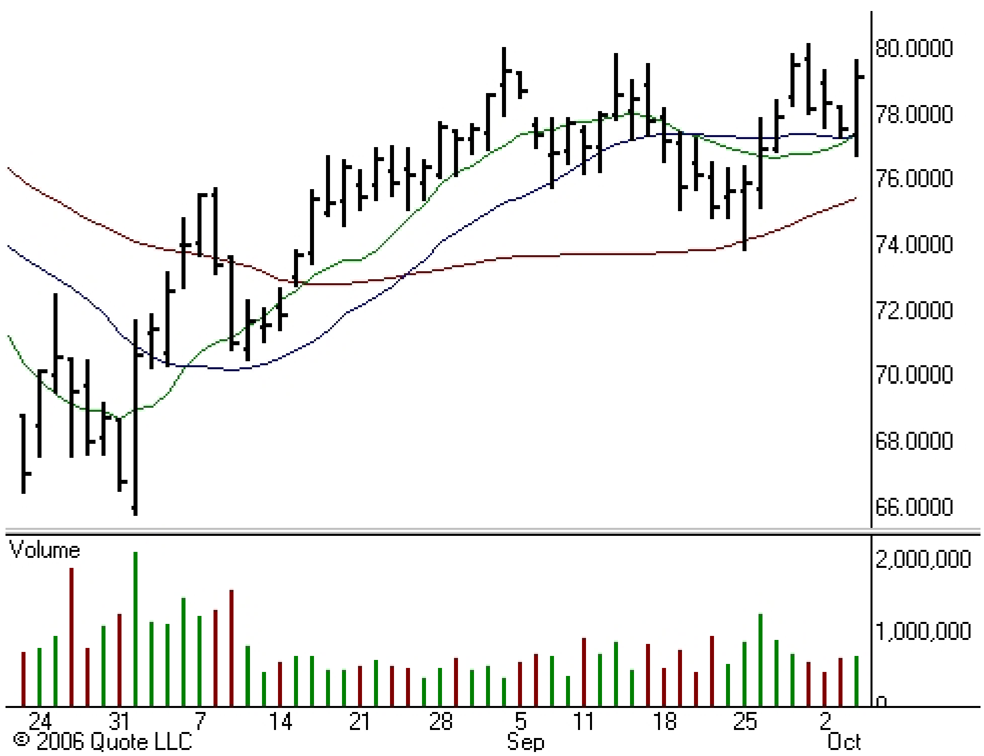
Chart 3

Vulcan Materials
(VMC:NYSE)
Long

Entry: **79.80**
Stop: **77.80**
Initial Target: **81.80 (trade toward)**

Pattern: LROD / 180 / Holy Grail / *Expansion Breakout

Comments: Although VMC has not broken above 80.00 resistance yet, I am suggesting it because I want to anticipate such a breakout. That's because such a breakout over August and early and late September tops will also trigger a Rule of 4 Breakout. Also notable is the reversal up in VMC on Wednesday from the 1-2-3 Pullback position.



OBSERVATIONS AND TRAILING STOPS

-- **Harley-Davidson** (HOG) (long) did not trigger.

-- **Armor Holdings** (AH) (long) did not trigger.

-- Thursday is day two in **Boston Properties** (BXP) (long). You are long from 104.10. Raise the stop to 103.10 and maintain the initial target on trade toward 106.10. As of Wednesday's close, you are up 25 cents.

-- Thursday is day two in **J. Crew** (JCG) (long). You are long from 29.85. Today you sold your first piece on trade toward 31.85, locking in a gain of 2.00. Raise the stop to 30.85 on the second piece and look to sell the second piece on trade toward 34.50. As of Wednesday's close, you are up 1.60 on the second piece.

-- Thursday is day four in **AutoZone** (AZO) (long). You are long from 104.10. Instructions were to sell your first piece on any open above 105.50, and AZO opened on Wednesday at 105.84. Therefore, you should have sold your first piece to lock in a gain of 1.74. Raise the adjusted stop to 107.00 on the second piece. As of Wednesday's close, you are up 3.91 on the second piece.

-- On Wednesday in **Caterpillar** (CAT) (short) it traded down near the open to 63.60, locking in a gain of 1.85. Subsequently, you should have lowered the stop on the second piece to 65.45 to break even, to which you were stopped out for a scratch on the second piece. (Note that there are some data vendors who show a discrepancy as to the low of the day. So I apologize if your data vendor does not show a low of 63.50.)

-- On Wednesday in **Overseas Shipholding Group** (OSG) (short) you were stopped out at 60.20, locking in a gain of 1.00 after covering your first piece, locking in a gain of 2.00 on Tuesday.

-- Thursday is day seven in **FactSet Research** (FDS) (long). You are long from 49.40. Raise the stop to 49.00 and lower the target on trade toward 50.90 as Thursday will be day seven in this stock. As of Wednesday's close, you are up 54 cents.

-- Thursday is day seven in **USG Group** (USG) (short). You are short from 46.65. Maintain the stop at 48.65 and the initial target on trade toward 44.65. As of Wednesday's close, you are down 21 cents.

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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