Market Monitor

Version 2019-05

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May 9, 2019

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 relative calm in the stock markets over the last few months was rattled this week by renewed trade tensions between the U.S. and China. Stock prices rose and fell with every news report or tweet. This increase in volatility has impacted my short-term view of the market, but has not changed the longer-term trend.

Many of the domestic stock market indices entered this month near important levels of resistance, including the S&P 500 (see chart to the right). In addition, the market was starting to become a bit extended on a short- and intermediate-term basis. So the table was set for some sort of pull back and just waiting for a trigger event. Well, President Trump pulled the trigger over the weekend by tweeting that he would increase tariffs from 10% to 25% on roughly $200 billion of imports from China this Friday. Market futures are down this morning as I write this as China is threatening retaliatory measures if the increased tariffs go into effect as planned.

While the short-term technical environment has weakened, the weight of the evidence continues to point to a healthy market environment. Intermediate- and long-term technical indicators, as well as our fundamental models, point to a healthy market environment. In addition, junk bonds, which tend to reflect investors appetite for risk, have moved down only slightly over the last few days. This is an indication that investors are not extremely concerned about the recent drop in stock market prices. However, if the stock market continues to decline, many of the economically sensitive bonds (including junk bonds) would likely decline as well.

Some increased attention is warranted as the Early Warning Model has been waving a cautionary flag recently. A definitive break above the major resistance zones (the 2018 highs on the S&P 500 and the 2019 interim highs on the S&P 600 Index (small cap stocks)) would indicate the uptrend has resumed.

The short-term market environment will likely be dictated by the outcome of the U.S. and China trade negotiations being held Thursday and Friday of this week. If a trade deal is reached, the market will likely resume its trend higher. However, if negotiations fall apart, risk management will be become more critical.

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		Bull Market	
Trend Analysis:			
Short-Term Trend Rating	Sell	Negative	NA
Intermediate-Term Trend Rating	Buy	Positive	NA
Long-Term Trend Rating	Buy	Positive	9.6%
Momentum Analysis:			
Short-Term Momentum Model	Sell	Negative	-20.1%
Intermediate-Term Momentum Model	Buy	Mod Positive	13.8%
Long-Term Momentum Model	Buy	Positive	15.7%
Fundamental Analysis:			
Economic Model	Buy	Positive	9.9%
Earnings Model	Buy	Positive	11.9%
Monetary Model	Buy	Positive	19.0%
Inflation Model	Buy	Positive	13.3%
Valuation Model	Hold	Neutral	2.2%
Credit Conditions Analysis:			
Short-Term Credit Conditions Model	Buy	Positive	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	Hold	Neutral	NA
Intermediate-Term Overbought/Oversold Signal	Sell	Negative	-4.1%
Long-Term Overbought/Oversold Signal	Buy	Positive	NA
Investor Sentiment Analysis:			
Short-Term Sentiment Model	Hold	Neutral	-8.3%
Intermediate-Term Sentiment Model	Hold	Neutral	-11.1%
Long-Term Sentiment Model	Sell	Negative	-2.7%
The Weight of the Evidence Average:			**3.8%**
S&P 500 average gain/annum from 11/16/1979:			**8.8%**

(Source: Ned Davis Research)

Summary: The market environment is starting to deteriorate on a short-term basis. The most notable differences in the Stock Market Scorecard, when compared to last month, are that both short-term trend and short-term momentum indicators have turned negative.

Stock Market Environment
Primary Cycle Analysis

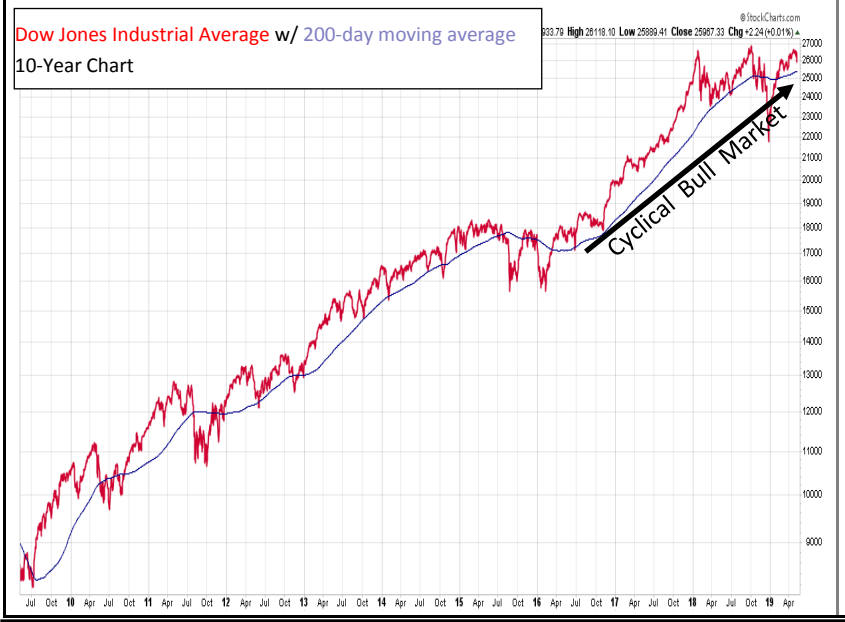
The stock market tends to move in cycles that tend to repeat over time and are generally associated with the overall business cycle.

- **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) trend. 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 Industiral 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 Cycle: The long-term bull market that started in 2009 remains in tact.



Bull Market

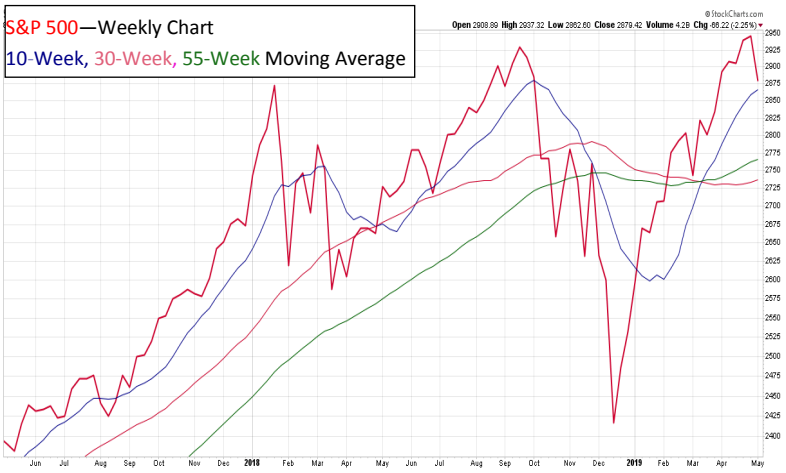
Cyclical Cycle: The cyclical (short-term) trend of the market remains up.

Report produced with data through 5/8/2019

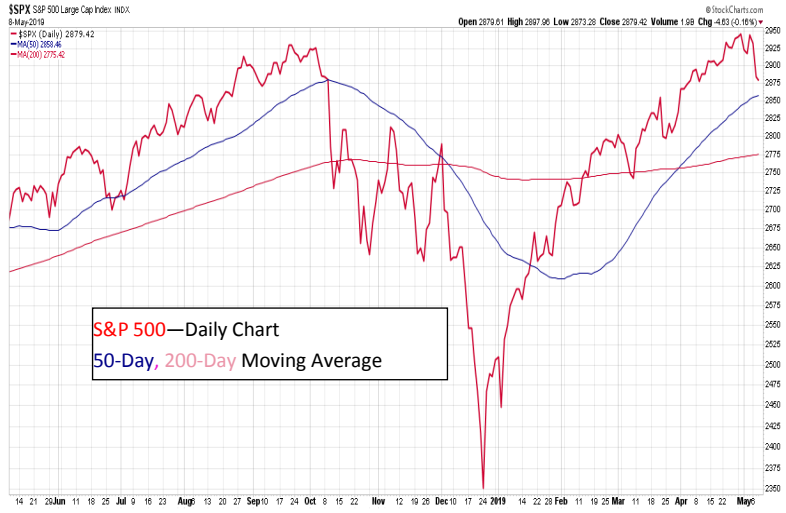
Stock Market Environment
Trend Analysis—One Year Charts

Trend Analysis:	Signal	Indicator	Historical Return
Short-Term Trend Rating	Sell	Negative	NA
Intermediate-Term Trend Rating	Buy	Positive	NA
Long-Term Trend Rating	Buy	Positive	9.6%

The short-term trend of the S&P 500 turned down over the last two weeks. The index is now in a decline trending below both its down trending 5-day and 10-day moving averages. The index closed today right at its 39-day moving average.



The intermediate-term trend, based on a weekly chart of the S&P 500, is still positive. The index price is falling but remains above its rising 10-week moving average. The 30-week and 55-week moving averages have also bottomed and turned up.



The long-term trend of the market remains up with the index above both its rising 50-day and the 200-day moving averages.

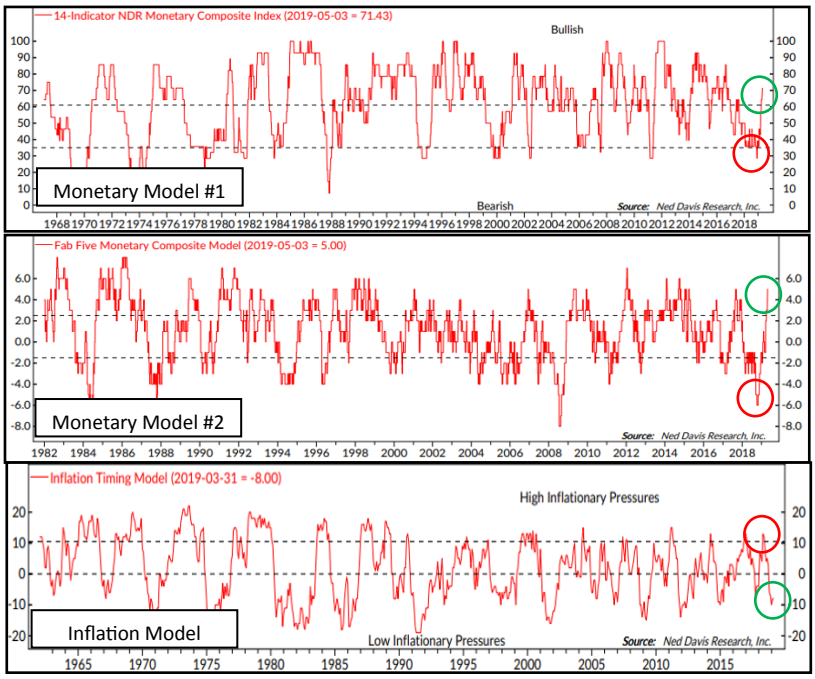
Stock Market Environment
Momentum / Fundamental Analysis

	Signal	Indicator	Historical Return
Momentum Analysis:			
Short-Term Momentum Model	Sell	Negative	-20.1%
Intermediate-Term Momentum Model	Buy	Mod Positive	13.8%
Long-Term Momentum Model	Buy	Positive	15.7%

There was some movement in the momentum indicators when compared to last month. Not surprisingly, the Short-Term Momentum Model has turned negative with the recent downward price pressure in the market. The Intermediate-Term Momentum Model, however, popped up to Moderately Positive from Neutral last month with approximately 78% of the 157 sub-industry groups tracked by this model now in a positive configuration.

	Signal	Indicator	Historical Return
Fundamental Analysis:			
Economic Model	Buy	Positive	9.9%
Earnings Model	Buy	Positive	11.9%
Monetary Model	Buy	Positive	19.0%
Inflation Model	Buy	Positive	13.3%
Valuation Model	Hold	Neutral	2.2%

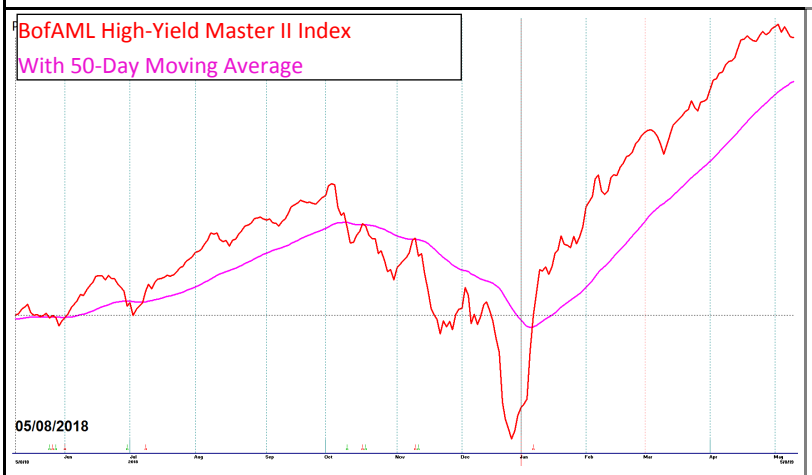
The fundamental indicators are green across the board with the exception of the Valuation Model. The Valuation Model, which is the composite of two NDR models, is a bit conflicted with one model indicating an expensive market environment and the other indicating an undervalued market environment. They can't both be right and that is the value of a weight of the evidence approach.



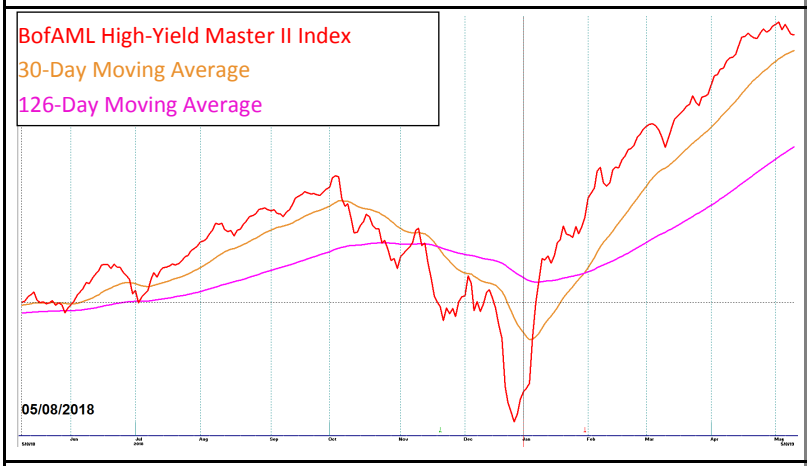
What I believe has changed significantly from the end of 2018 to now is the accommodative monetary policy and low inflation environment. Both of these are supportive of a positive economic environment and could be supporting a positive stock market. Note the negative values (red circles) at the end of 2018 and the swift change to a much more positive environment (green circles) in 2019 .

Stock Market Environment
Credit Conditions Analysis

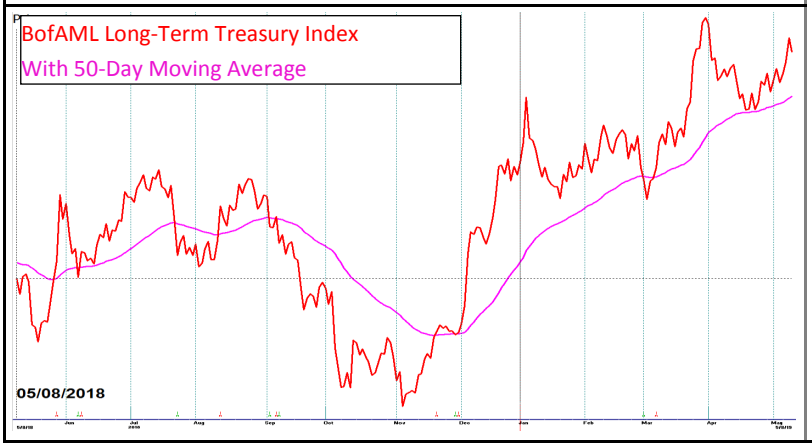
Junk bonds are one of the best indicators of overall market sentiment. When risk rises, junk bond prices fall as investors demand a higher yield to compensate them for the additional risk (remember bond prices fall as yields rise). When risk subsides, junk bond yields tend to fall given more favorable 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.



The recent downward price pressure in stocks is hardly noticeable in the BofAML High-Yield Master II Index. It remains well above its 50-day moving average.



Our intermediate-term indicator continues to indicate a positive market environment. The BofAML High-Yield Master II Index remains above the rising 30-day and 126-day moving averages.



When market risk rises, it is often accompanied with a flight to quality (i.e. US Treasuries) which drives Treasury yields lower and Treasury prices higher. While Treasury prices have increased over the last few weeks, I don't see a flight to safety at this point.

Summary: The junk bond indicator remains positive, indicating investors continue to be willing to hold risk assets. The long-term credit conditions index (not shown) continues to indicate an accommodative environment with credit conditions looser than the long-term average. Overall, credit conditions remain positive.

Stock Market Environment
Early Warning Model

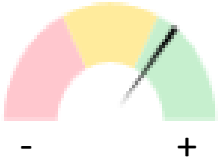
The Early Warning Model is designed to give investors an indication when the market has gone too far in one direction and whether it's ripe for reversal in trend based on overbought / oversold and investor sentiment indicators. Like a rubber band that has been stretched too far, the market tends to snap 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

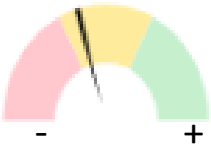


The overbought / oversold indicators have been waving a cautionary flag lately and we may have entered the preliminary stages of a corrective pull back.

Investor Sentiment

Short-term

Intermediate-term



Long-term

Investor sentiment has become quite optimistic over the last several months which is generally associated with a higher probability of a pullback. Historical analysis indicates that the best gains come after the investor sentiment become extremely negative (which is represented as a positive indicator reading on our gauges to the left).

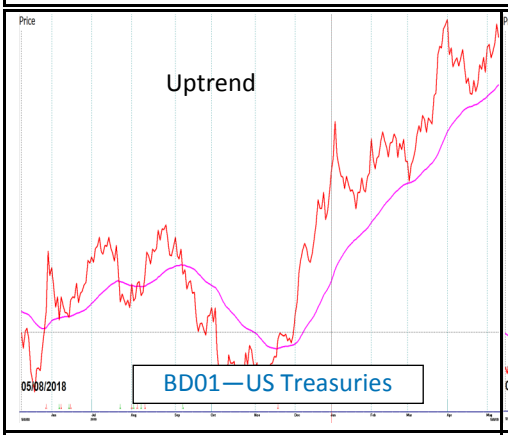
Summary

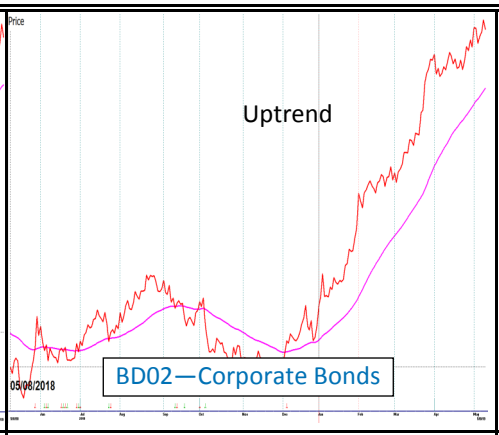
Mean Reversion Potential	High
New Investment Rating	Hold

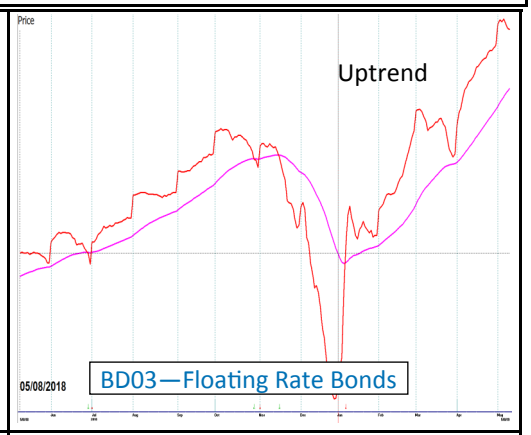
The early warning board is indicating a higher probability of a mean-reversion move which may have started this week. If you have new money to put to work in the market, wait for the current overbought condition to work off and investor sentiment to pull back.

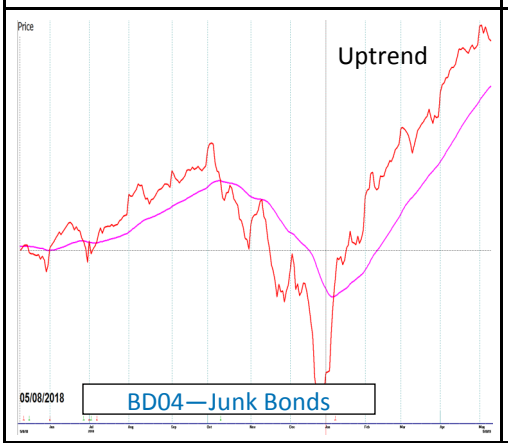
Bond / Income Environment
Overall Assessment

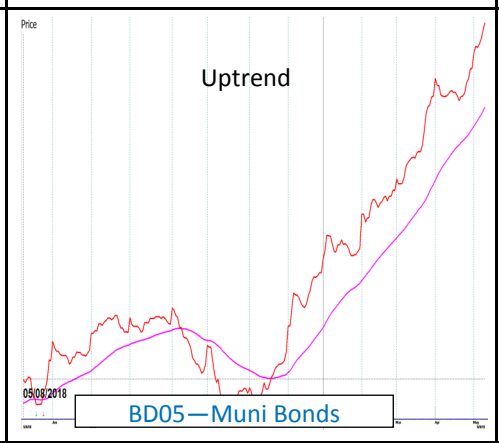
The following charts represent 10 groups that encompass a large portion of the bond / income environment. Each group is the average of 10 large mutual funds and plotted with its 50-day moving average to help us visualize the trend.

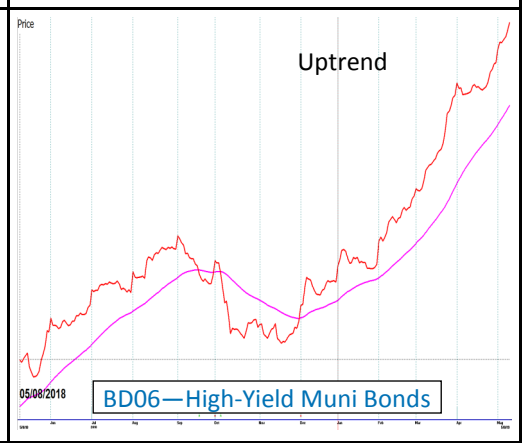


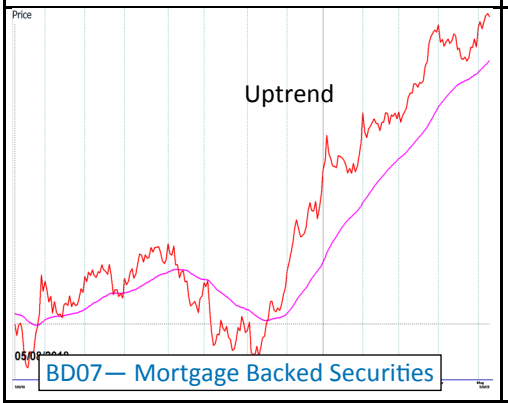


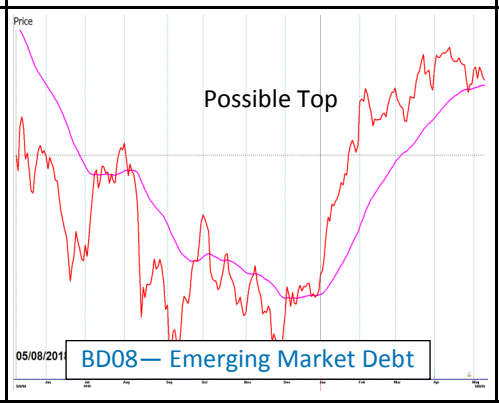


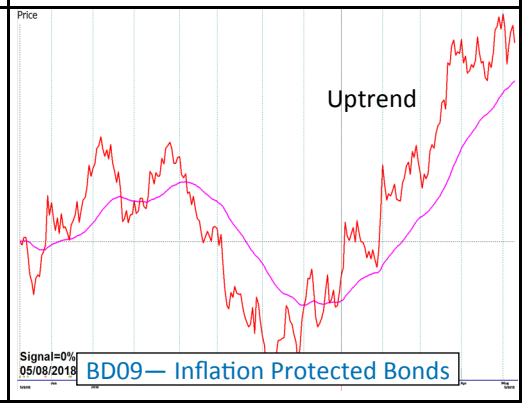


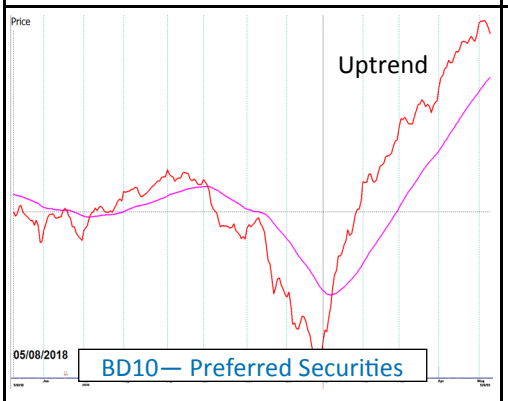












All of the bond groups, with the exception of Emerging Market Debt (BD08), remain in uptrends. Preferred Securities (BD10), has the best risk-adjusted return (UPI), absolute return, lowest draw-down and lowest downside volatility (UI) of the 10 bond/income groups for the year-to-date-period.

Municipal Bonds (BD05) and High-Yield Muni Bonds (BD06) are also providing excellent risk adjusted returns in the current environment. When risk elevates in the stock market, these groups tend to trend up.

Economic sensitive bonds (BD03, BD04, BD10) have pulled back just a little bit during the past few trading days, but the declines are relatively small indicating investors are not overly concerned with the recent increase in stock market volatility. Emerging markets, however, may be in the process of putting in a top.

Equity and Bond / Income Environments
Overall Assessment

Overall Assessment: The weight of the evidence continues to point to a positive market environment. While the technical (trend and momentum) environment is starting to show some weakness as a result of selling pressures this week, the overall environment remains positive. The fundamental backdrop and credit environment continue to point to a positive market environment.

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 to overall market exposure for the equity portion of your portfolio and is 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 dropped from 91.7% last month to 78.1% this month reflecting the short-term weakness in the market.

Equity Allocation Models	Model Rating	% Equity Allocation
RGB Market Trend Model		16.7%
RGB Market Momentum Model		13.9%
RGB Fundamental Factors Model		22.5%
RGB Credit Conditions Model		25.0%
Model Equity Allocation:		78.1%

Bond / Income Allocation

The bond / income environment remains positive with all groups providing positive year-to-date returns. Remain invested in bond/income groups that are trending up. If the stock market environment continues to weaken, the economic sensitive bond groups (Floating Rate Bonds-BD03, Junk Bonds-BD04, Emerging Market Bonds-BD08, and Preferred Securities-BD10) will likely start to trend down as well. Set stops to limit downside risk.

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.