Market Monitor

Version 2019-09

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September 12, 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 volatility in the equity markets experienced in August subsided recently and has been replaced with a more steady uptrend in most of the major indices. However, there has been a considerable shift in the financial markets over the last week that isn't apparent when looking at the charts of the major indices in isolation. While the major indices have trended up recently, there has been a rotation out of many of this years' winning groups/sectors (including bonds) into groups that have underperformed. The two most notable changes that I have witnessed over the last few days include:

1. **Small-cap Stocks**: Small-cap stocks have started to outperform large-cap stocks in a significant manner for the first time in the last six months. Small-cap stocks generally outperform during broad market rallies as they are considered more risky. With investors moving back into small-cap stocks it may be an indication that investors are bullish on the future of the economy and now willing to invest in a part of the market that has considerably underperformed for most of this year. For example, the Russell 2000 Index has provided over twice the return of the S&P 500 (5.4% vs. 2.5%) since September 1st. The positive shift is also apparent in the banking, energy, telecommunication and transportation sectors.
2. **Treasuring Yields**: 10-Year Treasury yields reached a multi-year high of 3.24% in November 2018 and have fallen over the course of 2019 to a low of 1.47% just last week, which was close to matching the all-time low that was set back in 2016. The decline over the last nine months represents a 55.6% decline in rates and was indicative of a market that perceived economic weakness on the horizon. However, over the last five trading days, the 10-Year Treasury yield has spiked back up to 1.75% (a 19% increase). The potential shift to a rising interest rate environment could have implications, particularly to our lower volatility portfolios that tend to be tied to the movement of interest rates.

While it is too early to tell if these shifts are temporary or the beginning of a significant change in the longer term trend, I do believe that these changes bear watching so that we can adjust our portfolios to the realities of today's market. The bond and income groups that we track are susceptible to changes in interest rates. While most of these groups are holding up pretty well, now is a good time to review your stops and have a plan in place in the event your stop is triggered.

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	Buy	Positive	26.2%
Intermediate-Term Momentum Model	Hold	Neutral	6.5%
Long-Term Momentum Model	Buy	Positive	15.5%
Fundamental Analysis:			
Economic Model	Buy	Positive	11.3%
Earnings Model	Buy	Positive	11.7%
Monetary Model	Buy	Positive	18.6%
Inflation Model	Buy	Positive	13.2%
Valuation Model	Hold	Neutral	2.7%
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	Buy	Positive	10.2%
Long-Term Overbought/Oversold Signal	Sell	Negative	NA
Investor Sentiment Analysis:			
Short-Term Sentiment Model	Buy	Positive	30.3%
Intermediate-Term Sentiment Model	Buy	Positive	33.0%
Long-Term Sentiment Model	Buy	Positive	10.8%
The Weight of the Evidence Average:			**15.3%**
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: The market has stabilized since last month's increase in volatility and this can be observed with the mostly green trend and momentum indicators. The fundamental and credit condition indicators continue to point to a healthy 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: While volatility has increased over the last 1.5 years, that has not changed the long-term (secular) trend of the market which remains up.

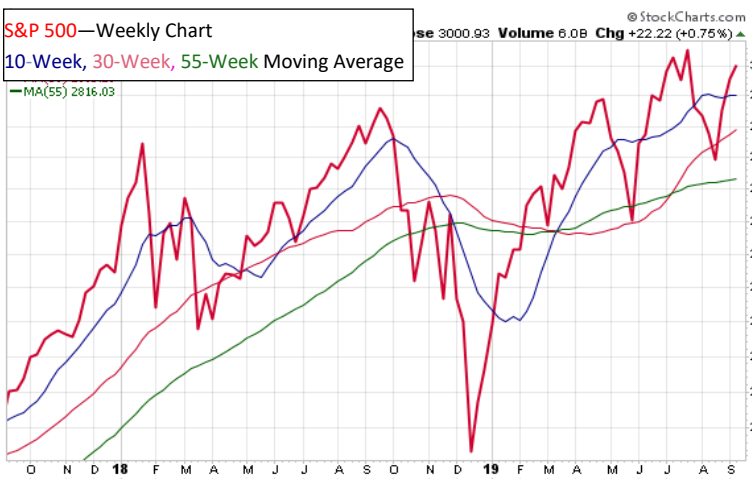
Bull Market

Cyclical Market Cycle: The cyclical bull market also remains in tact.

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 weakness that developed in August has resolved to the upside. The S&P 500 Index turned up at the end of August and remains in a short-term uptrend, trending above its 5-Day, 10-Day and 39-Day moving averages.



The intermediate-term trend of the S&P 500 is up. The index is above all three moving averages and the 30-Week and 55-Week moving averages continue to trend up. The 10-Week moving average, the shortest moving average we use for our intermediate-term trend analysis, has flattened out during the recent volatility.

The long-term trend of the market remains up with the 50-Day moving average trending up above the 200-Day moving average. The 200-Day moving average is starting to turn up which is what you would expect if we are in a long-term uptrend.

Stock Market Environment
Momentum / Fundamental Analysis

	Signal	Indicator	Historical Return
Momentum Analysis:			
Short-Term Momentum Model	Buy	Positive	26.2%
Intermediate-Term Momentum Model	Hold	Neutral	6.5%
Long-Term Momentum Model	Buy	Positive	15.5%

By looking at the three models that we use to asses overall momentum of the market, the momentum board appears to be generally positive. However, when I dig under the hood a little, the environment may not be as positive as the board reflects. Specifically, the intermediate-term model is neutral but not by much. It is only slightly above a negative reading. In addition, while the long-term model is indicating a positive reading, that reading is not positive by much.

If the recent rally in the equity markets that started in late August is to continue, I would expect to see much more energy behind the upward move. With significant overhead resistance (marked by the all-time highs in the large cap indices in July 2019) quickly approaching, we would prefer to have an uptrend coupled with stronger momentum.

	Signal	Indicator	Historical Return
Fundamental Analysis:			
Economic Model	Buy	Positive	11.3%
Earnings Model	Buy	Positive	11.7%
Monetary Model	Buy	Positive	18.6%
Inflation Model	Buy	Positive	13.2%
Valuation Model	Hold	Neutral	2.7%

Both the Economic and Earnings Models have slipped over the last few weeks but not enough to change the overall fundamental market environment which remains positive.

Economic Model: The overall economy, as measured by the 15 economic indicators of the Economic Model, continues a multi-month decline but remains in a positive state.

Earnings Model: The earnings growth of the S&P 500 companies continues to grow but the rate of growth has slowed considerably over the last several months.

Monetary Model: The monetary environment remains extremely accommodative with both monetary models used in the stock market scorecard at very bullish levels.

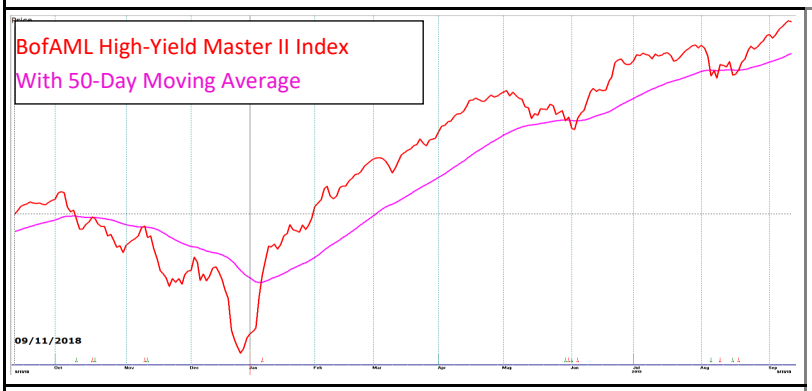
Inflation Model: The inflation model we use continues to point to an extremely low inflationary environment. The S&P 500 has historically returned in excess of 13% per year when the Inflation Model has been in this current configuration.

Valuation Model: The valuation models continue to provide conflicting signals with one model indicating an overvalued market and the other indicating an undervalued market environment. This conflict does not appear to be resolving itself any time soon.

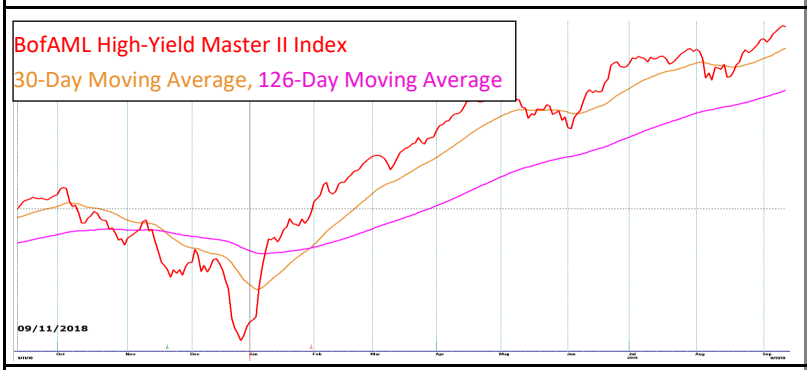
Stock Market Environment
Credit Conditions Analysis

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.

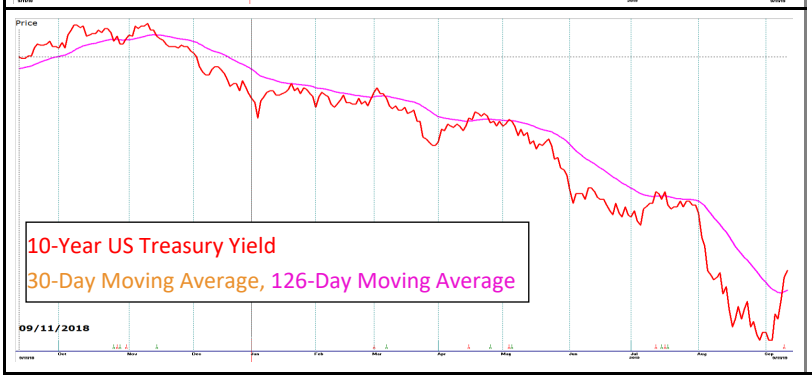
Credit Conditions Analysis:	Signal	Indicator	Historical Return
Short-Term Credit Conditions Model	Buy	Positive	NA
Intermediate-Term Credit Conditions Model	Buy	Positive	NA
Long-Term Credit Conditions Model	Buy	Positive	NA



Short-term Credit Conditions: Junk bonds fell in August with the rest of the equity market but quickly recovered. With junk bonds solidly above their 50-day moving average, risk in the equity markets appears to be low.



Intermediate-Term Credit Conditions: The intermediate term trend of junk bonds was not impacted by the August volatility and remains in a positive configuration.



US Treasury Yields: After falling for much of the year, US Treasury yields have bottomed and started trending back up. This is a sign that investors are shifting out of the relatively safety of US Treasuries and into riskier assets.

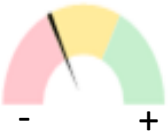
Summary: While junk bonds demonstrated some weakness last month, any weakness has quickly dissipated. All the credit indicators (including the long-term credit conditions—not shown) remain positive.

Stock Market Environment
Early Warning Model

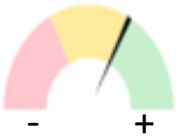
The Early Warning Model is designed to give investors an indication when the market has gone too far in one direction and whether it's ripe for reversal in trend based on overbought / oversold and investor sentiment indicators. Like a rubber band that has been stretched too far, the market tends to snap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

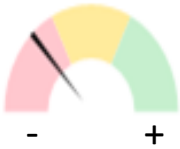
Short-term



Intermediate-term



Long-term

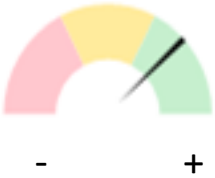


The oversold conditions presented last month have been worked off and are starting to move back to an overbought condition.

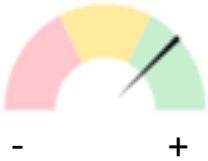
Investor Sentiment

Short-term

Intermediate-term



Long-term



Despite the recent bounce in the equity markets, it has done little to change overall investor sentiment. Sentiment remains low across all time frames which is generally a positive indication for the market.

Summary

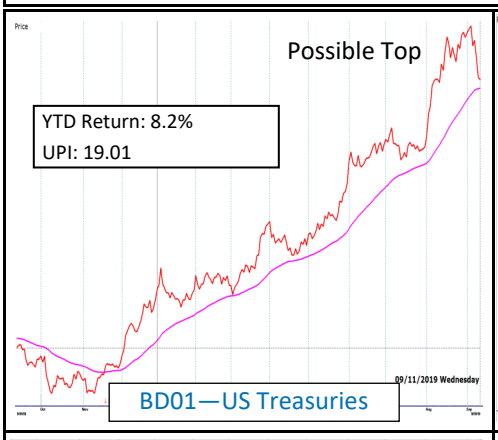
Mean Reversion Potential	Neutral
New Investment Rating	Hold

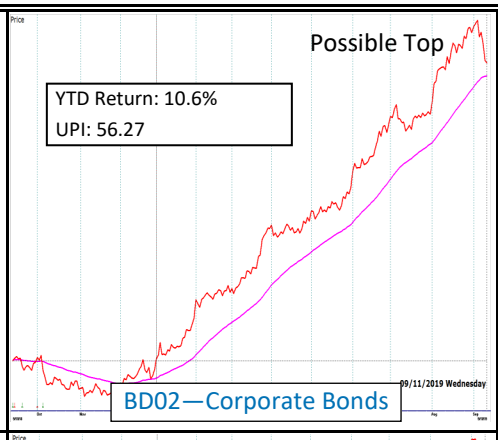
The Early Warning signals are mixed at the moment and therefore does not provide any clear guidance for a strong move in either direction.

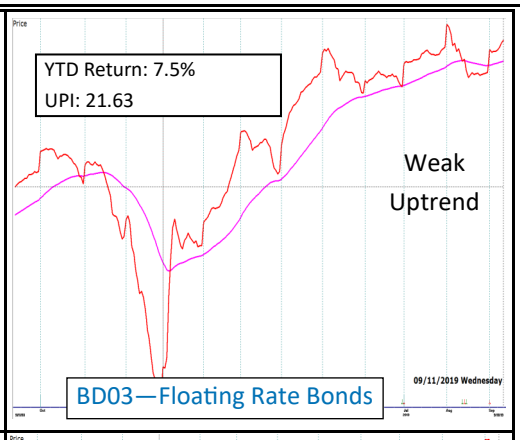
The Early Warning Model is a tool designed to provide an indication when the market has moved too far in one direction which in our view means the probability of a counter trend rally is above average. The Mean Reversion Potential, based on the trend reversal data displayed, is a belief that prices and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

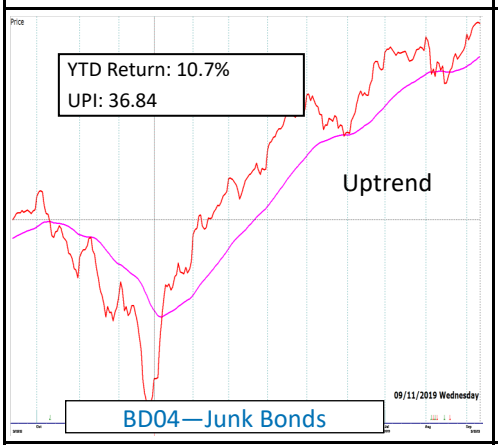
Bond / Income Environment
Overall Assessment

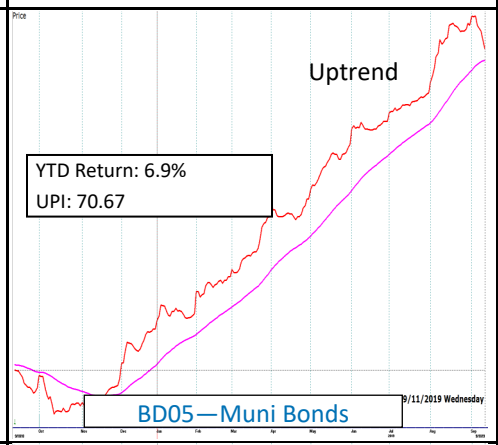
The following one-year charts represent 10 groups that encompass a large portion of the bond / income environment. Each group is an equally-weighted composition of representative mutual funds. Each group is plotted with its 50-Day moving average to help visualize the trend.

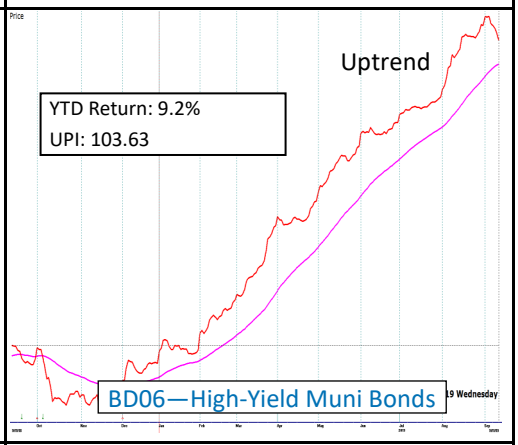


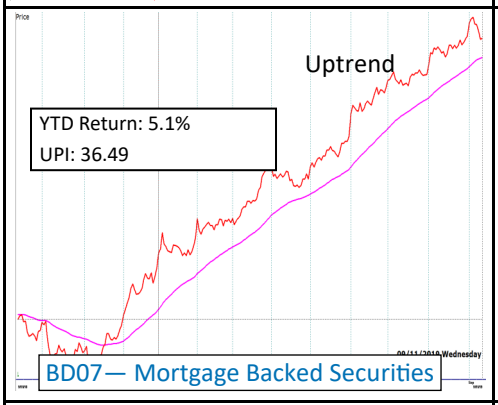


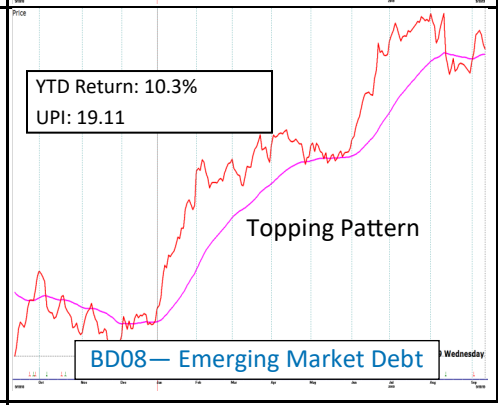


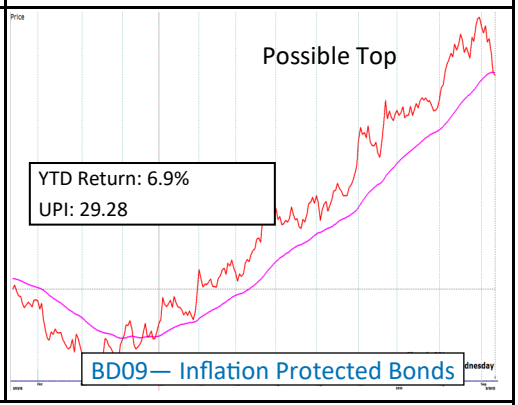


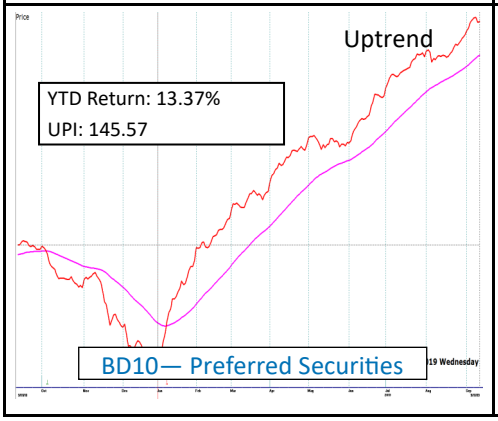












The recent spike in interest rates has had an impact on many of the bond / income groups shown her, but the impact has been fairly mild so far. If the recent rise in rates continues, many of these groups, in particular the interest rate sensitive groups (BD01, BD02, BD05, BD06, BD07, and BD09), will likely start to form short-term downtrends. The economic sensitive groups (BD03, BD04, BD08 AND BD10) should do better in a strong economic environment but will face some headwinds from rising rates.

Equity and Bond / Income Environments
Overall Assessment

Overall Assessment: The weight of the evidence continues to point to a positive market environment, however, when we look into each of the Stock Market Scorecard indicators it may not be as positive as it might appear on the surface. In particular, sub-par momentum and deteriorating fundamentals reflect a market that might not be as strong as the Scorecard reflects. Set stops based on your personal tolerance for risk to limit downside risk if the market environment should change dramatically.

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 has increased to 93% this month (up from 60.0% last month).

Equity Allocation Models	Model Rating	% Equity Allocation
RGB Market Trend Model		25.0%
RGB Market Momentum Model		20.8%
RGB Fundamental Factors Model		22.5%
RGB Credit Conditions Model		25.0%
Model Equity Allocation:		93.3%

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

Bond / Income Allocation

The bond and income groups have started to decline / flatten out over the last week as interest rates spiked higher. This is a good time to reevaluate your stops and be prepared to take action if your stops are triggered. I wouldn't add to any of the bond / income groups at this time and suggest waiting to see if the recent rise in interest rates is temporary or if this is the start of a longer-term uptrend in interest rates.

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.