

## The Big Picture

This weekend, we're going to try and gather clues as to whether the hitherto popular assumption about the (bearish) classification of the secular trend is valid or, at best, constricting. (There are significant reasons for which a technician might wish to relax such an assumption, which we'll discuss briefly in the course of this write-up).

We'll start with the weekly chart of the **Nasdaq Composite**, upon which we've provided a timeline depicting significant changes in trend that have been witnessed since the secular peak that formed in the year 2000.



Having moved above 2500 recently, the Nasdaq is now worth approximately 50% of its value at the highs in 2000. In the 24 months that followed that secular peak, the Nasdaq fell at a pace that was as neck breaking as its rise in a similar period preceding the all-time peak. 80% of the index' value had eroded by the end of the '00-02 run.

Every attempt at a rally in the years 2000 and 2001 was sold into and it was not until mid-2003 that the index was able to make a higher high on any level of trend above the minor trend. It took a further 6 months for the index to make a higher high on the major trend. That occurred in Jan 2004, when the index managed to surpass the level of its early-'02 reaction highs.

That occurrence was the first hint of a reversal on the cyclical (major) trend. For a short period it had looked as though the breakout was a false move. In hindsight, we see that the index was actually only consolidating at those

levels. For the large part, this consolidation on the major trend lasted for all but 3 years (the mid-'06 lows formed at around the same level as the '04 highs).

The rest of the market did not join the Nasdaq indices – the Nasdaq-100 experienced similar action to the Nasdaq Composite – in the doldrums (relatively speaking) over that three-year period. During that period, most major indices not only regained most of the losses from the secular bear but, in many cases, went on to make new all-time highs.

**Doesn't a new all-time high mean that the secular bear market is over?** This is a question that often gets asked. The answer to that question, according to many technicians, is "maybe".

The reason the answer is not a resounding (and almost redundant) "Yes!" is due to the fact that secular bear markets can often be long, drawn-out affairs wherein higher highs might be made before the lows are revisited again until the cycle is broken. Take a look at the chart of the Dow Jones Industrial Average between the years 1960 and 1980, located at the following link, to see what we are talking about:

<http://stockcharts.com/charts/historical/djia19601980.html>

Some might have considered the 1973-breakout, which followed a recovery from a 35% cyclical bear market, as the birth of a new secular bull. Those folks who bought that idea probably were surprised to find that the index had lost close to 50% of its value two years later.

Another stellar cyclical bull followed the 1975-lows; nearly all of the losses from the preceding cyclical bear were regained in two years... Only for the index to come crashing down once again in '77/78.

It wasn't until 1983/'84 that the secular bear was finally over. Of course, this fact wasn't for certain until perhaps a couple of years later, when weary investors realized that every attempt at a sell-off was greeted with buying pressure, rather than vice versa.

**So, which stage of the cycle are we in now?** Well, that is an excellent question. We'll see what the charts might be saying in that respect, in a second.

**Why is it important to know the classification of the trend?** That is an even better question. In a nutshell, many technical indicators and trading signals need to be interpreted slightly differently given differing trending conditions.

For example, a potential negative divergence on a daily chart might only be pointing to the need for a brief consolidation during a strongly bullish major trend, while such a development would be a sell signal during a sideways or bearish major trend.

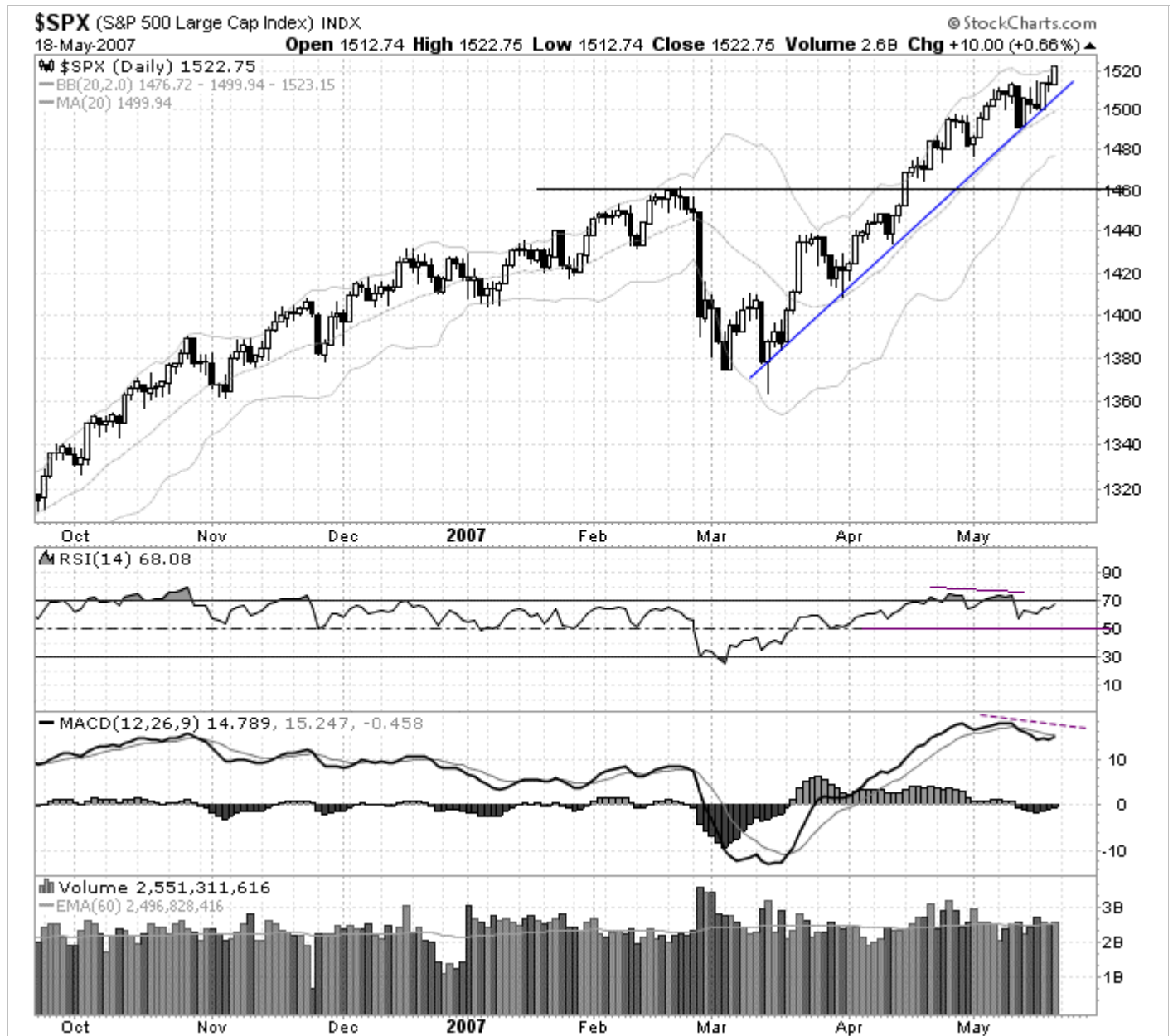
As a result, accurate classification of trend plays more than a perfunctory role in market analysis.

Moving on...

We'll start with the daily charts of several major indices, which we've sparsely annotated, before we get to the weekly charts wherein we believe the true story lays.

The negative divergence on RSI that showed up on the **daily chart of the S&P-500** a couple of weeks ago still persists. However, it has not been able to do any serious damage so far. With the index' having bounced off its 20-dMA last week and pushing the upper Bollinger Band late this week, it should only be a matter of time before the negative divergence fails.

For its part MACD is now threatening a negative divergence. However, even if that signal confirms, other developments will have to take place if anything other than a minor reaction move is to be expected. A breaking of the old major resistance level at 1460 is not the least of these.



We'll breeze through the next few charts starting with that of the **Dow Jones Industrials**. This chart continues to lead the pack, making new highs virtually every day and, thereby, providing the media bandwagon an almost endless stream of headlines.

The index continues to be severely overbought on the daily chart; a small correction (maybe of a few hundred points) would not hurt the index and might provide an opportunity for a healthful cooling-off before resumption in the breathtaking move.



The **Nasdaq-100** continues to trade in a minor uptrend, although there has been a lot of churning at the highs over the past 3 or 4 weeks. This process had left a negative divergence on RSI last week but the lack of selling pressure has meant that the centerline of that indicator was not violated and, therefore, the NDX stands in good stead to breakout above minor resistance at 1910 in the near future.



It will take a breaking of potential support from the old resistance level, at 1850, before the bulls stand up to take notice.

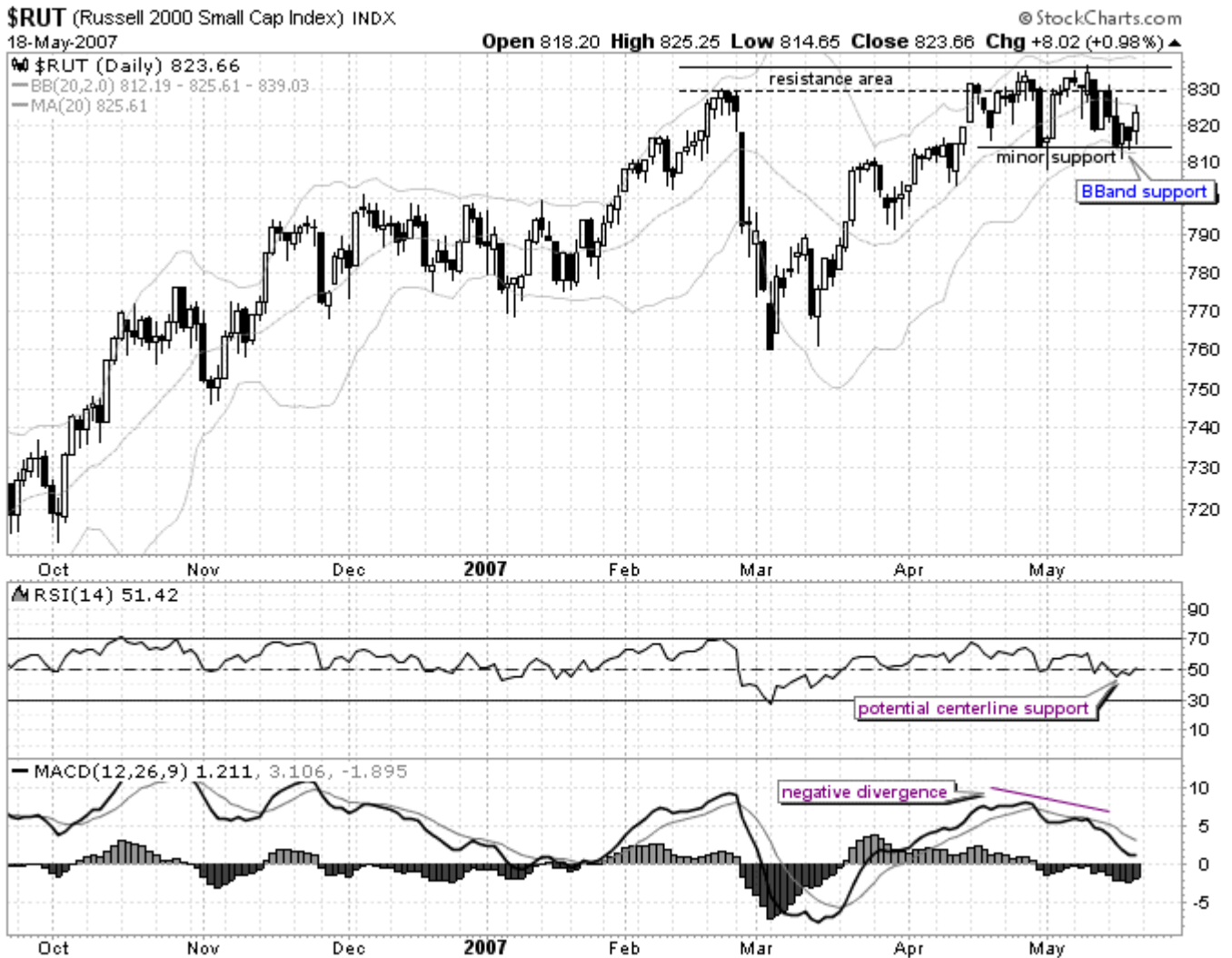
The next two charts are those of the two indices upon the shoulders of which we'd placed the burden of the short-term trend, in our nightly commentary pieces of the past week.

The **Nasdaq Composite** was on the verge of breaking the all-important support level of 2525, as well as the RSI centerline, on Tuesday. Early on Wednesday, it looked like the index had managed to achieve that task. It wasn't to last, however, as the bulls came to the rescue before day's end and the sanctity of the resistance-turned-support level was maintained.



As long as price can continue to stay above 2525, this index might have the ability to start catching-up with its better performing peers...

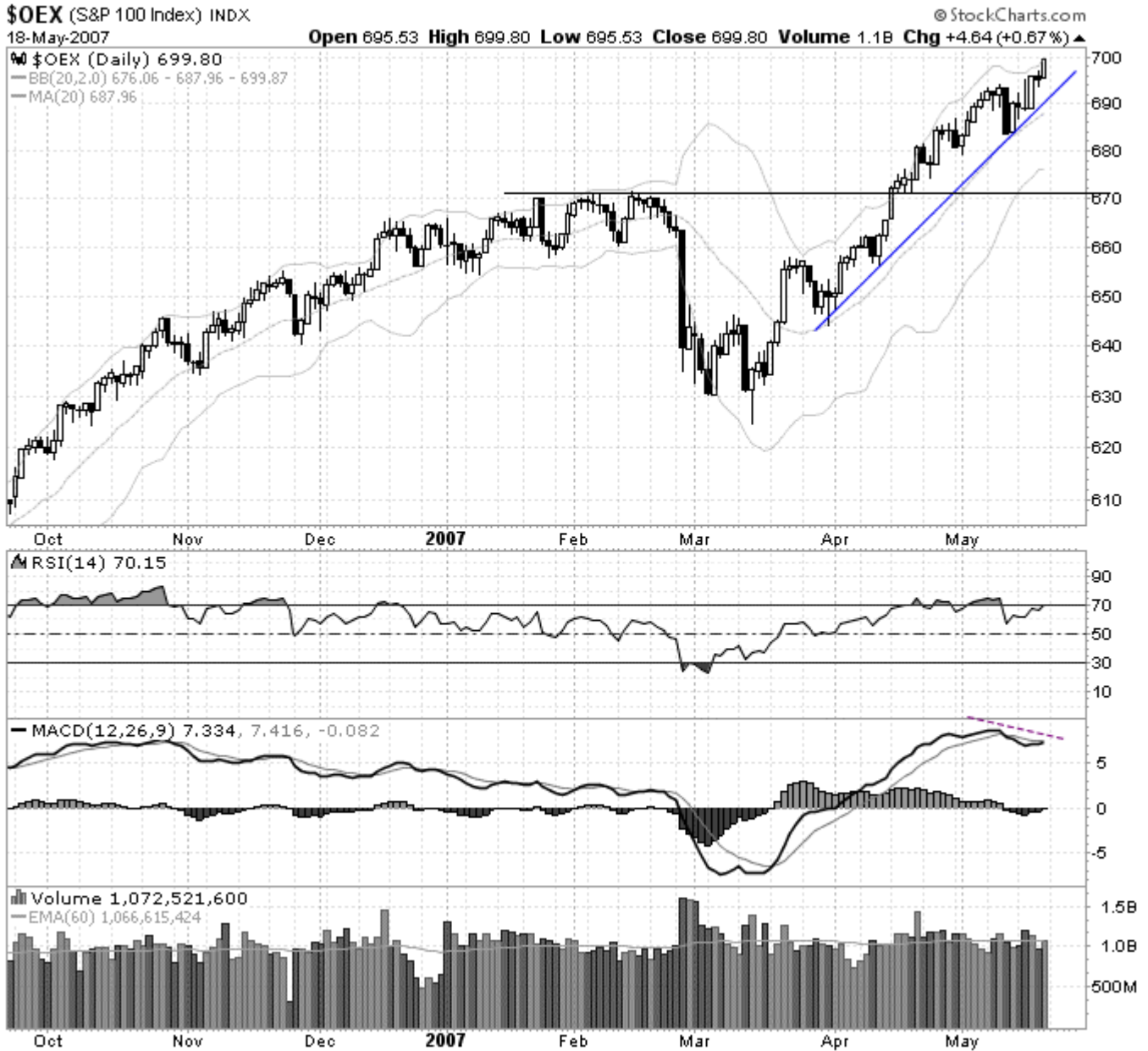
The **Russell 2000**, which has had a far better time of things over the past 4-5 years, was the other index that we'd been watching closely over the past couple of weeks.



The RUT penetrated its RSI centerline on Tuesday and moved sideways before taking that indicator back above the centerline by the end of the week. In the end, minor support has held and the Bollinger Bands, which were expanding as of the middle of the week, are now flat and will provide another layer of support to prices.

Can the bulls grab a hold of this index and push it to new all-time highs?

The last daily chart that we'll look at this weekend is that of the **S&P-100 Large Cap Index**. This index continues to trade in a bullish minor trend. MACD is showing a potential negative divergence but one probably shouldn't get too bearish until potential support at 670 gives way.



Now we'll move on to weekly charts covering action seen over the past decade on a number of the major US stock indices. In the process we'll also try and discern potential targets for the present long-term bullish move...

A few months ago, we'd highlighted a potential inverted H&S pattern on the **weekly chart of the S&P-500**. The following chart shows that pattern and potential targets drawn from it. The lower of these targets (1561) is just over 2% above current levels and basically at the level of the all-time highs (to-date) seen on this index.



Considering that the first target for the pattern has virtually been met, it might be worth considering how far the index might actually overshoot that target and if, perhaps, it may reach the higher target (of 1770), which has been calculated based upon a projection of the percentage gained (between the lows and the neckline of the pattern) from the level of the breakout.

At this point, a little bit of Elliott Wave theory might be in order... EWT states that "Wave 3s" are typically the strongest of all waves. If the climb from the 2002-lows is in fact part of an "impulse wave", then we might actually currently be in wave 3 of a cyclical (at least) bull move.

Leaving EWT aside, there are a number of other signs pointing to potential further upside or, at least, the lack of stimulus for a bearish reversal. These include the ominous fact that neither RSI nor MACD has gotten overbought as yet. Just take a look at how far the SPX traversed even after encroaching upon the highlighted area in the late-90s.

The **weekly chart of the Dow** shows that despite having gone bananas for months now, the index has only just moved into overbought territory as per RSI. For a point of reference, take a look at what the index did upon several successive visits to overbought territory in the late-90s.



Momentum indicators aside, the inverted head and shoulders pattern and the apparent bull rectangle pattern provide targets of 14200+ and 16000+, respectively.

Giving the recent increase in slope (see dashed lines), who is to say that those targets will not be attained over the coming year or so? Now, please note that we're not calling for any such thing, just pointing out the potentialities of a market in idiot mode. It is our job to listen to the markets through the charts and act according to what we believe it is saying.

Moving on...

The potential Elliott Wave Theory count mentioned earlier – wave 3 of 3 – “looks” even more compelling on this **weekly chart of the Nasdaq-100**. The dashed lines represent the potential waves 1, 2 and 3.



EWT aside, there are a number of potentially significant bullish signs. The breaking of cyclical resistance, which is possibly the rim line of a large Cup w/ Handle pattern, in late-'06, followed by a retesting of that level during the March declines, is a significant development. MACD and RSI each has lots of room to the upside and CMF is now at its highest level since the 2000-peak.

The **Russell 2000 weekly chart** provides ample proof that Small Caps stocks have had a great run over the past 4½ years. The index has barely stopped to take a breather since its 2002/'03 lows.



Significant support lies at 775 and at 675. It would take a breaking of the latter support level to cause any threat to any level of trend above the intermediate.

Not every index has performed as well as the SPX or the INDU. We look at that as an opportunity, rather than as a problem. After all, it is the relatively cheap laggards that will be bought into during the latter stage of an epic move, not the fattened leaders of the first half.

The **S&P-100** is one such index. Although it has started to pick up momentum over the last year or so, the OEX is still 15-20% off its all-time highs. However, there is a potential inverted head & shoulders pattern that targets a move at least half way to those levels, if not beyond.



Our aim in having presented these charts today has been to not only provide a picture of what the markets have done over the past few years but also to try and remind ourselves, as well as you, the reader, that regardless of how far a market may have progressed and how ridiculously highly-priced stocks may seem relative to years gone by, there can be much more upside.

Additionally, the article should serve as a reminder that indicators and other technical tools are not sacrosanct. They need to be implemented and interpreted in a manner befitting current market action.

The markets are currently bullish – on every level of trend – and until proven otherwise, the wise trader has to go with the trend, while taking safeguards in the event of an unforeseen reversal.

That brings us to the end of this week's issue of *Purely Technical*. We hope that you've enjoyed reading it and that it is a useful addition to your usual methods of research. Please feel free to provide us with comments and suggestions that may help us to better cater to your needs. We look forward to hearing from you!

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Have a great trading week!

Regards,

Asher Pinto

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