

The Big Picture - Stocks

Wow, what a week that was!

The choppy action that has characterized the markets over the past few weeks continued. Prices started to decline almost from the word go on Monday and the point-by-point trickle did not stop until early Friday, when the bulls stepped in and, in the case of most indices, caused a retracement of 38%-50% of the week's losses.

At the end of the week, neither camp can really stake claim to being the victor.

The only sure thing that can be gathered from the action over the past few days is that volatility is seemingly here to stay, which is a good sign for traders, not to mention that it means that it provides us with an excellent phase during which to launch our new website.

[More information on the launch of the all-new TheMarketMessenger.com will be provided in an upcoming mailer to existing subscribers of *Purely Technical*. Stay tuned for that].

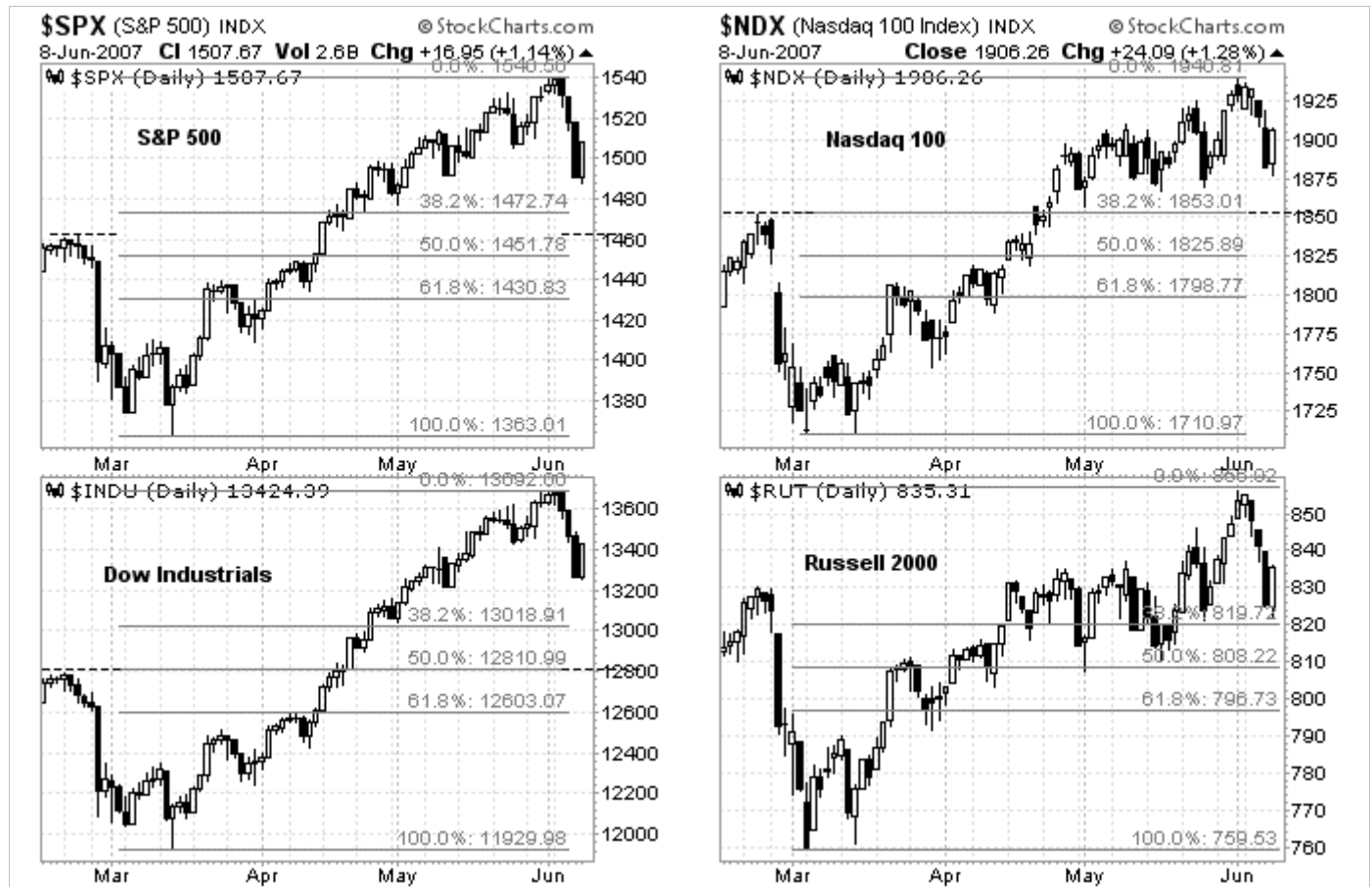
Rally Retracement

Before we get into the individual charts, let's take a quick look at how much of the Mar-May rally had been retraced on SPX, NDX, INDU and RUT as of the lows on Friday morning.

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Inside This Issue:

- The Big Picture - Stocks
 page 1
- The Big Picture - Commodities
 page 11



Those charts show us that of the four indices mentioned above only the RUT was able to get even close to the 38% Fibonacci retracement level of the rally before bouncing.

Now whether this was a dead cat bounce or, indeed, the end of the correction of the rally is yet to be seen. Let's take a look at the charts of a handful of the major indices to find out potential signs of confirmation either way and also to lay a road map to our trading plan over the coming weeks.

We start with **the daily chart of the S&P-500**.

This index actually put in its highest daily closing level – ever – on Monday, before starting to sell-off. By mid-day on Wednesday, the minor bull channel that had guided prices higher for 3 months finally gave way.

At the close of the day, price was sitting on the 20-day Moving Average, which had supported the rally on 4-6 previous occasions. So at that point things didn't look too bad.

All that changed on Thursday, when the markets experienced one of the most controlled days of selling witnessed over the past few months. By the end of that day, the SPX was actually sitting at its lower Bollinger Band. Yes, it went straight from its 20-dMA to its lower Bollinger Band in one day flat. Needless to say, there were some nervous traders that evening.



By this point, the centerline on RSI had failed and the negative divergence on MACD, which was threatening to be obliterated last week, was back in the picture and potentially calling for further declines over the coming weeks.

On Friday, calmer heads prevailed and the markets rallied virtually from the word go.

In the end, lots of bearish signs still exist and they are as follows:

- 1) Negative centerline crossover on RSI: The bulls will want to push this indicator back above its centerline immediately; the bears will want a move towards the 30-line.
- 2) Negative divergence on MACD: With the indicator still a reasonable distance away from its 0-line, not to mention oversold territory, there is lots of room for a resumption in the selling.
- 3) Secular resistance in between 1525 and 1553: We would have been perhaps a little over-eager, if not foolish, had we assumed that there would not be a bit of a fight at this very significant mark.
- 4) Previous major resistance at 1460: Prices often like to retest significant breakout levels. This one has not been tested as yet and may act as a magnet to short-term action. (We'd look at any such move as a likely buying opportunity)

Having laid out those factors that favor the bears, we have to state that it would simply take another up day like Friday's to throw many of those potentialities out the window.

We can't see the future, but what we can do is plan for it. We'll discuss such plans shortly; first, let's take a look at **the weekly chart of the S&P-500...**



The weekly is showing a bearish engulfing candlestick, which is another checkmark for the bear case. However, the upper line of the broken major bull channel has supported prices this week. The index needs to be able to move below that line once again, in order for any bearish scenario to play out.

Until and unless that can happen one has to assume that the bull move will continue...

At this stage it might be apt to mention **our trading plan for the next couple of weeks...**

In the event that the market finds a bottom and the momentum indicators go/stay in positive territory, it's a no-brainer; our plan will be to have more long stock picks than short and more bullish options picks than bearish ones.

If the volatility continues and there is no clear trend over the short-run, we'll continue to ride our existing picks with trailing stops and will hold off initiating too many new positions. For those of you who have been following our nightly commentary, you know that we've taken such a posture as of early in the past week.

In the event that the market continues to descend and moves below Friday's lows, towards the major resistance levels that were broken a couple of months ago, we'd probably add a few short picks along the way but would not get too aggressive on the short side. Our ultimate plan would be to aggressively add long positions as soon as the market reaches the previously mentioned old resistance levels and show any sign of a "washout".

Now, this doesn't mean that we'll blindly buy any stock out there, of course. Rather, we'd use our usual methods of analysis to eke out the best trading opportunities on the long side and add them to the trading picks lists.

Another manner in which we would look to profit from any such scenario (a decline to 1460) is by purchasing at-the-money Calls (at that point). This would allow us to lock-in a maximum loss and leverage a potential rebound. It is easily possible that such a rebound would retrace 50% of the decline up to that point – say, to ~1500 on the SPX – within 2-4 weeks.

The following is a quick look at a potential Long Calls play on SPX options, given the scenario just envisioned. Shortly, we'll look at a similar example using Nasdaq-100 Calls.

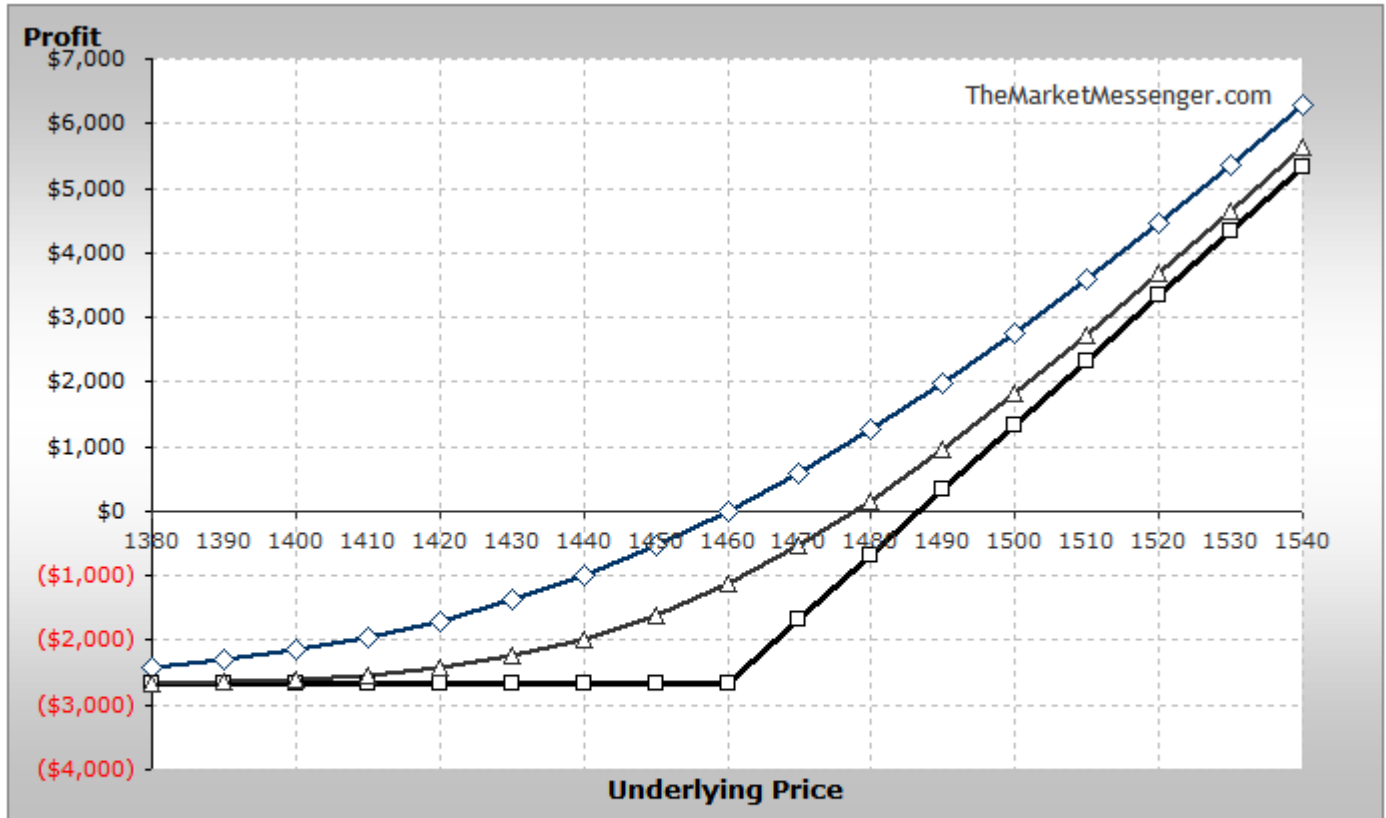
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A potential options play, given a resumption of the sell-off, using **Long Calls on the S&P-500**...

If the SPX reaches support at 1460 very early next week, the at-the-money July 1460 Calls should be trading at around \$27.50. If that level is reached closer to the end of the week, those Calls should be trading at around \$25.90.

The following is a P/L diagram depicting a hypothetical purchase of said Calls assuming that the mentioned support level is hit on Wednesday. If current levels of implied volatility (equivalent to 12.22%) persist, the Calls should be trading at \$26.70 at that point. The three lines depict the following:

- a) Hypothetical P/L as of Wednesday, Jun 13, assuming an implied volatility level of 12.22%
- b) Hypothetical P/L as of Jul 6 – two weeks before expiration – assuming the same volatility level as above
- c) P/L as of expiration, Jul 20, assuming a price of \$26.70.



Option Legs	# Shrs/ Contracts	Expiration Month	Strike Price	Premium (Price)		Max Profit	Max Loss
Long Call	1	Jul	1460	26.70	Contract Expiry	20-Jul	Unlimited / \$2,670
					Debut	13-Jun	
					Original IV	12.22%	Unlimited / \$2,670
					Projected Exit 2	6-Jul	Unlimited / \$2,670
Net Debit/(Credit)				26.70			

The diagram shows us that given the scenario wherein the SPX falls to 1460, at which point Calls are purchased, and thereafter the market retraces 50% of the declines within a couple of weeks (all before expiration of the options), a 50%-100% gain is expected to arise.

On to the charts of the Nasdaq-100 and a couple of other leading stock market indices...

Starting with the **daily chart of the Nasdaq-100...**

The NDX broke the minor uptrend line on Thursday and, at that point, was just a few points away from minor support that has been tested several times over the past month or so; it was also just a percentage point or two away from previous major resistance.

Given any continuation in the sell-off, that is the level at which we'd look to pick up some calls. More on that later...



By the close on Friday, the index had made a sharp turnaround and was retesting the broken uptrend line. The key to the future of this market rests on whether prices can move back above the line and prove Thursday's breaking was a fake-out.

If the broken trendline proves resistance, it should come as no surprise if price moves downwards quickly towards the all-important level of 1850.

So far the RSI centerline has proven support; will this continue? Also, MACD is once again showing a potential negative divergence and is still a distance away from its own centerline. Translation: There is enough room for the index to decline, if the bears can kick it up a notch.

Now, a look at **the weekly chart of the Nasdaq-100...**

As has been the case over the past 6-7 weeks, the NDX closed above the upper line of an old major channel, having slid below it during the week.

That aside, the big takeaway from this chart is the trend in Bollinger Band Width. The Bollinger Bands moved farther apart this week and as long as that continues, one needs to expect a continuation in high volatility and perhaps a sharp move (direction as yet unknown) over the coming weeks and months.



Our longer-term bias on this index is bullish and will continue to be so until the index makes a convincing move below 1850 and/or breaks the rising intermediate trendline shown on chart above.

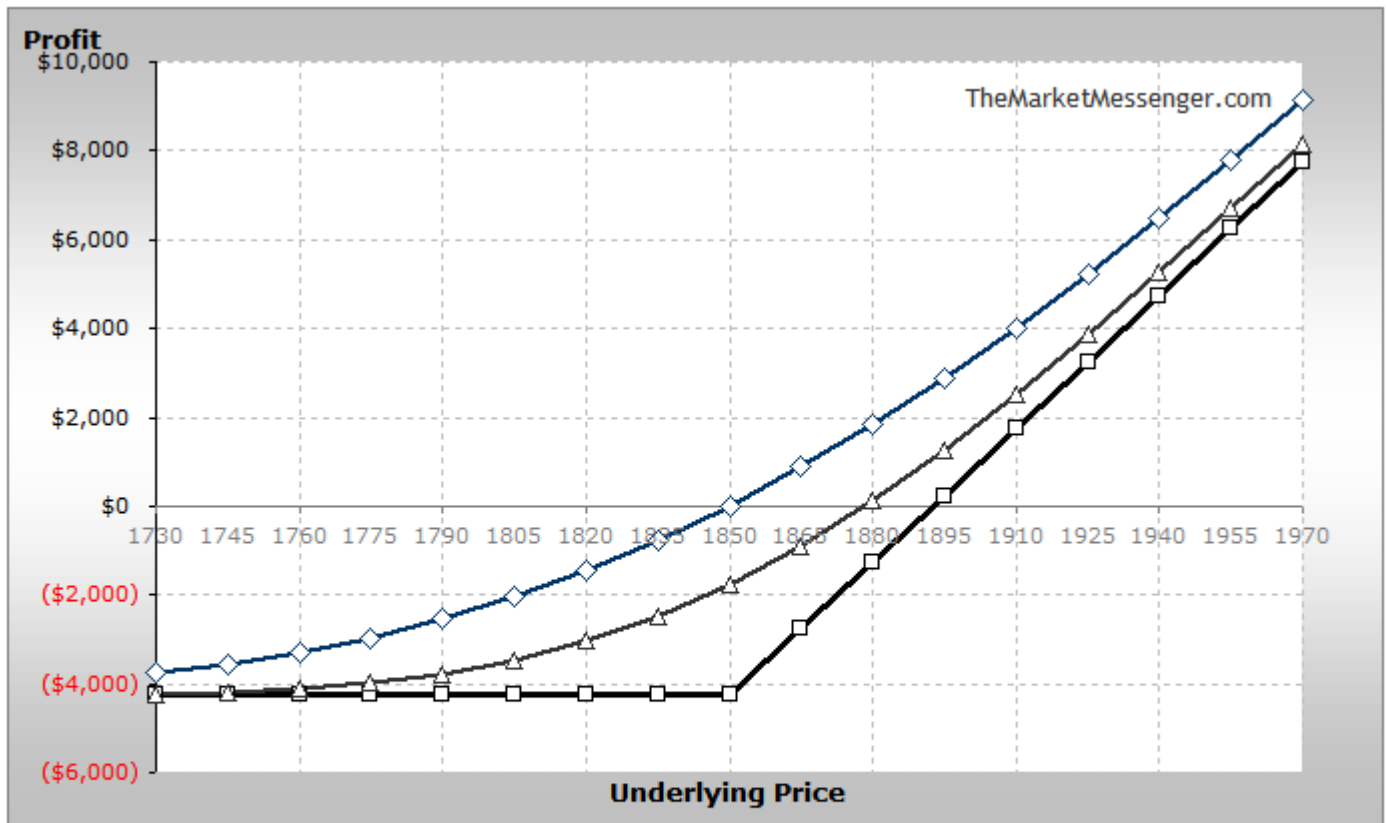
However, we'd initially take any such move to the all-important level of 1850 as an opportunity to pick up some calls, in anticipation of a strong rebound, perhaps all the way to the recent highs.

A look at a potential options play in the form of **Long Calls on the Nasdaq-100...**

If the NDX reaches support at 1850 very early in the week, the at-the-money July 1850 Calls should be trading at around \$43.80. If that level is reached closer to the end of the week, those Calls should be trading at around \$41.30.

The following is a P/L diagram depicting a hypothetical purchase of said Calls assuming that the mentioned support level is hit on Wednesday. Assuming an implied volatility equivalent to the current 16.00%, the Calls should be trading at \$42.60 at that point. The three lines depict the following:

- a) Hypothetical P/L as of Wednesday, Jun 13, assuming an implied volatility level of 16.00%
- b) Hypothetical P/L as of Jul 6 – two weeks before expiration – assuming the same volatility level as above
- c) P/L as of expiration, Jul 20, assuming a cost of \$42.60.



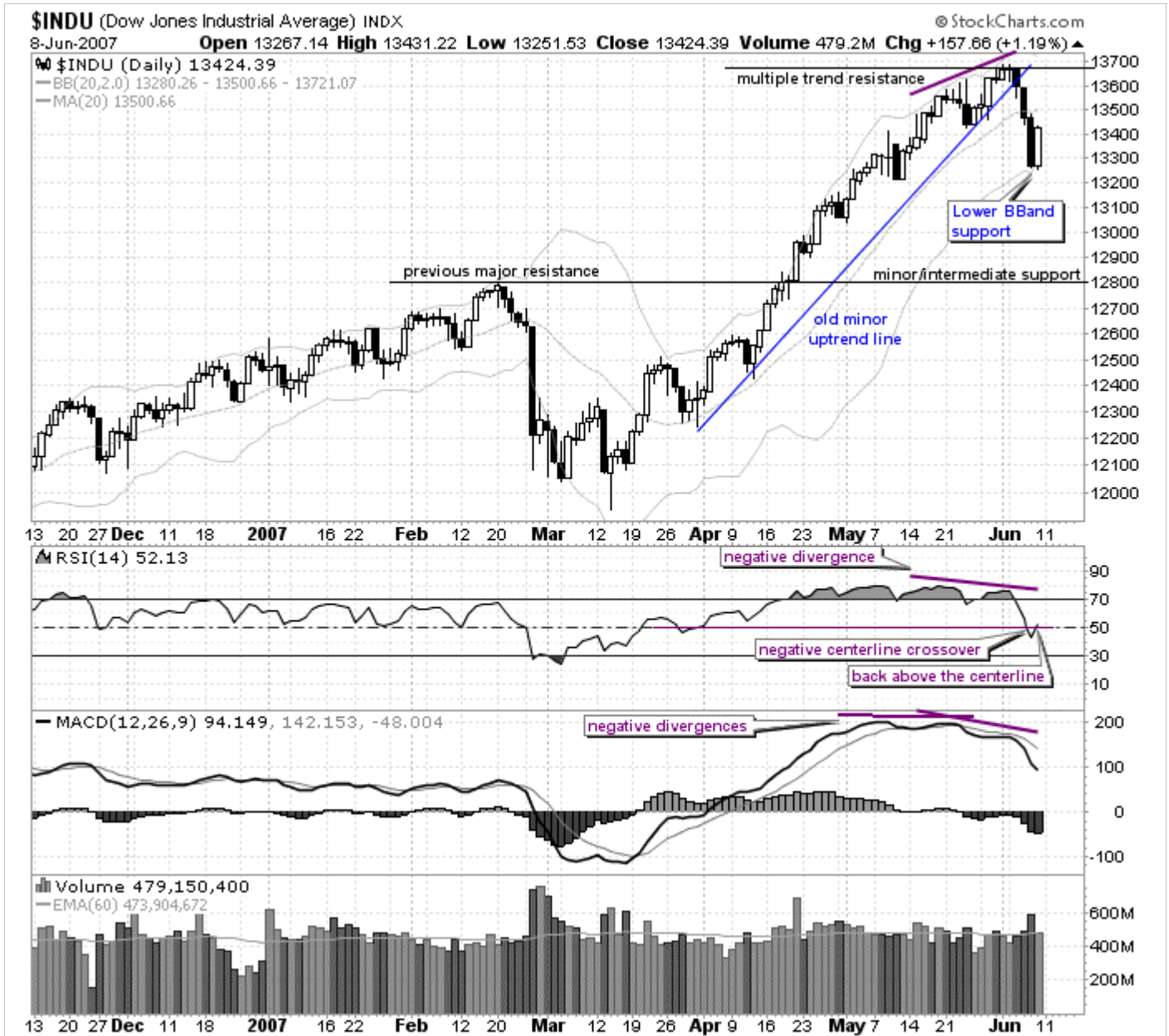
Option Legs	# Shrs/ Contracts	Expiration Month	Strike Price	Premium (Price)		Max Profit	Max Loss
Long Call	1	Jul	1850	42.60	Contract Expiry	20-Jul	Unlimited / \$4,260
					Debut	13-Jun	
					Original IV	16.00%	Unlimited / \$4,260
					Projected Exit 2	6-Jul	Unlimited / \$4,260
Net Debit/(Credit)				42.60			

The diagram shows us that given the scenario wherein the index falls to 1850, at which point calls are purchased, and thereafter the market rallies back to the highs (all before the July expiration), a gain of 100% or more would arise.

We'll update these potential options plays over the next few days. After all, they come into the picture only if the sell-off resumes and will be moot if we have already embarked upon another assault at new highs.

Next, a look at the **daily chart of the Dow Jones Industrials...**

The Dow fell all the way to its lower Band by Thursday and in the process also broke the centerline on RSI and completed a negative divergence on MACD.



On Friday, the Bollinger Band provided support to the index and the ensuing bounce sent RSI back above its centerline. It remains to be seen if that support is maintained over the coming week.

The last stock index chart that we'll look at in this issue is the **daily chart of the Russell 2000**...

The Russell 2000, which is one of the indices on which we believe rests the markets' fortunes through the summer months (the others being the Nasdaq indices), has fallen back into the congestion zone between 815 and 840 that had choked it during April and May.



The index is absolutely trendless at the moment and we are unable to read anything from it, except to state the somewhat obvious fact that a move below 815 is likely to have bearish consequences and a move above 855 ____.

Moving on to *The Big Picture* on commodities...

The Big Picture - Commodities

We're going to concentrate on the metals in this overview of the commodities markets. There are some interesting developments that need to be looked at.

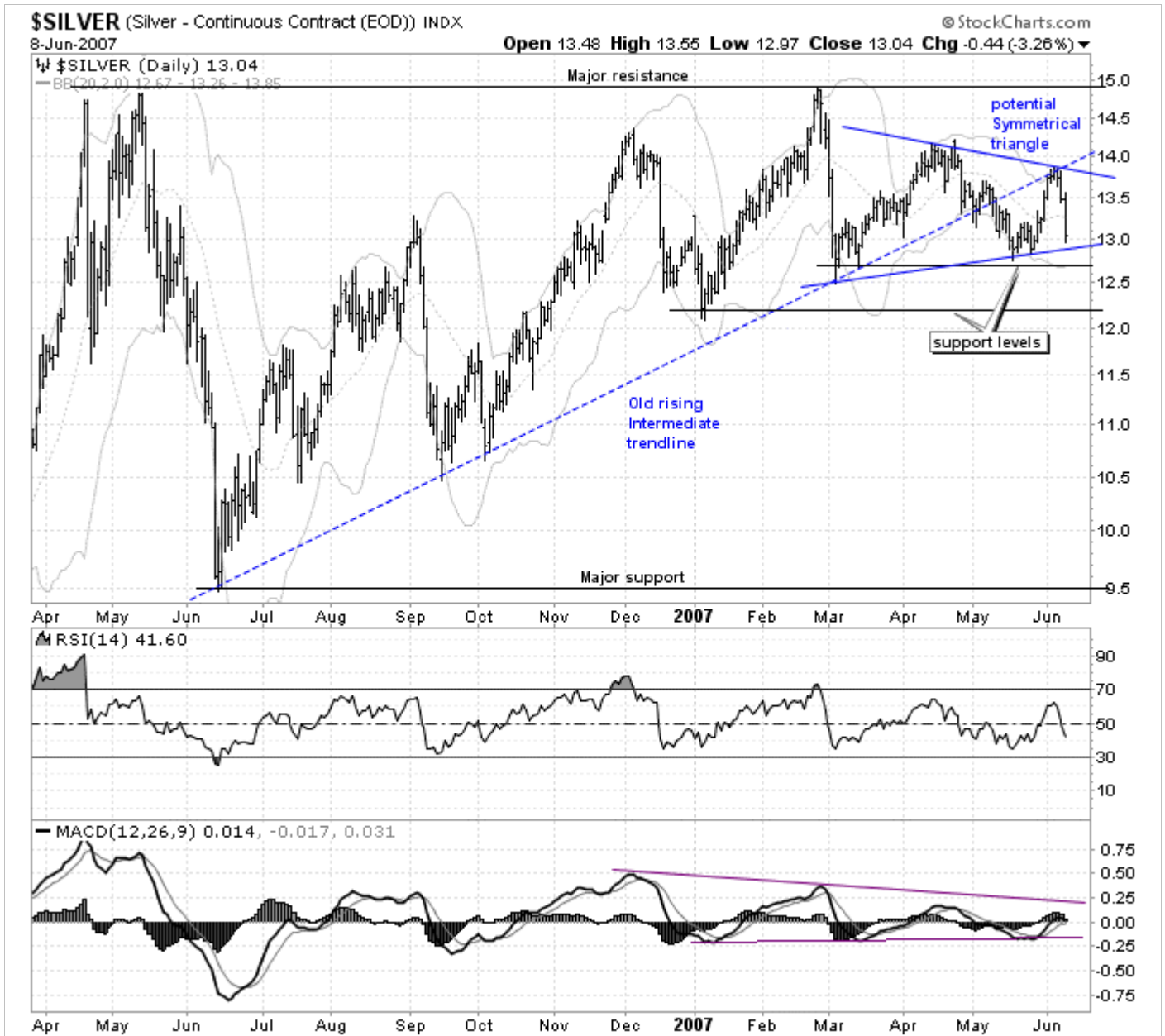
The daily chart of Gold now shows a bonafide falling minor trend. There have been three lower highs and three lower lows on the metal since its April highs.

Earlier this week, a testing of the broken rising intermediate trendline was completed and there were a couple of big down days at the end of the week. RSI and MACD are now both trading below their centerlines and intermediate support at 637 is being challenged once again.



Any breaking of that support line brings a potential double top into play. That pattern targets a move to 560 or so, which is around the level of recent intermediate and major support.

The daily chart of Silver is not faring much better. The old rising intermediate trend was retested earlier this week. That line proved resistance and the ensuing two-day \$0.75-decline has left a potential symmetrical triangle on the charts. That triangle calls for a \$1.75-2.00 move, in the direction of the breakout.



The daily chart of Platinum also shows a retesting of a broken intermediate uptrend line. RSI has failed to move back above its centerline and MACD continues to show a negative 0-line crossover. However, the metal has not been able to break (and stay) below previously broken intermediate resistance at 1280.

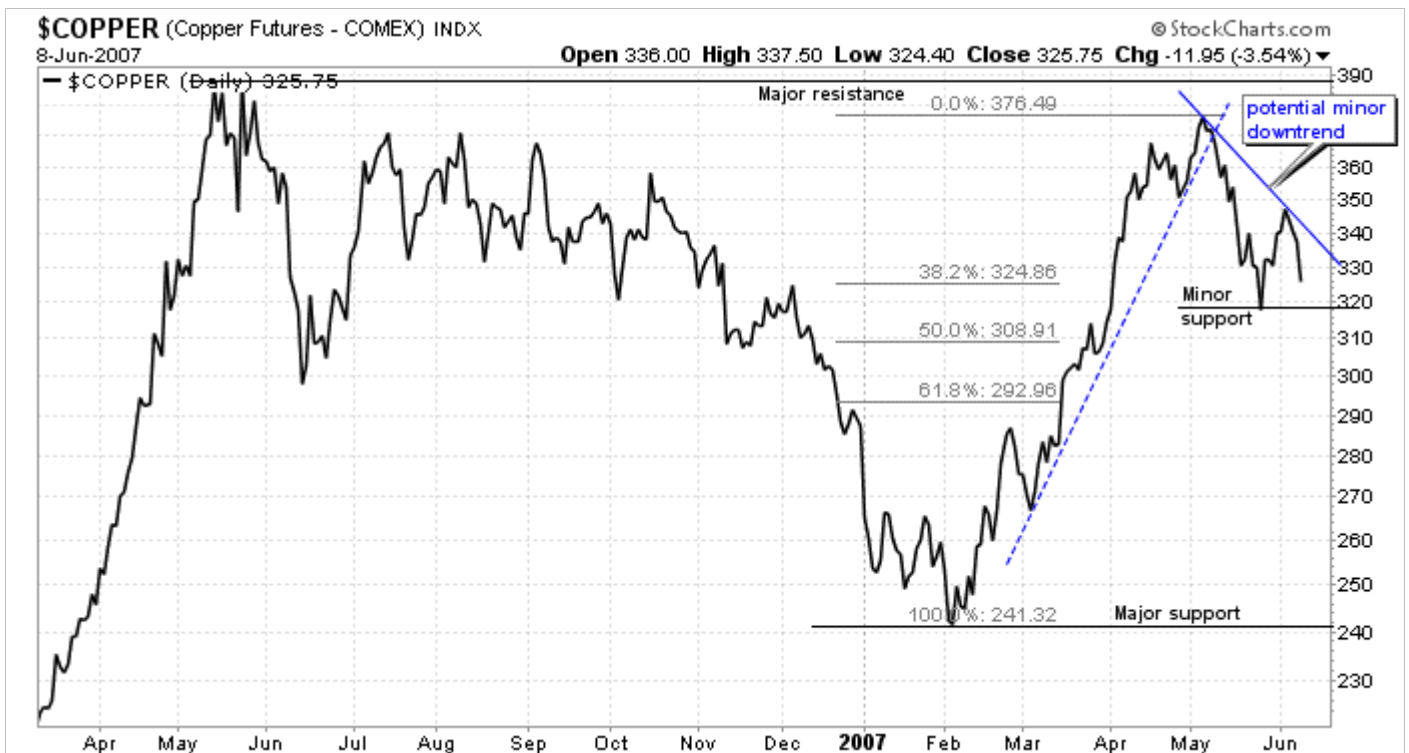


We'll close this week's issue with charts of two industrial metals...

The daily chart of Alumin(i)um shows that the rising support line that has existed for the better part of a year is being threatened at the moment. Any breaking of that line makes a move to lateral support at 1.12 possible.



The daily chart of Copper is now showing a lower high on the minor trend. If minor support at 318 is broken, there will (obviously) be a lower low, which will cause a bearish classification of the minor trend. However, it is worthwhile paying attention to the Fib retracement area between 292 and 308, which could provide support to falling prices.



That brings us to the end of this week's issue of *Purely Technical*. We hope that you've enjoyed reading it as much as we've enjoyed bringing it to you...

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Have a great trading week!

Regards,

Asher Pinto

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