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Dow Theory Chartist

Special Report

June 1, 2004

Dow Transports Non-Confirmation Warning

[Refer to charts on page 2]

The Dow Transports failed to confirm the recent short-term price low of the Industrials, thus warning of a potential trend reversal. The intermediate-term trend has been confirmed down since the sell signal of March 10, 2004, and will remain so until an actual price trend-reversal signal is given (since a Dow theory sell signal remains in effect until proven otherwise.) However, since price trend-reversals are quite often preceded by non-confirmation warnings, this recent one should elicit caution from those traders playing the current downtrend.

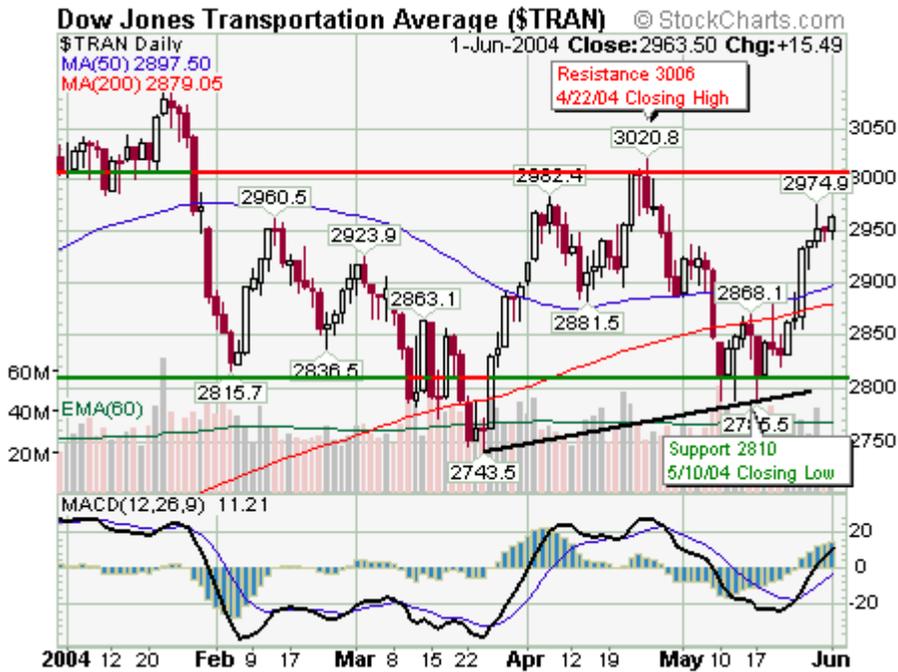
In addition to the non-confirmation by the Transports, the Industrial's price low on May 17, 2004 was not confirmed by its MACD indicator, a measure of momentum. This is also a frequent occurrence prior to a price trend-reversal.

The price and momentum non-confirmations were validated when their respective short-term trends reversed up, which is where they remain today. The current up trends of the Industrials and Transports have resistance at the April closing highs and support at the May closing lows (exact levels are shown on the charts.) A confirmed breakout from this trading range would provide the next signal – up for a buy and down for a sell (or trend continuation.) Until then the markets are essentially in neutral mode; i.e., a trading range.

I want to emphasize that a non-confirmation is only a warning and not a signal. It is always prudent to wait for a confirmed trend-reversal signal before acting on it. It is also not unusual for non-confirmation warnings to be invalidated. The July 2003 short-term cycle high for the Transports was not confirmed by the Industrials, for example, but the warning went on to be invalidated when both averages bottomed at higher lows and subsequently broke out to higher highs in August (thus leaving an almost a three month gap between signals.) In regards to the current market, it is important to monitor the aforementioned resistance points. If the current short-term trends reverse down without first bettering them, the onus will be on the previous closing lows to hold as support. If they do not hold, the existing downtrend will probably accelerate rather than reverse. *Despite the trend-reversal warnings, the risk remains to the downside because that is the direction of the existing trend.*

In my previous newsletter, I stated that the expectation was for the previous trend reversal point to be a major top. However, I also pointed out the possibility of a 3rd phase to the cyclical bull market. The next Dow theory signal will go a long way in determining which of those scenarios is playing out.

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(Charts courtesy of StockCharts.com)



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