The Harmonic Trader Report Monthly

September 2015

"Patterns into Profits!"

September 9th, 2015

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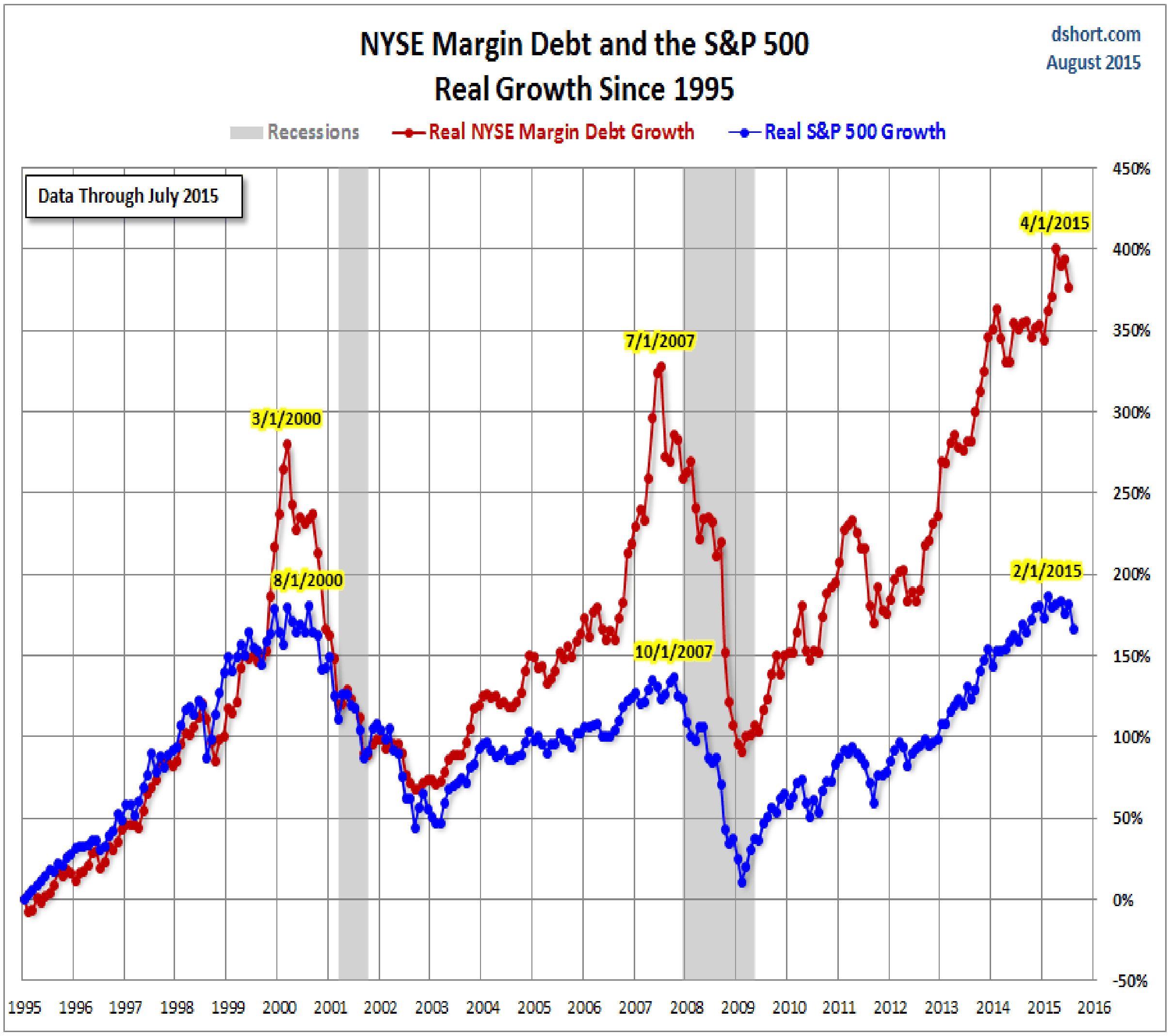
QE Adjustment

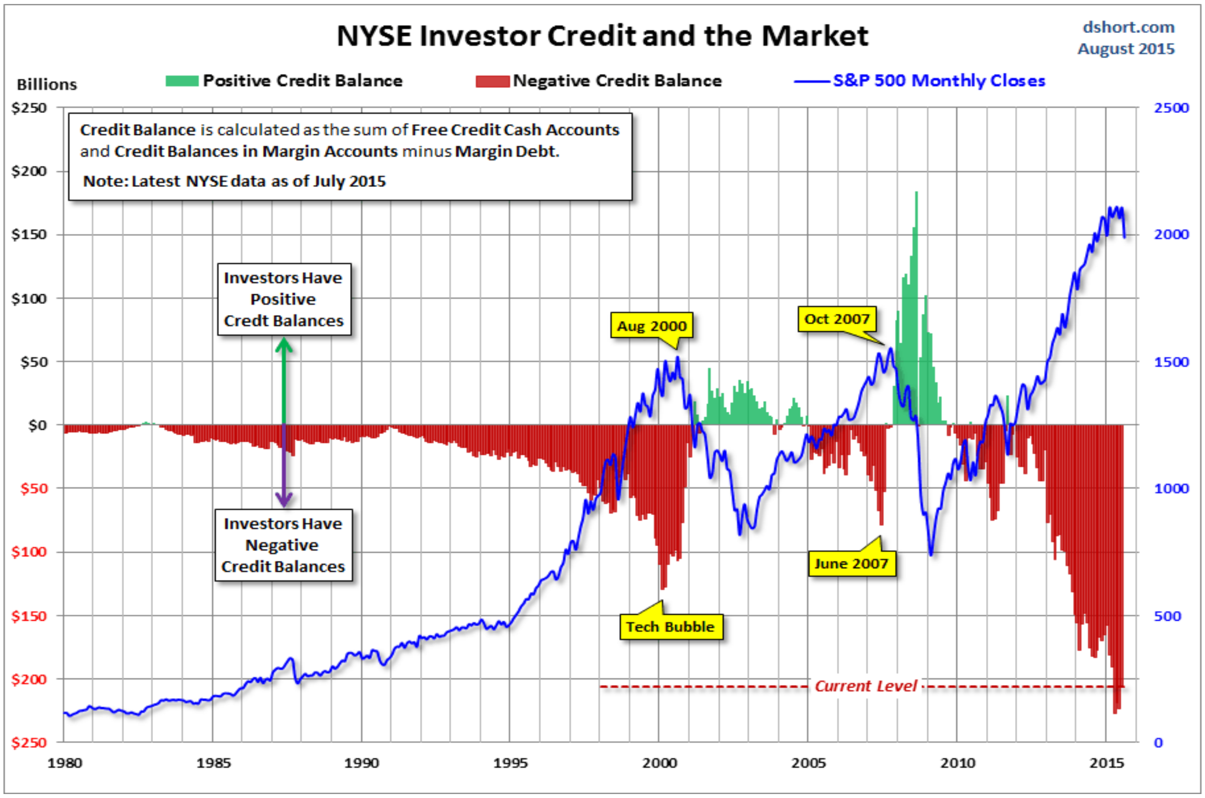
We are at a point where the markets have triggered substantial technical action that has changed the character of the seven-year bull market. We are no longer at a point where we can consider upside targets until some degree of stabilization is reached in price and Relative Strength. As I mentioned at the end of my report last month, I said: "*Even if the S&P 500 declined 10% from current levels, it would merely be retesting last year's failed harmonic resistance. Therefore, despite the stagnant summer action, I believe there is much to be anticipated as we enter the final months of the year*." http://harmonictrader.com/htreport0815.pdf The real question is now that the S&P has dropped 10% is this a buying opportunity? The short and long answer is not yet. I think the most important consideration is a relative time perspective. We must think about what has transpired since the 2008 low. Even if this is a correction within a much larger bull market, the clear reality is that lower levels need to be tested to establish constructive bullish signals for a resumption of this trend. This leads to my general assessment of what has fueled this market for the past 6 years.

The following chart shows *NYSE Margin Debt* going back 35 years. We can see a direct correlation of margin debt to asset prices. Quite frankly, these readings set up a macro-scenario where this asset bubble could actually burst back to real market-based valuations without the easy Fed policies and continued margin debt expansion. Although these stats are released 30 days after the fact, we can see that the debt levels are already rolling over.



http://www.advisorperspectives.com/dshort/charts/markets/nyse-margin-debt.html?NYSE-margin-debt-SPX-growth-since-1995.gif

At the same time, you may notice on the second chart that the *Net Credit Investor* levels are quite severe. In fact, the readings are at all-time extremes. The problem with the Fed raising rates is that it would require some degree of adjustment in margin debt. Any change in the zero rate policy would impact the level of borrowing and require a (natural) adjustment in price, as it comes down to simple laws or supply and demand.



http://www.advisorperspectives.com/dshort/charts/markets/nyse-margin-debt.html?NYSE-investor-credit-SPX-since-1980.gif

With these larger forces unfolding, I want to reference comments from the July Report: "…*I have been considering what might occur beyond these larger targets. What levels could be considered if the S&P 500 exceeded the 2140 area, the NASDAQ Composite rallied above 5300 or the German DAX continued higher …they all must go through some type of consolidation or retracement BEFORE a larger continuation can occur… the S&P 500 was unable to rally convincingly above the 2100 level is the first sign of some sluggishness…early signs of change at obvious and significant natural harmonic targets must be regarded as a point of pausing to relieve the pressure of the past three years. As the market enters the second half of the year, we have another situation … This will require the next several weeks to resolve the overall situation but the year's inflection point is increasingly close*."

From a technical standpoint, the clearest indication of the degradation of the past year's progress has been exhibited in a steady downtrend of Relative Strength (RSI). The RSI readings in many markets on the weekly charts have been steadily declining for quite some time. With this recent correction, these languishing RSI readings now have continued to break down. In fact, the weekly chart must now register at a minimum 30 reading to truly define an oversold situation. Until then, the RSI remains in a clear downtrend.

Standard and Poor's 500 ETF (SPY): Daily
Bullish Shark ->Bearish 5-0 Pattern with RSI

The S&P 500 ETF exemplifies the declining RSI situation clearly. The daily chart registered a reading of under 20 – 18.44 to be exact. This is significant. In my years of research of Welles Wilder's Relative Strength with harmonic patterns, the clear extremity of an oversold reading under the 20 level must be treated differently than a simple test of the 30 limit. This differentiation is vital within the Harmonic Trading approach that relies upon exclusive measurement of the markets based upon their movements. In fact, we must consider a daily reading under 20 as not a complex buy signal but a situation that requires further consolidation including a secondary test of the extreme oversold level under 30 before any constructive bullish behavior can be considered. Therefore, this reading is just an early sign.

The interesting aspect of the daily action in the SPY is the clear harmonic patterns that have formed. Last month, I addressed the importance of the Bullish

Shark that completed at the 88 6% retracement on my Twitter feed in regards to the S&P 500 September Mini-contract (ESU5) as the initial decline was reaching a capitulation (check the feed @harmonictrader). For the ETF, the 88.6% retracement from last October's low defined harmonic support at the 184 level with a distinct Shark Pattern. When I released the discovery of this structure, I stressed the importance that it represented a corrective structure that typically reversed to complete a 5-0 pattern. In this case, the target for the initial reaction has been tested at the 195 level. Now, the market is at a critical make-or-break harmonic resistance and the price action has already started to roll over.

Standard and Poor's 500 ETF (SPY): Weekly Bearish 1.618 with RSI

All of these indications and the clear continuing downtrend of the RSI weekly readings indicate that this market needs more time before we can consider a low has been established. Certainly, we can project what is possible but these are at much lower levels than the current low. Although I will expand upon this next month, the weekly price action has already signaled the possibility of testing 157-162 level with a 38.2% bull market retracement and a shorter-term impulsive 1.618 @ 162.

NASDAQ Composite Index (^IXIC): Weekly Bearish Bat Potential Reversal Zone (PRZ)

For the past 18 months, I have outlined and reviewed the significant measurements that define the critical levels for the tech sector. Namely, the NASDAQ stocks have been flashing clear signs that this harmonic resistance was capping the rally, noted particularly by the extreme buyer's exhaustion in Amazon, Netflix and others that jumped 10% or more in a single day back in July only to have the broader index do nothing but continue to rollover.

^IXIC 04-SEP-15 HarmonicAnalyzer (TM) v6.05 Copyright © 2001-2008 HarmonicTrader.com, LLC. All Rights Reserved

Clearly, the most important harmonic resistance level is the 88.6% retracement that completes at 4680. The price action tested this level nearly a year ago. Despite some consolidation that retested the all-time high, this structure still defines the entire measurement basis going forward. After this initial reaction, the price action that unfolds beyond the immediate correction will confirm the magnitude that this pattern presents. Simply stated, a violation of the recent lows will trigger a substantial correction of the bull market the past seven years. This is an immediate issue that the market must resolve before any other possible scenario can be considered. Therefore, the next two months will likely dictate what happens over the next year.

German DAX (^GDAXI): Daily
Bearish Deep Crab Pattern

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After exceeding the weekly Bearish Deep Crab, the price action reversed above the extended PRZ while not exceeding the ideal 2.0 extension stop loss point. The recent decline has validated this bearish structure and defined immediate retracement targets that suggest a full retest of the 7-year uptrend line converging with an important a minimum 50% retracement at 8000. For now, the index must test the 38.2% weekly retracement at 9100 before any structural support can be considered.

iShares Emerging Markets ETF (EEM): Weekly Bullish AB=CD?

Over the past two years, I have outlined numerous scenarios for both equities and currencies in the emerging markets. It is incredible to think that the heyday of the BRIC countries (Brazil, Russia, India and China) has crumbled, accelerated by the meltdown in Crude Oil. What were previously remarkable growth stories, these markets have suffered substantially.

From an HT perspective, the only possibility of an immediate structural signal within the Emerging Markets ETF (EEM) is the following weekly Bullish AB=CD in the $28 area. However, the severity of the recent decline warrants caution with a full blown retest of the 2008 lows at stake if the long-term price action is unable to stabilize.

September Conclusion

The markets are at a true make-or-break situation where the easy money strategies of the past 7 years might finally be catching up with the natural valuation forces of supply and demand. We are in the midst of another "QE Adjustment" phase that is challenging the current bullish environment. The potential of this adjustment is especially evidenced by many of the U.S. Dollar pairs against South America and Asia currencies. As we have addressed over the past two years, we are looking at a U.S. Dollar that is surging to historic extremes that have previously triggered contagion panics – most notably 1982 and 1998. This may be mere speculation but many of these financial markets and their respective currencies - the Mexican Peso and the Brazilian Real, in particular - are at such a state that further devaluation will create an unprecedented situation. All of this is cause for concern, as the U.S. will need to *adjust* to more than a normal bump in the road. In such uncertainty, markets tend to overreact and take quite a bit of time before any reasonable valuation can be established.

After one of the least volatile periods on record, the NASDAQ, S&P500 and Dow Industrials have finally blinked. Many are equating this price action with the pullback three years ago while failing to recognize the relative position of these indices. The 2011 correction was still trying to recover from a devastating bear market. Now, these markets are pulling back from ideal bearish structural situations that possess greater implications than three years ago.

A larger technical problem will emerge if the market continues below the recent lows any time over the next 6-12 months. There seems to be a consensus that this is more likely as we approach the ominous October seasonal period. In the short-term, I expect further volatility where sharp countertrend corrections could swing the markets +/- 5% from current levels. Regardless, the structural state of most equity markets sets up a challenging situation for next year. We are at a point where the long term decade-long patterns have been tested completed and are now signaling measureable reversals at hand.

For now, the capitulation action in August has abated but the key technical event will be an eventual weekly oversold RSI reading (less than 31) for the major US equity indices to signal a buying opportunity. The all-time retracements from the 2008 low would also be triggered on a violation of the recent lows - where minimum 38.2% retracements of the last seven years would become relevant considerations. At that point, the U.S. bull market would require hard look at the long-term price action to ascertain the possibility of yet another severe 50% bear market correction

- representing the third in the first 15 years of this century. We are not there yet but the action of the past month has validated these possibilities.

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:

http://harmonictrader.secure-mall.com/item/The-Harmonic-Trader-Monthly-Report-30

Best Regards,

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By Scott M. Carney

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