

Two-Year Anniversary Special

TheMarketMessenger.com turns two years old in a couple of weeks and, in commemoration of the event, we're glad to invite you to our members lounge...



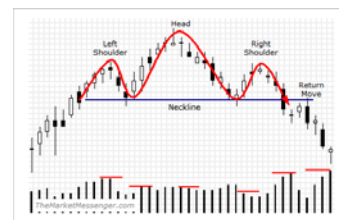
Two-Week FREE Pass

As part of our 2-year anniversary special, we're giving you the chance to try out ALL of our membership services FREE for two weeks [Jul 6 - Jul 20 '09].

[Sign up for YOUR FREE PASS](#) and allow us to prove to you that we have amongst the best stock charts, market analysis, stock picks and options picks available!

Several Indices Showing Head & Shoulders Tops

Volumes were below average, as was to have been expected, this week. With that caveat in place, however, there are several signs that the momentum is starting to move in favor of the bears. [At the end of this article, we'll explain why volume might actually not increase much, even if prices fall 10-20% over the coming weeks...]



When the markets experienced a big 3% drop on the Monday before last, we prognosticated that there was not likely to be much immediate follow-through to the downside and that a bounce towards the 20dMAs was to be likely to materialize.

That expectation was purely due to the fact that the lower bollinger bands on the broader indices were flat and, as such, likely to provide short-term support.

In the end that is exactly what happened and the broader indices were trading back at their 20dMAs within a week. There was a bit of consolidation at the 20dMAs and even several hours of trading (including a couple of daily chart closes) above the 20dMAs.

Until this Wednesday, things were up in the air. Prices were around the 20dMAs and it was starting to look like the sell signals generated in the previous week were about to be nullified. Not only were the indices threatening to move back above the 20dMAs, but their RSI readings actually moved back above 50, which meant that the negative centerline crossovers (the second most important sell signals, in our books) had potentially failed.

Nothing less than an immediate drop of some significance was demanded. And, on Thursday, that is exactly what the markets provided...

After a 3% drop on Thursday, most of the broader indices are on the verge of breaking minor support and several are displaying potential head & shoulders tops that call for a move that would represent a bonafide correction of the snapback rally that took place between March and June.

So needless to say traders will be watching the various minor support levels closely early in the coming week. They'll also be watching the bollinger bands closely. Unlike last time, the lower bollinger bands are no longer flat; they are falling and, as such, likely to allow prices to eke out lower levels.

S&P-500 index daily chart...



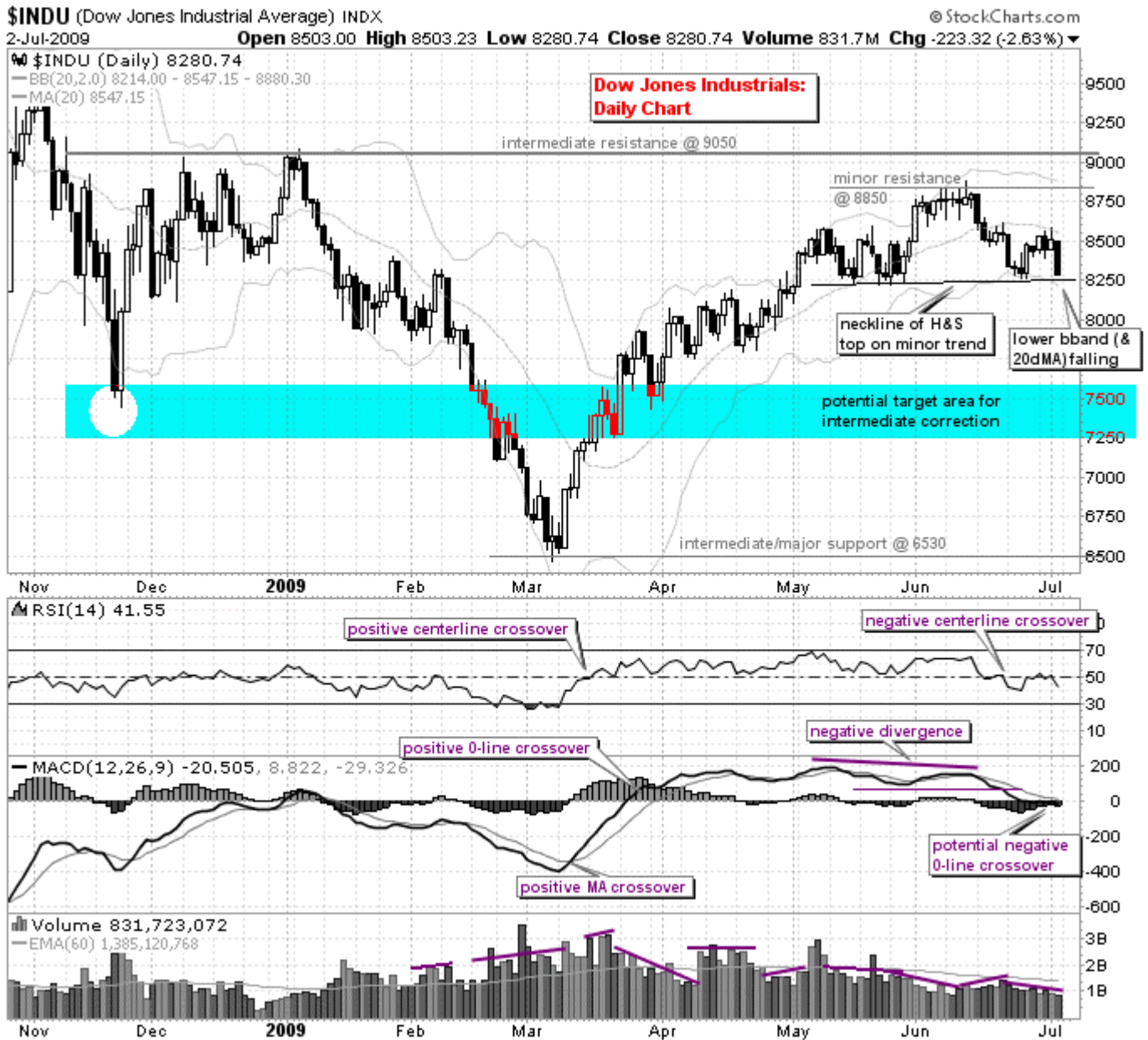
The S&P-500 retested its 20dMA for most of the week, before falling 2.9% on Thursday and settling at 896, which is just a smidgen above the rising neckline of a potential [head & shoulders top](#) that is now apparent on the minor trend. The H&S pattern, which started to form in early-May, measures 75 points or so in height and, as such, calls for a drop to the 815-level.

Thursday's drop has also moved RSI back below its centerline and has also pushed MACD into (or very close to) negative territory. Additionally, the lower bollinger band is now starting to fall and, as per bollinger band theory, that can be seen as a sell signal as well. The only thing that brings an iota of doubt to the recent move is the fact that volume levels have been below average. Price action usually demands the utmost respect, but it doesn't hurt if volume confirms a move.

Earlier, we'd mentioned that the target derived from the H&S top on the minor trend lies at around 815. If the markets do indeed start to sell off, we'd look at that level as only a preliminary target. We (as well as several other technicians, it has to be said) believe that the action since October of last year is part of an [inverted head & shoulders pattern](#) on the intermediate/major trend, and that the right shoulder of said pattern is currently undergoing formation.

Based on the guideline that the shoulders of head & shoulders pattern are typically symmetrical (i.e. they are typically of the same height and/or duration), the target for the lows of the potential right shoulder is likely to be in the 735-775 area.

Dow Jones Industrials Average daily chart...



The Dow is also showing a potential inverted h&s formation similar to that on SPX. The only difference in this case is that this index turned around before reaching the heights of the intervening peak between the left shoulder and the head (early-Jan '09 peak). An alternate view might be that the neckline of the inverted H&S on this index is actually a downward-sloping neckline and, if so, it calls for the lows of the right shoulder of the pattern to form at a lower level than those of the left shoulder.

In other words, if the Dow is indeed in the process of forming an inverted H&S pattern on the intermediate/major trend, we could see a drop to the 7250-7600 area, over the coming weeks, and once such a move has taken place the lows of the right shoulder would be complete.

Focusing in on the most recent action, we see a potential H&S top on the minor trend. The neckline of that pattern lies at 8250 and its height measures around 600 points. The target derived from it is, therefore, 7650.

Volumes have been below average and falling on this index, as well. So the bears will want to see a rise in trading activity along with lower prices in the sessions to follow. While volume action may seemingly not be confirming the bearish case, there are several other signs including a falling lower bollinger band, a falling 20-day moving average, a negative centerline crossover on RSI, and a negative 0-line crossover on MACD, that do tilt the scales in the favor of the bears.

Nasdaq-100 Index daily chart...



NDX has been the "odd-man-out" as it were, over the past several months (years even), so its no surprise that this index is now showing patterns similar to those seen on the minor, intermediate or major trends of the broader indices. While the bulls have been holding on to hope so far, as far as this index is concerned, there are signs that any further declines should bring about a decent correction of the 40%+ rally since the Nov/Mar lows.

Prices have already fallen below the 20dMA, but the lower band is only just showing signs of starting to point downwards. If it does start to decline, it will allow for a smoother path to lower levels over the coming weeks.

A decline of more than a couple of percentage points would also confirm a negative centerline crossover on RSI, as well as push MACD into negative territory.

There are a couple of minor price support levels (1415 and 1340) that will need to be contended along the way, but a move towards the old intermediate resistance level (1285) or even a filling of the gap left behind on Apr 3rd might well be possible, if the rest of the markets move as suspected.

Let's move on to the weekly charts now...

S&P-500 index weekly chart...



Zooming out to the level of the weekly chart, we can see the potential inverted H&S pattern a little more clearly.

This chart also shows us that aside from lateral price resistance, the index has been finding resistance from the 0-line on weekly MACD. Having now reached the 0-line, after having been deeply oversold just a few months ago, MACD has now "reset" and the next swing move is free to take place.

Additionally, you'll want to note that RSI has fallen back below its centerline this week and that brings about the possibility that the positive centerline crossover that took place a few weeks ago is at risk of being nullified.

If the index loses ground over the coming week or two, be on the lookout for a bit of support near the 855-level, which is the level of the 20-week moving average, at present. Any such support could well be only temporary, however; as we'd shown you earlier (on the daily chart), it is quite possible that a move towards the 735-775 area is on the cards.

Dow Industrials Average weekly chart...



The 20wMA on the Dow sits at around the 8000-level and may provide a bit of support before the lows of the (presumed) right shoulder are put in place.

Speaking of the potential inverted H&S pattern on the intermediate trend, this chart shows that the pattern is approximately 2500 points in height and, given that the neckline resides at 8750 or so, calls for a move towards the 11250-level.

Nasdaq-100 Index weekly chart...



We've superimposed the Fibonacci retracement levels of the entire cyclical bear market on the weekly chart of NDX, above. We can see that the index completed a 38% retracement of the cyclical bear market before falling from the highs, a couple of weeks ago.

Notice that unlike SPX and INDU, this index is actually still showing positive readings on weekly RSI and MACD. It will be interesting to see if that remains to be the case, over the coming weeks.

 The next "stacked" chart provides a look at the important lateral prices levels, as well as Fibonacci retracement levels of the '07-09 bear market, on SPX, INDU and NDX...

Support/Resistance & Fibonacci Levels on S&P-500, Dow Industrials and Nasdaq-100...

\$SPX (S&P 500 Large Cap Index) INDX

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2-Jul-2009

Open 919.86 High 931.92 Low 896.42 Close 896.42 Volume 14.4B Chg -22.48 (-2.45%)

\$SPX (Weekly) 896.42



\$INDU (Weekly) 8280.74



\$COMPQ (Weekly) 1796.52



And, finally, let's take a look at implied volatility...

The Volatility Index (VIX) daily chart...



The VIX had seemingly broken out of a descending triangle, until the index moved back above the 27-level, which had been seen as support to the aforementioned pattern, and closed at the 20dMA, on Thursday.

It will be interesting to see if the VIX breaks above its 20dMA in the near term, but the crucial level that traders will want to keep their eyes on is the long-term support/resistance level at 30-31, of course.

At the beginning of tonight's write-up we'd mentioned that we'd be talking a little about why volumes may not increase as/when prices fall over the coming weeks. Well, we're going to provide the explanation now...

As you know, for a few weeks now, we've been pointing out the possibility that the broader indices have been in the process of forming a large inverted head & shoulders pattern since October of last year. If so, the indices are on the verge of plunging into the right shoulder of the said pattern.

A quick look at the write-up on the [head & shoulders bottoming](#) formation that we've provided you with in our educational section, will show you that a drying up of volume is exactly what should be expected during the formation of the trough of the right shoulder such a pattern.

The intuition of course is that there is less interest on the part of investors to sell out of their positions - in other words, there isn't as much of a panicking - as prices make a third attempt at moving to new lows (major lows, in this case) and once more and more traders start to realize this fact, prices turn around to the upside and a lasting reversal ensues...

Have a great trading week!

Asher Pinto

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