THE
HARLEY
MARKET LETTER

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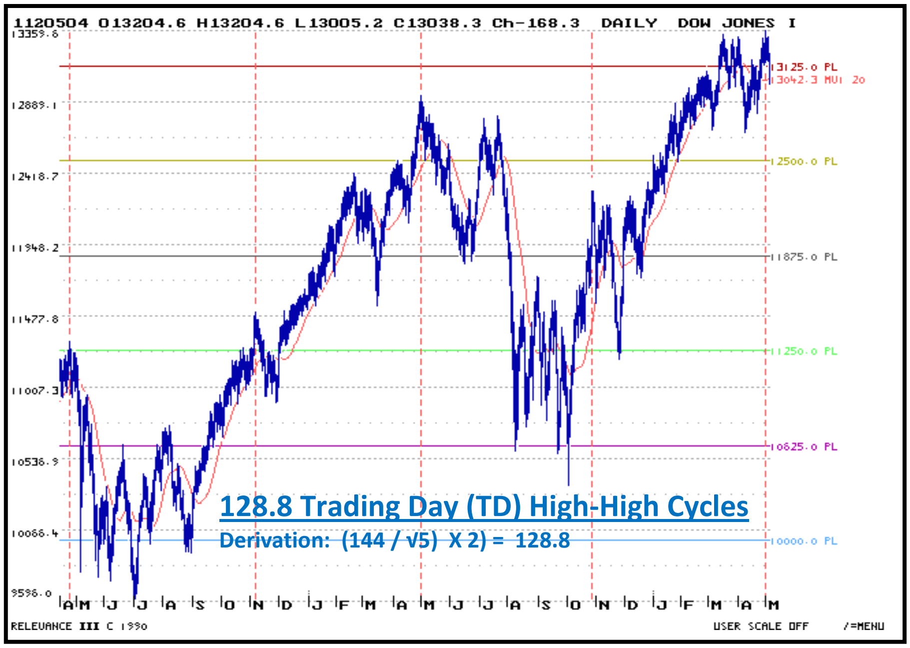

STOCK MARKET

Lower into Early June

A rolling high in the making: the New York Composite and Dow Jones Transports saw their high on March 19; the NASDAQ peaked out on March 27; the S&P 500 on April 02; and finally, the Dow Jones Industrials crested on May 01st of this week to complete the process. Rolling tops like this are always difficult to nail down. But the true "cycle high" is where the final index of the "Big 5" as I like to call them establishes its high for the move. The last index to peak out in an intermediate move more-often-than-not is the DJIA. Following the May 01, 2012 cycle high, I'm looking for a short – but sharp – intermediate decline into early June.

The Dow chart above depicts a cycle I've shown before that averages 128.8 trading days (TDs). The Dow high on May 1st coincided with the latest occurrence in this cyclical rhythm. I note, too, the clustering of Fibonacci counts on the monthly NASDAQ chart. Fibonacci sequences of 144, 55, 34, and 21 months from past important highs and lows when carried forward all line up with the latest high. In putting it all together, it would appear that an intermediate stock market high has just been completed. Not a bull market killer – but a high from which I'm expecting a serious selloff to occur between now and the June 04/05, 2012 time period. To profit in this move, investors may wish to consider those broad market vehicles designed to appreciate in a declining market. I particularly like those inverse ETFs that create a synthetic short on the Dow, the S&P, the NASDAQ, and the Russell 2000 (e.g., DOG, SH, QID, TWM).

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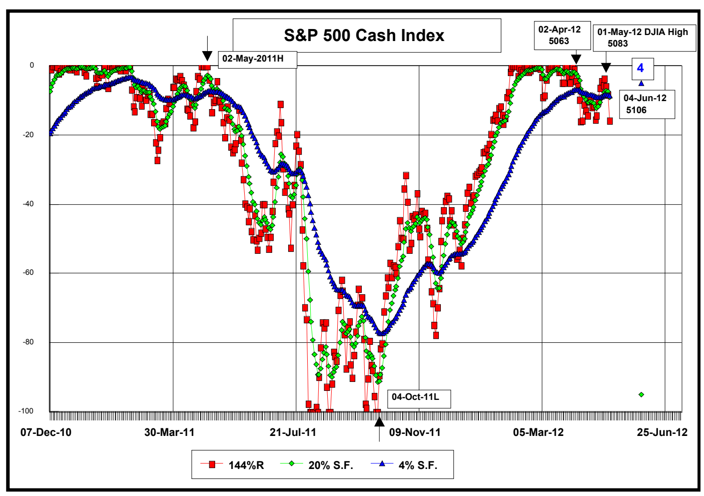
Fibonacci-Derived Market Cycles

39.8 = (89 / √5)	**128.8** = (64.4 * 2)	**238.8** = (39.8 * 6)
64.4 = (144 / √5)	**159.2** = (39.8 * 4)	**272.8** = (610 / √5)
79.6 = (39.8 * 2)	**168.6** = (377 / √5)	**337.2** = (168.6 * 2)
104.2 = (233 / √5)	**208.4** = (104.2 * 2)	**441.4** = (987 / √5)

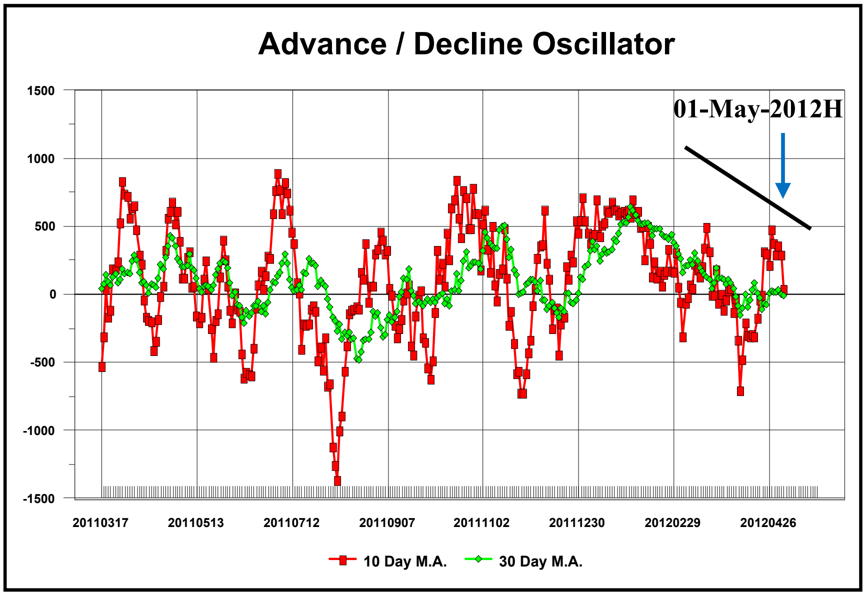
Cyclical Analysis

I have found that the vast majority of cyclical functions in the markets can be defined by dividing the Fibonacci numbers 89, 144, 233, 377, 610, 987, etc. by the square root of five. In the tabular listing at the top of the page, I have noted what I have found to be the dominant time counts representing cyclical functions across all time frames. I have observed these same numbers on monthly, weekly, daily, hourly – even one-minute – charts in all markets. There seems to be a universal constant at work here.

On the daily chart of the S&P 500 above I have shown a 0.382 – 0.236 – 0.382 fibonacci relationship pointing to a turning point in the June 04/05, 2012 time period. The pattern and indicator structure would appear to suggest we should be anticipating an important cycle low in the first week of June. A low in the June 04/05 time period would occur approximately 441.4 trading days from the 31-Aug-10 low (the most-recent 377 trading day / 78 week cycle bottom).

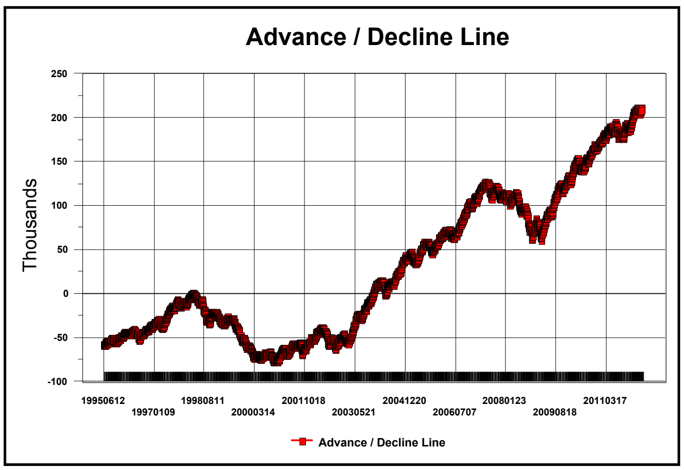


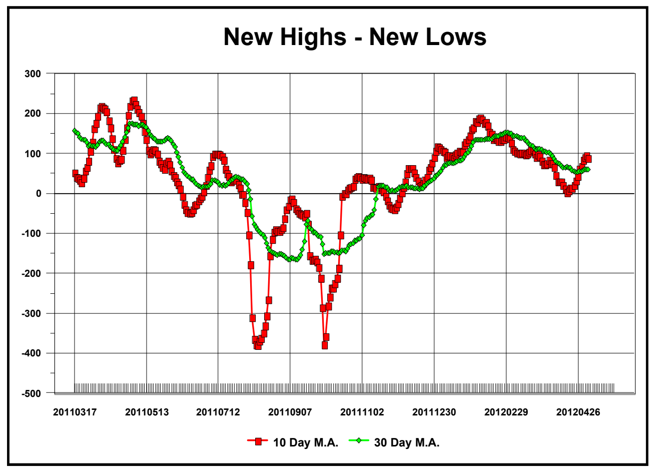
My 144 day percentage range indicator reflected a divergent structure at the 02-Apr / 01-May highs. In order to get this indicator back down into historical "oversold" territory will require some serious selling pressure over the next four weeks. "Sell in May and Go Away" might well pan-out again this year.



Market Internals

At left I show my 10 day / 30 day Advance/Decline Oscillator. The computation for this indicator is derived by keeping a tabular listing of each day's net difference between advancing issues and declining issues on the New York Stock Exchange. I smooth the raw data with both a ten day and 30 day moving average. This Advance/Decline Oscillator is useful for assessing the market's relative degree of overbought/oversold. I would expect my A/D oscillator to see its 10 day and 30 day components at least down in the -800 level at my expected June 04/05 cycle low. The 10 day component – being the more-volatile of the two – may get down close to the -1000 level at the June bottom.





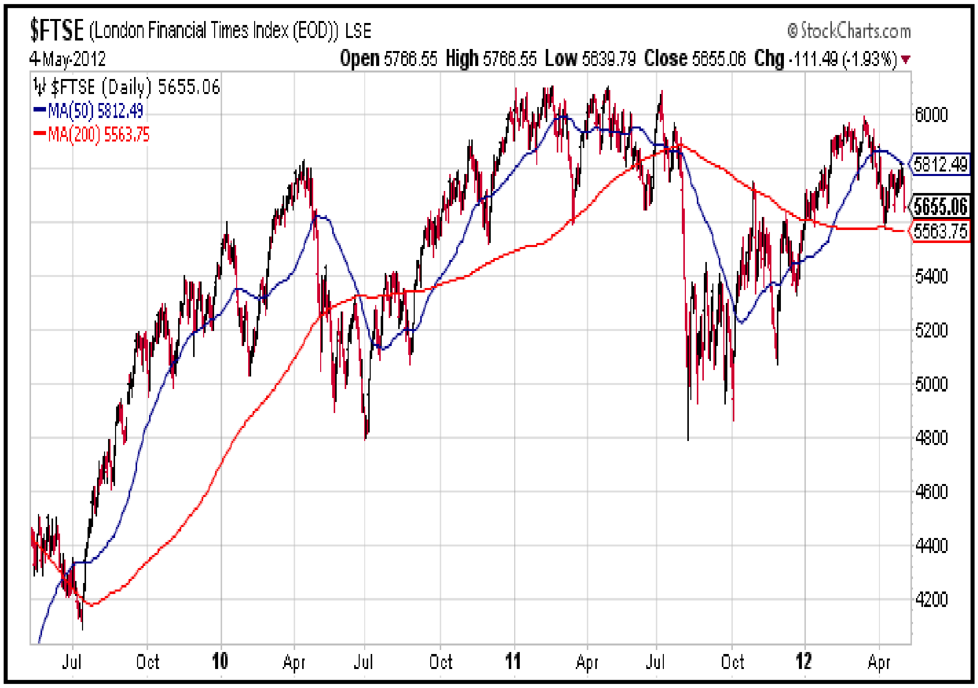
The NYSE Advance/Decline Line is computed by maintaining a running total of each day's net difference between advances and declines. Often – but not always – this indicator divergences from price at important tops and bottoms. The A/D Line has just come off a record, all-time high.

I have a plethora of cycles and Fibonacci relationships clustering in the June 04/05, 2012 time period that I believe will mark the low point in this down move just now getting underway. On the S&P 500 chart at left I show a cycle I have found that averages 164.5 trading days (TDs). It has not missed a beat since its July 18, 2006 Genesis Point. I have placed my computer cursor at the June 4th point on the chart. The red ellipse denotes that date with a 0.382 fibonacci retracement – my minimum expectation for the pending decline.

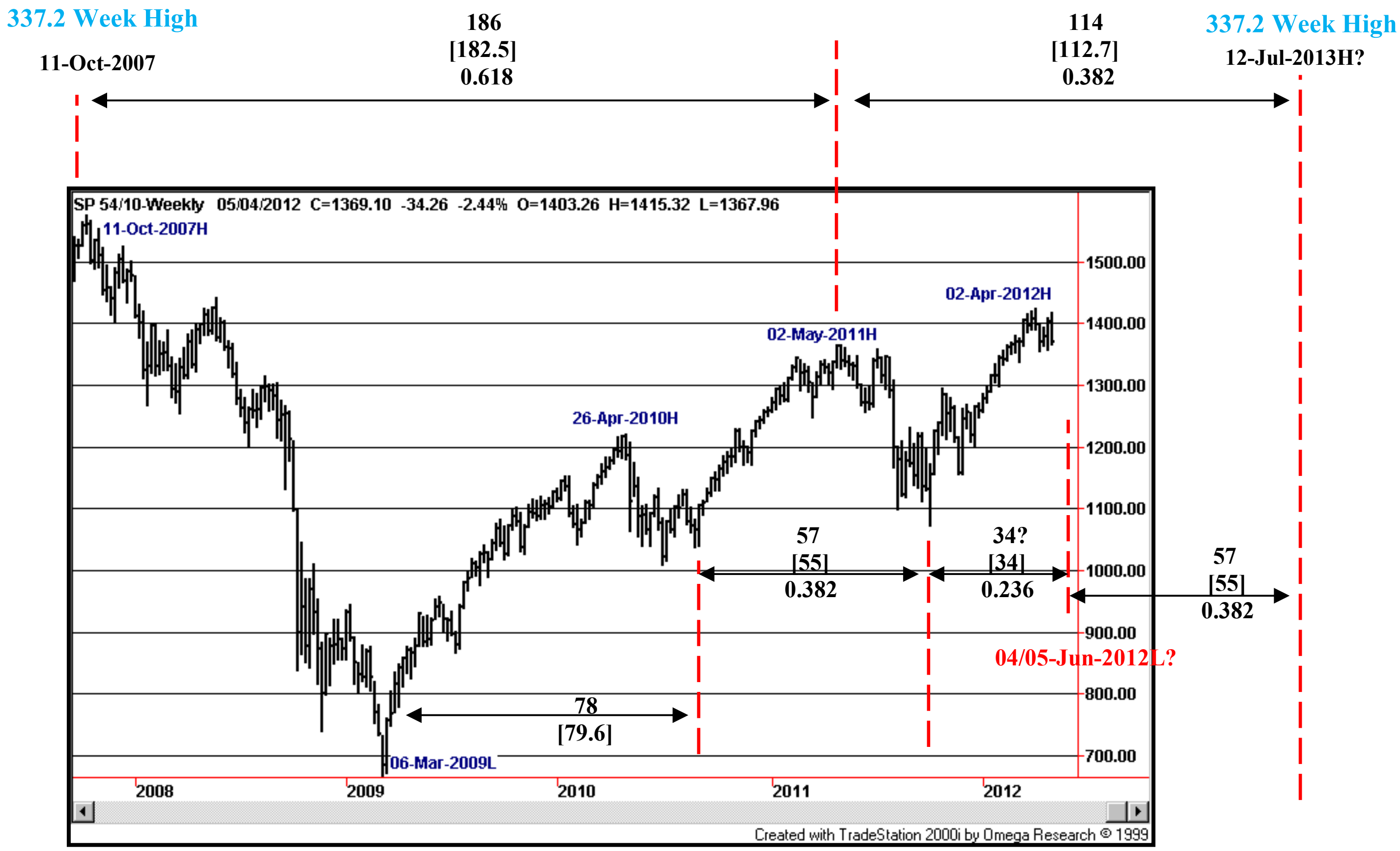
European Indices

I watch the European indices very closely for signs of confirmation or divergence with respect to our markets on this side of the pond. The United Kingdom FTSE-100, French CAC-40, German DAX, and Russian RTSI tend to follow the patterns in our markets very closely. But when divergences occur, it pays to take notice.

As can be seen, the major European indices all topped-out in February-May of 2011 – over one year ago. Indeed, the divergent action present in the European indices is beginning to become more problematic. With the Dow, S&P, and NASDAQ having just scored new recovery highs, none of the European indices has confirmed the move. Note the extreme weakness in the CAC-40.



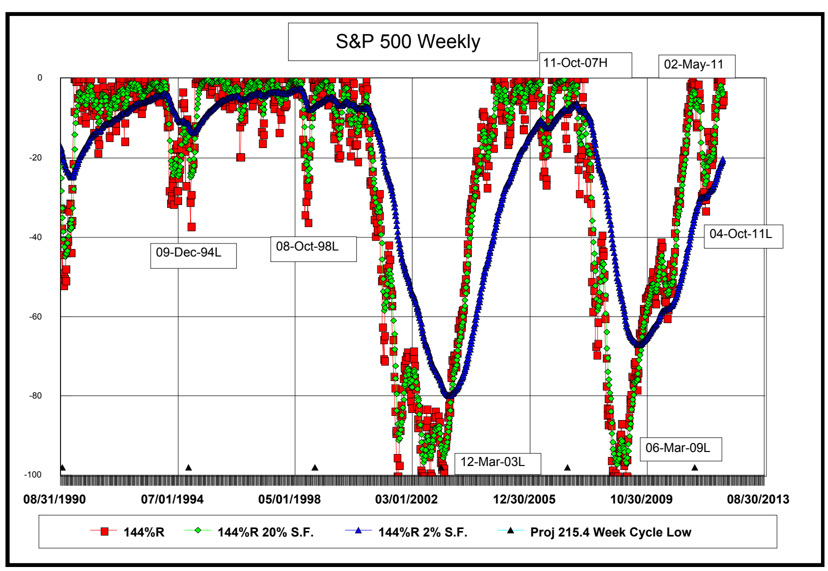
The one index that I pay the closest attention to is the United Kingdom FTSE-100. Although not as weak as the CAC, the FTSE – like the DAX and the RTSI – is trading below its 50 day moving average (shown in blue). The FTSE recently bounced off its 200 day moving average but with the cyclical winds coming out of the north, I would expect the downside pressures to push the FTSE back down into the lower end of the August 2011 – March 2012 range. While the U.S. stock indices are at risk down to their October highs of last year, the FTSE is already there.



Long-Term Cycles

Readers of *Technical Analysis of Stocks and Commodities* magazine may have seen the interview of me in the recent April 2012 edition. In that interview, I discussed a 337.2 week cycle in the stock market that has consistently defined all of the important highs going back to the October 1974 bottom. I also discussed this cycle in the March 27, 2012 issue of this market letter.

This 337.2 week cycle has defined all of the major peaks in the market over the course of the last 37 years. Its roots – like nearly all market cycles – are grounded in Fibonacci numerology: [(377 / √5) * 2 = 337.2]. This last occurrence in this cycle marked the October 2007 highs. Should the pattern continue, we should look to the July 12, 2013 time period for its next occurrence. On the weekly chart of the S&P 500 above, I have depicted the weekly time counts and Fibonacci ratios that line up with that date. I examined the time period between the October 2007 high and the May 2011 high and found an interesting 0.618 / 0.382 fibonacci ratio in that high-to-high sequence. Just as interesting, I found a nearly-perfect Fibonacci count across the pattern of lows (assuming a June 04/05, 2012 low) that would also point to the July 2013 time period for a bull market top in the move now underway from March 2009. A move down from July 2013 into November 2015 should then be expected for the next "four-year" cycle trough.

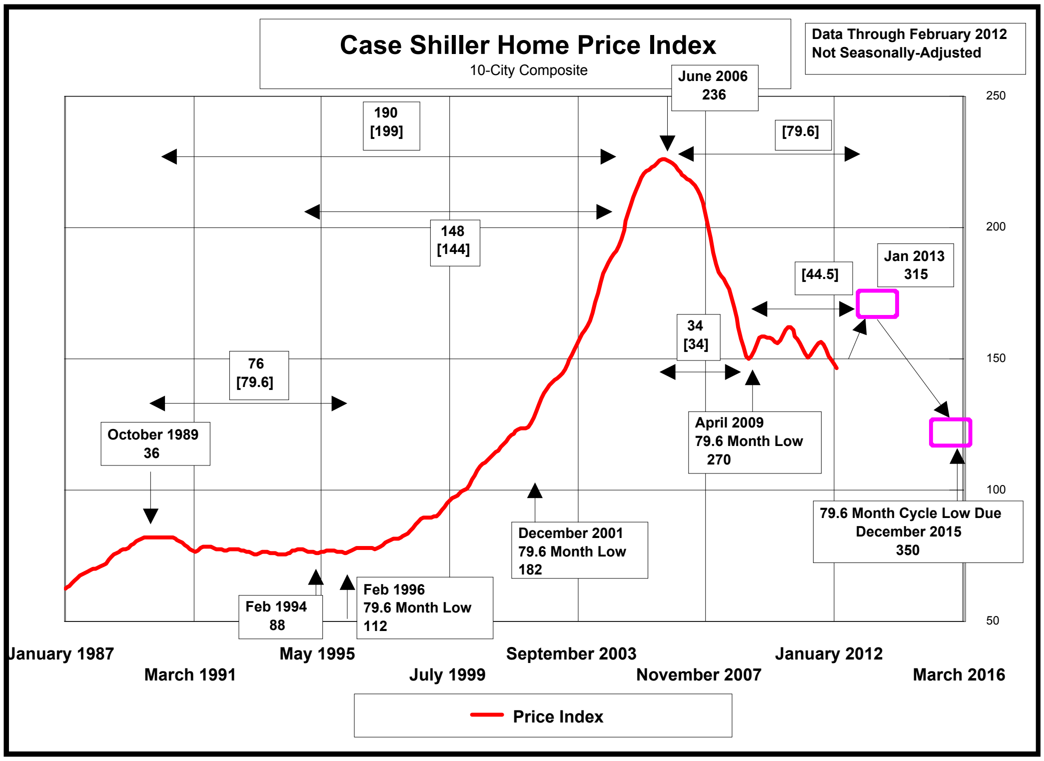


S&P / Case-Shiller Home Price Index

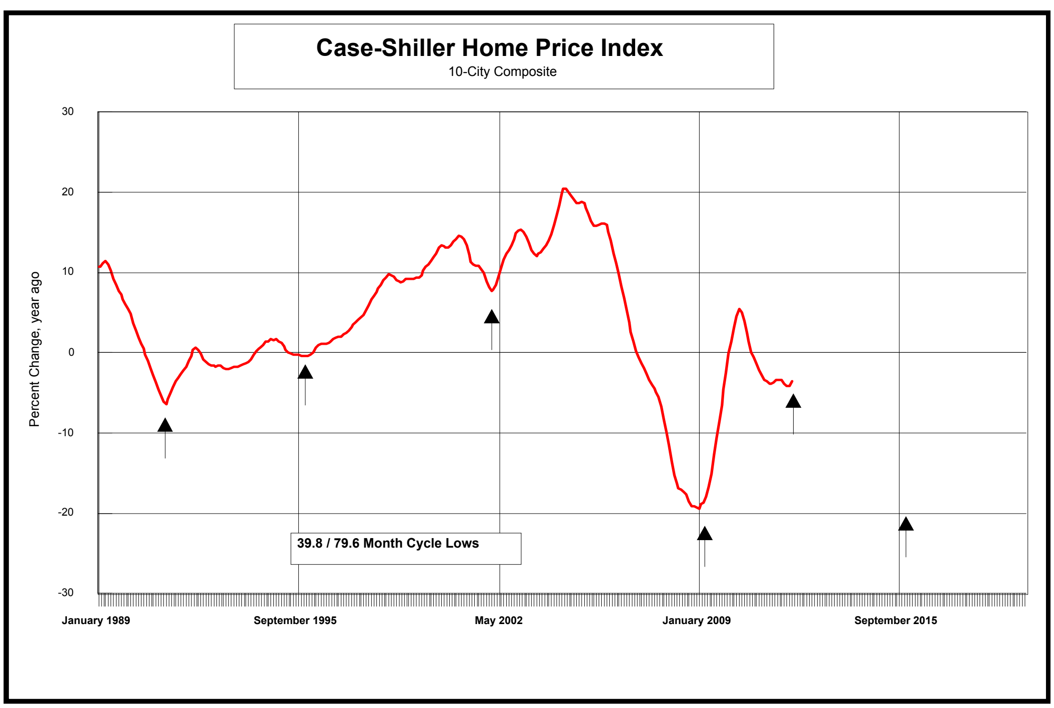
Most of us have a great deal of interest in the trends for the housing market. Standard and Poor's publishes data for the Case Schiller Home Price Index. The Case-Shiller home price index, compiled by Standard & Poor's and usually referred to as the S.&P./Case-Shiller index, tracks the value of residential real estate in 20 metropolitan regions across the United States. There are multiple Case-Shiller home price indices: A national home price index, a 20-city composite index, a 10-city composite index, and twenty individual metro area indices.

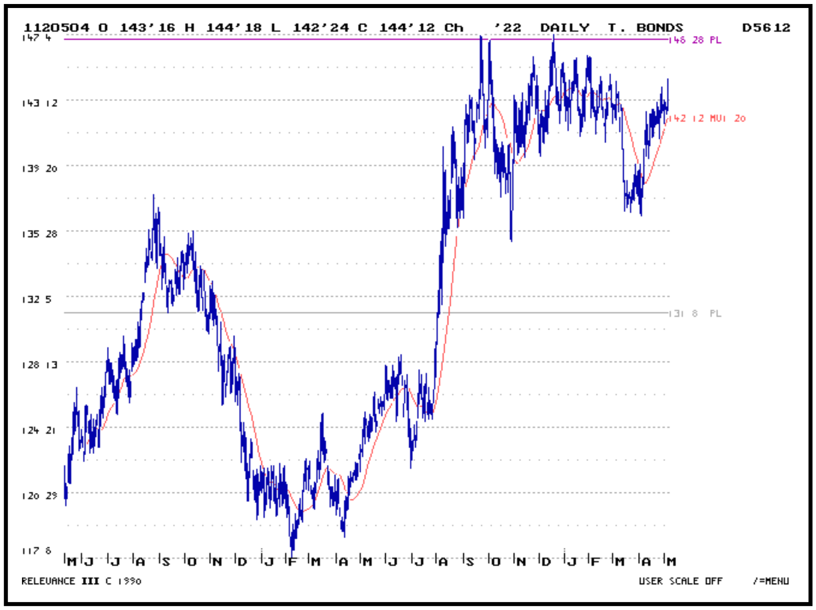
The methodology, developed by Karl E. Case, an economics professor at Wellesley College, and Robert J. Shiller, an economics professor at Yale, collects data monthly on sales of existing single-family houses. The index is published on the last Tuesday of each month, with a two-month lag.

The data is published in both graphical as well as digital form – meaning one can get the raw data and dump it into a spreadsheet for analysis – which I have done. On this page are two charts. The graph at the top of the page depicts the raw data of the index from 1987 through the present.



The chart below contains the same data plotted in a slightly different format reflecting year-over-year change – it represents, in effect, a 12-month rate of change or price velocity from which I have been able to extract the evidence of a 79.6 month cycle. A pairing of 79.6 month cycles equates to 159.2 months – about 13.3 years. This 13.3 year trough-trough sequence is quite evident in the data going back well into the 1800s for home prices in the U.S. The 10-City Composite just ticked down to below the April 2009 level. On my roadmap above, I show that the trend remains down into late 2015.

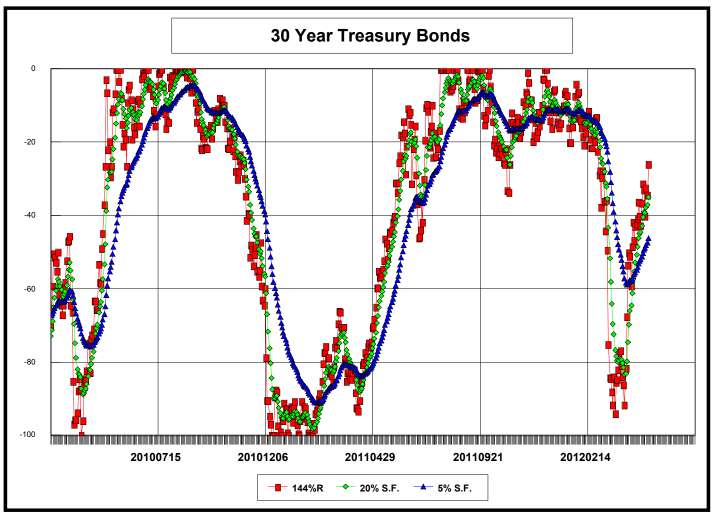


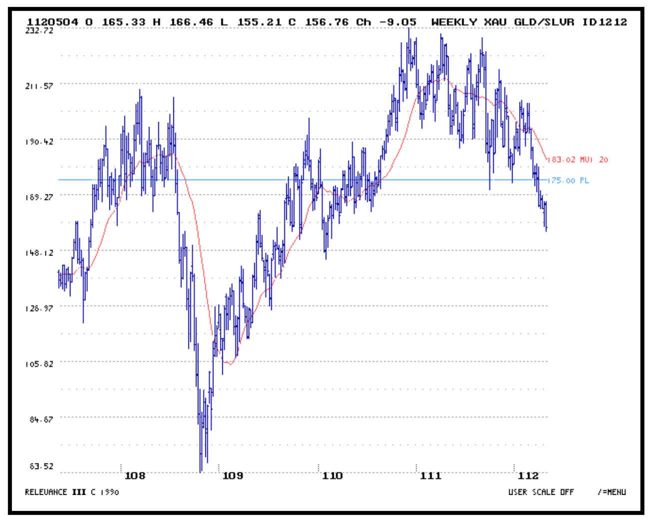


BONDS

Poised to Make All Time Highs

Bond prices have essentially traded sideways over the course of the last seven months. With the stock market now on the verge of falling out of bed, I look for a very robust rally in the bond market from present levels. I would expect to see new, all time highs in the bonds. The 30 year – chart at left – will probably break out above the 146 20/32nd line I have drawn. My time target for the rally high in this move coincides with my time target for the low in stocks: June 04/05, 2012. My 144 day percent range indicator has turned up in concert with the rising price. With just under 20 trading days remaining in this move I am expecting, I would not anticipate this indicator to rise much above the -20 level. I would expect to see some kind of divergent structure develop at the expected early June high.





PRECIOUS METALS

A slowly evolving top in this sector to be sure: first platinum, then silver, then the XAU, then gold. It remains my view that the precious metals complex has completed a major bull market top. The last bear market in the metals spanned the 1980–2001 time period – right at a Fibonacci 21 years. I would expect the current bear market – now in its infancy – to span a similar period of time. Over the course of the last six months, gold has traded between 1,600 and 1,800. The 1,500 line basis Comex Gold is my next major price octave below where we are now. I believe that's where this market is heading. The chart of the XAU Gold and Silver Index depicts an index that is weak and getting weaker. The 175 line has been decisively broken to the downside. My near-term target for the XAU is the 150 level – we are almost there.