THRASHER ANALYTICS

Market Update

Dipping Our Toe in Equity Capitulation Waters

There are four ways to approach a swimming pool. One may jump right in, screaming “cannon ball!” as they hit the water, another may wait to watch others approach and see how they react to the water, and a third may make excuses why they can’t get in, finally the fourth may dip a toe in first to test the waters. The same applies to the market. On December 22nd, 2018 I wrote a similar letter pointing to signs of capitulation, noting that it seemed like a good time to dip a toe in the proverbial market waters. I believe that time is upon us now with this latest 10% decline in stocks. Over the last several weeks I’ve written warnings of the break down in market internals and drops in risk appetite, I of course did not expect the market to respond in such an expedited fashion but alas here we are. With that let’s look at the carnage that’s before us today…

We are in thin air with regards to market stats. The S&P has declined in by 10% in a single week just four times: the ’87 crash, 2000, 2001, and October 2008, marking this week as the worst since the Great Financial Crisis and setting February up to one of the top five worst months since 2003. Today’s puke into the close felt capitulatory. I can’t explain it (nor can anyone else) but it had that *feel* of blood running down the streets as the famous Buffet quote would cite. There are now calls for an emergency Fed rate cut and I wouldn’t be surprised if Powell fell to the pressure. The Fed Chair already has one black mark on his record for resisting the market’s urges back in December 2018 and the financial market’s response was anything but understanding. We already know how much pressure the President has put on the Fed and I think it’s possible we see Powell come out on Sunday with an announcement. I say that as a speculator and without any hard data. What data I do have is price-related and it looks…awful.

4-Sigma Move

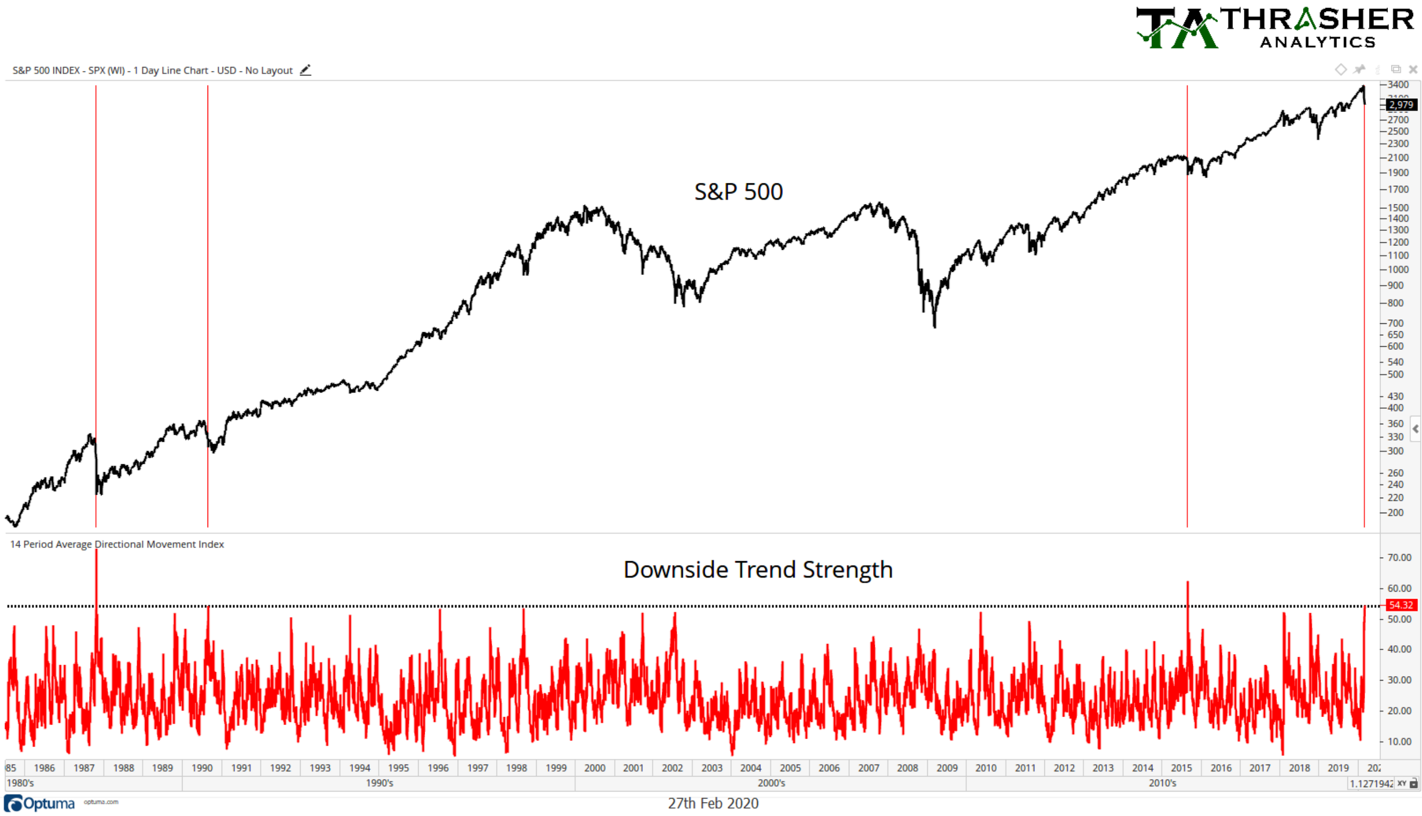
The S&P 500 is nearly 4 standard deviations below its 50-day Moving Average, an ‘accomplishment’ we didn’t achieve even in Q4 ’18. We saw 4-sigma breached at the 2011 and 2015 lows (nearly reaching 5 sigma in 2015). After that we’d have to go back to 1990,

Options

From an options perspective, we're not near an extreme reading in the average put/call ratio, which sits at just 0.75, well off from the 2018 high of 0.9 or 0.85 in August of last year. It's interesting that option trades aren't showing the same level of panic as equities.

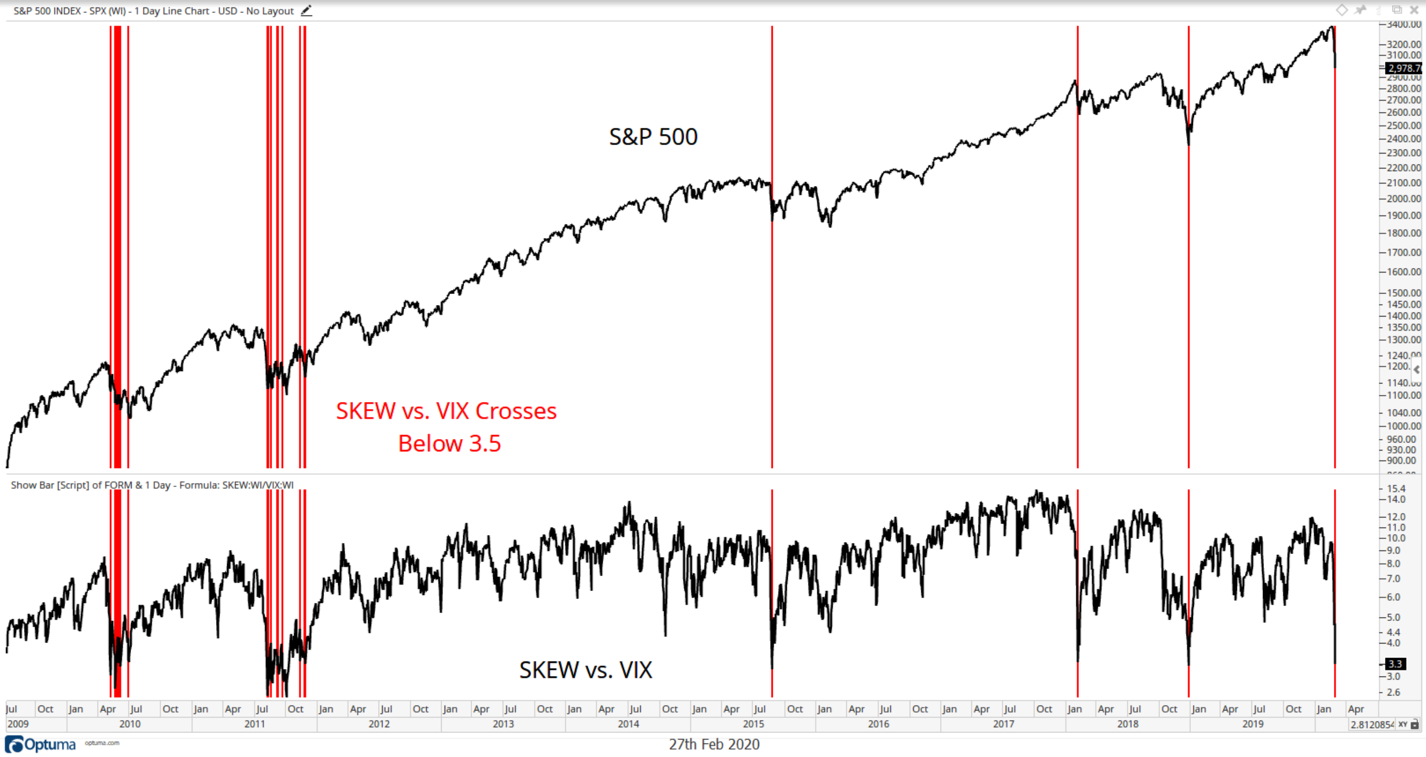
Trend Strength

The first chart I want to show is of the DI- component of the ADX Line, which is an indicator that measures trend strength, and for the DI-, the downside trend. This indicator is at its highest level since 2015 and has only reached this high three previous times since 1985.



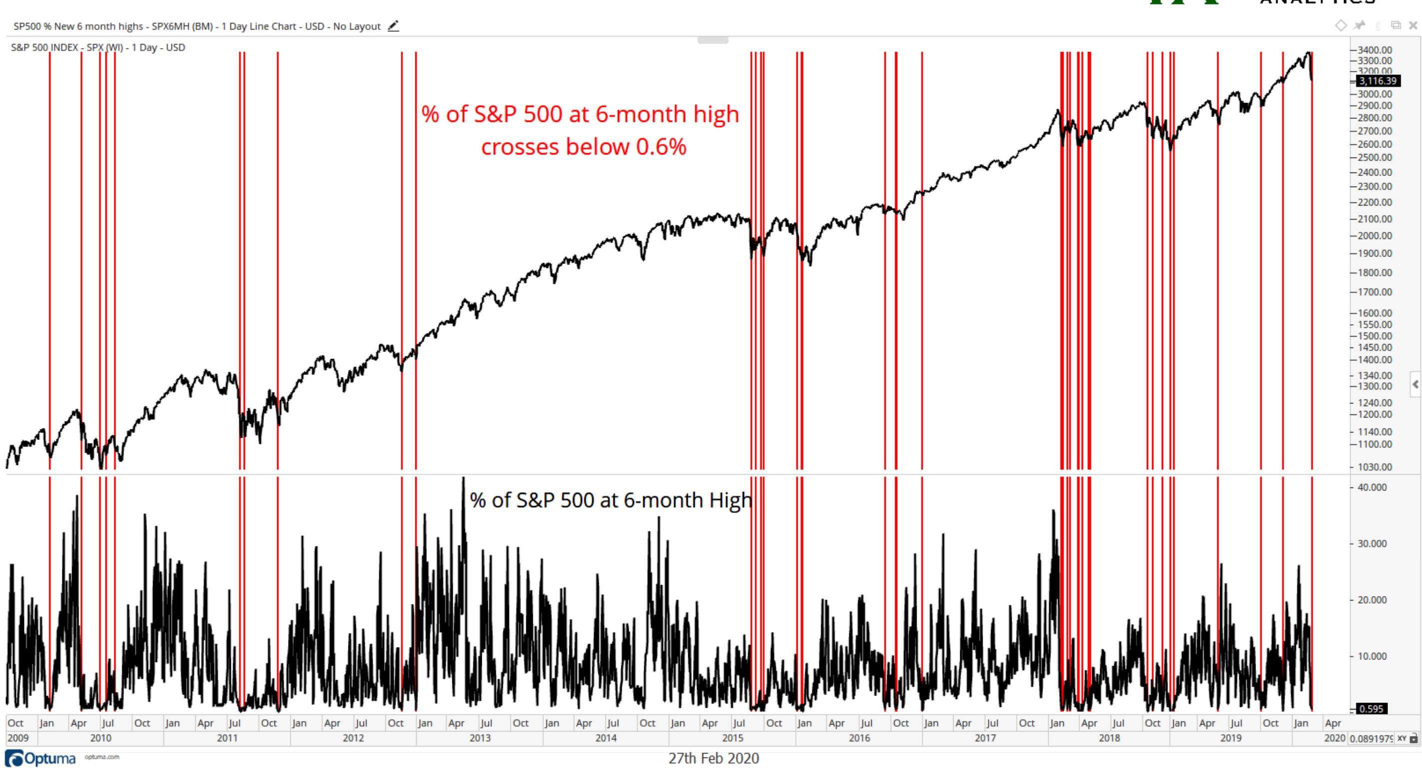
Volatility

Next is the Ratio between the SKEW Index and the Volatility Index. As a reminder, the SKEW Index measures 'tail risk' based on out-of-the-money S&P 500 options. It was developed after the '87 crash. During an up trend in equities, we typically see SKEW outperform the VIX, with the inverse being true during market weakness. Needless to say, the VIX has taken full control of this relationship, sending the ratio to near-record lows. We haven't seen this low of a ratio between the two since the bottom in December and February 2018. Each time it's reached this level we've been near or at a low in equities. Due to the 'flash crash' in 2010, this level was reached ahead of the final low but in 2011, and 2015, equities bottomed and eventually retested this level.

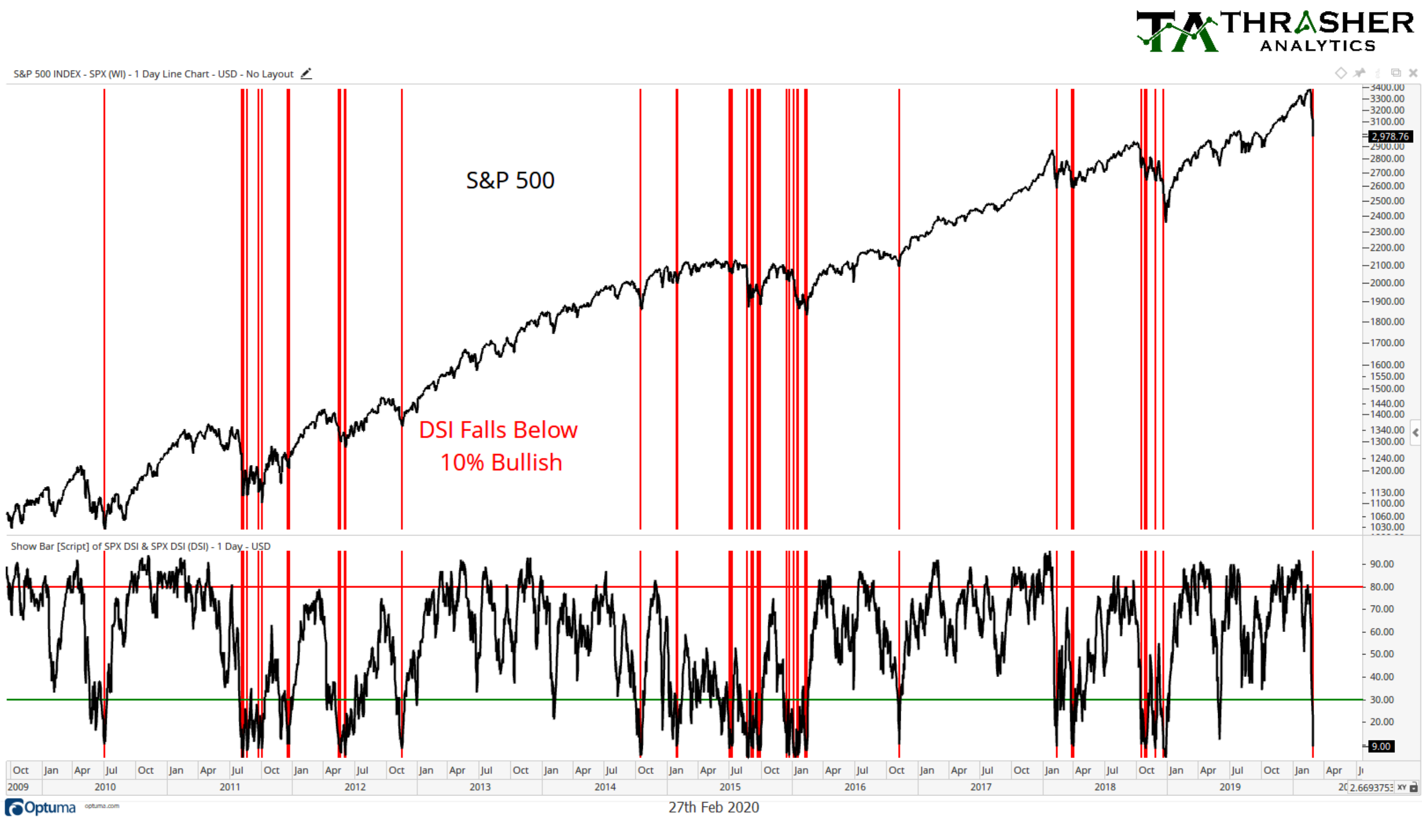


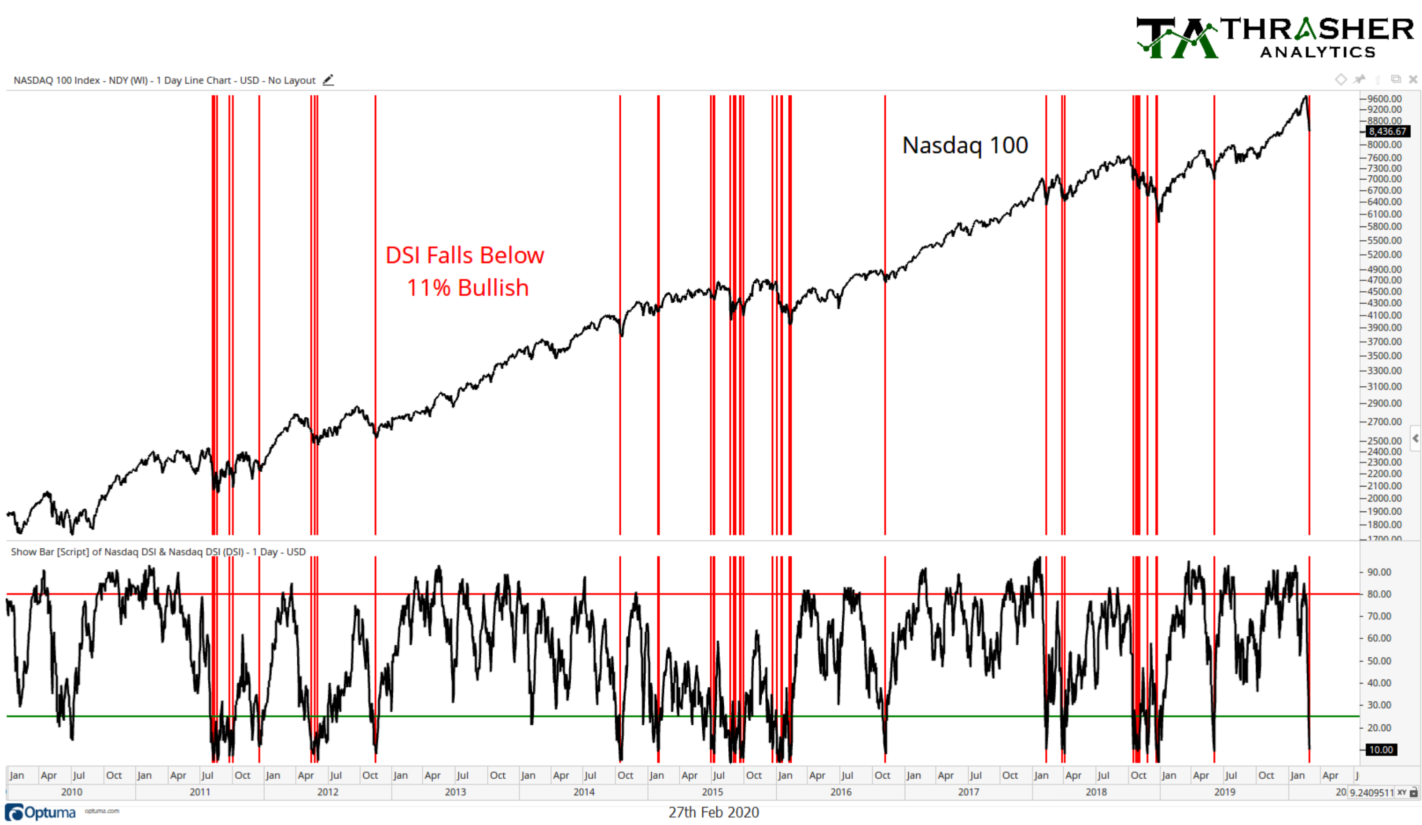
Breadth

Only 8% of the S&P 500 remains above the 50-day Moving Average and none of the Dow Industrial stocks enjoy such a luxury. Let's take a look at the breadth of the S&P 500. There are less than 0.6% of SPX stocks at a 6-month high. This low of a reading is more common than the other extremes I've shown, but shows the broad level of participation to the downside within the equity index – no stock has been left untouched by sellers.



Now lets look at some sentiment charts. The Daily Sentiment Index (DSI) for the S&P 500 and Nasdaq 100 has fallen off a clip. We're at just 9% bullish on the SPX and 10% on the Nasdaq.





Potential Price Support

Looking at a chart of the S&P 500 I want to keep things fairly simple. The anchored VWAP at the Dec. '18 low sits at 2941 (green line) quickly disappointed during the afternoon selling. I continue to watch the 200-day MA (blue line) for when price is able to recover it on a closing basis, a criterion many systematic traders will be targeting when stocks do eventually strengthen.

I'll be back next Sunday with a full letter.

Best Regards,
Andrew Thrasher, CMT

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