Technical Market Action

Just as no Christmas number of a magazine or periodical is complete without a picture of Santa Claus, a snow scene or a holly wreath, no financial letter or service is complete, at this time of the year, without an Annual Forecast. So let me add another prediction to the multitude that already have been issued. But before I start, I would like to fill in a little background.

The market reached a high of 213.36 in the industrial average and 68.77 in the rails in May of 1946. The high of the industrials was considerably above the previous February 1946 high of 207.49, but the rail average just about equalled the previous February 1946 high of 68.42. This was the first cautionary signal because on all previous rallies, since the start of the bull market in 1942, the rails had led the advance. In addition, many individual issues had built large potential distributional areas from January to May of 1946 while the public was scrambling for "new issues" at any price. This letter turned cautious on the market when the 200 level was penetrated and predicted the possibility of a decline to 174. The average reacted to 193 then rallied back to 205 in August to broaden out the distributional area and indicate the possibility of a decline to the 170-160 area. The market started a sharp decline in September and reached a low of 160.49 on the industrials and 44.00 on the rails in October 1946. That brings us up to our prediction for 1947.

In January 1947 when the averages were 176, I was of the opinion that the market was in an intermediate uptrend that would carry to the 185-200 level. After that, I predicted a reaction and consolidation to be followed by another attempt at new highs later in the year. I also thought that the rise would be extremely selective and would feature the heavy industry shares, oils, chemicals, etc. I did not like the action of the soft goods stocks such as department stores, liquors, moving pictures and luxury items as these issues had not yet reached their downside technical objectives. The actual course of the market did not quite follow this pattern. The individual issues recommended in most cases, moved sharply higher, while the issues with unfavorable technical patterns worked lower. However, the averages were able to reach only the lower part of our anticipated 185-200 range at 184.96 in February. The rail average reached 53.65. This rally was followed by a downdrift that carried the industrial average back to 161.38 in May. The rails reached a new low at 40.43. The subsequent rally carried the industrials to a new high of 187.66 in July but the rails, at 51.92, failed to better the February high. The industrials, in several attempts since that time, have failed so far to penetrate the July high of 187.66. The rails, however, recently penetrated the July high to reach 52.88 even though they were unable to penetrate the February high of 53.65. This is the first evidence of rail leadership in almost two years.

Now, finally, the prediction for 1948. I believe the long and narrow trading range of the last sixteen months, between roughly 161 and 187 in the industrial average, is a base area that will be ultimately penetrated on the upside. The rail average also has a favorable technical pattern with six tops in the 54-52 area and a head and shoulders bottom pattern at, roughly, 44 in October 1946 for the left shoulder, at 40 in May 1947 for the head and 46 in December 1947 for the right shoulder. My reasons for predicting that both these patterns are base areas are based on (1) the vast majority of instances that individual issues have reached the downside objectives outlined by their early 1946 distributional area. They were not all reached at the same time. Chrysler reached its downside objective

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in October, 1946. Pennsylvania Railroad reached its downside objective during the past month. (2) A great many important issues in both groups have already given individual bull market signals of their own by penetrating trading ranges and reaching new high territory. It is true that other issues have reached new lows but these issues are just reaching the downside objectives outlined by the early 1946 distributional tops. Only in extremely rare cases have individual issues reached their downside objectives earlier in the year and then formed a trading range to penetrate it on the downside.

Thus, going ahead on the premise that the trading range of the last sixteen months is an accummulation area, what is the possible objectives for the averages on an intermediate upswing? The present base patterns indicate 210-215 for the industrials and 65-75 for the rails. This checks with objectives of around or slightly above the 1946 high of 137 on the New York Herald-Tribune 100-Stock average (now 122) and around the 1946 high of 149 on the New York Times 50-Stock combined average (now 116).

This does not mean that all groups, or even individual issues in the same group, will rise equally. In fact, the rise will be extremely selective. Issues that have reached their lows earlier in the year and have already formed sizeable base patterns will show bettern market action than issues that have only recently reached their downside objectives and require backing and filling in a trading range to form a base. The groups with the most favorable technical patterns at the moment include the steels, rails, automotive issues, building issues, farm implements, machine equipments, oils, chemicals, papers and certain miscellaneous groups. I will endeavor to cover the most interesting individual issues in subsequent bulletins. Most of them are now in our recommended list of issues.

As to the timing of the upside penetration, that is uncertain. It requires a change in the pessimistic or rather apathetic attitude of the investor and speculator of today. If the penetration occurs shortly, the objectives outlined above are a reasonable expectation. If these objectives are reached early in 1948, it is possible, after several months of consolidation, that the market may embark on a move into even higher territory before the end of the year. If the rise is delayed and the averages sink back into the 170-160 buying range, it will mean the enlargement of the base area and an even greater intermediate term objective then outlined above to be reached later in the year. I favor the possibility of a nearer term penetration.

In my next letter I will cover the fallacies which are apparent, in my opinion, in the current bearish prognostications.

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December 31, 1947

HAPPY NEW YEAR