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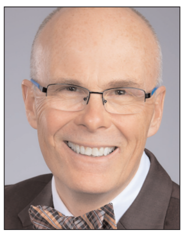
The market according to Dow



Keith Richards

There are 6 tenets of Dow Theory, originally devised by (and named for) Charles H. Dow (1851–1902), journalist, founder, and first editor of the Wall Street Journal and co-founder of Dow Jones and Co.

The first three tell us that:

-The market discounts all known information;

-There are three trends in a market (up, down, sideways), and;

-There are three phases illustrated via those trends (accumulation, participation, distribution).

There are more elements to each part of those tenets, so read up on the subject for greater detail. Three of the more important tenets of Dow Theory, insofar as market analysis goes, are the last three tenets. They are (in a nutshell):

-Transports must confirm moves by the industrials;

-Volume must expand to confirm the legitimacy of a trend, and;

-Trend is assumed to be in place until it signals a change – which is kind of like Newton's first law of motion stating, "An object in motion stays in motion until acted upon by a force."

Let's look at those last three tenets applied to the Dow indexes:

Transports must confirm Industrials: FAIL

In a nutshell, when the widely followed INDU indicator (the Dow Jones industrials, as can be seen on the bottom line of the chart on page 287) rises to a new high, we need a similar move by the TRAN (Dow Jones transportation, represented by the top line on chart) to confirm the validity of a bull market. And vice versa in a bear.

Charles Dow, through this tenet, was probably the first analyst to be concerned about market breadth – that is, how well-distributed, or concentrated, a market is in leadership.

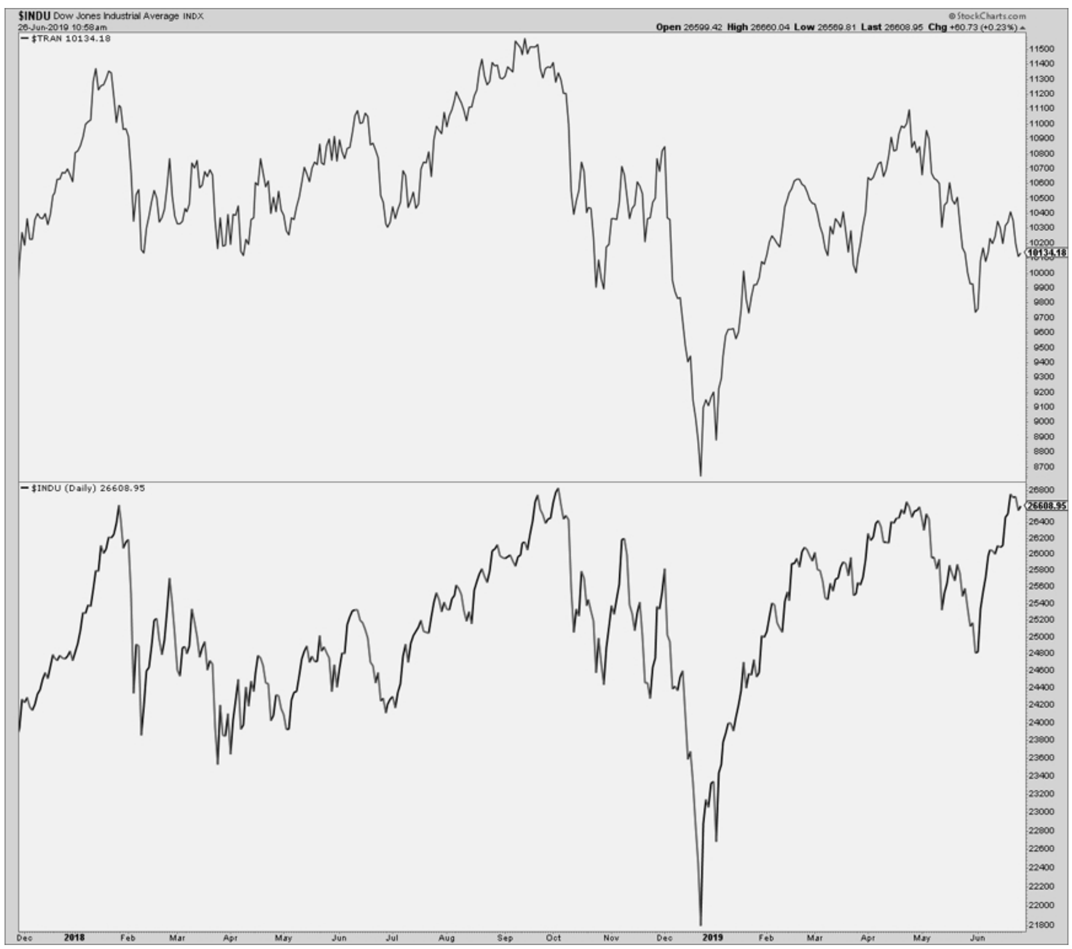
The chart of the Industrials index shows a new high earlier this month. Meanwhile, the Transportation index is well below its 2018 high. Non-confirmation between these two indexes is a problem for followers of the Dow Theory.

Volume must expand with the trend: FAIL

Volume is NOT rising for the major U.S. or Canadian indexes. Although volume on major North American indexes is typically softer during the summer – this time volume has been declining through much of the rally over the year. The current volume pattern has not been typical of the seasonal patterns, nor for a rising market.

Trends remain in place until they signal a change: ARGUABLE

As sports writer Dan Cook said regarding a baseball game, "It ain't over until the fat lady sings." The fat lady singing, in the concept of trend analysis, is a failure to put in a successive



series of higher peaks and troughs (bull market) or lower peaks and troughs (bear market). When the succession of either peak-trough trending evidence ends, you enter into the "distribution" phase – according to Charles Dow.

Technical people like myself, Stan Weinstein, and Ralph Acampora have added another phase to Dow's work by calling one of the distribution phases a bottom, and one of them a top. Either way, you are either trending or going sideways according to Dow Theory.

Right now, the market has put in very marginal – almost non-material highs over that of the peak in May. But I would argue that those new highs look pretty lame. Especially because the high on INDU didn't take out the one in October (as the chart shows).

Meanwhile, there is no argument that Dec. 24, 2018 saw a lower low. If you want to steadfastly argue that the high of late June that took out May's high was indeed significant, then you could argue that the low in early June took out the December low. So – it is not completely clear if we are in a mega-long consolidation pattern.

Conclusion

My conclusion regarding the above Dow tenets is that the market is currently marching on thin ice. Should transportation stocks make up for their underperformance over the summer – the markets might become a safer bet. For now, there is a distinct potential for a more bearish situation if we do not see evidence of rising trend, increased volume, and confirmation by the Dow Transportation index. These indicators do not suggest selling everything and running for the hills. Instead, they suggest caution, and a careful eye on the factors noted above.

Transports have failed to confirm the new highs on the industrials. For that matter, the June high on the NASDAQ was not a new high, and the small caps are also below their former highs.

But—staying true to the theory: Transports are the issue here, and they are not confirming the move by the Industrials. Volume, too, definitively fell while markets rose to the new high of a few days ago. So we have two of the three tenets inarguably failing. The third is arguable—as described above. All in, I think this review of the Dow tenets adds further input to suggest that markets may continue to be range-bound over the summer. A "real" break of about three per cent through a former high by the Dow that lasts at least three days – which the recent high did not meet – would allow me to change that forecast. See my book *Sideways* for more on this "3 n' 3" rule.

Keith on BNN Bloomberg

Keith's next BNN Bloomberg television appearance is on Tuesday July 16 at 6 p.m. Keith appears regularly on BNN Bloomberg's *MarketCall* to answer viewer questions on the technical analysis of stock trends, and to provide unique insights on the factors of technical analysis used in successful investment management. (Note: Times and dates may be subject to change)

If you have questions about the technical analysis of stock trends for individual stocks, be sure to phone in with your questions for Keith during the show. Call toll-free at 1-855-326-6266 or email your questions ahead of time (specify they are for Keith) to marketcall@bnnbloomberg.ca.

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