TECHNICAL SCOOP
CHART OF THE WEEK

Charts and commentary by David Chapman
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26 Wellington Street East, Suite 900, Toronto, Ontario, M5E 1S2
phone (416) 604-0533 or (toll free) 1-866-269-7773, fax (416) 604-0557

david@davidchapman.com
dchapman@mgisecurities.com
www.davidchapman.com

The Bullhorn

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

I confess. This was a new one on me. I had never heard of a "Bullhorn" pattern. I saw it mentioned first in a weekly article from a gentleman who writes under the moniker of "Thirdeyeopentrades". "Thirdeyeopentrades" appears to be someone by the name of Robert Cote although I have been unable to find a website. As to the "Bullhorn" pattern, I have not been able to find such a technical pattern in any of the books on "Technical Analysis" that I own nor was I able to find it via "Google".

This is not to diminish what appears to be a potentially powerful bull pattern. There is a pattern known as the "Megaphone" pattern or broadening top. It is a rare pattern. The Dow Jones Industrials (DJI) appears to be forming a "Megaphone" pattern. However, what appears as a top can also be a huge five point consolidation pattern. Later on in this article, I will show the DJI "Megaphone" pattern.

First the "Bullhorn" pattern. I don't know whether this might qualify as a new technical pattern but it certainly is potentially compelling. This is a logarithmic chart so I do note it only appears on a log chart. Both gold and silver are exhibiting a bullhorn pattern. I have labeled it according to cycles described by the Aden Sisters www.adenforecast.com. Mary Ann and Pamela Aden write a monthly investment letter known as "The Aden Forecast".

The Aden gold cycles can be described as follows. It was also described in the August 2013 "Thirdeyeopentrades" newsletter.

- An A wave rise.
- A B wave decline that could retrace a Fibonacci 38-50% of the A wave rise.
- A C wave rise that is the longest of the up moves.
- A D wave decline that could be a strong decline but ultimately holds above the previous B wave decline.

If the cycle is correct then the A wave rise could take gold up to that downtrend line from the September 2011 top. That line is currently near $1,680. This would not be dissimilar to what happened in 2008-2009 that after gold bottomed at $681 it rose until March 2009 to $1,005, which was close to the March 2008 high of $1,014. Gold then consolidated for a number of months (the B wave decline) before it began its C wave ascent. The A wave rise was 47.5% off the previous D wave decline. A similar rise this time could in theory take gold to almost $1,750. However, the downtrend line from the September 2011 top appears to be more likely. At that point, Gold could consolidate forming what might be a large head and shoulders bottom.

If a large H&S bottom formed on gold then once it broke through the downtrend line from the September 2011 top the potential objective could be up to $2,400. In looking at the expanding "bullhorn", the top of the C wave could potentially go over $3,000.

So how long could it take to play the next A, B, C, D cycle out? Since a possible D wave bottom in February 2001, there have been 4 cycles. These 4 cycles measured from the previous D wave bottom to the next C wave top have been respectively approximately 2 years, 3 years, 2 years and 3 years. So could the next C wave top be seen within 2 years or sometime in 2015? What should follow is a nasty D wave decline. I confess I didn't see this last nasty D wave decline coming but I will be ready for the next one and hopefully we can all benefit from the next C wave rise.

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Silver is exhibiting a similar pattern. The A wave rise could take us potentially up to trendline currently near $35. At that point, the B wave consolidation could take place. This could also form a potential head and shoulders bottom pattern. Once the pattern broke to the upside, potential objectives for silver could be as high as $53. If silver were to go to the top of its expanding "bullhorn" in theory the C wave rise for silver could rise to over $100. This is not as improbable as it sounds. If silver were to reach the inflation-adjusted top of January 1980 of $50 silver would today have to reach almost $140. Gold's inflation adjusted high of $850 in 1980 is today near $2,400.

The DJI is exhibiting what might be a rare "Megaphone" pattern or broadening top. The "Megaphone" pattern is a series of higher highs and lower lows. This is the opposite of a symmetrical triangle that makes a series of lower highs and higher lows. If it is a top pattern as many technical analysts purport then when the pattern completes it falls through the bottom of trendline connecting the lower lows. The thought of the DJI falling below 6,000 and objectives down to…well…let's just say zero isn't enough.

Since zero is highly unlikely (but 6,000 is not impossible) then more likely the "Megaphone" pattern could like a symmetrical triangle be a huge consolidation pattern. This suggests that once this D wave is complete the DJI could fall in an E wave decline to the 6,000 zone and the bottom of the "Megaphone". Once that low is in then the DJI could embark on its next bull market to the upside. This could take one or two years to play out depending on when the top occurs. Cycles indicate that there is the potential for an important long-term cyclical low around 2016. The DJI still has room to move higher within the current "Megaphone" pattern.

The DJI chart is below.

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Bonds are exhibiting a different pattern. Bonds as measured here by the CBOE 10 year Treasury note have broken out of what appears to be a head and shoulders bottom pattern. The pattern has minimum potential objectives up to 3.18%. The 10-year Treasury note is already up to 2.81% so it may not have much further to go. One reason that the Fed may have to continue its bond purchase program known as QE is that China in particular and even Japan are trying to get out of their huge holdings of US Treasuries. Someone has to buy them and at the end of the day, the Fed is the buyer of last resort.

Can the Fed afford to "taper"? The answer here says no. Why? Because the stock market would fall and bond yields would rise further. That is not what the Fed wants. Rising interest rates are already a cause for concern in the bond market particularly the huge interest rate swap market that dwarfs the bond market in size. There are rumours of hedge funds and banks being stressed by the current rise in interest rates. Clever accounting has allowed the large money center banks in the US (and Europe) to cover up the bad debt on their books.

As well, the large international banks are being required to raise their capital levels to comply with new Bank for International Settlement (BIS) regulations. That means either getting rid of assets or raising more capital. The international banks remain under a lot of pressure with fragile balance sheets. Since the financial crisis of 2008, the banks have continued to delay or obfuscate the problems that caused the financial collapse in the first place.

Finally, one has to be concerned about the Fed itself. The Fed only has $55 billion in capital. Against that they hold about $3.6 trillion in US Treasury bills, notes and bonds, and, mortgage backed securities. With interest rates rising it wouldn't take a large rise to effectively wipe out the Fed's capital. The Fed cannot exit its position in bonds. Who are they going to sell to? All they can do is continue to expand their balance sheet (and the monetary base) by continuing to buy securities from the financial institutions who themselves have stressed balance sheets.

Since the financial crisis of 2008 there has been QE1, QE2, operation twist and QE3 (although some say there has also been QE4). Each round of QE has been in response to drop in the stock market. Now the Fed has a stock market that could fall as well as bond prices currently falling which in turn could nip any economic recovery in the bud.

Taper? Not likely. Meanwhile gold and silver could be in the early throes of their next strong move to the upside. Does gold smell a crisis in the making?

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