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TRADING

Bellwether looks set for more choppy action

TECHNICAL ANALYSIS
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INVESTORS' focus in recent times has been in Europe as politicians and bankers there try to find homes for trillions of euros worth of precarious debt. It's easy to forget in such an environment that the United States is still the biggest game in town.

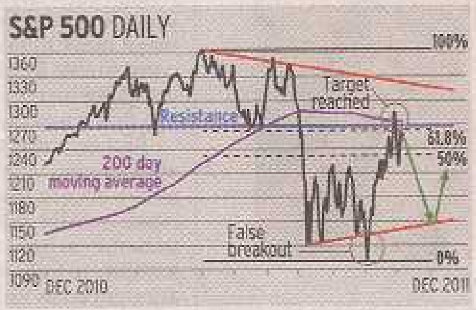
Alan Clement, an international futures trader and member of the Australian Technical Analysts Association, this week takes a look at the S&P 500 Index, the world's biggest market in terms of capitalisation. Clement advises us to keep an eye on the index as "its moves have a major effect on the direction of stockmarkets around the world".

When this column last looked at the S&P 500, we flagged the possibility of a fast and severe sell-off. That happened in early August after the value of the index crossed below the 200-day moving average, a popular line of equilibrium used by investment managers, who are quick to sell when the market falls below that level.

After that, the market spent two months consolidating. Then in early October it broke downward as sellers dumped stock.

However, this dive proved to be short lived as buyers moved in, wrong-footing the sellers and their short positions, Clement says.

"False breakouts normally lead to quick moves in the opposite direction. That's what we saw as a breathtaking rally unfolded, catching many investors by surprise," he says.



As the market rose from the false breakout, it moved towards a series of upper resistance points, including the blue horizontal resistance line that had provided a floor for the market before August. Those lines included the 61.8 per cent Fibonacci retracement level — 61.8 per cent of the market's pre-August high (the dotted horizontal line). Another upper resistance level was the 200-day moving average, where sellers were queuing up to dump stock.

That selling came a couple of weeks ago as the market went through the 200-day moving average. That resulted in a sharp move lower, wiping out the previous week's gains. "This signalled that the market had run out of steam and would not be heading any higher for now," Clement says.

So, where to from here?

Clement sees two possibilities. The latest fall could be the start of another major leg to the downside, taking the index down to the 1000 area. Or, and more likely, he believes, given the strength of the rally off the early October low, is buyers will defend that low, at least for now, leading to a few months of sideways consolidation, possibly between the two red trend lines.

"Investors would be wise to be cautious about buying or selling during this period as the market will likely remain highly volatile," he says.

As usual, investors should consult a licensed financial adviser before risking capital in the markets.

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