WEEKLY MARKET UPDATE

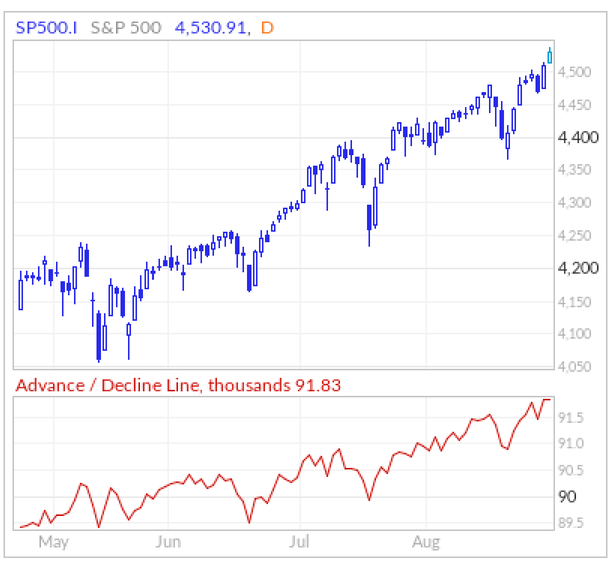
August 30, 2021

Pulling back the curtain

This weekend is Labor Day weekend and officially the end of summer in the markets. As such, I'm assuming that many will not read this because you are squeezing in the last bit of fun before the kids go to school and the days get shorter.

For those of you who's attention I do have this week, I'm going to get into the weeds a bit. Let's start with something most of us know. We know the markets have been moving higher (in spite of valuations and "the dog days of summer"). What you may not know is that, usually, volume is lighter in the summer as much attention is taken from the markets and placed in more fun areas of life. This year is no different.

The markets right now are interesting in that the S&P 500 looks different than the other indexes when you look at the average participation. Basically, when markets hit new highs, you would like to see most stocks hitting new highs and the participation of stocks confirm those new highs. Let's look at some charts.



You can see to the right that both lines are agreeing with each other (going up together).

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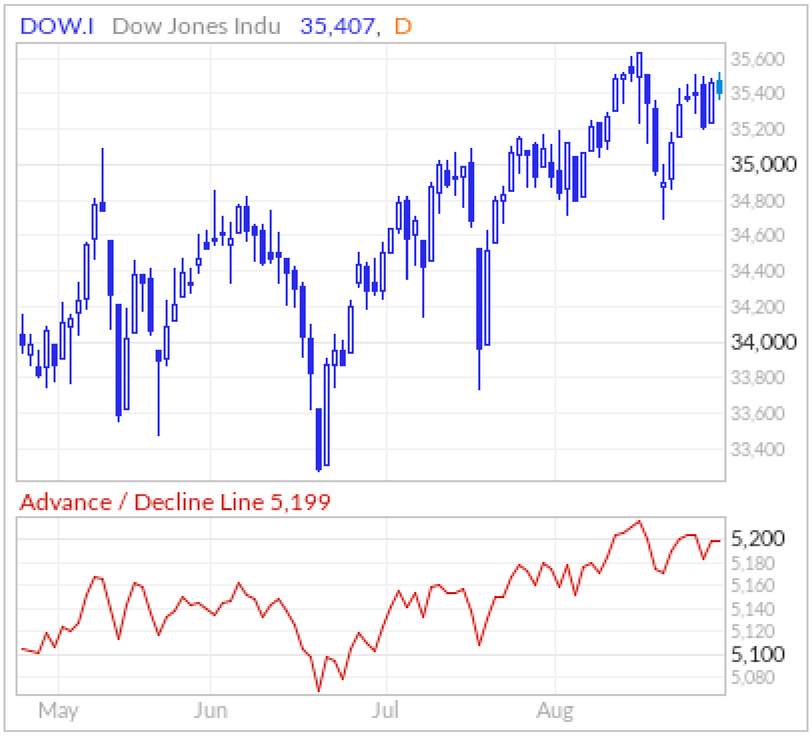
As always, you can click on the charts to access larger versions!

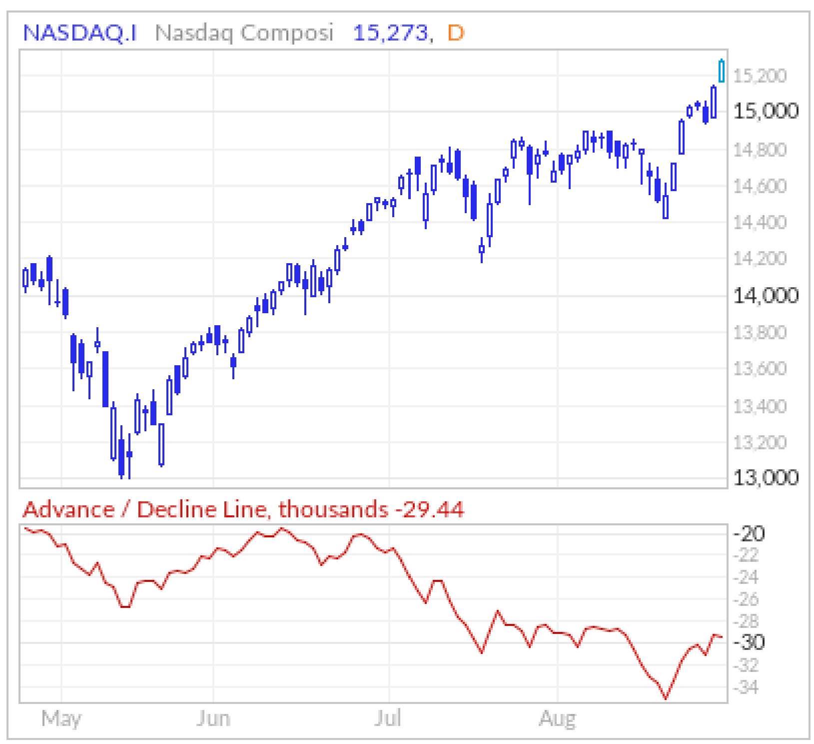


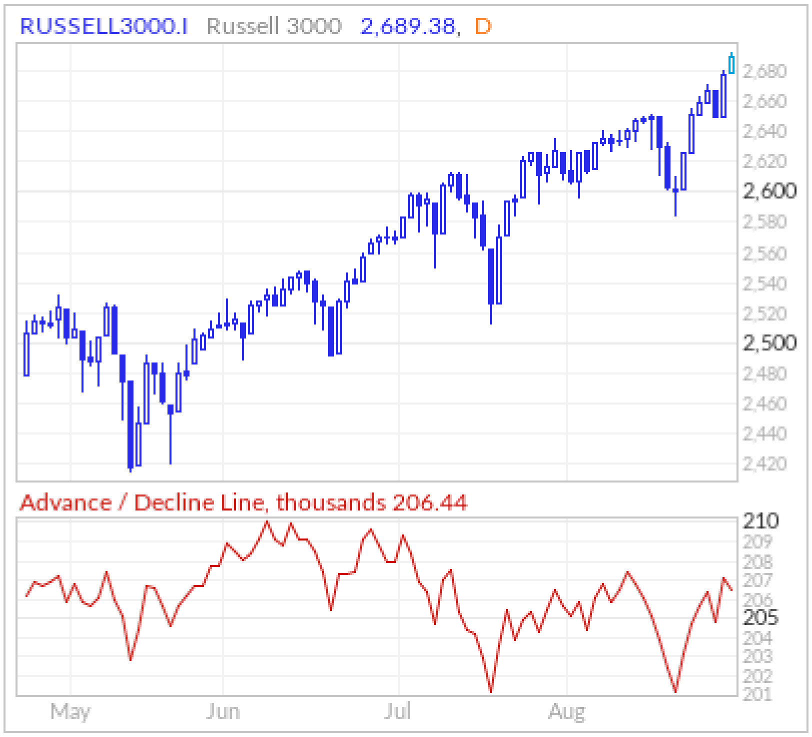
The Dow Jones Industrial index (to the left) isn't breaking out to new highs, nor is the Advance/Decline (A/D) line. So those lines are to be expected. You would like the Dow to confirm a new high in the S&P 500. Now it gets interesting.

The Nasdaq (below) is saying something completely different. There are more stocks in the Nasdaq going down than are going up. That is a bad trend. So, while the Nasdaq is at new highs, the A/D line is not confirming it. We have mentioned this before in different ways. The reason the Nasdaq is at new highs is because the largest five companies (Apple, Microsoft, Google, Amazon and Facebook) are doing most of the heavy lifting and driving the index level higher.

That can only happen for so long. As we have said before, those five stocks represent 40% of the weighting in the Nasdaq and roughly 22.5% of the S&P 500. Those weightings are hovering around all-time highs, and this typically is not a good thing for the markets looking forward. Add to that, that the stocks are trading at pretty high valuations, and you have a precarious market environment.

Let's take a look at another chart. This one is the Russell 3000 index (pretty much the whole stock market) (chart on next page).

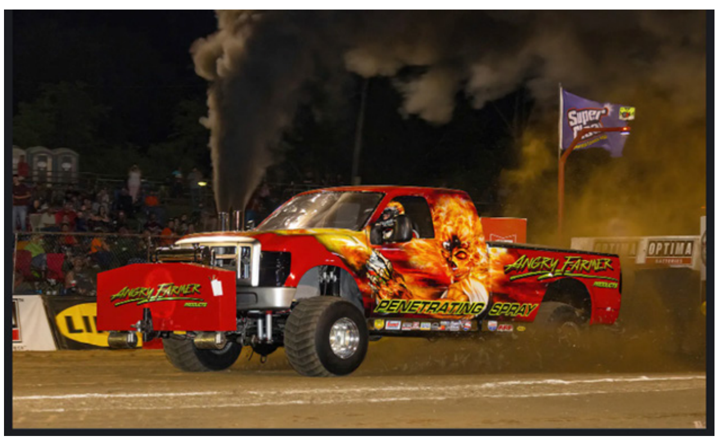




With this, we are looking together at large cap stocks, mid cap stocks, and small cap stocks. You can see that it is at a new high, but the A/D line isn't supporting that new high.

Now I'm not saying the world is coming to an end, but I am saying that the market will have to reconcile this divergence. One of two things will happen.

Option 1: The market will be confirmed by the A/D line. Option 2: The market will be pulled down by the weight of the stocks going down as the top five stocks can't continue to move the market higher. Option 2 is a bit like tractor pulls (see flaming truck below). Now maybe I'm the only one who has watched one of these, but as the weight gets closer to the tractor, it gets harder to pull, eventually just digging the tires into the ground. If you've never watched, perhaps I just gave you something to do over the long weekend (though we'll be cheering on the Huskies instead!).



Anyhow, since the model picks up on trends, right now the upward trend is our friend. But once we pull back the curtain, we notice that everything doesn't look quite as good as you would expect.

For now, we will continue to watch things very closely. Enjoy the last week of summer and have a good Labor Day. We'll close by saying our heartfelt condolences to those who lost a loved one in Afghanistan in the past week's tragic turn of events, and a big thank you to any of you who have served there over the past 20 years. Your sacrifice has not got unnoticed or unappreciated.

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