

# THE McCLELLAN MARKET REPORT

INSIDE	
ROCKET FUELED FOR LAUNCH	P. 1
COPPER & COMMODITIES	P. 4
SHOW PROMISE	
BRING BACK UPTICK RULE	P. 5
TIMING MODELS	P. 6
BONDS NOT DONE YET	P. 7
WITH DOWNTREND	
IS VIX STILL USEFUL?	P. 8

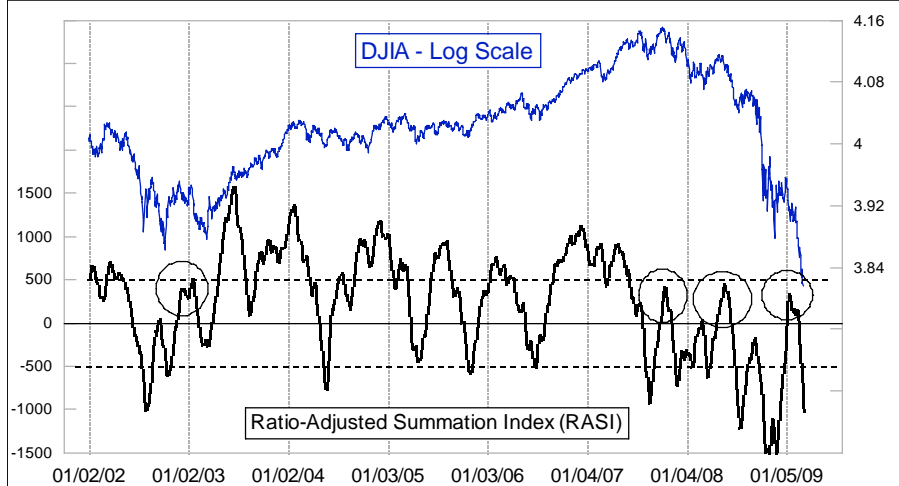
Prepared After the Market Close, March 10, 2009

Report #334, March 11, 2009

## RASI Recoiled and Ready To Fire Again

One of the great early discoveries about the Summation Index back in the early 1970s was its ability to confirm or refute the strength of a new uptrend. Getting low enough to signal an oversold condition, and then following that low reading with a high enough reading could affirm that a new uptrend had the strength to continue. But the use of raw data for the numbers of advances and declines created interpretational problems, because the thresholds for low enough and high enough could expand or contract with the changing number of issues traded.

A significant improvement was made with the introduction of the Ratio Adjusted Summation Index (RASI) a few years later. It factors out the changing number of issues traded, and is thus better for making longer term historical comparisons. The top chart on page 1 shows the RASI, and perhaps the most important message is has to convey is about the strength of a new



uptrend. It shows this by either succeeding or failing in its effort to climb up above +500 after an oversold selloff.

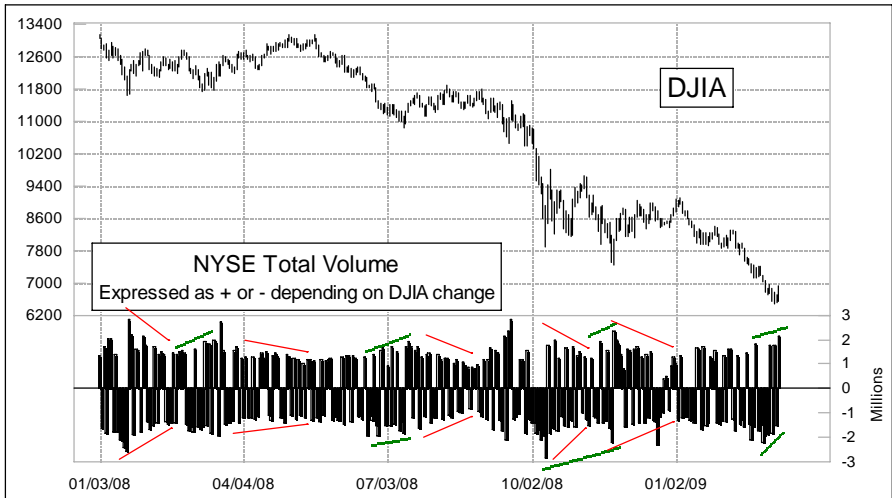
Ever since the 2007 price top, we have seen 3 successive failures as indicated by the circles. We have to look all the way back to early 2003, at the left end of the chart, to see a prior failure at the +500 level. Such failures tell us that the bulls don't have the needed amount of rocket fuel to escape the gravitational clutches of the bear market, and that at least a drop back to the prior low is in order.

That model has worked well in 2007 to 2009, and now we once again have an oversold enough RASI to merit another launch attempt. Whether this launch attempt will get into orbit is a question for several weeks from now, but we should at least get to see a robust bounce from here on that attempt.

The big single up day on March 10, following good earnings news out of Citigroup, appears to have gotten this new launch attempt under way. We have outside confirmation that it should be more than just a single up day from

### BOTTOM LINE

The market got oversold in March by just about any measure one can name, and now a bounce appears to be under way. Look for the first bounce to fail, with a top likely to arrive March 12-17, ahead of expiration, and then a selloff to make people say, "See, I told you it was a failing rally." Once that is accomplished, look for the next rally to bring much more surprise and denial. Gold prices are heading downward, as commercial traders are big time net short. But the commercials are net long copper, and it is trending upward, showing early signs of economic recovery. Bonds are still trending down, and not done yet with this downtrend.



the bottom chart on page 1. This chart looks at total NYSE volume in an innovative way, showing positive or negative bars according to whether the DJIA was up or down each day. This way, we are comparing total volume on up days to other up days, and the same for down days.

What we find upon examination is that divergent bottoms are very important, where prices make a lower low but on smaller volume. Rising total volume on up days can be a confirming sign of strength for the overall market. And where we see instances of volume contraction on both up days and down days (the red lines), that says a top is forming.

The idea of an oversold enough bottom deserving of a bounce is confirmed by the indicator in the chart at the top of page 2. The DJI Oscillator Positive Index examines the individual Price Oscillator for each of the 30 Dow component stocks to see if it is above or below zero. It then totals up the readings for all 30 stocks to show the percentage of that group with positive Price Oscillators.

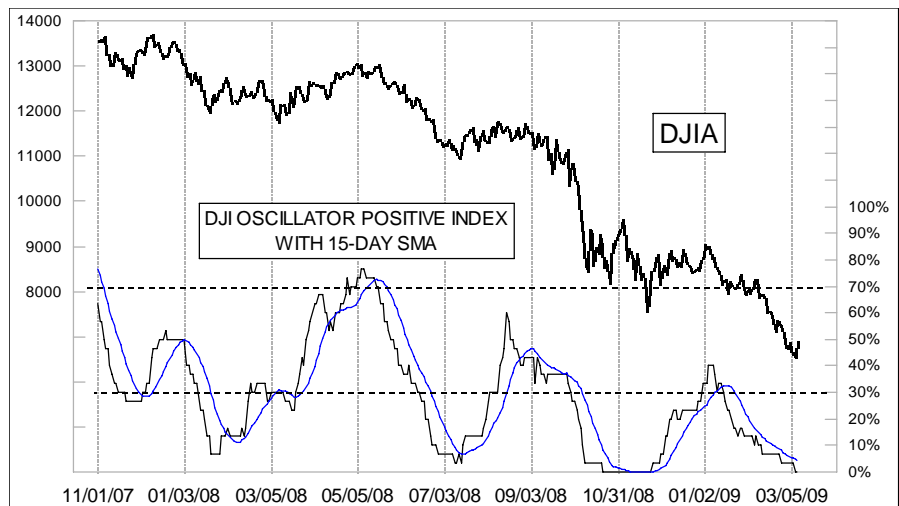
Last week, this indicator got down to zero for only the 4th time in the last 20 years that we have been keeping this data. It stayed at zero for several weeks in October and November 2008, so it does not have to bounce just because of a zero reading. But this is a terribly oversold reading deserving of a bounce, so we should be aware and ready to pounce on the bounce when it arrives.

**Bottom Line:** Stock prices are already oversold enough to be deserving of a very robust bounce. Whether that bounce turns into an uptrend is a question for another time. Right now, we should play the bounce for what it is worth, and see a few weeks from now whether it will signal that the bulls have the strength to continue the effort.

## Page 3 Charts

**Chart 1:** The A-D Line dropped below the level of the low posted in November requiring a rescaling of the chart. The largest rally of the year on March 10 was only able to bring the A-D Line back to that November low. The roughly 20,000 unit drop is similar to the extent of other selling waves we have seen lately, setting up a nice oversold opportunity.

**Chart 2:** The Daily Volume Line also took out the November low and required a chart rescaling. If the rally



begin on March 10 fails to take the Volume Line back above the November low, then another selloff could start immediately.

**Chart 3:** The McClellan A-D Summation Index built a small triple top in January and February. This formation is typically a precursor to a sharp drop to follow, and this one fulfilled that. The move down has taken the Summation to -2258, an area where many reversals have been seen. It takes a net 873 more advances to turn this indicator back up on March 11 and start a short term move higher. A turn up would create a third higher bottom on the Summation which would be a modestly bullish development. A more bullish development would be for the Summation to move above +2650 (or +500 for RASI, see p. 1), to show enough liquidity to support further price advances.

**Chart 4:** The Volume Summation also built a drooping triple top prior to the February-March drop. This Summation is also at a level where many reversals have occurred. It did turn up on March 10 by a very small amount, thanks to heavy up volume. Sharp one to three day price drops typically occur during this phase of a Summation advance from low levels.

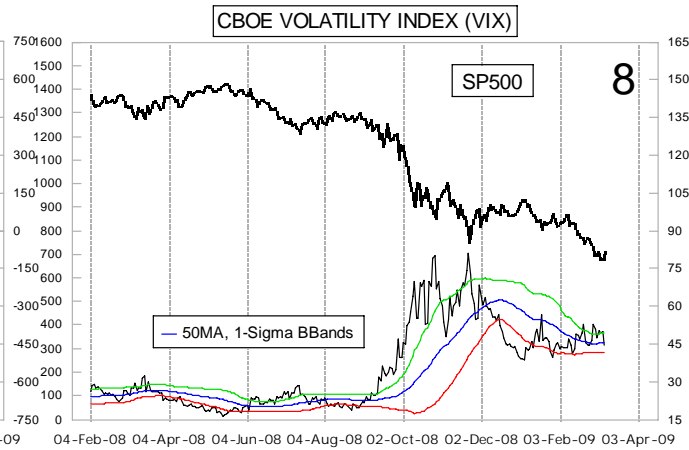
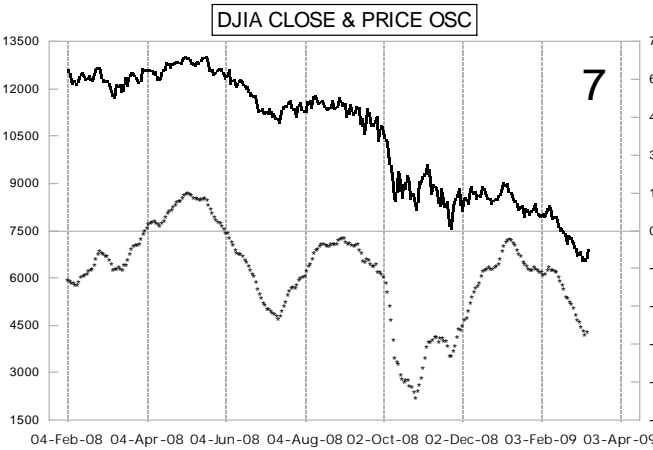
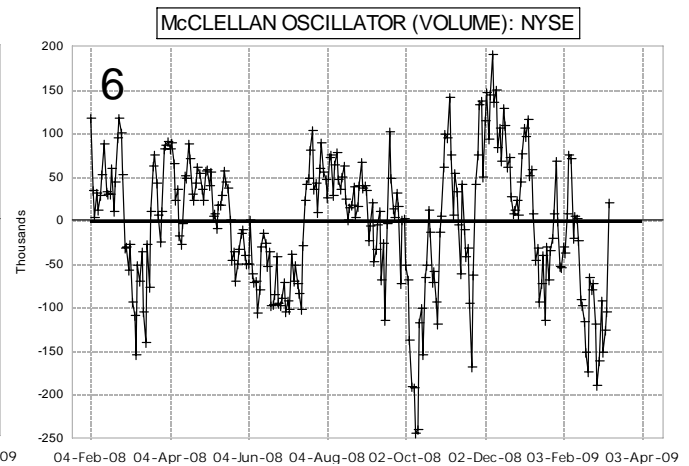
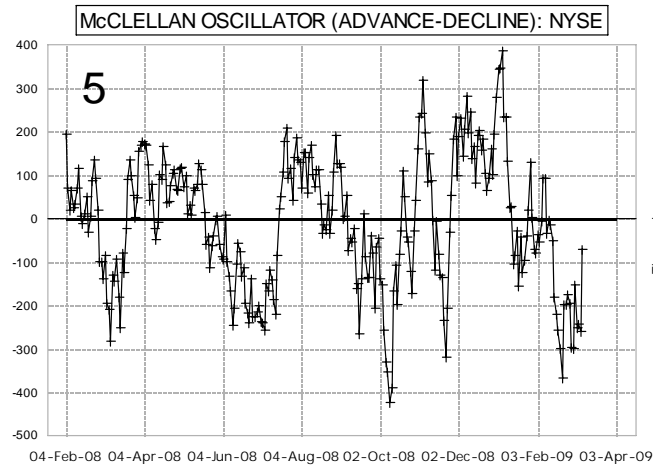
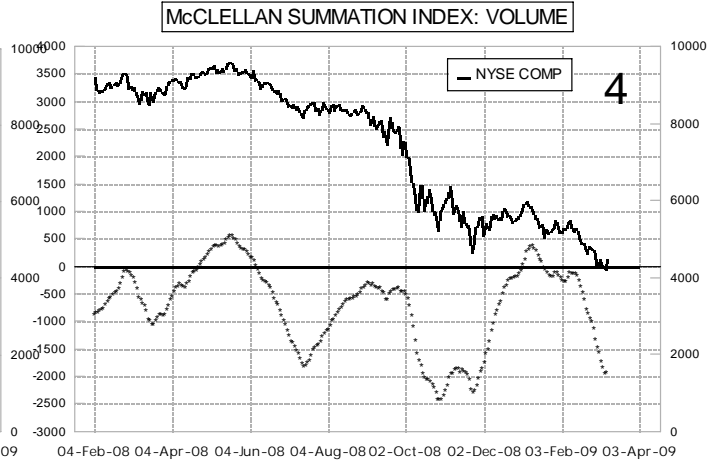
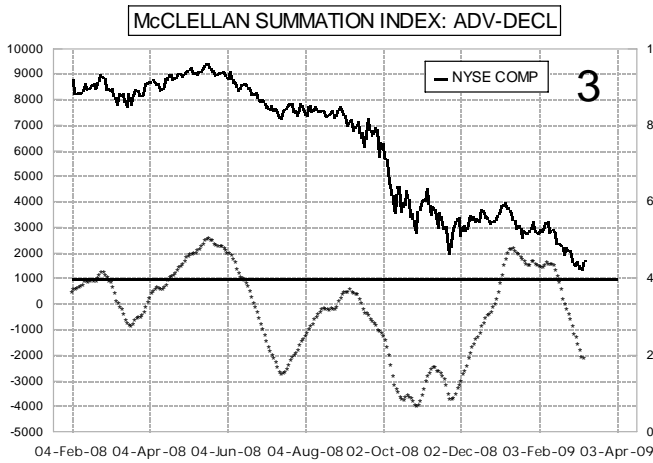
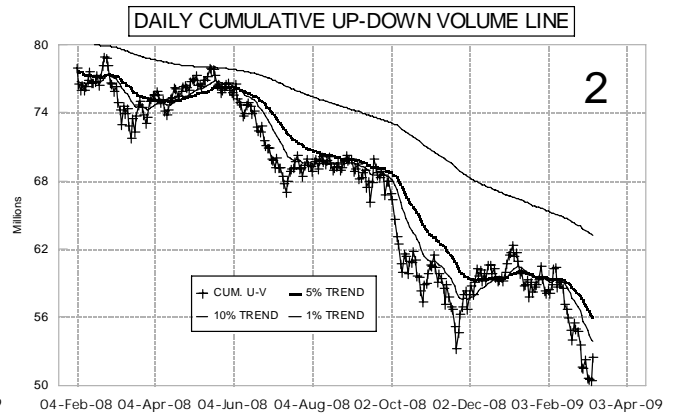
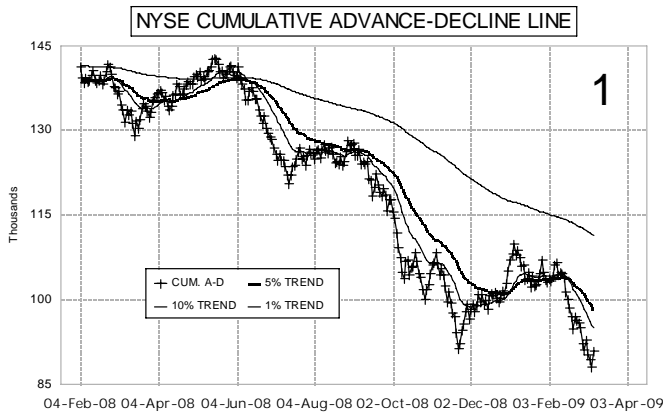
**Chart 5:** The McClellan Oscillator formed a *very* nice third rising bottom prior to the March 10 rally. It was at such a low level that it required more net advances than there are issues traded on the NYSE to get back above zero. Now, it will go above zero should there be 873 more net advances on March 11. The Oscillator has now created a significant bullish divergence of a higher bottom than it made in October while prices made new lows. The kind of energy shown on March 10 can usu-

ally only be sustained for about 6 trading sessions, enough time to take the McClellan Oscillator back up to extreme high readings requiring another consolidation. At the end of that consolidation look for what the late Kennedy Gammage in his southern drawl called a “Bah spike”, a sharp drop in prices and the Oscillator (often to just below zero) to a bottom from which prices started a more sustained advance.

**Chart 6:** The Volume Oscillator was able to get back above zero. The bulls would not want to see this indicator slip back below zero right away leaving a simple up and back down pattern to indicate that the bears were still in control. Like the A-D Oscillator, it also has created a bullish divergence with the October lower low.

**Chart 7:** The DJIA Price Oscillator turned up right at the top that formed between the late October and late November price lows. This is a good place for a reversal to occur. If the up move can be continued, then the price downtrend line that can be drawn across the September, January and February tops should be attacked and broken. The Price Oscillator is low enough to merit a healthy rally, even if it is only a bounce.

**Chart 8:** The CBOE Volatility Index (VIX) dropped back below its 50-day moving average but was not able to break below an uptrend line that can be drawn across lows from last August. It is right on the line, so any continuation lower would break that trend. It will take a move below the January lows to indicate that a price uptrend is in progress. The VIX tops that were made near 31-32 in 2007-08 are patiently awaiting a retest. For more on the VIX see a full discussion on page 8.



# Gold Turns Down At \$1000

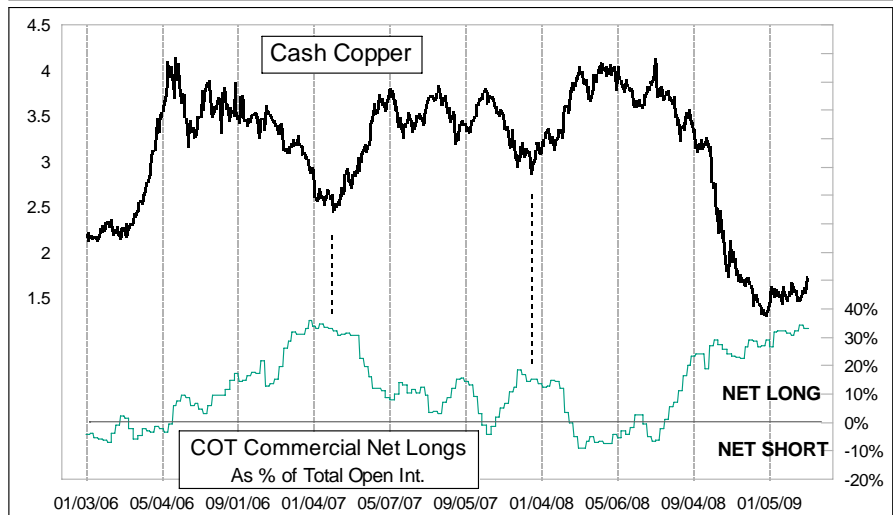
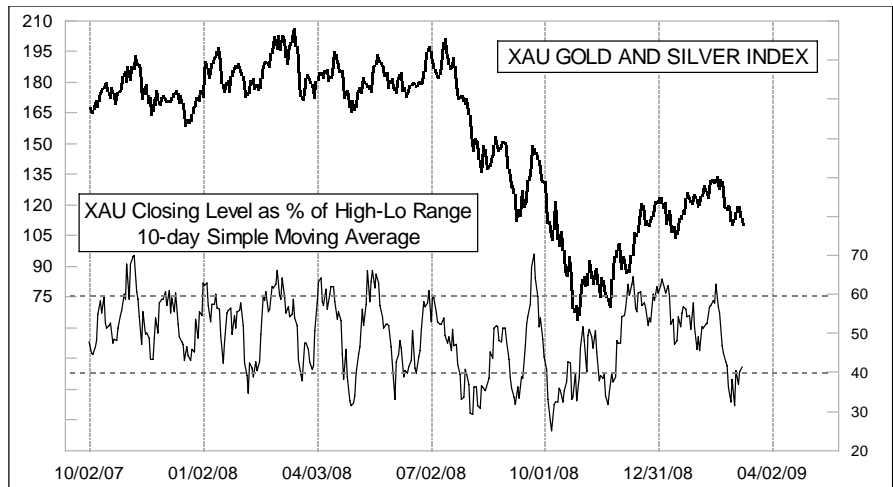
On Feb. 20, gold prices made it all the way back up to touch the \$1000/oz level again, the level which had marked the highs in March 2008. But the XAU only made it back about 50% of the way to the highs it made at that time. For now it appears that the psychological resistance of the \$1000 level and the excessive speculative sentiment that had built up are going to keep gold and gold stocks from continuing higher for now.

The top chart on page 4 shows an interesting indicator that we originally envisioned as a way to graphically depict where the XAU had closed within each day's high-low range. Adding the smoothing effect of a 10-day SMA made a pretty nice indicator. Only later did we realize that what we had created was simply a 1-10 stochastic oscillator. Still, it works nicely.

The relevancy of it right now is that it got down to an oversold level, but the bounce from that oversold level failed. A good rule for this indicator (and several others) is that when an overbought or oversold indication does not seem to matter, then you are in a trending condition. That appears to be the case now for gold, with the trending direction being downward.

The same does not hold true for copper, which has been beaten down with the weak economy, but now is making a comeback. While the commercial traders are net short gold in a big way, they are similarly big in their net long position for copper. They were early in taking that position, but now they are finally being proven correct.

The bottom chart shows gold's leading indication for the CRB Index. The

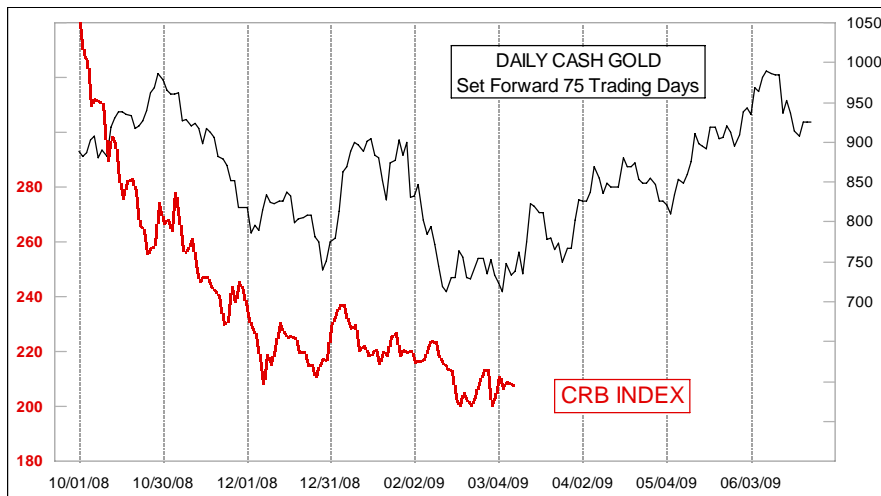


75 trading day offset illustrates how commodities in general follow the dance steps that gold traced out almost 4 months earlier.

The CRB Index is now at a point equivalent to when gold was bottoming at just above \$700/oz back in November. So what lies ahead is the CRB's echo of the rally in gold back to \$1000. The reason it works this way is that

when there is available money to lift prices, it flows first into gold, then into other areas of the economy. Now it is time for commodities to rally.

**Bottom Line:** Gold bonked at \$1000 and ran out of steam. It is backing off now, presumably for another attempt later this year. But the echo of that up move to \$1000 should be felt in the commodities markets starting now.



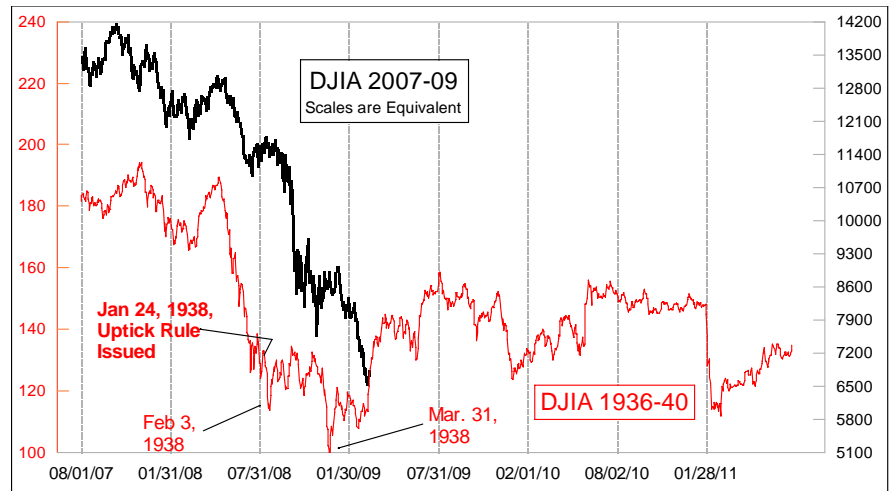
# Return of "Uptick Rule" Should Help Bulls

The elimination of the Uptick Rule in 2007 has gotten a lot of blame for the recent ugliness in stock prices. A lot of credible analysts say that the blame has been overdone, and perhaps that is so, but we do not agree with those who say that the Uptick Rule's elimination had nothing to do with the stock market's decline.

To review briefly, the SEC instituted this rule back on Jan. 24, 1938, under the authority of the Securities Exchange Act of 1934. The basic idea

is that you can sell stock you own at any time the market is open, but if you want to sell stock short, i.e. sell stock that you have borrowed to make a bearish bet, then you have to wait for an uptick. That means that the last price direction change for that stock has to be upward. This prevents the short sellers from creating and then profiting from their own cascade of selling by temporarily interrupting the flow of the short sale orders' execution.

The impetus for that rule change was a really horrendous and steep price decline in 1937, as seen in the top chart on page 5. We showed this chart on page 2 of our last issue for the price pattern analog comparison, but it is worth revisiting for this story on the Uptick Rule. The implementation of that rule did not stop the decline all by itself, but it was helpful in putting in a final bottom in March 1938, leading to a big



rebound.

The reported reason for getting rid of that rule in 2007 was that changes in the structure of the market made it both moot and impossible to enforce. Traders had other ways now of initiation short positions, through options, futures, and other more exotic products. And with some equities trading up to 500 times a second, how can anyone determine the "last" price direction change? Or so went the arguments, which continue to this day.

Absolute cause and effect in the markets is hard to measure, but we can say that right after the Uptick Rule was eliminated, volatility in the market began to increase. One interesting measure of volatility is what's known as a 10 to 1 Down Volume Day, with down volume outweighing up volume by a ratio of 10 to 1 or more. The indicator in the lower chart counts the numbers of such days over the preceding year, and right now it is up to 27. That's one every couple of weeks. For most of the 1990s and 2000s, it stayed at or below 4, or less than 1 per calen-

dar quarter. It may just have been coincidence that the volatility which this indicator measures picked up right after the elimination of the Uptick Rule, and that the collapse of banks is what has really driven the increased volatility. But the timing seems suspicious.

Digging a bit deeper, we note that the stock market topped out on Oct. 9, 2007, 3 months after the Uptick Rule was eliminated. So it is fair to say that during the first 3 months without an Uptick Rule, it was still a bull market, despite some preliminary deterioration of the internals. It is worth noting that during those 3 months, there were 5 instances of a 10 to 1 down day, which is more than had been seen in any 12 month period since 1991. It seems fair to say that even during a bull market phase, the absence of the Uptick Rule contributed to much bigger selling on down days than had been seen before.

Reimplementation of this rule is going to be tricky, because of the aforementioned complexity of the markets. We hope that they do get it figured out, and soon.



**Sherman McClellan**  
Publisher

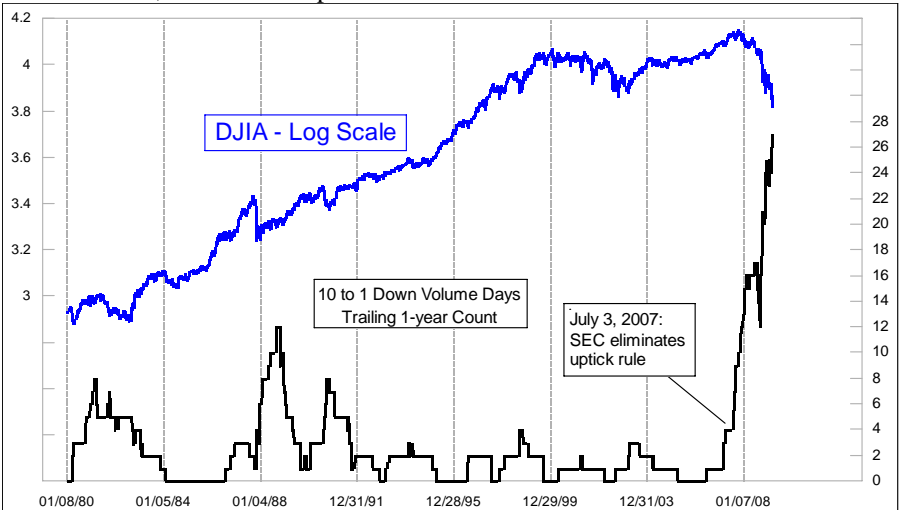
**Tom McClellan**  
Editor

**The McClellan Market Report**,  
ISSN 1094-8163, is published 24  
times a year.

Annual subscription rates:  
By Email & web access \$195  
By 1st Class Mail (US) \$220  
By Fax \$270

Visa, Mastercard, and Discover cards  
accepted, or mail payment to:  
**McClellan Financial Publications**  
P.O. Box 39779  
Lakewood, WA 98496-3779  
Phone (253) 581-4889 fax:584-8194  
Subscriptions: (800) 872-3737  
or at [www.mcoscillator.com](http://www.mcoscillator.com)  
email: [tom@mcoscillator.com](mailto:tom@mcoscillator.com)

©2009. All rights reserved. Any reproduction of the words, graphs, tables, or analysis, in whole or in part, without the express consent of McClellan Financial Publications is strictly prohibited. Analysis is derived from data believed to be accurate, but such accuracy or completeness cannot be guaranteed. It should not be assumed that such analysis, past or future, will be profitable or will equal past performance or guarantee future performance or trends. Information is provided to assist readers in forming their own understanding of market structure and no statements made herein should be construed as recommending any specific course of action. All trading and investment decisions are the sole responsibility of the reader. From time to time the principals of McClellan Financial Publications may have open positions in the markets covered.



## TIMING MODELS

Stock Indices (DJIA, SPX, Nasdaq, NYSE Comp., etc.)			
SIGNAL	SOURCE	PREDICTED	ACTUAL
Top	Uncommon A-D Osc	Feb 23	Feb 24
Bottom	SP500 Up-Dn Osc	Feb 25	---
Bottom	DJIA Stochastic	Feb 27	---
Top	SP500 Close/Sum	Feb 27	---
I Top	Nasdaq ST Price Osc	Mar 2	Mar 4
I Top	DJIA Close/Sum	Mar 3	Mar 4
I Top	DJIA ST Price Osc	Mar 6	Mar 4
Bottom	NYSE A-D Osc	Mar 11	
J Top	NYSE A-D Osc	Mar 12	
J <b>Top</b>	<b>NYSE Vol. Summ</b>	<b>Mar 16</b>	
J <b>Top</b>	<b>SP500 Price Osc</b>	<b>Mar 16-20</b>	
J Top	DJIA Up-Dn Osc	Mar 17	
Bottom	SP500 ST Price Osc	Mar 17	
Bottom	DJIA Up-Dn Osc	Mar 20	
Top	SP500 ST Price Osc	Mar 23	
Top	Nasdaq A-D Osc	Mar 24	
Top	NDX A-D Summ	Apr 20	

Experimental New Indicator, "BC"			
Predicted Signal		How It Turned Out	
Implied Top	Oct 30	Top	Nov 4
Implied Bottom	Jan 10	Bottom	Jan 20
Implied Top	Mar 17		
Implied Bottom	Apr 8		

Bond Market (Corporate & Treasuries)			
SIGNAL	SOURCE	PREDICTED	ACTUAL
Bottom	T-Bond Up-Dn Osc	Feb 20-23	Feb 19
Top	T-Bond Stochastic	Feb 24	Feb 24
Bottom	T-Bond ST Price Osc	Mar 6	Mar 4
Bottom	T-Bond Stochastic	Mar 23-26	
Bottom	T-Bond ST Price Osc	Mar 26	
Bottom	T-Bond Up-Dn Osc	Apr 6	
Bottom	T-Bond Stochastic	Apr 8	
Top	T-Bond ST Price Osc	Apr 13	
Top	T-Bond Stochastic	Apr 16-20	

Gold and Precious Metals Stocks			
SIGNAL	SOURCE	PREDICTED	ACTUAL
Bottom	XAU ST Price Osc	Feb 20	Feb 19
Bottom	[Dollar Index Top]	Feb 27	Mar 2
I Top	Gold Up-Dn Osc	Mar 2	Mar 6
Bottom	XAU ST Price Osc	Mar 10	
* Top	XAU ST Price Osc	Mar 11	
* Top	XAU Up-Dn Osc	Mar 13	
* Top	Gold ST Price Osc	Mar 13	
Top	[Dollar Index Bottom]	Mar 18	
Bottom	Gold Up-Dn Osc	Mar 20	
Top	XAU Close/Sum	Mar 20	
Top	[Dollar Index Bottom]	Apr 1	
Bottom	XAU ST Price Osc	Apr 2	
Bottom	XAU Close/Sum	Apr 7/8	
Top	[Dollar Index Bottom]	May 1	

## The Signals

If you throw a rock into a still pond, the effects are obvious and the impacts of the waves emanating out from the impact point can be identified. If you throw a rock into a rushing river, it will have exactly the same amount of effect as in the pond, but you won't be able to see it due to the stronger effect of gravity pulling thousands of gallons over the rocks and rills.

There has not been much that has gotten in the way of the downtrend up until now, so identifying the actual dates of the arrivals of these signals is a bit harder than usual. One thing that is pretty safe to say is that the apparently conflicting top and bottom signals for Feb. 27 appear to have canceled out each other, with no evident effect on

prices.

Even the March 2-6 top dates, for which there was a 3-signal cluster, had a rather muted effect on prices.

The next big event on the schedule is the top identified by cluster J, due March 12-20. That is a pretty wide time frame, but I suspect that the actual top for that cluster will arrive early in the time window. March 20 is quarterly options and futures expiration, which is always a good time to look for the options players to get into a bit of chicanery in order to either protect or fulfill their positional bets. Throwing the outcome into doubt are a couple of bottom signals due March 17 & 20, plus conflicted signals for gold March 18-20.

If you thought we were back to a neat an orderly market, you might want to think again.

## What To Expect

**Stocks** appear to be rebounding from oversold, but a top due March 12-20 (expiration time) appears to be blocking the path to a linear uptrend.

**T-Bonds** are still trending down. Bottom signals due March 23-26 represent a likely time target for an end to the downtrend, if it wants to stop.

**Gold** is trending downward, but a top cluster due Mar. 11-13 appears ready to provide at least a temporary interruption in that downtrend, then a resumption downward after this week.

## HOW THEY WORK

These timing models are based on our proprietary calculation method. This technique involves a computationally complex comparison of two or more carefully selected indicator values. This yields the date and direction of a projected future turning point. Making several such comparisons can help paint a picture, one reversal point at a time, of the future structure.

Once generated, signals remain in effect, though the result can have greater or lesser significance based on what the market is doing when the date arrives. Certain indicators are slightly less accurate in pinpointing the exact date, so we may print a range of dates. Price Oscillators and Summation Index signals are usually more important, though sometimes not as precise in time. Uncommon A-D refers to an oscillator derived from NYSE stocks that are not part of the Common Only list in Barron's. Dates in bold denote signals of greater potential strength according to our research.

These models do not catch every market turn, but the signals usually show some effect in the market action. It is important to understand that the market does not have to go up from a bottom; it may just stop going down. It does not have to go down from a top, it may just stop going up. Some bottoms turn out to be just a flat spot before a continuation up.

The BC indicator is an experimental new tool, not related in method to the other signals.

"Actual" dates listed for NYSE Indices are for the NYSE Comp/Dow Jones Industrial Average. Letter groups denote clusters of signals. ST Price Osc means "Short Term Price Oscillator."

Past performance of these mathematically generated turning point projections in no way guarantees future results. These dates may be useful in planning for the future, or giving greater confidence at turning points. **We would not, however, attempt to trade any of the markets based solely on these models.**

# Bonds Fail Upturn Attempt

T-Bonds made a valiant attempt to convince the world that they were headed higher again. They got a lot of help from the continuing difficulties in the financial markets, and with comments from various government officials about how terrible everything is.

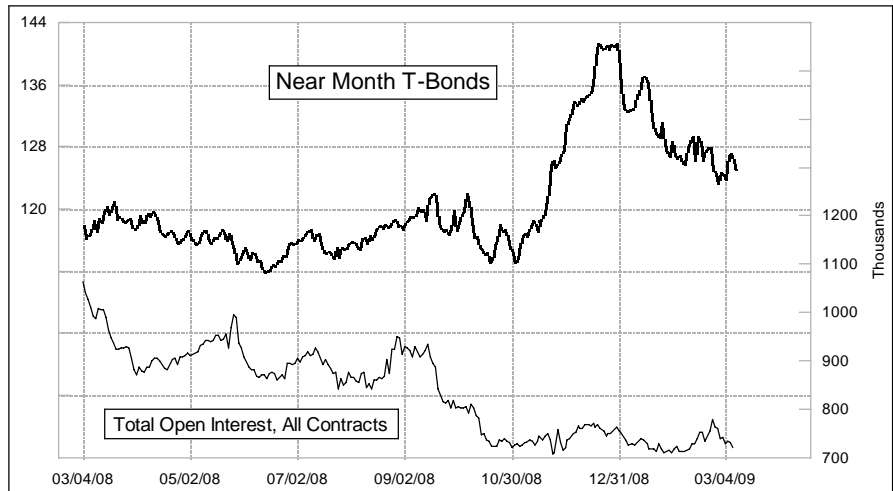
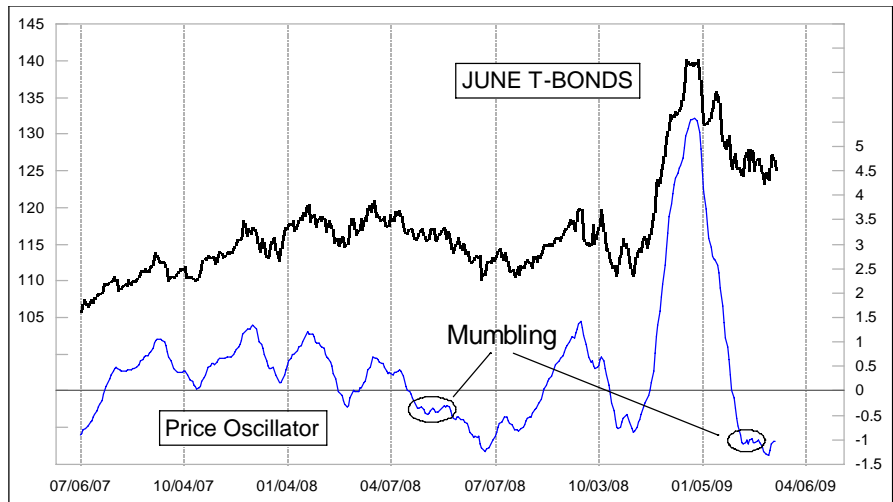
But that upturn effort was rejected when the still-negative Price Oscillator for the June T-Bond contract turned back down again. A few weeks ago, it had been “mumbling”, chopping up and down without making a clear message, like the way that the character “Mumbles” in the Dick Tracy comics would have his mouth be drawn.

Anytime a Price Oscillator turns down while it is still below zero, it gives us the promise of a lower closing low on the ensuing move. That promise can get yanked away if prices turn up again promptly, but for now the message is one of a continuing downtrend.

That message is confirmed by what the open interest numbers are doing. Open interest is simply the count of all open futures contracts, and the rule for interpreting open interest in T-Bonds is that it will tend to increase as prices move in the direction of the dominant trend. Open interest will tend to contract during “corrective” moves. So you can tell which direction is the dominant trend direction by asking open interest.

Right now, we are seeing that open interest had been moving upward as bond prices were falling into the Feb. 27 low, and it began falling again during the rebound attempt. This conveys a message that downward is still the dominant trend direction for the long term T-Bond prices.

Having bond prices continued



downward does not necessarily mean that the economy is going to bounce back right away. Bond prices got way too high last year when yields fell all the way to 2.5% for the 30-year T-Bond, and bond prices will also likely correct back too far rather than just returning quietly to an equilibrium state.

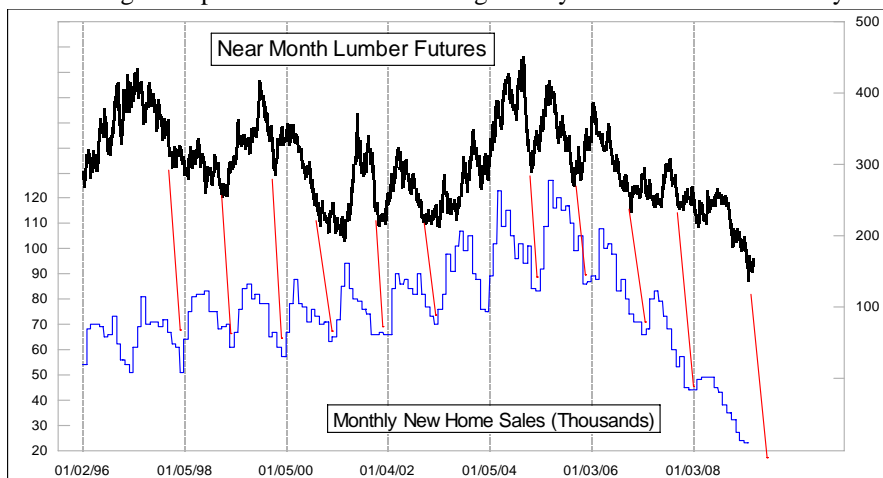
One reason to think that the economy is not going to jump up out of bed right away is that we have not really

seen a great bottom yet for lumber prices. The recent low for lumber futures prices was on Jan. 29, and lumber is trying to rally back from those low levels.

As the bottom chart shows, lumber has to have bottomed a long time earlier before a bottom is seen in the monthly data for new home sales. You can probably detect that there is some significant seasonality in those new home sales data, since people don't tend to buy new houses in January, especially in snowbound northern states.

If the Jan. 29 low for lumber prices turns out to be THE low, then we still have a few more months to go before we are likely to see a bottom in new home sales. And we have an even longer time to go before those sales get back up to what would have recently been considered a “normal” level.

That means low short term interest rates are likely to be with us for the foreseeable future. Fed Funds tends to turn up about a year after lumber prices, so mark your calendars for the January 2010 FOMC meeting.



# Is the VIX Indicator Really Kaput?

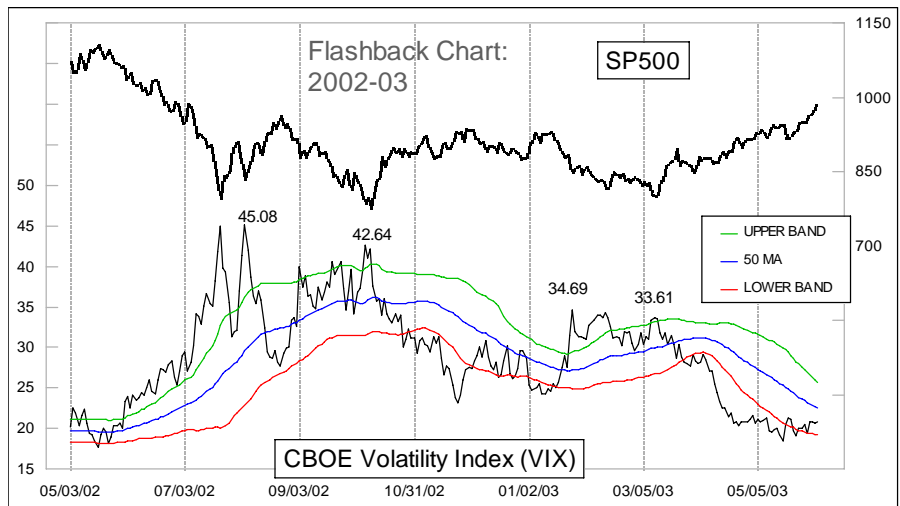
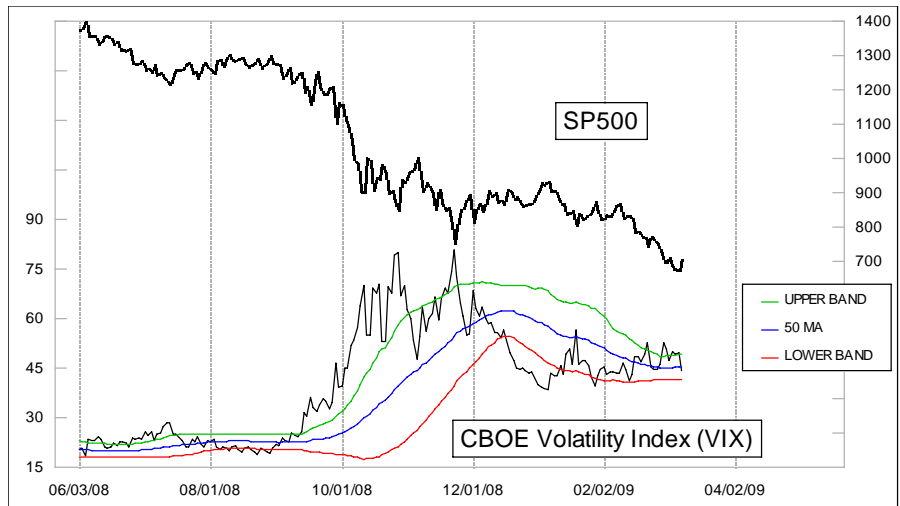
In the March 6 issue of the Wall Street Journal, an article appeared under the headline “VIX Seems to Be Failing as Signal of Indexes (sic) Nearing Their Bottom.” Subscribers to the online edition of the WSJ can read that whole article at <http://tinyurl.com/VIXfailing>.

The thrust of this article was that because price indices are making lower lows and the VIX is not getting back to the highs it posted late in 2008, that the VIX was somehow failing in its role of marking a final bottom for the price decline. In our view, this is the wrong way to interpret the message that the VIX is giving.

Unfortunately, the history of the VIX is limited, since it is based on the prices of index options (previously the OEX, now the SPX). Index options have only been around since the 1980s, so we cannot go back to see how the VIX data performed in the great bear markets like the 1930s and 1970s.

But we can go back and look at the one long and grinding bear market that has occurred during the VIX’s history, which culminated with the bottoms in 2002 and 2003. The middle chart on this page shows that the VIX peaked at 45.08 on Aug. 5, 2002. We should point out that this VIX data is back-calculated by the CBOE, following the change in calculations from using OEX options to SPX options in September 2003. The VIX made a lower high when the SP500 fell to a slightly lower low in October 2002, and the VIX made still lower highs as the price lows were retested in early 2003, on the eve of the US invasion of Iraq.

What this demonstrates is that the



climactic VIX readings were seen at the climactic momentum lows for prices. The momentum lows are often not the final price lows for a bear market. So seeing a pattern of lower VIX peaks as the bear market wraps up is not a sign of failure of the indicator. It is rather the normal way that the VIX works.

Not shown here, but also worthy of mention, is the fact that the VXO (the

original VIX) peaked at 150.19 on October 19, 1987. When that crash low for the price indices was retested on December 4, 1987, the VXO only got up to 47.63.

The bottom chart shows the leading indication that short term interest rates give for what the VIX should do a couple of years later. It is not a perfect leading indication; it is merely very good. One might try to adjust the time offset between these two to get a more perfect alignment, but this one is good enough to get the general ideal.

We are just about at the end of the period when this leading indication says the market should be experiencing high VIX readings. Between now and 2010, the VIX should echo the rapid drop in interest rates as the greater liquidity resulting from low rates is finally felt in the stock market. Greater liquidity means smaller bid-asked spreads, and smaller movements of prices to find available buyers or sellers. That drives down the VIX, as options traders accept a smaller premium for taking risks.

