TRADING THE S&P W

By Daryl Guppy

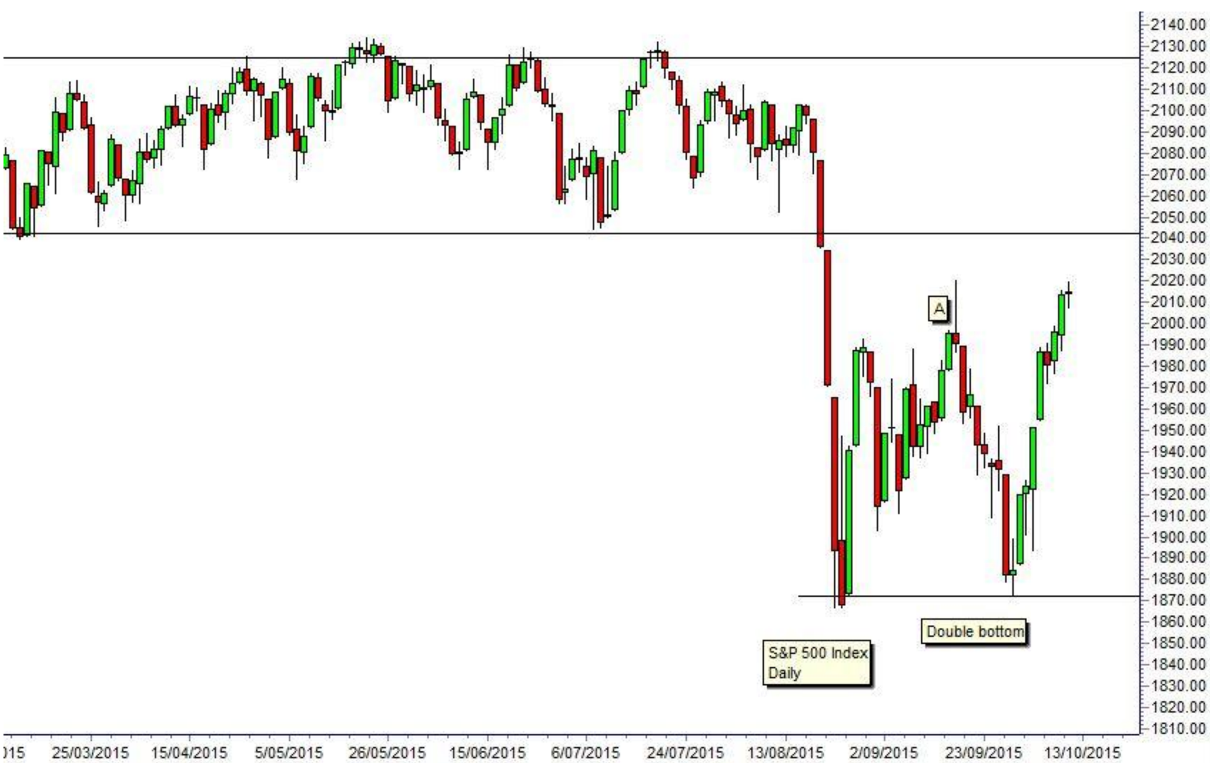
Over the past few weeks there has been an inconsistency in the US indexes. The behavior of the Dow was different to the behavior of the S&P 500 and the NASDAQ. The Dow developed a pattern usually associated with an end-of-uptrend behavior and this suggested traders should sell short. The S&P and NASDAQ just showed a pullback in the context of a strong uptrend. A pullback is a buying opportunity on the long side.

This is a two to one vote in favor of a pullback and a rebound so traders have been waiting for evidence of the rebound before entering new long positions.

A new rebound pattern has emerged and been confirmed on the S&P 500 index. This is a W pattern. The left side of the pattern was created on August 25 with a plunge to near 1870. The rally and subsequent retreat is an integral part of this W pattern. The retreat briefly reached near the 1870 level before developing a strong rebound rally. The rally and retreat signaled a W pattern.

Aggressive traders went long around 1900 in anticipation of the rally moving above the pattern high near 2000. Conservative traders wait for confirmation the rebound rally can close above 2000. This higher close confirms a higher probability that this is a W pattern.

The rebound rally has a significant resistance level to overcome before it can reach the projected target for this type of pattern. The projected target is calculated by measuring the height of the middle of the pattern from the support level to the middle peak of the pattern – the center of the W – shown as point A on the chart.



When this value is projected upwards from 2000 it gives a value near to 2125. This is the resistance level that constrained the rise in the S&P from 2015 May to July. However, the S&P must first move above the lower edge of the long term support level – now a resistance level - near 2040. A move above 2040 is also a move above the upper edge of the long term Guppy Multiple Moving Average on the weekly chart.

The move towards 2125 will not be smooth so traders anticipate volatility as the S&P moves towards this target level. This signals a resumption of the longer term uptrend but the pattern of behavior also indicates longer term weakness in the uptrend. In the longer term traders watch for how this W rebound pattern may develop as part of a much larger end-of-up-trend pattern developing over 3 to 6 months.

Note; A W pattern is a rebound pattern following a trend correction. A double bottom pattern develops after a significant and prolonged trend change and signals a new long term uptrend.