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Current Commentary on the Primary Financial Market Trend

The Weekly Peak

A New Bear Market Rally Is Likely to Begin

Last week I laid out a preliminary case for the possibility of the S&P 500 trading higher in the near-term. It started with technical analysis and ended with a little bit of "less bad" fundamental fill-in.

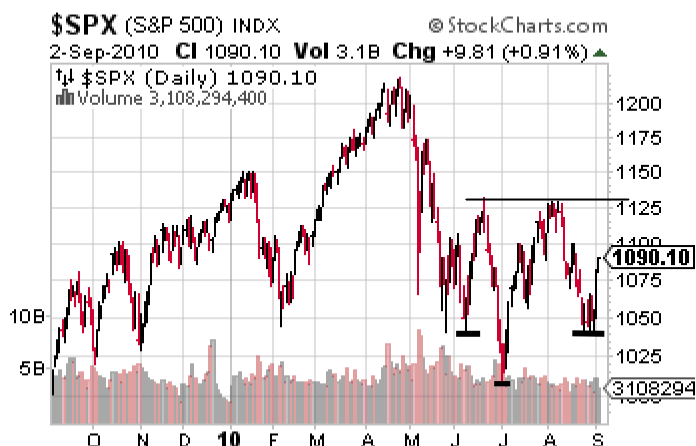
Technically speaking, I wrote about a bullish **Inverse Head and Shoulders** pattern that was unconfirmed but had completed its pre-confirmation structure last Wednesday by putting in its right shoulder in dipping to 1,039.83 and then closing at 1,055.33.

I presented this pattern in the context of a competing and confirmed bearish Head and Shoulders pattern in an effort to determine which pattern would succeed and provide us with the near-term direction of the S&P 500. I concluded that 1,040 would be the line to watch but expanded that line to a range of between 1,040 and 1,080 this past Monday.

Below 1,040 and the bearish Head and Shoulders would be the winner in a sign that the index would go much lower while above 1,080 the Head and Shoulders would be invalid leaving the bullish Inverse Head and Shoulders pattern left standing.

In addition, on Tuesday I wrote about how the Inverse Head and Shoulders would "need to find some volume and spike higher to remain valid."

Well clearly the index spiked higher and through 1,080 on Wednesday and on increased volume. In so doing, the bearish Head and Shoulders pattern was destroyed while providing "**the validating spike higher for the bullish Inverse Head and Shoulders**."



Yesterday, I also mused:

> In addition and relative to the days ahead, based on the dozen or so charts of various Inverse Head and Shoulders patterns that I've studied, I expect that we'll see another spike or two but perhaps after a day of consolidation if this pattern is the real deal.
>
> **Those additional spikes on increasing volume will bring greater validation to this pattern prior to its confirmation if that should come**.

By the close yesterday we had another one of those spikes albeit on weak volume.

Now that we have those two spikes higher off of the right shoulder, the current chart of the S&P 500 looks even more similar to the charts of the various and confirmed Inverse Head and Shoulders patterns that I have reviewed.

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In fact and relative to what I wrote last Friday about how uncanny the current chart of the S&P 500 looks to the chart of the Dow in 2002 and 2003, it has become even more uncanny with these two spikes. That particular chart has a third and larger than the first spike directly after the second spike.

Many of the other charts that I've studied also contain multi-day spikes higher toward the confirmation point.

While I have no clue what lies ahead with today's nonfarm payrolls report, if the current chart continues to bear a greater resemblance to the various Inverse Head and Shoulders patterns that I have studied as it has been doing, it would suggest that the report will be in-line at the very least if not contain some sort of positive nuance or upside surprise.

Again, I have no clue whether that happens, but it is now strongly suggested after the index's back-to-back spikes higher and by drawing parallels between the current chart of the S&P 500 and confirmed Inverse Head and Shoulders patterns that I have studied.

Should that happen today, should the S&P 500 spike higher once more, the index will be brought that much closer to the confirmation point of this pattern or 1,131 precisely or 1,135 "for purposes of sound reason, round numbers, and respect of resistance around that level."

While at that point many people will believe the S&P 500 to have put in its rally already and rightfully so considering it will have moved significantly from 1,040, the real rally will begin when the index hits that 1,135.

For once the bullish Inverse Head and Shoulders pattern is confirmed with the index crossing through 1,135, should this come to pass, the **target** for this pattern is **1,250**. *That* is **the real rally** if it should come to be.

This is especially true considering that quite often technical targets are overshot and sometimes significantly so as was the case with the Dow's 2002 and 2003 pattern.

However, in the case of the Dow, it proved to be a spectacular shot up before a rather rattling ride down a few years later.

So too would it be the case now if the S&P 500 moves through 1,135 to rally much higher. It would be a good if not great rally but it would be a bear market rally and those tend to have ugly endings for many who get their hopes up just a little bit too late.

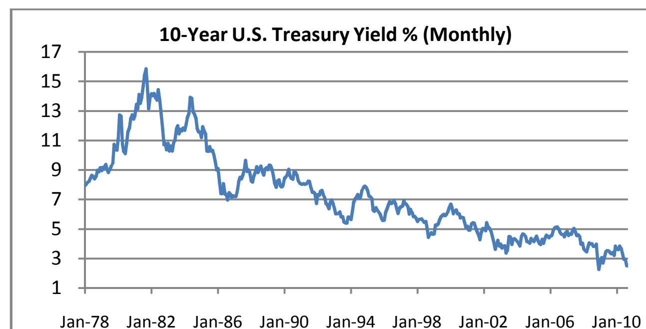
It might even be a multi-month bear market rally that will reignite all of the talk about the resumption of the bull market, but in the end, it will only be a rally in a bear market.

And thus, if the S&P 500 does move up and through 1,135 and higher yet, I encourage you to see it for what it will be: **a bear market rally**.

Sam's Stash, Gold, and the S&P

I first wrote about Treasurys strengthening in the near- to mid-term on March 26 when the 10-year was close to 4% and most big banks had begun to forecast a 10-year yield closer to 5% or even higher by the end of this year.

Specifically, I wrote: "I believe this chart says the yield on the 10-year looks as though it will stay below 4% with another possible spike down."



Well the chart remains the same – in trend – and now we have the 10-year well below 4% with the spike down on a monthly basis.

On July 9, I began writing about the 10-year going to 2%.

> In fact, 2008's lows suggest that the "pull" of the trend is toward that 2% crater, and thus the mid-2% level or even back to that very nadir of late 2008 may be where the 10-year finds itself trading. By that time, of course, should it occur, Europe will have gotten much worse and the "double dip" debate will be over.

Well we have our mid-2% level on U.S. slowdown fears alone since Europe has had a summer of respite and rest before it starts to heat up again soon.

Most recently, I have been writing about the 10-year going below 2% on a flight to safety wave unlike any that we've seen yet in the first stage of the financial crisis or the current ligament between that stage and the second stage that will unfold in Europe with its sovereign debt and its banks.

I still believe this will occur but if the S&P 500 rallies for a month to several months as detailed in the first section of this paper, Treasurys will back off a bit during that rally as risk is bid up and safety backed away from to some degree. While it's impossible to know what that might look like I'd take an initial stab in saying the 10-year will move back above 3% and maybe move closer to 3.5%. This precise level will depend on how convincing the rally is and how long Europe holds up.

Once the rally fades and/or once Europe's sovereign-debt and banking woes come back to the surface, I suspect we'll see Treasurys strengthen once more and begin to move quickly toward that 2% level on the 10-year.

When we put all of this together, Treasurys have been a great ride and there's more ahead even with a possible pullback this fall but that ride is going to end abruptly when investors demand a much higher rate of return to own U.S. debt. When this occurs, yields will soar as Treasurys weaken significantly if not collapse. This month I will be detailing, finally and after a spring and summer of promising, how I believe this happens exactly or as exact as one can get with something that's both unchartered and uncharted territory.

But because this ride will end abruptly, it's not one I'd be staying on beyond 2% even if Treasurys stay at that level or lower for a significant period of time. Again, when it stops, it will throw everyone off rather rudely.

Looking at the dollar, this one's tricky.

Three weeks ago I wrote a piece called **The Dollar's Going Higher** (August 13). The reason for writing that piece was a combination of thinking the dollar would strengthen from a continued flight to safety and in relation to the euro.

However, now that I have come to believe that we're very likely to see a rally in the S&P 500 over the next month to several months due to the technical pattern detailed in the first section of this note, it seems likely that the flight to safety will lessen during this same time period.

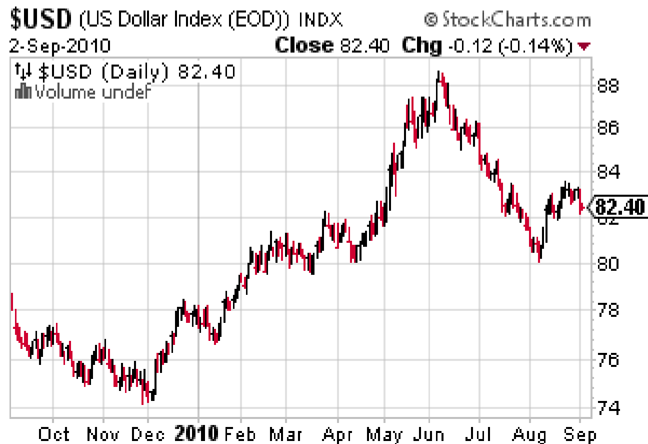
It won't go away, but it will thin out and there will be less investor interest to spread among the various safe haven asset classes.

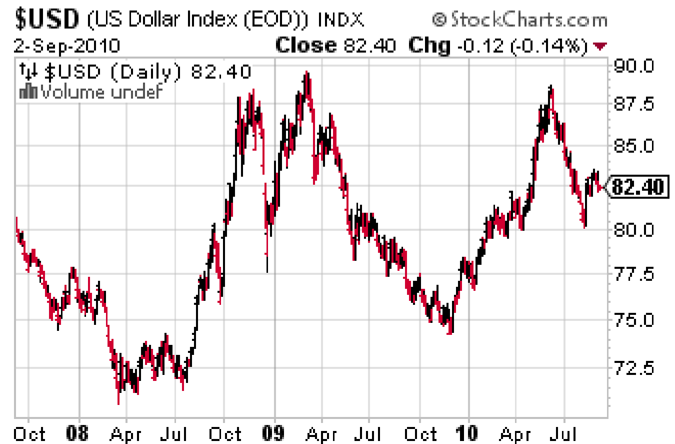
In addition, there are so many other factors to influence the currency markets, factors that are well beyond my simplistic scope, that it's tough to know how the net influence will show up in the chart.

Speaking of the chart, or charts, there's not a lot of definitive help on this one as shown on the next page.

The 1-year chart of the dollar index could go either way with more of an uptrend but it's an unstable uptrend carrying the downtrend from approximately 88 to 80 between the beginning of June and early August. Placed in the context of the 3-year chart, a possible triple top formation is back on the table and the overall picture becomes that more unstable. Put in the picture of the 30-year chart (not shown but contains a strong primary and downward trend), the dollar index is going down as I had also noted in the August 13th note and in a note on the seeming near-term correlation between gold and the dollar.

If I had to guess at this point and it is nothing more than that or a guess, I'd be inclined to say the dollar index goes back to 80 and either hangs out there supported by an undercurrent of safe haven hedging by investors or potentially moves to somewhere as low as about 72 to about 75 as support is found at each approximate level. This will depend, in part, on whether and for how long investors embrace risk over the coming weeks and/or months.





In addition, as I first pointed out a few months ago, this chart contains a potential triple top that confirms slightly lower than 75, but should the dollar index decline to that level, I continue to have a hard time seeing that pattern playing out any time soon. This is mainly because its fulfillment suggests 60 or lower and based on the 30-year chart of the dollar index, it will be nearly impossible for the dollar index to recover from that level and this, of course, would suggest severely weakened or collapsed Treasurys.

Now as I wrote above and is detailed to some extent in **Lender of Last Crisis** (May 5), I do believe all of that is going to happen, but these things always take longer than you think and I don't see Europe imploding and the U.S. running to its rescue in what will turn out to be a fatal move within the next few months. I believe that will take at least 12 if not 36 months or more to begin to play out.

So going back to the dollar index in the near-term as in the rest of this year, I would guess that it will move back to 80 and remain supported there or begin to move to that lower level of support between 72 and 75.

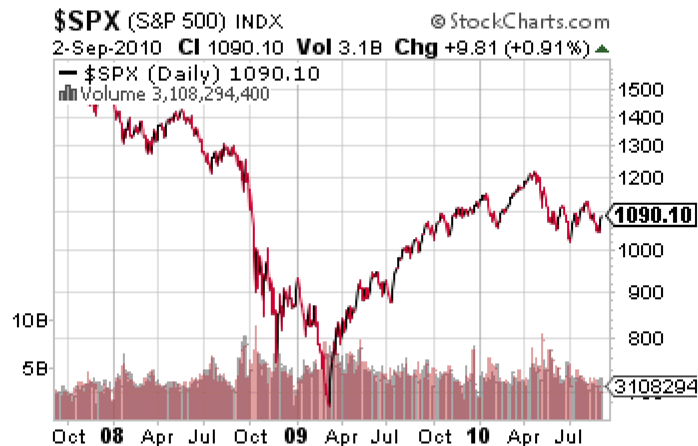
This view is clearly different than the one I wrote about just three weeks ago and I likely will be putting out a note on the topic with my revised opinions within the month and what may be most interesting will be a fresh dissection of the seeming correlation between gold and the dollar this year.

Looking at gold, it's clearly moving up. After breaking through the $1,220 per/ounce level, it's only gone up and this is consistent with much of

the very intriguing information that I'm reading on this precious metal.

At some point, if I ever digest everything I've read and can put it into one cohesive picture with the charts, I'll do so. In the meantime, gold's primary trend is up, but I must point out that I will be much more comfortable with this chart once gold makes it through $1,310 per ounce and more on that in a future note.

And now, lastly, let's take one more look at the S&P 500 – the long-term look.



The S&P 500 may be setting up for a very nice rally in the near-term, but the S&P 500's primary trend remains down.

This will remain the case until the S&P 500 is at 1,565 at which point it is flat. At 1,566 the S&P's long-term trend can be considered to be up ever-so-slightly.

Never say never but that level seems pretty far from where I'm sitting and especially considering the debt storm of the last 30 years and its various ramifications.

In addition, if the S&P did move toward that level, I would be inclined to believe that the S&P 500 was peaking in a triple top.

Since that's another negative reversal pattern with roughly the same measuring implication as the index's current and confirmed double top of about 425 on a logarithmic chart, there may be some cheer around it for a period of time, but in the long-term, ultimately, such a pattern would confirm what the double top confirms or the fact that we're in the **worst bear market of our collective lifetime**.

As always, **thank you** for taking the time to read this week's piece.

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