THE McCLELLAN MARKET REPORT

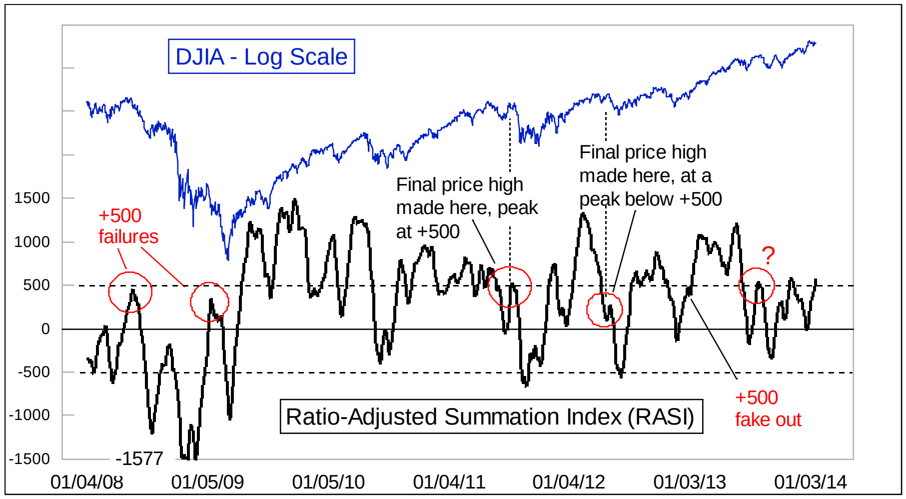
INSIDE

Prepared After the Market Close, January 21, 2014 Report #451, January 22, 2014

RASI Above +500 Wards Off Evil, At Least For Now

With all of the potential for problems in the market, the bulls still have one argument in their favor, which is that breadth data have been strong. That means liquidity is good, and thus the market is much more immune from the worst sorts of problems. There can still be garden variety corrections, and one is more than due right now. But a crash is off the table.

The key piece of evidence of that strong breadth is shown in the first chart. The Ratio-Adjusted Summation Index (RASI) is just like our classic Summation Index shown on page 3, except that the RASI adjusts for changing numbers of issues traded on the NYSE. When the RASI makes a corrective dip and then is able to climb up above +500, it says that the rally has achieved "escape velocity", and thus does not need to come falling back down to earth.



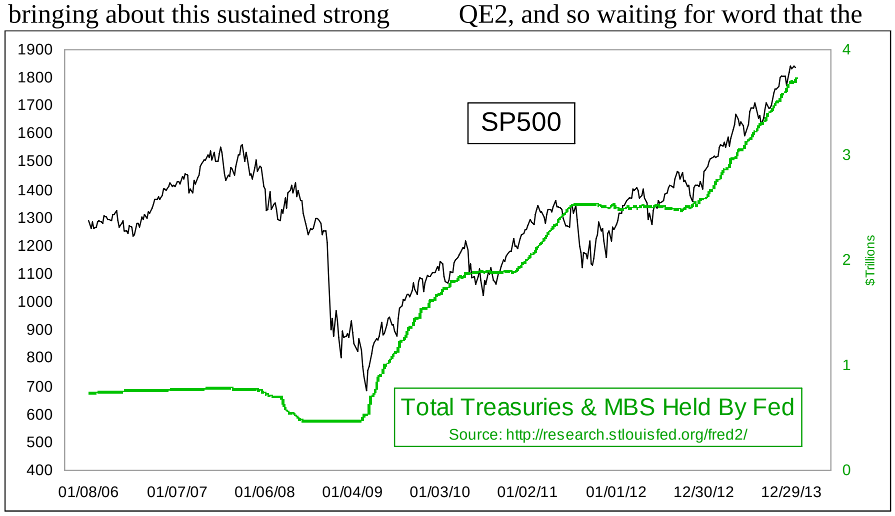
Back in 2008 and early 2009, we saw classic failure signals from the RASI when it failed to climb up above +500. And then after the March 2009 bottom, the RASI was able to surge up well above +500, which announced that things had changed and the bear market was over.

If "credit" is to be awarded for bringing about this sustained strong liquidity, then the Fed should be first in line. QE may be slowing, or maybe not depending on who one believes, but it has been a positive factor for the stock market even if it has not been as much of a help to the "real" economy.

For as long as the Fed keeps pumping money into the financial system through its purchases of Treasury and mortgage backed securities (MBS), the positive effect should continue for the stock market. The big caveat to this is that stock prices reached their tops ahead of the actual end of both QE1 and QE2, and so waiting for word that the

BOTTOM LINE

Seasonality has pulled the market down into a low ideally due Jan. 22-23, but another top is due Jan. 28-30. In a bearish scenario, that will be a top to drop out of, and overly bullish sentiment indications support that idea. But positive breadth data say that liquidity is not a problem. So the market stands poised between overly positive liquidity (from the breadth data) and overly bullish sentiment data. That's a recipe for going nowhere. Look for a tradeable stock market top due Jan. 28-30, also for gold stocks, and coinciding with a bottom for T-Bond prices. Who wins in early February, bulls or bears, is seriously in doubt now, and perhaps depends on the comments of new Fed chair Janet Yellen. Bernanke killed the housing bubble in 2006; Greenspan killed the stock bubble in 1987. Volcker killed the gold bubble. Arthur Burns killed the Nifty Fifty bubble. So it's not so much a question of whether Yellen will kill a bubble, but which one, and when?



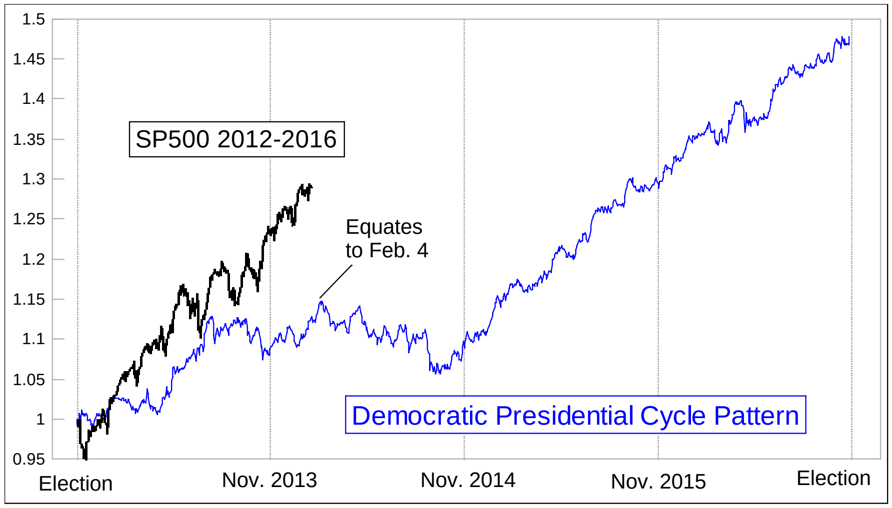
Report #452 will be published on **Wed., Feb. 5, 2014**

Fed actually has tapered down to nothing this time would likely mean missing the actual top.

The chart at the top of page 2 shows a comparison of the current SP500 plot to the average performance during years when a Democratic is in the White House. Both are on the same scaling, showing that the market since the 2012 election has been slightly stronger than the average performance. We count presidential years somewhat differently than others, starting each of four years as of the beginning of November rather than January, since November is when the election occurs. Investors tend to respond to the election outcome as soon as it is known.

While the overall performance has been slightly better than average, the SP500 has still managed to generally follow the ups and downs of the Pattern. That is relevant now because it shows a top equating to Feb. 4, and then a decline into September. That Feb. 4 date is very close to the cluster of top signals due Jan. 28-30 from our Timing Models (page 6).

Bottom Line: There are lots of reasons why the market ought to correct, but the strong breadth says that any damage should be diminished.



Page 3 Charts

Chart 1: The A-D Line continues to display itself in a strongly bullish pattern by rising from the lower left to the upper right on the chart.. It is into new all time high postings. The bottom that formed at the end of last year came right at a trendline that can be drawn across prior lows in the middle of the chart. That provided extra power to the current advance. Weak markets follow a weak A-D Line, so there is some immunity from harm offered by breadth data.

Chart 2: The Daily Volume Line shows the same bullish construction, moving from the lower left to the upper right on the chart. However, the Daily Volume Line made its highest posting on January 15 and has failed, so far, to confirm the higher postings on the Daily A-D Line. Because the Daily Volume Line is more closely correlated with price action, this is troubling for some of the price indices. Both the DJIA and NYSE Comp made closing highs on January 15, in conjunction with the Daily Volume Line, but both those high closes were below the highest closes made on December 31. This can be a serious divergence, if it is allowed to stand.

Chart 3: The McClellan A-D Summation Index has risen to +2887 in January, a level that proves quite sufficient liquidity to allow prices to move to higher levels as they are moved to do so. The recent Summation postings have been congested rather than well spaced out, reflecting the relatively low Oscillator numbers. The price action in the Composite has been flat since the end of last year with the index unable to close above its end of year value.

Chart 4: The Volume Summation has flattened out into an almost horizontal move. This explains the inability of the price indices to get above their year end highs in January. Horizontal Summation moves can only go on for so long before a correction takes place to drop them down to lower levels. It is extremely hard and would be very unusual to see the Summation take off and run higher directly following a horizontal move, such as is being painted out.

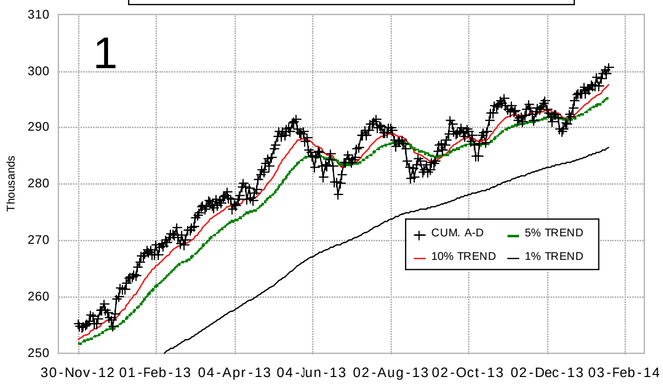
Chart 5: The McClellan Oscillator dropped to a +12.7 on Jan. 13, failing to confirm the negative numbers in most other indicators on that day. That action provided the compression such as one would experience on the down stroke on a trampoline before the recoil produced a move up. It only took 2 days for the NYSE Comp to post its high for the month and the DJIA to challenge its Jan. 7 only higher posting for the month. The Oscillator would show a change in the market structure by dropping out of its very tight January posting range. Santa gave us 6 Oscillator postings in a row above +100, with the highest coming on Dec. 24 at +171. January has only given us one day above +100 on Jan. 10, and that was a meager +103

Chart 6: The Volume Oscillator shows a similar tight posting range, but closer to zero and with several crossings of the zero line. A straight edge can be laid across all the tops on the chart excluding two September spikes that can be attributed to Bernanke and the Fed. The narrowing of the oscillations across zero since the end of June on the lower end and September on the higher end echoes the less volatile price postings. It will take a change of Oscillator character to identify that the market will move in a new direction or become more volatile.

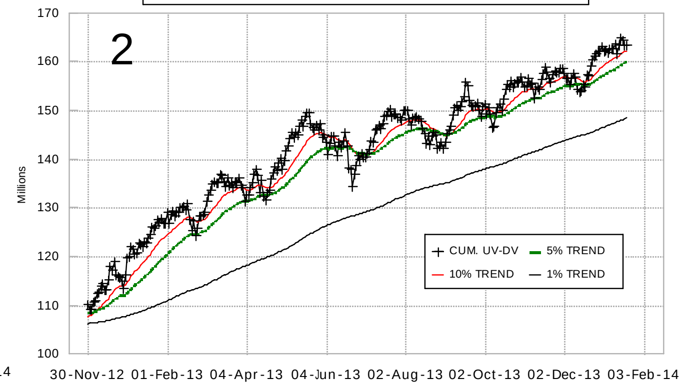
Chart 7: The DJIA Price Oscillator made its high at +199.7 on Jan. 7, the day that the DJIA closed at its high for the year, so far. On Jan. 15 the Price Oscillator managed to only go down by 1 point, as the DJIA retested its Jan. 7 high, if you can call about 95 points lower a retest. The declining Price Oscillator explains a good bit as to why January has been unable to exceed the December price high. There is still quite a bit of room between the current +156 posting and the zero line. Having the Price Oscillator turn up before reaching zero would invite the DJIA to run to a new high. It takes a change in the current pattern of higher highs and higher lows to produce the type of divergence that provides the expectation of a larger correction taking place.

Chart 8: The CBOE Volatility Index (VIX) is narrowing the spread between the upper and lower bands confirming what is seen in the Volume Oscillator. The spot VIX is back down in the vicinity of its lower band, where it stays during positive market action. It will move away from that area as the market generates greater price swings.

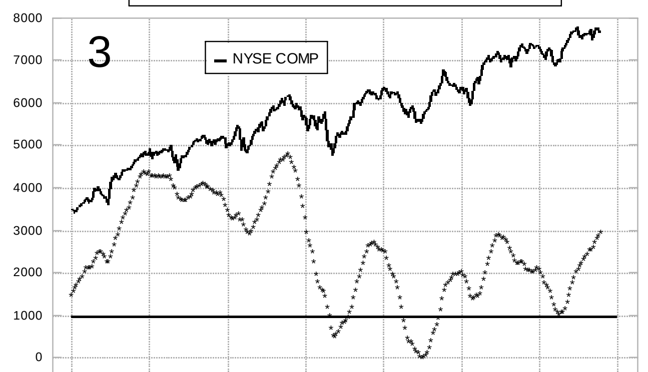
NYSE CUMULATIVE ADVANCE-DECLINE LINE



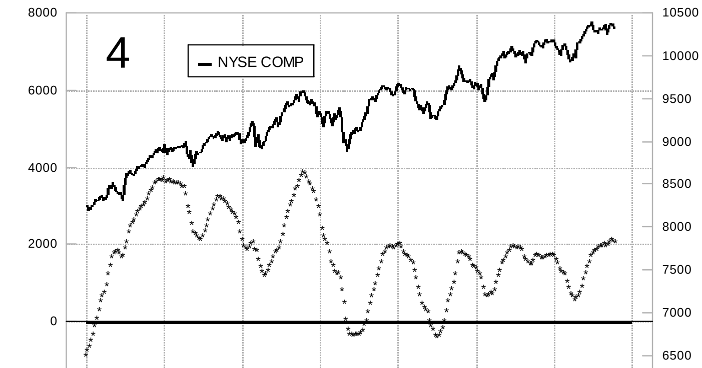
DAILY CUMULATIVE UP-DOWN VOLUME LINE



McCLELLAN SUMMATION INDEX: ADV-DECL

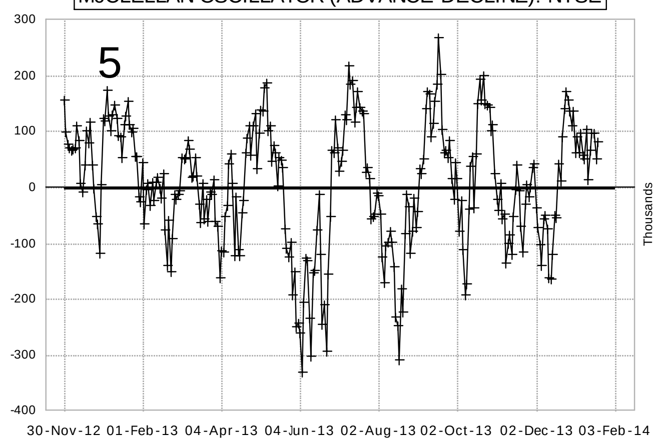


McCLELLAN SUMMATION INDEX: VOLUME

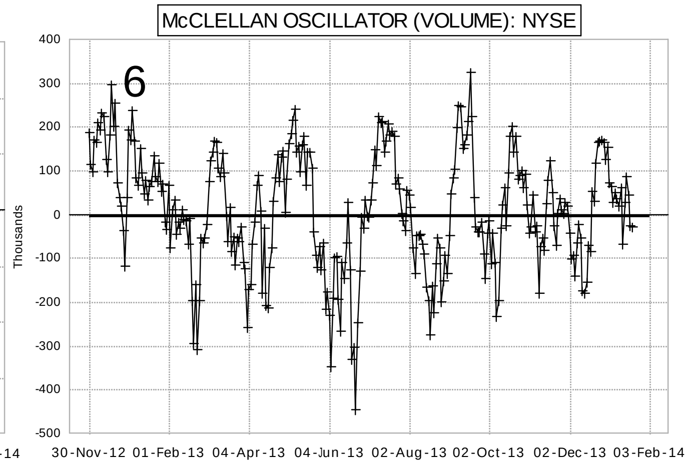


Access daily values for the A-D & Volume McClellan Oscillators and Summation Indices at www.mcoscillator.com/Data.html

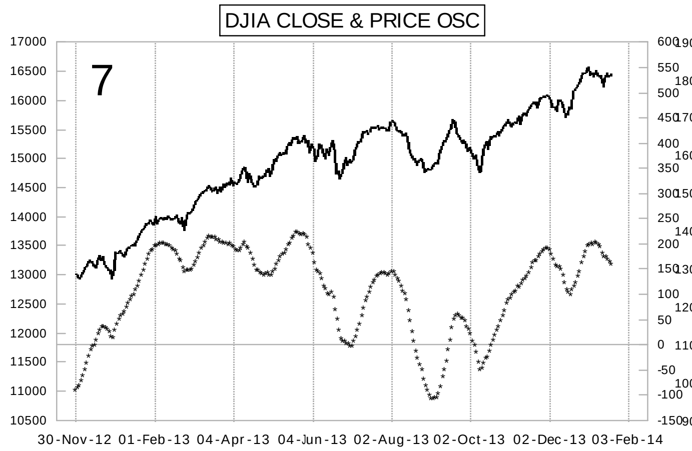
McCLELLAN OSCILLATOR (ADVANCE-DECLINE): NYSE



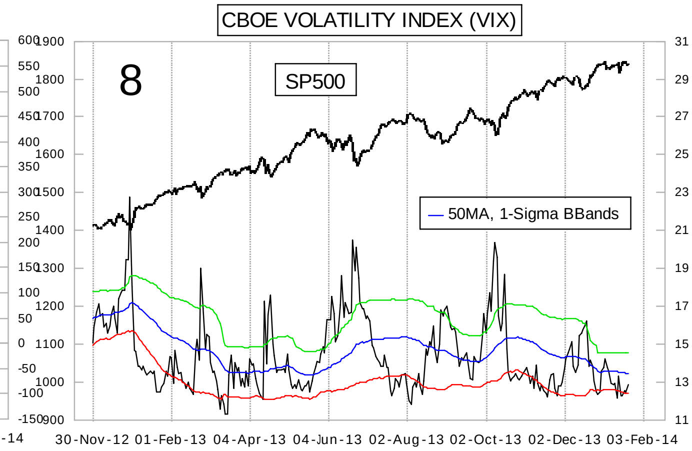
McCLELLAN OSCILLATOR (VOLUME): NYSE



DJIA CLOSE & PRICE OSC



CBOE VOLATILITY INDEX (VIX)



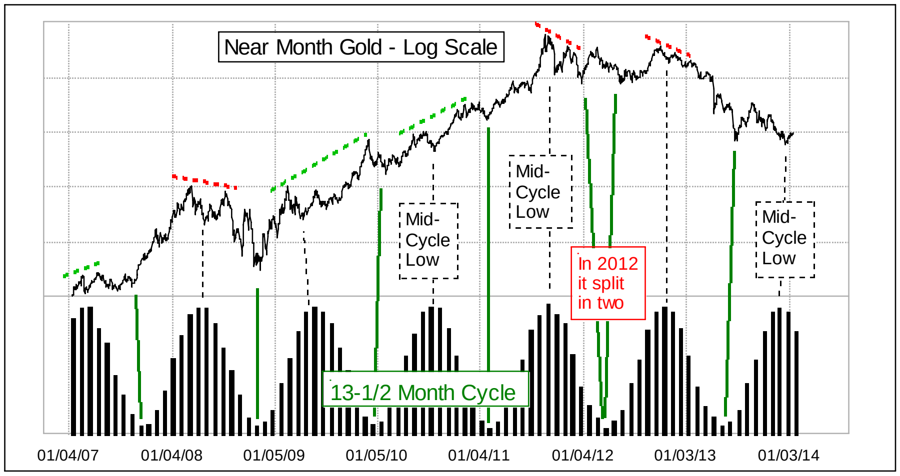
Slow Upturn So Far From Gold's Mid-Cycle Low

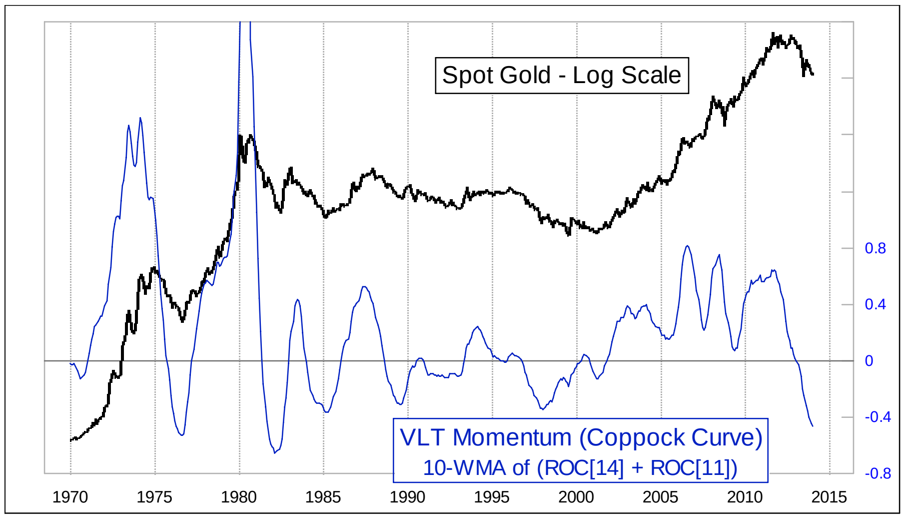
The bottom in gold prices at the end of 2013 was roughly on schedule for when the mid-cycle low was due as part of the 13-1/2 month cycle. The top chart updates that relationship. The mid-cycle lows occur roughly at the time of the peak in the dominant cycle, sometimes early or late, and those mid-cycle bottoms are also usually not as significant as the major cycle lows.

Thus far the upturn has not been all that robust. To ensure a longer term bullish condition for gold, the second half up move needs to get itself going and to exceed the high at $1420/oz that was made during the first half of this 13-1/2 month cycle. Failing to get above that level would create a bearish "left-translation" condition that tends to be followed by a more severe decline toward the major cycle low, usually taking out the price level of the mid-cycle low.

Meanwhile, the Coppock Curve for gold prices is nearing a major "buy" signal by virtue of being at a very low level, and getting close to an upturn. Gold would have to close above $1413 at the end of January for an upturn to come this month, but that number drops to $1337 for the end of February, and down into the high 1200s for March. The exact levels depend on the closing prices for January and February, so they cannot be known perfectly yet.

But the lower that the Coppock Curve gets, the easier it is to achieve an upturn. And the upturns from oversold levels like this tend to be associated with meaningful rallies in gold prices





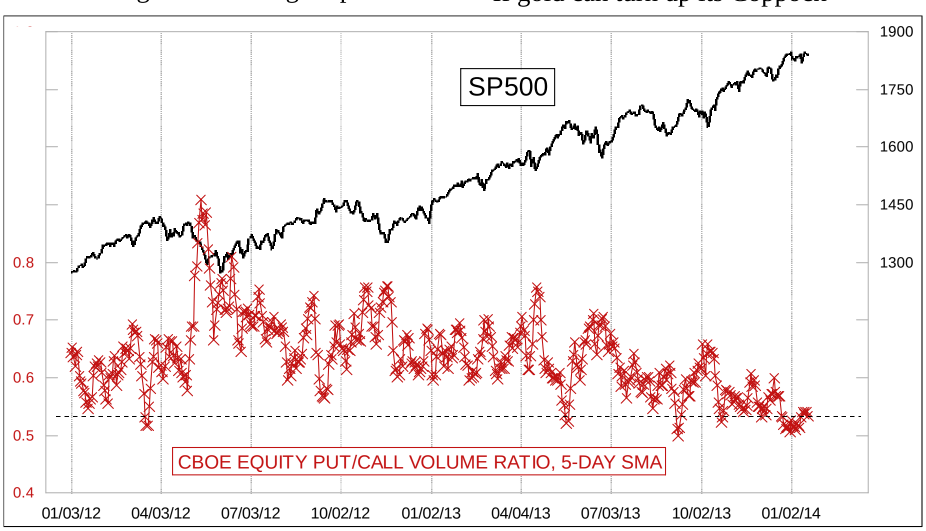
lasting several months.

E.S.C. Coppock first created what he called his Very Long Term (VLT) Momentum indicator years ago after hearing from an Episcopal priest that the typical grieving period was 11-14 months. So Coppock used those numbers to construct the math behind his subsequently eponymous indicator.

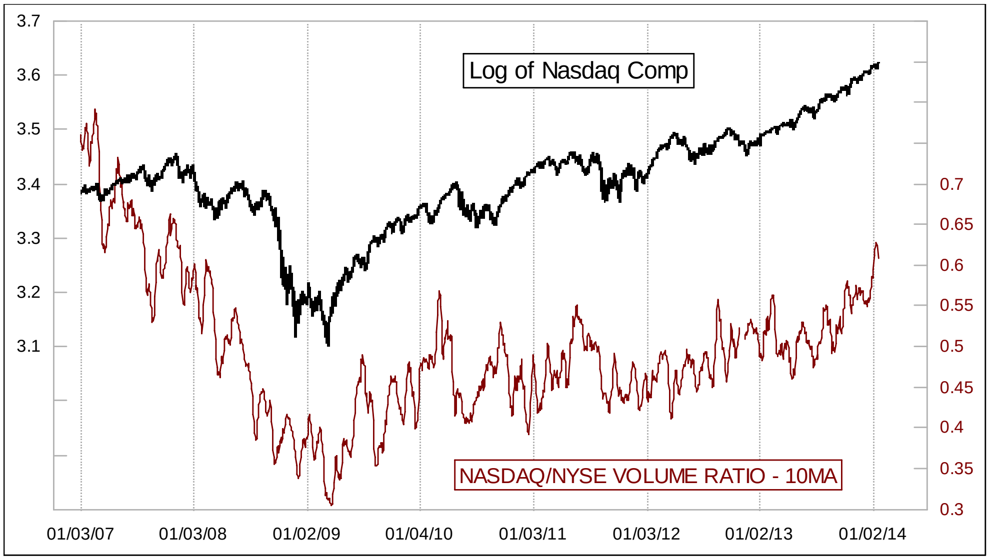
If gold can turn up its Coppock Curve soon, and mount a rally to above $1420 before the next cyclical downward move toward the 13-1/2 month cycle low due in July, that would be a larger bullish signal for gold going forward.

Sentiment Not Right for Bull Trend

For as strong as the breadth numbers are (see RASI article on page 1), it remains a problem for the bullish case that so many traders believe in the bullish case. A case in point is shown in the bottom chart, where we see that trading of equity options has been favoring calls for the past few months, and especially so just in the last 3 months. We have not seen any sort of big spike upward lately, and past readings like the one in early January at a very low level have been nearly always associated with meaningful price tops.



Nasdaq/NYSE Volume Ratio



Many years ago, traders used to watch the comparative volume between the NYSE and the American Stock Exchange (AMEX). Back then, the AMEX was the upstart, where the more speculative stocks would trade. Use of that ratio fell out of favor as the AMEX changed the nature of the issues it traded, and as the Nasdaq took over (starting in 1971) as the place where the hot new upstarts would list and trade.

According to legendary analyst Walter Deemer, it was his fellow analyst Tony Tabell who first figured out years ago that the Nasdaq/NYSE volume ratio could replace the older version. It has gotten a little bit more challenging lately, with two different figures being quoted for NYSE volume. One is for trades done specifically at the NYSE, and the other is for all trades everywhere of NYSE-listed issues. Our view is that the larger composite volume numbers are the more legitimate, and that's what we base most of our analysis on.

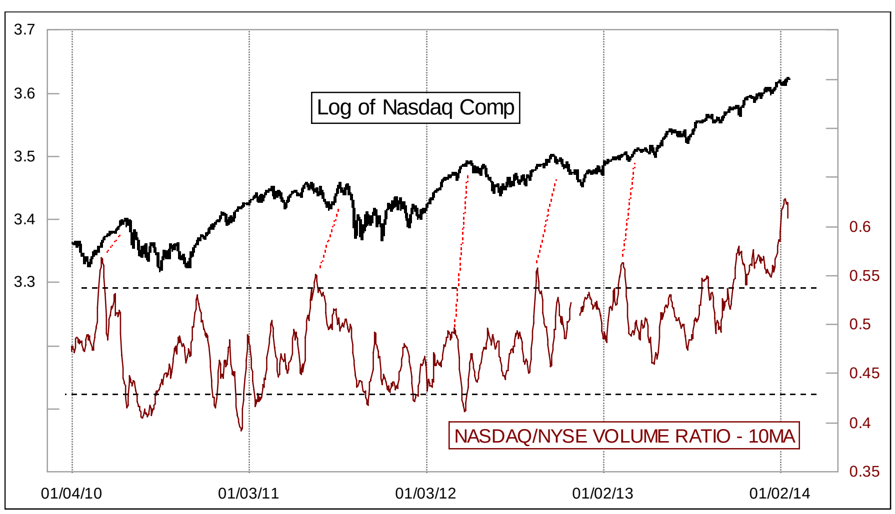
In the top chart on page 5, we can see that the 10-day MA of this ratio has recently moved up to its highest level since late 2007. It appears from this evidence that traders are moving back toward favoring the more speculative issues listed on the Nasdaq.

High readings for this ratio (and its moving average) have historically marked important price tops by virtue of showing the excessive speculation associated with such price tops. But we can see by zooming in closer in the lower chart that there is a twist to this relationship.

The chart below shows the same relationship, zoomed in to show just the last four years' data. What we see at this resolution is that the peaks in the 10MA of the volume ratio tend to precede the final price highs by just a few days or weeks.

That is important because we saw a peak in the 10MA back on Jan. 14, and it has been falling since then. So at some point after that date, we should expect to see the final price high for this up move that would be associated with that peak.

Over the past year, the peaks in this indicator have not done as good of a job of leading to important price highs. But the spike up in early January was to a much higher level than we have seen in quite a while, which implies much greater importance for this episode. We will know very soon whether we are going to have a typically important price top following this volume ratio top, and in keeping with the 1929 scenario on page 7, or if instead the Fed and the plentiful liquidity can continue to trump the bearish forces.



Sherman McClellan
Publisher

Tom McClellan
Editor

The McClellan Market Report, ISSN 1094-8163, is published 24 times a year by email & web access.
Annual subscription rate: $195

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

TIMING MODELS

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

	Signal	Source	Predicted	Actual
F	Bottom	NDX A-D Osc	Jan 8	Jan 13
F	Bottom	SP500 ST Price Osc	Jan 9	Jan 13
F	Bottom	NYSE A-D Summ	Jan 10	Jan 13
	Top	SP500 ST Price Osc	Jan 14	Jan 15
	Top	DJIA ST Price Osc	Jan 16	Jan 15
	Bottom	NYSE Volume Osc	Jan 23	
	Bottom	NDX A-D Osc	Jan 23	
	Top	Nasdaq ST Price Osc	Jan 23	
G	Top	Nasdaq A-D Osc	Jan 28	
G	Top	DJIA Up-Dn Osc	Jan 29	
G	Top	NYSE A-D Osc	Jan 29-30	
G	Top	SP500 ST Price Osc	Jan 30	
	Bottom	DJIA ST Price Osc	Jan 31	
	Top	DJIA Up-Dn Osc	Feb 3	
	Top	SP500 Up-Dn Osc	Feb 4	
	Bottom	SP500 Up-Dn Osc	Feb 5/6	
	Bottom	Nasdaq A-D Osc	Feb 6	
	Bottom	Nasdaq Up-Dn Osc	Feb 10	
	Top	DJIA ST Price Osc	Feb 18	
	Bottom	Nasdaq ST Price Osc	Feb 19	
	Top	NDX A-D Osc	Feb 20	
	Top	Uncommon A-D Osc	Feb 24	
	Top	DJIA Up-Dn Osc	Feb 25	

Experimental Indicator, "BC"

	Predicted Signal		How It Turned Out	
	Implied Top	Dec 8	Top	Dec 9
	Implied Bottom	Jan 12	Bottom	Jan 13
G	Implied Top	Jan 30		
	Implied Bottom	Feb 20		

Treasury Bond Prices

	Signal	Source	Predicted	Actual
	Top	TYX ST Price Osc	Jan 7	Jan 7
	Bottom	T-Bond Stochastic	Jan 15	Jan 15
	Top	TYX Price Osc	Jan 21	forming
	Bottom	TYX ST Price Osc	Jan 23	
G	Bottom	TYX ST Price Osc	Jan 31	
	Top	TYX ST Price Osc	Feb 6	
	Top	T-Bond ST Price Osc	Feb 11	
	Top	TYX Price Osc	Mar 4	
	Top	**T-Bond Price Osc**	**Mar 5**	

Gold and Precious Metals Stocks

	Signal	Source	Predicted	Actual
	Top	**XAU Price Osc**	**Jan 9**	Jan 13
	Bottom	Gold ST Price Osc	Jan 13	Jan 15
G	Top	XAU Close/Sum	Jan 29	
	Bottom	XAU ST Price Osc	Feb 11	

The Signals

The month of January is getting a lot more clear in terms of what these signals are calling for. We even have a new cluster of top signals (G) due Jan. 28-30 for the stock market, with equivalent signals in bonds and gold as well.

Top clusters are not as common as bottom clusters. We believe that this is because tops generally tend to be more diffuse, whereas bottoms in the stock market tend to be more concentrated events. So getting the signals to detect the ripple in the liquidity stream which brings a top is harder to do if the energy for that top is more spread out. Thus, the occurrence of this top cluster at the end of January carries special interest.

This is all the more relevant given that our experimental BC Indicator agrees with an implied top due Jan. 30. Sometimes those signals invert, which is why we say that they are "implied" tops or bottoms. But with the cluster of regular signals calling for a top at that time, this one is much less likely to invert.

If the 1929 analog (updated on page 7) does still have some sway over stock prices, then the late January top cluster could very well be a "top to go down out of" as opposed to going up into. The strong breadth we have been seeing rules out a cataclysmic crash event, but we could still see a normal correction which follows the 1929 top script.

What To Expect

Stocks show a minor bottom due just as this issue is being published (ideally Jan. 23), followed by a cluster of top signals due Jan. 28-30. The BC Indicator seems to agree with that idea of a top at the end of January. So if the stock market is going to continue following the 1929 analog in some way, that late January top is the one to watch, to see if prices do head down into February. A dip into February is contrary to the normal seasonal tendency, so that scenario is far from certain and merits close observation.

T-Bonds show a minor top due to arrive right about now, and then a bottom due at the end of January, just as stocks are making some type of top.

The **XAU** agrees on a top for stock prices at the end of January. Gold and the stock market are not regularly in good correlation, but sometimes they can fall into step together for brief periods.

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.

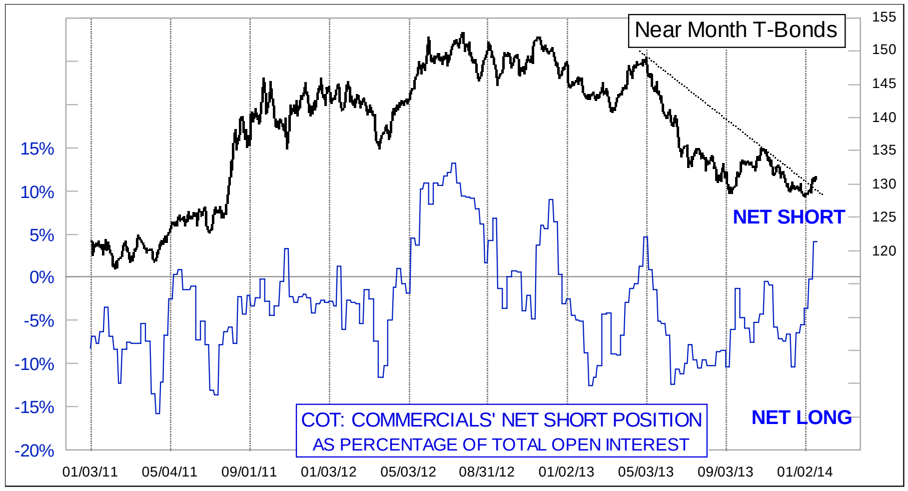
These models do not catch every market turn, but the signals usually show some effect in the market action. It is important to understand that the market does not have to go up from a bottom; it may just stop going down. It does not have to go down from a top, it may just stop going up. Some bottoms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

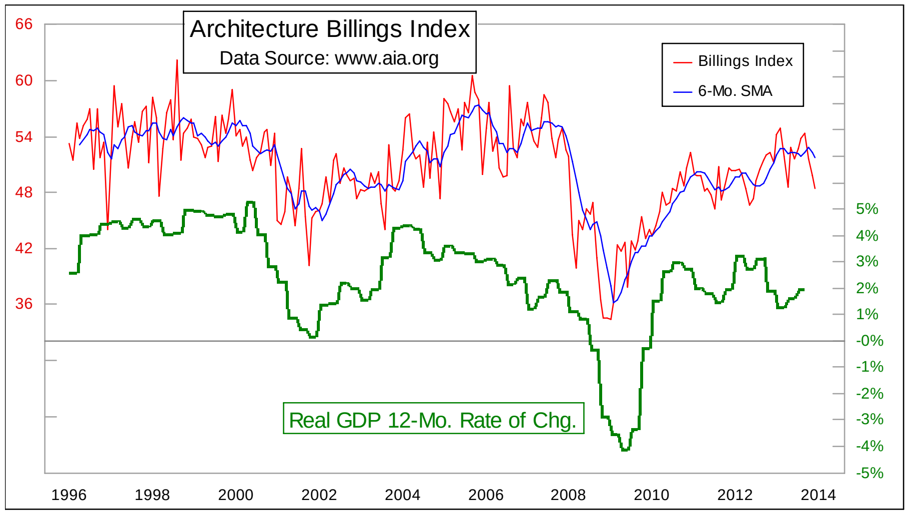
The BC indicator is an experimental new tool, not related in method to the other signals.

"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**.

Sudden Change in T-Bonds Sentiment





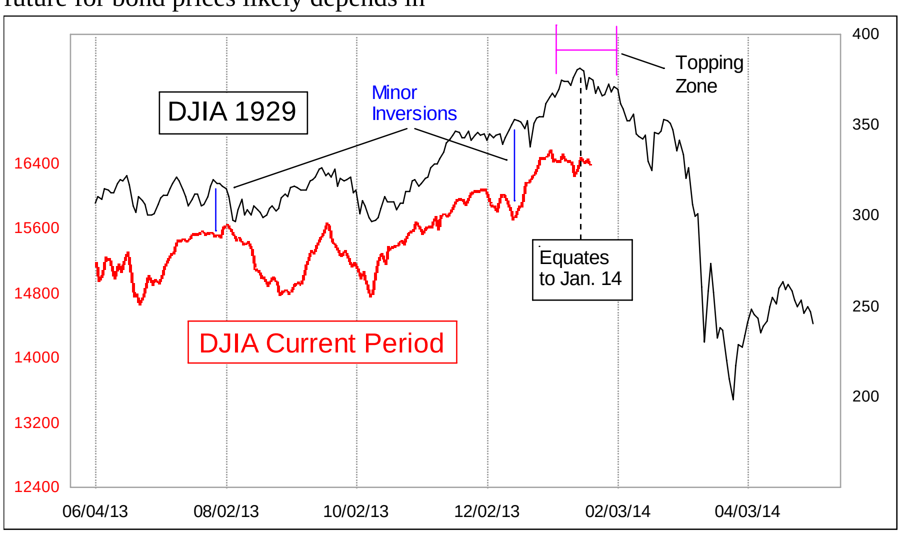
From a bottom at the end of December, T-Bond prices have jumped up by enough to break the declining tops line which dates back to the price high back in May. Ordinarily that would be seen as a really bullish development to break a downtrend line.

But this breakout has been accompanied by a sudden jump up to a net short position by the presumably smart-money commercial T-Bond futures traders, according to the Commitment of Traders (COT) Report. And in this most recent instance, the point of concern is not just the surge to a net short position, but also the very urgent nature under which the commercial traders have abandoned their net long position for this new net short position.

The last time they did that was back at the April/May top, and the surge was not nearly as urgent. But it still produced a really important price top and ensuing decline. This one is more urgent, and thus presumably a more important condition.

But contradictory information comes from data from the American Institute of Architects, whose Architecture Billings Index (ABI) took a sudden downturn in December. The ABI serves as a pretty good leading indicator for overall GDP growth, and so this sudden downturn is a message that Q4 GDP (and perhaps beyond) may be more problematic.

Interestingly, the ABI Inquiries Index (not shown) ticked up in December, although December's value is still below the trend of recent values. So the picture is not absolutely clear, and the future for bond prices likely depends in a big way on the whims of the FOMC members concerning how they plan to taper (or not!) their purchases of bonds in the marketplace. In other words, bonds at this point can tip either way, according to the data, and there is not a compelling case in either direction which can overcome all of the conflicting data.



1929 Analog Still In Play

We have featured the 1929 price pattern analog a lot recently, mostly because the story is so compelling, and the outcome is so dramatic, assuming that the price pattern correlation continues. It has not been a perfect correlation at any point in the history of the current pattern following the 1929 pattern; it is merely very good.

Along the way, there have been minor inversions, and so the current seeming inversion of the 1929 top that would have equated to Jan. 14 is not necessarily a breakdown of the pattern. It could just be a different version of normal noise this time.

We figure that we would know if the current market is breaking from the 1929 pattern if stock prices suddenly turn higher into February. That would be in direct contravention from what the 1929 pattern shows. Until then, chopping sideways in the topping zone is not yet a big enough violation of the pattern to invalidate it.

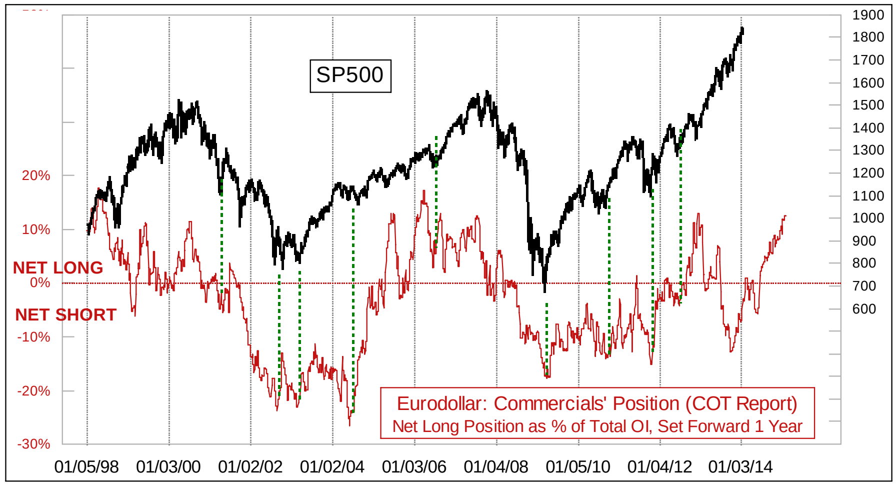
An Old Friend May Be Back

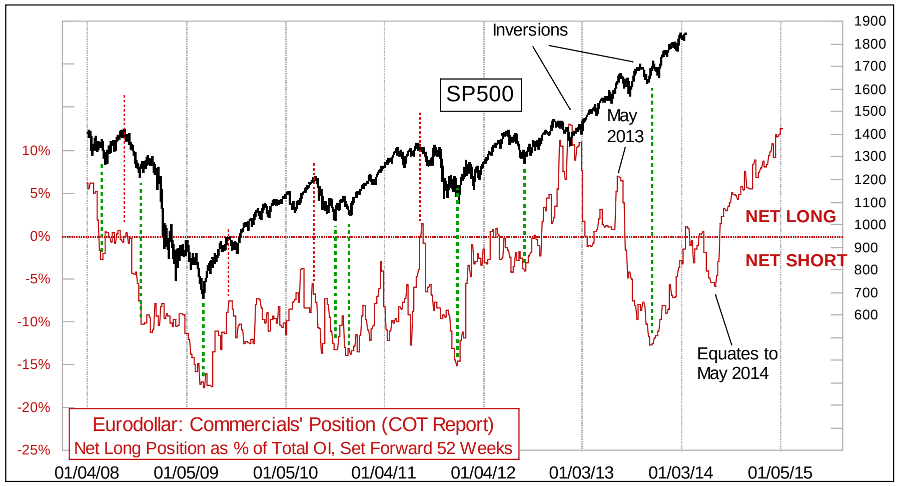
With the help of a keen-eyed subscriber, it was in 2010 when we first figured out that COT Report data on eurodollar futures could be used as a leading indication for the stock market. We first observed that the eurodollar COT data gave about a 1-year leading indication for short term interest rates, but soon after realized that the SP500 tends to follow in those same footsteps about 1 year later.

As a brief review, eurodollars are not an exchange rate, but rather an interest rate product, tied to dollar denominated deposits in European banks. Short term rates affect stock returns, and so that seems to be the relationship.

The top chart shows the leading indication relationship all the way back to 1998. Generally speaking, it has been a great correlation, with only minor anomalies. It foretold the tops in 2000 and 2007, along with the ensuing declines. It also foretold the rally off of the 2009 low. Lately, however, it has run into troubles.

The middle chart helps us to see the exact nature of the problem. Beginning in late 2012, the SP500 started showing inversions from what the eurodollar COT data suggested should happen. The biggest inversion occurred after a top that was due in May 2013, when stock prices were supposed to have seen a big dip, but instead kept on chugging higher. We blame the Fed for putting a thumb on the scale, and interfering with normal fund flows and banking relationships. Such interference might arguably have been a good thing, if it prevented a severe market decline. But as the 1970s Chiffon margarine commercial taught us, it's not nice to fool around with mother nature.





The SP500 now appears to be getting back on track. Maybe one day the Fed will not be the most dominant factor in the financial markets, and nature can once again take its course.

If now is that moment, then a meaningful decline is in store toward a bottom due in May 2014. And if the eurodollar COT data does indeed take over and dominate the story once again as it did before, then that May bottom should be followed by a really robust rally into the end of 2014, well ahead of the rally called for by the Presidential Cycle Pattern shown on page 2. That is a story line we will keep in mind, and watch for, but not necessarily believe in fully, given the market's predilection to undergo divergences from the pattern.

Adding confirmation to the idea that 2013 saw some strange relationships is what we see in the bottom chart. Lumber futures COT data give about a 5-week leading indication for what the SP500 will do, and it works great except for a big honkin' inversion last summer, the same time when the market was also inverting from the eurodollar COT leading indication. Something was clearly weird back then.

We saw a period of disagreement back in 2011. It resolved with the market catching up with the message, and flying right thereafter. The 2013 experience was different, with the SP500 pretty much just ignoring the message, and then getting back on message beginning in September. Hopefully this all means that the market is getting back on track, and will behave properly and predictably in the future.