THE McCLELLAN MARKET REPORT

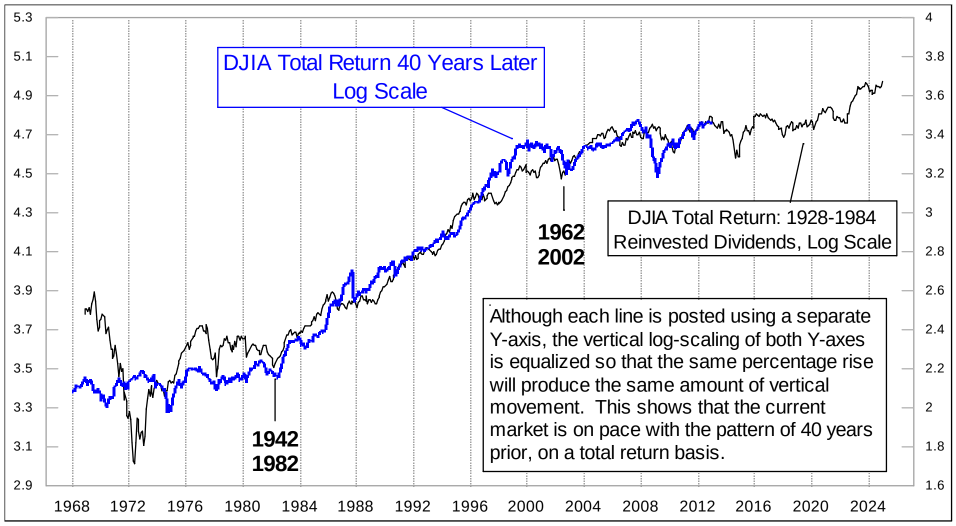
INSIDE

Prepared After the Market Close, December 18, 2012 Report #425, December 19, 2012

Is It 1973 Again?

A lot of analysts are now comparing the decade of the 2010s to that of the sideways 1970s. We have been talking about that for years, projecting as long ago as the start of this newsletter in 1995 that we would see a sideways period in the 2000s and 2010s. We projected this based on how there had previously been sideways periods about every 40 years going back as far as stock market data exists.

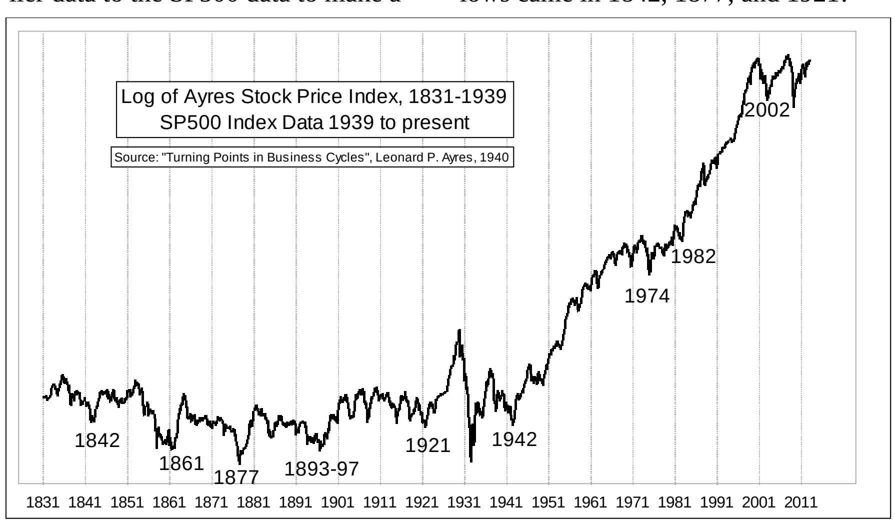
The sideways part of that 40-year cycle is not the only part that shows similarity from one era to the next. The big growth years of the 1980s and 1990s looked a lot like what the stock market had done in the 1940s and 1950s, so much so that when we put the two periods on the same chart the plots are almost identical. That's what we did in the first chart above, comparing the total return performance of the DJIA in each era, aligned so that the 1942 and 1982 bottoms are at the same point in the chart.



The blue chart plot is the current one, and if you zoom in close you can see that the two plots are right on top of each other right now. This implies that the market is poised for a decline like we saw in 1973-74, which is an ugly prospect to contemplate.

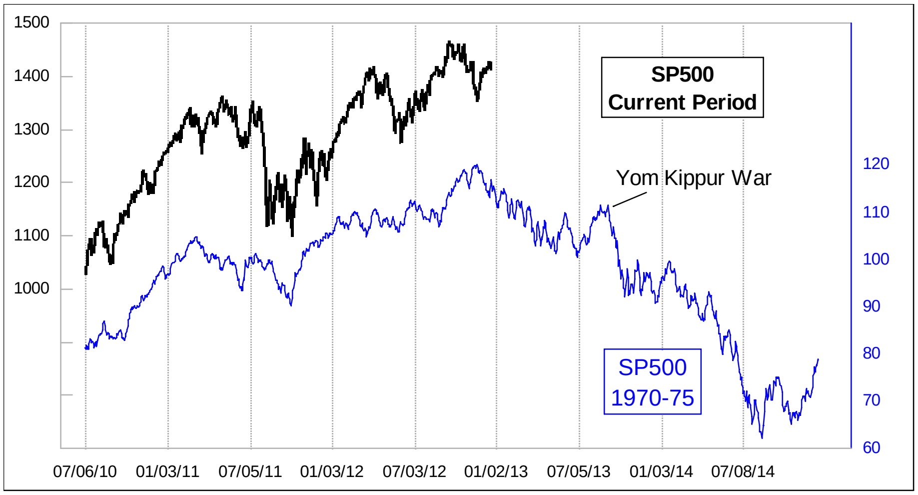
The lower chart takes a longer view at how this 40ish year cycle has affected stock prices. This data series goes back to 1831, and was published in 1940 by Leonard Ayres of the Cleveland Trust Company. We have connected that earlier data to the SP500 data to make a continuous series. What this shows is that about every 40 years, there is an important price bottom which sees prices go up afterward in a big way (1861, 1897, 1942, and 1982). Note that the important cycle bottom is not necessarily the lowest price low, but rather the transition point from secular bear market to secular bull market.

There has also been a significant low about halfway through the 40-year period, at least most of the time. Those lows came in 1842, 1877, and 1921.



BOTTOM LINE

The sideways 1970s was projected years ago to be repeated in the 2010s, and so far it looks like the market is generally following that script. The sideways period is not due to end until around 2022, and in the meantime it is a great period for market timers who can figure out how to buy low, sell high, and repeat. In the shorter term, stocks should be seen as topping now, then a sharp drop is due right at the end of December to a bottom due Jan. 3. The 8-month cycle bottom is due Jan. 15 to Feb. 4. That should bring a failing rally to a top in May 2013, then more damage. Bonds are getting so oversold now that a decent bottom appears imminent. Gold prices are still falling, and won't reach a 13-1/2 month cycle low until May 2013.



The market seems to have skipped making a significant mid-cycle low in the 1960s, although the 1962 bear market felt pretty significant at the time. The 2002 low was more in keeping with the magnitude of those prior examples.

Coming back to the question at the start of this story, the chart on page 2 zooms in closer on a comparison of the daily price plots of the SP500 now versus in the early 1970s, with the best price pattern alignment we could achieve. It is not the best pattern analog we have ever seen, but it is good enough to at least be interesting. It also helps to remind us that not all of the market action has to be considered to be built in; there can still be reactions to news events.

For example, the Nov. 15, 2012 bottom appears to align to the 1973 top. But remember that the early November decline was partly in response to Hurricane Sandy, and also fueled by the surprising (to many) reelection victory by President Obama. And the bear market in 1973 was amplified by the combined attack by several Arab nations against Israel in 1973, and the resulting oil embargo against the U.S. as retribution for providing assistance to Israel. To see a similar outcome in 2013, we would probably need to have similar economic inputs, as well as a repeat of the Fed's stupid efforts in 1973 to fight inflation during a recession.

Bottom Line: The similarity of the current decade to the 1970s is remarkable, though not perfect. 2013 does not look to be a good year for the market, something we already knew from our other analysis.

Page 3 Charts

Chart 1: The A-D Line says, ignore the Fiscal Cliff, ignore the Obama Care tax hikes, ignore the Middle East saber rattling, it's full speed ahead into new all time high ground. After breaking out above the previous highs, it pulled back down to the 10% Trend to gain strength for the latest bounce to new highs. It is hard to find anything to not like about the behavior of this indicator, unless one is a bear.

Chart 2: The Daily Volume Line hasn't made it into recovery high ground yet, but it has made it up to a downtrend line that can be drawn across highs on this chart which uses total volume data regardless of where it is traded. Using NYSE floor traded volume only, that trendline across tops goes all the way back to the 2007 top. It will be significant should the Daily Volume Line be able to continue higher breaking out above overhead resistance. But should it stall right here, then that would also be telling a story that all would need to pay attention to.

Chart 3: The McClellan A-D Summation Index is up to +2200, with some acceleration as it moved above the +2000 level. It needs to move solidly above about +2550 to send a message that this move has some legs and is not just a failing rally. If the Summation Index were to stop advancing short of the +2550 level, that would indicate the track of a failing rally that would indicate that we should expect a bearish outcome of the next decline.

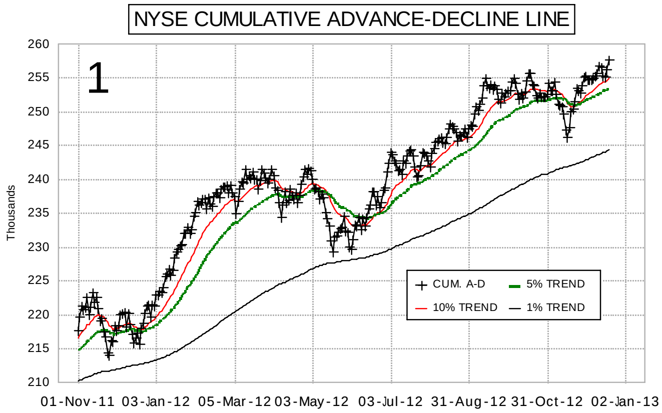
Chart 4: The Volume Summation moved easily back up above the zero level. That has allowed the NYSE Comp Index to make a slightly higher high for the year. That still leaves it 172.06 points below its April 29, 2011 high. If there is continuation higher by the Daily Volume Line and this Summation Index, then that objective could be reached. But if it stalls here, the production of a marginal high would be an empty victory.

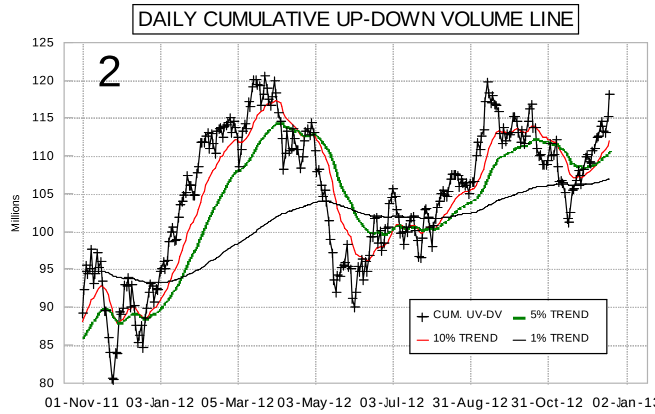
Chart 5: The McClellan Oscillator went from a deep oversold level in mid-November into a complex pattern above zero, which confirmed that control had shifted to the bulls. The very shallow dip below zero was not confirmed by the Volume Oscillator, and provided room for the rally that has resulted in the higher high in the NYSE Comp. It will take more positive action by the Oscillator to allow other price indicators to confirm the action by the Composite. That can be possible as the Summation Index still has room to move higher.

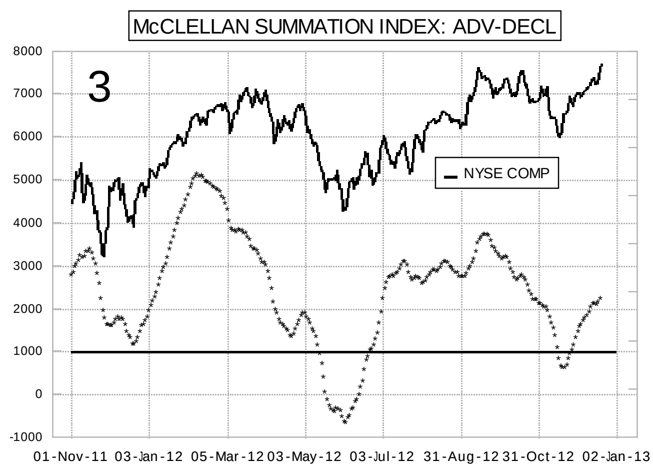
Chart 6: The Volume Oscillator is the stronger of the two Oscillators and it is reaching into higher ground for the current complex move above zero. As price moves are more closely correlated with Volume indicators than A-D, this strength is responsible for the new high in the NYSE Comp. The Volume Oscillator does not stay long at such a high level as it finds itself now. But it can bounce around above zero for some time as it shows on the left side of the chart. This indicator can have very sharp 2 or 3 day drops to consolidate postings that get too high.

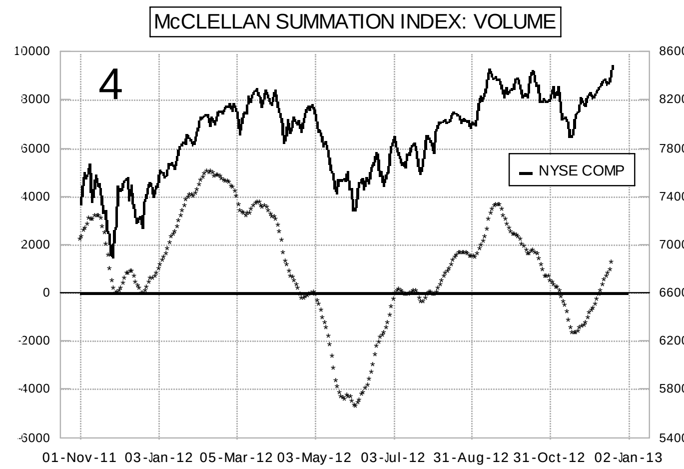
Chart 7: The DJIA Price Oscillator has made its way back up above zero from a fairly deep low. It appears to be accelerating as it moves higher above zero. There is still room for it to move higher. The move so far appears smooth in structure, implying strength for the move up. This is different from the bumpy move up seen in the middle of the chart. However, the DJIA is still 235.97 points below its September 20, 2012 high. It is the smaller cap stocks of the NYSE Comp that are leading the large cap stocks of the DJIA higher.

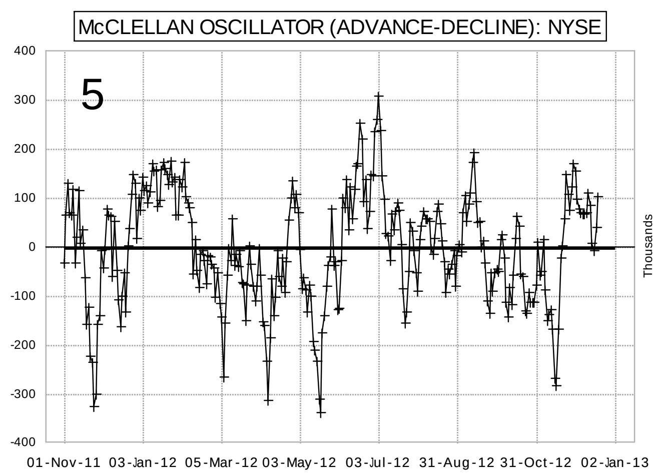
Chart 8: The CBOE Volatility Index (VIX) continues to live below a downtrend line that can be drawn across the highs. A breaking of that trendline should prove to be a bearish event. But so long as the VIX remains below it, the force of price is likely to be higher. The SP500 offers much resistance at its closing highs of 1461.05 on Sept. 19, 1461.40 on Oct. 4 and 1460.91 on Oct. 17. While the SP500 is making higher highs, the VIX is not confirming that by making lower lows, which is a big source of concern.

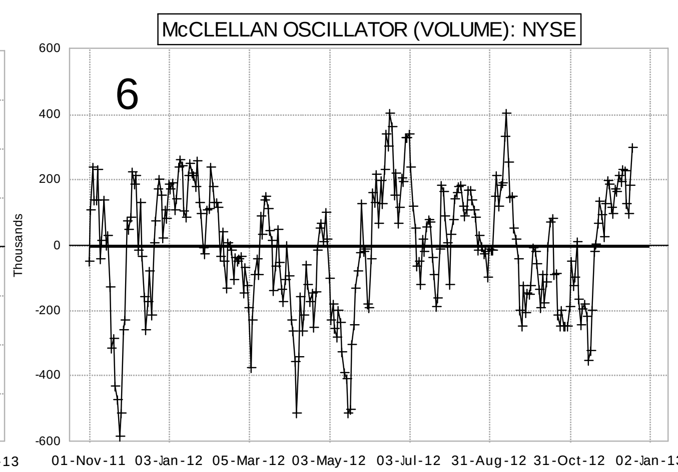

NYSE CUMULATIVE ADVANCE-DECLINE LINE
1
Thousands
CUM. A-D
5% TREND
10% TREND
1% TREND
01-Nov-11 03-Jan-12 05-Mar-12 03-May-12 03-Jul-12 31-Aug-12 31-Oct-12 02-Jan-13

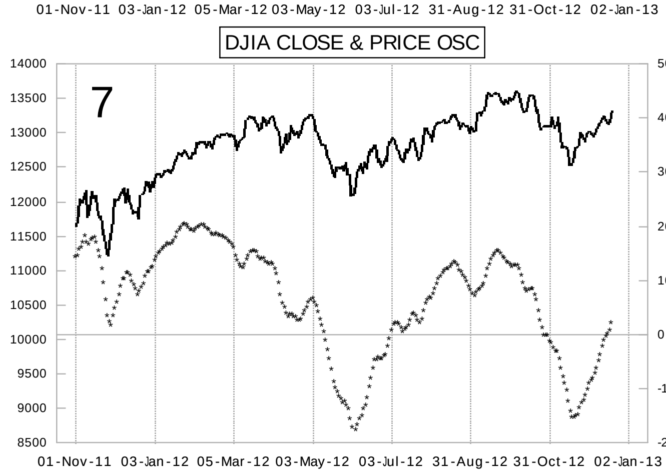

DAILY CUMULATIVE UP-DOWN VOLUME LINE
2
Millions
CUM. UV-DV
5% TREND
10% TREND
1% TREND
01-Nov-11 03-Jan-12 05-Mar-12 03-May-12 03-Jul-12 31-Aug-12 31-Oct-12 02-Jan-13

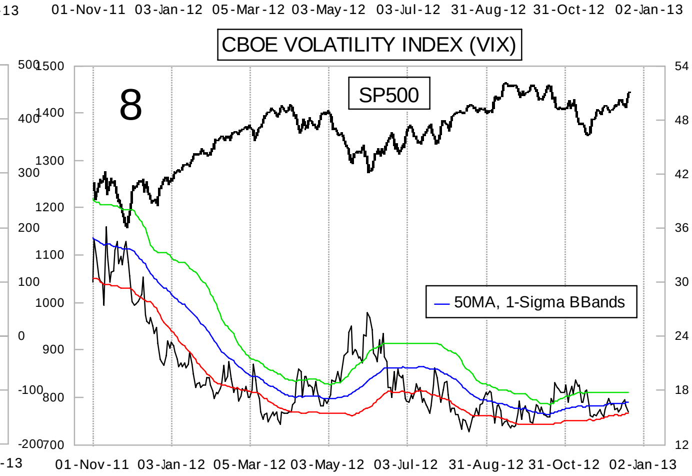

McCLELLAN SUMMATION INDEX: ADV-DECL
3
NYSE COMP
01-Nov-11 03-Jan-12 05-Mar-12 03-May-12 03-Jul-12 31-Aug-12 31-Oct-12 02-Jan-13


McCLELLAN SUMMATION INDEX: VOLUME
4
NYSE COMP
01-Nov-11 03-Jan-12 05-Mar-12 03-May-12 03-Jul-12 31-Aug-12 31-Oct-12 02-Jan-13

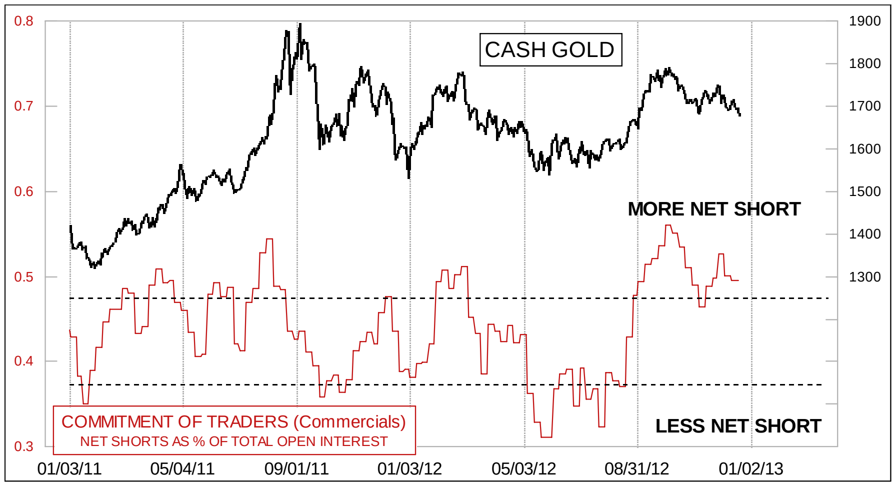

McCLELLAN OSCILLATOR (ADVANCE-DECLINE): NYSE
5
01-Nov-11 03-Jan-12 05-Mar-12 03-May-12 03-Jul-12 31-Aug-12 31-Oct-12 02-Jan-13


McCLELLAN OSCILLATOR (VOLUME): NYSE
6
Thousands
01-Nov-11 03-Jan-12 05-Mar-12 03-May-12 03-Jul-12 31-Aug-12 31-Oct-12 02-Jan-13


DJIA CLOSE & PRICE OSC
7
01-Nov-11 03-Jan-12 05-Mar-12 03-May-12 03-Jul-12 31-Aug-12 31-Oct-12 02-Jan-13


CBOE VOLATILITY INDEX (VIX)
8
SP500
50MA, 1-Sigma BBands
01-Nov-11 03-Jan-12 05-Mar-12 03-May-12 03-Jul-12 31-Aug-12 31-Oct-12 02-Jan-13

Gold Breaks Trend (in Euros)



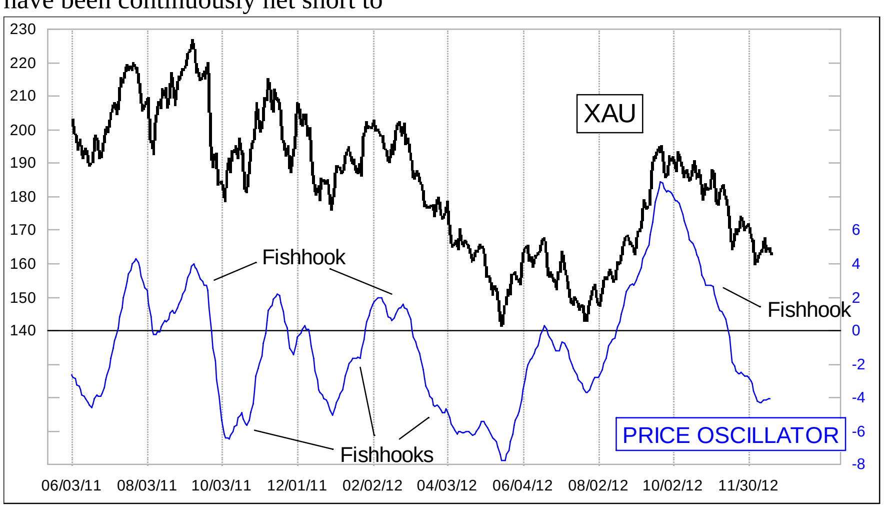
Perspective is everything. To a trader who thinks in dollars, the price of gold is still above its rising bottoms line, and has been in a symmetrical triangle structure since 2011. Symmetrical triangles are indecision patterns which *usually* resolve by seeing the prior trend reassert itself. So that would mean that gold prices are more likely to break out to the upside, eventually.

But to a trader who looks at the world in euro currency terms, the picture is wholly different. What was a symmetrical triangle in the dollar price of gold is now a bearish rising wedge structure if we price gold in euros. And the price of gold has now broken its uptrend line, come back to test the underside of it, and now pushed further downward. That is decidedly bearish behavior.

So which one is right? As we noted in our last Report, when the dollar price and the euro price of gold disagree, it is usually the euro price that knows the real deal about where both are headed. So when there are divergences, it is better to listen to the euro price. This suggests that the uptrend break on the euro price spells big eventual trouble for even the dollar price of gold.

A lower price of gold is certainly how the commercial gold futures traders are betting, as shown in the middle chart. This is data from the weekly Commitment of Traders (COT) Report, which we cover nearly every Friday in our *Daily Edition*. The "commercial" traders are the big money guys, usually major banks and investment firms but also some gold producers, and they are presumed to be the smart money. They have been continuously net short to varying degrees since late 2001, and so the game consists of evaluating their comparative net short position. The horizontal lines in the chart are arbitrarily drawn, but pretty well reflect where "high" and "low" have been over the past 2 years.

The current reading is down just a bit from its recent peak, but still high enough to say that gold prices have further to fall.



The bottom chart shows that gold mining stocks had been trying to rally just recently, and even saw the Price Oscillator for the XAU turn upward at a fairly deep level. But as of Dec. 18 that upturn has failed, and the Price Oscillator has turned back down (hard to see after just one down day, but it's there).

A quick downturn like this after just a few days of a rising Price Oscillator leaves behind a structure we call a "fishhook". These are important because they highlight the failure of the forces of reversal, and show that the door is open for the preceding trend to reassert itself. A Price Oscillator turning down below zero carries the *promise* of a lower closing price low on the ensuing move.

Bottom Line: Gold is in a downtrend, and that should continue.

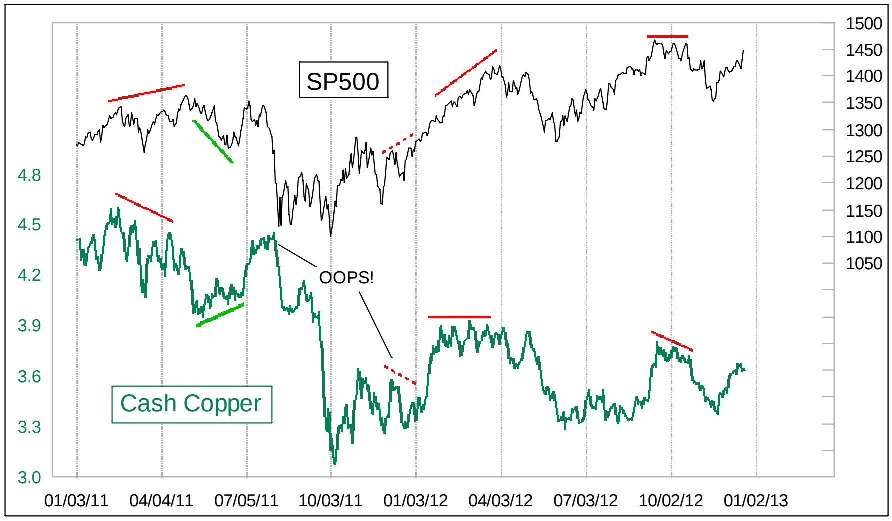
Copper's Message For Stock Market Not Good

While the major averages this week are surging to a higher high, copper is not joining in the fun, and that carries a troubling message for the stock market.

For years, market analysts have been calling copper the "metal with a PhD in economics". Because copper is used extensively in construction, automotive, and other forms of industry, copper prices are often viewed as an indicator of overall economic activity. But what those analysts do not realize is that copper's behavior changed in a big way starting in 2007.

Previously, copper prices would move up and down in a pretty good correlation to bond yields, but with a relatively poor correlation to the stock market. Beginning in 2007, copper changed from being an economic indicator, and started to just be a stock market indicator. Its correlation to the SP500 is strongly positive, but with a twist: When the two disagree, it is usually copper which knows the truer story about where both are headed.

The top chart on page 5 looks at copper versus the SP500 over the past 2 years, and the correlation is pretty obvious. We can also see that when divergences appear, the resolution is usually in the direction that copper dictates. Usually, but not always. A couple of notable missteps are highlighted.



All of this is relevant now because copper on Dec. 18 did not join the stock market in surging to a higher high, and instead moved lower in spite of a drop in the dollar that day. A falling dollar should have made copper more expensive, all else being equal, and so to have them fall together means that copper lost even more ground when measured in real terms. This could be the start of a bigger decline for both.

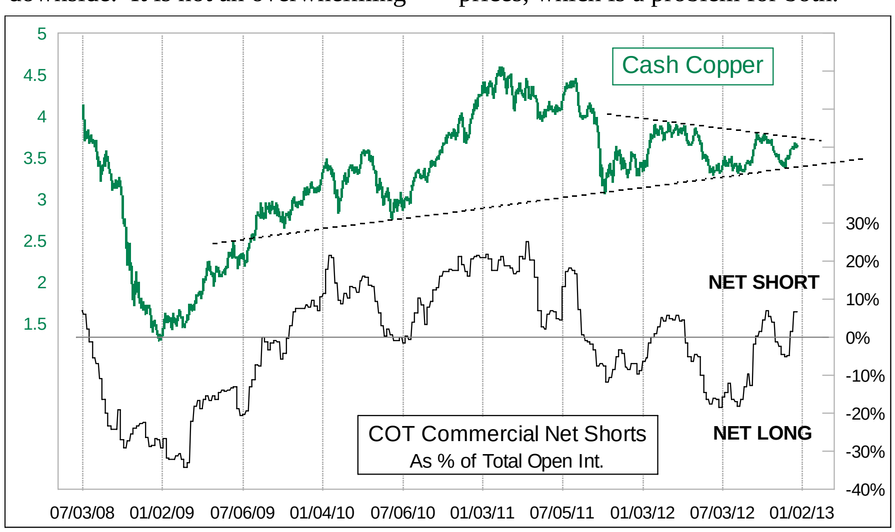
The SP500 has not yet climbed above its September/October highs, but the NYSE Comp has done so, as shown on page 3. Copper has thus far not confirmed that stock market strength.

This apparent new divergence arises in a condition where the COT data show a meaningful bias toward the downside. It is not an overwhelming one, like what we saw back in early 2011, but the commercial traders' current net short position is back up to a level that was high enough to mark price tops in early 2012, and again just recently in October.

As with the COT data on gold, some of the commercial copper traders are producers who are using futures to lock in prices for their future production. So some analysts have said that this factor should discount from the usefulness of such data if we are just measuring what the producers do all the time anyway.

But copper producers are perhaps more aware than anyone of what prices are doing, and what they are likely to do. So if they suddenly ramp up their forward sales above past ambient levels, that could be seen as a reasonable sign that those producers think the current price is one that is worth locking in. In other words, they see the risk of a decline.

Bottom Line: Copper prices are not sharing in the bullishness seen in stock prices, which is a problem for both.



Sherman McClellan
Publisher

Tom McClellan
Editor

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TIMING MODELS

Stock Indices (DJIA, SPX, Nasdaq, NYSE Comp., etc.)

	Signal	Source	Predicted	Actual
F	Top	SP500 Close/Sum	Dec 10	Dec 12
F	Top	NYSE Volume Osc	Dec 11	Dec 12
F	Top	SP500 ST Price Osc	Dec 12	Dec 12
F	Top	Nasdaq A-D Osc	Dec 14	Dec 12
	Top	NDX A-D Summ	Dec 19	
	Bottom	Nasdaq ST Price Osc	Dec 20	
	Top	NYSE A-D Osc	Dec 21	
	Bottom	NYSE A-D Summ	Dec 27	
	Bottom	NYSE A-D Osc	Jan 3	
	Bottom	Nasdaq A-D Osc	Jan 3	
	Top	NYSE A-D Summ	Jan 15	
	Bottom	DJIA ST Price Osc	Feb 11	

Experimental New Indicator, "BC"

Predicted Signal		How It Turned Out	
Implied Bottom	Dec 2	*Top*	Nov 30
Volatility Event	Jan 2		
Implied Top	Feb 10		

Bond Market (Corporate & Treasuries)

Signal	Source	Predicted	Actual
Bottom	T-Bond Stochastic	Dec 20	
Top	TYX Close/Sum	Dec 27	
Top	TYX ST Price Osc	Dec 27	
Bottom	TYX ST Price Osc	Jan 8	
Top	TYX Close/Sum	Jan 11	
Bottom	**TYX Price Osc**	**Jan 17**	
Top	T-Bond Price Osc	Jan 24	
Bottom	T-Bond Price Osc	Jan 31	
Bottom	T-Bond Close/Sum	Feb 1	

Gold and Precious Metals Stocks

	Signal	Source	Predicted	Actual
	Bottom	Gold ST Price Osc	Dec 10	Dec 5
F	Top	XAU Up-Down Osc	Dec 13	Dec 12
F	Top	Gold ST Price Osc	Dec 14	Dec 12
	Top	Gold ST Price Osc	Dec 18	Dec 17
	Top	XAU ST Price Osc	Dec 26-28	
	Bottom	Gold ST Price Osc	Jan 11	
	Top	**Gold Price Osc**	**Jan 14-15**	

The Signals

The big top cluster (F) which called for a stock market top Dec. 10-14 did indeed bring the rally to a halt right on schedule. After a rest break for a couple of days, the stock market has surged ahead once again, perhaps as an effort to honor the outlier top signal due Dec. 19, which was a little too far out to include in cluster F.

We like to identify these clusters whenever the signals appear to define them. Getting more signals talking about the same type of turning point (top or bottom) within a short period of time lends greater evidence to the validity of that idea, and implies that it will be a more significant one and not just part of the noise.

In our last Report, we discussed the Jan. 2 "volatility event" that our experimental BC Indicator shows. Rather than marking a top or a bottom, those particular wiggles in the BC Indicator tend to mark an electric pickup in price volatility. Most times it is a quick selloff.

Now we have a couple of actual bottom signals due Jan. 3, which with the BC Indicator's volatility event suggest that the new year could get off to a bad start. And with a top due Dec. 21, the implication is that there won't be a "Santa Claus Rally" this year, which if true would be a bearish message for next year.

Otherwise, the Timing Model signals are entering a dry spell, something which should change as stock prices revert to more sideways action. It is a natural function of these signals that trending markets tend to produce fewer signals, while sideways markets produce more. Someday we'll get the book written which explains exactly how these signals work, but that remains a task that will have to wait for a period when we have more spare time.

What To Expect

Stocks show a late top due now, sort of an addendum to the big top cluster that had been due Dec. 10-14 and which appears to have come in on time. The Dec. 19 top signal comes from the Summation Index for Nasdaq 100 stocks. Another minor top is due Dec. 21, which is typically when the Santa Claus Rally is supposed to begin, and it is followed by bottom signals indicating that Santa Claus may fail to call this year at Broad and Wall.

T-Bonds should see a top due Dec. 27, just as stocks are entering a bottoming period.

Gold similarly shows a top due Dec. 26-28, implying that the strong correlation to stock prices which so many analysts had come to take for granted just a few weeks ago has now broken, or inverted, or something. Look for a top then, followed by a bottom Jan. 11 before a more important top due Jan. 14-15. The longer cycles in gold say that we not should expect a real, final bottom until May 2013.

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.

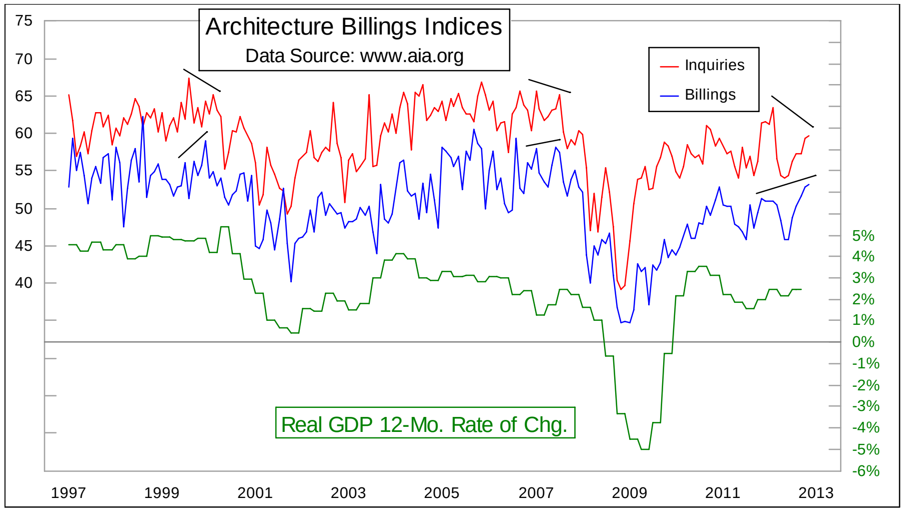
These models do not catch every market turn, but the signals usually show some effect in the market action. It is important to understand that the market does not have to go up from a bottom; it may just stop going down. It does not have to go down from a top, it may just stop going up. Some bottoms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

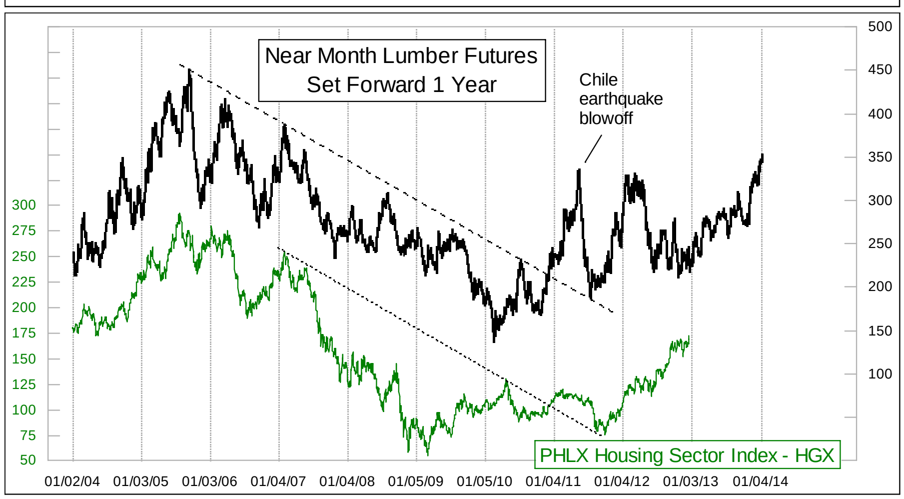
The BC indicator is an experimental new tool, not related in method to the other signals.

"Actual" dates listed for NYSE Indices are for the NYSE Comp/Dow Jones Industrial Average. Letter groups (A, B, C, etc.) denote clusters of signals. ST Prc 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**.

Economic Signs Suddenly Look Up





With the U.S. government poised on the brink of a fiscal crisis, and the potential for a huge tax rate hike (or perhaps none at all), there is significant room for worry about the future health of the U.S. economy. But a couple of important but not well followed economic indicators are saying that the economy in 2013 could be stronger than many think.

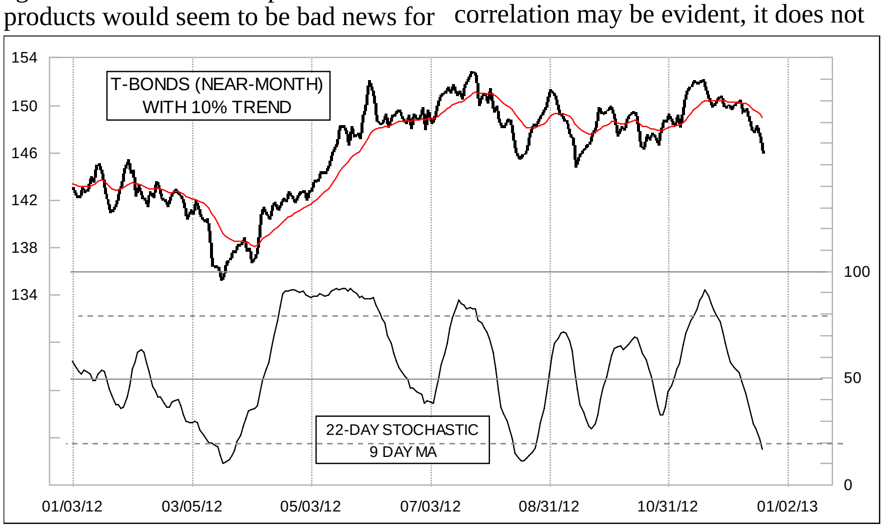
The top chart shows the latest data from the American Institute of Architects (www.aia.org). They publish results from surveys of member firms, in an effort to gauge the levels of activity. Their two main indices are related to "inquiries", which are prospective business, and "billings" which is about work that is actually getting done.

Both data series are published monthly, and have a considerable amount of noise. But both have a fairly strong correlation to what the GDP data actually turn out to be, once such data is finally tabulated and published. That is important right now because both series have been rising for the past 6 months, implying an uptick for GDP in the 4th quarter.

One fly in the ointment for that seemingly good news is that while billings are up in a big way, the inquiries index is not showing the same degree of robustness. There are a few past examples of such divergences, and in each case the news is not good for GDP growth.

Another piece of bullish news is that lumber futures prices have now recovered to the highest level since the end of the housing bubble five years ago. And while more expensive wood products would seem to be bad news for the building trades, the middle chart reveals that the movements of lumber prices tend to be followed about a year later by similar movements in the share prices of housing related stocks. It is not a perfect relationship, but the correlation is evident, and it implies that 2013 ought to be a good year for the HGX Index shown in that chart.

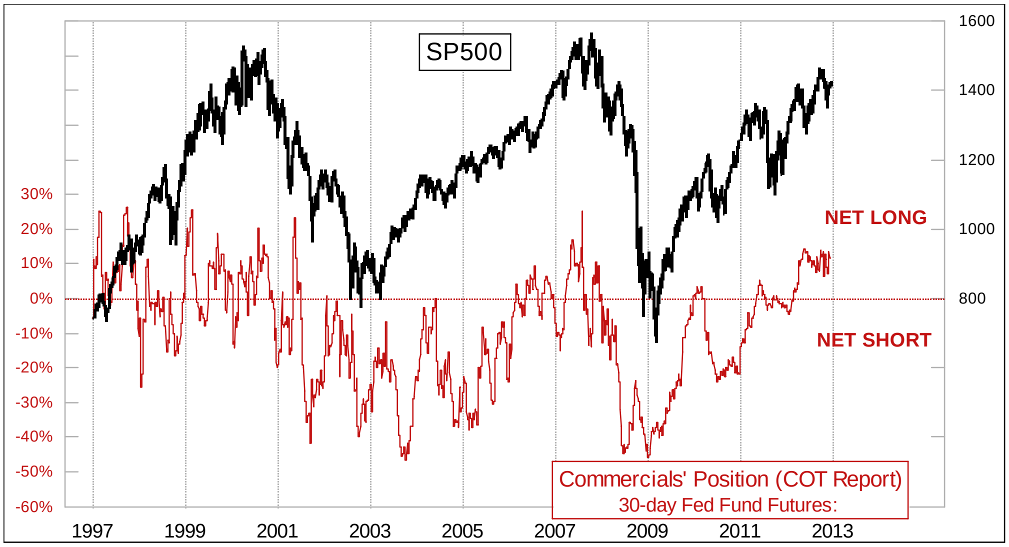
We would caution that while such correlation may be evident, it does not always work out to make money for investors. In 2008, for example, lumber prices hinted at a much more bullish outcome than what was seen in the HGX, as housing stocks got sucked down in the vortex of the whole financial collapse. You can still see that it traced out the same dance steps as lumber prices had a year earlier, but in a much more bearish way.



For their part, T-Bond prices seem to be rapidly pricing in the likelihood of that positive economic growth hinted at above. But the bottom chart shows that this may be getting a bit overdone. The 22-9 stochastic oscillator is now down to below the 20 level, which marks where the really oversold bottoms are seen. It is still falling, as are bond prices, and thus the presumptive trend direction is still down. But what is noteworthy is that the upturns from such low readings are usually associated with the more important bottoms for bond prices, and thus with the more important rebounds.

Saying it another way, when the bungee cord gets more stretched, the bounceback is bigger. The message here is that the bond market may be overdoing its response to better economic news.

Bottom Line: T-Bonds have not turned up yet, but when they do it should be a decent rally. And given our expectation of an important top for stock prices, it makes sense that bond prices should turn upward.



Exploring A New Indicator

The data in the Commitment of Traders (COT) Report is among the most interesting of data out there to tell us about the financial markets, and about how the different players are positioned. But there is so much data there that one cannot follow all of it. The most recent weekly COT Report contained data on 155 different futures contracts, which is more than anyone could reasonably follow.

To take that weekly report and separate out its constituent parts is a lot of work, and so we have not even gotten around to doing that for all of the interesting ones. But this past week we finally got around to looking at the COT data on the 30-day Fed Fund futures contract.

We went into this exploration expecting to find that it worked similarly to the way that the COT data for eurodollar futures worked, giving a 1-year leading indication for what the stock market does. After all, both are interest rate related, and are employed by banks and major financial institutions to help manage their financial assets and obligations. But we were surprised to find out that it did not work that way.

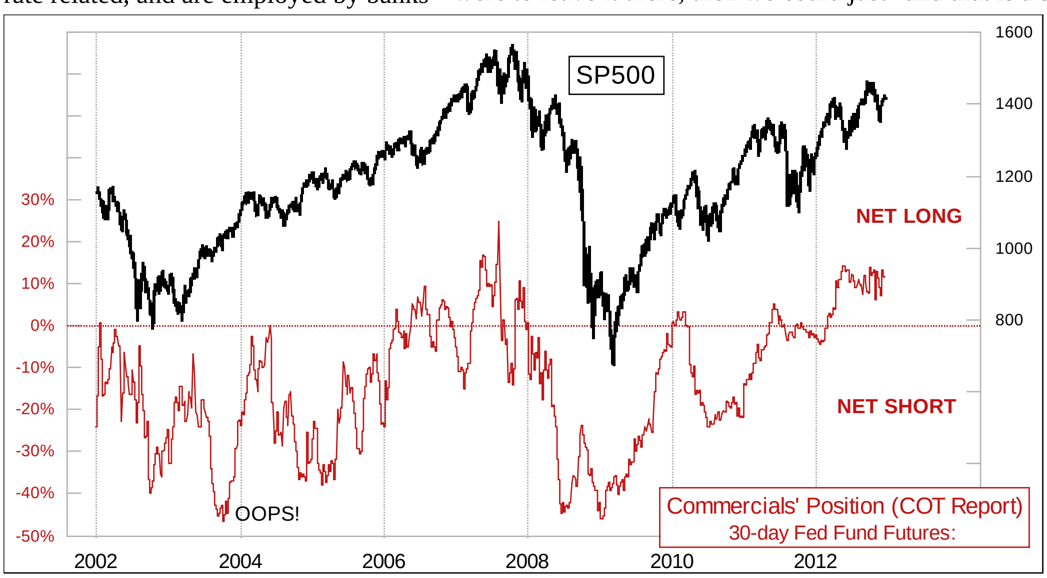
The top chart above shows a really long term look at the relationship between the SP500 and the net position of commercial traders of Fed Fund futures. The correlation is pretty obvious, and is interesting because this data can give us yet another source of information about how stretched the stock market's rubber band is at any given time. Importantly, it is a seemingly coincident relationship, not the 1-year leading indication we see with the commercial traders' net position in eurodollar futures.

Right now, this long term look at this relationship shows that commercials are up to the sort of net long position which is typically associated with important tops for stock prices. If we were to leave it there, then we could just receive the bearish message for stocks and move on.

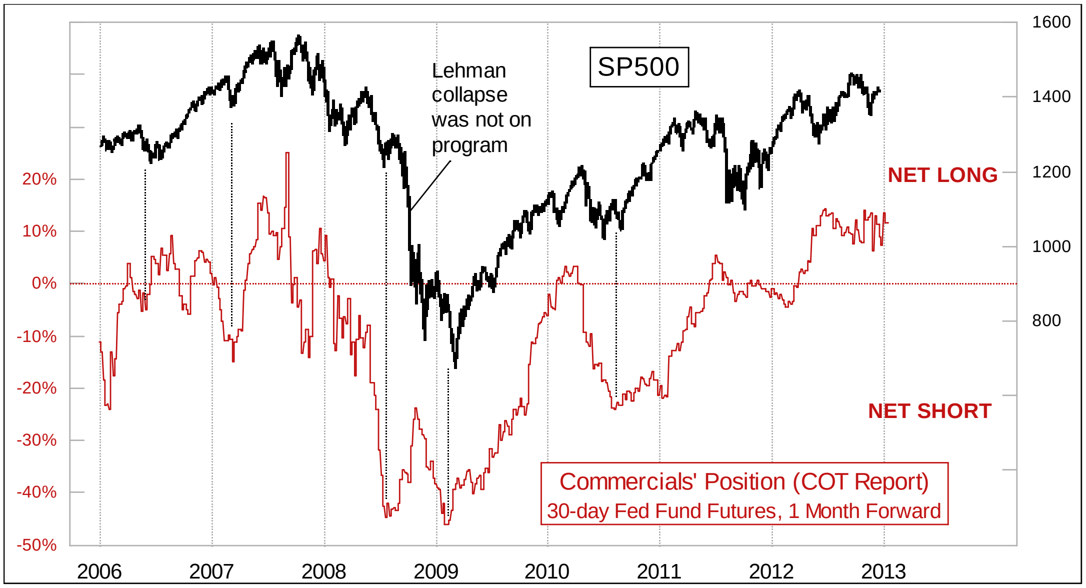
But a closer look shows that the situation is just a bit more complicated than that simplistic view. The lower chart on page 8 zooms in a bit on this relationship, and we see that as we move closer, the coincident correlated relationship still seems to be working as described above. The really low readings in 2003 were an interesting anomaly, and we can say now that it was "interesting" as we study 9 year old history, whereas if we had been tracking it in realtime then it would have seemed much more anomalous than curious. What that 2003 "oops" showed was that the stock market's rubber band was really stretched, even if it was not evident in stock prices at the time.

The current net long position for the commercials is the biggest that we have seen since the 2007 stock market top, and that is a source of concern to anyone who cares about the possibility of repeating a 2008 style decline. We saw similar high readings back at the 2000 market top, so that is all the more reason for concern.

But as we zoom in even closer on page 9 we see that the relationship gets even more interesting. When we zoom in closer, we find that it is not a coincident relationship after all. At a closer view, we find that we have to shift the Fed Funds COT data forward in order to see the right correlation.



That's not a bad thing, but rather a good thing. If you can find something that is going to tell you a month ahead of time which direction the stock market is likely to go, that's a golden treasure. If we had had this tool for much of the past decade, we could have drawn a nice picture of what the stock market would do, and we would have been on the right side of the trend most of the time. Who could want more than that?



This relationship admittedly got into trouble during the 2008 financial crisis. This indicator showed that a rebound was due in late 2008, but the commercial traders evidently did not know that Tim Geithner (then the NY Fed President) was going to torpedo Lehman Brothers in its moment of need, and exacerbate the collapse. Other than that, the correlation is really good with this 1-month forward offset.

Or at least it seems to be, until we get closer to the current time frame. The final chart below zooms in even tighter, showing the relationship of the SP500 to this Fed Fund futures COT data since 2010. For much of the chart, the correlation works as described above, with this COT data giving a one-month leading indication for what the SP500 would do.

It correctly told of the 2010 top, and even the Flash Crash in May 2010 by virtue of the rapid drop that the commercial traders showed. It correctly called the 2010 bottom, and the rise to the top in July 2011.

That was when the Federal Reserve announced the end of QE2, and the stock market reacted badly. Somehow the commercial Fed Funds futures traders know what the reaction would be a month ahead of time, because they started paring back their net long position. They even marked the bottom correctly in October 2011.

Shortly afterward, though, is when this whole relationship got into trouble. Keep in mind that we have had this data for a long time, but only just this past week had the time to assemble it and chart it for consideration. Beginning in January 2012, the whole nice leading indication relationship seems to have disappeared entirely. It seems somewhat inverted, but even that characterization does not seem quite right. Instead, it just seems broken, like a speedometer no longer connected to the wheels of a car and instead showing something else entirely.

Is it inverted? Is it just disassociated? We cannot say just yet. We are glad in a strange way that we did not dig into this data before and get so cozy with it to rely on it, only to find in 2012 that the relationship was suddenly kaput. Perhaps it will someday start working again as it did before 2012, or perhaps inversion is the permanent new relationship. Ask us in 3 years, and we'll give you a better answer.

Prospecting in the data like this is a risky proposition. One might find a dry hole, with no useful relationship to exploit. Or one might find a seemingly great insight, only to discover that it suddenly breaks down and does not work any more. Such is the nature of data mining, and at a minimum it provides us with a reminder that even seemingly good market relationships can sometimes go south without warning. We wish we had a better insight to offer now, and we'll continue to watch this one now that we have the data distilled, to see if it offers us any more useful insights in the future.