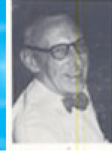
john magee technical analysis



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"Americans are by nature an open, gregarious and honest people. Our only native breed of criminal is the congressman." Mark Twain

NOVEMBER 2007 – STATE OF THE MARKETS – cloudy with a chance of meatballs

Recently Mark Hulbert (at MarketWatch) canvassed newsletter writers and found 83% of the best performing newsletters bullish, and the worst performing newsletters bearish. At this we raised an eyebrow, then raised the other, which made us look a little like Groucho Marx, but such is the state of the markets. Say the secret word and win a booby prize. Secret word might be bullish, might be bearish. But SURPRISE --

the secret word is *mulish*. (As in Mule. As in how do you get the attention of a mule – first you get a two by four….) We have exercised our talents for taxonomy by describing sideways markets as mule markets. We haven't done much with taxidermy lately, but have some pretty fearsome pictures of fighting bull heads from Sevilla.

We won't be going back to Sevilla anytime soon. Not with the state of the dollar, which brings us to the state of the markets. In June (now clear in retrospect) the Dow entered into a Mule Market, now 6 months long. Mule markets may also be called congestion phases, or trading markets and lots of other things not fit for a family newsletter. It has been reasonably clear for sometime that the market is in a new phase. Analyzing this phase is always a speculative proposition, until it finally defines itself. By definition a trading market is not over until it breaks indisputably out of its range. The range of the present market is 12517 to 14198. Trading ranges can be continuation or reversal formations.

In other words we could be forming a massive top here – or a massive platform to take the market higher. Classical trend following methods have kept us basically long for years, with a little bear trading in 2003. And classical method has us still long, but Dow prices are drilling down deeper looking for our stop, as seen in the chart. The stop on the chart is about as robust as you can get. The conjunction of an important trendline, an important support line and the basing point calculation is serendipitous, if not accidental (or random, or mysterious, or strange, or psychic). Of course these "coincidences" occur too often in charting to be accidental. (And by taking all the words in the Bible you can reproduce all the plays of Shakespeare….) (or is it vice versa?)

As we remarked a chance of meatballs. Looking at the present formation it is possible to construe as a double top (neckline 12517), or depending on developments, as the beginning of a head and shoulders. Whatever you want to call it major movements are in the making. We can certainly see a double top, but the rectangle which starts it off in June seems to be looking for something symmetrical on the right side – in other words a complex top with a double top built into it. Here one major trend line has been broken. Another is about to be broken, but the longest trendline –from 2003—has not been broken yet. At bottom a closer look in another chart.

Now for the intuitive stuff. What is going on right now feels more like the end of something than the beginning of something. Runaway gold and oil (you will remember we hinted that these might be good bets), collapsing dollar, meatballs in the Dow. But the thing about blowoff markets is you never know where they stop. But they will stop, and playing them now is playing with the devil's fireworks.

So what do we think of all this? Generally we try to avoid thinking and stick to analyzing. For sometime now we have been saying that portfolios should be well hedged with shorts or options. In a mule market this is doubly important. Our readers should be further hedged by gold silver and oil positions. Do we foresee a market wipeout? Our least favorite thing to do – measure formations. But – since you asked. The extremes of the range are wavelow 12517, wavehigh 14198, or 1681 point range. A collapse could

reach 10836. Given the way investors have been conditioned declines of less than this magnitude would presumably attract rabid buying. The worst subprime crisis in the world has got to reach a discount point sooner or later. And the media hype around the crisis will die down sooner or later. But there is no need to ride the roller coaster down. Just observe the stop, and similar stops in individual stocks and go to the beach. Or invest in real estate. (Wait. Is it absolutely clear that is a joke?)

We didn't need to know the details of the subprime mess to predict a real estate crash, though we did know that lying cheating and usury were going on. We looked at the chart and said sell this sucker. After all how chart dumb do you have to be to not recognize an unsustainable curve? Meanwhile those fundamental analysts and super quantitative hedge fund managers and risk analysts at the bluest ribbon firms were busy buying pigs in pokes.

High and low horizontal lines mark the probable range. Excursions beyond those lines are tests, but mark the extremes. The August low was intraday and did not close below the line, touched our stop but closed up. Given the chicken little squawking of the media we may be at the low now. Certainly the sloped trendline, the horizontal line and the basing point stop represent impressive support. Strong closes below these markers may augur major trouble for bulls. Still if we were to speculate (not analyze, speculate) we would expect the present trend to continue. That being a sideways market we would first of all look for more trading markets. Our stop is not a speculation. It is the result of analysis. Hit it and we're out.

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