THE McCLELLAN MARKET REPORT

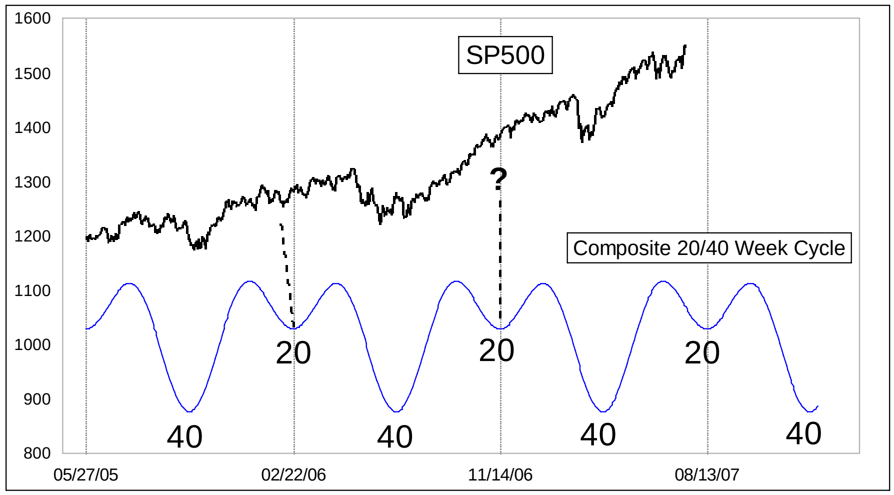
INSIDE

Prepared After the Market Close, July 17, 2007 Report #295, July 18, 2007

Trouble Brewing Ahead of 20-week Cycle Bottom

The DJIA has been getting a lot of favorable attention lately by making new all-time highs, and by ticking above 14,000 for the first time intraday on July 17. But it is troubling that the gains are being largely confined to the large caps. This may be a classic case of the generals outrunning the infantry, and it looks like the setup for a summer correction into a 20-week cycle low.

Our first chart compares the SP500 to our composite 20/40-week cycle pattern. This alignment incorporates the phase shift that we contend occurred in 2005 (see MMR #288). The March 2007 bottom was the most recent iteration of the stronger 40-week cycle, and so the next 40-week cycle low will be due in early December. That means that sometime this summer we should see a manifestation of the 20-week cycle bottom, which is the half-period harmonic of the 40-week cycle.

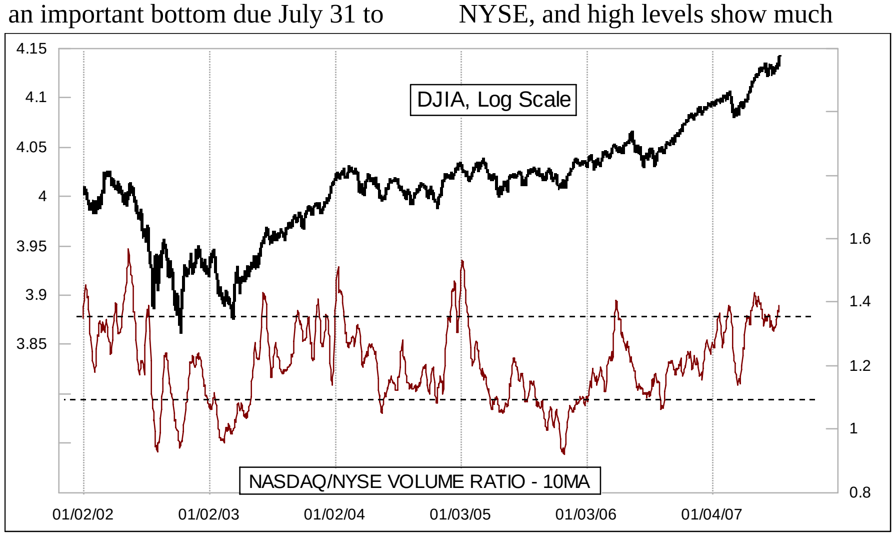


The last time that a 20-week cycle low was due in November 2006, the market was in such a strong uptrend that prices barely gave any hint of feeling the effects of it. This summer looks different, and we should indeed see some manifestation of it this time. Our Timing Model signals say that there is an important bottom due July 31 to August 2, which is not too far in time from the ideal date of August 13 shown in this pattern. It is worth noting that the 20-week lows tend to be a lot less punctual than the 40-week cycle bottoms, so a few weeks early or late for the arrival of the 20-week cycle low is not out of the ordinary.

Adding to the cycle low expectation is confirming evidence like what we see in the lower chart on page 1. This simple indicator looks at the ratio of trading volume on the Nasdaq versus on the NYSE, and high levels show much

BOTTOM LINE

Things were looking really good for the stock market to continue higher, right up until the time when the big cap indices surged to new highs and did not take the A-D Line with them. That says liquidity is not supporting the advance, which means trouble. The 20-week cycle low is ideally due August 13, but our mathematically derived predictive Timing Model signals say that the important bottom should be July 31 to Aug. 2. Stock prices ought to be able to rally strongly out of that low. Gold prices should bottom around the same time, although their trending ability is stranded between the commercial gold traders who say gold should run higher, and the US dollar which is oversold and poised for a rebound. Bond prices should see a minor top ideally due July 27, just as stocks and gold are bottoming, and then bonds should make a final swoon to an exhaustive low due August 10.



more interest in the more speculative Nasdaq stocks. Persistently high readings are reliably associated with tops for stock prices, which is what the 20-week cycle says should be happening.

One dissenting voice is the message from commercial stock index futures traders, as detailed in the weekly Commitment of Traders (COT) Report, published by the CFTC. The commercials are the big-position, smart-money traders who presumably know what lies ahead for the prices of the futures contracts they trade.

In recent weeks, we have seen commercial stock index futures traders return to a net long position in a big way. This implies that stock prices are headed higher in the weeks ahead. The unusual aspect of this is that the commercials usually ramp up their net longs as stock prices head down into a bottom. This time, we are seeing the commercials increase their net longs to the biggest level since 1999 even as stock prices make higher highs.

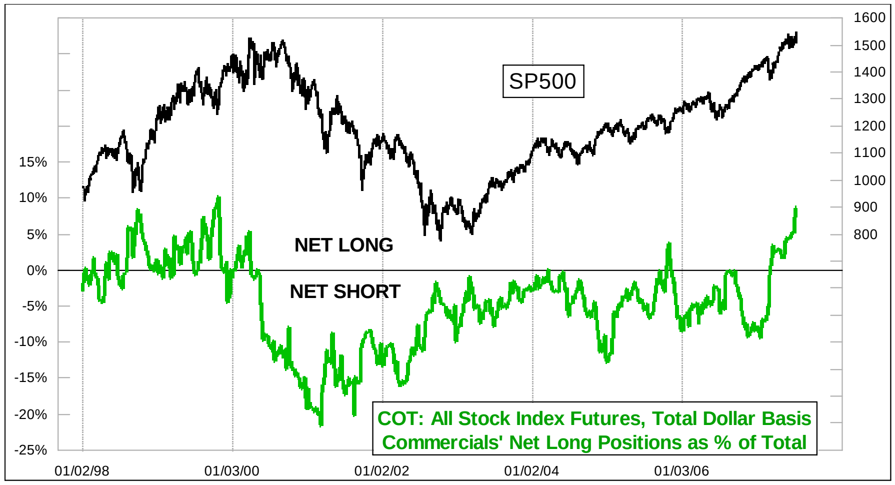
This sends a message that the advance has a lot farther to go, even though that message may be refuted by the weaker NYSE breadth numbers and by the market's seeming obligation to put in a 20-week cycle low. The ultimate interpretation that we take from the sum of the evidence is that there is more yet to come from this uptrend, but that a temporary interruption will hit the market this month leading to a bottom around the end of July.

Bottom Line: The weakness in breadth numbers has popped up relatively suddenly, and says that there are problems with the liquidity stream. Those problems should be acute, rather than chronic, and should lead to a bottom due July 31 to Aug. 2.

Page 3 Charts

Chart 1: The A-D Line made its high for the year on June 4 at +157,028 on our arbitrary scale. That number was retested on June 19 at +154,948, on July 9 at +155,372 and on July 13 at +155,586. The inability to make new highs is somewhat troublesome, but there has been no indication of anything like lower lows. The A-D Line just appears to be moving sideways and has been doing that since the middle of April.

Chart 2: The Daily Volume Line also made its high on June 4 at 89,264,878 on our arbitrary scale. That number was challenged on July 13 with a posting of 89,117,634. It is disturbing to



have new higher price highs in several indicators and not have this indicator confirm, in spite of its ability to move above the June 19 retest peak.

Chart 3: The McClellan A-D Summation Index is continuing its bumpy behavior with each bump up able to equate to an advance in price, usually to a new higher high. With the Summation turning down at a level below the mid June Summation low and below the +2000 level, any extension of the move down could produce more price damage than we have seen with this indicator above the +2000 level. The February 2007 high in the Composite would appear to be an inviting target for an intermediate consolidation. The bearish rising wedge that is bounded by the highs since May 2006 and the lows of this year appears as a warning currently.

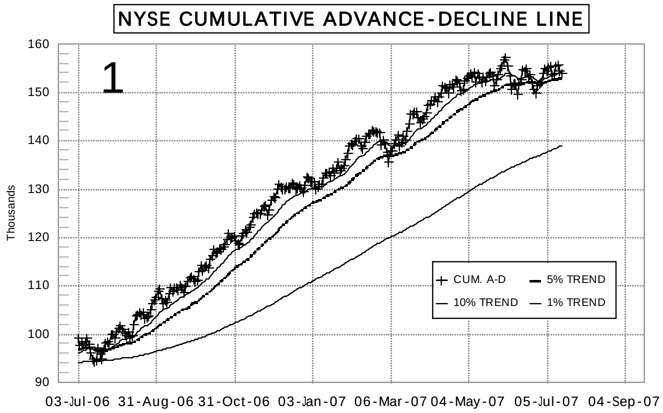
Chart 4: The Volume Summation declined to kiss an uptrend line that can be drawn across the June 2006 and March 2007 lows. The bounce up off that line has been less than impressive so far. In fact for the last 15 trading sessions, the Volume Summation has had its postings within the narrow range defined by the "gap" down on March 5, 2007. That was the day that the March price low was established leading to the advance into the July high.

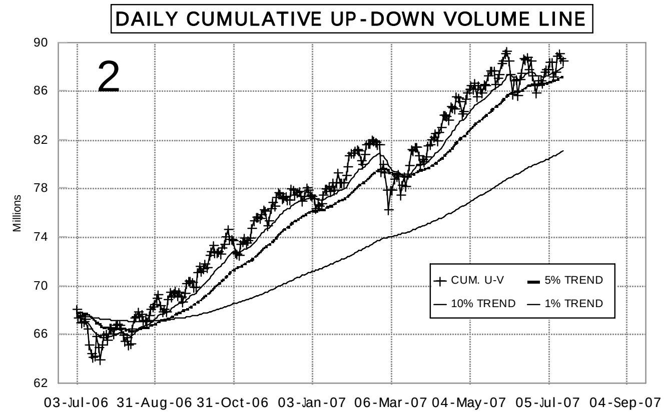
Chart 5: The McClellan Oscillator has shown quick rapid movement back and forth across the zero line. Disappointing to the bulls was the lack of a high Oscillator posting showing initiation off the June low postings. There was a high Oscillator posting following the March low and it correctly indicated subsequent upward trending price behavior. The +96 on the day ahead of the July 4 holiday does not indicate the same level of "oomph" that the +190 did back on March 21. The tired market may be putting itself down to rest until the 20-week cycle low expected for July 31 to August 2.

Chart 6: The Volume Oscillator managed to hold just above the zero line on July 17 right at an uptrend line that can be drawn across the last couple of bottoms. Any kind of down day on July 18 would take it below zero. This Oscillator also fails to show the initiation type of high postings following the June low, just the normal recovery from the deeply negative values reached.. This kind of behavior suggests volatile choppy price action to follow.

Chart 7: The DJIA Price Oscillator turned up at an interesting level. Take a straight edge and draw a horizontal line across the chart at the level of its last low. It was a break below that level that accompanied the sharp price break at the end of February. The Price Oscillator might not hold on the next test of that level, taking prices for an exciting ride. For now the trendline that can be drawn across the May 2006 and February 2007 DJIA highs offered quite adequate support when tested in June. New price highs were produced in July when the Price Oscillator turned up above zero.

Chart 8: The CBOE Volatility Index has continued to take its 50-day moving average and its upper and lower bands higher rather than letting them decay back down toward the pre-February values. The best part of the price advance by the SP500 during April and May occurred during the time that the VIX was generally below the 50-day moving average. Only the June 19 failing retest of the price high has produced a posting below the 50-day moving average. The VIX must be complimented on its ability to peak with the more important price bottoms.


NYSE CUMULATIVE ADVANCE-DECLINE LINE
1
Thousands
CUM. A-D
5% TREND
10% TREND
1% TREND
03-Jul-06 31-Aug-06 31-Oct-06 03-Jan-07 06-Mar-07 04-May-07 05-Jul-07 04-Sep-07


DAILY CUMULATIVE UP-DOWN VOLUME LINE
2
Millions
CUM. U-V
5% TREND
10% TREND
1% TREND
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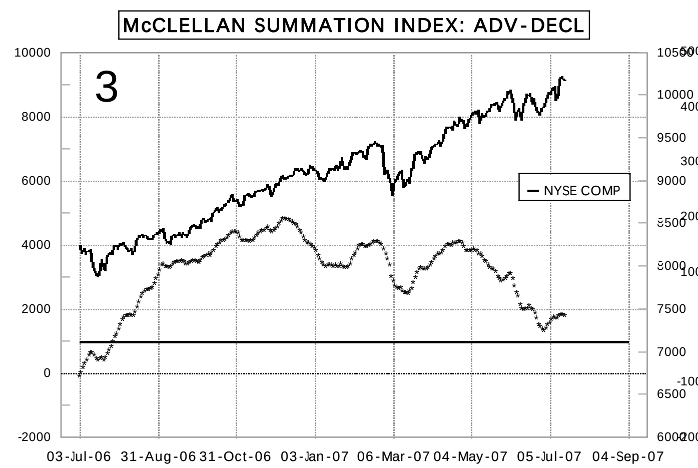
McCLELLAN SUMMATION INDEX: ADV-DECL
3
NYSE COMP
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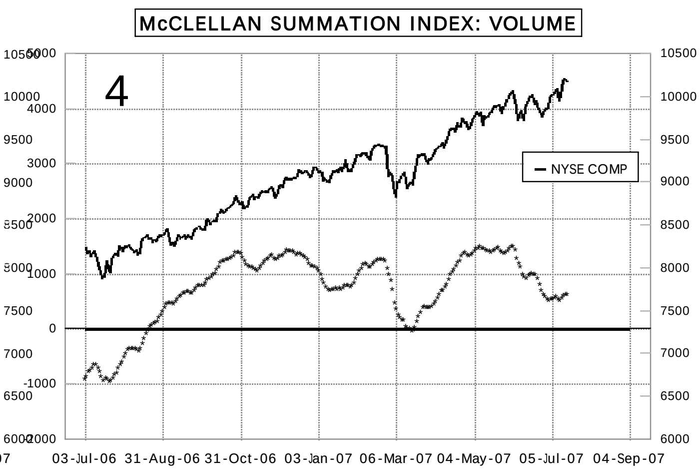
McCLELLAN SUMMATION INDEX: VOLUME
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NYSE COMP
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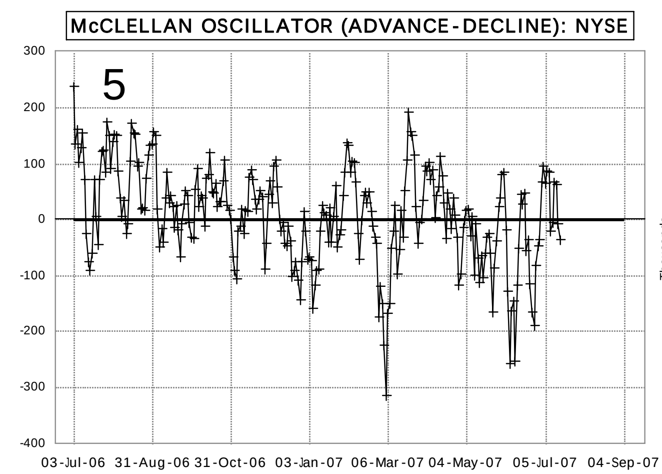
McCLELLAN OSCILLATOR (ADVANCE-DECLINE): NYSE
5
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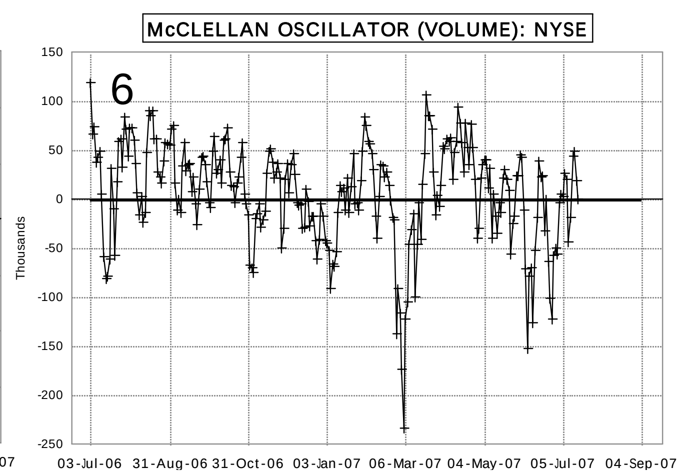
McCLELLAN OSCILLATOR (VOLUME): NYSE
6
Thousands
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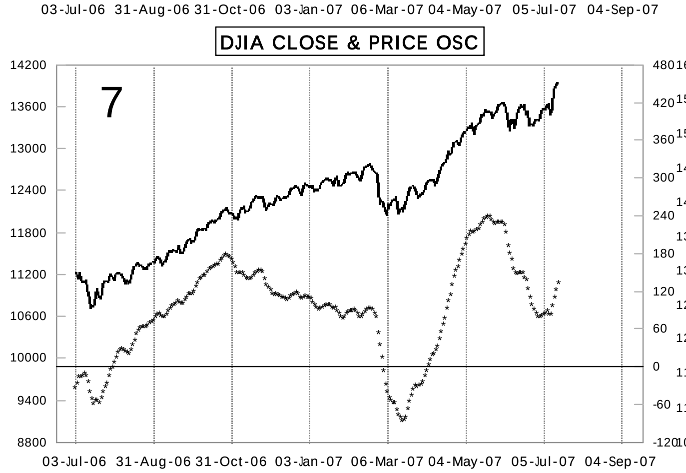
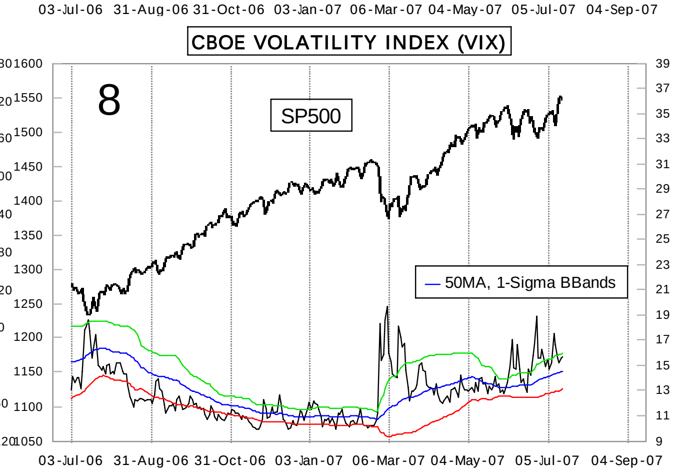

DJIA CLOSE & PRICE OSC
7
03-Jul-06 31-Aug-06 31-Oct-06 03-Jan-07 06-Mar-07 04-May-07 05-Jul-07 04-Sep-07

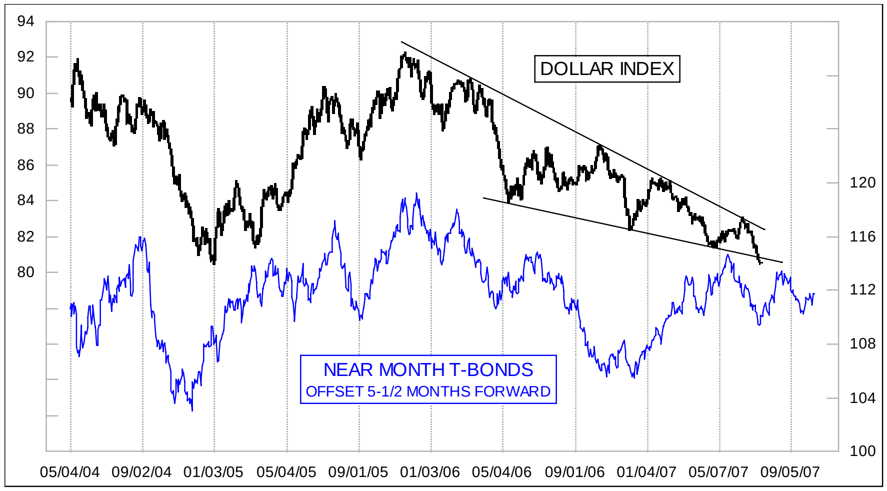

CBOE VOLATILITY INDEX (VIX)
8
SP500
50MA, 1-Sigma BBands
03-Jul-06 31-Aug-06 31-Oct-06 03-Jan-07 06-Mar-07 04-May-07 05-Jul-07 04-Sep-07

Curious Conundra for Gold Prices

There are a lot of cross currents at the moment for the gold market, and several indicators which we really like are in disagreement with each other. These are the sorts of times that make this business interesting.

In the top chart, we see that the leading indication from bond prices for the Dollar Index is calling for an up move into August. If such an up move were to occur, it would presumably be bad news for gold prices, since a rising dollar tends to hold back gold prices. It is important to note the use of the phrase "tends to" when reading that sentence.

Worth noting in this chart is that the Dollar Index has already fallen down out of a descending wedge formation, presumably making a bearish break to the downside. But false breakouts do occur, and a falling wedge is generally a bullish structure (eventually), so there is good reason to suspect that this apparent breakout will reverse itself.



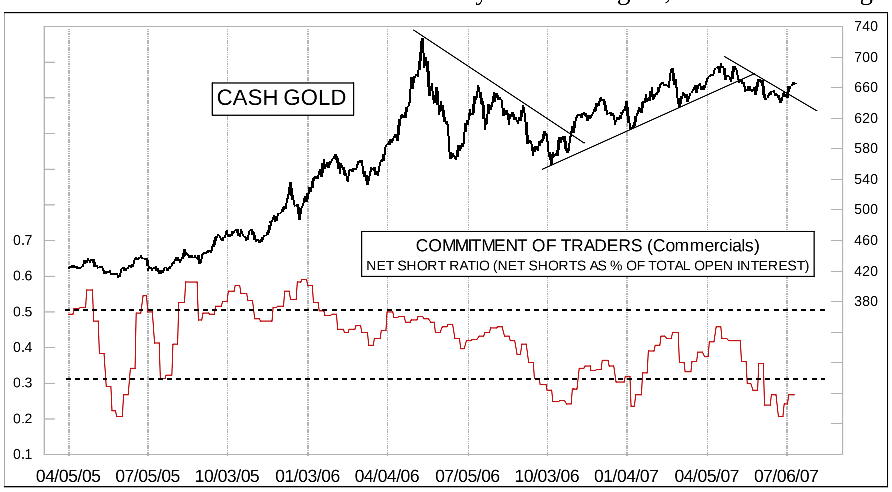
It is an interesting phenomenon that the Dollar Index can simultaneously be affected by the price movements of T-Bonds 5 months ago, and by the movements of short term interest rates almost 3 years ago (see page 8). The financial markets are far more interesting in this way than most people know.

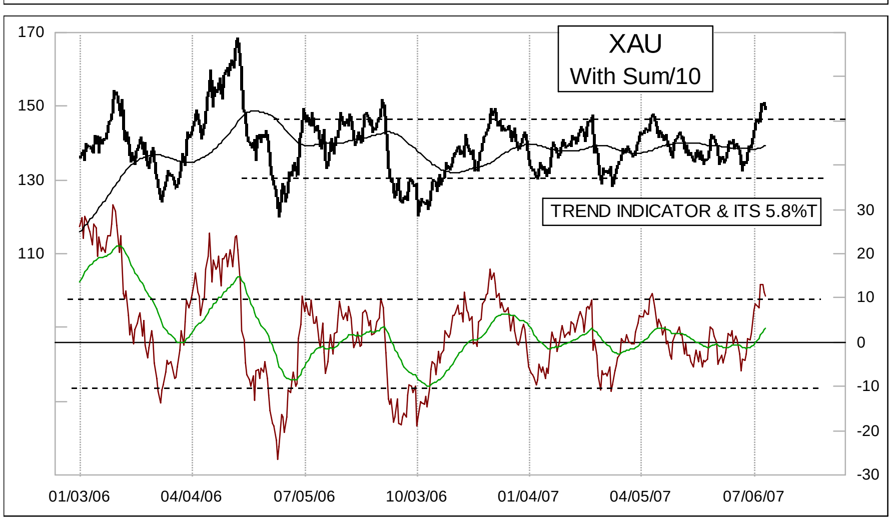
At the same time we are seeing a condition for the dollar that is presumably bearish for gold, we are also seeing commercial gold futures traders at a comparatively small net short position. They have not actually been net long since 2001, so the interpretational task is to gauge the relative level of the net short position.

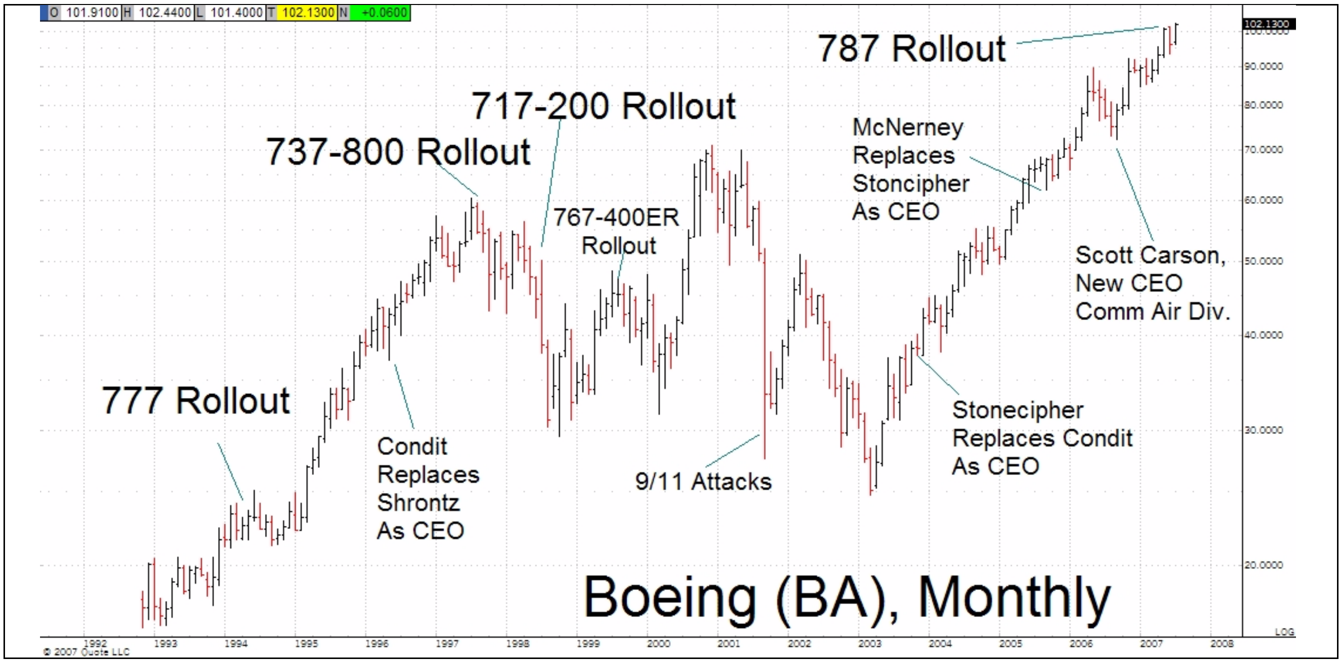
Low levels like this one tend to be associated with important price bottoms, and they represent potential energy to fuel an advance much like a coiled spring. Already we have seen a breaking of the downtrend line for gold prices, and the commercials are just barely getting started at building back a bigger net short position. It would take a lot more building than this to say that a top is at hand, provided of course that the parameters for "high" and "low" thresholds are not undergoing some larger change right now. If the commercial traders are right, then perhaps gold prices will be able to rally in spite of the expected rebound in the dollar forecasted by our first chart.

Our bottom chart shows that the XAU is back up to the top of its price range seen during the past year, even as its Trend Indicator is back up to an overbought level. The Trend Indicator is based on how far prices are away from the Sum/10 line, which is a Summation Index of Price Oscillator readings divided by 10 to put it back into the range of recent prices. This overbought reading makes this a great place to stop, if the XAU wants to stop. But if this is the start of a new trending move like the one we saw in 2006, then the XAU can go on to much bigger overbought levels.

Bottom Line: This is a mixed up time for the dollar and for gold prices, with great signs giving us conflicting information. It is not the best condition for a gold uptrend, but one is possible.







Sherman McClellan
Publisher

Tom McClellan
Editor

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

Annual subscription rates:

By Email & web access	$195
By 1st Class Mail (US)	$220
By Fax	$270

Visa, Mastercard, and Discover cards accepted, or mail payment to:
McClellan Financial Publications
P.O. Box 39779
Lakewood, WA 98496-3779
Phone (253) 581-4889 fax:584-8194
Subscriptions: (800) 872-3737
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Boeing's New Jet Is Not Good News

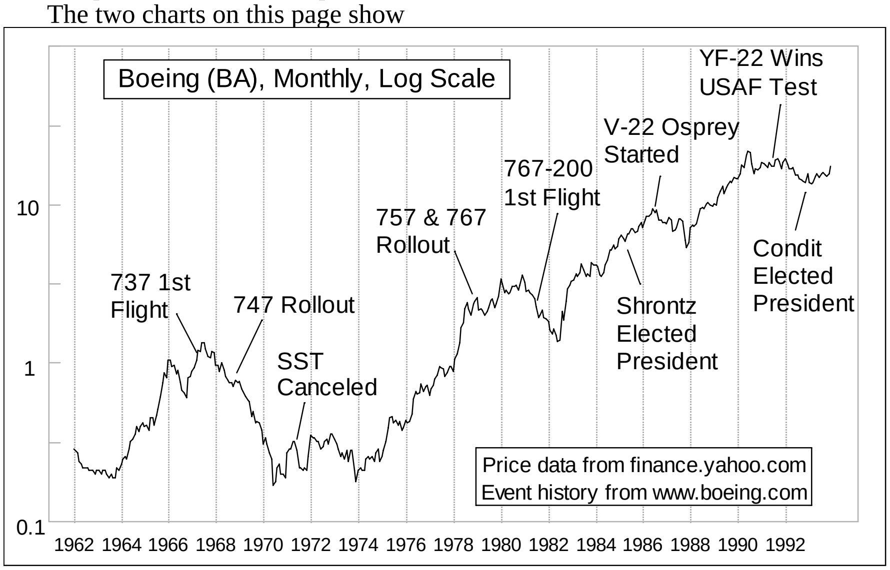
Earlier this month, Boeing held a "rollout" ceremony for its newest passenger airliner, the model 787. The rollout was held July 8, for the fun date numerology of 7/8/07.

A rollout is not the same thing as a first flight. They just roll a seemingly complete plane out of the production facility to let the press have their first real look. Excitement has been building lately for this plane, and for Boeing's stock price, because a lot of orders for it have been rolling in from around the world. This order flow comes despite no real proof that the plane will fly, nor that it will meet its performance objectives. Optimism seems to be priced in.

The two charts on this page show what previous model rollouts have meant for Boeing's share price, and the news is not bullish. Boeing's stock price has a well demonstrated tendency to see a peak that coincides with a new model rollout. The 737-800 rollout in 1997 also happened to coincide with the merger with McDonnell-Douglas.

Interestingly, the appointment of a new CEO seems to be a much more bullish event for Boeing than the development of a new airplane. It is also worth noting that Boeing does a lot more than build planes, with work in defense, satellites, electronics, etc., but in the market's view Boeing is an airplane maker.

Given the history shown here, the rule of thumb for Boeing is "New Airplane - - BAD, New CEO - - GOOD."



TIMING MODELS

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

	Signal	Source	Predicted	Actual
E	Bottom	NYSE Volume Osc	July 10	July 10
E	Bottom	NYSE A-D Osc	July 10	July 10
E	Bottom	A-D Summ Index	July 12	July 10
	Bottom	DJIA Close/Sum	July 17	
	Bottom	DJIA ST Price Osc	July 20	
	Bottom	**SP500 Price Osc**	**July 26**	
	Top	SP500 Up-Down Osc	July 27	
F	Bottom	NYSE A-D Osc	July 31	
F	Bottom	NYSE Volume Osc	July 31	
F	Bottom	DJIA ST Price Osc	Aug 1	
F	Bottom	DJIA Up-Down Osc	Aug 1-2	
F	Bottom	NYSE A-D Osc	Aug 2	
	Top	Nasdaq Up-Dn Osc	Aug 7	
	Bottom	SP500 Up-Down Osc	Aug 9	
	Top	NYSE A-D Osc	Aug 16	
G	Bottom	A-D Summ Index	Aug 20	
G	Bottom	Uncommon A-D Osc	Aug 21	
G	Bottom	SP500 ST Price Osc	Aug 21	
	Top	DJIA ST Price Osc	Aug 28	
	Bottom	Nasdaq A-D Osc	Aug 28	
	Bottom	NDX A-D Summ	Sep 20	

Bond Market (Corporate & Treasuries)

	Signal	Source	Predicted	Actual
	Top	Bond CEF A-D Osc	July 3	July 2
	Top	T-Bond ST Price Osc	July 9	July 10
F	Top	T-Bond Stochastic	July 23-27	
F	Top	T-Bond Close/Sum	July 26-Aug 2	
F	Top	T-Bond ST Price Osc	July 27	
	Bottom	**T-Bond Price Osc**	**Aug 10**	

Gold and Precious Metals Stocks

	Signal	Source	Predicted	Actual
	Bottom	Gold Close/Sum	July 2	July 5
	Bottom	[Dollar Index Top]	July 2-3	July 5
	Top	XAU Price Osc	July 6	July 12
	Top	XAU Up-Down Osc	July 9	July 12
	Top	[Dollar Index Bottom]	July 19	
	Top	XAU ST Price Osc	July 24	
	Bottom	XAU Up/Dn Osc	July 26	
F	Bottom	Gold ST Price Osc	July 27	
F	Bottom	Gold Up/Dn Osc	July 31	
	Bottom	XAU ST Price Osc	Aug 17	
	Top	XAU Close/Sum	Aug 28	
	Top	XAU Price Osc	Aug 31	
	Top	[Dollar Index Bottom]	Aug 31	

The Signals

The stock market bottom which was due to arrive July 10-12 surely did come in, with the DJIA gaining 570 points since July 10. That was a nice tight cluster, which gives greater confidence and legitimacy to the notion that a turning point ought to be a meaningful one.

We do not get to see such concentration again until the end of July, when cluster F is due to arrive with 5 separate signals calling for a bottom July 31 to Aug 2. The 3 day time span of that bottom window does not mean that we will see a bottom lasting for 3 days. Rather, the difference in their dates is a bit like a rifleman who shoots at a bulls eye but whose bullets make different holes in the target. We would prefer to have a magic indicator that tells us the exact moment when a top or a bottom will arrive, but we have to settle for the level of time accuracy that our tools can give us, and use that knowledge to help plan for what to do when the time arrives.

The top signals for T-Bonds also came in pretty nicely, hitting within a day of these projections. The end of July event that has given off such a big heat signature for the stock market also appears to be an important time for bond prices, with 3 separate top signals arriving just ahead of the stock price bottom window. That late July top for bond prices ought to be the top which prices drop out of into the climactic bottom we expect to see in August.

What To Expect

Stocks have had a great bounce, and now we expect things to get a bit more noisy and less smooth. We are still in a seasonal period during which prices are supposed to be trending generally higher, but there will be some meaningful interruptions in that trend. The biggest interruption should be the one that puts in a bottom July 31 to Aug. 2, which ought to be a great trading bottom.

Bonds still have further to fall before the downtrend is done. The final slide into an August 10 bottom should begin from a top due sometime at the end of July, with a wide time swath in these signals. Our best guess for a top date would be July 27.

Gold is resting now from its recent gains, but has further upside movement yet to come. But it too should see a nice trading bottom along with the stock market at the end of July. We are also seeing the beginnings of a top cluster for gold stocks at the end of August, coupled with a bottom for the dollar at the same time likely bringing a top for gold prices.

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.

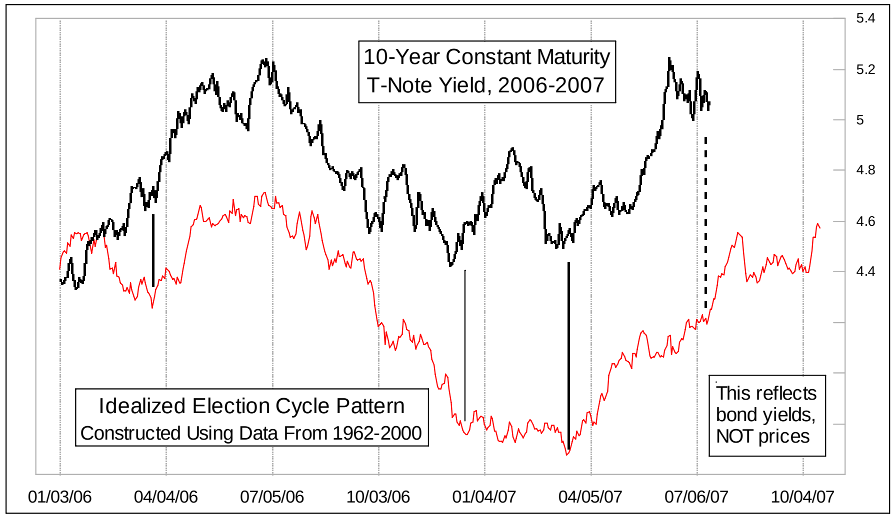
Once generated, signals remain in effect, though the result can have greater or lesser significance based on what the market is doing when the date arrives. Certain indicators are slightly less accurate in pinpointing the exact date, so we may print a range of dates. Price Oscillators and Summation Index 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.

"Actual" dates listed for NYSE Indices are for the NYSE Comp/Dow Jones Industrial Average. Letter groups 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**.

Bond Yields Still Paused, Waiting For Final Up Thrust



We show again in the top chart on page 7 our Election Cycle Pattern for 10-year T-Note yields, a pattern which we believe continues to exert a controlling influence over the bond market. During the 3rd year of a presidential term, bond yields typically move higher from March to August, and that is what has generally been happening this time as well, although the big upward spike to the June 12 top was a bit on the extracurricular side.

Such extracurricular moves are not unprecedented, since after all there are more factors governing the bond market than just the 4-year pattern. But when an unplanned move away from the Election Cycle Pattern's suggested path occurs, bond yields tend to get back on track right around the time of an important inflection point in the Pattern, such as those that we have highlighted with vertical lines in this chart.

The current inflection point may not look as important as others, like the March 2007 bottom, but it is nevertheless a meaningful pause ahead of the final upthrust to the August bond yield top. The 10-year T-Note yield got out ahead of itself at the June top, and has been biding its time since then, waiting for the train to come along so that yields can get back on schedule. We fully expect to see another upward thrust for bond yields into August to fulfill that part of this Pattern.

The longer term picture for T-Bond prices shows us that we have seen an historic change of trend. The same bond move that pushed yields up into the June high also pushed the long bond's futures prices down far enough to break a 27-year uptrend line. We have blown up the lower chart to a larger than normal size to allow you to better see the details in this data-rich chart.

It is worth pausing to note that the data in this chart are a composite of several different strings. When the CBOT changed the specs on the long bond futures from an 8% notional yield to 6% in 1999, they issued "adjusted" historical data back to 1980 to which we have appended the subsequent data. Whether this is "genuine" or not is a debatable point, but we have little choice when the exchanges change the specifications on a product.

The fact that the rising bottoms line in this chart reasserted its validity after the spec change makes it genuine in our view. Now that it is broken, and with bond prices coming up to test the underside, we can say with good confidence that the secular uptrend for bond prices is now over, and a new era is beginning for interest rates.

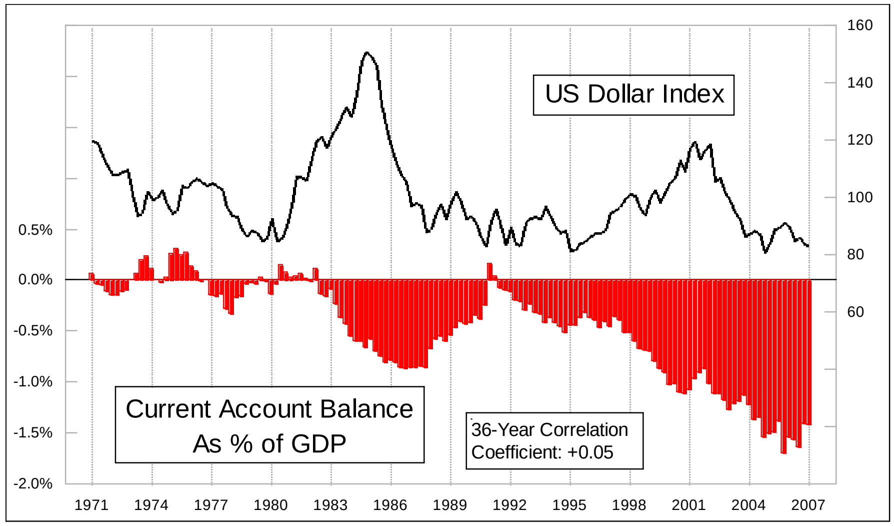
Trade Deficit Might Not Kill The Dollar

In a paper published by the NY Fed (see http://tinyurl.com/23bqam), Fed staffers Linda Goldberg and Eleanor Wiske Dillon make the argument that the lower value of the dollar does not necessarily help solve the problem of the large trade deficit. A trade deficit occurs when people and companies in the US buy more stuff from overseas than we sell to overseas, and economists like to call this the "current account balance."

In theory, a devaluation of the dollar should make US products more attractive to overseas buyers, and also make imported products more expensive for US buyers, thereby changing purchasers' incentives and correcting the trade imbalances which may develop. The authors of that paper argue that other factors such as the custom of trade invoicing in dollars, plus higher distribution costs for foreign products once they reach our shores, serve to keep those market forces from working.

In their paper, Ms. Goldberg and Ms. Dillon go through lengthy economic explanations and scenarios to make their points, which we concede have some merit. But we take a much more simplistic approach to a lot of things, preferring to look at what the data actually do rather than to throw theory at a problem in hopes of solving it.

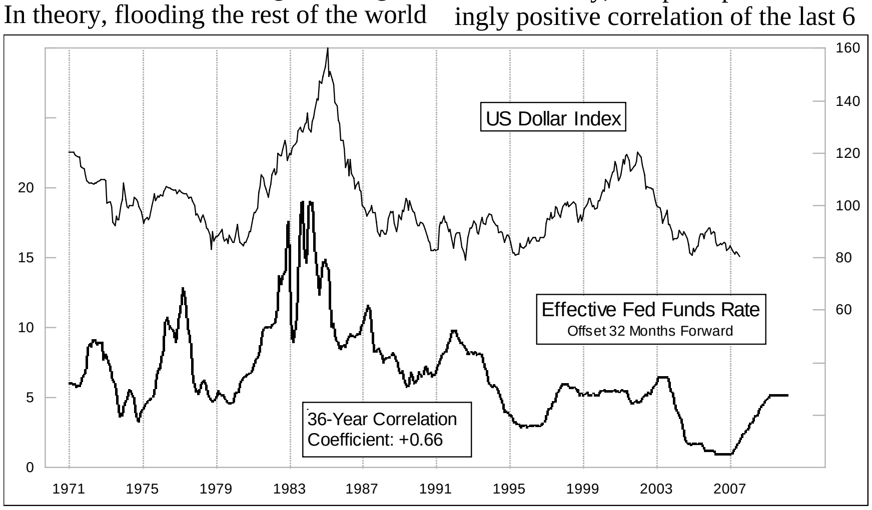
In the top chart on page 8, we compare the US Dollar Index to the Current Account Balance, which has been normalized by dividing it by GDP. It is not news to most people that the Dollar Index has fallen by over 30% since 2001, during a period in which the Current Account Deficit has grown larger. In theory, flooding the rest of the world with more dollars to buy the world's stuff means that the supply of dollars in foreigners' hands increases, thereby diminishing the dollar's value, and that theory works over the past 6 years.



But a longer term view shows that the relationship is not quite as simple as that. At some points, the Dollar Index and the trade deficit seem to move together, but at other times they appear to move in opposition to each other. A statistical study for the entire period shown in this chart reveals a Pearson's Correlation Coefficient of only +0.05, and a scale where +1.0 indicates a perfect positive correlation, and -1.0 shows perfectly inverse correlation. A zero reading means that the two are not correlated at all.

On that basis, we cannot reasonably infer anything about the future for the Dollar Index based on the direction of movement of the trade deficit, and vice versa.

Now, it may be that at some point, the trade deficit will get so large that the relationship begins to change in a fundamental way, and perhaps the seemingly positive correlation of the last 6 years is evidence that such a change is already upon us. But it is difficult to demonstrate such a relationship based on historical data for the US trade deficit.



A better way to forecast what lies ahead for the value of the dollar is to look at interest rates. Currency traders know that higher or lower short term rates make the dollar more or less attractive to hold because of the return one gets on one's short term deposits in that currency. News events about what the Fed intends for short term rates can often move currency values by quite a bit from day to day, making the foreign exchange markets pretty exciting.

But the longer term relationship between the Dollar Index and interest rates is much more interesting and mysterious. As we show in the lower chart on page 8, the Effective Fed Funds rate makes for a much better forecasting tool for the Dollar Index than does the trade deficit, but there is one hitch. We have offset the Fed Funds rate forward by 32 months to illustrate that it tends to lead the movements of the Dollar Index by almost 3 years. Thus, the decline of more than 30% in the Dollar Index was caused not so much by Americans buying cheap Chinese goods at Wal-Mart as it was by Alan Greenspan taking interest rates down to 1%.

We are just now getting to the inflection point when the rise in interest rates from that 1% level should finally start to matter for the value of the Dollar Index. We should start to see the value of the dollar begin to rise over the next few months.

Whether that rise leads to any changes in the trade deficit is a subject that we will leave to the economists to argue about.