

Lumber, Utilities, and Gold

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This paper compares the characteristics of the Lumber/Utilities Index with the Lumber/Gold Index from the start of 2008 to the end of 2020.

These charts begin in 2008 because that's when the WOOD ETF started. The WDUTX indicator is calculated by dividing the price of the WOOD (Lumber) ETF by the price of the XLU (Utilities) ETF. The WDAUX indicator is calculated by dividing the price of the WOOD (Lumber) ETF by the price of the GLD (Gold) ETF.

For these charts, the VTI (total market) ETF chart has Ned Davis' favorite, intermediate-term average combination, a 13-week average (the green line) and a 34-week average (the red line). The WDUTX and WDAUX charts have a 2-week average (the green line) and a 16-week average (the red line).

The Sub-Prime bear market was already underway in 2008, with VTI dropping from over \$75 to below \$40 by November. WDUTX/WDAUX turned bullish a few times during 2008 but mostly they agreed with the VTI.



Observations

When the WDUTX or the WDAUX fast average only gets a little above the slow average, then it may not mean very much. In September the fast average got pretty far above the slow average, but the VTI did not even get above its fast average, so it was not surprising to see WDUTX and WDAUX drop back below their red line in October.

If the WUDTX/WDAUX fast average crosses the slow average and the slow average doesn't really turn to follow the fast average, then the crossing may be just market noise. In other words, if the slow average keeps going in its original direction or it only turns far enough to be somewhere near horizontal, then the signal is not compelling. In 2008, even the crossover in September barely got the slow average above horizontal (and the increasing decline in the VTI contradicted the WDUTX).

In March of 2009 the VTI fell below \$35 and then rose to reach its fast average by the end of the month. In April WDATX and WDAUX both turned positive with the fast average convincingly crossing above the slow average.

By the start of May, the fast averages were well above the slow averages, signaling a market turn up. VTI price confirmed the WDATX signal as it was far enough above its fast average to cause the fast average to turn up. But the VTI averages did not cross until the end of July, another three months.



In late June the WD fast averages crossed below their slow averages, but did not get very far below it before crossing back above the slow average in the second half of July. Also, the slow average only turned down a little past horizontal, so this wasn't a strong WDATX signal. In November WDAUX gave another negative signal, but neither the WDATX nor the VTI confirmed it.

In May 2010, WDAUX was in a steep decline. WDUTX also turned down. WDUTX confirmed the strong WDAUX signal in the second half of May. The WDUTX signal coincided with a downward ABC Setup signal in the VTI.



From August to January the WDAUX trend went flat and it chopped sideways. But at the end of September, the WDUTX and the VTI signaled a turn up within 10 days of each other.

In 2011, the WDAUX turned down in April and the WDUTX turned down in early May, as the VTI was making an new high. While some people were "buying the dip" in June, both WD indexes were steadily declining.

The VTI bounced up in July, but the fact that neither of the WD indexes turned up was a serious warning. The decline in the VTI that started in late July was not pleasant. By the time the market hit a low in early October, it was down more than 20% from its July high.

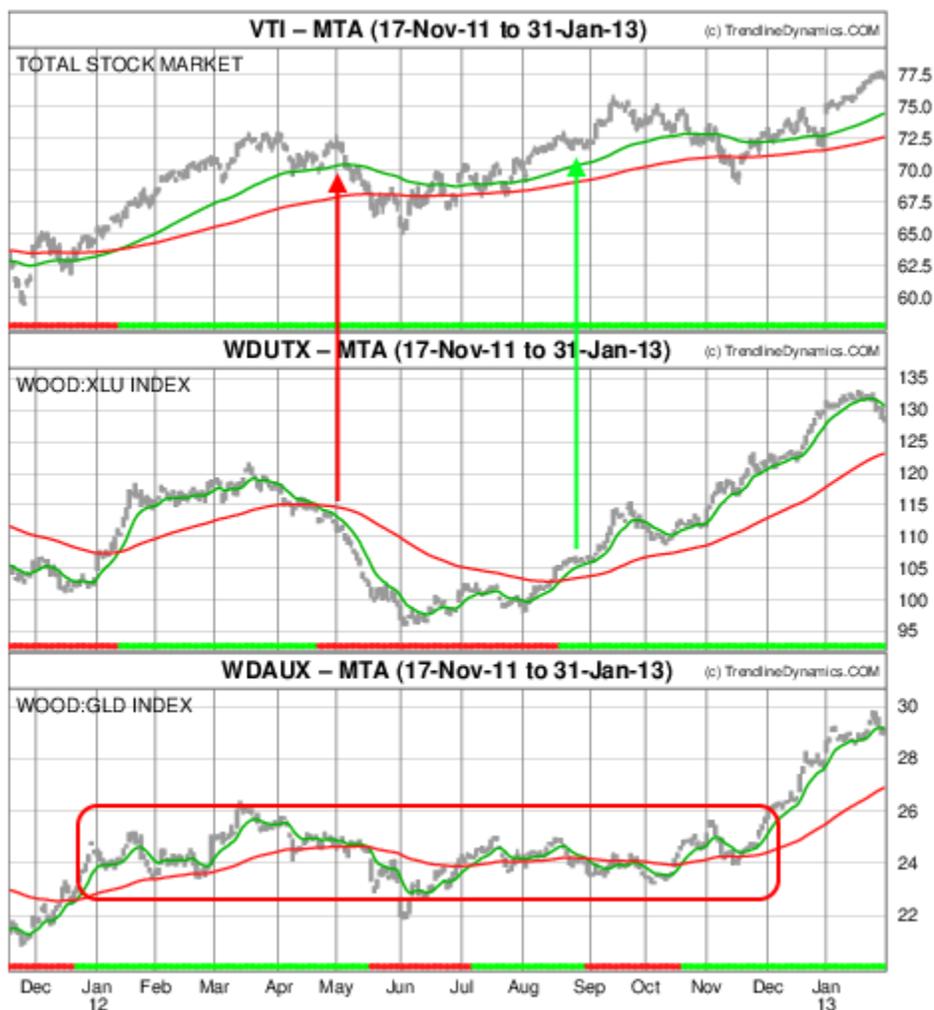


By the end of the year, all 3 indicators turned up within a month of each other.

While the moving averages of price were telling us everything was fine, the WDUTX gave us a negative signal at the beginning of May, and a positive signal near the end of August. The negative signal would have gotten us out of VTI at about \$72.50, and the positive signal would have gotten us back into VTI at about \$72.50.

Some people will look at this and think that it was a useless exercise. Remember that you never know what will happen for any given signal, no matter what indicator you choose. This exit and re-entry turned out to be a wash, but the exit signal in May 2011 saved us from walking into a huge pothole.

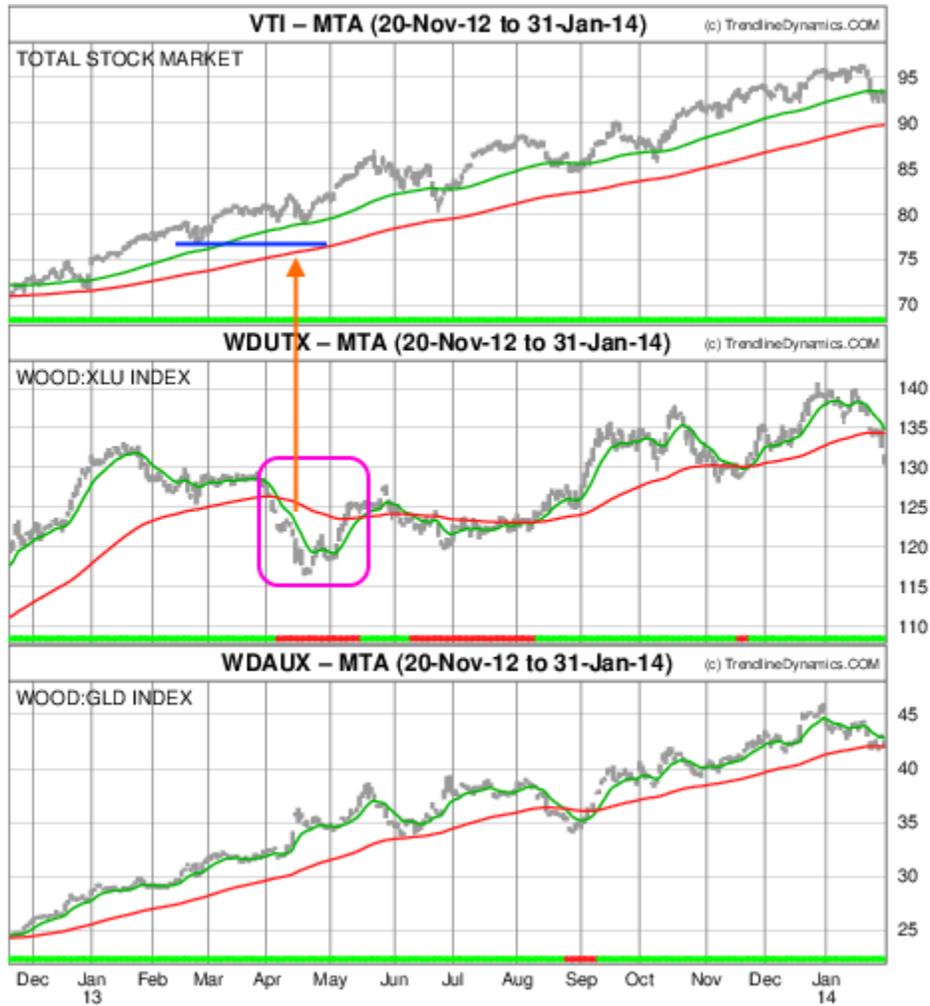
Signals from well-designed indicators aren't telling us about what will happen next. They are telling us about a shift in the probabilities (i.e., what is likely to happen next). When the reward-to-risk ratio drops below 1, it's time to either hedge or get your money off the table.



In 2012, WDAUX again went flat. This time for almost a year. This is the kind of thing that is hard to identify while it is happening. It only becomes really clear in hindsight. That's why studies like this are useful.

April of 2013 brought a credible negative signal from WDUTX. The fast average crossed below the slow average and by the time we got to where that orange arrow is, the slow average had visibly turned down.

But there was no confirmation from either price or the WDAUX. So what should we do? First, it's time to go look at other indicators like money flow and so on. Second, it never hurts to establish a hard stop (a price level which, if it's broken, you will unhesitatingly exit). An easy way to find a good stop level is to go back to the last local low. In this case, that happened in late February. Draw a line forward from that low (about \$77). If price closes below that, **bail**.



There was another negative signal from WDUTX in June, but the fast average never got very far below the slow average and the slow average remained pretty close to horizontal.

This year is rather surprising. It appears that in 2014 both WDUTX and WDAUX have gone off the rails. Price is in a fairly steady uptrend. WDUTX is in a steady downtrend. And WDAUX has once again gone flat for months in a row.



Without digging into other indicators and looking at the economy, I have no idea what caused this.

There's some more chop in WDAUX in 2015. By the time it's obvious that the sideways trend is over in WDAUX, price has already fallen more than 14% so that doesn't do anybody any good.

There's also a flat period in WDUTX from mid-February to June, but fortunately the sideways move manages to stay just above the slow average. After a while, the WDUTX fast average breaks down through the slow average. By the time it is clearly headed down and the slow average has visibly turned down, it's already late July. However, VTI doesn't turn down for another month, and by that time it's glaringly obvious that WDUTX is in a very serious decline.

I think I would have started selling in early August, and definitely when price broke down through the 8-month blue trendline.



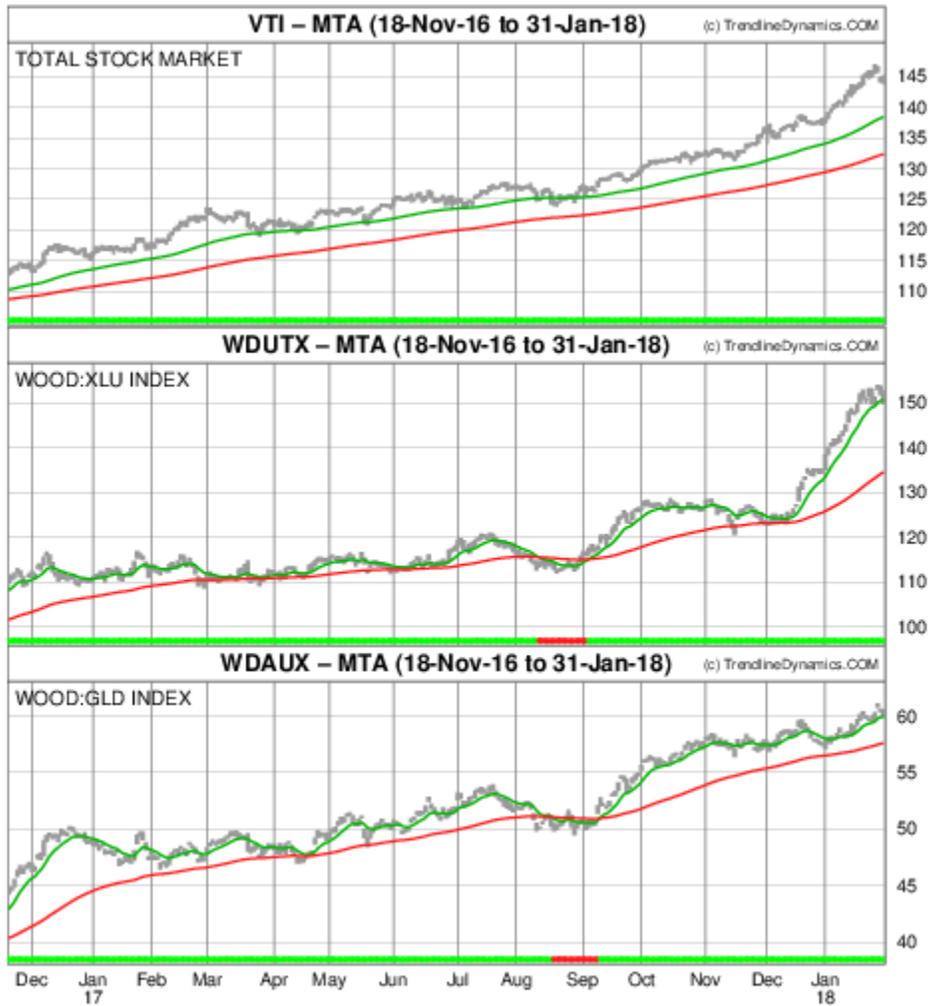
In November, WDUTX does an interesting head-fake. But even if you bought VTI on November 13th or 14th and then sold it near the end of December, you still would have broken even, give or take.

WDUTX made a couple of weak attempts to get above its slow average in April and May. WDAUX made a better attempt at the end of May, but that turned out to be a false signal. So neither WD index got overtly positive until sometime in August.



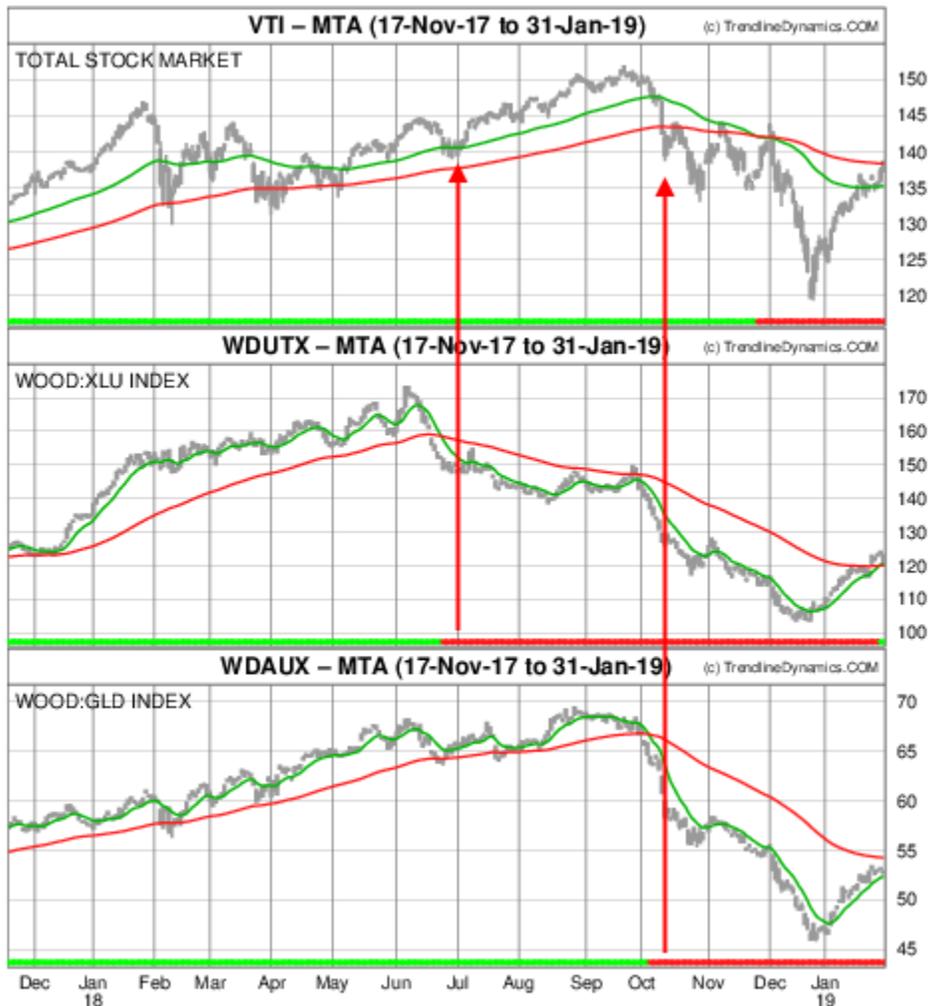
From what I've seen so far, the WD indexes are better at marking exits than entries. In this case, trendline analysis would have given an entry in the 2nd week of March, the MTA would have given an entry in the 3rd week of March, and even the 13/34 average crossover would have gotten you in by late April. All three of those methods beat the WD index entry signals in this case.

In 2017 the market was off to the races. The WD indexes gave a couple of half-hearted warning signals in August, but neither one got the slow average much past horizontal.



In July of 2018 WDATX gave a clear negative signal with the fast average below the slow average and the slow average visibly starting to turn down. WDAUX was a little late to the party, not giving a clear signal until VTI had already fallen 10%.

You have probably noticed that I have consistently placed any of the signal arrows a week or so after the fast average/slow average crossover. Throughout the charts there have been quite a number of false crossovers.



Here in 2019 we again see major lags between the price entry signal and the WD index signals.



January of 2021, both WDATX and WDAUX produced negative signals on almost the same day. Three weeks later the price of VTI (and many other securities) fell 30%-40% in just under 5 weeks.

