5 Ways to Improve Your Trading

by Tom Aspray

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Dear Fellow Trader,

Investing and trading are lifelong pursuits as we all strive to make more money and to have fewer losing trades. In order to achieve this you need to have discipline and develop a trading plan that has your confidence.

In my analysis, volume plays a large role and my methods of using volume are shared in “The Best Volume Indicator”. I have found that many of my best trades occur when I am buying a pullback or selling a rally and these patterns are detailed in “My Favorite Chart Patterns”. Many traders get into trouble by not paying enough attention to their entry levels, and I think that my chapter “Finding High-Probability Entry Levels” can help you find better levels to enter a trade.

Some traders often depend on indicators that are closely correlated like the RSI and MACD. This often gets them into trouble. In “Combining Two Powerful Technical Tools,” I demonstrate how a measure of the stock market’s internal health and a sentiment indicator can be used to identify low risk entry points.

The final chapter discusses the less well known Mass Index. It appropriately warned of a trend reversal in February 2008. The next major trend change signal came at the end of February 2009, which was one week before the bear market low.

To your profitable trading,

Tom Aspray

The Best Volume Indicator

According to legendary Dow theorist, Richard Russell, volume tends to expand in the main direction of the trend, and since it's always helpful to know the direction and strength of a trend, MoneyShow's Tom Aspray details the nuts and bolts of a leading indicator he has relied on over the years.

Volume is one of the best tools that an investor or trader can use to tell whether money is moving into or out of a stock or ETF. Regular readers know that my favorite volume indicator is the on-balance volume (OBV) that was introduced in 1963 by Joe Granville in his book *Granville's New Key to Stock Market Profits*.

As I have been using it for about 30 years, it is not surprising that I have my own way of interpreting it. It can be looked at in a very simplistic manner or it can also be analyzed in depth using trend lines and moving averages. As I discussed in an earlier trading lesson OBV: Perfect Indicator for All Markets, it can often be a very good leading indicator.

In the early 1980's before it was a popular approach I always advocated looking at multiple time frames, initially concentrating on weekly, daily, and intra-day data. After a few years, I added in monthly data, which can be very useful for determining the major trend and can be especially helpful for longer-term investors.

In this article, I would like to explain how I apply the OBV on monthly, weekly daily and even hourly data. In addition, I want to review some of the specific OBV formations that I have found to be quite reliable in both up or down markets.

The most basic level of OBV analysis is to determine whether it is following the price behavior. In other words, in an uptrend the OBV should be keeping pace with prices or leading prices higher. In a downtrend, both the OBV and price should be making a series of lower highs and lower lows.

In some instances, you will also see the formation of bullish or bearish divergences between the OBV and prices that can alert you to important changes in trend. Of course, the longer the time frame the more important and reliable the signal will be.

In a recent *Charts in Play* column, I reviewed the monthly OBV analysis on the gold futures contract as it has been making new highs with prices since 2002. This is the most basic level of OBV analysis but as the gold example illustrates it can be a powerful tool.

Figure 1

The first market I would like to cover is the very popular **Spyder Trust** (SPY), which tracks the S&P 500. The monthly chart of the **Spyder Trust** (SPY) above covers the period from 2009 until the present. The monthly OBV had moved above its WMA at the end of August 2009 (not shown) and made convincing new highs with price in April 2010.

Over the next four months, the OBV tested its rising WMA before completing its bottom formation at the end of September 2010. When the OBV drops down to test its rising WMA, it identifies a good buying opportunity no matter what time frame you are using. Conversely, when the OBV rallies back to its declining WMA, it provides a good selling opportunity.

The OBV made a new high in February 2011 but as prices were making another new high in April, the OBV formed a negative divergence, line a. This made a correction likely but not an end to the major uptrend. The SPY made further new highs in May but the OBV did not and by the end of June (line 1), the OBV had dropped below its WMA.

The extent of the volatility over the next four months is evident by the wide ranges on the monthly chart. The low for SPY in October was lower than the August low but the OBV did not make a new low, forming a positive divergence, line b.

By the end of March 2012, the OBV had made it back to its declining OBV but it turned lower the following month. It was not until the end of July 2012 (line 2) that the OBV moved above its flat WMA. Though the monthly OBV is rising and above its WMA, it has not yet surpassed the highs from 2011. This will need to be watched in 2013.

The weekly chart covers from the end of April 2012 up to the present. The weekly OBV dropped below its WMA in early May but when SPY made lower lows, the OBV formed a positive or bullish divergence, line c. By the week ending June 16 (line 3), the OBV was back above its WMA and by early July was in a clear uptrend.

The weekly OBV did make new highs with prices in mid-September but broke its uptrend, line d, in early October. The OBV then formed a series of lower highs as indicated by the downtrend, line e. By the first week of December the OBV had moved above both its WMA and the downtrend (line e) which was a good reason to be bullish on stocks.

Figure 1

The weekly OBV pulled back the following week but by the time prices were dropping at the end of the December, the OBV was rising and holding above its WMA. The weekly OBV has made decisive new highs in 2013 but shows a wide gap with its rising WMA that may be warning of a February pullback.

Figure 2

Now let's look at the daily and hourly analysis of the **Spyder Trust** (SPY). Though the weekly OBV did form a positive divergence at the November 2012 lows, the daily OBV did not. The daily chart shows that the day after the lows, the downtrend in the OBV, line a, was broken, and by November 21, the OBV was back above its WMA.

A couple of days later, the OBV pulled back to its rising WMA (line 1), which is one of my favorite bullish setups as SPY was also testing its 20-day EMA. Seven days later, there was a similar formation as SPY again tested its rising 20-day EMA and the OBV pulled back towards its rising WMA. The daily OBV did make new highs in December before SPY corrected.

The five-day fear-of-the-cliff selloff dropped slightly below the 50% Fibonacci retracement support but then SPY closed the year back above the 20-day EMA. Though the monthly and weekly OBV were positive, the daily OBV did not break out of its trending range, line b, until the middle of January. The OBV did make new highs and is above its WMA and support at line c.

On the hourly chart I have also added the starc bands as it provides a multitude of good examples of how these bands work in any time frame. Using hourly OBV requires a consistently good level of volume as large surges once or twice a day can make it less useful as the "noise level" is definitely higher.

The hourly OBV was above its WMA on 1/15, and early on 1/17, SPY started bumping into the starc+ bands for several consecutive bars until 2:30 pm (line 3) and SPY closed lower the next hour. This was a sign of weakness and with prices near the starc+ band, it was a high-risk level to buy, but a low risk area to sell.

Over the next five hours, the SPY declined to its hourly starc- band and the OBV dropped well below its WMA. Early on January 22 (line 4), the OBV dropped back to test its WMA. On this rally, the SPY went from $148 to just above $150, point 5, and reached its starc+ band.

This was indeed a high-risk time to buy as SPY dropped for the next three hours back to the starc- band while the OBV dropped back below its rising WMA for a couple of hours (see circle) before turning higher. SPY and the OBV rallied for the next several days as both made new highs.

On February 1, SPY gapped higher and tested its starc+ band for the next five hours as noted by the area identified by point 7. The following day, prices gapped lower so holding a trade overnight was not a good idea. In a few hours, SPY was below the starc- band. By the daily close, however, the hourly OBV had formed another bullish zigzag (line 8) as the uptrend had resumed. As of mid-day on February 6, the hourly OBV had not confirmed the highs.

The Russell 2000 is one of the averages that has moved to new all-time highs in 2013, so I wanted to look at the monthly and weekly analysis of the **iShares Russell 2000** (IWM). At the end of May 2009, the monthly OBV (line 1) had moved back above its WMA, which was the start of an 11-month rally. The OBV did confirm the April 2010 highs and then turned lower.

Over the next four months, the OBV dropped back to test its rising WMA (point a), which was a bullish setup. By the end of September, the OBV had turned higher, signaling that the uptrend had resumed. From the August low, IWM rallied for another eight months with only one lower monthly close.

Figure 3

The OBV made a new high in April 2011, but IWM made a marginal new high in May before closing lower. The OBV broke its uptrend, line b, in June and dropped below its WMA in July 2011 (line 2). The OBV made lower lows for the next three months. The OBV was weaker than prices on the decline as it dropped below the 2010 lows while IWM did not. At the end of November 2011, the OBV formed a positive divergence, line d.

Though IWM rallied, the volume was not impressive as the OBV just briefly made it above its WMA in March (see yellow circle) before reversing. It did hold its uptrend, line d, and by the end of September 2012, the OBV was back above its WMA.

The OBV tested the WMA in October (another zigzag) and then broke through resistance, line c, at the end of November (line 3). This indicated that the January effect, where small caps outperform, was going to be followed in 2012-2013.

The weekly OBV moved above its WMA on July 30, 2010 (see vertical line), and then as IWM dropped back to test the lows, the OBV was stronger (circle e) as it stayed above its WMA. At this time, the monthly OBV was positive from May 2009. The OBV shows a bullish uptrend into the middle of February 2011 when it peaked.

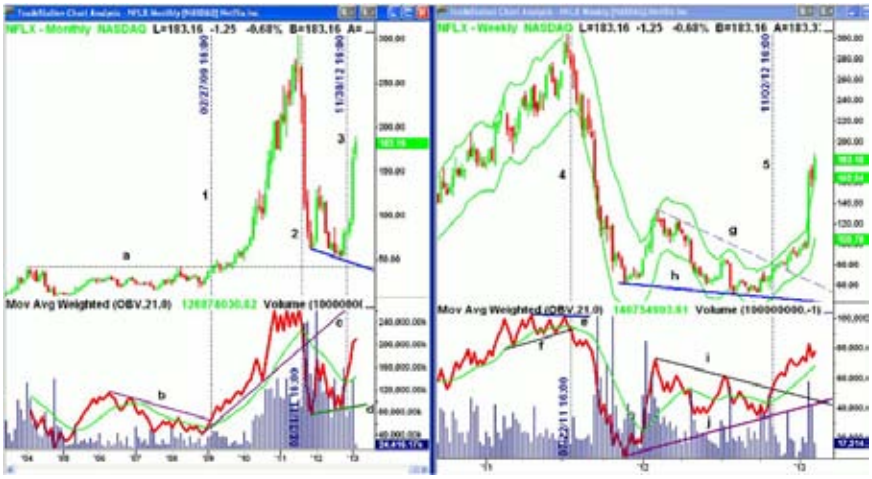
IWM continued higher until early May, but the OBV dropped below its WMA and formed a trading range. The OBV surged to marginal new highs in July but IWM was lower and the monthly OBV dropped below its WMA at the end of July. This would have allowed for an exit before the debt ceiling selling reached its full panic mode.

The weekly OBV dropped below its WMA and support (line f) as IWM was breaking its corresponding support. The OBV made lower lows in November, but IWM did not, and by the second week of January, the OBV was back above its WMA. This coincided with the rally into the late March highs. On the ensuing eight-week correction, IWM held its support just below $74 but the OBV formed higher lows.

Two weeks after the lows, the OBV moved back above its WMA and then soon moved above the previous highs (line g) at the end of June. IWM rallied to a new high of $86.96 in the middle of September 2012, but by early October, the OBV was back below its WMA.

As the monthly OBV moved back above its WMA at the end of November, the weekly OBV was below its WMA but above its uptrend, line h. By December 14, the weekly OBV was above its WMA, confirming the January effect. By early January, the weekly OBV had moved above its resistance at line i.

Figure 4



This method also works for commodities, as well as individual stocks. One of the most volatile stocks in the past few years has been **Netflix Inc.** (NFLX). The monthly chart shows the trading range that developed from 2004 through early 2009, line a.

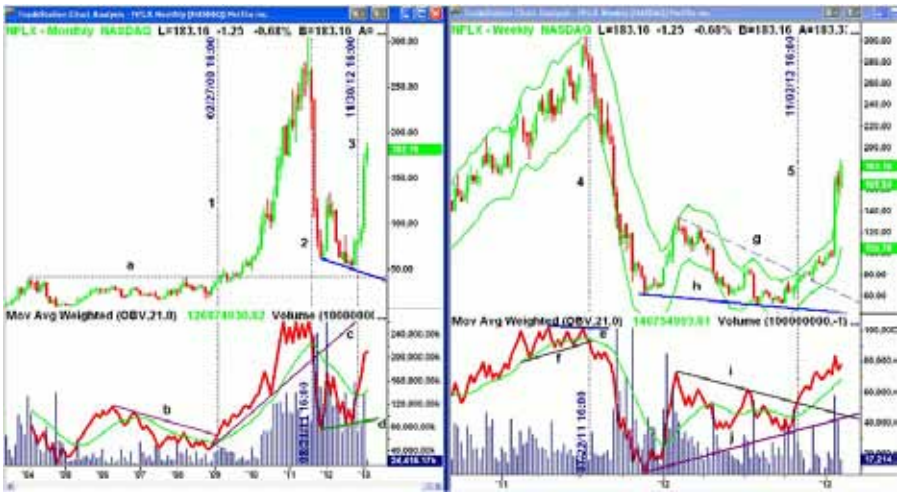
The OBV surged in 2005 but then peaked in 2006 and formed a downtrend (line b) over the next three years. This downtrend was broken in February 2009, line 1. The next month, NFLX closed above its monthly resistance at $41.79, line a, and began its dramatic rally.

By the middle of 2010, one was able to draw a clear uptrend in the OBV, line c. At the end of August 2011, the monthly OBV dropped below its WMA as NFLX closed at $235. The next month, the uptrend in the OBV was also violated.

In August and September of 2012, NFLX made lower lows, but the OBV made a higher low, line d. This monthly positive divergence took 11-months to develop. At the end of November, the monthly OBV moved back above its WMA and the following month confirmed the divergence

The weekly OBV shows a pattern of higher highs from 2010 up through its peak on April 23, 2011. NFLX made another new high the week of July 16 but the OBV formed a lower high, line e. This negative divergence was then confirmed when the OBV dropped below support (line f) the following week, line 4. The July high at $304.79 was very close to the weekly starc+ band at $305.48.

Figure 4



The weekly OBV stayed below its WMA until January 14, 2012, when there was a strong surge in volume. By the end of April, it was back below its WMA as the OBV formed a downtrend, line i. The OBV formed higher lows in September 2012, line j, while prices formed lower lows (line h). This bullish divergence was also noted in the monthly data, which is a powerful but rare bullish indication.

In October, the OBV moved back above its WMA and broke through its downtrend the next week, line 5. Two weeks later, NFLX also broke through its downtrend, line g, as the OBV was again leading prices. By the end of the November, the monthly OBV had also turned positive.

Figure 5

The liquidity in NFLX allows for clear hourly OBV patterns in NFLX but as I noted before, this is not always the case. On January 2 (line 1), the OBV moved above its WMA. It stayed positive until the afternoon of January 8, line 2, as its WMA and the uptrend (line a) were both broken. NFLX had stayed above its starc+ band for three hours the previous day.

By the morning of January 10, the OBV was back above its WMA (line 3), and it soon was in a clear uptrend, line b. This OBV support was broken on January 15, and two hours later, the OBV dropped below its WMA. The following day, NFLX had dropped below the starc- band.

In the first hour of trading on January 18, the volume was heavy, which moved the OBV back above its WMA. By the end of the day, the OBV appeared to be forming a short-term bottom as it had again moved back above its WMA. This was three days before it reported very strong earnings as the stock opened at $143.99. The hourly OBV (not shown) was in a clear uptrend before lunch on the day prior to the earnings report.

So how should you incorporate the OBV into your investing or trading? For investors, I think the use of the monthly and weekly OBV data will be one of the best technical tools, in addition to chart analysis, that you can use with or without fundamental analysis. I would use both to find likely buy candidates but use the weekly as the trigger in most instances.

For most traders, I would use the combination of the weekly and daily analysis, along with the starc bands to help keep you from buying at the wrong time. The hourly charts can help with this as when prices are at the hourly starc+ bands, you will often be able to get a better price by waiting a few hours. Of course, Fibonacci and pivot point analysis can be used to help determine your entry points

Also, keep an eye out for the zigzag formations as they can often provide low-risk entry points. Though I provided only bullish examples in this article, at market tops you will often see the OBV rally back to its flat or declining WMA before the selling gets heavy.

Disciplined short-term traders can use a combination of the daily and hourly data on many markets but one should only take hourly signals that are in agreement with the daily trend. Be careful about holding positions overnight if the starc bands have been tested for several periods.

As I discussed in 5 Rules for Success in 2013, pay particular attention to your entries, the risk of every trade, and learn to scale out of your profitable positions.

My Favorite Chart Patterns

Continuation patterns come in many shapes and sizes, but the one thing they all have in common is allow good trading or investing opportunities, says MoneyShow's Tom Aspray.

Last summer's rally in gold and the gold miners coincided with a strong seasonal period, and after the dismal performance in the first half of the year, a rally was overdue. The rally was impressive as the **SPDR Gold Trust** (GLD) rallied 20% from the late-June lows to the late-August highs.

In late July's Is Gold's Rally a Bull Trap?, I shared the reasons why I thought the rally in gold and the **SPDR Gold Trust** (GLD) was a bull trap. GLD triggered a weekly low close doji sell signal in the early part of September suggesting that the rally might be over.

This chart I presented on November 5 subsequently got quite a bit of attention as the technical evidence suggested that the bull trap was ready to close. My high degree of confidence in this analysis came from the classic flag or continuation pattern (lines e and f) that had formed in GLD since April of 2013.

This type of formation can present some of the best trading or investing opportunities, and that is why they are my favorite chart formations. They allow one to clearly define both the risk, as well as the potential reward, and the market will give you clear signals when you are wrong.

The high in August 2013 (point 2) just reached the 38.2% Fibonacci retracement resistance from the high at $174.07. This, therefore, was a key level of resistance. As prices declined from the highs, the daily on-balance volume (OBV) began a new downtrend and by October the OBV was acting weaker than prices.

The rally in the OBV from the June lows had been weak, which was one of the main reasons I thought that this rally was a pause in the downtrend, not an important low.

After the decline from point 2 to point 3 and the weak OBV readings, the stage was set for a technical rebound that was expected to fail. The rally failed just below the minor 61.8% Fibonacci retracement resistance (point 4). The previous decline allowed one to calculate an equally downside target for GLD at $115.74. This was the first target as additional lower targets could also be calculated from this formation.

The updated chart from January 23's Buy the Miners Not the Gold shows that the downside target was exceeded just before Christmas as GLD had a low of $114.46. As GLD was making its low, the daily OBV was above its WMA, which meant that only a fewer sellers were pushing prices lower. This was a positive sign.

Though this example was of a market in a downtrend, the same rules apply when a market is in a strong uptrend. In order to be successful, you do not need to buy at major bottoms or sell at major tops. Though this may happen periodically, most will make more money by identifying the pauses or corrections within the major trend.

Identifying major bottoms is not really that easy as a stock or ETF will not show up on one's radar until they have already started to move higher. Momentum indicators like the RSI or stochastics will generally give positive signals at major lows but they frequently give false signals before the final low is in place.

I have found volume to be the most valuable tool in identifying a major bottom and the OBV generally does a good job of confirming that a stock is being accumulated. Positive relative performance is also important as you increase the odds of success when you are buying stocks or ETFs that are acting stronger than the S&P 500.

One of my favorite entry techniques is to buy setbacks in major trends as the monthly and weekly data can give you a reliable reading on the major trend. This confirmation can give you additional confidence that you are indeed buying a setback in a major uptrend.

Some of the major market-moving stocks of 2013 provide some excellent examples of what typically occurs during a stock or ETF's major trend.

Micron Technology (MU) was one of the best performers in 2013 as it was up 243%. It formed a bottom between May 2012 and December 2012 as the rallies failed below $7.00, line 1. MU made a low in June of $5.30 and this low was briefly broken for several days in October before it turned higher.

The technical studies bottomed ahead of prices at the end of November as the relative performance moved above its WMA and its resistance at line b. The RS line then surpassed the prior two peaks signaling that MU was a market leader. The strong action in the RS line favored buying the pullback from the weekly resistance.

The OBV was also bottoming as it moved above its WMA and then held above it as MU dropped back to test its 20-week EMA (point 1), which was typical of a correction.

The low volume evident on the weekly chart was a sign that there were not many sellers. The RS line also held well above its WMAs on the pullback (point 2) and then turned sharply higher.

On the daily chart, the signs of a bottom and then a tradable correction are even more evident. As MU dropped back below its 20-day EMA and reached a low of $5.33, the daily relative performance was forming higher lows, line b. The RS line then moved above the zero line as MU closed well above its EMA.

The daily OBV had moved above its WMA before the end of November and broke its downtrend, line c, at the same time the RS line was overcoming its resistance. MU rallied steadily for the next three weeks rising from $5.77 to $6.89.

MU continued to edge higher for four days after the weekly RS line broke out to the upside but the RS line was forming a slight negative divergence, line d. The OBV also failed to make new highs and then volume spiked as MU gapped to the downside.

Over the next few days, MU dropped down into the zone of support between the 38.2% and 50% Fibonacci retracement support levels that were calculated from the October low of $5.16. The correction low at $6.07 was just above the 50% support at $6.03 as stops could have been used under the 61.8% support at $5.82.

On the correction, the daily RS line dropped well below its WMA but did hold above the breakout level. The OBV dropped below its WMA, but after the one day of high volume, it dropped to very low levels. Four days after the low, both the RS and OBV were able to move above their WMAs.

After the two-week correction, MU closed sharply higher at $6.96 and right on the weekly resistance at line a. For the next 11 weeks, MU continued to edge higher, eventually reaching a weekly closing high of $10.22 (point 2) at the end of March. MU had been trading above its weekly starc+ band for three weeks in a row and therefore was overbought.

On the weekly chart, prices moved sideways for six weeks. The weekly RS line had confirmed each new price highs and stayed above its WMA on the correction. The RS line had long-term support at line d.

The OBV had a very shallow correction as it also held well above its rising WMA and longer-term support. The OBV broke its short-term downtrend as MU was making its correction low on the week ending May 3 (line 3). The volume was heavy the following week as once again MU moved sharply higher.

This correction looks much different on the daily chart as it shows a clear-cut flag formation, lines a and b. The momentum had shifted by May 6 as the prior swing high was overcome and the breakout of the flag occurred two days later. It was confirmed by the OBV and the RS line (not shown) both moving through their resistance.

From the breakout close at $10.23, MU rallied to a high of $14.60 on July 1 before the rally stalled at the weekly starc+ bands. The correction lasted four weeks as the 38.2% Fibonacci retracement support from the early May lows did hold.

This correction was more complex because after completing the triangle formation and surging above the prior peak (point 1), MU again corrected back to support in the $13.00 area before it moved out of the broader trading range as identified by lines d and f.

The OBV confirmed the price action as it also broke out of its trading range, lines g and h, with the heavy volume in early September. The relative performance (not shown) also confirmed the price action as it moved well above its previous high. The major rally then resumed as MU hit a high of $23.66 before the end of the 2013.

Another market leader in 2013 was Celgene Corp. (CELG) from the red-hot biotech sector. The stock completed its bottom formation in early January 2013 as the resistance at $18 was overcome but the technical studies gave advance warning of the breakout.

The relative performance was in a clear uptrend by November 2013 (blue line). The OBV moved above its WMA in July, and by September, was leading prices higher. The OBV again tested its WMA in November (see arrow) before a strong year-end surge.

At the May 2013 high of $181.82, the relative performance formed a light negative divergence, line b. A similar negative divergence was evident in the OBV as it also formed lower highs, line c. This was consistent with a correction as their WMAs were both moving higher.

On the daily chart, one can see the formation of a flag, lines d and e, over the next six weeks. The daily RS line had also formed a divergence at the May 14 high, line f. The first half of the correction ended in early June as CELG hit a low of $111.50.

This was a drop of 15.4% from the high, but CELG held above the 38.2% support from the November 2012 low, which was at $108.45. After a two-week bounce, CELG made a new correction low at $110.53, which likely stopped out some of the early buyers. The chart support, line e, did hold.

This is pretty typical as those who bought near the initial low, likely raised their stops after CELG moved higher and then were stopped out near the final correction lows. The daily RS line moved back above its WMA two days after the lows and broke through resistance at line f, as prices were breaking the downtrend, line d. (line 1).

The Aspray's OBV Trigger (AOT) formed a positive divergence, line g, at the correction lows. It was well in positive territory a few days before prices broke out to the upside. Referring to the weekly chart, the short-term downtrends in both the RS and OBV, lines d and c, were also broken, providing further confirmation that the correction was over.

Caesars Entertainment (CZR) was up over 200% in 2013 but the rally really began in the latter part of 2012, when after making a low of $4.52, it rallied for the next four weeks, finally closing back above its 20-week EMA (line 1).

The strength of the rally pushed the relative performance above its WMA, suggesting that it was starting to become a market leader. The volume on the rally was the heaviest since March and the OBV also was able to move above its WMA.

As CZR hit a high of $8.25, it reached the weekly starc+ band. The stock consolidated for the next seven weeks (forming a triangle on the daily charts) before accelerating to the upside. During the sideways period, both the RS and OBV held above their WMAs.

The relative performance and OBV were strong in both February and March as CZR hit a high of $18.32 the week ending March 22 but then closed weak at $16.38. This reversal suggested the market was ready for a rest as CZR had closed well above its weekly starc+ band the prior week (see arrow).

Both the weekly RS and OBV analysis had confirmed the highs so a correction was expected. Using the November 2012 low, the 38.2% Fibonacci retracement support was at $13.05 with the 50% support at $11.39. Four weeks after the highs, CZR hit a low of $11.84, which dropped prices right into the support zone.

Nine weeks later, CZR dropped to a low of $12, which retested the lows, line b. The upper boundary of the flag formation, line a, was well defined. The flag formation was completed in July (line 2) as the relative performance also completed a similar formation, lines c and d.

The OBV broke its downtrend, line e, two weeks ahead of the breakout and then moved back above its WMA as prices were breaking out. The triangle had measured upside targets in the $22-$23 area but CZR actually hit a high of $26.57 in September.

The current weekly chart of Caesars Entertainment (CZR) suggests that it may be in the process of completing another flag formation. The resistance from the September high at $26.57, line a, is now being tested as CZR has bounced several times after testing its 20-week EMA.

The correction from the September highs dropped CZR back to the support zone between the 38.2% and 50% retracement levels. This area also corresponds to the highs from early in 2013 as old resistance becomes new support. The quarterly pivot for CZR is at $20.10 with the weekly uptrend, line b, now at $19.51.

The weekly relative performance did confirm the recent highs and is now testing its resistance at line c. The RS line shows a strong long-term uptrend, line d. As long as the relative performance does not drop below the late 2013 lows, it will continue to indicate that CZR is a market leader.

The OBV has been much stronger as it broke out to the upside at the end of the year as it moved above the downtrend, line e. It is ready to make another new high this week and is clearly acting stronger than prices. It is well above its rising WMA and support at line f.

The daily chart shows fairly tight ranges and low volume so another pullback to the $20-$21 area is possible over the short term.

I hope these examples have stimulated your interest in trading continuation patterns. They come in many shapes and sizes but do have common features and characteristics that allow for good trading or investing opportunities.

One way to find such stocks is to keep a list of stocks that you notice have had dramatic rallies or those that are frequently on the new-highs list. Then check on them every few weeks and wait until they go into a corrective mode. Once they do, you can define a buying zone and develop a strategy.

Using technical tools like the OBV or relative performance will help you determine whether the major trend is positive or not. The daily technical studies will often give you advance warning of a price breakout, or alternatively, confirm the breakout which will give you more confidence in your decision.

There have been quite a few stocks and ETFs that have just recently completed continuation patterns. Oftentimes, you will get a retest of the breakout level, and I will be looking for opportunities like this in the weeks ahead to feature in my daily column.

Finding High-Probability Entry Levels

The key to making consistent profits in the markets is to enter trades where there is relatively low risk compared to much higher reward, thus MoneyShow's Tom Aspray shows how you can spot good entry levels, set profit targets, and devise an exit strategy.

Picking tops or bottoms is generally quite difficult as one often does not have clear technical divergences that can give them enough conviction and discipline to take a position. Oftentimes traders will convince themselves that a market can't go any higher or lower and keep fighting the trend as they are repeatedly stopped out.

Successful trading or investing is dependent on trying to put the odds in your favor and then having a clear exit strategy for when you are wrong. The S&P 500 had several wide swings in 2012, which made it a difficult year for many traders and investors. Buy and hold was only possible for those who were totally oblivious to current events.

I am not convinced that 2013 will be any easier despite the stock market's strength so far in early 2013. To successfully trade retracements, you need to have patience and there are several technical tools that can help you identify in advance potential buying or selling zones.

Typically, when a retracement is ending, it will be a difficult time for the investor or trader as the market momentum and the sentiment is at a level that causes many to question their analysis making it more difficult to act.

I realized early in my career that most retracements take longer than one expects as one must consider how long the prior rally or decline has lasted. For example, if a rally last three or four months then a three-four week correction would not be surprising. On the other hand, if the breakout rally last just three weeks, a five- or six-day correction is often enough.

A good example of a retracement after a brief rally occurred in the Spyder Trust (SPY) towards the end of 2012. The SPY had reversed to the upside on November 16, which turned out to be a quite uncommon v-shaped bottom. Four days after the lows, the OBV and S&P 500 Advance/Decline line had both moved above their WMAs, which was a positive sign.

By December 12, the SPY had surpassed the early November highs and on December 18, (line 1) the OBV moved above the October highs, line b, as it was acting stronger than prices. The A/D line made a new all-time high as it overcame its high from both October (line c) and September.

The SPY was quite close to its daily starc+ band suggesting it was a high-risk area to buy. Three days later, SPY gapped lower as fears of the fiscal cliff hit the market. The Fibonacci retracement analysis revealed that the 38.2% level was at $141.53 with the 50% support at $140.21. The SPY closed on December 28 at $140.03 (point a).

At this point, SPY was close to the starc- band, which made the 61.8% Fibonacci support at $138.88 the key level to watch. It was also very close to the November 28 low of $139. The strong upside reversal the following day was quite a bullish sign even though the close at $142.41 was just 2.5% above the 61.8% support.

I have found that the first retracement from a bottom will often drop below the 50% support level while retracements that form have after more prolonged up or downtrend generally hold between the 38.2% and 50% retracement levels.

After looking at a large number of charts over the years, I can often spot those that appear to have a major trend that they are now retracing. If you spend the time, you should be able to also accomplish this. One of my favorite sites for this is www.finviz.com as it allows you to look ten charts per page that can be selected by sector or fundamental data.

Let's look first at **Hess Corp.** (HES), which has been in the news quite a bit lately. The first chart covers from April 2012 through February 2013. HES had peaked at $67.86 in February 2012 and by the end of June had dropped briefly below the $40 level.

To determine trend changes, one of my favorite tools is the multiple time frame analysis of the on balance volume that I discussed in a recent trading lesson. The daily OBV on HES had moved above its WMA at the end of June and then by the middle of July had broken its downtrend, line a. The weekly OBV (not shown) also formed a bullish divergence at the June lows.

In this article, I will concentrate on the more pronounced retracements, but one should note that after the initial upside spurt in HES, it dropped back to the minor 61.8% support. By August, the weekly OBV had turned positive as HES spiked to a high of $57.34 on September 14.

The steepness of the early September rally suggested a correction was likely and from the June lows, the 38.2% Fibonacci support was at $50.60 with the 50% retracement support at $48.60. As we started the fourth quarter, the pivot was at $51.08, which was also an important level to watch.

HES traded in a range for 31 days before dropping back to the 38.2% and quarterly pivot support. Those who were impatient and bought in the $52.50 area should have used a stop under the 61.8% support at $46.41. This would have been a risk of at least 11.6%. Taking this large a risk on any one position can eventually destroy your account.

After closing below the quarterly pivot, HES dropped to a low of $48.20 in the next five trading sessions. Since HES had rallied over 30%, I typically look to buy at the mid-point between the 38.2% and 50% Fibonacci support levels. In this case, that would have been at $49.60 with a stop at $46.18, which was 0.5% below the 61.8% support level.

Before any orders were placed, I always calculate the risk, which was 6.9% higher than I like. Moving the buy level to say $49.18 lowered the risk to 6.1% while buying HES at $48.60 would have meant a risk of 5%.

The initial upside target would be the old high at $57.34, so if you bought at $49.18, you were risking $3 for the potential to make just over $8. The November low of $48.20 was tested in December as HES dropped back down to $48.29. Those who were very patient had a chance to get an even better price since HES held the lower boundaries of the flag formation at line c.

Using the November low, the 127.2% Fibonacci retracement target was at $59.90, which would have been the general level to part or half of the position. HES closed above the quarterly pivot on December 12, and then retested it at the end of the year. The flag formation was completed on January 4, and on January 25, HES opened at $63.15, which was above the 161.8% Fibonacci target at $62.88.

The same methods, of course, work in a down trending market. HES formed a top in the spring of 2011 as the OBV formed a negative divergence when HES was making its closing high (point 1). The divergence was confirmed when the OBV dropped below its support at line d. HES rebounded once more toward its highs before the selling picked up in early May.

On June 20, HES had a low of $67.65, which was over 22% below the high at $87.40. These two points could be used to calculate the Fibonacci retracement levels. The 38.2% retracement resistance was at $75.17 with the 50% level at $77.54. Therefore, the mid-point was $76.35.

On July 5, HES hit $77.12 and just barely exceeded the quarterly pivot at $76.69. For those considering a short position and sold at $76.35, the 61.8% retracement resistance was at $79.90. Therefore, a stop at $80.30 (0.5% above $79.90) would have been appropriate. This would have been a risk of 5.2%.

As it turned out, HES eventually formed a flag formation but the OBV started to break down before it was completed, which supported the negative technical outlook. The 127.2% Fibonacci retracement target at $64.93 and the 161.8% target were hit on two consecutive days in early August. HES finally hit a low of $52.63 before it rebounded.

Another oil company that is still part of the Charts in Play portfolio is **Valero Energy Corp.** (VLO) and this time we will look at the weekly chart. VLO formed a broad trading range between May 2011 and July 2012. VLO started turning higher in the summer of 2012 as the weekly OBV moved above its WMA at the end of June.

The OBV broke through its downtrend, line c, at the end of July (line 1). Two weeks later, the price resistance, line a, was also overcome. On September 14, VLO reached its weekly starc+ band (point 2). The next week, VLO closed lower indicating that a retracement might be underway.

The quarterly pivot was at $29.98 while the 38.2% Fibonacci support, calculated from the June low to the September high, was at $28.86. The 50% retracement support level was at $27.18. The mid-point was therefore $28.02 and the risk to 0.5% below the 61.8% support at $25.50 was 9.6%.

This was clearly too high but between October 12 and early November, VLO tested the 38.2% level several times and then closed back above its 20-day EMA on November 6 on good volume. On November 7, I recommended buying at $29.68 and $29.14, which was below the prior day's close at $30.06. I used a stop at 27.68, which was below the multiple lows in the $27.89 area.

As it turned out, over the next week, VLO tested the $28.60 level twice and just before Thanksgiving completed its daily flag formation. It was a positive sign that throughout the correction from the September highs, the weekly OBV held above its WMA (circle 4).

The 127.2% Fibonacci retracement target was at $35.97 and on January 15, the 50% sell level at $35.98 was hit. Soon after, the 161.8% target was reached, and by early February, the 261.8% Fibonacci target at $44.64 was also exceeded. VLO consolidated at the weekly starc+ bands for several weeks in the latter part of February where some additional profits were taken. Another meaningful correction is likely sometime this year.

Jarden Corporation (JAH) is a $4.6 billion dollar provider of housewares and accessories, which after a 38.2% correction into the May 2012 low of $37.39 began a new uptrend. The OBV surged through resistance, line a, in August, which was a bullish sign. When JAH peaked on October 17 at $55.77 (point 1), the OBV formed a slight negative divergence (line e).

The first wave of selling was quite heavy as JAH dropped below the quarterly pivot at $49.80 and reached the 38.2% support at $48.72 (point 2). This took JAH back to the support from August and early September, which may have encouraged some to buy.

This is generally not a good idea, but in this case, it could have worked. Those who bought the first pullback (point 2) were likely tempted to raise their stop once JAH rebounded back to $53.95 (point 3). That stop would probably have been hit on the following decline.

This is where patience is so important as after a rally that lasted from the middle of May to the middle of October, a more lengthy correction would be expected. More often, the next part of the correction phase will take the stock below the initial low by enough to stop one out before the retracement is over.

By December 14, JAH traded down to $49.40 and tested the lower boundary of the flag formation, line d. It dropped below the quarterly pivot that day but closed back above it. A nice bottom formation formed over the next two weeks (see circle) before JAH gapped through resistance at line c, to start off the New Year.

By January 22, the 127.2% Fibonacci target at $57.74 had been hit and two weeks later the 161.8% target at $60.20 was exceeded. As I have discussed in past articles, I also use traditional chart methods to obtain price targets. In this instance, the height of the flag (dashed red line) was $9.81, which when added to the breakout level at $52.59 gives you an upside target at $62.40. JAH spiked to a high of $64.87 on February 27.

If you are looking for stocks to buy, the tools that I have discussed here can be found online or created using a spreadsheet. I would suggest you start by scanning charts and looking for those who have had significant rallies and are now correcting from those highs. Try to come up with at least ten candidates.

Once you have your list , first look at the long-term charts to be sure that the rally was not just a rebound in a longer term downtrend. Then do your calculations of the retracement levels, quarterly and monthly pivots, as well as your chart analysis. Do a risk calculation based on buying the midpoint between the 38.2% and 50% Fibonacci support levels with a stop under the 61.8% support.

If the risk is too high on a stock, don't give up on it but set up some price alerts at the 38.25 and 50% support levels, as well as the quarterly pivot. Sometimes, as was the case with Valero Energy (VLO) and Jarden Corporation (JAH) you will get a period of price consolidation during the retracement that will allow an entry where a lower risk stop can be used.

Combining Two Powerful Technical Tools

After 30+ years in the financial markets, MoneyShow's Tom Aspray has seen just about every kind of indicator available, but there are two that he has found particularly effective, which he shares here.

There are a wide range of technical indicators that traders and investors can use to determine the market's trend and to pick stocks. I have found that the most effective combination of indicators use either different data or non-correlated data.

For example, if you were to use the MACD-His, RSI, and stochastics you are likely to get similar results from all three as all are based solely on price. In many of my columns I generally feature two key technical tools even though I do use others.

The first is the on-balance volume (which I discovered from Joe Granville's book before I even had my first computer), which is my favorite volume tool and one that I have used confidently since the 1980's. Looking at the monthly, weekly, and daily OBV analysis can give you a good idea whether a market is being accumulated or distributed.

In the past ten years or so, I have relied more heavily on the relative performance. It measures how a stock or an ETF is performing relative to a benchmark like the S&P 500. In an up market, those stocks that have positive RS trends in all time frames do better than the overall market. Also when a market is correcting, these stocks will generally decline less than the overall market.

To determine support or resistance level, I like to combine my chart analysis with Fibonacci and the monthly/quarterly pivot levels. The pivot analysis was added more recently after John Person was kind enough to share with me his unique methodology.

When the Fibonacci and pivot analysis highlight the same levels of support or resistance, it can identify high-confidence price levels of where you should be buying or selling.

In this week's lesson, I want to demonstrate how two non-related technical tools can help you determine changes in the market's trend. This first is the McClellan oscillator, which was developed by Sherman and Marian McClellan and is calculated from the A/D data. The second is a sentiment indicator, the Total Put/Call ratio (P/C), which measures the volume of puts traded divided by the volume in calls. It can be downloaded free from the CBOE.

On the bottom of the NYSE Composite chart, I have plotted the eight-period WMA of the Total Put/Call ratio in green and the three-day SMA in red. I added this so that it could be used by the TradeStation platform.

When the ratio is above 1.0, it means that more puts are being traded than calls. So a reading of, say 1.2, indicates that a majority are bearish. Conversely, a reading of 0.5 indicates that twice as many calls have traded than puts, which reflects a high level of bullish sentiment.

The first chart covers the period from February-August of 2007. At the end of February, the stock market had its biggest one-day drop in five years as it reacted to the selling in the Chinese market. The NYSE Composite traded below its starc- band for five days ending on March 5 (line 1) as the McClellan oscillator hit -307.

Stocks rebounded for five days before dropping once more as the NYSE made a lower low (line a) on March 14. The McClellan oscillator only dropped to -60 and therefore formed a positive divergence as indicated by line b.

The SMA of the P/C ratio broke above its prior high on February 23, which was two days before the plunge. It peaked at 1.46 on March 5 and then dropped back to 1.10. As the NYSE was making its low, the moving averages of the P/C were making lower highs, line c, indicating that fewer option traders were bearish.

The uptrend in the P/C, line d, was broken four days after the low. The P/C also spiked later in the month as prices pulled back to their 20-day EMA when the McClellan oscillator dropped briefly below the zero line.

During April and May both indicators were in a trading range but the NYSE Advance/Decline line was clearly positive as it was making higher highs with prices and staying above its WMA. In June, the bearishness picked up as the NYSE consolidated for a few weeks. The lower highs in the P/C, line e, preceded the next upside breakout.

The new highs in July were accompanied by low readings from the McClellan oscillator, which formed a negative divergence, line f, as the NYSE Composite was making another new high (line 2). The P/C ratio was very low but had started to edge higher. The ratio broke out to the upside on July 24 as the NYSE closed below the lows of the prior 13 days.

As stocks continued to plunge from the July highs, the NYSE closed below its starc- band for two consecutive days (see arrow) and the McClellan oscillator hit a low of -334. The P/C SMA turned down at the same time. The NYSE rally failed at its declining 20-day EMA as the McClellan oscillator rebounded to the zero line. The P/C SMA had dropped to 1.07 as the level of bearishness decreased.

As the market again turned lower, the P/C ratio turned up forming a new uptrend, line b. The NYSE Composite dropped well below the starc- band on August 16 but then closed on the day's highs. On that day, the McClellan oscillator only reached -251 therefore forming a bullish divergence, line a.

The SMA of the P/C ratio made a new high as the market was making its low. Three days later, the uptrend in the P/C, line b, was broken and the McClellan oscillator confirmed its positive divergence by moving above the prior high and the zero line.

By early September, the stock market was in a new uptrend as the McClellan oscillator peaked at +259 on September 4. The P/C ratio did not drop decisively below the zero line and the prior lows until September 21. By October 11, the NYSE made an intra-day high of 10,387, which has still not been exceeded.

At these highs, the P/C SMA dropped to a low of 0.77. The NYSE Composite quickly turned lower and had dropped below its starc- band on October 22. On this decline, the McClellan oscillator broke convincingly below the zero line (see arrow) and hit a low of -182. The P/C SMA edged slightly above the 1.00 line.

Just seven days later as the NYSE was making a new closing high at 10,308 (line 2), the McClellan oscillator was only able to rally to +47. The P/C SMA only dropped slightly below its WMA to 0.95 and held its uptrend, line d. Four days after the NYSE highs, the P/C was making new highs and was in a solid uptrend.

The next three months were pretty tough for the stock market as at the NYSE had an intra-day low of 8343 on January 23 (line 1). The NYSE Composite was down 19% from the October high. As the NYSE was making its low, the McClellan oscillator was just below the zero line and the SMA of the P/C ratio had dropped below its WMA. Two days later, the uptrend in the P/C, line a, was also broken.

Market sentiment was quite negative at this time, and as I interviewed a series of experts in February, majority thought that we were in a bear market. The NYSE shows a broad trading range over the next two months as the lows were tested again on March 17.

The McClellan oscillator formed a short-term positive divergence at these lows, line c, and overcame its resistance, line b, on March 20 (line 2). The P/C turned higher in the latter part of February and peaked as prices were making their lows. The uptrend in the P/C, line d, was broken on March 20, confirming the positive signal from the McClellan oscillator.

The rally from the March lows was a classic bear market rally as the NYSE rallied up to the 61.8% Fibonacci retracement resistance but did not close above it. During the two-month rally, the McClellan oscillator stayed in a range and as is sometimes the case failed to give any clear signals.

The P/C ratio was in a well-established downtrend, line e, during this period, which was broken as the NYSE was making its highs. The McClellan oscillator decisively dropped below the zero line on May 21 (line 3), and by then, the P/C also had moved above 1.00.

During sideway periods in the McClellan oscillator, the NYSE Advance/Decline is more useful. It was in a clear uptrend from early April and did not break its uptrend until May 23. This bear market rally lasted just long enough to change the opinion of the previously bearish advisors.

Since the 2008 financial collapse is hopefully an anomaly that will not be repeated, I will skip forward to the 2009 market low but will Tweet the 2008 chart out next week. The rally in early 2009 (line 1) tested the daily starc+ band before prices reversed. The NYSE then tried to consolidate above the November 2008 lows.

What followed is a classic example of how the McClellan oscillator acts during an interruption in the downtrend or continuation pattern (highlighted in yellow). The oscillator formed twin peaks, line a, before dropping below support. The P/C ratio was in a downtrend at the time indicating that puts were not being bought.

The NYSE tested the starc- band on February 23 as the McClellan oscillator was making its low at -359. It then made two higher lows forming the positive divergence, line b.

The P/C moving averages made their high a day before the low in the McClellan oscillator and then formed lower highs, line c, as the market was bottoming. This was a sign that the sentiment was less bearish in early March than it was in February, which was a positive sign.

By March 12 (line 2), the McClellan oscillator had moved well above the zero line and the uptrend in the P/C had been broken as the bottom formation had been completed.

In May and June of 2012, there was another example of a classic setup. The NYSE Advance/Decline (not shown) had topped out in March and violated support in early April. The McClellan oscillator stayed below the zero line as the NYSE was making its highs. This was a sign of weakness.

The Dow Industrials made new highs on May 1, but the NYSE (see arrow) and the other major averages did not make new highs. The Dow Industrials A/D line (not shown) also failed to confirm the May 1 highs.

Just five days later, the NYSE had dropped below its starc- band as the oscillator violated support and the P/C had moved above the resistance at line c. On May 18, the oscillator made its low at -329, which coincided with a peak in the P/C SMA at 1.34.

The rally did not last long and the NYSE Composite made new lows on June 4. The McClellan oscillator just dropped to -123 and did not make new lows. Therefore, a bullish divergence, line b, was formed. The SMA of the P/C formed lower highs, line d, which confirmed the action in the McClellan oscillator. By June 6, a bottom had been confirmed as I noted at the time in Rally Potential That Bears Don't Expect.

I realize that many of you may not have the capability to plot the McClellan oscillator with the P/C ratio. As I mentioned in an earlier article, you can monitor the McClellan oscillator on StockCharts.com by following this link.

In an earlier trading lesson, A Treasure Trove of Technical Tools, I focused on the site www.indexindicators.com, and they also have a wide range of Put/Call data. This includes the CBOE Total Put/Call, CBOE Index Put/Call, and CBOE Equity Put/Call.

The chart above covers all of 2013 and below the chart of the S&P 500 is a chart of a five-day SMA of the Total Put/Call ratio. I use these signals to time the **Spyder Trust** (SPY) and the above chart can be found here.

In late December of 2012 as stocks dropped sharply in reaction to concerns about the fiscal cliff, the ratio spiked to one standard deviation above the mean (point 1). The technical reading at that time indicated this was a buying opportunity.

As the **Spyder Trust** (SPY) was making its low in February at $147.23, the five-day SMA of the P/C SMA came very close to the two standard deviation level at 1.09 (point 2) with a daily high in the P/C of 1.17.

A similar sharp increase in put volume, as measured by the SMA of the P/C, occurred in the middle of April, as noted by point 3. The decline from the May high to the June low was more severe as the **Spyder Trust** (SPY) dropped 6.4%. The MA of the P/C formed twin peaks (point 4) at 1.15, and on a single day, the P/C came very close to 1.40.

The lowest reading, so far in 2013, came in the first week of September (point 5) as the P/C SMA had a low of 0.77 with a single day reading of 0.67. The **Spyder Trust** (SPY) had another correction from the September 20 high to the October 9 lows as it was down 5.2%. The SMA of the P/C reached the 1.00 level at the October low (point 6).

At the start of December, the P/C dropped below 0.80, and it is now trying to turn up as the stock market is correcting. It is well below levels normally associated with market bottoms and the McClellan oscillator has been quite weak since the middle of November. Both should be monitored as we head into the end of the year.

I hope these examples will have demonstrated why combining these two quite different technical indicators can be a valuable tool. They are especially accurate in identifying short-term market bottoms but are not as good as the A/D line in identifying market peaks. Both are quite good in confirming market corrections. Veteran option expert Larry McMillan, has developed several computer-generated trading systems from the Put/Call data, which you may find interesting.

In terms of the stock market's major trend, the NYSE Advance/Decline, is still the best tool and the readings from it should be combined with the McClellan oscillator and Put/Call ratio. The A/D line will also help tell you whether a market correction is just a pullback within a major trend or whether a more significant correction is likely.

Power Your Portfolio with the Mass Index

Developed by Donald Dorsey, the Mass Index is an indicator that identifies trend reversals, and here, MoneyShow's Tom Aspray explains how it helps him in his analysis.

The majority of technical tools that I use in my analysis and discuss in my trading lessons are ones that I have used for decades or are strategies that have evolved over the years. I was fortunate in the early 1980s to have access to CompuTrac, which included the majority of today's most frequently used technical indicators.

I do continue to do additional research and came across a technical tool that, I think, investors as well as traders should consider adding to their arsenal of market-timing indicators.

It is called the Mass Index, which first appeared in the June '92 *Technical Analysis of Stocks & Commodities* article "The Mass Index", by Donald Dorsey. As he said in the article "Range oscillation, not often covered by students of technical analysis, delves into repetitive market patterns during which the daily trading range narrows and widens. Examining this pattern, Donald Dorsey explains, allows the technician to forecast market reversals that other indicators may miss." Dorsey proposes the use of range oscillators in his Mass index.

Essentially, it measures the narrowing and widening of the range between the high and low prices. The signals do not tell you the direction of the trend change but that is when I rely on other tools such as the NYSE Advance/Decline and the on balance volume.

To calculate the Mass Index:

1. Calculate a nine-day exponential moving average (EMA) of the difference between the high and low prices.
2. Calculate a nine-day exponential moving average of the moving average calculated in Step 1.
3. Divide the moving average calculated in Step 1 by the moving average calculated in Step 2.
4. Total the values in Step 3 for the number of periods in the Mass Index (e.g., 25 days).

$$\sum_{1}^{25}\left[\frac{9\text{-day EMA of (High - Low)}}{9\text{-day EMA of a 9-day EMA of (High - Low)}}\right]$$

In my research I found the Mass Index to be most useful on the weekly data. On the weekly chart of the S&P 500, the Mass Index is in blue and there are two horizontal lines, one at 27 (in red) and the other at 26.5 (in green).The chart covers the period from the early part of 2006 until early in 2010.

Mr. Dorsey looked for what he called “bulges” which was when the Mass Index moves above the 27 level. The first example occurred on August 7, 2007, (line 1), which was two weeks after the July stock market high as the first hints of the mortgage crisis resulted in a wave of selling. Two weeks later, the S&P 500 formed a panic low on August 16.

The Mass Index dropped back below the 27 level at the end of September but did not drop below the 26.50 level, which would have signaled a change in trend. A second bulge occurred the week ending November 16 (line 2) as the Mass Index stayed above 27 until the middle of December.

Then on February 1, 2008, the Mass Index dropped to 26.46 (line 3), which was below the key level of 26.50 (green line) and signaled a trend change. As I discussed in detail in an earlier article, the NYSE Advance/Decline line (see chart) had formed a series of negative divergence since June of the prior year and was already in a well-established downtrend. This indicated that the trend change was to the downside.

The Mass index started to turn up in the fall of 2008, and on November 7, another bulge was formed (line 4). The Mass Index continued higher and peaked at 28.04 in early December. The Index then declined dropping to 26.33 on February 27 and a new trend change was signaled.

The S&P 500 made its bear-market low the following week, and by the end of March, the A/D line had broken its long-term downtrend and had turned positive.

So what has happened since? In this example we are looking at, the Spyder Trust (SPY), which gave identical signals in 2007 as the cash S&P 500. The next bulge occurred on July 7, 2010, (line 1), which was almost a month before the debt ceiling vote, the downgrade of US debt, and plunge in the stock prices.

On August 27, 2010, the Mass Index dropped to 26.36 (line 2) indicating that a trend change was at hand. At the time, the AAII survey of individual investors revealed that only 20.7% were bullish. This was an historically low level that was consistent with a stock-market bottom. In the September 8, 2010, report I noted that the NYSE A/D line had made a new high, which was a bullish sign for stocks.

The Mass Index stayed below the zero line until the following August as it moved back above 27 (line 3) on August 27, 2011. This came during a period of much concern over the Eurozone debt, and by the later part of September, many analysts thought we were already in a recession.

The selling reached a fever pitch on October 4 as most stocks dropped sharply before reversing back to the upside and closing the day higher. The high-to-low ranges were quite extreme as the **Spyder Trust** (SPY) had a high of $112.98 and a low of $107.43. Just seven days after the lows, the A/D lines on the S&P 500 and Dow Industrials completed their bottom formations.

This analysis can then be compared with that of the **PowerShares QQQ Trust** (QQQ) as the weekly chart covers the period from late 2008 until early September of 2013. The Mass Index moved above 27 on November 11, 2008 (line 1). This alerted the investor to be looking for a change in trend.

The Mass Index dropped below 26.50 on January 9, 2009, signaling a trend change (line 2). In early March, the QQQ dropped back towards the November 21 low of $25.05 but only hit a low of $25.63 suggesting a double bottom could be forming. The relative performance analysis at the time indicated that the QQQ was acting stronger than the S&P 500.

The Mass Index stayed below 27 until July 7, 2010, (line 3), which was a month before the previously mentioned debt ceiling fight and stock market plunge. The new uptrend was in place on the chart when the Mass Index dropped below 26.50, line 4, on September 17, 2010.

It was almost a year before the Mass Index again moved above the 27 level (line 5) on August 12, 2011. It was almost five months later when the Mass Index dropped to 26.35 confirming a new trend change. As is the case for the **Spyder Trust** (SPY), the Mass Index has stayed well below the 27 level, which is consistent with no change in the major uptrend for stocks.

What about other major market turns? This chart covers the Nasdaq Composite from the middle of 1995 until the latter part of 2000. On August 4, 1995, the Mass Index moved above the 27 level and stayed above it until the end of the year.

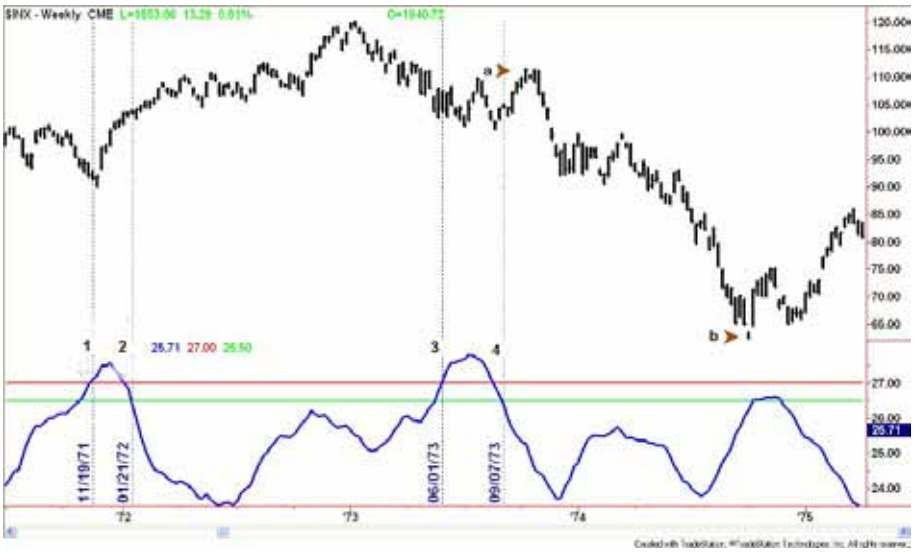
The inset on the chart (1995-1996) shows that four weeks after the Mass Index signaled a trend change, the continuation pattern, lines a and b, was completed. This was an indication that the prior uptrend had resumed.

The Mass Index did not come close to the 27 level until January 16, 1998, (line 3), when it hit a high of 26.99. A month later, it dropped below the 26.50 level, but because it had not moved above the 27 level, a trend change was not generated.

Of course, these levels could be adjusted or optimized, but in my initial review, I wanted to start with the guidelines of the creator. Modifications may be included in a future article.

The next "bulge" or what I would call an early warning signal was on September 25, 1998, (line 4), when it came close to the 28 level. The prior high, line c, was overcome in the middle of December. The Nasdaq Composite gained about 12.8% before the Mass Index dropped below the 26.50 level, line 5, on February 26, 1999.

The Nasdaq Composite closed at 2288 and then rose 85% until February 4, 2000, (line 6), when the Mass Index next moved above the 27 level (line 6). Of course, the Nasdaq Composite peaked at 5132 in March of 2000, but the Mass Index did not drop back below the 26.50 level until July 28 (line 7).



When I research an indicator or methodology, I also like to look at some of the key historical periods, so I can gain further insight on how it might have performed. This chart covers the S&P 500 from late 1971 through the latter part of 1975, which includes one of the worst bear markets.

The warning signal came on November 19, 1971, as the Mass Index crossed above the 27 level one week before the S&P made its low. Two months later, the Mass Index dropped to 26.40 and signaled a change in trend.

The S&P 500 rallied until early 1973, and by the middle of February 1973, one of my favorite market timing indicators, the weekly NYSE Advance/Decline line had turned negative.

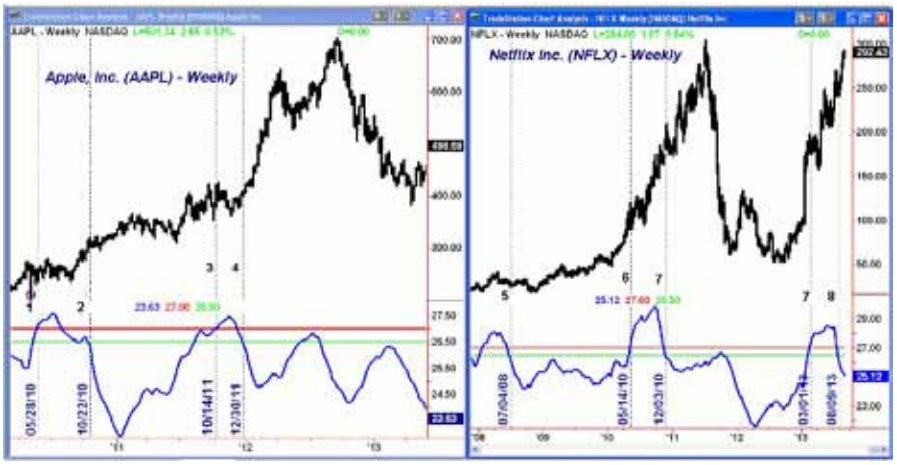
The signal or bulge in the Mass Index did not occur until June 1, 1973, (line 3), as it rose to a high of 27.81 by the middle of July. By September 7, 1973, a trend change was identified as the Mass Index dropped to 26.39, line 4. The S&P 500 rallied for seven weeks before it was hit with heavy selling.

From the October 1973 high, point a, to the October 1974 low (point b) the S&P 500 lost 43.5%. I also looked at some periods from the 1960's where the Mass Index also performed well. For example, it signaled a trend change near the S&P 500's low in September 1962 and then another in early 1963 very close to the highs.

In my initial research, I concentrated mainly in the major averages and market-tracking ETFs. It was designed apparently to also work on stocks, so I wanted to examine how it has worked on two widely followed stocks, **Apple, Inc.** (AAPL) and **Netflix Inc.** (NFLX).

On May 28, 2010, the Mass index on AAPL moved above the 27 level (line 1). In the latter part of September, the

stock made a new high for the year overcoming the resistance at $283. On October 22, the Mass Index dropped to 26.33 signaling a trend change, line 2.



The next early warning signal (line 3) came on October 14, 2011, and at the end of the year (12/30/11) the Mass Index declined to 26.41 and below the key level of 26.50, line 4. A month later at the end of January, AAPL overcame the resistance at $431 which was bullish. In July 2012 the Mass Index rose to 26.86 but did not make it above the 27 level and the stock topped in the middle of September.

Neflix Inc. (NFLX) signaled a trend change on July 4, 2008, when the stock closed at $27.21, line 5. It was not until April of 2009 that NFLX surpassed the price high at $41.75 from early 2008.

The 27 level was next overcome on May 14, 2010 (line 6) as the Mass Index had surged from 26.80 to 27.38. This was followed by a trend change signal on December 3, 2010. The stock continued higher until June 2011 when it peaked at over $300 per share. The weekly OBV turned negative two weeks after the high.

The Mass Index rose above 26.50 in October of 2011 but never made it above the 27 level. The most recent signal from the Mass Index came on March 3, 2013, when it rose to 27.48. Eight weeks later, NFLX broke out above the resistance at $198. The trend change was signaled on August 9, 2013, and since then, NFLX has surged from $246 to a new high of $293.06. The weekly OBV on NFLX is currently positive and shows no signs yet of a top.

So, how will I incorporate the Mass Index into my analysis? I will be scanning the major averages and the index-tracking ETFs each weekend, looking for readings above the 27 level, as well as the overall trend of the Mass Index.

At this point, my research has convinced me that the Mass Index is a useful confirming tool for market timing. It will supplement my analysis of the Advance/Decline and the on-balance volume, which are still the most important.

These examples show how it has worked at major trend changes, as well as giving confirmation that an up or down trend has resumed. I have pointed out several examples where significant chart resistance was overcome after the Mass Index moved above 27 but before it dropped below 26.50. There were also cases where the Mass Index dropped below 26.50, and the trend change was subsequently confirmed a few weeks later by a breakout in prices.

The Mass Index is available on many free websites including StockCharts.com. I will be doing further work with this indicator, so look for updates in the future.