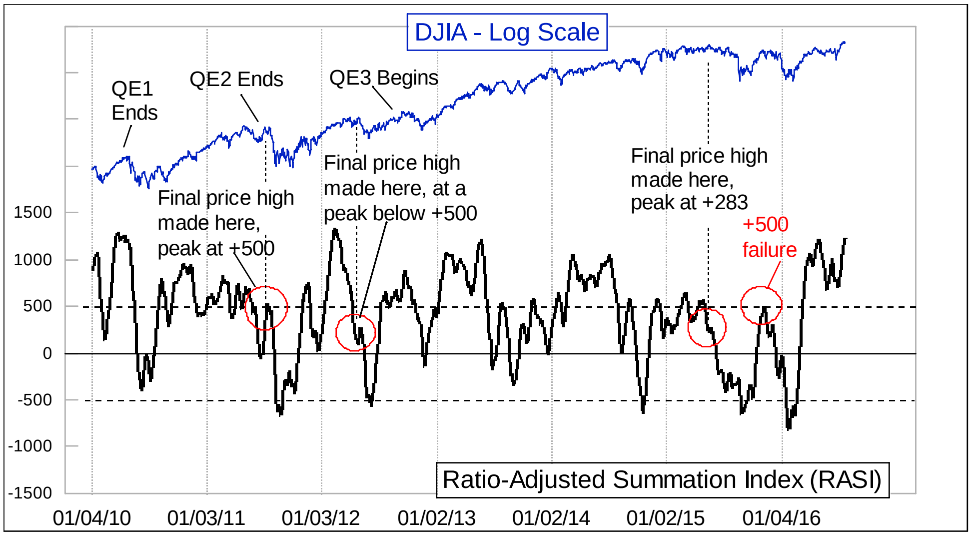
THE McCLELLAN MARKET REPORT

INSIDE

Prepared After the Market Close, July 26, 2016 Report #511, July 27, 2016

High Summation Index



High on our list of true market maxims is this: "Gobs of breadth is a good thing." Strong breadth can only happen when liquidity is strong, and money is plentiful enough to lift the majority of stocks. That is not a condition which typically goes away rapidly.

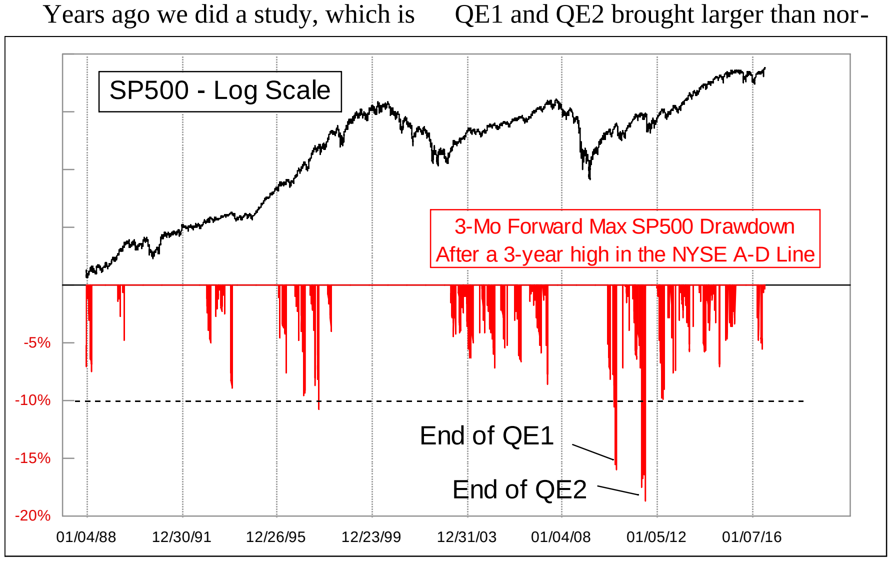
The strong breadth shows up in the form of a new all-time high for the NYSE's A-D Line. The major tops of the market's history typically announce themselves with a divergent condition, with prices making higher highs and the A-D Line making lower highs. We do not have that condition now.

The strong upward slope of the A-D Line helps to push the McClellan A-D Summation Index up to really high levels. The first chart shows the Ratio-Adjusted Summation Index (RASI), which factors out the changing number of issues traded on the NYSE, and thus it is better for long term analyses.

The RASI is now up at a really high level. That has two simultaneous messages. First, it says that the market has gotten a bit stretched, and so a normal corrective period is in order. Second, it says that this is not the end of the uptrend. Big price tops usually arrive with the RASI below +500. If the RASI had failed to make it up above +500, that would be really worrisome, but that's not the condition we face right now.

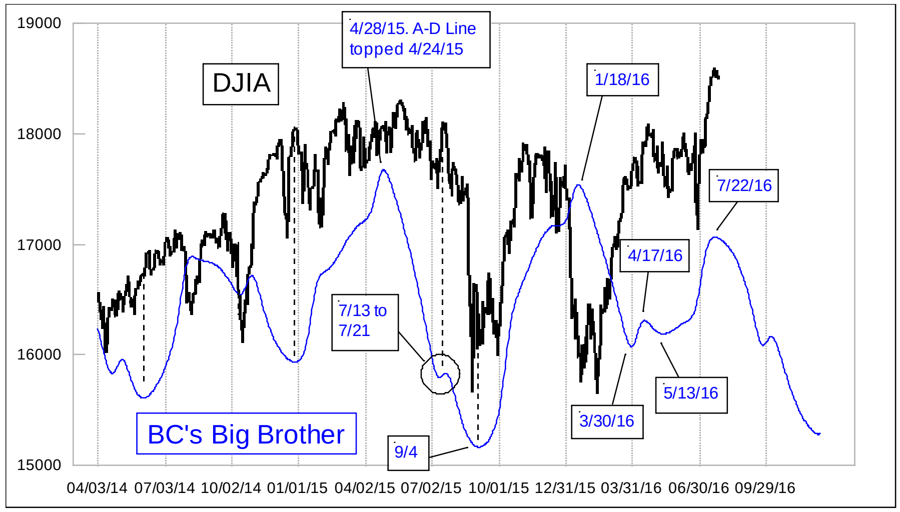
Years ago we did a study, which is updated in the lower chart. We wanted an answer to the question of how much risk there is if we have a new high in the A-D Line. So the lower portion of the chart shows the worst 3-month forward drawdowns seen after a new 3-year high for the A-D Line.

Generally, risk is limited to about 10%, and this "rule" has persisted for decades. But there are a few historical exceptions to that rule. The ending of QE1 and QE2 brought larger than nor-



BOTTOM LINE

In an election year with 2 new challengers running, the market tends to do worse than with an incumbent running. That worse performance is usually focused into September and early October, but there is preliminary choppy work to do. Look for a sharp drop into a bottom due Aug. 3-5, and another bottom due Aug. 22-23 before a late-August pop. That pop should set up for the September decline. Gold prices and T-Bond prices should also fall, just as they previously were all rising together with stocks. After the October low, we expect a robust rally for both stocks and gold into early 2017. Bonds, we're not so sure.



mal drawdowns. There was also a rare 13% drawdown in late 1978 (not shown in that chart). But most of the time, risk over the 3 months after a new high in the A-D Line is really minimal.

That does not mean a normal garden-variety correction cannot happen, and indeed we expect to see one between now and October.

The chart here on page 2 is an update of one shown in our last Report, in a discussion of our still-experimental BC Indicator. This is BC's Big Brother. It's big turns have a pretty amazing track record at coinciding with major turns for stock prices. Less impressive is its consistency at declaring whether those turns should be tops or bottoms. In other words, it inverts sometimes.

That does not seem to be the case right now. Big Brother showed a top due July 22, and the DJIA's actual closing high (so far) was on July 20. The SP500 made its high on July 22. So we'll call this one "pretty good". Coming up, Big Brother shows a drop that resembles one from last summer.

Bottom Line: Having really strong A-D numbers tells us that liquidity is plentiful, and so the risk of a major decline is extremely small. But at the same time, we are seeing an overbought condition which merits a corrective period.

Page 3 Charts

Chart 1: The A-D Line has had an exceptional run up from the February 2016 low. That run has taken it to a new all time high. This action shouts out that there is huge liquidity sloshing around that is available to be put to use in the stock market or economy. This run up has taken the A-D Line as far above its 1% Trend as it has historically been able to get. So, now it will be up to the 10% and 5% Trends to see if they can contain any correction.

Chart 2: The Daily Volume Line chart doesn't show the highs that it made last year. So, it isn't apparent that the Daily Volume Line has not yet been able make a new high. But it is very close to last year's highs after the latest bounce up off the June low. It is because of the reluctance of this indicator to make new highs that we see the disparity between the DJIA and SP500 making breakout moves above last year's price highs, while the broader NYSE Comp. has only been able to retrace back up to the breakdown point just before the August mini crash.

Chart 3: The McClellan A-D Summation Index has managed to move slightly above its April 28 high of +4805.2 with a highest posting of +4865.2 on July 22. This area between +4700 and +5300 is prime reversal territory for the Summation Index. It is not surprising to see this indicator stall out where it is now. When the Summation Index is at such a high level, there is the need to relieve the overbought condition. But the price moves associated with a correction that begins at such a high Summation level tend to be very limited. There tends to be a larger price correction following the next Summation high that follows the initial drop.

Chart 4: The Volume Summation Index is not anywhere close to equaling or exceeding its April high. This is in keeping with the under performance of the Daily Volume Line. But unlike the A-D Summation Index the Volume Summation Index has not yet turned down to confirm a top being in. Perhaps the Fed announcement on Wednesday July 27 will cause the topping action to be completed or further the breakout move by moving the Summation higher.

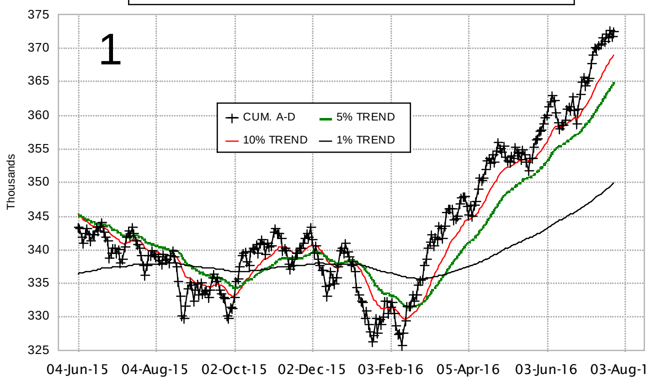
Chart 5: The McClellan Oscillator topped out July 12 at +193.36 before dipping below zero for only one day on July 25. The complex Oscillator structure above zero made it clear that the bulls were in control. The one day dip below zero said the bears weren't able to take back control. If a simple up and back down below zero shows up now it would be clear that the bulls were not able to regain control. It is necessary for the Oscillator to remain below zero for the Summation Index to correct its current very high level.

Chart 6: The Volume Oscillator has spent some time above zero in the recent action following the deep negative posting associated with the Brexit low. But it has not shown the initiation height that it demonstrated subsequent to the September and February price lows. It will need to bounce up higher to maintain its postings above zero or drop below zero to complete the current positive complex pattern.

Chart 7: The DJIA Price Oscillator was pushed below zero by the Brexit results. By dropping below zero the presumption of the DJIA making a higher high was removed. As it has turned out, the DJIA has moved to a higher high anyway. The dip below zero does not rule out a new higher price high, it just makes it more iffy. The Price Oscillator turned down on July 26, the day before the Fed announcement. Other Price Oscillators failed to confirm that reversal. Either they will confirm by turning down after the Fed does its thing or the DJIA Price Oscillator will have more upside work to do. As it stands now there is a significant divergence with a higher price high on the DJIA and a lower Price Oscillator high. This indicator topped at +207.2 and there are many many top reversals near this level.

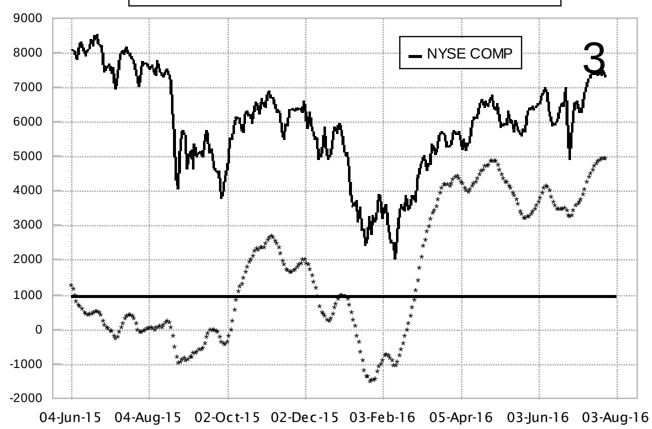
Chart 8: The CBOE Volatility Index (VIX) has had a couple of closes below 12 and five intraday lows below 12 here in late July. These are very low levels for the VIX. There have only been a couple of instances which were widely separated in time where postings below 10 were seen in the last 25 years. If the stock market is to continue trending higher, it will be incumbent on the VIX to remain near these recent low levels. But if there is a correction to start soon, the VIX should acknowledge that by moving back up to higher levels.

NYSE CUMULATIVE ADVANCE-DECLINE LINE

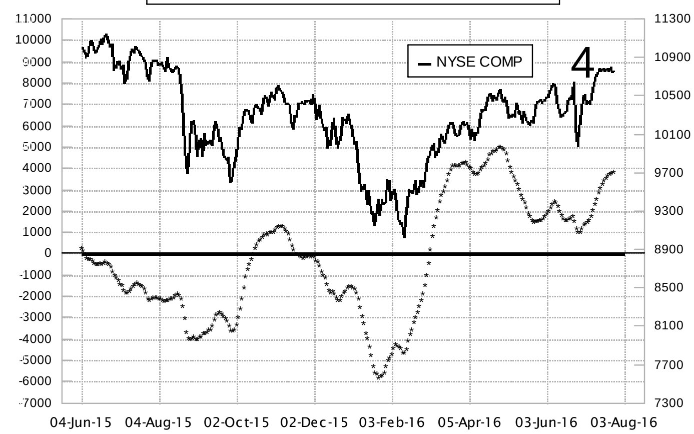


DAILY CUMULATIVE UP-DOWN VOLUME LINE

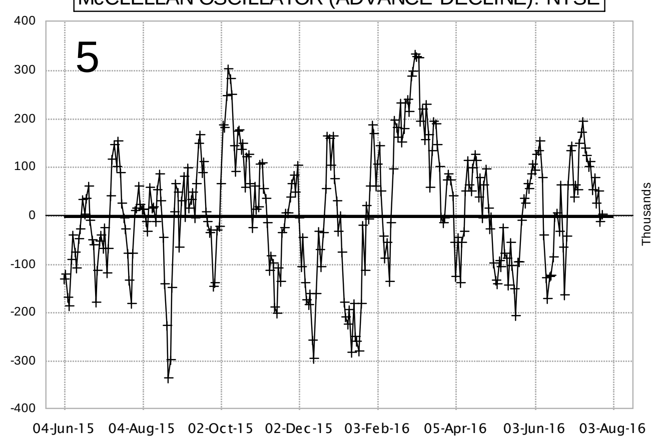
McCLELLAN SUMMATION INDEX: ADV-DECL



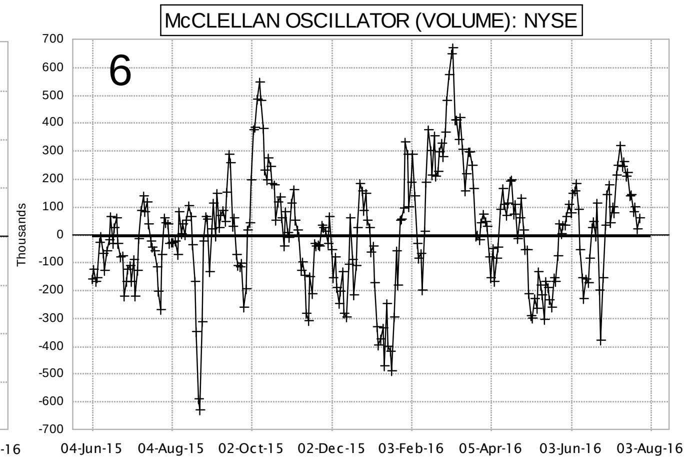
McCLELLAN SUMMATION INDEX: VOLUME



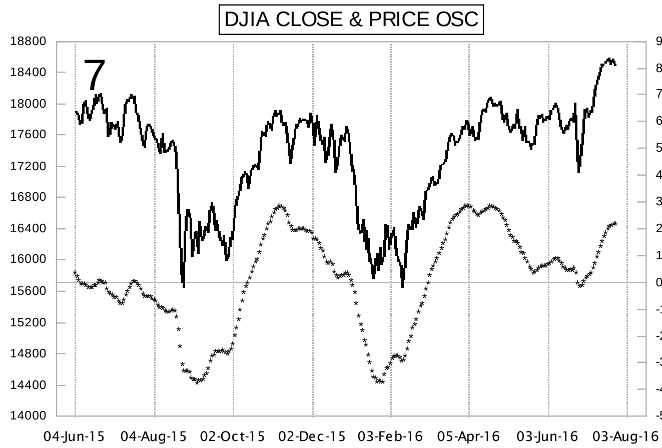
McCLELLAN OSCILLATOR (ADVANCE-DECLINE): NYSE



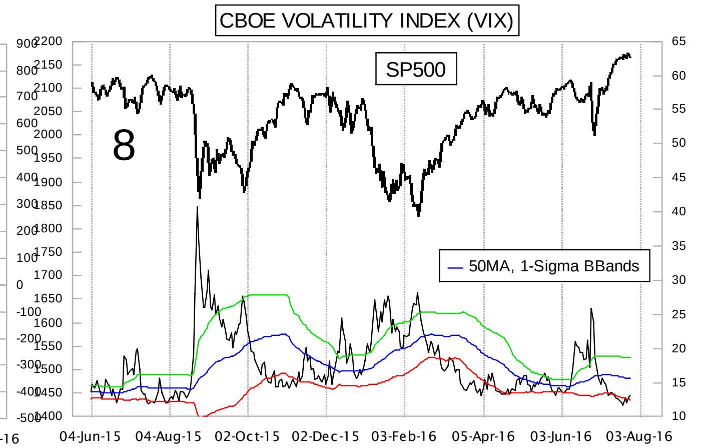
McCLELLAN OSCILLATOR (VOLUME): NYSE



DJIA CLOSE & PRICE OSC



CBOE VOLATILITY INDEX (VIX)

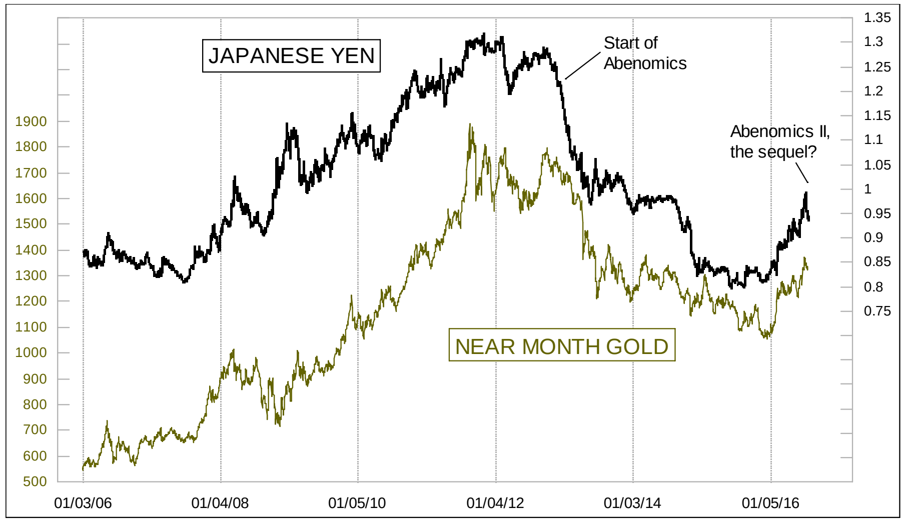


Gold Matching Yen's Movements

Gold conspiracy buffs are a unique class of people. There are not as many of them these days as there were in the 1980s and 1990s, the years which followed the huge bubble top in 1980. They are dying off, and not being replaced at the same rate. And yet they still exist, and still say funny things.

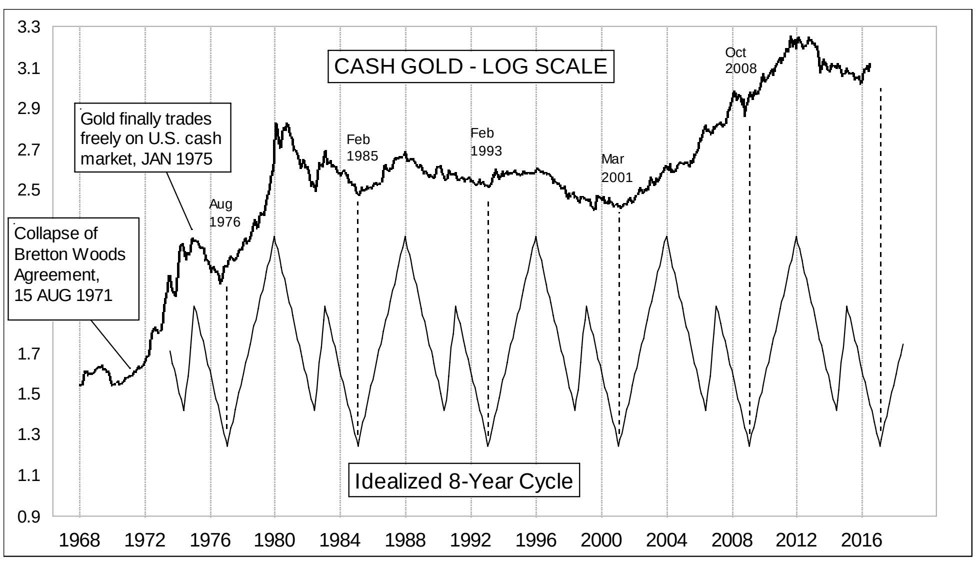
One such conspiracy theorist recently asserted to us that gold prices "are controlled by the COMEX". If that's true, then the correlation evident in the first chart says that the COMEX must also be controlling the yen. The U.S. does nearly $200 billion of trade per year with Japan, and somehow the COMEX is controlling the exchange rates of the two currencies?

The problem with conspiracies is that they are difficult to pull off, and even more difficult to keep secret. On top of that, the massive market forces and speculative actions can overwhelm the actions of any small group, sometimes including central banks. If anyone believes that the COMEX has the power to determine the paths of both gold prices and the yen, then that person needs to do a bit more research.



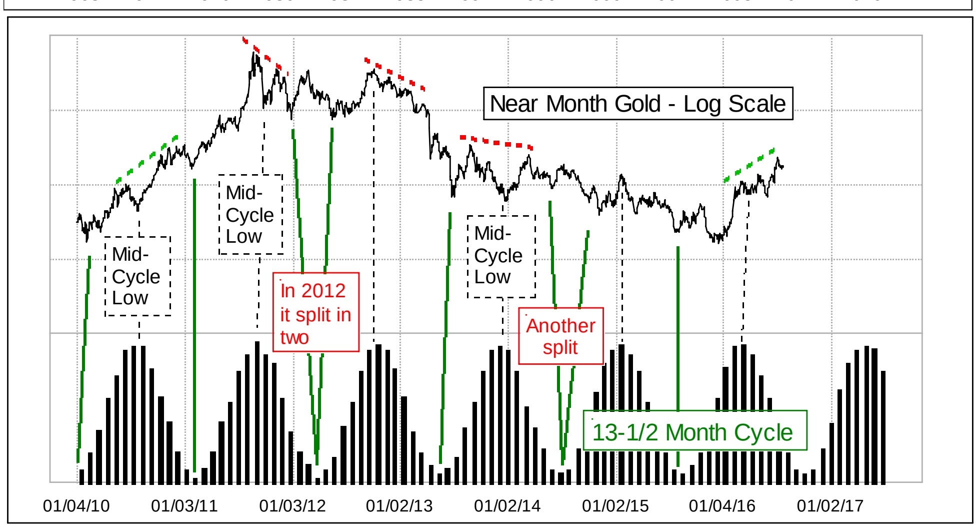
The implication of this correlation is that the immediate future path of gold prices is inextricably tied to the future of the yen. And PM Abe just got reelected with a mandate to do more to help Japan's economy, which has traditionally meant driving the yen lower.

All of this is unfolding as gold prices are making their final plunge toward a major price low as forecasted by 2 separate and independent cycles. The 8-year cycle is depicted in the middle chart. Based on when these cycle lows have arrived in the past, the next one is due sometime between August 2016 and March 2017.



Our thesis is that we are going to see this next 8-year cycle bottom arrive coincident with the 13-1/2 month cycle low due later this year, as shown in the bottom chart. Ideally that cycle low is due in October, but it can arrive plus or minus a month and still be considered "on time".

One other message from this cycle is that coming out of that next cycle low, we ought to see a big rally to a higher price high. That message comes from the fact that the current cycle has seen "right translation", meaning that the high on the right side of the midpoint is above that on the left side. That is a bullish configuration, promising us better things in the next cycle.



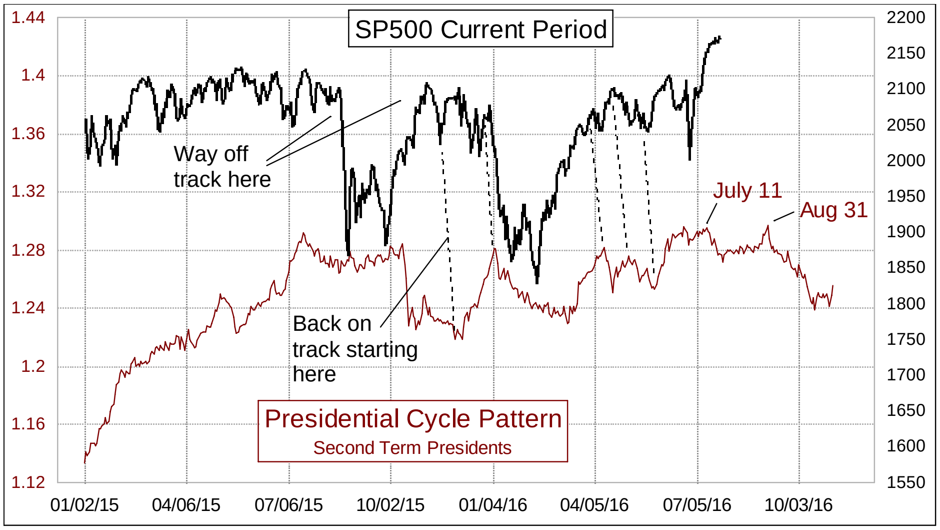
Bottom Line: Gold is joined at the hip right now with the yen. Both should head lower into a major cycle low due later this year.

Presidential Cycle Shows Decline Coming

Election years are different from other types of years, in terms of the way that the market follows its normal seasonal pattern. And among election years, there is a further difference depending on whether an incumbent president is running for reelection, or if instead there is the condition we have now, with two new challengers contesting for that job.

Under that condition, the market does not do as well in election years. And following an early July top, the market typically transitions into a bearish mode as worries about the election outcome start to occupy investors' thoughts.

Ideally, this version of the Presidential Cycle Pattern says that a top should arrive July 11. The actual highest closing high for the SP500 on the recent up move was on July 22, but the SP500 rose up into this little plateau on July 14, very close to the ideal date.



There is one more top shown in the pattern due Aug. 31, ahead of the more concerted drop into October. A low in October also happens to fit with the leading indication from the NINO4 weather data featured back in MMR #509.

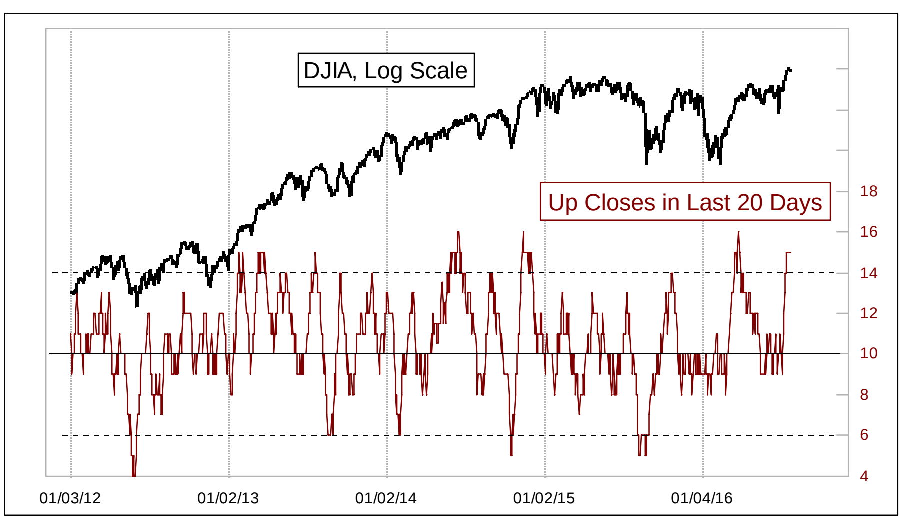
We can worry about identifying the low point in October when it gets closer. For now, we have an overbought condition appearing roughly on schedule to deal with. One indication of that overbought condition is the simple indicator in the lower chart. It counts how many times the DJIA has closed higher over the past 20 trading days.

Readings above 14 or below 6 show extended conditions. The really low readings are more reliably associated with bottoms than the high ones are with the exact day of the tops. But in every case where there is a reading of 14 or 15, it is associated with an important top. We just may have to wait a couple of days for that top to finish being formed.

This indicator reached a reading of 15 on July 18. The final price high (for the moment anyway) was on July 20.

The last spike high in this indicator brought a reading of 16 on March 29, which was followed a few days later with a DJIA top on April 1 (and a slightly higher high on April 20). The key point is that if the bulls can get everyone marching in formation together for a protracted period, they end up consuming all of their energy after a while, and cannot keep the band together. A corrective period is the natural remedy, and one is due now.

Bottom Line: We are now out of the bullish phase of the Presidential Cycle, and getting ready for a meaningful decline starting in a few weeks, and bottoming in October.



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TIMING MODELS

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

	Signal	Source	Predicted	Actual
	Top	DJIA ST Price Osc	July 7	July 6
	Top	DJIA Price Osc	July 8	July 6
	Bottom	DJIA Price Osc	July 8	July 7
	Bottom	DJIA Close/Sum	July 11	July 7
	Bottom	Uncommon A-D Osc	July 27	
A	Bottom	NYSE Vol. Summ	Aug 3	
A	Bottom	DJIA ST Price Osc	Aug 3	
A	**Bottom**	**SP500 Price Osc**	**Aug 4-5**	
	Bottom	Uncommon A-D Osc	Aug 15	
	Bottom	**SP500 Price Osc**	**Aug 22-23**	
	Top	Nasdaq Up-Dn Osc	Aug 26	
	Bottom	NYSE A-D Osc	Aug 29	
	Bottom	SP500 Close/Sum	Sep 22	

Experimental Indicator, "BC"

	Predicted Signal		How It Turned Out
	Implied Top	July 4	Top July 1
	Implied Top*	July 22	Top July 20
A	Volatility Event	Aug 3	
	Implied Bottom	Sep 14	
	Implied Top	Oct 2	

*This signal from BC's big brother, see p. 2

Treasury Bond Prices

Signal	Source	Predicted	Actual
Top	T-Bond Stochastic	July 13	July 11
Bottom	T-Bond Close/Sum	July 14	July 18
Top	T-Bond ST Price Osc	July 26	
Top	T-Bond Up-Dn Osc	July 27	
Bottom	T-Bond Up-Dn Osc	Aug 12	

Gold and Precious Metals Stocks

Signal	Source	Predicted	Actual
Top	Gold ST Price Osc	July 7	July 6
Top	**Gold Price Osc**	**July 25**	July 21
Top	GDM ST Price Osc	July 27	
Bottom	**Gold Price Osc**	**Aug 17**	
Bottom	**GDM Price Osc**	**Aug 22**	
Top	Gold ST Price Osc	Aug 23	
Top	Gold Up-Down Osc	Aug 24	

The Signals

The big news is that the top signal from BC's Big Brother that we wrote about in our last Report seems to have come in right on schedule. That top was curiously not identified by our regular Timing Model signals.

Those signals did correctly mark the top we saw at the beginning of July, and they do offer confirmation of a special type of signal for the BC Indicator known as a "volatility event". We call it that because when there are those little wiggles in the BC Indicator (see MMR 510), there tends to be a jump in volatility which is otherwise hard to characterize.

As we look at these signals, it is worth keeping in mind that the Democratic National Convention is underway as we write this, with renewed calls for business-unfriendly tax hikes and minimum wage hikes. And the FOMC just started a 2-day meeting on July 26, with the post-meeting announcement due out in the afternoon of July 27. That announcement could have a weight on how these signals play out.

An action on rates by the FOMC, or even an adverse comment, could help to nudge the stock market out of the very narrow range we have seen over the past 2 weeks, and could help fulfill that Aug. 3 "volatility event".

And that volatility event from our experimental BC Indicator coincides with a cluster of bottom signals due Aug. 3-5 from our conventional signals. The bold-letter designation on one of those indicates that the nature of that signal is similar to other big ones in the past that have had greater importance for stock prices. So get ready for the market to get more exciting!

What To Expect

Stock prices drop after the July 27 FOMC meeting announcement. We don't know what they are actually going to say, just that the market is set up to not appreciate whatever it is. Volatility should rise into a climax due Aug. 3-5. Another important looking bottom is due Aug. 22-23, so far coming from only one signal and not yet confirmed by other ones. But gold does show a bottom due then as well.

T-Bonds have been moving sideways for the past week, attempting to hold support. A top due July 26-27 is likely going to be related to the FOMC meeting announcement, and should be more of a top to go down out of rather than up into.

Gold shows important looking bottom signals due Aug. 17 and 22. Those could be referring to the same bottoming event, as they are actually only 3 trading days apart. But that is not likely to be the final price low for gold's decline into the 8-year and 13-1/2 month cycle lows due later this year.

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**.

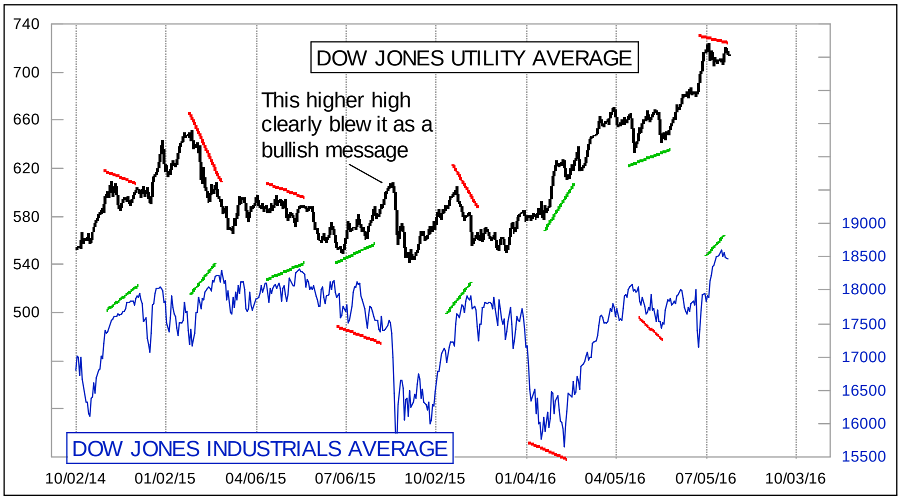
Utilities Divergence Is Bad News For Stocks

Normally the movements of the DJIA and the Dow Jones Utility Average are pretty well correlated. That makes sense, because after all, each is made up of stocks. It is when they disagree with each other that we can get useful information.

Usually when there is a disagreement, it is the DJU that ends up being right about where both are headed. That is important because the DJU made its top back on July 6. The DJIA continued higher and its all-time high (so far) was on July 20, creating the bearish divergence we see now.

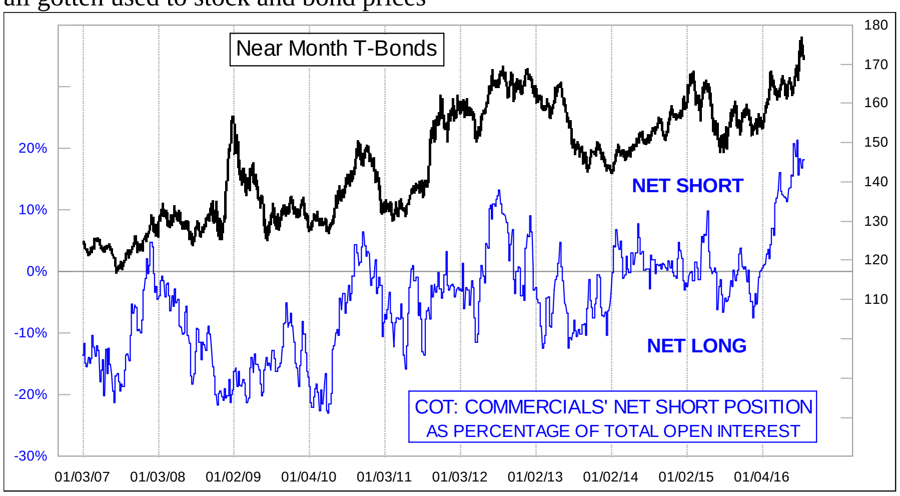
That news is of immediate concern to stock market investors. But it could also mean a big decline for utilities stocks, as the "chase for yield" suddenly becomes not quite so fashionable.

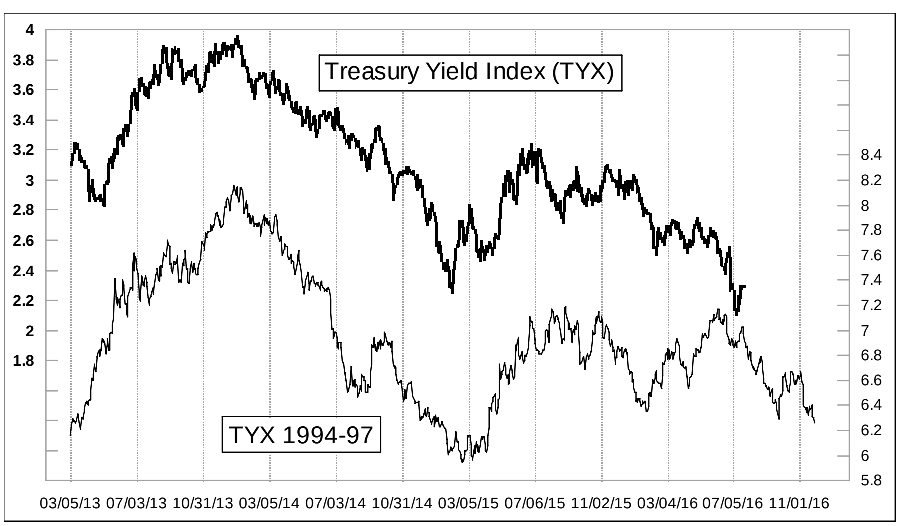
And that leads us to a similar expectation for bond prices. We have all gotten used to stock and bond prices



doing the opposite of each other, but we foresee a likelihood of both types of assets falling in price over the next 3 months or so.

One big reason is the data in the Commitment of Traders (COT) Report, the highlights of which we feature every Friday in our *Daily Edition*. The "commercial" traders are the big money, and usually also the smart money. They





recently moved to a new all-time high net short position in T-Bond futures, evidently betting on a big drop for bond prices.

The commercials are often early in getting to a big skewed position like this. But they are nearly always proven right when they do (eventually). So the message to take from this is that bond prices really have no business being up this high, and are going to have to do something to remedy that.

There is one fly in the ointment for that hypothesis, though. The bottom chart shows a comparison of the current plot of the Treasury Yield Index (TYX) versus that same index from a period in the 1990s. There is an impressive pattern correlation between the two.

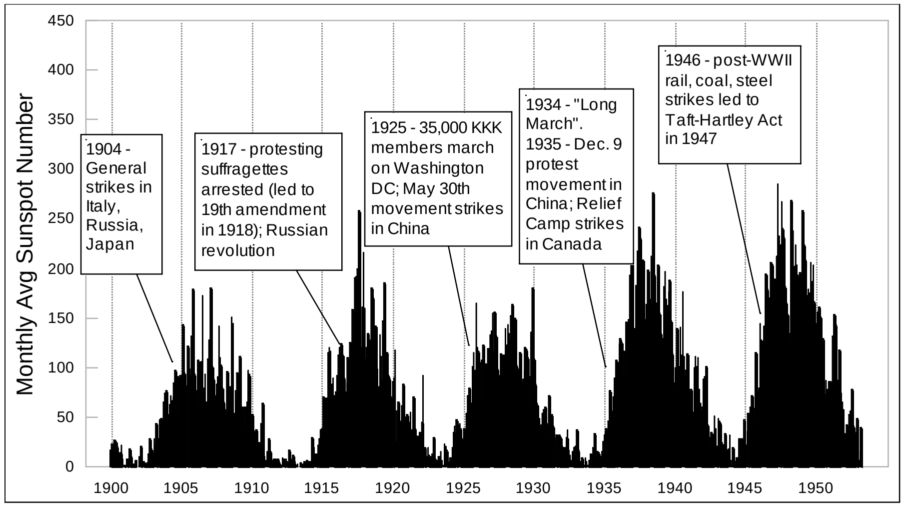
If that pattern correlation is going to persist into the future, then that would mean the TYX should fall further from here. The TYX measures the current yield-to-maturity of the most recently issued 30-year Treasury bond. So for the TYX to go lower as indicated, then bond yields would have to fall, and bond prices rise.

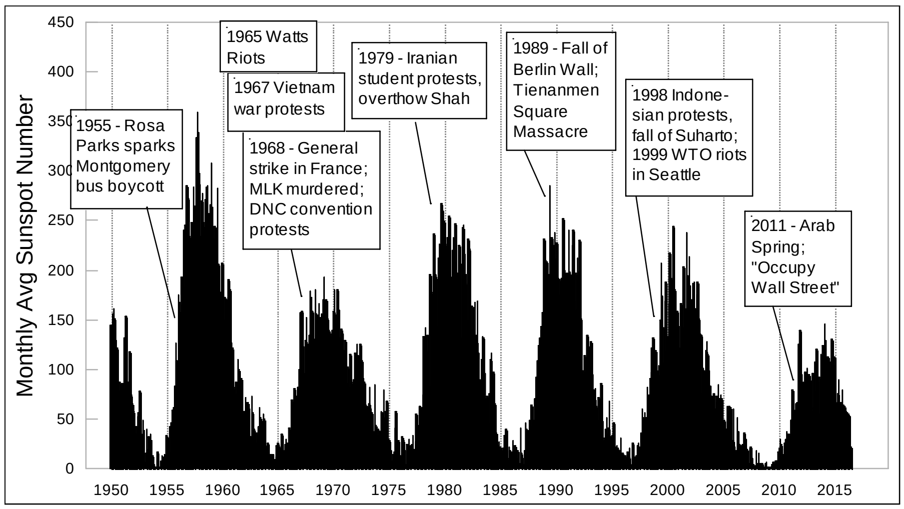
That is in conflict with the message from the COT data, and so we have a quandary. The two cannot both be right. Our preference is to follow the COT data, because pattern analogs like this can and do break correlation, and usually a the moment when one is most fervently counting on it to continue working.

Perhaps if the world's central banks realize that ZIRP is killing Deutschebank and other major banks, they'll let up, and allow rates to normalize again.

Bottom Line: Commercial traders are making a huge bet now on lower bond prices (higher yields). They are usually right.

2016 Protests Not Likely to Have Lasting Significance





2016 has seen a lot of protests in the news, or so it seems. The two major parties' presidential nominating conventions have seen some protests, which is pretty typical. There are also the protests over police shootings by groups like "Black Lives Matter", and counter-protests in support of police.

But these protests are not likely to have lasting historical significance. We say that because the really significant protest movements in history, movements which led to actual change in policy or practice, have tended to appear during the ascending phase of the 11-year sunspot cycle. This is a thesis first put forth by Russian researcher A. L. Tchijevsky who correlated instances of wars, revolutions, riots, etc. with the sunspot cycle, going back over 2000 years. He wound up spending a long time in a Russian gulag because his views about what sparked the 1917 Russian Revolution conflicted with those of Josef Stalin.

The first two charts on page 8 show the monthly sunspot number, and the 9-14 year cycle period is fairly evident. Typically we see the major protest movements on the ascending phase of each cycle, and the Arab Spring in 2011 was a great example.

This is not to say that there are not protests at other times in the sunspot cycle. But the point is that protests arising at other times do not typically arouse the same degree of mass support from the public. Something about increasing solar activity seems to work on human brains, increasing our collective uppitiness such that long-festering problems finally come to a head.

Curiously, the rising phase of the sunspot cycle also tends to coincide with rising economic prosperity, and a rising phase for the stock market. And the sunspot minima tend to mark important lows for the DJIA, plus or minus a year.

That's important because the last solar minimum was in 2009. Counting forward by the average 11-year period length gets us another stock market low around 2020. If we use the 9-14 year range of values for the period between sunspot minima, then we get 2018-2023.

One other point worth noting about this relationship is that there is often a major market dip halfway through the sunspot cycle, roughly coinciding with the peak in the monthly sunspot numbers. We did not see a mid-cycle low in the 1920s, as the roaring boom/bubble then painted over it. And we arguably did not see one in the current sunspot cycle, with the Fed's QE programs keeping the market aloft.

Once we get past the next solar minimum in 2018-2023, we can expect another major protest movement to erupt sometime in the mid-2020s. And we can also expect a big boom for stock market prices at the same time. But as we slide into the next solar minimum, the expectations of higher long term stock prices (absent more QE) should be reduced.