Market's return gives us a handle (and a cup) on its trend

TECHNICAL ANALYSIS
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THIS year was not good for investors. With all the shocks coming out of Europe (Greece, Ireland, fears about Spain), the relative strength in the Australian economy didn't manage to push the market higher. In fact the market looks like finishing the calendar year roughly where it started it.

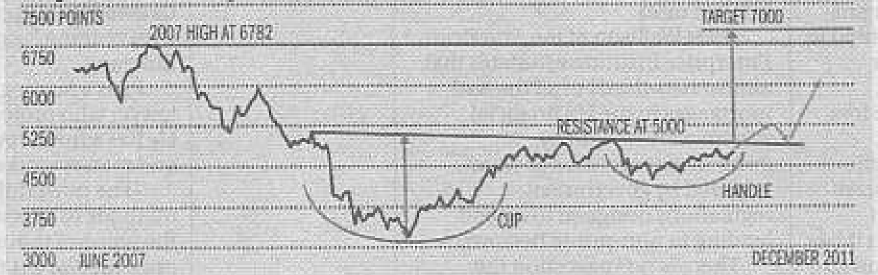
But things may be beginning to move in a better direction. Australian Technical Analysts Association member Alan Clement has provided a graph of the S&P/ASX 200 Index that shows we have been going through what technical analysts call a "Cup and Handle" formation. And it is a bullish sign.

The cup is represented by the steep dip the market took from late 2008 to March 2009 and the quick recovery from there to the April 2010 high. "The handle of the pattern is formed by the much shallower retracement between April and July this year and the recent uptrend we've seen since then," Clement says.

This formation of a long-term "higher low" tells us the sellers are becoming weaker and the buyers are more eager to take positions at higher levels. In other words, the sentiment is turning more bullish, Clement says.

"Price action since April has seen buying pressure increase each time the market has retraced, forming a pattern of higher highs and higher lows," he says.

The Cup and Handle pattern will be complete when the market breaks through the resistance level of 5000 points that has acted as a ceiling for the past three years.



Cup and Handle pattern

If this occurs, Clement says, we can project a price target by taking the height of the cup pattern from its low to the 5000 ceiling and projecting it forward from the breakout point. That, investors will be pleased to know, would give a potential target of the S&P/ASX 200 of 7000, exceeding the pre-crash 2007 high of 6782.

A target of 7000, Clement says, may seem like fantasy from where we are, but bear a couple of things in mind. The Australian sharemarket is currently priced low historically in terms of price to earnings, and to get back to the long-term average would mean a rise in the value of the market.

"Also, while the US markets have been outperforming the Australian market lately, it is the Asian markets that Australia is now much more correlated with, and so it will benefit as they start to catch up with the US markets," he says.

Markets never go up in a straight line and Clement warns it could take months or even years to reach 7000 points.

Clement also warns: "If the market declines below the April level of 4200, this would negate the Cup and Handle pattern, and return the market to a neutral to bearish stance. Investors looking to enter the market should look to buy breaks above 5000, or enter on retracements from above that level."

This column does not constitute investment advice. Investors should consult a qualified financial adviser before risking capital in the sharemarket. Also, as this is the final technical analysis column of 2010, we wish readers compliments of the season and a happy and prosperous new year.