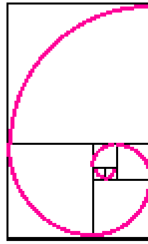

Sand Spring Advisors LLC

Mid-Winter Thoughts

by,

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February 19, 2006

There are certain holidays each year that often see markets acting one way before the holiday, and completely differently after the holiday. Labor Day, New Year's Day, 4th of July, Memorial Day, and Washington's Birthday weekend (more recently labeled Presidents' Day weekend) are all periods around which I have witnessed significant market turns over the years. Holiday weekends with full moons tend to be particularly prone to sentiment changes after the long weekend passes.

As one example of such, after Washington Birthday's weekend 23 years ago in 1983, I remember gold reversing from a top near $510 to a low near $390 in just a matter of days. I recall this particularly well because I had taken my fiancé on holiday to the Caribbean, leaving behind a few arbitrage spread positions at the venerable Morgan Guaranty Trust Company. During that vacation, the hotel reception phone hardly stopped ringing for me, and since there were no telephones in the individual bedrooms of the hotel, I made multiple mad dashes through the hotel corridors and breezeways to talk with New York. In the end, all my spread positions were fine, but the vacation was essentially a bust.

By May of that year, I was more cognizant that long weekends (particularly with full moons) were ripe periods for trend reversals. Sitting in Morgan's London trading room with its head trader Martin Stokes (a smart fellow, but a basic skeptic on technical analysis), he asked me what I thought of the gold market. Gold had been in a "rising wedge" formation for several months, slowly clawing its way back from the $390 low made during the February 1983 fast move lower (when I'd been sitting on the Caribbean beach) to a late May price of approximately $442. A long Bank Holiday/Memorial Day weekend lay ahead, with a full moon set amidst it.

"Gold is going to drop precipitously out of its rising wedge formation," I stated.

"When will this happen?" Stokes asked.

"The logical time would be immediately after the coming Bank Holiday/Memorial Day weekend," I responded.

"In London time?" Stokes asked in a slightly mocking way.

"No, I would guess that it will not happen until the New York market opens. That's when the change in sentiment should hit. After the long weekend, during initial London trading, gold might even move up slightly first in a misdirectionalcontinuation of the current trend."

Perhaps my work ethic at the time was not what it is today, but I had another vacation planned for myself (-- using a holiday-shortened week for a few days off was just too efficient a tactic for a young trader with only two weeks of vacation per year.) This time, I was driving my fiancé down to the Devon/Cornwall coast of England for a week of relaxation and sightseeing. But I was damned if I was going to miss out on my perception of an imminent market decline after the holiday weekend. Without really discussing it with my big boss in New York (nor with my fiancé who was still bemoaning all the trading phone calls from our last vacation), I left my "prop account" 4000 ounces short gold (my limit at the time) and gave Martin a "one-cancels-other" order to buy back my 4000 ounces either on stop at $447 (about $5 above the current market at the time) or to buy them with a take-profit order at $410 ($32 below the market). I asked for a call on either "fill."

Martin looked at me sheepishly. "You really think we can go all the way back to $410 while you're away? We haven't traded there in months."

"I know it seems a long way away," I said. "Maybe I'm nuts, but that's what the chart implies."

So my fiancé and I piled into the rental car, spent a lovely weekend meandering our way down through Devon, and by late Tuesday afternoon pulled into Torquay, Devon. I think our hotel was the large white building pictured below.

The hotel concierge had a message for me upon arrival: "Call Martin Stokes in London."

I placed the call nervously, fully expecting that my nearby stop-loss order might have been elected. I could picture my nascent trading career coming under harsh criticism from my boss in New York for having left on holiday with another open position. Back in those days, losing $20,000 – even for a big bank like Morgan – mattered (at least in my mind).

"Guess where gold is?" Martin asked me when he came on the line.

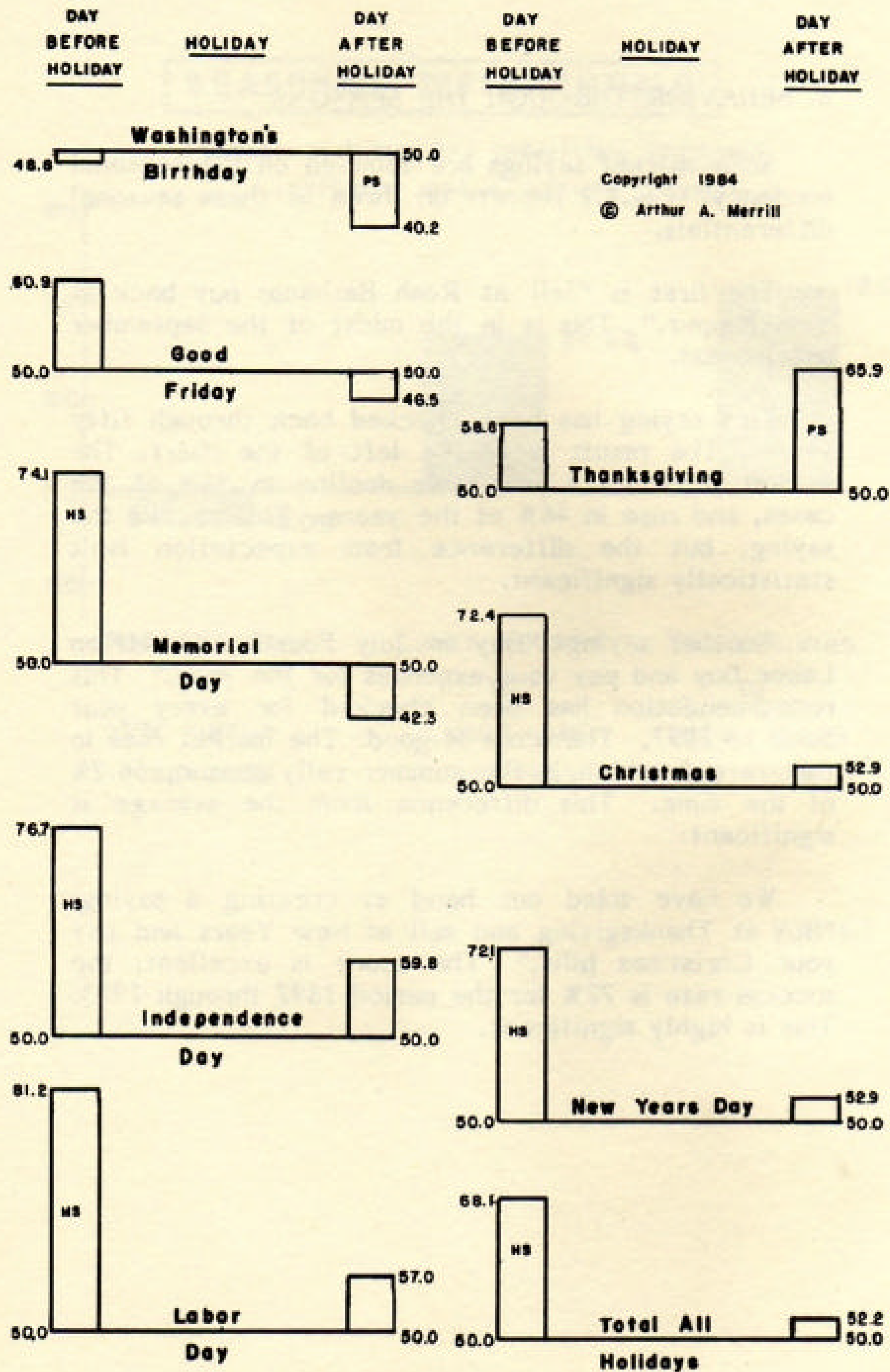
"Did my stop get hit?" I asked nervously.

"Far from it, dear boy," Martin responded kindly. "New York just filled your buy order at $410 about an hour ago, and we're currently trading $415. Bar, you nailed it. London first traded up to $445, but when New York came in, gold traded straight down. There was no real news. Comex just went limit down for no reason. I guess everyone was long."

I smiled, and enjoyed the rest of that vacation thoroughly – position-free.

I tell this story as we now sit here in early 2006 because I sense more reversals hanging around this holiday weekend – and while I wish I could say for sure that these reversals will reside in the equity indices, the setup is not perfect. In imperfect fashion, there is no full moon this weekend (the full moon was last weekend). There is no PEI cycle date. But there is a Bradley turning date. There is also an amazing complacency amidst investors even as certain internet stocks (eBay, Google, Amazon, among others) have recently fallen from grace, while the global geo-political situation with the Muslim world has clearly worsened in recent weeks. Arguably, ever since the March 2003 equity market low, we have also witnessed a weekly "rising wedge" formation that -- to my eye at least -- looks ever so similar to the rising wedge formation that I first spied on daily gold back in May 1983.

Washington's Birthday weekend is also not exactly known for its "bullish" setups. In an enjoyable 1984 text "The Behavior of Prices on Wall Street" (as updated from the 1st edition published in 1966) esteemed market analyst and author Arthur A. Merrill showed that through history, most post-holiday trading sessions are "up days" – with the notable *exception* of Washington's Birthday which Merrill termed "especially bearish." Looking at daily trading patterns back to January 1897, Merrill produced the following table. Given the long-term history of rising equity prices over the past century, the proclivity for the day after Washington's Birthday to fall more often than it advances seems worth noting.



Source: The Behavior of Prices on Wall Street, 2nd Edition, 1984, by Arthur A. Merrill

I thus must wonder whether the small negative "hang-day" witnessed this past Friday might not be the harbinger for some more significant equity weakness to come beyond this long weekend? The fact that a Bradley cycle turn is due sharpens this perspective.

If trading after this weekend does bring some weakness, at this point I see Fibonacci support developing around 1229-1231 on the S&P 500 cash chart. But if equities continue to vault higher, and take out the mid-Jan 2006 highs, then the next upside levels to look for would be 1319.50 and then 1334.70. Psychologically, I am trying to be ready to accept such a latter path if it transpires – to admit that my immediate bearish view is wrong -- but first I want to see how this coming week behaves.

I previously wrote in mid-January of George Lindsay's "Three Peaks and a Domed House" formation, and promised more Lindsay analysis in this letter. Over the past month, I have indeed been studying much of Lindsay's writings within a text entitled "Selected Articles by the Late George Lindsay" compiled by Investors Intelligence.

As one note to the "Three Peaks and a Domed House" formation, Lindsay wrote:

> "Sometimes prices get back to the starting level [of the formation] in one continuous downtrend, and sometimes there are extended recoveries on the way down. But there has never been an exception to the rule that the entire gain in a Domed House has eventually been canceled."

In the current instance, I do not believe that the market weakness seen into early February quite did the trick to complete the formation to the downside. Instead, I view recent strength as

still being part of an “irregular” Three Peaks & Domed House top, with at least one more plunge left to go. Call current price levels as a potential “point 27” on the idealized Lindsay formation.

Seldom, of course, do equity markets “crash” during this time of year. Crashes are more of an autumn phenomenon. Thus, I cannot in good faith put forward that I expect much follow-through to equity weakness – even if such does emerge over the coming days. It might simply be a fast trading move down to 1230, with 1319-1335 S&P levels then still possible into the spring. Or maybe after a sharp break, we would only be able to claw back to a “second shoulder” lower high in May-June, before renewed downside weakness would be cyclically due in July-October.

But a minor “swan dive” lower between now into late March (maybe with some sort of terrorist inspired catalyst/excuse) would make sense to me.

Individual chart patterns that I continue to see as particularly vulnerable include those of MBIA, Ruby Tuesday’s, Wells Fargo, William Sonoma, and the XLY Consumer SPDR. For better or for worse, I am personally short them all. Please make your own decisions in your own trading.

RI, Daily
02/17/06
O: 27.65 H: 28.55 L: 27.65 C: 28.05
-0.46
Ruby Tuesday's
(daily)
1.000 (32.99)
0.910 (31.67)
0.764 (29.54)
0.618 (27.41)
0.500 (25.69)
0.382 (23.96)
0.236 (21.83)
0.146 (20.51)
0.090 (19.70)
0.000 (18.38)
target

WFC, Weekly
02/17/06
O: 61.55 H: 64.04 L: 61.20 C: 63.61
+1.88
Wells Fargo
(weekly)
0.000 (64.12)
0.090 (61.18)
0.146 (59.37)
0.236 (56.44)
0.382 (51.69)
0.500 (47.84)
0.618 (44.00)
0.764 (39.25)
0.910 (34.51)
1.000 (31.57)
1.382 (19.14)
1.618 (11.45)

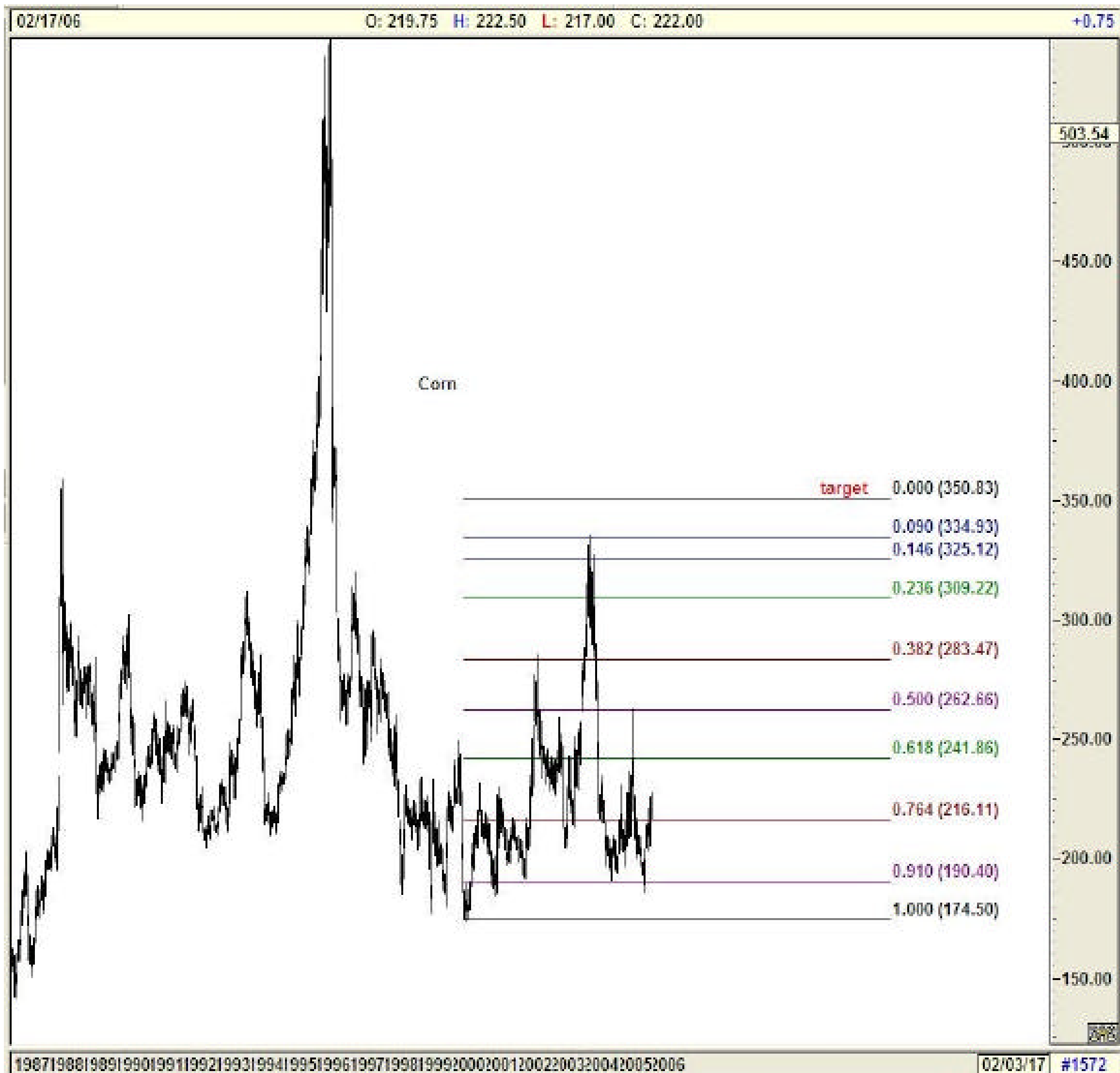
WSM, Weekly
02/17/06
O: 38.41 H: 40.02 L: 38.18 C: 39.80
William Sonoma
(weekly)
0.000 (45.14)
0.090 (41.78)
0.146 (39.70)
0.236 (36.34)
0.382 (30.90)
0.500 (26.50)
0.618 (22.10)
0.764 (16.66)
0.910 (11.22)
1.000 (7.86)

XLY, Weekly
02/17/06
O: 33.26 H: 33.83 L: 33.05 C: 33.62
XLY (Weekly)
target

As a side-note to the patterns above, the Russell 2000 and the Biotech BTK indices also look very overbought. Similarly, copper and the precious metals appear very toppy, so don't be surprised to see more weakness developing in either or both. If selling gold on Washington's Birthday worked back in 1983, the current price pattern of gold also might allow such to work again in 2006. February-June is typically a seasonally weak period for gold, while July-January is the seasonally stronger portion of the year.

So does anything look good on the long-side?

Interestingly – another batch of commodities – wheat and corn (September futures contracts pictured below) – appear on the move to the upside. I see a clear Fibonacci rhythms with defined upside targets on both. It is a known fact that Russian wheat stockpiles will be depleted over the next two years, and China will shortly be a net wheat importer of some magnitude. The demand side of the equation is there. If U.S. weather patterns turn awkward in the summer, this may be one trade where the speculators (currently very long) get it right over those who currently expect another record U.S. grain/corn harvest.



As a last note, there are other techniques of George Lindsay that I have enjoyed learning about in my recent reading – his "top-to-top counts," "low-low-high counts," and "basic move counts" among them. But I have decided to await applying any in public until I become comfortable with them through private experimentation and practice. Lindsay was clearly a brilliant man that should not be forgotten amidst other early master technicians such as Gann and Elliot. But understanding and applying all of his techniques is not a science or creative art that I want to practice naively.

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