

>: Profit From the System

Wednesday, November 21, 2007 / Chris Rowe

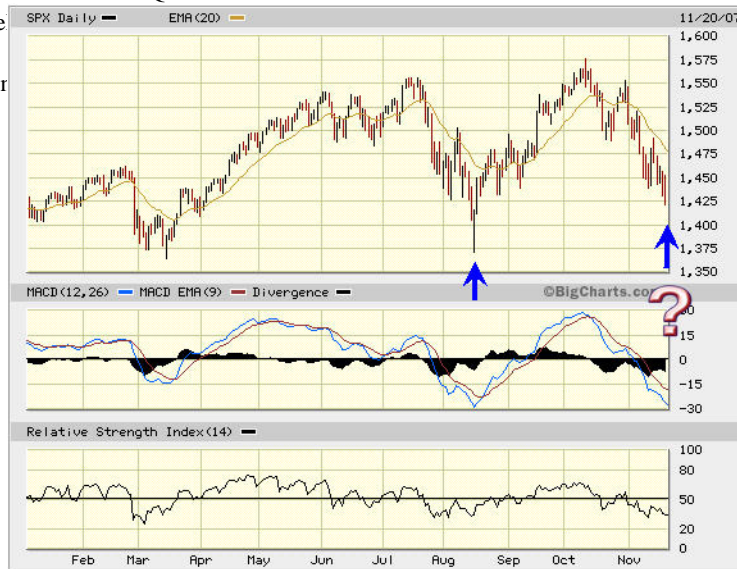
Dylan asked me if I wanted to fill in for him today since we won't be publishing tomorrow because of Thanksgiving. (Translation: Dylan has a case of writer's block today.) So I'll briefly share with you what I'm seeing in the market so you can spend this weekend feeling confident about what we're looking at.

You might recall last week's article, "[A Profitable System](#)", where I talked about my system and the importance of having a system.

(If you don't know what I'm talking about below, you might want to check out [last week's article](#) where I describe how this works.)

The NYSE Bullish Percent Index and the NASDAQ Bullish Percent Index have moved lower as the external indices (Dow, NASDAQ, NYSE, S&P 500) moved down to these low levels.

Traders are wondering if this is going



My best guess is yes, but I'm not going to try to call a bottom. My internal indicators are showing that we are, in fact, way oversold, but I will wait for the internal indicators to reverse back up before my market posture changes. We are oversold, which makes my bearish positions a little riskier, but we are still in a short-term downtrend.

In fact, when I realize that the stock market has bottomed out, it's only partially based on what the chart above is showing. I'll explain...

The internal market leads the external market, as I said last Thursday. In fact, the order that things usually move in is:

1. Sentiment
2. Internal Market
3. External Market
4. Sentiment.
5. And so on...

It starts off with "the market" moving lower, and as we get to a low point, investors become more and more bearish and less and less bullish. But the fact is that when market sentiment gets to be excessively bearish, it's a *contrary indicator*, meaning that it's actually a bullish sign. Remember, the sentiment is basically a reaction to what people see when they look at the external market.

The goal is to stay ahead of the crowd. So I make it a point to clearly identify what's happening right now. When I see sentiment is way too bearish, I'm preparing to get more bullish by putting together a shopping list of bullish positions that I will take when I get the next signal which comes from the internals.

Here's how the cycle works.

1. First the breadth of the market changes.

If we are talking about reversing higher from a low point, we would see a larger number of stocks move up again as more and more stocks are

joining that bullish party. We usually see this happen before the external market turns around and it becomes obvious to everyone else that mainly watches the external market.

2. The external market turns around.

At this point, individual investors and even professional investors are watching the S&P 500, Dow, NASDAQ, etc. to see if they break certain "resistance levels" or move above certain moving averages. What they're looking for is confirmation that the new market rally "has legs". This does make sense, and I do focus on that aspect, too. But by this time, the internal market (if it's a real rally) would have already turned around. We already saw the sentiment indicators change, and we saw the internals change, so we are already confident in the move.

(NOTE: Everyone who sees a market bounce off of a double bottom feels *much* more confident than when it made its first bounce - in August).

3. Sentiment changes. In this case, the sentiment will have already changed from excessively bearish (a bullish sign) to kind of bullish and kind of bearish. Everyone becomes more and more bullish until there is finally excessive bullishness. At this point, the cycle begins again as we take it as a warning sign to reduce bullish exposure.

Let's respect this warning as we have both profited from it and have avoided losses because of it many times in the past.

Remember, there is still strength in the longer-term internals, but flags are going up.

I don't want to act prematurely, but we must also accept that our timing is never going to be perfect. And we don't have to act prematurely. We only have to hedge, and reduce bullish exposure little by little. We don't want to fight the trend or trade against the trend overall.



The absolute recent market top was found with extremely excessive bullishness on October 11. On that same day in a weekly commentary to *The Trend Rider* members, I said:

One day prior, I sold out of a bullish position (AOB calls); the day of the high (October 11), I sold out of another bullish position (EMC calls). The next day, I recommended puts in Amgen, and I sold out of another bullish position. The following day, I sold out of another bullish position, recommended one new bullish position on a stock in a much stronger sector, and I initiated a bearish position (and this was on a Friday). And the following day I sold out of three more bullish positions.

In total, from October 10th through October 15th, I exited seven bullish positions (profitably), initiated another bullish position in a stronger sector, and initiated two bearish positions.

While I feel that this is a

reduce our bullish exposure



Therefore we have to

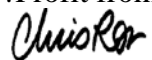
November 6th, based on my indicat

ther two a couple of days after that.

bottomed out, it's only partially based on what the chart above is showing. I'll know what the sentiment indicators are tomorrow, but I think I have a feeling of what I'll see.

Dylan tells me to send his regards, and on behalf of Dylan, "GOBBLE GOBBLE".

?Profit from the Trend?

A handwritten signature in black ink that reads "Chris Rowe". The signature is written in a cursive, slightly slanted style.

Chris Rowe

Chief Investment Officer

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