Market Monitor

Version 2021-02

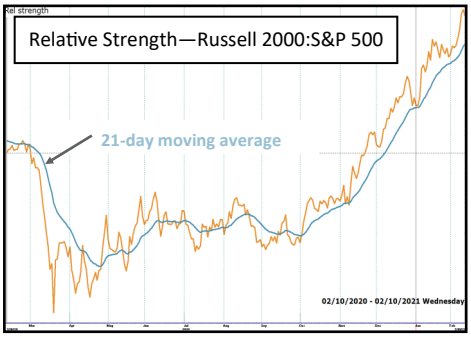
Written by Rob Bernstein

February 11, 2021

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.

If you would like to learn how to make the most of the *Market Monitor* newsletter please watch the webinar I provided last year. Click here to watch recording. If you would like to download a copy of the presentation, click here.

After a strong uptrend in the stock market that started last November, the stock market pulled back slightly heading into the end of January. The S&P 500 Index pulled back 3.7% over the last four trading days in January, but quickly recovered that decline during the first part of February. The S&P 500 Index is up 5.3% month-to-date. The Russell 2000 Index (small-cap stocks) pulled back 4.4% heading into the end of January but has recovered that decline and then some. The Russell 2000 Index is up 10.1% so far this month.



Small-cap stocks have been outperforming most other segments of the market since last October. The chart to the right shows the relative performance of the Russell 2000 Index compared to the S&P 500 Index. The upward sloping line indicates that small-cap stocks are outperforming large-cap stocks and the trend isn't slowing down. This is generally a positive sign for the stock market as it is an indication that investors are willing to invest in this riskier segment of the market.

Also driving stock prices higher are a rise in commodity prices. Commodities are in a strong uptrend (see page 5) which tends to be inflationary as higher commodity prices drive consumer prices higher. As commodity prices rise, so do treasury bond yields. Rising yields cause bond prices to fall driving investors out of bonds and into stocks and commodities. The current scenario is described as Stage IV of the business cycle as illustrated by Martin Pring in his book, *The All Season Investor.* Stage IV tends to be bullish for stocks and commodities and bearish for interest rate sensitive bonds, such as Treasury bonds.

However, rising bond yields provide some challenges to risk-averse investors as interest rate sensitive bond prices start to decline. Economic sensitive bond groups, on the other hand, tend to do well during this period of the business cycle as prices in these segments are influenced more by economic activity and overall default risk (which tends to remain low during periods of economic growth), than interest rates.

COVID-19 cases, hospitalizations and deaths are declining. COVID-19 vaccine distribution is improving. Both of these factors will have a positive impact on consumer spending and therefore, corporate profits. While there are always concerns in the market, I think the weight-of-the evidence points to a positive stock market environment.

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	9.5%
Momentum Analysis:			
Short-Term Momentum Model	Buy	Positive	27.3%
Intermediate-Term Momentum Model	Buy	Moderately Positive	13.6%
Long-Term Momentum Model	Buy	Positive	15.5%
Fundamental Analysis:			
Economic Model	Hold	Neutral	3.9%
Earnings Model	Sell	Negative	1.0%
Monetary Model	Sell	Neutral	12.7%
Inflation Model	Sell	Neutral	-5.0%
Valuation Model	Sell	Negative	-2.1%
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	10.1%
Long-Term Overbought/Oversold Signal	Buy	Positive	NA
Investor Sentiment Analysis:			
Short-Term Sentiment Model	Hold	Neutral	8.6%
Intermediate-Term Sentiment Model	Hold	Neutral	13.1%
Long-Term Sentiment Model	Sell	Negative	-1.9%
		The Weight of the Evidence Average:	8.16%
		S&P 500 average gain/annum from 11/16/1979:	9.11%

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 Fundamental Analysis is sending a cautionary signal, but the Trend, Momentum and Credit sections suggest a positive market environment. The weight-of-the-evidence continues to point to a positive market environment.

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 long-term (secular) trend of the market is up. The current secular bull market started in March 2009.

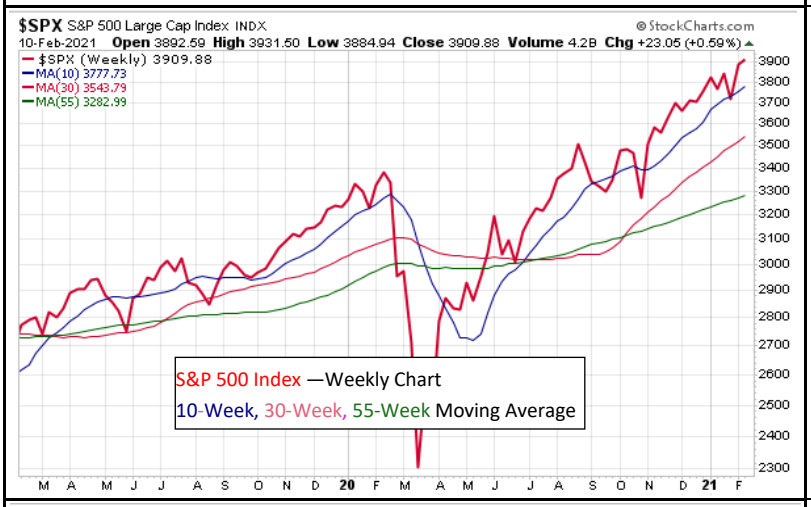
Bull Market

Cyclical Market Cycle: The cyclical bull market that started after the pandemic induced selloff, remains positive.

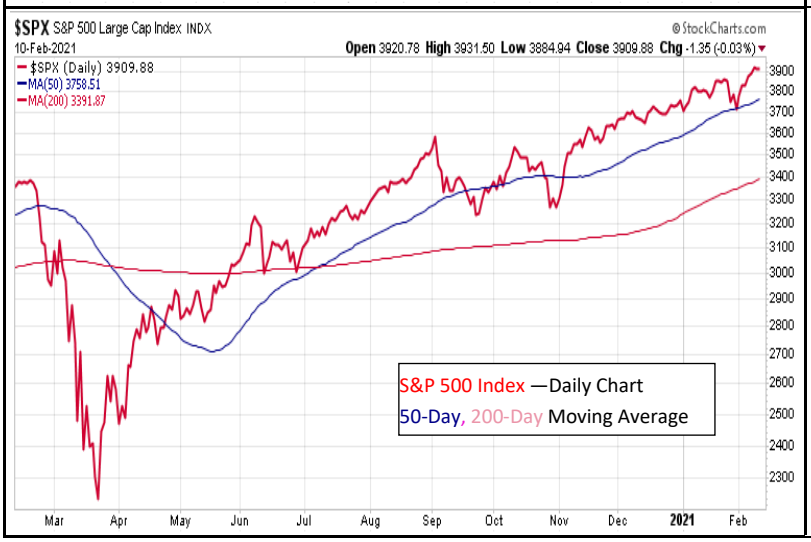
Stock Market Environment
Trend Analysis — One-Year Charts

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	9.5%

Short-Term Trend: The S&P 500 Index resumed its short-term uptrend after a brief downtrend at the end of January. The index is currently above its 5-Day, 10-Day and 39-Day moving averages and all three moving averages are trending up. This is a bullish configuration.



Intermediate-Term Trend: The intermediate-term trend of the market is also up. The weekly chart of the S&P 500 Index remains comfortably above its 10-Week, 30-Week and 55-Week moving averages, which are all trending up. The sell off at the end of January, barely registers on this weekly chart.



Long-Term Trend: The long-term trend of the market remains up. The S&P 500 Index is trending above its rising 50-day and 200-day moving averages.

Stock Market Environment
Momentum / Fundamental Analysis

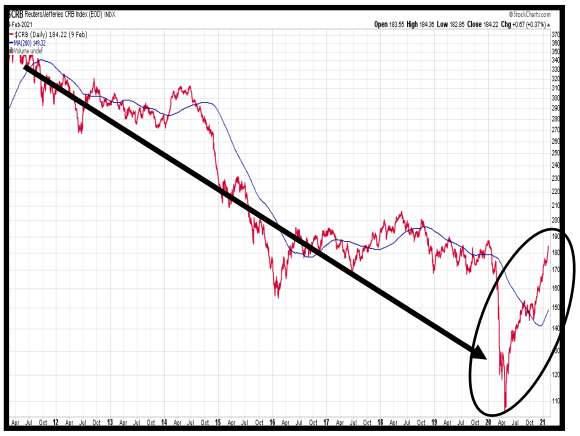
	Signal	Indicator	Historical Return
Momentum Analysis:			
Short-Term Momentum Model	Buy	Positive	27.3%
Intermediate-Term Momentum Model	Buy	Moderately Positive	13.6%
Long-Term Momentum Model	Buy	Positive	15.5%

Momentum models are used to provide some insight into the speed (or rate of change) at which prices are moving. The models are indicating that the strength of the price movements in the market, across all three time frames, is positive. In fact, there has been some improvement in the Intermediate-Term Momentum Model compared to last month. The Intermediate-Term model is a model produced by Ned Davis Research that measures the percentage of 157 sub-industry groups that are considered technically healthy. The current reading is 74% and the value is rising.

	Signal	Indicator	Historical Return
Fundamental Analysis:			
Economic Model	Hold	Neutral	3.9%
Earnings Model	Sell	Negative	1.0%
Monetary Model	Sell	Neutral	12.7%
Inflation Model	Sell	Neutral	-5.0%
Valuation Model	Sell	Negative	-2.1%

The Fundamental Analysis section of the RGB Stock Market Scorecard is indicating quite a bit of red. In my opinion, this should not be taken as an indication that risk is high but rather that risk is rising. This is a caution sign that we should pay more attention to the overall economy in the weeks and months ahead. As has happened many times over the last decade, bad economic news has been positive for the stock market, so we don't want to base our investment decisions solely on deteriorating economic results.

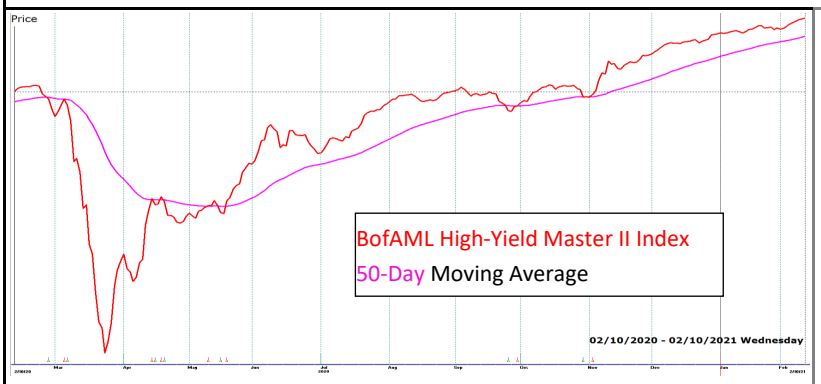
Since last month, the Inflation Model, that measures the rate of change of commodity prices, the Consumer Price Index (CPI), producer prices and industrial production, showed the most change by continuing its recent decline. A decline in this model represents an increase in inflationary pressures. For example, commodity prices, as represented by the Reuters/Jefferies CRB Index, recently spiked (see circled area) reflecting an increase in inflation pressures. This is a stark difference to the long-term decline in commodity prices prior to 2020, which was reflective of a more deflationary environment. The recent rise in commodity prices is at least partially a result of the easy money policies that the Federal Reserve created over the last decade. Recently, the Fed has indicated that it will let inflation run above its 2% target for a period of time, so the recent increase in inflation is likely a welcome sign for the Fed that would rather fight inflation than deflation.



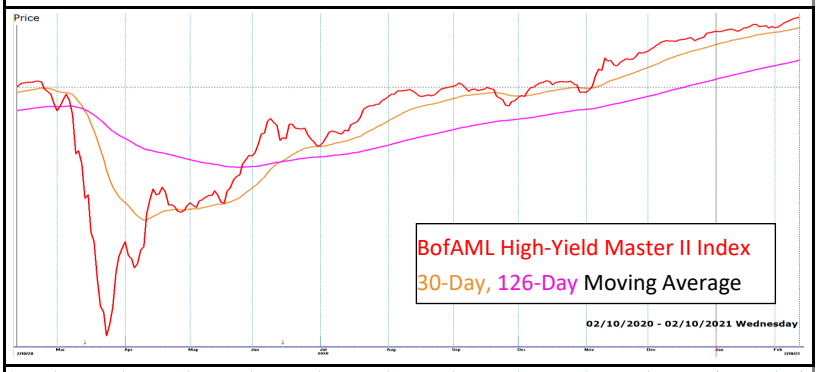
Stock Market Environment
Credit Conditions Analysis — One-Year Charts

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.

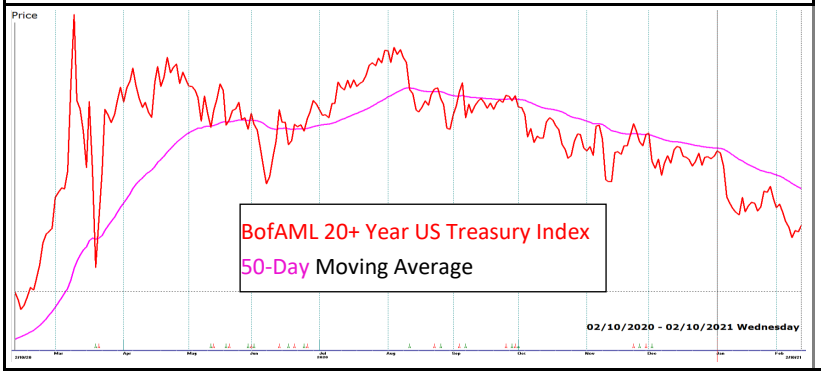
Credit Conditions Analysis:	Signal	Indicator	Historical Return
Short-Term Credit Conditions Model	Buy	Positive	NA
Intermediate-Term Credit Conditions Model	Buy	Positive	NA
Long-Term Credit Conditions Model	Buy	Positive	NA



Short-Term Credit Conditions: Short-term credit conditions remain positive as reflected by the uptrend of the BofAML High-Yield Master II Index (junk bond index). The index remains above its 50-day moving average indicating a positive stock market environment.



Intermediate-Term Credit Conditions: On an intermediate-term basis, the BofAML High-Yield Master II Index remains above its rising 30-Day and 126-Day moving averages.



Long-Term Treasury Prices: Treasury prices are also indicating a low risk environment as US Treasuries continue to decline.

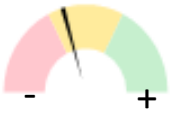
Summary: The short- and intermediate-term credit indicators are positive indicating a positive environment for most risk assets. Long-term credit conditions (not shown) also remain positive.

Stock Market Environment
Early Warning Model

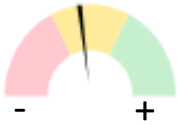
The Early Warning Model is designed to give investors an indication when the market has gone too far in one direction and whether it's ripe for a reversal in trend based on overbought / oversold and investor sentiment indicators. Like a rubber band that has been stretched too far, the market tends to snap back towards its mean when stretched too far in one direction. These are contrarian indicators. Historical data shows that the best stock market gains come when the market is oversold or investor sentiment becomes extremely negative. This is reflected by the gauges moving into the green. Conversely, when the market becomes overbought or investor sentiment becomes too bullish, historical data suggest the stock market is more likely to fall in the future and therefore represented by the gauges moving into the red.

Overbought / Oversold

Short-term



Intermediate-term

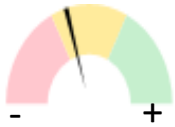


Long-term

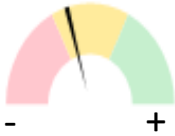
The stock market overbought / oversold indicators are neutral. The market is neither overbought nor oversold and has shown some small improvement from last month.

Investor Sentiment

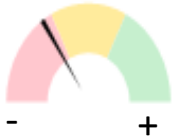
Short-term



Intermediate-term



Long-term



There has been some improvement in the investor sentiment indicators. While investors are still bullish, they are not as bullish as they were four weeks ago.

Summary

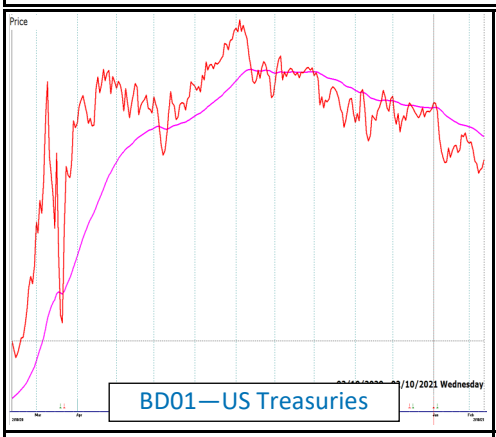
Mean Reversion Potential	Overbought
New Investment Rating	Hold

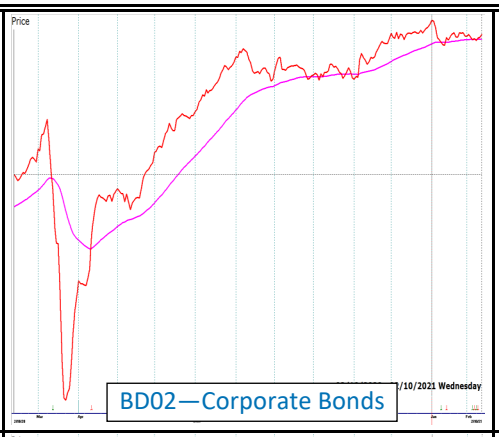
There has been some small improvements in the Early Warning Board, but it still indicates that caution is warranted.

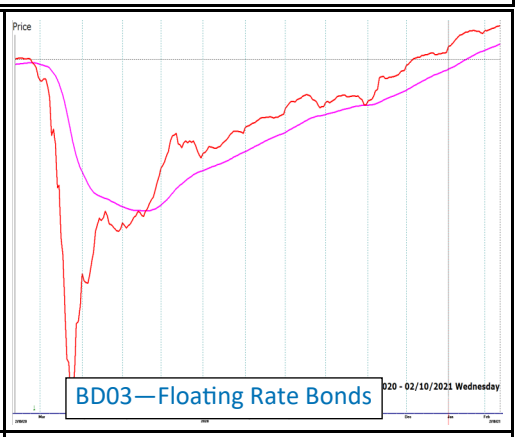
The Early Warning Model is a tool designed to provide an indication when the market has moved too far in one direction, which in our view, means the probability of a counter trend rally is above average. The Mean Reversion Potential, based on the trend reversal data displayed, is a belief that prices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

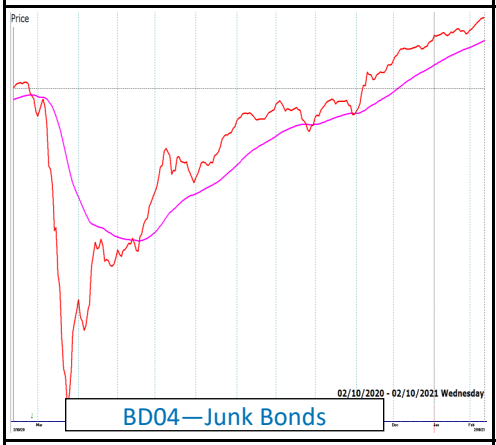
Bond / Income Environment
Overall Assessment

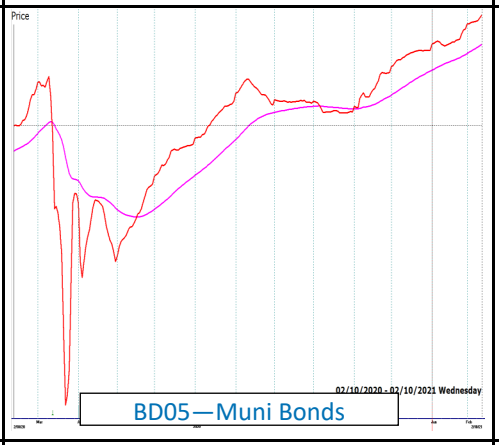
The following one-year charts represent 10 groups that encompass a large portion of the bond / income environment. Each group is an equally-weighted composition of representative mutual funds. Each group is plotted with its 50-Day moving average to help visualize the trend.

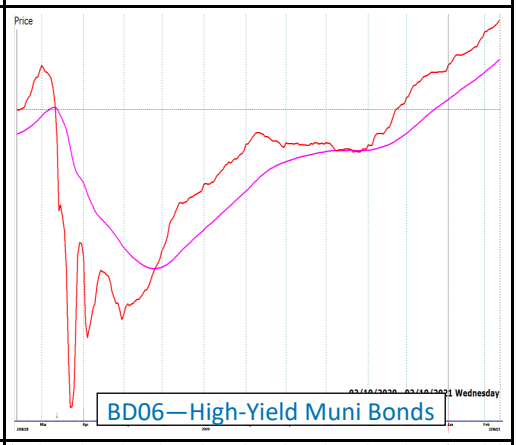


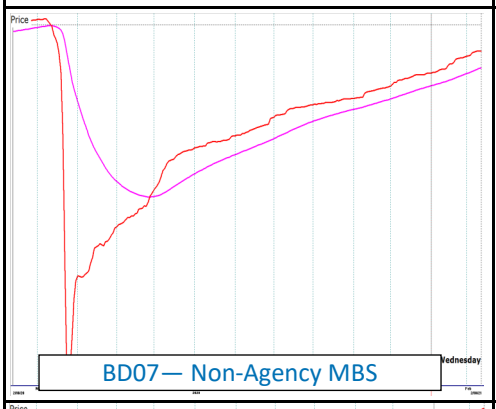


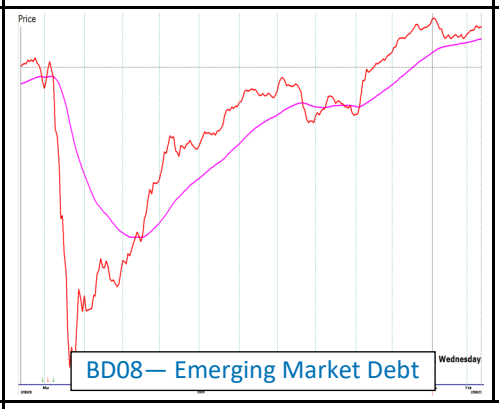


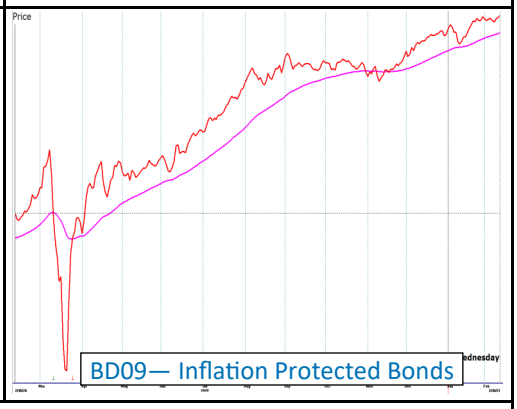


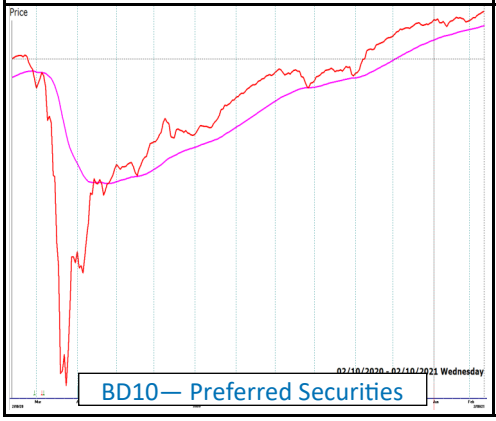












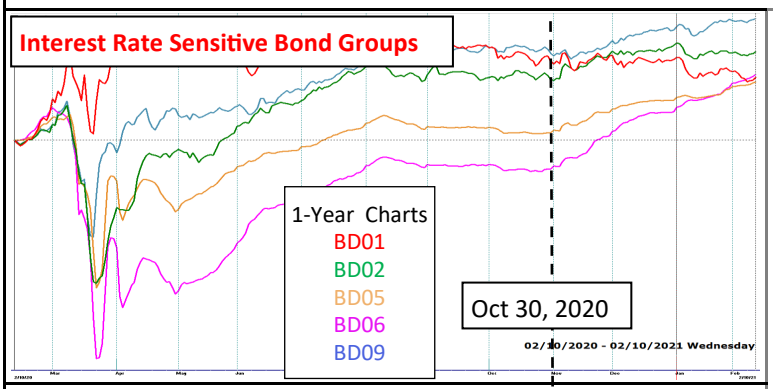
Eight of the ten bond / income groups shown above are in attractive, low volatility uptrends. The rise in interest rates has been a headwind for US Treasury Bonds (BD01), which is in an intermediate-term downtrend, and Corporate Bonds (BD02), which are trending sideways.

Bond / Income Environment

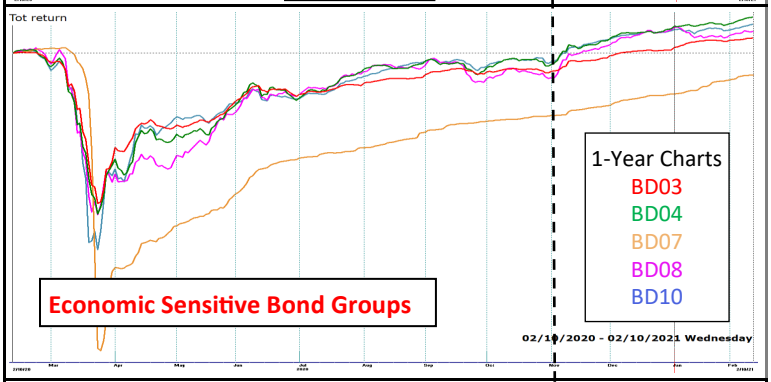
		Statistics for 10/30/20 - 2/10/21						YTD	One Year
Symbl	Description	Return	Annual Return	ULCER	UPI	MaxDrawDown	SD	Return	Return
BD07	Bond/Inc - Non-Agency MBS	6.40%	25.44%	0.00	5913.96	-0.02%	0.48%	2.95%	-3.34%
BD06	Bond/Inc - High Yield Muni	6.83%	27.29%	0.01	3805.57	-0.03%	0.44%	2.39%	4.84%
BD03	Bond/Inc - Floating Rate	5.20%	20.35%	0.05	413.38	-0.20%	0.59%	1.42%	2.29%
BD05	Bond/Inc - Muni Bond	3.54%	13.55%	0.05	228.78	-0.18%	0.37%	1.12%	4.30%
BD04	Bond/Inc - Junk	7.50%	30.23%	0.15	199.82	-0.60%	0.99%	1.38%	5.62%
BD10	Bond/Inc - Preferred Securities	5.88%	23.22%	0.16	139.73	-0.70%	0.76%	0.79%	4.47%
BD08	Bond/Inc - Emerging Market Debt	7.34%	29.53%	0.75	37.91	-1.65%	1.29%	-0.61%	3.33%
BD09	Bond/Inc - Inflation Protected	2.73%	10.33%	0.25	37.28	-0.85%	0.69%	0.58%	9.17%
BD02	Bond/Inc - Corporate	2.09%	7.83%	0.50	13.79	-1.13%	0.83%	-0.64%	6.59%
BD01	Bond/Inc - US Treasuries	-0.93%	-3.36%	1.07	-4.10	-2.08%	1.13%	-1.42%	4.65%

The bond / income groups listed above are comprised of equally weighted groups of mutual funds representing each group. You cannot invest directly into one of these bond / income groups.

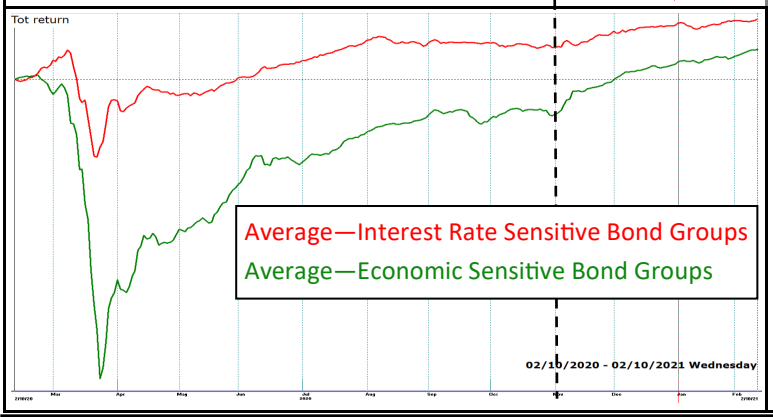
I adjusted the ranking period for the table above to start at 10/30/2020 which represents what I consider to be the current market environment. The bond / income groups are sorted by UPI (a measure of risk-adjusted return) for the time period 10/30/2020 through 2/10/2021. This provides some insight into which groups are providing the best risk-adjusted returns following the rotation in the stock and bond markets that started last year.



Despite the increase in interest rates, many of the interest rate sensitive bonds continue to trend up. Muni Bonds (BD05) and High-Yield Muni Bonds (BD06) are even ranked in the top half of the ranked list above. This is likely due to the increased likelihood of state and local governments receiving aid in the next round of stimulus.



The Economic Sensitive Bond Groups tend to be more influenced by overall economic conditions and expected default rates and have continued their low volatility uptrend. As long as the economy continues to recover, these groups should trend up. The rate of increase may subside as we extend further into the recovery, but there are no indications of that yet.



The Average—Economic Sensitive Bond Groups (an equally weighted average of BD03, BD04, BD07, BD08 and BD10) continues to outperform the Average—Interest Rate Sensitive Bond Groups (an equally weighted average of BD01, BD02, BD05, BD06 and BD09). Since October 30, 2020 the Economic Sensitive Bond Group has gained 6.5% (~25% annualized return) compared to the Interest Rate Sensitive Bond Group that has gained 2.8% (~10% annualized return).

Equity and Bond / Income Environments
Overall Assessment

Overall Assessment: The weight-of-the-evidence continues to point to a favorable market environment with the trend, momentum and credit indicators all pointing to a positive market environment. The deterioration of the fundamental model is something to monitor but does not in itself mean the stock market will start to decline. Remain focused on what the market is doing (not what you think it will do) and set stops to avoid life altering losses. The economic sensitive bond groups, as well as some of the interest rate sensitive bond groups, are in attractive, low volatility uptrends.

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 or adjust your overall exposure to the market based on your personal tolerance for risk and investment approach. It is not designed to be an investment timing tool. The overall equity allocation is at 79.8%. Previous readings are January 78.3; December 87.5%; November 85.8%; October 85.8%; September 70.6%, and August 84.8%.

Equity Allocation Models	Model Rating	% Equity Allocation
RGB Market Trend Model		25.0%
RGB Market Momentum Model		22.3%
RGB Fundamental Factors Model		7.5%
RGB Credit Conditions Model		25.0%
Model Equity Allocation:		79.8%

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

Focus on the bond / income groups in the top portion of the UPI ranked list on page 9. There continues to be some extremely attractive risk-adjusted returns available to individual investors.