THE McCLELLAN MARKET REPORT

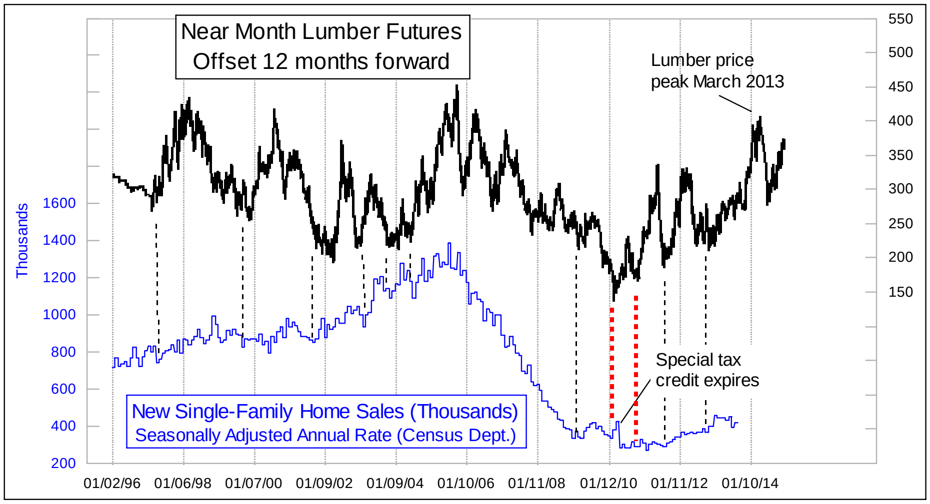
INSIDE

Prepared After the Market Close, November 19, 2013 Report #447, November 20, 2013

Housing Rebound Not Done Yet

The housing market has been recovering slowly since the collapse from the 2008 financial crisis, but it has been a recovery. And given the message from our first chart, that recovery is not done yet.

It should not be a surprise that there is a linkage between lumber prices and the housing market. But the exact nature of that relationship was a little bit of a surprise to us when we first began looking at it back in 2008. It turns out that lumber prices lead a lot of housing related data series by exactly 1 year.



That is reflected in the first chart by having the lumber futures price plot shifted forward by one year. So for example the lumber price peak in August 2004 was followed by the peak for new home sales data a year later in July 2005. They appear aligned in this chart because the lumber price data have been shifted forward.

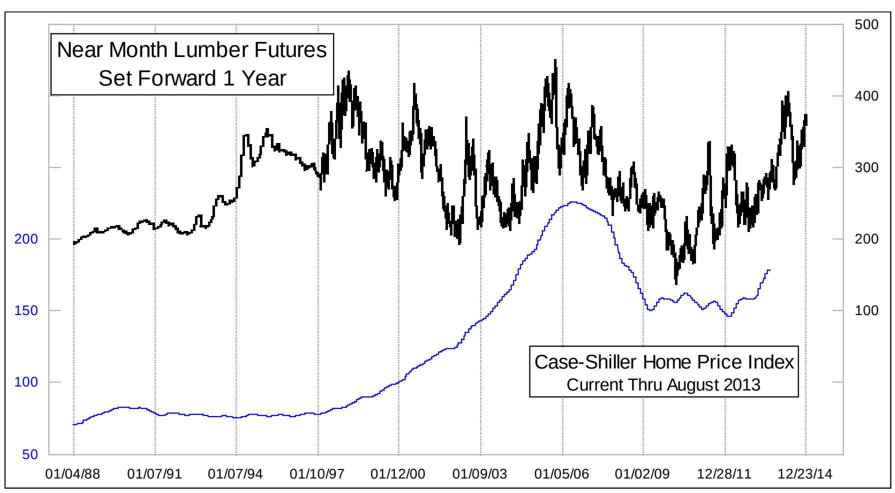
Lumber made its price bottom in January 2009, and new home sales bottomed a little over a year later. The shape of that bottom in home sales was disrupted somewhat by Congress trying to “help” with tax credits that shifted around some home sale transactions.

Looking ahead, the lumber price peak back in March 2013 is forecasting a continued rise in new home sales into early 2014. After then, the picture gets a little bit more rocky. One hypothetical scenario which seems to make sense is that the Fed could potentially end its QEternity program, and perhaps even raise short term rates slightly, causing a big rush to get into a new mortgage in early 2014, and then a slowdown thereafter. We don’t know if that is how it will turn out, but that seems to fit lumber’s message.

Lumber’s message also seems to work somewhat for home prices, as modeled by the Case-Shiller 10-City composite price index shown in the lower chart. Here, the correlation is not quite as good as it is for new home sales, but it is still evident. One point to understand is that this home price index was created in the 1990s, so the left end

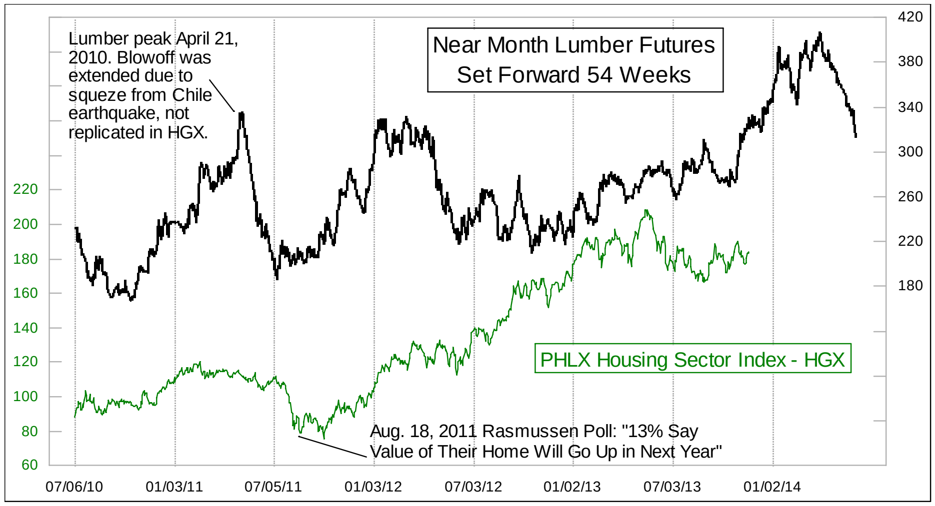
BOTTOM LINE

Bullish seasonality is now upon us, but the overall market does not yet appear to be in a position to respond to it. Housing stocks, however, do appear poised for a big swoop up toward a top ideally due in March 2014, if lumber’s leading indication is to be believed. That leading indication has only been working for about 40 years, so it is not yet surely proven. Bonds appear poised to tip in either direction, and most indications point to lower bond prices (higher rates). Gold looks stagnant, and is apparently at the mid-cycle point of the 13.5-month cycle. That midpoint typically sees a bottom of some importance, so we look forward to gold rising in the months ahead.



of the chart is made from back-calculated price data. And the shape of the top in 2006 did not match lumber's exact price plot from a year before, although the general correlation was there.

Lumber can also give great insights for stock investors, because housing related stocks show this same one-year lag echo of lumber's price movements. The chart on page 2 shows lumber's leading indication for HGX, an index of home builders and material suppliers for the housing industry. In this case a 54 week offset seems to give a better correlation to the HGX versus an exact 1-year offset. We showed a longer term version of this relationship in the Nov. 7 Chart In Focus article, still available in the Learning Center on our web site.



Lumber's rally to the March 2013 price top suggests that the HGX should exhibit a corresponding rally into the spring of 2014. It may not look exactly like lumber's price plot, but it should be a noticeable rally. And after that presumptive spring 2014 top, housing stocks should see a significant selloff as the echo of lumber's mid-2013 selloff.

Bottom Line: Between now and about March 2014 looks like a good time for housing stocks, and rising prices for homes as well.

Page 3 Charts

Chart 1: The A-D Line failed to confirm the new highs on the price indicators. While price indices made a higher high, the A-D Line made a lower high before dropping below its 10% Trend on the last posting. Despite the Fed's best efforts, the A-D Line is saying the liquidity is not abundant. But it takes a move below the 5% to really confirm a more negative action than a mere consolidation is taking place.

Chart 2: The Daily Volume Line that is more closely in gear with price action was able to make a higher high along with prices. But it was stopped at a trendline that can be drawn across the May and September highs. Now it is right at the previous highs that were put in just ahead of the breakout. The Timing Models bottom that is due right now might be able to give a bounce here at that line of support. Here too, it takes some sustained postings below the 5% Trend to identify something more than a short term consolidation taking place. The market's powerful moves come when both A-D and UV-DV are working together.

Chart 3: The McClellan A-D Summation Index topped at +2830 on October 30. That's high enough to suggest the market has achieved escape velocity and continue higher, eventually. But for now its chart has a lower high and lower low shape. The Summation made a much lower high as prices broke out to a higher high. This is classic divergence and an indication that all is not well with the bullish side of the market. The NYSE Comp's price action since September is that of a rising wedge where prices rise into a contracting set of highs and lows, and that carries a negative interpretation that is waiting for a break down to confirm the wedge, or a breakout higher that negates the wedge structure.

Chart 4: The Volume Summation Index matches the wedge shaped price action. A continuation of the current move down will break the uptrend line that can be drawn across the recent lows and most likely precede a comparable price breakdown. But the Volume Summation is still well above its Nov. 12 low, leaving open the possibility of making a higher low should the Summation turn up before dropping to a lower low.

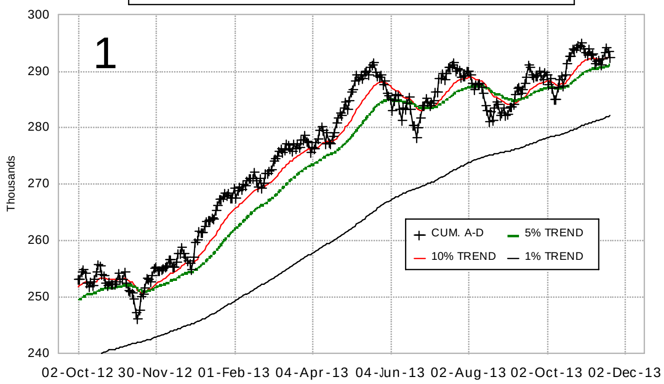
Chart 5: The McClellan Oscillator gave us a complex pattern below zero in the recent action prior to a one-day pop above zero that was quickly reversed. The simple one-day pop reinforces the idea that the bulls are not currently in charge of the market. It will take some more sustained negative Oscillator postings to take the Summation lower, and confirm that the bears are going to maintain control. A failure by the bears here would set up for another bullish up leg.

Chart 6: The Volume Oscillator was able to spend several days above zero, but here again in just a simple pattern of up above and back down below that says the bulls failed to gain control. We will have to see if the bears can do something with the ball that has been handed to them. Since the June low, each of the Volume Oscillator lows has come in at a higher level. That is in keeping with the price progression to higher highs. The bears will want to see this indicator able to make a lower low in the next down move, and if they fail, it's the bulls' ball again.

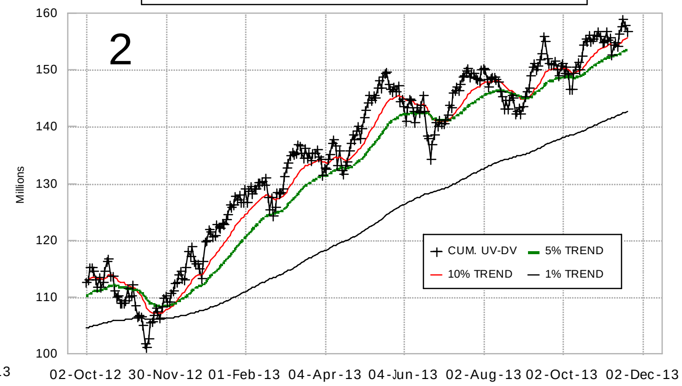
Chart 7: The DJIA Price Oscillator has refused to confirm any of the divergences that have been showing up in other indicators. It has just chugged up relentlessly. It is going to require a reversal of this indicator to confirm that the bears really are a force driving the stock market. This indicator is at +163.4 and rising. It runs into difficulty continuing higher in the area of + or - 200. For 10 of the 13 trading days in November, this indicator has risen between 5 and 10 points per day, so it could take several more days to get high enough to arrive at an overbought top. That does not remove the possibility of putting in a top at anytime it wants to, but it does cast doubt on the bears' potential for success.

Chart 8: The CBOE Volatility Index (VIX) dropped to a low level and stayed there during the current price move to higher levels. A jump up above its 50-day moving average will announce a bearish move, and a move all the way above the upper band will suggest an oversold completion of the bears' activities for the moment. .

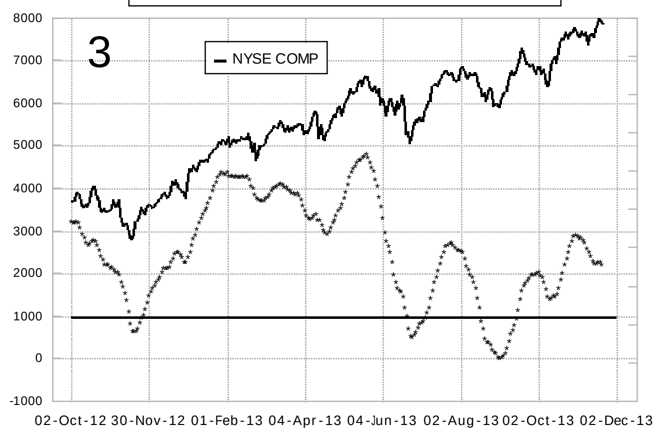
NYSE CUMULATIVE ADVANCE-DECLINE LINE



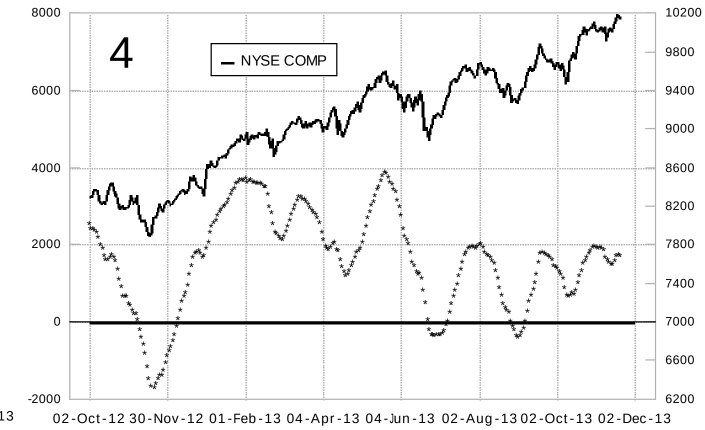
DAILY CUMULATIVE UP-DOWN VOLUME LINE



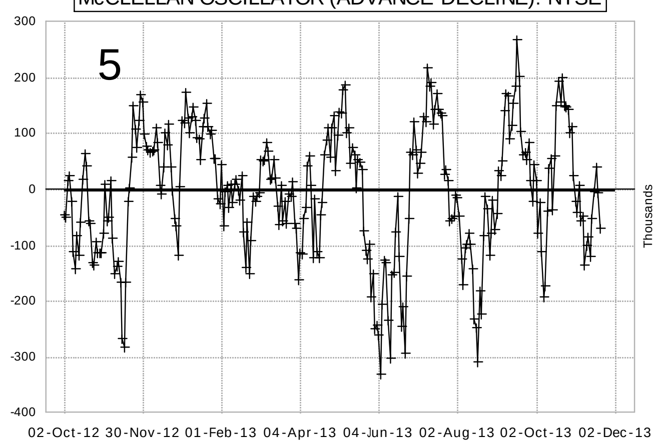
McCLELLAN SUMMATION INDEX: ADV-DECL



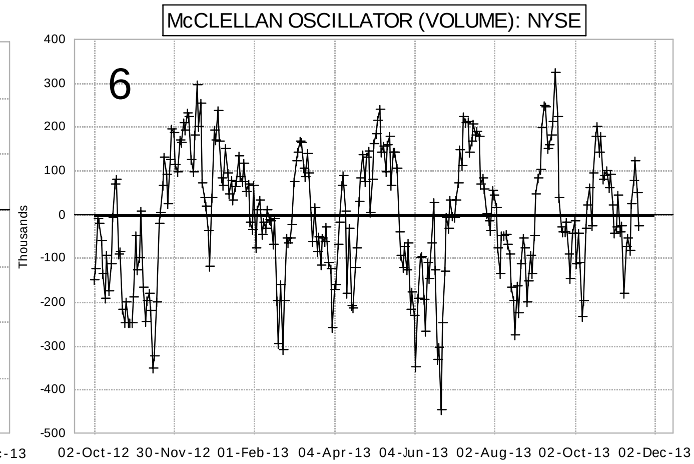
McCLELLAN SUMMATION INDEX: VOLUME



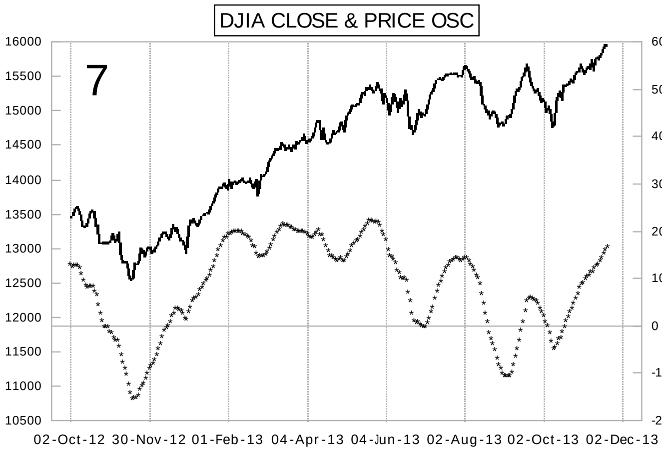
McCLELLAN OSCILLATOR (ADVANCE-DECLINE): NYSE



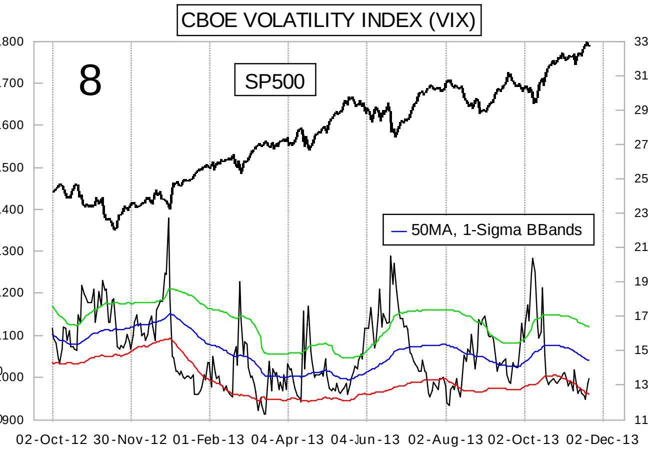
McCLELLAN OSCILLATOR (VOLUME): NYSE



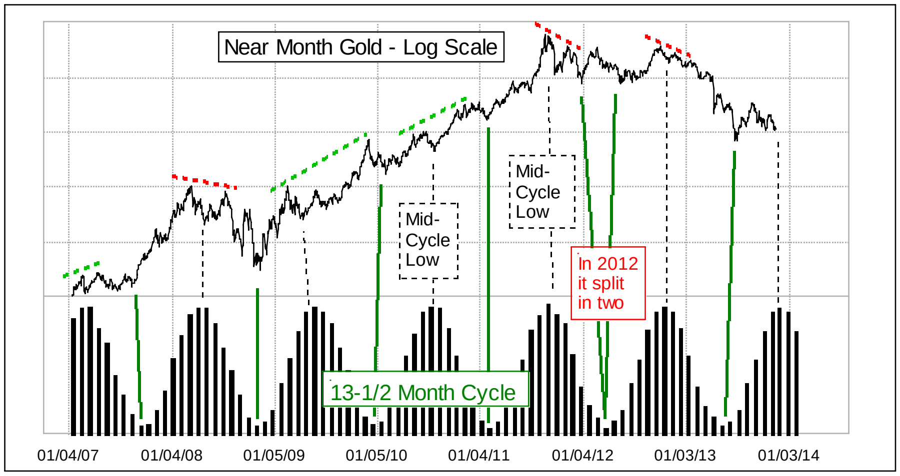
DJIA CLOSE & PRICE OSC

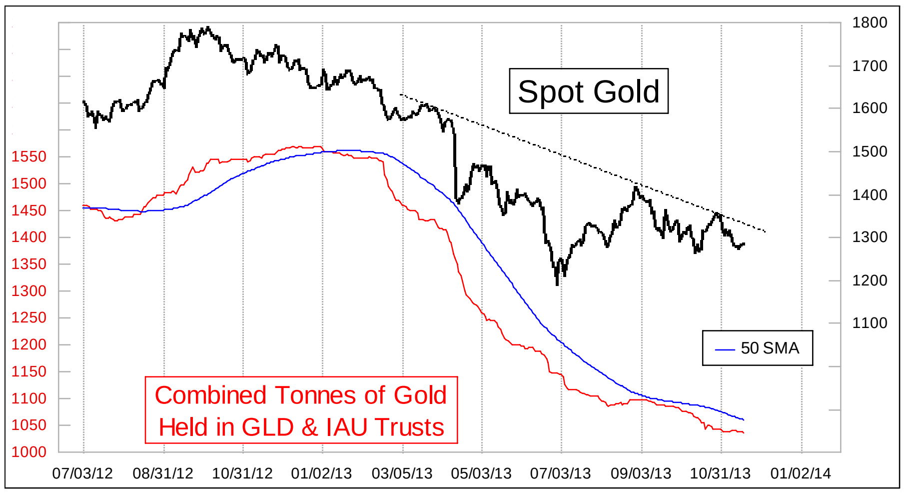


CBOE VOLATILITY INDEX (VIX)



Gold At Mid-Cycle Low





Gold prices move with a fairly regular 13-1/2 month cycle. Not everyone understands this, which is part of the explanation for why some analysts talk about "seasonality" in gold prices. If it were a 12-month cycle, then that would make a lot of sense, but it is not.

The last major bottom for this cycle arrived in June 2013, about 1 month late versus the ideal schedule. The up move that is part of the new ascending phase of the cycle appeared as it was supposed to, although it was somewhat more tepid than a lot of the initiation up moves we saw after past cycle bottoms.

Now gold prices appear to be forming the normal mid-cycle low which tends to arrive as the idealized cycle pattern in the chart is showing a top. We sometimes say that this is really a "bactrian" cycle, like the two-humped variety of camels in the Bactria region of Asia. Gold tends to form tops on either side of the cycle's midpoint, and actually the arrangement of those tops can give us insights about the future.

If the left-hand top is higher than the right-hand one, as was the case in 2011 and in 2012-13, then that conveys a more bearish message about the future. That's known as "left-translation" among cycles analysts.

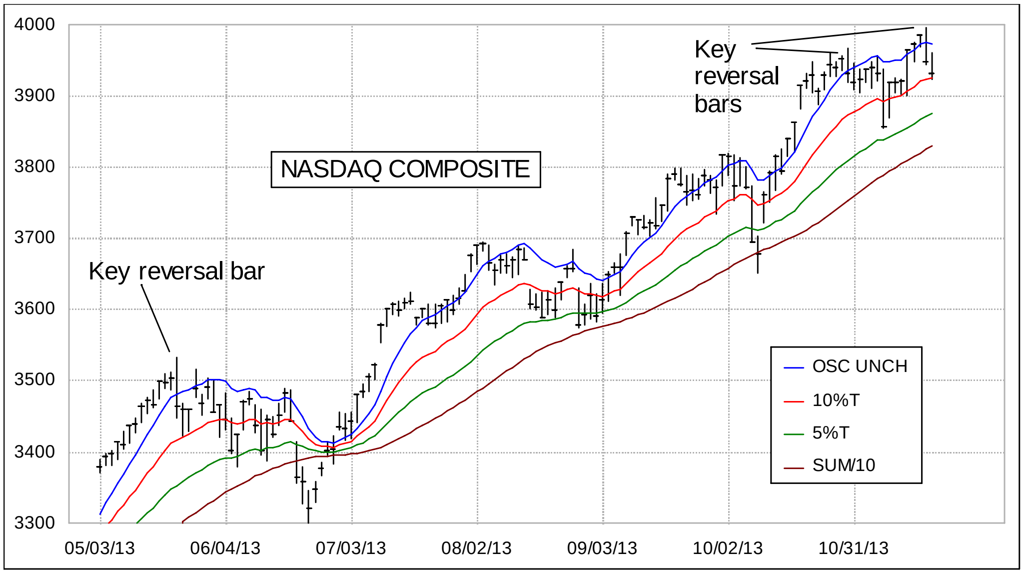
The opposite condition, right translation, is much more bullish, and it implies that the drop back into the next major cycle low need not be as severe. We do not know yet how this current cycle will turn out, since we are just now at what appears to be the mid-cycle low, but it will be important to see if gold prices can meaningfully exceed the Aug. 28 high, which was at $1419 for spot gold.

Meanwhile, the major gold bullion ETFs continue to lose assets. At the peak in late 2012, IAU and GLD together held 1569 tonnes of gold bullion. But as investors have lost interest, those ETFs have had to sell those holdings to keep the share price close to NAV, and now the two together hold just 1037 tonnes. That is a drop of 1/3, and it represents a lot of potential fuel for an upside move in gold, as those investors who were once willing to own that much gold start to come back in.

Interestingly, we are not seeing the same effect in assets of SLV, iShares' silver bullion ETF. Its assets underwent a huge drop back in the summer of 2011, after silver prices got knocked down from another attempt at the $50/oz level. But assets have been slowly rising since repeating that 2011 low in early 2012. This increase in ETF assets is occurring in spite of the continuing downtrend in silver prices. It just does not work the same as GLD and IAU.

Bottom Line: Gold is at a mid-cycle low, and just needs to show signs of strength to signal the start of the second half's expected rally. Sentiment is very well set up to support such an up move.

Nasdaq's Key Reversal



On Monday, Nov. 18, both the SP500 and the Nasdaq Comp executed "key reversal" bars, a bearish sign for the overall market. You may see differing definitions elsewhere, but our understanding is that there are 3 requirements for one of these signals.

First, there must be an "outside day", meaning that the entire day's high-low range eclipses the prior day's range. Second, it must occur at an extended price condition, otherwise there is not something to be reversed. Differing definitions of extended can be used, but the principle is still there. Third, the closing price change must be in the direction of reversing that extended condition. In other words, if it does not reverse, then it is not a reversal.

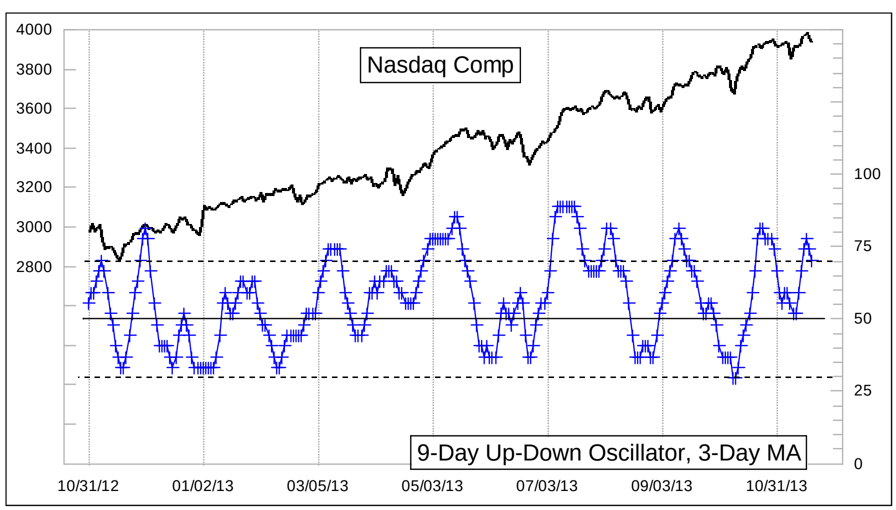
Monday's price bar met all three requirements. So did another price bar back on Oct. 30, which led to only a 2% drop before the Nasdaq Comp surged ahead to a higher high. And way back in May, there was a much more typical key reversal bar that led to a more significant selloff. Whether we get a little one like two weeks ago, or a more significant one like May-June, is up to the market, and is not yet revealed.

One other way to see the extended condition in which this latest key reversal bar has arisen is in the lower chart on page 5. Our Up-Down Oscillator is among the simplest of indicators in its design. It measures the percentage of up closes over the lookback period, in this case 9 trading days, and then smoothes that with a 3-day simple moving average to produce what you see here. Extended readings occur when it goes above 70 or below 30.

So if we did not have the higher price high to tell us that the Nasdaq Comp was at an extended condition, we could have seen it in this chart by virtue of the 9-day Up-Down Oscillator going up above 70. Such readings do not mandate a reversal; they just say that it will be that much harder for the move to continue with the rubber band already stretched. The corrections from such extended conditions usually do not end until this indicator gets back down toward zero, especially when it is a divergent second top.

Random Thoughts

As bad as things are in Washington, DC, or locally, or in the wake of hurricanes, typhoons, or tornadoes, those of us still looking at the grass from the green side each have much to be thankful for. We wish each of you the happiest of Thanksgiving celebrations.



THE McCLELLAN MARKET REPORT

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TIMING MODELS

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

	Signal	Source	Predicted	Actual
	Top	Nasdaq ST Price Osc	Nov 6	Nov 6
	Top	NYSE A-D Osc	Nov 8	Nov 6
B	Top	SP500 ST Price Osc	Nov 11	Nov 15
B	**Top**	**DJIA Price Osc**	**Nov 13**	Nov 15
B	Top	Uncommon A-D Osc	Nov 15	Nov 15
C	Bottom	SP500 Price Osc	Nov 19	
C	Bottom	NYSE Vol. Summ	Nov 19	
C	Bottom	Nasdaq A-D Osc	Nov 21	
C	Bottom	NYSE A-D Osc	Nov 21-22	
C	Bottom	DJIA ST Price Osc	Nov 22	
C	Bottom	NDX A-D Osc	Nov 22	
	Top	Nasdaq ST Price Osc	Dec 2	
	Bottom	NYSE Vol. Osc	Dec 4	
	Top	Nasdaq A-D Osc	Dec 4	
D	**Bottom**	**SP500 Price Osc**	**Dec 9-10**	
D	Bottom	DJIA Up-Dn Osc	Dec 10	
D	Bottom	Nasdaq ST Price Osc	Dec 11	
	Top	SP500 Price Osc	Dec 12	
	Bottom	**NYSE A-D Summ**	**Dec 17**	
E	Top	NDX A-D Osc	Dec 30	
E	Top	NYSE A-D Osc	Dec 31	
E	Top	NYSE A-D Summ	Jan 3	
E	Top	NYSE Vol. Osc	Jan 3	

Experimental Indicator, "BC"

Predicted Signal		**How It Turned Out**	
Implied Top	Nov 1	Top	Oct 29 - Nov 4
Implied Bottom	Nov 20		
Implied Top	Dec 8		
Implied Bottom	Jan 12		

Treasury Bond Prices

	Signal	Source	Predicted	Actual
	Bottom	T-Bond Up-Dn Osc	Nov 11	Nov 11
	Top	TYX ST Price Osc	Nov 15	Nov 18
C	Top	T-Bond Close/Sum	Nov 20	Nov 18
C	Top	T-Bond Up-Dn Osc	Nov 22	
C	Top	T-Bond Stochastic	Nov 25	
D	Top	T-Bond Close/Sum	Dec 11	
	Top	T-Bond Stochastic	Dec 19	
	Top	T-Bond Up-Dn Osc	Dec 27	

Gold and Precious Metals Stocks

	Signal	Source	Predicted	Actual
	Top	**XAU Price Osc**	**Nov 11**	Nov 7
C	Top	XAU ST Price Osc	Nov 25	
C	**Top**	**Gold Price Osc**	**Nov 26**	
	Top	Gold ST Price Osc	Nov 29	
	Top	Gold Close/Sum	Dec 13	
	Top	XAU ST Price Osc	Dec 20	
	Top	**Gold Price Osc**	**Dec 27**	
	Top	XAU ST Price Osc	Jan 3	

The Signals

There are no new signals for T-Bonds, and just one new top signal (another one!) for the gold market due Jan. 3. But the stock market table has fattened up quite a bit, with now a much bigger cluster of bottom signals in group C calling for a bottom this week. And we also have two new clusters of signals that have developed.

Cluster D calls for a bottom Dec. 9-11. That is in conflict with the implied top due Dec. 8 according to the experimental BC Indicator, but those signals can invert which is why we say that they are "implied" tops or bottoms. We showed a chart of BC in our last Report, in case you want to see for yourself.

We have grouped several signals in the bond and gold tables into cluster C, because they are due around the same time. That may or may not be a valid grouping, especially since T-Bond prices appear to have already topped ahead of the other top signals still ahead.

Thus far, the important looking bottom signal due Dec. 17 has not picked up any other signals to offer confirmation. If it really were a big event, we'd expect to see more of a "radar signature" in the form of other signals.

What To Expect

Stocks do not have much time left to do much correcting into the bottom cluster C, which extends out as far as Friday, Nov. 22. With 6 separate signals, plus confirmation from the BC Indicator, it ought to be a significant event. But it is important to remember that sometimes a bottom is what prices go down into, and sometimes what they go up out of. It does not have to be both.

T-Bonds already appear to have topped, so it is hard to put the Nov. 22 & 25 tops into context. A Dec. 11 bond top signal agrees with a stock market bottom also due then.

Gold seems like it cannot get up off the floor, and should be held back some more by the pair of tops due Nov. 25-26, plus one more due Nov. 29.

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.

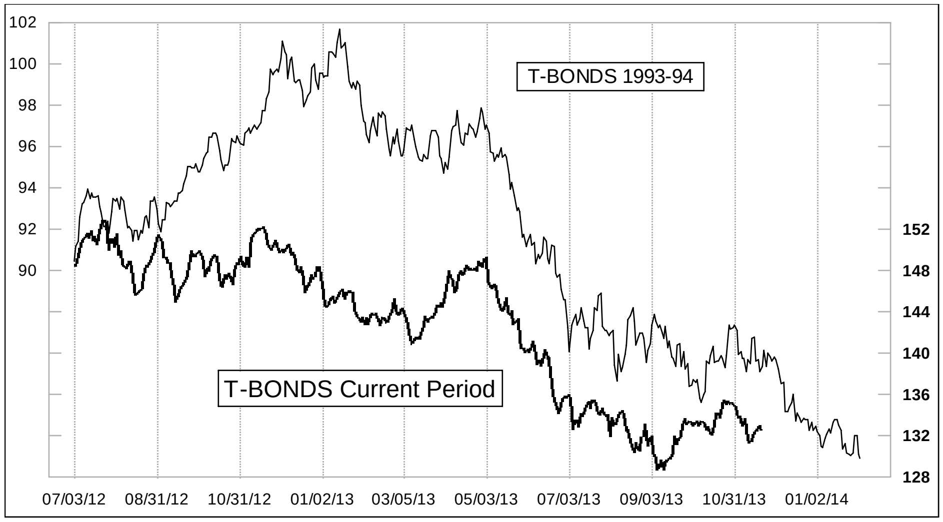
The BC indicator is an experimental new tool, not related in method to the other signals.

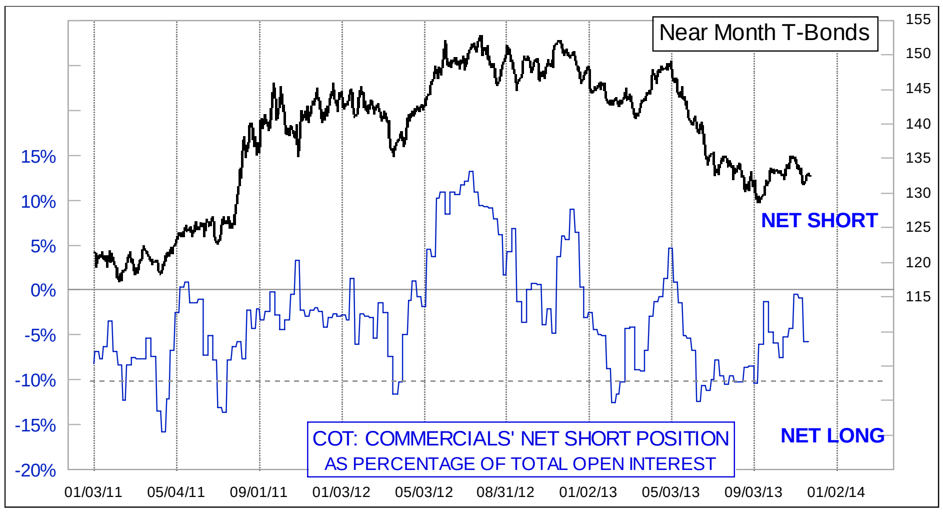
"Actual" dates listed for NYSE Indices are for the NYSE Comp/Dow Jones Industrial Average. Letter groups (A, B, C, etc.) denote clusters of signals. ST Prc Osc means "Short Term Price Oscillator."

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**.

T-Bonds Setting Up For More Downside

In our last Report, we portrayed a pair of price pattern analogs for T-Bonds, each of which appeared to be “working”, but which offered different outlooks about where bond prices would be headed in the future. The additional 2 weeks of evidence since then favor an outcome more like the 1993-94 pattern shown again here in the top chart on page 7.





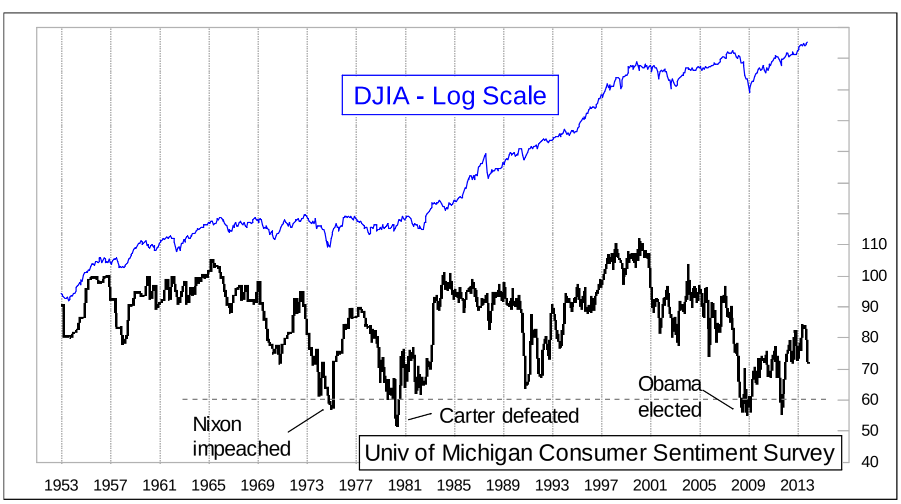
That is relevant because it portrays a pretty bearish outlook for bond prices into early 2014. If that is really how things turn out, then the higher interest rates which would accompany lower bond prices could well be part of what kills the housing market rally into early 2014 that is discussed on page 1. That is all hypothetical, but it does fit together.

The October government shutdown meant a big pause in the delivery of data for the Commitment of Trader (COT) Report, published by the CFTC. Since the shutdown ended, the staff at the CFTC had been at work catching up, and now the COT data are up to date.

But as the middle chart shows us, those data don’t really tell us what is ahead for T-Bond prices. The commercial traders have been maintaining mostly net long positions over the past 3 years, only rarely going to an actual net short position. The most recent reading is pretty much in the middle of the recent range, so there is no real message of sentiment being skewed too far in one direction or the other. Saying it more plainly, bonds could move meaningfully in either direction, up or down, based on this indicator being fairly neutral at the moment considering its recent range.

Consumer Confidence

The University of Michigan has been publishing its Consumer Confidence Index since late 1952. It moves up and down with the public’s mood, and not surprisingly, it correlates well with the stock market.

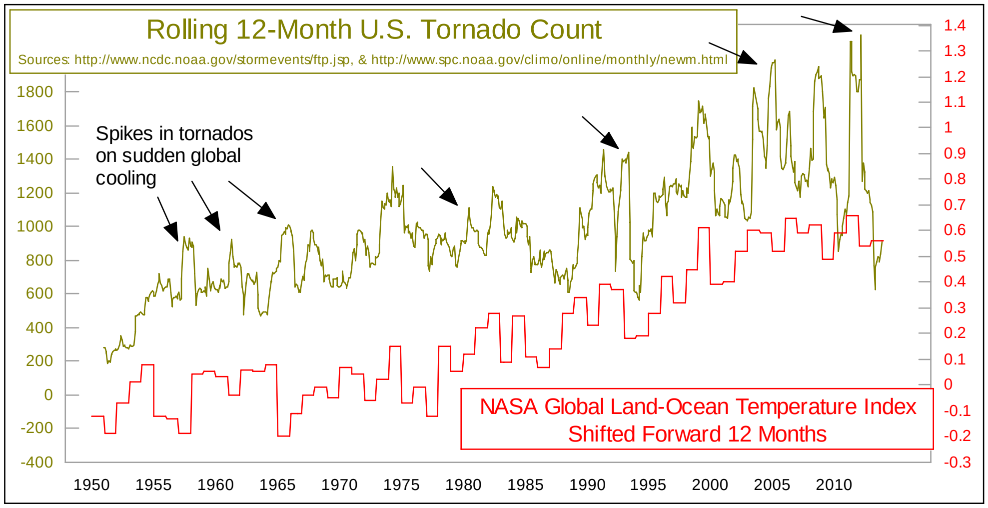


The index has taken a sudden drop over the past 6 months, no doubt related in part to the clumsy rollout of the Affordable Care Act. November’s preliminary reading was 72, which is still above the critical 60 level. History shows that when it gets down to 60 or below, that tends to mark a point of political and/or social upheaval.

Mitt Romney did not benefit from the most recent dip below 60, in August 2011, because that was more than a year before the 2012 presidential election. By the time of the election, this index had rebounded to 83, and President Obama was reelected.

The current drop is trouble for those who favor the status quo, and if it continues for the next year, then it will mean trouble for the incumbents in the 2014 congressional elections.

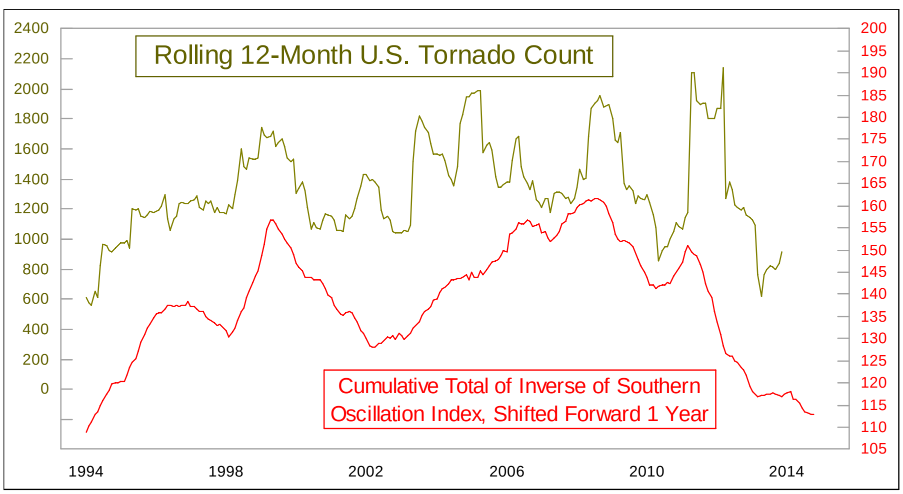
What The Tornadoes Mean for the Market

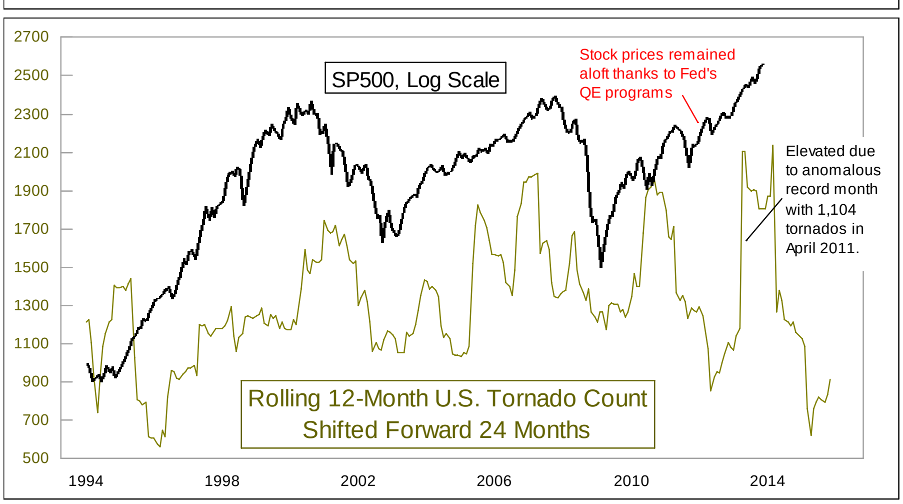


It was with sadness that we watched the news reports of late season tornadoes hitting states in the midwest. Unlike the destructive hurricanes which form well out in the ocean, and which we can track via satellite days in advance, tornadoes pop up with very little warning, and can be so devastating.

We in no way want to take away from the tragic nature of that story, including the 6 deaths reported in Illinois. But we do think you might find it interesting to see the surprising relationship between tornadoes in the U.S. and the movements of the stock market. But first, we should lay some groundwork to help with understanding.

The top chart shows a plot of the 12-month rolling tornado count. There is some seasonality to tornadoes, so summing them over a year factors out that seasonality. In that chart, we also include some data from NASA on global average temperatures, which helps us see that tornadoes and global warming actually are correlated. Separate analysis by many climate scientists has shown that hurricane and typhoon counts and severity actually do not relate to global temperatures, despite what some alarmists keep on saying. But tornadoes clearly do.





Interestingly, rising temperatures lead to a rising trend in tornado counts. But the arrows highlight that sharp spikes up in tornado counts also seem to appear when there is a sudden cooling trend, like what we are going through worldwide over the past 3 years.

We have not found a good way to model tornado counts with temperature data, but the middle chart shows that data on the Southern Oscillation Index (SOI) does give us a leading indication for what tornadoes will do. The SOI is based on atmospheric pressure differentials in the Pacific Ocean, and is closely linked with the cycles of El Niño and La Niña. The recent SOI values suggest that we should continue to see decreasing overall tornado numbers in the U.S.

And that all matters for investors because of the correlation evident in the bottom chart. Tornado counts tend to precede movements in the stock market by a couple of years. The bear markets in 2001-02 and 2007-08 matched the corresponding downturn in the rolling 12-month tornado count, after accounting for the 2-year lag.

Interestingly, the big downturn in tornadoes in 2009-10 should have brought an equivalent drop in stock prices. But the Fed's multiple QE programs seem to have papered over that dip. We did get a decent downturn in 2011, but the market rebounded much more quickly than this model would have suggested was possible.

That is relevant because the big drop in tornado counts since the peak in 2011 says we should see a big drop for the stock market in 2014-15. So as with the question we posed in MMR #445, who is going to be stronger: the Fed, or the entire planet?