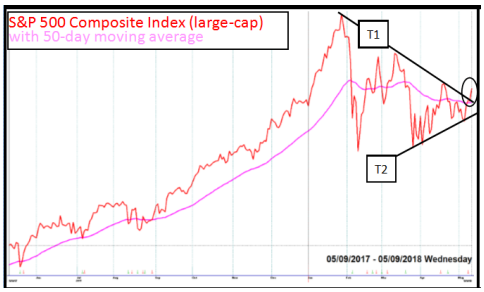
Market Monitor

Version 2018-05

Written by Rob Bernstein

May 10, 2018

The *Market Monitor* newsletter is intended for individual investors with a desire to manage the conflicting goals of managing risk and earning a fair return by providing a unique perspective of general market conditions.



The market may have broken out of a pattern of declining peaks (T1) and rising troughs (T2) that has defined the market environment for the last three months. Prices have compressed during this time into a smaller and smaller range. This compression tends to act like to a spring. The tighter the compression, the more energy is released once the spring is released. As of yesterday, it appears that the 'market spring' has been released with what appears to be a decisive break above T1 (see circled area on the chart to the right). A continuation of this trend higher will provide confirmation that the recent bit of volatility may be over.

Although the market environment is improving, there is no guarantee that this trend will continue. There is significant resistance ahead that may keep prices subdued as we approach the late January highs. In addition, there has been a vast amount of good news (a solid April Employment Report indicating strong jobs growth with limited wage inflation, strong earnings reports for the first quarter, overall inflation contained at or below the Fed's target, diminishing chances for trade wars, improvement in relations with North Korea, etc.). However, despite all of the good news, the stock market has struggled to advance. What will happen to the market when it is faced with bad news?

Commodities have shown strength over the last month which may be a good opportunity for aggressive investors. Rising commodity prices are generally a signal that we are in the later stages of the business cycle which can be a dangerous time in the market. Market tops can happen quickly and the market tends to top before the actual economic environment starts to deteriorate.

Summary Assessment

Indicator	Assessment
Business Cycle: Stage IV	Bonds: - Stocks: + Commodities: +
Long-Term Breadth	?
Short-Term Breadth	+
Junk bond Indicator	?
Market Indices	+

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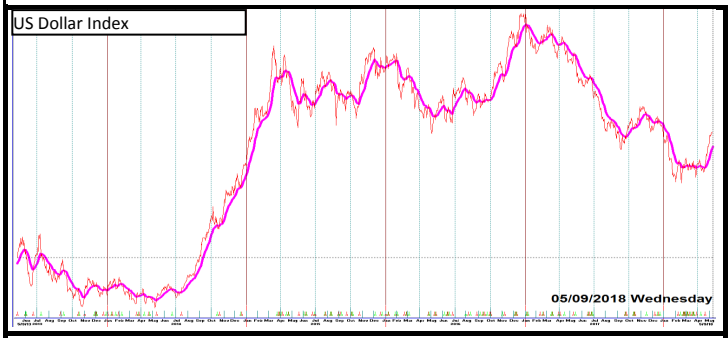
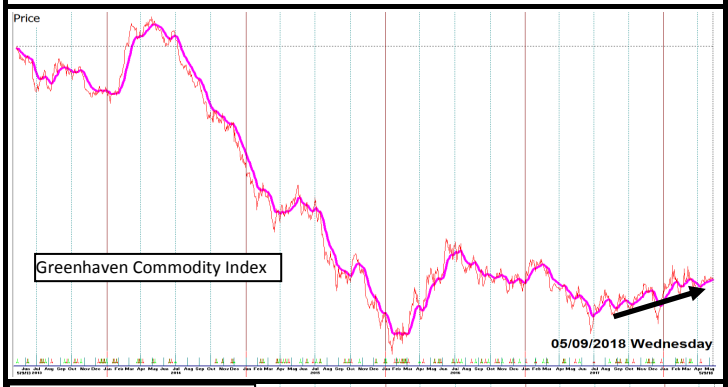
Economic (Business) Cycle

Five-Year Charts

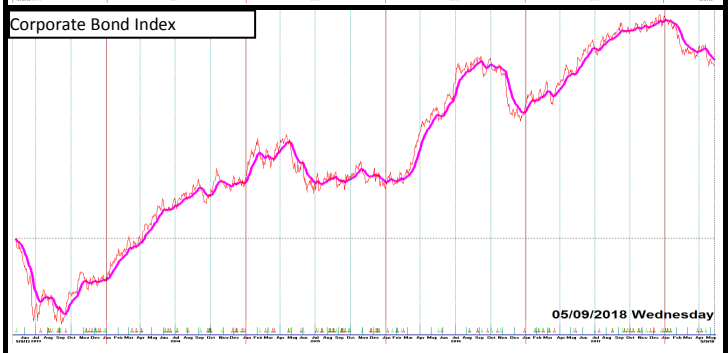
The business cycle is defined as alternating periods of expansion and recession. The purpose of reviewing the business cycle is to attempt to understand the macro-economic environment. This provides us clues as to how the broad asset categories (stocks, bonds and commodities) may perform. For purposes of the business cycle analysis, we will use a 21-day (approximately one month) moving average of the components of the business cycle as defined by Martin Pring in the *All Season Investor* to focus on the longer term trends.



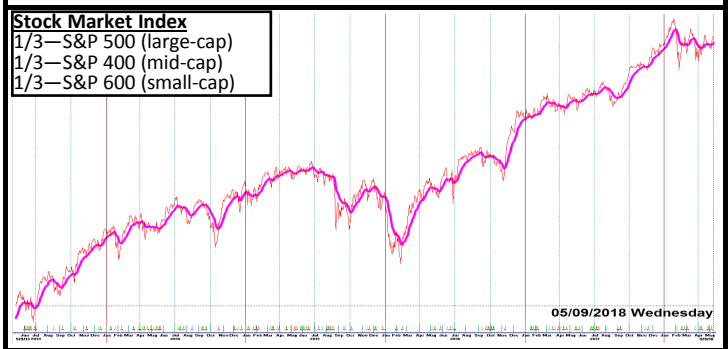
The US Dollar has halted its year long decline and is now trending up.



An uptrending US dollar generally puts downward pressure on commodity prices. However, despite the recent rally in the US Dollar, commodity prices continue to trend up slowly indicating that there may finally be some signs of inflation within the US economy.



Corporate bond prices peaked at the beginning of the year and continue to trend down.



For business cycle purposes, the Stock Market Index is in an uptrend. Although the 21-day moving average of the Stock Market Index is now moving sideways after peaking earlier this year, the sideways price action appears to be more of a consolidation of previous gains than a topping pattern.

Summary: I believe we are in Stage IV of the business cycle as defined by Martin Pring in the *All Season Investor*. This is a period of time that is positive for stocks and commodities but negative for bonds.

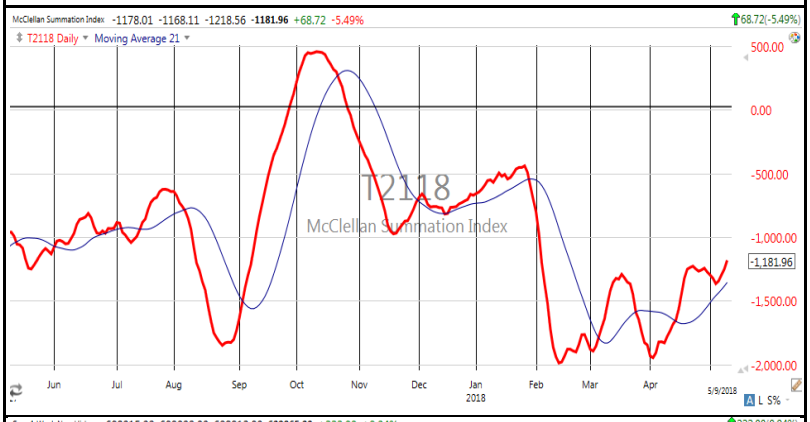
Stage IV	
Bonds	-
Stocks	+
Commodities	+

Report produced with data through 5/9/2018

Long-Term Market Breadth

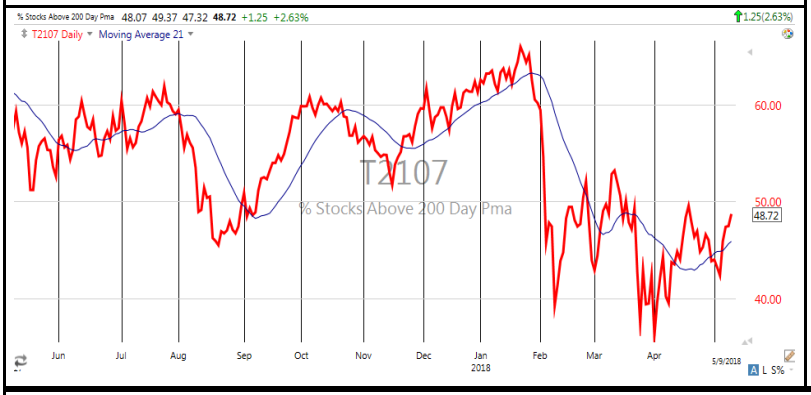
One-Year Charts

The New York Stock Exchange Composite Index is in an intermediate-term down trend which is confirmed by its declining 50-day moving average. The 50-day moving average is approaching the 200-day moving average which, if crossed, would be an indication of a longer-term downtrend.



The McClellan Summation Index has recovered some of the recent decline but remains negative.

The Cumulative 4-Week New High / New Low Indicator is starting to trend up again...a positive indication for the longer term trend. In addition, while the market declined from mid-April to early May, this indicator trended sideways indicating underling strength.



The percentage of stocks trending above their 200-day moving average is neutral with a current value of 48%. A jump back above the 50% level would indicate that the longer term trend of a majority of the stocks on the NYSE has turned up.

Summary: The long term health of the market is improving but has not improved enough to consider it positive.

Long-Term Market Breadth
?

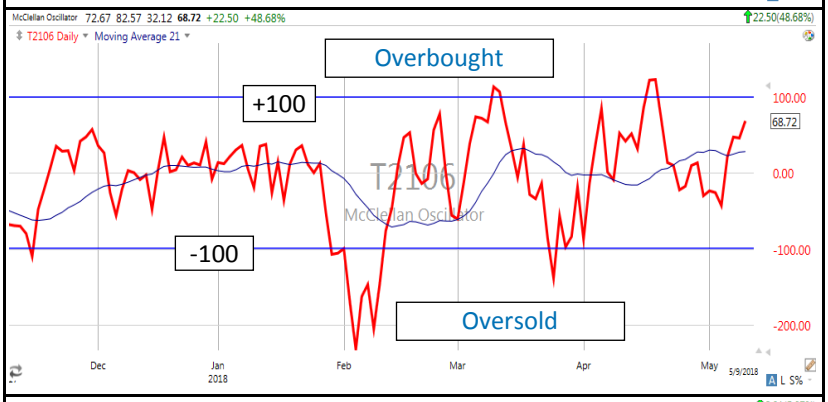
Report produced with data through 5/9/2018

Short-Term Market Breadth

Six-Month Charts

The New York Stock Exchange Composite Index is trending sideways on a short-term basis. Both the 21- and 50-day moving averages are also trending sideways with a slight downward bias.

Although prices are moving sideways, there is strength in the Advance / Decline Line which reached a new high today. This is an indication that there are more stocks advancing than declining in the current market environment. This is considered a bullish divergence and a positive indication for the market as a whole.



The market is neither overbought nor oversold on a short-term basis as indicated by the McClellan Oscillator.

The percentage of stocks trending above their 40-day moving average is at approximately 60% and has been trending gradually higher since the initial selloff in early February.

Summary: Short-term market breadth continues to improve. While the improvement is not reflected in the price of the NYSE Composite Index, it is an indication that there is strength in the market.

Short-Term Market Breadth
+

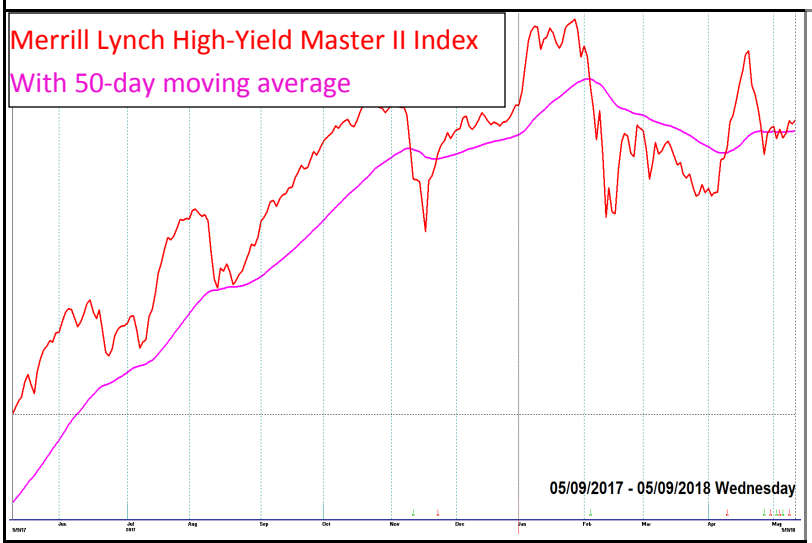
Junk Bond Indicator

One-Year Charts

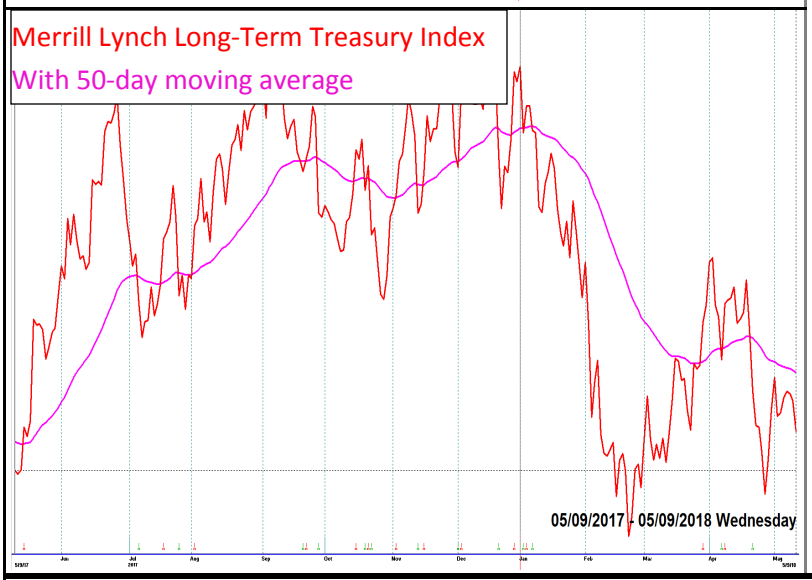
Junk bonds are one of the best indicators of overall market sentiment. When risk rises, junk bond prices fall as investors demand a higher yield to compensate them for the additional risk (remember bond prices fall as yields rise). When risk subsides, junk bond yields tend to fall given more favorable market conditions (i.e. lower risk). Falling yields drive junk bond prices higher. As junk bonds generally trend in the same direction as stocks, following the trend of junk bonds provides a good overall indicator for the equity markets. Assessing junk bonds in conjunction with US Treasuries gives us a reasonable clue to the overall risk in the market.

There are four general configurations for junk bonds and US Treasuries:

- Junk bonds rising, Treasuries falling – Generally a positive market environment.
- Junk bonds rising, Treasuries rising – Generally a positive market environment.
- Junk bonds falling, Treasuries falling – Generally an uncertain market environment.
- Junk bonds falling, Treasuries rising – Generally a negative market environment, especially if Treasuries are surging higher.



The Merrill Lynch High-Yield Master II Index is trending sideways and currently just above its 50-day moving average. The strong surge in early April quickly faded and the index is whipsawing back and forth across the 50-day moving average.



The trend of the Merrill Lynch Long-Term Treasury Index is down. After a brief flight to safety during the recent market volatility, Treasury bonds have resumed the downtrend that started in December of last year and is near the lows for the year.

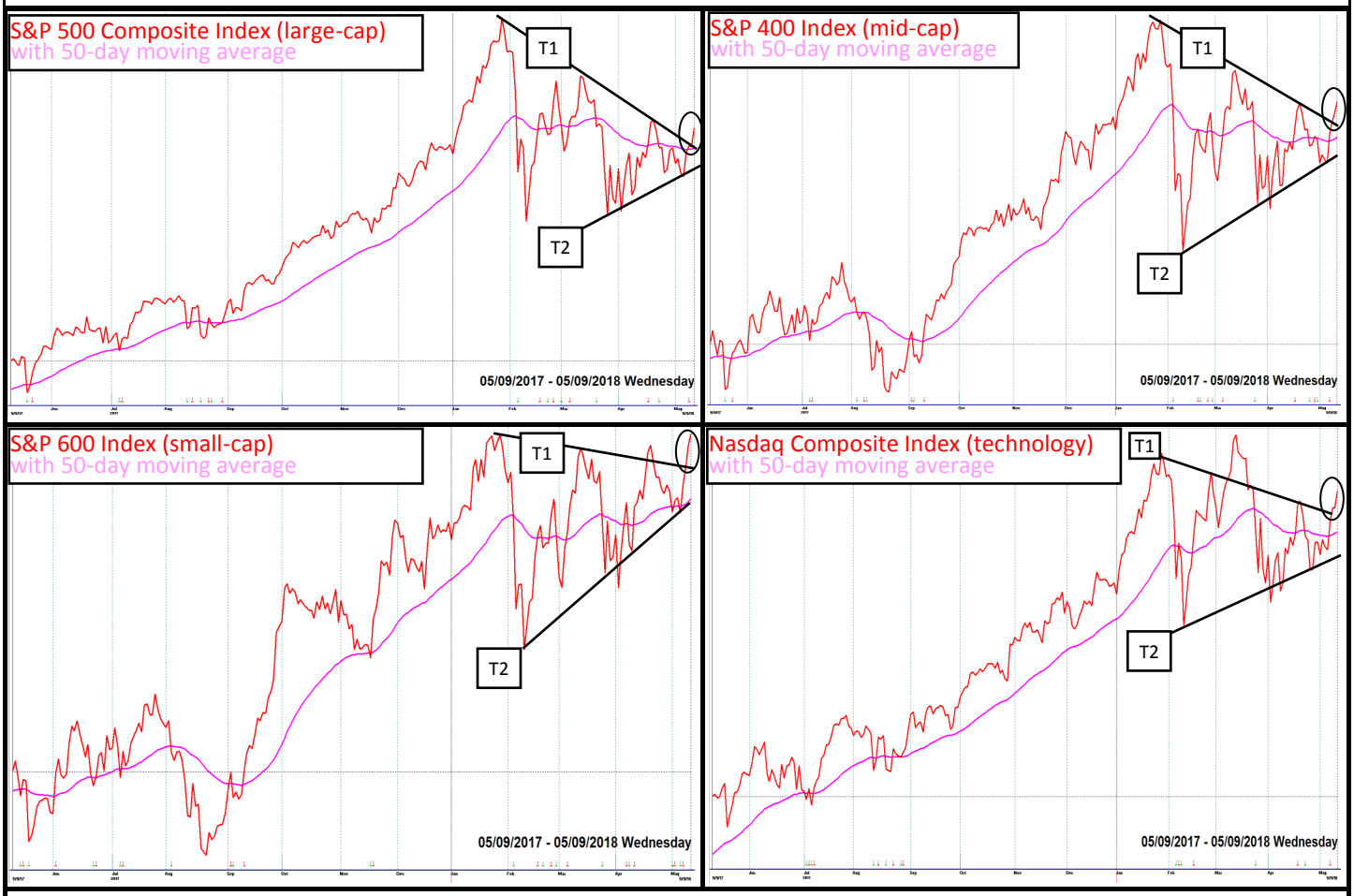
Summary: The junk bond indicator is not providing any definitive clues as to the direction of the market. There is little evidence that investors are seeking the safety of US Treasuries and little evidence that investors are taking on risk. The indicator is neither positive nor negative.

Junk Bond Indicator
?

Market Indices

One-Year Charts

Tracking the major indices allows us to understand how the broad market is performing. Although there is no perfect market index, we can track multiple indices to help us understand the trend (either up, down or sideways). In addition, by studying the behavior of different indices we can attempt to identify any biases in the market (i.e. capitalization bias, style bias, etc.).



Over the last three months, the major indices have been trading within an ongoing consolidation/correction process. As the consolidation progresses between support (T2) and resistance (T1), the triangle pattern that is created develops a narrow point. At some point either support or resistance has to give way to a new trend.

As the compression between support (T2) and resistance (T1) narrows, prices coil like a spring generally providing a significant move in one direction or the other. Often in an up trending market, that coil will resolve to the upside but, of course there is no guarantee that will happen.

It appears that we may have a clue to the future direction of the market as all of the major indices shown above closed Wednesday above T1 (see circled area on each chart). There is no guarantee that this breakout will continue and there is significant resistance ahead (particularly with the January highs), but odds favor an upside run in the short-term. Only a break above the January highs will indicate that the recent correction process is over.

	Market Indices
Summary: The breakout above T1 in the major indices is a bullish event that looks like the beginning of a short-term uptrend.	+

Market Watch List

Calculation Period: 12/31/2017—5/9/2018

Recent Rank: 3/23/2017—5/9/2018

Rank	Ticker	Name	Period Return	Annualized Return	UI	UPI	Maximum Drawdown	Recent Rank
1	BD03	FLOATING RATE BONDS	1.41%	4.04%	0.14	36.48	-0.42%	5
2	BD06	HIGH YIELD MUNICIPAL BONDS	1.22%	3.49%	0.56	8.36	-1.05%	4
3	CO02	COMMODITY GENERAL	4.84%	14.33%	2.21	7.02	-5.37%	3
4	EQ12	TECHNOLOGY	9.43%	29.08%	4.73	6.41	-9.84%	18
5	EQ01	AEROSPACE/DEFENSE	5.80%	17.32%	3.31	5.59	-8.24%	27
6	EQ19	STYLE GROWTH	5.13%	15.23%	4.18	3.93	-9.77%	15
7	EQ18	CAP SMALL	3.93%	11.54%	3.93	3.23	-9.24%	8
8	CO05	COMMODITY ENERGY	8.03%	24.45%	9.04	2.84	-15.05%	1
9	EQ05	CONSUMER DISCRECTIONARY	3.30%	9.61%	5.00	2.16	-9.36%	14
10	EQ02	BANKING / FINANCIALS	2.77%	8.05%	4.76	1.94	-8.91%	7
11	CO01	COMMODITY AGRICULTURE	0.89%	2.55%	2.54	1.47	-5.01%	34
12	CO03	COMMODITY METALS	1.11%	3.18%	3.15	1.39	-6.17%	16
13	FR02	FOREIGN - EUROPE	2.11%	6.10%	5.81	1.25	-9.50%	9
14	EQ16	CAP LARGE	1.74%	5.02%	5.57	1.11	-10.05%	12
15	EQ17	CAP MID	1.43%	4.09%	4.90	1.08	-9.76%	13
16	FR06	FOREIGN - INTERNATIONAL SMALL CAP	1.27%	3.63%	5.38	0.89	-10.05%	11
17	EQ03	BIOTECHNOLOGY	0.85%	2.42%	8.99	0.40	-16.80%	40
18	EQ07	HEALTHCARE	0.37%	1.05%	7.03	0.32	-11.29%	22
19	FR03	FOREIGN - ASIA PACIFIC (EX-JAPAN)	0.02%	0.05%	5.11	0.24	-10.03%	23
20	FR01	FOREIGN - JAPAN	-0.09%	-0.26%	5.89	0.16	-10.88%	2
21	EQ08	INDUSTRIALS	-0.28%	-0.78%	5.11	0.08	-8.99%	25
22	BD05	MUNICIPAL BONDS	-0.98%	-2.76%	1.32	-	-1.91%	21
23	BD10	PREFERRED SECURITIES	-1.99%	-5.52%	1.34	-	-2.09%	30
24	BD07	MORTGAGE-BACKED SECURITIES	-1.81%	-5.03%	1.45	-	-2.10%	31
25	BD04	JUNK BONDS	-0.81%	-2.27%	1.34	-	-2.13%	24
26	BD09	INFLATION PROTECTED BONDS	-1.24%	-3.46%	1.31	-	-2.25%	32
27	BD02	CORPORATE BONDS	-3.02%	-8.31%	2.04	-	-3.15%	33
28	BD01	US TREASURIES	-2.94%	-8.11%	2.28	-	-3.34%	35
29	BD08	EMERGING MARKET DEBT	-4.64%	-12.60%	2.23	-	-6.08%	37
30	CO04	COMMODITIES PRECIOUS METALS	-2.13%	-5.92%	5.79	-	-8.41%	36
31	EQ13	TELECOMMUNICATION	-4.45%	-12.08%	4.54	-	-8.51%	29
32	EQ15	UTILITIES	-3.06%	-8.42%	4.08	-	-9.27%	17
33	EQ09	INSURANCE	-2.69%	-7.42%	5.59	-	-9.75%	28
34	EQ20	STYLE VALUE	-0.63%	-1.78%	5.63	-	-9.79%	10
35	FR05	FOREIGN - EMERGING MARKET	-0.54%	-1.52%	6.02	-	-10.81%	38
36	EQ14	TRANSPORTATION	-2.47%	-6.83%	7.63	-	-11.70%	20
37	EQ11	REAL ESTATE	-4.03%	-11.00%	7.23	-	-11.93%	6
38	EQ10	MATERIALS	-2.83%	-7.81%	7.58	-	-12.66%	19
39	EQ06	CONSUMER STAPLES	-9.92%	-25.60%	7.83	-	-13.91%	39
40	EQ04	CONSTRUCTION	-8.34%	-21.85%	10.37	-	-14.79%	26

The market watch list is comprised of equally weighted groups of ETFs and mutual funds representing each sector/group. You cannot invest directly into one of the market watch list components.

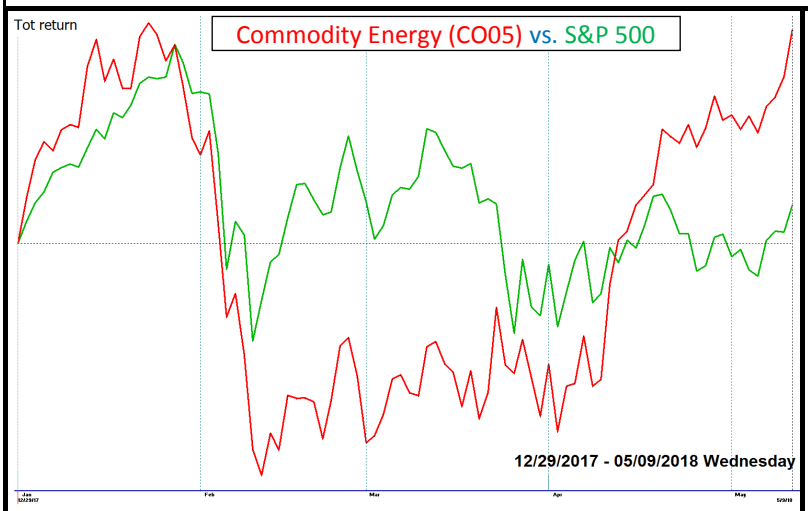
The market watch list is sorted first by Ulcer Performance Index (UPI), a measure of risk adjusted return, and then by Maximum Drawdown (MDD) for the calculation period. Negative UPI values are set to zero. Recent Rank indicates how sectors rank (based on a UPI / MDD ranking) for the Recent Rank time period. Sectors with the largest positive change (moved up 10 spots or more) are highlighted in green and indicate sectors with increasing momentum. Sectors with largest negative change in ranking (moved down 10 spots or more) are highlighted in red, indicating sectors with diminishing momentum.

Market Watch List—Selected Charts

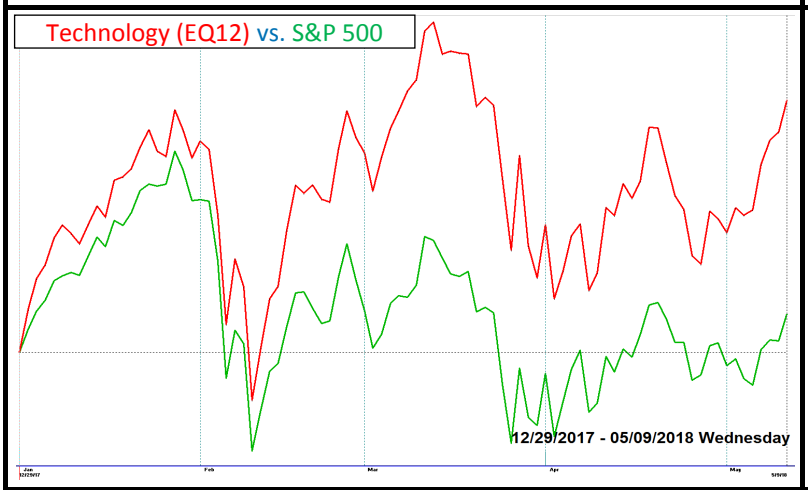
Year-to-Date Charts

I have ranked the Market Watch List from the beginning of the year so that the results include both the strong run up in January as well as the volatile period that followed. There is no perfect time period to rank the list and I suggest that investors look across multiple time periods to get a good idea of how the market is performing. The Recent Rank column includes the period from the March low in order to get an idea of what is performing best since the most recent dip.

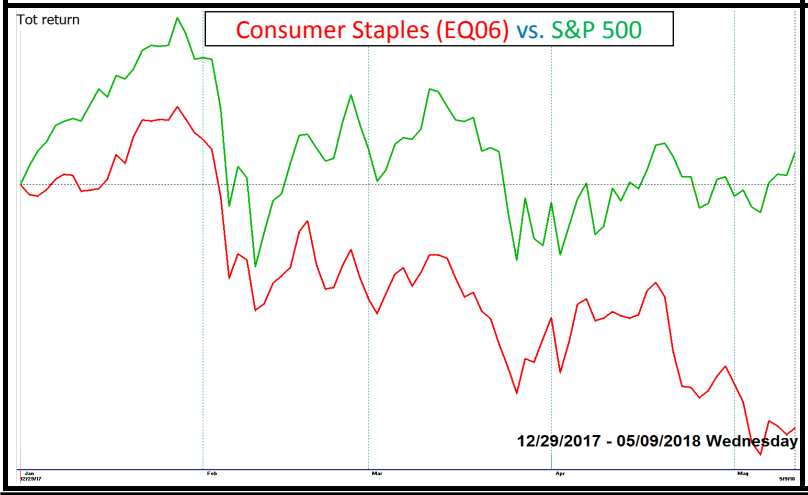
I have included a few charts below to provide some insight into how some of the different sectors are performing.



All of the Commodity groups have moved to the top half of the Ranked Market Watch List with the exception of Commodity Precious Metals (CO04). Commodity Energy (CO05), which is up 8.8% year-to-date, is the top performing commodity sector and closed near its January high. A strong penetration above the January high would be a positive indication for this group. Energy and other commodity groups tend to outperform in the late stages of the business cycle and that can provide an opportunity for aggressive investors.



Technology (EQ12) has outperformed many of the other sectors and is up 9.4% year-to-date. As long as this sector continues to lead, it bodes well for a continuation of the uptrend that started in February 2016.

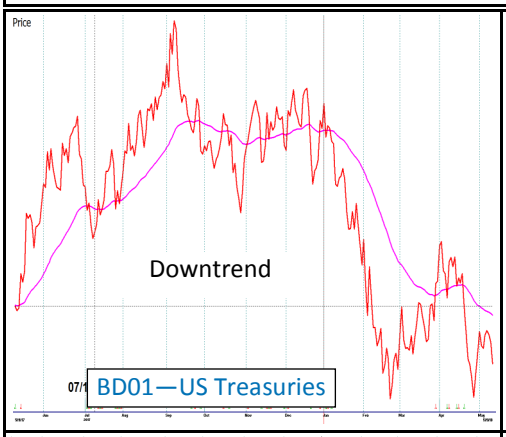


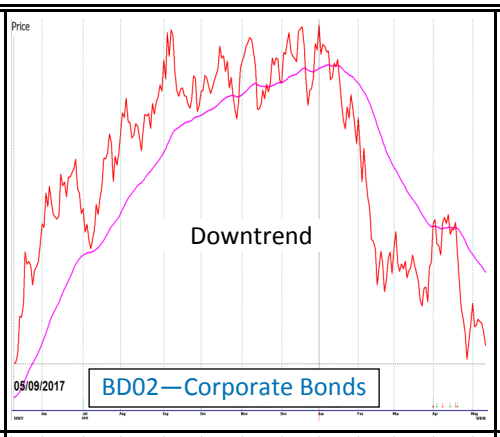
Consumer Staples (EQ06) tends to outperform during periods of market weakness. However, this defensive group has continued to underperform since the February selloff and is down 9.9% year-to-date.

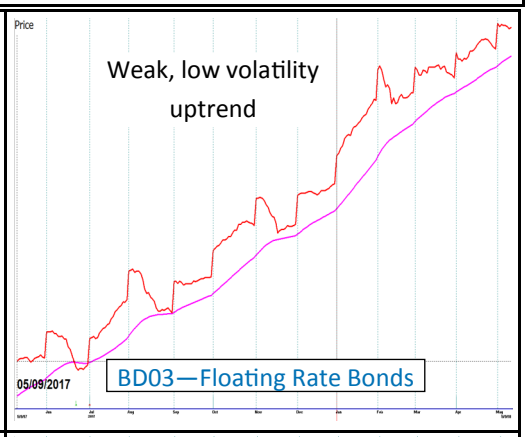
Market Watch List—Selected Charts

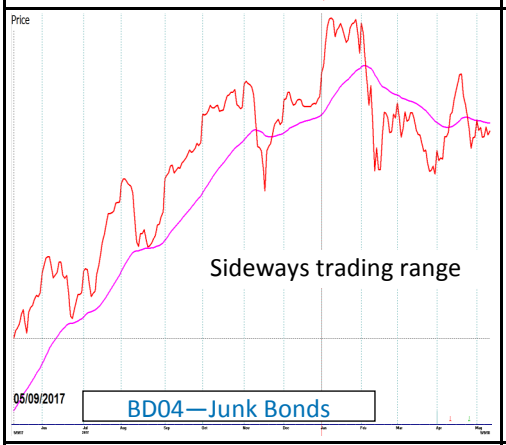
One-Year Charts

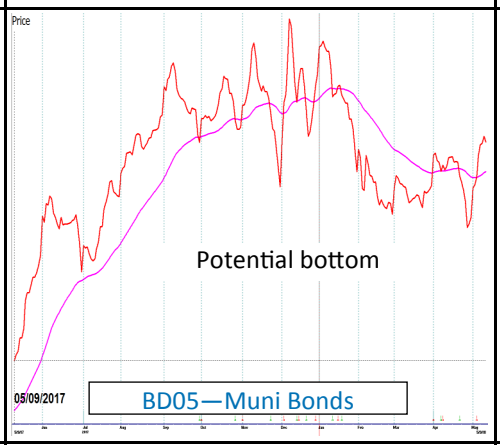
The following charts are the 10 bond and income groups included in the Market Watch List.

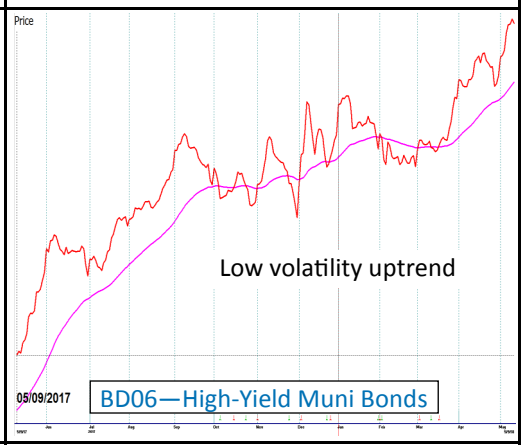


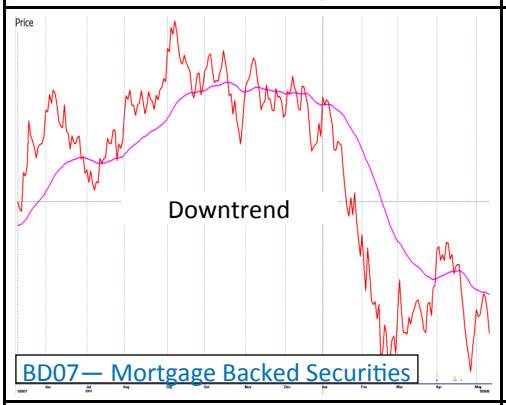


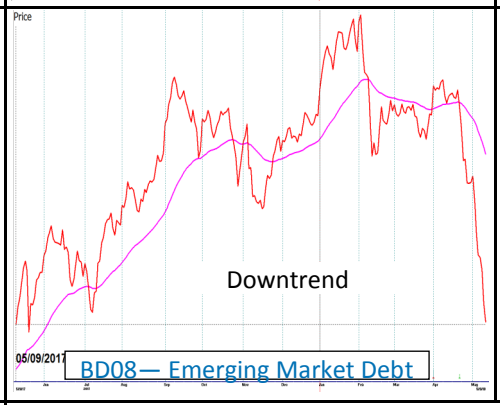


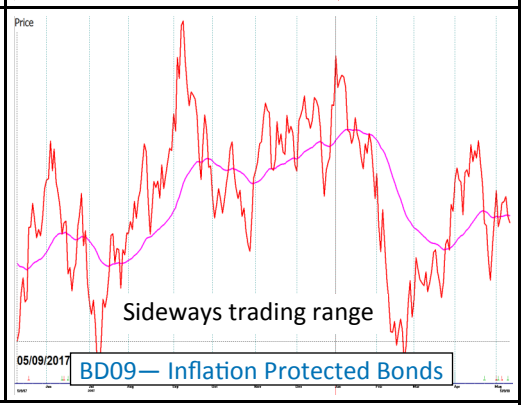


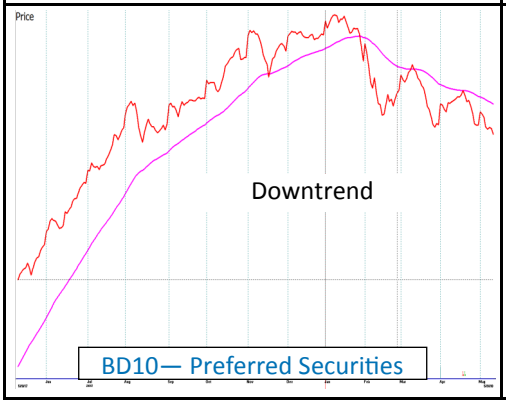












Most of the bond groups, with the exception of Floating Rate Bonds and High-Yield Municipal Bonds, are trending sideways or are in well-defined downtrends. Given the efforts of the Federal Reserve to raise interest rates and initial indications that inflation may be picking up, the bond area of the market will likely be a difficult part of the market to navigate for the foreseeable future.