

THE McCLELLAN MARKET REPORT

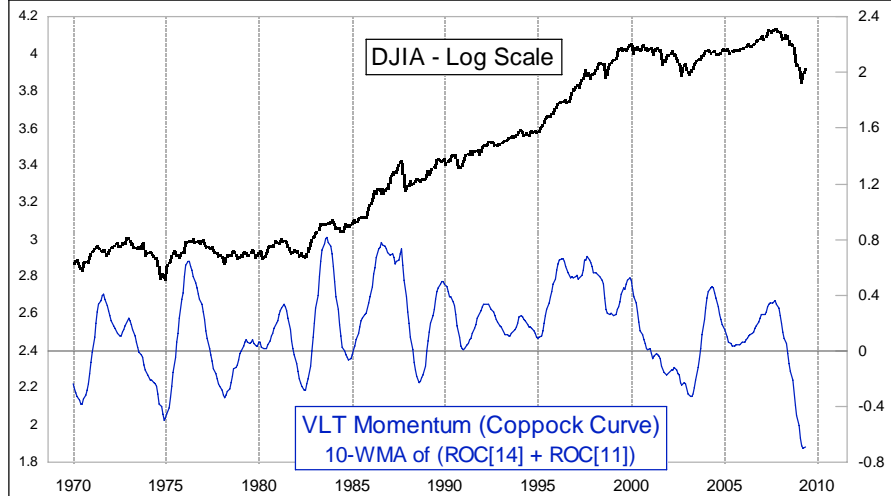
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Prepared After the Market Close, May 26, 2009 Report #339, May 27, 2009

Coppock Upturn Inevitable; Now What?

Back in Report #332, we introduced a discussion of a long term timing indicator developed by the late E.S.C. Coppock. He called it his Very Long Term (VLT) Momentum indicator, but the world came to call it the Coppock Curve. It is based on looking at the rate of price change over two lookback periods, 11 and 14 months, which are combined and then smoothed with a 10-period weighted moving average (WMA). Coppock used it as a signal for a low-risk entry point to catch a long uptrend following a deep correction.

The rapid decline in the DJIA since the October 2007 top has taken the Coppock Curve down to its lowest level since the market bottom in 1932. The DJIA has already rebounded by as much as 31% from the March 9 low, and that still was not enough to turn up the Coppock Curve. But the calculations involved mean that the task gets



easier with each passing month, and so at the end of May, the DJIA only needs a close above 8172.59 to turn up this indicator.

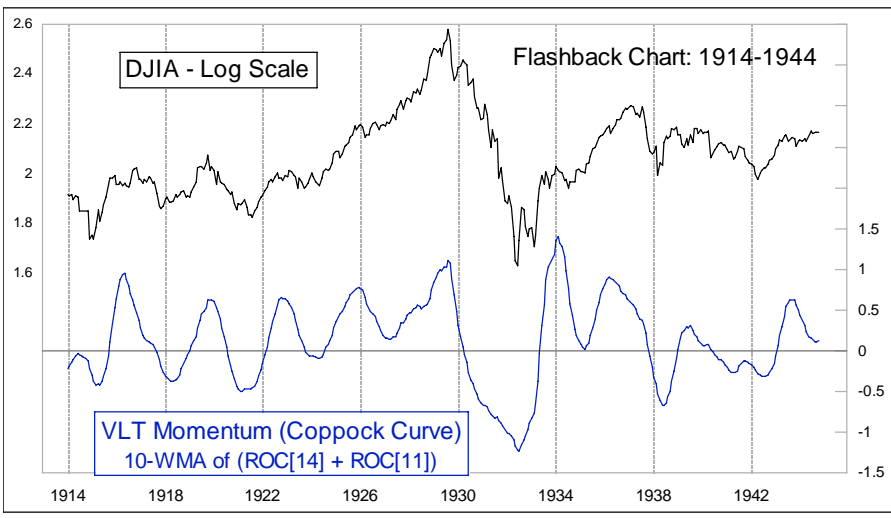
But the lesson from 1932 is that when the Coppock Curve gets this low, the moment it turns up is not as good of a buy signal for the long term as it is when the upturn comes at a less negative reading. The lower chart on page 1 shows the Coppock Curve at the time of the 1932 bottom. The DJIA hit a low of 41.22 on July 8, 1932, and rose to a

high of 79.93 two months later, nearly a double. The Coppock Curve finally turned up as of the end of August 1932, but by then the initial rally was done and a big retracement down to early 1933 was just about to get under way.

That was one example of a time when the month that saw the upturn for the Coppock Curve did not mark such a great buying opportunity. But having said that, someone who would have bought the DJIA in August 1932 and held on for the entire rise in the Cop-

BOTTOM LINE

All of the money-creating that the Fed did last fall says that its echo should be seen in rising stock prices into August, then a crash in September and October. But the similarity of the current market to the way prices behaved after the 1932 bottom casts doubt on that model. Rising oil and a falling dollar are now weighing on stock prices, but the dollar should reverse now and oil should top out in June, clearing the path for whatever summer rally we're going to get. Gold has been unimpressive, given the dollar weakness, and is set up for a sizable drop. Bonds are terribly oversold, and the 30-year yield is now at a 14-year high in its spread over inflation. That means bonds should head up in price, to everyone's surprise.



pock Curve would have come out pretty well after surviving the drawdown.

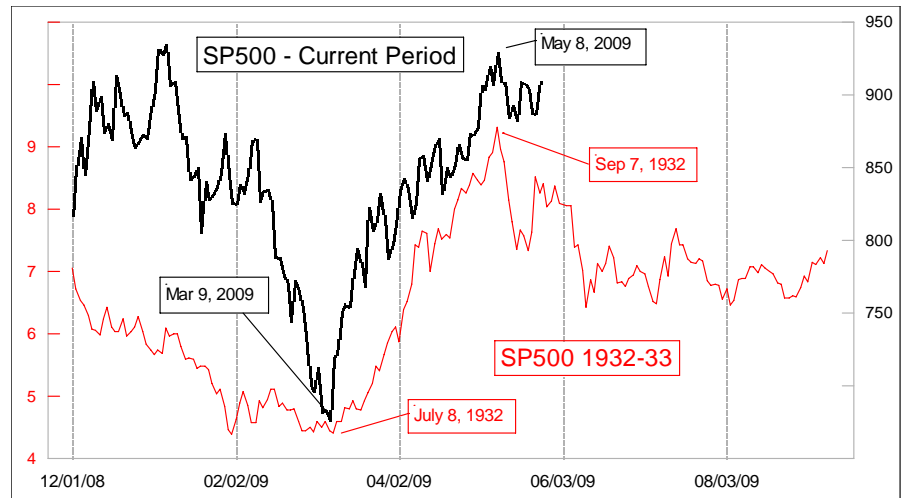
Examining this similarity to the 1932 bottom last week got us looking at what other similarities there might be between the current market and the upturn in 1932. The chart on page 2 compares the behavior of the SP500 then and now, and the similarity is alarming. In each case, the advance took exactly 60 calendar days. The price structures immediately preceding the bottoms show some similarity, although looking back farther in time than the history shown here reveals that there is not great correlation during the months leading up to the bottoms.

Many people think that it was the election of FDR that put in the bottom for the stock market, and that is just not true. He was not elected until November 1932, and not inaugurated until March 1933, by which time the bottom was already in. The event which put in the 1932 bottom was the Lausanne Conference, at which Britain and France agreed to lift the requirements for Germany to pay postwar reparations for WWI. That was seen as lifting a heavy burden off of the financial markets, much like the Fed's TALF program to buy up troubled financial assets was seen as the turning point for the market in 2009. Even though the dance steps leading up to the bottom in 2009 were different from what was seen before the 1932 bottom, the response following each bottom has been similar, which implies that the market has entered a new phase where different rules of physics are in play. That is less than good news for the weaker seasonal part of 2009.

Bottom Line: Making an exhaustive up move just to get to a buy signal is not a recipe for success. The market is very likely to see higher highs in the months ahead, but also likely to see trouble during the second half of 2009, particularly in September and October when the "sugar high" of money creation wears off.

Page 3 Charts

Chart 1: The A-D Line has been strong enough to stay above its 10% Trend pulling both the 10% Trend and 5% Trend back above the 1% Trend. This puts the Trends back into a bullish configuration for the first time since the end of 2007. Brief consolidations can be expected to occasionally take the A-D Line down to test the 5% Trend. The



market may have a large variety of problems facing it, but when the A-D Line zooms up this strongly, liquidity is not one of those problems.

Chart 2: The Daily Volume Line came up to test the July 2008 low and promptly backed off to find support on its 10% Trend. This indicator has also pulled both the 10% and 5% Trends up through its 1% Trend to put it back into a bullish configuration. Until this indicator can move above its May 8 top, prices will have difficulty doing more than just probing the highs for this move up off the March low. Having the A-D Line make a higher high without Volume Line confirmation is a troubling sign for the moment.

Chart 3: The McClellan A-D Summation Index is only slightly below its May 12 peak of 4822. The modest Summation decline has accompanied a sideways price action on most price indices. The NYSE Comp is back up to the January 6 top while the Summation is considerably higher than it was at the January top. This suggests that once the extreme Summation high has been consolidated back down toward neutral, then prices should be able to move above the current top. The RASI Summation discussed in prior Reports clearly is pointed to initiation of an up trend for prices.

Chart 4: The Volume Summation is high enough to be ready for some consolidation and decay back down toward its neutral level. The choppy horizontal price action is consistent with the high level and modest declining structure of the Summation Index. The pattern of higher highs and higher lows will need to be broken before the constructive nature of this indicator can be reversed.

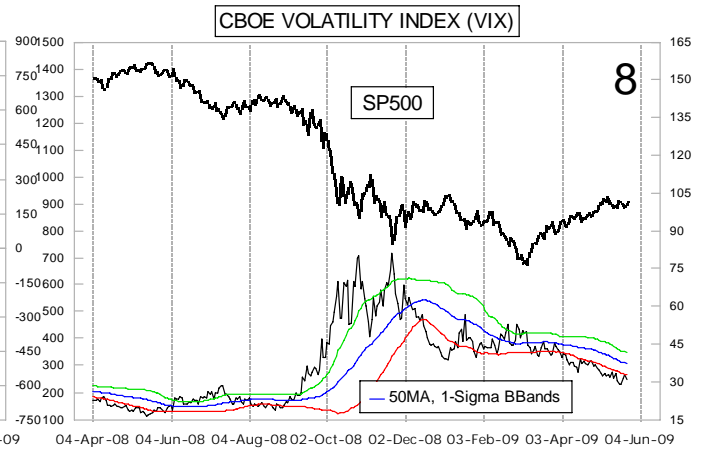
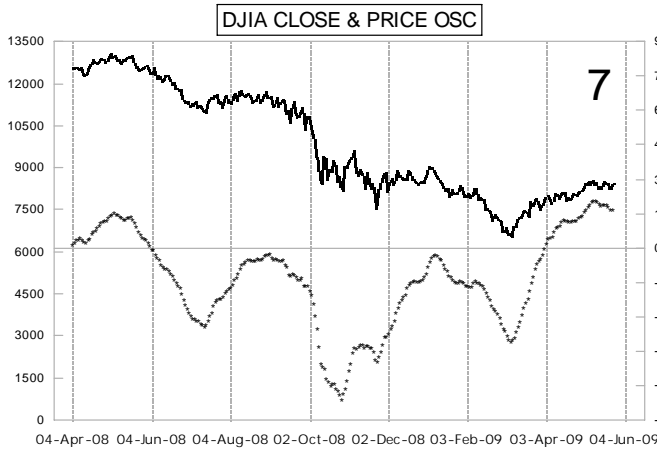
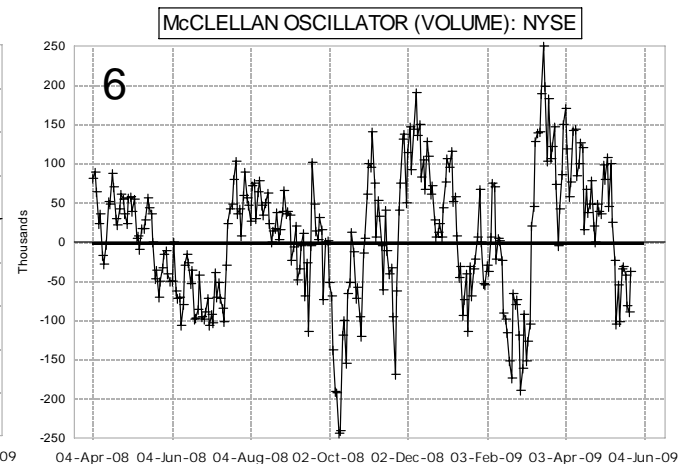
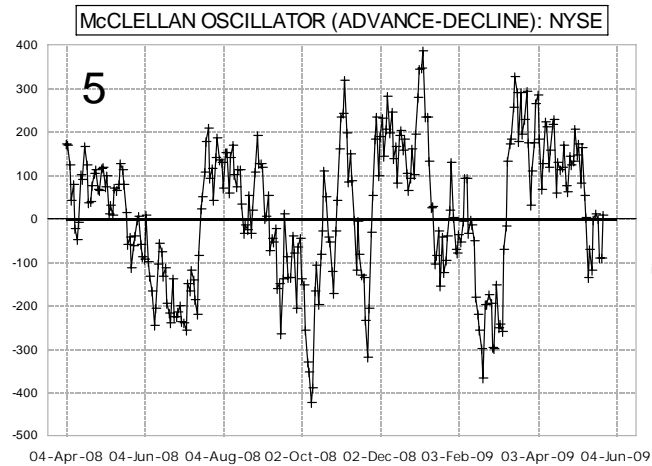
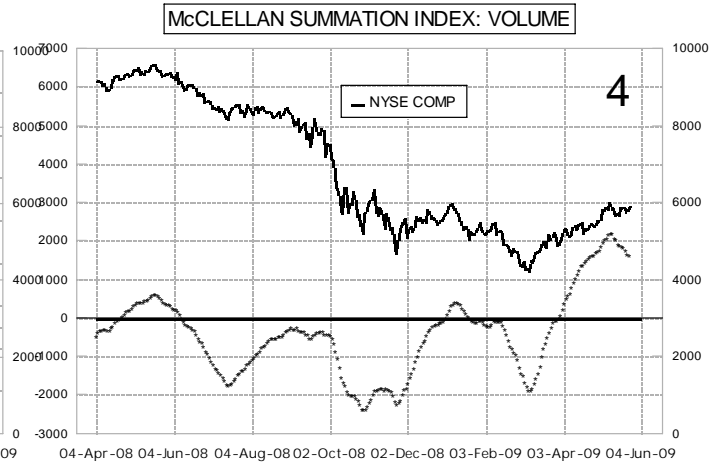
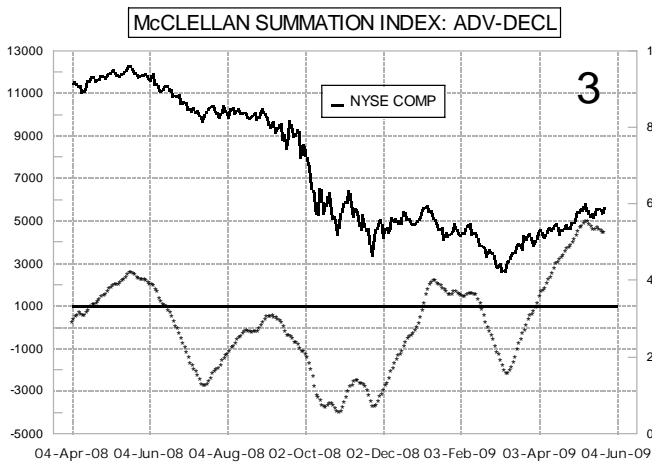
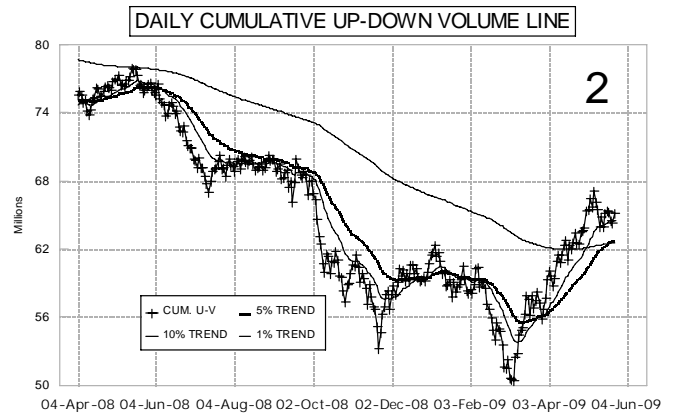
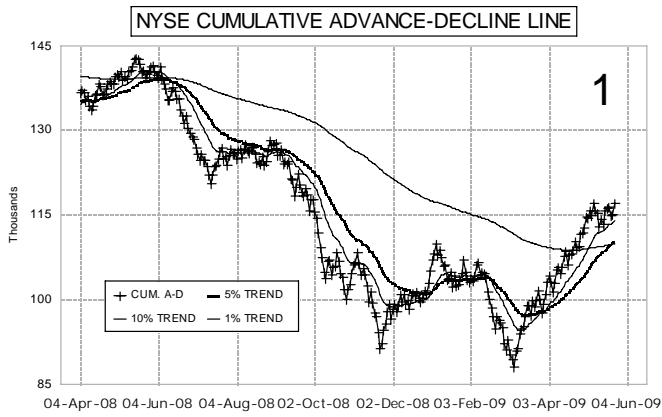
Chart 5: The McClellan Oscillator is

creating a similar structure to the one that formed about a year ago. The oscillations above the zero line were followed by a couple of oscillations from moderately low levels to just above zero before dropping down to a complex oscillation pattern well below zero. That is what would be required to pull the Summation back down to a more neutral level.

Chart 6: The Volume Oscillator has been doing its oscillations below zero, just as it did a year ago. When it completes its complex structure below zero it should reverse into a complex pattern above zero. That is what it did a year ago. If this indeed is what happens with this indicator, then prices should not have any problem making new recovery highs.

Chart 7: The DJIA Price Oscillator has not gone to the ultra high levels achieved by the breadth Summations. This has been consistent with the more limited price action by the DJIA, which is still below its January high. Its ability to drift off sideways appears to be a sign of strength. If the price and the Price Oscillator can both make higher lows than were made in March, then that would confirm a major reversal in trend direction.

Chart 8: The CBOE Volatility Index (VIX) has been staying below the lower band since the beginning of April. This is the normal behavior of this indicator during a trending move up by prices. It will take a move up by the VIX back above its lower band to announce the beginning of a more important price consolidation. We have already seen one troubling development, which was a lower VIX low without a higher price high, which suggested excessive confidence which must be worked off.



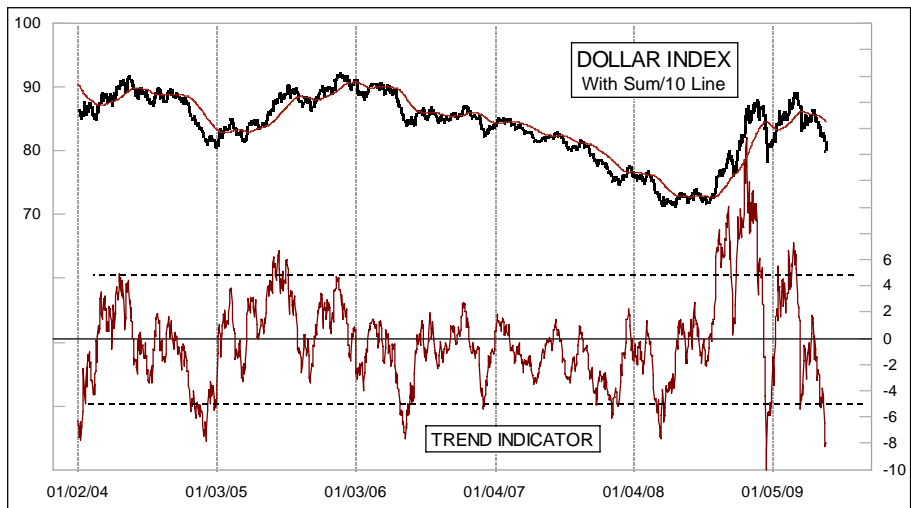
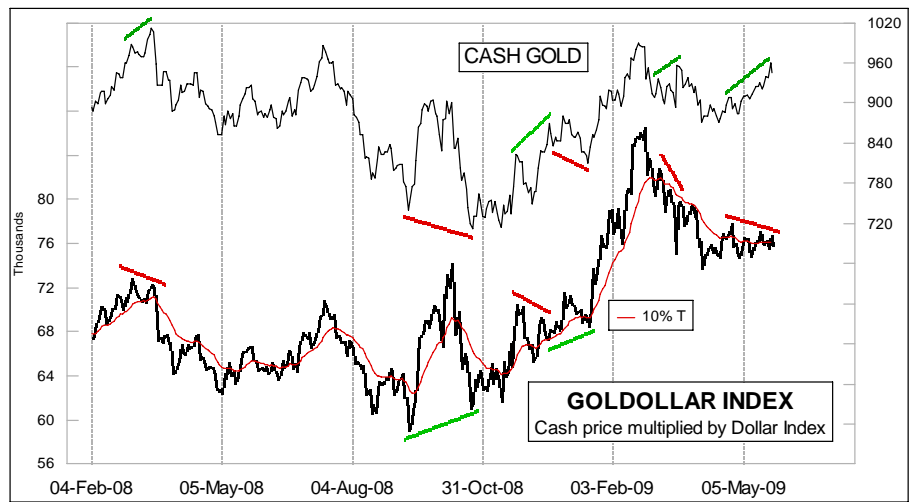
Gold Strength Not Up to Dollar Weakness

The headline for gold in our last Report was “Gold Bottom Coming Very Soon”. Sure enough, gold prices responded to their oversold condition and the coiling of buying pressure with a decent rally. Now the situation has changed dramatically, and gold is no longer a safe place to be (not that it ever is at any time).

The biggest reason for this is that in real terms, gold prices are still in a downtrend. The top chart on page 4 compares gold prices in dollars to our Goldollar Index, which combines the cash price of gold with the US Dollar Index. This creates a unitless measure of gold prices, portraying its behavior in real terms without the effects of changes in currency valuations on the dollar.

When we see a divergence between gold prices and the Goldollar Index, it is nearly always the Goldollar Index which is telling the truer story. Had we seen a set of higher highs in the Goldollar Index to confirm the uptrend in cash gold prices, then it would be a much more bullish situation. Instead, the Goldollar Index is refusing to confirm the uptrend in gold, saying that in real terms, gold prices are still in a downtrend.

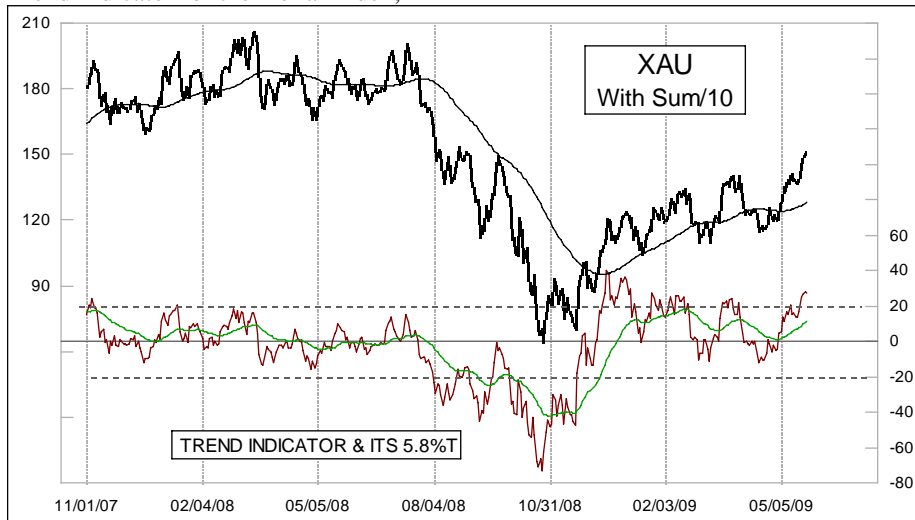
Gold has been given a great opportunity to move higher, thanks to a sharp decline in the value of the dollar as the world loses confidence in the Fed’s efforts to restimulate our economy without resorting to printing too much money. The middle chart shows the Trend Indicator for the Dollar Index,



and it is about as oversold as it ever gets, meaning that the world’s currency traders may have overestimated the bearish case against the dollar. The Trend Indicator is based on how far the Dollar Index is away from its Sum/10 line, a moving-average type of indicator which is derived from a Summation

Index of Price Oscillator values divided by 10. Readings down at this level are universally associated with important bottoms, although the bottoming process does not necessarily have to be done just because this indicator is oversold.

The same Trend Indicator is shown in the bottom chart, this time for the XAU. Here, it is showing an overbought condition that is the opposite of the oversold condition in the dollar. Gold stocks have risen to a higher high, doing better than the overall stock market, thanks to the apparent strength in gold. But when the real trend in gold described above starts to become clear, the dollar price of gold will likely make up for lost time in getting back to where it ought to be.

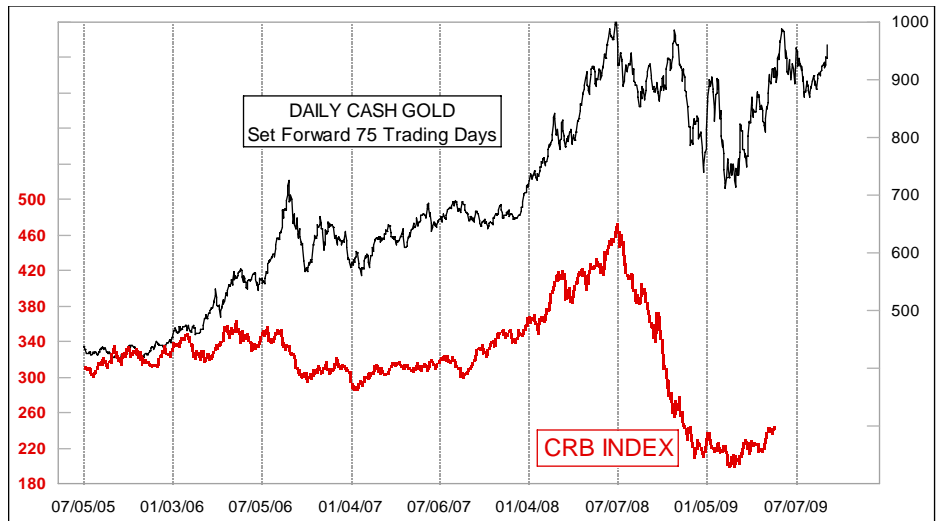


Bottom Line: Gold is up to a moderate overbought condition, something that it has achieved thanks to the dollar going to a hugely oversold condition. Gold really should have done better with what it was given, so the relatively tepid response says that

gold is actually weak and subject to a drop from here.

Commodities Near a Late-June Peak

The leading indication given by gold prices for commodities is one of our favorite examples of the “Liquidity Wave” phenomenon, by which we mean that it demonstrates how price behaviors in once market are repeated later in another market. Physicists speak of waves moving through a medium, and for Liquidity Waves, the financial markets are that medium. Each of the different price indices or other indicators represent waypoints along the path within that medium, and so a wave that creates a peak in gold prices will be the same wave that creates a peak in commodities



about 4 months later.

Exactly why it works this way is one of the wonderful mysteries of the financial markets, and likely has to do with the viscosity of money, i.e. how quickly it can flow from one place to the next. We discuss this concept more fully in a DVD that is available on our web site’s Products page.

The top chart on page 5 shows the 75 trading day leading indication that gold prices give for the CRB Index. The CRB is now climbing upward as the echo of gold’s third visit to the \$1000/oz level. It is important to note that the CRB Index is nowhere near retesting its July 2008 high; this principle is not about identifying price levels. Instead, it is about the direction of movement, and on that basis the CRB Index is indeed tracing out gold’s dance steps.

This same phenomenon also shows up in the relationship between gold prices and crude oil prices. You have probably seen descriptions of the gold/oil ratio, where one price is

divided by the other to show an over-valued or undervalued condition, but that is just not the best way to look at their relationship. Like the CRB Index, oil prices follow the movements of gold with a lag time of around 4 months. So the up move we are seeing now in oil is the echo of a similar move in gold prices 4 months ago.

What this relationship also says is that oil prices are nearing a top, ideally due to arrive on June 20. We don’t recommend that you chisel that date onto your calendar, but rather to understand what gold’s chart pattern says is supposed to be happening with oil prices.

You might notice at the left end of that lower chart that the correlation was not as good then as it seems to be now. The CRB Index has had that 4 month leading indication relationship with gold for a long time, but it is only recently working this well for oil. We hypothesize that the rising popularity of commodity index investing by hedge funds and others has increased the

continued on page 8



Sherman McClellan
Publisher

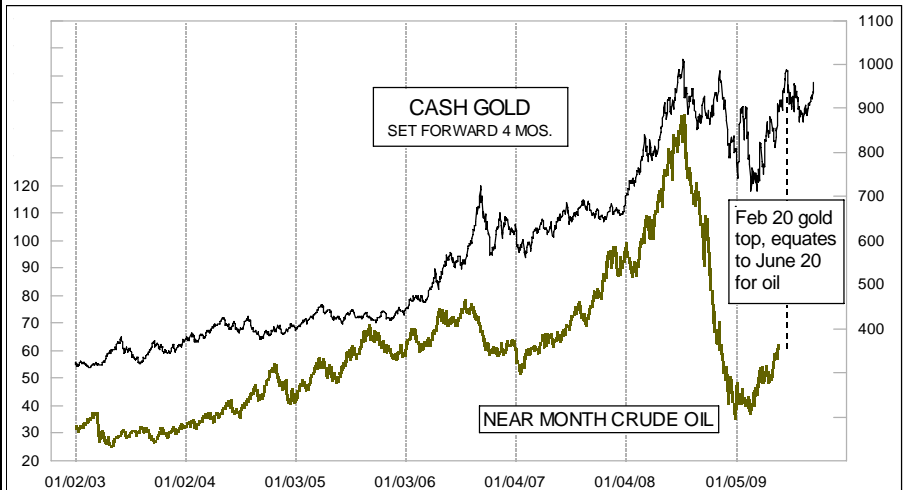
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TIMING MODELS

Stock Indices (DJIA, SPX, Nasdaq, NYSE Comp., etc.)			
SIGNAL	SOURCE	PREDICTED	ACTUAL
Bottom	NDX A-D Summ	May 5	---
Top	DJIA Stochastic	May 11	May 8
Top	Nasdaq Price Osc	May 15	May 18
L Bottom	Nasdaq ST Price Osc	May 18	May 21
L Bottom	NYSE A-D Osc	May 19	May 21
L Bottom	NYSE Volume Osc	May 22	May 21
Bottom	SP500 ST Price Osc	May 27	
Bottom	Nasdaq ST Price Osc	May 27	
Top	NYSE A-D Summ	June 2	
Bottom	DJIA Stochastic	June 8	
Top	Uncommon A-D Osc	June 10	
Bottom	Nasdaq A-D Osc	June 12	
Bottom	NYSE Volume Osc	June 18	
Top	Nasdaq ST Price Osc	June 19	
Bottom	NYSE A-D Osc	June 25	
Top	SP500 Price Osc	July 20-21	

Experimental New Indicator, "BC"			
Predicted Signal		How It Turned Out	
Implied Top	Mar 17	Top	Mar 23
Implied Bottom	Apr 8	Bottom	Apr 7/8
Implied Top	Apr 24	Top	Apr 17
Implied Bottom	July 7		
Implied Top	July 24		

Bond Market (Corporate & Treasuries)			
SIGNAL	SOURCE	PREDICTED	ACTUAL
Bottom	T-Bond Stochastic	May 6	May 8
Top	T-Bond ST Price Osc	May 7-8	May 6
† Bottom	T-Bond Up-Dn Osc	June 1-2	
† Bottom	T-Bond Stochastic	June 3-4	
Bottom	T-Bond Stochastic	June 8	
Bottom	T-Bond Close/Sum	June 11	
Bottom	T-Bond ST Price Osc	June 17	
Bottom	T-Bond Price Osc	June 22	

Gold and Precious Metals Stocks			
SIGNAL	SOURCE	PREDICTED	ACTUAL
Bottom	[Dollar Index Top]	May 8	May 11
Top	[Dollar Index Bottom]	May 12-13	(see *note)
Bottom	Gold ST Price Osc	May 13	May 11
Bottom	[Dollar Index Top]	May 20	May 18
Top	XAU Close/Sum	May 22	May 22
Bottom	XAU Close/Sum	May 27-28	
Bottom	Gold ST Price Osc	May 29	
Top	XAU ST Price Osc	June 1	
Bottom	[Dollar Index Top]	June 5	
Bottom	[Dollar Index Top]	June 17	
Bottom	Gold Price Osc	June 18	
Top	[Dollar Index Bottom]	June 22	
Top	Gold Price Osc	June 22	

*Note: Dollar Index did bottom May 13, gold unaffected.

The Signals

We are in a period now when these signals are not showing any clusters, nor many "important" signals. Sometimes it just works out that way. A cluster of the same type of signal in a short time frame implies a more important event, just as a 747 has a larger radar signature than a hummingbird.

The last cluster was for bottoms due May 18-22, and we did see a bottom within that time window.

It is not unusual to see an unfocused market, and an unclear set of signals, following a strong up move like we have seen since the March low. It is normal for the market to consolidate sideways after such a move, and not to have a real agenda involving reversals.

Gold is showing some important sig-

nals in June, and the June 18-22

period should be really interesting. We have "important" bottom and top signals in close proximity, so that could result in wild gyrations. It could also be that they cancel each other out, like two sumo wrestlers colliding. We don't know which way it will work out, but we do know that gold is overbought right now.

What To Expect

Stocks show a disorganized set of future signals, with little to hang our analytical hats on.

T-Bonds show a set of bottom signals due June 1-4, which ought to be a pretty meaningful bottom in bond prices. T-Bonds are certainly oversold enough now to deserve an important

bottom, but we may have to wait a week for those signals to arrive before bond prices are allowed to actually go up.

A **dollar** top June 5 should mean a bottom for **gold**, but their relationship has not been as well correlated lately. From now until June 17-18, gold looks problematic.

Tom McClellan at Traders Expo

Tom will be speaking at the Traders Expo in Pasadena, CA. The Expo runs from June 3-6, and Tom's appearance is on June 6 at 1:15 PM. Admission is free, but you have to register. You can use the link on the Home page of our web site, www.mcoscillator.com.

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.**

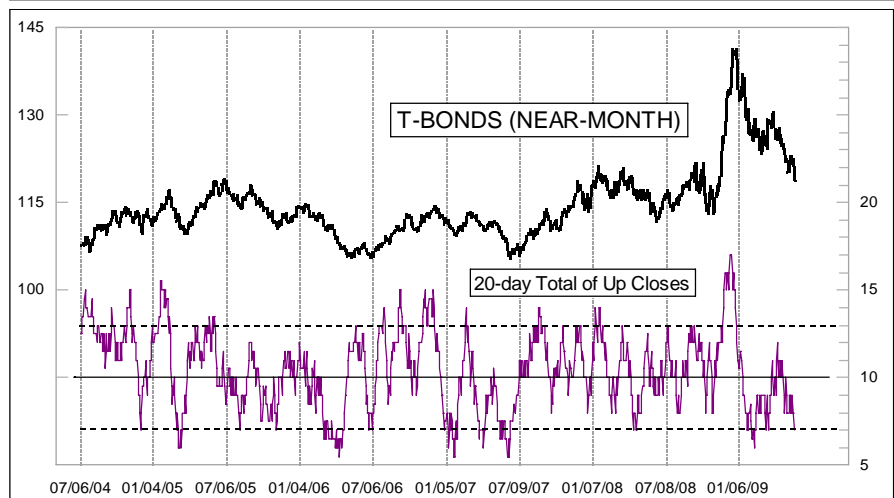
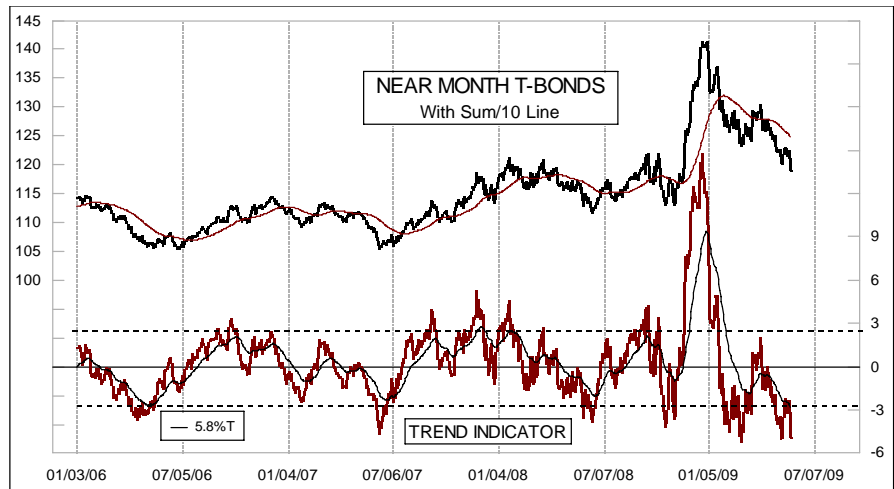
T-Bonds Refuse to Turn Higher

The rally that was supposed to appear now, based on how bonds behave in the first year of a presidential term, has been a no-show. Instead, T-Bond prices have moved down to a deeply oversold condition in sympathy with the dollar. The financial markets seem to be saying that investors do not have confidence in the Fed and the Obama administration to restart the fires of the economy without massive money printing.

The one saving grace is that everyone seems to be voicing that message in unison, and it has reached a state of near unanimity of opinion the likes of which are only seen at important turning points. The top chart on page 7 shows the Trend Indicator for T-Bond prices, and you can compare it to the Trend Indicator chart for the Dollar Index on page 4 to see that both of them are really oversold. Such deep oversold readings are associated with important price bottoms, eventually.

Also showing an oversold condition is the indicator in the middle chart. It simply looks back over the past 20 trading days (roughly 1 month) and counts how many trading days saw T-Bond prices close up. It is down now to a reading of just 7, and it does not tend to go too much lower than this. The trouble is that it can flash an oversold reading like this right at the bottom, or well in advance of the final low with still a lot more downward work to do. As with any other type of overbought and oversold indicator, it can stay at an extended reading for a long time.

One big fundamental reason to still think that bonds are going to move



higher out of this oversold condition is the fact that bond yields have been rising without the backing of the inflation numbers. Since making a bottom in yields back in December 2008, both the 10-year and 30-year bond yields have been rising while the CPI inflation rate has been sharply falling.

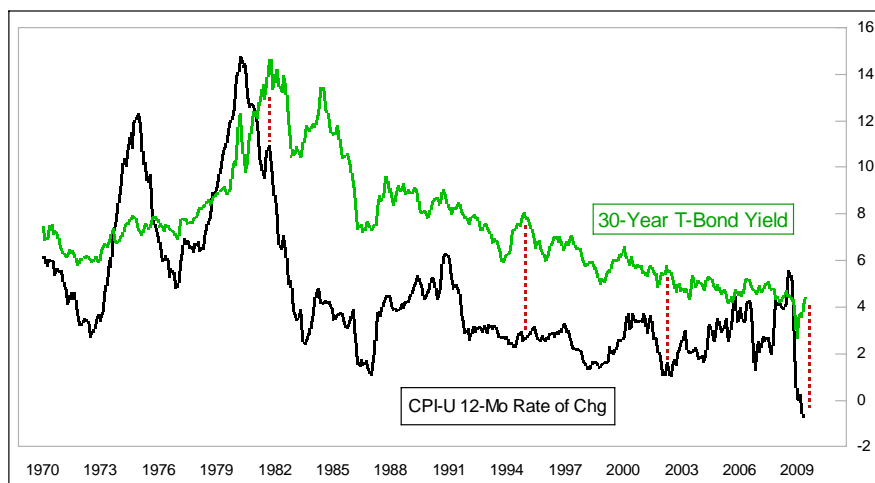
These two generally tend to move together. They can disagree slightly from month to month, but in general

there is a strongly correlated relationship there. In the rare event that bond yields move upward without inflation joining in the rise, what follows next is generally a reversal back downward for bond yields.

Right now, the spread between the 30-year T-Bond yield and the inflation rate (as of April's CPI number) is 5.18 percentage points. That is the biggest raw spread that we have seen since December 1994, and is an unsustainable level of difference between these two. Either yields are going to have to come down, or inflation is going to have to rise. Given that oil prices have come back up again from their lows, some rebound in inflation is to be expected.

But yields have also always come down from a big spread like this, and so we should expect that to be the case this time too.

Bottom Line: Bonds are overdue for a turn higher, and should be expected to make that turn very soon. A set of Timing Model bottom signals says June 1-4 is the latest that such an upturn should arrive.



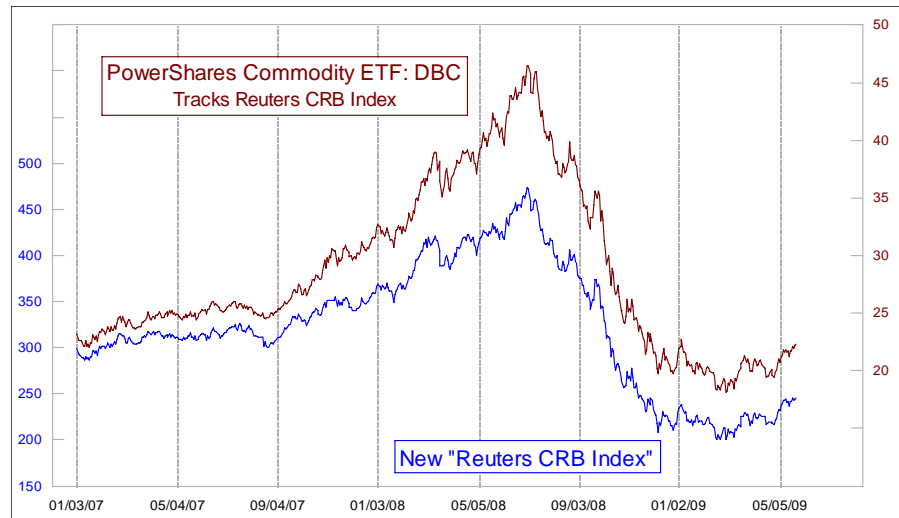
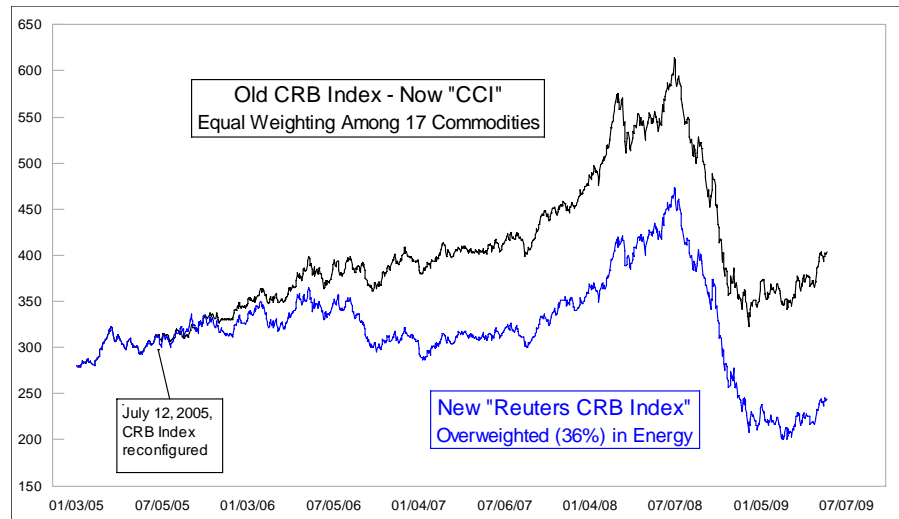
CRB Index *(cont'd from p. 5)*

overall correlation of the different commodities with each other, bringing oil's price behavior into better correlation with the CRB Index, and thus with gold's leading indication.

Mentioning oil in the context of commodities prices brings up another important point, one lost on most people except for the few who are intimately involved with commodities trading. The CRB Index of commodities prices has been around since the 1950s, but it has undergone a few reconfigurations over the years. The most recent was in 2005, when the former equal weighting among all of the components was set aside. Now, the new "Reuters CRB Index" is weighted according to a formula that determines how important each of the component commodities are to the overall economy. Accordingly energy futures now have a 36% combined weighting instead of 17.6% before, while wheat and hogs are each now down to just 1%.

The top chart on page 8 shows the new Reuters CRB Index compared to the old version which is now called the Continuous Commodity Index, or CCI. It is clear that there has been a difference in overall performance since the change was implemented. But it is also clear that the two are still highly correlated. So, to the extent that gold prices give us a leading indication of which direction the CRB Index is going to move, that leading indication also works for the CCI.

We were asked a question about this recently by a subscriber, who wrote to ask how one can make money from knowing that gold prices lead commodities prices. One way of doing that



directly is through use of any of the several commodities related ETFs that are now traded. You can see a list of them at <http://tinyurl.com/Commod-ETFs>

The middle chart shows one of those ETFs, DBC, which tracks the new Reuters CRB Index. It is a fairly tight correlation. Some of the commodities

ETFs have had trouble in tracking their indices because of the difficulty of rolling over expiring commodity contracts to new contract months. You should do your own homework before jumping into this game.

One other way to play this relationship is through the trading of stocks which track the commodities markets. One good example is Potash Corp. (POT), which makes fertilizers. The bottom chart shows that it correlates very nicely with the CCI, with an interesting twist: when the two diverge, it is a sign that a turn is coming. That is actually a negative for someone trying to use Potash as a trading vehicle to take advantage of gold's leading indication. But it is not too large of a negative factor.

Bottom Line: Gold prices are saying that commodities prices should continue rising toward a top ideally due June 20. Oil prices should follow that same path as well, then see a correction into July.

