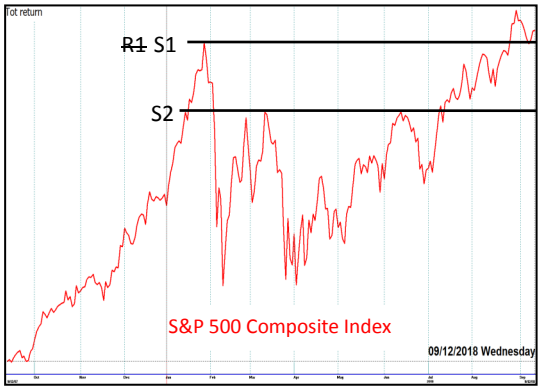
Market Monitor

Version 2018-09

Written by Rob Bernstein

September 13, 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 S&P 500 Composite Index, like most of the major market indices, broke above a critical resistance level (R1) over the last few weeks as it penetrated recent, year-to-date highs. As expected, the markets then pulled back to test those levels (now considered support—S1) over the last week before bouncing. The bounce has been fairly anemic so far. What happens over the next week will be important in determining the longevity of the current uptrend.

Market uptrends are defined by stronger up legs interrupted by weaker down legs. As long as this pattern persists, the market should be considered in an uptrend. For the current uptrend to continue, the market will have to make a new high fairly soon. Of course a drop below support (S1) has the potential to bring in additional sellers. If that happens, the next significant level of support on the S&P 500 is marked on the chart above as S2.

The month of September has historically been characterized by higher volatility. With markets close to all-time highs, trade tensions still in the headlines and the run-up to mid-term elections, there is certainly opportunity for volatility to spike. However, there is no guarantee that will happen. If trade war rhetoric progresses towards trade deal announcements, the market could shoot higher. Wouldn't that be timely if this happened right before the mid-term elections? Seasonal patterns are important to recognize but are not reliable enough to trade. Watch the charts and make adjustments to your portfolio based on what is actually happening in the market.

Summary Assessment

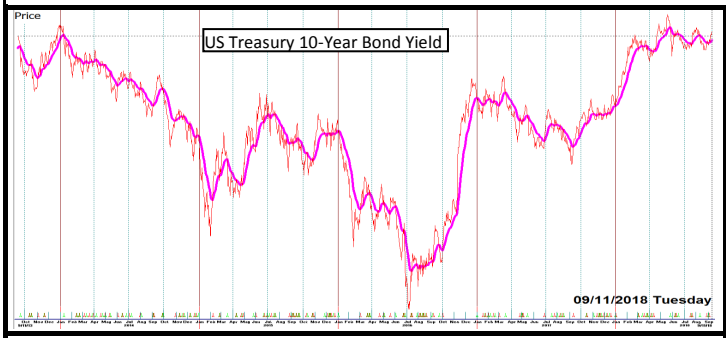
Indicator	Assessment
Business Cycle: Stage IV	Bonds: - Stocks: + Commodities: +
Long-Term Breadth	?
Short-Term Breadth	+
Junk Bond Indicator	+
Market Indices	+

The *Market Monitor* is provided for general information purposes only. It does not constitute an offer to sell or a solicitation to buy a security, and is not an offer to provide any specific investment advice. Past performance is not a guarantee of future performance. It is not possible to invest directly in an index. Subscribers of the newsletter must take into account their personal financial situation, including financial needs and tolerance for risk, when making investment decisions. Always reference a fund's prospectus before buying any mutual fund or ETF. Most data and charts are provided by FastTrack (www.fasttrack.net) or TC2000 (www.worden.com). Questions about this newsletter can be addressed to Robert Bernstein at 858-367-5200 or rob@rgbcapitalgroup.com.

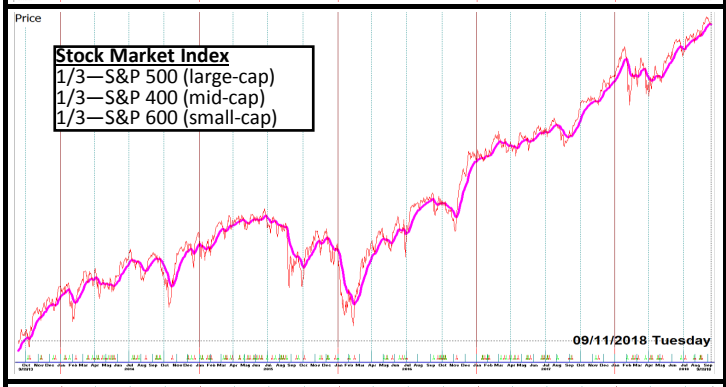
Economic (Business) Cycle

Five-Year Charts

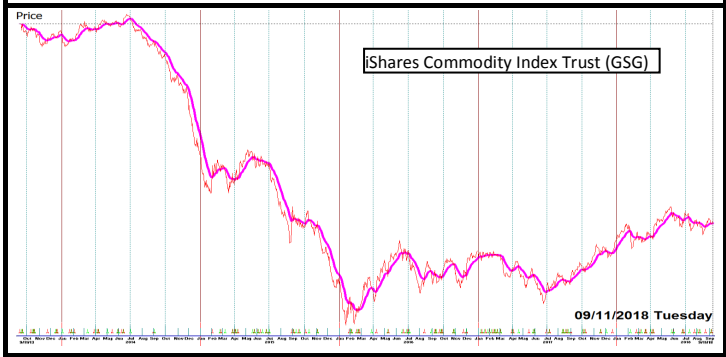
The business cycle is defined as alternating periods of expansion and recession. The purpose of reviewing the business cycle is to attempt to understand the macro-economic environment. This provides us clues as to how the broad asset categories (bonds, stocks and commodities) may perform. For purposes 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.



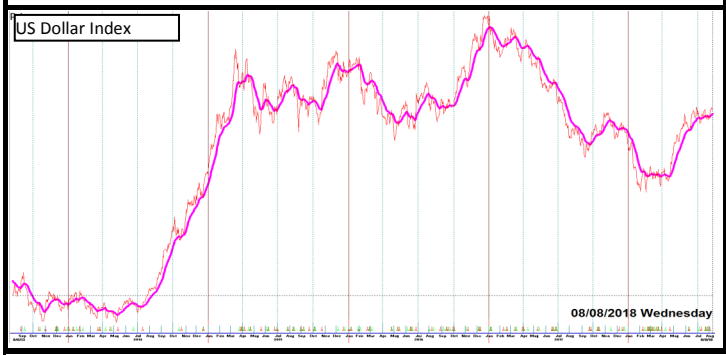
Yields on 10-Year US Treasury Bonds have flattened out over the last several months despite the Fed's focus on raising interest rates. This flattening of yields has provided some support for bond prices (not shown).



The long-term trend of the stock market remains up.



The trend of commodity prices is trending up but has flattened out over the last few months.



Reviewing the US Dollar Index provides some perspective on the trend of commodity prices. The recent flattening of commodities may be attributable to a rising US Dollar.

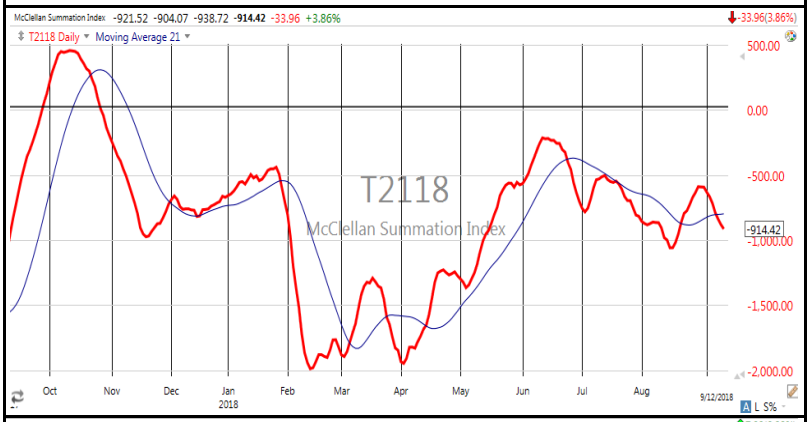
Summary: The business cycle isn't a precise science. Sometimes stages can progress out of sequence or be skipped entirely. Although the current environment appears to be in Stage IV (positive for stocks and commodities) we need to mindful that we could regress backward or jump forward with little notice.

Stage IV	
Bonds	-
Stocks	+
Commodities	+

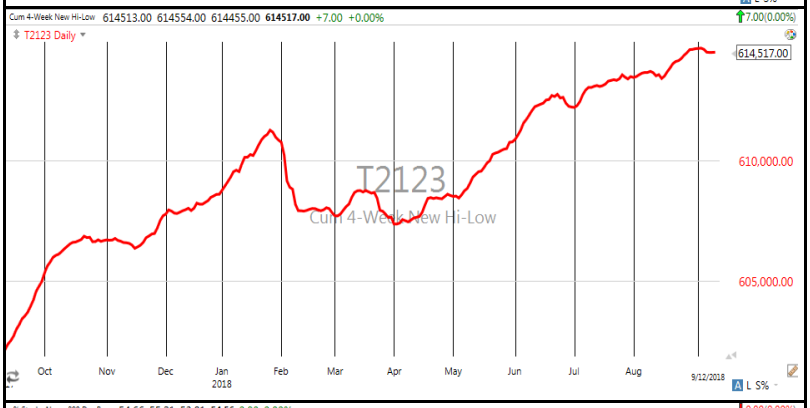
Long-Term Market Breadth

One-Year Charts

Although the New York Stock Exchange Composite Index is trending up above its uptrending 50-day and 200-day moving averages, it is struggling to break above overhead resistance and still remains below the January peak.



The McClellan Summation Index has trended down over the last few months reflecting the uncertainty in the NYSE.



The Cumulative 4-Week New High/New Low Index has been steadily trending up reflecting a healthy market environment. The recent leveling off of this index is of no big concern currently.

The number of stocks in long-term uptrends (over their 200-day moving average) has fallen over the last two weeks but remains over the neutral 50% level.

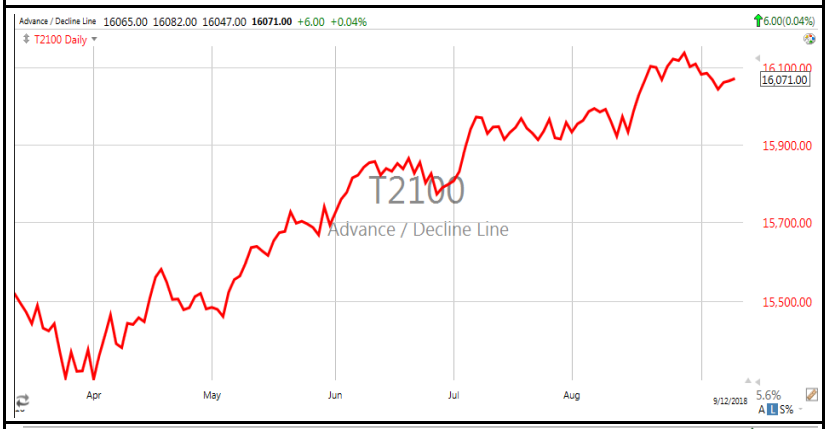
Summary: Long-term breadth indicators continue to provide a mixed message. Improvement in the McClellan Summation Index , an increase in the number of stocks in long-term uptrends, and/or rising prices on the NYSE would indicate a healthier market environment.

Long-Term Market Breadth
?

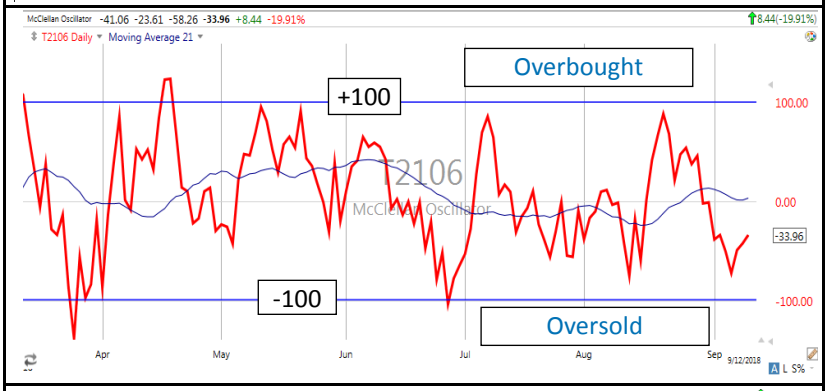
Short-Term Market Breadth

Six-Month Charts

The NYSE Composite Index is in a weak, choppy uptrend.



The trend of the Advance/Decline Line is more stable and reflects a healthy market with more stocks advancing than declining.



The McClellan Oscillator has spent the majority of the time within the normal range (defined as between +100 and –100). The McClellan Oscillator is not indicating a short-term overbought or oversold condition currently.

The number of stocks above their 40-day moving average has weakened and is currently at the 50% level.

	Short-Term Market Breadth
Summary: Short-term market breadth remains positive but certainly has room to improve.	+

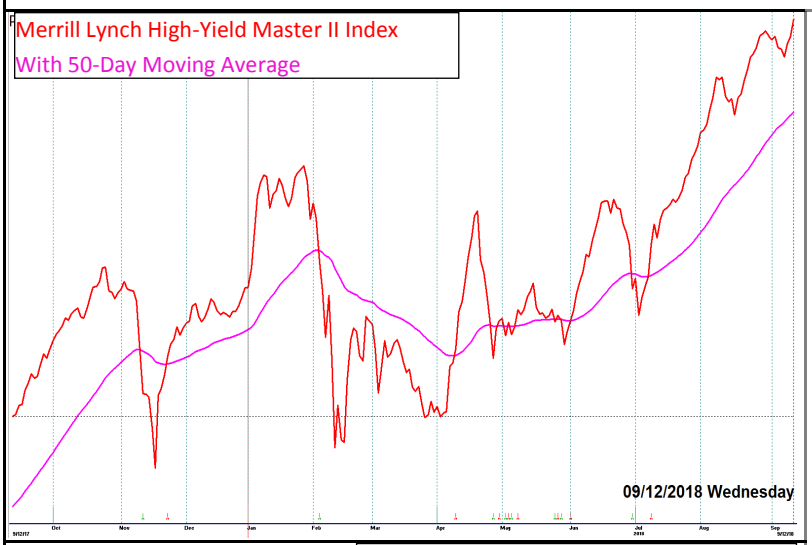
Junk Bond Indicator

One-Year Charts

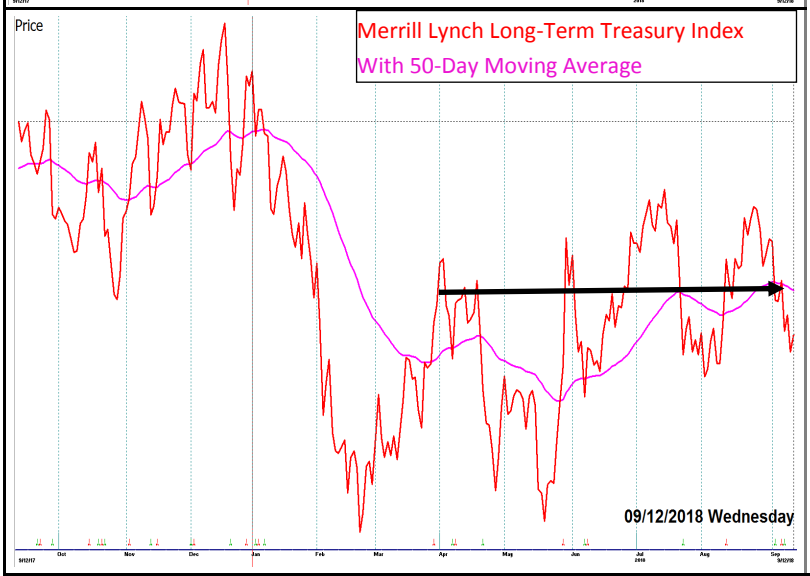
Junk bonds are one of the best indicators of overall market sentiment. When risk rises, junk bond prices fall as investors demand a higher yield to compensate them for the additional risk (remember bond prices fall as yields rise). When risk subsides, junk bond yields tend to fall given more favorable 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 of junk bonds is trending up above its uptrending 50-day moving average. This is a sign that investors are willing to take on risk.



Long-term treasuries have settled into a trading range and are trending sideways. There is no indication of a flight to safety.

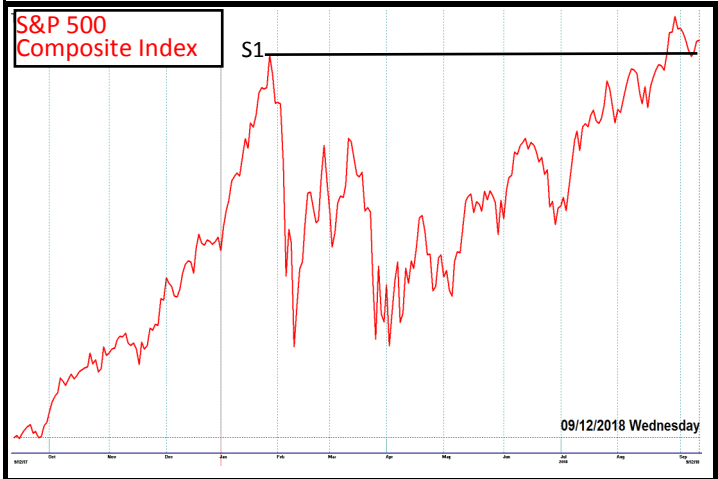
Summary: With junk bonds trending up and long-term treasuries moving sideways, there is little evidence of elevated risk in the current market environment.

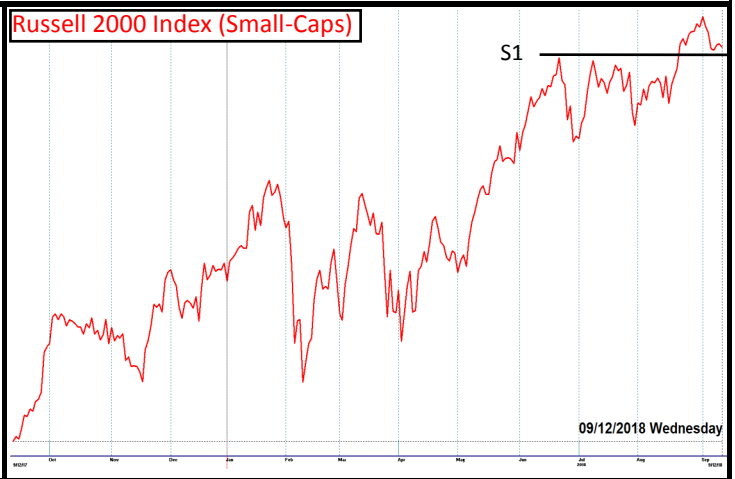
Junk Bond Indicator
+

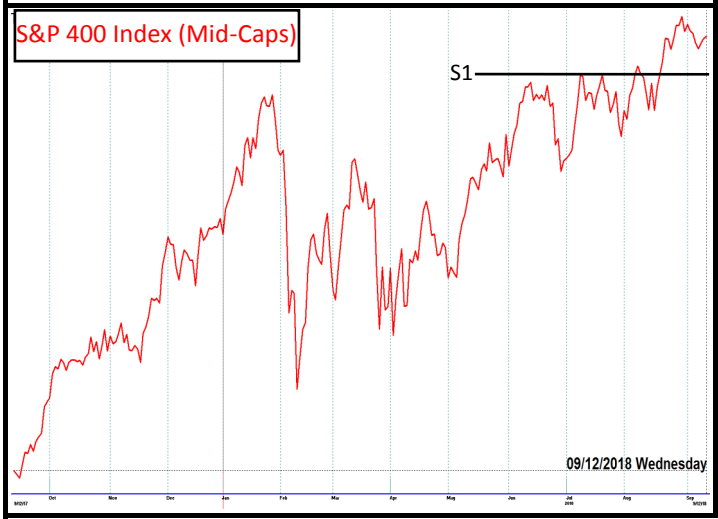
Market Indices

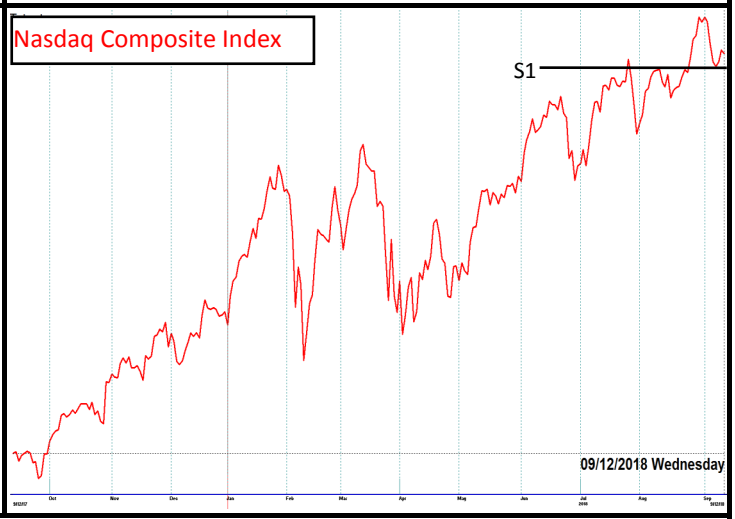
One-Year Charts

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.).









All of the major indices shown above have broken through overhead resistance levels within the last few weeks. These resistance levels, marked by year-to-date highs, now serve as an important level of support. As often happens when the market breaks through to new highs, they will pull back to re-test those levels; this time as support (S1). Pullbacks such as these are a healthy part of a market uptrend. All of the indices, with the exception of the S&P 400 Index, have pulled back to their breakout point in a very classical technical setup. If the uptrend is to continue, we would expect to see the major indices breakout to new highs within the next week or so.

Summary: The major indices are in long-term uptrends. As long as they remain above S1, the market environment should be considered positive.

Market Indices
+

Market Watch List

Calculation Period: 4/13/2018 —9/12/2018

Recent Rank: 6/20/2018—9/12/2018

Rank	Ticker	Name	Period Return	Annualized Return	UI	UPI	Maximum Drawdown	Recent Rank
1	EQ07	HEALTHCARE	15.89%	42.48%	1.13	36.08	-3.56%	3
2	BD06	HIGH YIELD MUNICIPAL BONDS	2.69%	6.59%	0.17	28.19	-0.50%	7
3	EQ11	REAL ESTATE	12.09%	31.52%	1.13	26.30	-3.14%	10
4	EQ18	CAP SMALL	12.02%	31.31%	1.25	23.70	-3.67%	19
5	EQ19	STYLE GROWTH	11.64%	30.23%	1.35	21.09	-4.06%	14
6	EQ05	CONSUMER DISCRECTIONARY	11.50%	29.84%	1.35	20.86	-3.49%	21
7	EQ16	CAP LARGE	9.51%	24.37%	1.10	20.51	-3.04%	8
8	EQ20	STYLE VALUE	7.41%	18.71%	0.97	17.47	-2.87%	15
9	EQ17	CAP MID	8.40%	21.36%	1.17	16.81	-3.27%	17
10	BD03	FLOATING RATE BONDS	1.32%	3.20%	0.09	16.39	-0.45%	2
11	EQ12	TECHNOLOGY	10.74%	27.74%	1.95	13.31	-5.38%	18
12	EQ15	UTILITIES	9.90%	25.42%	2.00	11.86	-5.15%	4
13	EQ03	BIOTECHNOLOGY	10.27%	26.44%	2.37	10.45	-6.81%	22
14	EQ14	TRANSPORTATION	7.62%	19.28%	2.67	6.59	-6.48%	20
15	EQ08	INDUSTRIALS	6.12%	15.32%	2.13	6.39	-5.08%	5
16	EQ13	TELECOMMUNICATION	6.18%	15.47%	2.31	5.96	-4.80%	9
17	EQ01	AEROSPACE/DEFENSE	6.35%	15.93%	3.17	4.48	-8.24%	1
18	EQ02	BANKING / FINANCIALS	3.33%	8.19%	2.04	3.17	-5.49%	27
19	EQ06	CONSUMER STAPLES	4.08%	10.08%	3.29	2.54	-7.13%	6
20	BD05	MUNICIPAL BONDS	0.86%	2.07%	0.22	1.54	-0.73%	23
21	CO05	COMMODITY ENERGY	3.71%	9.13%	5.18	1.43	-9.88%	36
22	EQ09	INSURANCE	1.95%	4.74%	2.22	1.36	-5.82%	11
23	EQ04	CONSTRUCTION	1.73%	4.20%	3.53	0.70	-6.75%	30
24	BD04	JUNK BONDS	0.77%	1.85%	0.60	0.21	-1.33%	16
25	BD07	MORTGAGE-BACKED SECURITIES	0.36%	0.88%	0.38	-	-0.98%	24
26	BD09	INFLATION PROTECTED BONDS	0.26%	0.63%	0.59	-	-1.25%	26
27	BD02	CORPORATE BONDS	0.16%	0.38%	0.69	-	-1.61%	13
28	BD10	PREFERRED SECURITIES	0.16%	0.37%	0.76	-	-1.62%	12
29	BD01	US TREASURIES	0.03%	0.07%	0.74	-	-1.69%	25
30	EQ10	MATERIALS	-0.18%	-0.43%	3.74	-	-6.78%	28
31	FR01	FOREIGN - JAPAN	-4.91%	-11.39%	4.54	-	-7.99%	31
32	BD08	EMERGING MARKET DEBT	-8.29%	-18.74%	5.41	-	-8.60%	29
33	CO02	COMMODITY GENERAL	-1.65%	-3.92%	4.96	-	-8.97%	33
34	FR02	FOREIGN - EUROPE	-5.68%	-13.09%	4.71	-	-9.18%	34
35	FR03	FOREIGN - ASIA PACIFIC (EX-JAPAN)	-7.35%	-16.74%	4.91	-	-9.37%	32
36	FR06	FOREIGN - INTERNATIONAL SMALL CAP	-10.26%	-22.88%	5.78	-	-11.19%	35
37	CO01	COMMODITY AGRICULTURE	-9.50%	-21.29%	7.85	-	-13.21%	37
38	FR05	FOREIGN - EMERGING MARKET	-13.19%	-28.79%	8.31	-	-14.42%	38
39	CO04	COMMODITIES PRECIOUS METALS	-13.81%	-30.00%	8.72	-	-16.51%	39
40	CO03	COMMODITY METALS	-9.03%	-20.32%	10.57	-	-19.09%	40

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.

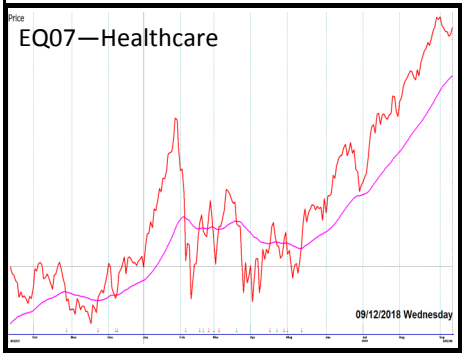
The market watch list is sorted first by Ulcer Performance Index (UPI), a measure of risk adjusted return, and then by Maximum Drawdown (MDD) for the calculation period. Negative UPI values are set to zero. Recent Rank indicates how sectors rank (based on a UPI / MDD ranking) for the Recent Rank time 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.

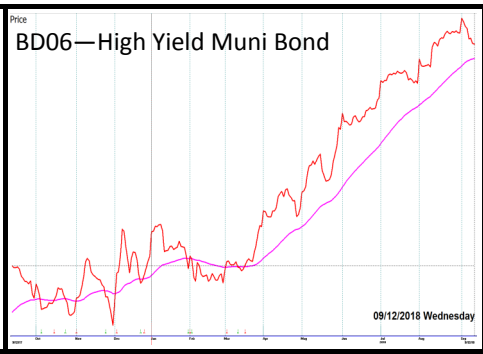
Market Watch List—Selected Charts

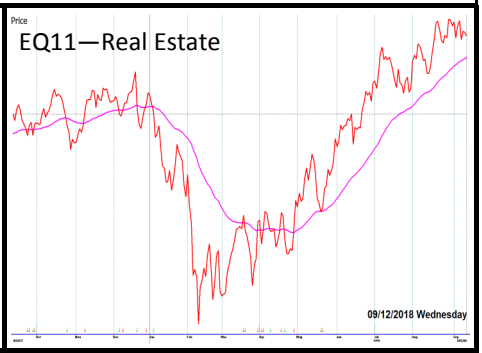
One-Year Charts

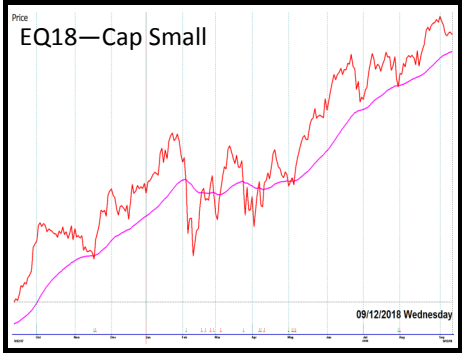
I set the calculation period for the Market Watch List to 4/13/2018, as this is the time that the initial volatility from the January/February sell-off had subsided and the markets settled into a choppy uptrend. The recent rank period is set at June 20, 2018, the time period when some of the relative relationships I discussed last month (i.e. outperformance of small caps over large caps and outperformance of consumer discretionary vs. staples) that existed for most of the year started to change.

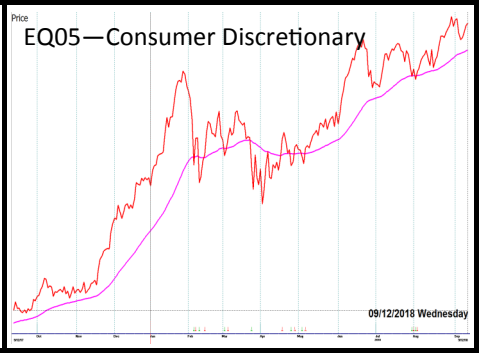
Instead of selecting a few individual charts this month, I have included a chart of each of the 40 sectors in the order they appear on the Market Watch List so you can visualize how each of the sectors are performing over the last year. I have plotted each sector along with its 50-day moving average as an indicator of trend.

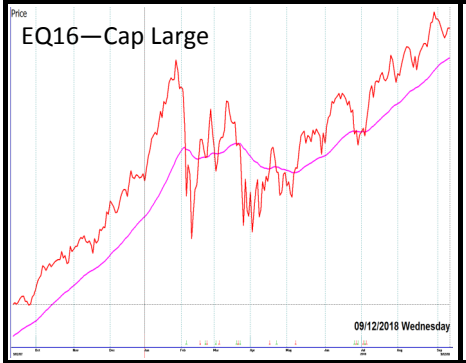


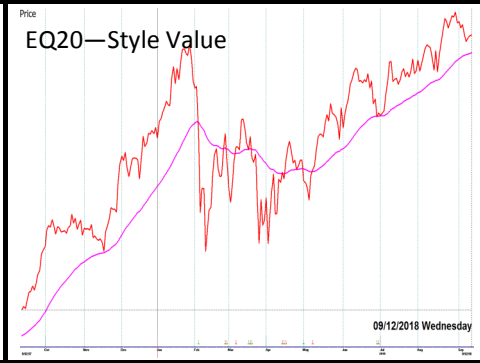


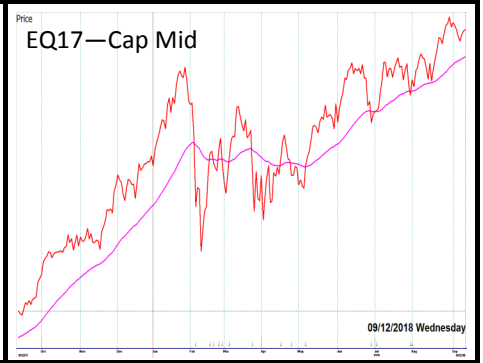


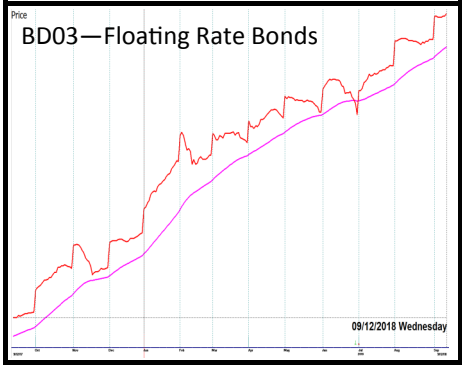


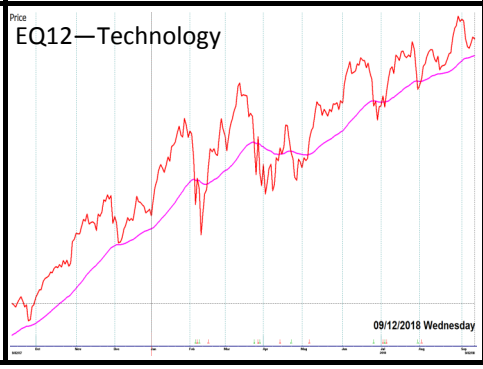


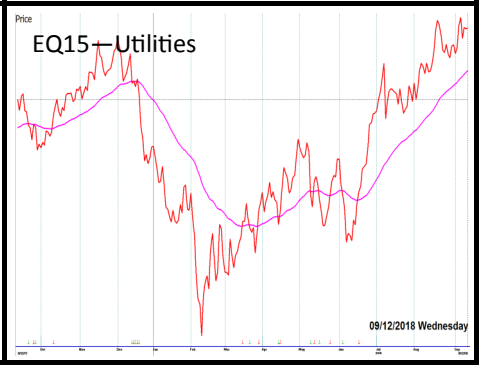






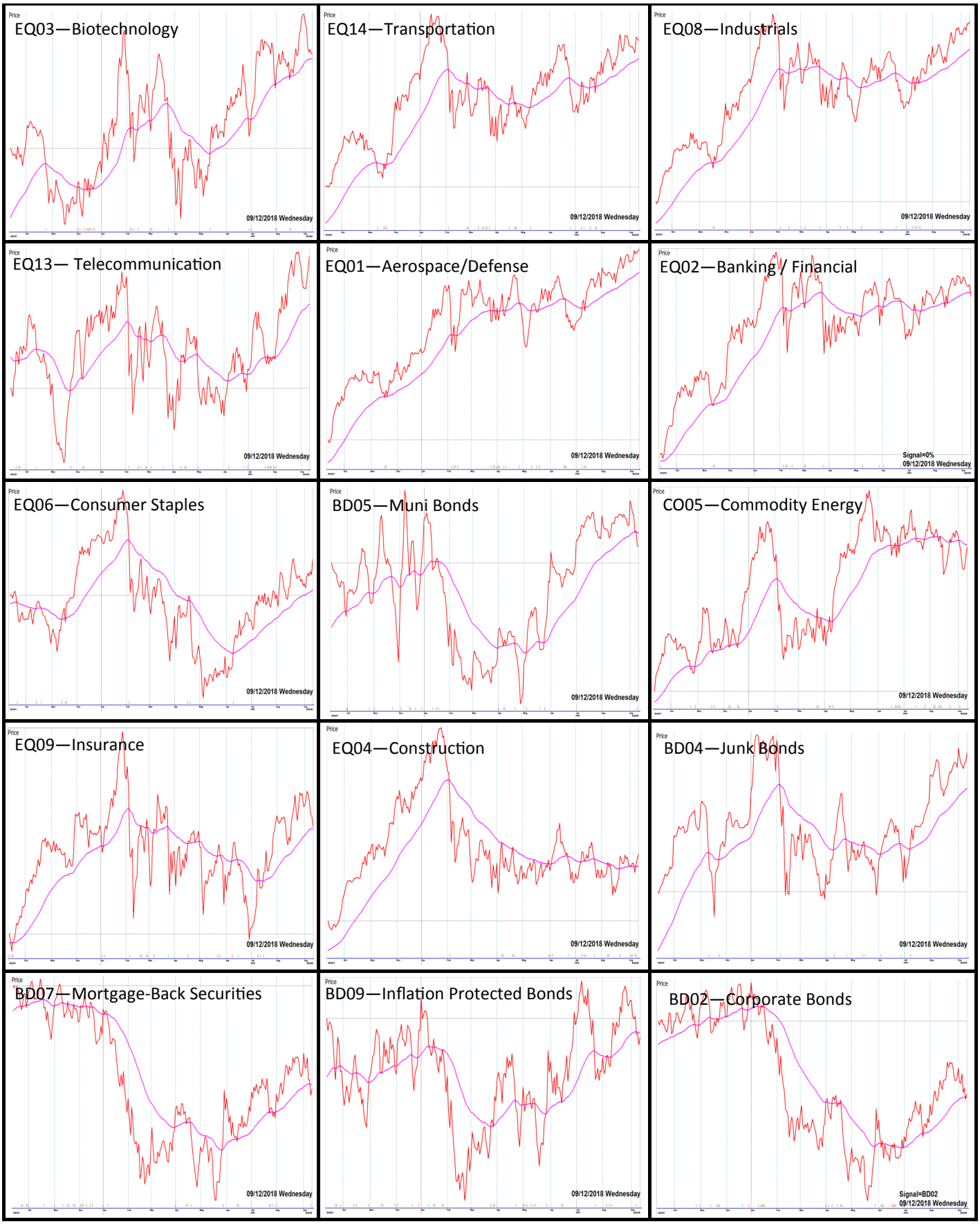






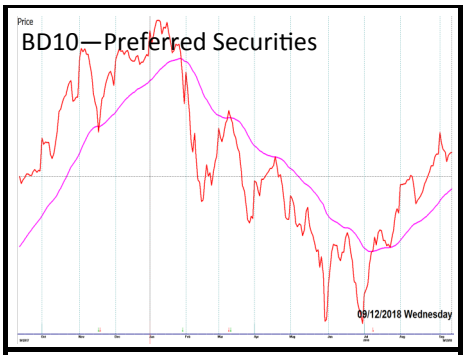
Market Watch List—Selected Charts

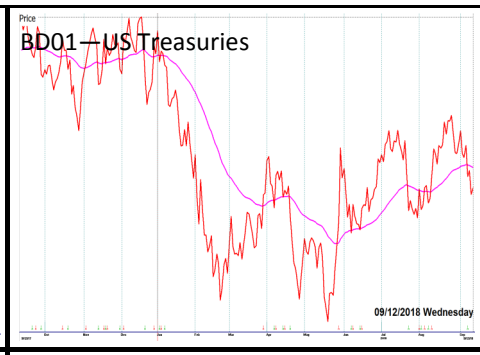
One-Year Charts

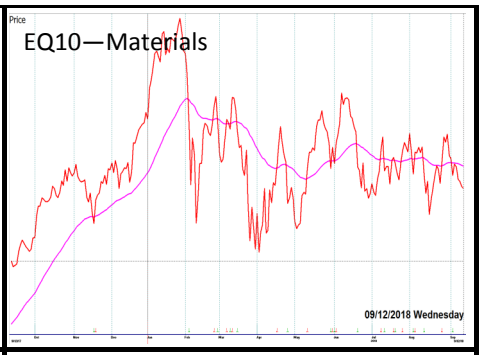


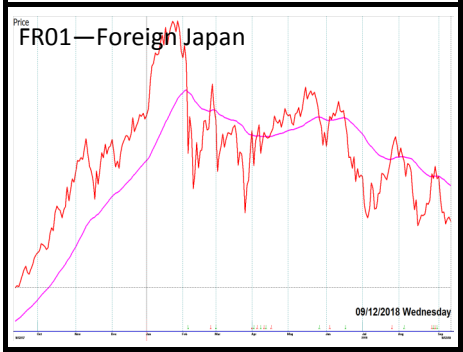
Market Watch List—Selected Charts

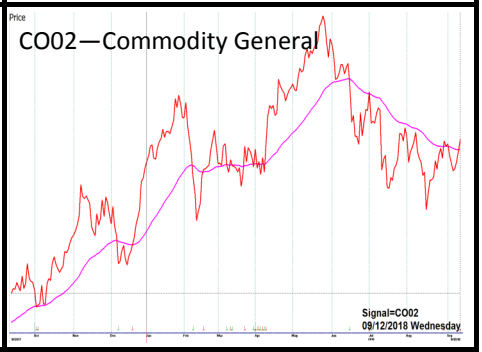
One-Year Charts

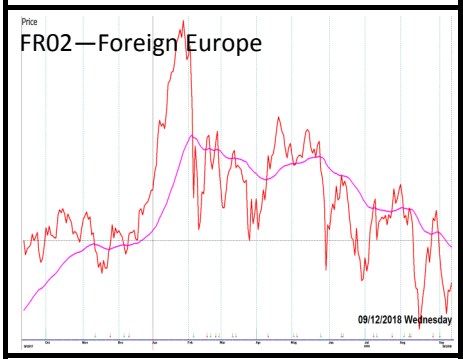


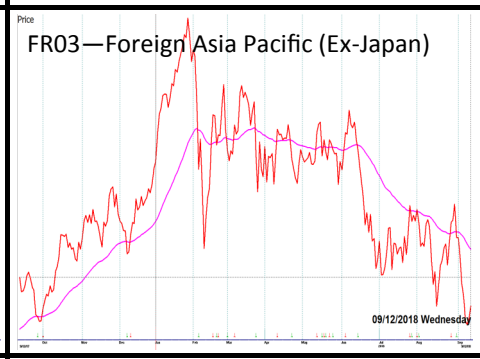


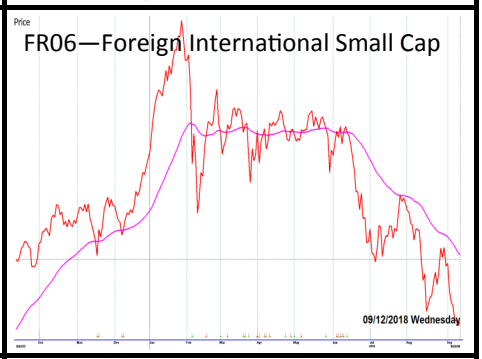


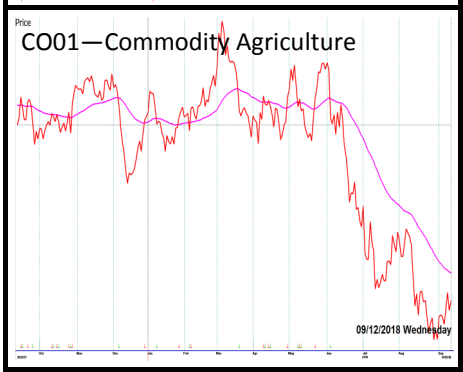


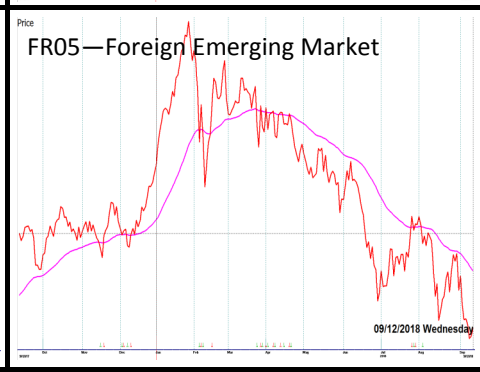


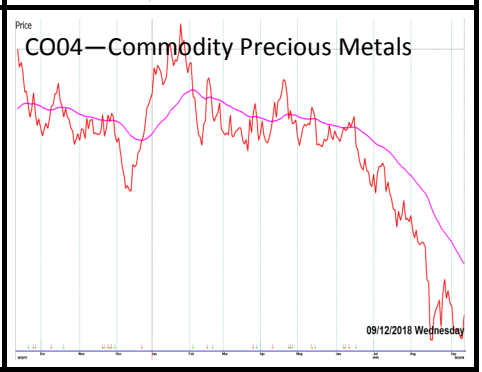


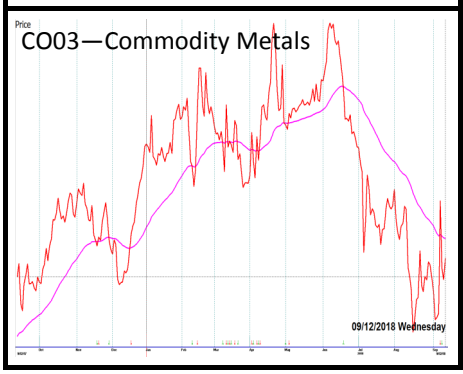












A few observations:

- Foreign stocks and commodities are underperforming US equities.
- With the exception of high-yield municipal bonds, the top half of the market watch list is dominated by equities.
- Aerospace/defense and industrials, two groups hit hard by potential trade wars are showing increasing momentum, a potential sign that trade war rhetoric may start evolving into trade deals in the near future.