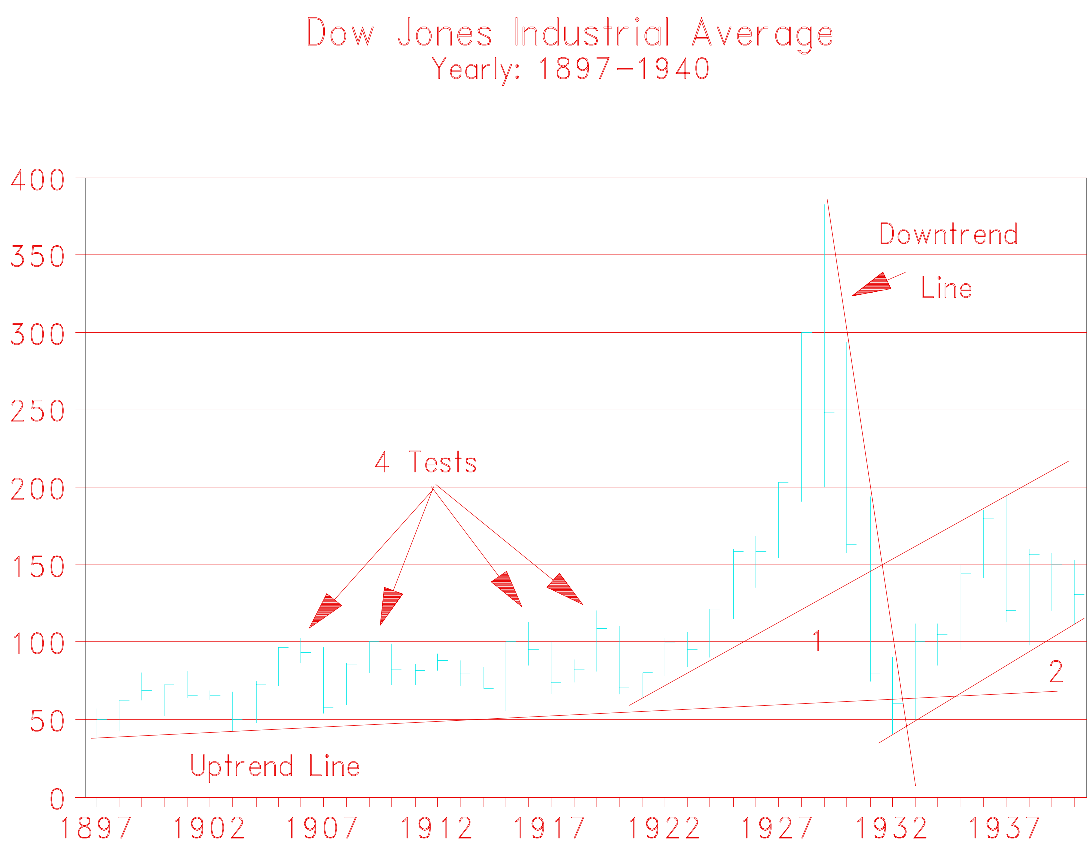


A technical review of the trading patterns of the Dow Jones Industrials prior to 1940 reveals several interesting notes which should be remembered. The chart above covers the yearly activity between 1897 and 1940. This chart provides a few technical patterns which are not only interesting, but also vital to a technician's perspective. The patterns take place in various commodities, interest rates and whatever involves human emotion and interaction. If it is something that can be charted, then these aspects will apply.

I have drawn on this chart two simple standard technical lines. The first is labeled the Uptrend Line and its construction was accomplished by tying together the two extreme low points on this chart. These points were the price lows of 1897 and 1903. We can see that from there onward the general activity of the market held above this technical support area. The panics of 1907 and the panic sell off of early 1915 both managed to support above this line. You will note that it was not until 1932 when this technical support line was violated.

Quite often, many students of technical analysis view a break of the Uptrend Line to be something indicating extreme bearishness. In fact nothing can be further from the truth. Normally major lows in a market take place when the long-term Uptrend Line is violated. The major low quite often lies somewhere just below. Look at the price action which took place in 1933. You will notice that 1933 opened below the Uptrend Line, but it managed to penetrate it on the upward movement that followed during the inflationary expectations under Roosevelt.

If a break of the Uptrend Line is indeed the sign that the market will continue sharply lower, then a subsequent rally must move back up to test the Uptrend Line, and then fail to exceed it. In other words, it will bounce off the Uptrend Line and then if it drops below the previous low, then the market is in real trouble. But when a major low is forming, the Uptrend Line is normally penetrated and then the subsequent rally gets back above the Uptrend Line as was the case in 1933.

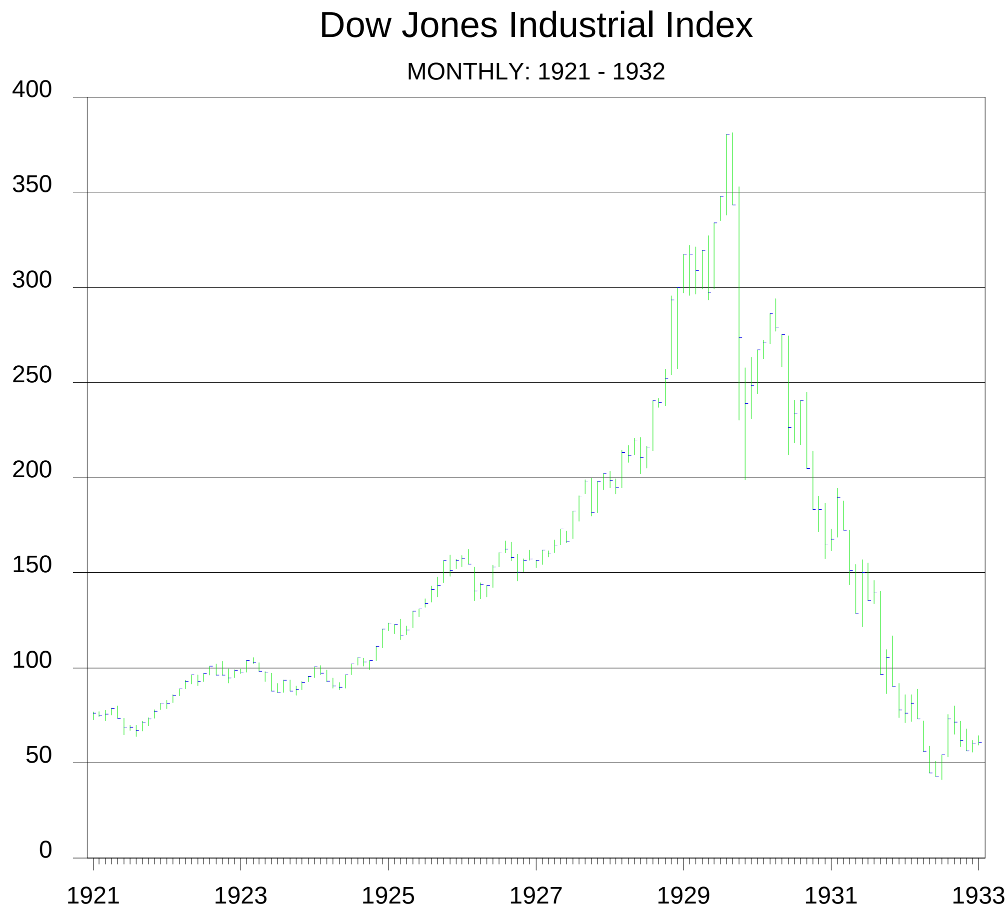
To help illustrate this normal technical reaction, I have drawn two additional Uptrend Lines marked # 1 and # 2. Line # 1 was constructed by tying the lows of 1921 and 1924 together. Here you will notice that during 1931, the market penetrated this Uptrend Line and there was no rally back to even attempt to test it on a yearly level. This is the indication of a very bearish atmosphere. Obviously, the market continued to collapse into 1932. But take special note of the rally which came about into a peak during 1937. Note that the high of 1937 stopped dead, bouncing off of this Uptrend Line # 1. This is the type of pattern which indicates that the market has merely made a reaction and that a further resumption of the downtrend will unfold. Indeed, the market fell back to Uptrend Line # 2, which was constructed by tying together the lows established during 1932 and 1933. Had this Uptrend Line # 2 been broken and a test or rally back up to it bounced off as was the case at the 1937 high, then perhaps we would have dropped back to test the 1932 low once again. But the market held the Uptrend Line # 2 and subsequently a consolidation phase developed to bring about a renewed uptrend into the years ahead.

Another important factor about this chart is the use of the Downtrend Line. This line is constructed by tying together the highs made during 1929 and 1930. Just as the market remained above the major Uptrend Line from 1897 all the way into the 1929 high, indicating that an uptrend was still in motion. But note that the market remained below the Downtrend Line during 1930, 1931 and 1932, indicating that a downtrend was still in motion as well.

The importance of this downtrend line is perhaps even greater in the determination of whether or not a major low is in place. Note that during 1933, even though the market opened below the Uptrend Line, it opened above the Downtrend Line. These two lines therefore served a purpose of focusing our attention on a major junction within market activity. Note that the 1933 price low actually bounced off the Downtrend Line. Again, just as the 1937 high bounced off the Uptrend Line # 1 indicating that "resistance" had been encountered, the market bounced off the Downtrend Line indicating that "support" had been encountered in 1933.

This is the value of technical analysis. We have reviewed the countless fundamentals which were a part of the day-to-day situation through the 1921 period up to 1940 thus far. Trying to determine where the market was headed based upon fundamental assessment of the events surrounding the market was not always a clear-cut case. Confusion was prevalent and we read how most analysts had remained bearish throughout the 1921 era up even into 1928. We read how when Jesse Livermore publicly stated that he was bullish, he was accused of trying to talk the market higher to help Coolidge get re-elected. Technical analysis smooths out all the bumps, ignoring these sorts of comments by providing pure unbiased guidance.

Although technical analysis can be applied to gold, cotton, wheat, interest rates or the retail sales of any company, each market or indicator does retain a certain uniqueness. Although the general princi-



ples of technical analysis may be applied to anything that can be charted, the actual patterns of a given market may not be the normal patterns in another.

Referring once again to the annual chart from 1897 to 1940, I have marked out four rallies prior to the major top in 1929. Part of the reason why many analysts were bearish in 1924 when chastising Livermore is the fact that the market had tested the 100 area four times before and subsequently failed by dropping at times as much as 50% in the aftermath. Because people had been burned four times before, they remained skeptical when the market began to approach that lofty 100 area in 1924.

Take note that four tests of that 100 area had taken place. Each high was slightly different from its predecessor, but each had been followed by a sharp collapse the year thereafter. Now let us look at the Monthly Chart # 1 covering the period of 1921 to 1932. Note that during the early stages, the market once again, on a monthly level, attempted to test the 100 level four times before successfully pushing through it in 1925. Whatever pattern you find on one level will also exist in all others. That means that the patterns on a yearly chart will be repeated within a monthly, weekly, daily or even intraday chart pattern. The general patterns are actually like a brainwave. Each person has his own distinctly different brainwave pattern and such is the case with markets themselves. The patterns that we are looking at here will be repeated during the 1960-1970 period when dealing with the 1,000 point level of the Dow. The classic four attempts apply to the stock market but not necessarily to gold, copper or bonds for that matter.

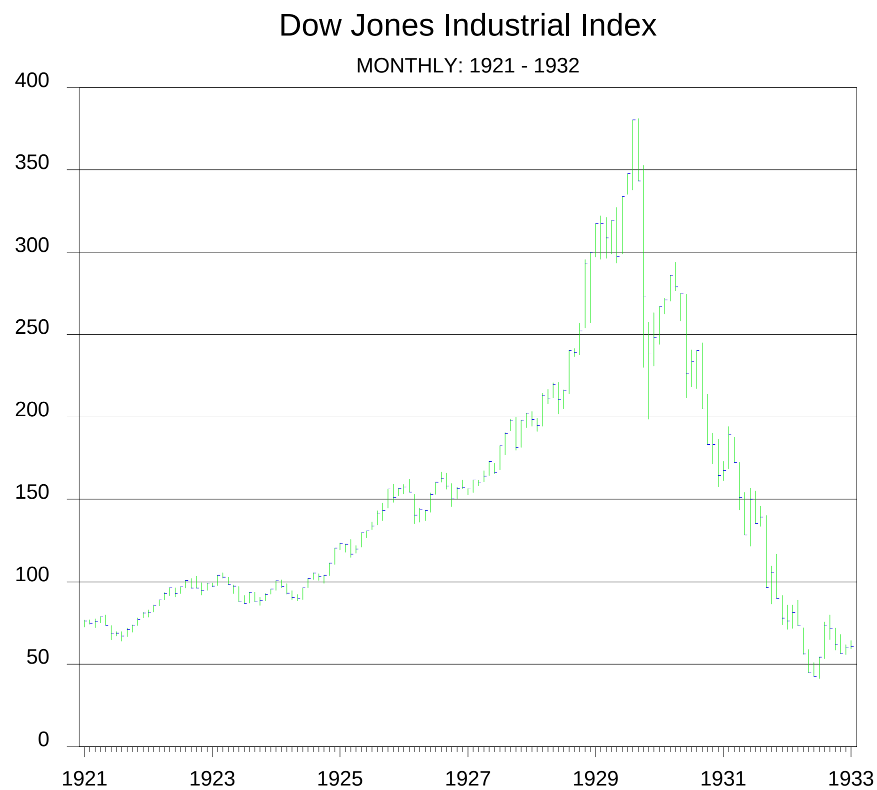
Let us look at the Uptrend Lines on this monthly chart. Here we can see that the major Uptrend Line was penetrated during 1931. On a monthly level the market rallied back to test it, but failed to close above it. Take note of the minor Uptrend Line marked # 1. Here the panic collapse of November 1929 punched through it, but failed to close back below it. That indicated that the market was ready for a consolidation phase before resuming any continued downtrend. But after the recovery of early 1930, the market turned downward again with a vengeance. It closed below the Uptrend Line # 1 and for the next two months it attempted to close back above it without success. That was the test which indicated that one had better be out of there from the long side.

You might be thinking that perhaps this is easy to talk about in hindsight, but that is not true. This same form of analysis applies to current trading activity and if you look for this type of testing pattern, you will find that it works every time. Once the previous low is penetrated, then you have the confirmation that the trend should press lower in the near future. Caution is advised when you arrive at a junction such as the case between the Downtrend Line and the Uptrend Line on the annual chart during 1933 as we reviewed earlier.

Now take note of the Downtrend Line. This line was the last Downtrend Line constructed by tying the 1929 high to the September 1931 high. You may ask what about the previous highs between these two points and why didn't I use those instead? The answer is that I did. But the market kept pushing through those Downtrend Lines periodically, but kept failing. This was the final Downtrend Line, and for right now this is the one we are concerned about. The others we will discuss shortly.

Note here that the market finally exceeded this Downtrend Line during the month of the major low in 1932. It also managed to close above it. Note that the pattern is one of a testing pattern in respect to this Downtrend Line. Exceeding the Downtrend Line intraday is not a major buy signal. But the pattern clearly displayed a tendency to continue higher rather than lower. Therefore, the market successfully accomplished a test of the Downtrend Line from the upside downward. That was the test which signaled that the market was coming to an end insofar as the downtrend was concerned. Most major downtrends come to an end by testing the final Downtrend Line taken from the major high.

Now let us try to answer that question about how do we know which points we should use to create the Downtrend Line. The Monthly Chart # 2 illustrates the first Downtrend Line. This line was constructed by taking the 1929 high to the 1930 recovery high. Looking at this chart we can see that the market remained below this Downtrend Line until the February rally of 1931. Everyone was quite bullish if you recall with many prominent people going on record saying that the depression and the downtrend had finally come to an end. But there was no follow-through during March of 1931 as the market fell back gravitating toward the 1930 lows. It was April of 1931 when the major Uptrend Line was broken slightly, but at month end the final bell had rung when the market lacked enough

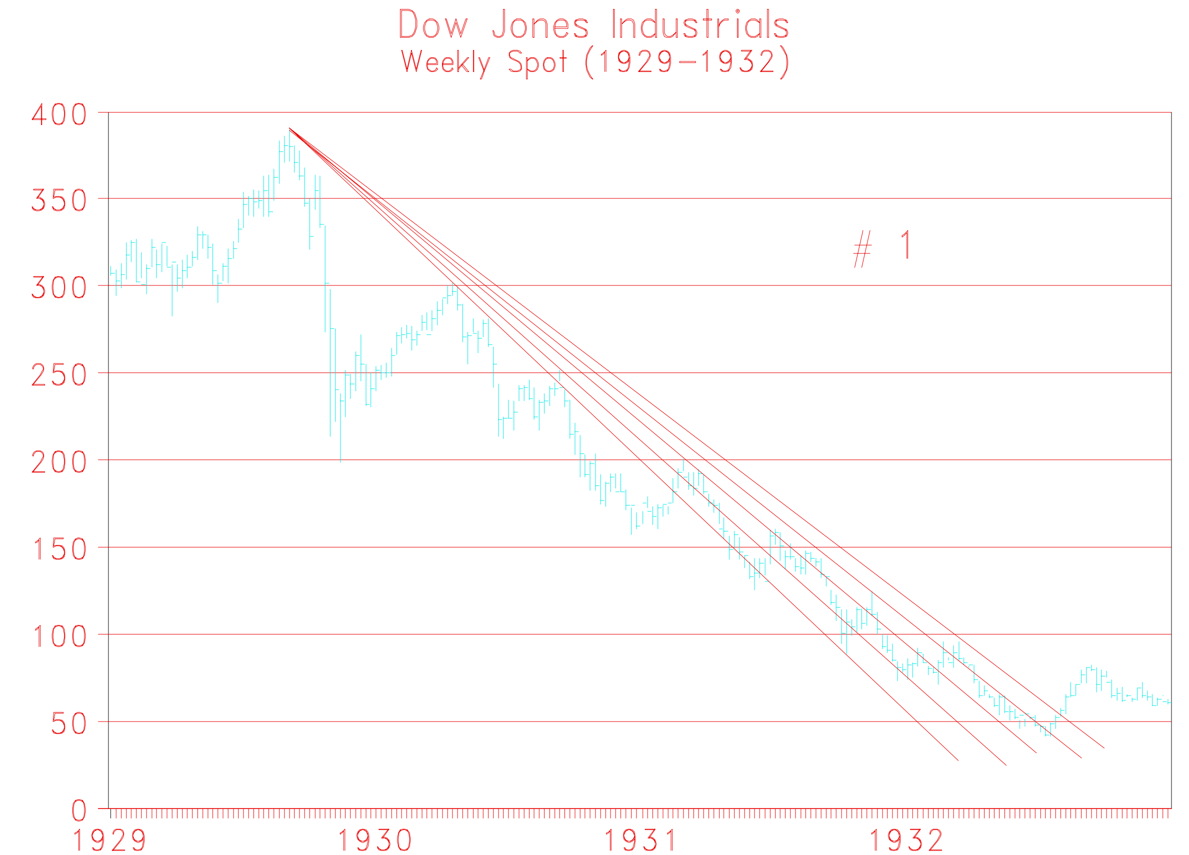


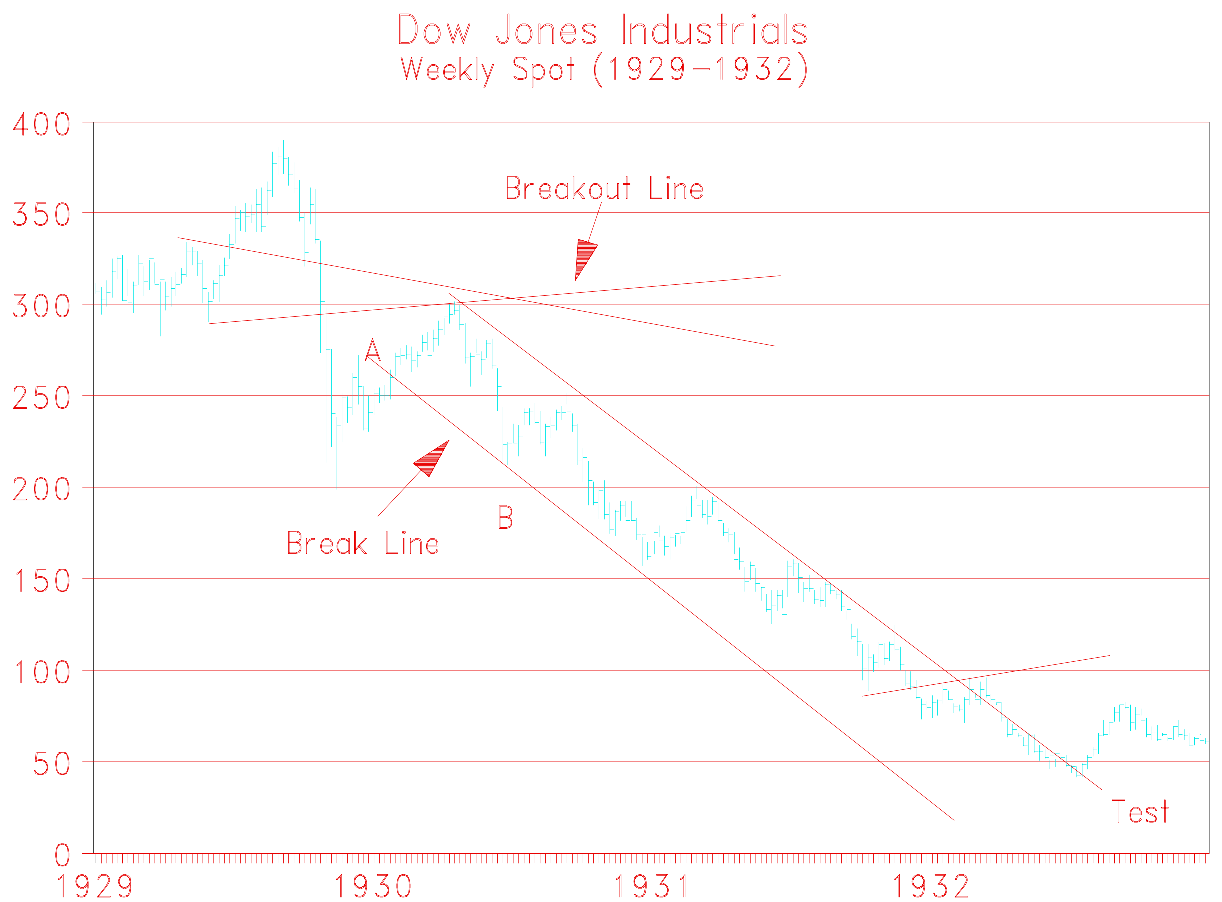
strength to close back above it. This conjunction of testing the Downtrend Line and penetrating the Uptrend Line could have been a technical bottoming action as we saw in 1933 on the annual chart. However, unlike 1933, which rallied back above the Uptrend Line, here we find that the market tested the major Uptrend Line early in May of 1931, but collapsed into the end of the month. This was the opposite type of pattern needed to signal a low. June fell and tested the Downtrend Line and then rallied back to the Uptrend Line but it failed to close above it. July merely headed back down again.

This was undoubtedly a confusing conjunction period. But the testing of the Uptrend Line with the subsequent failure to remain above it on a closing basis signaled further weakness in the market. Therefore, looking at the Monthly Chart # 3, you can see that we would have continued to draw new Downtrend Lines from the major high to each new high until we found the correct pattern which eventually unfolded at the bottom in 1932.

There is another method which I have taught at numerous seminars on technical analysis. This is the development of a Reaction Channel. To illustrate this, let us now look at the weekly chart covering the period of 1929 through 1932. The first chart illustrates the five Downtrend Lines which were constructed throughout the course of the collapse. We can see that the market broke through to the upside, creating five Downtrend Lines in the process. The Weekly Chart # 2 illustrates a method of technical analysis which I developed through studying market activity.

Beginning with the first spike reaction in early December 1929 (point A), and tying that to the first reaction low following the


Dow Jones Industrials
Weekly Spot (1929–1932)
400
350
300
250
200
150
100
50
0
1
1929
1930
1931
1932


Dow Jones Industrials
Weekly Spot (1929–1932)
400
350
300
250
200
150
100
50
0
Breakout Line
A
B
Break Line
Test
1929
1930
1931
1932

1930 high (point B), we have captured more than merely highs and lows. We have captured the thrusting reaction forces to form both strength and weakness. I have named this line the "Break-Line" because it provides a more definitive source of technical support in comparison to the standard uptrend line normally taught in technical analysis. Here we have taken the reaction high before the major 1930 recovery peak and joined it with the reaction low thereafter. Taking a parallel off the 1930 high provides us with this reactionary force in a channel format.

You will immediately notice that throughout the course of the bear market, the oscillations of the market activity remained by and large within the confines of this channel. This helps to quantify the market direction far better than employing the simple Downtrend Line. Again, if we focus at the bottom of the chart where the market finally made its low, you will notice once again a testing pattern. The market on a weekly level tested the top of the channel early that week and then rallied away from it. Clearly we have a reversal in trend like no other throughout the entire course of the bear market.

This channel provided guidance on all rallies insofar as defining the technical points where the trend would have begun to reverse between 1930 and 1932. At no point did the market exceed the top of the channel, fall back to test it, and rally away from it until the major low had come into play during 1932.

Technical analysis was thought to be a lot of mumbo-jumbo. Even today, many fundamentalists assert that technical analysis is of no use. Those who purport such statements are normally unfamiliar with this form of analysis and lack the understanding of market patterns and movements to provide any form of a fair assessment. Although fundamental analysis is by far the most widely employed, the thinking process of man evolves and changes to such an extent that what used to be bullish often becomes bearish. There are no definitive rules which one can go by to say that if interest rates reach a certain level then the market will peak or bottom, whichever is the case. There is no such concrete rule book because the market reacts to a broad set of fundamentals on an international as well as a domestic level. Only a full and complete understanding of the international forces at work will provide a clear understanding and successful implementation of fundamental analysis. Most fundamentalists have failed over the long haul to remain consistent because they have not grasped the entire scope of the thousands of variables involved internationally to come up with the true underlying forces that are at work.

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