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Stalking Major Moves: Looking for Signs of Where the Market is Headed

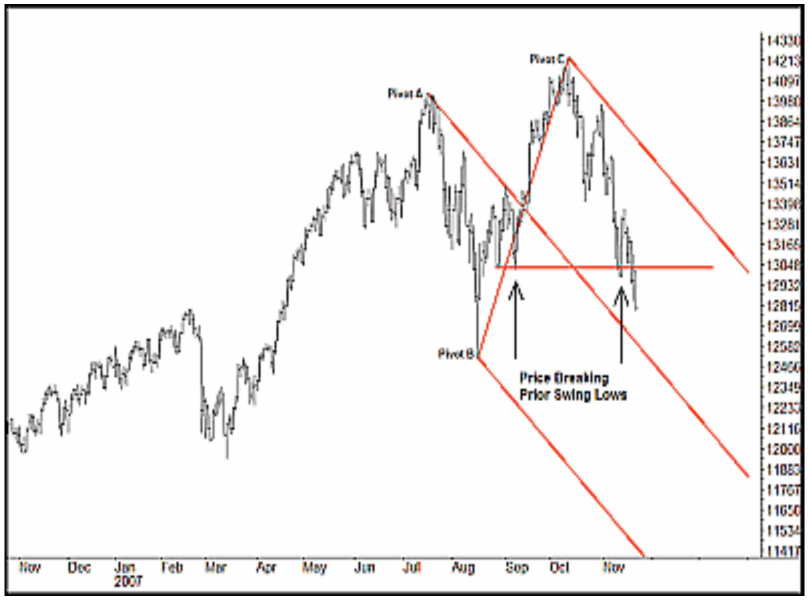
I have had the privilege of making my living as a professional trader for the last 37 years. I began my career by learning to draw daily bar charts on large sheets of paper, and I still update my own hand drawn charts on 27 different markets each afternoon after the market closes; I keep daily, weekly and monthly charts on each of these markets. I find this practice of updating these charts each afternoon invaluable because while updating each one, I am always on the lookout for a change in behavior in that market that will give me an early clue, that a change in trend is either imminent, or is in the process.

Over the past several years, I have been honored to be asked to speak four or five times a year at the Traders Expos and Forex Trading Expos, held around the United States. Besides teaching free and paid sessions featuring my own trading methodology, and meeting thousands of traders at each of the Expos, MoneyShow.com interviews me on four or five topics each time, and then these interviews are run between Expos on their Web site [and they are archived there as well]. Two of the topics that always come up are: Where are interest rates heading, and where do I see the Dow going in the next six to 12 months.

At the September 2008 Forex Expo, I was asked again to predict where I saw the Dow headed for the rest of the year; for reference, the Dow was trading at roughly 11,500. I told Tim Bourquin, the interviewer, that I had just updated my long-term Dow chart before getting on the plane yesterday, and I felt that the Dow would be below 10,000 in about a month, and was headed to 6350 by year's end. Tim was surprised at the severity of sell off I was predicting, but I told him the charts I keep by hand had clear signs that a sell off was imminent. Later in the week, there were rumors that Lehman Brothers and AIG might fail and indeed, Lehman Brothers and another firm failed over the weekend, and the Dow did indeed accelerate to the down side.

After speaking with Tim Bourquin at MoneyShow.com this week, I decided you might find it interesting to see the 'snap shot' charts of the Dow I work with, recreated on a computer charting package so that they have the lines, prices, and formations that were on my hand drawn charts right before each Traders and Forex Expo since last November, as well as a current chart. Perhaps you will be able to see the signs I look for when stalking changes in behavior, and just why my prediction of this massive sell off of the Dow has been so accurate.

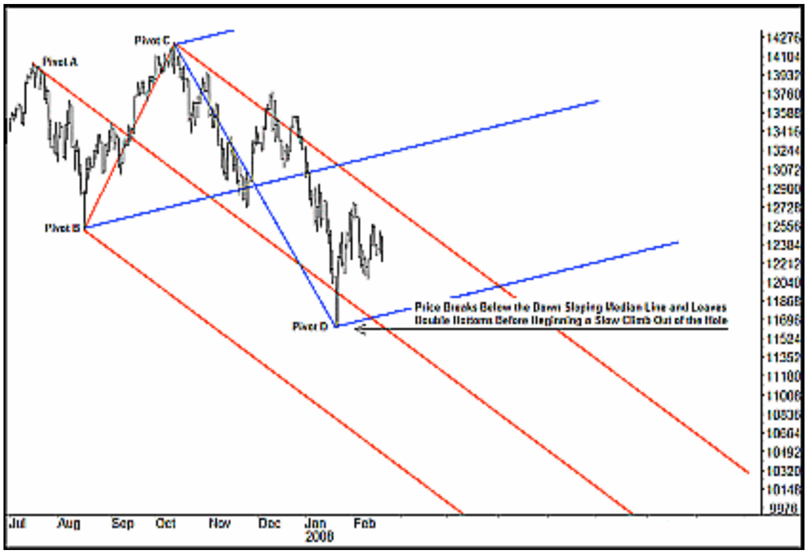
Let's start with the Dow Jones daily bar chart that was drawn just before last November's Traders Expo, held in Las Vegas:



The Dow made a new high in October of 2007, but then began to sell off its highs. It made one attempt to rally and re-approach the prior high made in October, but in early November, price began breaking below prior Swing Lows. It was clear that prices were not only making lower highs and lower lows, but the confirmation of breaking and closing below the prior Swing Lows [which was also a broad area of congestion] was a sign that the sellers were still in control of this market, and lower prices were coming.

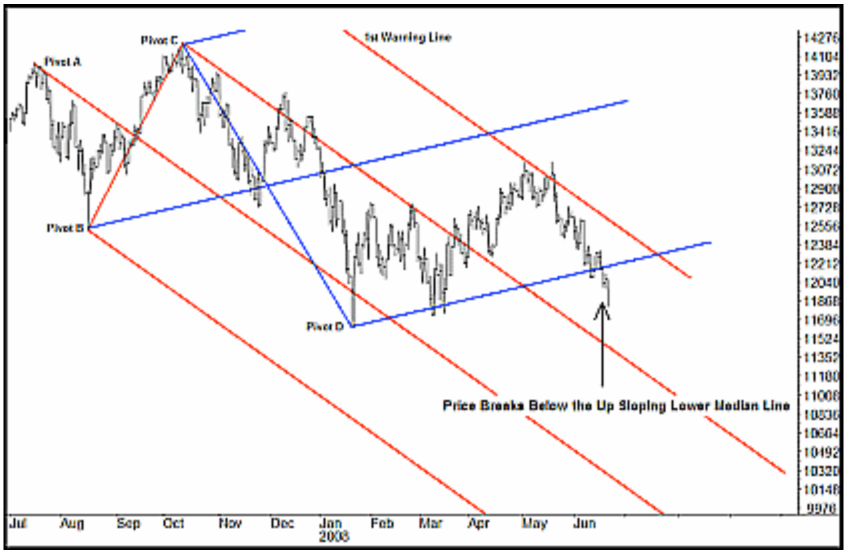
The Dow was just below 13,000 before my interview last November, and I told Tim Bourquin that I felt the Dow would break the low of the last major recession, 7300, sometime in 2008. Even though there was no credit crisis yet, no bank failures, no bail out packages to lead me to my conclusion, the charts told me all I needed to know: Prices were headed lower and probably quite a bit lower.

Let's look at the chart that was drawn just before this past February's Traders Expo, held in New York City, and see what clues it offered about the direction of the Dow and what I said in my interview with MoneyShow.com:



The Dow spiked lower in mid-January of this year and then began to climb higher - a change in behavior. When it began to make higher highs and higher lows, I added in an up-sloping median line set. When speaking with Tim for the MoneyShow.com interview, I told him the Dow was still well below the upper median line parallel, drawn off the high at Pivot C and the new up-sloping median line was only gently positive, so I felt that while the market would consolidate and perhaps rally a bit higher, the chart still looked bearish to me. I still felt we'd see a move to 7300 in the Dow during 2008.

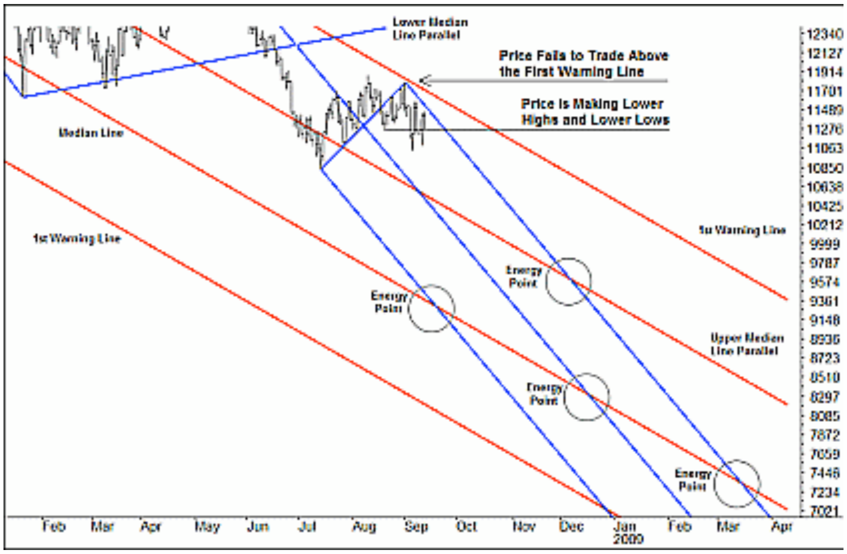
Let's look at the chart that was drawn just before this past June's Traders Expo, held in Los Angeles, and see what clues it offered about the direction of the Dow and what I said in my interview with MoneyShow.com:



Between February and mid-May, the Dow did exactly what the prior chart had predicted: It traded gently higher, consolidating in a 1200 point range as it made higher highs and higher lows. The combination of the Dow gently rallying and bars moving to the right each day brought the price of the Dow above the red down sloping Upper median line parallel. Once price closed outside the upper parallel, I added a red down sloping first warning line to the right of the upper parallel, because with roughly 80 percent probability, my statistics show that price will make it to that next line. Note that it worked like a charm! But once price tested the first warning line in mid-May, a change in behavior occurred: The Dow basically left double tops just above 13,100 and then turned lower and began making lower highs and lower lows.

More important, in early June, the Dow broke and closed below the blue gently up sloping Lower Median Line that had marked the beginning of the consolidation rally. As I spoke to Tim Bourquin during the MoneyShow.com interview, I re-iterated that I was extremely concerned that the Dow was in serious trouble and the recent sell off was likely to accelerate. The red down sloping median line set was clearly in control and this new change in behavior to lower highs and lower lows, coupled with the close below the up sloping lower median line led me draw in new targets on my hand charts. I now felt we might easily see a move 1000 or more points lower than the prior 7300 major low in the Dow yet this year.

Let's look at the chart that was drawn just before this past September's Forex Trading Expo, held in Las Vegas, and see what clues it offered about the direction of the Dow and what I said in my interview with MoneyShow.com:



This is a closer look at the same chart so you can see more of the future potential moves that the Dow may face. The Dow sold off to the 10,850 area, breaking back below the down sloping red upper median line parallel before beginning a climb higher—another change in behavior. The Dow basically rallied about 800 points but when it approached the down sloping red first warning line, it ran out of up side directional energy and began a sell off with lower highs and lower lows—another change in behavior.

I know most of you want to know where the Dow is going, where this will all end, and when it is time to start buying stocks again. But remember, I am in the trading business. I don't predict the weather—I don't predict where things will start and stop; instead, I look for signs of a change of behavior and work with Median Lines—*and Median Lines are leading indicators*. This gives me an edge on the majority of other retail and professional traders, because I am already stalking the markets I trade for turns *before* they occur. Then I look for high probability trade entries in those markets, to take advantage of the moves, and what the charts tell me are likely to happen.

You can see I have circled a number of areas on the chart above. Those are Energy Points or areas of confluence, where two or more tested lines cross. I am proud to say this is one of the innovate indicators I have brought to the world of trading, and I teach traders how to use these areas to greatly improve their trading results in their trading, in my seminars, and one-on-one mentoring. Energy Points act as price attractors, so when I see one on my charts, I automatically draw a circle around the area.

By looking at the circled areas, you can see the various areas where price may be drawn to. The red down sloping Median Line set is still ‘calling the tune’ in this market, more than a year after it was drawn. It’s too early yet to know if the new blue down sloping Median Line set will work.

But to me, one thing was clear as I sat down to be interviewed for MoneyShow.com in September: The Dow was about to head much lower. If price broke below the 10,827 low made in July, the fall would be swift and brutal. And the week before I left for the September Forex Trading Expo, price changed behavior and began making lower highs and lower lows. I told Tim that the Dow was in real trouble, the United States was in real economic trouble—and this was before Lehman and AIG failed or were bailed out. The charts were telling me all I needed to know. The Dow was going to test, and likely significantly break the prior 7300 lows. And it was looking more and more like the sell off was coming soon.

Let’s look at the chart that I just finished updating on October 10, 2008, as I began to write this article:

The Dow continued its downside behavior, making lower highs and lower lows. And in the past ten trading days, the ranges have widened, and the sell off has intensified. There have been more bailouts, more failures, and a package put together by the United States Government—and the Dow continues to the down side.

You can see by the Energy Points I circled on the current chart just where the Dow may go. There may be a good selling opportunity if the Dow rallies soon around the 9600-9700 area. The down side targets that are most likely to be meaningful are at a re-test of the 7300 area, if price can slow its descent, and then congest a bit before falling. There's another Energy Point at the 6300 area that is also a good candidate to be a price attractor. And obviously, there are areas below the 6300 level that the chart shows as possible targets; in short, the Dow and the United States economy are in dire trouble.

As I told Tim during the September MoneyShow.com interview, I hate to sound so negative on the United States economy, and our stock market. But we are facing high inflation [in my opinion, inflation is currently running at 17-20 percent and the recent sell off in the US Bond and Note market may be reflecting that], and are on the brink of a 1930's type depression. Our elected officials do not have a plan—in fact, in my opinion, only solving the inflation problem, and then the passing of time will allow the Dow, as well as housing prices, to begin any significant rally, although from significantly lower levels.

Where will the Dow and housing prices be when the bottom is finally in? I am a trader, not a forecaster. I'll look for a sign of behavior, and I'll be one of the happiest persons in the United States when I see signs that a major bottom has form—because I have been so negative for so long. But until our leaders give the economy the medicine, the sickness will continue.

Paul Volcker, where are you when we need you?

I wish you all good trading.

Best,
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