

Wealth Creation and Preservation

Hot Topics: MARKET OUTLOOK

The most important page at www.WCandP.com

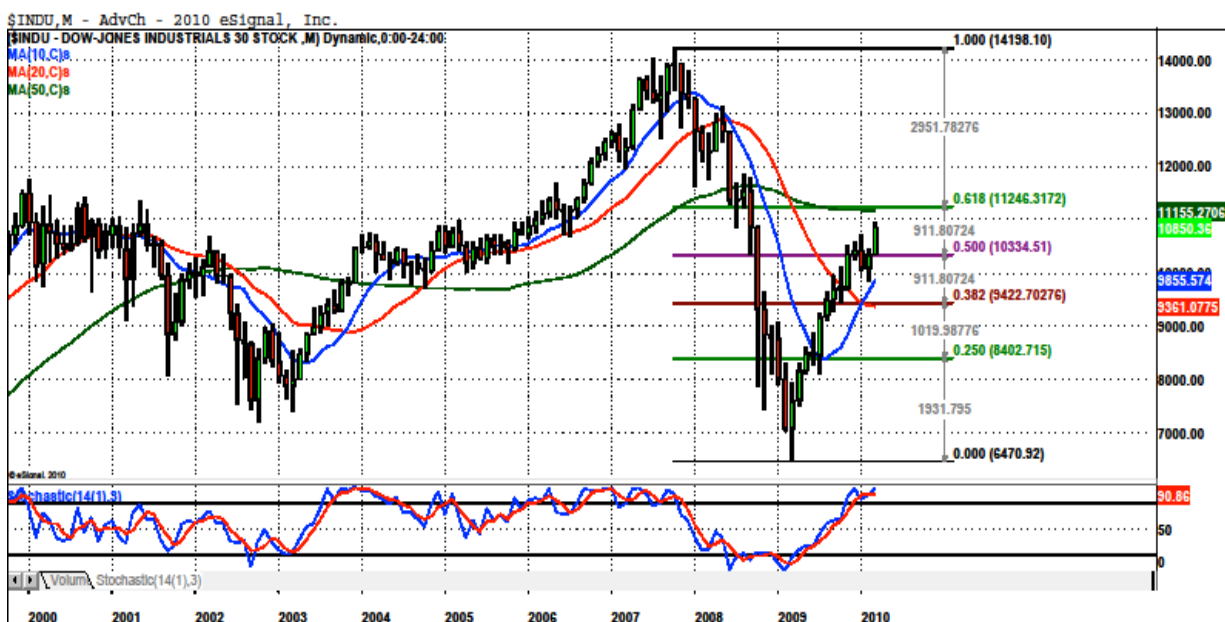
Information for non-subscribers

Updated 27 March 2010

NOTE: A new strategy is discussed at the end of this article.

Wave 3 Down may have been postponed – but that doesn't mean it isn't coming

Please take a look at the following chart, provided by eSignal:



This is a Monthly chart of the Dow Jones Industrial Average. Each red or green vertical bar represents one month of trading, and this chart shows a little more than 10 years of trading in all. In this instance the old and it is true that "a picture is worth a thousand words".

The first thing that literally jumps off the page is the speed at which the market fell between late 2007 early 2009, compared with the "great crash" of 2000-2002 that devastated so many investors. That latter market decline did not trace out a very good Elliott wave pattern, but the more recent crash certainly has.

I have inserted a Fibonacci relationship indicator which shows the top and bottom of the market and the amount to which the market has retraced its decline. In a normal Elliott wave, retracements will and somewhere between 38.2% and 61.8% of the distance covered by the previous wave. As you can see, the Dow has now retraced a just under 61.8% of its decline, and therefore is free to begin falling in Wave 3 at any moment. Ever since the Dow had retraced 50% I had said that it was ready to fall, but

it is often true of markets that they will go to extremes of optimism or pessimism before they finally turn. That way, many more investors and much more money are sucked in right at the peak - which is why so many people lose money in the markets.

Of course, any item that you happen to track may or may not form valid Elliott waves at any particular points along the way. The Dow could certainly move to a non-Elliott pattern and remain there for an indefinite period. Such a possibility must always be considered, which is why we don't utilize Elliott wave analysis by itself. We look at numerous other technical factors and we look at the fundamentals.

Look at the Stochastics on the bottom of this chart, and noticed that they continue in the overbought area very close to the maximum of 100. This does not mean that the market *must* turn in the very near future; as you can see in the period 2006 to late 2007, the stochastics remained in the overbought area for the entire period. (See *Moneywise*, page 188).

The fundamental argument is much more difficult to make because the market is being manipulated by government, the Federal Reserve, banks, and institutional investors all over the world. There are trillions of dollars sitting in cash earning almost no interest at the moment, all of which could push the market significantly higher if they were to be thrown into the market. On the other hand, if we look at confirmations or non-confirmations from other indexes, we find that there are numerous non-confirmations which would indicate that the Dowse trend may be an anomaly.

According to fundamental analysis, stocks are expensive. Personally, I am much happier selling stocks today than I am buying. The charts indicate many stocks which appear to have peaked and are just waiting for the moment when they begin to fall. I am always happy to sell stocks when I have nice profits to people who are desperate to buy them, and that is a situation which we find ourselves today.

All of these things cause me to fall back on my Elliott wave analysis, and based upon that analysis it is my decision to retain and add to our inverse ETFs and, as the market begins to turn down, our DIA puts.

The strategy for Wave 3 down

There are numerous ways in which you can approach a Wave 3 down scenario. You can move all of your money to cash; unfortunately cash isn't paying anything these days, and the value of your money declines steadily because of inflation. The alternative is to use an effective hedging strategy, where you position yourself to make money regardless of the direction of the market. Such a strategy is not easy to maintain, and it requires active, consistent management to make it work. With the tools available to us today, however, it can be done. Here's what I am doing for my clients right now:

(The remainder of this article is available only to subscribers to *Wealth Creation and Preservation*. To obtain your own subscription please click on the Our Newsletter button on the website. Charles' clients will receive *Wealth Creation and Preservation* at no cost.)