Two-part ChartSpeak this week. In part 1 we go over a few of our stock picks from our Long List that hit our targets last week. In part 2 we go over a few “ratio” charts. These charts compare related or contingent industries and discuss how the movement of one chart can be used to forecast the movement of another.

First some of our picks from last week.
Now let’s go over some ratios. We’ll cover 1) bond yields vs. housing stocks, 2) gold stocks vs. gold (the commodity), and 3) oil stocks vs. the airlines.

1) Bond Yields vs. Housing Stocks

The lay public thinks Alan Greenspan set interest rates when he and his Fed cohorts move rates at their FOMC meetings, but the rates the Fed changes are the overnight rates banks charge each other and the discount rate…not interest rates. Interest rates feed off the 10-year bond yield, and since almost everyone who buys a house will borrow money at this rate, the $TNX will be approx. inversely related to the housing sector.

The first chart below is the 10-year bond yield. The second chart is the housing sector. You can see the highs on the first chart line up fairly well with the lows of the second chart and vice versa. If you trade housing stocks, watch $TNX for confirmation of a move or a divergence and thus a possible reversal coming soon after.
2) Gold Stocks vs. Gold (the commodity)

If gold companies were valued with the exact fluctuations of the price of gold, a $HUI vs. Gold chart would be a flat line. The first chart below tells us this never happens. The price of gold changes based on sources that are outside the scope of this document, and companies are run by humans who can be wasteful and inefficient with their work. Gold stocks sometimes lead the price of gold and sometimes lag. When they lead, the stocks do great, but when they lag, they tend to correct pretty hard.

The first chart below is $HUI (a gold index) vs. GLD (a gold ETF exactly linked to the price of gold). When this chart moves up (gold stocks are leading), gold stocks do great (see the second chart), but when the first chart moves down, gold stocks correct.

So if you are a gold stocks trader, watch the ratio chart $HUI vs. GLD for confirmation of a move or a divergence. When it moves up to confirm the move up in gold stocks, sit tight and enjoy the ride, but when this moves down (it broke down this past week), gold traders should be taking profits and going to the sideline to wait for the next entry.
3) Oil Stocks vs. the Airlines

Twenty percent of an airline’s cost is fuel. Airlines will hedge their fuel costs to some degree but they are still subject to higher costs when the price of oil rallies. If you trade the airline stocks, it only makes sense to watch the performance of oil stocks as confirmation of a move or a divergent sign of a reversal.

The first chart below is the $OSX (oil services sector) vs. the airlines. When oil stocks outperform the airlines, airline stocks severely lag the market, but when oil stocks underperform the airlines, airline stocks do very well. Notice the downtrends in the first chart below nicely correspond to uptrends in second chart and vice versa.

If you trade the airlines, it only makes sense to use the performance of oil stocks to confirm a move or to offer a warning a reversal may not be far off.
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