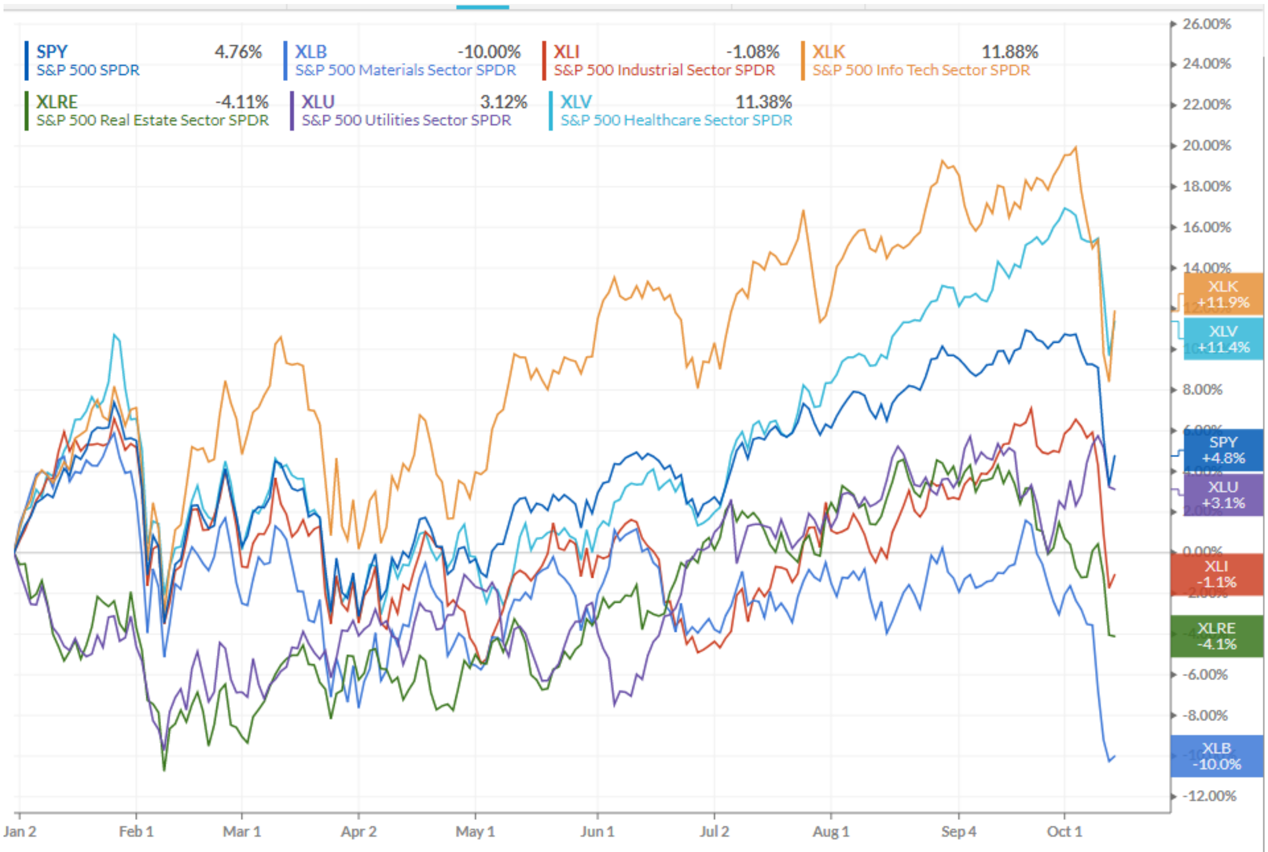
THRASHER
ANALYTICS

BI-WEEKLY RESEARCH & ANALYSIS

ThrasherAnalytics.com

THRASHER ANALYTICS

Sector Dashboard

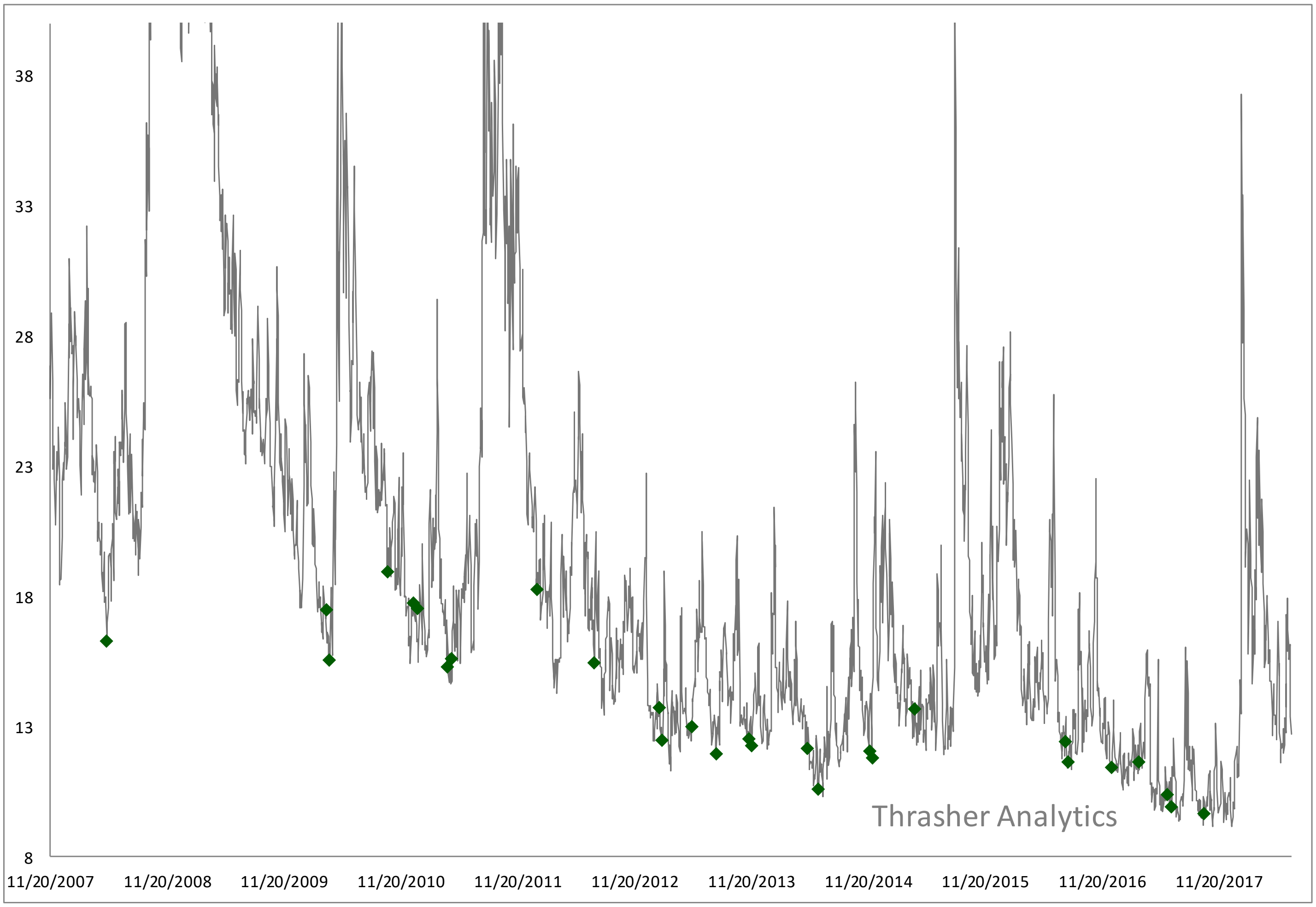


Long vs Short Sector Matrix

1D 5D **1M** 3M 6M YTD 1Y 3Y 5Y

	+ XLY	+ XLP	+ XLE	+ XLF	+ XLV	+ XLI	+ XLB	+ XLRE	+ XLK	+ XLC	+ XLU
– XLY	-	3.6%	7.3%	2.2%	5.1%	1.8%	-2.0%	-0.8%	2.2%	3.5%	5.6%
– XLP	-3.5%	-	3.6%	-1.4%	1.4%	-1.8%	-5.4%	-4.3%	-1.4%	-0.1%	1.9%
– XLE	-6.8%	-3.5%	-	-4.8%	-2.1%	-5.1%	-8.7%	-7.6%	-4.8%	-3.6%	-1.6%
– XLF	-2.1%	1.4%	5.1%	-	2.9%	-0.3%	-4.0%	-2.9%	0.1%	1.3%	3.3%
– XLV	-4.8%	-1.4%	2.1%	-2.8%	-	-3.1%	-6.7%	-5.6%	-2.7%	-1.5%	0.5%
– XLI	-1.8%	1.8%	5.4%	0.3%	3.2%	-	-3.7%	-2.6%	0.4%	1.7%	3.7%
– XLB	2.0%	5.7%	9.5%	4.2%	7.2%	3.8%	-	1.1%	4.3%	5.6%	7.7%
– XLRE	0.9%	4.5%	8.2%	3.0%	6.0%	2.7%	-1.1%	-	3.1%	4.4%	6.5%
– XLK	-2.2%	1.4%	5.0%	-0.1%	2.8%	-0.4%	-4.1%	-3.0%	-	1.3%	3.3%
– XLC	-3.4%	0.1%	3.7%	-1.3%	1.5%	-1.6%	-5.3%	-4.2%	-1.2%	-	2.0%
– XLU	-5.3%	-1.8%	1.7%	-3.2%	-0.5%	-3.6%	-7.1%	-6.1%	-3.2%	-2.0%	-

VOLATILITY RISK TRIGGER (VRT)



It's encouraging yet amazing how the market continues to follow its historical patterns. As you well know, the market saw quite a bit of volatility since my last letter, with the Volatility index rising from sub-12 to over 28 at one point on last Thursday, a 100+% change over just a few days. In my last letter I shared several charts that were showing a bearish bias towards the market with a strong emphasis on the weekly consolidation in volatility that we don't see very often but when we do, has led to moves like we just saw.

The front portion of the VIX curve is now inverted, with October>November>December. However, the curve has remained in backwardation further out into 2019 contracts. The fact that the market had already begun pricing in some nervousness over the midterm election, it didn't take much to push the front months of the curve higher with this recent selloff.

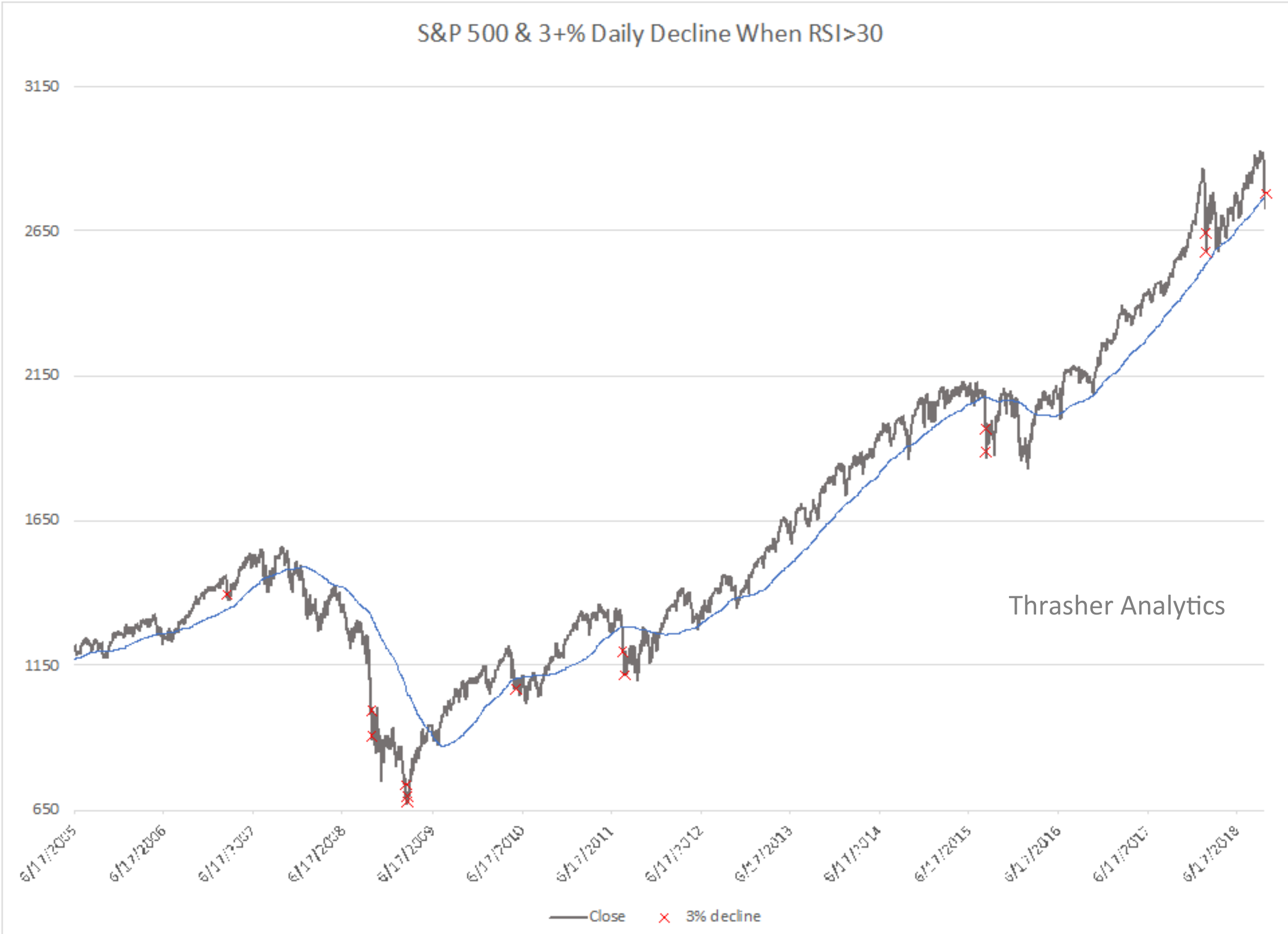
Broad Market Commentary

In my last note I focused on several bearish pieces of data, notably the bearish divergence momentum, the financial sector and its lack of confirmation in the broad market new highs, several gauges of breadth/market participation declining, and the increase in beta exposure to U.S. equities by hedge funds while retail investors were also jumping into the equity pull and lowing their cash holdings to a historic low. We then had the market drop roughly 5% in 48 hours, should we really be THAT surprised? Sentiment was at record highs and nearly everyone was on one side of the proverbial market teeter-totter, a ‘reset’ was likely to happen and it did.

The S&P 500 is now back to its 200-day Moving Average, barely holding this level by the close of trading on Friday. My focus is squarely on that January prior high. We broke through it with ease on Wednesday. The index needs to reclaim this level to retain its hope of continuing to grasp its bull market status.

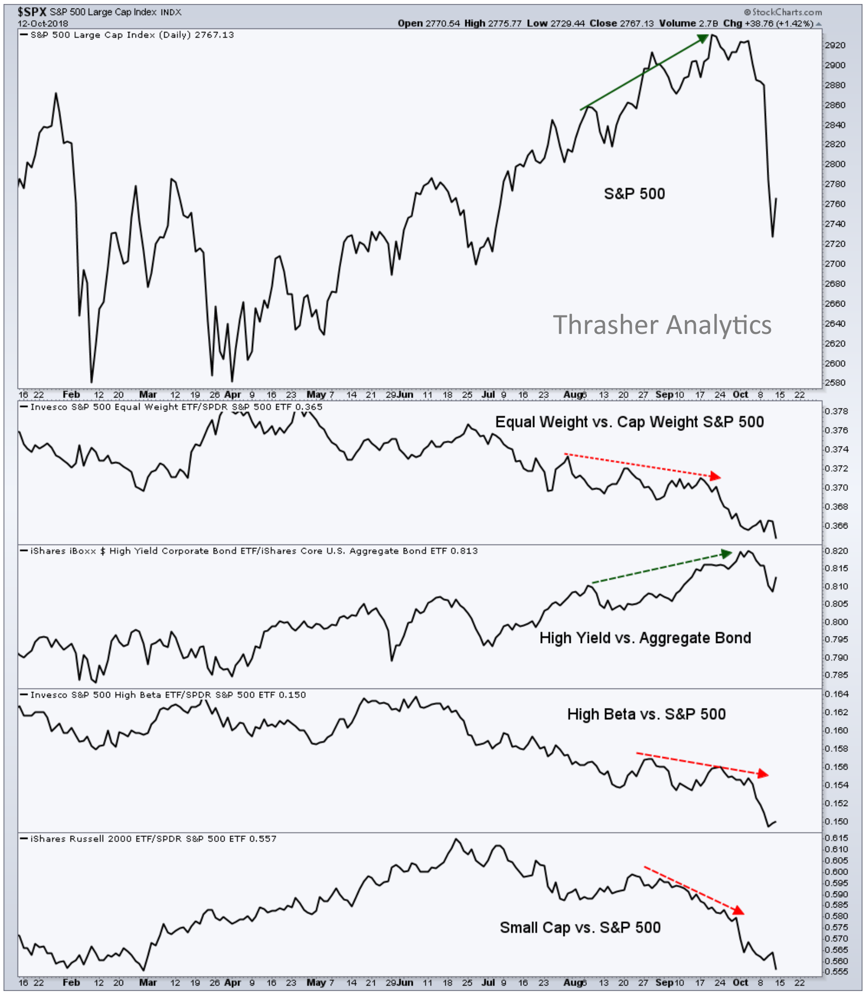
As I dive into on the next page, I think we’ll see a retest the low before moving materially higher. Since the RSI is now under 30, a bullish divergence of a higher low at the retest would be a welcomed sign that bulls have returned to take price higher. We’ll see what the market serves up.

Will We See A Retest of the Low?



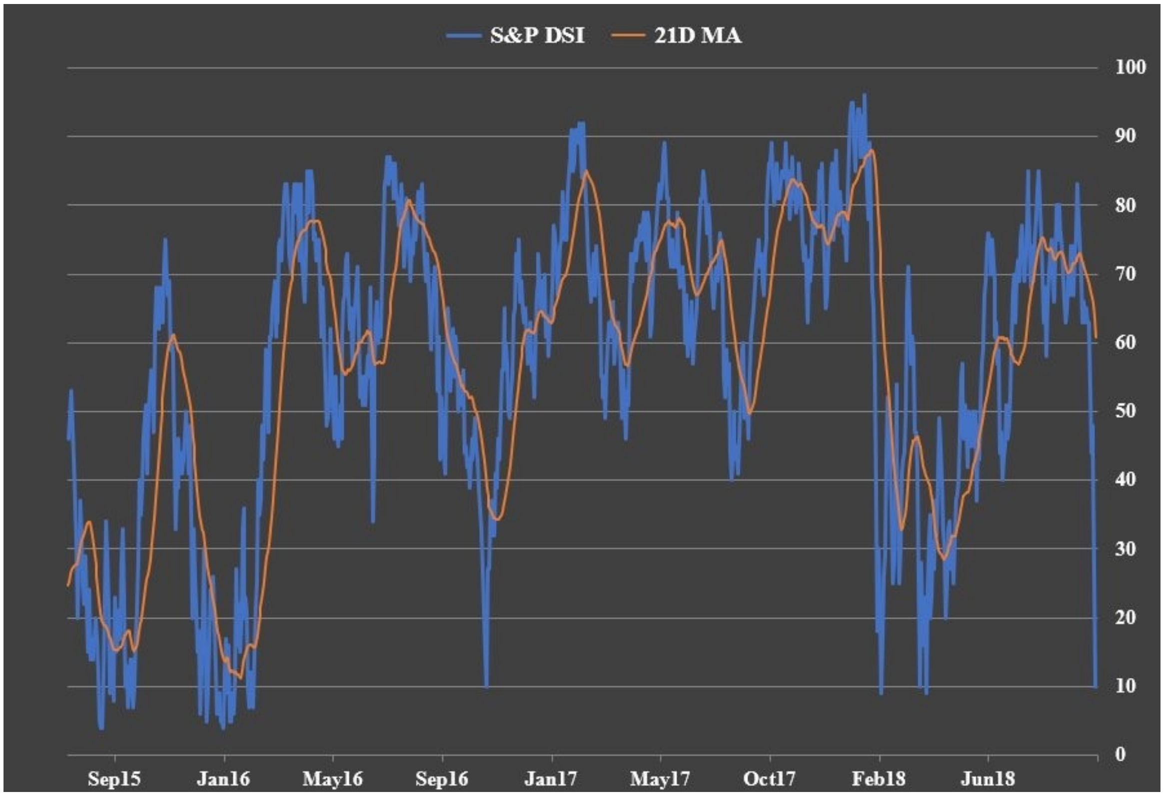
In my Special Update email I highlighted that historically when the S&P 500 declines 3% in a single day and momentum is very low that we often see it retest that low before returning to an up trend. To make that point a little easy to understand, the above chart shows the S&P 500 since 2005 with red marks when then index declines 3% or more and the Relative Strength Index (RSI) is less than 30. Most recently we saw this happened in 2010, 2011, 2015 and earlier this year with S&P re-testing its low. Some difference worth noting are that the 2010 and 2011 occurrence was with the index below its 200-day Moving Average, while in February of this year and last week, the market was still above its long-term average, as it was in 2006 too. I still think there's a high risk of a re-test but am happy to see the market prove me wrong with a solid rise in price.

Equity Risk Appetite



This chart should look familiar, I've shown it in several past letters to highlight the lack of risk appetite the market was experiencing as just a handful of stocks seemed to be taking the broad index higher. Equal weight has continued to make lower lows relative to cap weight S&P 500. High yield debt has held up relatively well, being the sole confirming component of the risk appetite chart. While hedge funds have been raising beta, high beta stocks have not been producing relative gains over the last several months. Finally, Small cap stocks have given back nearly all their relative gains obtained from March until mid-June.

Equity Sentiment Sinks to Prior Lows

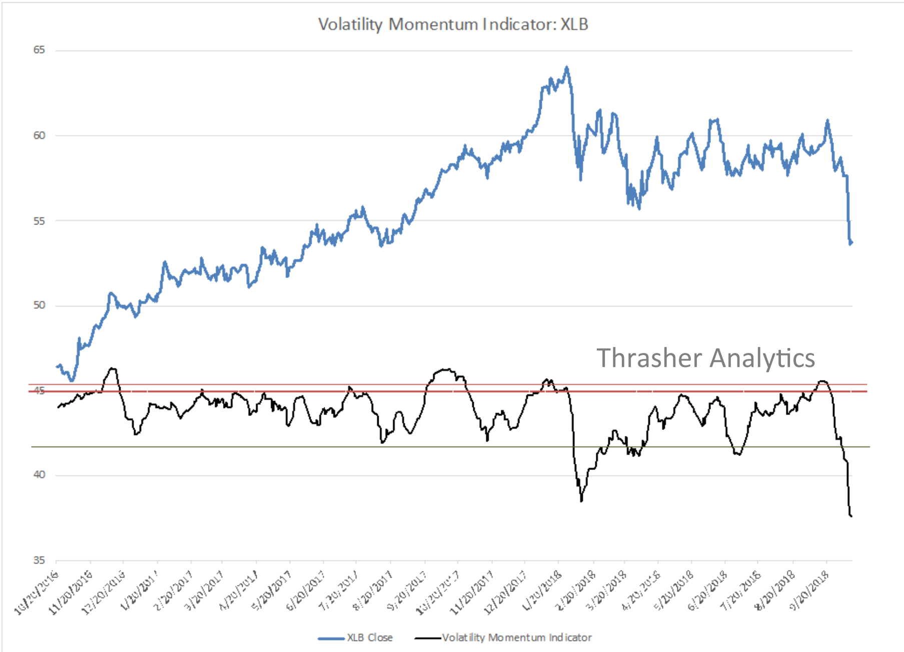


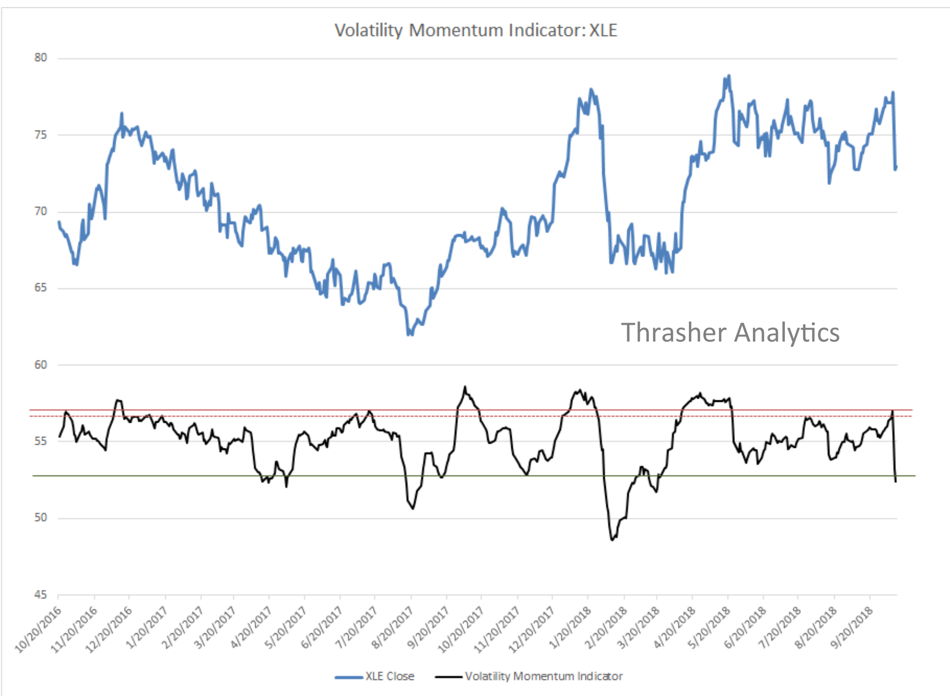
The Above chart comes from David Brady and shows the S&P 500's Daily Sentiment Index. Prior to the selloff we saw several readings over 80% bulls but as the tide has gone out, sentiment has sunk quite low. The DSI for the S&P has fallen to just 10% bulls, which was the low in February as well as in 2016. I expect the other measures of sentiment will confirm what DSI is showing as investors have now fled for the exits after Wednesday and Thursday's decline.

THRASHER ANALYTICS

Sector Volatility Momentum Indicator

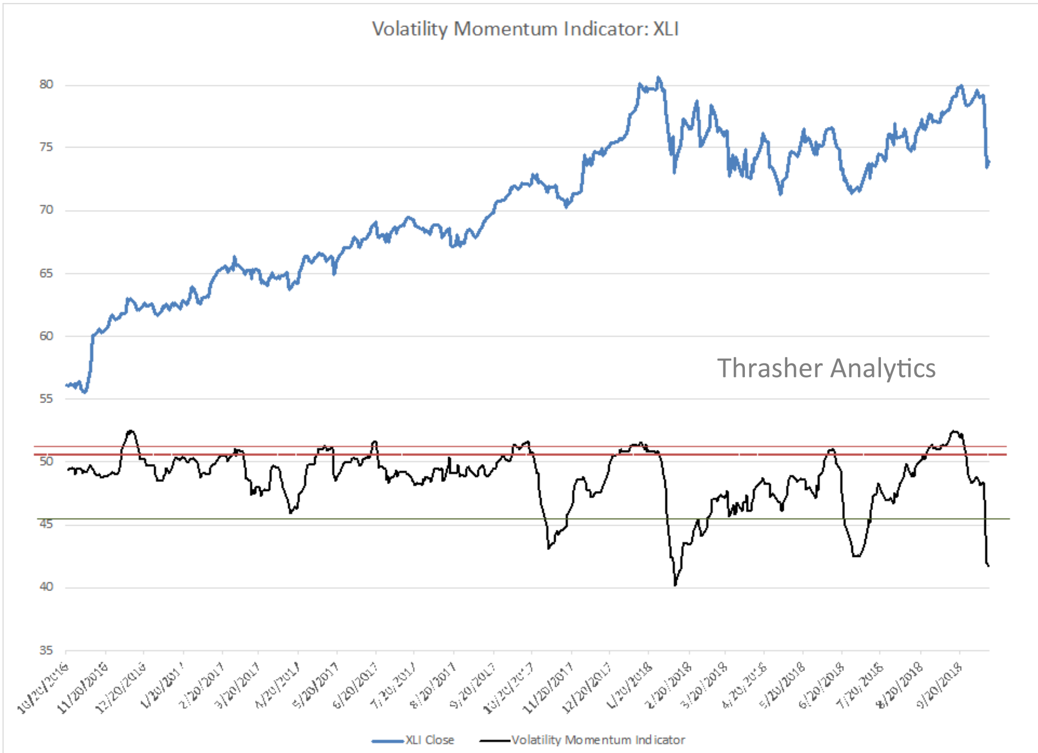
I'm still working on getting the Volatility Momentum Indicator (VMI) coded in something other than excel but have hit some roadblocks. So instead of not showing them at all, I wanted to provide an update after last weeks selloff of where each sector now stands. Hopefully progress will return to getting these in a more viewer-friendly format soon.

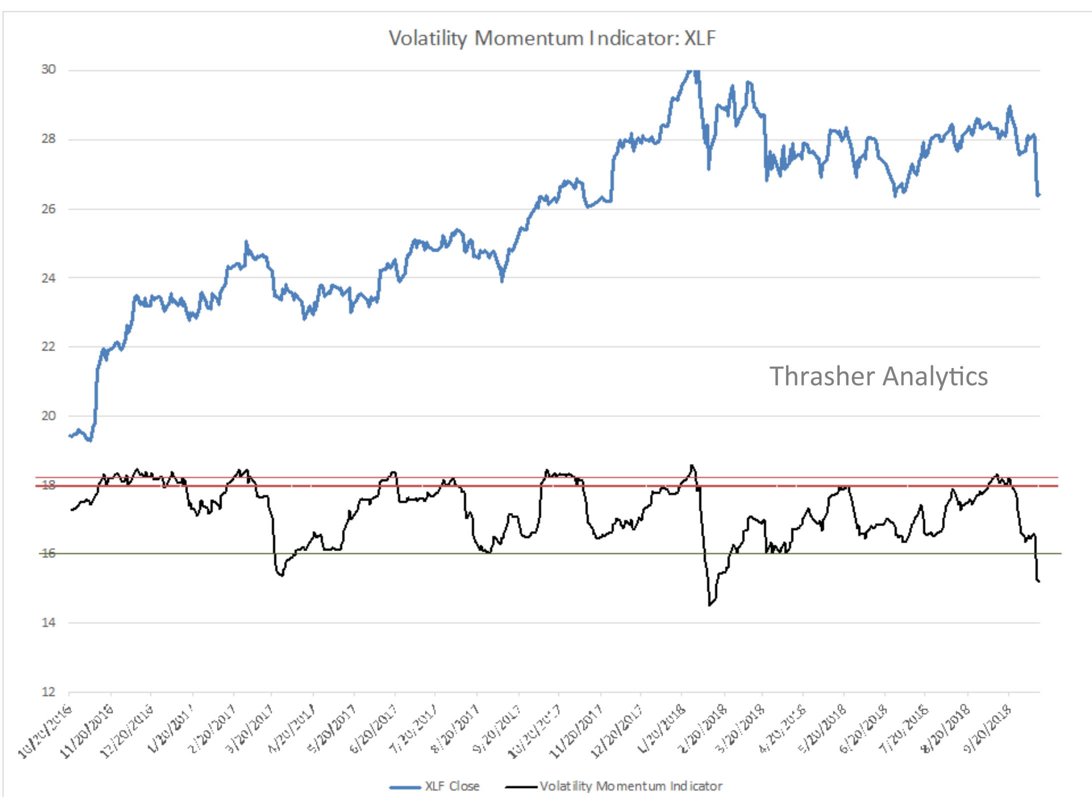




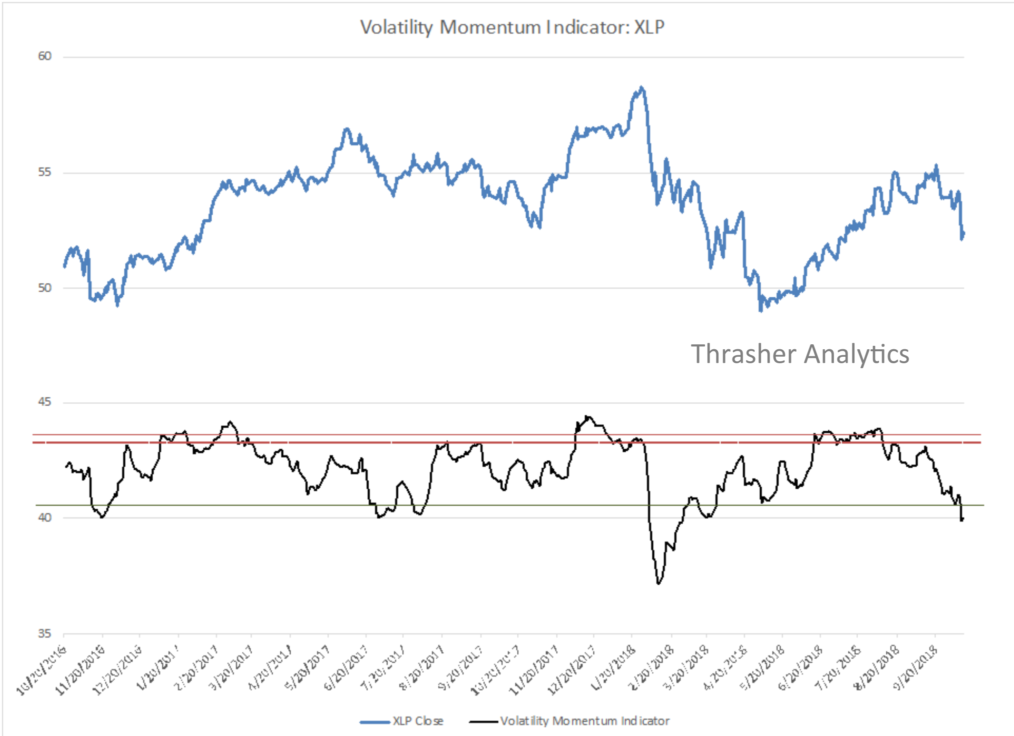
THRASHER ANALYTICS

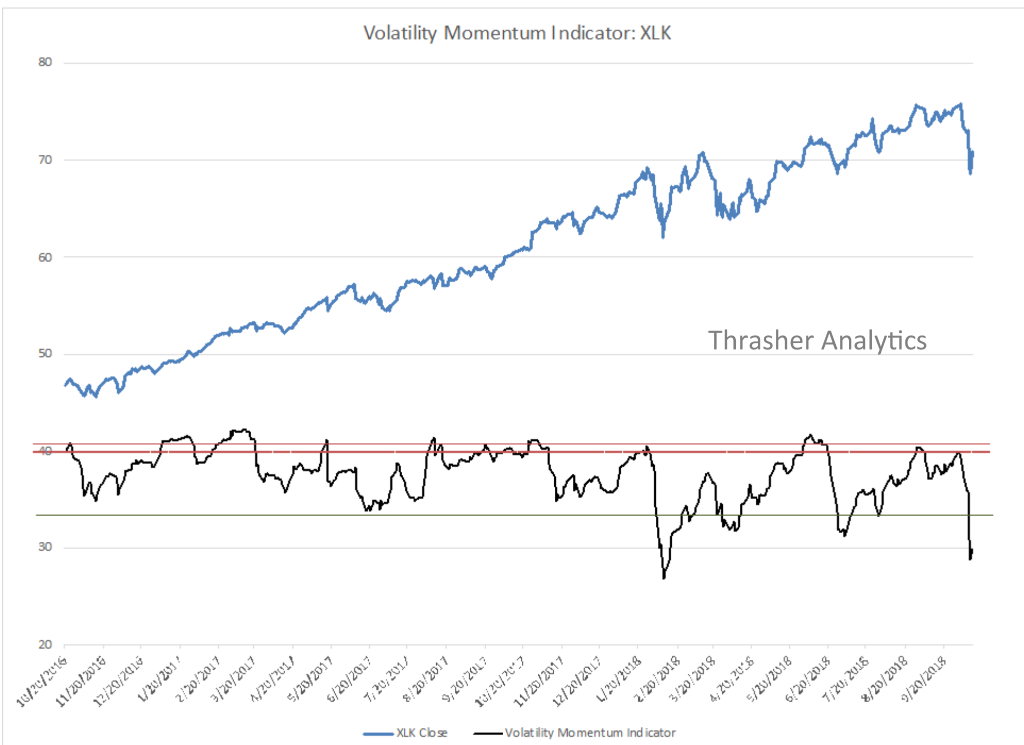
Sector Volatility Momentum Indicator





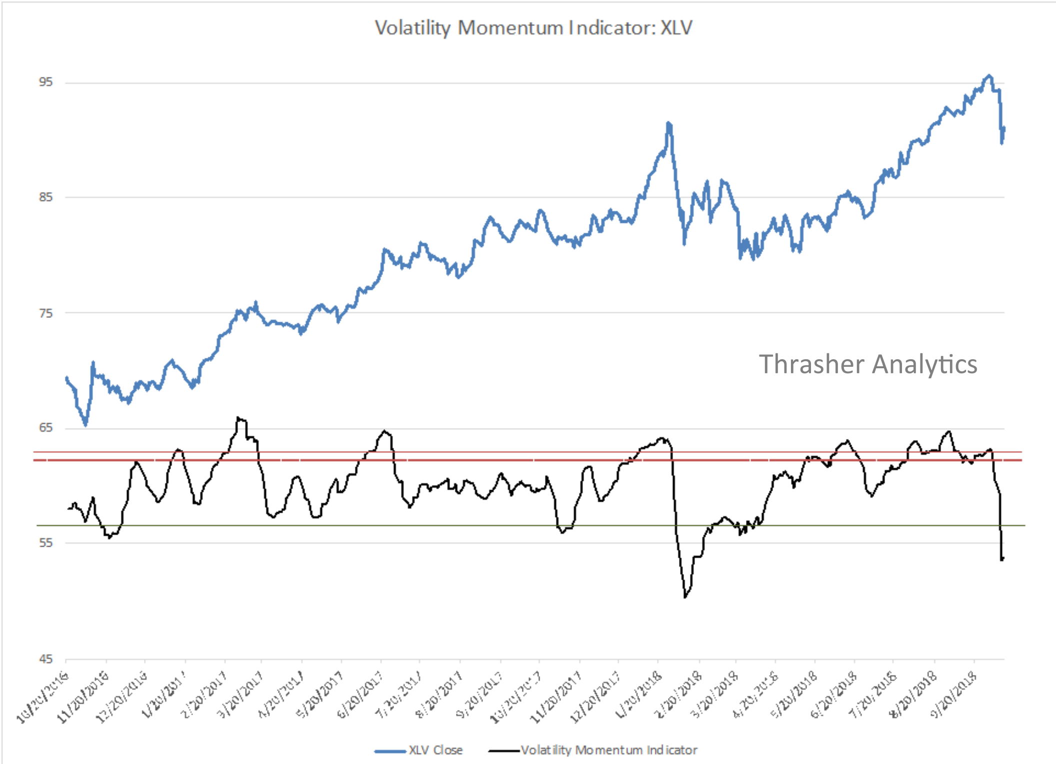
Sector Volatility Momentum Indicator

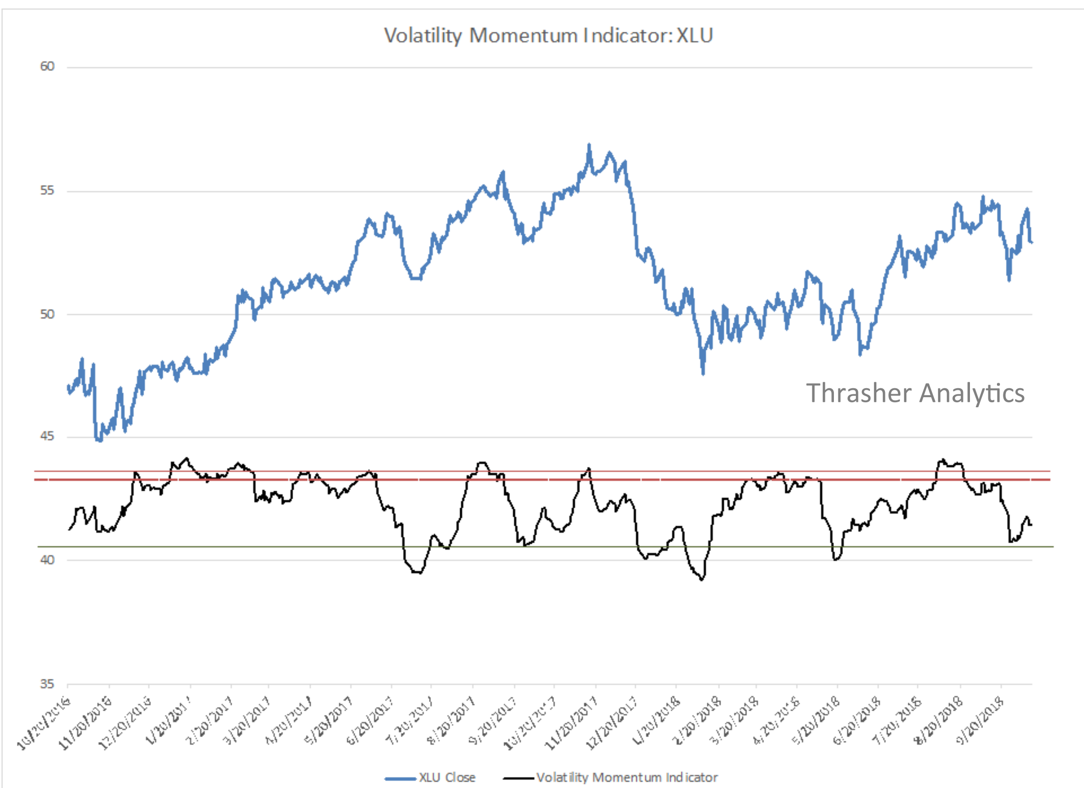




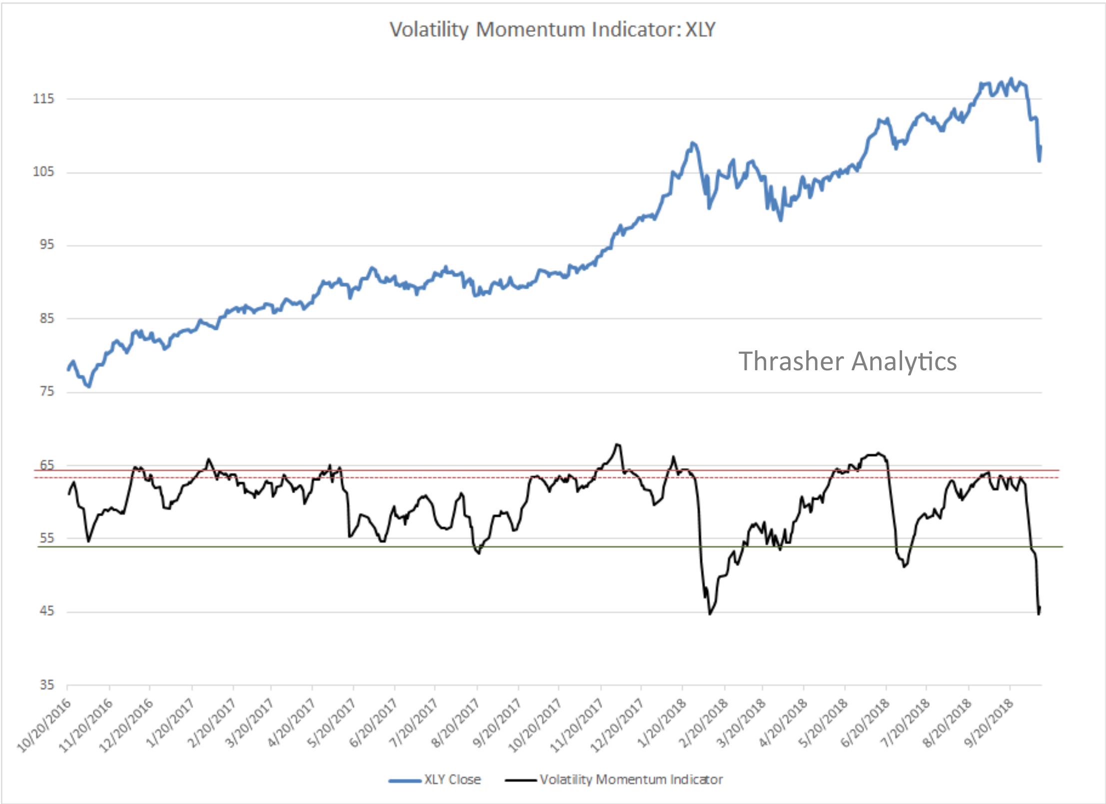
THRASHER ANALYTICS

Sector Volatility Momentum Indicator



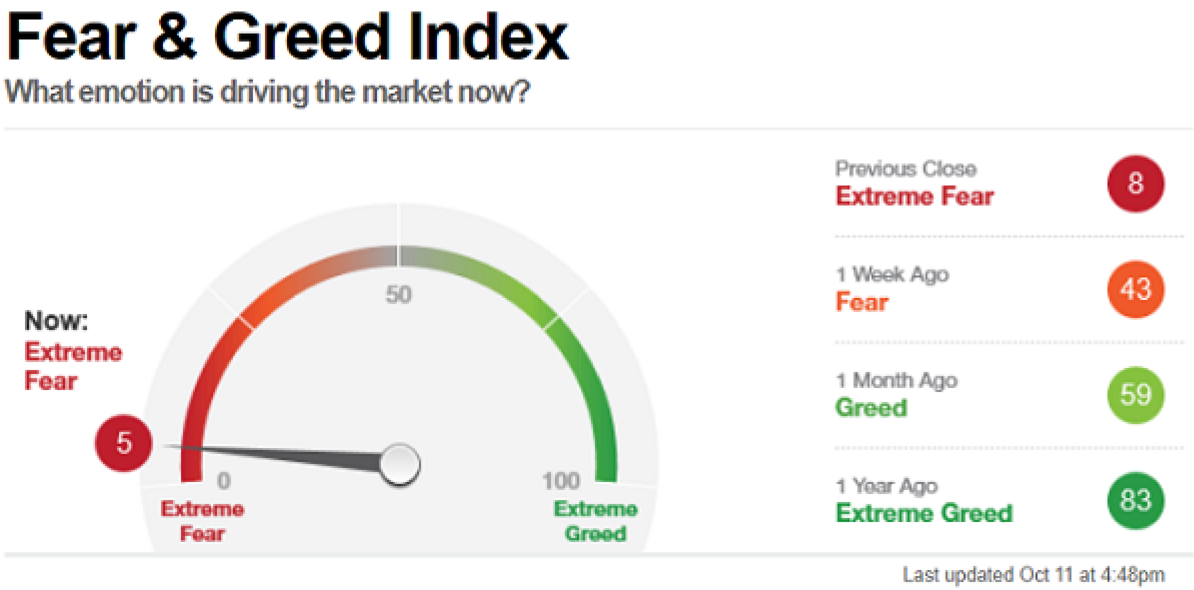


Sector Volatility Momentum Indicator



The broad theme of the VMI for each sector shouldn't be too much of a surprise, each sector has a VMI reading in 'oversold' territory. While each sector had previously been showing an elevated level or had just come off from being at an elevated level, the selloff in stocks has pushed VMI lower. Two weeks ago I wrote that the average VMI was at a point that had historically lead to a materially higher Volatility Index and that's exactly what happened with the VIX having shot higher.

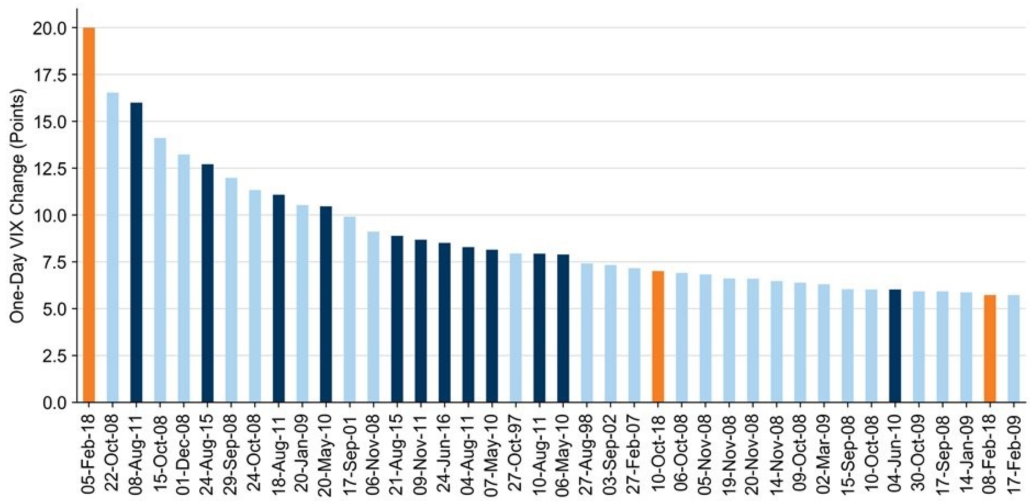
Fear & Greed Index Drops to Extreme Fear



One easy way to take the pulse of market is the CNN Fear & Greed Index, which has sunken to a 5 as of Thursday. This is an extreme reading, and largely influenced by the rock bottom levels in breadth and historically high Volatility Index.

Last Week's VIX Move Joins the 25 Largest List

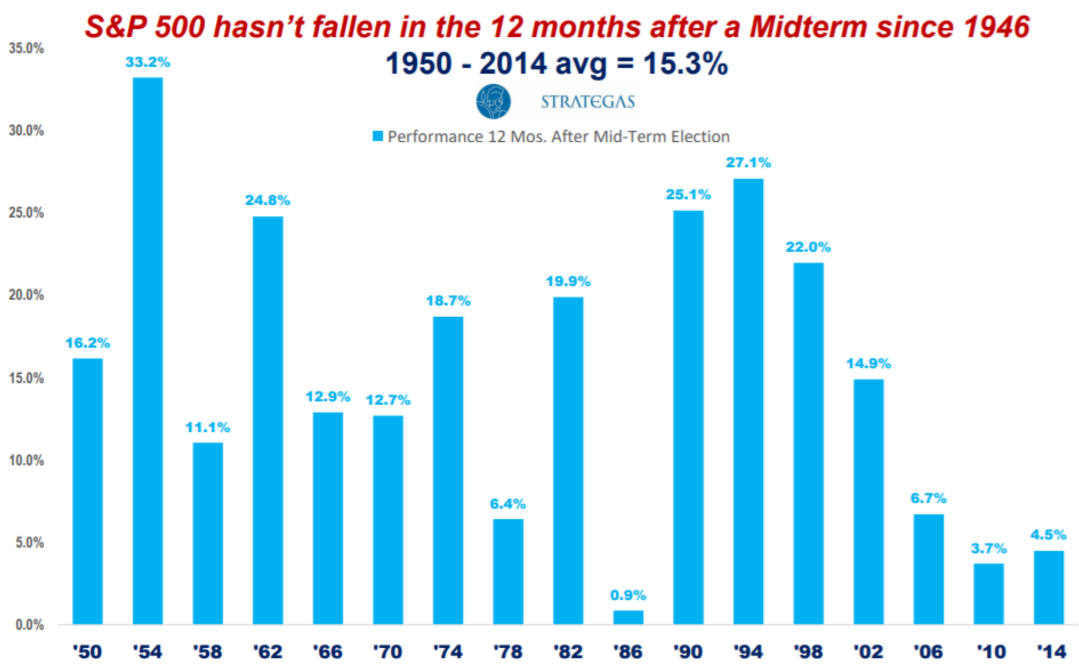
Exhibit 3: Wednesday was the 25th-largest one-day VIX spike; what stands out is that the majority of the top 25 have been in 2010-8
Largest one-day spikes in the VIX, 1994-; 2010- in dark blue



Source: Goldman Sachs Global Investment Research, Bloomberg

We won't soon forget the lack of volatility in 2017 and the speculation that it would return in 2018. While we haven't seen a multitude of spikes higher in the VIX, the moves the 'fear index' has made have been massive: February and October's events. The chart shows the 25 largest single day moves in volatility with the dark blue bars are each one-day VIX change since 2010. Goldman Sachs analyst Rocky Fishman shared the above chart with the note, "three of the 40 largest one-day VIX moves have happened this year, and 13 of the top 25 VIX move have happened in 2010-8." While last week's event seems to be a garden variety selloff, albet larger than what we've seen in recent years, it doesn't appear on its face to be record setting. Fisham however points out that, "compared with pre-event annualized realized volatility of 6.4%, Wednesday's 3.3% SPX selloff naively represents an 8-standard deviation event, the 5th-largest tail event in the index's 90-year history."

Midterm Election Equity Returns

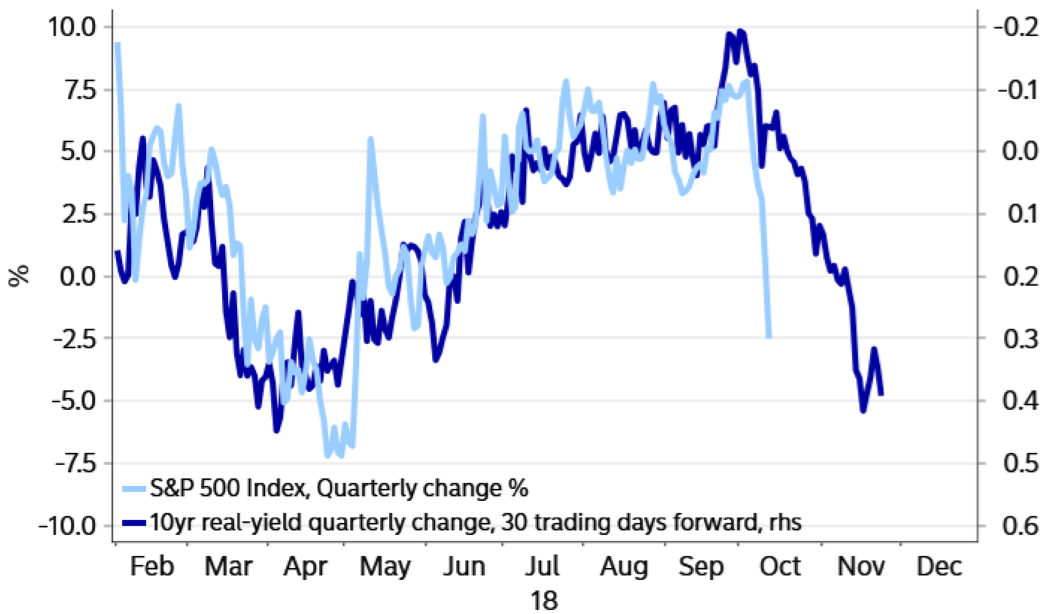


Time for something positive!

The above chart shows the stock market's return after the midterm elections, which is likely the only positive thing that can come from the chaos and noise of U.S. elections. Strategas shows that the S&P 500 has averaged over 15% over the 12 months after the midterms are over. It's important to point out that while these averages are bullish on the surface, it ignores the path each year took to get there. Markets don't move in a straight line and so we could still see periods of high volatility if we are to follow the roadmap laid out by election seasonality.

Stocks Performance Chasing Bonds

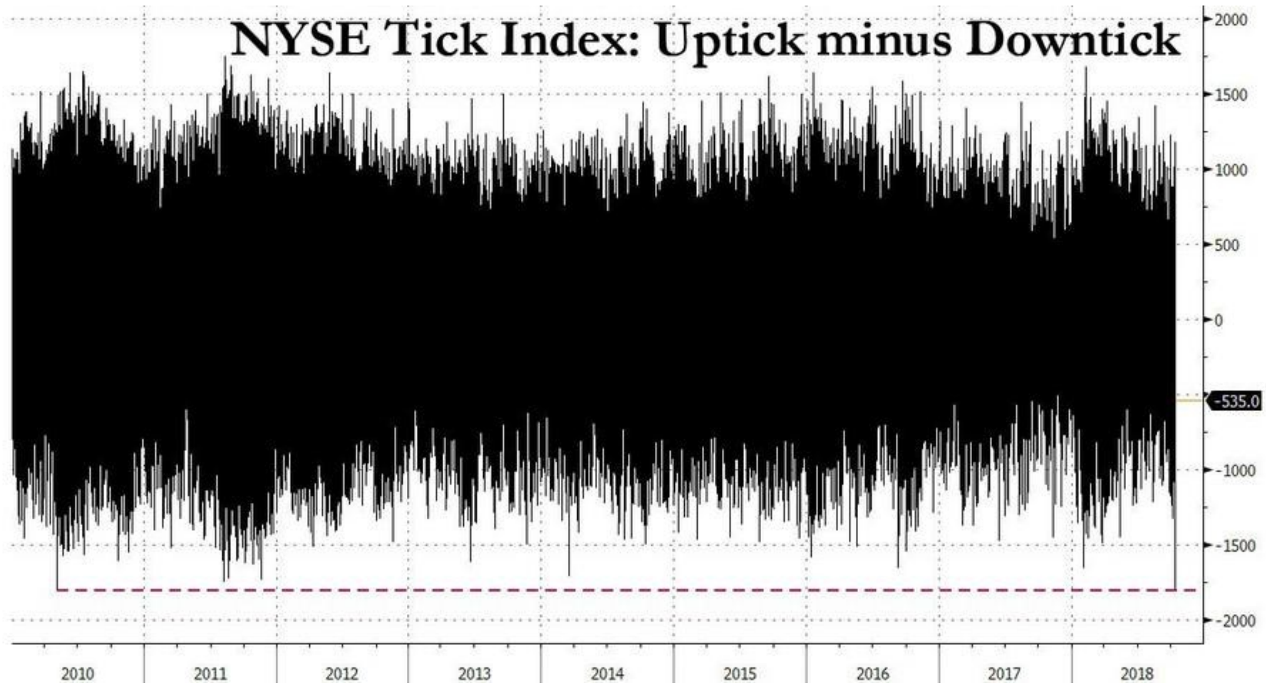
Chart 2: The development in the 10yr real yield explains the S&P 500, 30 days later



Source: Macrobond and Nordea

My focus often is with the equity market, but we can't view equities in a vacuum and not recognize other markets that may be having an impact. This chart from Nordea is a great example, which shows the 10-year Treasury yield change over 3 months, advanced forward by 30 days and the S&P 500's 3-month return. The two data sets have a strong correlation and fit the theme that stocks historically follow bonds. With the Treasury yield quarterly change having peaked out several months ago, it began forecasting a turn lower in stocks by late-September and early-October.

Have We Seen Capitulation?



The NYSE TICK Index calculates the number of NYSE issues that are ticking higher or lower, it's a very short-term focused breadth gauge but provides insight into the number of stocks that are moving higher or lower throughout the day. Last week saw the lowest TICK reading since the 2010 Flash Crash with a reading over less than 1,700. This was likely attributed to algo trading, but we can't use that as an excuse as algorithmic trading is part of the market whether you like it or not! This type of trade activity likely signals some degree of capitulation and would signal many trading systems to begin buying in search of a snapback rally in stocks. While we could see a move higher in the short-term, as I've said above - I still believe we'll see a retest at some point.

DISCLAIMER:

No reproduction, transmission, or distribution permitted without consent of Thrasher Analytics LLC ("Thrasher Analytics"). The material contained herein is the sole opinion of Thrasher Analytics.
This research has been prepared using information sourced believed to be reliable. Such information has not been independently verified and no guarantee, representation or warranty, express or implied, is made as to its accuracy completeness or correctness. It is intended for the sole use by the receipt to whom it has been delivered to Thrasher Analytics. The delivery of this report to any person shall not be deemed a recommendation by Thrasher Analytics to effect any transaction in any securities discussed herein. For more information please refer to our Terms & Service page of our website: http://thrasheranalytics.com/terms-of-service-agreement.