THE McCLELLAN MARKET REPORT

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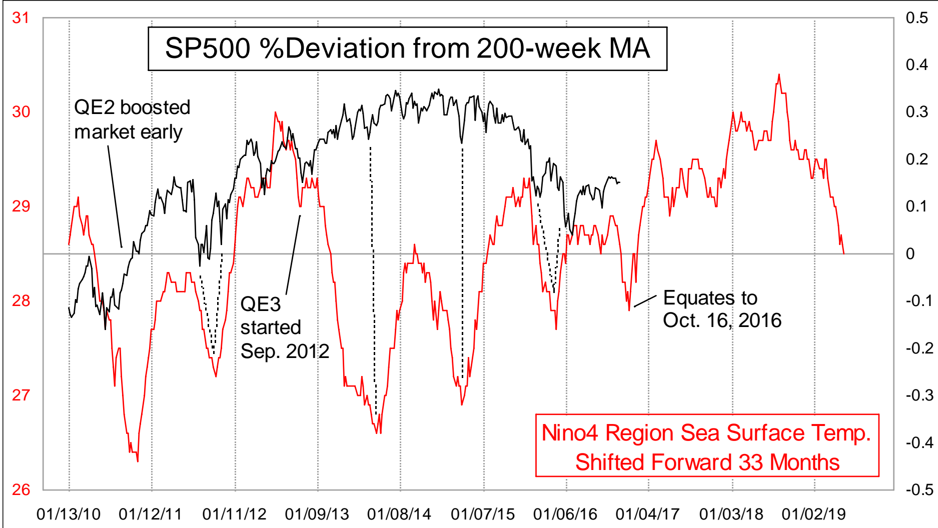
Prepared After the Market Close, September 6, 2016 Report #514, September 7, 2016

3 Big Setups For October Bottom

We have been expecting for some time to see a decline into an October 2016 bottom. This expectation has come from multiple sources, and we are also seeing confirming signs by way of momentum divergences and excessive complacency, saying that a decline ought to happen. So here in one sitting are our 3 big signs telling us about a looming October bottom.

First is the leading indication we get from some interesting climate data. Nino4 is the name of a region of the Pacific Ocean, and its sea surface temperature data is of interest to meteorologists who track El Niños. We have found that it is also really interesting for the stock market, giving a 33-month leading indication for what (detrended) stock prices should do.

It has not always worked perfectly, and the Fed's QE episodes seem to have thrown the relationship off track. But we have tracked the relationship back to the beginning of those temperature data in 1950, and it is a durable relationship.



Just don't ask us to explain why it works. After seeing enough data showing that it does work, one stops worrying so much about the "why".

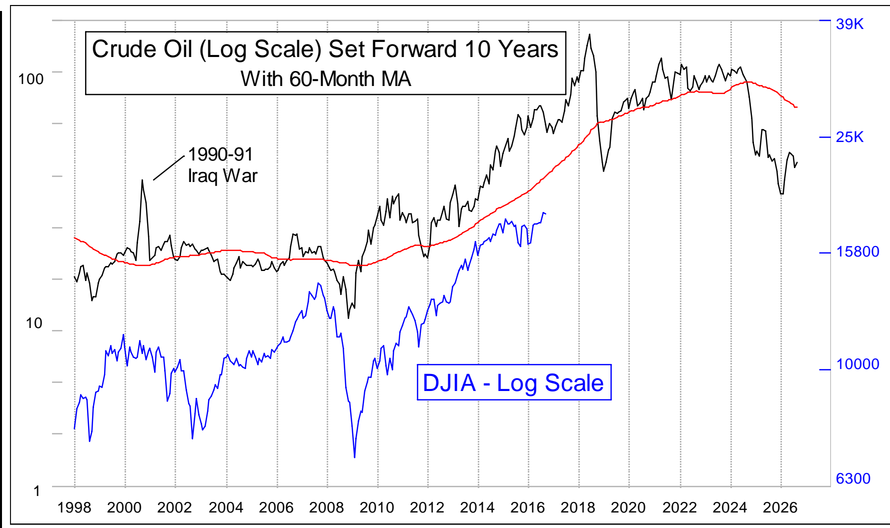
Another relationship we cannot explain but still use is the 10-year leading indication for the stock market that is given by crude oil prices. It has only been working since 1890, so maybe that is not enough "proof" for some people. We are satisfied, though.

The lower chart here on page 1 looks at just the last 18 years of that relationship so that we can better see the detail. We are now at the echo point of a soft spot for oil prices 10 years ago. Oil made a double-bottom in Oct. 2006 and Jan. 2007, before staring the huge rally up to its top at $145/brl in July 2008.

Whether stocks will fully echo that 2008 oil blowoff is somewhat in doubt. It was a strange bubble. Stocks did not fully echo oil's movements during the

BOTTOM LINE

We see bottoms ahead due Sep. 7-8, and Sep. 22-26, with a top somewhere in between. But the real bottom is not due until sometime in mid-October, a date yet to be determined. That should be the big bottom for stocks to go up from, and it should be accompanied by severe fear about the future as most bottoms are. Similar dates appear in our work for bond prices making tops, and gold making bottoms with stocks. Mid-October should see a big bottom for stocks and gold, and this should be that elusive *bottom to go up from*. Stocks and gold should be great holdings for a rally in each into 2017. But now is not yet the moment to catch that falling knife.



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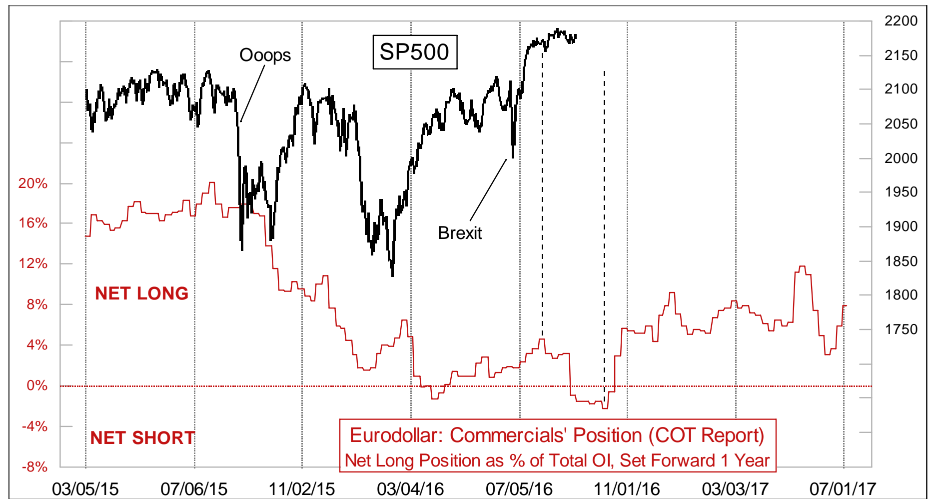
1990-91 Iraq War, nor some of the movements from the Arab Oil Embargo in 1973. So there is some doubt this time, but we are not yet to the echo point of where that blowoff really began.

The final sign pointing to an October low is the leading indication from the eurodollar COT data, shown in the chart on page 3. This too had problems with QE, especially with QE3, and it was thrown off a bit by last summer's China-sparked mini-crash. After a while, though, the market got itself back on track, topping in July-August 2016 on schedule.

Ahead we see the drop to a low due in October, but perhaps more importantly we also see the opportunity for rising stock prices into 2017. The other two charts on page 1 agree with that premise as well, and so that is something to get excited about.

Perhaps a better "story" from a non-technical view is that by October, we will probably have a good idea about who the next U.S. president will be, and so whoever it is will stop being an unknown risk.

Bottom Line: Stock prices should finish up this summer's corrective efforts with a bottom due in mid-October, and should then start a rally that lasts into 2017 or beyond.



Page 3 Charts

Chart 1: The A-D Line is relentless in staying above its 10% Trend, post Brexit. It has jumped up to a new all-time high again this week. This continues to make the statement that there is plenty of liquidity available to the market. Since it isn't coming from the US Fed (their asset holdings are a flat line), it is probably European Central Bank's QE that is making its way over to the US market due to the fragile state of the European economy and its financial institutions. Money flows to where it will find a good home.

Chart 2: The Daily Volume Line confirmed the new highs in the A-D Line by making a higher high itself. It is going to take these two indicators being able to spend some time below their 5% Trends before one can say that the bears have any worthwhile control of the stock market.

Chart 3: The McClellan A-D Summation Index has spent a long time drifting lower with the Oscillator staying negative. But all of that drifting was not able to take the Summation below the Brexit low that was made at the end of June. It was surprising that the break of the uptrend line that can be drawn across the January and June lows was not more damaging than it turned out to be. The NYSE Composite is not anywhere close to the uptrend line that can be drawn across the February and June lows. It will take getting the Summation Index much lower before significant price erosion typically takes place.

Chart 4: The Volume Summation has broken its uptrend line across the January and June lows. but that has not produced its usual bearish result. That will have to wait for this indicator to drop below zero. And to get there requires negative Up-Down Volume action that can drive the Oscillator deeply negative and keep it there for some time. The most that can be said for the bears is that they were able to set up a divergence on this indicator where the higher price highs were made with lower highs on the Summation Index. Usually that is not inconsequential.

Chart 5: The McClellan Oscillator spent 28 days below zero before popping back up slightly above zero. This is an unusually lengthy time to spend below zero, but not close to setting any records. It was the lack of negative amplitude that set this long string apart from other negative strings. These barely negative numbers just were not able to drive the Summation Index enough lower to do damage.

Chart 6: The Volume Oscillator had the same characteristic of lack of amplitude. There have been a couple of times recently where the Oscillator popped above zero without any lasting effect. It could be the same this time. In order for it to be different this time we will have to see some staying power to keep the Oscillator above zero. And we will have to see some positive amplitude. If the Oscillator just drops back below zero, without any positive staying power, it will give the bears an opening to do something useful to take the market lower.

Chart 7: The DJIA Price Oscillator, like the Summations, has broken the uptrend line that can be drawn across the January and June lows. But the bearish implications of this break have been completely missing this time. This indicator will need to drop below zero before price damage will become noticeable. The most that can be said for the bearish camp is that there is divergence between the higher price highs and the lower Price Oscillator tops recently. Were the Price Oscillator able to turn up while still above zero, that would suggest that the DJIA was set up to make a higher high.

Chart 8: The CBOE Volatility Index (VIX) has spent time at very low levels following the Brexit vote. It has recently bounced up to get near to its 50-day moving average. That bounce also caused it to touch the downtrend line that can be drawn across the August and February peaks. That downtrend line and the lower Bollinger Band are squeezing the VIX into a tight space. At some point in the near future the VIX will need to breakout to higher numbers and take the stock prices lower. The VIX typically moves inversely to prices. The very quiet price behavior recently has had the effect of pressing the upper and lower bands closer together. This is usually a prelude to greater volatility to come.

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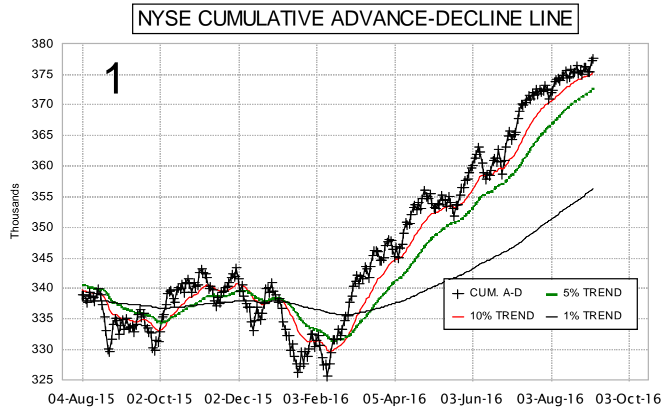

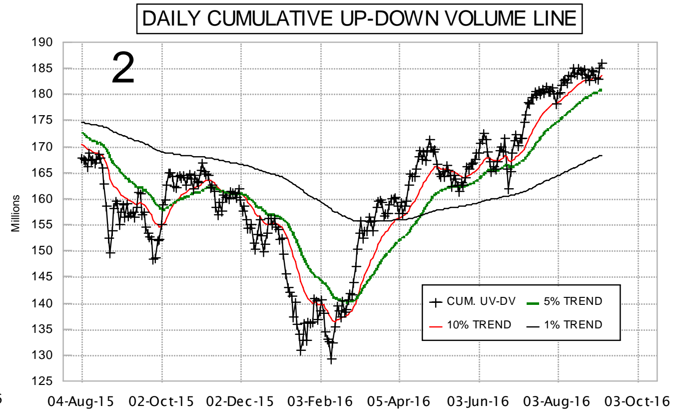

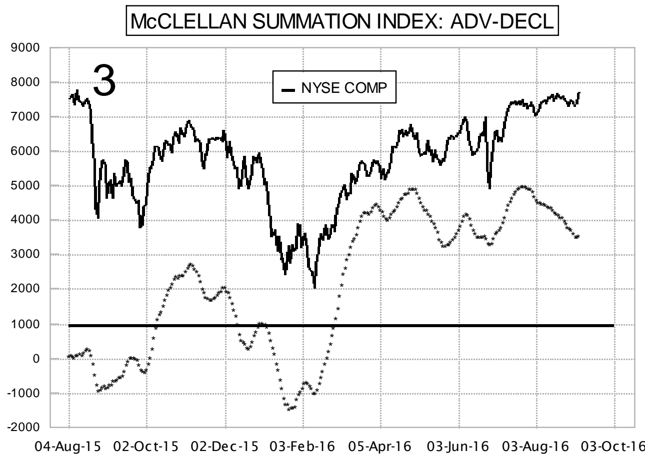

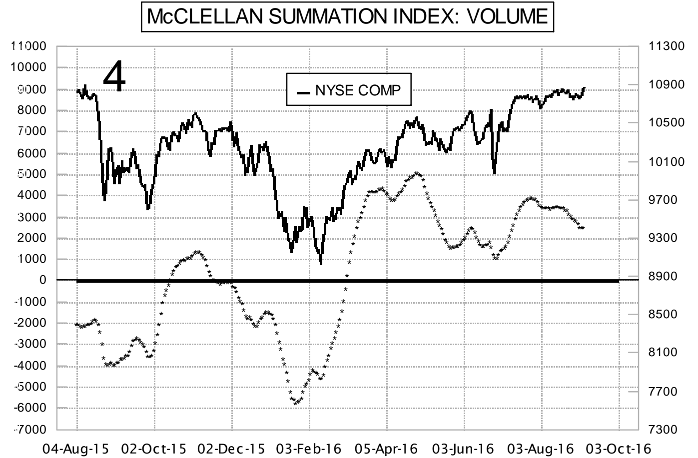

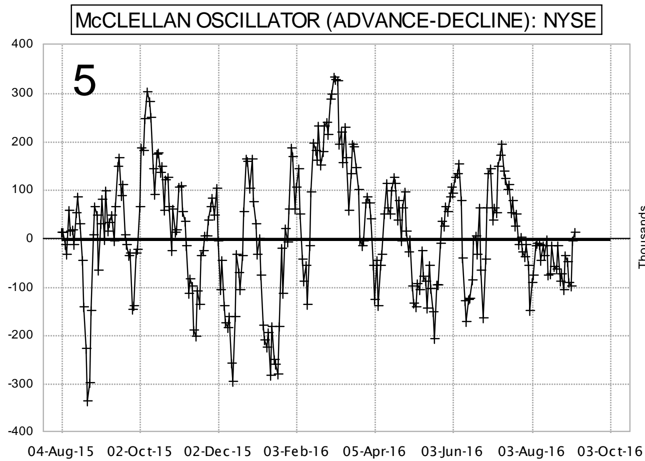

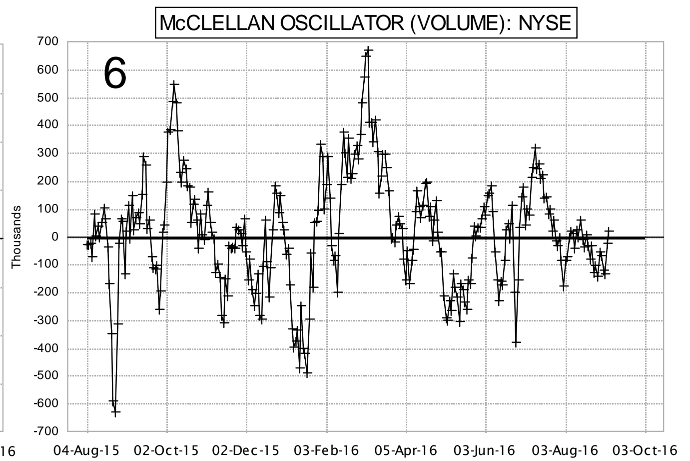

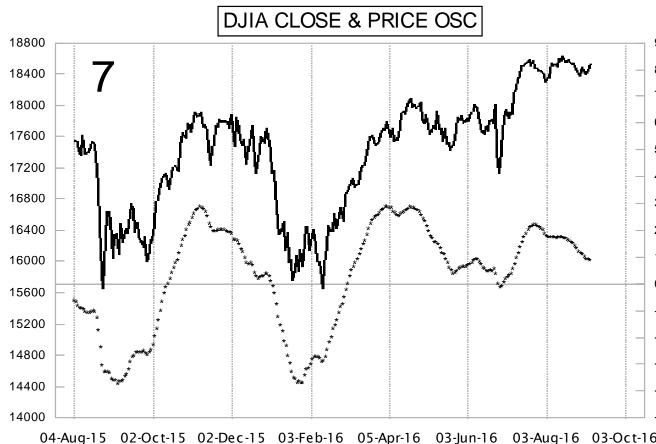

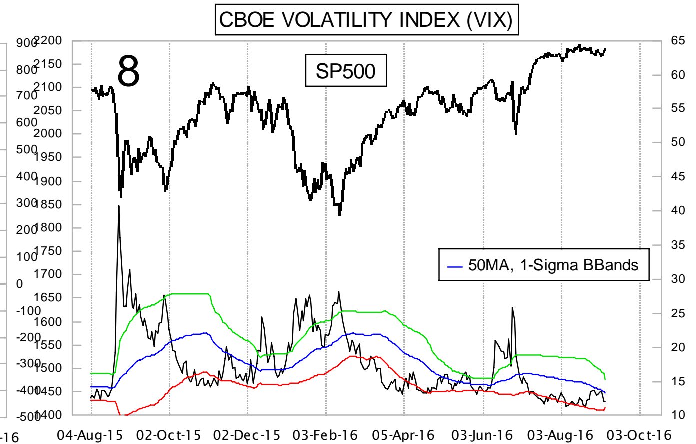

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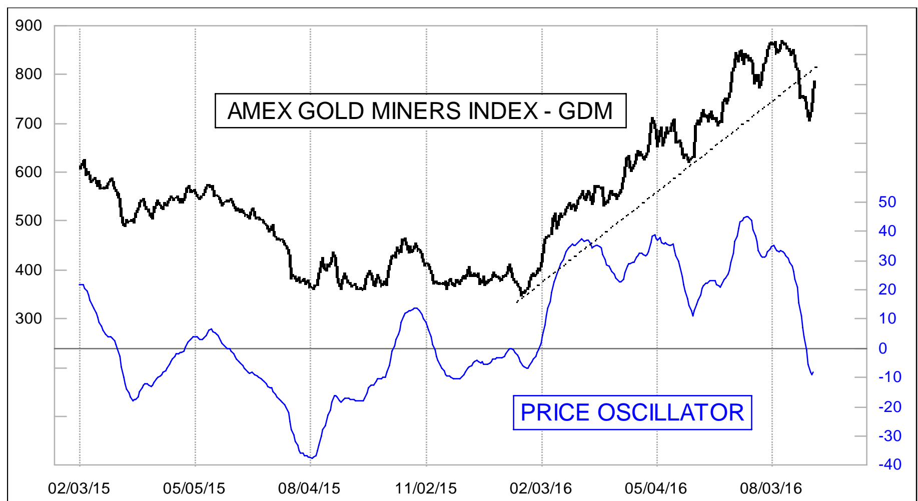
Gold Stocks Finally Correcting

The Price Oscillator for the GDM Index has finally made it back down to below zero, after an abnormally long duration up above the zero line. It helps in such an effort to have an uptrend that sees prices more than double.

But now the Price Oscillator is back below zero thanks to a strong decline that broke the rising bottoms line. Along the way, there was also a divergent lower Price Oscillator top as the GDM Index was making its final price high. Eventually this is going to set things up for the next uptrend opportunity, most likely at the 13-1/2 month cycle low for gold prices that is ideally due in October.

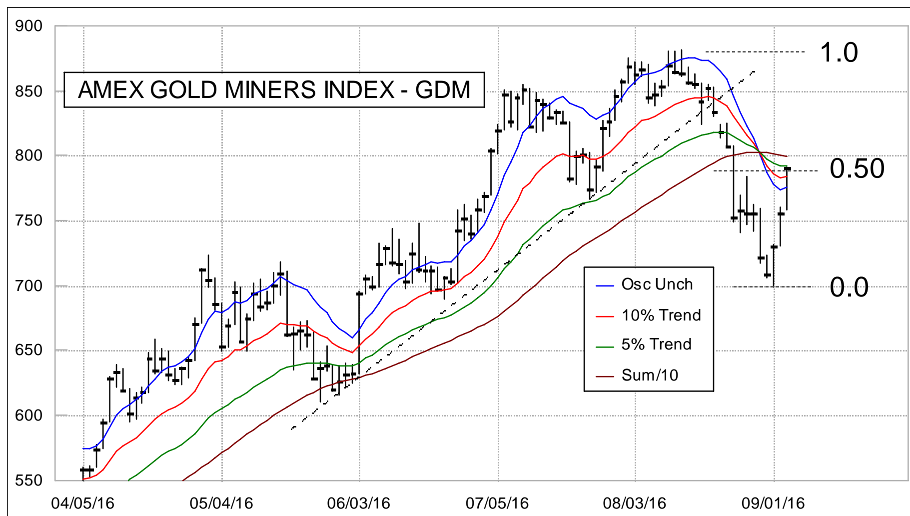
The act of having the Price Oscillator cross through zero can be seen in the middle chart. It is of a type often featured in our *Daily Edition*, where we focus on shorter term situations.

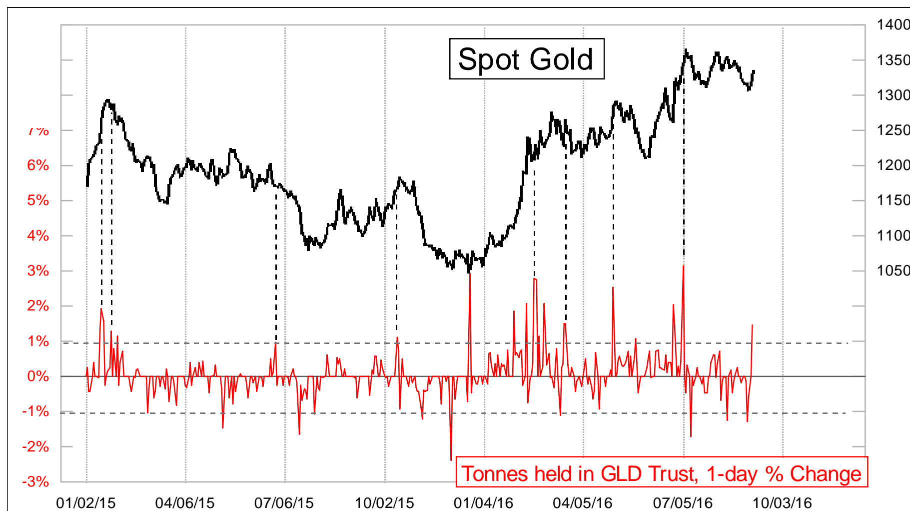


The Price Oscillator is measured as the difference between the 10% Trend and 5% Trend of closing prices. In more modern terminology, those equate to a 19-day and a 39-day EMA. They are the red and green lines in the chart, the two interior lines among the 4 moving average type lines.

The blue line is the Price Oscillator Unchanged line. A close above it means that the Price Oscillator turns upward. A close below it means the Price Oscillator goes down.

When all of the lines cross, as they did just a week ago, that is the same as saying that the Price Oscillator has gone through zero. Two different ways of seeing the same phenomenon.





The rally of the last 3 trading days has been a 50% retracement of the decline from the Aug. 12 intraday high. That's a normal event after a strong initial drop like this. It was enough of a rally to take the closing price up above the blue Price Oscillator Unchanged line, meaning that the Price Oscillator turns up and the bulls have the momentary presumption of control. But this presumption can be easily reversed if there is a close back below the blue Price Oscillator Unchanged line, an act which would turn down the Price Oscillator. Doing that while it is still below zero would convey the promise of a lower closing low on the ensuing move.

The bottom chart shows an interesting phenomenon related to this Sep. 6 rally in gold prices (and gold mining stocks). The rise in gold prices attracted money into GLD, the largest of the gold bullion ETNs. It was such a large rush that the 1-day rate of change was greater than 1%.

The bottom chart on page 4 shows that these big 1-day changes are pretty rare events, and more importantly they offer us important information when they do appear. The rushes into GLD seem to be more meaningful than the 1-day rushes out of it. Sentiment can be funny that way. People panic out of stocks; they panic *into* gold.

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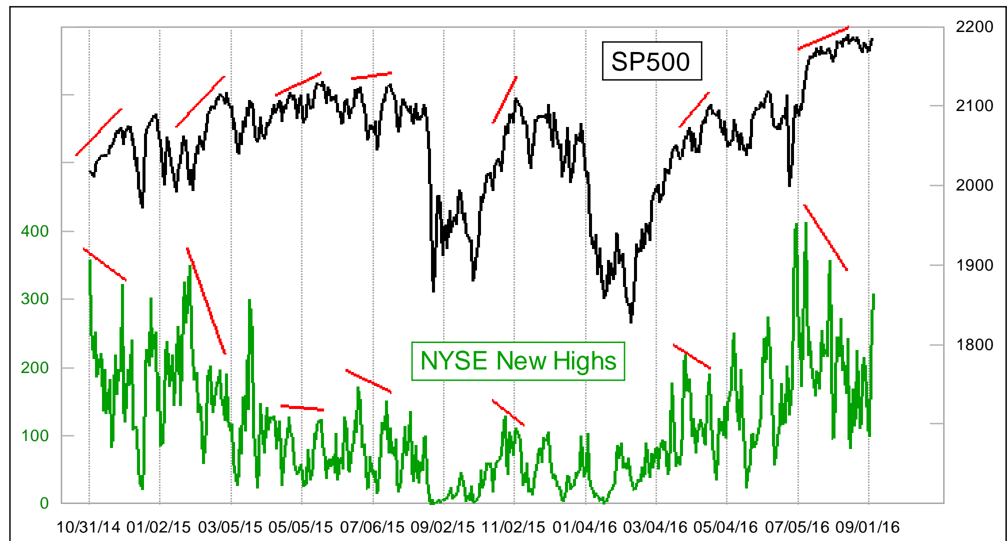
These instances of a one-day change in GLD assets of greater than 1% are reliably associated with important intermediate term tops for gold prices. They do not always work perfectly, but when we get the combination of a 50% retracement on short covering, and a 1-day rush into GLD, all while the commercial traders are still net short gold prices in a big way, it all adds up to countertrend rally within a downtrend.
Bottom Line: Gold has retraced upward within a downtrend, and still has a date with an important cycle low due next month.



New Highs Not Keeping Up

An up day on Sep. 6 saw 310 NYSE-listed issues make a new 52-week high. That is more than on any day since Aug. 1, but still not the size of a reading that we were seeing in July.

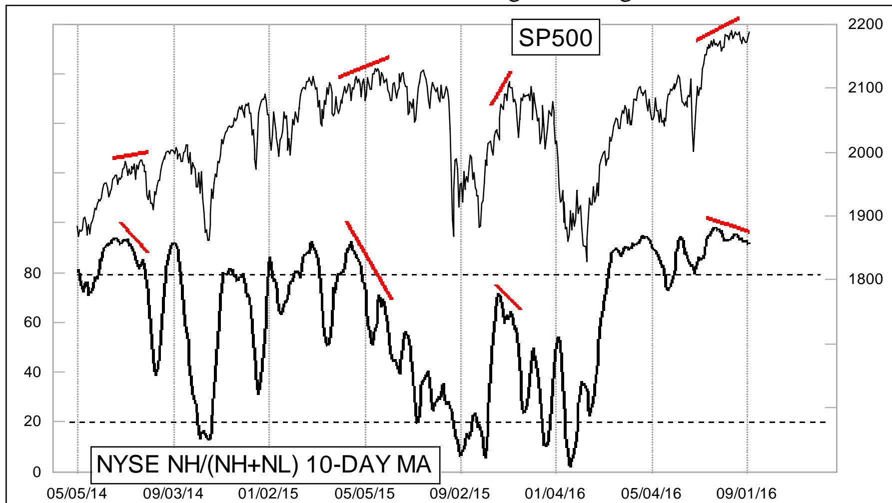
When there is a big divergence between higher highs in the major price indices and a lower high in the number of stocks making new highs, that is a warning of trouble. It says that there is a loss of participation as well as momentum in the advance.

Typically this means that a price decline of 4-5% is in order, or more, but we have not yet seen such a decline in the weeks since this latest divergence. Maybe it is a case of central bank buying of stocks holding the stock market aloft. Or maybe it is a case of a delayed response that is going to bring a bigger whopper of a response once prices are allowed to escape out of this range.

A similar looking divergence is evident in the chart below. This is an indicator created several years ago by money manager and technical analysts Mike Moody, CMT, who now works at Western International Securities but who once worked as a portfolio manager at Dorsey, Wright.

Moody's indicator incorporates the number of new lows as a way of normalizing the amount of new highs, and smoothes with a 10-day moving average. It generally conveys the same message as the raw data about divergences relative to prices, but makes such divergences perhaps easier to see without all of the spikiness of the raw data.

Better buying opportunities are found when this indicator goes (rarely) below the 20 level, on a scale from 0 to 100. Readings above 80 can see continuation of an uptrend, but when there are divergences like the one we have just seen, that typically brings a meaningful and noticeable selloff. So far, we have not gotten that response this time. Maybe this is an exception; maybe the response is still to be forthcoming.
Bottom Line: The bulls won't give up, even though the New Highs data say that they have lost their mojo. A reckoning is coming.



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TIMING MODELS

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

	Signal	Source	Predicted	Actual
	Bottom	**SP500 Price Osc**	**Aug 22-23**	Aug 26
	Bottom	DJIA ST Price Osc	Aug 25	Aug 26
	Bottom	SP500 ST Price Osc	Aug 25	Aug 26
	Top	Nasdaq Up-Dn Osc	Aug 26	Aug 29
	Bottom	NYSE A-D Osc	Aug 29	Aug 31
	Bottom	SP500 Up-Dn Osc	Aug 31	Aug 31
	Top	Nasdaq A-D Osc	Sep 1	
A	Bottom	Nasdaq ST Price Osc	Sep 7	
A	Bottom	Nasdaq A-D Osc	Sep 7	
A	Bottom	Uncommon A-D Osc	Sep 8	
	Bottom	NYSE Volume Osc	Sep 13	
	Top	DJIA ST Price Osc	Sep 16	
	Top	Uncommon A-D Osc	Sep 20	
B	Bottom	SP500 Close/Sum	Sep 22	
B	Bottom	Nasdaq Up-Dn Osc	Sep 22	
B	Bottom	DJIA Close/Sum	Sep 26	
B	Bottom	DJIA ST Price Osc	Sep 26	
	Top	NDX A-D Osc	Oct 7	
	Top	DJIA Up-Dn Osc	Oct 11-12	
	Bottom	SP500 ST Price Osc	Oct 12-13	
	Top	Nasdaq A-D Osc	Oct 20	
	Top	SP500 ST Price Osc	Oct 21	

Experimental Indicator, "BC"

Predicted Signal		How It Turned Out
Volatility Event	Aug 3	Bottom Aug 2
Implied Bottom	Sep 14	
Implied Top	Oct 2	
Implied Bottom	Oct 24	

Treasury Bond Prices

	Signal	Source	Predicted	Actual
	Top	TYX ST Price Osc	Aug 26-29	Aug 26
	Bottom	T-Bond Stochastic	Sep 1	Sep 1
A	Top	T-Bond ST Price Osc	Sep 6	
A	Top	TYX ST Price Osc	Sep 8	
	Bottom	T-Bond ST Price Osc	Sep 14	
	Top	T-Bond Up-Dn Osc	Sep 20	
	Bottom	TYX Close/Sum	Sep 23	
B	Top	T-Bond ST Price Osc	Sep 26	
	Bottom	T-Bond Up-Dn Osc	Oct 3	

Gold and Precious Metals Stocks

	Signal	Source	Predicted	Actual
	Bottom	**GDM Price Osc**	**Aug 22**	Aug 24
	Top	Gold ST Price Osc	Aug 23	Aug 25
	Top	Gold Up-Down Osc	Aug 24	Aug 25
	Bottom	Gold ST Price Osc	Sep 1	Aug 31
A	Bottom	Gold Up-Down Osc	Sep 6	
	Bottom	Gold Close/Sum	Sep 9-12	
	Bottom	Gold ST Price Osc	Sep 12	
	Bottom	GDM ST Price Osc	Sep 14	
	Bottom	GDM Close/Sum	Sep 16	
B	Bottom	Gold Price Osc	Sep 23-26	
	Bottom	**GDM Price Osc**	**Oct 19**	

The Signals

Even as the major indices continue to chop sideways, the picture for September and October is starting to get clearer. September the more so from these signals; more time will allow the price and breadth indicators to make October more clear for us.

What is clear now is that Cluster A says a bottom should arrive this week, i.e. Sep. 6-8. But then the relief should be limited, as another bottom is due Sep. 22-26.

The interesting point is how those same dates show up in both gold and T-Bonds. The price action in T-Bonds has a more reliable long-term inverse relationship to stock prices, but recently gold has fallen into step with bond prices. That's abnormal, and we expect gold to fall back into its sometime correlation to stock prices.

That expectation makes sense when cluster B shows stock prices bottom signals Sep. 22-26, a time when T-Bond price signals show a top due Sep. 26. And a signal from gold's Price Oscillator says that there should be a bottom due Sep. 23 to 26.

What To Expect

The two big clusters of **stock** signals (A & B) show bottoms for stock prices Sep. 7-8 and Sep. 22-26. Equivalent signals also appear in the other markets, with bottoms for gold and tops for bond prices (which usually move inversely to stock prices on short term time scales).

In between, stocks should have a top due around Sep. 16-20. Gold does not show that top in its signals, although it may still appear. When only bottom signals are shown, we have to infer the intervening top somewhere between the bottoms.

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**.

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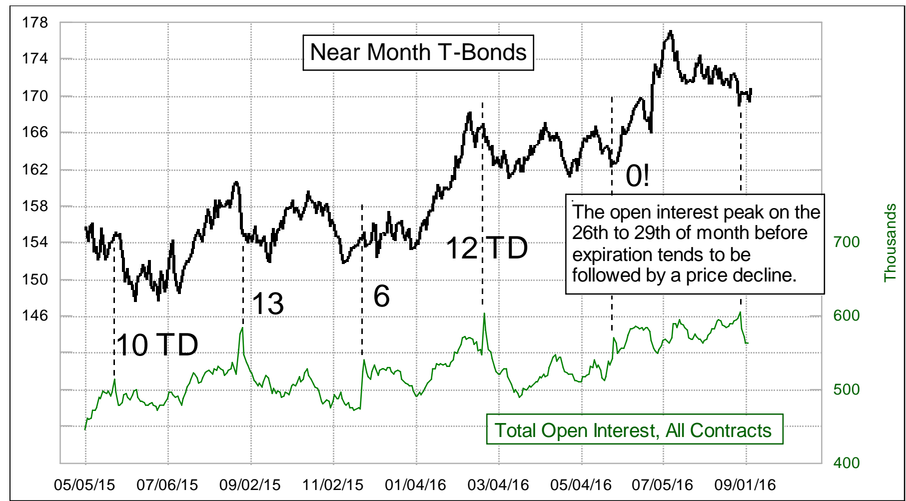
T-Bond Open Interest Peak

We reintroduced a topic in our last Report, something that we have been tracking for a long time. Every quarter, just before the active T-Bond futures contract month is about to expire, there is a peak in total open interest among all T-Bond futures contracts. For a few years now, those open interest peaks have marked a temporary price peak which has been followed by a price decline lasting anywhere from 4 to 16 trading days.

The last quarter's instance was a total bust, and proved that nothing works perfectly all the time. Open interest saw its quarterly peak right on schedule, but prices did not follow suit and make a price decline. Instead we saw a continuation of the rally right up into the July 8 top. That one was a great example of how a perfectly good signal can go bust.

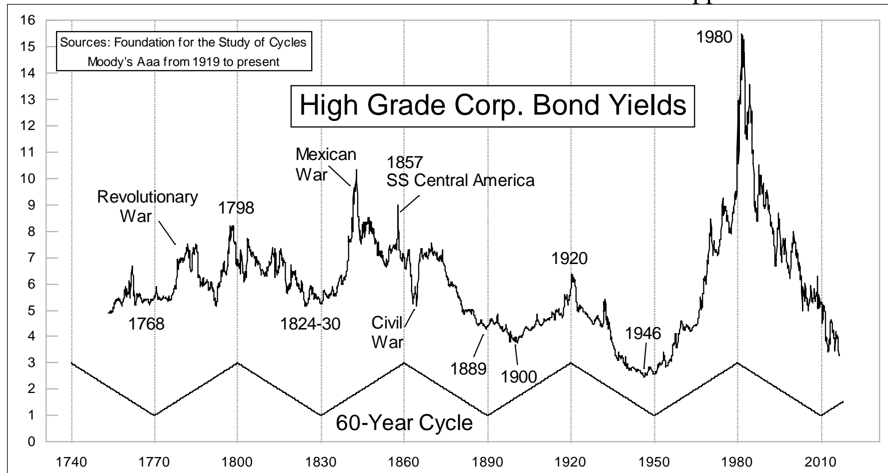
Now we are seeing another instance, with an open interest peak on Aug. 29, which is right on schedule.



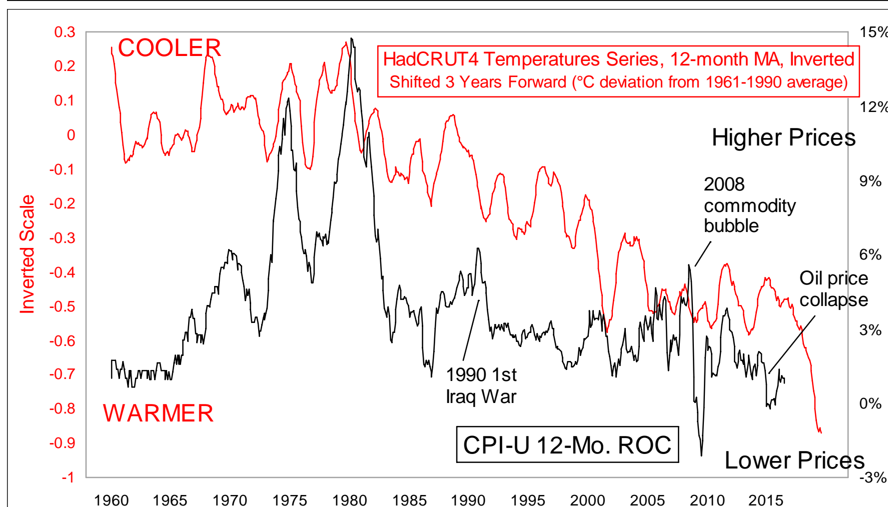
The newly active December T-Bond futures contract declined for 4 trading days, before jumping on Sep. 6 on the news of a weak ISM non-manufacturing number.

So was that it? Is that all of the decline we get from the open interest peak? That's hard to answer at this point. The usual duration of a decline after an open interest peak is longer, but we have seen them happen for this short duration before, including last time.

One point that we need to remember is that bonds are living on borrowed time right now. The 60-year cycle in interest rates says that we should have seen a yield bottom (price peak) in 2010, as shown in the middle chart. But the yield bottoms are generally not as punctual as the yield peaks. The bottom in 1946 was 4 years early. The bottom in 1900 was a full 10 years late. And yet the cycle still works and exists.



At some point the bond market is going to realize that it has partied past curfew, and is going to work extra hard to make up for lost time en route to the yield top due in 2040. But we are not at that point right now. With central banks buying up government and corporate debt, and now lately also buying up stocks and ETFs, the real market forces are not being allowed to work. It is hard to imagine that condition being allowed to persist for very long.



That said, the bottom chart shows that we are not yet done with low inflation, and thus low interest rates. Warmer global average temperatures equal lower inflation rates, thanks to better food production from the warmer temperatures and thus lower overall price inflation. History shows that there is about a 3-year lag between changes in global average temperatures and the equivalent changes in the CPI. The big El Niño event of 2015 means low prices lasting into 2018, and thus a prolonged delay in inflation and bond yields getting up off of the floor.

Bottom Line: For the very short term, a price decline is due thanks to the quarterly pattern of open interest peaks. But bonds are not likely to respond to the higher-yield mandate of the 60-year cycle until after 2018.

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Presidential Polls Update

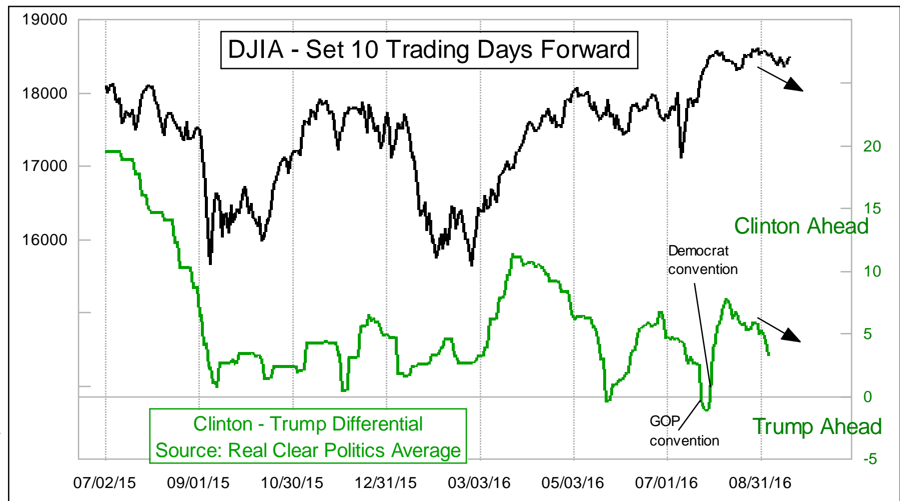
We have been tracking the relationship between the stock market and the presidential poll numbers since the 2000 election, and the relationship continues to "work". The movements of the DJIA tend to get repeated some number of days later in the poll numbers, with a drop in stock prices hurting the incumbent party candidate, and helping the challenger.

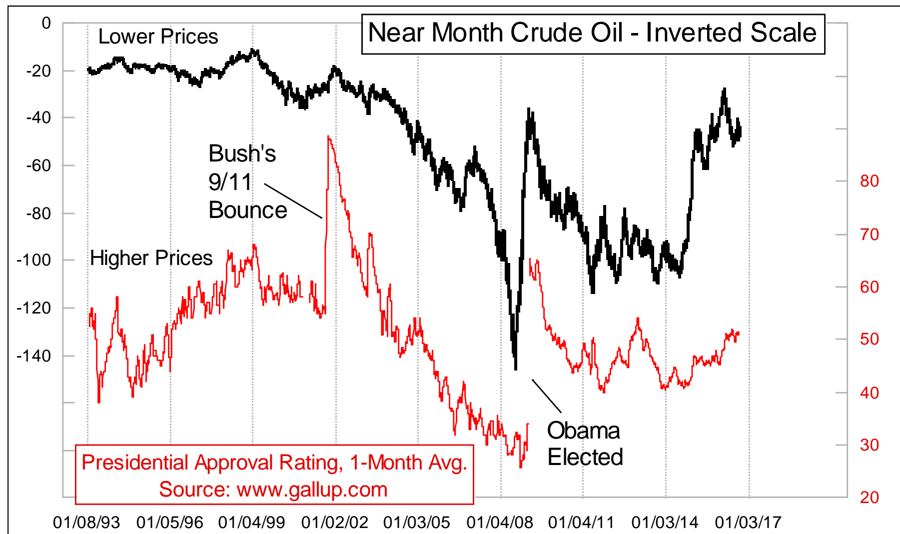
The top chart includes data on the RealClearPolitics.com average of recent poll numbers. Because that average adds its own lag, including polls released over the prior several days, it is currently running about 10 trading days (2 weeks) behind the DJIA's movements.

The DJIA peaked on Aug. 15, and has been gently trending downward since then. The recent change in the poll numbers is now reflecting that change in the public's mood which the stock market has already reflected. The RCP average does not yet reflect some recent network polls which show Trump actually ahead by a couple of points. Those will be having their effect on the average over the next few days.

It might be reasonable to think that Secretary Clinton's poll numbers would match President Obama's job approval numbers, since she is arguably running for a 3rd Obama term. But the history of the election poll numbers shows that it does not really work that way.

The most interesting finding in studying these data for a couple of decades is that the job approval numbers seem to be tied to oil prices. The middle chart shows crude oil futures prices on an inverted scale, to better illustrate the correlation to the job approval ratings. As oil prices go higher, gasoline prices follow, and the public seems to blame whoever is in the White House. President Obama's recent rise to over 50% approval is thus a reflection of the big drop in oil prices since 2014.

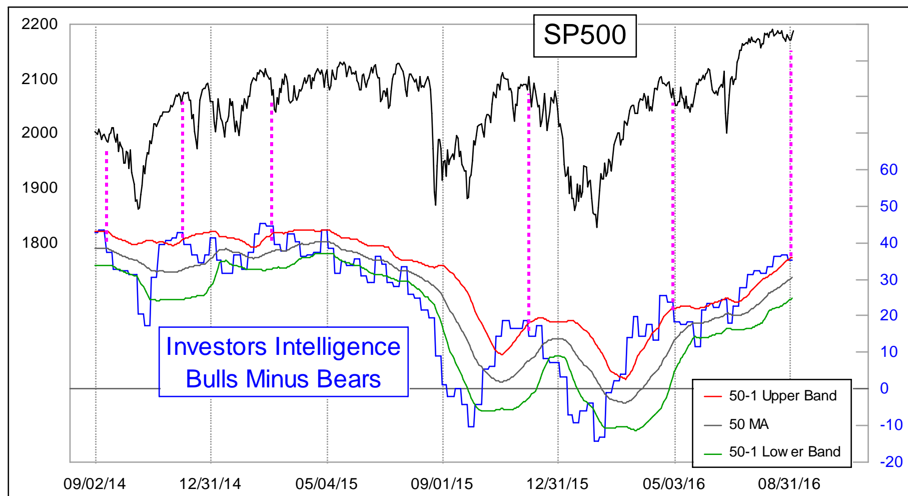




That seems like an awfully simplistic model to explain how people view the president's job performance. But it has been working pretty well since at least 1993 (earlier data are harder to come by).

Speaking of opinions, the data from Investors Intelligence show us something interesting in the bottom chart. The most recent survey shows 55.9% bulls and 20.6% bears, for a spread of 35.3pp. But that spread has dropped just slightly, and has now slipped just below its upper 50-1 Bollinger Band.

The dashed vertical lines help to show that a drop below the upper band can be an important "tell", especially when it occurs with the spread at a high level like this. The outcome does not necessarily have to be a severe decline, but these crossings do seem to mark meaningful inflection points for stock prices.



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