January 1999

FOREIGN EXCHANGE CYCLES:

Get Ready to Sell the Upcoming Cycle Top in the Dollar versus the Deutschemark Trade

Sell the Dollar-Mark on a break below last week's low of 1.6625 and look for 5 to 7 months of downside price action.

The monthly trend in the Dollar-Mark is down. We have been looking to sell a rally in the weekly chart and the elements of a low-risk, high probability trade have lined up. A sell setup bar occurred the week ending 12/4 after a 50% retracement of the dollar's bear move from late August through early October. This setup bar is in the timeframe that we expect for a top in the 20- and 40-week cycles. A price drop below last week's low would be strong indication that these cycle tops are in place. A Dollar-Mark below the swing low of 1.6617 would confirm this and most likely start a move to new lows this Winter and into next Spring.

This Special Report is a collaboration between Walter Bressert and Doug Schaff utilizing Walter's cycle and technical analysis combined with Doug's currency expertise and fundamental knowledge. Doug Schaff is a professional currency trader with a strong background in the D-Mark, Yen, British Pound, Canadian Dollar, Dutch Guilder, South African Rand, and emerging currencies.

Just as cycle analysis can help you buy into the beginning of strong bull markets it can also help you sell at the start of downtrends. The Dollar-Mark plummeted over 12% from late August into early October on the back of record German trade surpluses, strong capital flows, the momentum of European financial union, as well as a negative shift in dollar fundamentals. Last summer the world became wary of the U.S. stock market and investment capital flowed out of the dollar. "Trade with the trend" is a trader's survival mantra, but it does not imply a close-your-eyes-and-sell strategy. That can be worse than missing the move. The strong October/November rebound in U.S. stock markets was mirrored by a swift 50% retracement in the Dollar's losses. The following report looks at long, intermediate and shorter-term cycle analysis to find a low-risk, high probability place to sell the Dollar against the Deutschemark.

OVERVIEW AND SUMMARY

The dominant longer-term cycles in the Dollar-Mark are the 4-year and 40-week cycles. Each 40-week cycle is made up of two half-cycles of 20-weeks each. The 4-year cycle is in a confirmed downtrend that began August 1997 (at cycle top #5 on Chart 1) and is not expected to bottom for about 1-1/2 years. The current 40-week cycle, which began 4/3/98 (cycle top 5A on Chart 3), is coming to an end. The Dollar was 21 weeks into the second half of this 40-week cycle on 12/4/98 when a sell setup bar formed that we think marks the 11/27/98 high as the cycle top. The timing is close enough to focus closely on this one. 20-week cycles typically range from 16-22 weeks. 70% of these cycles do not go past 25 weeks. A break in Dollar-Mark below the 1.6625 low of the setup bar will trigger a high probability sell signal to confirm that the top of the current 20-week cycle is imminent. This top will also indicate the start of the next 40-week cycle, and signal that the next big move is about to begin.

Monthly Chart
The monthly Dollar-Mark chart shows 4-year cycle tops in 1981, 1985, 1989, February 1994 and August 1997.

Chart 1

The blue indicator drawn under the price bars is the Bressert Double Stochastic, which does a good job of finding the 4-year cycle tops. To target the 48 month cycles use half the cycle length, 24, as the input for the stochastic. You can see that it runs up against the ceiling at all the 4-year highs. In Chart 1 a sell signal confirming each 4-year top is constructed using the Bressert Double Stoch Sell1 signal (also available free on the website). When the oscillator turns down from above a sell line of 90, the price bar above it is painted dark red. A move of 500 points below the setup bar is used to "trigger" the signal, marked by a small red square. Only five such signals have occurred since 1981, each at a 4-year high for the Dollar-Mark. This signal located the high bar, and only the high bar, of each 4-year cycle. Once that cycle high has been confirmed you know the direction of the long-term trend.

Using the EMA Indicator to Trade with the Trend
Moving averages turn slowly but can be reliable trend indicators. The EMA Trend Indicator in Chart 2 is composed of two exponential moving averages. When the faster (red) moving average is moving up and above the slower (blue) moving average, the trend is up. When it is below the slower moving

average and moving down, the trend is down. In Chart 2 the EMA indicator is drawn over the price bars.

The key to successful trading is to trade with the trend; buying the dips in uptrends and selling the rallies in downtrends. Trend is defined as the direction of the next longer cycle than the one you are trading. For the weekly chart, the monthly trend indicator is used. For the daily chart the weekly trend indicator is used. When the monthly cycle is moving down you sell the tops of the weekly cycle. When the weekly cycle is down you sell the tops of the daily cycle. Both of these scenarios are in place for the Dollar-Mark which is why we have been hunting for a low-risk entry point to sell the dollar

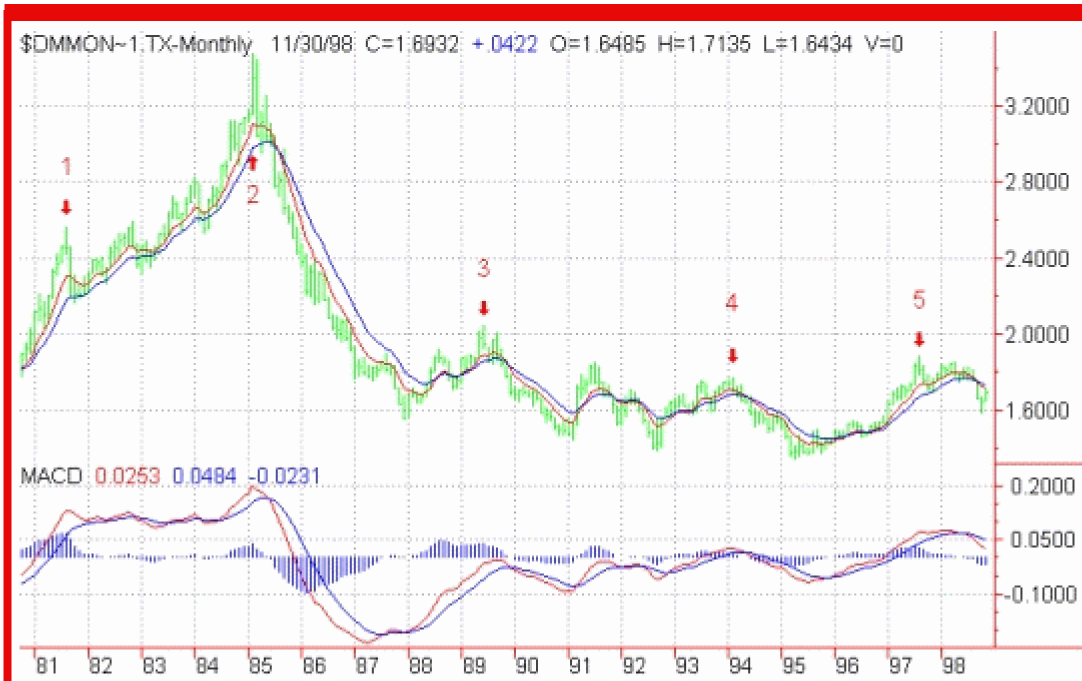

Chart 2

The MACD indicator is also excellent at showing trend. The lower portion of the chart shows the monthly MACD went negative back in May. The Bressert EMA Trend Indicator often crosses over after the MACD and therefore serves to confirm it. The monthly EMA Trend Indicator went negative in October.

Why is this interesting? Anyone trading the Dollar-Mark knows it's in an downtrend, especially after the rapid decline from late August. The challenge is to construct a low-risk sell into this trending market. That's what we're after, and the big picture gets us started. The 4-year high was made in August 1997. With an downtrend confirmed by the Bressert EMA Trend Indicator, the dollar should have another 1-1/2 years or so until it hits the low price of this 4-year cycle. Knowing that, you can focus on selling each shorter cycle top until that time.

The Weekly Chart

The 40-Week Cycle

The dominant weekly cycle is the 40-week cycle. Arrows on Chart 3 show the 40-week cycle highs and lows and the potential cycle top of 1.7145 that occurred the week of 11/27/98. The MACD is not a very good oscillator for timing the tops and bottoms but it does confirm them, unfortunately well after they have occurred. Notice that each time the oscillator crossed the lighter Crossover Line, a 40-week cycle top or bottom had occurred.

Chart 3

A 20-bar Bressert Double Stochastic helps pinpoint 40-week cycle highs in the dollar as they occur. The Double Stoch generates a red setup bar when the oscillator rises above the sell line and turns down. A drop below the low of the setup bar triggers a mechanical sell signal. Notice in the above chart how a setup bar was generated at or within one bar of each of the six 40-week cycle highs. Skipping ahead for a moment to Chart 4, the 10-bar stochastic generated a sell setup bar the week of 12/4/98. If the dollar trades below the low of that setup bar we expect the 20-bar stochastic to follow suit and turn down, creating a sell setup bar and confirming a 40-week cycle top at 5B.

Notice the bottom of the current 40-week cycle (1.5870, the week of 10/9/98) occurs late in the cycle between 5A and 5B. This is a characteristic of bear markets, and is known as Right Translation. As the trend of the larger cycle moves down, the bottoms of the smaller cycles shift to the right. Also, each cycle bottom is below the previous one, and each cycle top is below the previous top.

Adding 20-Week Cycles to the Picture Not surprisingly there is also a 20-week cycle in the Dollar-Mark. Placing a 20-bar and 10-bar double stochastic on the weekly chart helps us to pinpoint the corresponding tops and bottoms of the 40- and 20-week cycles.

Chart 4

The thinner line follows the 20-week cycle and the thicker one the 40. The two often top together at a 40-week high. The above chart includes a Keltner channel drawn using a 4.2 standard deviation from a 45-bar moving average. The upper and lower channel lines have contained prices fairly well historically, acting as moving trendlines in strong bull and bear markets respectively.

The 20-week cycles average 16-22 weeks in length but can contract or extend beyond that. The red setup bars in Chart 4 were generated from a Bressert Double Stoch S1 Sell Indicator using a 10-bar stochastic to help indicate the 20-week cycle tops. The number of weeks from one 20-week cycle high to the next are marked.

Starting from 4A at 12/9/94 there was a 23-bar cycle then a 17-bar cycle, totaling 40 weeks out to 4B at 9/15/95. There followed a 20-week and a 17-week cycle for a "40-week cycle" that took 37 weeks, to 5/31/96 at cycle top 4C. Then there were two 20-week cycles making a 40 that topped the week of 3/7/97 (4D). What followed were two very short "20-week cycles" reflected by two corresponding tops and bottom in the thinner 10-bar stochastic line. That took us to the 4-year Dollar-Mark high of 8/8/97 at cycle top #5.

The first 40-week cycle of the present 4-year cycle ran 34 weeks to a top at 5A. The second 40-week cycle began at that time (4/3/98) and has probably ended. The Dollar-Mark had a short 20-week cycle to July 10. The second 20-week cycle looks like it took 20 weeks and topped at 5B, the week of 11/27/98. The bottom of the 40-week cycle was 1.5870 (spot value) which traded the week ending October 9. Actually that low occurred October 8, the same day the S&P stock index bottomed.

Why the Next 40-Week High should be an Excellent Selling Opportunity

The monthly EMA trend indicator went negative in October indicating the downtrend is likely to continue. From 1977 until now, there have been fourteen 40-week cycle tops that occurred with the monthly EMA in negative territory (i.e. that were rallies in a bear market). During periods when there were no sell signals listed, the weekly chart was in an uptrend. 12 out of the 14 signals below heralded moves averaging 24.40 pfennigs each. One of the two losses was 4.50 pfennigs. The other was 1.35 pfennigs. Both losses occurred over a three-week time period. The gains took from 9 weeks to 32 weeks to move from entry to top. A 20-bar Bressert Double Stoch Sell1 signal triggered sell signals near each of those cycle tops, as follows:

Trigger Date	Trigger Price	Cycle Bottom	Move in Pfennigs	Percent	Trigger to Bottom in weeks
9/30/77	2.2930	1.9810	31.20	14%	15
6/23/78	2.0640	1.7020	36.20	17.5%	19
6/15/79	1.8880	1.6790	20.90	11%	29
4/18/80	1.8280	1.7320	9.60	5%	14
10/4/85	2.6180	2.1930	42.50	16%	25
4/25/86	2.1830	1.9610	22.20	10%	25
12/5/86	1.9630	1.7665	19.65	10%	9
8/21/87	1.8470	1.5560	29.10	16%	19
8/19/88	1.8620	1.7095	15.30	8%	14
4/13/90	1.6915	1.4670	22.45	13%	32
*1/25/91	1.4940	1.4435	5.05	3%	3
4/3/92	1.6390	1.3870	25.20	15%	22
**12/11/92	1.5665	1.5450	2.15	1%	1
1/13/95	1.5405	1.3445	19.60	13%	14

* Position bought back after 5 weeks at 1.5075 on a buy signal (not shown) for a loss of 1.35 d-marks.

**Position stopped out in 3 weeks, 50 points above the prior cycle high at 1.6160, for a loss of 5.45 pfennigs.

Confirmation of the current 40-week cycle high will most probably occur with the monthly EMA trend indicator negative. We therefore believe the sell signal associated with it will provide profit potential in line with the above listed signals.

Increasing the Odds Using 40-60% Cycle Retracements

One of the most consistent tools for determining price objectives are the 40-60% retracements (derived from the Fibonacci .382-.618 relationship). Most cycles will retrace at least 40% and possibly 50 to 60%.

Chart 5

The 40-60% retracement can be used to enter the market when a cycle top or bottom is due. The best sells occur when:

1- Price rises into a 40-60% retracement, and
2- A mechanical sell signal is generated.

As of 11/27 the dollar, at 1.7145, had slightly breached the 1.7100, 50% retracement of the current 20-week cycle, from the top at (ii) to the bottom at (iii). The 10-bar Double Stochastic has turned down from above 90 producing a sell setup bar. If Dollar-Mark trades below the low of the setup bar, at 1.6625, a sell signal will be triggered. 40-week cycle highs typically occur with the 20-bar Double Stoch indicator above 90, near the ceiling. The Double Stoch is at 83 now, however more time may not be needed as 40-week cycles have ended with the 20-bar Double Stoch at lower levels. Should a sell signal be triggered, base your stop on the presumed 40-week cycle top of 1.7145 shown at 5B. Fine tune your trade entry using the daily chart.

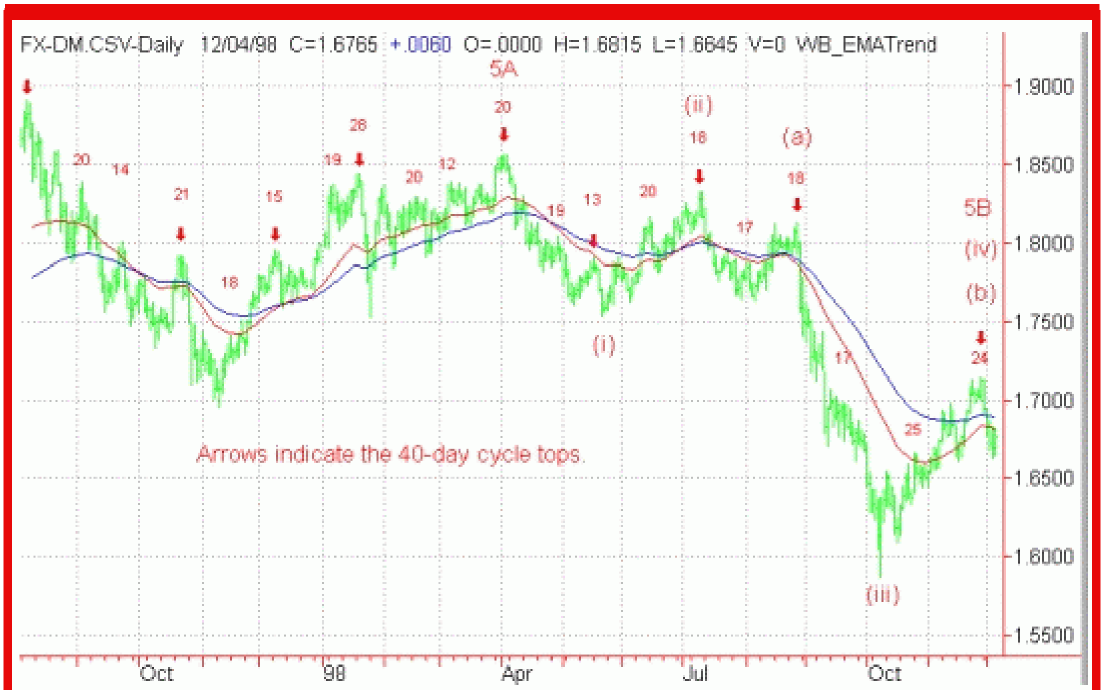

Chart 6

The Daily Chart

Since the current 4-year cycle began in August 1997 there has been a trading cycle of approximately 16-18 market days. This cycle has been the most visible and consistent daily cycle, but has the greatest profit potential when conjoined with an awareness of the 40-day cycle. Down arrows in Chart 6 indicate the 40-day cycles. The latter have been running a bit short of 40 market days lately, although the most recent one, starting from August 27 at (a), extended to finish at cycle top (b) along with the 20- and 40-week cycles at (iv) and 5B respectively.

These cycles are shown in the above chart with a Weekly EMA Trend Indicator. Trend for the daily chart is set by the weekly trend indicator. Having the Weekly EMA Trend Indicator over daily prices makes the trend for the daily chart easily visible. It is in a downtrend so you can look to sell rallies.

The daily MACD, drawn over prices in Chart 7, catches the 40-day cycles pretty well. When it is negative you can take the sell signals generated by the 10-bar and 20-bar stochastics (thin light blue and thicker dark blue lines below). These work best when the weekly EMA Trend Indicator is down.

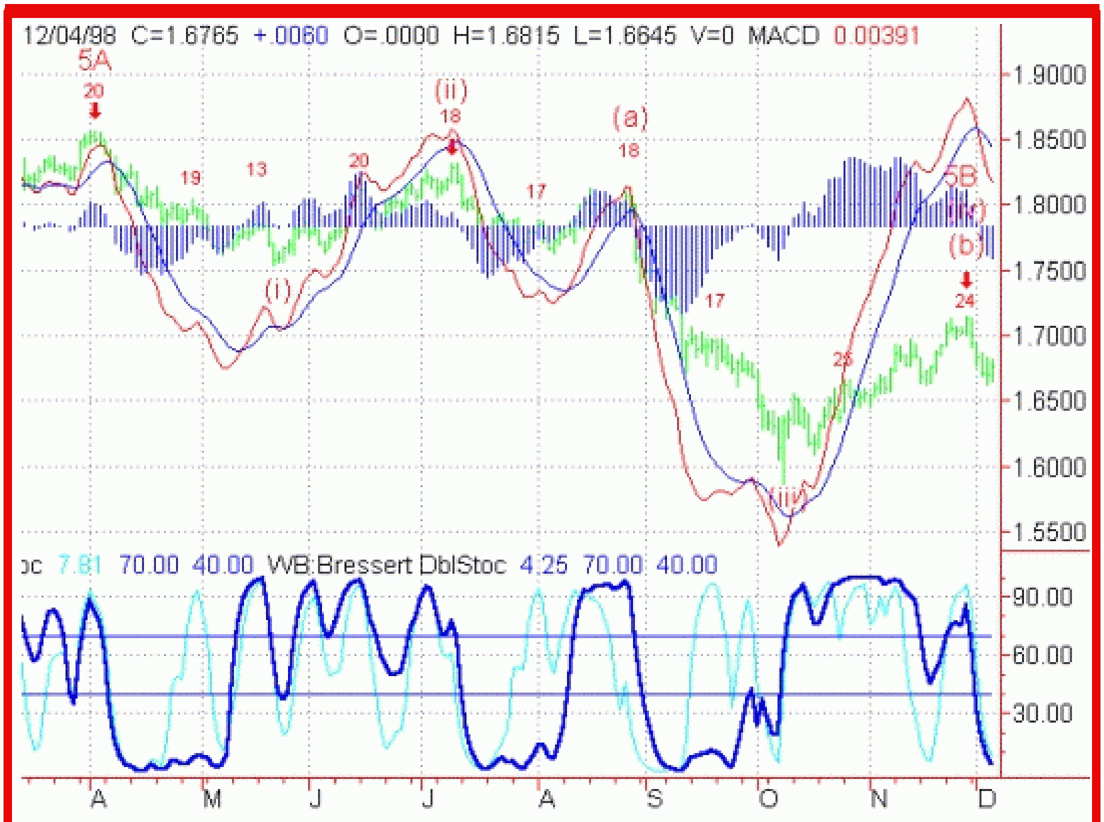

Chart 7

Red down arrows on Chart 7 are reminders of the 20-week cycle tops. Each 20-week cycle is comprised of 4-6 trading cycles of approximately 20 days each. This average holds true especially over two 20-week cycles.

The most recent 20-week cycle began July 9 at (ii). Within that cycle, five trading cycles have been completed so far: of 17 and 18 days to the cycle top at (a), 17 and 25 days to (b), and the fifth was 24 days to the estimated 40-week cycle top at 5B. The previous 20-week cycle (which began the current 40-week cycle at 5A) had 4 trading cycles. Given the position of the weekly oscillators, the current 20-week cycle is most likely finished. The daily oscillators are low and there could be a short term rally in the dollar over the next few days or week. If that fails under the recent high of 1.7145 at 5B a head and shoulders will have formed projecting the next move on the daily chart to 1.6100.

SUMMARY AND STRATEGY

The monthly trend of the Dollar-Mark is down. We have been looking to sell a rally in the weekly chart. A sell setup bar formed the week ending 12/4 after the dollar had retraced half of its losses from late August through early October. This setup bar has occurred in the timeframe that we have been expecting a top in the 20- and 40-week cycles. A price drop below last week's low of 1.6625 would be a strong indication that these cycle tops are in place. Sell the Dollar-Mark on a break below last week's low of 1.6625. Base your stop on the presumed 40-week cycle top of 1.7145 that traded 11/27/98.

Whatever the price level of this top, a mechanical sell signal will offer the opportunity for both long-term and short-term positions to be established with the expectation of a substantial drop into the Spring as the next 40-week and 20-week cycles top.