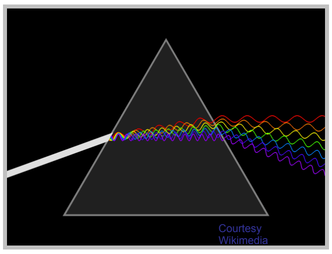
How Stock Forecasts Work

Stock Market Cycles - Predicting The Stock Market

The underlying basis for The Market Forecast analysis and stock market predictions, is stock market cycles. What surprises people at first, is that stock markets are a lot more periodic than most would think. As a quick review, let's look at how those cycles form, why the exist, and how we can harness their predictability to really profit in the markets.

Cycles In Stock Market Data

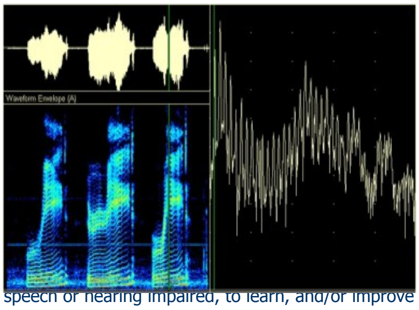


If you have ever played with a prism, no doubt you were surprised when you first saw how an ordinary white beam of light can be split it into all the component colors of the rainbow. The prism acts as spectral filter, passing only certain wavelengths of light through the wider or more narrow parts of the prism.

If you could zoom in to see the actual wavelength detail, it might look something like the graphic on the right:

What is a Stock Cycle?

Definition: A repeating, periodic disturbance which moves through a medium from one location to another.

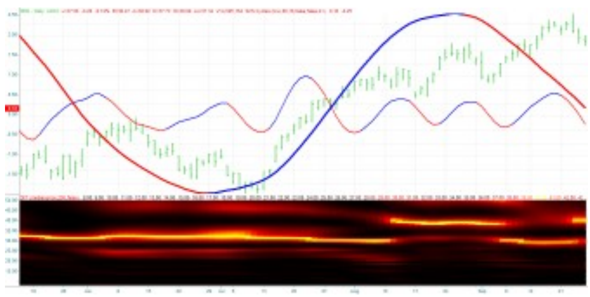


Light travels in waves, as does sound, and of course water. Any vibration across a solid surface is also considered a wave.

It was the study of sound wave motion that first got me started working in cyclical analysis. That was 1980. I was developing algorithms for software that would analyze speech and then display it in real time across a computer screen.

Computerized speech analysis was a relatively new technology. From that original research, grew a product that was used in hospitals, schools, and clinics to help those who were speech or hearing impaired, to learn, and/or improve their speech intelligibility.

During that time, some traders who had heard of my work, approached and asked if I could develop a similar system to analyze cycles in the stock market. It took me by surprise, and seemed a very strange request, "cycles in the stock market - you've got to be kidding?" But, to my amazement, all of the stock data I was provided confirmed a very real series of strong, and surprisingly consistent, cycles in the markets.



Spectral output of the stock market (like the voice spectragaph above) showing consistent price cycles between 75-80 days, 35-40 days, 8-10 days.

In that instant, I knew it was time to learn everything those guys understood about turning that kind information into profits.

What Causes Stock Market Cycles To Form?

Just like light, or even waves in the ocean, stock markets appear as a complex waveforms, where market movement is actually a summed total of the individual oscillations from its component stocks. Interestingly, each stock will also have several waves of oscillation within its own price movement too. Waves within waves. Let's consider some of the reasons why those would even exist.

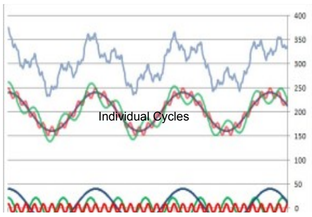
The ebb and flow and periodic price motion for any given stock can be due to:

- **Quarterly earnings** reports affecting the perception of a stock's potential going forward, can trigger a sudden wave of buying or selling from the anticipation,

Sum of All Cycles

or release of the results.

- **Seasonal sales** causing an increased interest in the stock, frequently seen in the retail sector before or after holidays.
- **Stock options** expirations on a regular monthly or quarterly basis, used by traders to hedge positions that cause extra buying or selling after expiration.
- **Bi-monthly fund contributions** whose members add new monies with each paycheck.



There are other regular factors that can affect a stock's price, and we may not always be aware of every underlying "reason" for them.

But here is the key: It's not the "why" for the directional movement that's critical, rather, it's knowing which direction and the **size** of each developing wave that really tells you ALL you need to know to start **earning big profits and protecting them against reversals**.

Those same cyclical factors, when applied to the markets, can dramatically improve your market timing - and profits.

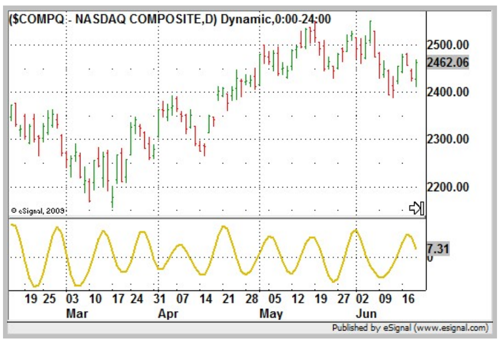
To discover the developing oncoming waves in the markets, we'll need more than just the naked eye or simple technical indicators. We'll need spectral tools that can reveal market direction (phase), speed (frequency), and the size (amplitude) of developing buying or selling waves. Armed with that financial information, we can know with confidence whether its time get out of the way, or time go along for the ride.

Fortunately, some very brilliant mathematicians and engineers have already developed such tools. Their algorithms carry fancy names like Fourier analysis, Mass Entropy Spectography, Wavelet analysis, etc. Each can do something similar in a slightly different way, but in essence, they filter complex noisy data, and separate out underlying periodic wavelengths within the data.

When we apply that technology to a stock or market index, we can see the data through the lens of these mathematical prisms, and with today's powerfully fast computers, instantly identify important frequencies, amplitudes, and current phases for each of the waves driving the prices.

Here is what that can look like:

Note the very consistent 10 day cycle in the lower panel on this graph.

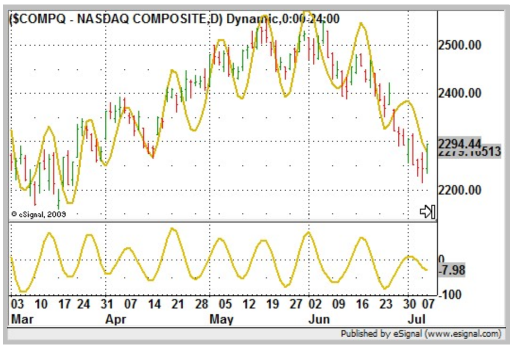


In the chart above, we are shown the most active short term trading cycle, which for the previous months, was creating a large portion of the NASDAQ's movement. By adding that cycle to the smoothed longer trend, we can see how well that cycle action identifies most of market's movement in the next chart below.

Here, the 10 day cycle is imposed OVER the price in the upper panel.

At this point, all we really want to know, is WHERE will cycles be in the in the next few days, or weeks, and by adding a couple confirming indicators, position our trades to profit from that upcoming move! It sounds fantastic of course, but let's see how it worked out for us:

The 10 day cycle accurately "Predicted" the index move down after June 16, and again, after June 29th.



As you can see, that 10 day cycle continued to oscillate on schedule and provide very accurate indications when the next "wave" down would occur. Trading that wave only required purchasing an inverse ETF that actually went up in value, as that NASDAQ came down.