Sand Spring Advisors LLC

Diamonds In the Sky: a Focus on the DJIA

by

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Some may want to believe that given the large rally on Wall Street this past Friday -- the worst of our bear move is now behind us. Indeed as I played squash with my 11-year old son this weekend, I heard relieved banter in the locker room from men in their 60's exactly to this effect.

But from a purely technical basis, and in spite of Friday's pop in prices, there is now no denying that the Dow Jones Industrial Average has traced out an almost perfect "Diamond Pattern." Although diamonds can occasionally be continuation patterns in nature, the pattern in this instance has <u>clearly</u> broken to the downside, leaving us a Diamond Reversal for the bulls to contend with.

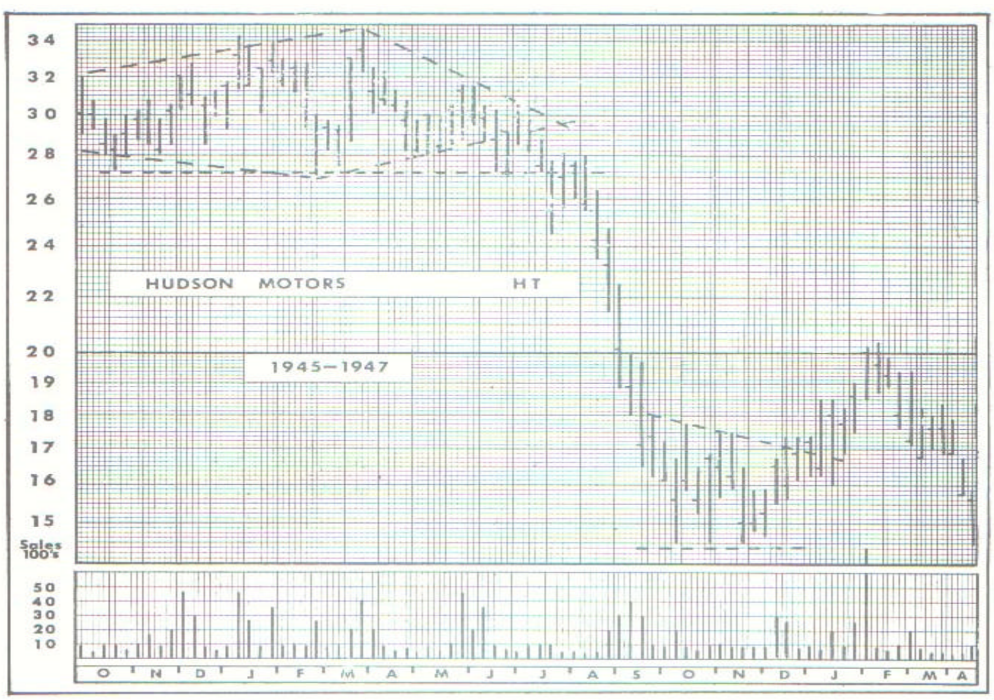
For those that are not familiar with the implications of a Diamond Reversal, we will quote here from the historic text by Edwards and Magee, *Technical Analysis of Stock Trends:*

> "The Diamond pattern is not a common pattern….Its 'natural habitat' is Major tops and the high-volume tops that precede extensive Intermediate reactions…Diamond reversal formations are often easier to detect on weekly than on daily charts….It carries a minimum measuring implication [that] prices should move at least as far from the breakout point as the greatest width in points of the pattern from its top to bottom. This, it must be emphasized, is a minimum rule…Generally, the new trend carries prices eventually well beyond the minimum measurement."

In the current instance, the high point of the diamond was at 11,750.3 made on January 14, 2000. The low was 9731.80, made on March 8, 2000, leaving a total distance of 2018.5 points. We think that the diamond was definitively broken on October 9, 2000 by the close that day at 10,568.40. Subtracting 2018.5 points from this breakout point, we obtain an estimated minimum target of **8,549.90.**

Now, as previously shown back on September 15th, we suggested that a break of the 100-week moving average would open up a likely descent of the DJIA to **8041.3** basis the decline's initial Fibonacci rhythm. Along the way, using the weekly Fibonacci rhythm, 9458, 8917, and 8379 would be expected minor stopping points.

On the charts below, we show the current DJIA Diamond formation in comparison to the Edwards & Magee classic formation. If the current DJIA chart is indeed a diamond of similar force and magnitude, we have barely begun our descent.



Now let's take a look at the short term daily and hourly rhythm of the DJIA descent to date to search for further clues.

Under Elliott wave rules, Wave C declines in corrective moves are often of the same length as the Wave A decline. If on the other hand, we truly have a Wave III decline on our hands (as looks increasingly likely), then Wave III can often reach 1.618 times the Wave I decline. Since our first move down (either a Wave A or a Wave I, as the case may be) was 2018.5 points in length, and the intervening rally ended at 11,401.2 on September 6, 2000, a Wave C down would likely end at **9382.7.** If we are instead in the midst of a more nasty **Wave III** down, then one would be looking for **8135.27 :** 11,401.2 – (2,018.5 x 1.618). This latter target is pretty close to our forecast target using other methodologies back on September 15th.

Lastly, on an hourly basis, we see a rhythm as depicted below. This would argue that **9204** is our approximate objective by the end of October. The hourly chart suggests that 10,305 should contain further rally attempts.

So let's combine <u>all</u> of our tools into some sort of organized schematic. Under the rules of Diamond Reversals, the Dow Jones is likely to eventually see 8,549.90, and we can find a specific target basis Fibonacci work on a weekly and daily basis **between 8043.3 and 8135.27.**

On a shorter-term basis however, it is probably only realistic to look for a maximum decline to 9204 by the end of October. By achieving such a target, the market would shatter the 9382.7 potential C wave support zone, and issue a confirmation that after maybe a 6-week bounce period into Dec 10-11, further lows would still lie ahead. Conversely, if we hold up above 9382.70 into late October, some credence must be allowed the more bullish case. That is not our preferred expectation right now, but it is obviously possible.

For now, the key point is that this past Friday's large rally off of the 10,014.2 level on the DJIA is likely to sputter out and fail below 10,305. The "Diamond in the Sky" that the Dow Jones has now left behind on the weekly charts is ever so dangerous in its ongoing intermediate term implications.

The men in the locker room may talk in relief of their portfolio's rebound, but America's wealth is likely to continue evaporating after an ever-so-short repose.

Send us your comments at info@Sandspring.com.

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