THE McCLELLAN MARKET REPORT

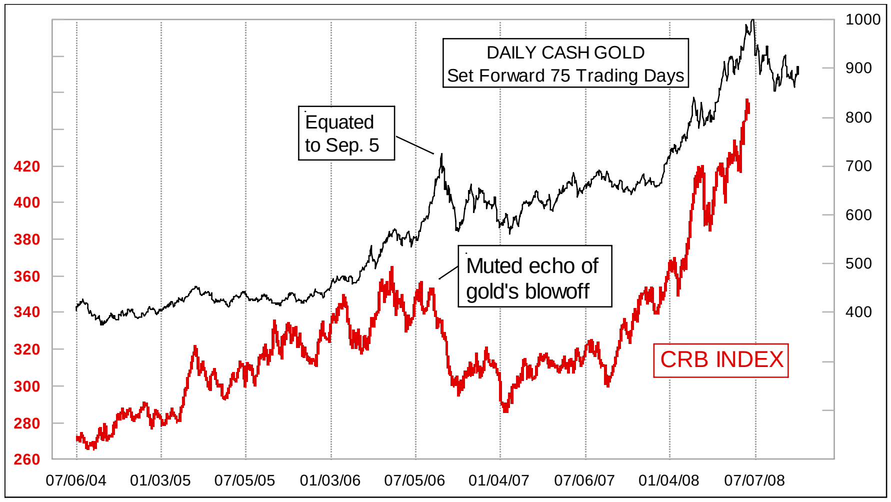
INSIDE

Prepared After the Market Close, June 24, 2008 Report #317, June 25, 2008

Commodities Have A Break Coming

We normally bury this first chart on page 4, but it is front-page news at the moment. Commodities prices have been screaming upward, led in a big way by the run up in oil prices. This is partly because energy futures are a big part of the newfangled CRB Index, and are still pretty big in the old version, now known as the CIY. But energy also directly affects the cost model for most other commodities, so there is a sympathetic effect.

As we see in the first chart, there is also a lagged effect on commodities prices from the movements of gold prices. When new money first becomes available, it flows first into gold and then about four months later it flows into commodities. Eventually, about 14 months after the flow into gold, that money surge shows up as a surge for consumer prices. The spike in the CRB Index now is the echo of the blowoff top in gold prices back in March. And the unwinding of gold's blowoff should bring an unwinding of the CRB Index blowoff as summer drags on.



BOTTOM LINE

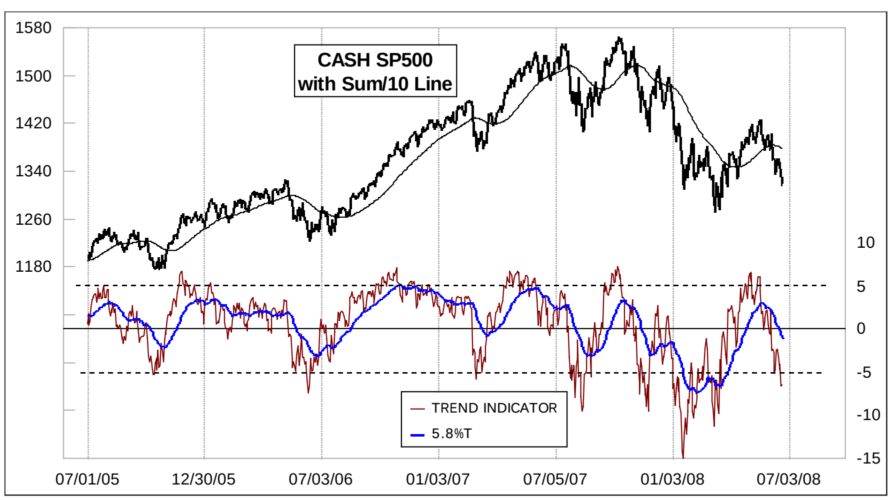
The June 23-27 bottom window we were looking for appears to be working out right, complete with a really oversold market ahead of the FOMC meeting. An oversold market this severe deserves at least a robust bounce, but it will be a while before we see if it can turn into a real uptrend this time. Look for a preliminary top for the stock market July 2, with T-Bonds retesting their recent lows at that same time (July 2-3). Currency traders are likely to be disappointed by what the FOMC does, and sell down the dollar. That should help push gold upward again, with a preliminary top due June 30 to July 1. We don't see the Fed raising short term rates now, even though it should hike Fed Funds to 3% right now. The FOMC will likely hold off until after the elections in November.

SP500 Oversold Enough For An Important Bottom

After topping on May 19, the SP500 has now fallen 7.6% on a daily closing basis. That takes our Trend Indicator down to an oversold enough level to qualify this as an important bottom, although it does not guarantee us that the market cannot get more oversold.

Our Trend Indicator is based on how far the SP500 is away from its Sum/10 line. That Sum/10 line is the result of calculating a Summation Index of Price Oscillator values, and then dividing it by 10 to put it back into the range of where prices are.

It appears that the June options expiration coupled with the June 24-25 FOMC meeting have pushed prices down to an important bottom. For many years, important oversold bottoms like this have been associated with



Report #318 will be published on **Wed., July 9, 2008**

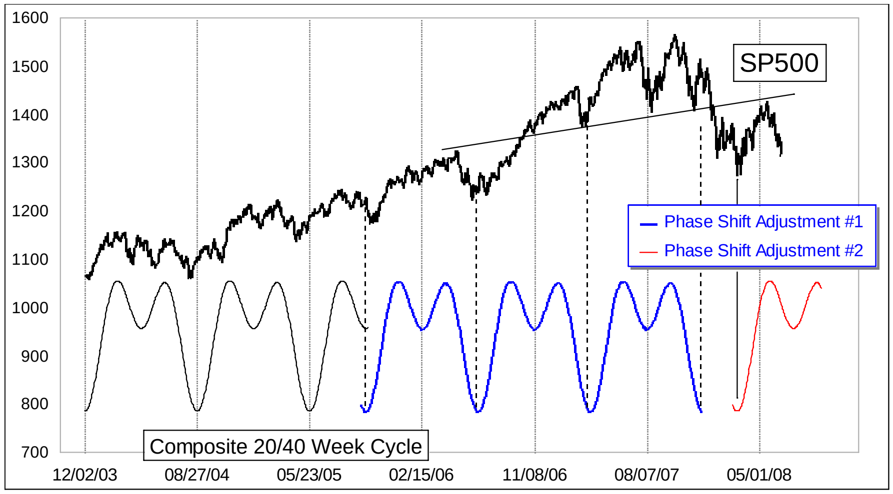
cycle lows in the 40-week cycle, as well as its half-period harmonic.

As we observe it, the 40-week cycle actually has had a period of about 185 trading days over the past 2 decades. It also has a funny habit of undergoing what we call a "phase shift" about every 6-8 years, by which we mean that it skips a beat, and then starts up again on some new schedule.

We have not commented on the 40-week cycle in the past several issues because the whole schedule got really screwy at the end of 2007, with things just not working right. That happens with any indicator or model, and when it does it is important to recognize the problem, set it aside for a while, and see if things settle down again. That seems to be happening now, with the current dip in stock prices arriving 15 weeks after the descent to the March 2008 low, which is within the normal variation in the period of the 20-week cycle.

So one hypothesis that bears watching is that we have seen another phase shift brought about by the whole sub-prime mortgage crisis. The March 2008 low could be restarting the clock on a new 40-week cycle schedule, which means that we are now seeing the arrival of the 20-week cycle (just a little bit early). We'll know later this year if that is the right hypothesis, but for now the market is oversold enough to at least merit a decent bounce attempt.

Bottom Line: June options expiration is now behind us, and it has brought us a nice oversold opportunity. Whether the bounce turns into a full uptrend is a question for another time, but for now there should be at least a strong bounce.



Page 3 Charts

Chart 1: The A-D Line has been declining since the May top failed to break out above a downtrend across the tops. But it is only in the last 4 days that it has been exhaustive in its decline. Now it is challenging the March low, but has not yet gone below that level. It would only take 2-3 days to do that and it would continue the progression of lower lows. Therefore, it would be bullish should the A-D Line fail to make a lower low in this move down.

Chart 2: The Daily Volume Line failed at the 1% Trend, and the subsequent decline has not yet taken out the March low. The large Volume Line move down on expiration Friday last week was followed by small changes on Monday and Tuesday. This pattern was able to put in the January price and Volume Line bottoms. At the March bottom the Volume Line had a large down day taking out the January Volume Line low with price following suit. The Volume Line is now in a position to take out the March low with a really large down day. But if it does not do that and holds above the March low, that would support a bullish case.

Chart 3: The McClellan A-D Summation Index dropped below zero on June 24 and has moved down 2531 points so far. This indicator has a little delay built into it at reversal points and will usually reverse within a couple of days of a price top or bottom. With 4001 net advances required to reverse this indicator and there being only 3364 issues listed on the NYSE, the Summation will need more than a day to reverse.

Chart 4: The Volume Summation is well below zero and approaching levels where reversals can be expected. The March Summation low was higher than the January low creating a divergent condition where price was lower at the March low. Now there is still an opportunity for both the Summation and price to make higher bottoms than were made at the March low. This would be a bullish outcome for this indicator and price. So, failure to accomplish those higher lows in June would be a disappointment to the bulls and an invitation to the bears to take control of the market.

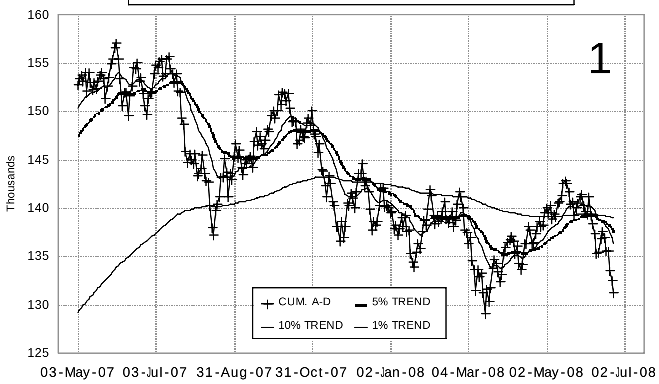
Chart 5: The McClellan Oscillator is contained by an uptrend line that can be drawn across the July and March lows and by a downtrend line that can be drawn across the May and June highs. If the FOMC announcement results in a higher McClellan Oscillator posting, then a higher low would be in place creating a divergence with price. The next Oscillator posting above zero would more than break out above the downtrend line and would reverse the direction of the Summation Index. The -240 posting is 5 points higher than the June 11 posting. Both of them are really oversold readings. Notice that the latest posting on the NYSE Composite is right at the level of tops made during the formation of the March price bottom. That is a nice place for prices to retest particularly with an oversold Oscillator.

Chart 6: The Volume Oscillator already confirmed a higher low made right on an uptrend line that can be drawn across bottoms since July. This indicator needs to jump back above zero to confirm a bullish outcome, or break lower to affirm a more bearish outcome.

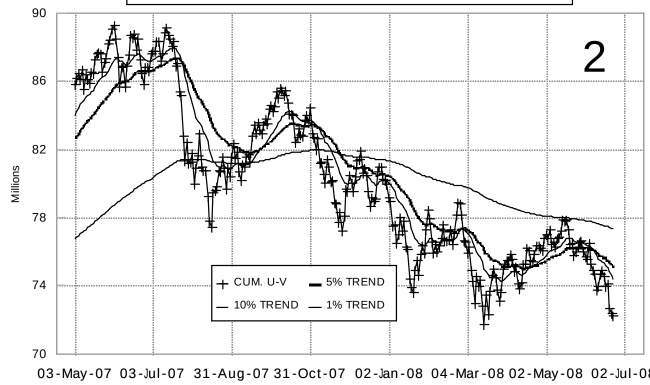
Chart 7: The DJIA on June 24 put in an intraday low just 2.54 points away from the January 14, 2000 high close. The March 10, 2008 close was 17.17 points above the 2000 high close with the intraday low also holding. At the January 22, 2008 intraday low of 11634.82 the 2000 high close was taken out but with the big intraday reversal that day the close was at 11971. So we now have in 2008 three separate retests of the DJIA 2000 closing high. But we need to see the Price Oscillator turn up to give confirmation of a reversal. Support levels such as this one are not usually successful in repelling a fourth attack should another one come later this year or next.

Chart 8: The CBOE Volatility Index (VIX) is contained between a downtrend line from the March high and steeper uptrend line across the May and June lows. A break of either of those trendlines should give a good indication of trend direction for prices. An immediate drop back below the upper band would leave a bullish lower top in place.

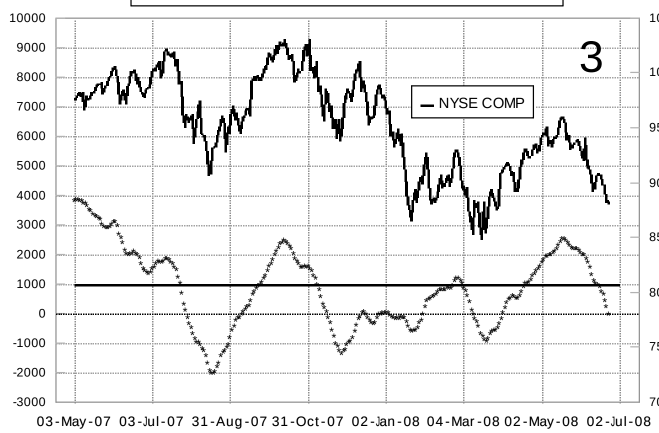
NYSE CUMULATIVE ADVANCE-DECLINE LINE



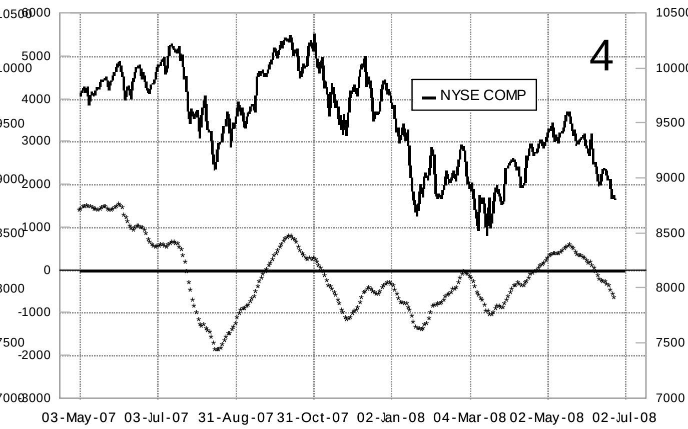
DAILY CUMULATIVE UP-DOWN VOLUME LINE



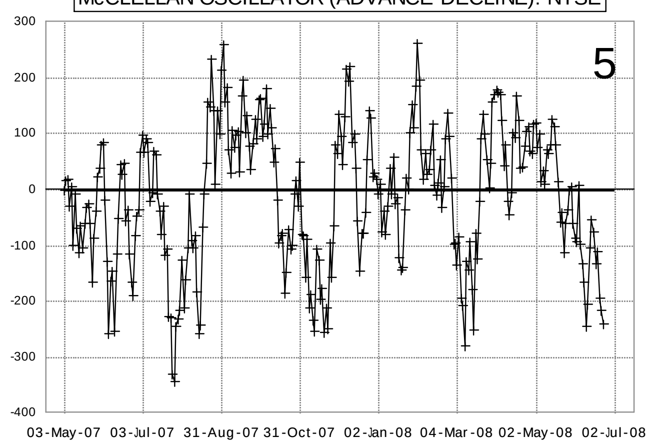
McCLELLAN SUMMATION INDEX: ADV-DECL



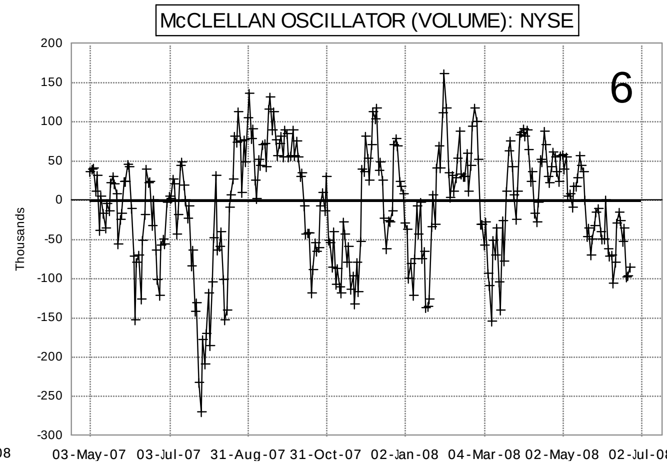
McCLELLAN SUMMATION INDEX: VOLUME



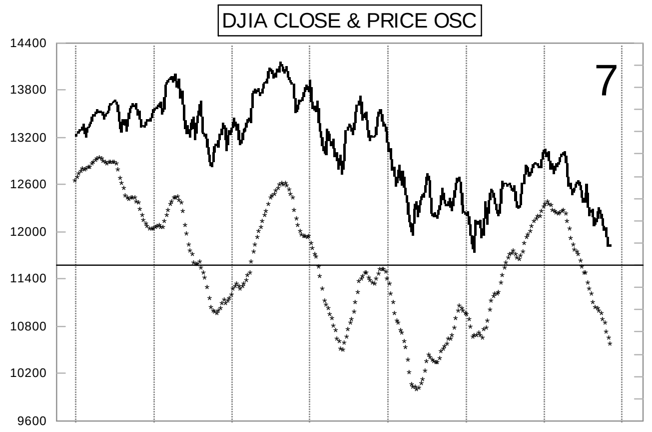
McCLELLAN OSCILLATOR (ADVANCE-DECLINE): NYSE



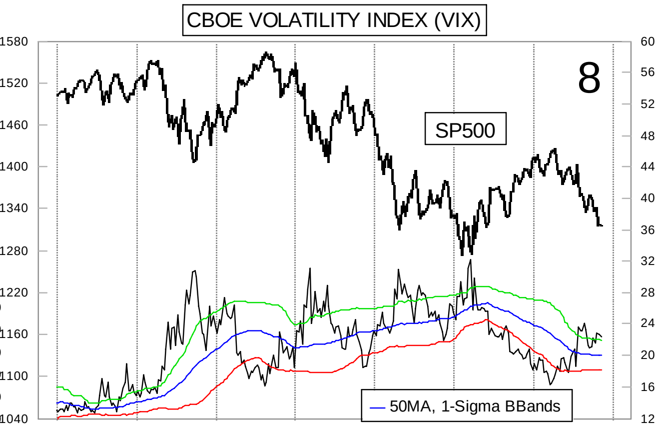
McCLELLAN OSCILLATOR (VOLUME): NYSE



DJIA CLOSE & PRICE OSC

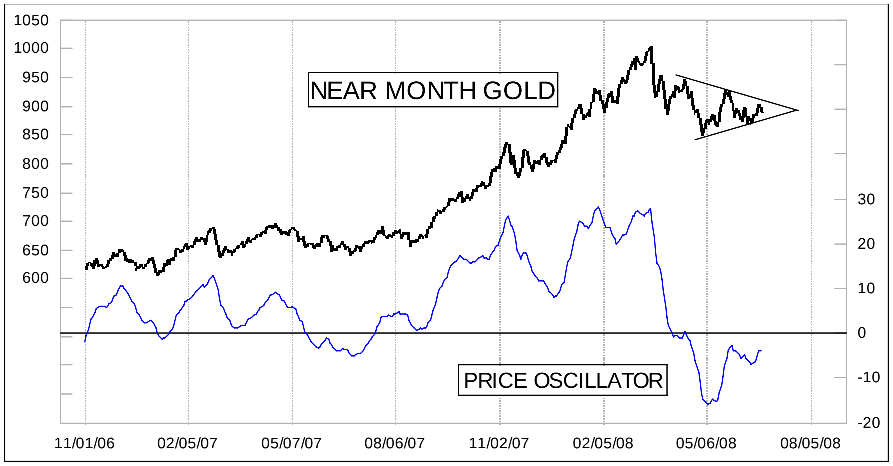


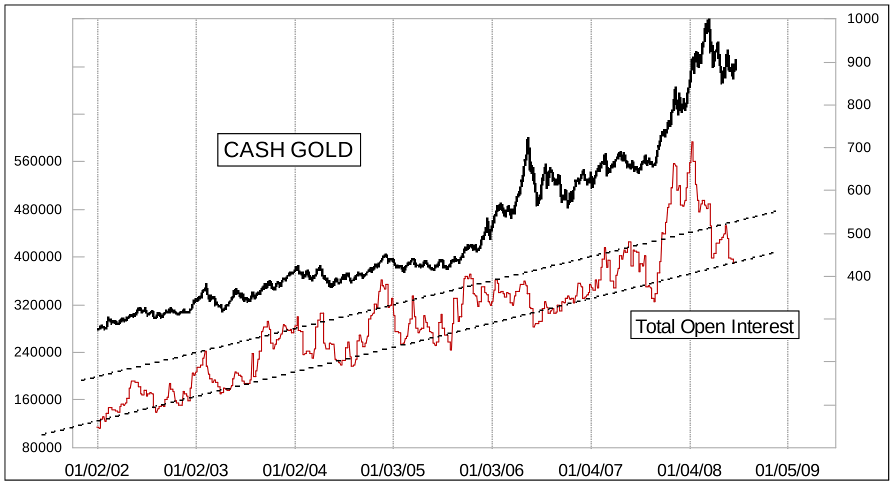
CBOE VOLATILITY INDEX (VIX)



Gold Poised to Rally

Ever since bottoming on May 1, gold prices have been forming a symmetrical triangle. Such structures are indecision patterns, with both rallies and selloffs seeing declining amplitudes, and they normally resolve themselves with a continuation of the preceding trend direction. In this case, that would mean a continuation downward, but there are a lot of other signs to say that gold is bottoming now, and the indecision will resolve itself by starting a new rally.





In the top chart on page 4, we show the Price Oscillator for gold futures. It failed to get up through zero on the first attempt, but then turned up as gold prices made a higher low. This Price Oscillator is poised to make a higher high, which promises better things ahead.

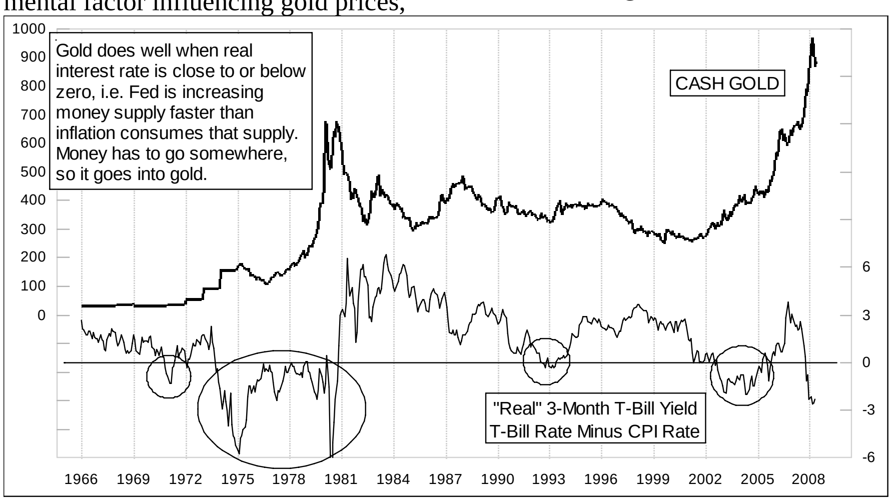
In the second chart, we show total open interest on gold futures. It has been in a long, multi-year uptrend, with oscillations up and down in a pretty well defined trend channel. Anytime that open interest moves outside the channel boundaries, there tends to be a price reversal.

Right now, open interest is down to the lowest level since September 2007, and is down to the bottom of the rising trend channel. What this says is that the speculators have been wrung out of the gold market over the past four months, and there is now a vacuum there to start pulling them back in.

You might ask why those speculators would go back into gold, and that is an essential question. The best answer has to do with the number one fundamental factor influencing gold prices, which is shown in the bottom chart.

The "real" T-Bill yield is derived by taking the current yield to maturity on 3-month T-Bills (or any other similar instrument of one's choosing), and subtracting the inflation rate. Right now, 3-month T-Bills have a yield of 1.83%, and the CPI's change from a year ago is 4.18%. That means the real yield is -2.35%.

Having a negative real yield has the effect of creating a whole bunch of extra money, and that money has to go somewhere so it goes into gold. Remember that gold has very little real-world utility, since you cannot eat it or burn it in an internal combustion engine. So people tend to bid up gold prices only when there is so much extra money sloshing around that the money cannot find any other legitimate uses.



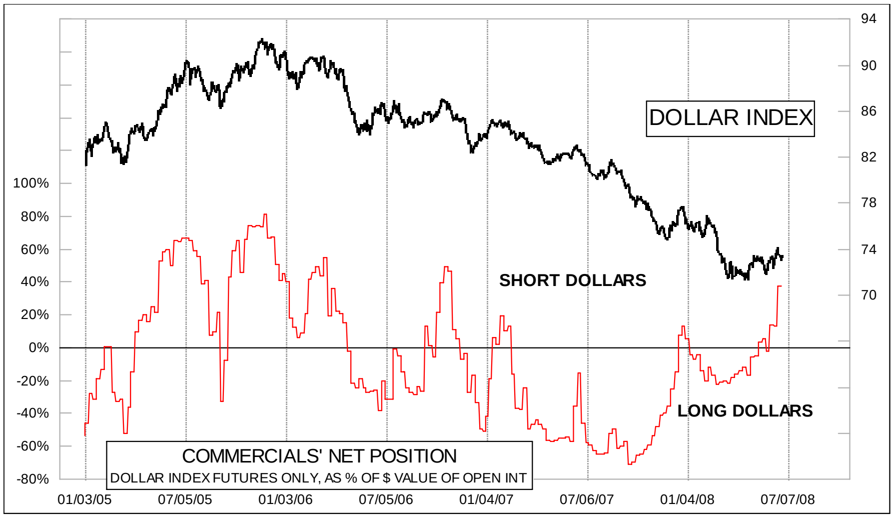
The circles in this chart show past instances of negative real T-Bill yields. The one at the far left end of the chart seems small, but it put enough pressure on the gold market that the US had to abandon the gold standard. During the late 1970s, when the pre-Volcker Fed was not willing to really fight inflation, gold prices zoomed upward because of all of that extra money being created, and inflation naturally followed.

The negative real rates in 2002 helped to get the big bull market in gold started, and that bull run saw only a brief pause in 2006-07 with the brief move to positive real rates. Now we are back to a big negative yield, and the Fed seems unwilling once again to accept the economic penalty of fighting inflation.

Currency traders have recently begun hoping that the Fed might step in and raise short term rates to help boost the value of the dollar. They got such encouragement directly from several Fed officials who alluded to concerns about the dollar. But the dollar bulls are likely to be disappointed.

The Fed's stated dual mandate from congress is to control inflation and optimize employment. But the Fed's real concern is over the stability of the banking system, and keeping its member banks solvent. That is why the FOMC is unlikely to raise rates for a while and help the dollar.

Commercial traders of currency futures evidently perceive this, as they have moved rapidly to a big net short position in Dollar Index futures, as seen in the top chart on page 5. Other individual currency futures contracts show the commercials with varying positions; this indicator just reflects positions in the Dollar Index futures. The current reading is the biggest net short position we have seen since October 2006. It says that the supposedly smart money commercial traders are not buying into the idea of the dollar going up in a big way from here.



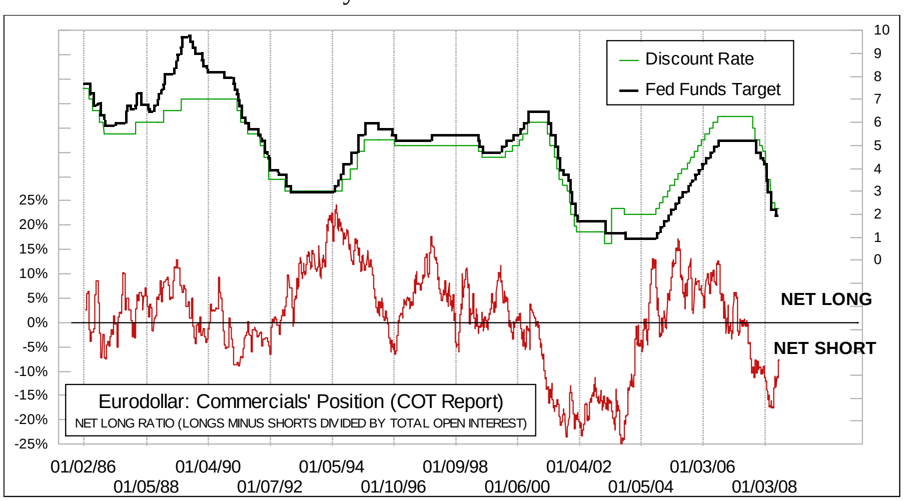
And the next chart helps to explain why the dollar won't go up. Commercial traders of eurodollar futures are still net short, meaning that they think short term interest rates should be going down. They have been unwinding that short position somewhat since January, but they are indeed still net short.

To review briefly, the term eurodollars does not refer to the exchange rate between the dollar and the euro. Instead, it refers to dollar-denominated deposits to institutions located outside the US. With total open interest of 8.9 million contracts, the eurodollar futures contract is the most liquid futures contract by far. It is the instrument that the major institutions use to manage their short term interest rate risk. By contrast, the 30-day Fed Funds futures contract only has total open interest of 746,000 contracts.

Looking at this chart, you can see that instances of Fed rate hikes just do not come when the commercial eurodollar futures traders are still at a big net short position. These traders will often get back to net long well ahead of the first rate hike, and they are just not there yet.

That tells us the Fed is unlikely to raise rates yet. This indication may work because of the prescience of the commercial eurodollar traders, or it may be because their net short position is itself an indication of a banking system in pain. The Fed does not want to inflict more pain on a vulnerable banking system, and so it holds off hiking rates until the situation is safer for the banks.

Bottom Line: The FOMC is likely to disappoint the dollar bulls, thereby deflating the dollar's recent up move. That should be great news for gold prices.



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
or at **www.mcoscillator.com**
email: tom@mcoscillator.com

TIMING MODELS

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

	Signal	Source	Predicted	Actual
	Top	Nasdaq ST Price Osc	June 9	June 5
	Bottom	Uncommon A-D Osc	June 12	June 11
	Top	DJIA Up-Dn Osc	June 13/16	June 13
	Bottom	DJIA Stochastic	June 17	June 18
	Bottom	NYSE Volume Osc	June 20	June 18
D	Bottom	DJIA ST Price Osc	June 23	forming
D	Bottom	DJIA Close/Sum	June 24	forming
D	**Bottom**	**NYSE Summ Index**	**June 23-27**	forming
D	Bottom	SP500 Stochastic	June 26	forming
E	Top	Nasdaq Up-Dn Osc	July 2-3	
E	Top	Nasdaq A-D Osc	July 7	
	Bottom	DJIA Stochastic	July 7	
	Bottom	DJIA Up-Dn Osc	July 7	
E	Top	Nasdaq ST Price Osc	July 8	
E	**Top**	**SP500 Price Osc**	**July 8**	
	Bottom	Uncommon A-D Osc	July 11	
	Bottom	Nasdaq ST Price Osc	July 16	
	Top	NYSE A-D Osc	July 21	
	Bottom	SP500 ST Price Osc	July 25	
	Top	DJIA Up-Dn Osc	July 29	
	Bottom	Nasdaq A-D Osc	July 31	

Bond Market (Corporate & Treasuries)

Signal	Source	Predicted	Actual
Bottom	T-Bond Stochastic	July 2	
Bottom	T-Bond ST Price Osc	July 3	
Top	T-Bond ST Price Osc	July 11	
Bottom	T-Bond Stochastic	July 22	

Gold and Precious Metals Stocks

	Signal	Source	Predicted	Actual
	Bottom	Gold Close/Sum	June 12	June 12
§	Bottom	XAU ST Price Osc	June 19	June 23
§	Bottom	[Dollar Index Top]	June 23	June 23
§	Bottom	[Dollar Index Top]	June 25/26	June 23
*	Top	XAU Close/Sum	June 26	
*	Top	XAU ST Price Osc	June 30	
*	Top	Gold ST Price Osc	June 30	
*	Top	XAU Up-Dn Osc	June 30	
*	Top	Gold Close/Sum	July 1	
*	Top	XAU Close/Sum	July 1	
	Top	XAU ST Price Osc	July 10	
	Top	[Dollar Index Bottom]	July 11	
	Bottom	Gold ST Price Osc	July 14	
	Bottom	[Dollar Index Top]	July 16/17	
	Top	Gold Price Osc	July 22	
	Bottom	Gold Up-Dn Osc	July 23	
	Top	[Dollar Index Bottom]	July 31	

The Signals

The big cluster of bottom signals for stocks June 23-27 appears to have arrived on schedule, with a little help from the quarterly options expiration as well as the impending FOMC meeting. As discussed elsewhere in this Report, that bottom appears to be important enough to be the equivalent of a 9-month cycle low, even though there are problems lately with that cycle.

Two weeks ago, things looked clear for a rise up to a top cluster due July 2-8. But now two separate bottom signals for July 7 have popped up, putting that nice neat top cluster into doubt. What had been a nice clear-cut big bottom leading to a big top is now much less clear.

Gold has also seen its pre-FOMC bottom in the form of a retest dip. Now gold prices have a 6-signal top cluster for June 26 to July 1, a cluster which is not interrupted like the stock market's top cluster. What the context of that gold top will be is unclear, but gold looks set to have an uptrend from here.

What To Expect

Stocks are in the process of fulfilling an important bottom signal cluster right now, and should head upward in a strong way. The first stop on that ascent was supposed to be a July 2-8 top, but that is much less clear now. The conflicting top and bottom signals in that time window may cancel out the topping condition which had previously been in the cards.

T-Bonds now have a couple of signals showing a bottom July 2 and 3. That is right in the middle of what was previously the clear-cut top cluster time frame for stock prices. If stocks do go up into July 2-3, then that would be a good reason for bond prices to go down to fulfill the July 2-3 bottom signals. A week later, we see bonds showing a top July 11, the same day that a bottom is due for the stock market. So "flight to quality" should continue to be the dominant theme, as well as the opposite condition wherein investors flee bonds to chase stocks as the mood strikes.

Gold prices should bounce up into a top at the end of June, as metals traders respond to the FOMC deciding not to do anything to help support the dollar. That is what we are predicting the FOMC will do, since this Report will go out ahead of the FOMC's post-meeting announcement. Another top due July 10-11 should keep gold from falling far after the month-end top.

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."

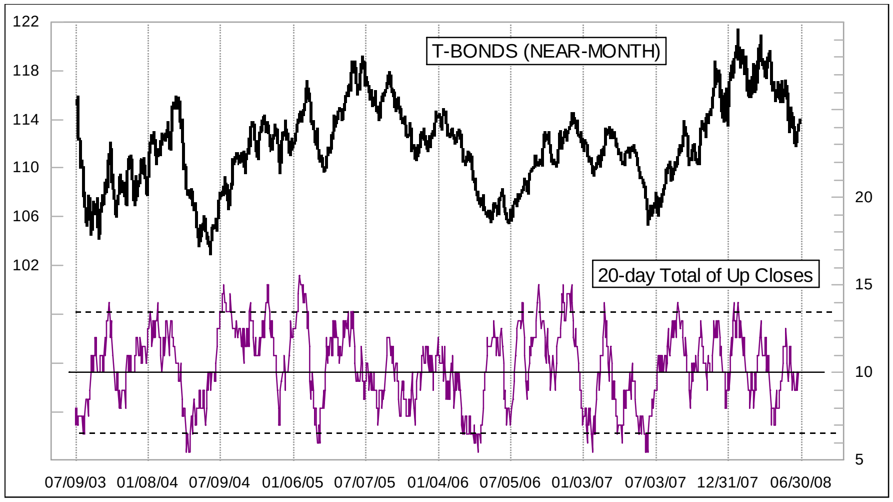
Past performance of these mathematically generated turning point projections in no way guarantees future results. These dates may be useful in planning for the future, or giving greater confidence at turning points. **We would not, however, attempt to trade any of the markets based solely on these models**.

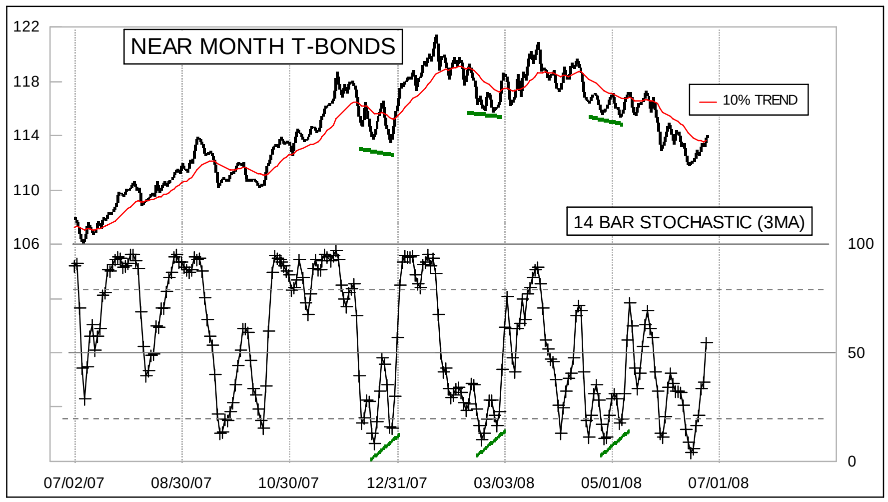
Unfinished T-Bonds Business

T-Bond prices have been in a downtrend since the top in January, and the decline has gone far enough now that it is appropriate to start looking for a bottom. The first two charts show indicators that should give specific indications at an important bottom, and we are not seeing those indications yet.

The indicator in the top chart measures the number of up closes over the past 20 trading days. An unchanged day counts has half. Taking a look at the price plot, you can see that if you pick out any of the important price bottoms over the past five years, they have all arrived with a very low reading on this indicator. There was one low reading in April, but the bond prices continued down much lower since then and have not established another very low reading to qualify this new price low as an important bottom.

In the second chart, we show the 14-3 stochastic for T-Bonds. It has been tracing out a complex structure below its 50 neutral level. Complexity implies strength for the side on which it is seen, whereas a simple across and back move shows a lack of commitment. Moreover, complex structures beneath 50 usually end only when there is a divergent condition relative to prices. We don't have a divergence yet, and so this pop up above the 50 line is likely just a quick countertrend rally coupled to the weakness in the stock market. As stocks rebound, bond prices ought to go back down and finish up the unfinished work of forming this bottom. Our Timing Model signals suggest that July 2-3 is a good time to look for that bottom to arrive.





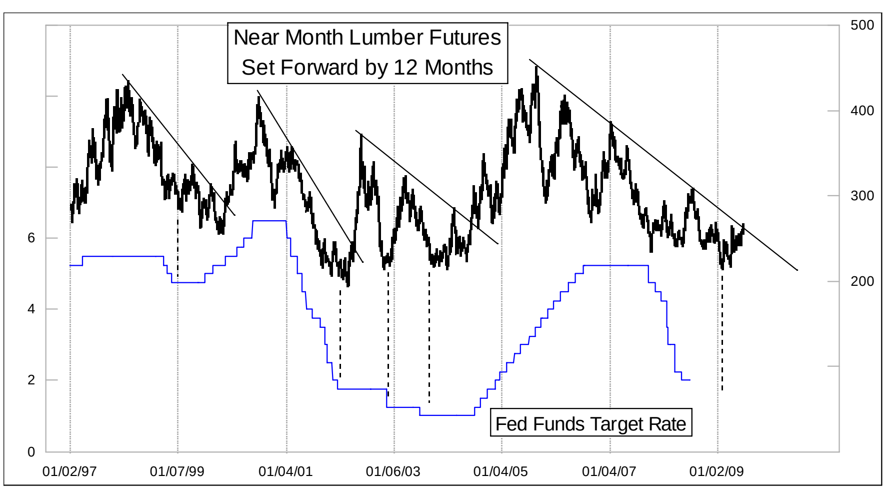
One More Reason Fed Won't Hike

After several rounds of mill closings and layoffs, lumber futures prices are finally starting to rise again and may even break the four year downtrend. That is good news for mill workers and timber people, but it does not mean that the Fed is ready to raise rates yet.

What we show in the bottom chart is that lumber prices give about a 1-year leading indication for what the FOMC will do with short term rates. By our reckoning, this means that the Fed will not get around to raising rates until after January 2009, even though we think that the FOMC ought to hike rates now.

Only in 1999 did the FOMC begin hiking rates ahead of when this leading indication said they would, and they did so to fight the tech bubble, which is not the same as the current oil bubble.

The reason why we think this works is that lumber prices are terribly sensitive to economic strength. The Fed usually likes to wait until it is sure the economy is strong enough before raising rates. A break of lumber's downtrend line would provide further confirmation that a rate hike is ahead, but not until 2009. If the FOMC were to see past the near term and look at the big picture, then they might be able to apply some countercyclical pressure to the business cycle ahead of the recovery. But we are not holding our breath waiting for them to finally get one right.

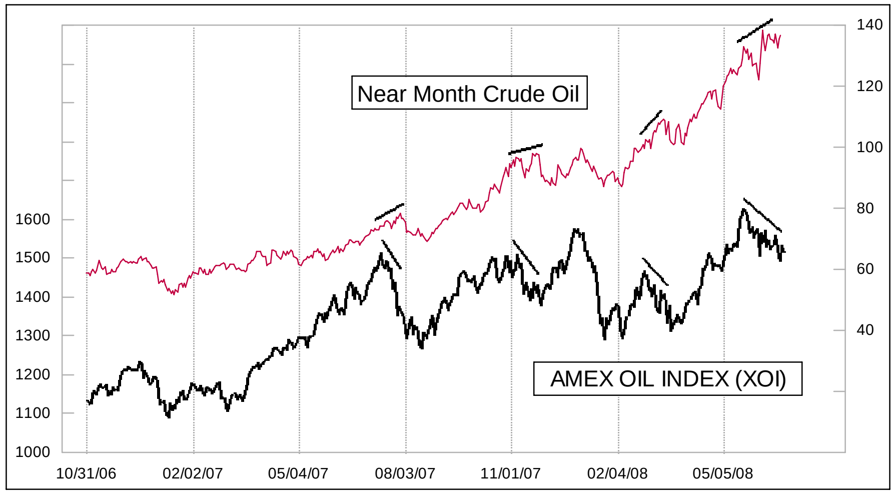


Oil Stocks Don't Confirm $140 Oil

Energy stocks in the AMEX Oil Index (XOI) bottomed in early February, ahead of the overall stock market's March 2008 bottom. Those energy stocks were led higher by the up move in crude oil prices and they matched crude's up move almost step for step.

But the latest surge to tag the $140/barrel price point was not matched by the XOI. Past divergences like that one have led to price declines for both oil and the XOI, and so far we have not seen the downward reaction which should come from this divergence.

We believe that part of what is keeping oil prices up right now is the blowoff taking place in the overall commodities market, as discussed on page 1. When that starts to break, as it should soon, then money is going to start coming out of commodities in a big way. Because of the proliferation of commodities funds in the hedge fund community, commodities prices have become much more cointegrated than they used to be. That is likely to pull crude oil prices down along with the other commodities, thereby fulfilling the XOI's divergence.



Odds and Ends

We mentioned the stock market's oversold condition on page 1, and here is another example of just how oversold the market has become. The middle chart on this page shows an indicator which measures the percentage of the 30 stocks in the DJIA whose Price Oscillators are above zero. The Price Oscillator for the DJIA itself can be seen on page 3, and it has been below zero since June 3. But not every component has had a negative Price Oscillator all that time. They move somewhat differently from each other, which is the benefit of having an index so that we can get a broader view.

But when the stocks in the Dow get too unanimous, as they are doing right now, the market is near a turn. Right now, only 13% (4 out of 30) have a positive Price Oscillator. Other than the low in January, we have to go all the way back to early 2003 to find a reading this low.

The bottom chart shows that we are still not out of the woods yet in terms of expectations for volatility. Options expert Larry McMillan introduced us to the concept that there is a Liquidity Wave relationship between short term interest rates and the VIX. In the bottom chart, we have set the 3-month T-Bill yield forward by two years to show how it forecasts what the VIX should be doing.

We have to understand that the VIX is going to move around a lot more wildly than short term rates will, like a dog's tail moving more than its head. But the relationship conveys the point that higher interest rates create more of an illiquid condition that takes a while to work its way out of stock price movements. The decline in rates that began (too late) in 2007 should see its echo in a lower range for the VIX beginning in late 2009. Until then, expect comparatively high VIX readings.