Financial Research, Education & Data

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February 2012
Charts as of 01/27/12

The FRED Report – Monthly Review

Research Piece for February: Utilizing MACD vs. Moving Averages

Positive	Negative	Neutral	Highlight
↑	↓	↔	Change

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Summary of Monthly Piece

ASSET CLASSES:

STOCKS:

Rating the three Market Principles:
As readers know, we break the stock market down into three basic market principles: (a) Sentiment, (b) Internal Momentum, and (c) External Momentum. I will review these here.

Sentiment: We use two indicators to measure sentiment. These are options activity and certain sentiment polls. For options, we use total CBOE volume and take the figure directly from the CBOE website. For our sentiment poll numbers, we prefer using % bears from Investors Intelligence. We use only the % bear's number because, in our opinion, the bears almost always take action. It is rare to find a complacent bear. Sentiment is what we call a "Condition Indicator". By this we mean it has nothing to do with timing trades – rather it is part of the overall mosaic of market activity.

Our current reading of the sentiment indicators is NEUTRAL. Sentiment indicators still suggest a high level of bearishness. The Put/Call indicator has fallen just into sell territory, and rebounded. Daily readings show high put buying on any sign of a pullback, a positive. Investor's Intelligence % Bears Readings gave a buy signal in September 2011 and has continued to remain elevated (the last was 30%). Our model has barely fallen as recent strength has unfolded, and is still near the highest levels we have seen since May of 2009. Anecdotal sentiment suggests that few investors are fully invested, and these indicators support continued rally in the first quarter, as do short-term price charts.

Internal Momentum: We use several Breadth indicators to measure internal momentum. We publish three indicators in this Monthly Review: the McClellan Oscillator, an Indicator of New Highs on the NYSE vs. New Lows, and our own breadth oscillator – called **Fred's Breadth Oscillator**, or FBO. The McClellan gives great trading signals, while the last two are also "Condition Indicators".

Our current reading of the internal momentum indicators is NEUTRAL. The weekly or intermediate FBO has started to advance in January 2012, ameliorating the biggest negative indicator for stocks. The daily FBO had a strong up-move into mid November, retraced much of the move into year end. It has put on another surge to start 2012. New highs have expanded, and lows have contracted. The McClellan Oscillator is overbought and right now this is our biggest concern – it is giving some short-term selling indications, suggesting an imminent short-term pullback could occur. After a sharp drop, then stock indexes should advance again.

External Momentum: We use several price indicators to measure this, and these are primarily tactical indicators. We use the 5 and 20 period moving averages, and a simple crossover to determine trend. We use Stochastics, another standard indicator, to measure overbought/oversold levels, or as we prefer to consider them, areas of risk and reward. The one criticism of Stochastics is that they are too sensitive, so we also have our own Price Oscillator we publish, called **Fred's Price Oscillator, or the FPO**.

Summary of Monthly Piece…..continued

Our current reading of the External Momentum indicators is NEUTRAL. Short -term Stochastics have moved to overbought, as have weeklies, but moving averages are positive and this configuration often occurs during an uptrend. The daily FPO shows waning momentum such that a correction could occur, but this should be a correction in an uptrend. This is why we have reduced our rating on external momentum to neutral from positive, however.

CONCLUSION: Stocks have rallied out of the Inverse Head and Shoulders mentioned in last month's report. It is not surprising to see overbought readings on some indicators as this occurs. Sentiment suggests a rally could carry further than people expect – **a test of the 137 area highs on SPY is not out of the question, whether before or after a sharp short-term correction remains the question?**

FIXED INCOME:

Treasuries continue to hold up, but may be building a broadening top formation. Accumulation models on the TLT have started to weaken, enough to suggest more correction in the first quarter. Corporate bonds have been volatile but have recently moved to new highs – and remain our favorite area for bond investors. Our favorite bond speculation is now international bond ETFs, as we could see a sharp rally in the European currencies over the next few months – we believe this would surprise the markets.

COMMODITIES:

Integral to our longer term strategic view of the markets is that we have entered an era of commodity inflation. Recent volatility has been challenging, however. Metals dropped sharply at the end of 2011. Our 7-month target for gold remains $2100/oz or 210 on GLD, whichever occurs first. Right now this target remains in effect. There is a strong seasonal tendency for the Petroleum Complex to rally in the winter, and we advocate overweight energy and energy stock positions into the January/February timeframe. We note that USO has actually already hit the bottom end of our target range for 2011 (40 – 43), and while we expect a strong January for oil there may not be much upside left here. We look for an opportunity in agricultural commodities late January/early February.

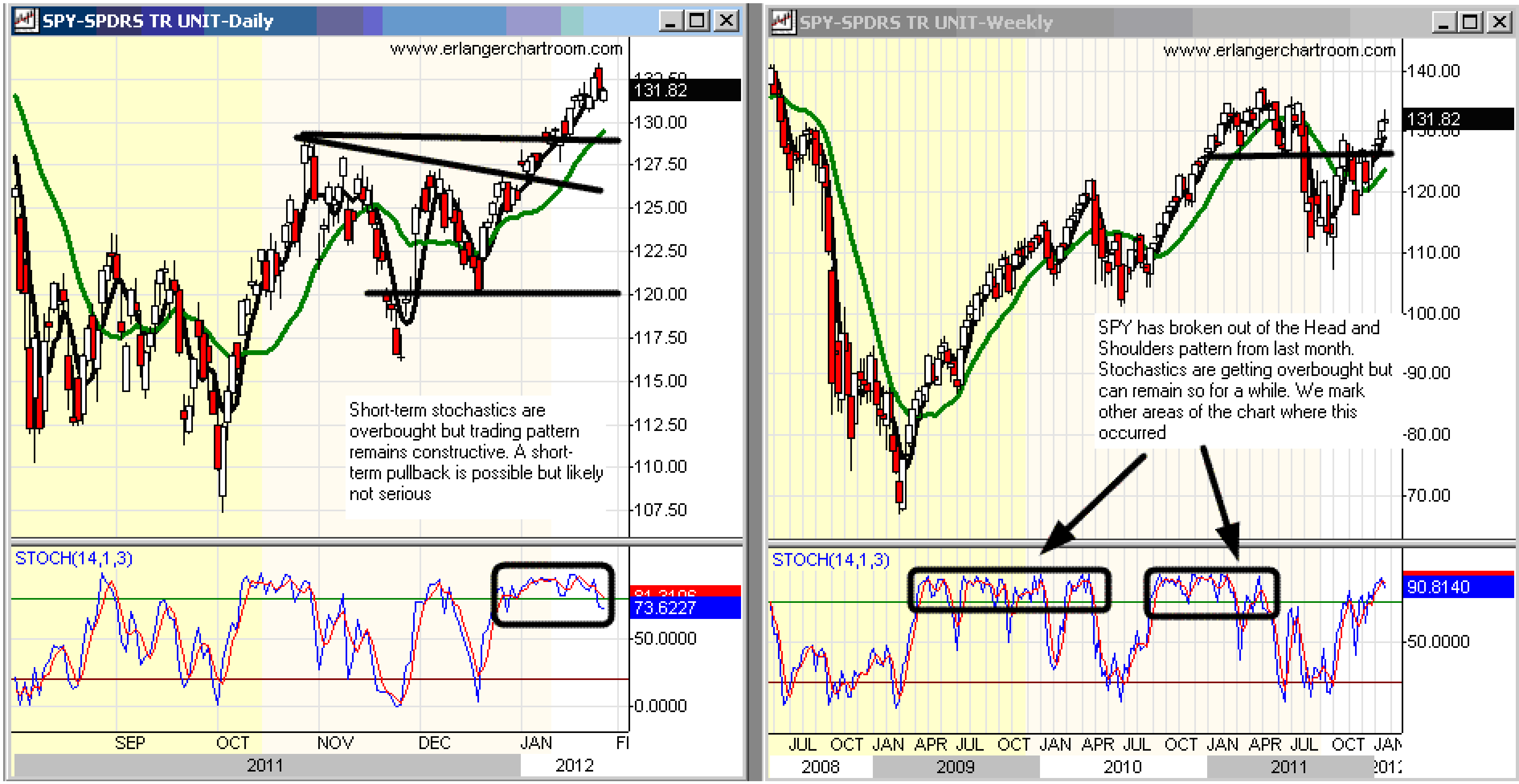
INTERNATIONAL:

International markets still look weaker short-term than the U.S. market. Emerging Markets have been volatile, and now look slightly stronger than Developed Markets. Yes, emerging markets could rally, but they still look to underperform US Small and Mid-Cap names over the course of 2012. **The Euro may surprise us with a rally in the first quarter**. If this happens EFA may rally strongly, and outperform EEM – a potential surprise. The FXY has fallen as Japan intervened. Australia is trading well, and remains an interesting alternative to the metals. FXA improved relative to GLD, and GLD is now rallying. Australia and Canada may be set to outperform in 2012.

SECTORS:

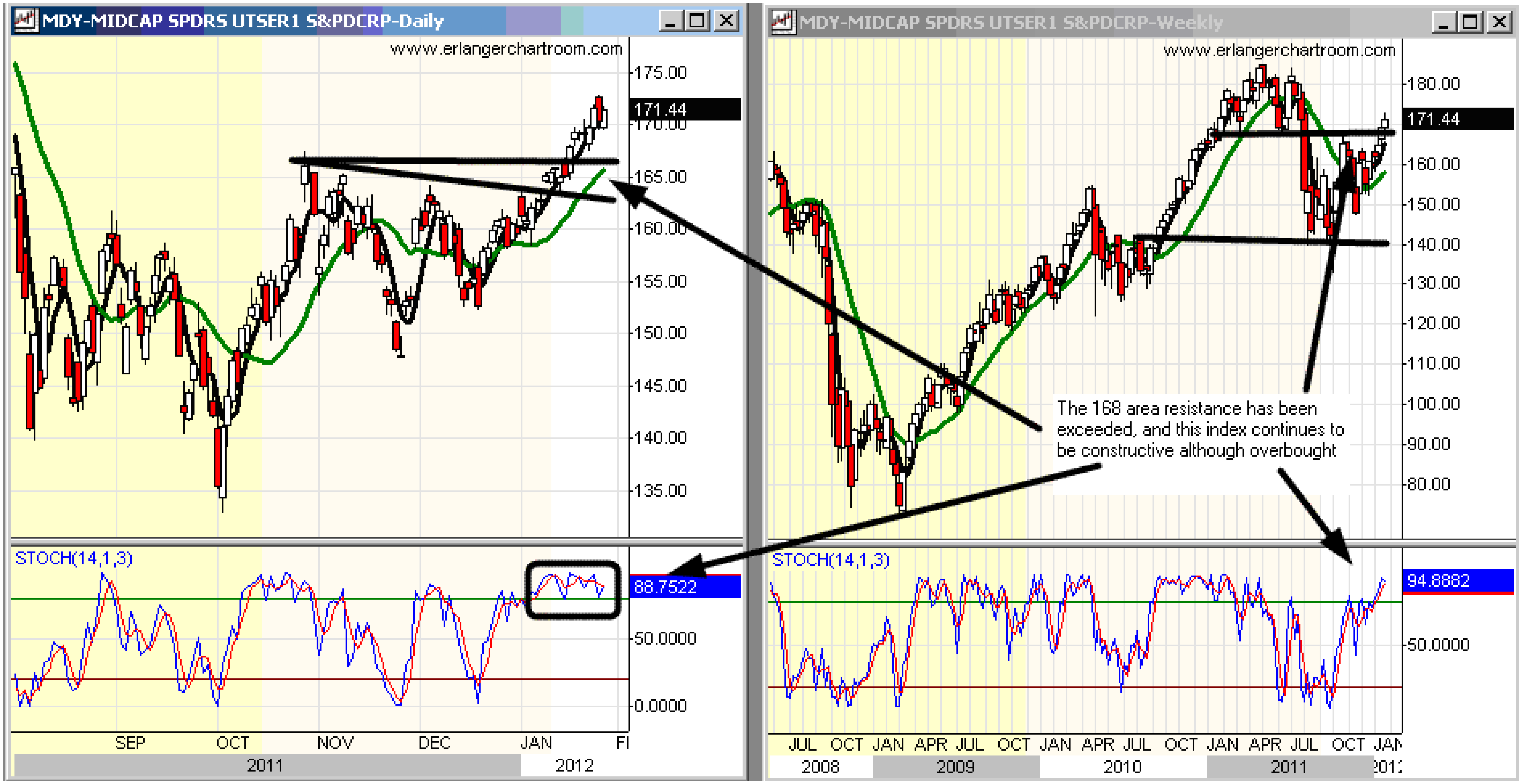
We have two over weights, the XLE (ENERGY) and XLV (Healthcare). Our two under weights are XLU (Utilities) and XLY (Discretionary). Our favorite DEFENSIVE sector remains Staples (XLP), once again near all-time highs. Energy is showing more signs of strength in our accumulation models, and should advance into February. The most interesting "up and coming" sector is XLV (Healthcare). Both price charts and accumulation models have improved substantially in recent weeks. We note that financials have improved enough to move to an equal weight – yes this is risky, but this could continue through the end of the first quarter. XLY's accumulation model has fallen dramatically – while there have been improvements in XLI (Industrials) and XLB (Materials). Perhaps what this is suggesting is consumer spending will fall off during the year, but businesses will start to spend. This is a long-term positive for the economy, in our view

Market Review: Price Charts – SPY – SP 500 ETF



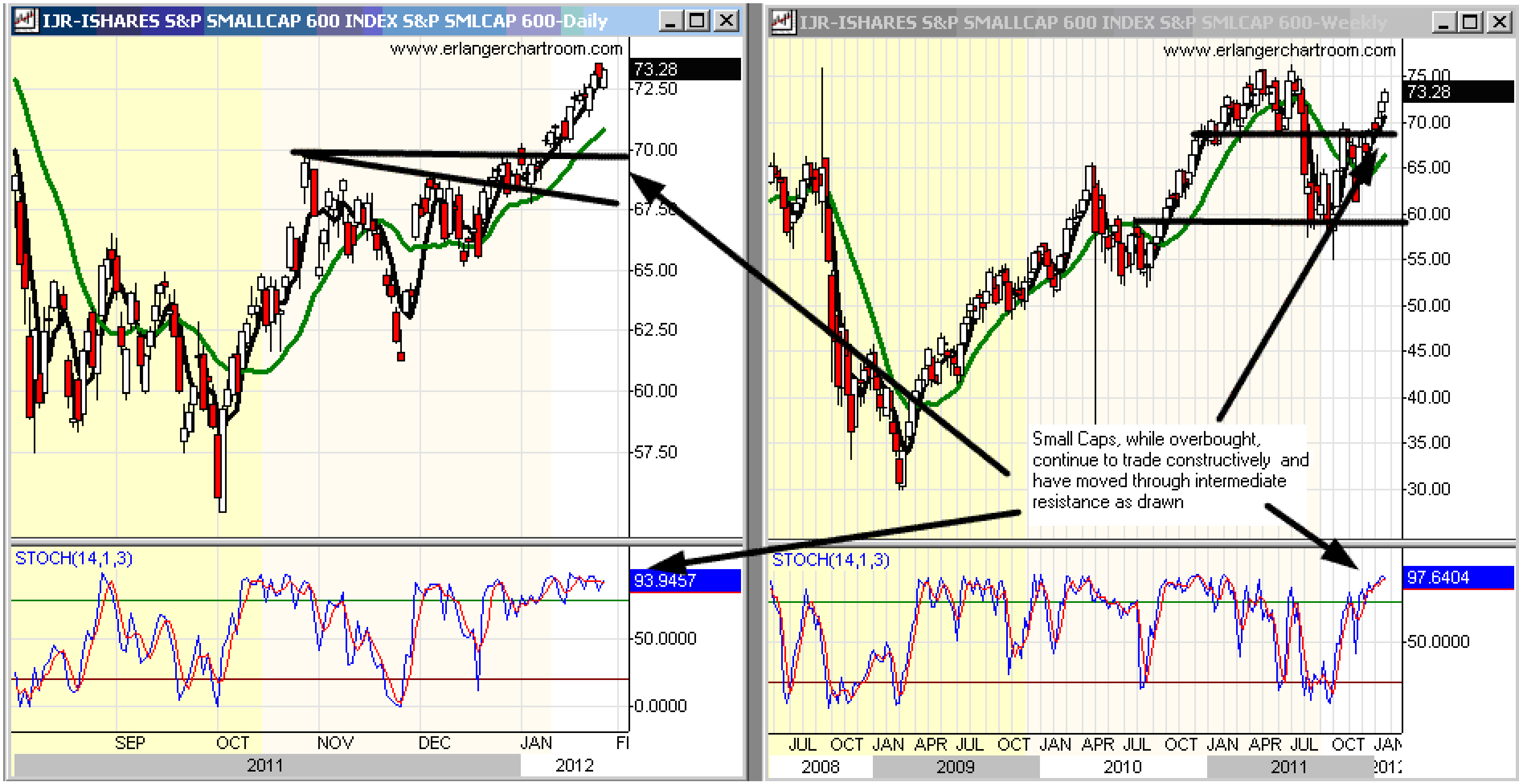
<u>The SPY has broken out of the Head and Shoulders bottoming pattern:</u> The SPY has moved up out of the bottoming patterns noted in last month's report. Stochastics have become overbought, but market breadth and other measures have improved enough that the market should move higher, even if a short-term pullback occurs. See pages 10 – 13 of this report for more on this. Exceeding the 137 area "Cambridge Hook" high in the first half of 2012 is certainly possible.

Market Review: Price Charts – MDY – MidCap SPDRS ETF



The MDY has similar patterns to SPY, but is slightly weaker, short-term: Mid-caps made all-time highs in 2011, suggesting a longer-term bullish trend. Most indicators remain bullish and accumulation models are still positive. Short-term weakness is relative – another way to look at this picture is that mid-caps are around 5% below all-time highs. We continue to believe that the price structure is more constructive than the current sentiment suggests, While stocks could pull back to resolve the short-term overbought at any time, we expect higher highs in 2012.

Market Review: Price Charts – IJR – IShares S&P SmallCap 600 Index ETF

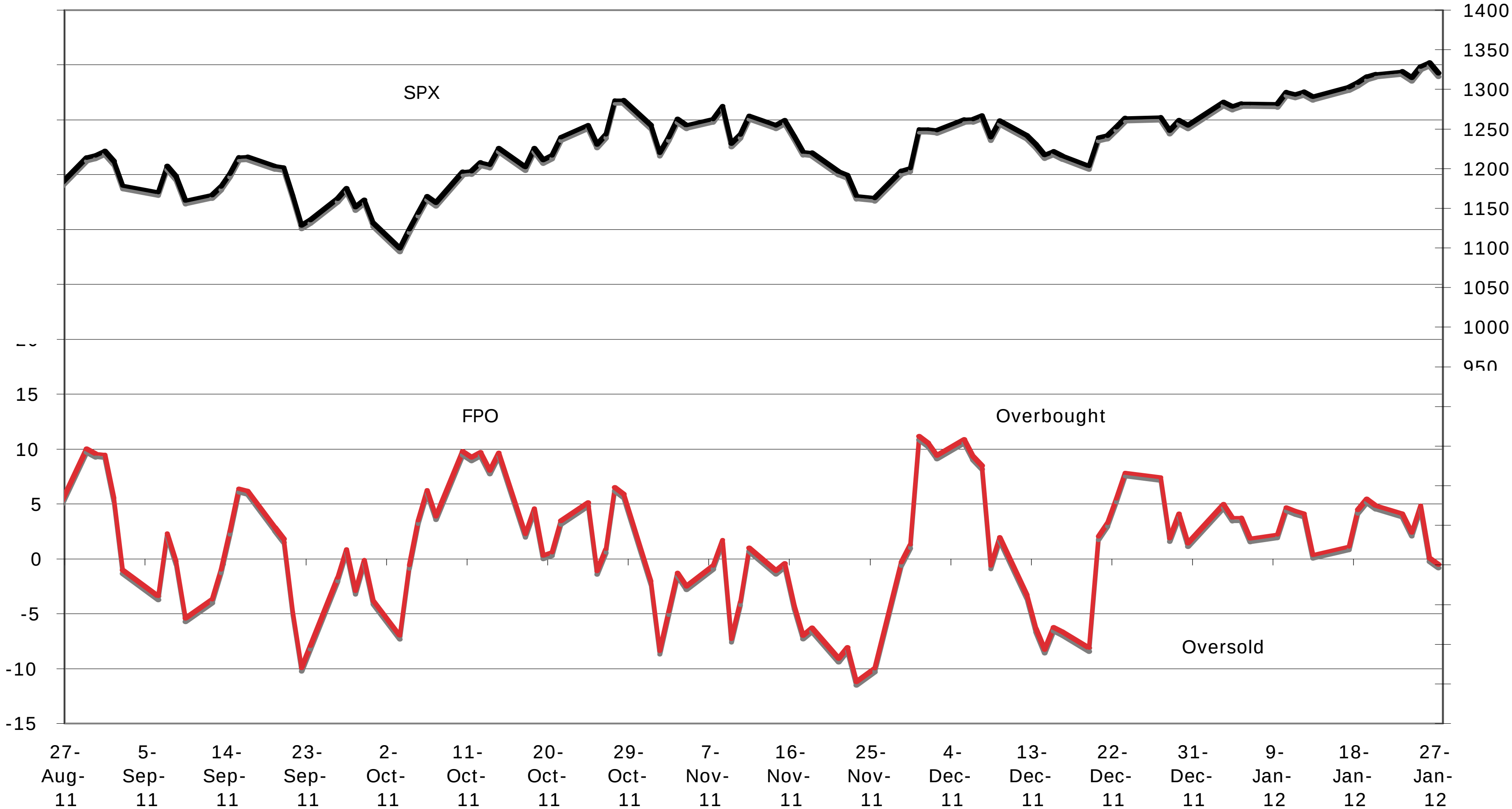


The Small Cap ETF has similar patterns, and has also made all time highs in 2011: Small caps made new highs in July 2011, and as with mid caps, the short-term weakness is overshadowed by longer-term strength. The accumulation model on IJR still remains positive. This could be a great year for small cap stocks as the economy continues to improve. This index should out-perform as recession fears abate later in 2012. We also think speculative money could flow into small cap names and out of emerging markets. Accumulate slowly.

Market Review: Price Charts – IYT – Transportation

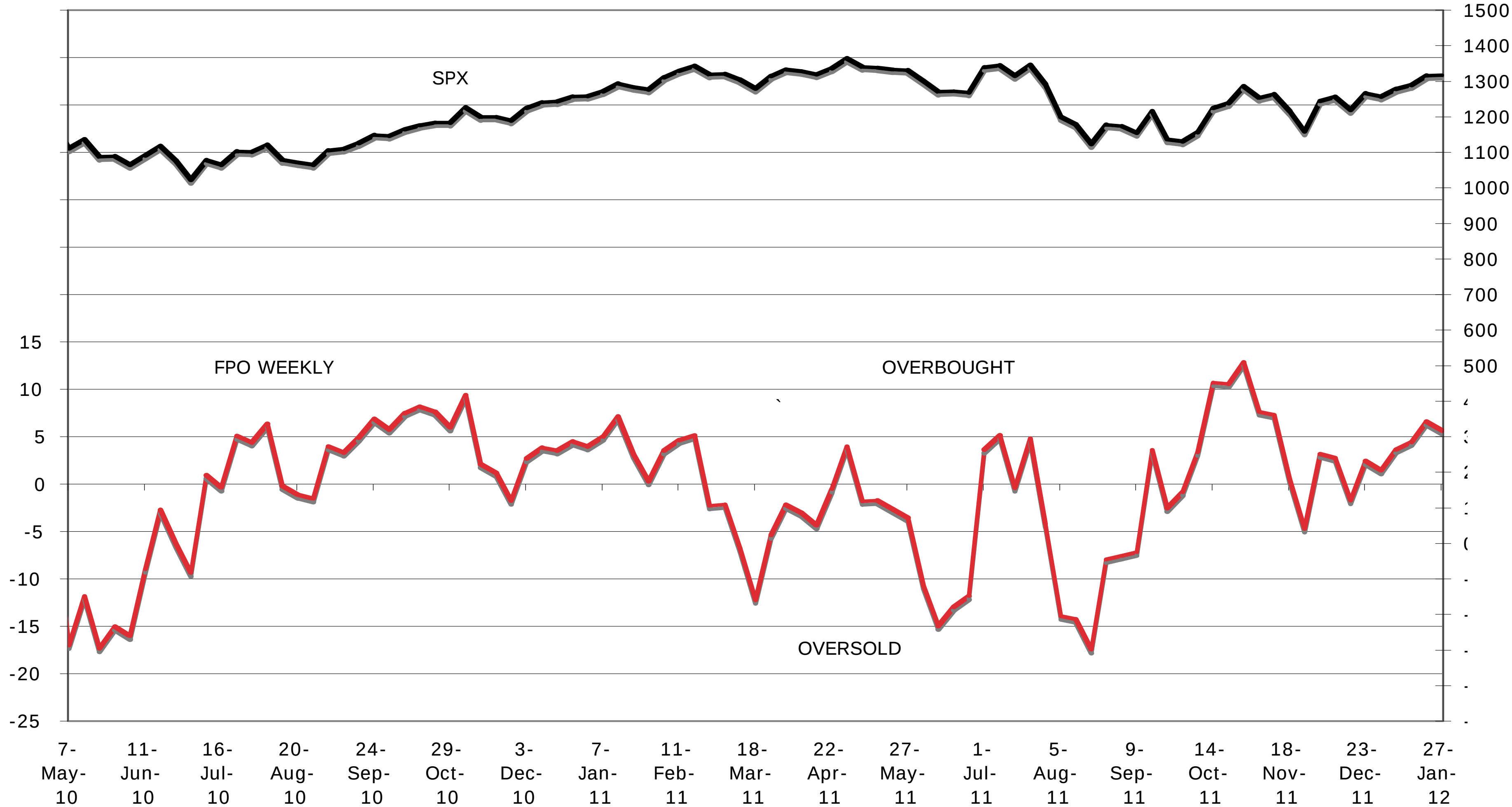
<u>The Transports have improved, breaking above the 90 area resistance</u>: Long time readers will recall that this index is our favorite measure of economic strength. This ETF is much improved since the last report, moving above the 90 – 93 resistance with an improving accumulation model. This suggests that the recent improvement in economic numbers should continue. Just as the other indexes are short-term overbought, so is IYT, but there should be higher highs in the first half, even if the market corrects.

Market Review: Price Charts – Daily – Fred's Price Oscillator



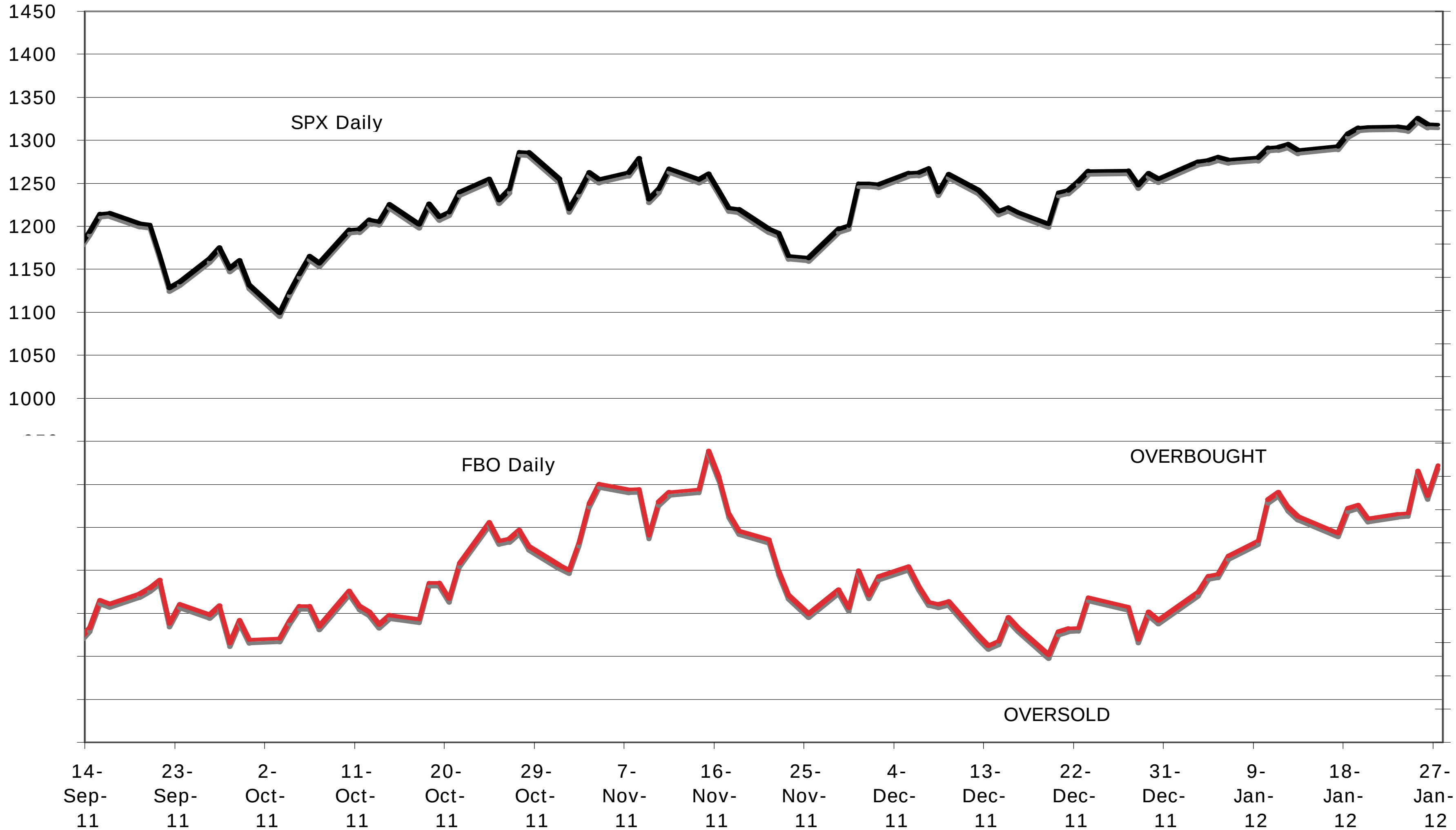
The daily FPO has made a series of lower highs, and is now slightly negative. This indicator suggested a short-term rally last month, and this has occurred. Now, the indicator suggests the market might pull back as it has gone slightly negative. Whether or not a pullback occurs, the market could make higher highs by March. Our concern is that Monthlies (see the January research piece) will be overbought once again, should the market rally into February. This implies a more severe correction may occur mid-year – some caution is indicated.

Market Review: Price Charts – Weekly – Fred's Price Oscillator



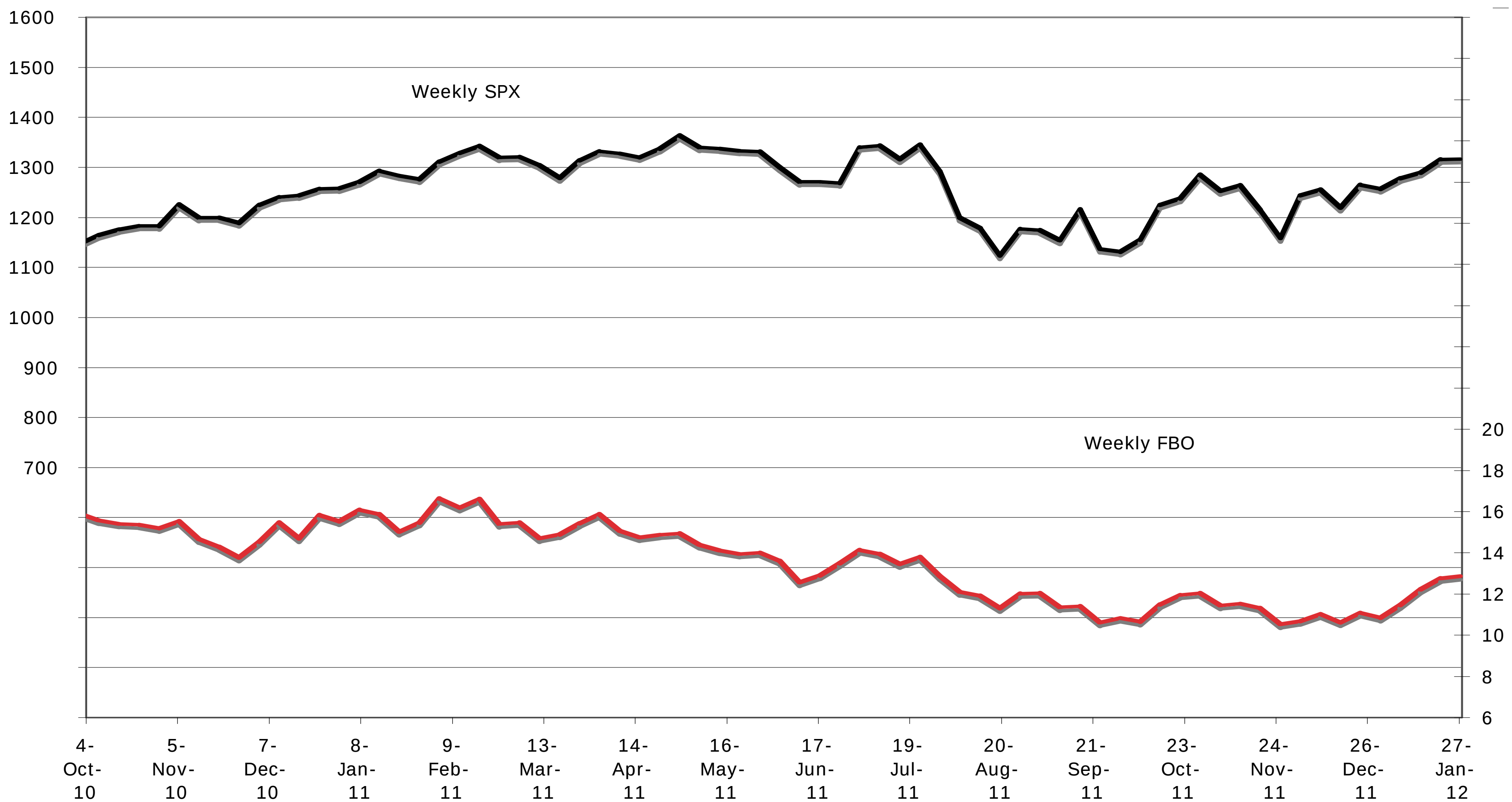
<u>The Weekly FPO moved to the highest level since 2010, a positive, before the November pullback:</u> The November pullback was more severe than expected. This indicator normally peaks through divergence and it should take several weeks, and a new closing high, for divergences to develop. This indicator continues to look positive longer-term. We rate it neutral and note that the next overbought reading will correspond with a monthly overbought, ushering in a period of higher risk. This seems to be several weeks away.

Market Review: Internal Momentum – Daily Fred's Breadth Oscillator



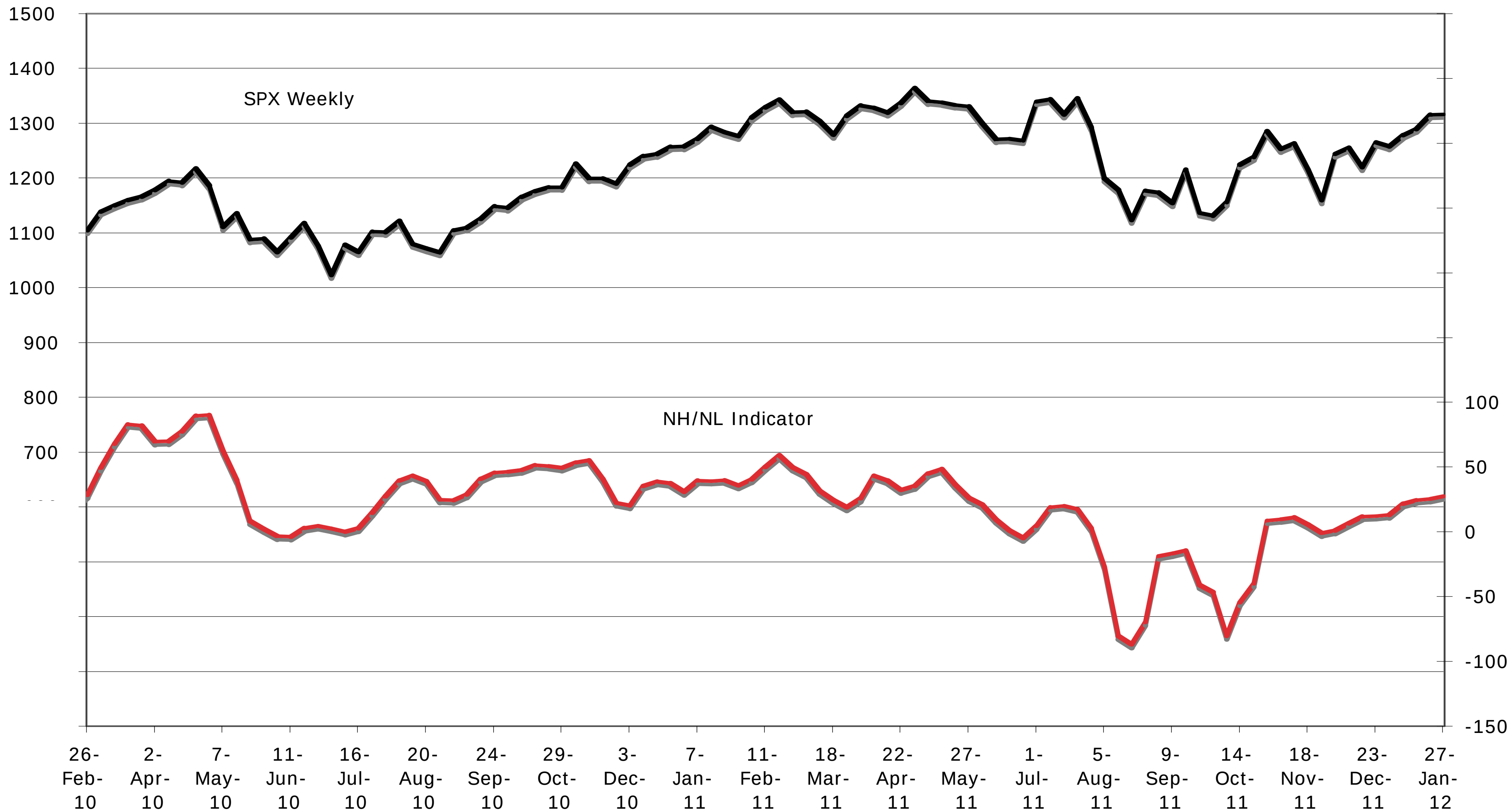
The short-term FBO is moving up: The indicator is now in overbought territory. However, we view this as somewhat positive, as breadth momentum indicators had a nice surge, and this was needed to confirm the recent rally. We rate this neutral/positive – while the overbought could be corrected at any time, the pattern suggests higher highs are in store.

Market Review: Internal Momentum – Weekly Fred's Breadth Oscillator



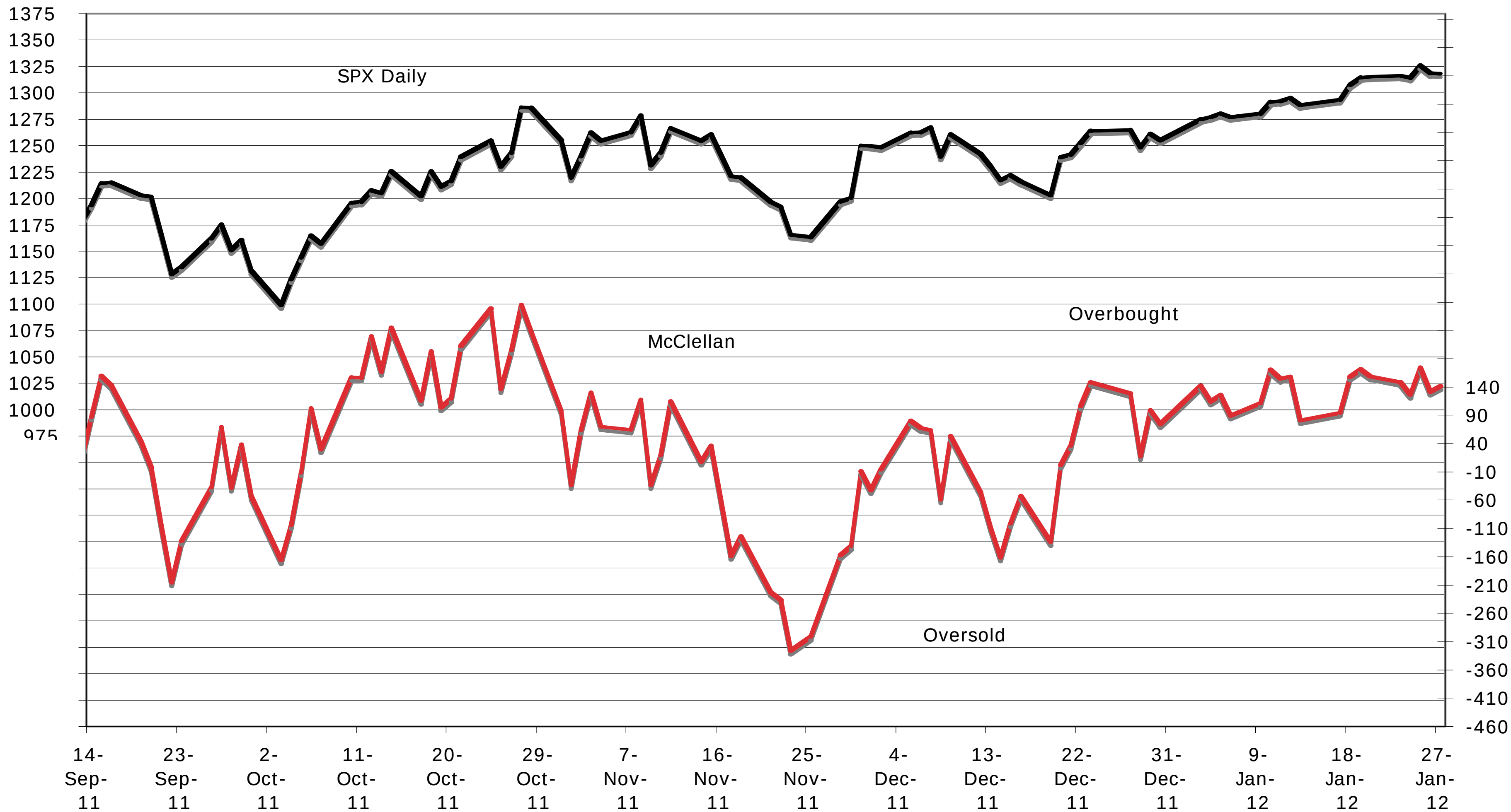
The Intermediate FBO has built a base, and is moving out to the upside: This indicator did not confirm the rally from August to December 2011. While weekly breadth numbers have been our biggest concern for stocks as a whole, this indicator has improved over the last four weeks. The broader indexes have been lagging a bit, and are now fully testing resistance. Since weekly breadth is improving but is not yet overbought, we view the current environment as intermediate-term positive.

Market Review: Internal Momentum – Fred's New Highs/New Lows Indicator



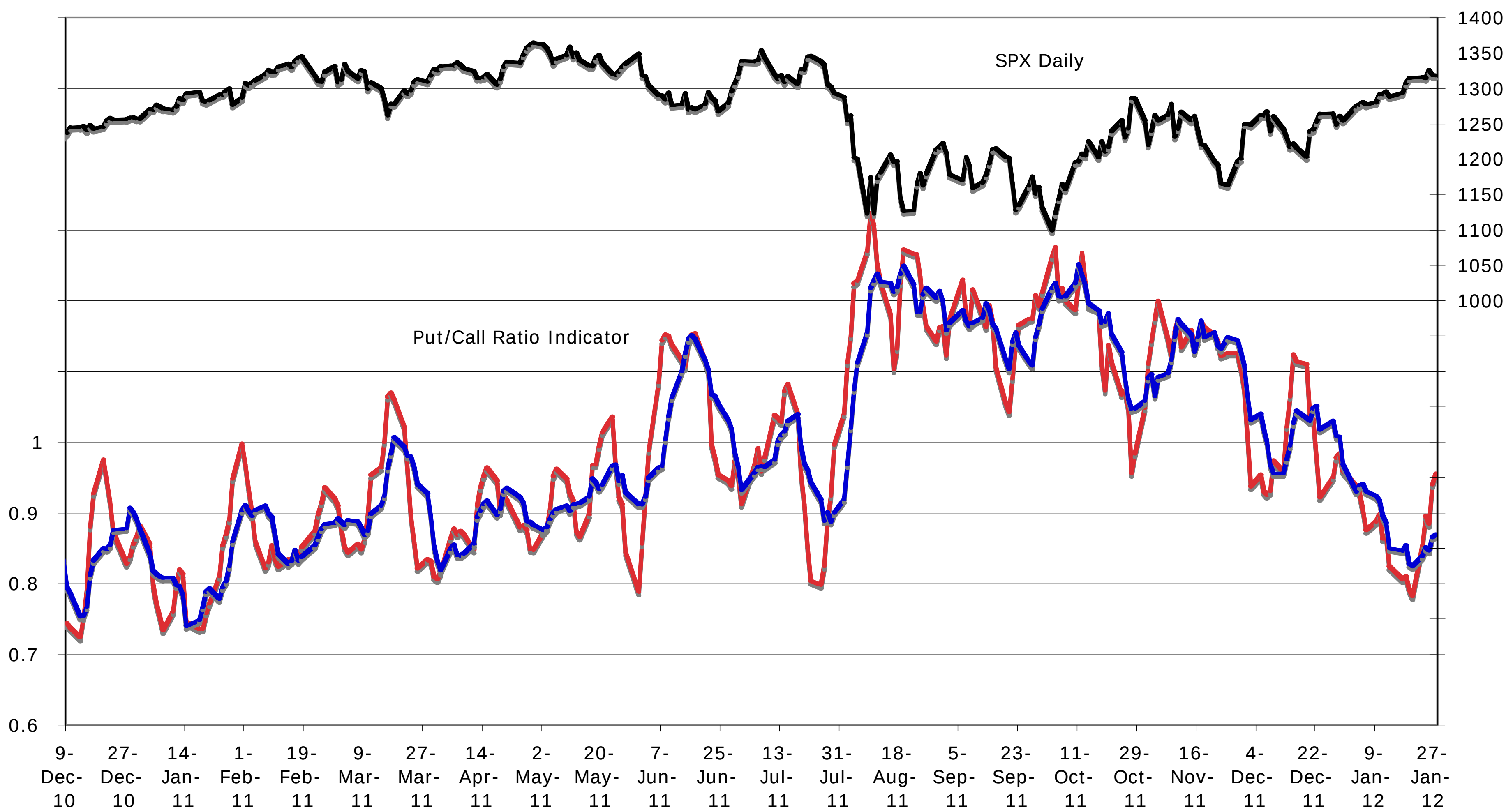
New Highs/New Lows have continued to improve since last month's report: This tool measures the difference between the amount of new highs and new lows on the NYSE. New lows have continued to contract over the last two weeks, and new highs are now expanding. This indicator often peaks and troughs early, has given bottoming signs, but no new signs that a peak is occurring. This indicator should continue to improve in the weeks ahead to sustain the rally.

Market Review: Internal Momentum – McClellan Oscillator



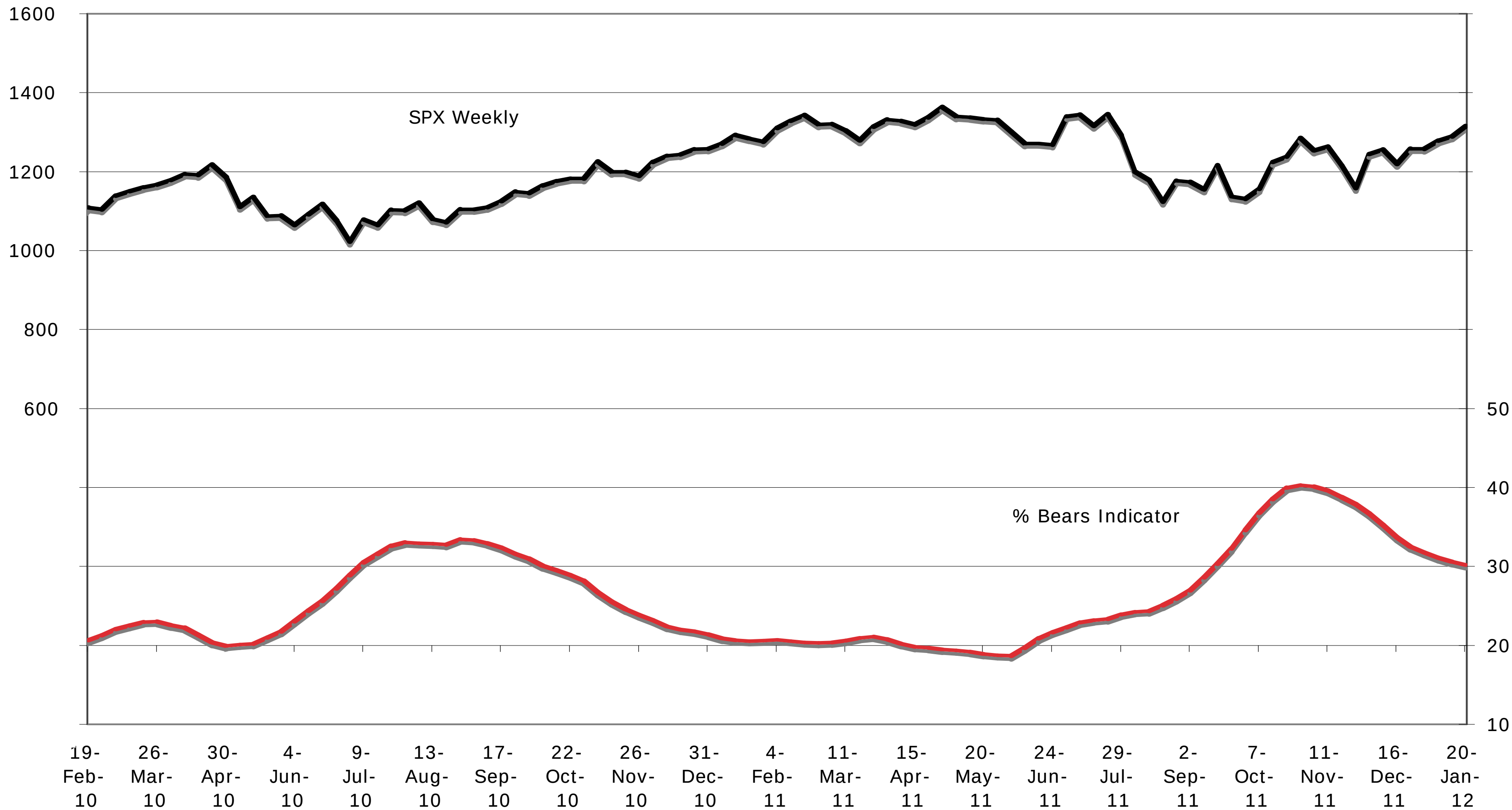
The McClellan Oscillator slightly overbought, and moving sideways: The McClellan is one of our favorite short-term timing tools. The pattern on the oscillator is positive – but with some risk, remaining slightly overbought since early December. Unless there is another breadth surge the chances of a sharp drop to "0" or even into negative territory is rising. This sort of drop means a period of negative breadth, which implies a short-term correction.

Market Review: Sentiment – Put/Call Ratio



The Put/Call ratio is Neutral: Sentiment indicators are "condition" indicators for us, and not timing tools. This indicator moved up sharply into the buying area on the correction in 2011 and has come down – not surprising as the market has rallied strongly. One favorable indication from put/call numbers is that put buying jumps up on any sign of weakness – suggesting that complacency is not yet a problem. Still, a short-term pullback is possible when looking at this indicator.

Market Review: Sentiment – Investors Intelligence % Bears Indicator (moving averages)



Investor's Intelligence %Bears indicator has started to fall off as the market rallied: The current reading is 30%, down from 32% since the last report, and this is normal behavior for this indicator. The %bears has been relatively steady in the last few weeks as the market accelerated, a plus. The indicator hit the highest levels seen since May of 2009 and remains in bullish territory. Normally a string of readings in the low 20's occurs before a market peak, and latest readings remain in the 28 area, a plus.

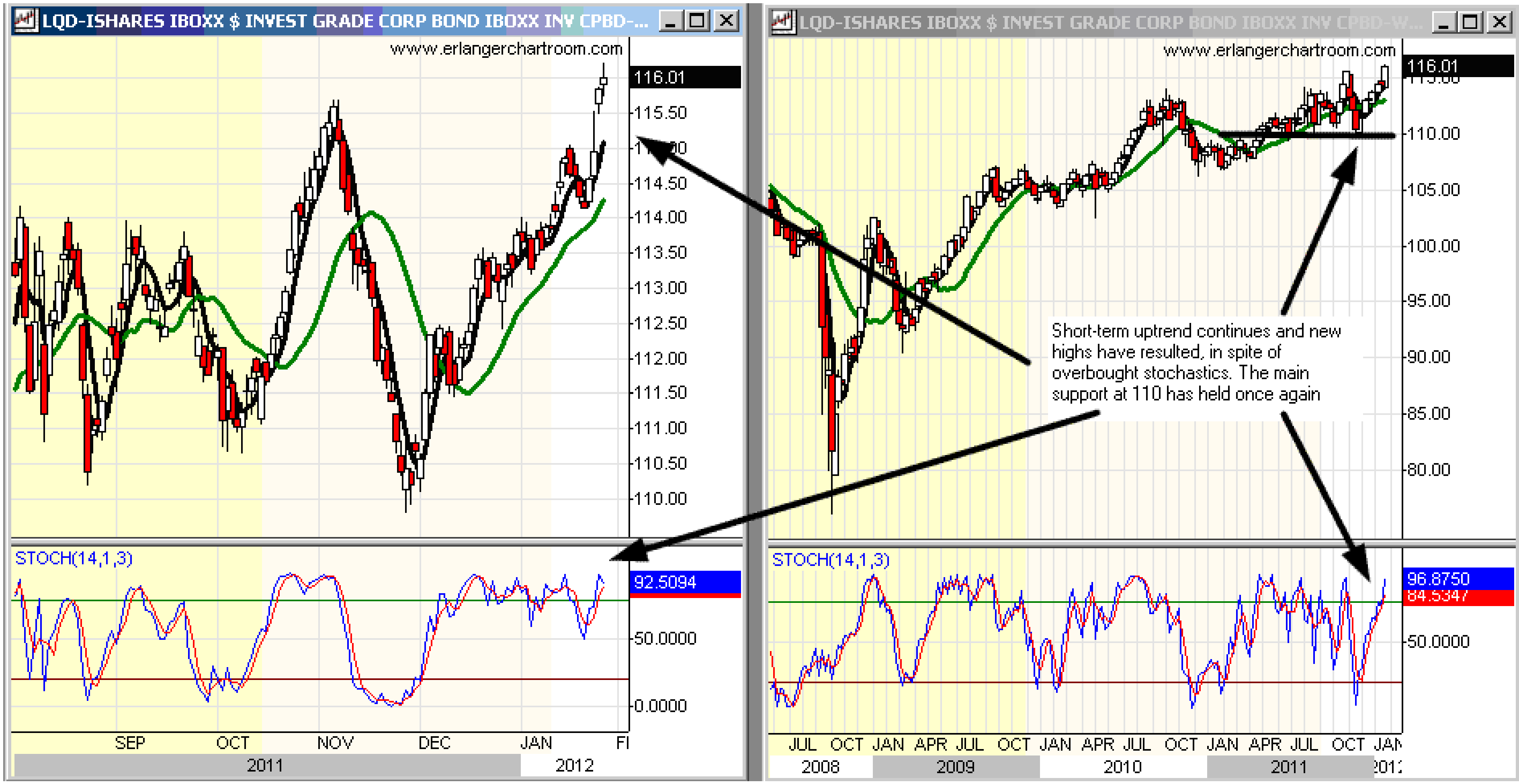
Other Markets: Bonds – TLT – iShares Barclays 20+ Year Treasury Bond

The TLT remains stronger than expected but there are more signs of deterioration: The TLT is fully testing 116 area support and has held. Accumulation models continue to slowly weaken. Monthly indicators remain overbought. Recent FED announcements have helped this market, but it still looks to decline and in fact bonds have made no net progress since September. Market sentiment may be changing from safety and income to income with growth possibilities, which would be a negative for TLT. Neutral to weak technical pattern.

Other Markets: Bonds – BWX – SPDR Barclays Capital Intl Treasury Bond

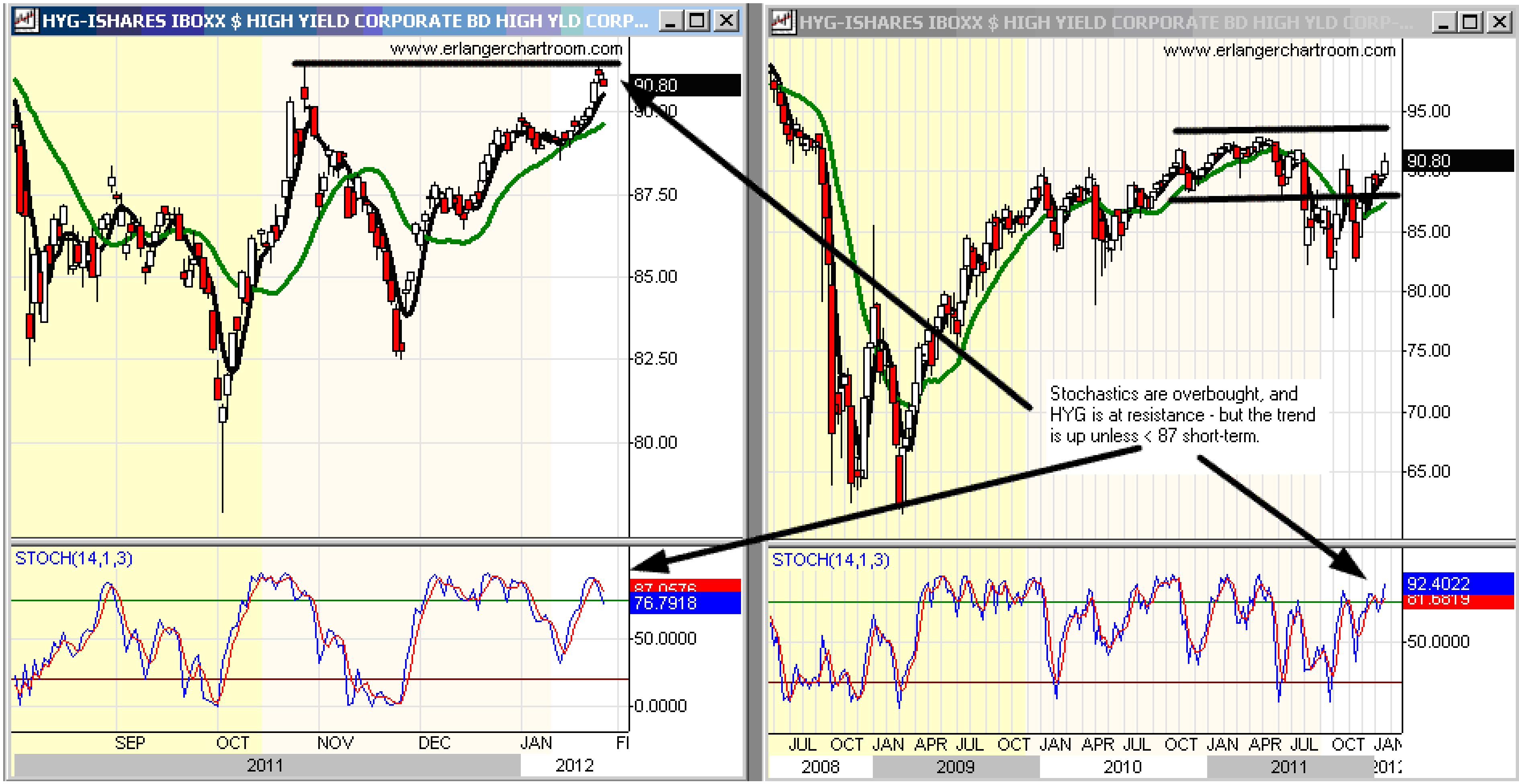
<u>The BWX has held the intermediate-term support</u>: Currently this ETF is volatile and weakness in the Euro has had an effect. The intermediate-term chart remains positive as the 57 area support has been fully tested, and held. Daily moving averages are now positive. The Japanese Yen pulled back due to intervention, which pressured this ETF. For the last few months we have recommended that BWX should be avoided, but now it is a buy, with stops below 56, for aggressive traders.

Other Markets: Bonds – LQD – iShares iBoxx $ Invest Grade Corp Bond



<u>The Corporate Bond ETF held long-term support and has made new highs:</u> The overall condition of rates remains a concern. This ETF remains intermediate-term up and has been our preferred bond investment over the last few months. Recent new highs are a plus and confirm our view. This remains our favorite area for new fixed income investing (which is not our favorite area for investing, however).

Other Markets: Bonds – HYG – iShares iBoxx $ High Yield Corp Bond



__The High Yield Bond ETF traded as a proxy for risk in 2011__: This ETF broke below support as the stock market corrected. It rallied along with stocks and is fully testing resistance. This ETF looks to be a range from 80 to 90 or so, and these layers of resistance from 90 - 94 are being tested. HYG may start to trade more in line with rates in 2012.

Other Markets: International – EEM – iShares: MSCI Emerging Markets

The EEM has underperformed the US in 2011: Intermediate relative strength continues to deteriorate. We have recommended de-emphasizing international markets, and note that if this were trading in line with the US it would be comfortably above the 45 resistance. For new international money, we would look at individual country funds, and if flexible would use US small or mid-cap funds instead. Further rally is possible, of course, but we think US Small and Mid-Cap will continue to outperform in 2012 on an intermediate basis.

Other Markets: International – EFA – iShares: MSCI EAFE Index

The EFA continues to under-perform the US and is now under-performing EEM: This ETF continues to under-perform the SPY and MDY. EFA looks weaker than SPY both on this recent correction and on the rally as well. We continue to see movement from Europe into the US. We believe that US markets, particularly the Dow and SPX, should outperform EFA in 2012, but it is quite possible that we see a sharp move up into the end of the first quarter in these markets. Aggressive traders can position for this now.

Other Markets: Currencies – FXE – CurrencyShares Euro Trust

<u>The Euro ETF has held at the 128 area support</u>: The failure at 140 on FXE suggested a retest of the 132 - 130 area, which occurred. The test of the 128 area support has been successful. Accumulation models have changed dramatically in recent days – suggesting the FXE could have a sharp rally, which looks to have started. We are not convinced that the Euro situation will be resolved favorably long term, but a trading move to 140 could occur over the next few months.

Other Markets: Currencies – FXY – CurrencyShares Japanese Yen Trust

The Japanese Yen ETF remains long term positive: Over the last two months we had been suggesting that government intervention in the Yen was likely, and this has occurred. FXY has held the 125 area support and a test of the highs is possible. We note that accumulation models continue to weaken, but stochastics became oversold. Should FXY test 130 and not penetrate it convincingly, a double top could be forming that essentially puts the cap on the Yen for 2012.

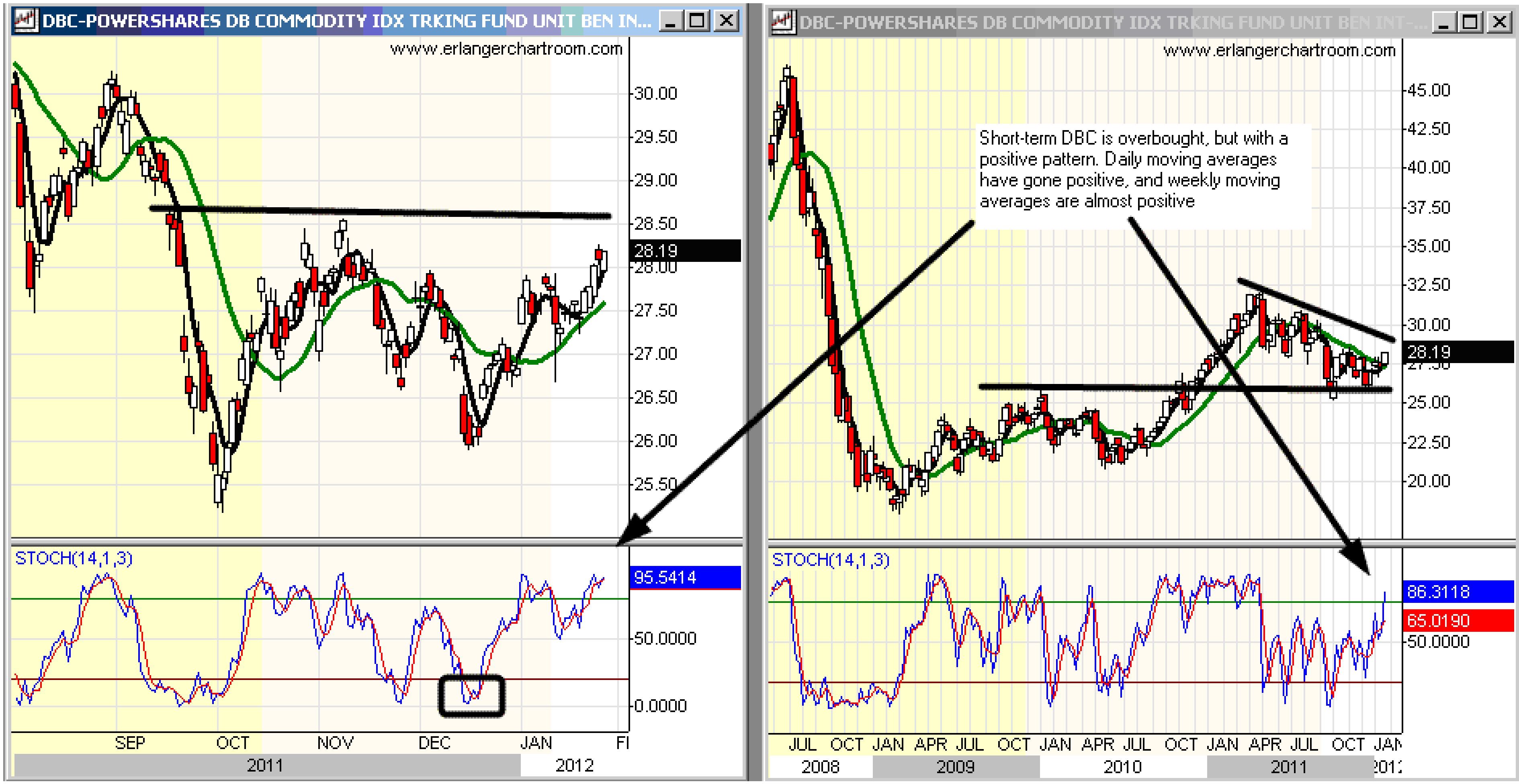
Other Markets: Currencies – FXA – CurrencyShares Australian Dollar Trust

<u>The Aussie Dollar held support, and rallied:</u> This currency is part of one of our longer-term themes, which is that commodity inflation is alive and well, and that the growth markets in Asia will ultimately lead the world in a global recovery. This currency trades with gold and our 8 -month objective for gold remains $2100/oz, or 210 on GLD as long as January closes above 160 (see p.27). FXA tested support at 95, retested successfully, even as gold has weakened. Now, it is rallying along with gold. This currency may be a surprise out performer in 2012.

Other Markets: Currencies – DXY – US Dollar Index

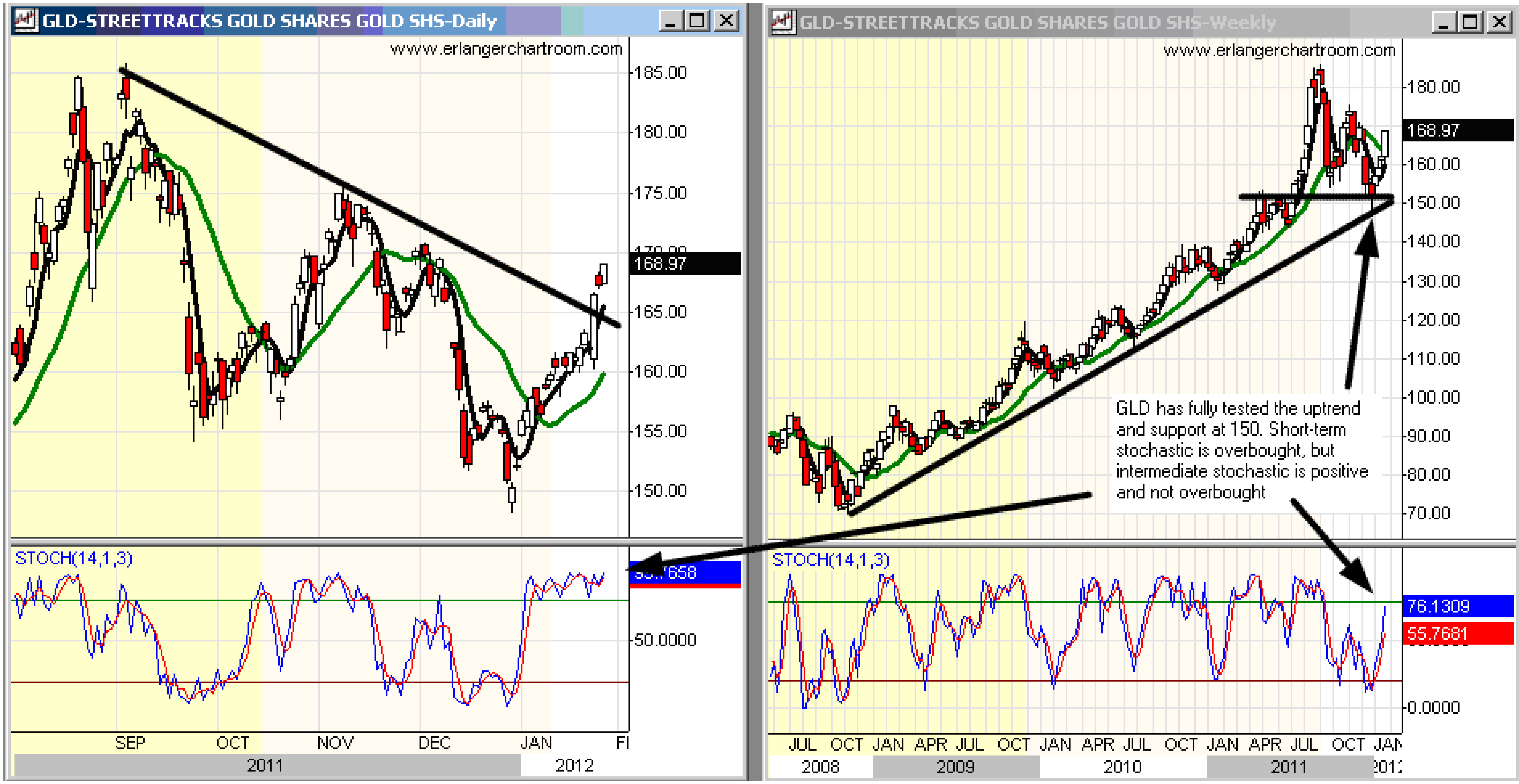
<u>The Dollar has rallied towards our target areas, but has failed to breech them</u>: The dollar index rallied above 80, but has so far, fallen slightly short of our 83 – 85 objectives. It now looks as if a short-term correction is underway. We expect a sharp rally in the Euro, which will likely set up the next intermediate buy point in the dollar. Note that because of changing long-term fundamentals in the Euro, the intermarket relationships that have prevailed in the dollar over the last few years may change.

Other Markets: Commodities – DBC – PowerShares DB Commodity Index



<u>The DBC commodity index has formed an intermediate-term wedge:</u> Commodities have a tendency to rally in the winter, and this has occurred with some commodities. The seasonal rally from November through the end of January is just about over. Oil has continued strong, and gold has been choppy but is now turning up. A move up through the downtrend line on DBC, as drawn, would tend to suggest new 52 week highs. We expect this in 2012. Also see pages 27 and 28.

Other Markets: Commodities – GLD – SPDR Gold Shares



<u>The Gold Market is rallying off support within a strong uptrend:</u> Gold remains one of our favorite long-term investments. We moved back to an equal weight in Gold, and continue to caution advisors against Silver, which could under-perform. **Our 7 month objective is still 210 on GLD, or $2100/oz on the nearby gold contract**. This number does seem very optimistic, and we encourage advisors to be bullish on the metals, but not to get clients overly excited about these prospects.

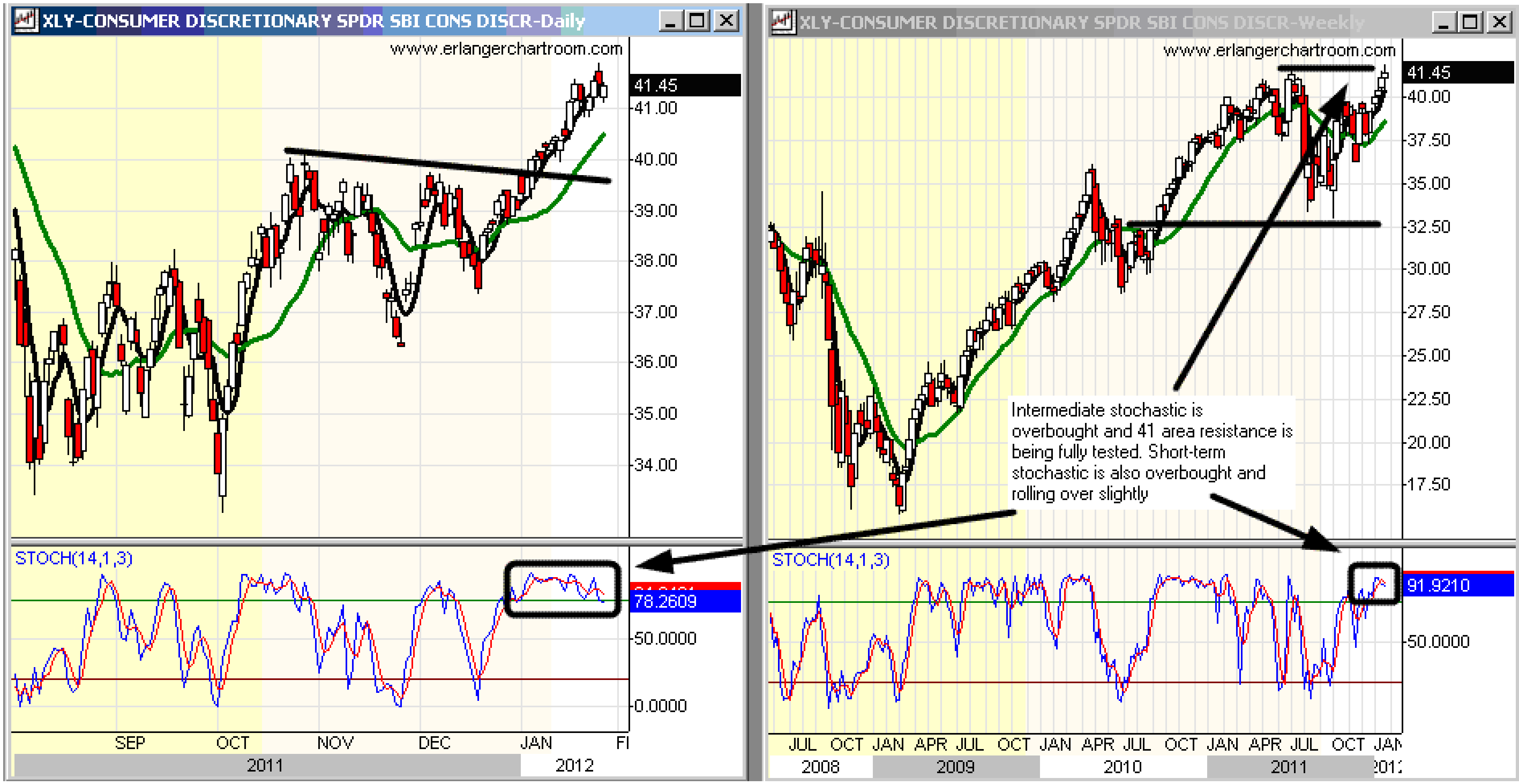
Other Markets: Commodities – USO – United States Oil

Crude Oil has rallied to intermediate resistance: Oil strength is in line with our long-term bias towards inflation and not deflation. Last month, we suggested that the seasonal move that occurs from November to January is occurring once again, and while we expect higher prices into January, the bulk of this move may have been completed. Cautious seasonal traders should consider sale here. The trading pattern on oil remains positive and accumulation models are still strong, so aggressive traders should trade the long side for now.

Other Markets: Commodities – UNG – United States Natural Gas

<u>The UNG has made new lows, after testing the short-term resistance at the $8.00 area</u>: We note here that **there have been issues surrounding the viability of the UNG due to contango.** We use it here simply because many advisors have no other way to get quotes on Natural Gas and advise readers to check with their compliance departments regarding this. There are layers of resistance between 6 and 8, and this market has surprised us several times with weakness. New breakdown unless above 6.50 soon.

ETF Sector Charts: Consumer Discretionary (XLY)

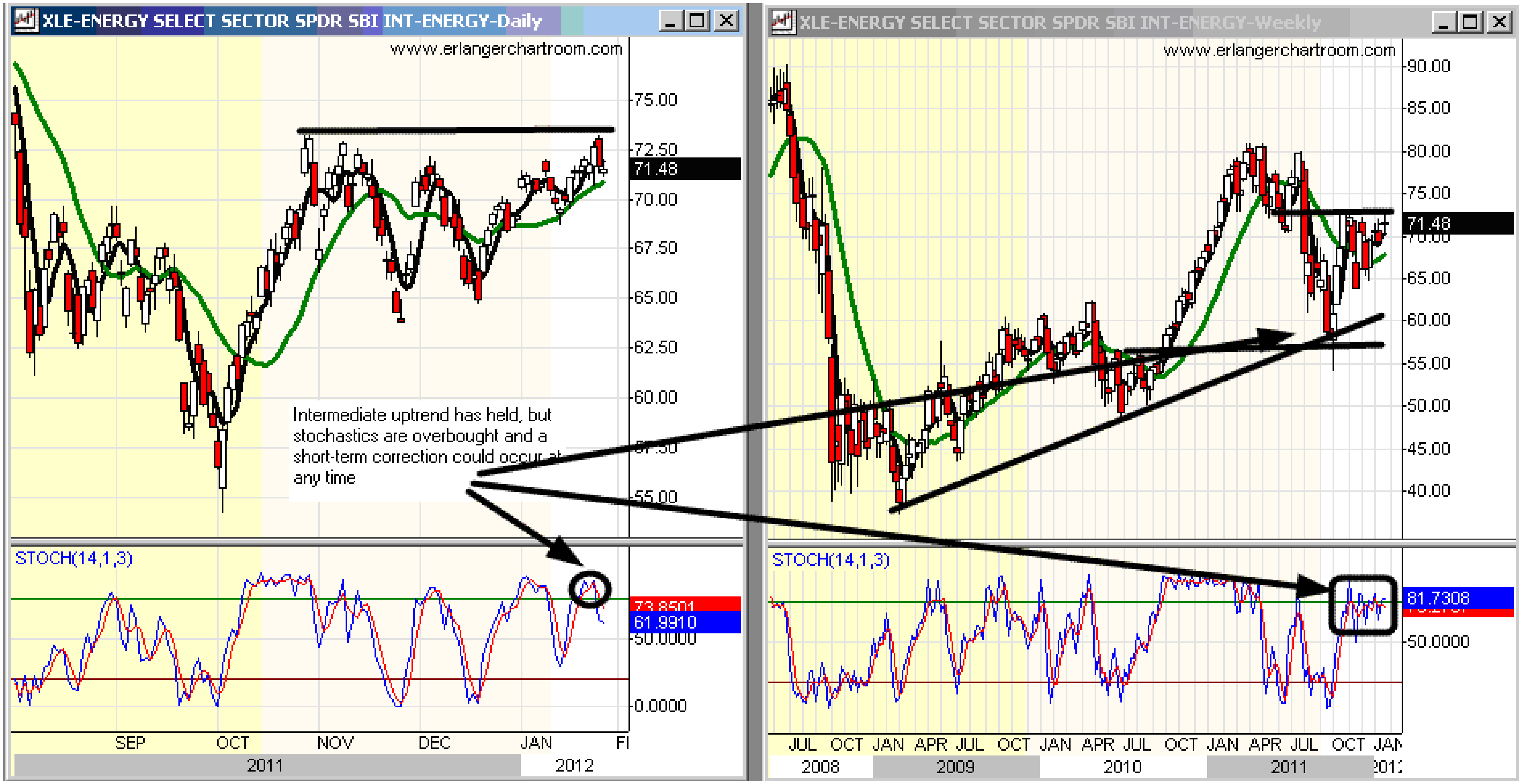


Consumer Discretionary has been one of our top sectors since January of 2009 but accumulation models have fallen dramatically: This sector remains long-term positive, but is short and intermediate-term overbought. Accumulation models on XLY have weakened so dramatically that, like industrials last year, may be suggesting economic weakness later in the year. For this reason, **we moved to an underweight on the sector,** although we acknowledge the risk of this. Clients may want to do this slowly. **UNDER WEIGHT**.

ETF Sector Charts: Consumer Staples (XLP)

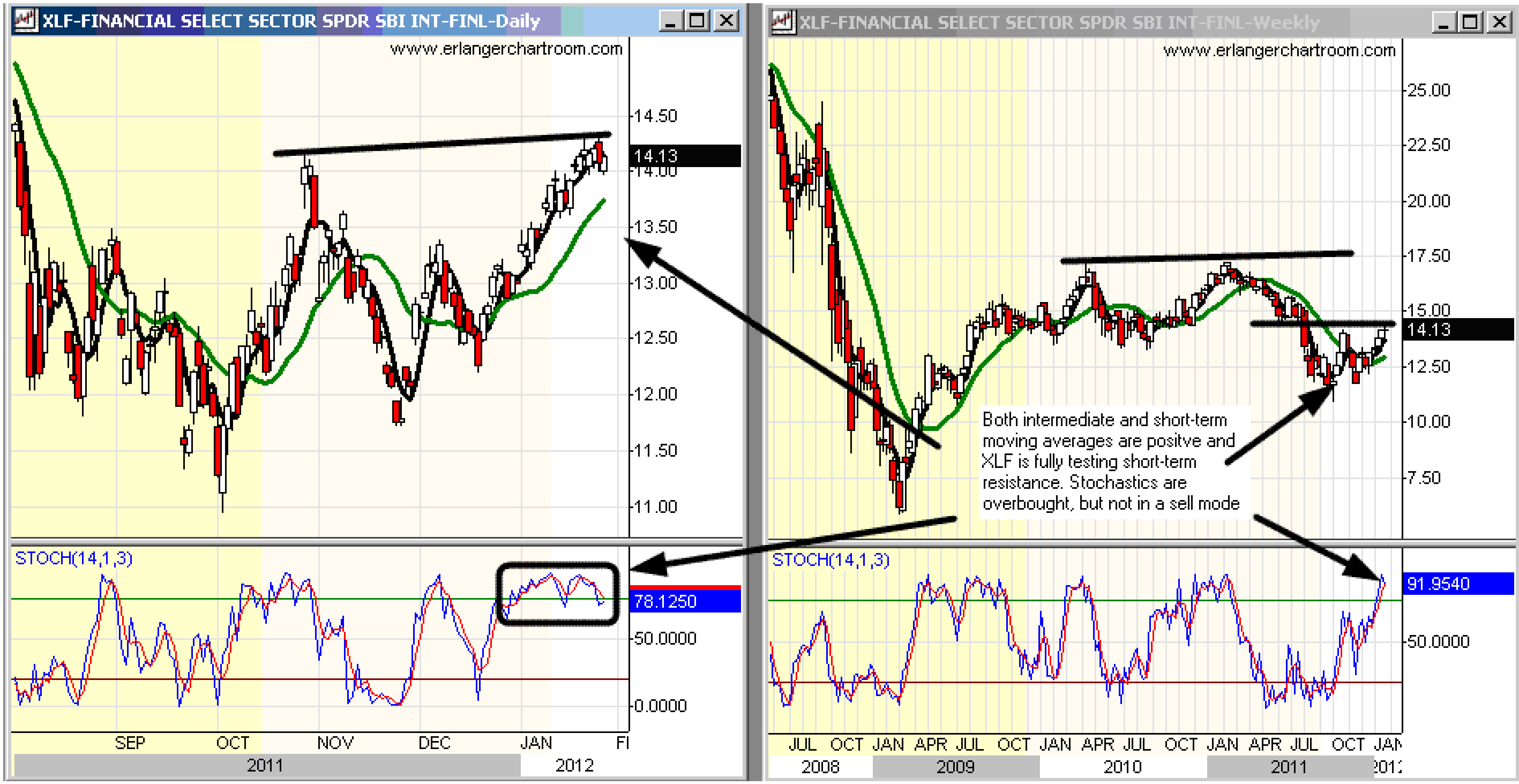
<u>Consumer Staples is our favorite defensive sector is performing well as the market rally continues, breaking out to all time highs:</u> The accumulation model remains one of the most attractive of the sectors and has improved. Note higher lows made in October vs. August, is a plus. We would continue to hold an equal weight in this sector even if the market rally continues. Short-term stochastic is in a sell mode, but market could have a short-term correction – XLP would do well if this is the case. Foreign money buys these names. EQUAL WEIGHT.

ETF Sector Charts: Energy (XLE)



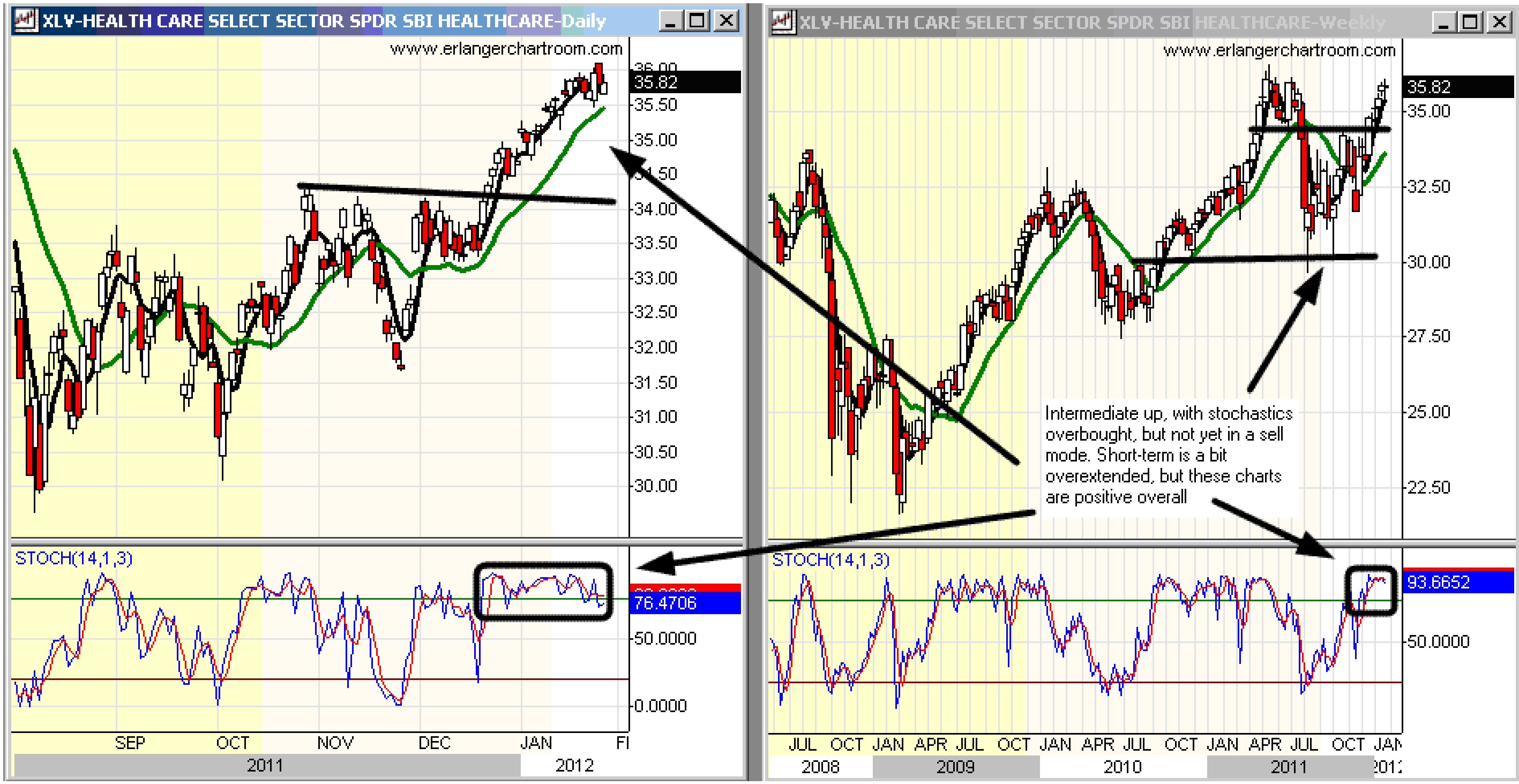
The XLE has held intermediate uptrend support: Energy stocks corrected along with the market last summer, but look stronger overall. We note that the intermediate-term uptrend has held, so far. Energy stocks are in the last two weeks of their favorable seasonal period. So far, the market is rallying in the first quarter of 2012, as forecast. One ongoing geopolitical concern we have mentioned is Middle East turmoil, and this may occur in the first half. We remain overweight for now, but caution subscribers to tighten up risk management just a bit as January ends. This sector does have some higher yielding names that should help after January ends. OVERWEIGHT.

ETF Sector Charts: Financials (XLF)



Financials have consistently lagged since March/April 2010, but this rally in early 2012 may have legs: Overall this ETF is weak as this sector barely exceeded the April 2010 high. We have been underweight this sector for most of the last two years, but feel the improvement in the accumulation models and trading in some key constituents (such as WFC) warranted an upgrade to an equal weight .This is an aggressive move for aggressive traders only. “Common knowledge” suggests upgrading this prior to the resolution of the Greek problems at the end of March is very risky – and it is, but so far the market is suggesting it could be a good trade. **EQUAL WEIGHT**

ETF Sector Charts: Health Care (XLV)

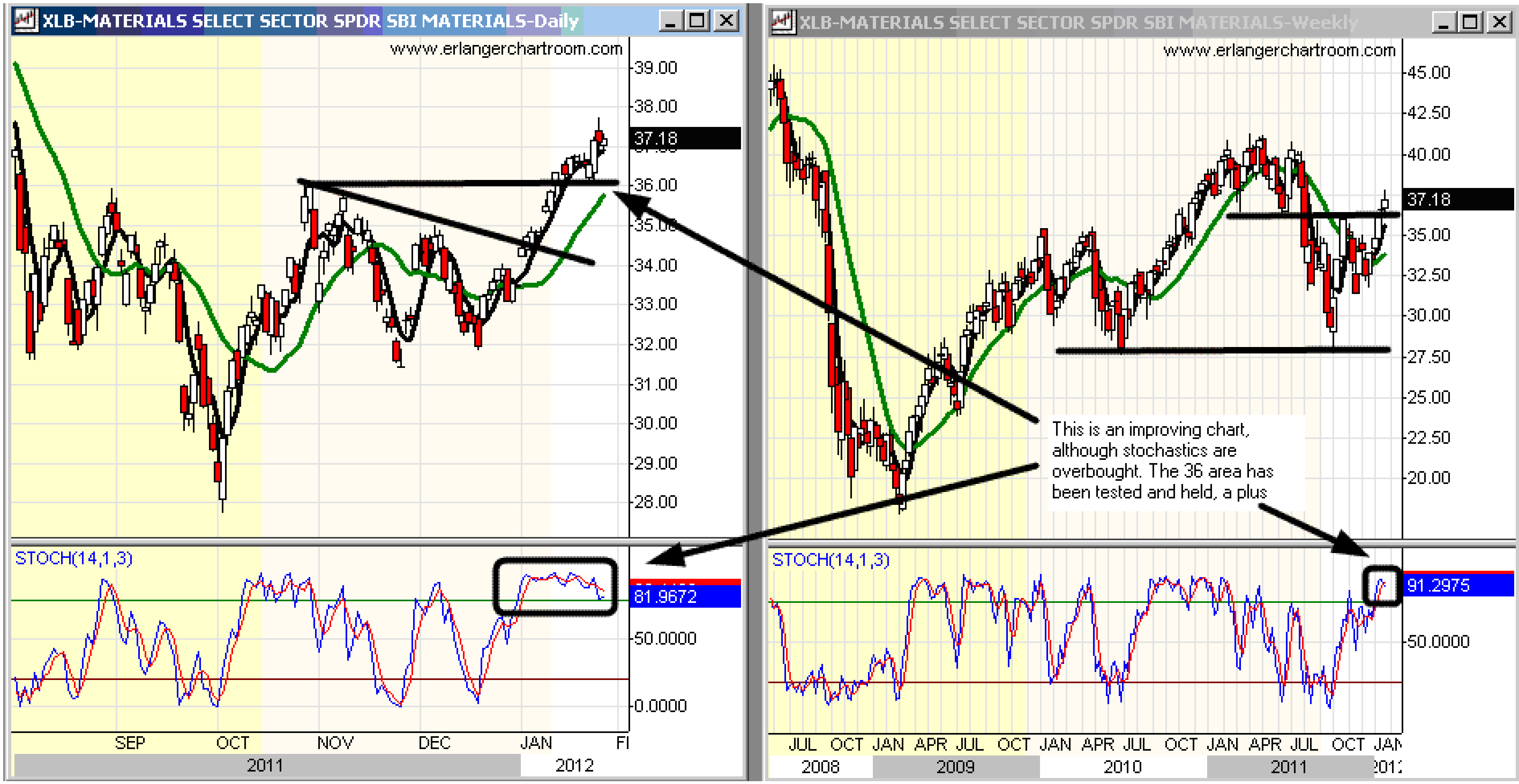


<u>Health Care has broken out short-term:</u> XLV lagged a little coming off the October lows after outperforming during the correction. However, our accumulation model continues to improve and now price has broken out short-term. This makes four months of improvement in the sector. Moving into 2012, an election year with a contentious healthcare bill dispute and a key Supreme Court case – strength here could surprise many, but the technical picture supports a surprise. “Common knowledge” suggests these stocks should not be bought until after the Supreme Court ruling this summer, but technicals suggest buying them now. We moved this to an overweight in the last Sector Review. **OVERWEIGHT**

ETF Sector Charts: Industrial (XLI)

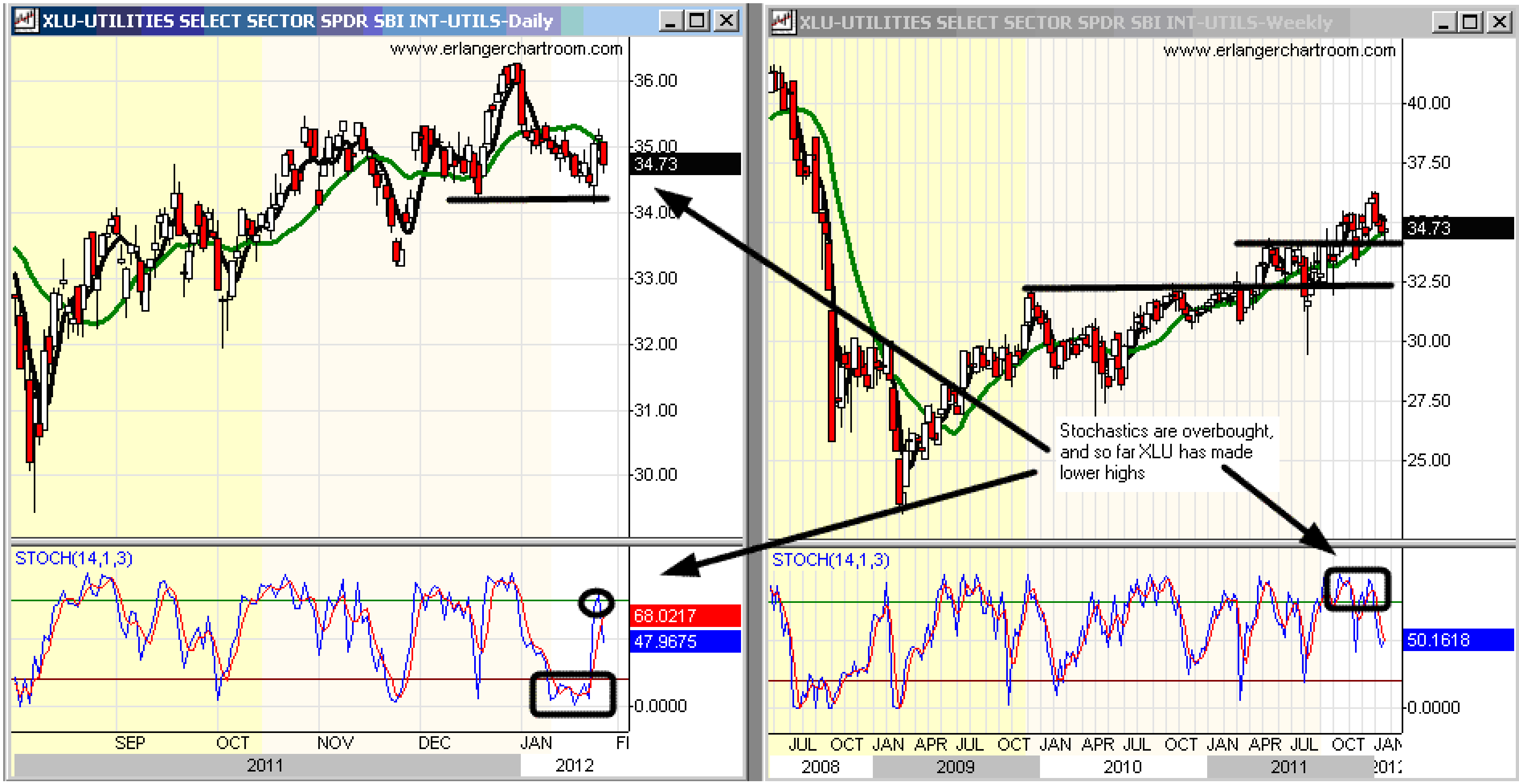
Industrials have improved over the last few weeks, and the pattern is now positive: Longer-term, the XLI has moved above the 35 area resistance. Our accumulation model continues to improve, but not as much as price. Overall we think this sector has a bit more to go. This sector has given conflicting readings from month to month, but is now a strong equal weight due to the short-term breakout. We remain an equal weight, mostly because the accumulation model is still neutral, but this could change. EQUAL WEIGHT

ETF Sector Charts: Materials (XLB)



<u>XLB has improved since the last report:</u> This sector is economically sensitive. Intermediate-term support at 27.50 has held, and recovery has accelerated in the last few weeks. Short-term this sector has lagged Industrials but accumulation models have continued to improve. The 36 area resistance has been exceeded, a plus. This chart now suggests that the economy may improve a bit, but performance here has been sporadic and this could change. EQUAL WEIGHT

ETF Sector Charts: Utilities (XLU)

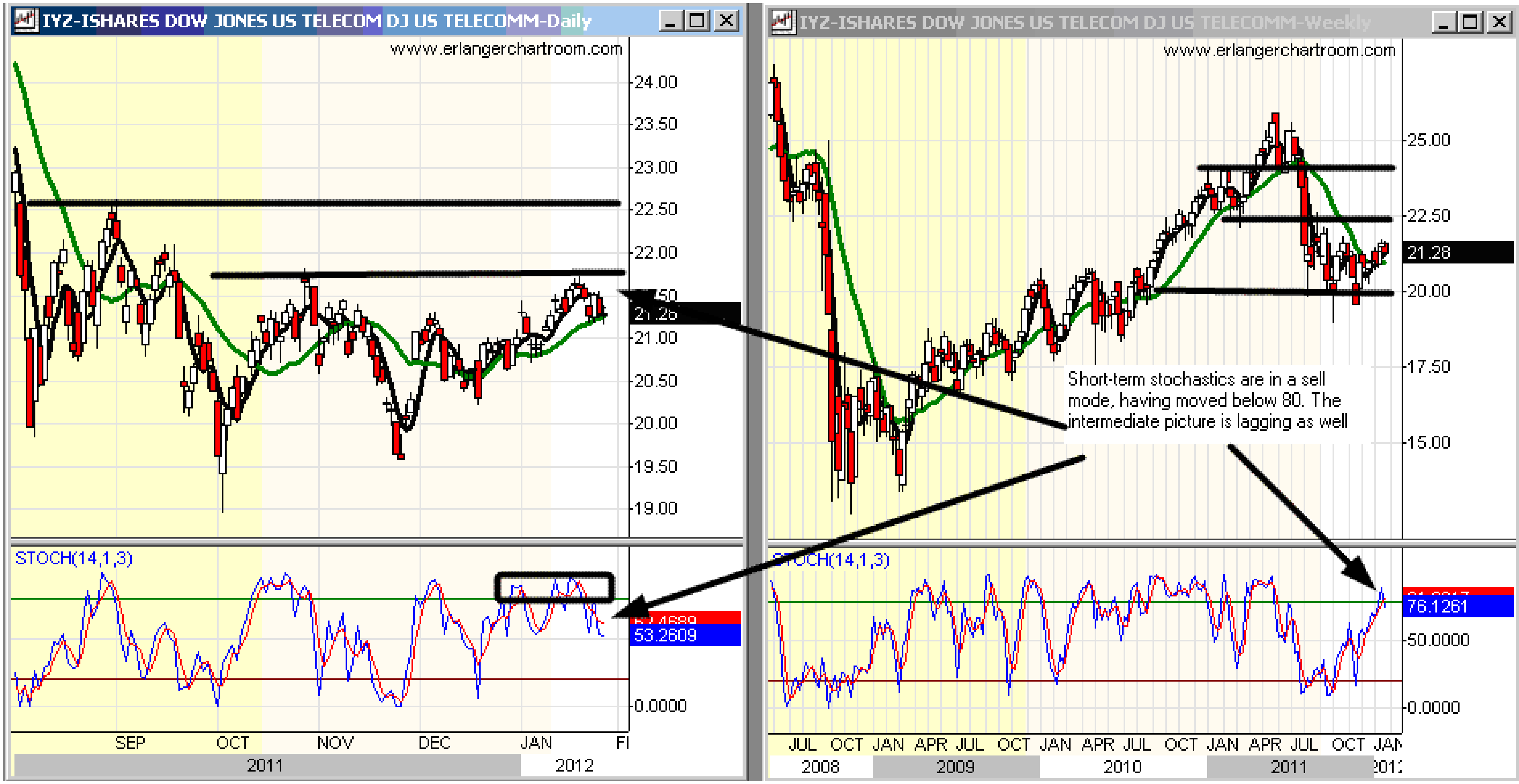


<u>Utilities have dropped sharply, as the market has improved:</u> The 2008 breakdown point resistance is at 37.50, still a ways from here. Our accumulation models have weakened considerably over the last month. This sector may have a really tough 2012, and advisors should discuss what to do if this is the case with clients. XLU is still a long-term underperformer from 2007 through 2010, but was among the best performers in 2011. Stochastics have gotten overbought on lower highs so far in 2012. Caution is indicated. UNDER WEIGHT.

ETF Sector Charts: Technology (IYW)

<u>Technology has started to lag at the start of 2012:</u> It remains one of the strongest sectors long-term and in the October rally traded again near multi-year highs. Higher lows as the market retested is also a big plus. However, strong stocks have started to weaken. Tech is "everybody's favorite overweight". We noted these problems in last month's sector review, and as short-term weakness continues, we will reduce this to an equal weight, albeit a strong one. **EQUAL WEIGHT**

ETF Sector Charts: Telecom (IYZ)



<u>Telecom has weakened short-term and has lagged during the recent rally:</u> Short-term resistance is now the 22 to 23 area, as drawn. IYZ is still substantially below the 2007 peak. Note lower highs than the August/September peak. This is normally a defensive sector and has stocks with good yields, but bad news on a major component (AT&T) hurt this sector in 2011. That news may now be behind the company and the stock should pick up. Many stocks have high yields, and this is a yield play. Individual components may do better. EQUAL WEIGHT

Research Piece: Utilizing MACD vs. Moving Averages

Over the last year, we have been asked questions about the popular MACD indicator. While the MACD indicator is widely used, we do not use it at The FRED Report. MACD stands for Moving Average Convergence/Divergence, and essentially it **measures the distance between moving averages**. **The idea is that it measures market strength in two ways – momentum as well as position of the lines**. Also, there are two ways to depict the indicator graphically – as lines and also as a histogram. We show daily charts of both the MACD and MACD histogram below. The last thing to remember is what's called, in technical parlance, an "unbounded" oscillator. As such, it is more of a trend following tool than a measure of overbought/oversold conditions. We have displayed the standard 5/20 moving averages we use on the charts as well.

The first problem with the indicator should be apparent and occurs because the indicator is “unbounded” – there is little information supplied by the indicator telling the trader just how high is high, or low is low. The indicator, when compared to traditional moving averages as shown on the chart, does not give much advance warning. In fact, there is not much difference between the performance of the MACD and the actual moving averages. Another way of looking at this is the indicator confirms but does not anticipate. That does not add much to forecasting the market.

Now, we discuss the standard FRED Report, which consists of the 5 and 20 day moving average, combined with the 14 day stochastic. The important things to remember about the **Stochastic are that it is (a) bounded, i.e. it moves between 0 and 100, and (b) is a true overbought/oversold indicator.** Most people think overbought/oversold indicators only tell whether the market is overbought or oversold. In fact, they also can tell whether you are overbought or oversold within the primary trend. We show our standard chart below and ask readers to note those areas where the stochastic moves below, and then above 20. Nothing is perfect, but this shows that the stochastic is quite effective at pinpointing turning points within a trend, more so than the MACD.

One could combine the MACD with the stochastic, but we prefer to look at the actual moving averages. Refer to the charts showing the MACD above – and note there are periods when the MACD declines, showing waning momentum, and the market continues to rally. Those points often come when the stochastic is above 80, suggesting a more cautious approach. We advocate raising stops, looking at breadth indicators, and so on, to protect oneself as the trend continues. The MACD can be useful, but also gives many false signals. We feel that more information is conveyed by the moving averages themselves, and when combined with stochastics this information can be useful to the trader or investor.

Below is a listing and definition of various proprietary and non-proprietary technical indicators we rely on during our analysis of the markets:

Moving Averages:

Moving averages are one of the building blocks of Technical Analysis, and there are almost as many ways to use this indicator as there are technicians.

At the FRED report we teach and use a dual moving average crossover system to determine trend. Our favorites are the 5 period and 20 period moving averages. We consider the trend to be up if the 5 is above the 20, and down if below it.

Stochastics:

The Stochastic Oscillator is one of the commonly used momentum oscillators and is standard on charting programs. There are two lines on the chart below, %K and %D.

%K is the faster of the two lines, and represents a mathematical formula that *measures where the current close is in relation to the trading range of the last "X" periods of time*. We use a 14 period look-back, so in plain English %K says where the current close is in the trading range of the last 14 days, expressed as a %.

At the FRED report we use it somewhat differently than is commonly taught. The standard way to use the indicator is to register a buy signal when it moves below, and then above, 20 (the lowest 20% of closing prices in the last 14 days). A sell signal is when the indicator moves above, and then below 80 (the highest 80% of closes over the last 14 days).

The other line, %D, is a 3 period moving average of %K. We have found that the Stochastic is sensitive, so we advocate taking signals only in the direction of the trend. When looking at the standard FRED report chart, this would mean taking buy signals when the 5 is above the 20, and sell signals when the 5 is below the 20, but using a different technique to exit positions. The reason for this is the Stochastic is quite sensitive, and can give early indications, especially in new trends. It also can get "stuck" in the direction of trends, which connotes strength and not weakness. Another, preferred interpretation is to use the indicator to measure risk. An example: buy in an uptrend, not when the stochastic is at 90% but rather wait until it falls below 50%, This way, even if a stock, commodity, or ETF does not give one of the "classic" signals, you can still use the indicator to assess risk, and leg into positions.

Fred's Price Oscillator (FPO):

This is an oscillator that I invented, using a combination of high, low and closing prices. Unlike the Stochastic, which is really sensitive, this indicator is designed to be less sensitive. Other than that it is, of course, proprietary, so we do not disclose much about the construction of the indicator. One of the characteristics of the tool is that when the Oscillator moves below/above -15/15 the market often creates a divergence. For those of you who do not know that term it means that price will make a new low/high and the oscillator will not confirm it. That is usually the sign of a turn. On really sharp strong market moves, a couple of these divergences can occur. We use weekly data in our examples for you, as we have that data going back to the 1970's on the SPX, and farther on the Dow Industrials, which work the same way. We would note that we keep FPO's on the commodities, but rarely publish these, as most subscribers are interested in stocks. Like most oscillators it is most useful at bottoms, so our examples show bottoms. We can, and will, show some analysis of tops as they occur.

Fred's Breadth Oscillator (FBO):

This is an Oscillator that I invented. Unlike the McClellan Oscillator, which is sensitive and gives a lot of signals, this tool is more of a trend following indicator. It is proprietary to the FRED report, so we do not disclose much about the construction of the tool. It generally moves between 12 and 18. Moves below 12 or above 18 imply a divergence bottom or top is coming with fairly high probability. This tool works best at extremes, and patterns can be significant. It also gives clearer signals at bottoms than tops, although when tops are perceived to be occurring we will publish these charts, appropriately annotated. The FBO is only useful on the stock market, where advance/decline data is published.

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