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THE LAST DOLLAR & THE TRIPLE DIVERGENCE:
THE PERFECT STORM

January 9, 2006

Nikkei: 16,428.21
*April 2003 low: 7,603.76

*- See March 31, May 3, & May 30, 2003 reports linked on homepage.

Dow Jones: 11,011.90

Regarding the Nikkei, where I have believed that the last gasp of US investor bullishness (buying power) has been expressed, the yearend sub-divisions in the Nikkei suggest a peak that conforms to the December 21, 2005 special yearend report's finding that that index has peaked or is peaking. From that report:

"What can we conclude? Considering the comments made in the Japan section above on this topic, this chasing of the Nikkei at these levels, and at a time of record capital influxes into Japanese equity, with US mutual fund cash at these levels, represents the last dollar getting invested!"

In that same report, I expressed the view that the front-running to get out of the market may cause the Dow to not even be able to traverse 11,000. Still, the following was added, with 11,000 just point away, anyway:

"I reported earlier this month that only minor sub-divisions remained in the Dow, with a peak possibility of 11,200 during the first two weeks of the New Year."

And from the conclusion of the Dec. 4, 2005 report (which was re-printed in the December 21, 2005 yearend report):

"As was the case at the end of 1999, by completing some minor pattern sub-divisions that could conclude around 11,200, the Dow is peaking in time for early January, against a backdrop of a number of fundamental and technical divergences. 8000 on the Index is a real possibility for the first quarter, en route to 6500 in 2006."

So, the conclusion of that letter was:

"The above rings true, so, we're long December 2006 puts. Markets are in major tidal shifts, as was the case exactly six years ago for the Dow, and 16 years ago for the Nikkei."

Okay, what happened today, in market history? Well, before anything else, it must be reported that during the nineties, I publicly identified every major peak in Japan, though only the perfectly forecasted and identified major secular and cyclical extremes of 1990, 1998, 2000 and 2003 are generally referenced. However, as regards those peaks of the nineties, a key point ought to be confessed: The correct identifications were often second attempts, after initially being incorrect some months earlier. Why is this germane today?

At the end of September of 2005, I pounded the table that the Dow was caught in a vice that could only squeeze the bulls. The index, however, has managed a pathetic rally, when compared to other US or world indices (especially Japan). In doing so, it has merely approached the 11,000 level, with a PE just under 20 and a dividend yield just over 2%. Still, stock lovers view this past August's bearishness with disappointment.

Today, technically, a most scary thing has been completed, as per an indirectly above-referenced divergence.

I identified the all-time peak in the Dow Jones on January 13, 2000; the peak was a day later. Almost six years later to the day, with the above-referenced sub-divisions to just under 11,200 complete, for all intents and purposes, the worst possible long term momentum divergence is now in place.

The fundamentalists among you may not fully appreciate the significance of the indicator below, but that is because the mathematical meaning as it relates to the fundamentals, which are themselves expressed in the crowd psychology that the momentum indicator captures, is not grasped by the analyst or observer.

For me, this very long term (monthly) indicator, as opposed to the weekly or daily indicators, which are the periods ordinarily followed by analysts, esoterically helps pinpoint the turning of a cruise-liner (long term turning point), while the other indicators help identify the turns of yachts (intermediate term) or speed boats (shorter term). I was waiting to see if this would occur but, in deference for the possibility that front-running sellers would cause the Dow to get stuck under 11,000, I preferred to wait and see if the small move necessary to create this amazing divergence and event would indeed occur. *Today, it happened.* While the Dow closed today at 11,011.90, the indicator below was taken just 5 points lower, a little earlier during the afternoon.

When one looks at a chart dating back to 1982, when the bull market began, one can see the enormous risk that exists. However, even looking back to 1990, one can see (below) how much air exists underneath this market. Moreover, even the very young investor knows about the pain experienced just 3 ¼ years ago, when the Dow bottomed at 7,196.

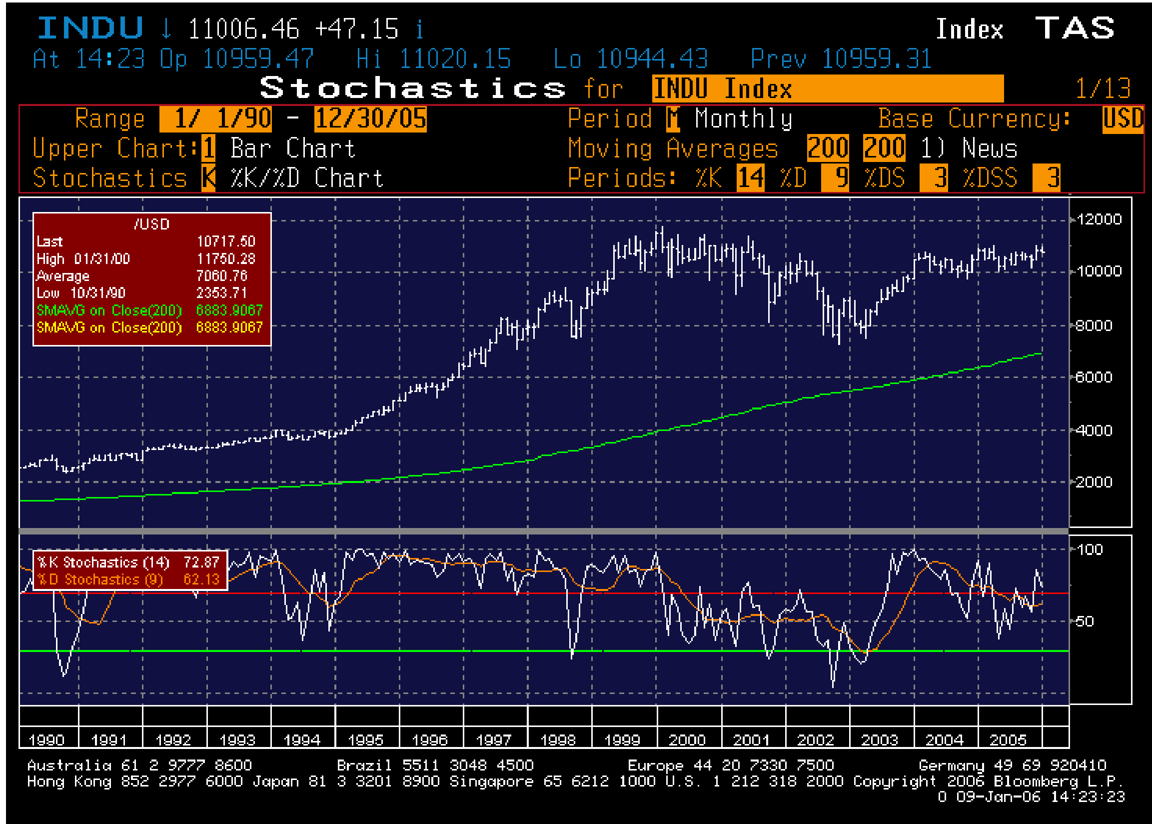
Well, then, please focus your attention on the very beginnings of 2004, 2005, and, now, 2006. Under the monthly Dow chart, is the monthly stochastic indicator. The monthly stochastic (I use heavy 14 & 9 periods for long term turning point efficiency in forecasting) is lower at each point. This has formed a triple divergence – the most negative and dangerous of all divergences in the indicator jungle!

The fact that the indicator is also pointing down, and that it is so long term ("heavy") in nature, suggests the possibility of dramatic and deep crashes that would have to be explained away as being caused by "unforeseeable and terrible events or external shocks."

Foolish investors who read the common press will again be putting the cart before the horse, as minds conclude according to what they can understand, as opposed to gaining knowledge and then concluding according to the findings of fact. The fact below is that the last dollar has been spent and no momentum remains. The engines were turned off long ago, and the trailing winds will allow the plane to crash, as those winds now die down.

The manipulations of the insider-trading Federal Reserve, and foreign market strength, represent false supports that are now things of the past (Greenspan exits this month). Please study this chart. With each year-beginning high (2004, 2005 & 2006), a lower low has been made in this, the most sacred of all my technical indicators. Almost a perfect six years since the all-time high in the Dow Jones, the Dow will come into line with where it "should be", in compressed fashion. This means Crash. This, then, will be remembered as a year of horror.

See next page for the 16-year monthly chart and monthly stochastic indicator, which appears immediately underneath the Dow's graph.



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