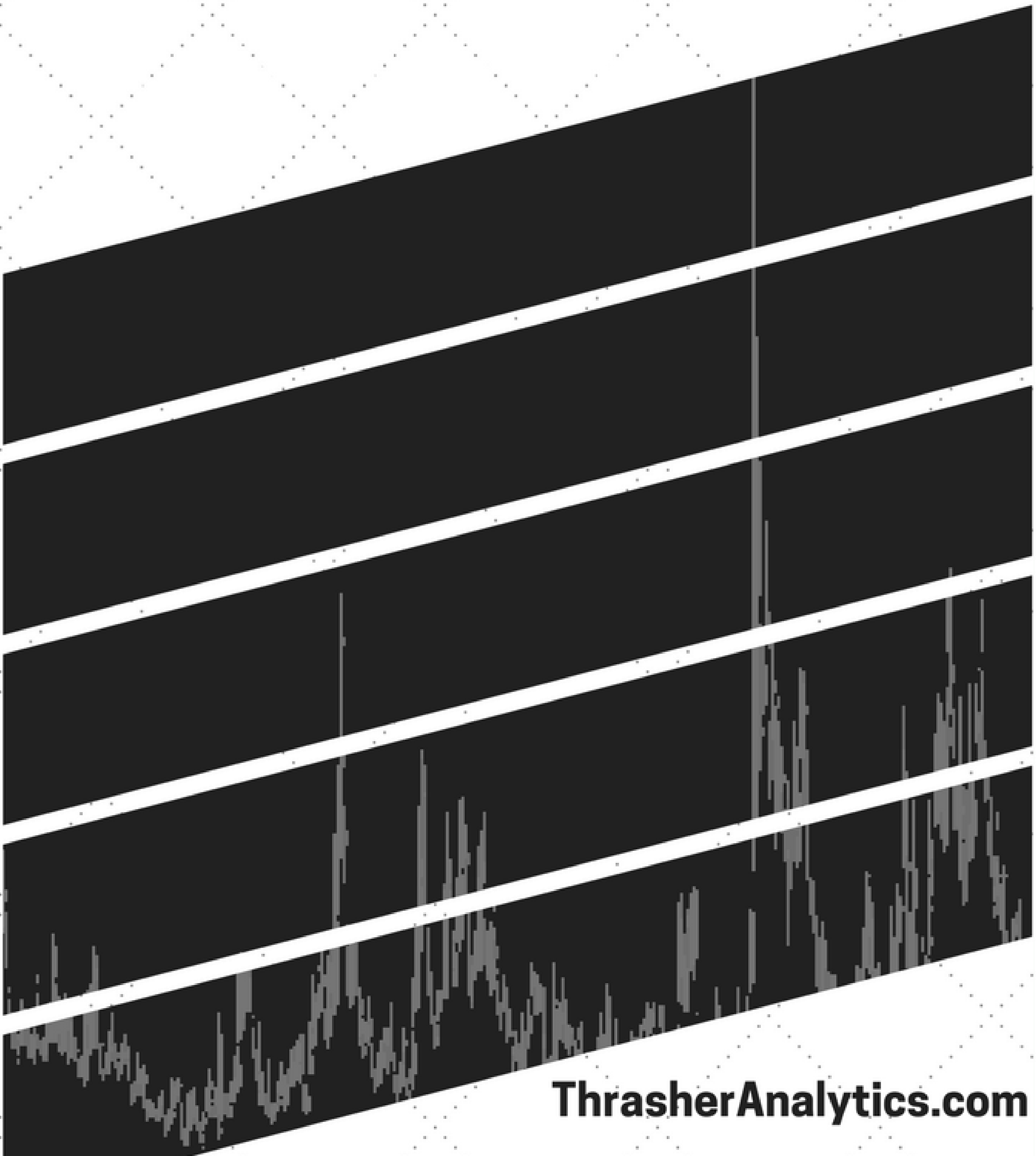
THRASHER ANALYTICS

BI-WEEKLY RESEARCH & ANALYSIS



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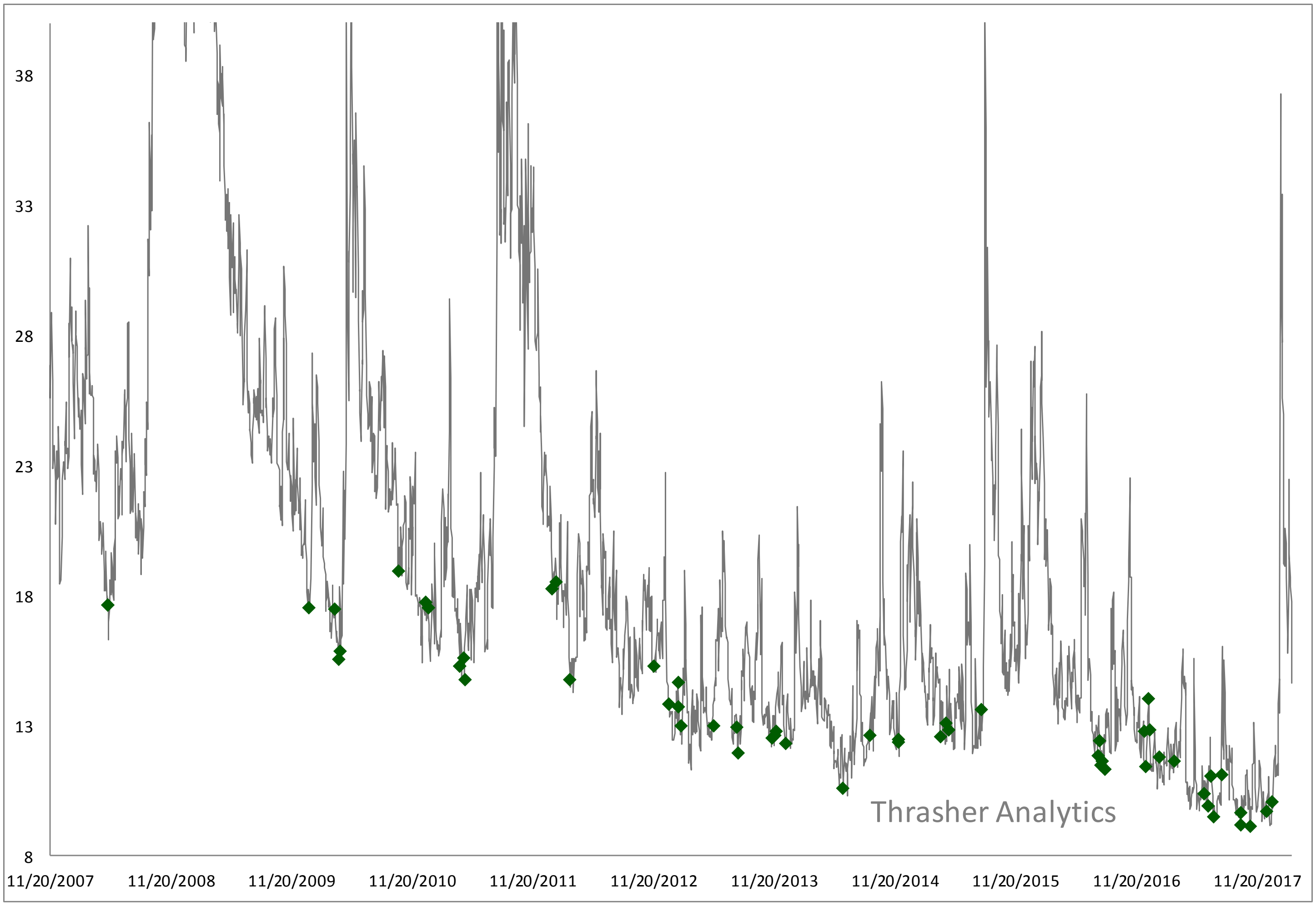
VOLATILITY RISK TRIGGER (VRT)

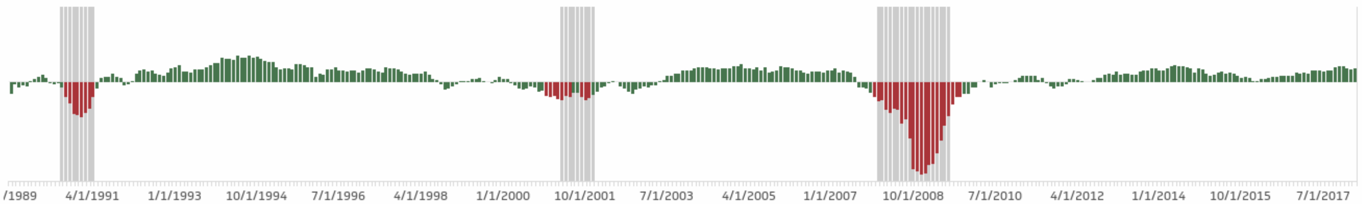


Well we saw a little bit of volatility over the last two weeks, with the VIX putting in (so far) a low earlier in the month after breaking temporary below 12. As I noted in my last letter and blog post from last week, Treasury volatility and short-term volatility as well as the SKEW Index have all been pointing to an expectation that equity volatility should be higher. I did an interview on TD Ameritrade Network discussing this topic as well, highlighting the market's underpricing of volatility and over-confidence towards stocks. This continues to be the theme within the market going into the final week of the second quarter, while the VIX is now off its low, it's still underpriced in my opinion.

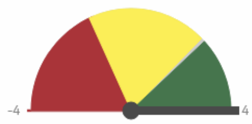
Looking at the recent movement of the VIX Index, for only the 33rd time, it's traveled from sub-15 for 3 weeks to back above 15. According to @OddStats the VIX was higher 30 of those 33 times 5 days later.

Economic Dashboard

Leading Economic Indicator



Corporate Composite



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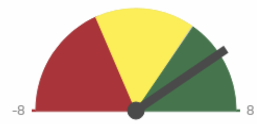
Industrial Composite



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Corporate Indicators

Indicator	Value	Threshold	Trend
Corp. Operating Surplus	1,675,924	1,645,587 Less Than	
Corp. Disposal Income	477,800	464,248 Less Than	
Corp. Cash Flow	-36.6	0 Less Than	

Industrial Indicators

Indicator	Value	Threshold	Trend
YoY Change in Manufacturing Sales	3	0 Less Than	
YoY Change in Industrial Production	4.3	0 Less Than	
YoY change in Non-Defense New Orders	7	0 Less Than	
YoY Change in Durable Goods New Orders	9.6	0 Less Than	
		0 Less Than	

Economic Dashboard

Banking Composite

2

Consumer Composite

-1

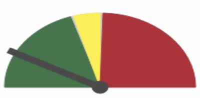
Banking Indicators

Indicator	Value	Threshold	Trend
% of Banks Tightening Standards	-11	0 Greater Than	
% of Banks Tightening Standards for Comercial & Industrial Loans	-3	0 Greater Than	
% of Banks Tightening Standards on Credit Cards	9.4	0 Greater Than	
Deliquency Rate on Credit Cards	2.5	2.5 Greater Than	
Deliquency Rate on Commerical & Industrial Loans	1.2	1.3 Greater Than	
Non-Financial Liabilities	459.8	433 Less Than	
Ratio of Non-Performing Loans	1.2	1.2 Greater Than	
% of Banks Increasing Willingness to Make Consumer Loans	9.2	0 Less Than	

Consumer Indicators

Indicator	Value	Threshold	Trend
YoY Change in Non-Farm Payroll	1.6	0 Less Than	
Avg. Weekly Hours Worked in Manufacturing	42.4	42 Less Than	
3Yr Change in Real Income	3.0	3 Less Than	
YoY Change in Retail Sales	4.1	5 Less Than	
Housing Building Permits	1,379	1,283 Less Than	
YoY Change in Consumer Sentiment	3.5	0 Less Than	
Barrel of Crude Oil	66.1	20% 6-month Change	
Shiller Home Price Index	197.0	194 Less Than	
Labor Slack	-0.8	0 Less Than	

Financial Stress Composite



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Financial Stress Indicators

Indicator	Value	Threshold	Trend
St. Louis Stress Index	-1.0	-1.1 Greater Than	
Kansas City Stress Index	-0.3	-0.4 Greater Than	
Chicago Stress Index	-0.8	-0.8 Greater Than	

Headline Economic Indicators

Real GDP Growth	**2.9%**
Nominal GDP Growth	**4.8%**
YoY Change in Federal Debt-to-GDP	**4.5%**
Unemployment Rate	**3.9%**
Inflation (CPI)	**2.4%**
Core Inflation (CPI)	**2.1%**
Inflation (PCE)	**4.4%**
Core Inflation (PCE)	**1.9%**

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Broad Market Commentary

The S&P 500 daily chart has found some resistance at the prior February and March highs. Last week the equity index struggled to break above these prior turning points and began working its way back to the consolidation level previously highlighted two letters ago. I think if we continue to decline then the 50-day Moving Average will most likely be a natural magnet for the S&P which could lead to yet another test of the 200-day MA. As I've said several times, this is not a market that's in a clearly defined up trend. The lack of strength to set new highs has now become more clear. This upper end of the range creates a nice risk-reward range that needs to be cleared to meet the lofty expectations that market sentiment has reached. The NAAIM Exposure Index has been above 100% for the last two weeks, meaning the average respondenant is fully invested right now. There have been 12 such 'fully invested' readings by the sentiment Index and the S&P 500 was only higher by an average of 0.7% two months later.

Technology Momentum

For the rest of this week's letter I want to focus on the tech sector and Nasdaq 100. The reason being that this is where market leadership is squarely placed and should be our focus in understand the risks within the market. If tech/Nasdaq lose their luster then there's not equity market strength to fall back on.

Let's start with a broad look at momentum of the tech sector ETF, XLK. Over the last two weeks the rate-of-change of XLK has moved negative and seen a lower high in its trend. A divergence has also developed in the Relative Strength Index (RSI) momentum indicator. We saw a similar development before the March decline in tech stocks.

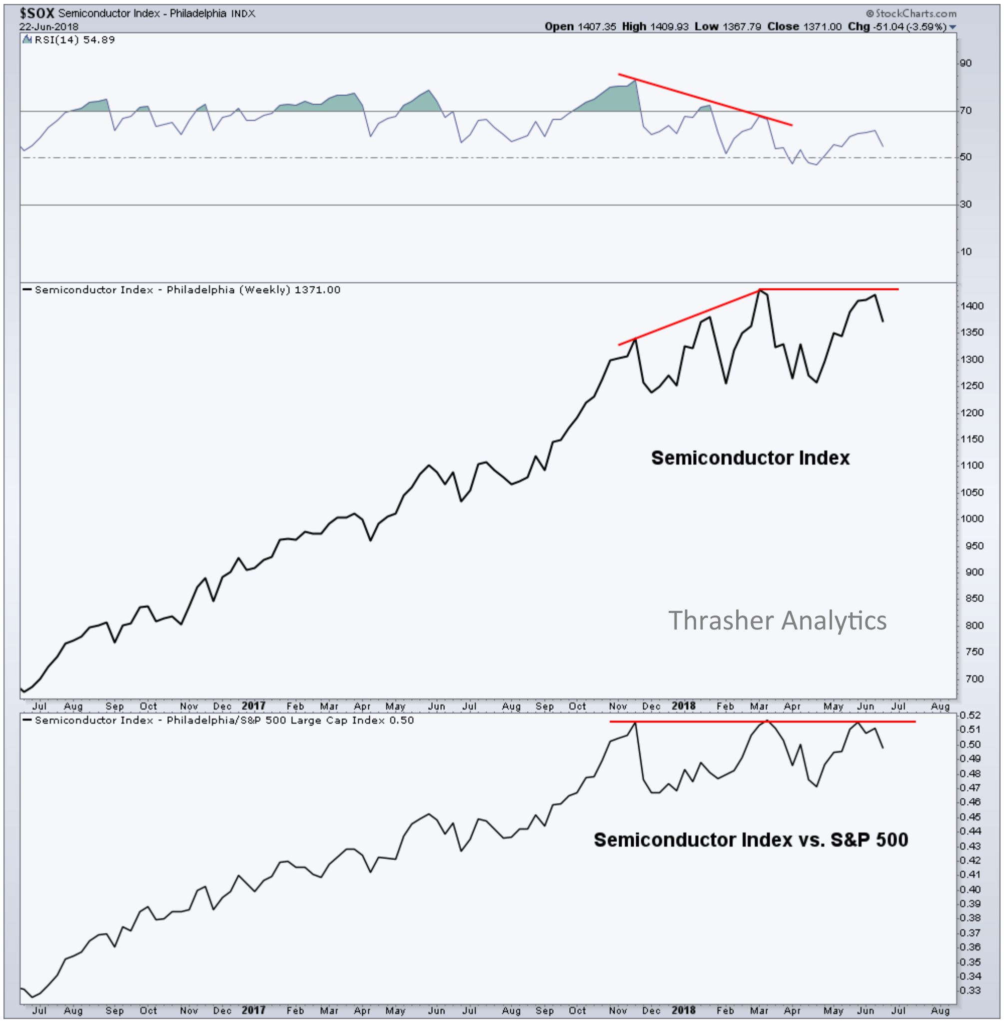
So from a momentum stand point, it appears things have begun to slow the speed at which their moving. While still early, the tech train isn't moving as fast down the tracks as it was earlier in 2018.

Technology Sector Volume

From a volume perspective, the interest in tech stocks also seems to be slowing. The On Balance Volume indicator adds the number of shares traded in XLK on positive days and subtracts them on negative days, creating an accumulative line for the ETF. While tech has rallied off the March lows, its been on weaker volume. In the bottom panel we have the Accum/Distr. Line which is based on a multiplier determined by where in the daily range the ETF closes, which gives more credence when closing at a high vs. a low when evaluating volume. It too hasn't been as strong, only just recently reaching its prior 2018 high even though price is well past the January level.

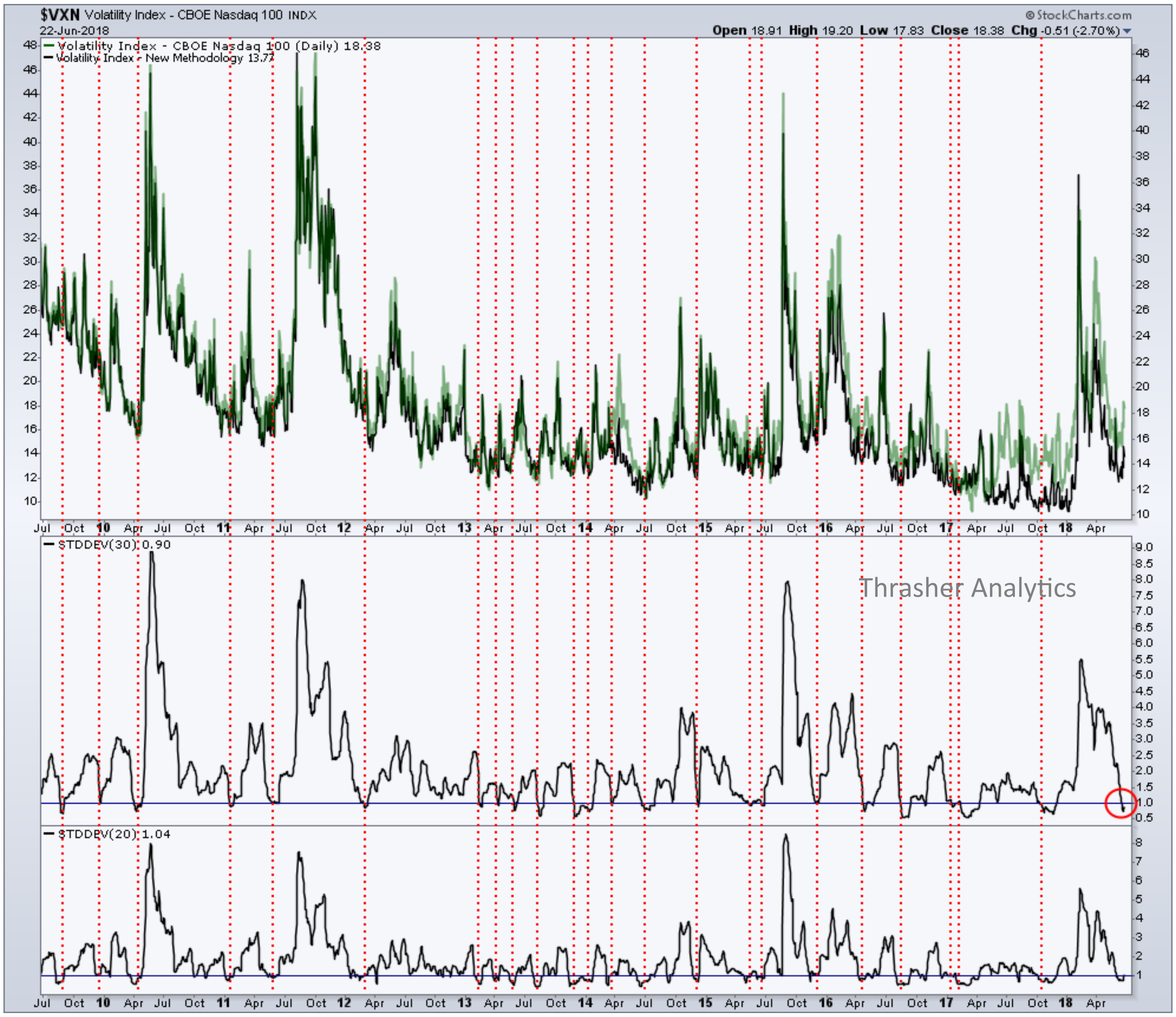
Looking at volume directly, we can see that the largest traded days since March have been distribution days. More above-average volume days have been on down days than up, not a great sign that traders and institutions are eager to keep accumulating tech exposure.

Semiconductor Index



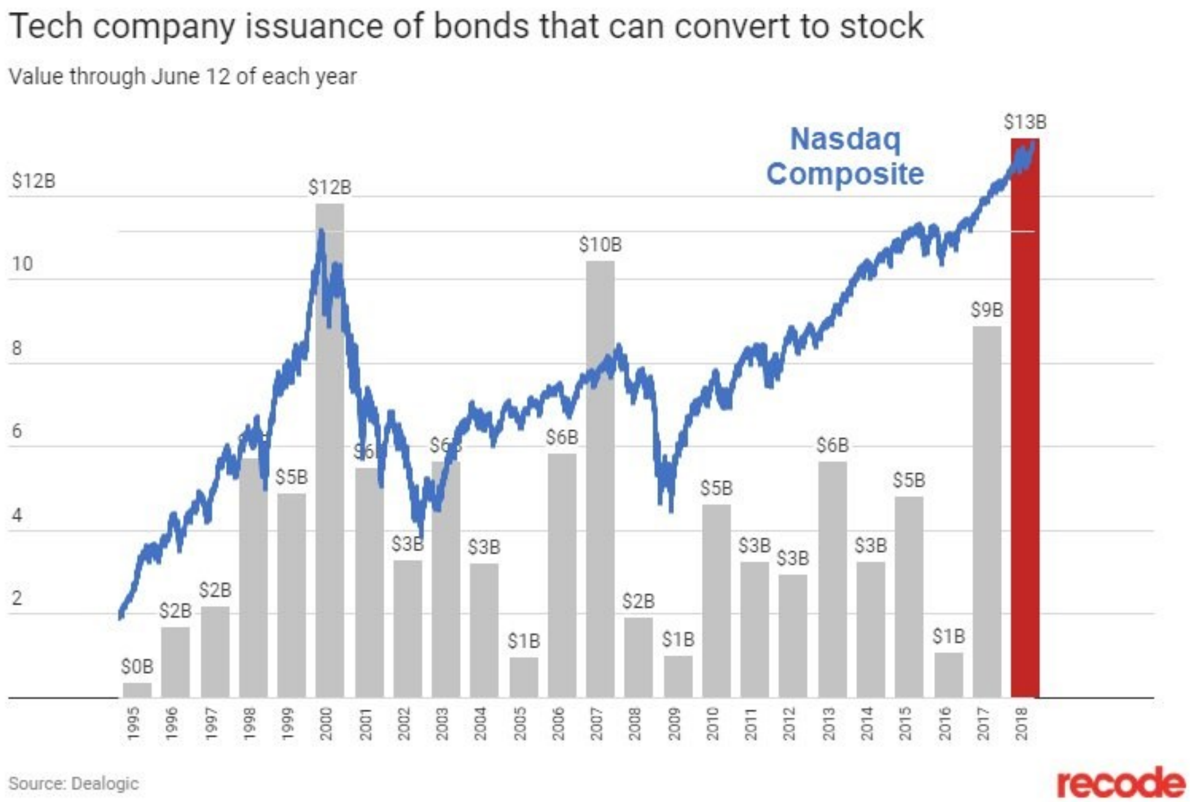
Tech stocks are highly correlated to the Semiconductor Index, which makes sense as there is a high reliance and usage of semiconductors in many of the technology company's products. If semi's begin to break down, then that would be an early warning that something is wrong with tech as a whole. Looking at the semi index we can see that momentum has begun to break down and the relative performance has struggled to confirm the new highs seen in price. Most recently semiconductors have been unable to get above the prior high in both price and relative performance. This isn't a major concern (yet) for the semis but it's could be an early warning that they are about to move lower which could take the tech sector as a whole with it.

Nasdaq Volatility



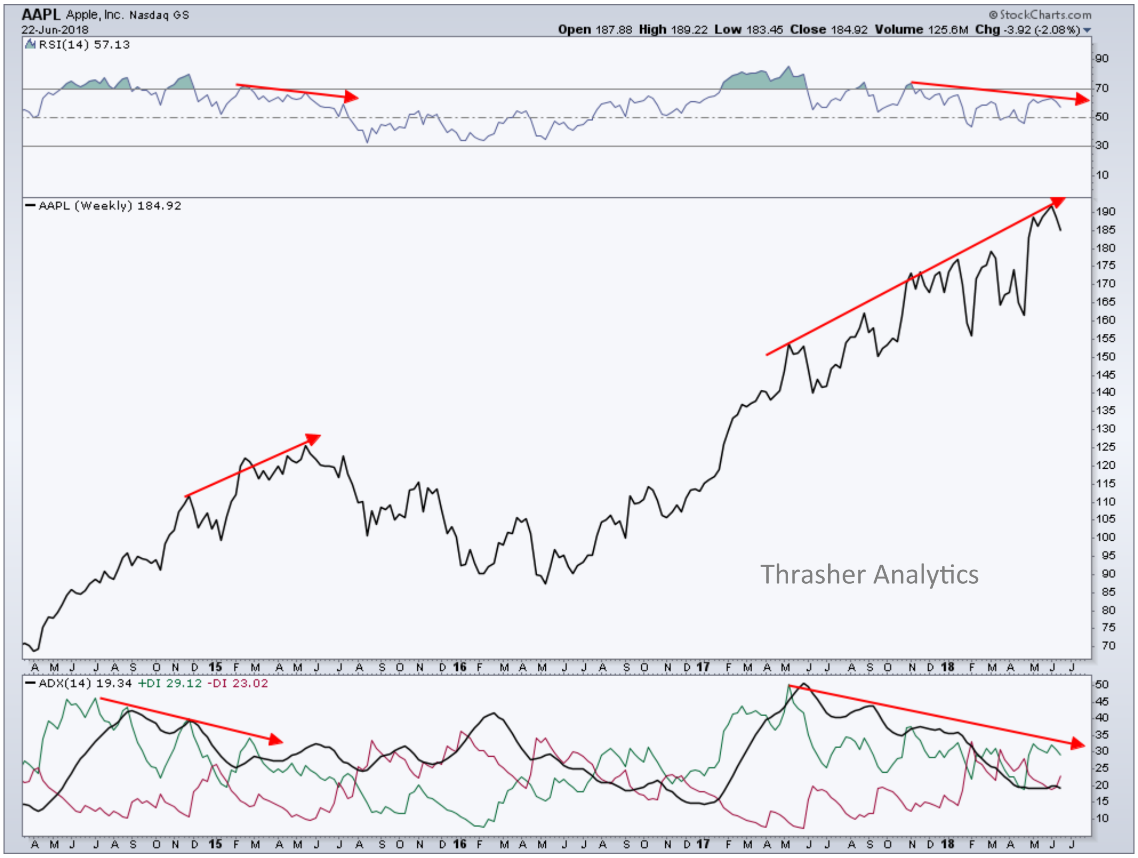
In my Charles H. Dow award winning paper I focus on the standard deviation of volatility as an early precursor to spikes in the VIX. I specifically wrote about the 20-day look back period. The above chart shows both the 20-day and 30-day, I include the 30-day just to show that this narrowing of dispersion in the Nasdaq VIX isn't just short-term. The red dotted lines show when the 30-day and 20-day standard deviation have moved below 1 and I've included the S&P 500 VIX (black line) with the Nasdaq VIX (green line) in the top panel. As the chart shows, dispersion has become very narrow both using the 20-day and longer-term 30-day look back periods. While not good enough to act alone as an indicator, this shows the over-confidence in the Nasdaq as traders have all but abandoned protection via options which has allowed a narrow trading range within the Nasdaq VIX.

Technology Stocks Issuing Convertible Bonds



Jason Goepfert shared this chart and the Recode story that tech stocks have been massively issuing convertible bonds. So far in 2018, $13.4 billion worth have been issued , eclipsing the prior records set in 2000 and 2007. This gives us an idea of the sentiment towards tech from a different perspective, one from the bond market. Once again, there seems to be an unquenchable thirst for tech exposure from nearly all corners of the financial market. How long can that last?

Top Tech Sector Stocks: Apple



To review the tech sector in it's entirety we should also review the largest stocks that make up the XLK ETF. First we have Apple, which has done very well over the last twenty-four months but things appear to be weakening on the weekly chart, mirroring what took place going into 2015. The RSI has begun to divergence, has as the ADX, which measures trend strength.

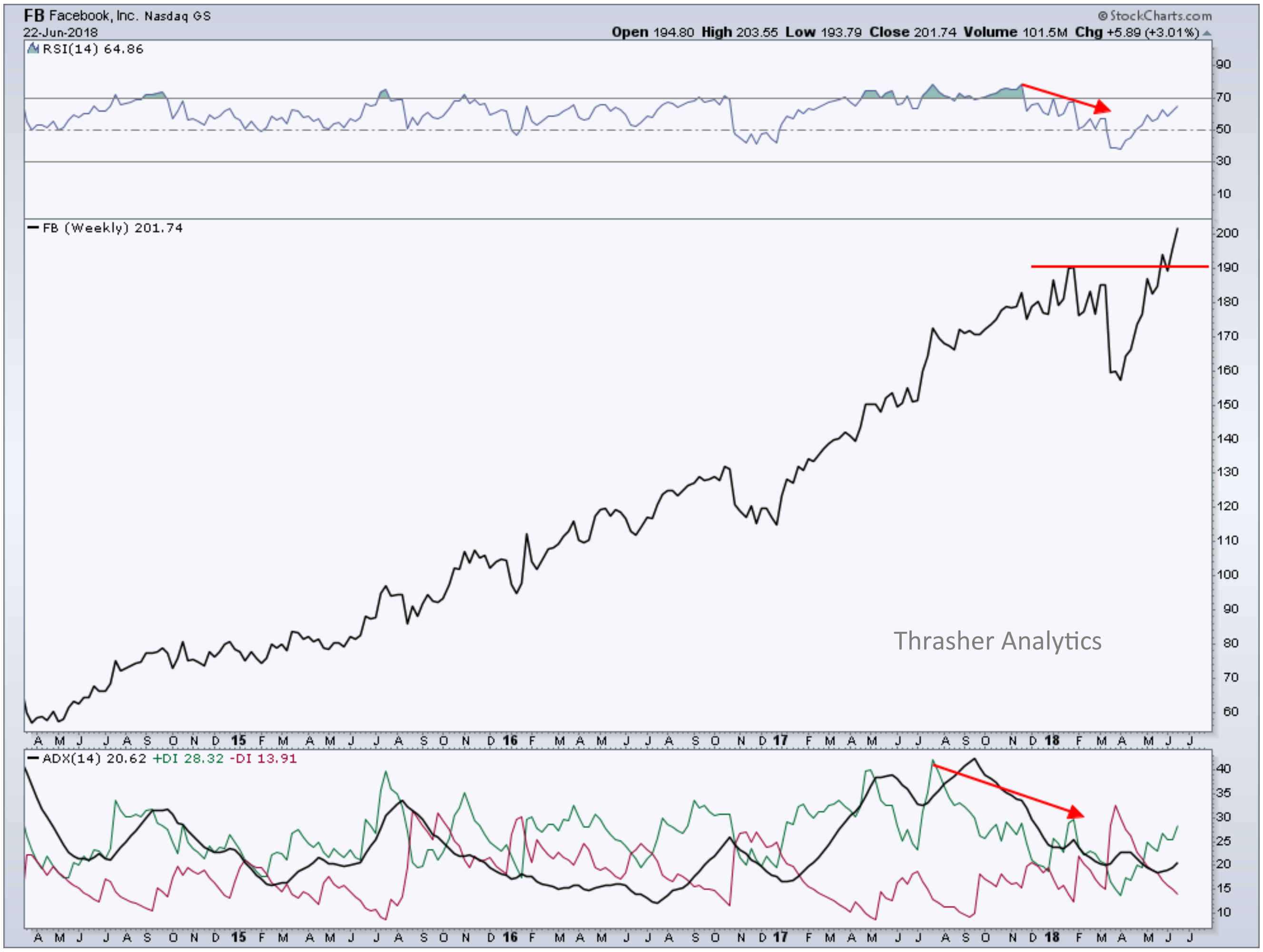
By using weekly charts we can filter out a bit of the noise of day-to-day price movement and show a clear picture of the longer-term trend and derivative indicators.

Top Tech Sector Stocks: Microsoft

You'll notice a trend with each of these…

Again we have a bearish divergence in the weekly ADX and RSI. While Microsoft has been moving higher, hitting fresh all-times high, momentum and trend strength have not been confirming these moves. We last saw a major divergence line this in Apple and Microsoft going into 2015, which lead to a decline in share prices for several months before bottoming and rebounding.

Top Tech Sector Stocks: Facebook



Facebook has recently broken out to a fresh-high which is always nice to see. Going into the January prior high, the RSI was diverging, as was ADX. As of now momentum for FB looks better as its moving up once again with price but trend strength still is well below its prior high. Facebook's chart is less bearish looking than Apple's or Microsoft's.

Top Tech Sector Stocks: Google

Next up: Google, which hasn't broken to a new high yet so we can't identify a bearish divergence but trend strength is well off its high. The RSI has been finding good support just under 50 at it prior low, creating a bullish range for momentum, a positive long-term sign.

Top Tech Sector Stocks: Intel

To round out the top five we have Intel. And once again, we have lower highs in momentum and trend strength. Intel has been in the news recently with the sudden exit of its CEO after he had an affair, which has brought some selling to the company's stock.

Tech Sector Summary

In summary, I am very concerned with the prospects for the tech sector, as I've been discussing for several weeks now. I think the longer this builds up, the larger the correct the sector could have due to the increased over-exposure to tech that will get created. While the timing of when the up trend in tech is suspect, and I'm not making a short-term or long-term top call in this note - what I am doing is highlighting a market risk. The S&P 500 is 26% tech, giving it one of the largest weightings since the dot-com era. There are plenty of catalyst that could spark a down turn in this area of the market - most obvious being the trade war with China but I think the high level of sentiment towards equities in general could also led to manager divesting their largest market exposure in a broad sell-off, which most likely is tech.

I continue to believe volatility is too low and will work its way higher this summer. Like all things, volatility doesn't move in a straight line so some ebbs and flows are to be expected. We've begun seeing the stories of the volatility short-sellers returning to the market, having dusted themselves off from the February blow-up. It's as if the massive volatility spike earlier this year didn't happen when you begin to see the extremely low level of concern that's taken over the market right now.

As a technical analyst I rely on price-action to be my main driver for decision and that hasn't changed. I continue to look for confirmation within price data that the market environment has changed. I don't believe to be smarter than the market as hubris can be the worst enemy of a trader. But when looking at the bearish divergences taking place in the top tech stocks, the lack of strength in semi's, the bullish sentiment in tech and the market in general, my internal radar has moved to cautious, now we'll see if price begins to confirm.

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