BI-WEEKLY RESEARCH & ANALYSIS

ThrasherAnalytics.com

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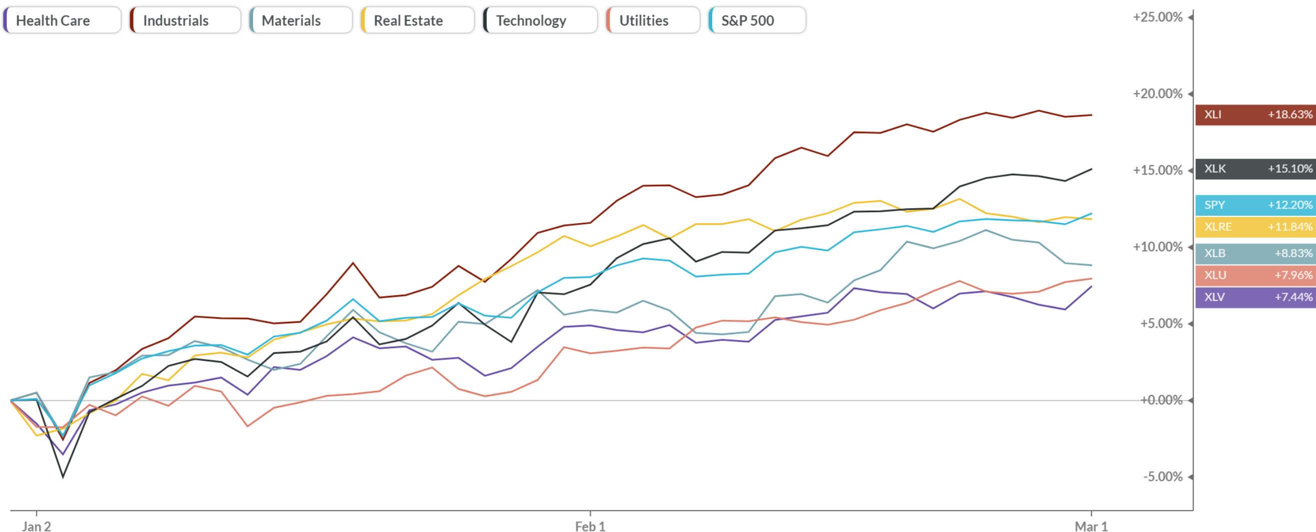

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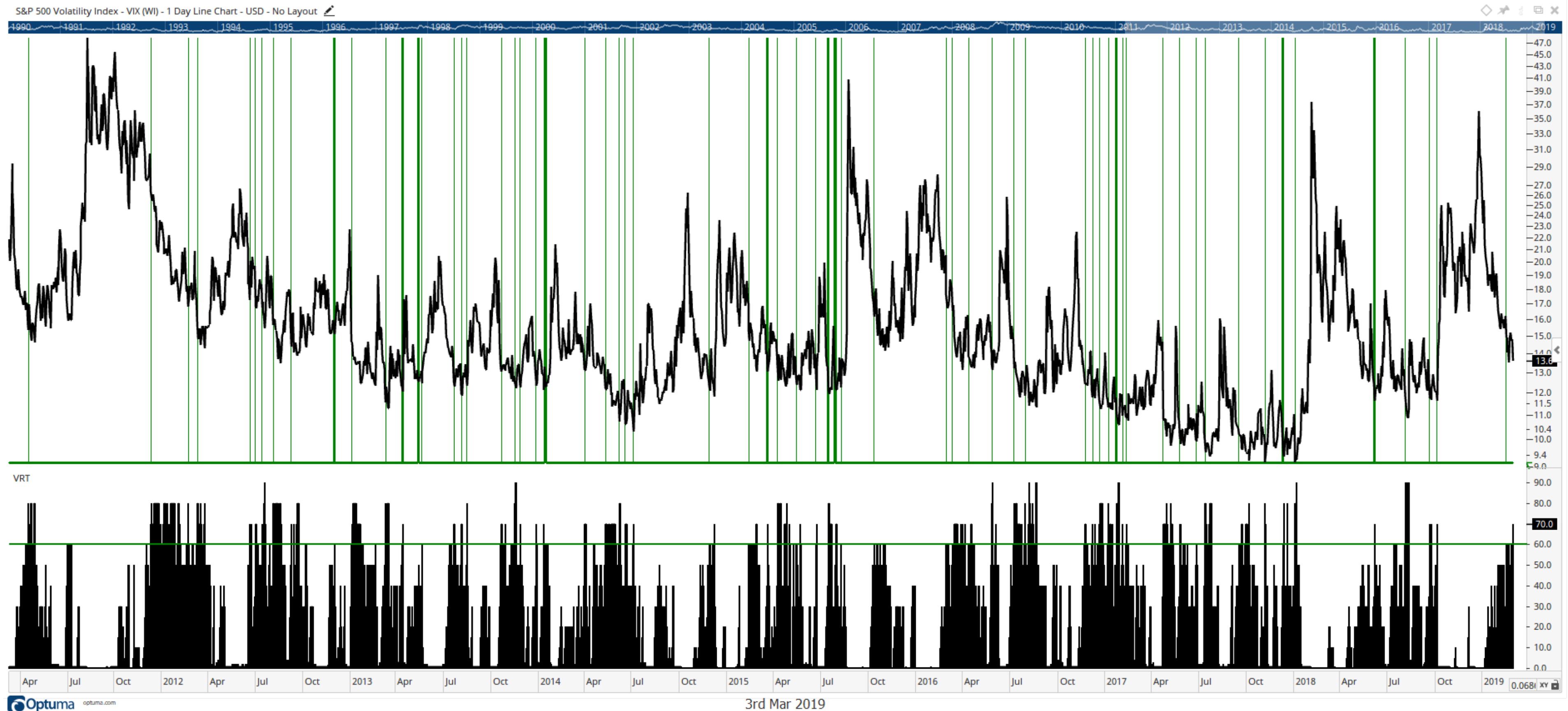
Long vs Short Sector Matrix

1D 5D MTD 1M QTD 3M **YTD** 1Y 3Y 5Y

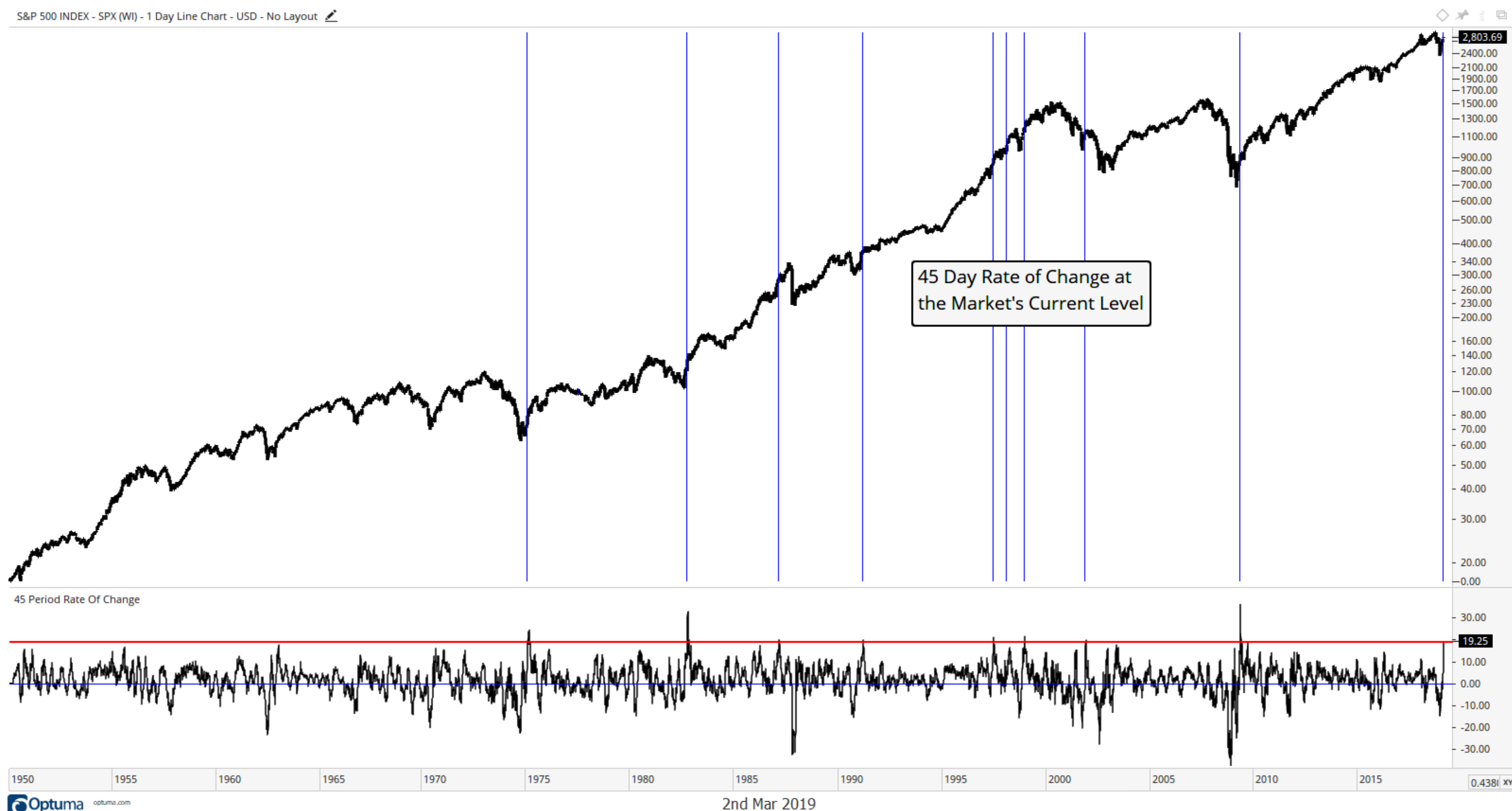
	+ XLY	+ XLP	+ XLE	+ XLF	+ XLV	+ XLI	+ XLB	+ XLRE	+ XLK	+ XLC	+ XLU
– XLY	-	-5.4%	3.7%	-0.2%	-4.8%	6.4%	-3.4%	-0.4%	2.9%	-0.1%	-4.3%
– XLP	5.4%	-	9.0%	5.2%	0.6%	11.8%	2.0%	5.0%	8.3%	5.3%	1.1%
– XLE	-3.7%	-9.0%	-	-3.8%	-8.4%	2.8%	-7.0%	-4.0%	-0.8%	-3.7%	-7.9%
– XLF	0.2%	-5.2%	3.8%	-	-4.6%	6.6%	-3.2%	-0.2%	3.0%	0.1%	-4.1%
– XLV	4.8%	-0.6%	8.4%	4.6%	-	11.2%	1.4%	4.4%	7.7%	4.7%	0.5%
– XLI	-6.4%	-11.8%	-2.8%	-6.6%	-11.2%	-	-9.8%	-6.8%	-3.5%	-6.5%	-10.7%
– XLB	3.4%	-2.0%	7.0%	3.2%	-1.4%	9.8%	-	3.0%	6.3%	3.3%	-0.9%
– XLRE	0.4%	-5.0%	4.0%	0.2%	-4.4%	6.8%	-3.0%	-	3.3%	0.3%	-3.9%
– XLK	-2.9%	-8.3%	0.8%	-3.0%	-7.6%	3.5%	-6.3%	-3.3%	-	-3.0%	-7.1%
– XLC	0.1%	-5.3%	3.8%	-0.1%	-4.7%	6.5%	-3.3%	-0.3%	3.0%	-	-4.2%
– XLU	4.3%	-1.1%	7.9%	4.1%	-0.5%	10.7%	0.9%	3.9%	7.1%	4.2%	-



The VRT has ratcheted up another notch , exceeding the prior high of 60, hitting 70 with Friday's close, a level that was last reached in October of last year. I continue to hold the belief that volatility is currently being under-priced and while the weekly data of the VRT still outside its needed threshold for warning of a higher risk, the daily data continues to signal the heightened risk of volatility appreciated considerably from its current level.

Not only is vol being under-priced (in my opinion) for the S&P 500 (via VIX) but, as I'll show further in the letter, the same development is taking place in Nasdaq, Russell 2000, and Dow volatility as well with volatility dispersion declining to very low levels.

The S&P 500 close on Friday above 2800 (by 3 points) which pushes it into the band of potential resistance as shown by the red line on the chart above. Momentum has consolidated just under 70, mimicking what price has done as well over the last week. Volume remains subdued, the only above-average trading day last week was on a down day.



Some traders have suggested that because the market has risen a considerable amount that it should decline and the current short-term up trend should end. Unfortunately (for them), history does not confirm this belief. Above we can see blue lines on the S&P 500 daily chart when the equity market has risen by its current amount (19.25%) over a 45-day period going back to 1950. While the same size is not large, the notion that because the market is up nearly 20% in such a short period of time never ended the preceding trend. Also note that only rarely did the market advance like it currently has during the middle of a protracted bear market, just once did this occur, during the post-dot com bubble.

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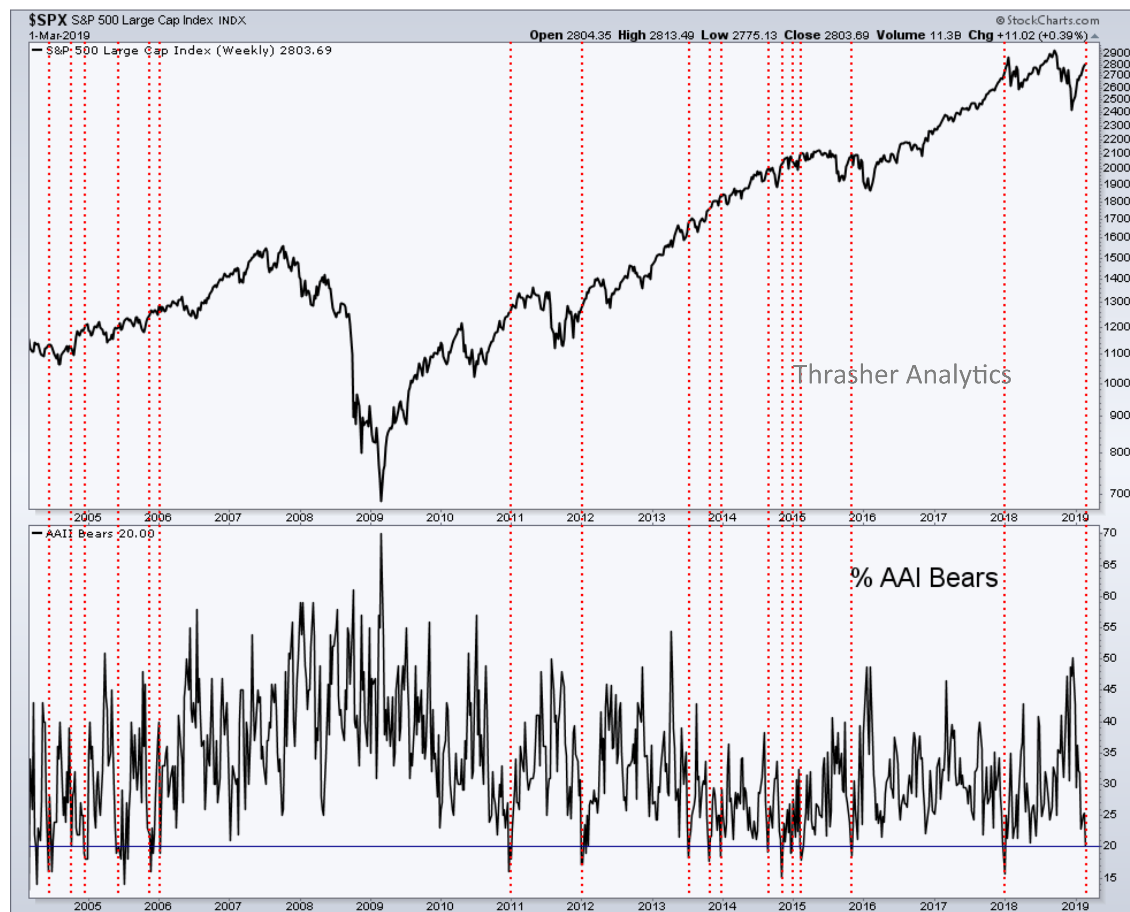
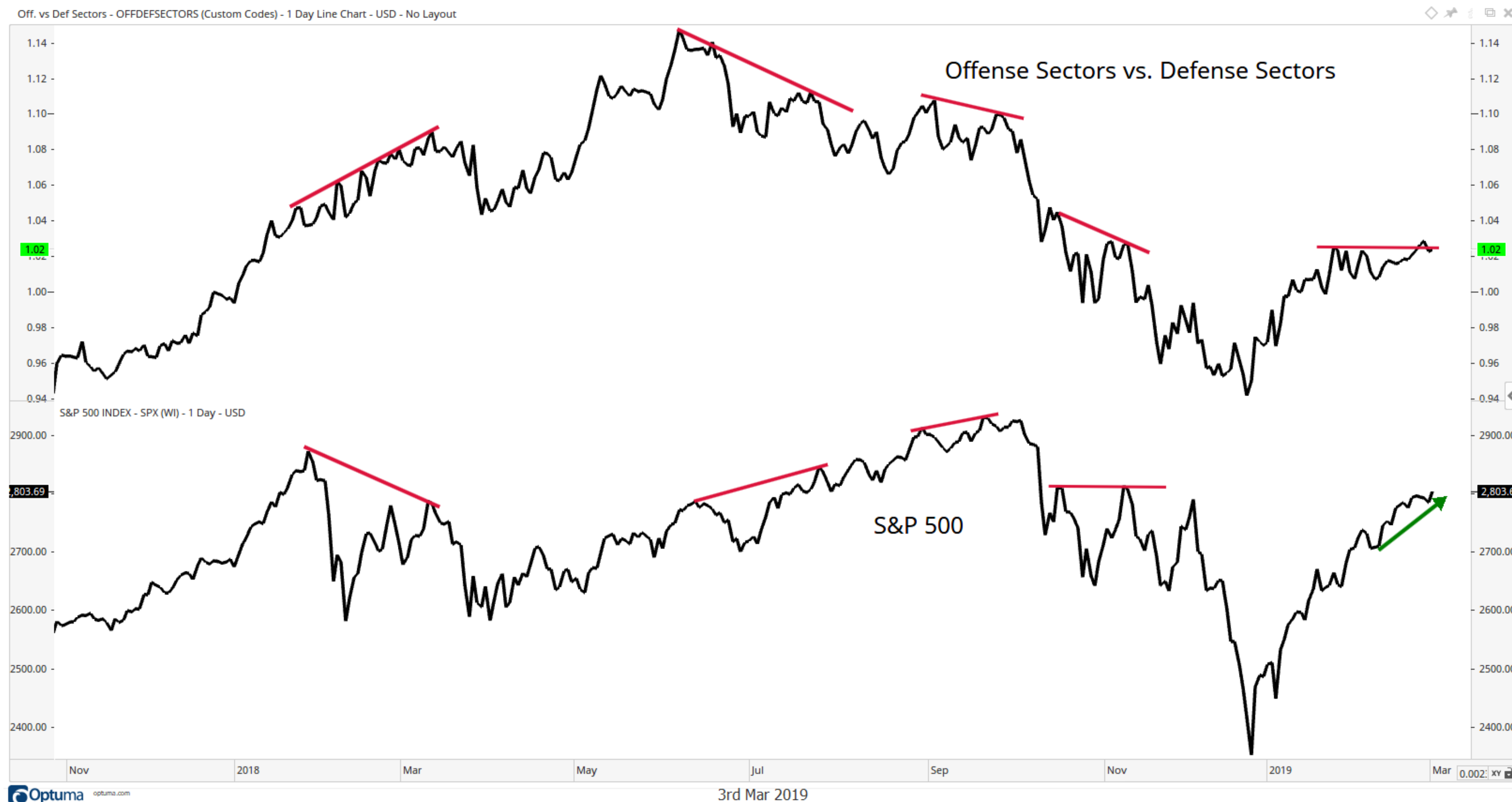
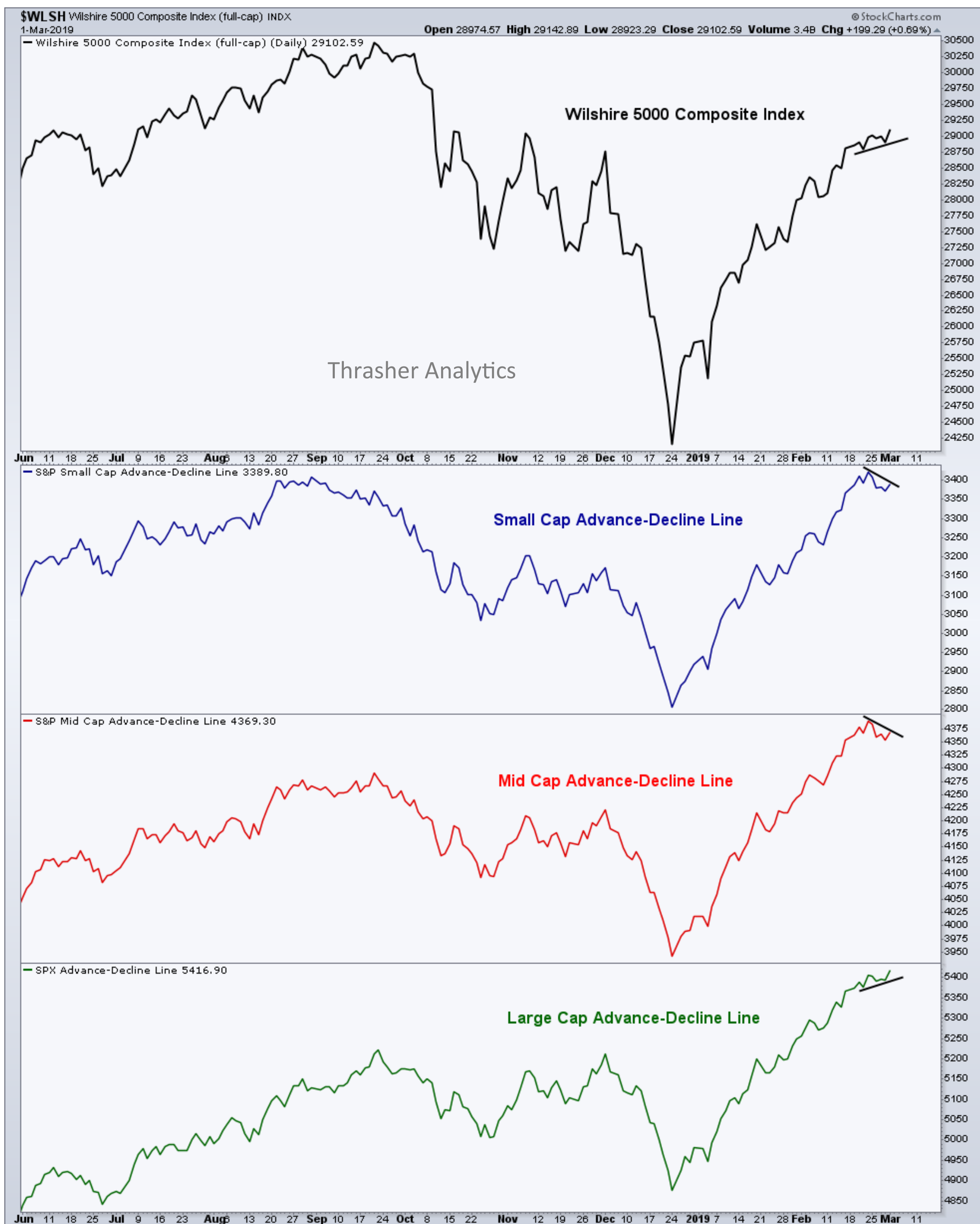


The AAII retail investor sentiment survey, which collects results each week, has seen its bearish reading decline to just 20%. This is something we haven't seen but a handful of times over the last 10 years. Most recently the 20% level was breached during the run up in January 2018, ironically, a similar type price action as we are seeing right now. You'll notice up trends were not always ended when bears disappeared. While we did see the market decline after the 2016 and 2018 readings, before then then market was able to continue its advance for at least a few more weeks if not longer in some instances.



Since the December '18 low the offense sectors, such as tech, financials, and consumer discretionary, have lead the more defensive sectors, such as utilities, health care, and consumer staples. That trend in out-performance has begun to stall with the latest advance in the S&P 500 yet to be confirmed in relative performance by the composite of offense sectors vs. defense sectors. A well-defined divergence has yet to occur, like it had before the prior September high, so I'm not overly concerned as of yet by this lack of offense sector strength - but over the next few weeks if the S&P continues to move higher I'll be watching what sectors are showing strength as well.

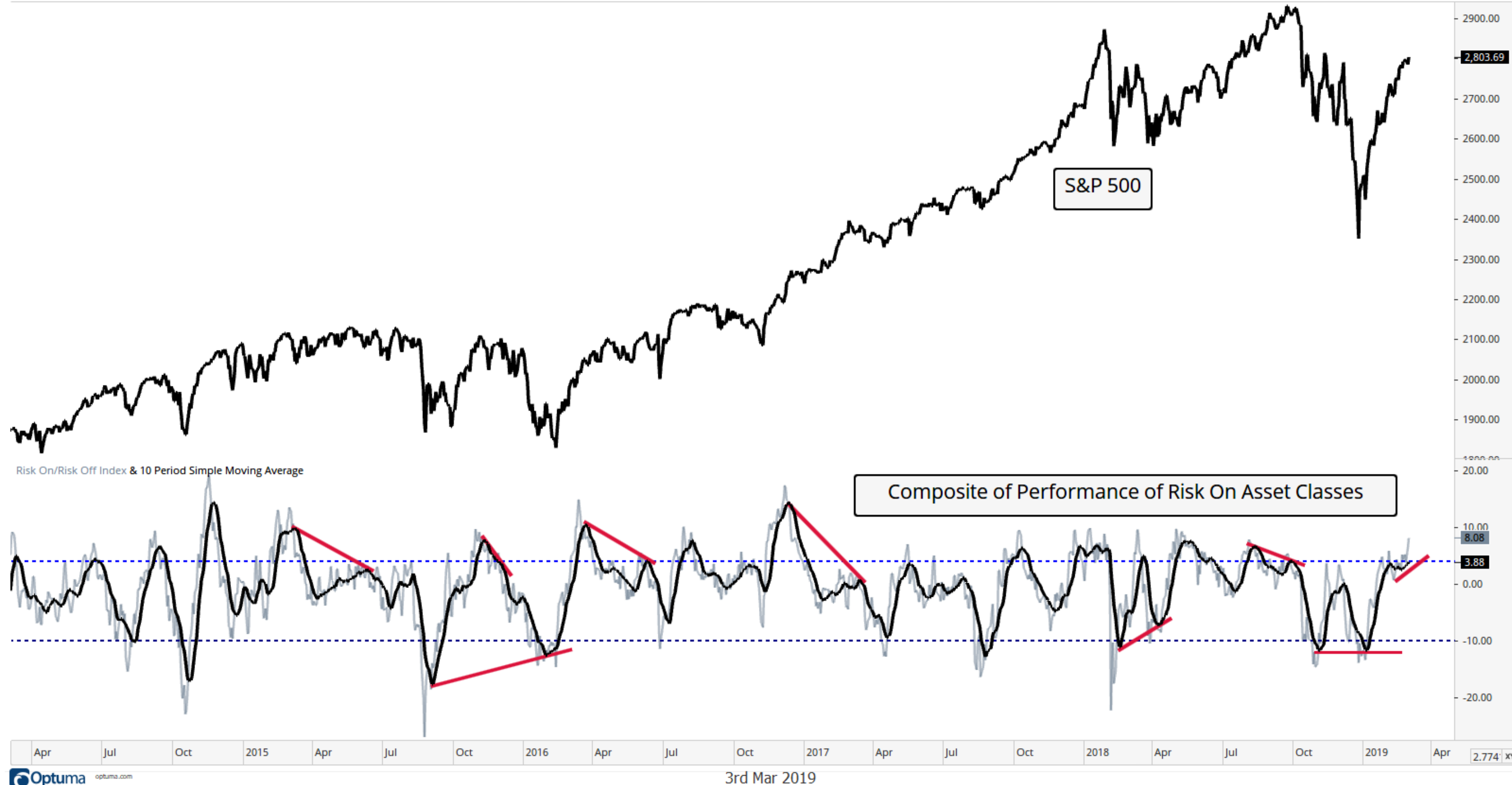


The chart to the left shows the cumulative Advance-Decline Lines for small-cap, mid-cap, and large-cap indices. A great deal of focus has been given to the strength in the S&P 500 Adv-Dec Line recently but I've yet to see anyone make any noise about the lower high in small– and mid-cap breadth indicators.

You may remember that it was a divergence in small-cap breadth that preceded the eventual peak in the broad equity market, which is fairly normal market behavior as traders begin to shift out of a buying behavior of more risky small cap stocks while not trading away from their large-cap breadthen. This change in trading behavior was ignored in September, but the divergence was much more pronounced back then than it is right now.

So again, like the offense vs. defense relative performance on the prior chart, this divergence is pretty small and something I'll continue to watch going forward if equities retain their current up trend.

For the most part, we have a fair bit of confirmation in risk appetite for the latest advance in the S&P 500. High yield continues to outpace Aggregate Bonds and Small Caps still are rising more than large caps, although Friday's move in the S&P did not set a higher high in small cap vs. large. Equal weight has stalled recently, putting in a performance that's been fairly in-line with the cap weight and the same type of market behavior can be observed by high beta which has also flattened out in relative performance.



The composite of risk on/risk off asset classes has continue to rise, confirming the latest trend higher in the broad index. While a divergence was created with a lower high back in September - warning that risk assets were beginning to under-perform and a double bottom in December as risk assets began to outperform. Currently we have a steady outperformance in risk-on assets, a positive sign for equity bulls.

Table 2: Since 1960, about two-thirds of the time, policy is eased during the third year of the US Presidential cycle. US equities were up during ALL these periods with average returns of 18%

			US Policy Stance (S.D.)*			
Episode	Start of 3rd year of Presidential term	End of 3rd year of Presidential term	At the start of 3rd year	At the end of 3rd year	Change during 3rd year	SPX performance
1	11/30/1962	10/31/1963	-0.09	-0.14	-0.05	30.9%
2	11/30/1966	10/31/1967	-0.59	-0.01	0.58	17.1%
3	11/30/1970	10/31/1971	-0.26	0.71	0.97	13.2%
4	11/30/1974	10/31/1975	-0.48	0.43	0.92	20.5%
5	11/30/1978	10/31/1979	0.00	-0.97	-0.96	9.3%
6	11/30/1982	10/31/1983	-0.32	0.19	0.51	22.3%
7	11/30/1986	10/31/1987	0.86	0.02	-0.84	3.2%
8	11/30/1990	10/31/1991	-0.12	-0.21	-0.09	29.1%
9	11/30/1994	10/31/1995	-0.38	-0.30	0.08	23.1%
10	11/30/1998	10/31/1999	-0.59	-0.25	0.34	24.1%
11	11/30/2002	10/31/2003	0.28	0.61	0.33	18.6%
12	11/30/2006	10/31/2007	-0.18	0.18	0.36	12.4%
13	11/30/2010	10/31/2011	0.72	1.13	0.41	5.9%
14	11/30/2014	10/31/2015	0.23	-0.27	-0.50	3.0%
15	11/30/2018	10/31/2019	-0.08	-0.06^		
Likelihood of policy easing during 3rd year of Presidential term					**64%**	
Median change during 3rd year of Presidential term					**0.33**	**18%**
Likelihood of policy easing during other years of Presidential term					**36%**	

Source: BofA Merrill Lynch Global Research, Bureau of Economic Analysis, Bloomberg, Datastream

Note: *US Policy stance is gauged by the average of real short term rates, real money supply growth, real-effective exchange rate, and the fiscal balance of the government. Green shaded regions denote policy easing during the third year of the Presidential term. ^Data as of January 31, 2019.

To the right is a table by BofAML showing the market's performance during the third year of a Presidential cycle. Historically the market has gone up every 3rd year of the cycle going back to the 1960s with an average return of 18%. This is a stat that I think will get replayed over and over in financial news but BofAML's Ajay Sigh Kapur makes a very interesting observation. That is, Fed policy was in the middle of an easing cycle two-third of the time, meaning the Fed's policies were more accommodative for equity markets during 64% of prior third presidential years.

So while presidential cycles are something I pay attention to, it's very interesting to shed light on the Fed's policy during those years. While there were just five years where the Fed rate declined during a 3rd year of the cycle, the market's performance was more below-average during three of them (9.3%, 3.2%, and 3.0%).

CBOE VVIX Index - VVIX (WI) - 1 Day Line Chart - USD - No Layout

Vol of VIX (VVIX)

VXST:WI - 1 Day Line Chart - USD - No Layout

9-day VIX

VXV:WI - 1 Day Line Chart - USD - No Layout

3-month VIX

S&P 500 Volatility Index - VIX (WI) - 1 Day Line Chart - USD - No Layout

Volatility Index (VIX)

VIX-VXV:Formula Codes - 1 Day Line Chart - USD - No Layout

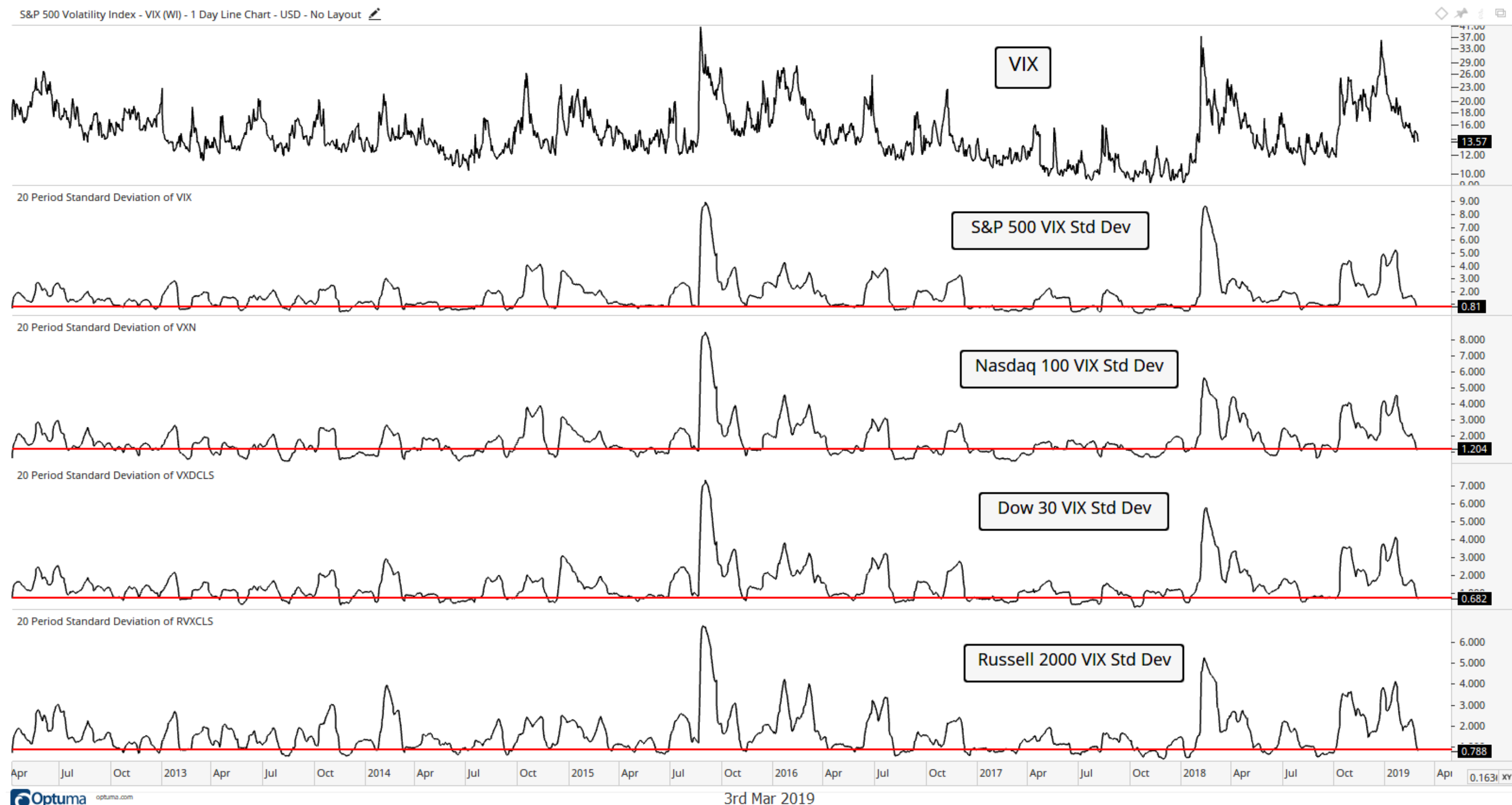
Backwardation

Contango

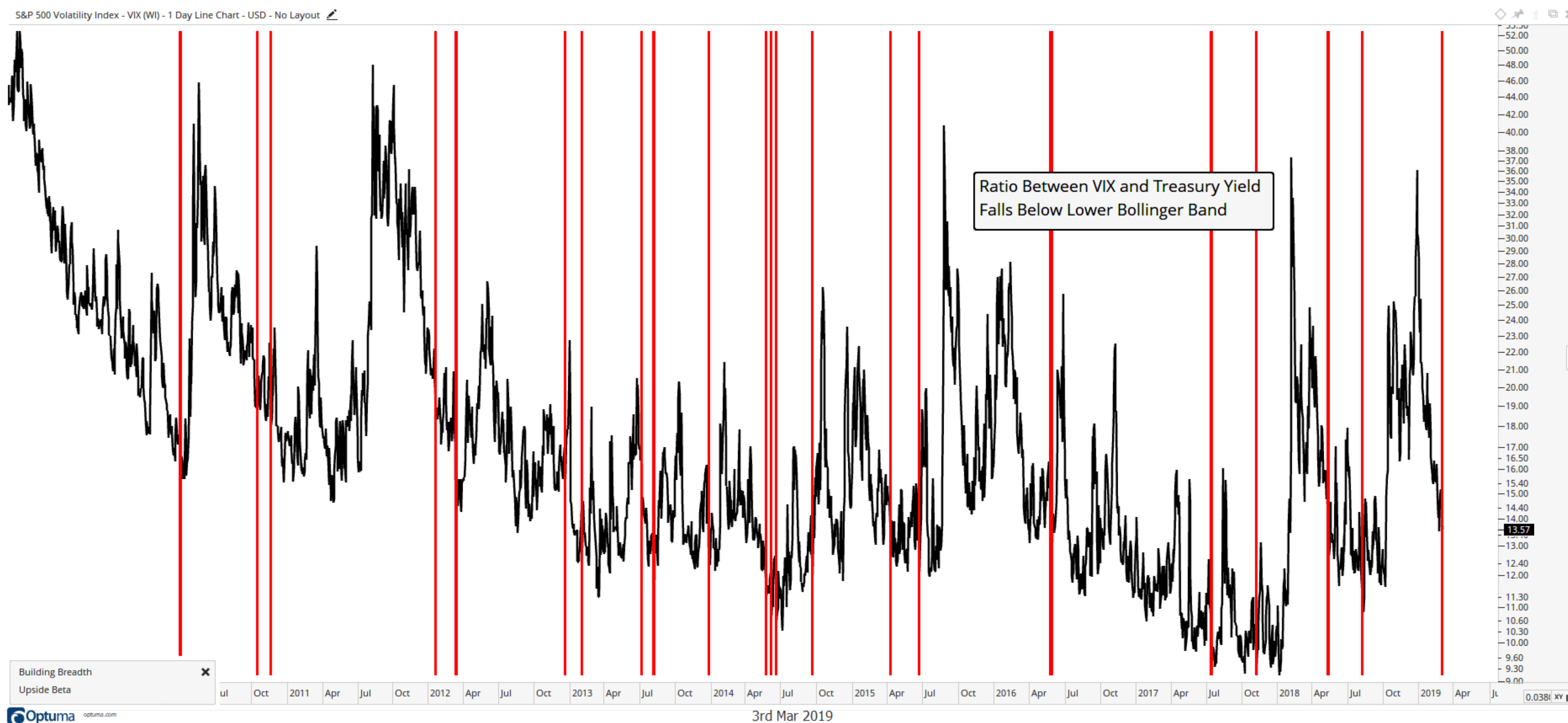
Optuma

3rd Mar 2019

Volatility across the board has fallen near multi-year lows with the VIX curve still firming in contango.



While the VRT uses a more technical method for evaluating volatility dispersion, the method I use in my paper, Forecasting a Volatility Tsunami that won the Charles H. Dow award, used a simple 20-day standard deviation. Above I've shown the 20-day Std Dev for the volatility indices for the S&P 500, Nasdaq 100, Dow Industrial, and Russell 2000. I've drawn red lines to show each indices to show that the current levels are extremely low. This means that volatility's dispersion (as measured by standard deviation) has fallen across the board for each of the major indices.



Many traders evaluate the Volatility Index (VIX) by whether it's above or below the upper or lower Bollinger Bands. While I agree this can be a useful exercise, an additional step I like to take when analyzing the VIX is compare it to the Treasury Yield's own movement and the ratios relationship with the Bollinger Bands. Often the VIX itself will fall below the lower Band on the same days as the ratio between vol and yield, but not always. One of those exceptions was on Friday, in which the ratio closed under but the VIX did not. The above chart shows when the ratio between the VIX and the 10-year Treasury Yield closes under the lower Bollinger Band. Often this has led to a snap-back in the VIX and marked a low in the 'fear index'. While this method of analysis is not as accurate as the VRT, it's still worth noting the development nonetheless as another sign that volatility has been aggressively sold.

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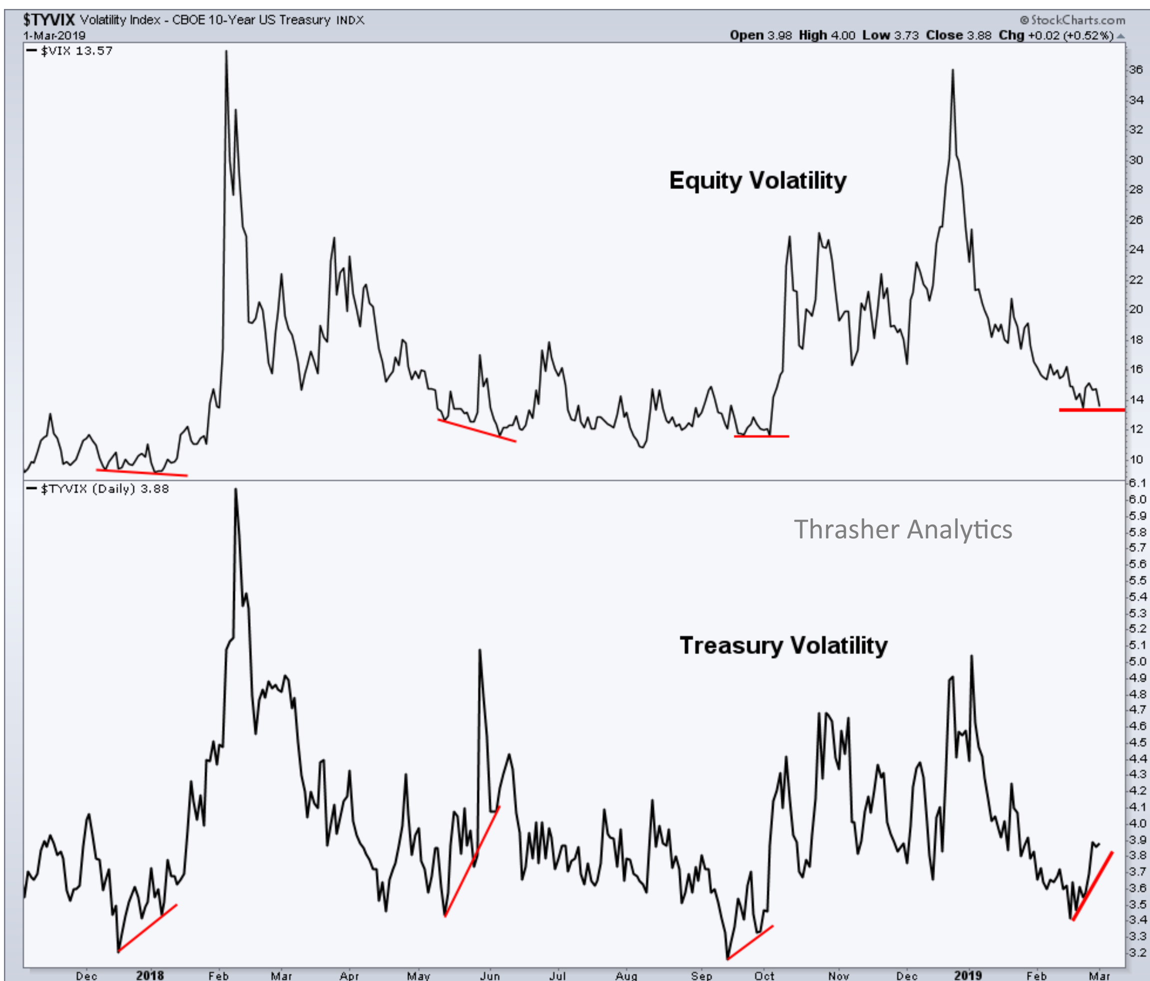
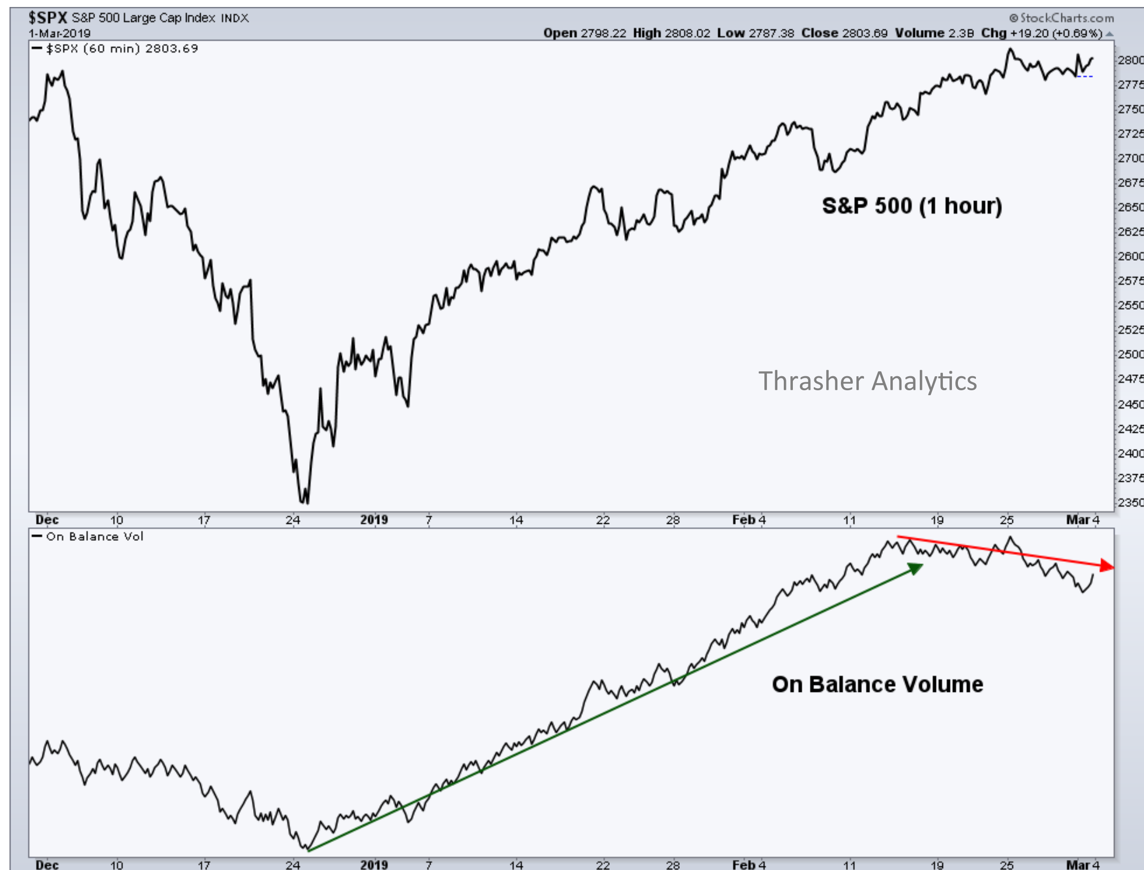


The chart on the left shows Volatility Index as a measure of equity vol and in the bottom panel is the Treasury Volatility Index. Treasury vol can be more sensitive to trader sentiment towards risk and has often risen, setting higher lows ahead of the equity volatility index.

We saw this occur before the large volatility move in January 2018 as well as the smaller moves in volatility back in June and just before volatility rose in October.

Once again we have Treasury volatility rising last week while the VIX tested its sub-14 low. It seems bond traders have gotten a little more uneasy with risk that’s not being felt just yet by equity traders as observed by the volatility market.



On Balance Volume (OBV) is an indicator that's a cumulative net total of volume, adding volume on up bars and subtracting volume on down bars. The above chart is a 1-hr chart of the S&P 500 and its respective OBV line. Net-volume bottomed with the equity index on December 24th and has been rising ever sense, confirming the trend off that low. However, that's changed here recently with OBV making lower highs since February 24th. This is a sign of potential distribution with more shares being traded on down bars and less volume on rising bars, based on hourly market data.

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