Technical Market Action

A sharp decline in commodity prices unsettled the stock market on Wednesday and the industrial average closed $3.00 lower at 170.95 and the rail average was off $1.33 at 49.87. At the day's low of 170.41, the industrial average had fractionally penetrated the January 26th low of 170.70. The rails, on the other hand, at 49.66, held fractionally above their comparable January 22nd low of 49.40. Volume increased moderately to 1,200,000 shares.

In last week's letter, we mentioned that the technical patterns of a great many commodities had certain characteristics of a broad distributional area, particularly in May Wheat and May Cotton, and that there were implications of a possible sharp break in commodity futures. Wednesday's decline was quite severe with Wheat futures off the limit of 10 cents and Corn down the 8 cents limit. May Cotton was down 131 points at the low but rallied at the close and was down 65 to 60 points on the day. The Dow-Jones Commodity Futures index was down $4.32 at 160.72. The more important commodity futures have now penetrated the recent trading areas on the downside indicating that these areas are distributional tops and that lower prices in commodities are in prospect.

The long term implications of a sharp break in commodities, particularly in the food group, are bullish on stock prices. Food prices are out of line on the upside in the general economic picture - just as stock prices appear to be out of line on the downside. Of course, drastic breaks in commodities are at first bound to cause some nervousness and uncertainty in the stock market but that will gradually turn to realization of the bullish effect of such a decline.

The pattern of the stock market is, in my opinion, the reverse of the commodity pattern. Commodities have had a sharp rise over the past year and built up a large distributional area at the tops. The stock market had a 53 point decline seventeen months ago and since that time has held in relatively narrow trading range near the bottom. Just as the commodity pattern turned out to be a distributional top, believe the seventeen-month trading range in the stock market averages will turn out to be a long accumulation bottom. Of course, more time may be spent in the area and prices may dip into the lower part of the 187-161 range into our oft-mentioned 170-160 buying area. Such a decline would enlarge the already broad potential base area.

The most favorable technical action would be continued weakness and irregularity into early next week. That would not only broaden the base but would bring prices into the indicated 171-167 and 49-48 decline objectives mentioned in our letters of two or three weeks ago.

Last week's lows of 170.70 and 49.40 were just at the top of these lows and a further dip seems indicated. Last week's technical rally carried back to only the indicated 176-175 resistance area. It would also bring not only our short term market gauges into an oversold position, but also the intermediate and longer term gauges. Such action could indicate the end of the tiring accumulation area and a start of the major upswing.

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