Technical Market Action

Today's letter is devoted to the technical action of the averages from early 1946 to date. Our discussion - for the sake of brevity - will be confined to the Dow-Jones industrial average since it is the most universally known.

The industrial average, during the first half of 1946, was in a distributional phase and was building up a heavy top pattern. The high of 213 was reached in late May. The warning that the heavy volume in a relatively narrow range was distribution, was given in early July 1946 when the industrial average penetrated the important 200 resistance level on the downside. At this stage, this letter turned bearish. This warning signal was later confirmed in September, 1946, when the market gave its famous bear market Dow Theory signal at 185. By combining the various downside count indications of the three point, one point and half point fluctuations of the industrial average during the January to July distributional phase, the 170-160 area was arrived at as the indicated downside objective for the decline. This is the area which, for the past year or more we have consistently advised as a longer term buying range.

Since September 1946, the market has dipped down into the 170-160 area on several occasions. Thus, the downside implications of the broad 1946 distribution have been reached. The actual lows were reached at 160.49 in October 1946 and 161.38 in May 1947. On three occasions the market has rallied back to the approximate Dow Theory bear market signal at 185. The February high was 184.96, the July high was 187.66, and the October high was 186.23.

The industrial average, as a result of the swings of the past year, has built up a twenty-five point trading range between, roughly, 185 and 160. The same pattern is present in the other market averages. Is this trading range a period of accumulation or distribution? The pattern is a broad one and a sizeable move is indicated when the range is decisively penetrated. An upside penetration would indicate 210-215. A downside penetration would indicate somewhere around 145. The answer will not be given until the range is penetrated in one direction or the other, either at 185-187 or at 160.

This letter, has taken the stand, and continues to do so, that the eventual penetration will be on the upside. It believes that waiting for the averages to give a Dow Theory signal will result in losing, if present count indications are correct, at least half the move. That is why stocks have been recommended for purchase in the 170-160 area rather than waiting for a bull market signal. If such a signal is awaited, it could result in such a buying wave that purchases could take place in the 190-195 zone rather than the 185-187 zone, just as the Dow Theory bear market signal resulted in such a selling wave that sales were closer to the 180-175 level than 185.

Our main reason for anticipating an upside penetration is based on the action of individual stocks. Just as the averages built up distributional areas in the first half of 1946, so did individual stocks. Just as the averages reached their downside objectives, so have the vast majority of individual common stock issues. I would venture the opinion that 90% of individual common stocks have reached the objectives outlined by their 1946 distributional areas. The remaining few are, at their lows, very close to the objectives outlined.

The third feature of the technical action of the averages, and this is the important point, does not hold true in individual stocks. The third feature is that the averages have built up a long trading range that has not yet been penetrated either upside or downside. This is not true of individual issues. Here the patterns are exceedingly diverse. Some stocks reached their lows in October 1946, while others broke sharply below October lows and reached their lows in May. A much smaller number have made their lows in the past few weeks. Also, some issues have built up substantial base areas, in a great many cases indicating relatively higher levels than a comparable 210-215 in averages. Others have built up only relatively small range areas and are in need of considerably more backing and filling before an important move is indicated. Still others have formed little or no range areas and require considerably more time before a move is indicated. Also, a great many individual issues have reached their downside objectives, formed substantial base areas and have penetrated them on the upside thus indicating individual bull markets of their own. These issues, on the base count indications, still have considerably higher price objectives. Individual issues with this pattern include such important stocks as American Smelting, Chrysler, Deere & Company, Gulf Oil, Standard Oil of New Jersey, Union Carbide, Union Pacific and Youngstown Sheet & Tube, to mention only a few.

On the other hand, I cannot recall, offhand, one single issue that has reached its downside objective as outlined by the 1946 tops, then formed a wide trading range and then penetrated the range on the downside to indicate that the range was distribution rather than accumulation.

This type of action on individual issues hardly indicates, at this stage, an area of distribution and lower prices. It rather indicates (1) higher prices and (2) extreme selectivity.

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