The Harmonic Trader Report Monthly

May 2015

"Never Trade the Markets the Same Way Again!"

May 06, 2015

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"Sell in May" aka Seasonality

As we begin this month's report, it seems that the old adage of "Sell in May and Go Away" is cited more each year. Although the long-term statistics are quite compelling for the argument, this philosophy overlooks several other factors that bears significant relevance. One of the clearest differences is the fact that most markets are trading close to or at new highs for the year and in many cases all-time highs. Whether the seasonal phenomenon comes to fruition this year not, I would look at any retracement as an opportunity to add to long positions until the weekly harmonic resistance targets are reached. Although I normally do not cite other work, I do believe it's important to look at the pure statistics of the "Sell in May" seasonality phenomenon historically. Here are a few links and blogs that contain detailed statistical research of the phenomenon throughout the past hundred years.

"David Aronson, author of Evidence-Based Technical Analysis (Wiley 2006), and his colleague Dr. Timothy Masters back-tested the Best Six Months Switching Strategy using their scientific method from 1987 (one year after the strategy was published in the 1986 Stock Trader's Almanac) to April 2006. They found that from 1987 through April 2006 the S&P 500 generated an annualized return of 16.3% during the Best Six Months compared to 3.9% for the Worst Six Months. Though no back-test can predict future results, in Aronson and Masters' opinion the Six-Month Switching Strategy was sound, valuable, and had predictive power. The returns were considered to be statistically significant, unlike any of the 6,402 rules tested for the book."

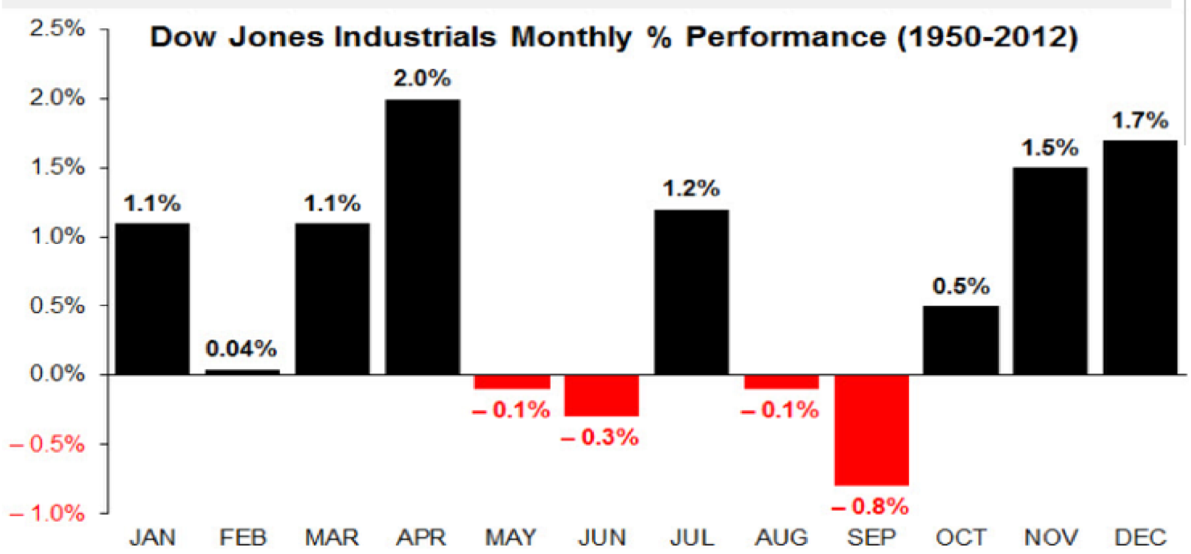
https://www.fidelity.com/learning-center/trading-investing/technical-analysis/sell-in-may-and-go-away

Others:

- www.en.wikipedia.org/wiki/Sell_in_May
- www.ryandetrick.tumblr.com/post/101425098005/welcome-to-the-best-six-months-of-the-year

Despite the overwhelming evidence, this is not the only long-term cycle that possesses relevance for the state of the current markets. Other annual cycles such as decennial patterns and presidential election terms are statistically valid considerations, as well. Therefore, one particular cycle cannot solely explain what is possible in future market action but it should be considered thoroughly. Personally, I respect the historic results and tend to favor this phenomenon. However, I look at seasonality a bit differently. Typically, the "Sell in May" season is preceded by bullish action in the first quarter. In fact, the following chart from Jeffrey Hirsch of *Stock Trader's Almanac* shows the monthly annual declines since 1950.

Figure 1. Dow Jones Industrials Monthly Percent Performance since 1950



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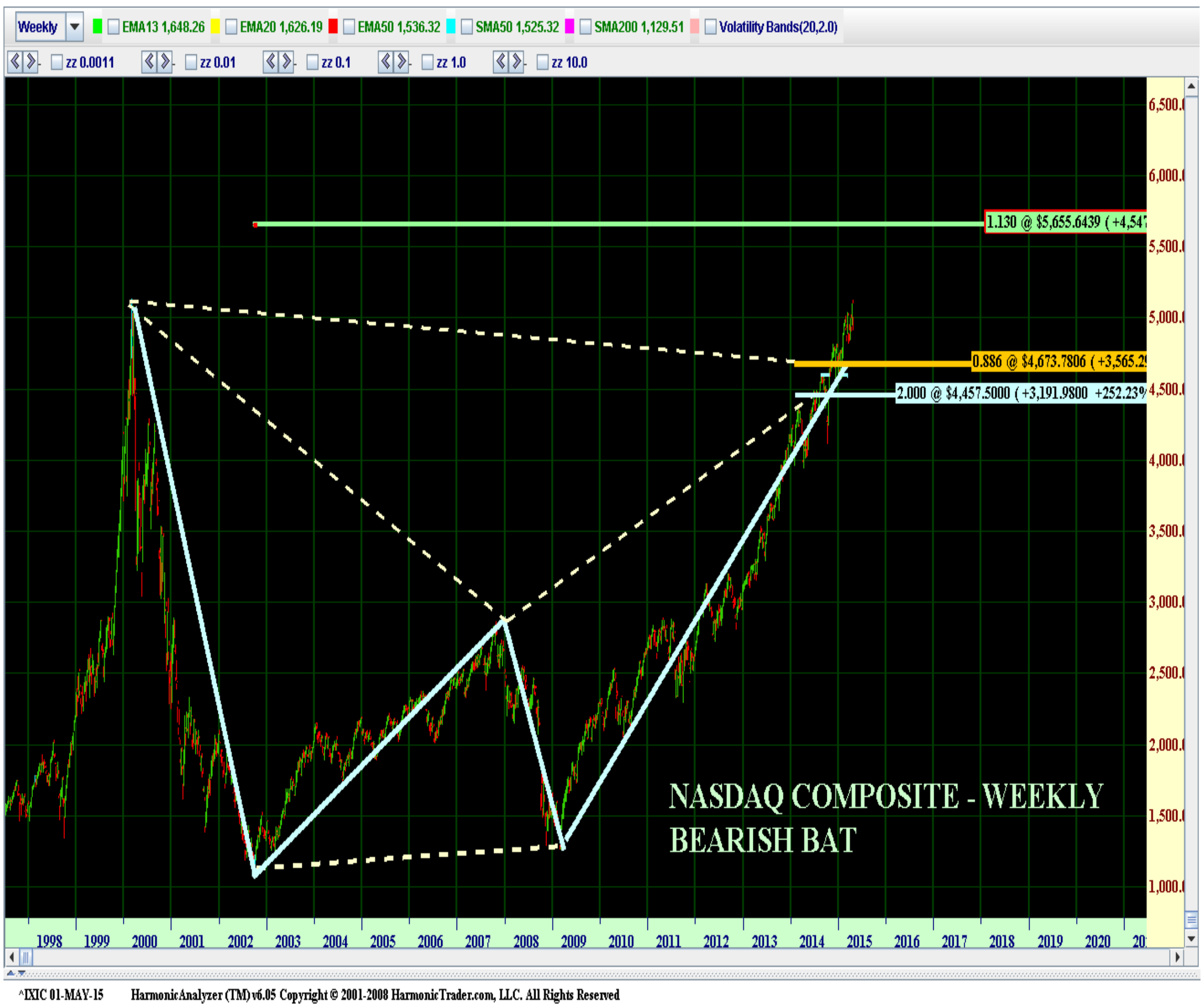
The most significant historical returns during this seasonality suggest that the greatest potential for a decline is the August-September period with an annual average decline of nearly 1%. Although the month of May is nominally negative since 1950, June fares worse historically with a 0.3% annual average decline over the past 65 years. However, July typically follows with a strong month that historically has recorded greater than a 1% gain. These types of fluctuating returns suggest that the seasonality phenomenon is more an environment of volatility and short-term trading opportunities. Despite the swings, it is important to be mindful of the year as a whole, especially during times of immense uncertainty. One of the most interesting aspects of this phenomenon is the overall performance for October. Although most of the worst market's crashes have unfolded during October, the historical performance since 1950 has realized a 0.5% average gain. Even over the past 40 years with the devastating crashes of 1974, 1987, 2000 and 2008 - all of which occurred during October of those respective years - the historical numbers are impressively bullish. Again, the focus should be on the opportunity not necessarily the negative theme.

NASDAQ Composite Index (^IXIC): Weekly
Bearish Bat Type-1 Failure



The situation in the NASDAQ Composite is quite clear. Now that the market has retested the all-time highs, the only question to consider is how far it can go? Since the price action violated the weekly harmonic resistance on the initial test of the completion point, this Type-1 violation is usually associated with strong continuation behavior. Although price action has been quite bullish, it is still early to commit to a larger scenario until the breakout above the all-time high has been confirmed, as the psychological 5000 level contributes to the entire resistance zone.

NASDAQ Composite Index (^IXIC): Weekly Failed Bearish Bat Potential Reversal Zone (PRZ) Type-1 Failure

The important consideration of this entire PRZ is the character of the price action after violating the harmonic resistance. In these situations, the Potential Reversal Zone (PRZ) serves as future support going forward, where the long-term uptrend will likely continue without much of a retracement. Specifically, the NASDAQ Composite should hold the 4500 level for any measured move in the future.

^IXIC 01-MAY-15 HarmonicAnalyzer (TM) v6.05 Copyright © 2001-2008 HarmonicTrader.com, LLC. All Rights Reserved

The immediate target of the 5000 level has been entirely satisfied in the past month. The index traded as high as 5100, well-above the 88.6% retracement at 4675. The index is at a point where the impending breakout will be triggered at slightly higher levels. In fact, the all- time 1.13 extension at 5655 serves as the long-term make-or-break where any bullish continuation beyond this point will likely take on an accelerated nature and rally to much higher levels. Regardless of the strength of the uptrend, it does not dismiss the need for patience and timing to maximize opportunities.

Apple (AAPL): Daily
Bearish Gartley

AAPL 01-MAY-15

Apple recently traded above 130 but formed an ideal Bearish Gartley pattern on the retest of the prior high. Although the price action was somewhat volatile at the completion of the structure, this pattern identified an excellent short-term pullback within this strong long-term uptrend. Despite the recent retracement, this pattern will likely only mark a pause within the weekly chart.

Microsoft (MSFT): Daily
Bearish Shark

The following chart shows an ideal Bearish Shark pattern that is retesting the recent high. Although this structure indicates a short-term pullback, these typically turn into 5–0 patterns that eventually continue within the predominant trend. In this case, the stock will continue higher after this pullback. But, the structure exemplifies ideal daily signals within the longer-term weekly uptrend for opportunities to get short.

iShares Biotech ETF (IBB): Daily
Bearish Bat

This Bat Pattern in the Biotech ETF (IBB) is another clear bearish structure within an aggressively bullish long-term uptrend. The price action failed to continue above the all-time high and is likely marking key resistance for the next several months.

IBB 01-MAY-15 HarmonicAnalyzer (TM) v6.05

Standard & Poor's 500 Index (^GSPC): Weekly
Failed Bearish Butterfly ---> 1.618 Bearish Projection

As we look at the S&P 500 index for the first time in a few months, the story remains the same. Our targets are higher – 5 to 10% at a minimum. The 2140 level remains the most significant 1.618 weekly expansion that should be tested in the next few months. Although the price action has seemingly stalled just above 2100 level, the demonstrative pattern in the price action of higher highs and higher lows throughout the past year clearly supports an underlying bid that should continue for quite some time.

Standard & Poor's 500 Index (^GSPC): Weekly
Failed Bearish Butterfly Potential Reversal Zone (PRZ)--->
1.618 Bearish Projection

This chart shows the price action following the violation of their butterfly pattern. The index has rallied sharply in an accelerated manner within striking distance of the weekly 1.618 projection 2140. This example demonstrates the type of accelerated price character that unfolds following the violation of a distinct harmonic pattern.

Standard & Poor's 500 Index (^GSPC): Daily
Bearish Deep Crab

Over the past few months, the price action has consolidated in a tight range that has formed a Bearish Deep Crab Pattern that is projected to complete in the same area as the long-term weekly target. This daily pattern coincides with the longer-term targets that define the general 2150 area as the ultimate objective.

Standard & Poor's 500 Index (^GSPC): Weekly Relative Strength Considerations

One of the most important considerations over the past two years has been the progress of the Relative Strength Index to hold well above the 50 mid-point line on the weekly chart. Although the market relieved some of the Overbought pressure last October, the uptrend has held firm, as the price continues higher while maintaining a consistent RSI reading. These are clear confirmation behavior of a trending market in a situation where the technical indicator condition manifests strong readings within a narrow range. The most important consideration regarding the RSI component of the weekly price action is the impending secondary test of the longer term overbought reading registered last year.

^GSPC 01-MAY-15 HarmonicAnalyzer (TM) v6.05 Copyright © 2001-2008 HarmonicTrader.com, LLC. All Rights Reserved

Within the Harmonic Trading approach, Relative Strength results are only significant when they form multiple readings within the same area. I presented this material in Harmonic Trading: Volume 2, where I outlined the rules for the RSI BAMM methodology. Although I will not completely go over the entire strategy in this report, you can access the material on the website in the Education section from the members' website at the PDF download link. The most significant RSI development occurs when a secondary extreme reading possesses a particular formation. The current RSI condition in the S&P requires another Overbought signal to trigger a bearish scenario. In fact, until the RSI weekly reading can reach 70, the overall uptrend will remain intact. The best situation for the bears would be a test of the weekly target as the RSI reading reverses from 70. Either way, the bullish trend will merely consolidate until this scenario has been realized.

May Conclusion

Although I tend to ignore what most "talking heads" have to say, it seems that they are less certain about the market's direction more than ever. From the HT perspective, the technical roadmap has been quite clear and convincing. Despite the strong trading behavior, the bears still linger. Many pundits tend to directly correlate rotational allocations that result in sector moves with overall weakness. The fact is that the market must continually circulate money where even the best winners will still need to experience pullbacks along the way. Even in the strongest of bull markets, there are plenty of opportunities on the sell side. The trick to capitalizing on this volatility is to realize that the predominant trend quickly resumes after sharp but brief corrections. In cases like Microsoft, Apple and the IBB, the strongest of uptrends will provide clear structural patterns to define important inflection points, as wells. Although most of these resistance targets have become mere speed bumps along the way, the market will still provide the structural signals necessary to indicate when the trend may be changing. Until then, the trend is your friend.

Please feel free to contact me at HarmonicTrader@HarmonicTrader.com, as I welcome your comments, questions and suggestions. If you are a trial member or wish to receive future reports, please sign up here:

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Best Regards,

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The Harmonic Trader Report Monthly

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Library of Congress
Cataloging-in-Publication Data

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