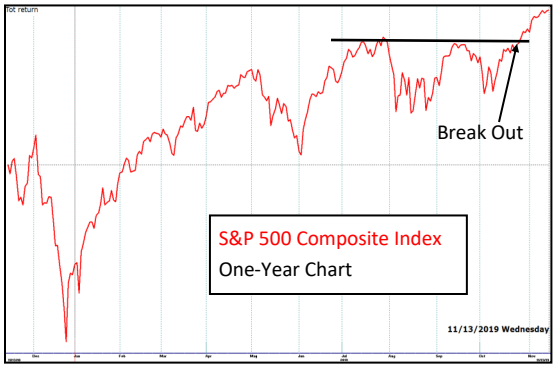
Market Monitor

Version 2019-11

Written by Rob Bernstein

November 14, 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 market environment is showing signs of improvement. Large-cap stocks broke decisively above the top of a six-month trading range a couple of weeks ago and the S&P 500 closed at an another all-time high yesterday. International stocks have also broken decisively higher and recently notched new 2019 highs. Domestic small- and mid-cap stocks are near the top of multi-month trading ranges and showing signs improvement. Defensive stock groups, such as consumer staples, REITs and utilities, have underperformed in recent weeks as investors move out of defensive groups into riskier asset classes. Value stocks, which have underperformed for the last 2.5 years, are showing signs of life as they start to outperform growth stocks. The Fed, that just one year ago indicated a strong likelihood of raising rates three to four times during 2019, has in fact reduced rates three times this year and recently indicated to the market that they don't have plans to increase rates for some time. Investors that worried about a yield curve inversion just two months ago are starting to see bond spreads widen. According to the Bespoke, there are very few times over the last decade that the yield curve has steepened so fast over such a short period of time. Add in a potential phase 1 trade deal with China and the future economic environment is looking, well...not so bad.

While there is certainly things that will create volatility along the way, such as impeachment proceedings that started this week and potential negotiation setbacks between the U.S. and China, these may end up being good buying opportunities.

The outlook for bond and income sectors is not as rosy. Treasury yields, which reached a low of 1.47% in early September, are now up to 1.88%, an almost 28% increase in a little over two months. At this point, we don't know if this was just a recovery in rates that went too far too fast, or the start of a new trend. While most bond groups have gone sideways during this time, a continuation of this trend of higher rates will certainly put downward pressure on interest rate sensitive groups (i.e. Treasuries, Corporate bonds, municipal bonds). Some of the economic sensitive bond groups (such as preferred securities and junk bonds) should hold up better if the economic environment continues to strengthen.

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	Buy	Positive	NA
Intermediate-Term Trend Rating	Buy	Positive	NA
Long-Term Trend Rating	Buy	Positive	9.6%
Momentum Analysis:			
Short-Term Momentum Model	Hold	Neutral	14.3%
Intermediate-Term Momentum Model	Buy	Moderately Positive	13.5%
Long-Term Momentum Model	Buy	Positive	15.5%
Fundamental Analysis:			
Economic Model	Buy	Positive	9.4%
Earnings Model	Hold	Neutral	10.9%
Monetary Model	Buy	Positive	10.4%
Inflation Model	Buy	Positive	10.4%
Valuation Model	Sell	Negative	1.6%
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	Hold	Neutral	10.2%
Long-Term Overbought/Oversold Signal	Sell	Negative	NA
Investor Sentiment Analysis:			
Short-Term Sentiment Model	Sell	Negative	-8.0%
Intermediate-Term Sentiment Model	Sell	Negative	-11.8%
Long-Term Sentiment Model	Sell	Negative	-3.2%
The Weight of the Evidence Average:			**6.4%**
S& P 500 average gain/annum from 11/16/1979:			**8.8%**

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: There have been some notable changes to the scorecard when comparing it to the scorecard published in last month's *Market Monitor*. Most notably, the trend of the market has improved and the early warning signals (overbought/oversold and investor sentiment) have turned down indicating that probabilities for a pullback are elevated. We will explore all of these on the next few pages.

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

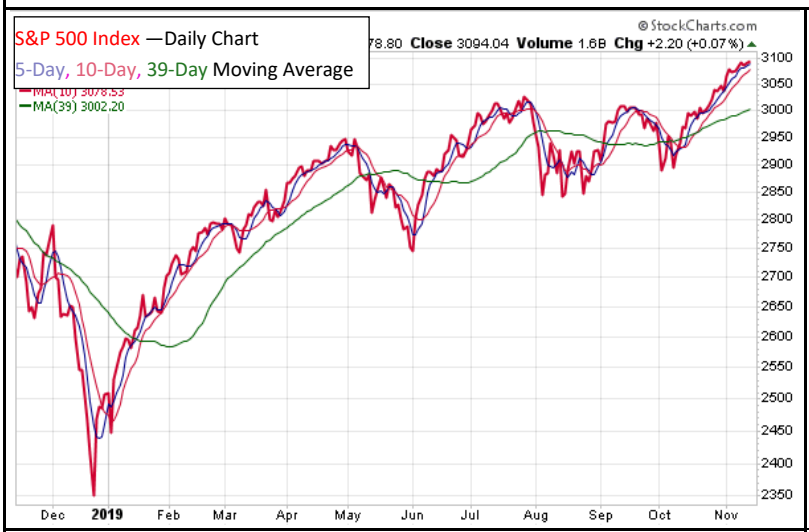
Secular Market Cycle: The secular bull market that started after the 2008 Financial Crisis remains in tact.

Bull Market

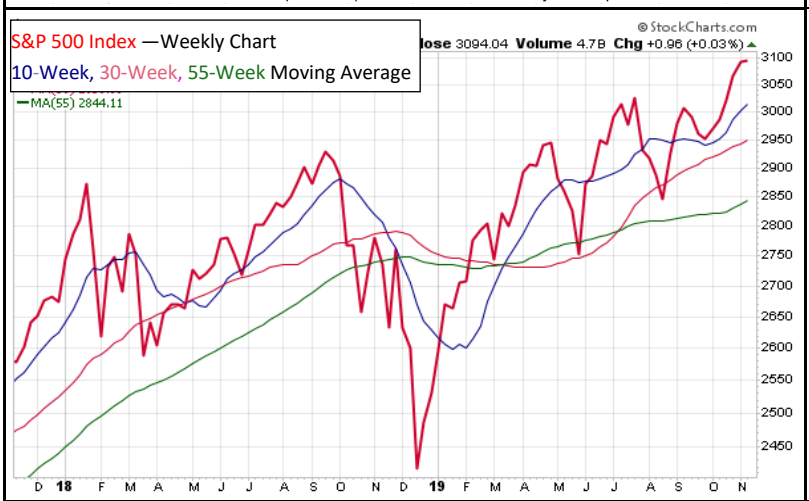
Cyclical Market Cycle: The shorter-term, cyclical cycle remains in an uptrend as well. Looking at the 200-day moving average of the Dow Jones Industrial Average helps us to visualize the longer-term trends of the market. The recent uptick in the 200-day moving average confirms this trend.

Stock Market Environment
Trend Analysis — One-Year Charts

Trend Analysis:	Signal	Indicator	Historical Return
Short-Term Trend Rating	Buy	Positive	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 Index is clearly up. The index is trending above its rising 5-Day, 10-Day and 39-Day moving averages.



We see a similar pattern on the weekly chart that we use for our intermediate-term trend analysis. The S&P 500 Index is trending above its rising 10-Week, 30-Week and 55-Week moving averages.

The long-term trend is positive and improving with the S&P 500 Index trending solidly above its 50-Day moving average which recently turned up after spending the last few months trending sideways. The 200-Day moving average has also continued to rise.

Clearly the trend is up across all time frames.

Stock Market Environment
Momentum / Fundamental Analysis

Momentum Analysis:	Signal	Indicator	Historical Return
Short-Term Momentum Model	Hold	Neutral	14.3%
Intermediate-Term Momentum Model	Buy	Moderately Positive	13.5%
Long-Term Momentum Model	Buy	Positive	15.5%

Momentum has made some improvements over the last month. The most obvious change is that short-term momentum went from a negative reading last month to neutral this month. However, taking a close look at the indicators, the short-term momentum indicator while providing a neutral reading, is just shy of being positive. In addition, while the intermediate– and long-term momentum indicator readings didn't change this month, there was improvement with both of these indicators. The bottom line is that momentum is starting to improve across all time frames, indicating that there is some 'oomph' behind this recent rally.

Fundamental Analysis:	Signal	Indicator	Historical Return
Economic Model	Buy	Positive	9.4%
Earnings Model	Hold	Neutral	10.9%
Monetary Model	Buy	Positive	10.4%
Inflation Model	Buy	Positive	10.4%
Valuation Model	Sell	Negative	1.6%

Economic Model: After declining for several months, the economic model has ticked back up and continues to provide a bullish indication.

Earnings Model: I have updated the earnings model to be a composite of four different earnings models to reduce our reliance on a single model. Three of the four models are indicating a decline in earnings growth over the last several months. While growth has slowed, earnings are still generally positive.

Monetary Model: Monetary conditions remain favorable.

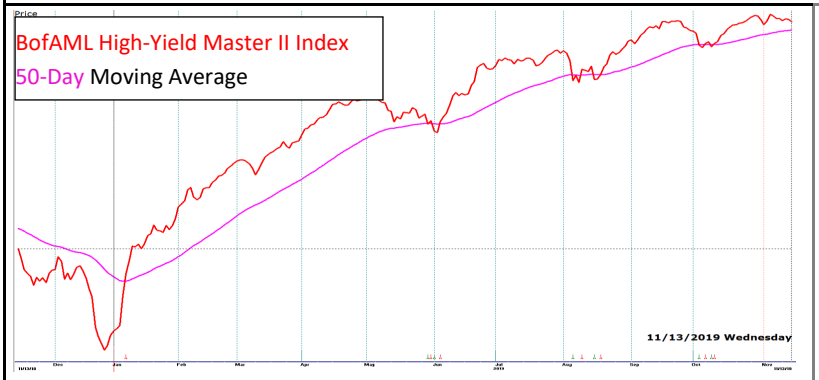
Inflation Model: The inflation model continues to indicate that there is extremely low inflation pressures in the current environment.

Valuation Model: I recently changed the valuation model to be a composite of five individual valuation indicators. The purpose of this change is to reduce the reliance on any single model. Currently, four of the five valuation models are indicating an overvalued market.

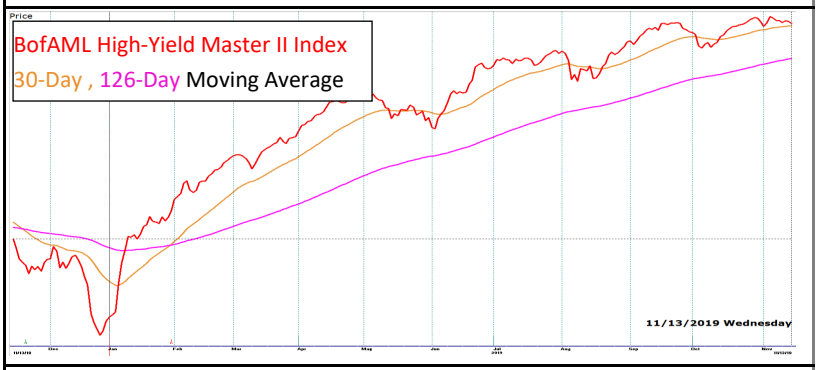
Stock Market Environment
Credit Conditions Analysis — One-Year Charts

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.

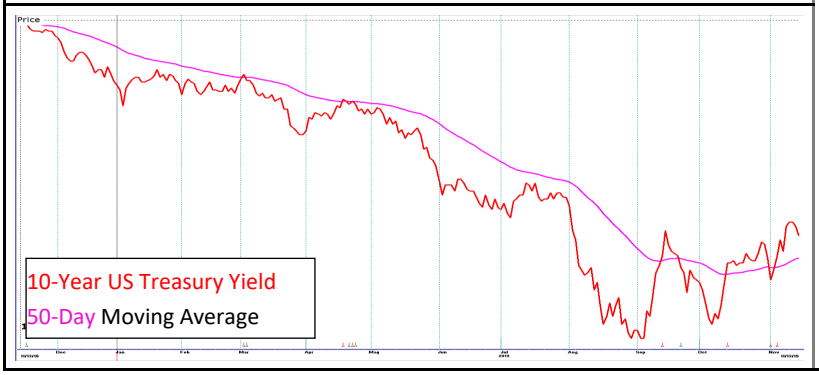
Credit Conditions Analysis:	Signal	Indicator	Historical Return
Short-Term Credit Conditions Model	Buy	Positive	NA
Intermediate-Term Credit Conditions Model	Buy	Positive	NA
Long-Term Credit Conditions Model	Buy	Positive	NA



Short-term Credit Conditions: The BofAML High-Yield Master II Index is above its 50-Day moving average. While the current trend is not exceptionally strong, it remains positive and is a good sign for the short-term market environment.



Intermediate-Term Credit Conditions: The intermediate-term trend of junk bonds remains positive. The index is above both the rising 30-Day and 126-Day moving averages.



US Treasury Yields: The 10-Year US Treasury Yield is starting to rise (along with its 50-day moving average) but does not appear to be a a flight to safety. Therefore, it is not significant in our overall analysis of the junk bond indicator at this time.

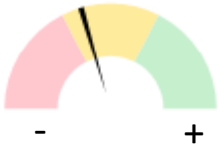
Summary: The junk bond indicator is positive on both a short- and intermediate-term basis. Long-term credit conditions, according to the Chicago Fed National Financial Conditions Credit Sub-Index (not shown), also remain positive.

Stock Market Environment
Early Warning Model

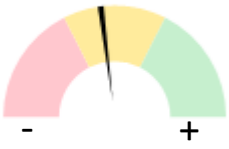
The Early Warning Model is designed to give investors an indication when the market has gone too far in one direction and whether it's ripe for reversal in trend based on overbought / oversold and investor sentiment indicators. Like a rubber band that has been stretched too far, the market tends to snap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

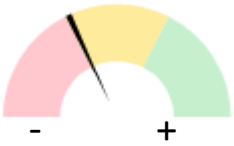
Short-term



Intermediate-term



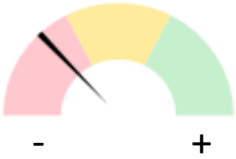
Long-term



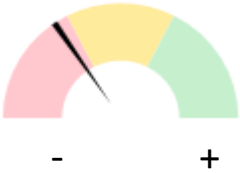
The overbought / oversold indicators are mostly neutral indicating that near-term market movements are unlikely to be caused by an overbought condition.

Investor Sentiment

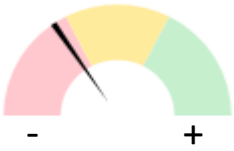
Short-term



Intermediate-term



Long-term



However, investors have turned more optimistic across all three time frames. As a contrarian indicator, this has the gauges in the red and warning that a potential pull back from the recent rally is elevated. I don't think this is an extreme condition at this point, and investor optimism could remain positive for a period of time without a significant pullback.

Summary

Mean Reversion Potential — Moderately High

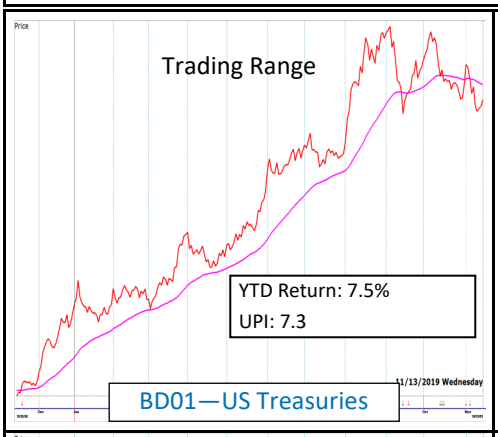
New Investment Rating — Hold

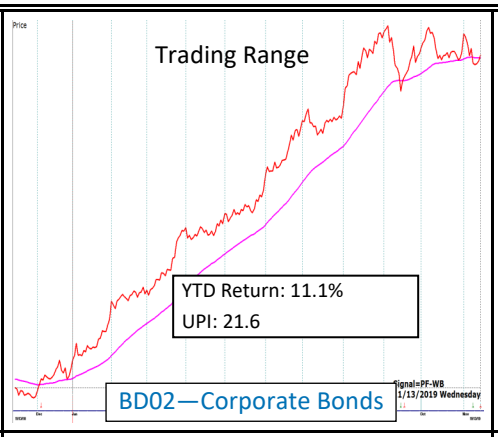
Last month the Early Warning Model did a good job of indicating that a short-term rally was probable and that is what happened last month. Now the indicators are indicating that a potential correction is becoming more likely.

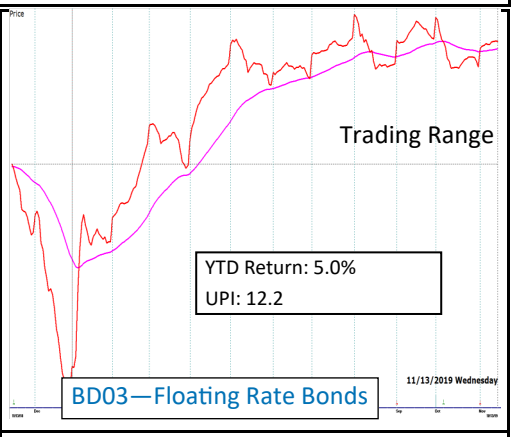
The Early Warning Model is a tool designed to provide an indication when the market has moved too far in one direction, which in our view, means the probability of a counter trend rally is above average. The Mean Reversion Potential, based on the trend reversal data displayed, is a belief that prices 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.

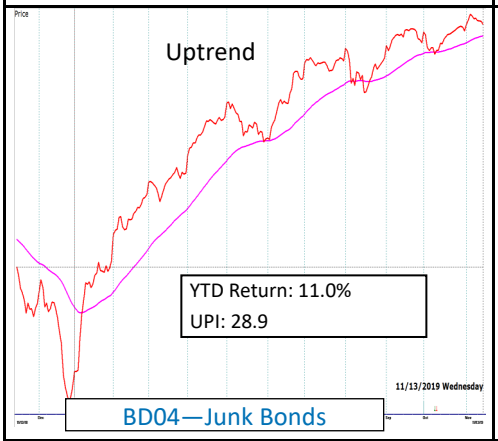
Bond / Income Environment
Overall Assessment

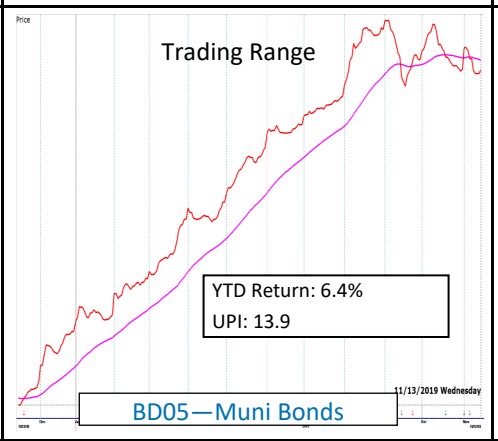
The following one-year charts represent 10 groups that encompass a large portion of the bond / income environment. Each group is an equally-weighted composition of representative mutual funds. Each group is plotted with its 50-Day moving average to help visualize the trend.

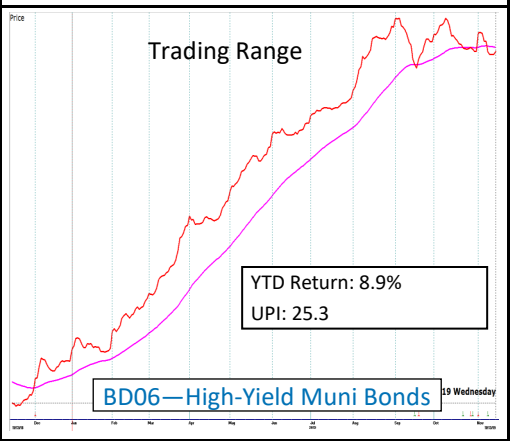


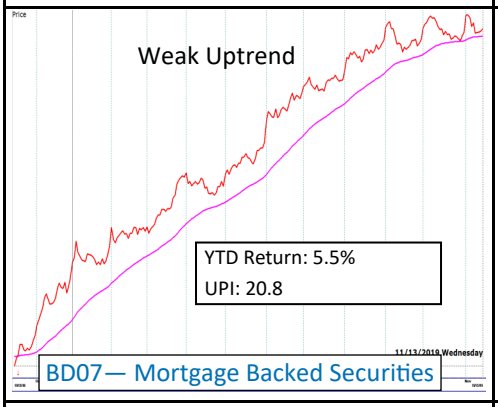


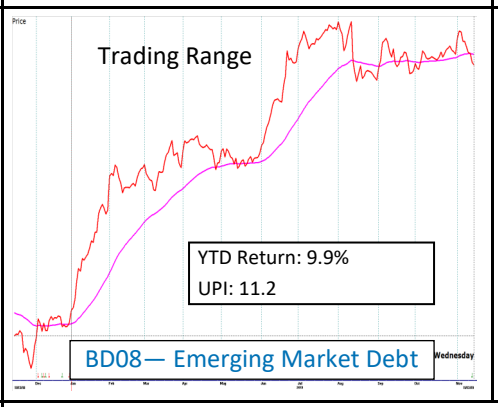


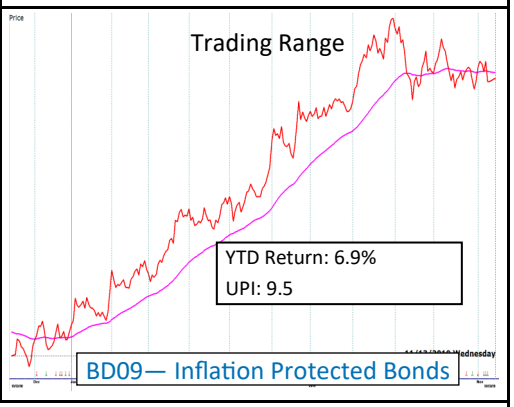


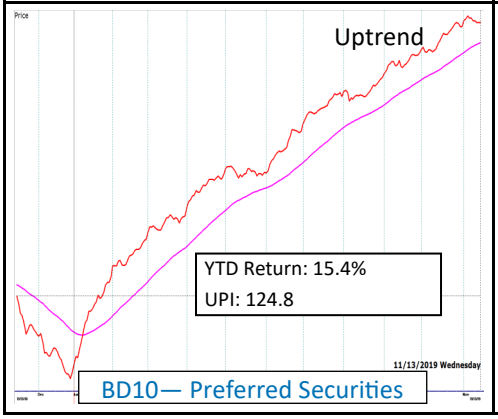












Many of the bond and income groups have entered into trading ranges or consolidation patterns, as can be witnessed by their flat 50-day moving averages. The recent rise in interest rates is creating a headwind for interest rate sensitive groups. If rates climb higher, these groups will likely rollover and start to decline.

The groups that continue to provide some upside potential include B04—Junk Bonds and BD10-Preferred Securities that are both sensitive to interest rates but also overall economic conditions.

Equity and Bond / Income Environments
Overall Assessment

Overall Assessment: The overall market environment appears healthy with strong trends and improving momentum. Credit conditions remain positive and fundamentals remain strong. While events, such as a setback in the U.S.—China trade negotiations and an ongoing impeachment process may create periods of volatility, I believe the market is generally in good shape as we head into a seasonably strong period for the market. I think we could see some potential downside pressure in the bond world if interest rates continue to climb higher.

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 increased this month to 85.6%. Previous readings are October: 69.8%, September: 93.3%; August: 60%; and July: 97.5%.

Equity Allocation Models	Model Rating	% Equity Allocation
RGB Market Trend Model		25.0%
RGB Market Momentum Model		18.1%
RGB Fundamental Factors Model		17.5%
RGB Credit Conditions Model		25.0%
Model Equity Allocation:		85.6%

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

Some of the strong risk-adjusted returns that have been provided by the bond and income groups have waned. For example, high-yield municipal bonds (BD06), which were providing some of the best risk-adjusted returns year-to-date, have trended sideways over the last two months. While these groups haven't declined, this might be an opportunity to upgrade some of your holdings in these groups to the more economically sensitive groups that are more likely to continue trending up if the overall economy stays strong. These groups include preferred securities (BD10) and junk bonds (BD04).

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.