



**STOCK
TRADER'S
ALMANAC**

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THURSDAY, DECEMBER 1, 2011



BULLISH

Thursday
December 1,
2011

First Trading Day in December, NASDAQ Up 18 of 24, Down Three Straight 2006-2008

Dow: 57.1% S&P: 61.9% NAS: 71.4% R1K: 66.7% R2K: 66.7%

"Oil has fostered massive corruption in almost every country that has been "blessed" with it, and the expectation that oil wealth will transform economies has lead to disastrous policy choices."

—Ted Tyson (Chief Investment Officer, Mastholm Asset Management)

NEUTRAL

Friday



Monday



Tuesday



Wednesday

Three Peaks And A Domed House And Other Lindsay Timing Models

By Ed Carlson, CMT

[Editor's Note: I am thrilled to bring you Ed Carlson's viewpoint on the current technical picture of the stock market with respect to the many models of the late, great technician, George Lindsay. Ed's new book, [George Lindsay and the Art of Technical Analysis: Trading Systems of a Market Master](#), is the Best Investment Book of the Year for the Stock Trader's Almanac 2012. Ed is arguably the foremost authority on the Lindsay method of technical analysis and has given us new insights into these useful market forecasting tools.

Ed provides a different take on the Three Peaks and a Domed House Pattern that we have been tracking since September 2009. Though his forecast uses much more detailed technical analysis and he reaches a slightly different conclusion his outlook is rather similar to ours. Our analysis is for a bit more upside over the next few months near the 2011 highs before we take out the October 3 lows. However, we agree in general with Ed's view that the next low point is likely to occur in the March-September 2012 timeframe.

In addition to his current analysis and the in depth explanations of the Lindsay methods in his book, Ed provides some fabulous history in the book and on his website, including some great video clips of Lindsay on Wall Street Week]

Lately, there has been a lot-o-chatter in the blog-o-sphere that the highs of February, April/May and July were the three peaks of George Lindsay's Three Peaks and a Domed House (3PDh) pattern. If that is true, then, by definition, the bull market is ongoing and there are higher highs in the offing. I disagree. Even if we see a new high beyond the May 2, 2011 intraday high, this interpretation, at best, represents a fundamental misunderstanding of Lindsay's work.

Higher Highs?

The rally since the closing low on October 3 is best described as a Right Shoulder (see Figure 1). While Right Shoulders are often thought of as a normal part of 3PDh patterns, they are better described as "often appearing" during a 3PDh (as opposed to being an integral part of the pattern). A Right Shoulder is expected but not required in a 3PDh (Lindsay's work contains many guidelines but few rules). Right Shoulders exist independently of the 3PDh pattern. Similar examples of the top of a 3PDh being followed by a large Right Shoulder can be seen at the high of 3/10/37 followed by the Right Shoulder of 8/14/37 as well as 6/14/48 – 10/22/48, 1/5/53 – 3/17/53, and 12/3/68 – 5/14/69.

Figure 1 ([Click to enlarge](#))

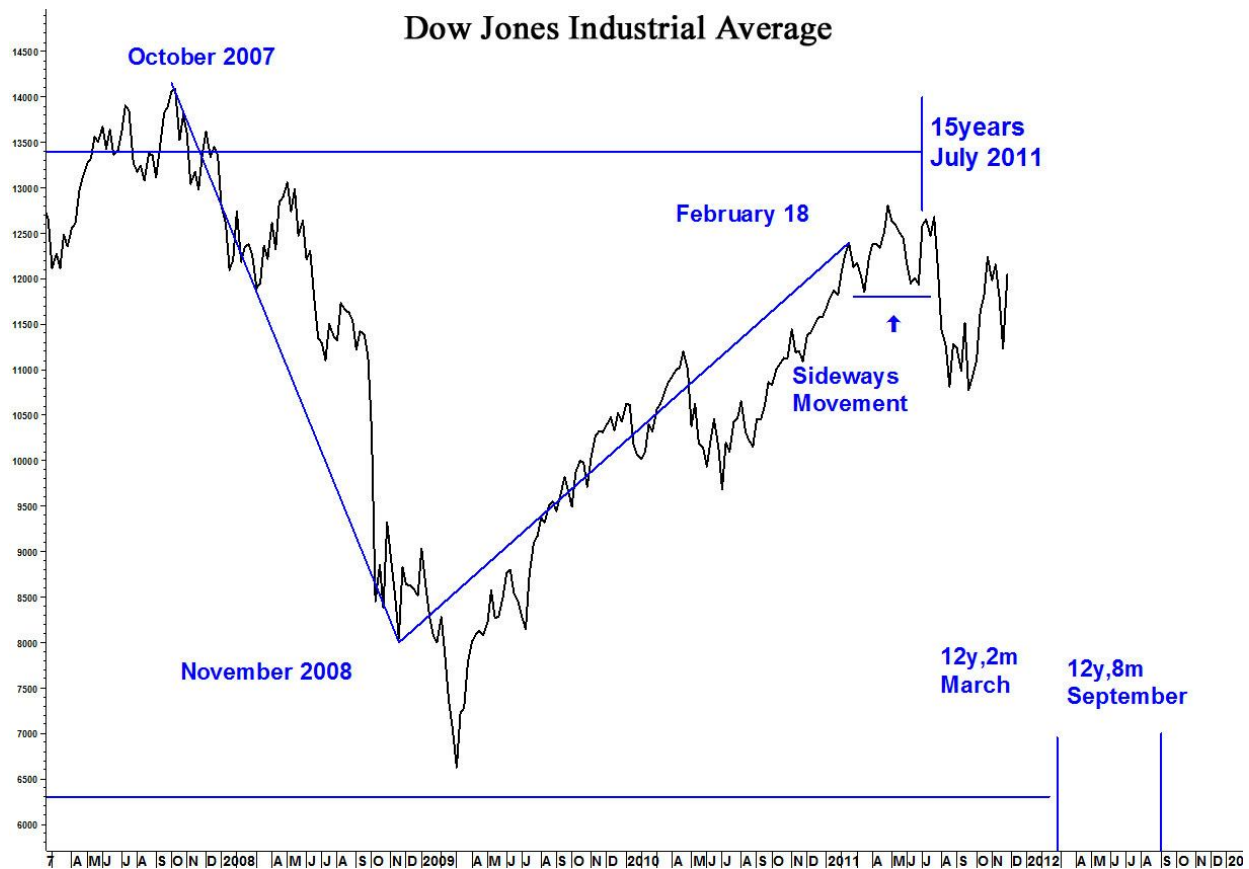


But the question remains “are there higher highs to be seen before lower lows?” That is, will the high of May 2 be exceeded before the closing low of October 3 is breached? Lindsay wrote that Right Shoulders have reached to higher highs than the top of his projected bull market top twice in the past (remember, Lindsay used multiple models to forecast market highs and lows, not just the 3PDh). The Right Shoulder of 2/9/66 exceeded the high of 5/14/65 just as the Right Shoulder of 11/21/16 had exceeded the high of 12/27/15. In both cases the Right Shoulder was the Cupola of a 3PDh pattern. If one finds that confusing (that a Right Shoulder can function as a Cupola), refer to the previous paragraph. 3PDh is not meant to be a free-standing model; Lindsay meant it to be used as one part of an integrated approach using all of his models. Bottom Line: I have not been able to find any 3PDh patterns in which a Right Shoulder exceeded the high printed at the Cupola. My conclusion is that May 2nd was the intraday high of the bull market and we are now in a bear market.

Bull Market Top

If this is a bear market, then where is the bottom? Lindsay said to look for the bottom of a bear market in a range of 12 years, 2 months to 12 years, 8 months from an important high. The most obvious important high of interest is the January 14, 2000 top. It counts to a range between March and September of 2012 (see Figure 2). But for this to be correct we must be able to confirm it by identifying a basic decline (from the end of the previous basic advance) which ends within this time frame. Unfortunately, the 2011 top played out as a Sideways Movement making our situation marginally more involved than normal. To understand this, we need to examine those other models of Lindsay’s which made up his integrated approach. Let us examine our forecast for the previous bull market top in order to understand our forecast for the bear market low next year.

Figure 2 (Click to enlarge)



We begin with the October 2007 top of the previous bull market and count the next basic decline from there. Lindsay told us to typically expect a low 13-14 months after a bull market top. It may be the ultimate low or a temporary low. Just like clockwork, November 2008 (13 months later) saw a temporary low (see Figure 2). That became, what Lindsay called, a Secondary Low. 13-14 months is the time frame of a long basic decline (376-446 days) and Lindsay's Principle of Continuity tells us we must begin counting the next basic advance from here. The fact that the market later declined into a final low in March 2009 is immaterial in Lindsay's counting system.

The market advanced 820 days until the February 18 top. 820 days is within the time span of a long basic advance (742-830 days). Lindsay told us to expect a long basic advance when it originates at a Secondary Low prior to the ultimate low. Also, Lindsay's Principle of Alternation told us to expect a long basic advance here as the previous basic advance into the October 2007 top, at 718 days, had been a short basic advance.

At this point the market looked ripe for a nice correction but not the end of the bull market. A 15-year interval (15 years to 15 years, 11 months) is a necessary requirement which had not been fulfilled by February. A 15-year interval is used the same way as the 12-year interval we discussed previously except it is used to find bull market tops, not bear market bottoms. Both are referred to as long term intervals. Counting from an important low in July 1996 tells us we can expect a bull market top no sooner than July 2011. So our situation is such that we have a basic advance that ends in February but no long term interval until July. This is shaping up to be either an extended basic advance or a Sideways Movement.

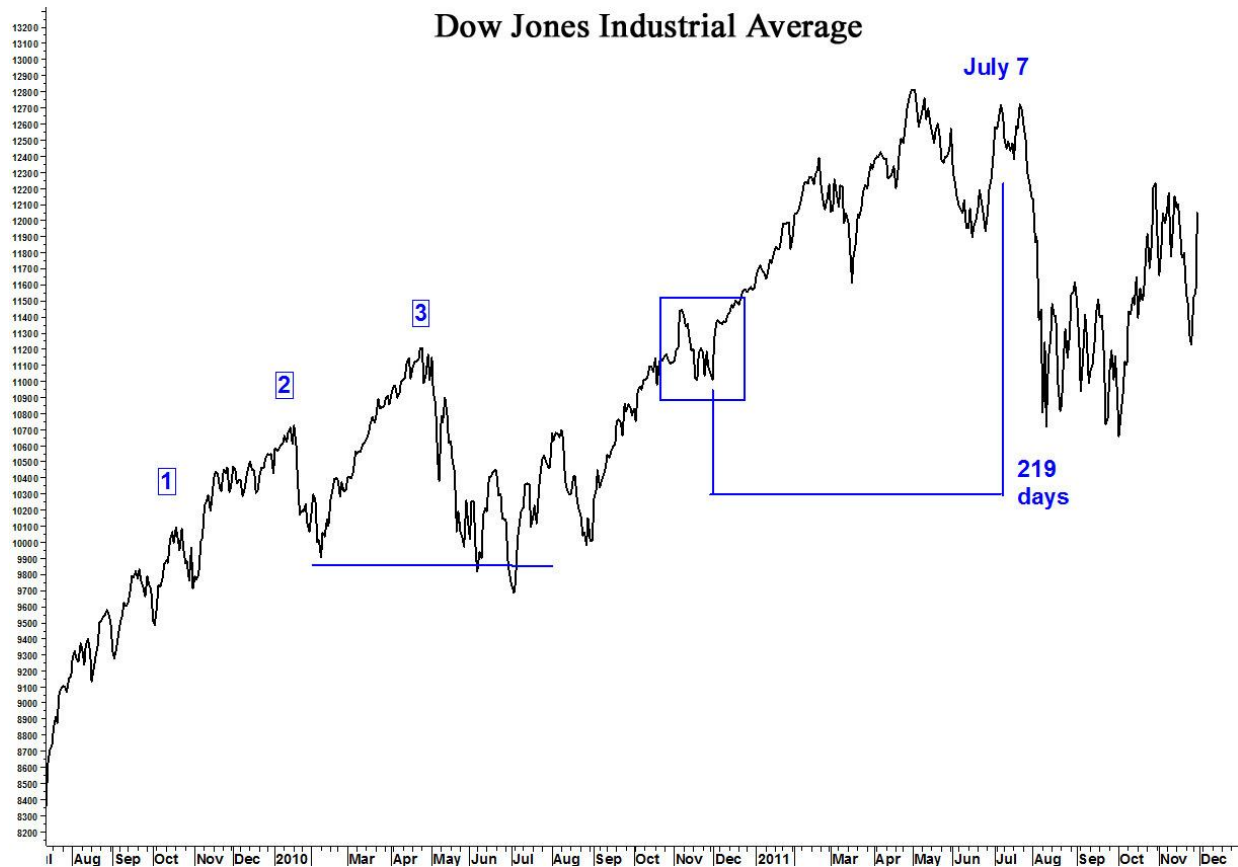
The alternative of an extended basic advance (929-968 days) gets disqualified quickly. Even though the longest possible extended basic advance (968 days) counted from the bottom of the previous basic decline (November 20, 2008) gets us to July (our 15-year interval), it fails to exceed the high of May 2nd. That leaves us with a Sideways Movement.

Sideways Movement

In a Sideways Movement we accept February 18 as the end of the basic advance. Fortunately, a long basic advance is exactly what Lindsay told us to expect (as opposed to the alternative of an extended advance). After the high in February we know we are "on hold" until July. What happened between February and July? The market made its intraday high on May 2nd; what we now know was the ultimate top in the bull market. Lindsay's model failed to identify that top because it came 893 days after the November 20, 2008 low. 893 days falls into the no-mans land between a long basic advance (742-830 days) and an extended basic advance (929-968 days). This is the Achilles heel of a Sideways Movement. Fortunately, Sideways Movements are very rare. Lindsay's methods do an excellent job of forecasting the final high of a Sideways Movement; unfortunately, the ultimate high of the bull market may be the first, middle or last high of this long consolidation. Rather than describing this pattern as the end of the bull market, I call it the beginning of the bear market. Two weeks later, the difference between the two highs, compared to what lies ahead, is immaterial to our portfolios.

The final high in the Sideways Movement was July 7 and it was forecast by both the Lindsay Timing Model and a Count from the Middle Section. But the 3PDh still played a role in this forecast. The three peaks came in October 2009, January and April 2010 (see Figure 3). The First Floor Roof played itself out in November 2010. It was quite short for a FFR but contained the requisite five reversals. The blog-o-sphere always wants to count the 7 months, 10 days to the bull market high from the second test in the base (the bottom of the First Floor Wall). That approach works well with a symmetric base – which this was not. Lindsay would often count from other points on the formation but the one thing these points all had in common was they were either an important high or low. In this case, counting from the fifth and final reversal in the FFR counts an almost perfect 219 days (221-224 is perfect) to the final high of the Sideways Movement on July 7. So it is from here we count our basic decline into the March-September time frame for a bottom to the bear market. In 2011, 3PDh did a better job of confirming other forecasts than in forecasting the high itself.

Figure 3 (Click to enlarge)



Bear Market Bottom

But which time span should we expect for this decline from July 7? The table of Standard Time Spans shows three options: subnormal, short, and long. Because the previous basic decline (October 2007- November 2008) was a long basic decline, Lindsay's Principle of Alternation tells us to expect a short basic decline (317-374 days) this time. The average short basic decline is 345 days. Counting 345 days from the July 7 high takes us to June 16, 2012 and is right in the pocket of that March-September timeframe.

At this point June 16 is likened to a back-of-the-envelope calculation. As we get closer to the March-September 2012 time frame we can then use our short-term models to forecast the actual date of the low. But for now I am confident that July 7, 2011 was the final high of a Sideways Movement and we now find ourselves in a bear market which will end sometime between March and September of 2012.

Ed Carlson, author of [George Lindsay and the Art of Technical Analysis](#) (published in English, Japanese, and Chinese), is an independent trader, consultant, and Chartered Market Technician (CMT) based in Seattle, Washington. Carlson hosts the MTA Podcast Series: [Conversations](#) and is a contributor to [Technical Analysis of Stocks and Commodities](#) and [SFO Magazines](#). He also manages the website [SeattleTechnicalAdvisors.com](#), where he publishes daily and weekly commentary. He spent twenty years as a stockbroker and holds an M.B.A. from Wichita State University.

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