New High - New Low Price Divergence Taking Place Flashing A Warning Signal?

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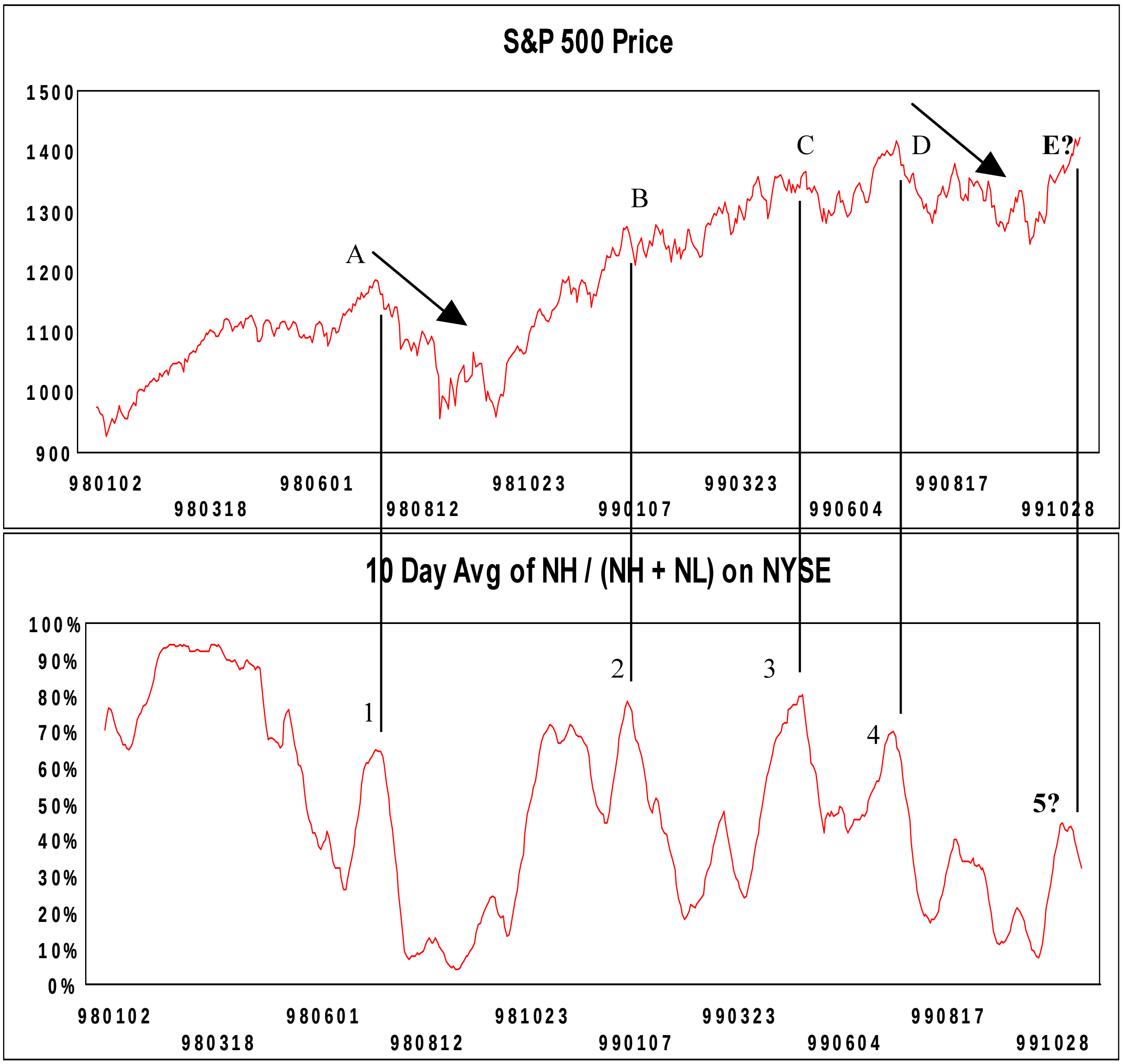

WHAT IS THE NEW-HIGH NEW LOW RELATIONSHIP?

One of the many timing indicators we use at Signalert Corporation (publisher of Systems and Forecasts) is the 10 Day average of New 52 Weeks Highs divided by the Sum of 52 Week Highs and Lows on the New York Stock Exchange. While this indicator can be used as a timing model by itself (to measure oversold and overbought conditions - using 30% and 70% as key buy and sell ratios) we also use it as a reflection of the internal components of the stock market. If the numbers of issues making new highs diminishes as the indices make new highs, then we know that fewer and fewer stocks are participating in the rally. This is referred to as a "negative new highs divergence".

INTERPRETATION

When popular stock market indices (in this example, the S&P 500) reaches new peaks, we like to see confirmation that the new high - new low relationship is making a relative new high as well. When this fails to happen, it is a signal that the market advance may be narrow, increasing risks of serious market declines.

Please look at point "A' in the preceding chart; the S&P 500 made a new high in the early summer 1998 but the New High - New Low relationship did not equal the levels it reached in March of 1998 (Point #1). Subsequently, the S&P 500 corrected over 10% during the Fall of 1998. At point "B", during early winter 1999, the S&P 500 made a new high in price which was confirmed at point 2 in the New High -New Low chart. Subsequent pullbacks were relatively minor, before the market's advance to Point "C", which again was confirmed at Point 3 by a new high in the New High - New Low ratio. We look at these two points as successful confirmations, and the market responded with forays into new high territory.

At Point "D", the S&P 500 made a new high (Summer 1999) but the New High -New Low ratio failed to confirm (Point #4). Just like the previous failure in August 1998, the New High - New Low divergence led to a broad market decline; about 10% again.

Point "E" represents the present - the S&P 500 making a new high recently. Now take a look at Point 5 on the bottom half of your chart - not only is the New High - New Low ratio failing to confirm; it is also at its lowest reading compared with the last four occasions when all time highs were reached by the S&P 500.

CONCLUSION

While this indicator (like all indicators) is not foolproof; this chart has shown that divergences between S&P 500 price and New High - New Low Ratios in the past several years have led to near term market weakness. Much of the last leg of this bull market has been quite narrow, with the large capitalization companies carrying the indices higher while breadth has been quite poor. Specifically, some of the largest technology companies (Microsoft, Intel, Cisco, Sun Microsystems, etc.) which are major components of both the capitalization weighted S&P 500 as well as the Nasdaq Composite, have risen by enourmous amounts, while many of the mid and small cap companies are down for the year. This chart reflects some of that narrowness; whether a market decline is looming in our future remains to be seen.