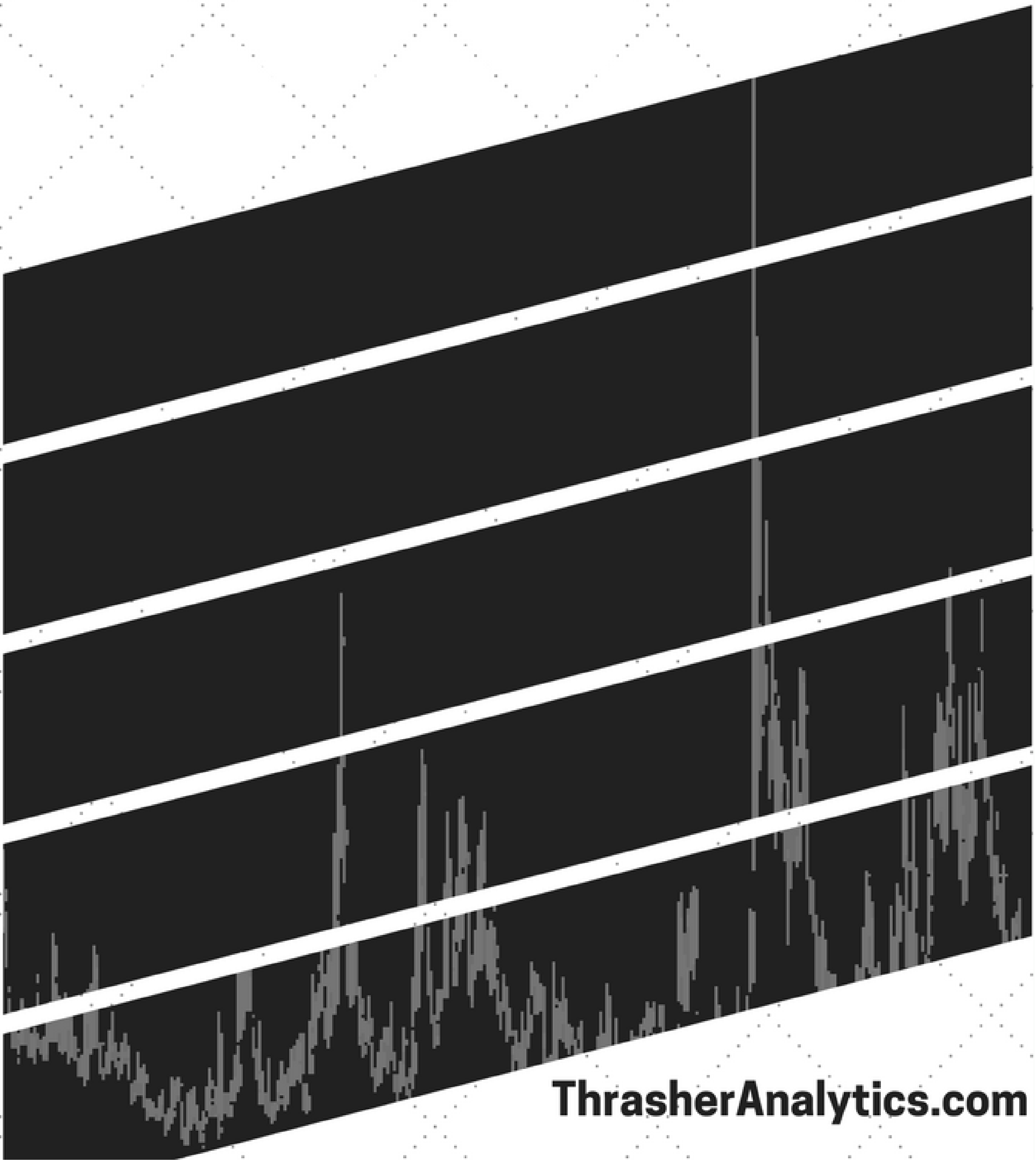
THRASHER ANALYTICS

BI-WEEKLY RESEARCH & ANALYSIS



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Below is a slightly different format for my letter, due to travel constraints and time I've written this one in Word vs. my normal format and included more commentary as well as sector charts.

My 12 reasons to dip a toe in the equity market email earlier this week appears to have been early. While the equities remain in a ripe state for mean-reversion as a massive weight has built up on one side of the proverbial market teeter-totter, confidence is still lacking for traders to make a move towards risk as of yet. My thesis partially relied on the catalyst of the Fed and the President. Both of which let us down, one a bigger surprise than the other. Fed Chairman Powell raised interest rates as expected and made an attempt to talk down growth expectations but still suggested 2019 would include three rate hikes rather than the market's perceived preference for just two. The biggest surprise came from the White House, as seems to be the new standard with its latest occupant. I did not think President Trump would shutdown the government, furloughing government employees' days before Christmas. The American people are now being held hostage over a boarder wall. Imaging calling American Express and demanding them to pay for a new car before you'll payoff your current balance. That's what's taking place right now in D.C. The impact on the economy and the market will be limited, as such as been the case with prior shutdowns but the drama surrounding the event takes center stage and gives investors yet another reason to hold on deploying capital. We also have rumors of the President interested in replacing Chairman Powell, this will have much larger implications for the market than the gov't shutdown if it does in fact happen.

You'll remember the Risk Appetite chart I share in each letter; the trends remain the same – down – as traders have yet to begin turning their risk dials back up. Looking at the carnage of last week, Thursday, we saw 1,271 new 52-week lows on the NYSE, this number dropped to 689 on Friday – a hopeful sign of selling exhaustion but need to see this trend of fewer new lows continue. Thursday also saw 40% of NYSE net-issues making a new. This is a level tested or exceeded once in 2016, once in 2015, and once in 2011, and a handful of times during the GFC. Needless to say - selling has been intense.

Traditionally we look at momentum of price but we can also look at momentum of breadth, applying the 14-day Relative Strength Index to the Advance-Decline Line of the S&P 500. Currently RSI for the A-D Line is at 24.96, a level that has only been reached one other time in the last 15 years, 2012. Momentum was not this strong to the downside in 2008. When looking at the 2012 period, RSI for breadth reached this level just before a low as put in, but price did in fact continue lower before the seller ceased. Two times we saw breadth become close to this level of 'oversold' was in 2011 at the first pivot low and in October 2008. Both times price did continue lower before a bottom was in place, in 2011 it wasn't much lower, and I don't have to remind you about October 2008 (hopefully).

Liquidity remains a large concern for the market and one that's been present ever since the February volatility spike (dubbed volmageddon by some). SocGen wrote on this subject in a recent note, "Whether it's due to continued structural changes in the market microstructure over the past couple of decades (higher proportion of algorithmic trading, reduced number of shares outstanding in listed equities, smaller dealer balance sheets due to regulatory requirements) or more of a late-cycle phenomenon, the diminishing liquidity in equity markets has been difficult to ignore and has severely diminished since the February VIX spike." This helps partially explain the large intraday moves within the U.S. equity market as of late. When liquidity dries up, price will move like a rock rolling down a hill until something stops it, in the financial market, what stops the rock (price) is demand (i.e. bids). Institutions are unlikely to step in when they see a Wall St. has become a liquidity desert. SocGen notes that liquidity issue appears to be focusd primarily in S&P futures, Nasdaq futures, and oil while fixed income markets remain closer to normal levels of bid-ask quantity.

On Fried I penned a note on my blog titled Breadth Drops & Protection Buying Rises to Major Level. That post can be found below. The point in make in the blog post as you'll read below is an extension of what I wrote to you earlier this week – we are due for a bounce. The major caveat is price must confirm. I will repeat what I've said in the past couple of letters and that is I do not believe well see a v-shaped bottom. History kept us from jumping on the initial October low, hopefully that study helped keep some powder dry within your portfolios vs. being (unfortunately) deployed at that point. I still think we'll see lower prices, but markets don't move in a straight line so some tactical counter-trends are likely in order. What I'll be watching closely for are improvements in breadth and momentum. We need to see stocks begin to strength, which will lead the broad market higher once they do. That hasn't happened yet so lower prices are likely still in store before a final low is traced out. This isn't the ideal way to end a year, but we must play the cards the market deals us and manage risk accordingly. On the following pages I've included an update for each S&P sector, with daily, weekly views as well as comparisons to the index and cap-weighted vs. equal-weighted charts. These broad snapshots of the sectors will be something I continually update and include in the letter going forward.

I wish you all a Merry Christmas and Happy Holidays. I'm leaving for the airport in an hour to visit my wife's family in New Hampshire. I'll be attempting to ski for the first time, so wish me luck and hopefully I don't return home in a full body cast! I hope you all get to enjoy time with family and friends and I look forward to the many great things instore in 2019.

Sincerely,

Andrew Thrasher, CMT
Thrasher Analytics LLC

Breadth Drops & Protection Buying Rises to Major Level

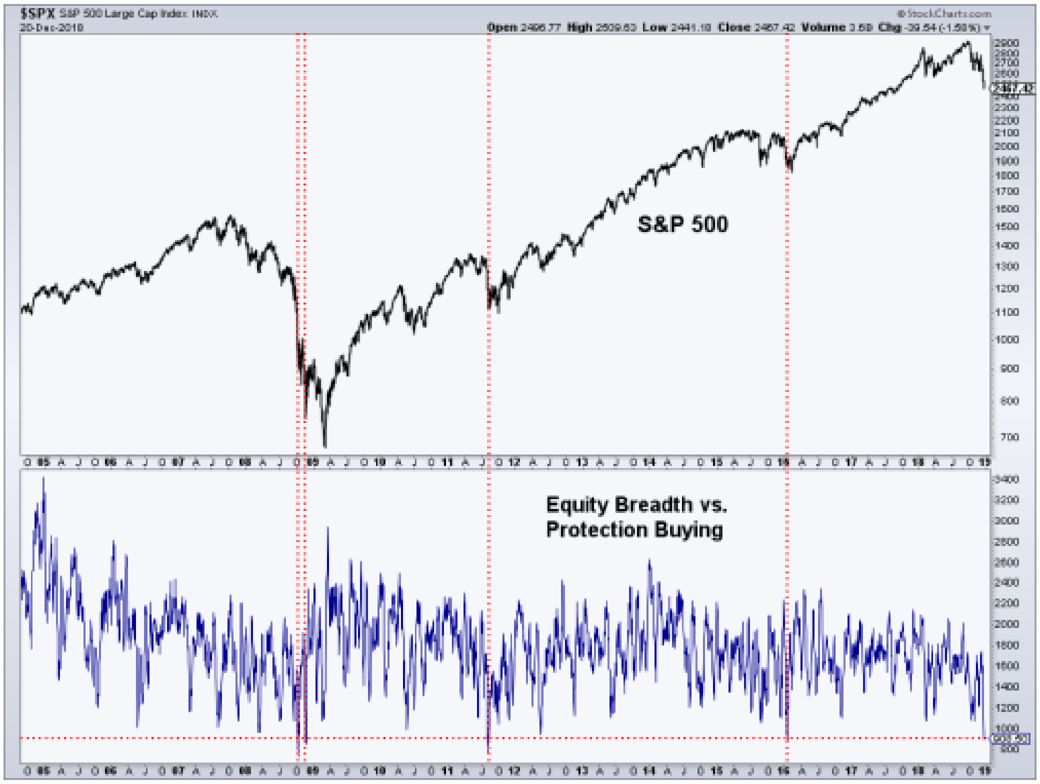
I don't have a ton of time this morning but there's one chart that really stuck out to me that I wanted to share but couldn't do it via 140 characters on Twitter. …

Many have been noting the major rise in the option put/call ratio, highlighting that it's at the highest level since the mid-1990s. This data is getting sliced, diced and forward returns are being analyzed by very angle. With that, I wanted to share one of my favorite charts when looking at the market in periods of a down trend. While the record high put/call ratio is significant, I believe more can be gleaned by smoothing out the data and not looking at simply a one-day snapshot.

The following chart looks at a spread. The first part of this spread is market breadth, which simply measures the number of stocks that are going up or going down as the stock market truly is a market of individual stocks and we want to know what those individual stocks are doing. The second part of the spread is the level of protection buying, which involves a specific measure of the put/call ratio.

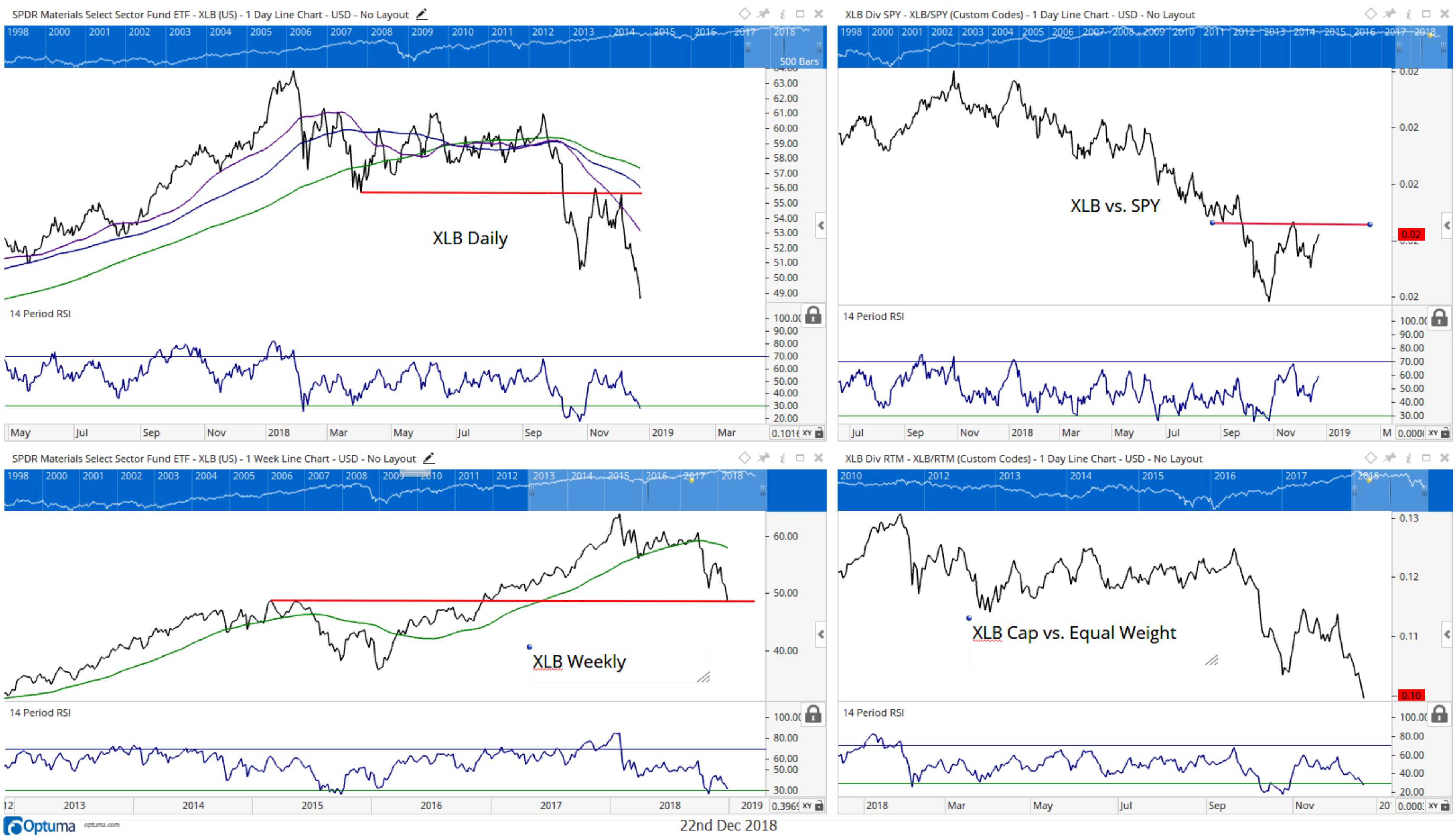
When the line is falling, we know there's a greater emphasis on protection buying than buying of individual stocks. This data can be quite noisy, so I've smoothed it out, giving us a better picture of what's taking place within the market and looking for signs of potential mean-reversion that could move stocks higher.

You'll notice we haven't seen this data this low very often. In fact, the current level has only been met four times in the last 15 years. Most recently in 2011 and 2016. Something I've been writing a lot about in my Thrasher Analytics letter is that I don't believe we'll see a v-shaped recovery whenever stocks do bounce. Historically when the market has declined by this degree, some type of consolidation and retest takes place. That's exactly what happened the last time this breadth vs. protection buying data got to its current level – the first low in 2011 that was then retested and the initial low in 2016 that was also retested.



So have stocks fallen to a low? Anyone that gives you an answer with any level of certainty is lying to you. We can't know when stocks will bounce, but what we can do is look for opportunities of potential good risk/reward entry points once time frame, risk tolerance, etc. have been taken into account.

We are now at a point where 93% of assets have produced a negative return, the highest percent in over a hundred years. There's been major market damage over the last few months. You may remember that volatility was contracting by a great degree back in September, acting as the first sign of trouble brewing that's now led to a double-digit slide in equities. Breadth has been thrown out with the bath water and all eyes are on buying protection via options to a level that's marked significant pivot points in the past, unfortunately we don't have a very large sample size to rely on. From here I want to see how the market responds, as nothing matters unless the market confirms what the data is suggesting. At the end of the day, price is what pays.



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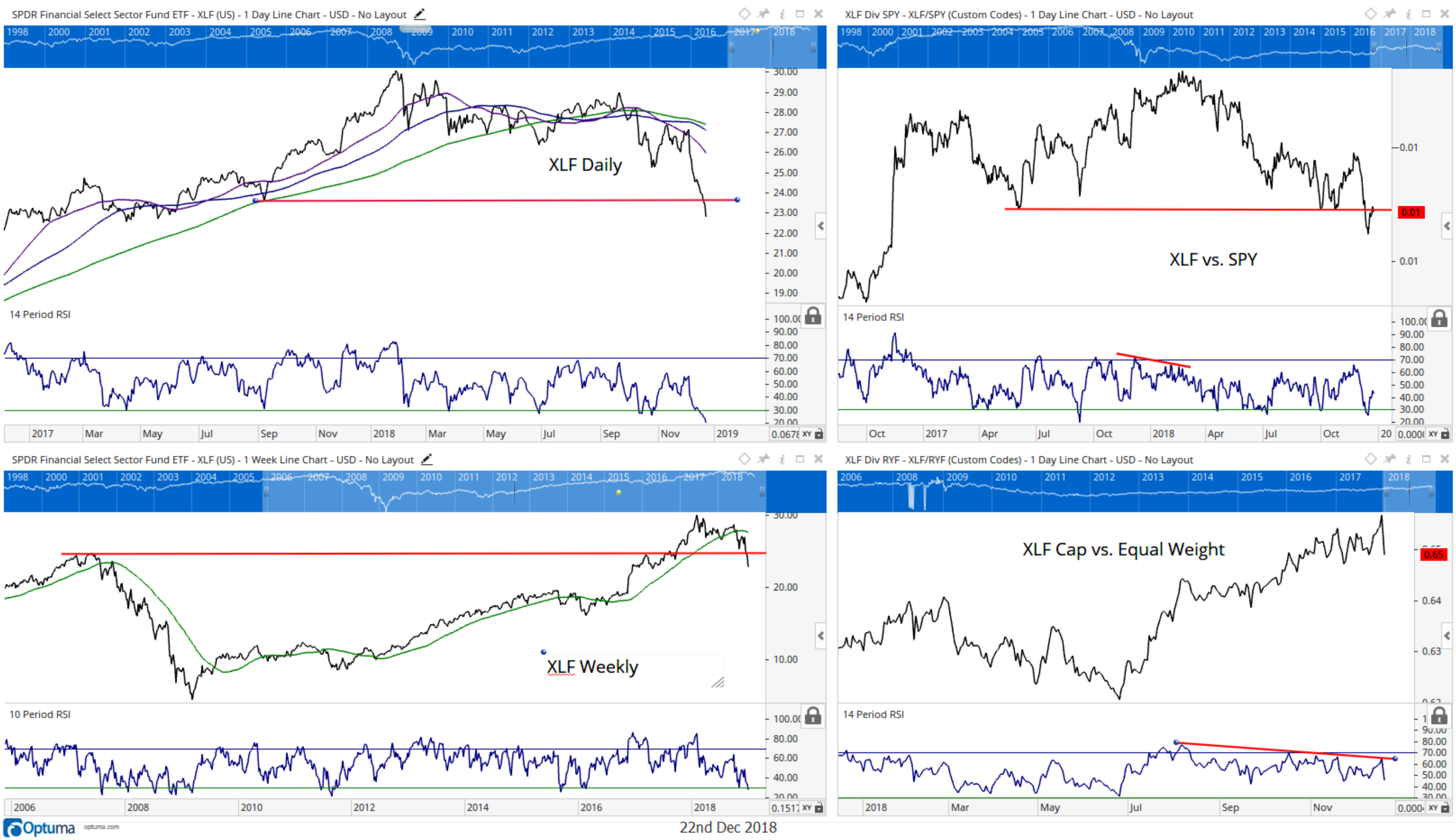

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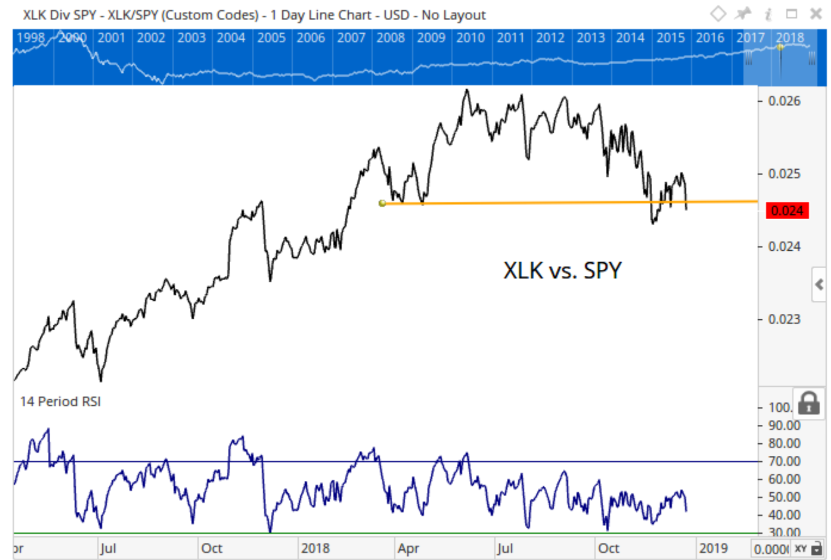

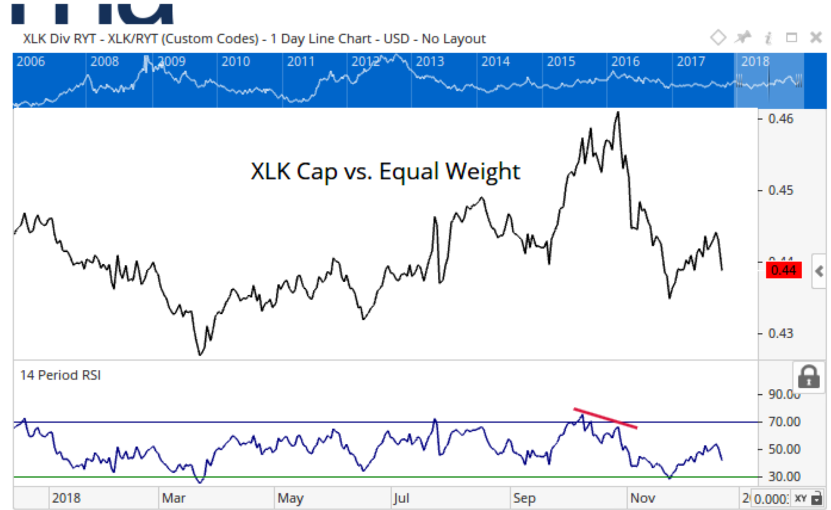

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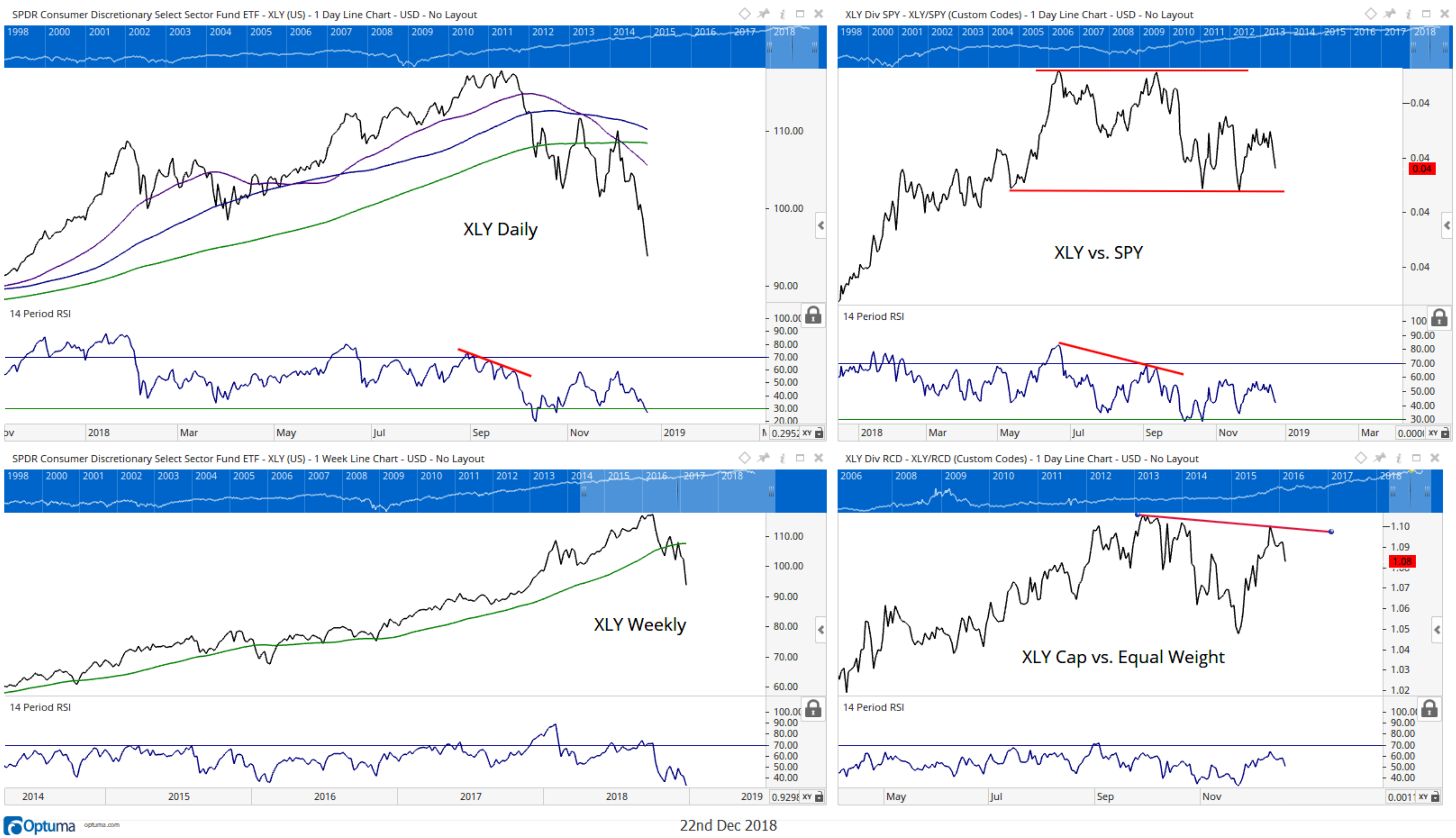

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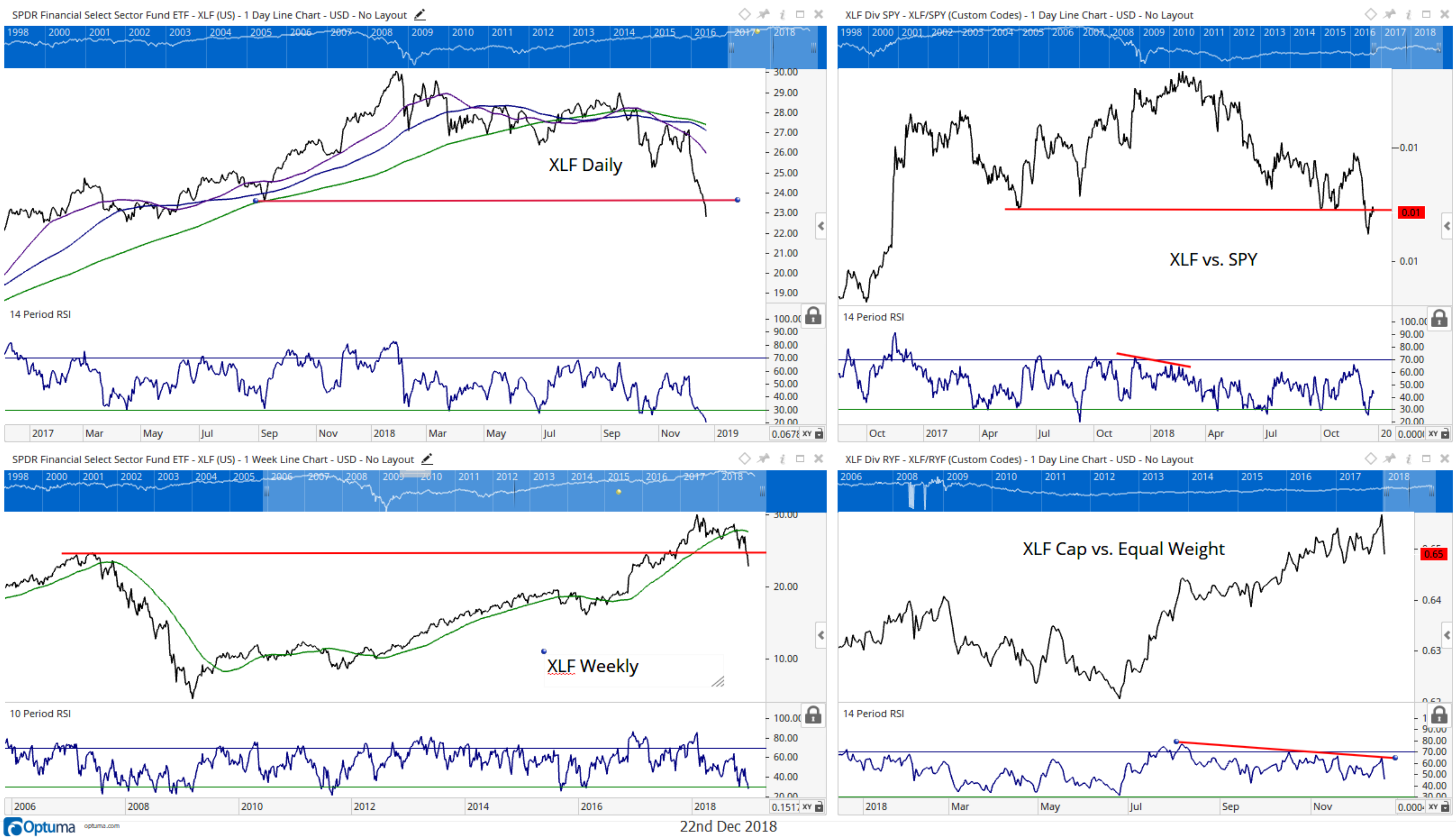

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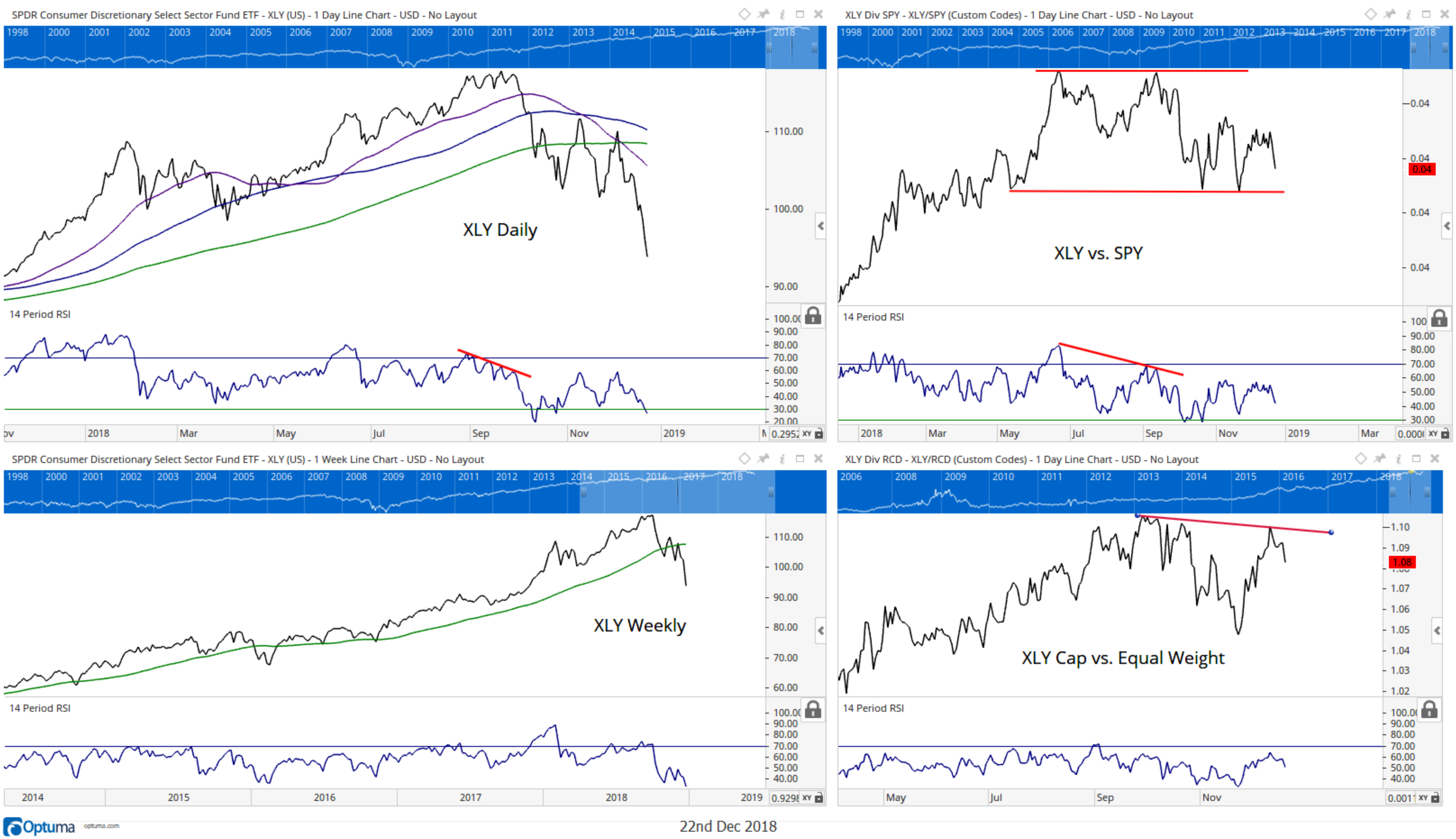

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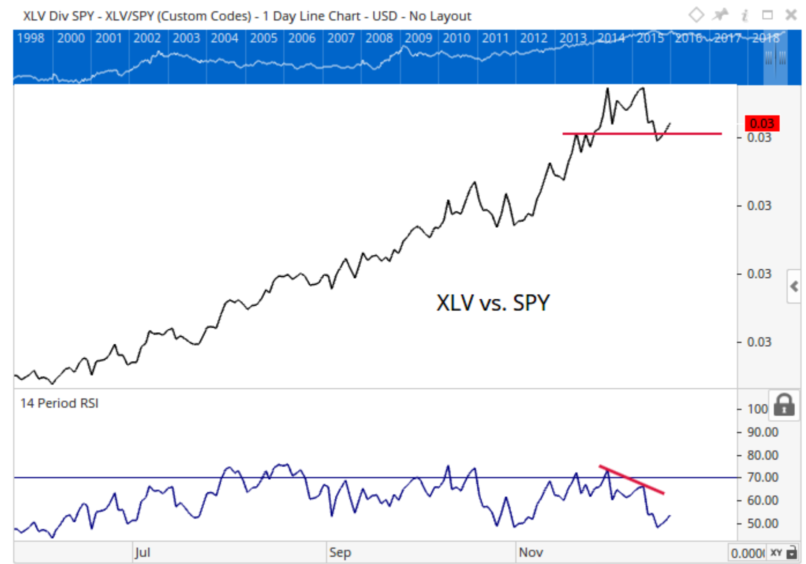

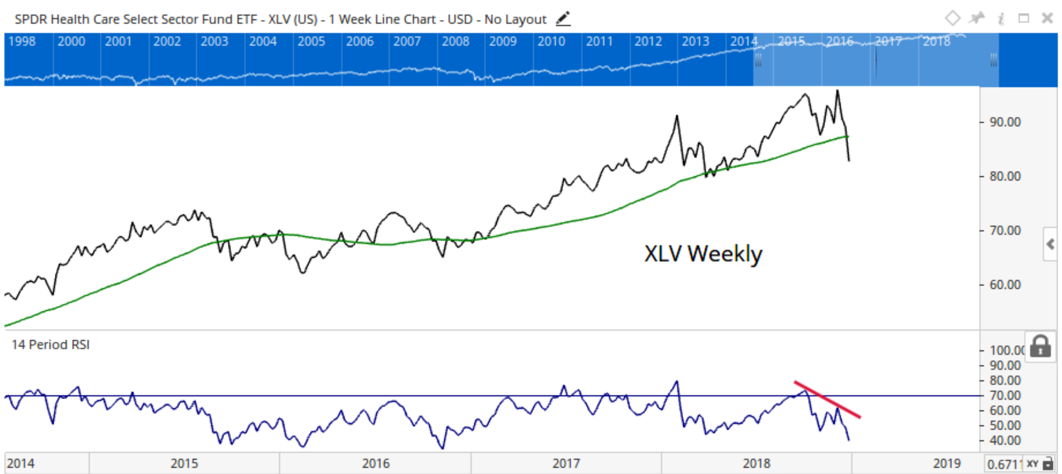

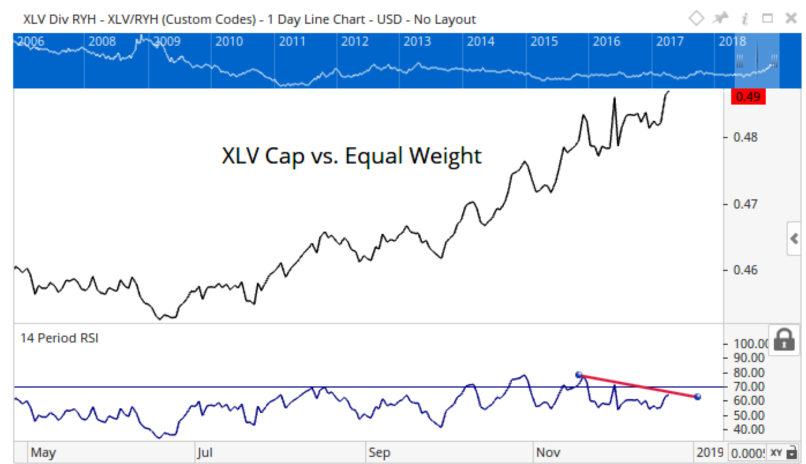

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