

How to use the NYSE Summation Index as a Trading Guidepost



Why Care about the NYSE Summation Index

Let me first start off by saying that this article will not cover the nuances of how the Summation Index was created, all the detailed math behind the equation or even exactly how it works. The purpose of this article is to dive into how to use the indicator as a trading guidepost for assessing the broad market.

If you would like to dig into the math and or history of the indicator, please visit any one of the following links:

http://en.wikipedia.org/wiki/McClellan_oscillator

http://stockcharts.com/help/doku.php?id=chart_school:technical_indicators:mcclellan_summation

http://www.mcoscillator.com/learning_center/kb/mcclellan_oscillator/the_mcclellan_oscillator_summation_index/

Now that we have the disclaimer out of the way, let me

contradict myself and briefly touch on the calculation.

The summation index at a high-level is the calculation of advances minus decliners (net advances) for a 19-day exponential moving average period minus a 39-day exponential moving average period. The summation index is the running daily tally of this equation, hence summation index.

According to the NYSE Euronext site, there are approximately 2,800 companies listed on the NYSE Composite. The number of advances minus decliners across these 2,800 stocks is the input for the 19 and 39 exponential moving averages (EMAs) of the NYSE Summation Index.

On really good day, the NYSE may have net advances of 2,000 and conversely on bad day the NYSE may have net decliners of 2,000.

While this article covers the NYSE Summation Index, you can have a summation index for any exchange.

The reason I and many other traders use the NYSE Summation Index is because of the breadth of the NYSE. There are literally thousands of stocks across many industries. The NYSE Summation Index can be used to monitor the health of major bull and bear markets.

So, while I get it that your charts, moon signs, or whatever edge you use keeps you whole the majority of the time, you still need indicators like the NYSE Summation Index in your trading toolkit to identify when market shifting events are on the verge of occurring.

Remember, broad market moves have very little to do with technical analysis or fundamentals. People are looking to buy or sell based on the raw market emotions of fear and greed. Once those two elements are prominent in any market, it's no longer about what makes logical or technical sense.

Bottom line, you need to understand and keep an eye on what the NYSE Summation Index is telling you.

Range for the NYSE Summation Index

There are two ranges you need to remember when it comes to the NYSE Summation Index: +1,000 to +1,250 and -500 to -1,000.

Don't believe me?

Take a look at the below chart of the NYSE Summation Index going back to 1999 (that's 15 years if you are counting).



When you look at the NYSE Summation Index, to me it's much easier to identify the peaks versus the bottoms. You can see time and time again how the NYSE approaches the 1,000 to 1,250 range and then gets slapped in the face. However, the pullbacks appear to stop anywhere from -500 to -1,000. Which is double the range of where things can start to shift relative to the range for market tops.

The index may tip over these thresholds slightly to the +/- 1500 range during extreme market activity, but this is very rare.

Confluence – Where the Summation Index and Trend lines say the same story

So, now that we know the Summation Index is not a magic bullet, we now need to determine a means to validate trading signals.

What better way to do this then using trend lines?

The reason I am going to use trend lines to illustrate how to validate the summation index signals is because trend lines are probably the one indicator every technician uses in their trading toolkit. Some traders use oscillators, others Elliott Wave, but at some point or another we all draw some sort of trend line on our charts.

Market Tops During 2012 to 2014 Bull Market Run



Let's start picking apart why the above peaks in the NYSE Summation Index were areas where longs should have begun taking a more defensive posture with their trading.

Below is a chart of the NYSE Composite from the lows of 2012

to the most recent highs in 2014. Notice where the NYSE Composite was hitting its supply line or resistance line at the same time the NYSE Summation Index was in the +1,000 to +1,250 zone.



It may be a little hard to see the exact touch points, but for the first and second peak, you can see the NYSE Composite clearly touches the resistance line while the NYSE Summation Index is touching +1,200.

What makes the third touch point unique is that the NYSE did not touch the resistance line. This is not a 100% requirement for the NYSE to pullback as the market can do any and everything, but the fact the resistance line was not touched and the NYSE Summation Index did not approach the +1,200 mark was one of the reasons I have believe the market will continue to make higher highs.

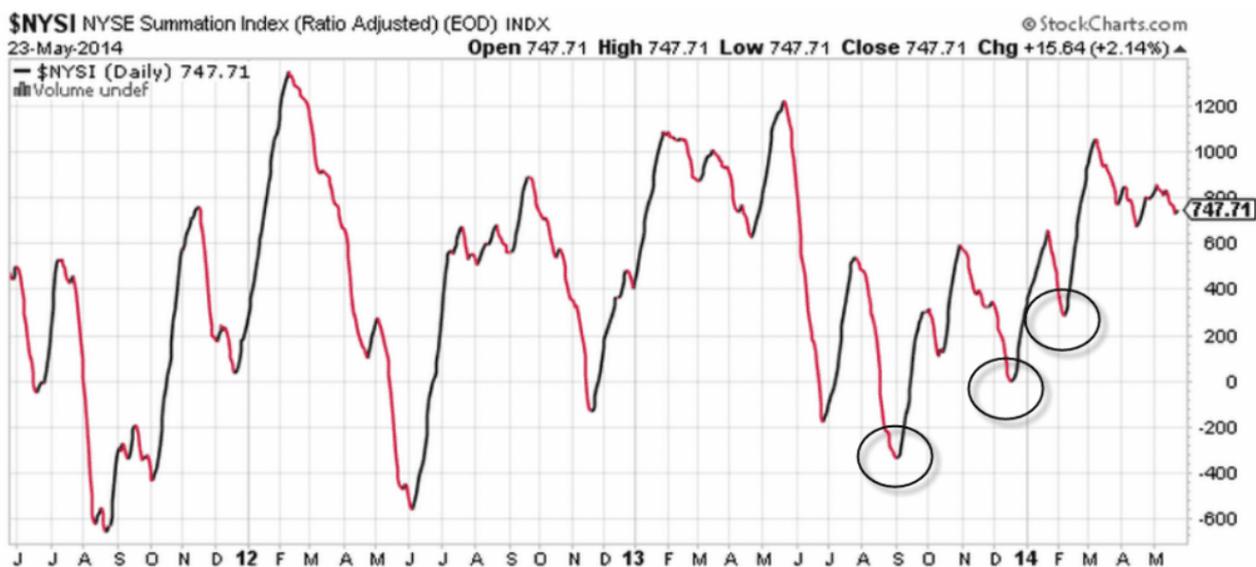
Based on the slope of the resistance line and the current value of the Summation Index at 747.71 as of 5/23/2014, the NYSE Composite could make a run over 11,000 before another top of any significance is in place.

Market Bottoms During 2012 to 2014 Bull

Market Run

The NYSE Summation Index is a running total of the NYSE McClellan Oscillator over a period of time. So, since this is a market breadth indicator, as a trend continues in a primary direction it's harder to determine the turning points for counter trends.

Now in plain English, as the market has continued to rally over the last two years (2012 – 2014), the troughs of the NYSE Summation Index have continued to rise as the market extends the bull market. So, where the market would rally as they NYSE Summation Index crosses -400, 6 months later the market could very well rally at -200 on the NYSE Summation Index.



Now let's take a look at the NYSE Composite chart during each of these lows on the NYSE Summation Index.



You have no trend line as confirmation for these bounces, because the market is trending so strongly. Now, for all you folks that draw a million lines on a chart, good luck with that. I use the Wyckoff method for drawing trend lines which prescribes that you only draw parallel or horizontal channels. So, I you will not see lines within lines on any of my charts.

So, to quickly recap, when the market is trending strongly, you will want to look for a confirmation of the NYSE Composite hitting a resistance line and the NYSE Summation Index peaking in the 1,000 to 1,250 range. In terms of buying the dips, the summation index may give you little indication of when things are oversold, because the negative readings may not hit the necessary extremes as the bias is to the bullish side.

Market Bottoms during the 2003 to 2008 Bull Market Run

Because the bull run from 2012 to 2014 has been so parabolic there hasn't been many cases where the bears were able to test the support line of the up channel. So, I had to look back quite a few years to find another bull market that covered several years, where we could assess how the market reacted when touching a support line and the NYSE Summation Index was

pushed to the -500 to -1,000 range.



There are 3 points in this chart where the NYSE Summation Index crossed the -500 territory which is the range we typically see lows occur in the market. Remember the -500 to -1,000 range we discussed earlier in this article.

I know there are 3 additional points where -500 on the NYSE Summation Index was crossed in late '07 and early '08; we will cover these in the next section of this article.

So, the lows in the NYSE Summation Index occurred in October '05, July '06 and July '07. Below is the chart of the NYSE Composite, so you can see how these lows on the Summation Index aligned with the lows on the NYSE Composite.



The first low in October, never touched the support or demand line. The market never makes it easy, so don't expect things to always fit perfectly within your analysis framework. This is where you as a trader need to make a call as to whether things need to align perfectly, or close enough based on your risk profile.

The next low comes in the June '06/July '06 timeframe. This low also coincided with a negative -500 reading on the NYSE Summation Index and the market rallied.

A similar situation occurred when the market rallied in August '07 as the NYSE Summation Index breached -500 and nearly touched -1,000. Shortly after hitting this low point, the market rallied to an historic high before the mortgage crisis crash.

How you can use the NYSE Summation Index to identify the start of Bear and Bull Markets

Start of Bear Markets

Going back to the previous section, there was a clear indication that the market was in trouble in late '07. After the NYSE Summation Index experienced a pullback below -750, the summation index then made a series of failed attempts to get over +500 only to quickly retreat back under the -500 territory. When the Summation index is unable to clear +500 before retreating, this is a clear sign that stocks are having weak bounces only to be slammed back down again.

Looking back at the NYSE Summation Index chart you will again see a number of runs at the -500 area without the market being able to successfully test and push through the +500.



There are no hard line rules for judging the transition to a bear market, so don't overdo it. Just remember to use your common sense. As you can see, the Summation index did not clear 500 convincingly. In addition, notice the distance between each push to -500 territory previously, versus the shorter duration for each push to -500 starting in late '07.



Just by looking at the NYSE Summation Index you would have known the market had shifted from a bull market to a cyclical bear market.

Again folks, this isn't rocket science, you just have to believe it isn't.

Start of Bull Markets

After the blood bath in the market, who would have known just as quickly as we shifted into a bear market, we were shifting back into a bull market? Let's look at the chart of the NYSE Summation Index for clues.



Notice how after the market reclaimed the +500 territory convincingly and the market never turned back below -500 on the NYSE Summation Index before rallying back above +1,000. This is a clear indicator that the bears are unable to push the market down with any significance before another rally ensues.

Now take a look at the NYSE Composite chart for this same period of time.



The bulls had a significant rally in terms of price, but by also monitoring the action of the NYSE, you would have known that now was not the time to take on large bear positions.

In Summary

Below are some key bullet points to highlight from this article:

1. The NYSE Summation Index is not a standalone tool for trading decisions

Bull Market

1. The market will have normal corrective pullbacks when the NYSE Summation Index enters the +1,000 to +1,250 range
2. The market will bounce when the NYSE Summation Index touches the -500 range
3. The market may bounce prior to touching the -500 area on the NYSE Summation Index if the market is experiencing a parabolic move
4. The market will not convincingly break -500 on the NYSE Summation Index

Bear Market

1. The market will have normal corrective rallies when the NYSE Summation Index enters the -500 to -1,000 range
2. The market will fall when the NYSE Summation Index touches the +500 range
3. The market may fall prior to touching the +500 area on the NYSE Summation Index if the market is experiencing a parabolic move
4. The market will not convincingly break +500 on the NYSE Summation Index

Shifting from a Bull to Bear Market

1. The market is shifting from a cyclical bull to bear market when the NYSE Summation Index has multiple touches of the -500 area within a short period of time and is not able to convincingly clear +500 on counter moves.

Shifting from a Bear to Bull Market

1. The market is shifting from a cyclical bear to bull market when the NYSE Summation Index has multiple touches of the 1,000 to 1,250 area within a short period of time and is not able to convincingly clear -500 on counter moves.