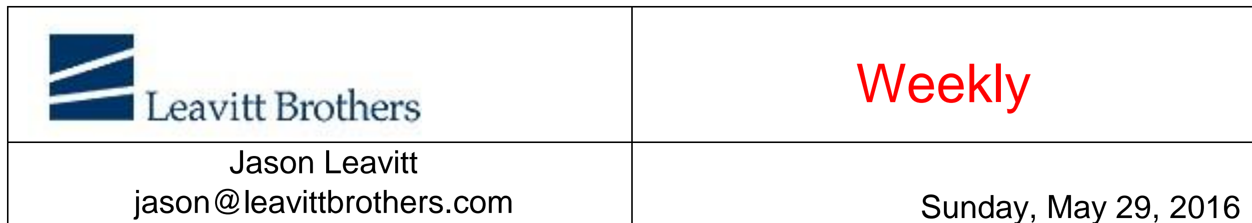

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We entered this past week with a bullish bias, and we ended up getting the biggest up week since February.

The previous week, the market dropped to an 8-week low but very quickly sprung back. I called it a false breakdown. Social media lit up with talk of a head-n-shoulders top resolving down, and some well-known money managers (George Soros, Stanley Drunkenmiller) were in the news with negative forecasts. Oh, and the FOMC minutes, which didn't reveal anything we didn't already know, reminded Wall St. the Fed still planned on raising rates this year. It was a perfect storm. Get everyone stacked on one side of the market...and then reverse it hard to other way.

Now the indexes are either near their previous highs or in the top-half of their ranges. Things change fast, don't they? The sky was falling less than two weeks ago; now the bulls are fearful they may have missed a great buying opportunity. This is life on Wall St. This is life as a trader. You either recognize the yings and yangs and learn to profit from them, or you are the dumb money who buys and sells at exactly the wrong time.

Stocks often break down, trap shorts and then spring upward. They also breakout, lure in new longs, and then get slammed. The indexes don't act nearly as cleanly and neatly as individual stocks do, but quick reversals after traders get trapped happen enough; you have to be aware of their potential. It's why last week I briefly mentioned the "trading chart patterns" progression. First you learn the patterns, how to recognize them and how to trade them. Then after some seat time, you'll learn when you can hold and when to quickly exit because a pattern is likely to fail. Finally, you'll do this second step, but instead of just taking a quick profit, you'll learn to reverse your position. Or you'll simply learn to fade failed moves.

This goes for any trading style, not just chart patterns. You learn to trade one way. Then you learn to recognize when failure is likely (based on various

factors), so you can manage the trade correctly. Then you step up your game and go the other way at exactly the same time the old you was trapped in a losing trade. You become the smart money. There are many traders who make their entire living just fading failed moves.

"Sell in May and go away" has not been good to the bears this year. With the Memorial Day holiday behind us, summer officially starts. I do not, under any circumstance, blindly play historical tendencies. Stats say the market is weaker May-October. I'm aware of this, but I don't really care. Stats also say the 8th year of a president's term is weak. Again, it's in the back of my mind, but I will not blindly enter a position based on this alone.

For now I continue to favor the upside. Until proven otherwise, the bulls deserve the benefit of the doubt. Let's get to the charts and see what they say.

Indexes

The S&P 500 Monthly: There is only one more trading day this month, so it's not too early to post the monthly chart. We have a 300-point range and are very close to the top of the range. A clean breakout measures to 2400. Don't think it can happen? That's exactly why it's very possible.

The S&P 500 Weekly: Boom. The S&P puts in its biggest weekly gain since February. I don't trust any move up until we get a clean breakout, but you can't wait for a breakout to get long. The S&P can quickly run 50 points, and you'll want to buy a pullback that never happens. Sorry, that's how the market works. You wait and wait and wait, and then you miss the train.

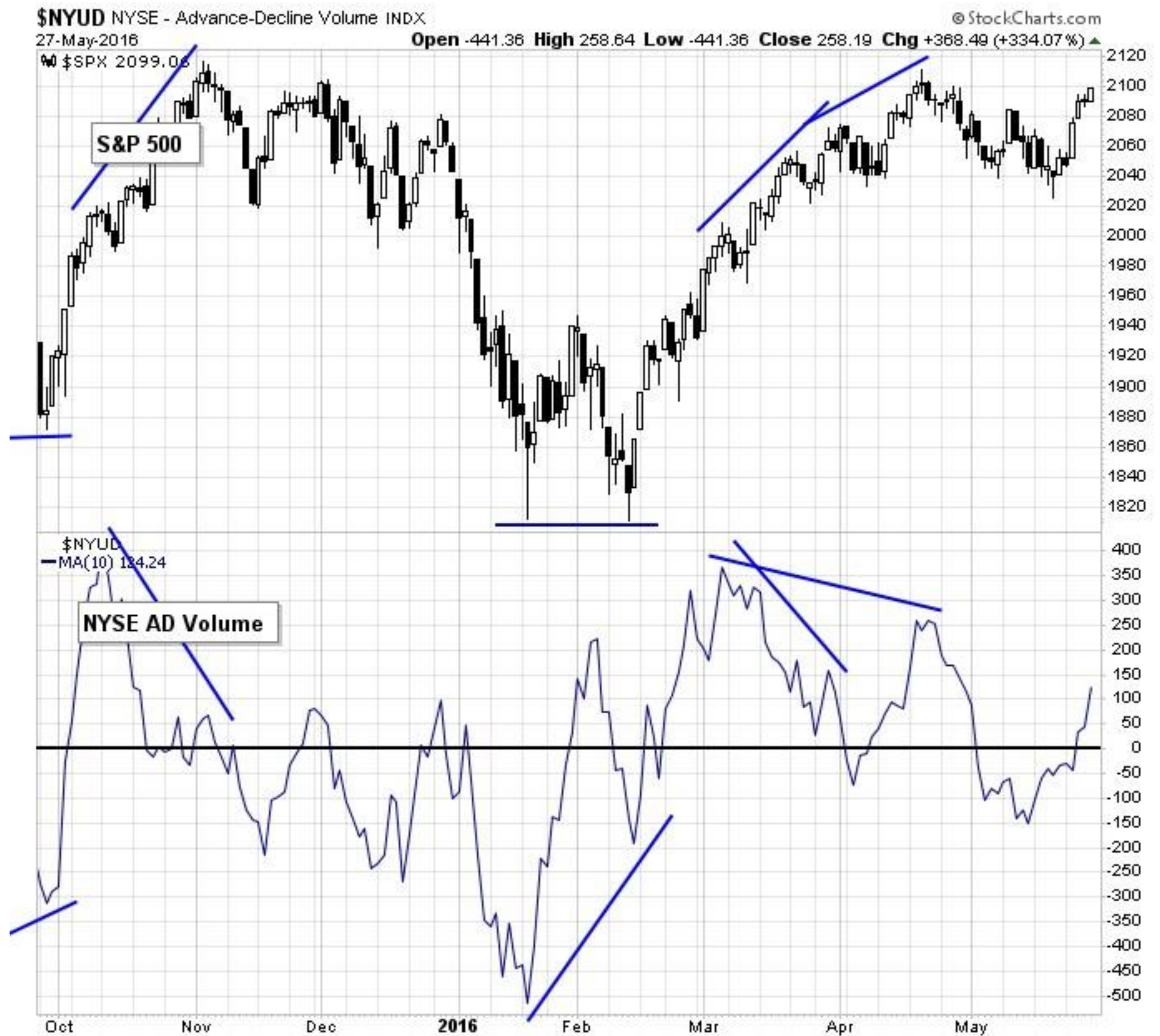
The S&P 500 Daily: It didn't take long for the S&P to move from the bottom of the range to the top, but until proven otherwise, I'm still going to consider this a consolidation pattern.

Indicators

S&P 500 vs. 10-day MA of NYSE AD Line: Unlike during the consolidation period that took place during November and December where the AD line sank well below 0, the AD like during the current consolidation pattern barely penetrated 0. So despite a little weakness the last two months, decliners never beat advancers by much. This is a good sign.

S&P 500 vs. NYSE Cumulative AD Line: Given the inability of decliners to beat advancers the last two months, the cumulative AD line has moved up to a new high. This is unlike last summer's consolidation where the cumulative AD line steadily trended down, warning of trouble beneath the surface.

S&P 500 vs. 10-day MA of NYSE AD Volume Line: The AD volume line, which lets the high-volume stocks have more influence, penetrated 0 by a greater margin, but still hasn't acted like it did in November and December. There doesn't seem to be the same internal weakness.



S&P 500 vs. NYSE Cumulative AD Volume Line: The deeper penetration of the AD volume line has prevented the cumulative AD volume line from moving to a higher high. This is similar to last November. We'll see what happens. Right now nothing is urgent, but if the S&P moves to a higher high, failure of this indicator to do the same will be a warning.

S&P 500 vs. NYSE New Highs: New highs have come off their 52-week high, but they haven't completely collapsed. If the S&P rallies next week and tests the highs from April and November, we'll want to see new highs expand. Failure to do so would be a warning.

NASDAQ vs. NASDAQ New Highs New highs at the Nas spiked to their highest level since December and then fell back into their patterns. It's a subtle hint strength is brewing.

S&P 500 vs. NYSE Bullish Percent: A ho-hum drop for the NYSE bullish percent off its high, but there wasn't much of a bounce last week. Nothing is urgent now, but things will get more interesting if the market rallies to a new high next week, but the bullish percent puts in a lower high.

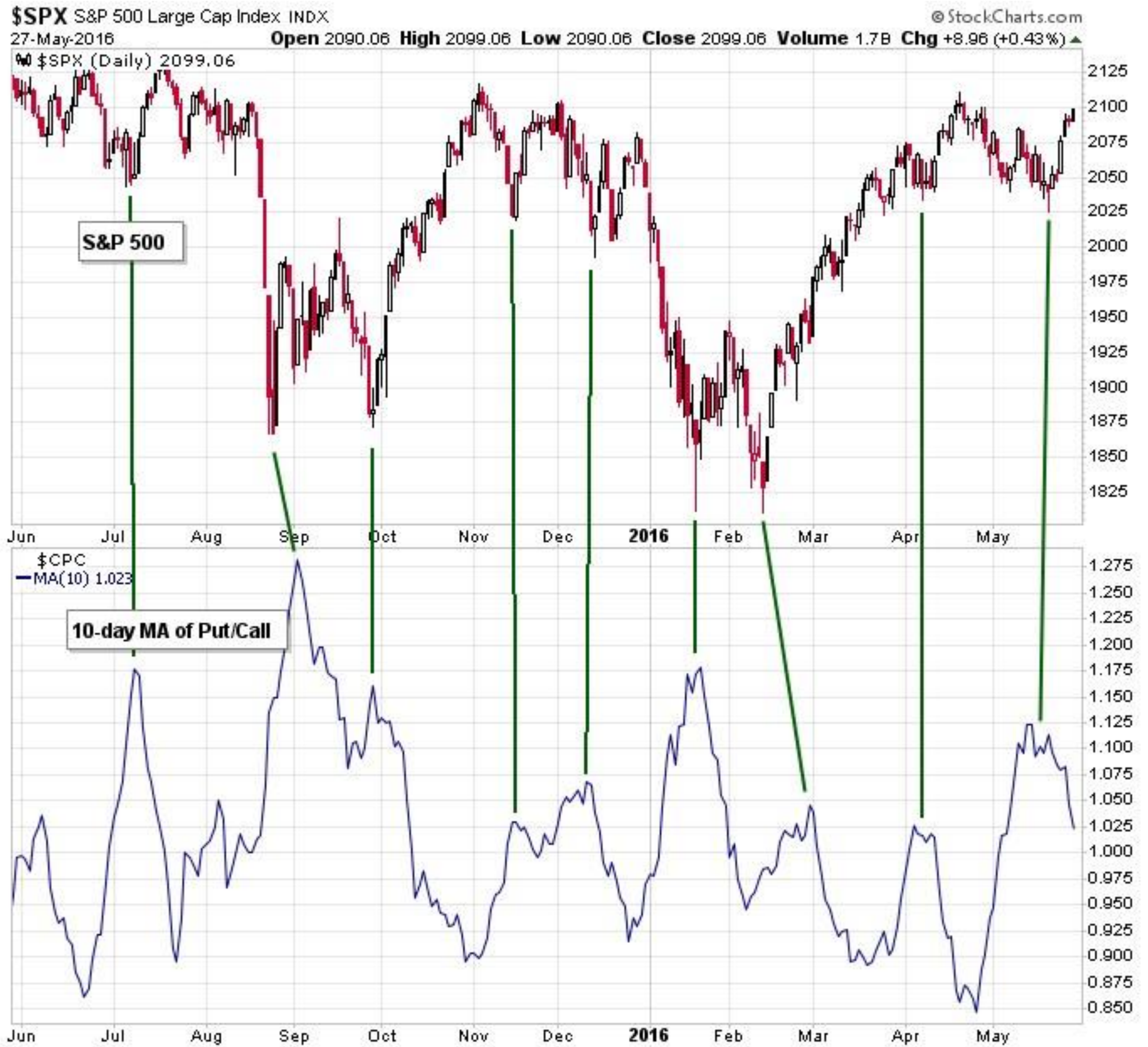
NASDAQ vs. NASDAQ Bullish Percent: The Nas bullish percent is in a similar situation. Things only get interesting if the Nas rallies to a higher high next week.

S&P 500 vs. Percentage of SPX Stocks Above 200-day MA: 75% of S&P stocks are above their 200-day moving averages. I don't see any internal deterioration here.

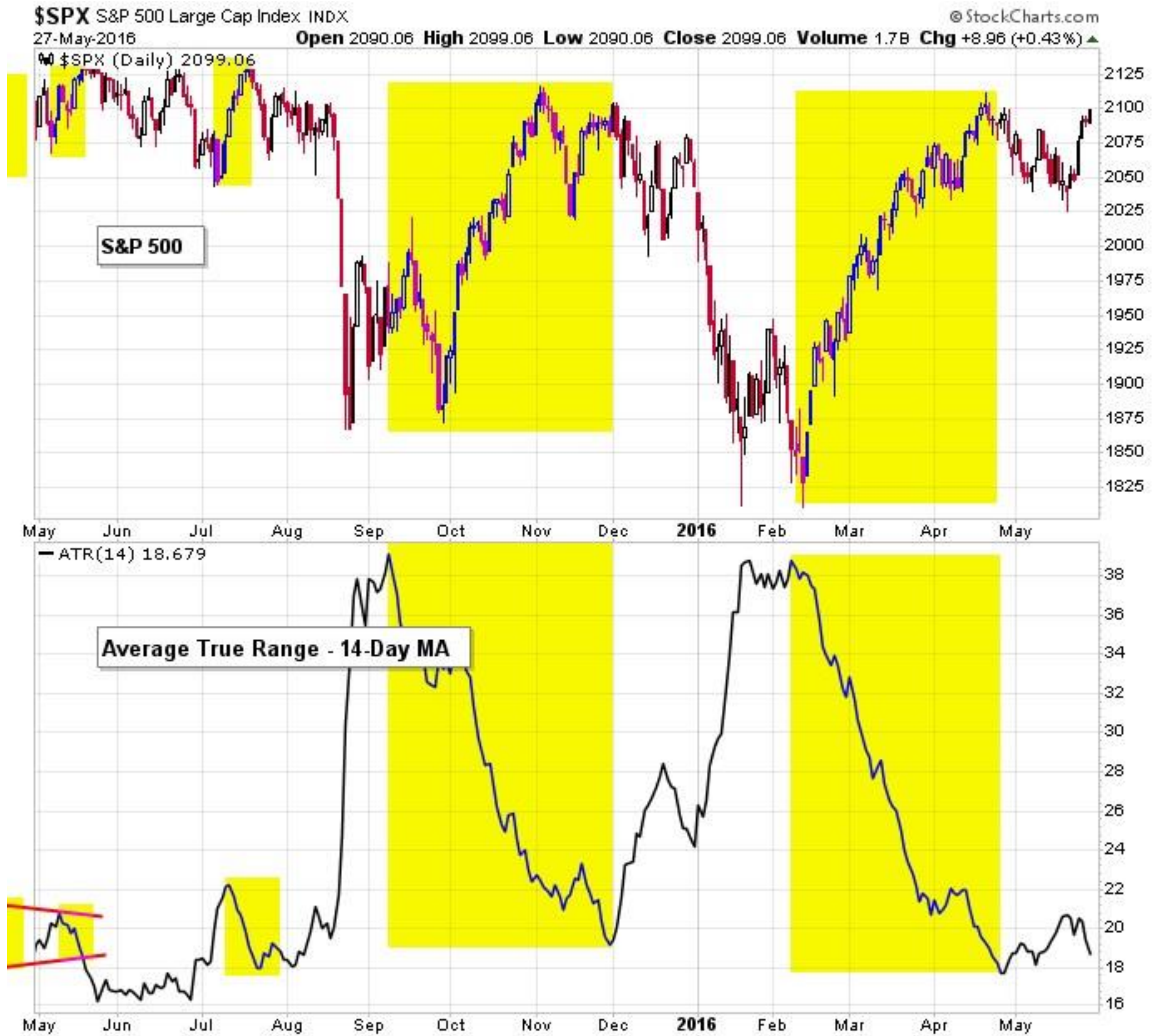
S&P 500 vs. Percentage of SPX Stocks Above 50-day MA: The percentage of S&P stocks above their 50-day moving averages diverged from the underlying price action and then trended down with some force. This led to the market topping in mid April. Now the indicator is improving, but it's not likely to make a higher high with the S&P. If we get choppy action (see yellow box in December), the market is not going to rally.

S&P 500 vs. Percentage of SPX Stocks Above 20-day MA: A big spike in the percentage of stocks above their 20-day EMAs. Solid improvement, but the indicator needs to break out of its down-sloping channel.

S&P 500 vs. 10-day MA of Put/Call Ratio: The PC has rolled over. This lends support to the market rally attempt.



S&P 500 vs. 14-day Average True Range: The ATR contracted on this latest run up. Exactly what the bulls want to see.



The Bottom Line

A false breakdown has been followed by the best up week since February. The indexes did great, and all indicators supported the movement.

The bulls had their backs against the wall; now the bears are in the same situation.

There's a legit possibility the S&P rallies to its high. Bearish rhetoric has ramped up lately, and so few investors think it’s possible. If the market wanted to surprise the most number of people, the S&P would break out and run this summer. It could happen. I don't know if it will, but the odds it happens are high enough to warrant having a plan in place to profit from it. If the market stays in its range, so be it. But at least contemplate what's possible and plan for it.

Bias remains to the upside.

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