# Technical Market Action

One of the major tenets of the Dow Theory is the principle of the confirmation of a trend by both the industrial and rail average before a major move is indicated. A corollary, of course, is that a divergence in the two averages usually indicates a probable change in trend. In the past, this particular phase of the Dow Theory has been subject to considerable criticism. The main objection was that the theory of confirmation was outmoded because of the growing importance of the industrial average and the lessening importance of the rails. At times these objections seemed partially justified at least. On several occasions, the industrial average moved ahead sharply and the rails either failed to confirm by reaching new high territory, or else the confirmation occurred after the major portion of the move had already been completed. However, in the past two years the theories of confirmation and divergence have worked out almost perfectly.

In February of 1946 the industrial average reached a high of 207.24 and the high on the rails was 68.42. This was followed by the sharp February decline with the averages reaching lows of 184.05 and 59.86. Subsequently, both averages rallied with the industrials in the lead and the rails lagging. This was contrary to previous performance. Since the inception of the bull market in early 1942, the rails had been the leaders in each advancing phase. The industrials penetrated their February high in late April but the rails failed to confirm. It was this divergence that prompted this letter to advise extreme caution and to predict in the letter of May 6th, 1946 that the potential distributional area built up in early 1946 indicated a possible decline to the 170-160 area in the industrial average. Ever since the September 1946 break I have consistently stressed this same 170-160 area as a major buying range. It has proven to be such for the past nineteen months.

To continue with the action of the market in early 1946, the industrial average reached a high of 213.36 in late May, 6.12 points above the February high of 207.24. The rails, however, could do no better than penetrate the February high of 68.42 by only a small fraction to reach 68.77. This divergence between the two averages proved to be an extremely important signal of a change in trend. Subsequently, both averages penetrated the February lows of 184.05 and 59.86 to confirm a downtrend. The averages declined to 160.49 and 44.00 in October. That proved to be low for the first phase of the decline. The next rallying phase carried to highs of 184.96 and 53.65 in February of 1947. It will be noted that the industrials reached the logical resistance point, the bottom of the 213-185 distribution area, but the rails failed to reach the equivalent 59, the bottom of the 68-59 distribution area.

The next intermediate decline was the second instance of divergence. In May, 1947 the rail average declined to a new low at 40.43, 3.57 points below the October low of 44.00. The industrial average, however, failed to confirm a renewal of the downtrend by holding above the previous October low of 160.49. The May, 1947 low was 161.38.

The third instance of divergence occurred at the July 1947 highs. The industrial average penetrated the February high of 184.96 to reach 187.66. The rail average failed to confirm, however, by attaining a high of only 51.92 against the February high of 53.65. A subsequent decline carried the averages to lows of 174.02 for the industrials in September and 46.00 for the rails in December 1947.

After that, the fourth instance of divergence occurred in early January of this year at 54.17. The industrial average failed to reach the July, 1947 high of 187.66 by 5.84 points at 181.82.

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The subsequent decline was the fifth instance of divergence. The industrial average broke the September, 1947 low of 174.02 and declined to a low of 164.07 in February. The rail average held at a point above the December 1947 low and met support at 47.48. It will be noted that, for the first time since the 1942-1946 bull market, the rail average showed better technical action than the industrials.

The sixth occurrence of divergence is the present technical pattern. The rail average has decisively penetrated all previous resistance points of the last nineteen months to reach a high of 59.63 on Tuesday, 5.46 points above the previous January high of 54.17, or a penetration of approximately 10%. On the other hand, the industrials at the April 23rd high of 184.48 and Wendesday's closing of 180.94, have failed to confirm the excellent technical action of the rail average.

That brings us up to date. Will the industrial average shortly confirm the penetration of the nineteen month trading range and prove the theory consistently advocated by this letter that the market is in a high accumulation area with considerably higher prices indicated over the longer term?

My opinion has definitely not changed. I believe that the industrial average will, over the comparatively near term, confirm the bullish pattern of the rail average. The only question is whether the confirmation will take place in the very near future or at a slightly later date. In other words, will we get a one-third to one-half correction of the 20.41 point advance of the industrial average from the February low of 164.07 to the April high of 184.48 immediately? Such a correction would carry the industrial average to 178-175. The second alternative would be a penetration of the July high of 187.66 and a rally to the 200-195 area before a technical correction occurs. A one-third to one-half correction from that point would carry the industrial average back to the 188-180 area. Ability to penetrate the previous high of 184.48 would indicate the probability of 200-195. Penetration of last week's low of 179.47 on the industrials would favor the possibility of 178-175 before the advance is resumed.

EDMUND W. TABELL

May 5, 1948

SHIELDS & COMPANY

Closings

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| Dow-Jones Industrials | 180.94 |
| Dow-Jones Rails | 57.97 |
| Dow-Jones 65-Stock | 66.91 |