

>: Today's Dangerous Market Indicators

Thursday, March 29, 2007 / Chris Rowe

What's up, all!?

First - Back on March 8th, in my article "These Simple Market Indicators Clarify this Market," the charts weren't accessible to some of you. Well, since many of you mentioned that in your feedback, I fixed the situation. My apologies. Click the link (the title above) to see the article with charts included.

Here we go...

This week's article will be broken into four short parts:

PART 1:Rant about stupid subject lines

PART 2:Today's Dangerous Market Indicators - "Bearish Hanging Man"

PART 3:"The December Low Indicator"

PART 4:The Importance of Relative Strength Trading - Learn From My Mistake

- Rant about stupid subject lines -

When I got an e-mail with the subject line "5 takeover targets that could double overnight" from a well-known place that I won't name, I was P'd off, not only personally, but on your behalf. These guys really have no shame, and frankly, I feel that our intelligence is being insulted. Do they think we're stupid? Don't they know the impact that the internet has had on the world? Don't they realize that this is the infancy stage of the Information Age and that - wait a minute ... I guess human nature doesn't change. I honestly almost opened it myself as I knew it wasn't SPAM, but something I signed up for. Yuck!

But then I thought a bit harder. Why on earth would they make such a ballsy statement like that (excuse the term, but it fits ever so well in this case).

The answer is that it really works! Hmm. Well, if we here at Tycoon ever send you something with subject lines similar to that one, then you can assume that we have something that's *REALLY* important to read.

Jason Jovine recently wrote an article titled "[Should You Invest in Penny Stocks?](#)"

"where he talked about these Russian Mob guys who send you enticing subject lines just to get you to open and read the penny stock recommendation (scam).

(I promise, I'm not racist here; I'm over 1/4 Russian, but when you read the recommendations, they are actually spelled out in a Russian accent. Besides, I've researched the issue, and it's a proven fact that that's where it mainly comes from.)

So what's the point? The point is that I'd like to think that the "reputable" newsletter guys out there who are actually recommending real stocks wouldn't have to operate under the same ethical standards as people conning suckers into penny stocks.

What's this world coming to? Okay, the rant is done. Let me make it up to you with something of value ...

- "The December Low Indicator" -

You've got to get yourself a copy of *The Stock Trader's Almanac* if you don't have one. (Did you think I did all of this research myself? LOL!)

They point out that The December Low indicator which was originated by Lucien Hooper (a Forbes columnist and Wall St analyst in the 70s) has, since 1952, been 92.8% accurate in forecasting a further stock market decline when the Dow closes below its December closing low in the first quarter (as it has this year). In other words, the lowest close in December is broken in the following (first) quarter.

Since 1952, this occurred 28 times. Out of those 28 instances, the market continued to decline 26 times (on average by 10.12%). In 2006 and 1996, the Dow bounced off the low, and in 1996, the market advanced 28%.

Below is a chart of the Dow from November 2006 through March 28th (at noon.) As you can see, the lowest close was December 1, 2006 when we closed at 12,194. In this re



confusion: Since we're talking seasonality, we should also think about the fact that in the four-year election cycle, the pre-election year (which we are obviously in) is the strongest performer. (Election year is typically strong, too, by the way.) But, although the December low indicator has a higher rate of accuracy in about the same time frame, we have to respect both seasonal indicators.

Besides, even though the market declined further 26 out of 28 times with an average decline of 10.12%, the fact of the matter is that in about half of those 28 instances, the market closed higher for the year. So both seasonal indicators may very well be right on. But we have to compare this to other indicators that we use (and I use several). Let's use the chart patterns as an indicator to confirm the seasonal indicator:

- Today's Dangerous Market Indicators - "Bearish Hanging Man" -

In my article titled "[Picking The Bottom](#)

", I talk about the importance of using several different indicators in conjunction with one another, and using one indicator to confirm the signal of another. This increases your odds of success tremendously, and one of the most common mistakes that novice traders make is placing too large a bet on just one indicator.

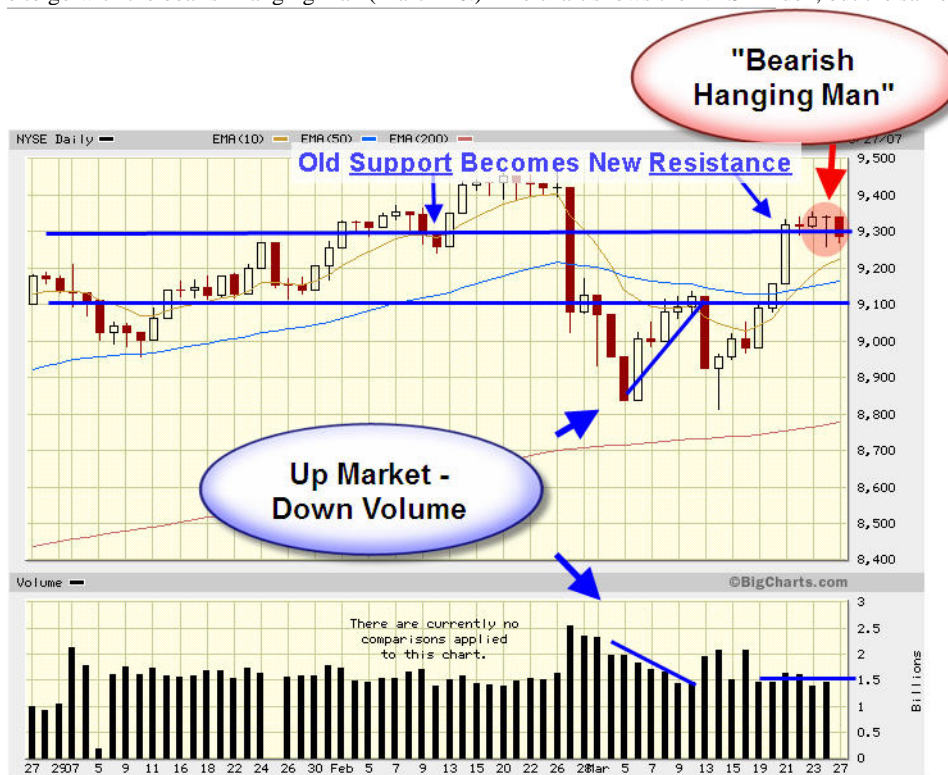
Not only is it important to use different indicators, but it's important to use indicators that don't relate to each other (*unlike using an advance decline line to confirm what the new highs/new lows indicator is telling you*).

So today I'll give you a *chart pattern* as well as a *seasonal indicator* to focus on and add to your arsenal.

"The Bearish Hanging Man"

I like to use "candlestick charts", and after looking at the chart below, I hope that you don't have to ask where they got their name from.

Below, I've highlighted the "bearish hanging man" (shaped like a cross) in red, which happens after a rally (or at the top of the recent chart pattern) like the one that we have recently seen and is a sign that the bulls might be getting tired of buying. You might even notice that there was exceptionally low volume to go with the bearish hanging man (March 26.) The chart shows the NYSE index, but the same pattern occurred on all major indices.



Since I'm showing you this simple chart pattern, I should mention one important thing. A "bearish hanging man" looks almost identical to a *bullish hammer* pattern, which, as opposed to the hanging man, is a *bullish* pattern. The preceding price action is what makes the difference. If you see that same cross shape after a sell-off, then it's a bullish hammer and you should add points to the bullish side of the indication card.

Obviously, the market is down as I write this (Wednesday), and Tuesday's selling was broad-based where nearly every sector participated in the downside move.

So for the short-term, based on everything that's happening today, the short-term stance is bearish. But when I trade, I play both sides of the market

with a slant towards the short-term stance (currently bearish).

This brings me to my next part, which is one solution.

- "The Importance of Relative Strength Trading - Learn From My Mistake -

The way that I personally like to trade is by focusing on sectors specifically instead of putting too much of an emphasis on timing the broad market. I take bullish positions in the sectors that are outperforming the market and outperforming other sectors, and I take bearish positions in the weak sectors.

While I personally like to take the next step and drill down to the strongest or weakest stocks within those respective sectors, the easiest way of staying in the strong sectors is by focusing on ETFs (Exchange Traded Funds).

There are plenty of different places out there to find sectors' relative strength ratings. Otherwise, you can compare the performance of different ETFs with each other or with the market using comparative charts. But the fact of the matter is that it's very easy to see when a sector is outperforming the market by watching a group of the heavier volume stocks, within that particular sector, when the market swings in either direction.

When one or several major funds get bullish or bearish on a particular sector, they initiate "buy programs" or "sell programs" where they put out orders to buy or sell several million shares of a group of stocks within that particular sector. These buy or sell programs can take weeks or even several months.

So what's key here is to understand that while relative strength may be a lagging indicator, when sectors start to move, the move can continue for a very long time as the institutions are rotating (huge positions) out of one sector and into another. Therefore, you want to be bullish on strong sectors that have recently started to show relative strength, and *not so much* on the sectors that *have been showing strength for a long time*, and may be overbought.

My recent mistake, when the market got slammed in February, was acting on emotion in one case in particular. What happened was this:

I saw the market drop 200 points in 60 seconds. I knew that it was time to lighten up on the bull side and pull out my shopping list of bearish trades that I had been working on. Everything was going fine except for one small part of my next move. When I went to lighten up the portfolio on the bull side, I sold out long call positions in two energy stocks.

Now, energy stocks had already gotten killed. They were way down, and many were building bases. Furthermore, when the market sold off, the energy stocks barely budged. I then watched the positions that I sold out of trade much higher as the market continued to weaken. Big mistake. Since I always have both bullish and bearish positions at any given time, the bullish positions that I should have held were the strong energy stocks' call options.

What's important when you make a mistake like that is not to dwell on it, but to recognize it, learn from it, and move forward.

That's all, folks. Rate my article if you have any energy left, and if not, I'll assume you absolutely loved it.

?Profit from the Trend?



Chris Rowe

Chief Investment Officer

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