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The Deviant Standard

Rigorous preparation for volatile markets

Summary

Today's persistent strength has forces us to give more weight to the possibility of an upward retrace that reaches much higher than where we are today. We had always considered this possibility, but had not given it much weight until today. Evidence suggest that we'll see at least a small down move soon, and the development of that move may help us to discern more about the retrace.

Markets on Tuesday

After a sizeable opening gap, buying was slow, but steady all day on Tuesday, with hardly any retraces of significance. That puts us in a position to start ringing some additional warning bells regarding the medium –term bearish picture.

This upward rally has now gone on for 38 hours of market time. When looking for divergences with our indicators, we want to use a chart that has about 100-140 bars for the entire move. If we were considering this move complete we would want each bar to represent somewhere between 16 and 23 minutes of trading.

Using a 20 minute chart for our example, we see that we no longer have a MACD divergence, even though there is still a divergence in EWO. Specifically, anything with 18 minute bars or higher lacks a divergence in MACD.

It is hard to draw firm conclusions if MACD and EWO do not agree, but the warning message sent by MACD is that the move up from June 8th is unfolding in five waves, with only wave 3 now in progress, or nearly complete.

If only wave 3 is complete, then the expectation is for a move longer than 38 hours total. So we also show a 36 minute chart, which would be the extreme. And now the EWO divergences are also gone.

Furthermore, on several charts, there's an RSI peak at around 11:30 on Tuesday. Often RSI peaks in a third wave of a third wave.

The sum total of these observations is the conclusion that market action is not inconsistent with five waves up from June 8th lows. However, with EWO divergences remaining on short timeframes, it's also still consistent with the possibility of a three-wave movement.

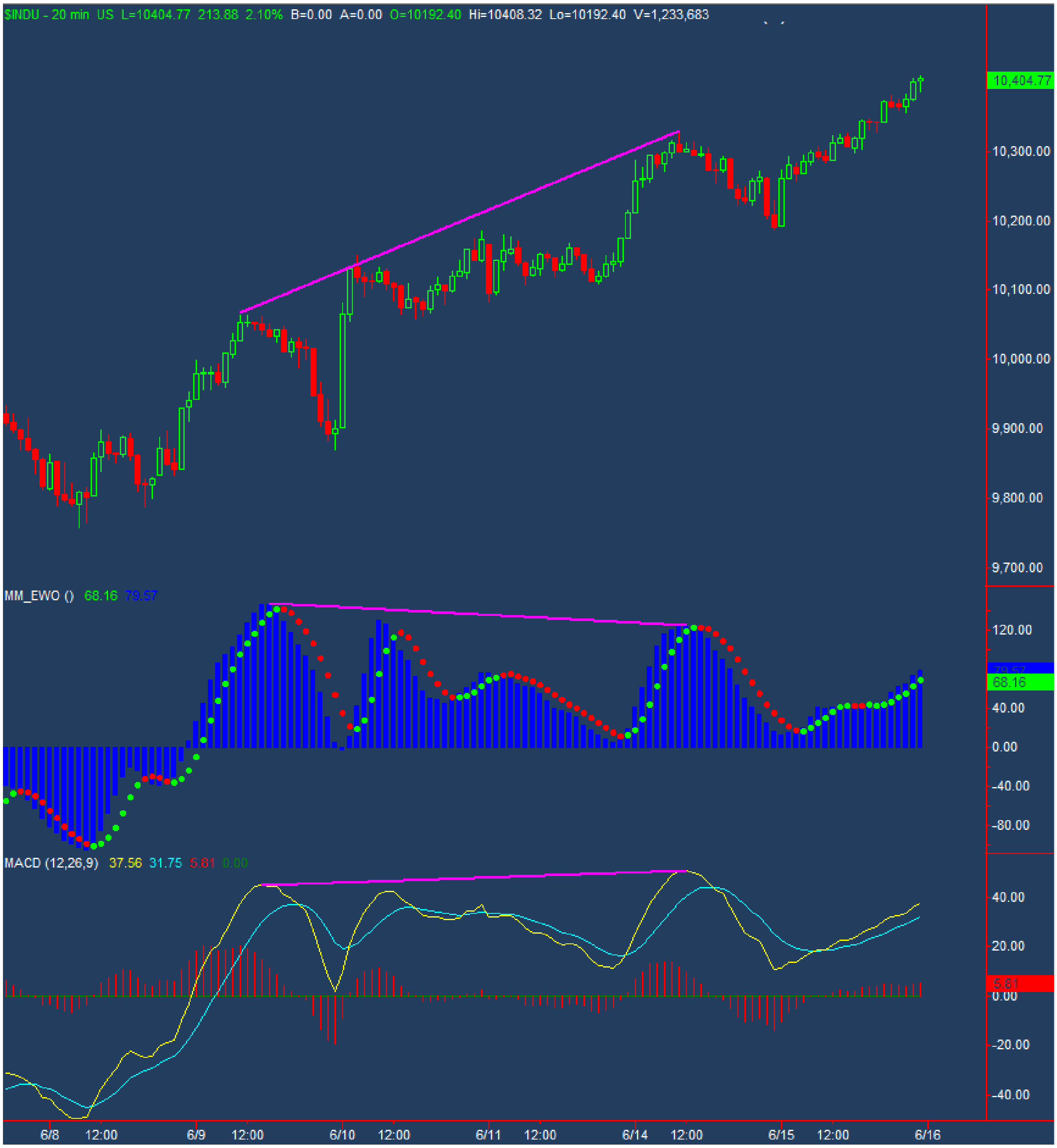

Figure 1 - 20 minute chart shows no divergence on MACD

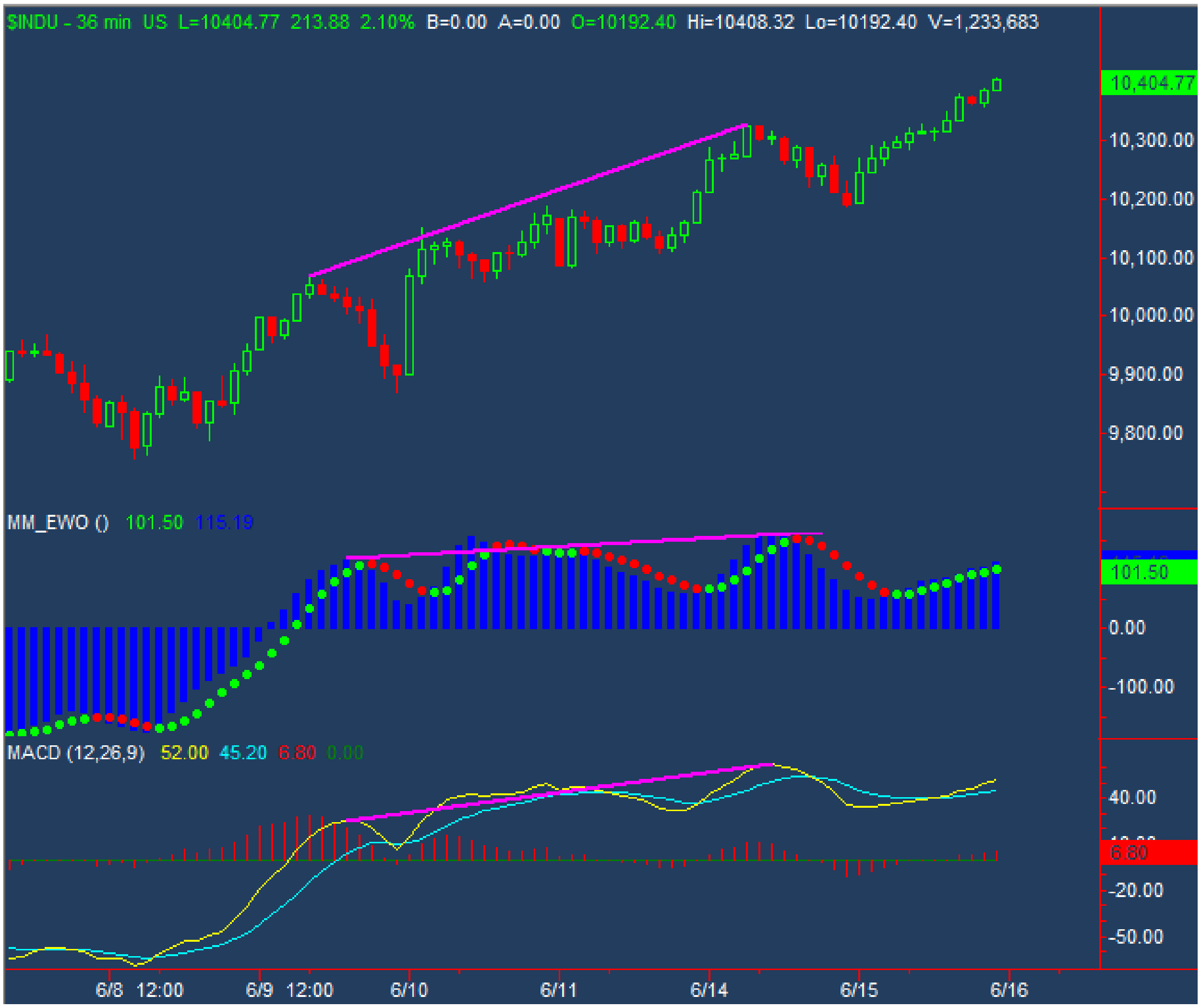

Figure 2 - Neither MACD nor EWO have divergences on a 36 minute chart

If the move up from June 8th lows is in three waves, then the move up from June 9th closing lows is a C wave. If we're in the middle of five waves up then the move up from June 9th is a wave 3. Both Cs and 5s typically unfold in five waves, so we should look for the end of five waves up. Figure 3 shows a 10 minute chart with wave counts, but not accurate for degree. There are a number of reasons to feel comfortable with these counts:

1. The chart has the right number of bars to use our technicals
2. EWO and MACD peaks are in wave 3.
3. RSI peak (vertical line) is at wave 3 of 3
4. EWO at wave 4 retraces 90% to 140% of EWO at its wave 3 peak.

This suggests that we've already well into wave 5 of this move and that it should complete soon.

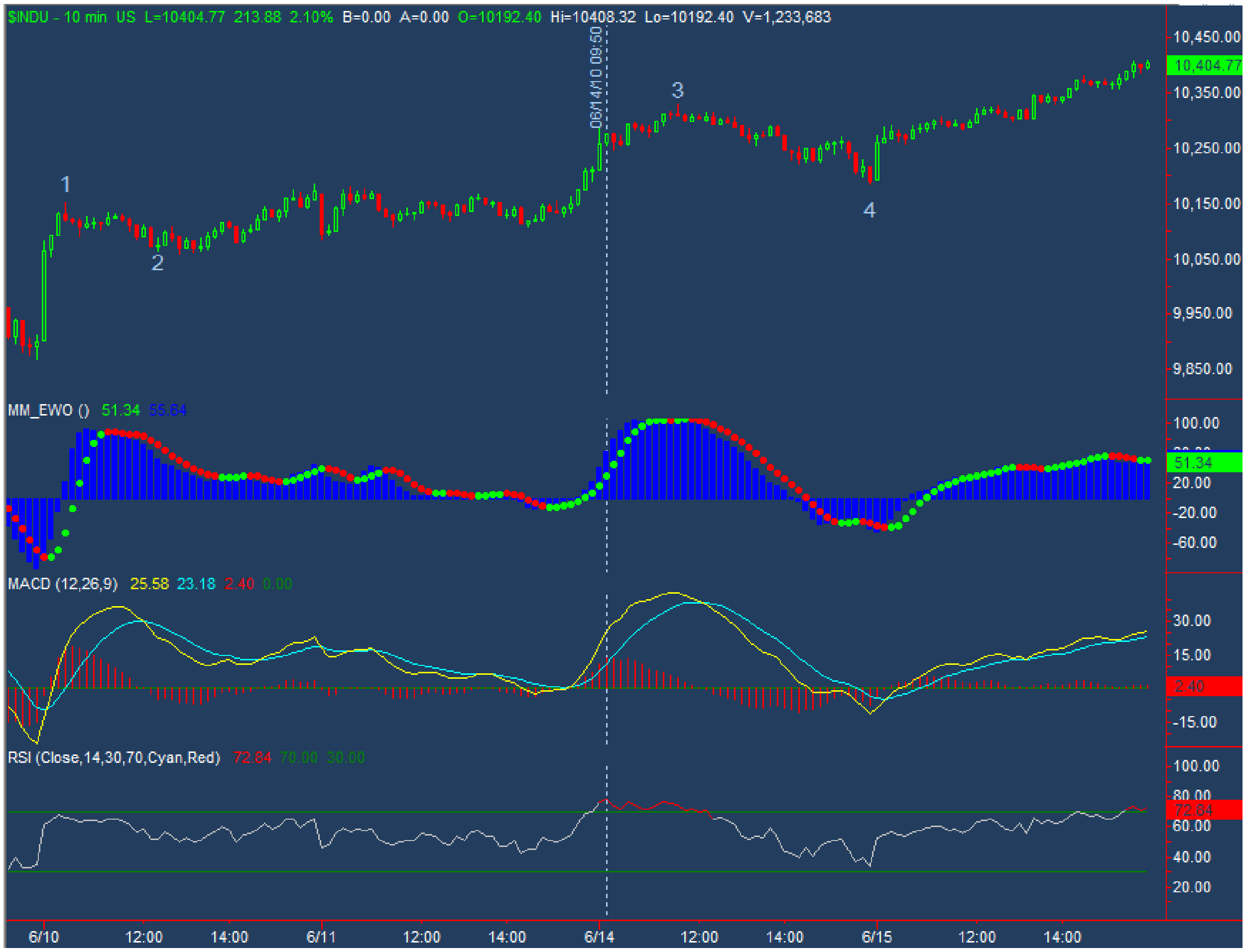

Figure 3 - Looking for 5 waves up

Outlook for Wednesday

At the end of a smaller degree five waves up, we should see some retracement. If it ends three waves up, then a resumption of the downtrend would be expected. This remains a possibility. Otherwise, the retracement would be a fourth wave in a five wave sequence. EWO behavior in fourth waves should be a clue. If EWO retraces more than 140% of the third wave peak then we can presume a completed correction.

If it is merely a fourth wave, then we'll end up with a large number of scenarios to consider when it completes. Specifically:

1. The five waves represent wave C of a running flat correction from May 25th. This would be the most bearish interpretation.
2. The five waves represent wave A of a zig-zag correction June 8th. This would lead to the expectation of a more significant correction upward.

3. The five waves up represents the start of wave C of (Z) of an as-yet incomplete correction from March, 2009 lows.

While we consider the last scenario to not lose sight of possible bullish scenarios that might develop, the expanding indications that we might see a greater upward correction have not done anything to suggest we change our perspective that a pivotal market turn downward has occurred.

Swing Trade Model Portfolio

More model portfolio names were stopped out today. All cup & handle breakdowns will remain valid should they materialize. We won't be looking at more names until our market perspective crystallizes.