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TRENDS AND TRADING RANGES

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The action of the past two weeks has taught a very important lesson. Unfortunately, it is one that we all seem to have to relearn from time to time. It has to do with the enormous power of an established trend. When the established trend is up, it is wrong to go fishing for a top. The trend is what the trend is until it is broken. Attempts to trade against it are filled with danger.

During the period just before and just after Thanksgiving, the Wyckoff Wave was at the bottom of its uptrend channel and on the verge of breaking the uptrend. This followed an unimpressive rally to a lower top on decreasing volume, which is clearly a negative indication. Why then did the trend hold? It appears as though this was a good example of the irresistable force meeting the immovable object with the demand line of the uptrend being the immovable object. The reason the irresistable force proved to be very resistable can be found in the volume. It failed to come in on the downside. Without the extra pressure created by increased volume, the uptrend had no difficulty holding its ground. In the end, it was a battle between a short term down trend and an intermediate uptrend. The short term trend lost badly because after it failed to flex its muscle, the intermediate trend did flex its, pushing the Wave to another new high.

The early December rally has now extended the string of upward thrusts in the entire advance to four. Will there be more? Anything is, of course, possible. However, a closer look at the fourth phase of the advance and the reaction to it should provide a better feeling as to the likelihood and potential success of a fifth phase. A good way to begin this appraisal is to see what the last rally accomplished and failed to accomplish.

There was only one accomplishment. The Wave made a new high. This is important, but it is not the whole story and probably not as important as how the new high was reached. When we consider this, we can see the failures of the rally. For example, the last rally continued the pattern of shortening of the thrusts. An advance that is plagued by this problem has a limited life expectancy that grows shorter with each passing day. We can also see that the rally failed to reach the overbought line of the uptrend. The previous thrusts were able to accomplish this. The indication here is of a weakening of the strength in the market. It should also be noted that the volume and interest brought out by the last rally fell well short of that experienced on the earlier thrusts. Apparently it is becoming more difficult to persuade people to chase after the market. That should make it more difficult to sustain the advance.

Do the failings of the last rally insure an immediate end to the intermediate uptrend? They do not do that, but they have helped lead to a situation that makes the trend vulnerable. This time the vulnerability is probably greater than it was around Thanksgiving. What makes the difference this time is volume. The market was able to sustain relatively high volume on the three days of reaction that ended last week. Ever since the market first started to move toward a trading range, it has been unable to produce a relatively high volume reaction. As a result, the uptrend has been able to maintain control. The failures of the last rally together with the ability to produce good volume on the downside may mark a shift in control from the uptrend to the trading range. This does not mean a major decline is just around the corner, but it would mark an important change.

We must keep in mind that at this point the above change is still only a possibility. To try to pick the top based on it would be wrong. First it is necessary to have the demand line of the uptrend broken or at least penetrated. The ten point figure chart indicates that this is possible since the downside objective is around 3020. The only way the Wave can get to that level is by breaking through the demand line. A decline to this level would respect the support level of the trading range, which would provide another signal that the trading range is taking over. The final step in this scenerio would be an additional rally, but to a lower top. This would complete the transition from uptrend to trading range and likely open a new array of trading possibilities. Until these steps are completed, however, the trend is up. Trading against it is unwise.

GROUP ANALYSIS

Since there still appears to be this battle underway between the uptrend and the trading range, it should not be surprising to find the groups covering a wide spectrum of positions. The important question is how to trade them. One answer is to avoid new commitments altogether until the battle is won. For those who choose not to wait, the focus will probably be best made on the long side as long as the demand line of the uptrend remains intact. After that, trades in either direction should be possible.

In the aerospace group, there is no question that the battle has been won by the trading range. In spite of a shakeout prior to the last rally, the group failed to break through the top of the trading range. This is an important failure, which suggests that this group not be considered a prime long candidate. A better course of action appears to be to let the trading range of the general market take control and to then use the volatility of the group to make it a good trading range vehicle.

One of the strongest groups since October has been the airlines. On the last rally, however, they got carried away with themselves and rallied into an overbought condition. The normal result in these situations is a correction, which occurred last Wednesday, Thursday, and Friday. The problem is that it was not a normal correction. A combination of wide price spread and sustained heavy volume produced a break in the demand line of the uptrend. This is a definite change of character. It warrants action by those who are long in these stocks. There will be a rally in response to last week's reaction, which should be used to do some selling.

In recent days, the auto group has also been in an overbought position, but has not collapsed like the airlines. The group cannot be considered for a long position now because of its location in the trend. However, as the trading range in the general market takes greater control, this group should be considered for long positions during rallies in the trading range. This is especially true as long as the uptrend in the group remains intact.

The banking group had its trading range confirmed by the last rally, which fell well short of the top of the trading range and which occurred on very unimpressive volume. This makes the group relatively weaker than the market and perhaps a short candidate. There is a problem, however. A potential spring position is developing. This in combination with the uptrend in the general market is a warning to leave the group alone for a while. The same warning applies to the chemical group. It is weaker than the market, but in a potential spring position and therefore vulnerable to a rally.

The building material stocks tend to parallel the banking issues. In a general way that is true at the moment. The building stocks are also coming off an unimpressive rally to a lower top and the trading range appears to be in control. The big difference here is the lack of a potential spring position. Therefore, the likelihood of an immediate rally is less. This group may be considered for the short side once the uptrend in the general market is broken.

Some of the market's most recent strength came in the computer group. It is still in its uptrend. Therefore, it should only be considered for the longside. If the market is unable to break its uptrend and becomes oversold, this group would be a good one to consider for a short term long position.

Both the diversified and the drug group are relatively weaker than the market over the short term. They have also both moved into trading ranges well ahead of the general market. When the market follows, either or both may present possibilities on the short side. Immediately, neither warrants any action. This is especially true of the diversified group, which appears to be testing a recent spring position. If the test holds, another rally attempt is almost certain. However, the relative weakness in the group should prevent it from being spectacular.

The electronics group seems to parallel the airline group with the exception that its strength goes all the way back to August. The group participated well in the last rally and ended up in an overbought position. The problem in this area is the action late last week. The correction to the overbought position appears to be a clear change in character. There should be another rally soon, which may best be used to take profits.

Gold and silver also participated in the last rally making a new high, but the group is still in some trouble. It is no longer able to rally to the top of its trend channel and has weakened the demand line of the uptrend. If the general market breaks its uptrend, this group will likely follow. Until then it is probably best left alone except perhaps to take profits from the long side.

The medical group is another leading group that has started to run into some problem. The nature of the problem is the breaking of the demand line. The difference here from the airline and electronics groups is declining volume instead of sustained heavy volume. This does not outweight the breaking of the trend, but the need to take profits immediately on the next rally is not as great. The person interested in a longer term trade can justify holding his position pending further development of the trading range.

Two groups that present themselves as candidates for new long positions of a short term nature are the office equipment and semi-conductor stocks. They are both holding on to uptrends in spite of reactions late last week. Since they are now positioned at the bottom of their trend channels, they can be considered for short term rallies as the market tries to work itself more clearly into a trading range.

Rotation in the market is usually a gradual thing. Last week, however, brought some abrupt changes. We have already mentioned the previously strong groups that have changed character. Their weakening is a primary reason for seeing the market moving out of the uptrend and into a trading range. The only thing that can prevent this is if some other combination of groups emerges to take their place. Based on their performances last week some are saying the oils and exploration stocks are going to fill this position. They do have the ability to take control and could keep the general market advance going. However, a few good days is not enough to say that they have all of the sudden become market leaders. It must be remembered that these groups have under-performed the market badly throughout the advance. It is not reasonable to expect them to all of the sudden take charge of a weakening market and drag is still higher. At this point, these groups are followers not leaders and probably will follow the market into a trading range if that is where it is headed.

The oil exploration group is already in a trading range. The rally last week was the most positive development in two months, but it did nothing to break the resistance that exists around 3000. Before we can justify saying that this group is ready to lead the market higher, we need to see the next reaction. If it holds more than half the gain on lower volume, we may have a new market leader developing. Until then, all we have is trading range action, which will not lead the market anywhere.

The oil stocks present a different picture, but the conclusion is about the same. The thing that makes this group look more positive is that the recent rally has broken the previous down trend. This is a positive development, but it should be kept in proper perspective. At this point, the rally has only made up about half the previous loss in spite of enormous effort. If the price cannot follow through from here, the result will be a bigger down trend. Another point that should be noted is the tremendous resistance area that lies across the 3400 area. This would give even the strongest of groups a hard time. It may be impossible for a group whose strength has just emerged and is untested. Both of these groups should be dealt with cautiously.