Market Update

Sector Rotation: June	
Technology	XLK
Health Care	XLV
Communications	XLC

Fixed Income Rotation: Q2	
Emerging Mkt Sovereign	PCY
Convertible Bond	CWB

Index & Sector Adaptive Trend	Up Trend	Down Trend
SPX		X
QQQ	X	
XLF		X
XLY	X	
XLK	X	
XLV	X	
XLU		X
XLP		X
XLI		X
XLRE		X
XLE		X
XLB		X

Daily Sentiment Index	% Bullish	5-day MA
S&P 500	77%	72%
Nasdaq 100	80%	75%
Nikkei	93%	91%
VIX	23%	26%
10yr Treasury	61%	60%
5yr Treasury	59%	56%
CRB Index	76%	75%
Gold	81%	75%
U.S. Dollar	53%	59%

*Green<25% Red>80%

Notable Breadth Data:	
SPX >50MA	94.06%
SPX >200MA	40.59%
Nasdaq >50MA	98.06%
Nasdaq >200MA	70.87%

***Strong Breadth**: The strength in growth of stocks rising above their 50-day moving average has been extremely impressive. We're now over the 99th one-year percentile for this intermediate-term breadth indicator. When we've historically gotten over the 97th percentile, stocks have needed some time to consolidate and 'catch their breath' (pun intended!). These consolidations have not been overly bearish, often presenting dip-buying opportunities. We last saw this in Feb. '19 after SPX crossed above its 200-day MA like it has done now, stocks dipped to test the 200-day MA, rose for two months and then corrected by 7% back to the 200-day MA once again. Another similar example is in Oct. '11, SPX crossed its 200-day MA with strong % above 50-day MA like we have today and then declined nearly 10%, putting in a higher low in the recovery process from the prior major correction. The dip was bought and*

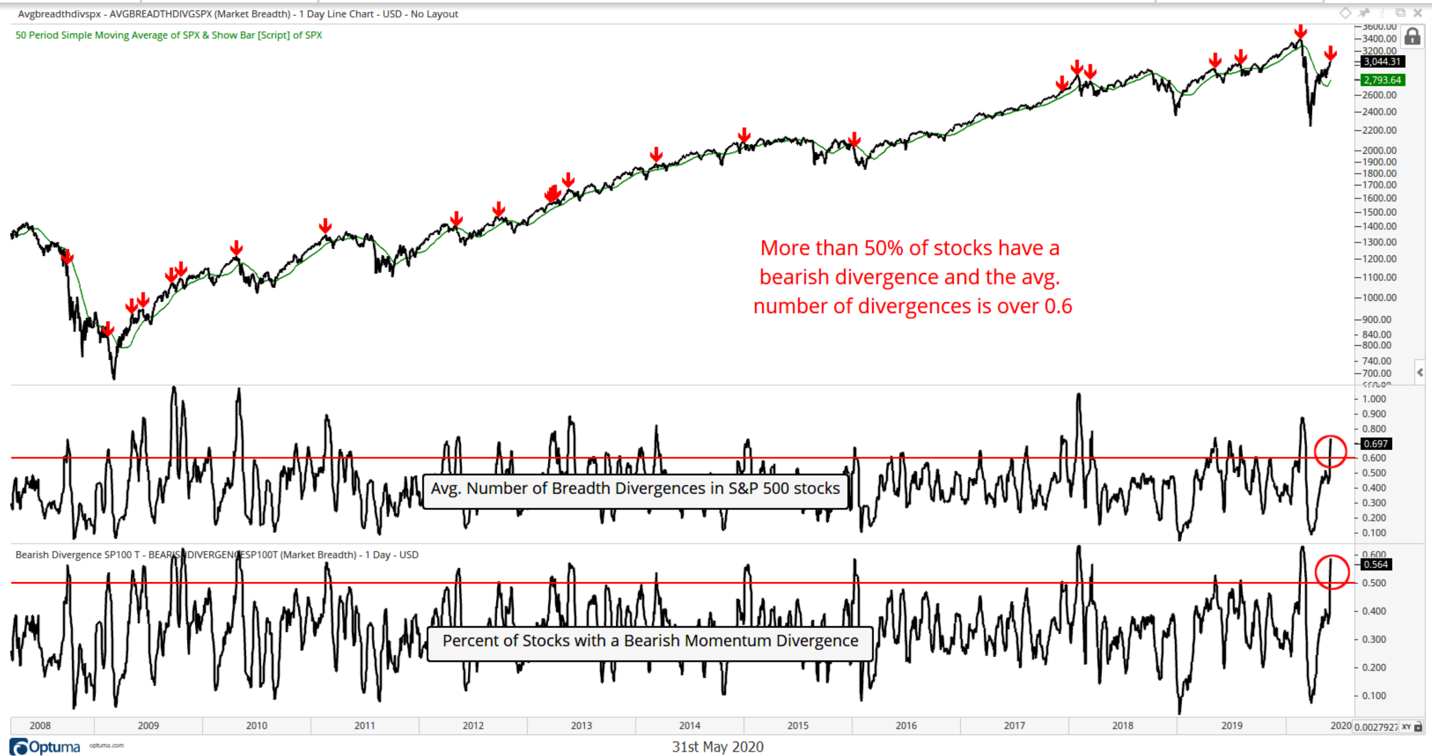
little over a month, rotating around its 200-day MA with no major decline to speak of before resuming its new uptrend. Since 1985, this short-term concern is actually a longer-term positive, as this strong of breadth reading has not happened during bear market inflection points but instead during defined up trends.

Tech Strength*: For a brief moment it looked like there was a rotation developing out of tech and into financials and other more beaten up sectors but we finished the week with many tech sub-industries still with up trends intact. In fact, software (IGV) and cloud tech (ARKW) made closing weekly new highs while banks (KBE) finished the week breaking back below their prior April highs, unable to close the gap created in March. If there is a rotation starting within sectors, it will surely take time to develop and there still appears to be some juice left in the tech space that's yet to be entirely squeezed out. For tech, I always want to know what semiconductors are doing and they continue to consolidate in relative performance with the S&P 500, not making higher highs like they typically do during strong tech up trends. Semi's are a leader on both the way up and the way down, so if tech is to continue their strong move higher, we need semi's to begin carrying the ball again, breaking out of this two month sideways move.*

Last Straw for Bear Rally Thesis*: What does the bear market rally thesis still have left to grasp on to? All I see left to put in this category is weekly momentum. The 14-week RSI finished Friday at 54 which is about where weekly momentum maxed out in May '01 and March '02 after a counter-trend bounce as well as in May '08. This is also the level momentum reached after the '09 low just before price began to consolidate for May until July.*

Bearish Divergences *Last week I began showing the sectors and the bullish and bearish divergence breadth tools I developed. These tools are extremely insightful and I've been excited to begin showing them in my letters. As I've shared these last two weeks, there's been a growing percentage of divergences for the Nasdaq 100, breaching 60% at one point. The same growing trend is also taking place for the large cap index. The tool looks at several measures of momentum to calculate possible divergences, so another way to look at the data is to find the average number of those momentum indicators are showing a divergence for each stock.*

Current Rise In Bearish Divergences*: We currently have 56% of stocks with a bearish divergence and the average stock has 0.7 divergences. This isn't quite to the level we saw earlier this year or in January '18 but when the data has been this high in the past, nearly every occurrence saw a pullback (of varying degree) in the index. Several were small short-term moves lower while others were much more substantial. Based on the strength in stocks back above their 50-day MA, I believe the resulting pullback (should one develop) will be shallower than say, a 10-20% decline. Since Jan. '09, the response from this growth in bearish divergence data has been with 86.4% of the occurrences seeing the S&P 500 move lower by an average 3-week decline of-3.56%. From a sector standpoint, 8 of the 11 now have more than 50% of their constituents with a bearish divergence. It very much seems stocks across the board have seen a strong rise but are beginning to have momentum pullback the throttle, diminishing the risk/reward attractiveness at this point in time – which also matches up with the seasonal trends for stocks during the summer months.*



***Demark**: From a Demark indicator standpoint, I noticed that the S&P 500 and Russell 2000 both developed TD Sell Setups (primary criteria is 9 consecutive closing prices greater than the closing price four bars earlier). This creates what Tom Demark calls a 9-13-9 sell count, because the Sell Setup is following a 13 countdown which occurred after a previous Sell Setup, a fairly rare pattern that is often followed by a change in trend. Demark indicators are very interesting to observe but quite complex in their formalization. While not a primary focus of mine, I do keep an eye on their development.*

***Fixed Income**: While stocks have been strong, so have bonds (to some degree) with 30yr and 10yr Treasury yields remaining below their April highs and the 5yr Yield back to its May low. High Yield spreads have also continued to move lower, a bullish sign from fixed income for risk assets.*

***Sentiment**: Sentiment has made a strong move higher, with the S&P 500 Daily Sentiment Index (DSI) now at 77% bullish, the highest level since before the bear market, Nasdaq 100 at 80% and Nikkei at 93% which is the highest level for the Japanese equity index this year. Meanwhile, VIX sentiment has fallen below 25% to 23% . Oil has experienced a massive change in sentiment, going from 3% bullish when oil prices went negative to 81% bullish on Friday. While futures sentiment (via DSI) has turned markedly bullish for risky assets, institutional investors apparently have been more cautious towards stocks. BNP Paribas notes, "sentiment surveys and institutional investor flows point to [...] little evidence of institutional investor participation in this latest leg of the rally."*

***Macro**: From a macro view, David Kostin at Goldman Sachs sums it up nicely in a recent note, highlighting that the SPX has now moved above Goldman's 2020 price target of 3,000, "A blend of monetary and fiscal policy initiatives, a bending of the viral curve in the US and optimism around the economic restart have buoyed the market to this point [but] the path of the S&P 500 through year-end is not likely to be smooth." [...] "uncertainty around virus developments and the pace of re-hiring could present fundamental challenges while escalating rhetoric around US/China trade and the 2020 election*

***Put/Call Ratio**: The drop in the put/call ratio has garnered a lot of attention recently, with the Equity P/C falling under 0.5 earlier in May. While the low level is a concern, I pay much more attention to when the P/C ratio begins to rise, a sign that option traders have shifted from being overly bullish (buying calls instead of puts is what pushes the ratio lower after all) to bearish (shifting to puts instead of calls, sending the ratio higher) while the equity market is still in an up trend. This framework has provided a much more accurate view of using the put/call ratio as a timing tool. We have begun to see a slight move higher in both the Index and Equity ratios, more notably in the Index ratio as shown on the chart below.*

***Conclusion**: I have moved to be more bullish intermediate/long-term with the resolution of the S&P 500 capturing its 50-day moving average and breadth seeing a strong improvement. However, the latest*

equities in the short-term. Like in mid-2009 when stocks consolidated, there was also a continued improvement in the percentage that were above their 200-day MA, an internal sign that individual equities were still trending higher while the index consolidated. If we do see weakness I'll be watching for the same setup, which would add to the bullish long-term thesis. If instead we see a breakdown of breadth on any pullback, then I'll need to re-evaluate from there. As always, I'll be sharing my data and analysis in this weekly letter along the way.

I'll be back next Sunday with a chart-focused letter.

Best Regards,
Andrew Thrasher, CMT

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