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The Deviant Standard

Rigorous preparation for volatile markets

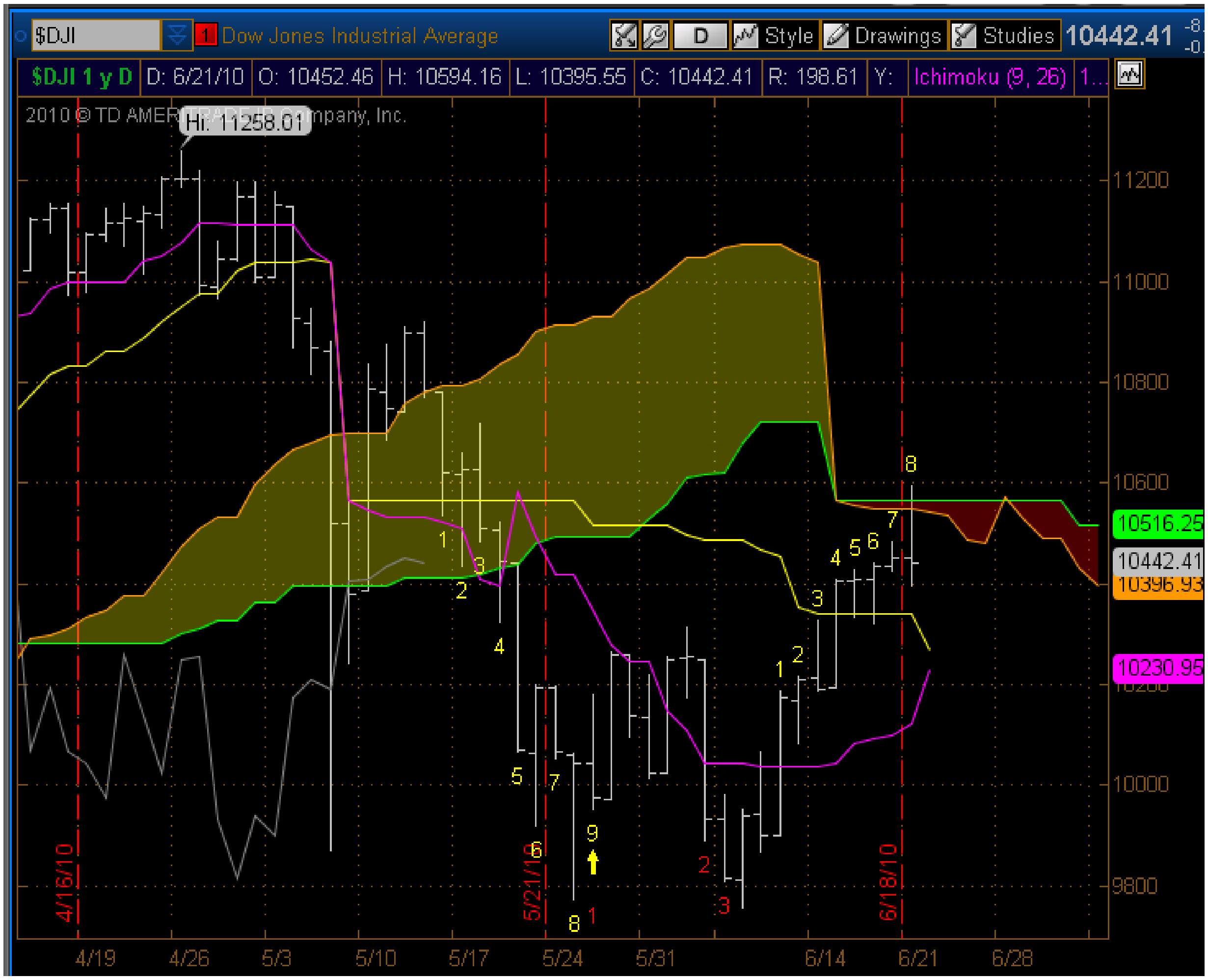
Summary

Monday's high appears to mark the end of five waves up from June 8th. If so, then we expect continued downside to at least retrace a portion of the move up, if not an immediate return to new lows.

Markets on Monday

After several narrow range days during options expiration week, and the narrowest in two months on expiration Friday, Monday's market saw range expand to just shy of 200 points on the Dow. Of course that range didn't move the market very far, as the index closed 6 points under where things left off on Friday. The intervening move reached just above a downward sloping 50 SMA, a new high up from June 8th lows before turning down. That high counts out well as then end of a 5-wave move up.

Volume was well below average for the past few weeks. We look short-term overbought on many measures. A daily Ichimoku cloud chart shows us up into resistance.



Aside from having a natural 5-wave structure, we notice the following features on a 30-minute chart shown in Figure 1:

- EWO and divergences at the wave (v) peak.
- The highest EWO and MACD values were within wave (iii)
- RSI peaked in wave iii of (iii).

These are classic behaviors for an impulse wave so that's what we will consider it unless future evidence forms to contradict this view. Further bolstering our perspective is price action that began to accelerate down from the peak. We should expect prices to continue downward – if they don't then that will be one possible impetus to begin revisiting other counts.

Because of the height of this move off of June 8th lows, if this is a correction then we expect that it is correcting a full five-wave down from April 26th. The two counts we're currently working with are show in Figure 2. The white count is the most bullish and shows Monday's high as the end of a running flat correction to complete wave 2. That would be the most immediately bearish count. The magenta count shows Monday's high as wave [a] of 2, with waves [b] and [c] to follow. There are other ways to count this, likely some we haven't considered. However, most play out in a similar fashion. In other words, we have two specific cases to consider:

1. Any move down now is just a retrace and wave 2 is not yet complete; or
2. Wave 2 is complete and we're heading back down.

If the market remains true to form, it will throw us some head fakes along the way.

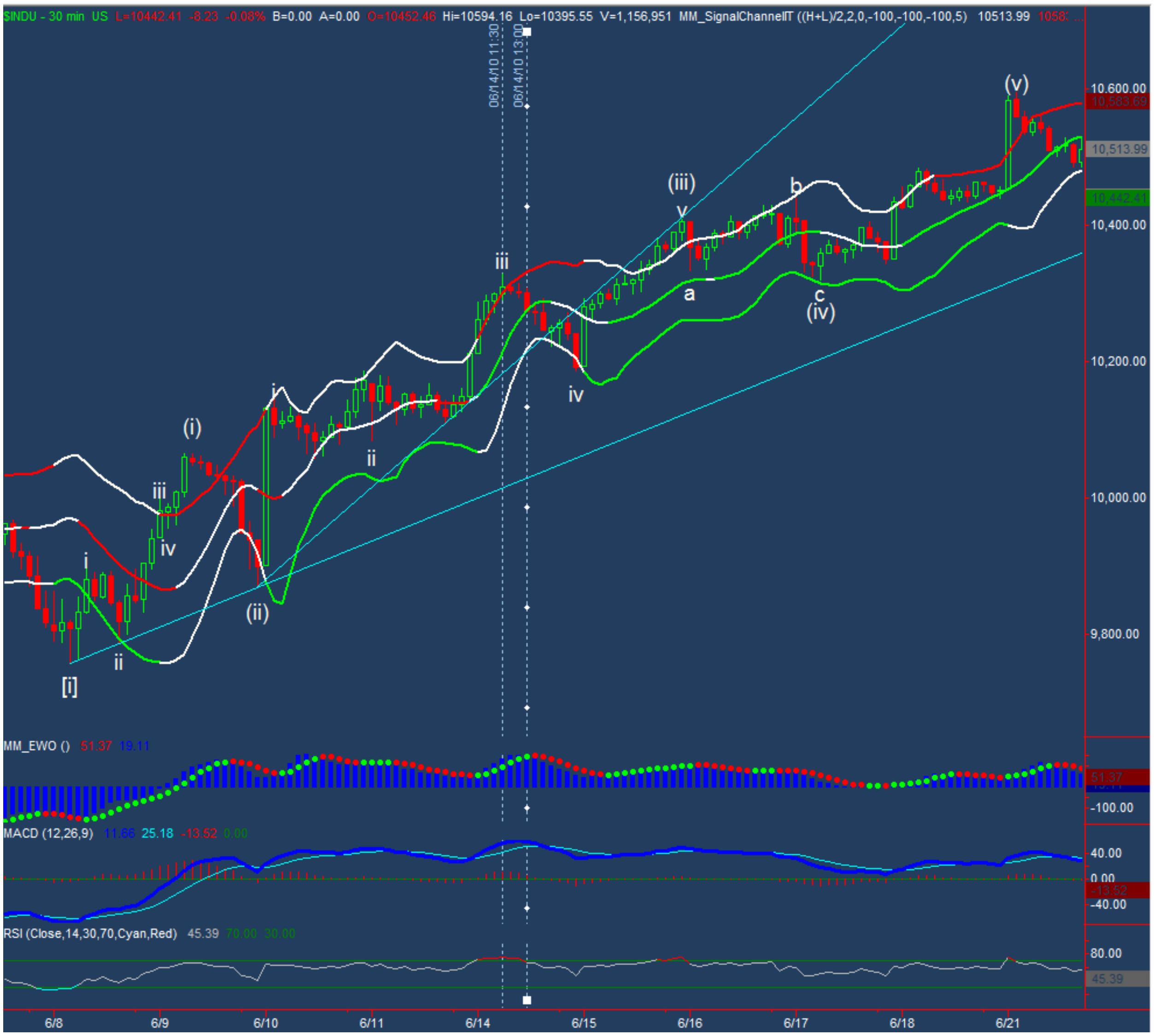


Figure 1- Five Waves Up from June 8

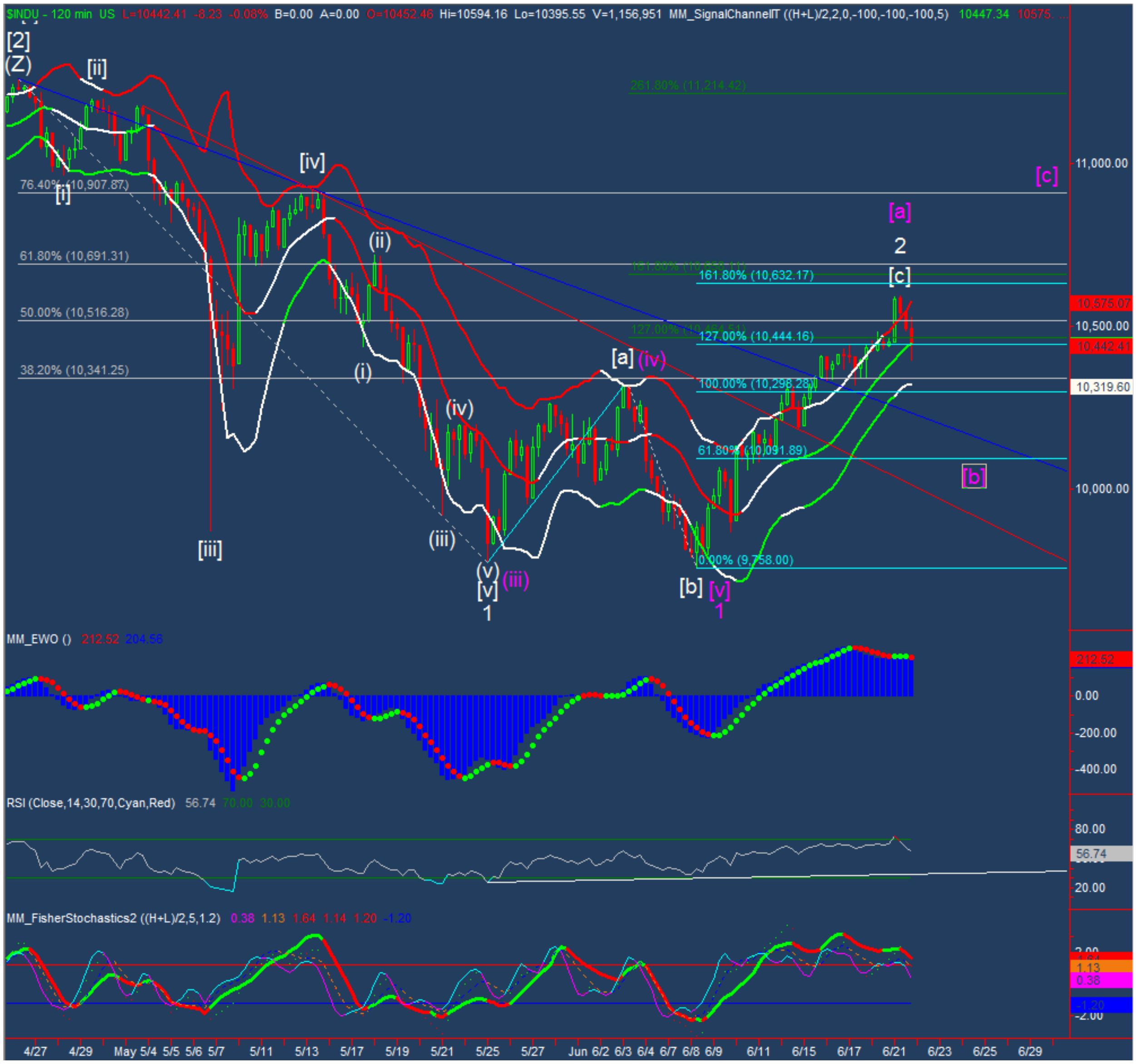


Figure 2 - Possible Counts

Outlook for Tuesday

We don't want to get ahead of ourselves looking downward. However, if our count is correct and we have turned, then we may now be in wave iii of (iii) of [i] of 3 of [3]. Therefore, we would expect it to pick up steam. The first order of business will be to see continued downside to confirm Monday's high as the end of five waves up. With continued weakness we can focus on determining which of our scenarios we are dealing with. The only true confirmation of a completed wave 2 would be taking out lows at 9,758 and continuing down with a wave structure that looks impulsive.

We'll want to use all the tools in our toolbox to try and figure out whether the correction is still in progress, or if it has ended.

Here are some factors that would lend weight to the scenario that the top is in:

- The Dow breaks the trendline up from the lows currently at about 10,375;
- The Dow breaks the peak of wave iii of (iii) at 10,328 to rule it out as the top of a first wave in some alternate wave count;
- Wave action downward looks impulsive and is free from overlaps;
- The centerline of our new adaptive channel turns down in multiple timeframes; It just started to curve down slightly as of the last hour on Tuesday. We want that to hold and extend to the daily chart. The weekly remains curved down;
- Reach a 30 minute EWO reading below -63 representing 140% retracement of the peak of the up move;
- See 30 minute MACD go below 0 and be turned back down from near the 0 line on a retest;
- New lows on indicators (MACD, RSI, and EWO) to match new lows in price;
- Pushing below lower bands of our adaptive channel on higher and higher timeframes while remaining contained by the centerline or upper band on any retraces.

Of course failure to observe these events would make it more likely that we have another high to put in. We don't expect the market to go down in a straight line and they will test our resolve. If we're on the way to new lows, retraces will do their best to convince us that we have seen a correction that is now over. If more upside is in store then there will be events that appear to indicate we're heading down. It's likely that the only chance we have of avoiding the frustration of false clues and contradictory evidence is if the market instead decides to frustrate us with a rapid move that denies additional good entries.

The point of harping on the likely ambiguity isn't to put us in a game of locating the iocane powder. Rather, be prepared. Wherever you place your entries and stops, be comfortable if they're hit. There won't be a perfect place to put them so make sure that you have a strategy that you've proven out and you stick to it.