Special K ETF
Add-on Package for MetaStock®
User’s Guide

by

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Part I  Installing the Package and What’s Included

Important:

Please remember you need four (4) years of data in memory to plot the Special K. Applying templates to smaller files will return “an out of range” error. We recommend you set your load options in the open dialog to 10,000, not the Equis default of 500. If you’re unsure, please watch the Formulas, Templates, Experts, and Explorations movie for a full explanation.

1 Introduction

Welcome to our Special K ETF Add-on Package for MetaStock© User’s Guide. On this DVD you will find formulas, layouts, templates, experts, and explorations to help you get maximum usage from the Special K indicator. We have included “ETF” in the title because that is the principal focus of the package, however, the Special K can be applied to any security.

In addition to the MetaStock tools mentioned above, the package also includes four data folders containing ETF data as well as three movies:

1. A tutorial on how to interpret the indicator
2. A presentation explaining the templates, experts, and explorations, as well as how to import the formulas.
3. A presentation explaining what layouts are included and how they should be interpreted.

You can also refer to Part II of this manual on page 15, which goes into greater detail about the indicator itself as well as the layouts and templates that come with this package.
1.1 Installing the formulas, data, layouts and templates

1. At the main menu click on *Install formulas, data and layouts*.

![Figure 1](image1.png)

2. This takes you to the *Select Your Data Vendor* menu which has two choices; Reuters Datalink and QuoteCenter. Click on your data provider and proceed to the next menu.

![Figure 2](image2.png)
3. This menu is where you install the formulas, layouts and data to plot the Special K. For example purposes, this figure shows the Datalink menu, but if you chose QuoteCenter on the previous menu, you would see the identical menu except it would be to install the formulas, layouts and data for QuoteCenter.

![Figure 3](image)

*Click* and follow the instructions in the Install Wizard. Do not change the default drive from c:\. The wizard is going to create the required path that MetaStock will look for to access the Special K layouts and templates.

4. On the next screen, *click* to begin the installation.

When you have completed the installation, click on the Back Button to return to the Main menu.
1.2 Educational Movies

The next three (3) items in the main menu are linked to tutorials. The first (about 45-minutes) covers the Special K concept and how the indicator should be interpreted. The second (just over 20-minutes) explains the concepts behind the layouts. And the final tutorial (10-minutes) explains the new indicators, experts, explorations and templates you have imported.

1.3 Using the Data

Please note that we tried to include a comprehensive directory of ETF’s in the Exchange Traded Fund folder. However, in order to plot the Special K you will need at least four (4) years of data. Since many of the ETF’s in the directory have only recently been listed, you will not be able to apply the Special K until you have at least four (4) years of data.

Also, make sure you load sufficient data into memory. We suggest that you change the load option, found in the MetaStock Open window, to 10,000 in memory.
1.4 Special K and Other Formulas

The following custom formulas are included in the package. They are required to plot the Special K, KSTs and other indicators included in the package.

1.4.1 Absolute Price

**Daily Special K Double Smoothing Input (2)** - Plots the daily Special K and allows two inputs for its moving average; the original average and its smoothing. The default is 100 by 100.

**Special K Weekly** - Plots the Special K using weekly data. Make sure your data periodicity is set to “W” in the Chart Toolbar. This indicator requires two parameters; one for the moving average and another for the smoothing of the MA. The default values are 52 and 26.

**Special K Daily P** - Plots the daily Special K for the “P” variable. This formula is included to accommodate several layouts and templates. It will also enable you to plot the Special K for any price plot. With custom indicators, the “P” variable represents the plot that the custom indicator is dropped on. With system tests and explorations, the “P” variable represents the selected plot. This may be useful if you want an indicator, exploration, system test, or expert to calculate on a plot other than the chart’s base security.

**Special K for P Weekly** - Plots the weekly Special K for the “P” variable.

**Daily KST (#11)** - Plots the KST for short-term daily data. This is used to help determine the direction of the short-term trend as well as its maturity; i.e., whether it is extended on the upside or downside.

**Long-term KST (#18)** - Plots the long-term KST using weekly data. This is used in the weekly Special K arrangement to help identify the direction and maturity of the primary trend.

1.4.2 Relative Strength Formulas

The following formulas allow you to plot securities relative to specific indexes. The most common approach is to compare the price of a stock or sector to that of the S&P Composite.

**S&P RS Using SPY** - Plots the relative strength line against the S&P ETF (SPY) for the base security (the close). A rising line indicates the security is out-performing the S&P Composite and vice versa.

**RS MSCI ACWI Daily** - Plots the relative strength line against the US dollar based MSCI World Stock ETF for the base security. A rising line indicates the security is out-performing the World
In a sense, the ACWI is the essential benchmark against which a security’s performance can be judged. However, in this package we limit this relationship between individual country ETF’s and the ACWI.

**RS DJ Commodity (DJP)** - Plots the relative strength line against the Dow Jones AIG Commodity ETN for the base security. An ETN (Exchange Traded Note) works off essentially the same concept as an ETF (Exchange Traded Fund) in that it tracks an index, in this case, a broadly based commodity series. A rising line indicates the security is out-performing the DJP and vice versa. This would primarily be used to select the best performing commodity against the Index, or, if you were bearish, the worst performing commodity.

### 1.5 Description of the Data

Historical data, which is either updated in Datalink or QuoteCenter, is located in the four (4) folders on the root of C:\ drive. It is listed as follows:

**C:\ Exchange Traded Funds** - A reasonably comprehensive databank of listed ETF’s as of mid 2010. Note that many of these series have been spliced to their tracking indexes, allowing the Spider sector ETF’s to trace a history back to 1989. Some of these ETFs are duplicated in other folders.

**C:\ ETF Cross Sector Ratios** - Contains all of the US iShares sector ETF’s as well as a composite security for every cross sector relationship used in the layouts. For example, it is possible to compare the Utilities ETF (IDU) with every other sector, the Consumer Cyclical (IYC) with every other sector, and so forth.

**C:\ ETF Cross International Markets and Indexes** - Contains individual country ETF’s as well as composite securities for relative strength relationships against the MSCI World Stock Index. Country ETF’s have been included in the layouts where there is a sufficient data history to plot the Special K.

**C:\ ETF Commodities and Indexes** - Contains individual commodity ETF’s, many of which have been spliced to their respective cash price in order to obtain a long history, most dating back to the late 1970’s. Also included are composite securities calculating relative performance against the Dow Jones AIG Commodity ETF (DJP). Finally, you will find several “cap” indexes, such as small cap value/growth, etc. as a tool to follow these changing relationships.
1.6 Special K Templates

The following templates may be applied to any security where there is at least four (4) years of daily data. Periodicity should be set to D (Daily) unless otherwise noted.

**Special K Daily** - The price, the daily Special K and the daily KST. The concept behind this arrangement is to use the Special K as an indication of the direction and maturity of the primary trend. The reason for including the short-term KST is to show overbought and oversold conditions because these are not apparent from the summed cyclicality of the Special K.

**Special K Weekly** - This template features the weekly closing price, Special K and Long-term KST. Using the weekly format allows a significant price history to be displayed. This template shows how well the Special K has reflected previous primary bull and bear markets. Generally speaking, when it has done a good job in the past this is likely to continue in the future and vice versa. The long-term KST is included to offer a more smoothed version of primary trend momentum. EMA crossovers by this indicator often provide reliable signals of a change in the direction of the primary trend.

**Special K Daily Nirvana** - I call this the “Nirvana” template because it provides four key ingredients for analyzing the long-term technical picture. These are the price and its long-term Special K. The template also includes the same information for the relative action against the S&P Composite. This is crucial because you not only want to be exposed to securities that are rising on an absolute basis but ones that are also appreciating faster than the market. For example, if both the price and RS are moving up, and then suddenly, the Special K for relative action signals a reversal to the downside and this is confirmed by the RS line itself, it’s probably time to look for another investment where the RS line is rising.

**Special K Weekly Nirvana** - Plots the price, the Weekly Special K, the RS line versus the S&P (SPY) and the relative weekly Special K. Periodicity should be set to W. This is a weekly version of the daily nirvana template described above.

**World Weekly Nirvana** - Plots the price, the Weekly Special K, the RS line versus the MSCI World ETF (ACWI) and the relative weekly Special K. Periodicity should be set to W.

**Special K Weekly Commodity Nirvana** - Plots the price, the Weekly Special K, the RS line versus the DJ AIG Commodity ETN (DJP). Periodicity should be set to W. This template is designed to isolate commodities that are out- and under performing the commodity market as reflected by the Dow Jones UBS commodity ETN.
1.7 Special K Layouts

Layout titles are preceded by a letter to denote their classification and for easier reference. A stands for US equity market, B for cross sector relationships, C for international ETF’s and D for commodity ETF’s.

1.7.1 The “A” Layouts

A Special K Daily Absolute Sectors plots the Special K Daily template for all the iShares Dow Jones sectors.

A - Special Daily RS Sectors - Plots the Special K Daily template for the relative strength of all the iShares Dow Jones sectors plus the iShares Lehman 20-year Trust (TLT). These are arranged in chronological sequence as they evolve through the sector rotation process starting with interest sensitives (deflation beneficiaries) and rotating through to energy (inflationary beneficiaries).

A - Special K Daily Nirvana Sectors - Plots the Special K Daily Nirvana template principally for the iShares Dow Jones sectors plus the iShares Lehman 20-year Trust (TLT). These are arranged in chronological sequence as they evolve starting with interest sensitives (deflation beneficiaries) and rotating through to energy (inflationary beneficiaries).

A - Special K Daily Cap Plays - Plots the Special K Daily template for different indexes and relative cap play relationships (growth vs. value, etc.)

A - Special K Weekly SPDR Absolute - Plots the Special K Weekly template for the Spider sectors back to 1989, again in rough chronological sequence.

A - Special K Weekly SPDR RS - Plots the Special K Weekly template for the Spider sectors back to 1989 in rough chronological sequence.

A - Special K Weekly SPDR Nirvana - Plots the Special K Weekly Nirvana template for the Spider sectors back to 1989 in approximate chronological sequence.
1.7.2 The “B” Layouts

Each of the layouts preceded by the letter “B” plot the Special K Daily template for that specific sector against every other sector. The charts appear in the rough chronological order we would expect to unfold during the cycle. They start with Bonds and work their way through to Oil and Gas Equipment. Plotting and analyzing these layouts provides an excellent way to appreciate whether a sector has broad or narrow appeal. For example, if you see a specific sector where the vast majority of its cross sector relationships are breaking to the upside, the odds are very high that it is emerging as a market leader.

B - Special K Daily Lehman 20-year Trust
B - Special K Daily Utilities
B - Special K Daily Homebuilders
B - Special K Daily Brokers
B - Special K Daily Financials
B - Special K Daily Financial Svs
B - Special K Daily Transports
B - Special K Daily Real Estate
B - Special K Daily Telecom
B - Special K Daily Con Staples
B - Special K Daily Con Cyclicals
B - Special K Daily Health Care
B - Special K Daily Technology
B - Special K Daily Gold Mines
B - Special K Daily Industrials
B - Special K Daily Materials
B - Special K Daily Energy
B - Special K Daily Oil and Gas Equipment
1.7.3 The “C” Layouts

These layouts feature individual country ETF’s both on an absolute and relative basis.

**C - Special K Daily International Absolute** - Plots the Special K Daily template for all the iShares MSCI Country ETF’s and some regions.

**C Special K Daily International RS the World** – Plots the Special K Daily template for all the iShares MSCI Country ETF’s and some regions relative to the MSCI World ETF (ACWI).

**C Special K Weekly International Nirvana** - Plots the Special K World Weekly Nirvana template for all the iShares MSCI Country ETF’s and some regions.

1.7.4 The “D” Layouts

These layouts feature individual commodity ETN’s or ETF’s, on an absolute and relative basis. Most of these securities have a very limited trading history and for that reason the actual commodities have been spliced to them. This provides a continuous historical series often going back to the early 1980’s and before.

**D Special K Daily Commodities Absolute** - Plots the Special K Daily template for certain commodity ETF’s.

**D Special K Daily Commodities RS** - Plots the Special K Daily template for certain commodity ETF’s relative to the Dow Jones AIG Commodity ETF (DJP).

**D Special K Weekly Commodities Nirvana** - Plots the Special K Weekly Commodity Nirvana template for certain commodity ETF’s.

1.8 Special K Experts

The experts have been designed to identify short-term signals that develop in the direction of the main trend, buy signals in bull markets and sell signals in bear markets.

**Special K Daily Pro Trend MA Signals** - This expert should be used with daily charts. The bullish primary trend is signaled when the Special K is greater than its 100-day SMA smoothed by a 100-day SMA. The short-term signal is triggered when the Special K itself crosses above its 10-day SMA. The buy signal remains in force as long as the Special K remains above its 10-day
SMA. Sell signals are triggered when both conditions are present in reverse. Bullish periods are highlighted in green, bearish ones in red and neutral periods in black or whatever color the base security is plotted in.

**Special K Daily Pro Trend Slope Signals** - This expert should be used with daily charts. The bullish primary trend is signaled when the Special K is greater than its 100-day SMA smoothed by a 100-day SMA. The short-term signal is triggered when the slope of the Special K itself reverses to the upside, and stays in force until it reverses to the downside. Sell signals are triggered when both conditions are present in reverse. Bullish periods are highlighted in green, bearish ones in red and neutral periods in black or whatever color the base security is plotted in.

**Special K Primary Trend** - This expert should be used with daily charts. The bullish primary trend is signaled when the Special K is greater than its 100-day SMA smoothed by a 100-day SMA. A bear trend is signaled when the opposite conditions hold. Bullish periods are highlighted in green and bearish ones in red.

### 1.9 Special K Explorations

**Special K Pos Slope Primary Buy** - Searches for securities where two conditions are met. First, the daily Special K is above its 100-day MA smoothed by 100 days (primary bull market). Second, where the slope of the Special K has just turned to the upside.

**Special K Negative Slope Primary Sell** - Searches for securities where two conditions are met. First, the daily Special K is below its 100-day MA smoothed by 100 days (primary bear market). Second, where the slope of the Special K has just turned to the downside.

**Special K ST MAX Buy in Primary Bull** - Searches for securities where two conditions are met. First, the daily Special K is above its 100-day MA smoothed by 100 days (primary bull market). Second, where Special K crosses above its 10-day MA.

**Special K ST MAX Sell in Primary Bear** - Searches for securities where two conditions are met. First, the daily Special K is below its 100-day MA smoothed by 100 days (primary bear market). Second, where Special K crosses below its 10-day MA.
Part II - The Theory and Application of the Special K

2  Introducing the Special K

The Special K combines short, intermediate and long-term time frames into one series and often peaks and troughs with actual bull and bear market turning points. It can be used in many ways. The two most important are its ability to identify primary trend reversals at a relatively early stage and second, using short-term changes in direction of this unique indicator help traders to spot 1-to 6-week buying and shorting opportunities. Since the Special K points you in the direction of the primary trend, it also indicates whether these short-term signals are triggered in the direction of the main trend. That’s crucial from a trading aspect because if things are going to go wrong, contra-trend price moves are typically where this will happen. Short-term buy signals in a bear market, for instance, will likely result in losses as will shorting from near-term sell signals in a primary bull market.

This educational tutorial will give you all the information you will need to interpret the Special K, but first we need to cover some background material to better understand the rationale behind the construction and application of this indicator.

2.1  The Three Trends

Price at any one time is determined by the interaction of numerous time cycles. Figure 5 features three of the most widely recognized. The thick green line represents the primary trend, or what are commonly known as bull and bear markets. They last on average between 9-months to 2-years and revolve around the so called four year business cycle. The approximate time separating the two troughs averages between 3- to 4-years. Markets rarely move in straight lines, so the primary trend is interrupted by intermediate price movements that average between 6 weeks to 9-months. They are represented by the blue line. Finally, the dashed brown line flags short-term price movements that average between 3- to 6 weeks. Some time ago, I devised three smoothed momentum indicators to reflect price movements in the short-, intermediate- and long-term trends. I called them “KSTs”, but more about them later.

Obviously, an investor, with say a 9-month to 2-year time horizon, looks to accumulate somewhere close to the bottom of the thick primary trend line and sell when it is in the process of peaking. If this can be accomplished within 10-15% of the final turning point, that investor should be happy. This process clearly requires a good faith attempt at understanding the direction and maturity of the primary trend. You may be thinking that a trader can ignore this information since he or she should only be focused on the dashed short-term trend. Nothing could be further from the truth and here’s why.
If you refer back to Figure 5, it's fairly obvious that the most bullish short-term rallies develop in the left hand part of the diagram when the primary trend is bullish. Similarly, the short-term trends with the greatest downside magnitude occur on the right hand side during the primary bear market. These are what we call “pro trend” moves because they move in the same direction as the primary trend. Price movements that operate in the opposite direction to the main trend are called “contra trend”. In my opinion, one of the most common mistakes made by short-term traders; i.e., those with a time horizon approximating 2 to 4-weeks, is trying to make money from these contra trend moves. We all know that a rising tide lifts all boats. In this instance, the rising tide is the bullish primary trend, and if you want your financial boat lifted, you should try and piggy back on its strength. One of the reasons for the failure of contra trend moves is that many of them turn out to be whipsaws.

Try sailing a toy boat on an incoming wave. It might sail into shore for a limited period, but if the tide is going out, it will be permanently marooned until the tide turns. Even if the tide is coming in, it may halt temporarily, but sooner or later a record wave will push it closer to shore. That’s also how it works in markets. As the bull market allows you to make a certain number of mistakes, primary bear trends take no prisoners for those trading on the long side.
2.2 The KST, a Key Special K Building Block

Before we take a closer look at the Special K and see how it fits into the market cycle model approach in Figure 5, I'd like to return to the idea of the three trends and introduce the KST.

Price at any one time is determined by the interaction of several different time cycles. You can see this from Chart 1, which compares the gold price to three different rate of change (ROC) indicators. The first is a 10-day ROC smoothed by a 10-day moving average (MA), the second a 20-day smoothed by a 10-day MA and the third a 30-day smoothed by a 15-day MA. The solid and dashed arrows plotted against the price point out the sharper price movements. You can also see three ROC’s are moving in concert, which means that the time cycles reflected by these parameters are “in gear.” When they are operating in different directions, such as in the February/March period, a trading range results. Agreement results in sharp trends and disagreement in trading ranges. This means that if you are relying on a momentum indicator constructed from one specific time span, you are only focusing on the time cycles reflected
by that time span and missing the big picture. Realizing this, I developed the KST indicator, a momentum series that incorporates four different time frames in its construction. Taken to its logical conclusion, I should have devised an indicator that incorporates an infinite number of parameters, but this only complicates matters, and I like to keep things as simple as possible. Besides, the four parameters used in the KST appear to work reasonably well for most markets over most time periods. It’s not a perfect indicator. That’s why I call it the “KST” because you know it’s not a Sure Thing. Because of its custom design it’s not possible to use the same indicator for all trends. That means that we have to have a specific formula for the short-, intermediate and long-term trends.

*Intraday formulas can also be found at http://pring.com/kstformulas.htm.*

One of the ways in which I have found the KST to be useful is to reproduce the short-, intermediate and long-term trends in a “stacked” format as in Chart 2.
The idea is that by looking at the long-term KST we get some perspective of the direction and maturity of the primary trend. The green and red waves reflect these bull and bear market trends as signaled by the direction of the long-term series. Obviously, there is a bit of poetic license going on as the KST reversed very slightly to the downside in 2005. However, one of the key points is to show you that the trading range of the short-term KST (the brown dashed parallel lines) shifts slightly to the downside during a bear market and the green ones slightly to the upside in a bull phase. There are two implications for this. First, if the long-term KST is in a clear-cut declining mode it would be reasonable to expect the short-term KST to peak out from the upper level of the bearish trading zone and vice versa. Second, if you can see that the KST has moved well beyond the norm of the recent trading range, then the odds of a primary trend reversal have increased. Such a signal was triggered at point A in early 2003, when the KST exceeded the upper area of the bear market trading range. The dashed brown arrows show bear market short-term KST reversals that took place after the indicator had fallen below zero. These were contra trend signals, and with the exception of the late 2001 instance, were not followed by much of a rally. Contrast that to the green arrows which indicate the pro trend signals; i.e., buy signals in a bull market. For the most part, they are far more profitable than the contra trend ones. The final point to note is that zero crossovers by the intermediate KST often confirm a primary trend change, as you can see from the small red and green arrows.

That’s a brief synopsis of how this KST arrangement is interpreted, but there is an alternative way to display that information and its done by combining these three series into one indicator—the Special K.
### Calculation of Special K for Weekly Data

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2.3 The Special K

The “Special K” gives us true summed cyclicity as the short-, intermediate and long-term indicators are combined into one all encompassing series. In effect, the overall trajectory of the short-term trend gets a new name, and that’s The Special K. The calculation is made by adding the short-term KST formula to that of the intermediate and long-term series. The formula for weekly data is presented in Table 1. There are two arrangements, depending on whether you are monitoring daily or weekly charts.

Chart 3
2.4 The Special K Weekly Arrangement

The weekly approach is shown in Chart 4, which compares the Special K to the long-term KST. The vertical lines show that the indicator often reverses simultaneously with the price. However, the dashed arrows indicate this is not always so. Of course, it is quite easy with the benefit of hindsight to see this, but when we are in the real world, we need techniques that will identify these reversals at a relatively early stage.

The Special K combines each of the three KSTs featured in Chart 1. If there is some long-term, primary trend cyclicality, it will show up in both the Special K and long-term KST. (The latter is plotted in the bottom panel to offer some smoothed perspective because the Special K is often quite jagged.) Another reason for plotting weekly data is the ability to include a much longer history that helps establish whether the series in question is subject to the four-year
cycle. The dashed brown arrows connecting the Special K with the KST in Chart 4 indicate the Special K typically leads at major turning points, offering an early bird warning that the primary trend may be in the process of changing. The jagged action by the Special K does come with a key advantage and that is the ability to construct meaningful trendlines. Five turning points where Special K trendline breaks have been confirmed by Dow Jones AIG violations appear on the chart. Four of these were quite timely, but the fifth, in 2004, resulted in a false break. It’s also possible to use crossovers of the dashed smoothing line as an indication of when the Special K may have reversed. This “signal” line is a 26-week simple moving average of a 52-week simple moving average of the Special K itself.

These are highlighted in Chart 5 by the vertical solid green and red arrows. The ellipses show that all is not perfect since the indicator occasionally triggers whipsaw crossovers. Note also that while the final peak and trough for the Special K usually coincides with that of the
price, the indicator does occasionally turn prematurely and sets up a divergence with the price. Two negative divergences are flagged in Chart 5 by the dashed red arrows. These discrepancies develop because the calculation of any momentum series assumes a normal cyclic range. In the case of the Special K, this is a four-year business cycle. If the cycle is extended in any meaningful way, any momentum indicator will peak or trough prematurely.

2.5 The Special K Daily Arrangement

My favorite method of displaying the Special K uses a calculation based on daily data incorporating simple moving averages in the formula (Chart 6).

In this instance, the formula (See Table 2) assumes the same time frames as those plotted on the weekly chart.
The difference is that a simple MA is substituted for the EMA and the parameters are multiplied by 5 to simulate the weeks. This approach is not an exact simulation because some weeks only contain four trading days because of holidays, but this does not appear to unduly affect its accuracy.

If you compare movements in the short-term (daily) KST in the bottom window with those of the Special K, you will see that they are very similar. The reason for including the short-term KST is to show overbought and oversold conditions because these are not apparent from the summed cyclicality of the Special K, but more of that in a bit. The Special K can be used in two broad ways; identifying major trend reversals and timing pro trend short-term moves.

### 2.6 Identifying Major Trend Reversals at an Early Stage

The following techniques help us to better time primary trend reversals:

1. Observing trendline breaks, such as that in late 2006 in Chart 6.

2. Identifying a reversal in a series of rising or falling peaks and troughs. For example, the end of the bull market in November 2007 was signaled in this way.

3. Finally, crossovers of the Special K’s smoothing. In this case, I typically use a 100-day smoothing of a 100-day simple moving average, as shown in Chart 6. By that method the series of declining peaks and troughs was still in force in mid September of 2008 as the chart closes. Please note that the 100/100 smoothing is not offered as the holy grail but more as a smoothing that appears to work reasonably consistently.
2.7 Using the Special K to Time Pro Trend Short-term Trades

The Special K can also be used in conjunction with the daily short-term KST. This latter series is interpreted as any other smoothed oscillator with overbought/oversold readings, moving average crossovers, divergences and so forth. The Special K on the other hand, is more of a primary trend swing indicator as it usually experiences rising peaks and troughs during a primary bull market and falling ones in a bear trend. As a result, the Special K is normally plotted with 3 or more years of data so that the most recent primary trend cycles are placed in perspective. If we also plot the regular KST underneath, two benefits are derived. First, we can use its gyrations to help identify short-term reversals in the Special K.

For example, if the KST is overbought and reversing as in May 2000 (Chart 7), it is more likely to result in an imminent reversal in the trajectory of the Special K. When the KST reverses...
to the upside and there is very little or no Special K response, the chances are that the bearish intermediate and long-term forces are dominating. Under such circumstances, the Special K is most likely going to register a new low, thereby confirming that the main trend remains bearish. Several examples of this phenomenon are flagged by the red arrows in Chart 7. The most glaring discrepancy developed in the August/September 2001 period when the KST experienced a gentle rally but the Special K continued in its decline with no sign of strength whatsoever. Bullish divergences develop when the KST declines but the dominant longer-term cycles used in the Special K calculation propel it upwards. A good example developed in November 2002 and January 2003 marked by the green arrows. The idea of rising peaks and troughs for the Special K is especially important. For example, look at the purple arrows at points A and B. That for the KST shows a lower low in November 2002 and that for the Special K a higher trough, if you can call it that, at B.

Finally, there is another way the short-term movements can help in deciding whether a specific short-term KST buy or sell signal is going to work or not. Note the horizontal line marking the short-term low in the Special K in May 2001. When the indicator violates this level, it signals that a new low in the price itself is likely. In the case of the May 2001 example, the Special K took out its low just about 2-weeks before the CRB did.

The reverse situation developed at point B, where the Special K moved to a new high. In this case, there was no lead by the momentum indicator as the price broke out more or less simultaneously with it.

### 2.8 The Special K and Relative Action

We occasionally see markets experience long-term linear up or downtrends, examples would include Japan in the 1980’s or the US in the 1990’s. Such trends do not lend themselves to momentum interpretation because oscillators, whose calculation assume a normal four-year business cycle, peak prematurely and trigger several false sell signals prior to the ultimate secular turning point. Because the calculation of the Special K assumes the cyclicality of the 4-year business cycle, it too suffers from this weakness during linear up or down trends. However, the Special K lends itself handsomely to trends in relative action. While market averages, such as the S&P, might occasionally experience a persistent linear uptrend, individual sectors are continually rotating leadership roles. For example, between 1998 and 2000 tech stocks performed admirably but financials were not so strong. In such situations, indicators such as the Special K are able to isolate emerging new leadership at a relatively early stage. That’s one of the reasons you will find a significant part of this plug-in is devoted to relative relationships, especially sectors relative to the US stock market.

In this respect, Chart 8 features the relative strength line for the S&P Financials, an early leading sector. When the line is rising it means that the financials are out performing the S&P and vice versa. One of the ETFs for this sector is the XLF. You can appreciate the long-term cyclical swings in the KST in the bottom panel and the Special K in the center one. The arrows
point to Special K moving average crossovers, which often occur simultaneously or close to trendline violations. As you can see, the cyclicality of this series consistently offered good signals in this 15-year period.

Chart 9 features the relative action of the S&P Materials, a sector that does well at the end of the cycle is therefore moving (in relative terms) in an opposite direction to the financials most of the time. If you compare Charts 8 and 9, you will see that the Financial Special K was declining in 2007/08 whereas that for Materials was advancing. The character of the Special K for Materials is also slightly different in that it is subject to strong intermediate swings within the 2003/05 primary Special K bear market and the 2005/08 bull market. I have drawn some bullish and bearish trendlines and their respective violations for the relative strength line itself. Note how the bearish dominant intermediate and long-term cycles pressured the Special K lower when the KST was rising at point X. This was negative until all three series violated down trendlines in October 2005. We see the same sort of thing develop almost a year later at point Y.
2.9 Conclusion

I have listed a lot of the benefits of this new indicator. However, it’s certainly no holy grail. Each security has its own unique set of market participants, and collectively they have their own characteristics as reflected in the price action. Consequently, as with any indicator, it’s important to look back and see what kind of characteristics have manifested themselves in the past. Are Special K moving average crossovers consistent or not? Does the indicator offer extended trends of rising or falling peaks and troughs? Have such reversals offered reliable signals in the past? If you can satisfy yourself that a specific, or set of specific, characteristics work fairly consistently, then go with the Special K. If not, recognize this weakness and use it with another market or security. Finally, I have compared the Special K to the long- and short-term KSTs, but there is absolutely no reason why you cannot substitute your favorite momentum indicator be it the RSI, stochastic, MACD, etc.

Good Luck and Good Charting!

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