THRASHER ANALYTICS

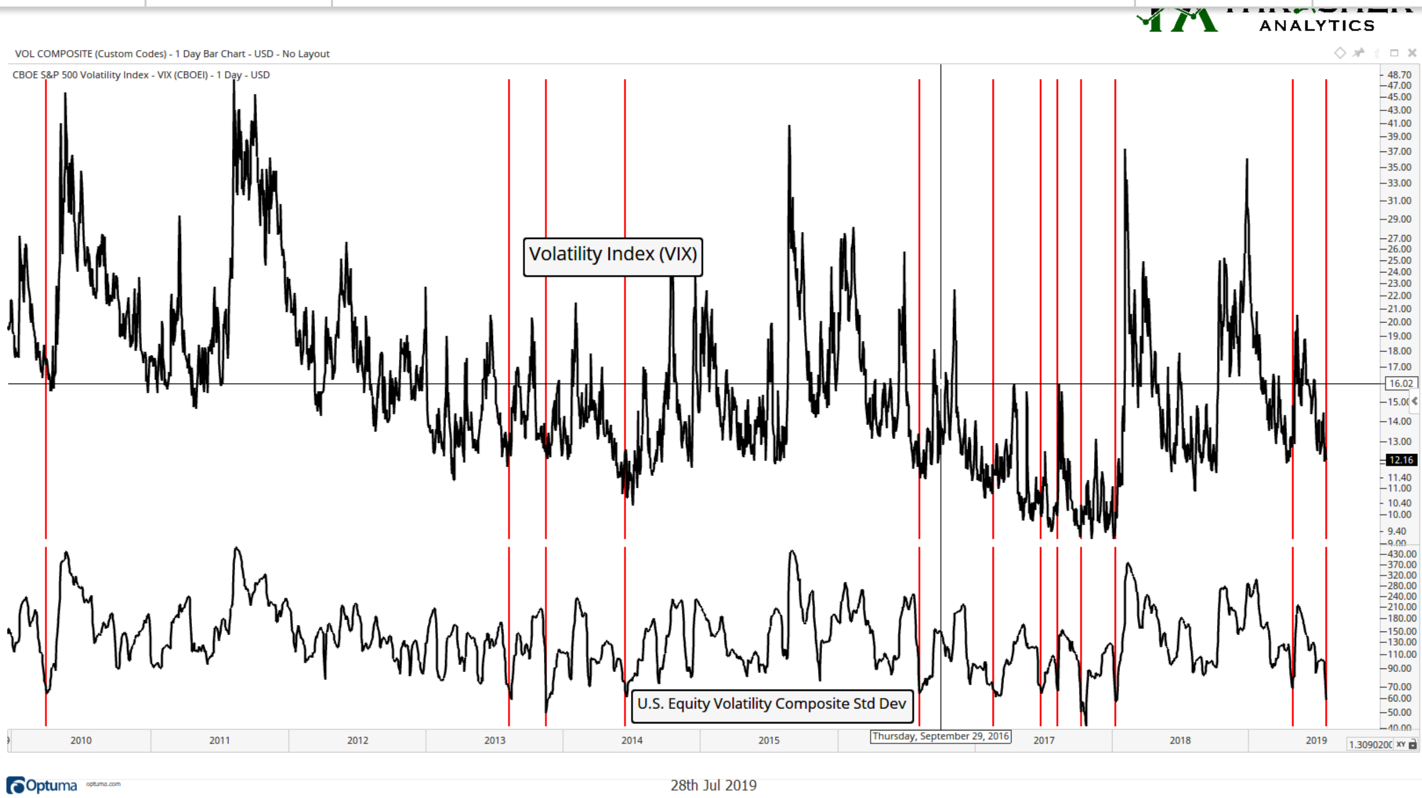
Breadth & Volatility

Just a few charts to share as we head into this week...

The focus this week will undoubtedly be on the Fed's rate cut. The last figure I saw from the CME was an expectation of 80% for a 25 basis point cut and 20% for a 50 basis point cut. It's not normal for there still to be this much indecisiveness in Fed futures going into FOMC week. Typically, there's closer to an 90+% consensus about what (if any) action the Federal Reserve will take. The fact that we still have a 20% expectation for 50 basis points leaves some kindling out for volatility to latch on to on Thursday.

Volatility
In April I wrote a guest post for John Brown's blog, citing the over-complacent volatility market as measured by the standard deviation of volatility for the major U.S. equity indices (Russell, Nasdaq, Dow, and S&P 500. I wrote to you about this development as well, with a little more detail. A few days later we saw the Volatility Index saw one of its largest two-day percent increases in the last decade as spot moved from roughly 13 to an intraday high north of 23.

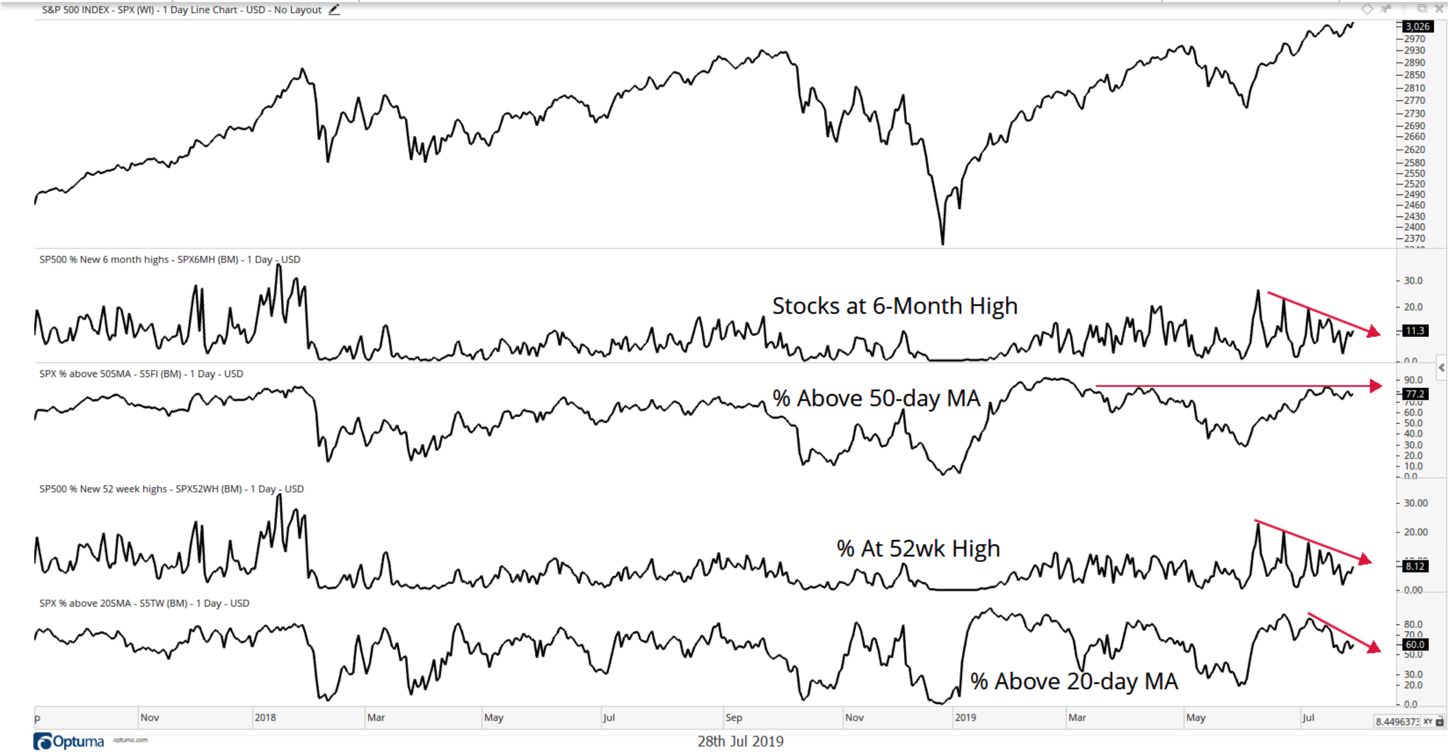
Once again, volatility across the board has become compressed based on the methodology I laid out in my Charles Dow award winning paper on volatility. Below is a chart of the VIX along with the standard deviation for a composite of volatility for the above-mentioned U.S. indices, the same type of analysis I did in my guest post for Josh's blog. The red lines indicate when std dev has fallen below 2.1 as it did last May and just before the January 2018 VIX-plosion.



As I've written in the last two letters, the Volatility Risk Trigger (VRT) has produced several signals. While there has not been a response move higher in the VIX, I still strongly believe that we'll see a move in volatility that could easily match at least what we saw in May with spot getting back into the 20s.

Breadth

I've shown several breadth charts in my last letter but I wanted to highlight this topic again as the major indices made a new high last week but saw a continued contraction in individual stock participation. Below is a chart of the S&P 500 and the % of stocks that are at 6-month highs, 52-week highs, above their 50-day Moving Average and their 20-day Moving Average. These gauges of breadth have been negatively diverging from the index.



Looking at a more analytic view of the above chart, the chart below looks at the same data but marks red lines at prior times that the breadth indicators have been at or below their current readings when the S&P 500 was at a one year high. We last had this criteria met in before the brief sell off in May, several times in December '17 and January '18 which the market was able to stretch higher before a quick move lower, then we had 2016, 2015, 2014 (each which led to a move lower in equities) and breadth wasn't this week again until we get back to 2007.

As I said in my [TD Ameritrade Network interview]() on July 19th, there's plenty of kindling for the market and volatility to grab on to and spark a left-tail move in stocks. Will it be the FOMC announcement? Something out of Europe or China? I don't (and no one else does either) have a clue. What I know is that volatility is showing an overly complacent market and fewer stocks are participating in the up trend. This is at time in my view where defense becomes the focal point in the next week or two. If these levels can improve and we can start seeing a higher degree of breadth in the U.S. equity market, then I'll happily lower my guard, we'll see what the market throws at us this week.

Best Regards,
Andrew Thrasher, CMT

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