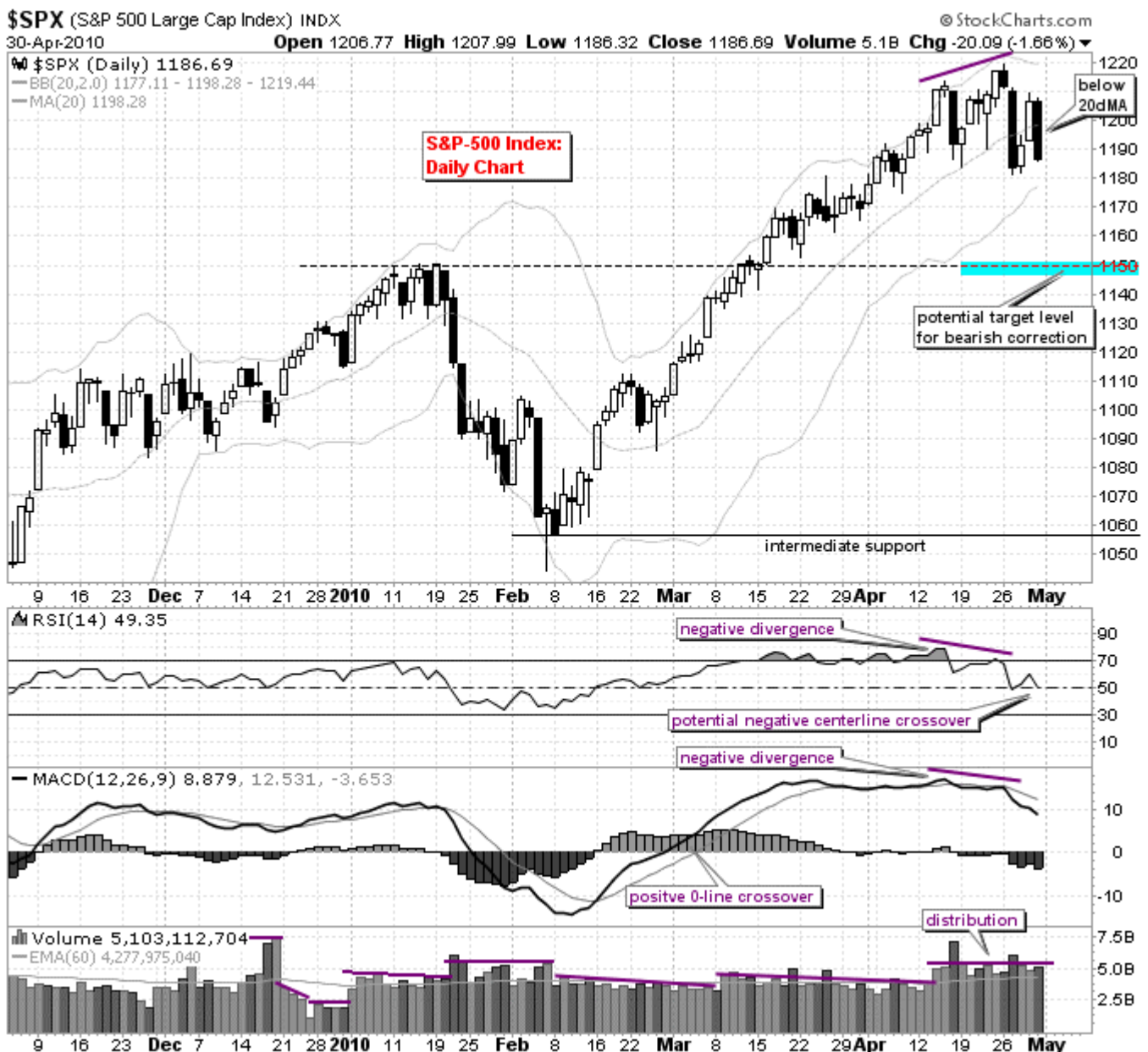


Sell Signals Confirmed, Finally!!

For several weeks, the market indices have been overbought and showing weak negative divergences, to no avail. Early this week (the final week of April), however, a couple of the indices were showing perhaps the most compelling negative divergences in a while and all that was needed was a confirmation of those signals and, preferably, a breaking of the 20-day Moving Average, as well.

After four sessions of choppy trading activity, the bears have managed to do the needful and it seems like a correction (if not an all-out bearish reversal) has begun.

S&P-500 index daily chart:



After having shown signs of "distribution" (trading volumes were well above average, as you can see), for a week and a half, SPX had reached a new high of 1217, at the close of trading on Friday, Apr. 23rd. That was also the highest level that the index has closed at since mid-September of 2008. On the following Monday, the index moved to a new intraday high, but closed the day with a small deficit (5 points).

It was at this point that perhaps only the most astute technicians would have noted the presence of a subtle potential negative divergence between price action and RSI. Now, there had been other instances, over the preceding weeks, of potential negative divergences that could best have been described as having been "weak"; none of those signals ended up being legitimate. There was something different about this one, however.

The intervening trough was a lot lower than those of the others had been and, as such, there was cause for concern (from the point of view of the bulls). Nevertheless, a new failure swing low was required, before the negative divergence could have been considered complete and a call for a bearish correction be made. On the following trading session (Tuesday), the markets obliged (emphatically so!)

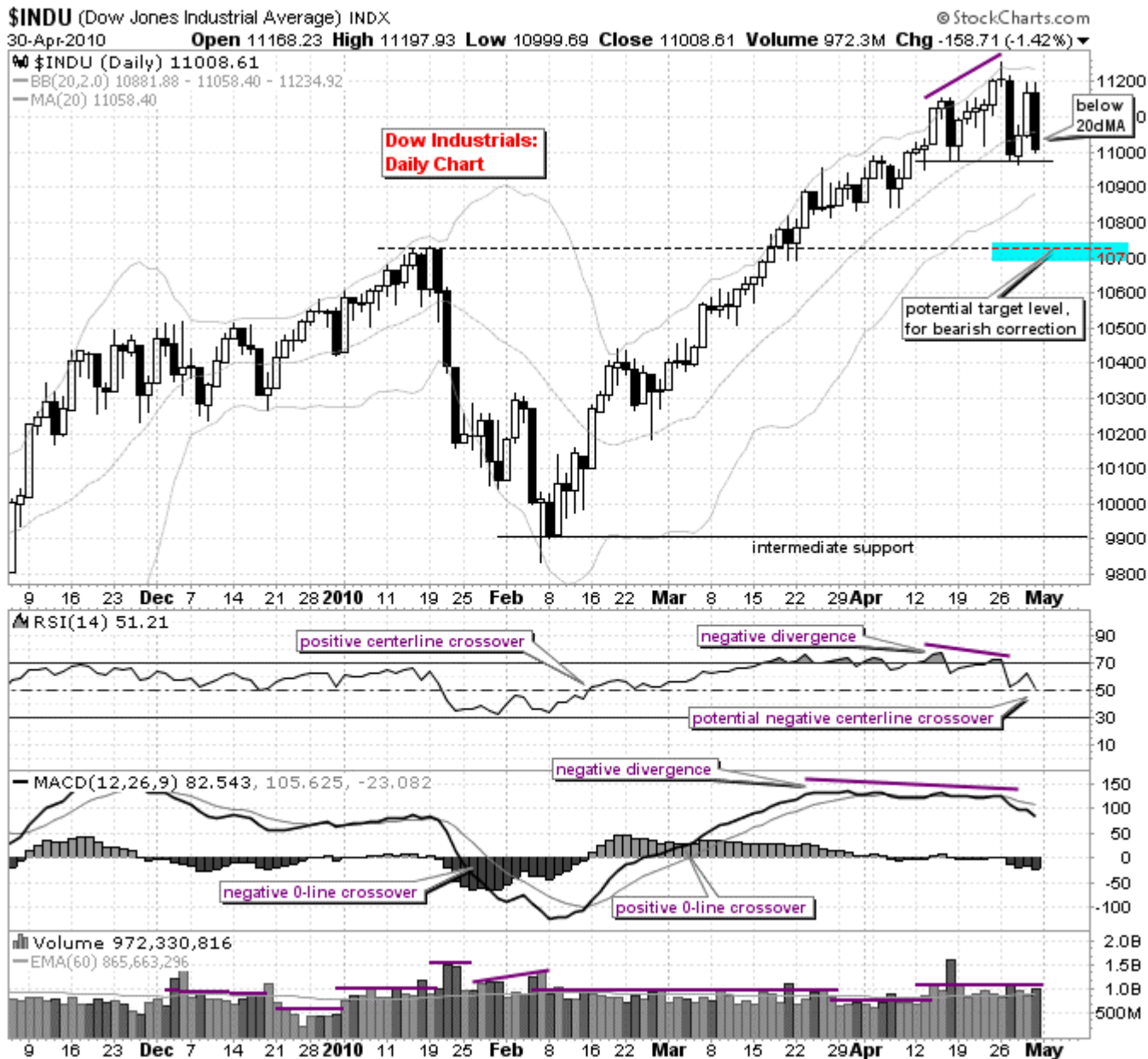
No less than a 28-pt. drop occurred during that session. In addition to confirming the negative divergence, the move also brought about another significant sell signal - a breaking of the 20-day Moving Average (20dMA). A negative divergence on MACD had completed itself, as well. It had appeared that the index was finally ready to undergo a much-needed correction, after nearly three months of relentlessly grinding its way to higher levels.

The drama wasn't over by that point, however. By the close of trading on Thursday, the index had actually moved back above its 20dMA and the sell signals had been cast in doubt. Nothing less than a decent decline was required on Friday and, on cue, the markets obliged. The 20-pt decline on Friday was just what the doctor ordered, at least as far as the bears were concerned, and it now looks like the index is, at best, undergoing a correction within an ongoing bullish intermediate trend and, at worst, a bearish reversal on either the intermediate or major level of trend. It's still early days though, if the latter of those courses of action ends up being true.

Assuming that this is only a correction at the level of the minor/intermediate trend, the old intermediate resistance level (1150) would probably be seen as a likely target, over the coming days (as long as the lower bollinger band - 1177 and rising - does not intervene to provide support to the index). The bulls will be hanging their hats on one last line of defense - the centerline on RSI - to provide a modicum of support to the rally, before getting out of the way and allowing the index to undergo a correction. If a negative centerline takes place, however, the target of 1150 - and perhaps much, much lower levels - will become a lot more likely.

[continued...]

Dow Jones Industrials Average daily chart:



The Dow (INDU) traversed a similar path to that of SPX's. So rather than plot the course, let's focus on what might happen next and what targets might be derived. A lot is riding on whether or not a negative centerline crossover can take place on RSI; the indicator is perched precariously atop the centerline, at the moment. There is also a minor support level at 10975, which shouldn't prove to be too much of an impediment for the bears, on its own.

If the centerline on RSI gives way, the index will unequivocally be experiencing at least a correction within an ongoing intermediate bull move. The old intermediate resistance level of 10735 or so will be seen as a preliminary target, but that may just be the beginning. It all depends on the level of the trend on which the market is undergoing a correction.

Nasdaq-100 Index daily chart:



NDX is sitting atop a minor support level at 2000, as of Friday's close. However, with a negative divergence having taken place on RSI, and MACD's having broken support, in addition to the breaking of the 20dMA, the bears will fancy their chances of bringing about a further decline of at least 60 points or so (the height of the recent minor consolidation). A move to the old intermediate resistance level (1895) may not even be completely out of the question.

Having examined the minor trends, through a studying of the daily charts, let's now take a look at the weekly charts in order to get a feel for the intermediate and longer-term trends...

S&P-500 index weekly chart:



SPX encountered its first losing week (-2.51%) of any consequence in around 13 weeks. So, one might say that a correction was overdue. That is true and the fact that weekly RSI had reached overbought levels, last week, and MACD has been showing a negative divergence for over a month and a half, are further reasons to have expected a correction, at this point.

For now, this chart doesn't necessarily look ominous. There is a bearish engulfing candlestick, but that's about it. If the negative divergence becomes complete, however, there might just be hell to pay and a target of 1050 (lower Bollinger band), might easy be on the cards. And, furthermore, if the lower Bollinger band were to start to point downwards at that point, a much bigger decline, say, to around the 900-950 area could easily be within the realm of possibility.

Dow Industrials Average weekly chart:



Once again, INDU is showing a similar picture to that of SPX'. So keep an eye on the potential negative divergence on MACD. If it confirms itself, a move to the lower Bollinger band (currently below 10000) will be a virtual certainty, but it's just as likely that a much larger decline (perhaps to the 8500-9000 range) would be in the offing...

Nasdaq-100 Index weekly chart:



NDX climbed to new intermediate highs, in the month of April. In the second to last week of the month, the index actually broke above the first resistance level of any significance from the intermediate bear move (the mid-2008 intermediate/major reaction high at 2050). It was not able to hold above those levels, however, and dropped 2.66%, in the last week of the month.

If the rest of the markets undergo a correction on the level of the intermediate or major trend, this index should easily be headed to its lower Bollinger band (1700), if not towards the 50% retracement level (1550) of the entire rally to date.

Conclusion:

After month-upon-month of the bulls' pushing the markets to higher levels, it's good to see the potential of a meaningful correction. The bears aren't exactly in the driver's seat as yet, but if we can get negative centerline crossovers on the daily charts, they'll be in pretty good stead to do so.

If that happens, you'll want to consider taking on a good number of bearish stock trades, and also consider doing what we're doing, in utilizing options strategies such as Call/Put Backspreads or Short Christmas Trees with Calls/Puts, which allow the trader to make a gain regardless of whether the stock moves a decent distance to the upside or to the downside.

That's it for this issue of Purely Technical. If you are not already a member, we invite you to take a look at the [membership services](#) that we offer, so that you can take advantage of the major market move that is imminent.

Best of Luck!

Asher Pinto

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