

Stock Market In A Rogue Wave

eResearch Corporation is pleased to provide a weekly commentary, authored by Tom McClellan, entitled "The McClellan Chart-In-Focus", which is a free technical analysis article published each week.

In this article, Mr. McClellan applies the concept of a "rogue wave" to the stock market and uses the crude oil price as an example.

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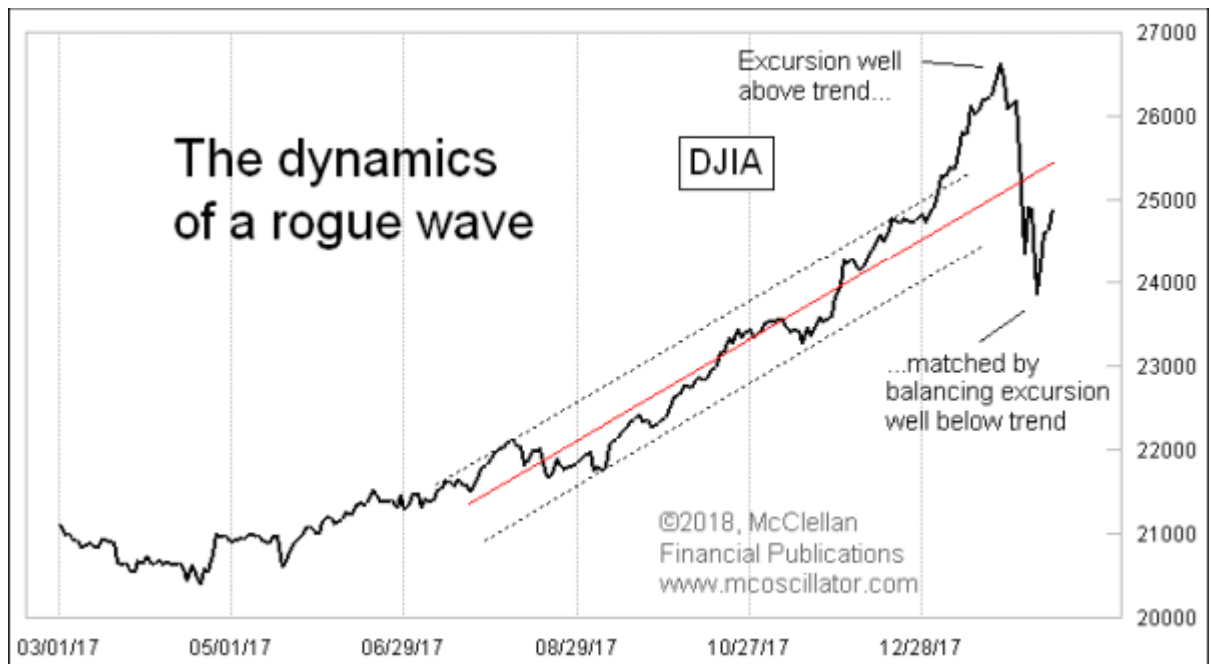
The McClellan Chart-In-Focus

by Tom McClellan (bio at end)

Stock Market In A Rogue Wave

The stock market is just coming out of a big rogue wave event, and that gives us clues about what lies ahead.

The term “rogue wave” gets used in other areas of science, most notably in analysis of big waves in the ocean. But they can occur in any medium where wave action is present, not just the ocean. They have even been observed in the [transmission of light waves through fiber optic cables](#).



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Rogue waves in the ocean get a lot of attention, especially from ship designers who need to make a hull and keel that are strong enough not to be broken by them.



A German research project known as MAXWAVE, funded by the European Commission, studied the phenomenon of oceanic rogue waves, and it had several findings that are relevant.

First, a rogue wave seems to “borrow” energy from adjacent waves to build to a much greater height than the surrounding chop.

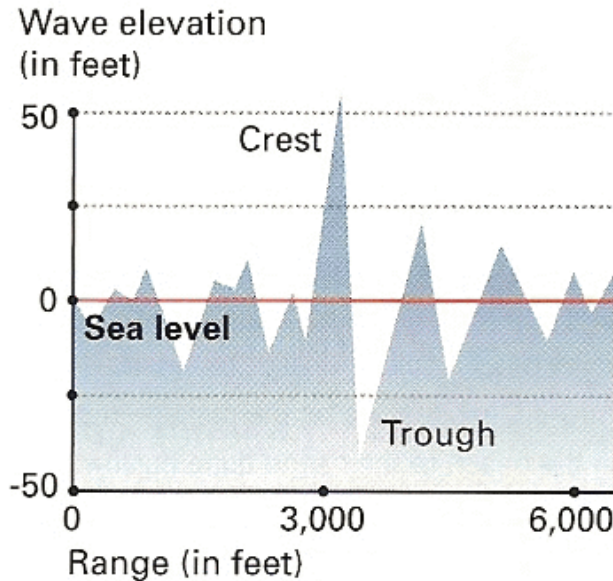
Second, the height of the crest of the rogue wave above “sea level” is usually matched by the depth of an adjacent trough, making such waves all the more destructive to ships.

Third, and perhaps the most significant finding, is that, “ship accidents were found to happen mainly in fast changing sea state conditions and in cases of crossing seas,” according to [a paper by W. Rosenthal](#) of the Institute of Coastal Research in Geesthacht, Germany. I will get to why this point is relevant below.

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This diagram shows data from that MAXWAVE study, depicting the actual wave height of a rogue wave passing an oil drilling platform.



A 95-foot swell, the highest seen by MaxWave, puts a spike in the data.

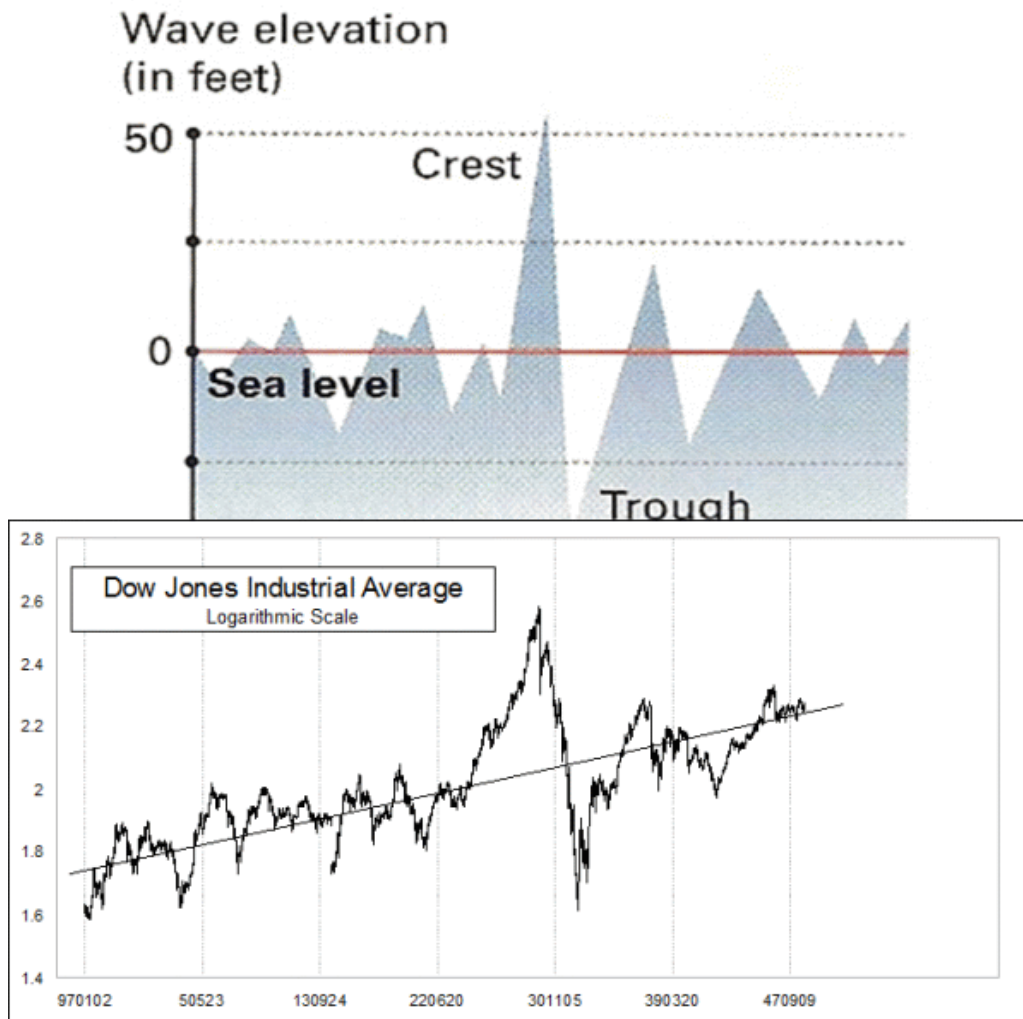
Notice that the peak and the trough are roughly equidistant from sea level. And that after the wave and trough pass by, the sea state returns back to sea level, with roughly even peaks and troughs afterward.

Rogue waves also occur in the financial markets. When I saw that MAXWAVE diagram a few years ago, it immediately reminded me of the 1929 stock market peak and the ensuing chaos.

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So I put together the twin images that I could see in my head, the better to see them together on the screen:



When applying this principle to the financial markets, the idea of “sea level” requires a little bit of interpretational latitude. Markets are not level, and they trend upward and downward. So if you substitute the idea of sea level with the word “trend”, then it makes more sense.

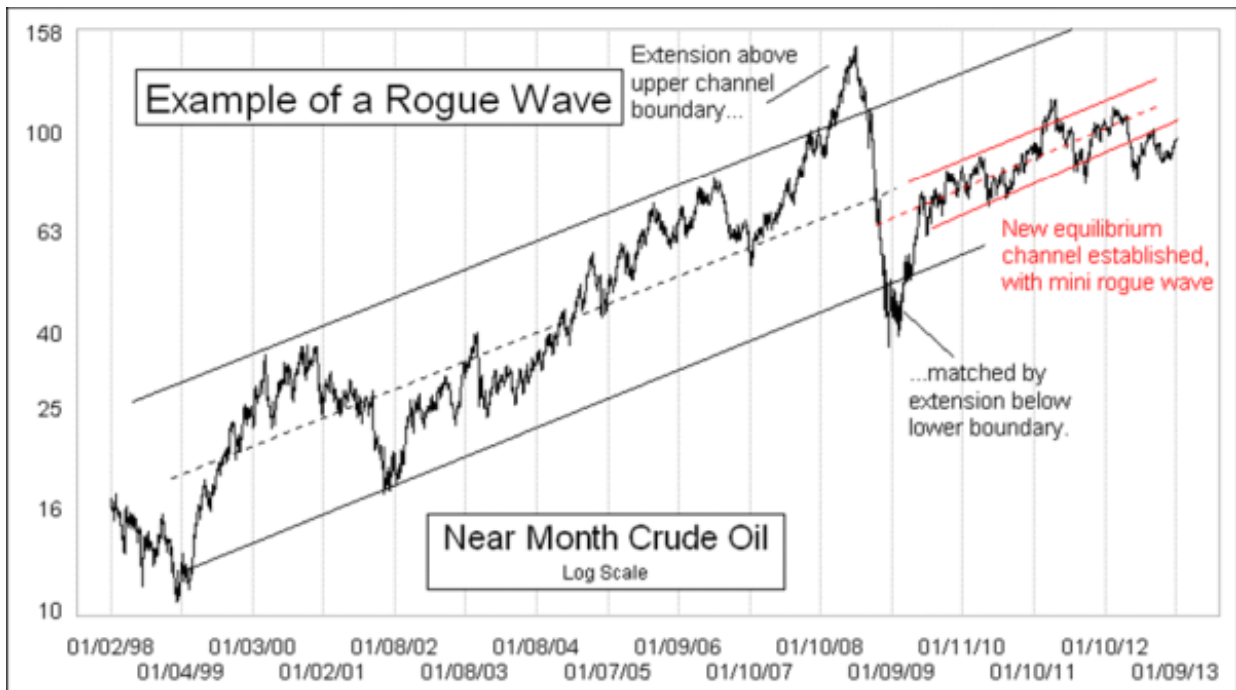
Note, in that comparison, that in the 1910s and 1920s, there were normal oscillations above and below a median line. Then, in the early 1920s, the oscillations quieted down, as the building rogue wave started to steal energy from the normal wave oscillation of stock prices. The price peak in 1929 was way above that median line, and then the trough in 1932 was equidistant below it (on this log-scaled chart). Afterward, the DJIA went back to oscillating up and down around the median line again.

The 1929 peak also fits the model of oceanic rogue waves by marking a “change in sea state”, ushering in a Great Depression, and fundamentally changing the banking system, the value of the dollar versus gold, the practices of workforce versus management, and other huge elements of how the economy operates. It also led to another world war.

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That is, of course, not the only example of a rogue wave. The oil price peak in 2008 provides us another textbook example of this principle:



Note that prices saw normal oscillations above and below the median line, or trend. But then something changed around 2007, leading to the big blow-off up-move to \$145/barrel in July 2008, followed by the equally big drop to \$35 in December 2008. After that low, crude oil prices returned back to the preceding trend, as a way of getting back to sea level.

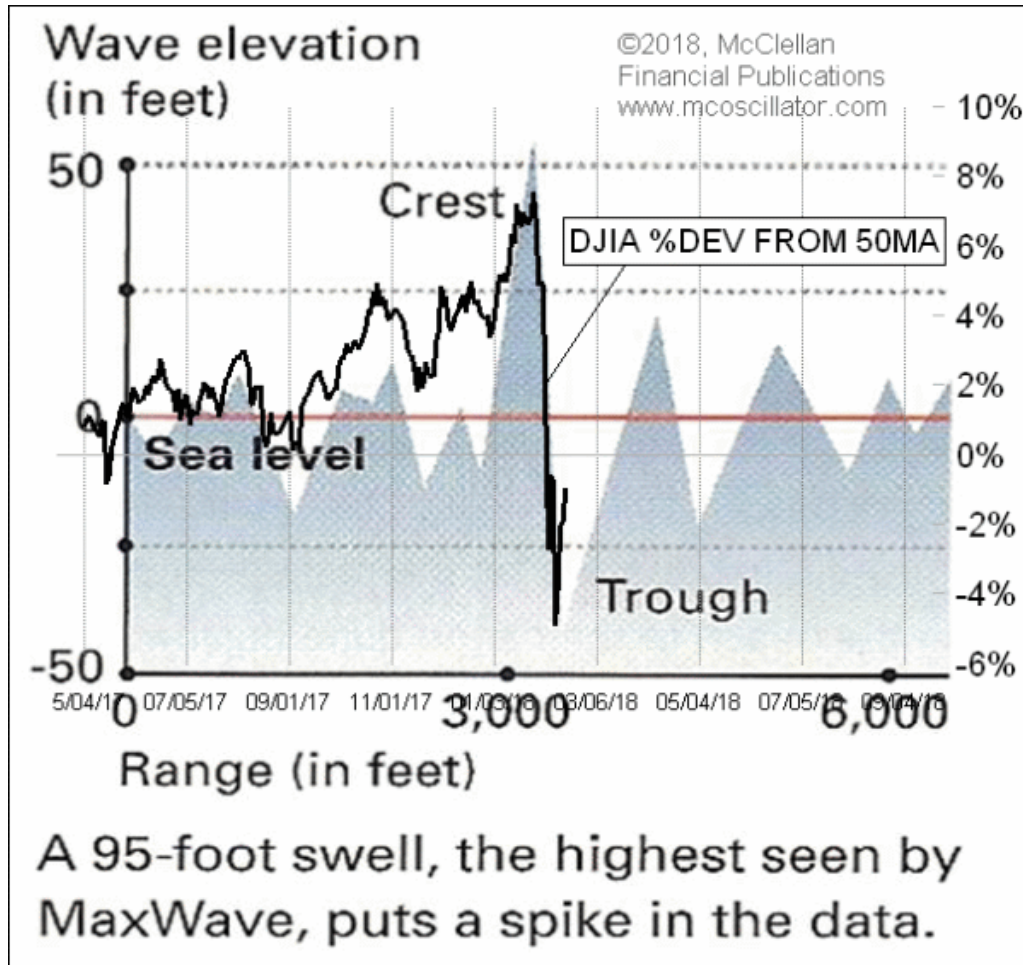
In this example, with crude oil prices, there is an additional cool element, in that there was a new equilibrium channel established after the 2008 low, and that channel saw its own miniature rogue wave in 2011. But all of this was part of a change in the “sea state” of the oil market, as fracking came to be a major factor, and OPEC eventually lost control of oil production quotas in 2014.

Coming back to the current day situation in the stock market, we have been seeing a steep uptrend in the stock market since the 2016 election. A steep uptrend makes it difficult to define “sea level”, or the trend for prices to return back to. But if we employ a plot of the SP500’s deviation from its 50-day moving average, that factors out the uptrend in prices and lets us see the wave action.

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Here is a plot of that deviation from the 50MA, compared to the MAXWAVE pattern:



The events in this rogue wave are obviously unfolding far faster than in the 1929 example. But the concept of fractal structures occurring on different time-scales is nothing new in technical analysis.

The stock market's mission from here is to get back to "trend", whatever that is going to mean this time. It probably does not mean a surge to a higher high than the January 26, 2018 price top, but just getting back up to the trend shown in the top chart would be quite a nice rebound.

The final point about rogue waves occurring at a change of sea state provides us with a lesson about what lies ahead. The summer of 2018 is not likely to see a continuation of the "Trump Trend" off of the 2016 elections. It is time to start being a market timer again.

Tom McClellan, Editor,

The McClellan Market Report

BW: Information on Tom McClellan and *The McClellan Market Report* and *The Daily Edition* follows below.

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ABOUT THE AUTHOR



Tom McClellan

Tom McClellan has done extensive analytical spreadsheet development for the stock and commodities markets, including the synthesizing of the four-year Presidential Cycle Pattern. He has fine-tuned the rules for inter-relationships between financial markets to provide leading indications for important market and economic data.

Tom is a graduate of the U.S. Military Academy at West Point, where he studied aerospace engineering, and he served as an Army helicopter pilot for 11 years. He began his own study of market technical analysis while still in the Army, and discovered ways to expand the use of certain indicators to forecast future market turning points.

Tom views the movements of prices in the financial market through the eyes of an engineer, which allows him to focus on what the data really say rather than interpreting events according to the same "conventional wisdom" used by other analysts.

In 1993, he left the Army to join his father in pursuing a new career doing this type of analysis. Tom and his Father spent the next two years refining their analysis techniques and laying groundwork.

In April 1995 they launched their newsletter, The McClellan Market Report, an 8-page report covering the stock, bond, and gold markets, which is published twice a month. They utilize the unique indicators they have developed to present their view of the market's structure as well as their forecasts for future trend direction and the timing of turning points.

A [Daily Edition](#) was added in February 1998 to give subscribers daily updates on their indicators and also provide market position indications for stocks, bonds, and gold. Their subscribers range from individual investors to professional fund managers. Tom serves as editor of both publications, and runs the newsletter business from its location in Lakewood, WA.

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