

## SPECIAL FEATURE

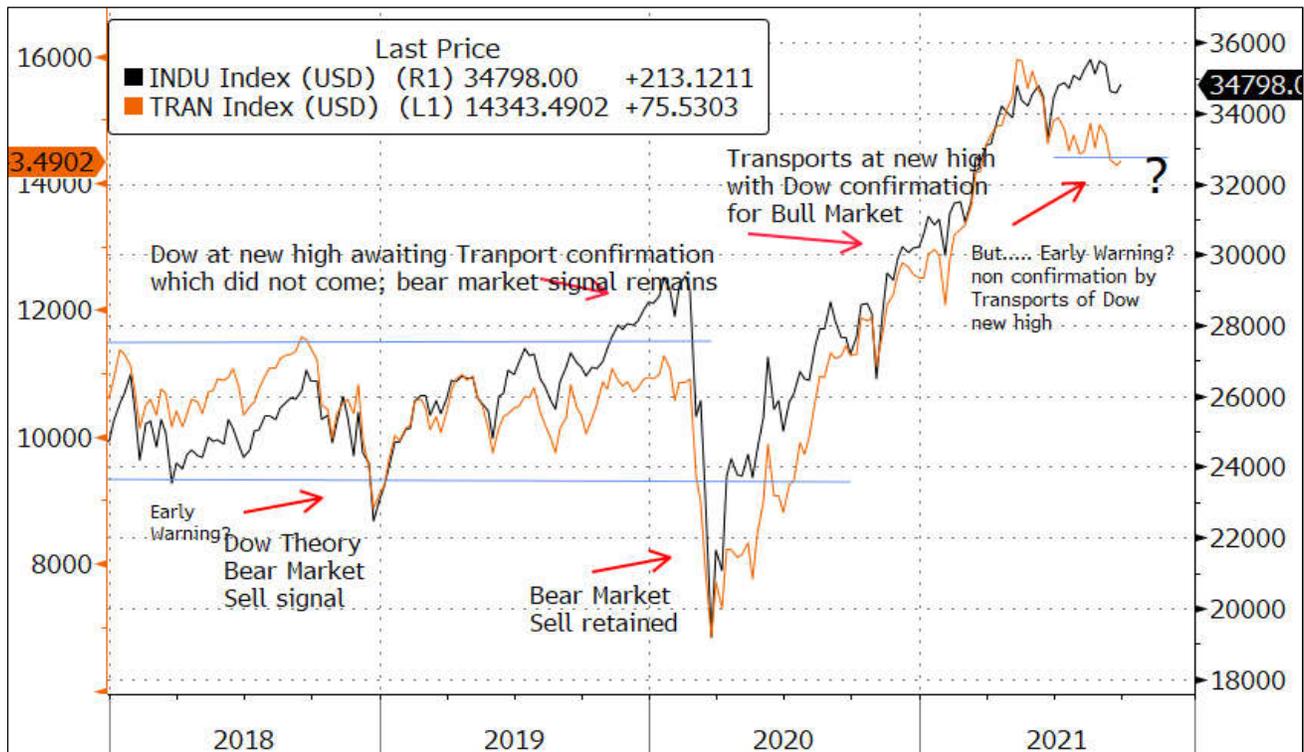
### Dow Theory: Offering a Market Warning?

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There has been little commentary as to what *Dow Theory* is telling us today, with the **DJIA** having made a recent new high and the **Dow Transportation** average lagging / failing to confirm slipping from its own new high months ago.

**Dow Theory** states that the companies that make the goods (DJIA) and those that transport the goods (Dow Transports) should move together; that when they don't, the reversal in one can eventually lead to a reversal in the other, either up (Dow Theory *Buy* signal) or down (Dow Theory *Sell* signal).

**Fig. F-1** Dow Jones Industrial Average (black line) and Dow Jones Transportation Average (orange line) (Weekly)



Source: Bloomberg and LY Advisors

The December 2018 break below the one-year 2018 support for both the DJIA and the Dow Transports represented a **Dow Theory Bear Market Sell** signal (Fig. F-1, left) which was addressed in *Technical Perspectives, Outlook 2019*

report, and was **confirmed** with the non-confirmation in price in the late 2019 rally (as the *Dow* made a new high, but the *Transports* did not; **Fig. F-1**, center).

Thereafter, one can note the **Bear Market decline followed through** on the original **Sell** signal from late 2018.

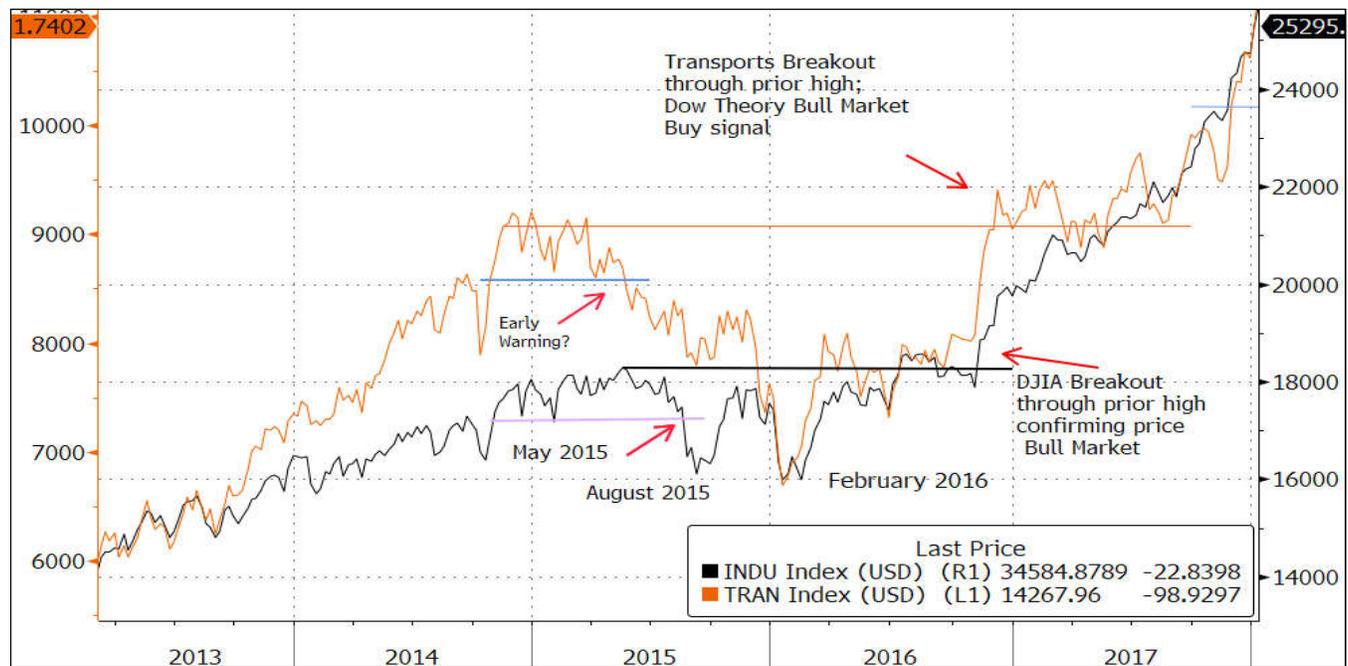
## Current Behavior

In late 2020 into 2021 both the *Dow* and the *Transports* rose to new highs for a **Dow Theory Bull Market Signal**. One could now argue that **signal may prove short-lived**.

Currently, the *Transports* has not confirmed the recent new high in the *Dow* and instead has just broken support and made an initial low, continuing its decline as the *Dow* is rolling over from the high (**Fig. F-1**, right) and could follow suit to the downside. **A Dow slip below the June low** would trigger a **Dow Theory Sell** signal. So currently a **warning** is in place.

Both indexes would need to reverse up to new highs in order to continue the Dow Theory advance in place from 2020.

**Fig. F-2** Dow Jones Industrial Average (black line) and Dow Jones Transportation Average (orange line) (Weekly)



Source: Bloomberg and LY Advisors

## Observing the History

One can observe (**Fig. F-2**, left), that the **Transports** *broke support* in early 2015, followed by the **Dow** breakdown in mid-2015 (**Fig. F-2**, left arrows) to **confirm** a **Dow Theory Bear Market** signal followed by the **decline for both into February 2016**.

The **DJIA** eventually made a new high in November 2016 (**Fig. F-2**, arrow “DJIA Breakout”) versus the 2015 peak, and later in December the **Dow Transports** made a new high versus its 2014 peak (**Fig. F-2**, arrow “Transports Breakout”). The **Bull Market signal** was registered when both the Dow and the Transports succeeded in breaking out to new highs, confirming one another. The advance continued into the warning noted above beginning in 2019.

The interim months from the **Transports breakdown** to the Dow breakdown represented a **period of non-confirmation**: *One average reverses course without yet having confirmation of the other*. Periods of non-confirmation can carry over several months until resolved.

The **two prior Dow Theory** non-confirmations that evolved into **Bear Market signals** prior to 2015 led to two large declines (**Fig. F-3** below).

In **1999** Dow Theory (**Fig. F-3**, left circle) played out with the **Transports** not able to sustain a new high in 1999 and then **failing first**, declining in late 1999 *while the DJIA moved to a slight new high (see arrow) into 2000 about 4 months later*. Both ultimately moved to new lows for a **Dow Theory Bear Market Signal**, as the bear decline evolved into 2002.

In the **2008** Dow Theory example (**Fig. F-3**, right circle) the **DJIA declined first and failed to confirm the Transports slight new high in 2008, 4 months later**, offering a **Dow Theory Bear Signal**, with both ultimately moving into the sharp bear market into the 2009 low.

**Both situations offered early Dow Theory** non-confirmations for those interim months, without reversing up again, **leaving potential for the subsequent Signals and market declines**.

The **subsequent advance into 2009** was confirmed by both to signal a **Dow Theory Bull Signal**.

**Fig. F-3 1995-2010 Dow Jones Industrial Average (black line) and Dow Jones Transportation Average (orange line) (Weekly)**



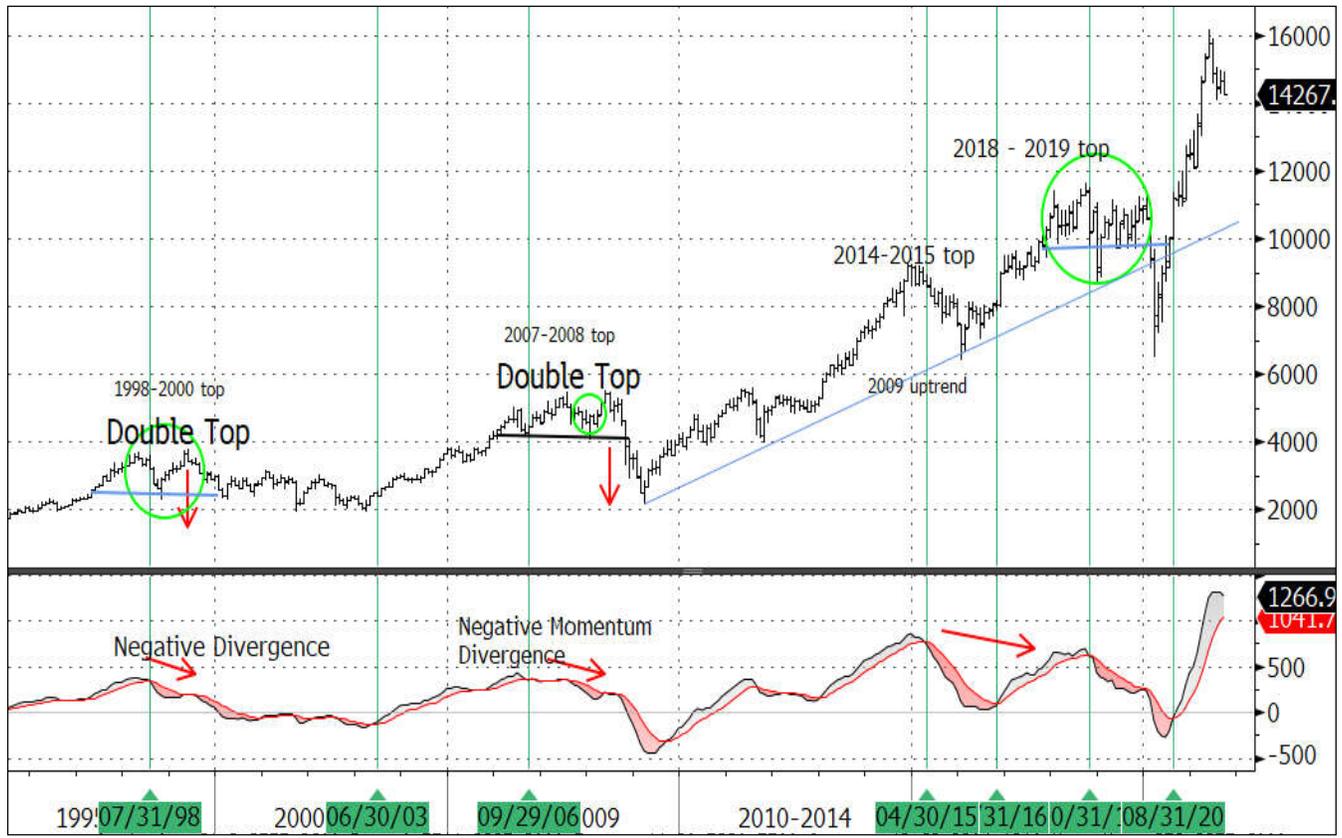
Source: Bloomberg and LY Advisors

## Transports Monthly Momentum Behavior

The behavior of the monthly momentum model for the Dow Transports in the prior 2 tops (Fig. F-4, with vertical lines depicting the momentum *Buy* and *Sell* signals) display an additional piece of Technical evidence available to aid in interpretation of the price behavior.

In 1998 the Transports monthly momentum experienced a *Sell* at that peak; but on the second price rally to a slight new high into 1999, the monthly momentum was unable to even register a *Buy*; and had it been able to, there would have been a negative divergence versus the 1998 peak (see left circle).

(The 1999 momentum failed to rise to the 1998 momentum level, see falling lower arrow, while price moved higher, see vertical arrow.) The failing momentum offered a 1-year warning of a weakening market.

**Fig. F-4 Dow Jones Transportation Average (Monthly)**

Source: Bloomberg and LY Advisors

In **2008** the **Transports** rally to a slight new high versus 2006 and 2007 **already creating a negative monthly momentum divergence** (momentum couldn't exceed the prior momentum level as price moved higher; see declining lower arrow). The monthly momentum continued to fall on the 2008 new price high (see vertical arrow), diverging and **warning over 10 months of impending risk**.

There was not a double top in the Transports in 2015, simply a direct monthly momentum **Sell**. Thereafter, the strength of the 2016 momentum **Buy** did **not lift anywhere near the level of the 2015 momentum peak** (Fig. F-4, declining right arrow bottom) and **momentum rolled over into a Sell in November 2018**, while **price was significantly higher in 2018 than in 2015**, creating a **negative divergence** of lower momentum to a higher price.

Thus, the **dramatic Transports 2018 negative momentum divergence over 2 years** proved important as precursor to the December 2018 price breakdown below 2018 support, for the **Dow Theory Bear Market Sell** signal.

History shows the **Dow** or the **Transports** can continue higher (or lower) for an extended period, creating a non-confirmation until the other joins to register a new signal (or fails to do so).

### **Current Behavior Conclusion**

Currently the monthly **Transports momentum** appears to be in the *process of making a reversal*, potentially approaching another *Sell* signal which may evolve over the weeks ahead. This, in conjunction with the early *Dow / Transport non-confirmation*, suggests a **Dow Theory Bear Signal** may be forthcoming over the weeks-to-months ahead.