Market Monitor

Version 2020-03

Written by Rob Bernstein

March 12, 2020

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.

What a difference a month makes!! In the February 12 issue of the *Market Monitor* I wrote: "Overall the stock market environment remains strong but I am starting to see some cracks." Well, those cracks opened and expanded quickly. The stock market is in a freefall with most of the major stock market indices down 19% or more. As I wrap up this month's newsletter, the futures market is indicating another down day which would place all of the major stock indices into what is considered bear market territory (a decline of 20% or more).

Index		2020 Peak Date	Decline Since Peak	# of Trading Days
Dow Jones Industrial Average	Large-cap Stocks	12-Feb-20	-20.30%	19
S&P 500	Large-cap Stocks	19-Feb-20	-19.00%	15
S&P 400	Mid-cap stocks	20-Feb-20	-24.80%	14
S&P 600	Small-cap stocks	16-Jan-20	-27.23%	37
Nasdaq	Tech/Growth Stocks	19-Feb-20	-19.00%	15
New York Stock Exchange	Broad Market Index	17-Jan-20	-21.20%	36
MSCI ACWI xUS	All World Index ex-U.S.	17-Jan-20	-18.70%	36
Value Line Arithmetic Index	Equal-weight Index	16-Jan-20	-27.60%	37
Merrill Lynch High-Yield Index	Junk Bond Index	20-Feb-20	-7.50%	14

The uncertainty surrounding the coronavirus has created some panic selling which I define as sell first and ask questions later. My guess is that the spread of the virus will get worse before it gets better. At this time, no one knows the economic impact of the virus but there will certainly be an impact to the economy. Some industries such as travel and leisure are being hit extremely hard. Others, such as consumer staples, have held up relatively well.

Positive events can happen in a crisis that will help stabilize the markets. Additional rate cuts, the introduction of a vaccine, and economic stimulus packages are examples of what could happen. This crisis will pass and there will be better days ahead.

The junk bond index is one of my favorite indicators for the overall health of the economy and currently, junk bonds are in a freefall along with the stock market. Junk bonds do a reasonably good job of signaling bottoms in the stock market. Once the downtrend in junk bonds reverses and crosses back above its 50-day moving average, it tends to be a good sign for the market. This is an opportunity in the making. Protecting capital, especially for those with a low tolerance for risk, during these difficult times is critical so that when the market bottoms (and it will bottom ☺) we can take advantage of the emerging opportunity.

Stock Market Environment
Stock Market Scorecard

The RGB Stock Market Scorecard is designed to provide a concise summary of the overall 'state of the market' based upon technical, fundamental and credit indicators. The technical indicators tell us how the market is performing over short-, intermediate- and long-term time frames. The fundamental models tell us how the market should be performing and the credit models act as a 'canary in the coal mine'. Using multiple indicators over multiple time frames provides a weight of the evidence approach to understanding the market.

Indicator/Model	Current Signal	Indicator Rating	S&P 500 Historical Return
Primary Cycle Analysis:			
Secular Market Cycle		Bull Market	
Cyclical Market Cycle		Bear Market	
Trend Analysis:			
Short-Term Trend Rating	Sell	Negative	NA
Intermediate-Term Trend Rating	Sell	Negative	NA
Long-Term Trend Rating	Buy	Positive	9.4%
Momentum Analysis:			
Short-Term Momentum Model	Sell	Negative	-20.1%
Intermediate-Term Momentum Model	Sell	Negative	-24.2%
Long-Term Momentum Model	Buy	Positive	15.3%
Fundamental Analysis:			
Economic Model	Buy	Positive	8.8%
Earnings Model	Hold	Neutral	10.7%
Monetary Model	Buy	Positive	18.0%
Inflation Model	Buy	Positive	13.3%
Valuation Model	Hold	Neutral	3.8%
Credit Conditions Analysis:			
Short-Term Credit Conditions Model	Sell	Negative	NA
Intermediate-Term Credit Conditions Model	Buy	Positive	NA
Long-Term Credit Conditions Model	Buy	Positive	NA
Overbought/Oversold Analysis:			
Short-Term Overbought/Oversold Signal	Buy	Positive	NA
Intermediate-Term Overbought/Oversold Signal	Hold	Neutral	7.9%
Long-Term Overbought/Oversold Signal	Buy	Positive	NA
Investor Sentiment Analysis:			
Short-Term Sentiment Model	Buy	Positive	29.5%
Intermediate-Term Sentiment Model	Buy	Positive	32.6%
Long-Term Sentiment Model	Buy	Positive	11.3%
		The Weight of the Evidence Average:	**8.94%**
		S&P 500 average gain/annum from 11/16/1979:	**8.60%**

The RGB Stock Market Scorecard is an educational tool designed to provide an assessment of current market conditions as of the date specified based on different market and trading indicators. For a description of each indicator and our source of data illustrated for the indicator, see the disclosures at the end of the document. Keep in mind that the signals and ratings should not be used in isolation and should be confirmed by other indicators and chart patterns. Signals and ratings are provided for general information purposes and are not intended as investment advice. The Current Signal is the signal generated by the specific indicator for the date specified to either buy, hold or sell securities designed to represent the market. The Indicator Rating provides values of positive, moderately positive, neutral or negative to provide an overall assessment based on the indicator value. Generally, positive ratings represent environments where the S&P 500 Index has historically provided above average returns and negative ratings represent environments where the S&P 500 Index has historically provided below average returns. The S&P 500 Historical Return represents the historical annualized return of the S&P 500 Composite Index while the indicator held the displayed rating. Past performance is no guarantee of future results.

Summary: The technical components of the Stock Market Scorecard have deteriorated while the Early Warning indicators have improved. So far the fundamental indicators have not deteriorated...at least not yet. In fact, we saw a slight improvement when compared to last month. However, if the impact of the coronavirus is sustained for long enough, the fundamental indicators will likely start to deteriorate as well.

Stock Market Environment
Primary Cycle Analysis

The stock market tends to move in cycles that tend to repeat over time and are generally associated with the overall business cycle.

- **Secular Market Cycle**—Secular (long-term) bull markets are defined by above average returns over an extended period of time. Secular bear markets are defined by long-term periods of flat or declining prices (i.e. below average returns). Secular cycles tend to last from 5 to 25 years.
- **Cyclical Market Cycle**—Cyclical bull and bear markets are shorter trends within the context of secular (long-term) trends. There can be several cyclical bull and bear markets within a secular bull/bear market. For purposes of this report we will define a cyclical bull market as a rise in the Dow Jones Industrial Average of 30% over 50 calendar days or a rise of 13% after 155 calendar days. A cyclical bear market is a 30% decline over 50 calendar days or a 13% decline after 145 days.

While we don't make investment decisions based on secular and cyclical cycles, it is helpful to evaluate current market conditions within context of the predominate trend.

Bull Market

Secular Market Cycle: Despite the sharp, fast decline, the stock market remains in a long-term uptrend.

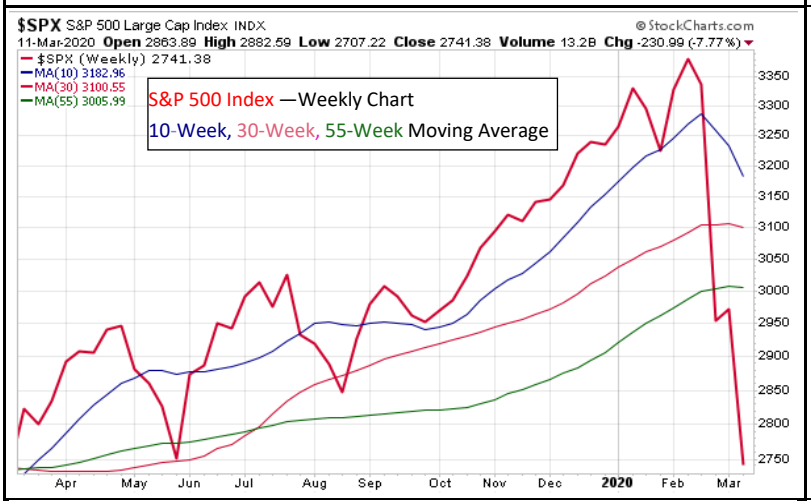
Bear Market

Cyclical Market Cycle: Ned Davis Research (NDR) has declared the cyclical (or shorter-term) trend as a bear market. This conflicts with the stated NDR definition above as the Dow Jones Industrial Average is down approximately 20% over the last 19 calendar days. Whether it meets the strict definition or not, we can probably all agree that the market environment is weak.

Stock Market Environment
Trend Analysis — One-Year Charts

Trend Analysis:	Signal	Indicator	Historical Return
Short-Term Trend Rating	Sell	Negative	NA
Intermediate-Term Trend Rating	Sell	Negative	NA
Long-Term Trend Rating	Buy	Positive	9.4%

The short-term trend is negative. The S&P 500 Index is trending down below its down trending 5-Day, 10-Day and 39-Day moving averages.



The intermediate-term (3 weeks to 6 months) trend is clearly down. The weekly chart of the S&P 500 Index is trending below its 10-Week, 30-Week and 55-Week moving averages. All the moving averages have also started to turn down.

Despite the violent downtrend over the last four weeks, the long-term trend of the S&P 500 Index remains up. While the 50-Day moving average has turned down, it remains above the 200-Day moving average at this point.

Stock Market Environment
Momentum / Fundamental Analysis

Momentum Analysis:	Signal	Indicator	Historical Return
Short-Term Momentum Model	Sell	Negative	-20.1%
Intermediate-Term Momentum Model	Sell	Negative	-24.2%
Long-Term Momentum Model	Buy	Positive	15.3%

Momentum attempts to capture the velocity of price changes over time. Given the speed of the recent decline, it shouldn't be surprising that the short– and intermediate-term momentum models are negative. While the long-term momentum model continues to flash green, it is only a few points from shifting to a sell signal. Momentum is clearly negative in the current environment.

Fundamental Analysis:	Signal	Indicator	Historical Return
Economic Model	Buy	Positive	8.8%
Earnings Model	Hold	Neutral	10.7%
Monetary Model	Buy	Positive	18.0%
Inflation Model	Buy	Positive	13.3%
Valuation Model	Hold	Neutral	3.8%

While this may be surprising, the fundamental indicators improved since last month with both the Inflation and Valuation models improving. At least so far, the fundamental backdrop remains strong.

Economic Model: The coronavirus scare has not impacted economic model as it remains in bullish territory. If this becomes a sustained crisis, the Economic model would likely start to decline, but that hasn't happened yet.

Earnings Model: Earnings will likely be impacted by the recent crisis but that hasn't happened. I suspect we will have a clearer picture once earnings season kicks off next month.

Monetary Model: The two indicators that support the Monetary model have improved over the last month and continue to indicate a positive environment.

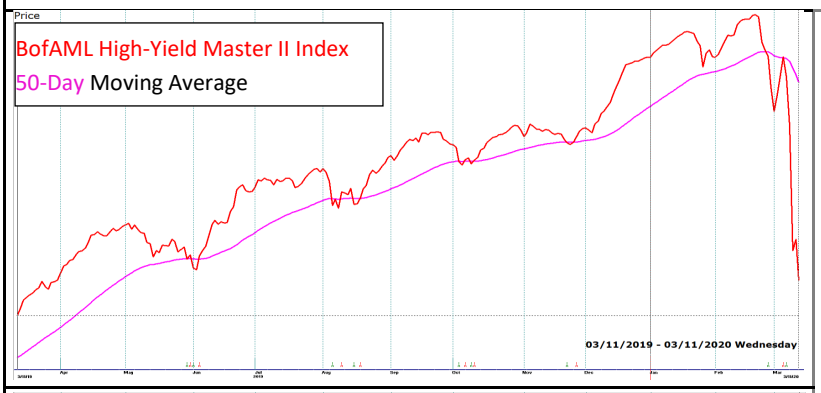
Inflation Model: There were some small changes to the Inflation model that moved the model from neutral last month to positive this month.

Valuation Model: With the rapid decline in prices, stock valuations are starting to look a bit better which tipped the Valuation model from negative last month to neutral this month as several of the component indicators that make up the Valuation model have improved over the last several weeks.

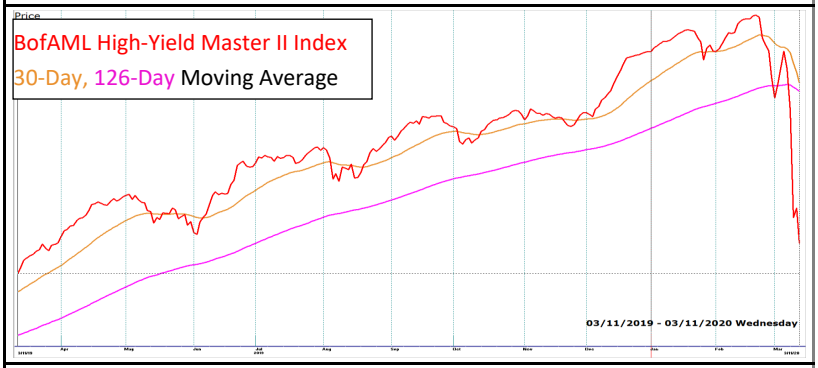
Stock Market Environment
Credit Conditions Analysis — One-Year Charts

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.

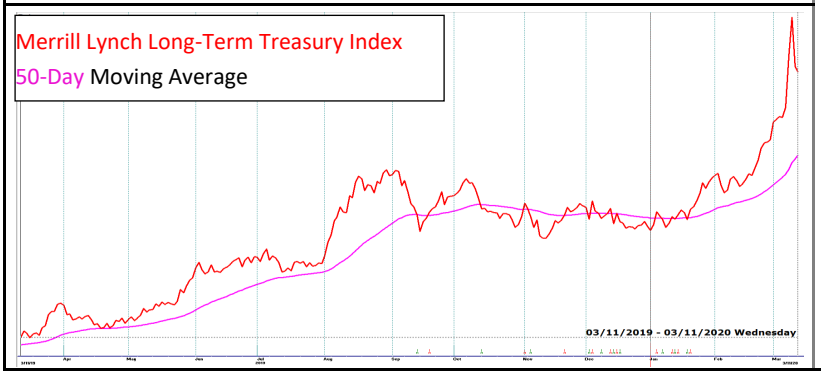
	Signal	Indicator	Historical Return
Credit Conditions Analysis:			
Short-Term Credit Conditions Model	Sell	Negative	NA
Intermediate-Term Credit Conditions Model	Buy	Positive	NA
Long-Term Credit Conditions Model	Buy	Positive	NA



Short-Term Credit Conditions: The BofAML High-Yield Master II Index fell below its 50-day moving average on February 26 and has remained below that level. The junk bond index is indicating that market risk is elevated.



Intermediate-Term Credit Conditions: The intermediate-term credit conditions remains positive, but not by much. As long as the 30-day moving average remains above the 126-day moving average the indicator is technically in a positive state. However, the moving averages are likely to cross in the next day or two.



Long-Term Treasury Index: Investors are fleeing to the relative safety of US Treasuries as reflected by the steep increase in Treasury prices. When Treasury prices rise in conjunction with falling junk bond prices, it is an indication of elevated risk.

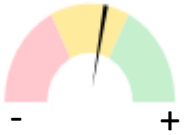
Summary: Short– and intermediate-term credit conditions are deteriorating and reflect higher than normal risk across those timeframes. However, long-term credit conditions (not shown) remain stable and do not reflect an increase in the odds of a recession at this time.

Stock Market Environment
Early Warning Model

The Early Warning Model is designed to give investors an indication when the market has gone too far in one direction and whether it's ripe for a reversal in trend based on overbought / oversold and investor sentiment indicators. Like a rubber band that has been stretched too far, the market tends to snap back towards its mean. The gauges below provide a visual representation of the state of each indicator: positive (green) or negative (red). The center (yellow) area indicates a neutral reading.

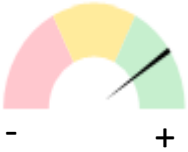
Overbought / Oversold

Short-term



Intermediate-term

Long-term

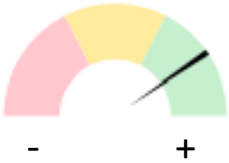


With all the bad news related to the coronavirus, there is some good news. The stock market is oversold suggesting that a tradable bounce may be around the corner. While the short-term overbought/oversold indicator reflects a neutral status, the indicator is designed so that it reflects a positive status once the market declines and then reverses. While we have the decline in place, we are now waiting for a reversal of the trend at which time the indicator will flash green.

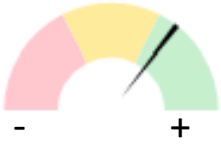
Investor Sentiment

Short-term

Intermediate-term



Long-term



Investors sentiment has turned negative across all three time frames as a result of the coronavirus and that is reflected in the Investor Sentiment indicators all moving to green. Again, this is good news as historical analysis suggests that some of the best stock market gains happen after sentiment has become extremely negative. (Note: as a contrarian indicator, negative sentiment is represented by a positive (green) reading.)

Summary

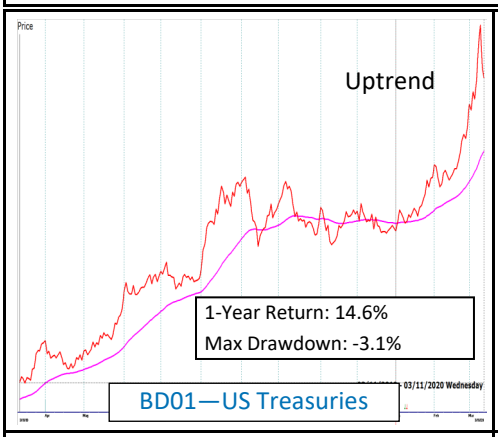
Mean Reversion Potential	Positive
New Investment Rating	Buy

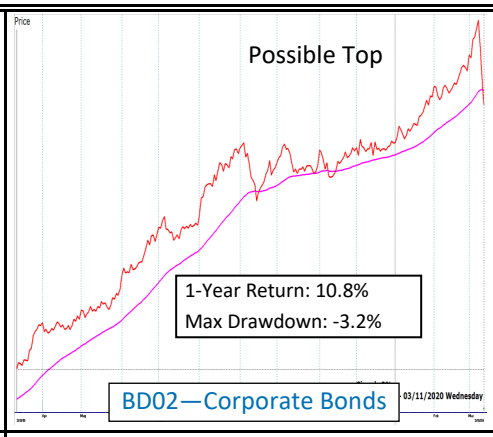
The Early Warning indicators are pointing to a market that is ripe for a reversal. While the probability of a reversal is elevated, the market could certainly move further down before that happens. Given the continued uncertainty surrounding the coronavirus this remains a high risk environment.

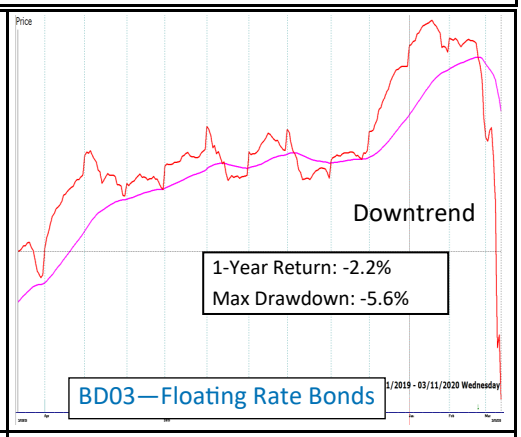
The Early Warning Model is a tool designed to provide an indication when the market has moved too far in one direction, which in our view, means the probability of a counter trend rally is above average. The Mean Reversion Potential, based on the trend reversal data displayed, is a belief that prices and returns tend to move towards their long term averages. The New Investment Rating, is a rating that we believe indicates whether current market conditions support new money being invested in the market. A negative/red reading indicates that the likelihood of prices moving down towards their mean is elevated in our view, while a positive/green reading indicates that the likelihood of a move up to the mean is elevated. These represent the opinions of Robert Bernstein and are not an investment recommendation. There is no guarantee the market will move in any one direction at any given time.

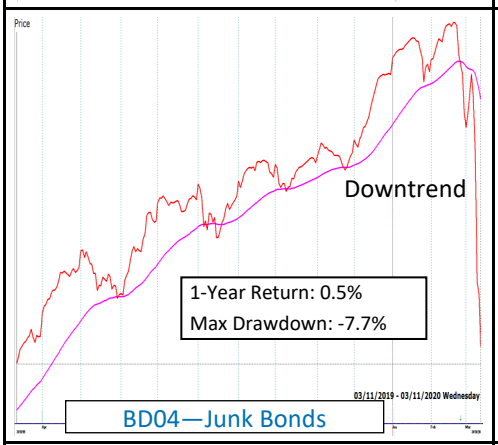
Bond / Income Environment
Overall Assessment

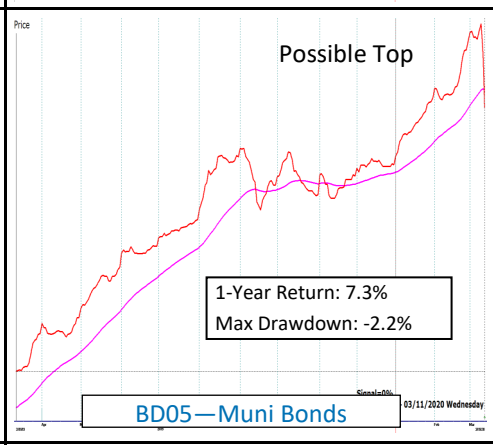
The following one-year charts represent 10 groups that encompass a large portion of the bond / income environment. Each group is an equally-weighted composition of representative mutual funds. Each group is plotted with its 50-Day moving average to help visualize the trend.

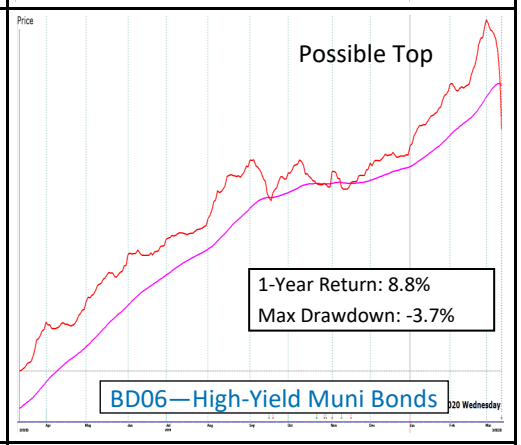


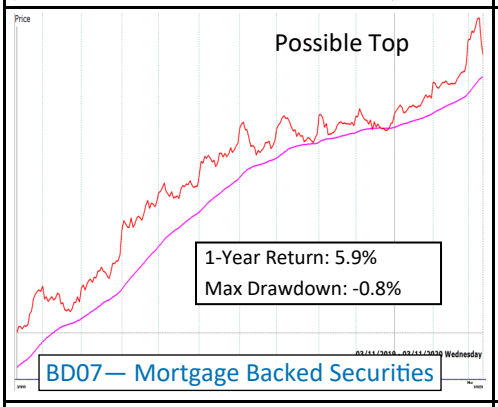


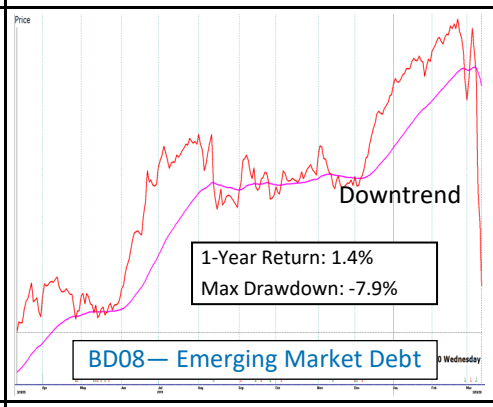


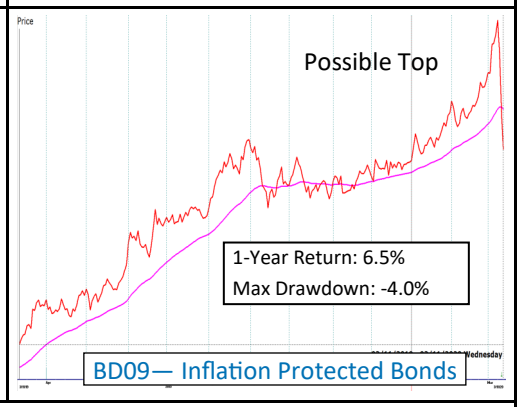


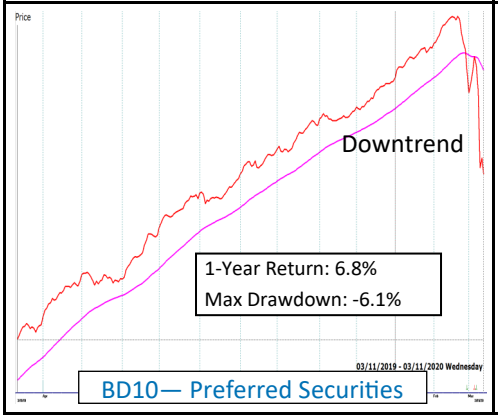












I changed the presentation slightly this month as UPI is less useful during market downtrends. Therefore, I have included Maximum Drawdown on each chart to give you a sense of how far each group has fallen since its peak. All the economic sensitive bond groups have rolled over and are now in downtrends.

The current environment is a high risk environment and the level of risk relative to the potential reward is high. For conservative investors, cash should be considered as an alternative until the volatility has passed.

Equity and Bond / Income Environments
Overall Assessment

Overall Assessment: Risk is elevated in the current market environment as we have witnessed a waterfall decline over a very short time period. While the fundamental backdrop remains strong, the uncertainty surrounding the coronavirus will likely create continued volatility in the stock market. At some point we will get through this uncertain period, but that timeline is unknown.

Dynamic Equity Allocation Guide: The Dynamic Equity Allocation Guide is based on a weight-of-the-evidence approach using the indicators described in the *Market Monitor*. It is designed as a guide of overall market exposure for the equity portion of your portfolio and not an investment recommendation. The guide is best used to confirm your overall exposure to the market based on your personal tolerance for risk and investment approach. The overall equity allocation decreased this month to 53.3%. Previous readings are February 77.5%; January: 83.1%; December: 89.8%; November: 85.6%, October: 69.8%, and September: 93.3%.

Equity Allocation Models	Model Rating	% Equity Allocation
RGB Market Trend Model		8.3%
RGB Market Momentum Model		8.3%
RGB Fundamental Factors Model		20.0%
RGB Credit Conditions Model		16.7%
Model Equity Allocation:		53.3%

The Dynamic Equity Allocation Guide is designed to provide investors overall guidance as to an approximate level of equity market exposure that may be appropriate for consideration for the equity portion of their portfolio as of the date noted. This is not meant to be an investment recommendation nor investment advice for any specific individual. The guide is based on the indicators within the selected categories from the RGB Stock Market Scorecard. Each Scorecard indicator is given a weight based on its current Indicator Rating and then averaged with the other indicators in that group. Each group has an overall 25% weighting. There is no guarantee that the Overall Equity Allocation or any investment in the equity markets will provide positive returns.

Bond / Income Allocation

The bond / income groups are in downtrends or indicating possible topping patterns with the exception of US Treasuries. If you use a moving average as a stop for your bond / income holdings, you would most likely have sold by this point. Cash is an attractive asset class when compared to these other groups. While the returns on money markets are not great, it is best to protect your capital during volatile periods such as this. There will be a great buying opportunity down the road and if we protect our capital now, we can take full advantage of the opportunity when it presents itself. Spend the time now to prepare for the eventual bottom in the market.

General Disclosure

This report expresses the opinions of Robert Bernstein and is provided by RGB Capital Group 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. It has been prepared from data believed to be reliable, but no representation is being made as to its accuracy or completeness. While every effort is made to provide information free from errors, the data is obtained from third parties and, as a result, complete accuracy cannot be guaranteed. Past performance is not a guarantee of future performance. Investing in securities involves risk of loss that clients should be prepared to bear. It is not possible to invest directly in an index.

Description of Indicators

Secular Market Cycle—Secular (long-term) bull markets are defined by above average returns over an extended period of time. Secular bear markets are defined by long-term periods of flat or declining prices (i.e. below average returns). Secular cycles tend to last from 5 to 25 years. Source: www.StockCharts.com

Cyclical Market Cycle—Cyclical bull and bear markets are shorter trends within the context of secular (long-term) trend. There can be several cyclical bull and bear markets within a secular bull/bear market. NDR defines a cyclical bull market as a rise in the DJIA of 30% over 50 calendar days or a rise of 13% after 155 calendar days. A cyclical bear market is a 30% decline over 50 calendar days or a 13% decline after 145 days. Reversals of 30% of the Value Line Geometric Index also qualify. Source: www.StockCharts.com

Short-Term Trend Rating – An indicator designed to identify the status of the stock market's short-term (0-3 weeks) trend. The indicator compares the current price of S&P 500 relative to 5-day moving average, the relationship of the 5-day to the 10-day moving average, and the relationship of 10-day to 39-day moving average. Source: www.StockCharts.com

Intermediate-Term Trend Rating – An indicator designed to identify the status of the stock market's intermediate-term (3 weeks to 6 months) trend. The indicator compares the current weekly price of S&P 500 relative to the 10-week moving average, the relationship of the 10-week to the 30-week moving average, and the relationship of the 30-week and 55-week moving averages. Source: www.StockCharts.com

Long-Term Trend Rating – An indicator designed to identify the status of the stock market's longer-term (>6 months) trend. The indicator incorporates the 50-day moving average of the S&P 500 relative to the 200-day moving average. When the 50-day moving average is above 200-day moving average, the indicator is positive and vice versa. Source: Ned Davis Research

Short-Term Momentum Model – A trend and breadth confirm indicator. History shows the most reliable market moves tend to occur when the breadth indices are in gear with the major market averages. This indicator compares the price of an All-Cap Dollar-Weighted Equity Universe to its 25-day smoothing and its A/D Line relative to a 5-day smoothing. The indicator is positive when both are above their respective smoothings, negative when both are below, and neutral when one is above and one is below. Source: Ned Davis Research

Intermediate-Term Momentum Model – A proprietary diffusion index developed by Ned Davis Research. The indicator is designed to determine the technical health of the market's 157 sub-industry groups (GICS categorizes the market into 11 sectors, 20 industries, and 157 sub-industry groups). Technical health is determined by the direction of each sub-industry's long-term smoothing and the rate of change of the sub-industry's price index. The indicator is positive when more than 79% of the groups are technically healthy, neutral when 56% - 79% are technically healthy, and negative when less than 56% are technically healthy. Source: Ned Davis Research

Long-Term Momentum Model – A buy/sell approach applied to the industry group diffusion index. The indicator is positive when more than 56.5% of the sub-industry groups are technically healthy and negative when less than 45.5 are technically healthy. Source: Ned Davis Research

Economic Model: A proprietary model developed by Ned Davis Research. During the middle of bull and bear markets, understanding the overall health of the economy and how it impacts the stock market is one of the few truly logical aspects of the stock market. When the Economic Model sports a "positive" reading, history (beginning in 1965) shows that stocks enjoy returns in excess of 23.7% per year. Yet, when the Model's reading falls into the "negative" zone, the S&P has lost nearly -22.4% per year. However, it is vital to understand that there are times when good economic news is actually bad for stocks and vice versa. Thus, the Economic Model can help investors stay in tune with where we are in the overall economic cycle. Source: Ned Davis Research

Earnings Model: A proprietary model developed by Ned Davis Research designed to indicate the overall health of corporate earnings. The indicator is based on the slope of the smoothed S&P 500 earnings per share. The indicator turns bullish when the smoothed indicator rises by 1.5% or more from the previous bottom (companies become more profitable) and turns bearish when the indicator falls below 10% or more from the previous peak (companies become less profitable). Source: Ned Davis Research

Monetary Model: A combination of two proprietary monetary models developed by Ned Davis Research. Monetary Model 1 is comprised of 14 indicators and plotted as a composite. Monetary Model 2 is made up of eight monetary-related indicators including money supply, and the bond and commodities markets. Source: Ned Davis Research

Inflation Model: A proprietary model developed by Ned Davis Research designed to identify cyclical changes in the rate of inflation. The Model consists of 22 individual indicators primarily measuring various rates of change of such indicators as commodity prices, the Consumer Price Index (CPI), producer prices, and industrial production. Source: Ned Davis Research

Valuation Model: A composite of two proprietary monetary indicators/models developed by Ned Davis Research. The first valuation indicator reviews the S&P 500 Price-to-Earnings GAAP Ratio relative to normal, expensive, and bargain valuation zones. The second model is a composite of seven indicators designed to reflect stock market valuations based on how various valuation indicators compare to their latest 10-year historical ranges. The seven valuation indicators incorporate earnings yields, inflation, and interest rates. Source: Ned Davis Research

Short-Term Credit Conditions Model: 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. On a short-term basis, junk bonds trending above their 50-day moving average is an indication of a healthy market environment. Source: www.fasttrack.net

Intermediate-Term Credit Conditions Model: 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. Using a 30-day and 126-day moving average cross-over provides a good indication of the intermediate-term credit conditions. Source: www.fasttrack.net

Long-Term Credit Conditions Model: The Chicago Fed National Financial Conditions Credit Subindex indicates positive values when financial conditions are tighter than average, while negative values indicate financial conditions that are looser than average. Source: Federal Reserve Bank Chicago

Short-Term Overbought/Oversold Signal: An indicator utilizing stochastics of the S&P 500 daily chart. %K is set at 14. %D is set at 3. The indicator is positive when %K rises above the 20-level from below. The indicator is negative when %K moves below the 80-level from above. The indicator is neutral when %K moves either above 80 or below 20. Source: www.StockCharts.com

Intermediate-Term Overbought/Oversold Signal: A signal based on the 40-day RSI on the NYSE index. The indicator is positive when the RSI falls below the 40-level and then reverses. The indicator is negative when the RSI moves above 60 and then reverses. The indicator is neutral when the RIS moves into the 45.5-57.5 range. Source: Ned Davis Research

Long-Term Overbought/Oversold Signal: An indicator utilizing the VIX and Z-Score bands designed to identify turning points in the market after overbought/oversold conditions are present. Source: Ned Davis Research

Short-Term Sentiment Model: A proprietary sentiment model developed by Ned Davis Research. The model-of-models is comprised of 18 independent sentiment indicators designed to indicate when market sentiment has reached an extreme from a short-term perspective. Historical analysis indicates that the stock market's best gains come after an environment has become extremely negative from a sentiment standpoint. Conversely, when sentiment becomes extremely positive, market returns have been subpar. Source: Ned Davis Research

Intermediate-Term Sentiment Model: A proprietary sentiment model developed by Ned Davis Research designed for the intermediate-term time frame. This model-of-models includes seven different sentiment indicators including advisory sentiment, valuation, market breadth, and the indicators of the short-term sentiment model. Source: Ned Davis Research

Long-Term Sentiment Model: A proprietary sentiment model developed by Ned Davis Research designed for the long-term time frame. This model-of-models is comprised of six independent sentiment indicators designed to indicate when market sentiment has reached an extreme from a long-term perspective. Source: Ned Davis Research

Description of Indices

S&P 500 Composite Index: The Standard and Poors 500 Index (S&P 500) is a capitalization weighted index of 500 stocks representing all major domestic industry groups. Historical returns provided by Ned Davis Research.