



The ETF Authority

The ETF Authority for Monday, July 21st, 2003

Volume 2, Issue #29

Published weekly on Sunday evening, [The ETF Authority](#) is a short-term trading newsletter that can help you profit from some of the most heavily-traded securities on the market -- exchange-traded funds (ETFs).

*Please Note: This is a fee-paid, subscribers-only newsletter. Any republication or retransmission of this web page or any of the contents herein is expressly prohibited. Click on the link below to subscribe to this newsletter today...

<http://www.StreetAuthority.com/subscribe-etf.htm>

IN THIS WEEK'S ISSUE:

1. [MARKET SUMMARY](#)
2. [WEEKLY ETF PERFORMANCE](#)
3. [ETF RELATIVE STRENGTH MONITOR](#)
4. [MODEL ETF PORTFOLIO](#)
5. [TRADE OF THE WEEK](#)
6. [CONTINUED GUIDANCE ON PREVIOUS TRADES](#)
7. [ETF SPOTLIGHT](#)
8. [WEEKLY EDUCATIONAL BONUS](#)

We urge all readers to print out this newsletter each week for maximum benefit...

(1.) MARKET SUMMARY

Friday's strong gains erased much of the losses the market posted earlier in the week. Overall, the market's performance was mixed, with several sectors showing moderate declines. Economic data were mostly bullish, which helped keep the debt-related ETFs in deep trouble. Alan Greenspan surprised the markets with a forecast for strong growth in the second half of this year. This could be setting the market up for quite a fall if the economy disappoints!

Next week has little on the calendar to set the markets afire. We are entering a seasonally difficult period, but the overall chart patterns remain consolidative, with the underlying trend moderately positive. We are nearing the end game, but I just don't see us turning sharply lower yet.

EARNINGS TALLY

This is earnings season, and at least one major company announced quarterly results on a nightly basis last week. In the process, several firms suggested that they might see a pick-up in activity in the second half of the year. On the other hand, however, the market's disappointing reaction to Intel's (INTC, \$24.66) strong results was surprising to many. Technically, the market needed to edge lower last week, and edge lower it did. Overall, the earnings numbers seem to be largely in line with expectations (which were for a fair-to-poor quarter). In the short run, at least, I see no technical reason for the market to rally. On the other hand, I see no reason for it to fall either. Barring any significant

earnings misses in the coming weeks, my thinking is that we'll see better price action as earnings seasons draws to a close.

MORE TECHNICALS

The broad market ended the week barely changed. The benchmark S&P 500 (SPX, 993.32) index closed below its 20-day moving average last Thursday, though keep in mind that the market did the exact same thing a week ago as well. This is another chink in the armor. However, the market is currently locked in a narrow trading range, so this close below the 20-day moving average is less meaningful than it would be if the market were at the end of an uptrend.

More importantly, the market has broken its trendline (see our Educational Bonus -- [section #8](#) below) from the end of April, and prices remain beneath it. This confirms the short-term trend as neutral to negative. However, the market appears to be developing a triangle formation, which augers well overall and suggests traders might want to purchase shares on any dips. Most triangles are considered continuation patterns, and this particular case appears to be an ascending triangle, which is nearly always bullish.

The recent underperformance by the Nasdaq is a minor concern to the bulls. The near [Island Reversal](#) in the composite index provides fodder for the bears. (An Island Reversal Top is an [exhaustion gap](#) higher followed by a [breakaway gap](#) lower. However, the gaps should overlap. Because they didn't, the Composite did not truly form an Island Reversal. Also note that Island Reversals, as a class, are not all that important as reversal signals go.) **There is substantial risk that the Nasdaq Composite has seen its high (despite my admonition regarding the Island Reversal), even if the S&P 500 has not.** However, if that theory holds true, then it would also mean that any new high in the S&P might not be a substantial one (not more than a few percent above the 915.41 zenith seen thus far).

OPTION EXPIRY REDUX

We saw the options pit try to take the S&P 500 SPDR (SPY, \$99.51) up to \$100. It is fairly common to see stocks with options attached to them close near a strike price on expiration day. Volume was low for an [expiration day](#), and volatility was not particularly significant either -- it was an atypical options expiration.

THE BOTTOM LINE

Prices remain stuck in neutral. Friday's good gains were enough to put us slightly behind the S&P 500 in our model portfolio, but I am comfortable with being heavily in cash for the moment. The day's low volume may have been partially due to "Friday in the summer syndrome", but I am concerned that we might see another small leg down here before rallying again.

I do not believe the broader market has put in its high just yet. Meanwhile, there is some risk that we've seen the highs in the Nasdaq, and the market is building what will be fairly substantial momentum divergences. In addition, it's worth noting that although the Nasdaq and even the S&P managed to post new highs last week, the N.Y. Stock Exchange Composite (NYA, 527.60) did not.

I expect the market to dip to a minor new low on either Monday or Tuesday. The maximum downside will likely be towards 962 on the S&P (anything below there would signal major trouble). From there, however, I expect the S&P to rally to new highs. The index has the potential to move up into the 1,030-1,068 range, which would equate to a 38.2% retracement of the entire bear market.

If you're currently a Free Trial subscriber to *The ETF Authority*, then your subscription is about to run out! [Subscribe today](#) to ensure that you don't miss a single one of editor Steven Poser's recommended trades. Visit the link below to view our subscription options for this publication...

<http://www.StreetAuthority.com/subscribe-etf.htm>

(2.) WEEKLY ETF PERFORMANCE

Below you'll find a table of weekly performance data for all ETFs that I track for this newsletter...

<u>Name (Ticker Symbol)</u>	<u>Open</u>	<u>High</u>	<u>Low</u>	<u>Last</u>	<u>Change</u>	<u>% Change</u>
<u>Major Indices</u>						
Dow Diamonds (DIA)	92.57	93.00	90.39	91.83	0.44	0.5%
S&P 500 SPDR (SPY)	101.20	101.90	98.16	99.51	-0.73	-0.7%
Nasdaq-100 Index (QQQ)	32.34	32.75	30.92	31.28	-0.56	-1.8%
Russell 2000 iShares (IWM)	95.47	96.30	91.54	92.25	-2.38	-2.5%
S&P 400 Mid-Cap (MDY)	92.07	92.67	89.24	90.30	-0.81	-0.9%
<u>International Indices</u>						
Japan Webs (EWJ)	7.98	8.01	7.50	7.64	-0.20	-2.6%
Canada Webs (EWC)	11.61	11.77	11.35	11.54	-0.02	-0.2%
<u>Fixed-Income Indices</u>						
1-3 Year Lehman U.S. Govt. Bond iShares (SHY)	82.63	82.65	82.37	82.41	-0.22	-0.3%
7-10 Year Lehman U.S. Govt. Bond iShares (IEF)	87.67	87.86	85.46	85.71	-2.07	-2.4%
20+ Year Lehman U.S. Govt. Bond iShares (TLT)	90.68	90.87	87.15	87.70	-3.09	-3.4%
iShares GS \$ InvesTopTM Corporate Bond Fund	113.25	113.95	111.00	111.69	-1.68	-1.5%
<u>Other Equity Index Based ETFs</u>						
Russell 1000 Value (IWD)	52.23	52.67	50.60	51.56	-0.29	-0.6%
Russell 2000 Growth (IWO)	51.90	52.25	49.11	49.70	-1.25	-2.5%
<u>Sector-based ETFs</u>						
Biotech HOLDR (BBH)	133.60	135.66	132.33	133.40	1.90	1.4%
Nasdaq Biotech iShares (IBB)	74.15	74.37	70.08	70.90	-1.95	-2.7%
Energy SPDR (XLE)	23.84	23.86	22.95	23.76	0.05	0.2%
Financial SPDR (XLF)	26.05	26.28	25.05	25.66	0.09	0.4%
Oil Service HOLDR (OIH)	58.60	59.75	55.85	59.45	0.95	1.6%
Pharmaceutical HOLDR (PPH)	81.65	82.06	78.80	79.70	-1.14	-1.4%
Retail HOLDR (RTH)	84.86	85.44	82.90	83.60	-0.35	-0.4%

Semiconductor HOLDR (SMH)	32.01	32.95	30.58	31.45	0.27	0.9%
Software HOLDR (SWH)	33.70	33.88	31.53	31.89	-1.29	-3.9%
Technology SPDR (XLK)	18.36	18.45	17.32	17.55	-0.46	-2.6%

(3.) ETF RELATIVE STRENGTH MONITOR

(Note: If you're a first-time reader or you are otherwise unfamiliar with our proprietary *ETF Relative Strength Monitor*, then please [click here](#) for a brief description.)

The Dow Jones Industrial Average (INDU, 9,188.15) was the only major index to show a gain last week. This was reflected in 17 of 23 ETFs losing ground (including, yet again, the bond market funds). The week's biggest loser among the ETFs we follow was the Software HOLDR (SWH, \$31.89), which sank -3.89%. The sharp losses took SWH to next-to-last place in our proprietary index. Meanwhile, the week's biggest gainer was the Oil Service HOLDR (OIH, \$59.45), which improved by +1.62%. We initially held a long position in OIH in our [Model ETF Portfolio](#), but the week's early losses had us stopped out before we could take advantage of the gains.

The weakness in the technology sector may warn of a possible turn in the markets. Still, we did see a few pockets of strength in tech last week. For example, semiconductor issues traded well again, as the Semiconductor HOLDR (SMH, \$31.45) rallied +0.87%, keeping it near the top of our relative strength rankings.

On the other hand, some of the market's strongest sectors are starting to show signs of weakness. Technology and the smaller cap stocks all took it on the chin last week, though the Russell 1000 Value Fund (IWD, \$51.56) and the Russell 2000 Growth Fund (IWO, \$49.70) both remain in the top 50% of our survey. The relative outperformance by the Dow also warns that people are starting to take profits and are looking at blue chips for protection. We are in the end game of the rally, but the fun is not quite over yet.

Here is this week's *ETF Relative Strength Monitor*...

<u>Name (Ticker Symbol)</u>	<u>1-week return</u>	<u>4-week return</u>	<u>13-week return</u>	<u>ETF Relative Strength Rank</u>	<u>Change from Last Week</u>	<u>4-week Average Rank</u>
-----------------------------	----------------------	----------------------	-----------------------	-----------------------------------	------------------------------	----------------------------

Major Indices

Dow Diamonds (DIA)	0.48%	-0.01%	10.00%	20	11	11.50
S&P 500 SPDR (SPY)	-0.73%	0.07%	11.11%	10	-1	10.75
Nasdaq-100 Index (QQQ)	-1.76%	2.96%	16.63%	14	-6	15.25
Russell 2000 iShares (IWM)	-2.52%	3.34%	20.83%	12	-7	18.50
S&P 400 Mid-Cap (MDY)	-0.89%	2.15%	16.59%	17	4	15.50

International Indices

Japan Webs (EWJ)	-2.55%	4.51%	19.94%	11	-4	16.50
------------------	--------	-------	--------	----	----	-------

Canada Webs (EWC)	-0.17%	-2.20%	12.04%	15	12	12.75
-------------------	--------	--------	--------	----	----	-------

Fixed-Income Indices

1-3 Year Lehman U.S. Govt. Bond iShares (SHY)	-0.27%	-0.47%	0.30%	7	2	8.50
7-10 Year Lehman U.S. Govt. Bond iShares (IEF)	-2.36%	-3.83%	0.07%	3	-3	6.50
20+ Year Lehman U.S. Govt. Bond iShares (TLT)	-3.40%	-6.45%	-0.33%	1	-3	1.75
iShares GS \$ InvesTopTM Corporate Bond Fund (LQD)	-1.48%	-3.09%	1.52%	4	-3	5.75

Other Equity Index Based ETFs

Russell 1000 Value (IWD)	-0.56%	-0.21%	12.43%	13	3	10.25
Russell 2000 Growth (IWO)	-2.45%	3.78%	22.75%	16	-6	19.50

Sector-based ETFs

Biotech HOLDR (BBH)	1.44%	5.97%	38.28%	23	2	17.50
Nasdaq Biotech iShares (IBB)	-2.68%	4.62%	36.35%	9	-8	13.25
Energy SPDR (XLE)	0.21%	-2.82%	6.55%	8	6	6.00
Financial SPDR (XLF)	0.35%	2.44%	12.35%	21	9	15.25
Oil Service HOLDR (OIH)	1.62%	-3.68%	6.87%	18	17	6.00
Pharmaceutical HOLDR (PPH)	-1.41%	-4.89%	7.83%	4	-4	7.75
Retail HOLDR (RTH)	-0.42%	3.08%	11.02%	19	4	16.50
Semiconductor HOLDR (SMH)	0.87%	8.82%	18.99%	22	-1	16.00
Software HOLDR (SWH)	-3.89%	-2.74%	12.88%	2	-12	8.75
Technology SPDR (XLK)	-2.55%	0.17%	15.38%	6	-12	12.25

(4.) MODEL ETF PORTFOLIO

	<i>Last Week</i>	<i>Since Inception</i>
S&P 500	-0.45%	+5.46%
Model Portfolio	-0.73%	+6.34%

Even though we were correct in being long OIH, we slightly underperformed the S&P last week. Sadly, we were stopped out of this long position when OIH tanked early in the week. Likewise, we sold out of the Nasdaq Biotech iShares (IBB, \$70.90) on Thursday. On the positive side of things, however, our short trade in the Japan WEBS (EWJ, \$7.64) turned out to be very profitable and helped keep our performance near that of our benchmark -- the S&P 500.

I am maintaining our short position in EWJ, and have decided to trail our stops to lock in at least a partial profit on this trade in case the bull market resumes there (not my forecast). I am also going to add SMH to the mix, as this fund continues to rally in the face of a weak technology sector. (For details, please see our "[Trade of the Week](#)" below.) Also, given the outperformance of the Dow, I am

going to shift our core long position from the S&P 500 SPDR (SPY, \$99.51) to the Dow Diamonds (DIA, \$91.83).

This week's instructions are:

- Trail EWJ stop to \$7.89.
- Sell SPY at the open on Monday.
- Buy 100 shares of DIA at the open on Monday.
- Buy 100 shares of SMH at the open on Monday as long as it opens above \$31.00 and below \$32.05. Set initial stops at \$30.25 and initial target at \$34.04.

MODEL ETF PORTFOLIO

PERFORMANCE SINCE INCEPTION

<u>ETF Name</u>	<u>Sym</u>	<u>Shares</u>	<u>Entered</u>	<u>Entry Price</u>	<u>Begin Value</u>	<u>Current Price</u>	<u>Current Value</u>	<u>Div</u>	<u>Chg</u>	<u>%Chg</u>
S&P 500 SPDR	SPY	50	23-Jun	\$99.45	\$4,973	\$99.51	\$4,976	\$0	\$3	0.06%
Japan WEBS	EWJ	-500	14-Jul	7.98	-\$3,990	\$7.64	-\$3,820	\$0	\$170	4.26%
Money Market Deposit							\$20,100	\$12		
<u>Portfolio Totals</u>			<u>19-May</u>		<u>\$20,000</u>		<u>\$21,256</u>	<u>\$12</u>	<u>\$1,267</u>	<u>6.34%</u>
S&P 500 Index	SPX	21	19-May	944.30	\$20,000	993.32	\$21,038	\$53	\$1,091	5.46%

WEEKLY PERFORMANCE

<u>ETF Name</u>	<u>Sym</u>	<u>Shares</u>	<u>Entered</u>	<u>Entry Price</u>	<u>Begin Value</u>	<u>Current Price</u>	<u>Current Value</u>	<u>Div</u>	<u>Chg</u>	<u>%Chg</u>
S&P 500 SPDR	SPY	50	23-Jun	\$100.24	\$5,012	\$99.51	\$4,976	\$0	-\$37	-0.73%
Japan WEBS	EWJ	-500	14-Jul	7.98	-\$3,990	\$7.64	-\$3,820	\$0	\$170	4.26%
Money Market Deposit							\$20,100	\$2		
<u>Portfolio Totals</u>			<u>11-Jul</u>		<u>\$21,415</u>		<u>\$21,256</u>	<u>\$2</u>	<u>-\$157</u>	<u>-0.73%</u>
S&P 500 Index	SPX	21	11-Jul	998.14	\$21,140	993.32	\$21,038	\$7	-\$95	-0.45%

POSITIONS CLOSED LAST WEEK

	<u>Sym</u>	<u>Shares</u>	<u>Entered</u>	<u>Entry Price</u>	<u>Begin Value</u>	<u>Current Price</u>	<u>Current Value</u>	<u>Div</u>	<u>Chg</u>	<u>%Chg</u>
Oil Service HOLDR	OIH	100	7-Jul	\$58.50	\$5,850	\$57.20	\$5,720	\$0	-\$130	-2.22%
Nasdaq Biotech iShares	IBB	50	30-Jun	\$67.61	\$3,381	\$70.20	\$3,510	\$0	\$130	3.83%

If you're currently a Free Trial subscriber to *The ETF Authority* and you're considering a subscription to this newsletter, then we have great news for you! Subscribe before your trial expires and save over 50% off our regular subscription rates. [Sign up today!](http://www.StreetAuthority.com/subscribe-etf.htm)

<http://www.StreetAuthority.com/subscribe-etf.htm>

(5.) TRADE OF THE WEEK

BUY 100 SHARES SEMICONDUCTOR HOLDR (SMH, \$31.45) AT THE OPEN ON MONDAY AS LONG AS IT OPENS BETWEEN \$31.00 AND \$32.05

SMH has been one of the strongest ETFs over the past several months. It is ahead +8.82% over the past four weeks, which ranks it first among all the ETFs we track. It also has strong gains of +18.99% for the past 13 weeks. Unlike other technology sector funds, SMH does not show a completed pattern higher. Using an arithmetic chart, I show targets at \$34.04, and with a semi-log chart, higher than \$35.00.



The Elliott Wave based wave counts (my new book, [*Applying Elliott Wave Theory Profitably*](#), should be available from Amazon.com by July 25th) show that Friday's low and reversal probably represented the end of a 4th wave correction. New highs are thus likely.

Our reasons for buying SMH are as follows:

- Still one more leg higher according to Elliott Wave counts.
- Strong relative strength.

- RSI not overbought despite strong gains.
- Single-day Candlestick reversal (doji).
- Rebounded after briefly trading below 38% retracement of 3rd wave.

RECOMMENDATION:

BUY 100 SHARES SMH AT THE OPEN ON MONDAY AS LONG AS SMH OPENS BETWEEN \$31.00 AND \$32.05. *DO NOT EXECUTE THIS TRADE IF SMH OPENS OUTSIDE THIS RANGE.*

TARGET: \$34.04

STOP: \$30.25

Assuming a purchase at Friday's \$31.45 close and a sale at our \$34.04 target, we will earn \$259 on this trade, or +8.2%.

(6.) CONTINUED GUIDANCE ON PREVIOUS TRADES

SOLD SHORT 500 SHARES JAPAN iSHARES MSCI WEBS (EWJ, \$7.64) AT \$7.98

The Japanese stock market fell last week, exactly as forecast. EWJ tumbled as well, and our gains were aided by a stronger U.S. dollar. However, the dollar reversed ground on Friday. In addition, the Japanese stock market managed small gains Friday and should rally further in reaction to the strong U.S. market gains on Friday morning. I do not expect any gains in Japan to be sustainable, and I continue to expect substantially lower prices ahead.



RECOMMENDATION:

DATE ENTERED: 7/14/03
 SOLD SHORT 500 SHARES EWJ AT \$7.98
 TARGET: \$7.16
 STOP: \$7.89 (*Revised*)

Assuming we close the trade at our \$7.16 target, we will make \$420, or +10.3%. If EWJ hits our revised stop, then we will post a small profit of \$45, or +1.1%.

(7.) ETF SPOTLIGHT

The S&P 500 SPDR (SPY, \$99.51) ranks right up there with the Nasdaq-100 Trust (QQQ, \$31.28) in both name recognition and trading activity. Although its average trading volume is only about 60% of that of QQQ (about 46 million shares per day compared to 72 million per day), the money volume (shares traded times price per share) is far higher for SPY, as SPY costs about three times as much per share.

What is the S&P 500 SPDR?

The S&P 500 SPDR is essentially a passively managed closed-end mutual fund that allows you to buy and sell the stocks that make up the venerable S&P 500 Index in one fell swoop. Essentially, the S&P 500 Index is meant to reflect the fluctuations in the value of the largest stocks traded in the United States. This does not mean that the firms are domiciled in the U.S. -- it just means they are traded here. Some of the fund's component shares are ADRs (American Depositary Receipt), which means

they represent shares of a company traded on another stock exchange. For a full list of the companies that comprise the S&P 500, please [click here](#).

How is the S&P 500 Computed?

The S&P 500 is a market capitalization-weighted index. This means the percentage of value that any given stock holds in the index varies each day with the total value of the stock itself. This total weight is determined by the stock's [market capitalization](#) (its price multiplied by the number shares outstanding). To understand how this works, let's look at a sample index of two stocks:

Company A has 100 shares outstanding and trades at \$10.00 per share. This gives it a market cap of \$1,000.00.

Company B has just 10 shares outstanding, but its price is \$20 per share, giving it a market cap of \$200.00.

For the sake of this example, our imaginary index will consist of just Company A and Company B. We will also assume the index's price is equivalent to its market cap divided by 10, or in this case 120.00. In this scenario:

Company A accounts for 83.3% of this index.

Company B accounts for 16.7% of the index.

On the following trading day, let's assume Company A rallies to \$12.00 per share (a +20% increase in value), giving it a market cap of \$1,200.00.

Company B jumps +15% to \$23.00 per share. Its market cap is now \$230.00.

As a whole, our sample index is now worth 143.00. Yet even though Company B's stock price rallied by more than Company A's (\$3 versus \$2), because its percentage gain was less, its weighting in the index fell to 16.1%. Meanwhile, Company A's weighting jumped to 83.9% of the index.

What does this mean to investors and traders?

Because the S&P 500 is a market capitalization-weighted index (similar to the example above), over time the major holdings within that index tend to get bigger, and the small tend to get smaller. As the larger component stocks gain more of the index's total value in an up market, more and more liquidity flows into these larger stocks (and less into the smaller components). In order to keep pace with the underlying index (over \$1 trillion is currently indexed to the S&P 500), fund managers are forced to purchase more of the largest shares to keep pace with their benchmark. (Similarly, as prices fall, they are required to sell more, since these stocks tend to account for a smaller percentage of the fund's value.) This means that a market cap weighted index intensifies rising and falling prices.

Dividends

SPY pays dividends on a semi-annual basis. The fund management company deducts 0.12% for expenses, but this still puts the yield on SPY above 1.5% (based on current market prices). This is more than what you'd earn in a money market account. However, that 1.5% yield can disappear in one day in lost market value. Therefore, you should not use the stock market as a replacement for income in your portfolio!

Changes to the Index

Standard and Poor's periodically changes the component stocks within its S&P 500 index. Anytime a company is delisted, goes bankrupt or is merged out of existence, S&P will remove the stock from the index and will replace it with another firm. Standard and Poor's also changes the index to reflect what

it sees as the most important sectors and industries in the market today. For example, the index was much more heavily weighted in technology stocks in 1999 and 2000 than it is now. As prices have dropped in tech stocks, their weighting in the index has fallen (at one time, the S&P 500 was starting to look a lot like the Nasdaq). Additionally, Standard and Poor's has been removing technology stocks from the index over the past couple of years and has been replacing them with services and industrial shares. A good long-term market-timing tool might be to wait for tech stocks to reach a very low weighting here, then start loading up on them at that time (just as the record weightings in 2000 provided an excellent sell signal).

Trading SPY

The liquidity in SPY is nothing short of astounding. In fact, it is not uncommon to see the shares "crossed" in the market. A [crossed market](#) occurs when the highest bid price (price market participants say they are willing to pay to buy SPY) is above the lowest offer price (price market participants are willing to sell SPY to you). Remember, most stocks and funds typically trade with a bid/offer (sometimes called bid/ask) spread, meaning the offer price is normally higher than the bid price. In a situation where you have a crossed market, however, you could theoretically (in practice, it would be nearly impossible) buy and sell at market prices and still make a profit (excluding commissions).

How can this happen? Remember that SPY trades actively on ECNs (Electronic Communications Networks). Because SPY is very liquid in all these locations, it is entirely possible for the bid on one ECN to be higher than the offer on another for brief moments throughout the day. However, with the multitude of direct access platforms available to retail and institutional investors, a crossed market is not likely to last for long and you will not be able to actually execute both sides of a crossed market simultaneously for a profit.

S&P 500 SPDR (SPY)

Type: Broad Index
Similar funds: Dow DIAMONDS (DIA)
 Nasdaq-100 Trust (QQQ)
 Russell 2000 iShares (IWM)
Options?: No

Performance Data

YTD High:	\$102.17	6/17/03	<u>Annualized return since:</u>	
YTD Low:	\$79.38	3/12/03	One-year	14.95%
YTD Return:	13.59%		Three-year	-11.72%
			Five-year*	-2.05%
Dividends:	\$1.42		Life of fund*	8.91%
Expense ratio	0.12%		* - Dividends estimated	

Correlation Data*

(1/1/02-6/30/03)

Holdings*

(as of 3/31/2003)

Dow Jones Industrials	96.3%	Microsoft (MSFT)	3.30%
S&P 500	98.5%	General Electric (GE)	3.23%
Nasdaq Composite	89.7%	Exxon Mobil (XOM)	3.00%
Nasdaq-100	87.2%	Wal-Mart Stores (WMT)	2.93%
		Pfizer (PFE)	2.45%
DIA	97.2%	Citigroup (C)	2.26%
QQQ	86.8%	Johnson&Johnson (JNJ)	2.19%
IWM	89.6%	Intl. Bus. Mach. (IBM)	1.69%
		Amer. Intl. Group (AIG)	1.64%
		Merck&Co. (MRK)	1.57%
		* Percent top ten are of total	24.26%

Average Daily Volume

Jun-03	41,331,914
2003 YTD	45,774,457
2002	37,796,929

Average Daily Price Range

Jun-03	1.5%
2003 YTD	1.9%
2002	2.1%

* - Correlation measures how closely the two items track each other

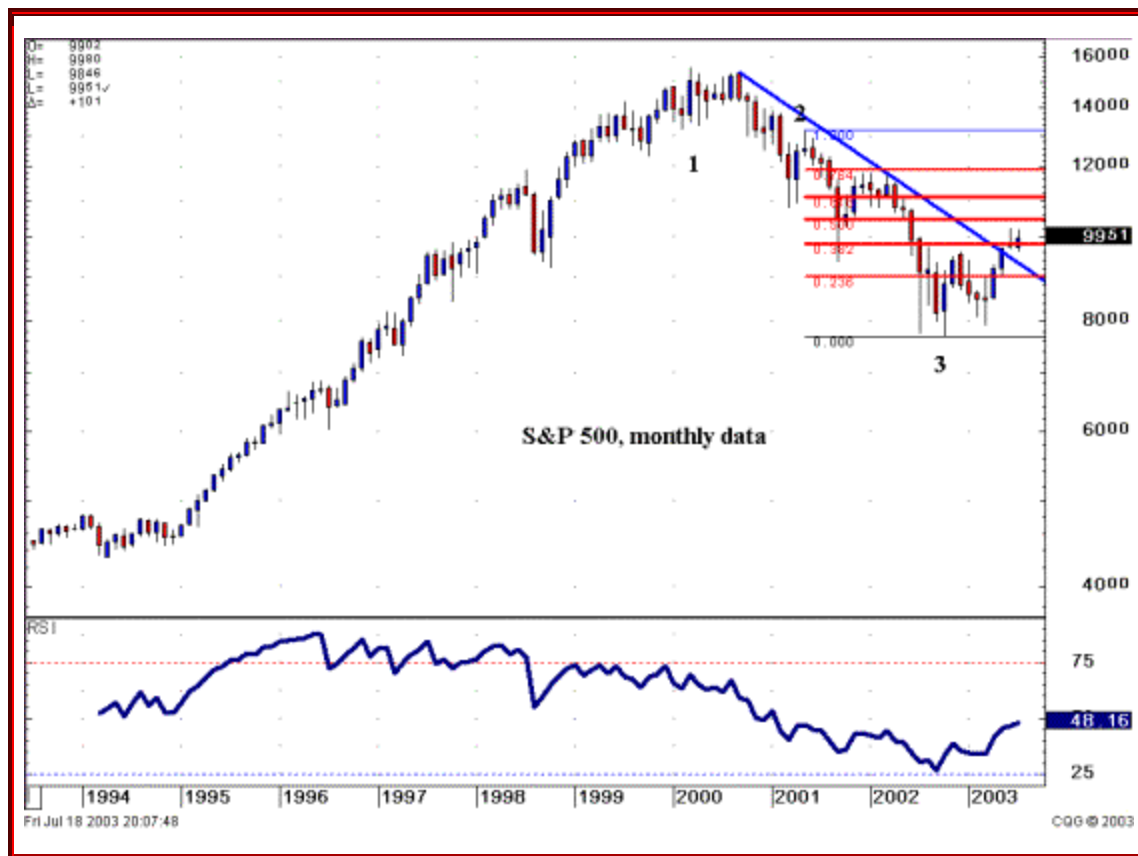
* Includes prior day's close (true range)

HOW TO MAKE MONEY IN SPY THIS YEAR

As long-term readers of these pages know, I still expect the S&P 500, on which SPY is based, to tumble to new lows later this year. However, I doubt the market is ready to falter quite yet. In fact, my current forecast is for a new short-term high in the S&P 500 with gains lasting at least into mid-August, and possibly into mid-September. After that, a final leg lower should begin.

So, to make money on SPY, I'd suggest holding SPY longs for the medium-term. Should this fund fall below the \$95.45 mark, however, you should then switch gears into short selling mode. The recent extreme momentum divergences at the highs, coupled with bears being told how foolish they are (extreme levels of bullish sentiment often signal market tops), tells me that we are in the end game here. However, a rally past \$100 looks likely again, with a new high targeting approximately \$104-\$108 before we collapse. Long-term says new lows.

The chart below shows the wave count from the highs. It is a monthly chart, meaning that one candlestick equals one month of information.



(8.) WEEKLY EDUCATIONAL BONUS -- TRENDLINES

In [last week's](#) Educational Bonus I spent a lot of time talking about trends, but you might have noticed that I did not discuss trendlines. This was for good reason: trendlines deserve their very own lesson.

Nexus of Supply and Demand

You have probably noticed that I draw trendlines in nearly all of the charts I show you in this newsletter. Trendlines represent a nexus of supply and demand. In an uptrend, the trendline acts as support. Below the trendline, you should expect that sellers will become more aggressive than buyers. However, as long as share prices remain above the trendline, buyers are in control. In a downtrend, as long as prices remain below the trendline, sellers are in control. Above the trendline, the back of those whom have been acting as suppliers (the sellers) is broken, and buyers are likely to become more aggressive.

See the chart below for an example of what I am talking about. If the S&P 500 closes below the blue trendline, then sellers are likely to quickly pile on to any downward price action and overwhelm the buyers.



When you look at a chart, your eye, even without the line drawn, is likely to "see" an area below which (in the case of an uptrend) the trend has probably broken. That would be a place where price losses are too large to ignore as mere daily fluctuations. A trendline more accurately depicts where the market's behavior may change (I am using "market" here as a general term, but I could use the words "stock", "bond", "ETF", "currency" -- or any traded asset or liability, for that matter -- in its place.)

What about regression lines?

Why not determine the trend by computing a regression (a statistical method for determining the average price change over a period of time)? The regression will give you a nice straight line that will also approximate the price action for the time period over which it was computed. However, that regression changes every day, as prices change. Furthermore, by definition, prices will fluctuate around the regression line in the past, but might not continue to do so in the future, so you really will not know when the trend has changed by simply looking at regression lines.

Why draw trendlines?

The point of drawing a trendline is to help you find a possible price area where the trend may change. **Change does not necessarily mean from up to down. It could also mean from up to sideways (or range trading), down to up, down to sideways or sideways to up or down.** Recall from last week's lessons that the market can have one of three trends: up, down or sideways. So, a break of a trendline does not have to mean that the direction of prices must reverse. It could just mean that prices will consolidate for a while before resuming the prior trend.

How do I draw a trendline?

If you remember your grade school geometry, you can draw an infinite number of straight lines through a single point. However, there is only one straight line that can be drawn through two points. Therefore, the minimum number of points that you need to draw a trendline is two. When you draw

an up trendline, you connect the lows of the bars or candlesticks on your chart. When you draw a down trendline, you connect the highs.

Take a look at the chart below. What do you think of the down trendline that I drew?



Three touches required to confirm a trendline

Clearly, prices are falling. In fact, they've been falling since the middle of June. Notice that there are only two touches on the trendline. The second day after the line begins (large red real body and large upper shadow) does almost touch the trendline, but I would typically ignore that day. Barring a huge acceleration lower (in the case of a downtrend), almost by definition, the trendline will be near prices on the second day. **This trendline can only be considered a tentative trendline. You can draw an infinite number of trendlines between any pair of points on a chart. The trendline is only confirmed once the line has been touched (or nearly touched) three times.** I cannot tell you how many times I see my friends in the media talk about a trendline that broke, and then show a chart on the television with a line that only touches two points. That is **not** a trendline.

Let's look at that OIH chart again:



Broken trendlines reverse roles

As you can see, I drew the first down trendline (in green above) off the high in June. Although prices continued their descent through July, the speed with which they were falling eased. In other words, the momentum of the price drop slowed. Notice also how the green line has acted as support the last few days. It is common for a broken down trendline to act as support as time goes by. Likewise, a broken up trendline will often act as resistance.

Let's think about the green trendline that broke in late June. After it broke, prices did not reverse higher. Instead, they meandered for a bit, but essentially continued lower (albeit at a slightly slower pace). When prices initially fall or rise very quickly after a trend change, then you will often need to redraw your trendline one or two more times before the stock, or market, settles into a more sustainable trend.

What is a valid trendline break?

I have always said that technical analysis is more of an art than a science. Although you can write trading systems based on indicators, recognizing reversal and continuation patterns, or determining whether a trendline has broken is often in the eye of the beholder.

I have seen many authors suggest that a break of a trendline is only valid if the break is still present upon the daily close. Others require that prices close through the old trendline for at least two or three days. Another rule of thumb is that prices must move through the trendline by at least 3%. The latter rule is of little use in certain low-volatility markets, or if you are day trading. For that matter, if you are highly leveraged, a 3% adverse price move against you could be highly damaging.

All of these rules of thumb are interesting to examine, but there are better ways of determining whether a trendline break is valid. I always look for additional evidence, such as:

- Increased volume

- Momentum in the break's direction rises
- Key moving averages are crossed
- The market gaps away from the broken trendline

A pet peeve

Back in the old days, everybody drew their trendlines by hand, using a pencil and ruler on paper. In these cases, you really didn't know the exact spot where the trend broke. The exact location of the trendline depended on such random factors as how close you held the pencil to the ruler, and how sharp the point on your pencil was. In these cases, analysts often took license and would draw trendlines that slightly broke extremes (in an attempt to find a better fit).

In this day and age of computer-based technical analysis programs, with their myriad of drawing tools, the art of technical analysis is often lost. I do not believe there is a great advantage in knowing, to the penny, the exact price level where a trendline might fail. As I noted above, there are many other factors that you must consider before taking action on a trendline break. Computer-based drawing tools make an approximation appear to be a scientific fact, but this can ultimately be dangerous to your profit and loss statement.

Using trendlines in your trading, investing and analysis

I am certainly not suggesting you should NOT use trendlines in your work with the admonition above -- quite the contrary. However, you should always remember to use trendlines in conjunction with other tools. Although it is beyond the scope of this article, trendlines have very definite meanings when used in Elliott Wave (see my book, [*Applying Elliott Wave Theory Profitably*](#), for more information on trendlines in Elliott Wave).

If your trades were with the old trend, then a trendline break should have you cover outstanding positions **as long as there is other supporting evidence**. Reversing your trade may only be advisable if the evidence for a trend change is incontrovertible. Such evidence may include a sharp increase in volume, confirmation of a reversal pattern (head and shoulders, double top confirmation), or a breakaway gap. If you do not have this kind of evidence, then I would advise you look for a retest to the old trendline before reversing your position. Trendline retests are quite common, and will allow you to enter your new position with tight stops (typically, you would place your stops beyond the price extreme on the day prices first breached the trendline).

SUMMARY

I could probably write a chapter in a book just on trendlines. No technical analyst worth his weight in salt leaves home without them. However, proper usage requires understanding what a trendline represents and what a break of one means. Using trendlines is as much an art as it is a science. Experience will help you to better identify lasting trend reversals from failed trendlines.

A number of other topics that are closely related to trendlines, but these are beyond the space I have in this week's issue. I will cover channels, which are very important in Elliott Wave Theory, at a later date, as will internal trendlines and support and resistance lines.

Thanks again for reading this week's issue, and good trading in the week ahead!



A handwritten signature in blue ink that reads "Steven Poser".

Steven Poser
Editor
[*The ETF Authority*](#)
New York, NY

DISCLAIMER

StreetAuthority, LLC is not a registered investment advisor or broker/dealer. Readers are advised that the material contained herein should be used solely for informational purposes. StreetAuthority does not purport to tell or suggest which investment securities members or readers should buy or sell for themselves. Site users should always conduct their own research and due diligence and obtain professional advice before making any investment decision. StreetAuthority will not be liable for any loss or damage caused by a reader's reliance on information obtained in this newsletter or on our web site. Our readers are solely responsible for their own investment decisions.

The information contained herein does not constitute a representation by the publisher or a solicitation for the purchase or sale of securities. Our opinions and analyses are based on sources believed to be reliable and are written in good faith, but no representation or warranty, expressed or implied, is made as to their accuracy or completeness. All information contained in this report should be independently verified with the companies mentioned. The editor and publisher are not responsible for errors or omissions.

StreetAuthority receives no compensation of any kind from any companies that may be mentioned in our newsletters or on our web site. Any opinions expressed are subject to change without notice. Owners, employees and writers may hold positions in the securities that are discussed in this report or on our web site, but are barred from trading any of these securities seven days before and after the initial publication of this report in accordance with our company policies.

**(c) Copyright 2003. StreetAuthority LLC and Poser Global Market Strategies Inc.
All Rights Reserved. Unauthorized Reproduction or Distribution is Strictly Prohibited.**