Princeton Economics

Forecasting The World

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Technical Analysis

Seminar Edition

PRINCETON ECONOMICS
TECHNICAL ANALYSIS

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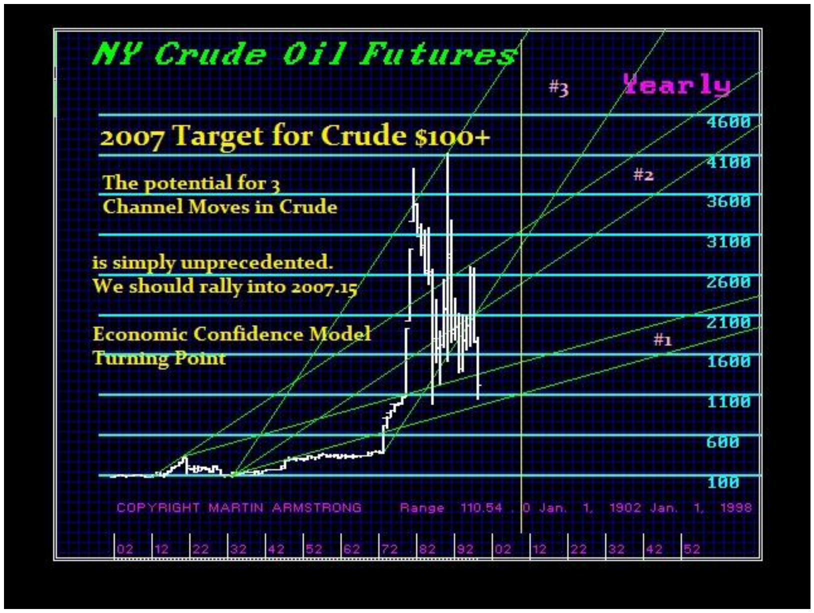
INTRODUCTION

Perhaps the most misunderstood form of analysis is charting followed by **Technical Analysis**. Nonetheless, you would not travel into an unknown region without at least a map. Charting is a roadmap of where the market has been. **Technical Analysis** is a vital tool to show us what the potential is for where we are going. One of the most critical aspects about investing and trading has always been ***How to Survive Your Own Trading Decisions***! For you see, when we make money, we buy another round of drinks and pat ourselves on the back for being so damn smart. When we lose, it was because of some conspiracy and never because we lost against the most formidable enemy of all – ourselves.

The most formidable opponent in finance is none other than ourselves. The Scottish Philosopher David Hume got it right when he said man is not ruled by logic, but passion. ***How to Survive Your Own Trading Decisions*** is all about winning the internal battle against our inner self that wants to just run with the pack. This is what we have to fight – that lure of emotion that gets us to trade things we should not do. **Technical Analysis** is our map to the future. It is not a standalone tool. It functions best as a confirming tool. So it is time to explore the secret hidden order of market movement that too many do not even understand.

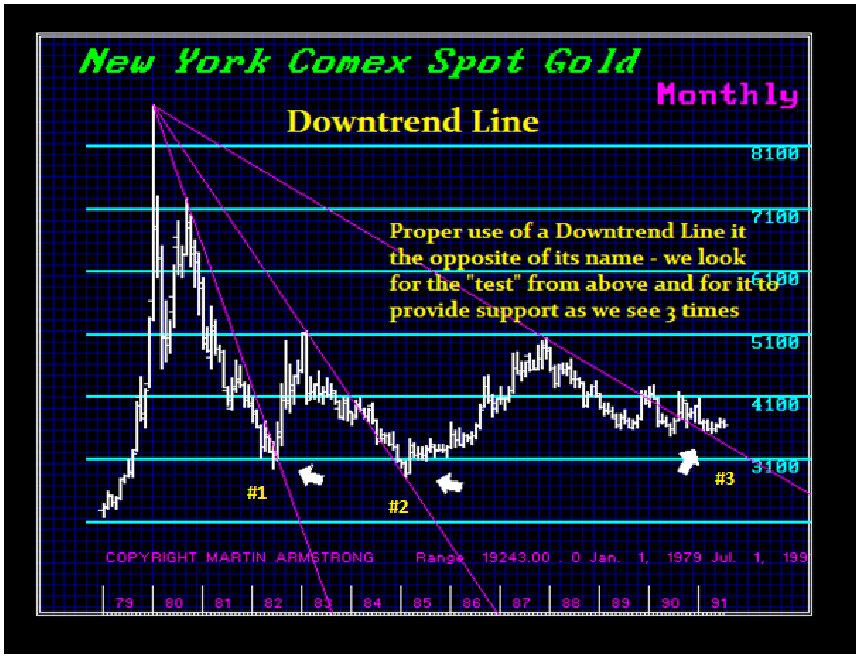
TECHNICAL ANALYSIS



Technical Analysis has generally been used perhaps for pattern recognition more so than anything else, which can vary greatly depending upon the experience of the analyst. The **Technical Analysis** that is employed here is by no means the standard pattern recognition. For **Technical Analysis** to be useful, we have to eliminate the human judgmental aspect as much as possible. Unless this is our goal, then we will always end up with just one opinion compared to another. Elliot Wave, for example, is used by so many different people, but because it is subjective, the opinions of those claiming to use the same wave structure that is really pattern recognition, varies greatly.

Technical Analysis is a roadmap that allows you to see where you have been and where you are going. Presented here is a Yearly forecast in Crude Oil that became widely broadcast to the extent even the Department of Energy wanted us to provide a forecast for them. Crude Oil had exceeded $3 in 1920 and fell to 66 cents in 1933. This 1933 event established a nice **Breakout Channel #1** from that low which provided the highs for oil during the 1950s and 1960s. The previous low took place in 1911 from which an 8.6 year rally into 1920 took place. **Breakout Channel #2** from the 1911 low was even a steeper angle which was in the mid-$20 range for the 1970s. After OPEC, it became clear that oil had been greatly suppressed. A third **Breakout Channel #3** was constructed from the 1933 low to the 1990 high. While it was clear on our timing models that oil would retest the $10 level going into 1998, we still had three dramatic channels that were showing anything <u>BUT</u> a nice calm future ahead in addition to our timing models. We then put out our forecast that crude oil would test $100 by 2007. With crude falling to test $10, that sounded nuts to a lot of people. But the more one swings to the down side, the powerful the rally in the opposite side – it's a pendulum. Our computer models were widely respected and everyone was taking notice. Even Marc Pitman of Bloomberg News was compelled to report that forecast. This was one of the most powerful technical setups one can have – a **Channel Move**.

The timing of course is separate and distinct from the price objectives which are derived from **Technical Analysis.** Why does **Technical Analysis** work? Fundamentalists laugh and say: **What? You draw a line and *shazam!*** One dean of a University had wanted to meet me. When he saw charts, he asked: **You don't believe in that stuff do you?** I replied if all the big trading firms used charts, don't you think you should at least understand what they are doing? General Patton read Rommel's book on tank warfare tactics and defeated him in North Africa. It does not matter what you believe, if your opponent will cover shorts based upon a chart pattern, just maybe you should know what the pattern is? **Technical Analysis** is really a graphical method of ascertaining mathematical solutions to trends in motion. Markets establish a character that is revealed by the angle of its price movement. That angle will then stay with that market for years. It can be ascertained by visually assessing the market behavior.



DOWNTREND LINE:

The **DOWNTREND LINE** is typically constructed by connecting two isolated descending highs. The **DOWNTREND LINE** is normally thought to represent the overall immediate trend of a given market. The popular misconception involving the **DOWNTREND LINE** is that an upside penetration of this line signals the beginning of an Uptrend and the end of the Downtrend. As illustrated here, that is not always correct. For example, occasionally you will see a **DOWNTREND LINE** actually perform the way it was ideally claimed as in #1 from the 1980 spike high in gold. The second **DOWNTREND LINE** in #2 was drawn connecting the 1980 and 1983 highs. This time the line failed to provide resistance confining the downtrend. Instead, the market flips back above the **DOWNTREND LINE** and then follows it down as it provides a guide to support. The **DOWNTREND LINE** #3 performs in the same manner eventually providing support in 1991. So what worked under ideal conditions 1980-1982 is not consistent, which can present some problems. However, that does not make the **DOWNTREND LINE** useless.

Additionally, more often than not, when this **DOWNTREND LINE** is applied to recent isolated highs rather than to major highs, it seldom provides a change in trend. When a market exceeds a **DOWNTREND LINE**, many traders automatically buy the market only to find that they have been led into what is commonly referred to as a "***Bullish Failure***" or a "***Bull Trap***". This term applies to a penetration of the **DOWNTREND LINE** that fails to follow through with a change in trend to the upside, and is quickly followed by a resumption of the downtrend itself.

The proper use of the **DOWNTREND LINE** demands caution and patience. If as in the case of #1 this line has contained the decline nicely, then there is a higher probability that there will be a shift in the trend. It is wise to use this as a confirming tool with other indicators.

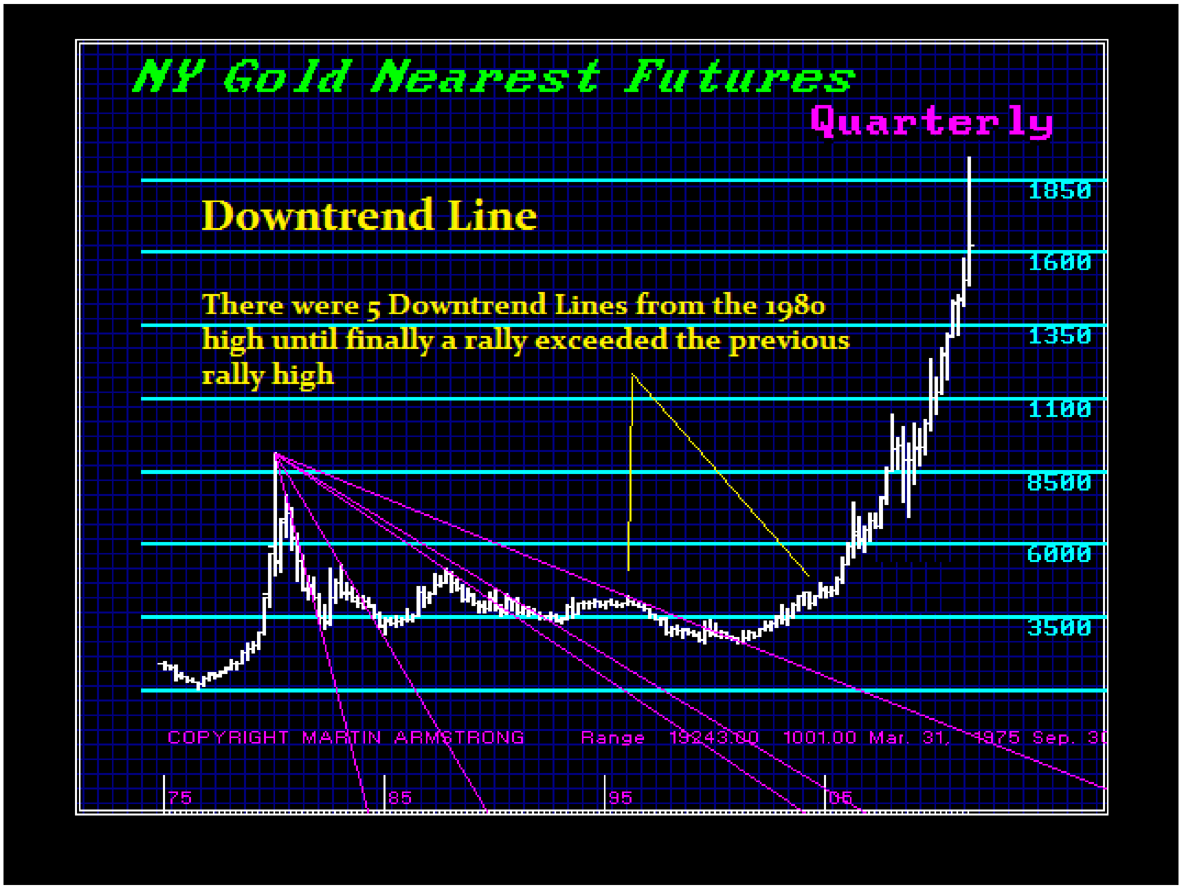
The **DOWNTREND LINE** should provide support once the market is above it. The market in question must bounce off of the line and quickly exceed the last high within 3 trading sessions. If the market fails to exceed the immediate high after breaking above this line, then it may act like #2 or #3 and follow this line lower as it is now converted into a support target.

If the **DOWNTREND LINE** fails to provide any support during any subsequent correction, then the downtrend will normally resume and the market is shifting the angle most likely following the Break Line or Breakout Line angle. To avoid getting caught up in these "***Bullish Failures***" or "***Bull Traps***", look to buy on a decline back to the **DOWNTREND LINE** using a stop on a closing basis just below. Preferably, use this only as a confirming tool.

Another important characteristic of the **DOWNTREND LINE** centers around how markets actually bottom. Many major bear markets tend to eventually exceed the **DOWNTREND LINE** when constructed from the major high. However, the market will often continue lower following the **DOWNTREND LINE** until it bottoms almost precisely on it from above ***#2*** on our illustration.

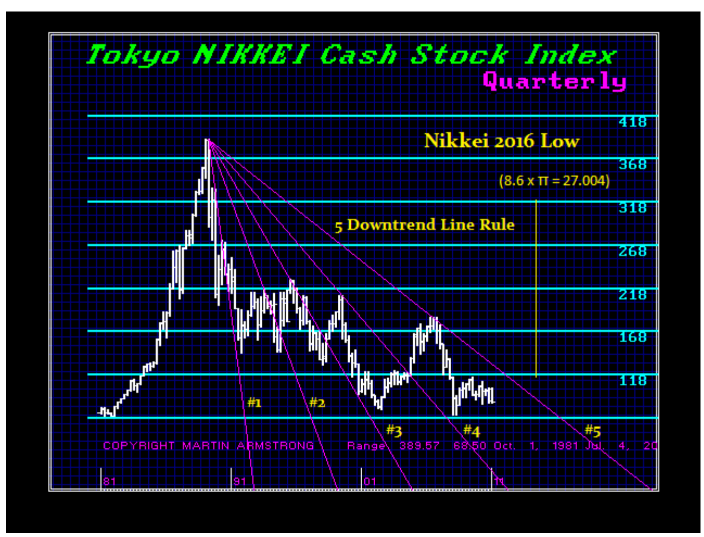
On occasion, new **DOWNTREND LINES** may need to be drawn from the major high to the reaction highs created during the false breakouts. Using the famous C**rash of 1929** on the Dow Jones Industrials ***(Figure #2)***, we can see that three major separate **DOWNTREND LINES** were required until the 1932 low eventually found support as was the case for gold in 1985.

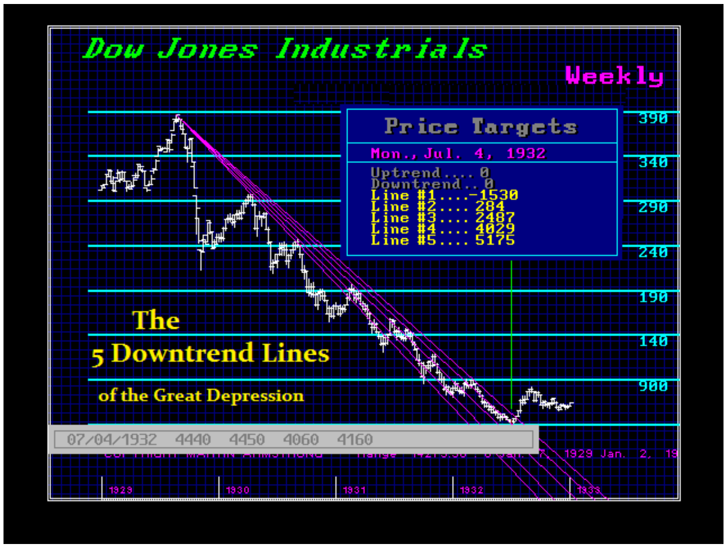
Figure #2



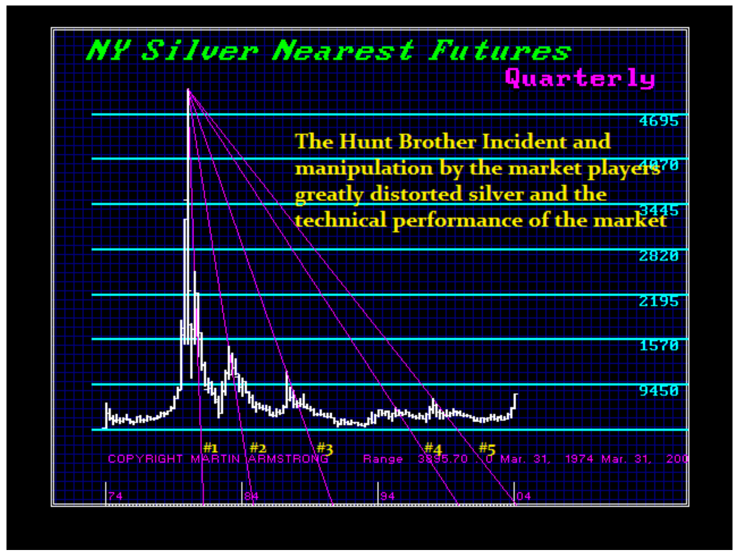
THE FIVE (5) DOWNTREND LINE RULE

Looking at a lot of major bear markets, one curious rule has emerged. We call it the **FIVE DOWNTREND LINE RULE**. There appears to be a total of FIVE (5) false breakouts in a major bear market. The sixth breakout seems to be the charm. Pictured above is gold. You can see clearly the **FIVE DOWNTREND LINE RULE**. How do we qualify a real breakout from just another false move? This seems to be easily distinguished when the current rally finally exceeds the high of the previous false break out. Even the rally in gold into 1987 failed to exceed the 1983 high by a few dollars. Therefore, we have to eliminate human subjective guessing if the glass is half full or half empty. This seems to be the best rule that appears to work with few exceptions. If we look at the Nikkei in real time, the 5 lines are in place, but we not flip back above and find it to provide support. Here when it is exceeded, the trend may change.

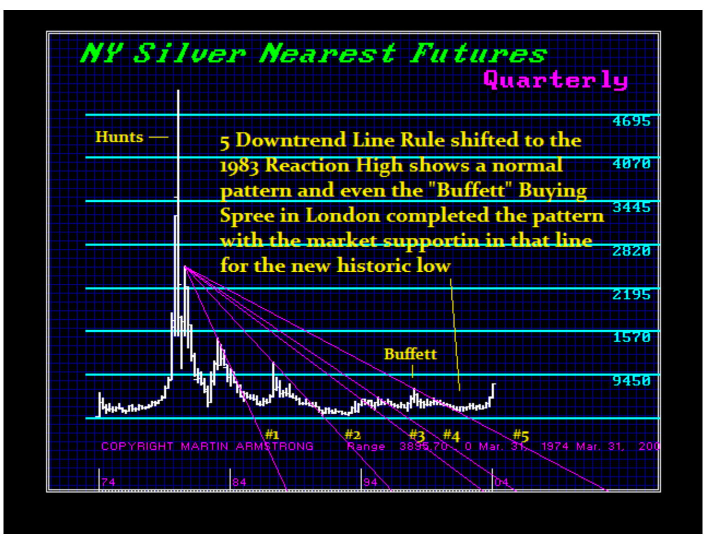




Looking at the 1929 Crash, the same **FIVE DOWNTREND LINE RULE** applied. The market here simply broke through that fifth line and that marked the change in trend. This may be the pattern we see for the Nikkei 225 as well. Clearly, that fifth line can be exceeded prior to the ideal timing target and then provide support. The second choice is to remain confined by that line and penetrate it only when the timing is right for the reversal in trend. Consequently, this is a confirming tool to be used with **TIME**.



Silver has been the most manipulated market ceratinly in my lifetime. The Hunt were simply buying silver since the 1960s. It was the dealers who touted them to the press and used them to spike silve to obscene levels in 1980. That abnormal spike is reflected in how it greatly distorted even the technical analysis. Here the **FIVE DOWNTREND LINE RULE** did not define the low, resistance or support at any time. The question became clear that the '80 high was some sort of freak event or did technical analysis just fail? It seems upon close inspection the answer was the former, not the latter.



When we use the 1983 reaction high rather than the deal manipulated high of 1980, suddenly everything now begins to fall back into place. The **FIVE DOWNTREND LINE RULE** worked perfectly from the 1983 reaction high. We still have 5 lines and the market exceeds those lines and support back on it from above on lines #2 through #5. This is a normal market pattern. Even the Buffet buying of silver in London of a $1 billion in 1997, failed to do much more than establish that last false rally. Silver still fell to new record lows.

Figure #3

UPTREND LINE:

The **UPTREND LINE** is typically constructed by connecting two isolated, ascending lows. The normal use of the **UPTREND LINE** assumes that while the market remains above this technical reference point then the ”uptrend" remains in motion. Despite this general expectation, more often than not, the market will easily penetrate an **UPTREND LINE** and find support slightly below. We have found that frequently, whenever a market penetrates the **UPTREND LINE** and then quickly closes back above it, a low of some sort is usually in place (***Figure #3***). This took place with gold at the 1982 low.

We can see here that the **UPTREND LINE** stood in July 1982 at 333.80 in gold. The market closed that month at $342.70. Therefore, the **UPTREND LINE** was “faded” causing a lot of longs at that moment to throw in the towel. This is one of the most interesting points in Technical Analysis. These traditional trend lines are often faded and that is the false move before the trend.

Markets love to make a last false move just before a trend. This cleans out the longs or shorts depending upon the direction of the move. It is necessary to clean out the dead wood. These are position that causes the market to reach maximum Economic Entropy. They travel with the trend, however, they actually provide the fuel for the opposite direction. In other words, they no longer support the trend in motion. These are longs in an uptrend that have bought yet no longer contribute as fresh buying power. Consequently, they are now the fuel for a panic sell off. They will sell in a panic or capitulate when an **UPTREND LINE** is faded. Likewise, a weak short will cover when a **DOWNTREND LINE** is faded to the upside.

Figure #4

However, when a market penetrates below an **UPTREND LINE** and then bounces off it during a reaction rally from underneath, then the trend usually continues lower (***Figure #4***). On occasion, a former **UPTREND LINE** may still provide resistance at a later point in time (***Figure #5***). Therefore, depending upon the pattern formed in a market, an **UPTREND LINE** can become future resistance that can provide a target for a subsequent new high.

Figure #5

<u>UPTREND (*Support*) LINE:</u>

This term is applied to a technical line that provides some measure of **SUPPORT** to a market. Often there will be several **SUPPORT LINES** on our charts and each line has its own significance. Some lines will provide support only for intraday movements, and will not support a major market move. At times when a market is in the process of dropping much lower, these **SUPPORT LINES** will work alternately. For example, the first may provide support for one day, and the following day the market may fall to the next **SUPPORT** line. These lines are not meant to provide an independent means of trading, but are just one form of input. Only when several other factors point to the same levels will we act upon one of these particular lines.

THE FIVE (5) UPTREND LINE RULE

Markets are FRACTAL and symmetrical. What takes place on one side, unfolds on another just as the same patterns replicate from one level of TIME to the next both up and down. Looking at a lot of major bear markets also reveals the same curious rule has emerged we call the **FIVE UPTREND LINE RULE**. There appears to be a total of FIVE (5) false breaks of also the **Uptrend Line** in a major bear market. The sixth break bottoming on the **Uptrend Line** that also seems to be the charm. Pictured above once again is gold. You can see clearly the **FIVE UPTREND LINE RULE**. How do we qualify a real breakout from just another false move? This seems to be easily distinguished when the current rally finally exceeds the high of the previous false break out to the upside.

Here the individual Uptrend Lines still offer some overhead resistance in the years ahead as can be seen above. These rarely provide a major resistance point. Nevertheless, the goal is once again to eliminate human subjective guessing if the glass is half full or half empty. This seems to be the best rule that appears to work with few exceptions.

Figure #6

BREAK-LINE:

This cyclically derived **BREAK LINE** (***Figure #6***) provides a good frame of reference as to when a market will break to the downside as well as what potential move we can expect. There generally are three **BREAK LINES** that can be drawn with a **HIGH** as the center focal point. This line is cyclical constructed by taking the **OPPOSITE** extremes which define a cycle's limits. Here we go to a **HIGH** and draw a line either side by connected the **FIRST** prior **HIGH** to the **FIRST** subsequent **LOW**. That first line drawn around the 2007 high in the Dow Jones Industrials marked #1. You can see this is taking the **FIRST** previous **HIGH** before and tying this to the **FIRST LOW** after the 2007 high. This line also nicely projects the general direction of the decline all the way into 2009. If we step back to the **SECOND** previous **HIGH** and tie that to the **SECOND LOW** moving forward marking this **#2**, this provided a good middle ground projection. Once this **BREAK LINE #2** gave way on a closing basis, the market crashed to follow **BREAK LINE #1**.

The key to it should stay symmetrical stepping back and forward in time in equal events (not time). Also drawn here is **BREAK LINE #1A** which is using the first events both sides of the February 2007 event. This was the ECM target and you will notice the steeper decent of this projection. This is still valid for the angel from each event remains with the market under review. This line by itself does not appear to be that significant, however, its importance will be revealed when we get to parallels.

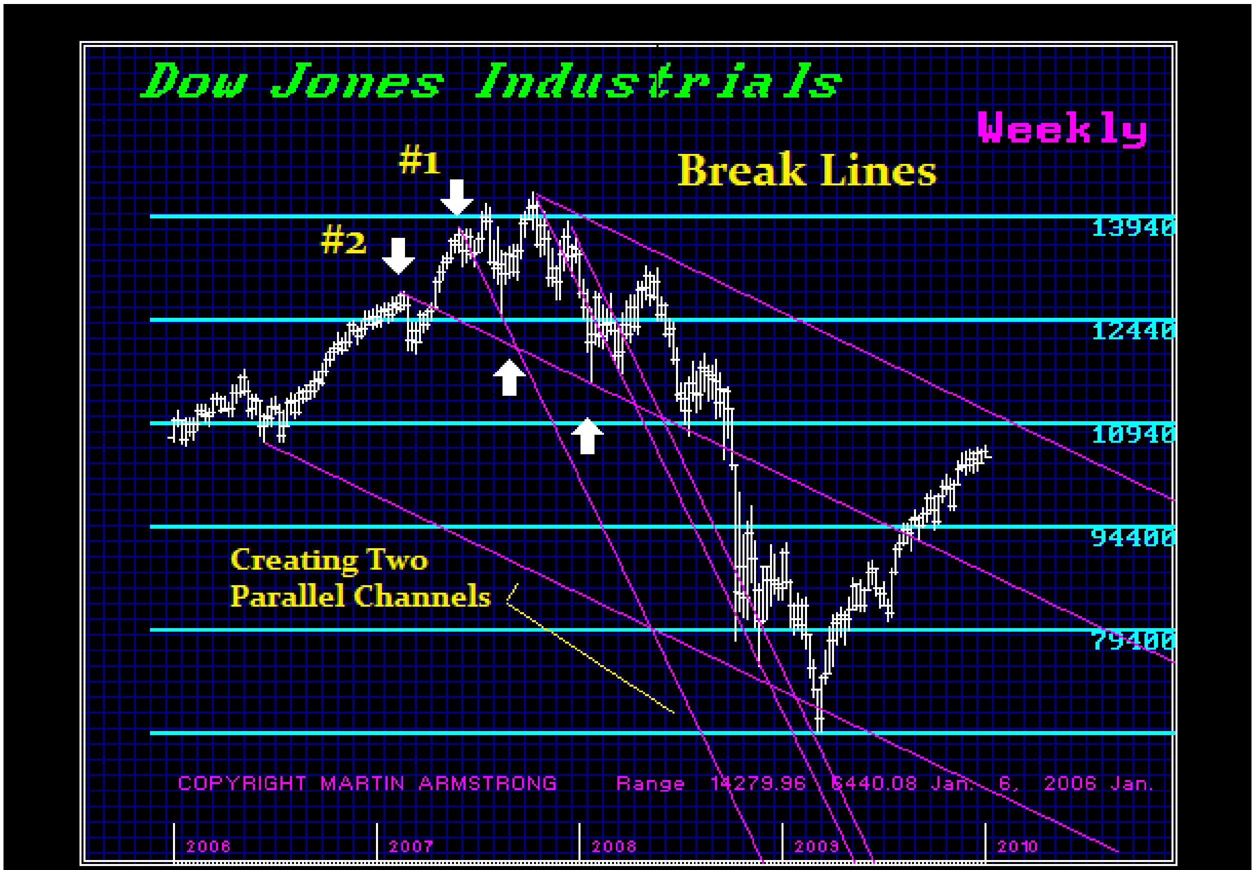


Figure #6a

The importance of creating **BREAK LINES** is the development of the angles the market under consideration has adopted in its price movement. The steep **BREAK LINE** from the February 2007 event that did not appear to be that important in ***Figure #6***, now takes on a whole new meaning once we begin to draw parallels in ***Figure #6a*** noted here as **#1**. Parallels have now been drawn from the major high and the **FIRST HIGH** thereafter. Notice we now have a CHANNEL created from this one angle around the ECM. Note how the market followed this angle more so than any other because that was the most significant target cyclically.

Our **BREAK LINE #2** is the same as in ***Figure #6***, but here a parallel has been drawn from the major high. This provides us with a general **CHANNEL** to watch and once this was broken on the downside on a closing basis, the market fell sharply following the **#1 BREAK LINE**. However, this **CHANNEL** is then expanded in the opposite direction so we go to the low in mid-2006 and draw another parallel. We penetrated this only for one month on a closing basis. Closing immediately back in that channel the next session signal that a low is typically just been established.

BREAK LINES provide a very different dimension to **Technical Analysis**. The key to understand is the angle of the market. As shown above, here is a **BREAK LINE** drawn the decline in 2008. Five parallels were then drawn all the way down to the final low in 2009. Notice how the rally still followed this angle in general. Markets may appear to be random, but they are not staggering around the parking lot like some drunk.

BREAK-LINES will provide two major benefits. First, they will illustrate the angle of the market. The steeper the descending angle, the greater the tendency for a market to decline rapidly. Second, **BREAK-LINES** will tend to provide support on a first test. If penetrated, look for a market to rally back to TEST it from underneath. If a market fails to get back above the **BREAK-LINE** after it has penetrated it, then expect the decline to continue.

Anyway we slice and dice a market, what is revealed buried within is a secret hidden order. The mere fact that we can draw lines and order is revealed demonstrates this is certainly not chaos. Always remember one thing – ***It's the angle that is important.***

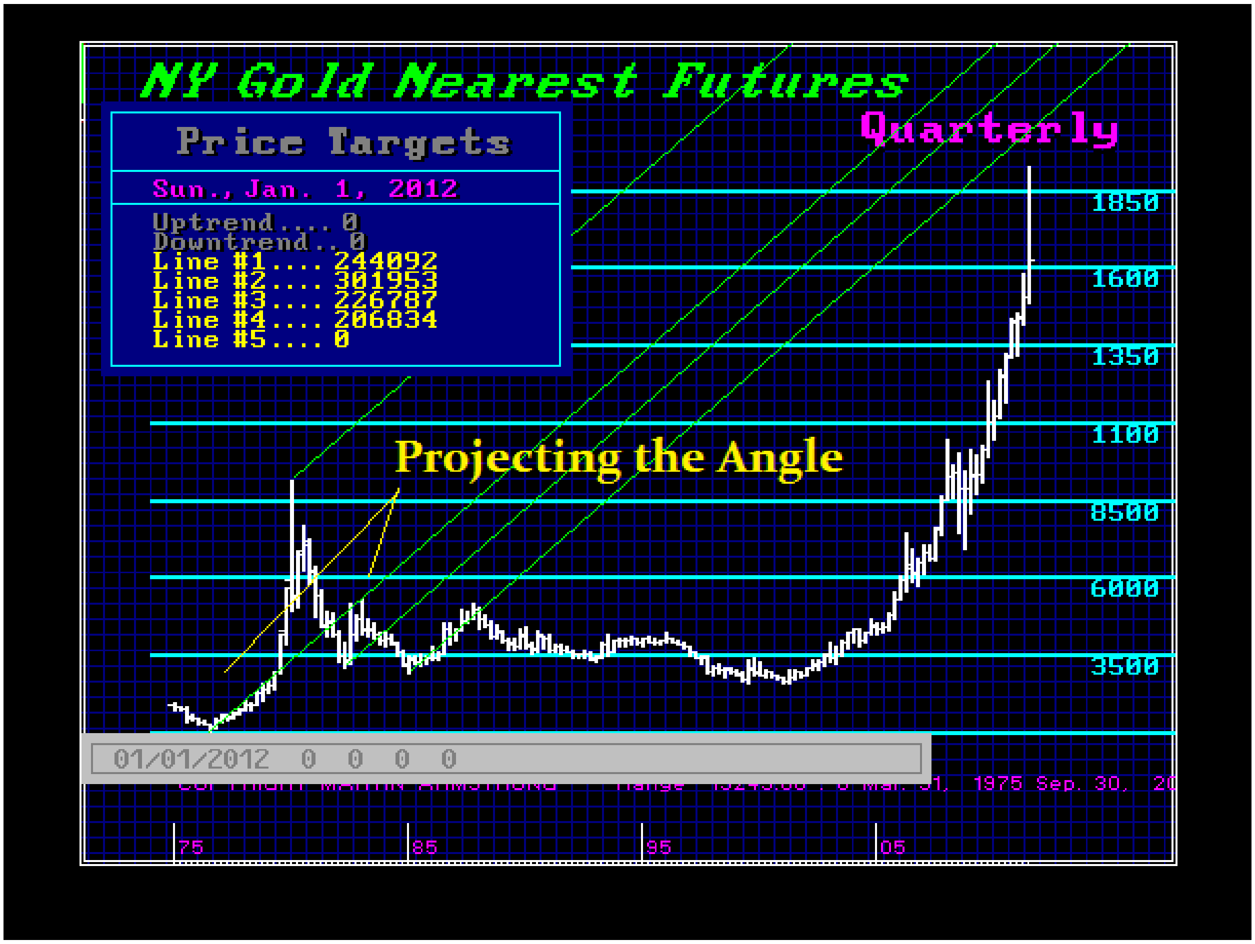
Figure #7

BREAKOUT LINE:

Similar to a **BREAK-LINE**, this cyclically generated **BREAKOUT LINE** (***Figure #7***) is constructed either side of a LOW instead of a HIGH. This cyclically derived **BREAKOUT LINE** provides a good frame of reference as to when a market will breakout to the upside as well as what potential move and steepness of the rally we can expect. Generally speaking there are also three **BREAKOUT LINES** that can be drawn with a LOW as the center focal point. This line is cyclical constructed by taking the **OPPOSITE** extremes which define a cycle's limits. Here we begin with a LOW and draw a line either side by connecting the **FIRST** prior LOW to the **FIRST** subsequent **HIGH**. That first line is drawn around the 2009 low in the Dow Jones Industrials. You can see this is taking the **FIRST** previous **LOW** and tying this to the **FIRST HIGH** after the 2009 low. This line also nicely projects the general direction of the rally that we can expect.

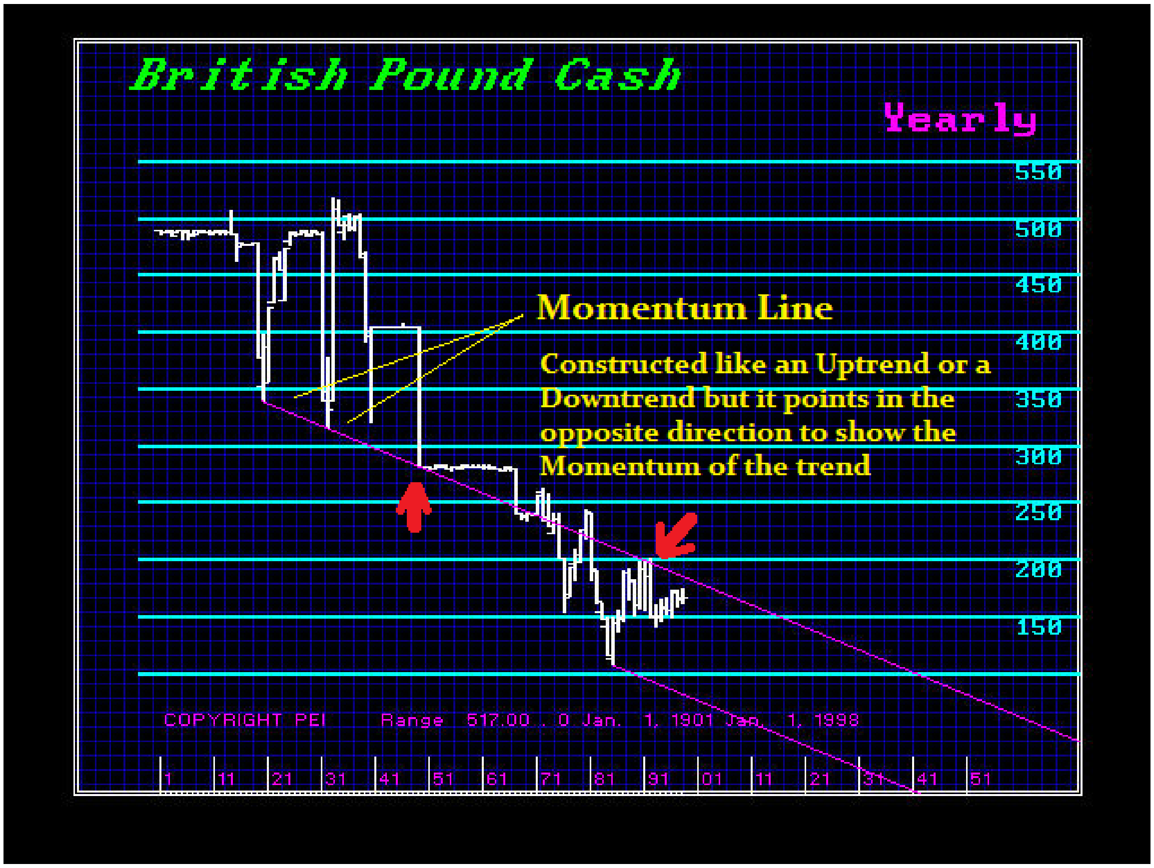
BREAKOUT LINES will provide two major benefits: First, they will illustrate the angle of the market for a potential rally. The steeper the ascending angle, the greater the tendency for a market to rally sharply. Second, **BREAKOUT LINES** will tend to provide resistance on a first test. If penetrated, look for a market to fall back to **TEST** it from above. If the market bounces off this **BREAKOUT LINE**, then the market is "***breaking out***" to the upside. If a market fails to get back above the **BREAKOUT LINE** after it has penetrated it, then expect the decline to become more bearish thereafter.

Her we have all three **BREAKOUT LINES** drawn either side of the 2009 LOW. That first line drawn around the 2009 low in the Dow Jones Industrials marked #1. You can see this is taking the **FIRST** previous **LOW** before and tying this to the **FIRST HIGH** after the 2009 low. This line also nicely projects the general direction of the uptrend all the way into 2011. If we step back to the **SECOND** previous **LOW** and tie that to the **SECOND HIGH** moving forward marking this **#2**, this provided a good middle ground projection as the rally began to run out of steam. Once again move back to the previous low in 2008 and connecting that to the high in 2010, this gives us **BREAKOUT LINE #3** showing a middle ground for the market to consolidate around. Note how after exceed this line into early 2011, the market fell back and held on a closing basis. Then we get the rally to the high in 2011. The market falls crashing through this line, then rallies back to test it before falling to a new low once again. These cyclical based forms of **Technical Analysis** excellent confirming tools that provide a "feel" for what the market is really doing using our visual input capacity.



PROJECTION LINE:

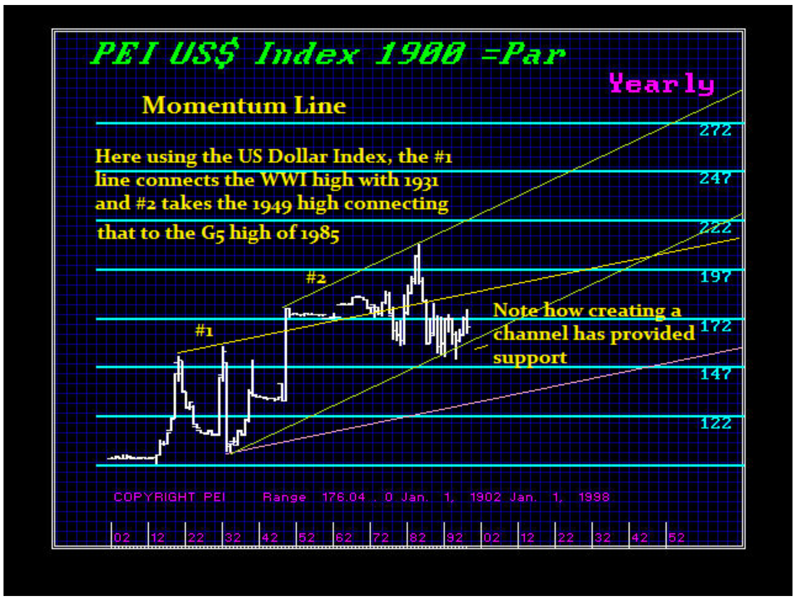
This line is derived purely from also a cycle perspective using the opposite order of a Break Line or Breakout Line. Here we are taking a broad view. In those two prior examples we are taking the focal event and beginning to the left back in time with the same type of event. In other words, taking the 1980 high in gold, we would normally create a **BREAK LINE** by beginning with the previous **HIGH**. Here we reverse the order taking a previous **LOW** and tying that to the subsequent **HIGH**. Instead of a BREAK LINE being generated from a HIGH, we get opposite, projecting an angle upward instead of down. This will still offer resistance for future rallies or reversing the order from a low will produce projection lines below the market for support.



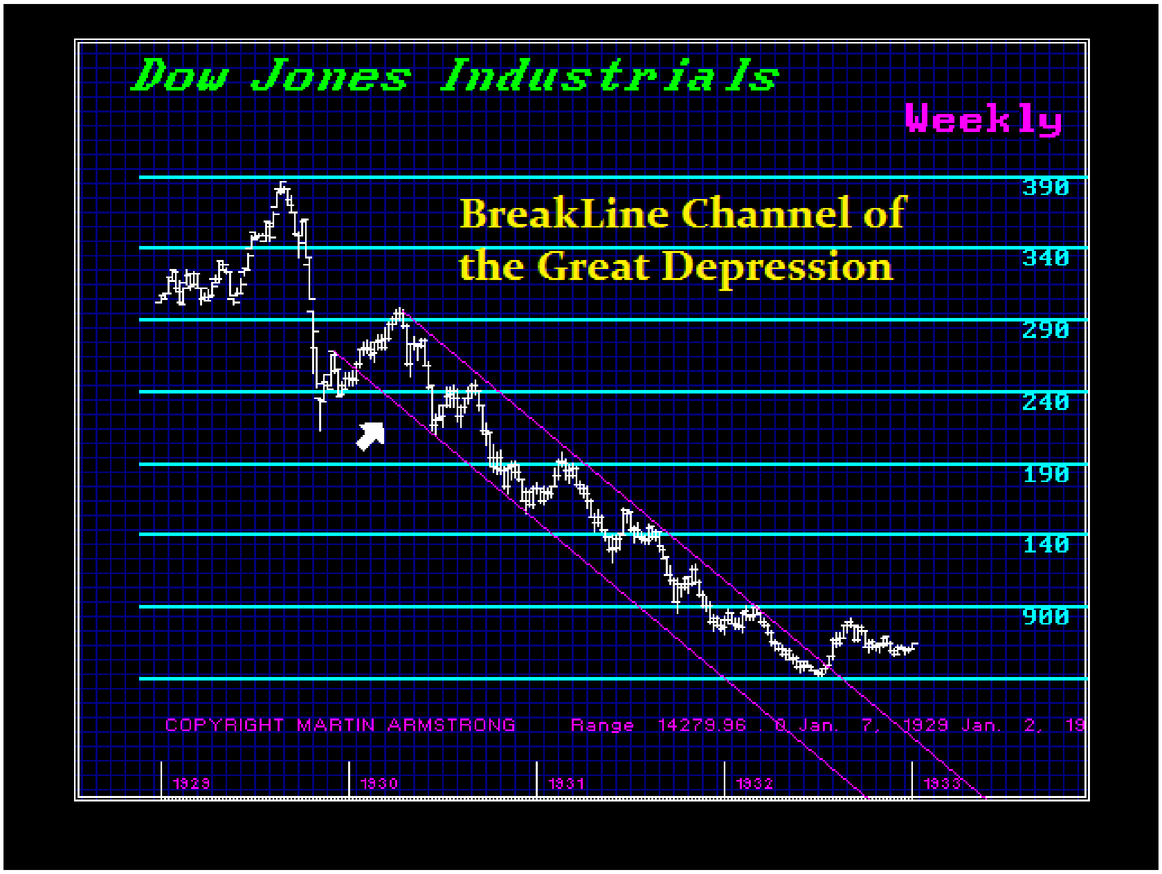
MOMENTUM LINE:

This line illustrates the **MOMENTUM** of a move. The angle of this line will act as a guide to the Momentum of the market up or down depending on the steepness of the angle In this case, we have constructed the **MOMENTUM LINE** by connecting the first two lows of 1920 and 1931. This actually gives us the devaluation low in 1949 and then the rally into 1990 after the G5 low in 1985. Until the British pound breaks back above this Momentum Line, it remains vulnerable to a challenge of the 1985 low.

Using the US$, the same concept will provide resistance and the momentum for the uptrend.



Channel Analysis



Break Line Channel:

Now we arrive at taking what we have learned by allowing the market to reveal its angular characteristics and we employ that creating a **Channel** to map the direction and orderly unfolding of the trend in motion. With everyone arguing all sorts of reasons and causes behind the decline and fall of the US share market during the Great Depression, this illustration shows the incredible orderly descent the market made despite its near 90% collapse.

On the weekly level of the Dow Jones Industrials, a **BREAK LINE** is constructed either side of the reaction rally into 1930 after the dreadful collapse of October 1929. A **parallel** is the drawn from the reaction rally high itself. These two lines now provide a channel that unlike the **5 Downtrend Lines** did contain the move without false indicators. Once again, it is the angle that is created by the cyclical forces within a given market that is the **MOST** important aspect to be understood and used in **Technical Analysis**.

The upward projecting lines are parallels from the **Breakout Line** drawn from the 1929 low to the reaction rally after the 1930 reaction high. This helps to illustrate resistance as the move unfolds. These are simply overlaid upon the main channel derived from the **Break Line**.

The obvious question would be: Didn't you have to Crash before getting this channel? The answer that is yes! However, that does not render this impractical. What is being illustrated here is the amazing regularity and order that exists within the market even under the most extreme circumstances.

Let us look at the 1987 Crash that short-lived. You would be developing your Break Line from the last event which in this case is the first rally in 1987. Assuming we are ignorant of the **Economic Confidence Model** targeting October 19th. We would have in place the first **Break Line** of '87. You should be developing parallels from the events up and down from the opposite points that create the **Break Line**. Once the new high is made, a parallel from that is now providing resistance. Using the parallel from the first '87 high shows us where the market gapped. The first parallel moving south of the **Break Line** rested at 18072 mathematically calculated. The actual panic low was 18100. Not bad for drawing lines! So even if we do not get to a prolonged decline as in '29, we are still positioned to handle short-term panics.

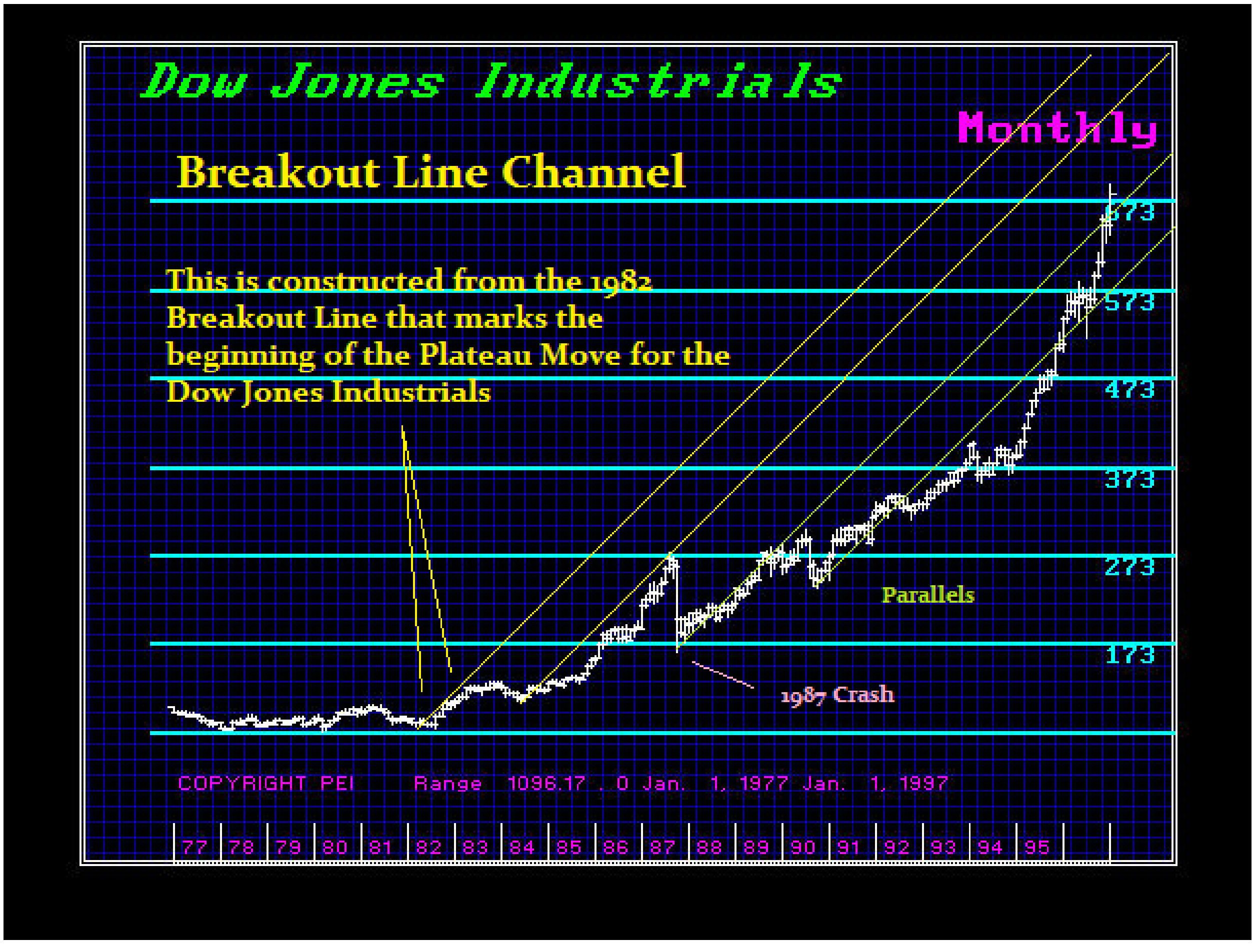
Let us supply this same method to the **DOT-COM BUBBLE**. We have the **First Break Line** from the prior high formation in late 1999. We should be running parallels from that to highs and lows as they form on the way up. You will notice we develop a nice **Breakout Gap**, which we will address later. This **GAP** eventually forms the primary channel for the subsequent decline into 2002 from the 2000 Bubble high.

The **Breakout GAP** is an important event. This occurs marking a **Phase Transition** that can become very significant. It can later form incredibly important support indicating the market and warn a real thrust is possible or in this case when the market falls back into it, it becomes the primary confining channel. Then there is the **Plateau Move** where a whole new paradigm unfolds.

Nonetheless, before we get to what I refer to as a **Channel Move**, this is illustrating that we need not hindsight to figure out what comes next. These are forward looking tools and methodologies that should be in place even if you had **NO** idea of major turning point ahead as defined by the **Economic Confidence Mode**.

The last major event that created a spike high or low should **ALWAYS** be mapped with the **Break Line** or **Breakout Line** and the angles developed should be consistently applied as the market moves into a new major event. This angle will help you see the event as it unfolds before your eyes.

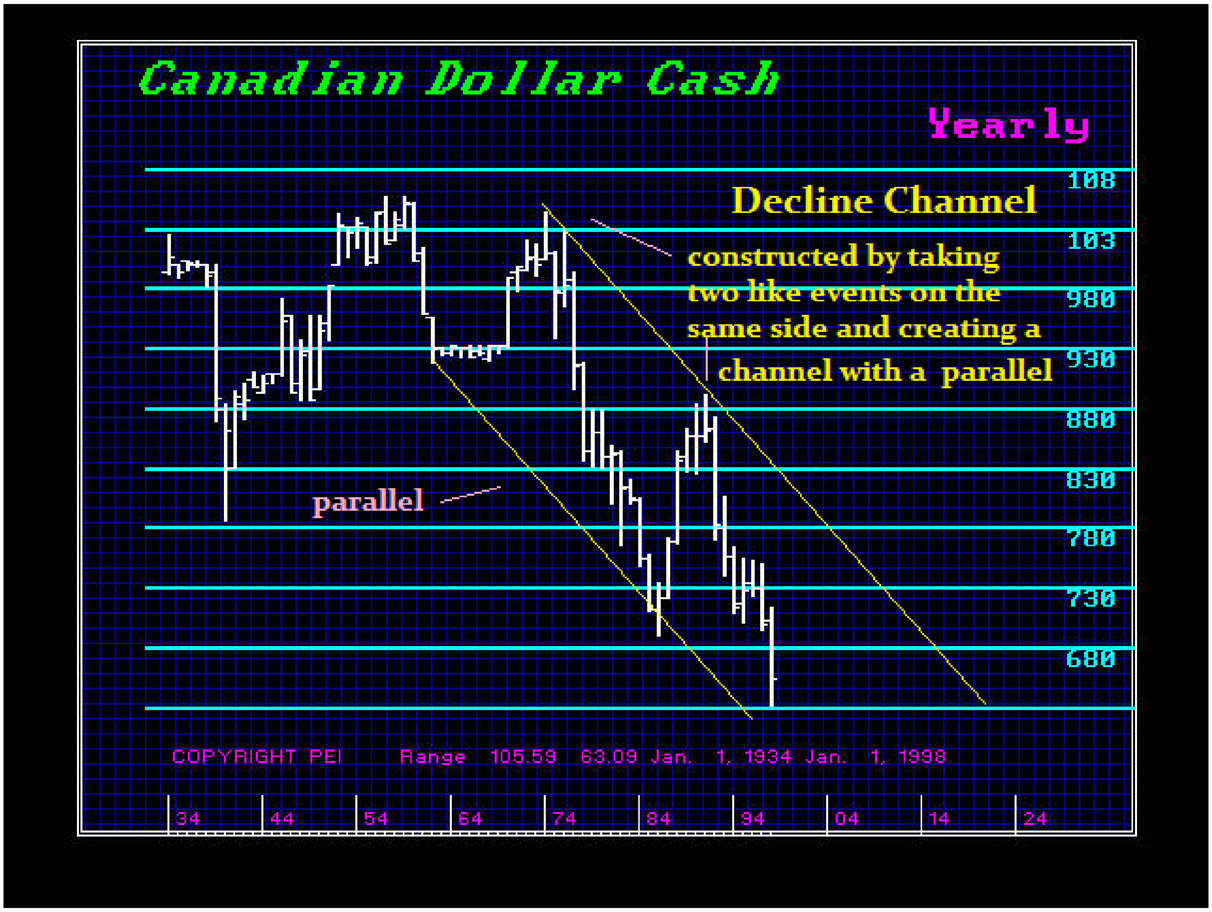
Remember one thing. As long as you understand what is unfolding, then you can assess the risks and rewards. The investigation of the **1987 Crash** revealed people sold because they had **NO IDEA** when the market crashed and burned and thus sold the low out of fear the same would happen tomorrow.



Breakout Line Channel:

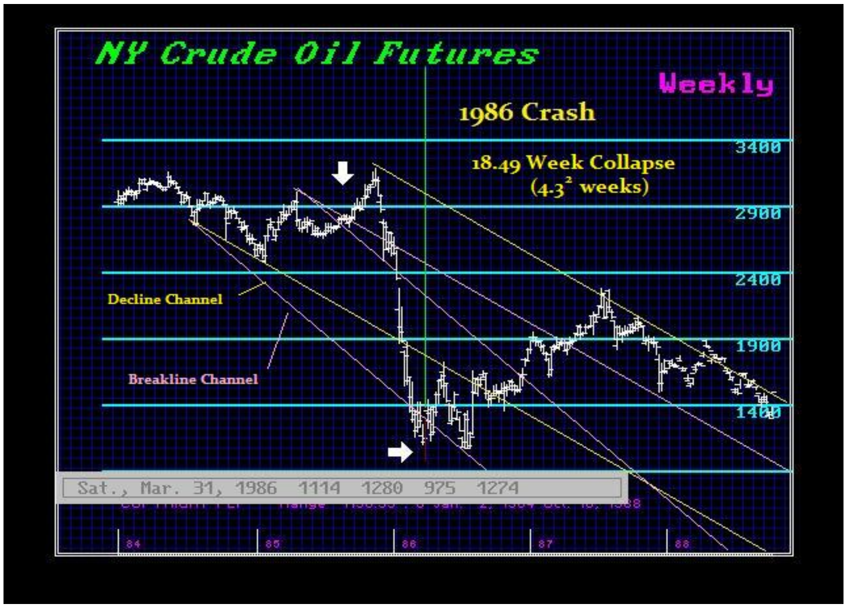
This chart is a representation of how a Breakout Line Channel is constructed, and will perform feats that simply cannot be accomplished with the standard forms of technical analysis. Here the entire beginning of a Plateau Move (discussed below) in the Dow Jones Industrials is really defined by the very first Breakout Line constructed from the 1982 Low. The channel is then constructed by drawing a parallel from the 1994 low. You will notice that the bottom of this channel then provides the high rather nicely for the spike high in 1987.

This channel is then expanded by extending this channel using parallels from the **1987 Crash** low and the 1990 low following the 1989.96 turning point on the **Economic Confidence Model**. You can easily see how this single Breakout Line Channel has helped to define the entire bull market since 1982. This further demonstrates how there is indeed hidden order within what may appear to be sheer chaos or walk others, unable to see the order within, have call randam walk theory. Unless you are in the trenches trading, it appears to be very hard to see the order lurking behind what most seem to think is pure chance.



Decline Channel:

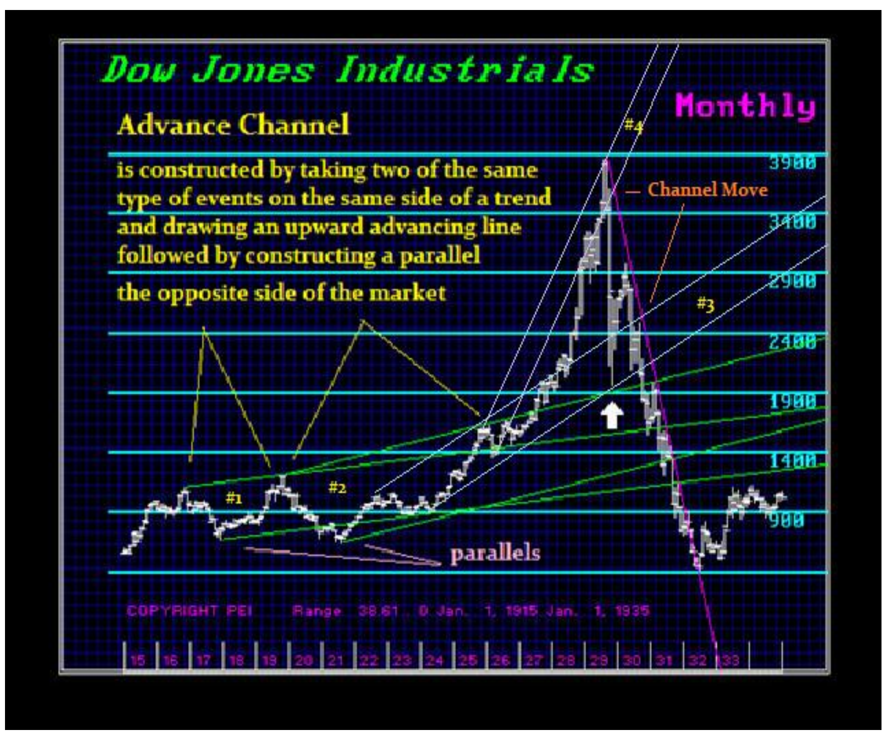
The Decline Channel is drawn by taking two of the SAME events on the SAME side of the market that cast a general declining trend and then using a parallel construct a channel. In the case of the C$, the two events were HIGHS. Here in Crude oil they were two LOWS. These do not capture the extreme angle between two opposite events, but the angles generated are still valid.



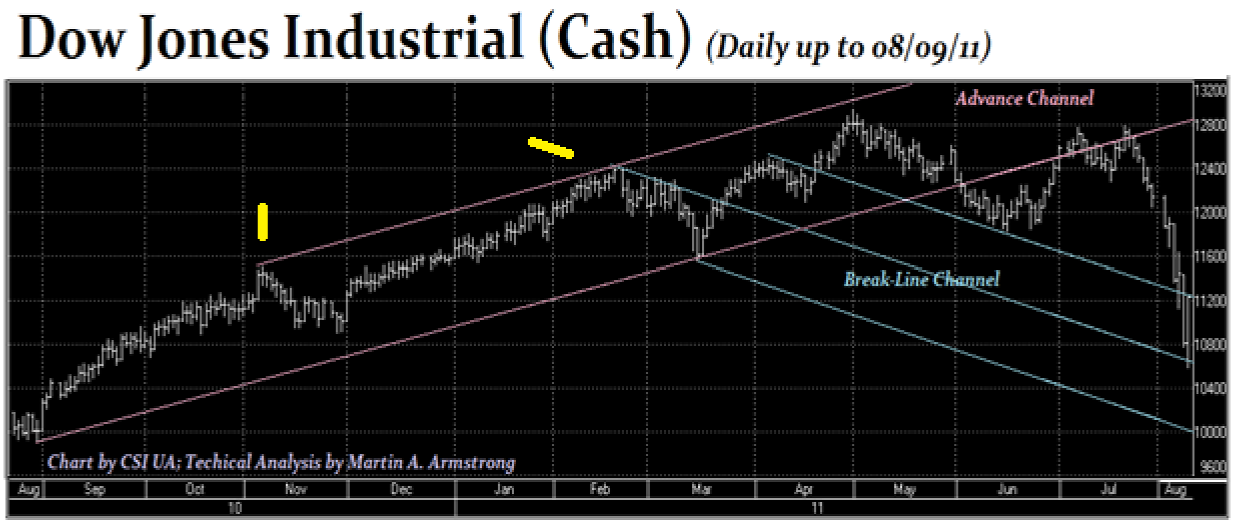
Here you can see a combination of using a **Decline Channel** in conjunction with a **Break Line Channel**. Both have indeed provided different perspectives. The **Break Line Channel** helps with the low, whereas the **Decline Channel** helps define the overall trend and helped with the subsequent reaction rally.

Advance Channel:

Here is an example of what we call the **Advance Channel**. The first **(#1)** has been constructed using the 1916 and 1919 highs. We then construct the bottom of the channel by drawing a parallel from the 1917 low. The **Panic of 1919** that creates a low in the Dow finally in 1921 broke the base of that channel. We can draw a parallel extending that same channel, but then the Dow penetrated the top end creating highs in 1925 and 1926. Readjusting now creating **Advance Channel #2** tying the 1919 and 1925 highs is again penetrated on the upside in 1927. We now create **Advance Channel #3** tying the 1922 and 1925 highs together, but this is exceeded in 1928. We can keep this process up and eventually reach **Advance Channel #4** tying 1925 to 1929 with the parallel at 1926 low. The Crash begins as soon as this is penetrated on the down side and we have a huge **GAP** between **#3** and **#4** setting this up for a **Channel Move**.

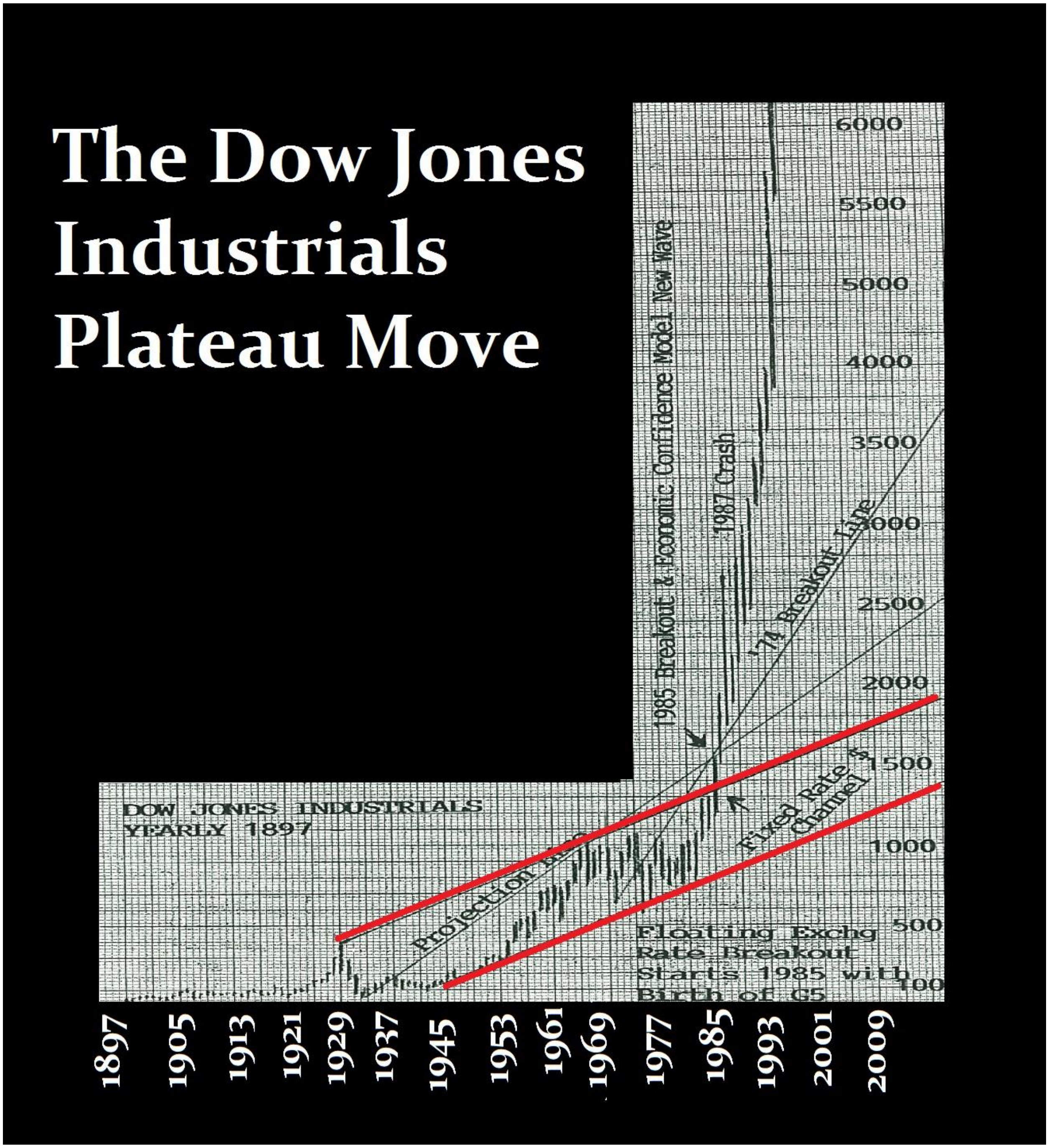


THE CHANNEL MOVE



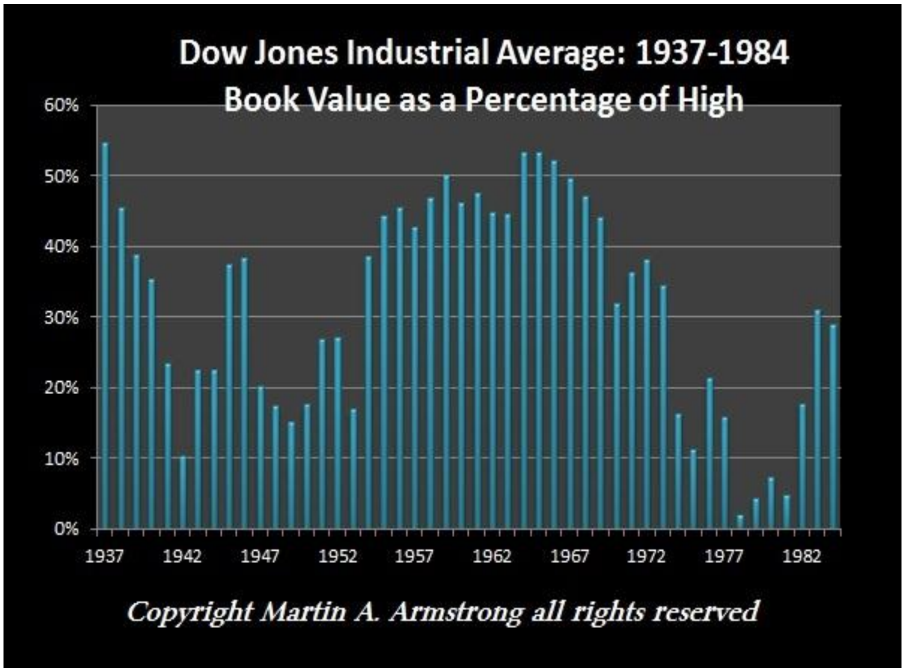
A **Channel Move** is where you have two sharply different channels with a large GAP between them as illustrated above. The **Advance Channel** is drawn with the trend. This is connecting two like events and then you run a parallel from the opposite event that began the move. This gives us the broad **Advance Channel**. The May 2011 high formed nicely still within this **Advance Channel**. The Dow broke through the bottom of this channel in June 2011. The Dow then rallied back into the channel. The underlying channel is constructed from the **Break Line** either side of the Mat 2011 high with parallels then drawn from the previous event high and low. This set us what we call the **Channel Move**. The GAP between these two Channels is then filled rapidly. This type of set up is fairly common in all levels of price activity.

Here is the Nikkei Crash from 1989. There was a nice **Advance Channel** previously, but the first **Break Line Channel** before the major high once again captured the bulk of the price move. Here, the market continued to follow the **Break Line Channel** which was not the case in the Dow.



PLATEAU MOVE

The most powerful technical move anything can make is what we call the **Plateau Move**. This is simply where the market under observation moves to a whole new paradigm. This was the case in the Dow Jones Industrials and it began at the very start of the birth of the Private Economic Confidence Model target for 1985. Everything we were showing on our computer models as well as this technical



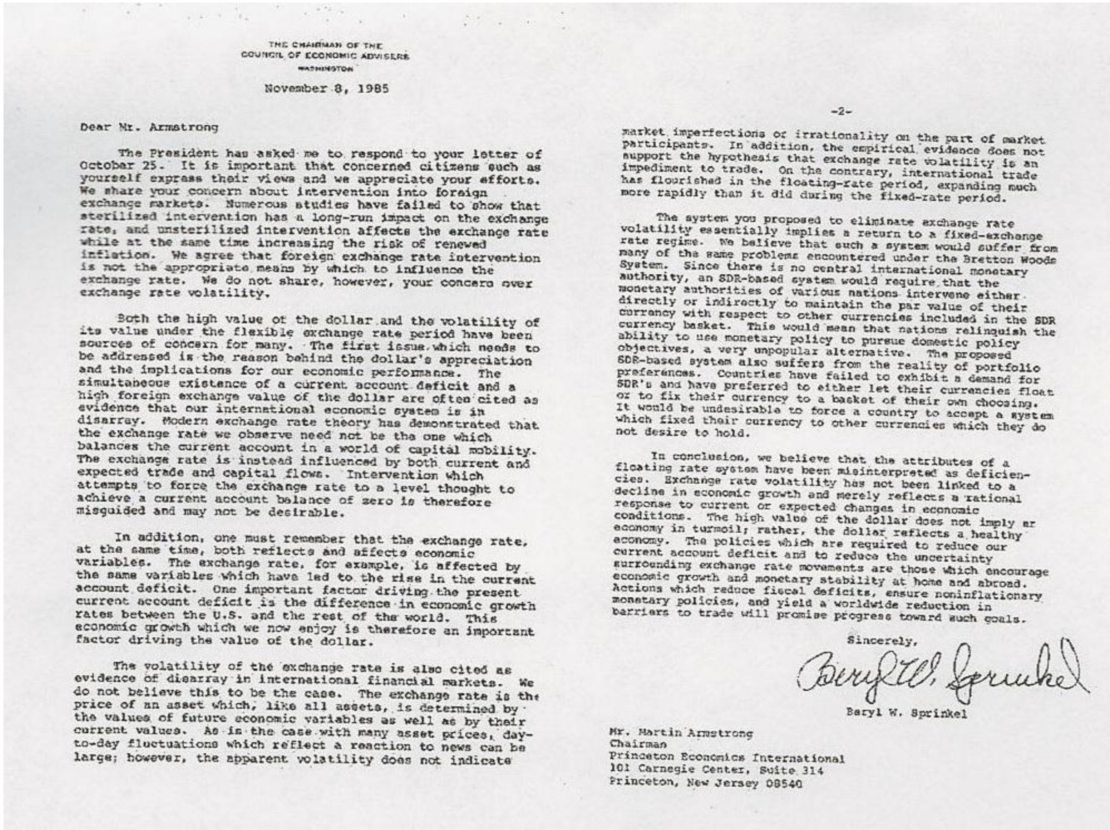
view of the market was screaming to be bought. At lectures around the world given at this period in time this move that was about to take place was easily seen in advance. Because of that, this led to the first conflict with the ***Commodity Futures Trading Commission*** that had actually subpoenaed a list of all clients on the theory that we were manipulating the **WORLD** economy, and this would **NEVER** have taken place but for our influence around the world. This only reflected the absolute ignorance of government that only judges everything by themselves – influence.

Here is a chart showing **WHY** the **Plateau Move** was going to take place even fundamentally. After a Public Sector Wave that began January 1934 when FDR began the New Deal coming out of the Great Depression (1934.05), confidence in the private sector had been shaken and people turned to government as the alternative. During such periods, government can sell bonds easily and they traditionally become the number one investment. The stock market takes second place and this chart on book value as a percent of the high for the Dow Jones Industrials between 1937 and 1984 illustrates the point. The stock market was ***DRASTICALLY*** undervalued. While government blamed us for the "***takeover boom***" since we did advise a number of the takeover players, there was real value there that could not be created. If someone says look your house is on fire that does not mean they started the fire. We beat the CFTC in court and no client lists were turnover. We moved all such information out of the United State after that skirmish.

In this case, a **Plateau Move** took place because we were shifting from a Public to a Private Wave on the Economic Confidence Model. Share prices were far too cheap and the evidence of that was clear when you could buy all the shares of a company, sell its tangible assets, and double your money! The market had seriously undervalued stock prices. Even the Japanese press was stunned by our forecast that the Dow would rally to 6,000 when it was just 1,000. It had exceeded that target in 1996. But that is what a p is all about and we were being **CONSERVATIVE** for the primary target was then 10,000. The Dow reached 11908 by 2000 and eventually 14279 by 2007.

Back Page of the Economist July 1985 ran for 3 weeks to announce the turning point in the world economy

The **Plateau Move** was so important, we took the bank page of the English magazine for three week in July 1985 marking the beginning of the this new Private Wave 1985.65 which was August 25th, 1985. This was the **Plaza Accord** giving birth to the G5. The agreement was later signed on September 22nd, 1985. The dollar versus the yen declined by 51% on the foreign exchange markets from 1985 until the 1987 Crash. Most of this devaluation was due to the $10 billion spent by the participating central banks. We even wrote the White House warning not to do what they were about to do. On November 8th, 1985, the Chairman of the Council of Economic Advisors responded



THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

November 8, 1985

Dear Mr. Armstrong

The President has asked me to respond to your letter of October 25. It is important that concerned citizens such as yourself express their views and we appreciate your efforts. We share your concern about intervention into foreign exchange markets. Numerous studies have failed to show that sterilized intervention has a long-run impact on the exchange rate, and unsterilized intervention affects the exchange rate while at the same time increasing the risk of renewed inflation. We agree that foreign exchange rate intervention is not the appropriate means by which to influence the exchange rate. We do not share, however, your concern over exchange rate volatility.

Both the high value of the dollar and the volatility of its value under the flexible exchange rate period have been sources of concern for many. The first issue which needs to be addressed is the reason behind the dollar's appreciation and the implications for our economic performance. The simultaneous existence of a current account deficit and a high foreign exchange value of the dollar are often cited as evidence that our international economic system is in disarray. Modern exchange rate theory has demonstrated that the exchange rate we observe need not be the one which balances the current account in a world of capital mobility. The exchange rate is instead influenced by both current and expected trade and capital flows. Intervention which attempts to force the exchange rate to a level thought to achieve a current account balance of zero is therefore misguided and may not be desirable.

In addition, one must remember that the exchange rate, at the same time, both reflects and affects economic variables. The exchange rate, for example, is affected by the same variables which have led to the rise in the current account deficit. One important factor driving the present current account deficit is the difference in economic growth rates between the U.S. and the rest of the world. This economic growth which we now enjoy is therefore an important factor driving the value of the dollar.

The volatility of the exchange rate is also cited as evidence of disarray in international financial markets. We do not believe this to be the case. The exchange rate is the price of an asset which, like all assets, is determined by the values of future economic variables as well as by their current values. As is the case with many asset prices, day-to-day fluctuations which reflect a reaction to news can be large; however, the apparent volatility does not indicate

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market imperfections or irrationality on the part of market participants. In addition, the empirical evidence does not support the hypothesis that exchange rate volatility is an impediment to trade. On the contrary, international trade has flourished in the floating-rate period, expanding much more rapidly than it did during the fixed-rate period.

The system you proposed to eliminate exchange rate volatility essentially implies a return to a fixed-exchange rate regime. We believe that such a system would suffer from many of the same problems encountered under the Bretton Woods System. Since there is no central international monetary authority, an SDR-based system would require that the monetary authorities of various nations intervene either directly or indirectly to maintain the par value of their currency with respect to other currencies included in the SDR currency basket. This would mean that nations relinquish the ability to use monetary policy to pursue domestic policy objectives, a very unpopular alternative. The proposed SDR-based system also suffers from the reality of portfolio preferences. Countries have failed to exhibit a demand for SDR's and have preferred to either let their currencies float or to fix their currency to a basket of their own choosing. It would be undesirable to force a country to accept a system which fixed their currency to other currencies which they do not desire to hold.

In conclusion, we believe that the attributes of a floating rate system have been misinterpreted as deficiencies. Exchange rate volatility has not been linked to a decline in economic growth and merely reflects a rational response to current or expected changes in economic conditions. The high value of the dollar does not imply an economy in turmoil; rather, the dollar reflects a healthy economy. The policies which are required to reduce our current account deficit and to reduce the uncertainty surrounding exchange rate movements are those which encourage economic growth and monetary stability at home and abroad. Actions which reduce fiscal deficits, ensure noninflationary monetary policies, and yield a worldwide reduction in barriers to trade will promise progress toward such goals.

Sincerely,

Beryl W. Sprinkel

Baryl W. Sprinkel

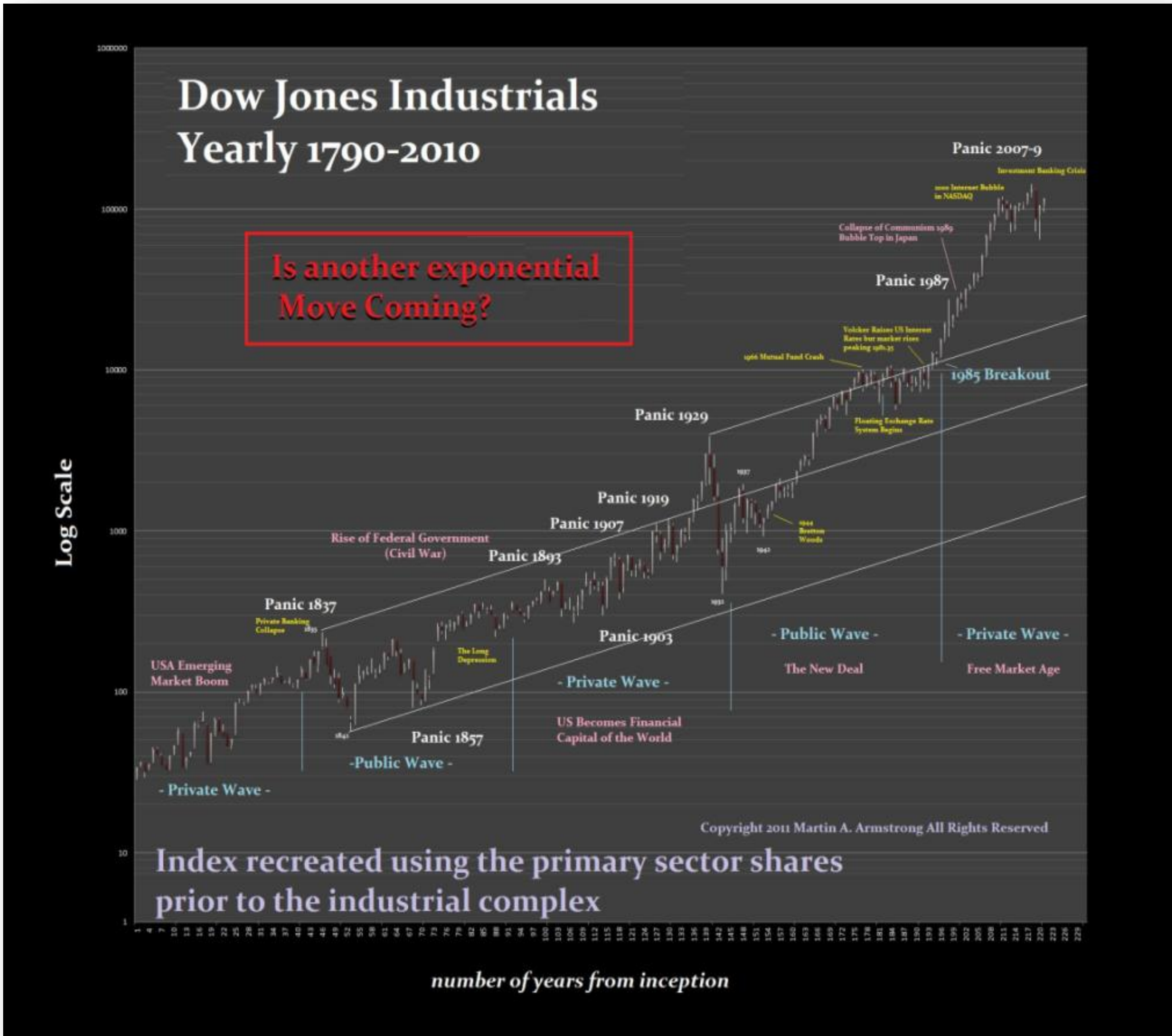
Mr. Martin Armstrong
Chairman
Princeton Economics International
101 Carnegie Center, Suite 314
Princeton, New Jersey 08540

stating there was no evidence that intervening in the foreign exchange markets would cause a rise in volatility. "***We agree that foreign exchange rate intervention is not the appropriate means by which to influence the exchange rate. We do not share, however, your concern over exchange rate volatility."***

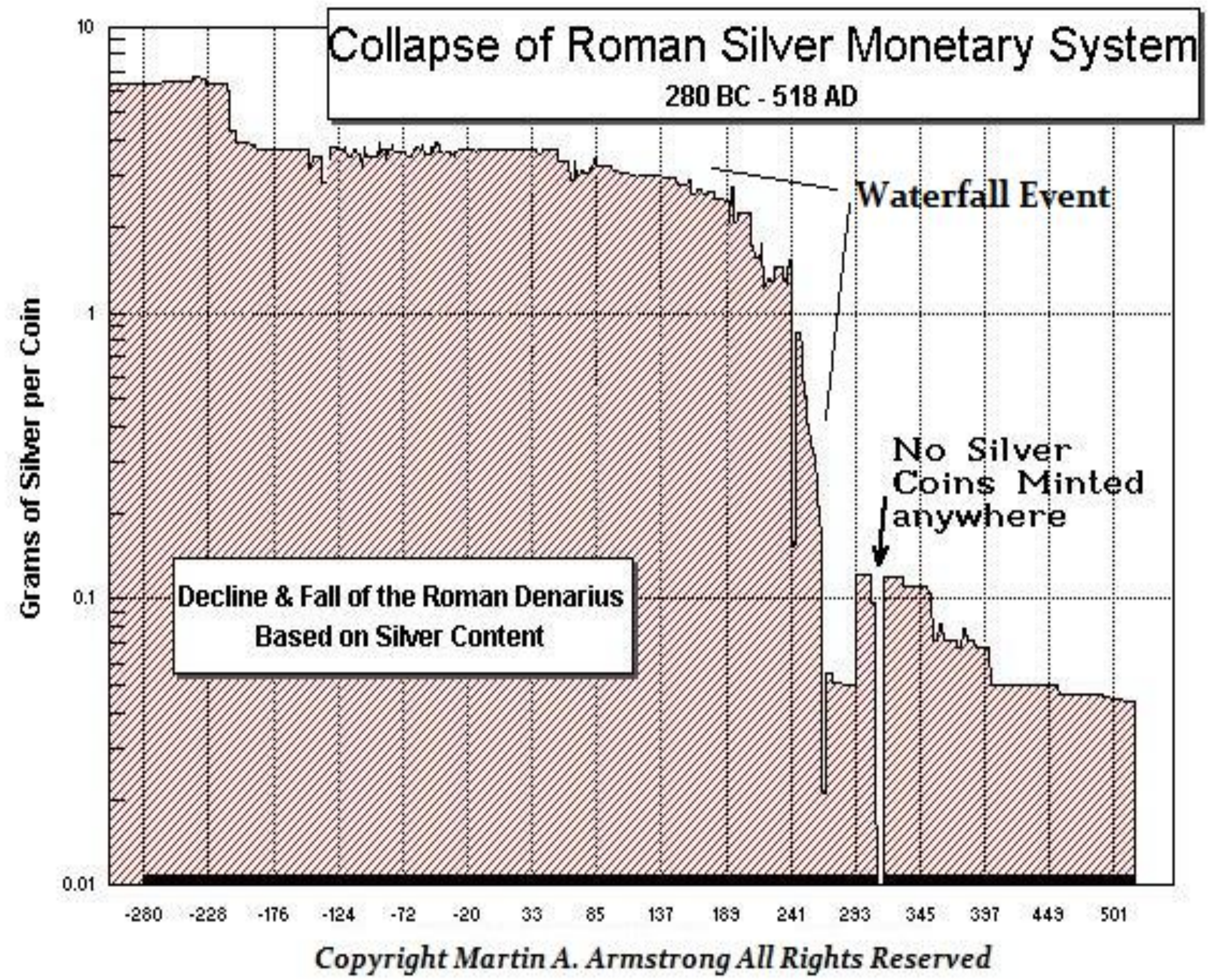
Despite being accused of manipulating the world economy, we took every effort to warn government **NOT** to embark upon such a policy. A **Plateau Move** is drastic. The target that we put out was the **MINIMUM** calling for a 600% advance (Dow from 1,000 to 6,000). Most **Plateau Moves** tend to average 1000% advances and then 1800%. Moving beyond that advance level in a short period of time (27.04 years (π x 8.6)), entails the typical all out **Phase Transition** move that takes place such as in Germany during the 1920s hyperinflation or the collapse in the purchasing power of the currency. That is **NOT** possible in the reserve currency as a first step. Such conditions will unfold only when the outer-lying economies collapse first. Then we are approaching in weather the **White Earth Effect** which is precisely what took place with the fall of Rome – the **Dark Ages**.

1985 Plaza Accord

From left are Gerhard Stoltenberg of West Germany, Pierre Bérégovoy of France, James A. Baker III of the United States, Nigel Lawson of Britain and Noboru Takeshita of Japan

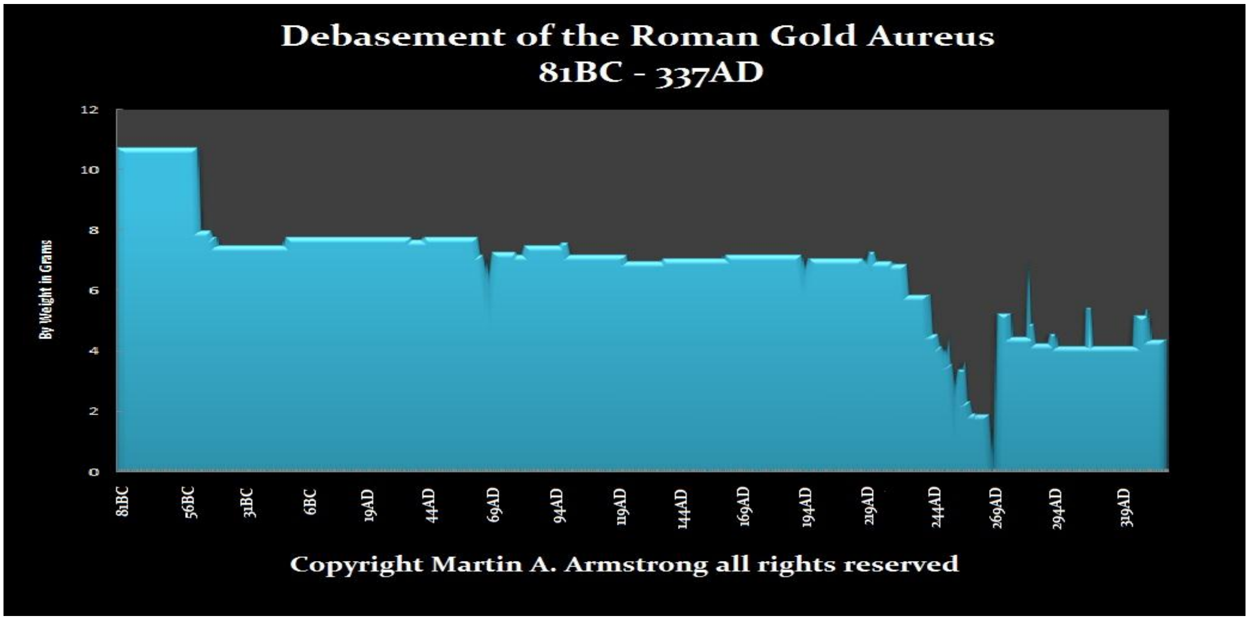


The **Plateau Move** is by far the most powerful pattern that can develop from the upside perspective. It is in many respects the reciprocal of the w that marks the collapse likewise of the instrument under observation. Even when we take the Dow Jones Industrials and we chart this on a log scale, the hidden order remains. Still we can easily see the **Plateau Move** that begins in 1985. The 1929 event broadened the channel created from the 1837 Panic. Taking a parallel using the same angle to the 1929 high clearly defined the 1985 **Plateau Move.** There is simply no other event that is such a warning as this pattern that was confirmed on EVERY model we had. From the government perspective, if we did not yell fire, there would have been none. That's just plain nuts.

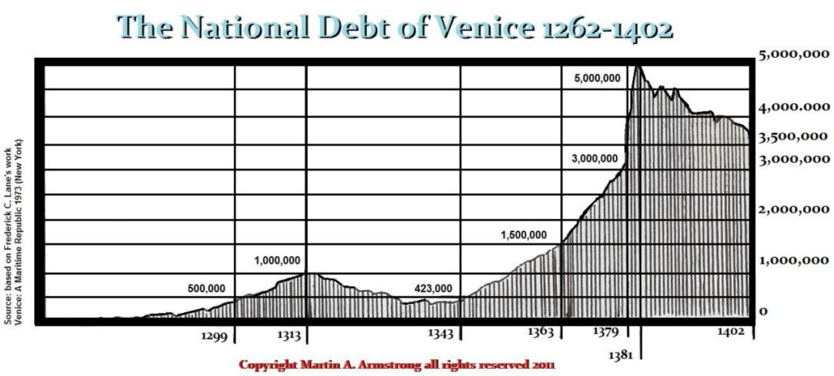


THE WATERFALL EVENT

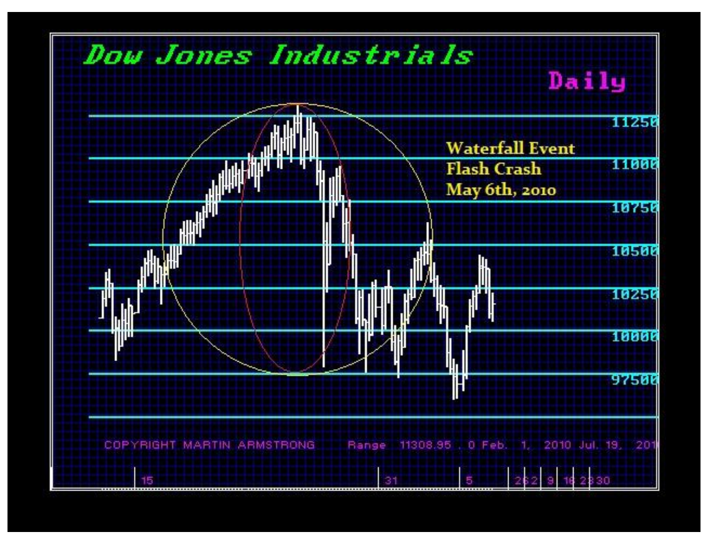
There is no other technical pattern worse than what we have called the **Waterfall Event**. Here is a chart of the Monetary System of the Roman Empire from 290BC through 518AD. The purchasing power of the Roman denarius fell to about 1/50th of what it once was through the debasement of the silver content. This is a **LOG CHART** so it minimized the full impact only so we can actually print this devastating collapse. We have all the data behind the Decline & Fall of Rome. This chart cost over $20 million to produce. We call this the **Waterfall Event** because that is what it resembles a waterfall. It begins generally with a curve of about 45^{o} and then it rapidly turns downward to a near 180^{o} drop at the end. There is no major ABC type of wave or Elliot Wave Structure at this level. Such patterns are generally within the normal day to day minor price movements we might call the quantum level. Here we are looking at the big picture and it is truly awesome.



Here is a picture of the Decline & Fall of the Roman Gold Aureus. Once again, we see the same type of Waterfall Event. The Byzantine Empire collapsed in the same manner. Here we have the debt of the Venetian Empire. After a Phase Transition that spike to a high, eventually this also rolls over into a Waterfall Event and plunges straight down.



Waterfall Events do take place on the minor time levels such as the May 6th, 2010 "***Flash Crash***" Again you see no discernable wave ABD or Elliot Wave pattern. The market just rolls over and collapses. However, because the markets are fractal, such events will migrate up the time scale and eventually materialize on the big picture level. What we saw in 2010, will appear at the larger level in time but not before 2032 at the very earliest.



CONCLUSION

This will provide an overview to technical analysis that is designed to capture the ***angle*** of the market. The object again is to eliminate as much as possible human interpretation that prevents all forms of pattern recognition forms of analysis from rising up the scale from a pure art form to a definitive form of tool.

Technical Analysis is vital to providing the price objectives that **Timing Models** do not provide. Simultaneously, **Timing Models** tell you **WHEN**, which **Technical Analysis** cannot provide. Blending both forms of analysis will help to open that door to understanding the possible alternatives for the future.