12 ~~Days of Christmas~~ Reasons Why It May Be Time to Dip a Toe Back In Equity Waters

The S&P 500 is now down over 13% from its September high, the Russell 2000 has fallen over 20% and the Nasdaq 100 is off by almost 16% since September. The selling thus far has been orderly, following the technical road map a reasonable trader would expect. First we had the narrowing of volatility dispersion to historic levels, along with a whole host of data signaling a decline in breadth as fewer stocks were participating in the up trend shown by the major indices in

their waterfall line decline, catching many off-guard. However, we were patient and knew not to buy the first pivot point low, as historically the lows get tested after that amount of selling. It's been truly amazing the lack of panic selling that's entered the market up until today, the VIX has remained relatively low, barely even attempting to break above 25 with little protection buying being shown in the options market.

Then at the end of last week we began getting reports of massive outflows from equity funds and ETFs along with sentiment surveys showing few bulls left in the retail space. It's about time! The next step is looking for panic-level selling, which I believe we began seeing today. Defensive sectors took their obligatory punch with health care down 2%, utilities dropped 3.2% and real estate fell 3.7%, falling to their 1-year average - leaving no sector untouched by the bears. Now we can look for some dips.

Here are a few of the things I'm seeing tonight that's preparing me to dip a toe into the equity waters. Let me first say that I'm not 100% sold that we've seen the FINAL low. I'd prefer to see more pronounced bullish divergences but it's important to keep an open mind when combing through the data. Remember, even in 2008 there were multiple double-digit rallies within the long-term down trend. Markets don't move in a straight line, in either direction, so the following twelve points are why I think we could see *at least* a counter-trend rally in U.S. stocks. We must keep an open mind and look for opportunities, seeing what the market throws at us.

1. First, Breadth is oversold. the number of stocks advancing compared to the amount of put protection being purchased is at a level we have seen just a handful of times since the GFC. Prior similar periods marked either the final low or the first low that was then re-tested before stocks rebounded.
2. The number of new 52-week lows on the NYSE has begun to come off its high, peaking at 648 last week the figure was at 499 as of end of trading today – still an elevated reading but at this point 'less bad' is all we can ask for.
3. At the prior October low only 11% of S&P stocks were above their respective 50-day Moving Average, as of today that figure is 16%, a very small improvement but again "less bad" is all we're looking for at this point. The Nasdaq and the NYSE also are showing a small positive divergence.
4. The declining volume to advancing volume on the NYSE finished today at 6.67:1. This figure was north of 10:1 in October and got up to 14.3:1 on December 4th.
5. Looking at the number of advancing vs. declining stocks smoothed by a short-term moving average we can look for bullish divergences, which marked the early 2018 low, the 2016 low, 2015 low, as well as several short-lived declines in equities as shown by this chart. This 2-

6. The Volatility Index closed above its upper 2 standard deviation Bollinger Band, which typically marks short-term exhaustion in volatility when spot is north of 24.
7. The Equity Put/Call ratio has finally moved substantially higher. Throughout this correction, traders were not seeking portfolio protection with SKEW remaining weak, VIX staying below levels you'd expect with multiple large down days, and the put/call ratios not getting extended. Well that's finally changed as of today with the equity put/call finished today at 0.97, which is the highest reading since November 2016, marking the low to the late-'16 decline.
8. The ratio of stocks to 30-year bonds is now 'oversold' with momentum at the lowest level since June 2016 and before that, February 2016 – both marking lows in equities.
9. Equal-weight S&P 500 vs. cap-weight S&P 500 has under-performed for most of 2018, however the ratio of equal-to-cap weight has not reached its October low, telling us that selling has lessened outside the mega cap stocks.
10. Semiconductors, which peaked in relative performance back in March as many semiconductor

by sellers, largely led by the disappointment from semis, so seeing some strength in this space among heavy broad market selling is a positive development.

11. DSI bullish sentiment for the S&P is now in single digits. This figure broke below 10% at the prior November short-term pivot low as well as in October. Before that we saw a sub-10% bullish reading briefly in late-April and at the February low. It's very rare for there to be less than 10% bulls as measured by DSI, telling us this may be a good time to turn contrarian.

12. Momentum on the weekly chart of the S&P 500 has fallen just above the prior 3-year range low. The chart below shows the initial range set in 2011 through 2014 before the 2015 correction/mini-bear broke through the lower range. This setup for the current new range, which began with the 2016 low, which got tagged in October of this year and we currently are just a few points above. While it's a 'chart crime' to evaluate an intra-week chart like this, I think it's important to recognize the range within momentum, so I plead guilty to the crime but for good cause!

chasing the first October low and I think there's been enough intensive selling that we could see at least a counter-trend rally in the very near future. I'm also keeping an eye out for a re-test potentially around mid-January based on several calendar models.

Powell will the likely raise rates on Wednesday and could give some comfort to the market with his 2019 guidance for Fed action going forward. The deadline for a Congressional spending bill is Friday. There are several reports of Senatorial Republicans working to get a deal done and we saw last week that the Dems want to avoid a shutdown as well. Trump (as always) is the wildcard here. He's given a fair bit of attention to the market and knows it's a barometer for his administration, so I think he'll likely cave and agree to a temporary agreement that avoids a shutdown the week before Christmas. No president wants a negative headline like that during the holidays. So, between the Fed and the Gov't shutdown, we could get a resolution to two major 'unknowns' by week-end, paired with year-end seasonality could give traders the confidence to return to equities before the ball drops on NYE.

Best Regards,
Andrew Thrasher, CMT

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