THE CHAPMAN REPORT

Charts and commentary by David Chapman

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Stock Indices

	Intermediate term trend	Short-term trend	week trend	intermediate strategy
S&P 500	up	up	down	Long hold (new highs)
NASDAQ	up	up	down	Long hold (new highs)
TSX Composite	up	neutral	up	Long hold
TSX Venture	down	down	down	Stand aside (new lows)

For the first time in 2013, the S&P 500 faltered after making new highs and fell slightly this past week by 0.3%. The NASDAQ exchange was down 1% after making new highs. Both the Dow Jones Industrials (DJI) and the Dow Jones Transportation (DJT) also made new highs this past week. The DJI rose 0.1% while the DJT was essentially flat losing a very small 0.04%. The new highs made by the indices followed by the lower close could be considered a reversal week. This may prove to be prescient if the indices were to fall further.

In Canada, the S&P TSX Composite managed to eke out a small 0.1% gain. However, the TSX Venture Exchange (CDNX) continued to falter falling to new lows while losing 3.5%. Despite making new lows, however, the CDNX continues to exhibit potential bottoming signs. The key weekly MACD is flat and the new low has not dragged it to the downside. There are a number of positive divergences in the indicators for the CDNX. The market needs some evidence, however, by taking out some earlier highs. The CDNX continues to trade at levels seen back in 2002.

The S&P 500 faltered this past week because of concerns that the Fed might prematurely end its stimulus program known as QE3. TC explains that further in the commentary under Precious Metals. A comment though from Fed Chairman Ben Bernanke minimized the view that the Fed's monetary stimulus has spawned economically risky asset bubbles. As the commentary under Precious Metals the FOMC overwhelmingly supported the continuance of the QE3 program despite the concerns of the dissenters.

The new buzzword may well become “sequester”. On March 1, 2013 huge spending cuts known as the “sequester” are scheduled to kick in unless an agreement to defer them can be reached between the Obama administration and Congress. Both are already pointing fingers that it is the other guys fault if the cuts kick in. The Pentagon has threatened to furlough upwards of 800 thousand workers and Homeland Security has said that delays at airports could become critical. The cuts could impact everything from healthcare and education to the Pentagon and the FBI.

The fight over the “sequester” appears to mimic the one over the “fiscal cliff” seen in late 2012. However, if that is a guideline than some “rabbit” should be pulled out of the hat by Thursday thus avoiding the cuts. However, as with the “fiscal cliff” it will be “wishy washy” and merely push the problem or the “can” as they say down the road. Somehow, the Republican controlled Congress allowing major cuts to the Pentagon does not appear to be in their DNA.

If the market has hit a high the first key number to watch is 1,480. A break under that level would signal a more significant drop to come. As long as the market can hold above 1,480 then it could recover and move once again to new highs. The S&P 500 has achieved TC’s minimal objectives at 1,525 but other objectives remain at 1,550 and 1,605. TC has no objectives above 1,605 at the moment.

Some indicators are rolling over and the VIX volatility indicator jumped this past week but there are significant negative divergences in the indicators on either the daily and more importantly the weekly charts. Tops are usually seen when there is significant negative divergences on the weekly indicators. This does suggest that while a pullback could be seen in the S&P 500 no major fall should occur at this time and the market could well recover and move to new highs above the current high of 1,531. As noted the key area to hold is at 1,480.

Charts created using Omega TradeStation 2000i. Chart data supplied by Dial Data.

Bonds

	Intermediate term trend	Short-term trend	week trend	intermediate trend strategy/bond model system
US Bonds	down	down (weak)	up	Stand aside
Cdn Bonds	down	neutral	up	Stand aside

Charts created using Omega TradeStation 2000i. Chart data supplied by Dial Data.

US Treasury bonds as represented by the 30-year US Treasury bond futures bounced back this past week gaining 0.4%. In Canada, the Canadian bonds as represented by the 10-year Government of Canada bond futures (CGB) also were up gaining 0.6%. Both the trend following systems and the bond model systems remain on the sidelines.

If stocks and especially gold faltered this past week because of fears that the Fed might prematurely end its QE3 program bonds rose on the week because of continued support from the Fed and its program of QE3. With both the Euro zone and Japan slipping back into recession it was thought that the Fed would have to continue to support its bond purchase program known as QE3. There were some positive numbers in the Euro zone this past week and the Japanese trade numbers improved (following an 18% devaluation for the Yen). The Fed purchased $1.4 billion of US Treasuries this past week under its QE3 program.

The Ten-year US Treasury note was at 1.97% this week down from 2.01% the previous week. The Two-year US Treasury note was 0.27% vs. 0.29%.

If the economy is improving, it was once again a mixed week for economic numbers. Housing starts for Jan were 890 thousand slightly below the expected 900 thousand and below Dec's 973 thousand; building permits for Jan were 925 thousand about as expected; intial claims rose to 362 thousand from 342 thousand; existing home sales for Jan slipped to 4.92 million when they expected 4.95 million; leading indicators for Jan was up a small 0.2% but below Dec's gain of 0.5%; and, the Philly Fed manufacturing index for Jan was a negative 12.5 when the market expected a positive reading of 2 and Dec's was a negative 5.8.

Inflation for Jan was low as could be expected. The PPI did, however, jump 0.2% while the CPI was flat. But ex food and oil the Core PPI was also up 0.2% and the CPI was up 0.3%. Shadow Government Stats www.shadowstats.com shows the CPI rose 1.1% in Jan. Year over year inflation is officially up 1.6% while shadow stats shows it up 9.2%. Shadow stats calculates the inflation numbers based on methodology in place back in the 1980's before the government began to tinker with the data to depress the reported CPI.

Key economic indicators out this coming week include durable goods orders for Jan expecting a decline of 4.2% vs. a gain of 4.6% in Dec; personal income for Jan is expected to be down 2.2% vs. a Dec gain of 2.6%; personal spending is expected to rise 0.2% the same as Dec; and, the ISM manufacturing index for Feb is expected at 52.5 vs. Dec's 53.1. Given the very weak Philly Fed this past week the ISM number is expected to be lower.

Here in Canada retail sales for Dec were down a sharp 2.1% vs. a gain of 0.3% in Nov. That caught a lot of analysts by surprise. This week the current account deficit for Q4 is out looking for a deficit of $16.9 billion vs. Q3's deficit of $18.9 billion. As well the Q4 GDP is out looking for a gain of 0.7% vs. Q3's gain of 0.6%.

Overall, the move upward for bonds this past week was minimal and did not change anything nor change the outlook for bond yields. The US 30 year Treasury futures have support in the 142 to 143 zone but under 142 could fall further to major support near 140. For the CGB's support is between 133 to 135 but under 133 a decline to 132 is probable. There remains low odds of any major rise in bond yields although on the other side the ability of bond yields to fall substantially lower is also low.

Interestingly enough large speculators (hedge funds amongst others) increased their COT for Treasury bonds this past week to 42% from 39%. That suggests that the hedge funds are buying bonds again.

Precious Metals and Currencies

	Intermediate term trend	Short-term trend	week trend	intermediate strategy
Gold	down	down (extremes)	down	Stand aside
Gold Bugs Index (HUI)	down	down	down	Stand aside (new lows)
Silver	down	down (extremes)	down	Stand aside
TSX Gold Index	down	down	down	Stand aside (new lows)
US$ Index	up	up (extremes)	up	Long hold
CDN$	down	down (extremes)	down	Stand aside

Precious Metals

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As was outlined in TC's Chart of the Week (Gold is in a rut! – Chart of the Week, February 21, 2013) it was not a good week for the gold bulls. Gold fell 2.2% while silver lost 4.6%. The other precious metals did not fare well either as platinum lost 4.2%, palladium dropped 2.4% and copper while not a precious metal it is usually at least a co-incident indicator dropped 5.3% one of its worst weeks in months.

Moreover, if the precious metals were down it usually means the gold stocks were beaten down. The AMEX Gold Bugs Index (HUI) fell 8.7% although the TSX Gold Index (TGD) fared considerably better losing only 3.1%.

It was the 2nd consecutive sharp week down for gold. Gold last peaked at $1,695 on January 22, 2013. Since then it has rapidly fallen just over 7%. The catalyst this past week was confusing statements from the FOMC minutes suggesting that some Fed officials were becoming increasingly uncomfortable with the Fed's current round of QE and looked to end it sooner rather than later. While it was certainly discussed ending QE any time soon was not supported by the majority. Supporters noted that the costs of QE3 are outweighed by the benefits. As to the FOMC itself voting for the continuance of the current monetary policy was carried handily 11-1. The lone dissenter, Esther L. George was concerned that the continued high level of monetary accommodation increased the risks of future economic and financial imbalances and, over time, could cause an increase in long-term inflation expectations.

While George and other Fed officials might be correct the reality is pulling QE could cause interest rates to rise and the stock market to fall and potentially sending the economy back into recession. That was effectively what took place after QE1 and QE2 ended. As well, many believe that the current round of QE is actually disguising the propping up of the banking system that is still laden with toxic positions in securities and derivatives. Everyone should keep in mind that the Fed is actually owned by the same banks that the Fed is primarily supporting. The Fed does not receive any funds from the US Treasury. However, the Fed buys US Treasuries from the banks. Since the financial crisis of 2008, the Fed's balance sheet has tripled from under $1 trillion to over $3 trillion. This is in line with the expansion of the monetary base that has grown from around $900 billion to over $2,800 billion.

The Fed purchases securities from the banks and deposits cash into the banks. The banks then can lend this money out or use it for whatever purpose they see fit. Loans especially help expand the money supply. But the banks can use it for speculative purposes as well investing in emerging markets or the stock market.

Both gold and silver have fallen into a major zone of support. Gold has support down to $1,540 to $1,550 and below that down to $1,500 to $1,525. The December 2011 lows was at $1,525 and the May 2012 lows was at $1,528. Silver has support down to $28. Silver's lows were seen in September 2011 at $26.58, December 2011 at $26.38 and in June 2012 at $26.07. Since the financial crisis of 2008 gold soared from a low of $681 to a high of $1,912 a gain of 180%. Thus far the gold has corrected roughly 27% of the rise. Silver rose from $9.07 to a high of $49.52 a gain of 446%. Thus far silver has corrected about 52%.

The correction for both gold and silver has therefore been quite normal. When one considers time this correction has been playing out for 17 months for gold and 22 months for silver. In terms of time this is also not unusual. While the 2008 correction was swift, (gold fell overall 33% and silver dropped 57% over a period of 8 months) this one has dragged on.

A drop below $1,500 might suggest a decline to around $1,450 for gold. For silver, a drop under $28 could set up a test of the $26 to $26.50 lows. Given the extremes in the daily indicators, a corrective rebound is more likely in the short term. As well as noted in the February 18, 2013 edition of TC gold has demonstrated a propensity over the past 12 years of making its yearly low in January or February. Lows were seen in those two months on 7 occasions over the past 12 years. This does raise the potential that a low might be in formation.

A clue might be in the most recent commercial COT. The commercial COT for gold rose to 35% from 33% the previous week. Short open interest fell 25,000 contracts while long open interest rose 4,000

contracts. On the other hand the large speculators COT (hedge funds amongst others) fell to 68% from 74%. Short open interest rose 25,000 contracts while long open interest was up 2,000 contracts. For silver the commercial COT rose to 37% from 35%. Long open interest was up 2,000 contracts while short open interest fell 6,000 contracts. The large speculators COT fell to 76% from 83% as short open interest jumped over 4,000 contracts and long open interest fell 1,000 contracts.

Given the shift in the large speculators COT it is quite possible that the source of selling seen over the past couple of weeks came from hedge funds. There has been some evidence that some players are becoming concerned about counterparty risk and are existing paper gold and silver for gold and silver in storage or fully allocated gold and silver. As well there was consistent rumours of a hedge fund going under over the past week and they may well have been unloading their positions in GLD and other forms of paper gold. In December, selling was attributed to a large Paulson hedge fund going under.

Gold has resistance up to $1,610 but above that level and especially above $1,620 gold could rise to $1,650 resistance. Further resistance would be up to $1,695. Above $1,695 would confirm that a low is in. For silver resistance is seen in a gap between $28.74 and $29.41. Above $29.50, silver improves. Further resistance is at $30 although stronger resistance would be seen between $30.60 up to $31.50. Above $31.50, silver would break out.

The fall for both gold and silver over the past couple of weeks has been swift. But daily indicators are at extremes suggesting that at minimum a bounce is probable. The reasons given for the fall that the Fed might end QE3 pre maturely or that the economy is improving allowing the Fed to end QE3 is not supported by ongoing evidence that at best the economy is sluggishly moving. Given that the Euro zone and Japan have fallen back into recession, there is a risk to the US economy as well.

Moreover, if the sequester of spending cuts are allowed to go through the US would most likely fall swiftly into a recession. That in turn could see unemployment rise back over 8%. That is the opposite direction that the Fed wants to see it go as it moves away from the QE3 goal of 6.5% unemployment. That increases the odds that QE3 is here to stay for the foreseeable future.

Both gold and silver bounced back on Friday after being down on the day. Follow through this coming week to the upside would be positive.

As for the gold stocks they have fallen sharply to levels that leave them even more undervalued to the price of gold and silver than they were at the lows of the 2008 financial crisis. Both the HUI and the TGD made new lows for their move down this past week. Their daily indicators are also at extremes suggesting that this sell-off has been very overdone. As with gold and silver a buying opportunity may be at hand. The HUI above 400 and the TGD above 280 would improve their outlook considerably. Both are in major zones of congestion support dating back to earlier years.

Currencies

Charts created using Omega TradeStation 2000i. Chart data supplied by Dial Data.

Is the US$ Index breaking out and headed to higher levels? If so the rise in the US$ Index does not appear to be because of any inherent strength in the US economy and a desire to hold US$. Instead it appears more a function of weakness in Europe and Japan. The US$ Index jumped a sharp 3% this past week as the Euro fell 1.4%, the Swiss Franc dropped 0.9% and the British Pound fell 1.8% after Moody's stripped Britain of its Aaa credit rating dropping it a notch to Aa1. The Japanese Yen finally halted its steady decline gaining an insignificant 0.01%. The Cdn$ fell 1.5% following the release of weak retail sales.

The Euro fell following news that economic forecasts shows that the Euro zone will remain mired in recession through 2013. As well the ECB announced that institutions will pay back less than thought against the Long-Term Refinancing Operation (LTRO). The Euro fell back to 1.3180 dropping for the third consecutive week. Major support for the Euro is at 1.30.

All of this has helped push the US$ Index to its highest levels since November 2012. In hitting a high of 81.70 on the week the US$ Index took out the November highs of 81.52. Above lies the January 2012 high of 82.05. Those highs may also be the top of what appears as the left shoulder of a potential head and shoulders top pattern. With the US$ Index taking out the November high of 81.52 the focus is now on the January 2012 high. A break above puts the entire potential head and shoulders in doubt. The top of the head is at 84.25 and was seen in July 2012. It is possible that the US$ Index is trying to make some sort of broadening pattern. If that were correct, the US$ Index could rise to the top of the channel that is currently near 87.

The rise this past week for the US$ Index is not so much because of a strong US$ but that the other currencies are weakening. Many continue to believe that despite official denials there is an ongoing currency war. A rising US$ would not do any favours to the US as it could weaken exports while potentially increasing imports. That in turn would increase the US trade deficit.

Japan has been aggressively pursuing a QE program designed to bolster their domestic economy. The Euro zone has also expressed a desire to increase exports in order to stave off a recession. In that respect they would welcome weaker currencies. The question is would the US also act to weaken the US$. Naturally, Europe, Japan and the US have all pledged to pursue growth strategies rather than devalue their currencies in order to achieve their fiscal and monetary goals. Evidence, however, suggests that they are willing to let their currencies fall in order to improve their economies.

The Euro commercial COT improved to 44% this past week from 42% the previous week. It was primarily due, however, to short covering as short open interest fell 8,000 contracts. The Swiss Franc commercial COT jumped sharply to 36% from 21% while the British Pound commercial COT rose to 61% from 59%. The Japanese Yen commercial COT rose to 81% from 80% and the Cdn$ commercial COT rose to 44% from 41%.

Given that all of the major currencies commercial COT's were up it raises some thoughts that this rally in the US$ Index may be short lived. The US$ Index has resistance to 82 but above 82 a run to 83 is probable. On the other side a decline back below 81 would be negative. Under 80 the US$ Index could fall back to the neckline of that possible head and shoulders pattern near 78. Still the breakout on the US$ Index the previous week appears compelling and suggests higher levels. On the other hand if the US$ Index were to fail here it would suggest that the 78 neckline could soon be hit once again.

If this is a period of currency wars then in all likelihood the US$ rally should not last long. The Euro zone, Japan and the US are all faced with sluggish economies. A rising currency does not do them any favours in helping their export industries. The US$ Index sometimes demonstrates seasonal weakness from February to May. That may help to determine whether this is a top or not.

Energy

	Intermediate term trend	Short-term trend	week trend	intermediate strategy
Oil	up	down	down	Long
Natural Gas	neutral	down (weak)	up	Long (caution)
XOI Index	up	up (weak)	down (small)	Long hold
TSX Energy Index	neutral	down (weak)	up	Long hold (caution)

Charts created using Omega TradeStation 2000i. Chart data supplied by Dial Data.

Oil prices fell sharply this past week losing 2.9%. The decline would have been more except for a rebound on Friday following a release of report that showed that German business confidence had climbed to a 10 month high. Driving oil prices down this past week was the EIA report that showed that crude supplies jumped a sharp 4.1 million barrels on the week leaving them 35.7 million barrels above last year's levels. To complete the EIA report gasoline supplies fell 2.9 million barrels and are 1.2 million barrels below last year; and, distillates fell 2.3 million barrels leaving them 19.9 million barrels below last year.

The story on the week, however, was the sudden drop in oil prices on Wednesday. Crude fell along with other commodities on weak Euro zone economic numbers, a rumour that Saudi Arabia would hike output

and fears that the Federal Reserve would prematurely end its stimulus program known as QE3. Not helping oil was the jump in jobless claims and the report that the Philly Fed was weaker than expected.

Somewhere during all of the bad news on Wednesday, a large seller came into the futures market and oil prices fell swiftly catching everyone by surprise. The drop on the week took WTI down to $93.13. Strong support is visible down to $90 and there is a chance that oil prices could test down to there. There is also support at $91. Resistance does appear firm at up to $98. There is interim resistance at $95. Above $98 there is further resistance up to $100. Over $100 resistance comes in at $106.

Since topping near $110 back in February 2012 oil prices appear to be unfolding in a five wave pattern to the downside. As it often the case with these five wave patterns the first wave down is the steepest bottoming just below $78 in June 2012. Wave 2 or the B wave took oil prices to just about $100 in September 2012. Wave 3 or the C wave fell to $84 in early November 2012. Wave 4 or the D wave appears to have just completed. If this is correct this would be the fifth wave or E wave down. It should hold in the $89/$90 zone.

There also appears to be a larger five-wave pattern that has unfolded from the April 2011 highs at $114. However, once again this appears to be the start of the fifth or E wave to the downside. This wave could go as low as $80. However, that could only occur if oil prices break below $89. Once this wave is complete oil prices could start a new major wave to the upside. For this coming week oil prices could extend the drop that got underway this past week. Only over $95 does oil prices stand a chance of moving higher instead.

Brent crude ended the week at $114.10 leaving a spread of $20.97 between Brent and WTI. That was down from a high of $23.18 on February 8.

Natural gas (NG) prices jumped 4.4% this past week breaking a string of 4 consecutive weeks to the downside. NG extended its withdrawals losing 127 Bcf this past week falling to 2,400 Bcf in storage. Still the withdrawal was 13 Bcf below the 5 year average and 28 Bcf smaller than the previous year. The withdrawal came about despite warmer weather. In March the build period for NG usually gets underway.

NG prices found support at the 40 week MA and the 200 day MA. There is resistance at $3.40 but a breakout above that level could see NG prices rise to $3.60. On the other hand this rebound could be short lived and a break under $3.15 could send NG prices tumbling down as low as $2.70. Interim support is at $3 and $2.80.

Despite the weakness in oil prices this past week the energy stocks held in. The AMEX Oil & Gas Index fell a small 0.1% and the TSX Energy Index (TEN) was up 0.4%. The XOI still appears as if it has broken out a huge triangle pattern that has potential objectives up to 1,750. The XOI has support down to 1,300 but below that a decline to 1,250 and even 1,200 is possible. The TEN continues to form what appears as a bottom pattern. The up week helped. The TEN breaks out above 260 and especially above 280. Potential objectives are up to 340. The TEN has support at 250 but below that a decline to 240 is possible.

Oil prices have fallen back this past week stalling the advance that appeared to be getting underway. There is potential for a decline to $89/$90. Regaining above $95 is positive. New highs would be seen above $98.

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DEFINITIONS OF TERMS

Intermediate-term trend (weekly trend): Of interest to conservative long term investors. As long as the intermediate trend is up, conservative long term investors can continue to hold. But watch the short-term trend for possible trend changes coming.

Short-term trend (daily trend): Of interest to more aggressive investors and traders. When the short term trend turns up more aggressive investors and traders may wish to go long. Note though that all strategy signals are based on the intermediate trend only.

Strategy:

Buy: All buy signals relate solely to the intermediate trend. A buy signal is issued when the intermediate trend turns up.

Sell: All sell signals relate solely to the intermediate trend. A sell signal is issued when the intermediate trend turns down.

Stand aside: intermediate strategy is in stand aside mode following a sell signal.

Long or long hold: intermediate trend is up following a buy signal and investors can continue to remain long.

Long or long hold – topping or caution: short term indicators are diverging negatively and there are other indicators indicating to us that the market may be topping out. Confirmation will only come when the intermediate trend turns down and issues a sell signal.

Stand aside - bottoming: short term indicators are diverging positively and there are other indicators indicating to us that the market may be about to change from stand aside to buy. Confirmation will only come when the intermediate trend turns up and issues a buy signal.

Stand aside – accumulate: similar to stand aside – bottoming above except investors may wish to consider accumulating. Confirmation will only come when the intermediate trend turns up and issues a buy.

(New highs, new lows): market or index is making new highs or new lows.

Trend Signals:

Up – Trend is up.

Down – Trend is down.

Neutral – Trend has entered a transition phase before either resuming the current trend or changing trend. This is a caution zone and signals that a trend change may be in the offing.

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