

# Market Commentary

August 27, 2020



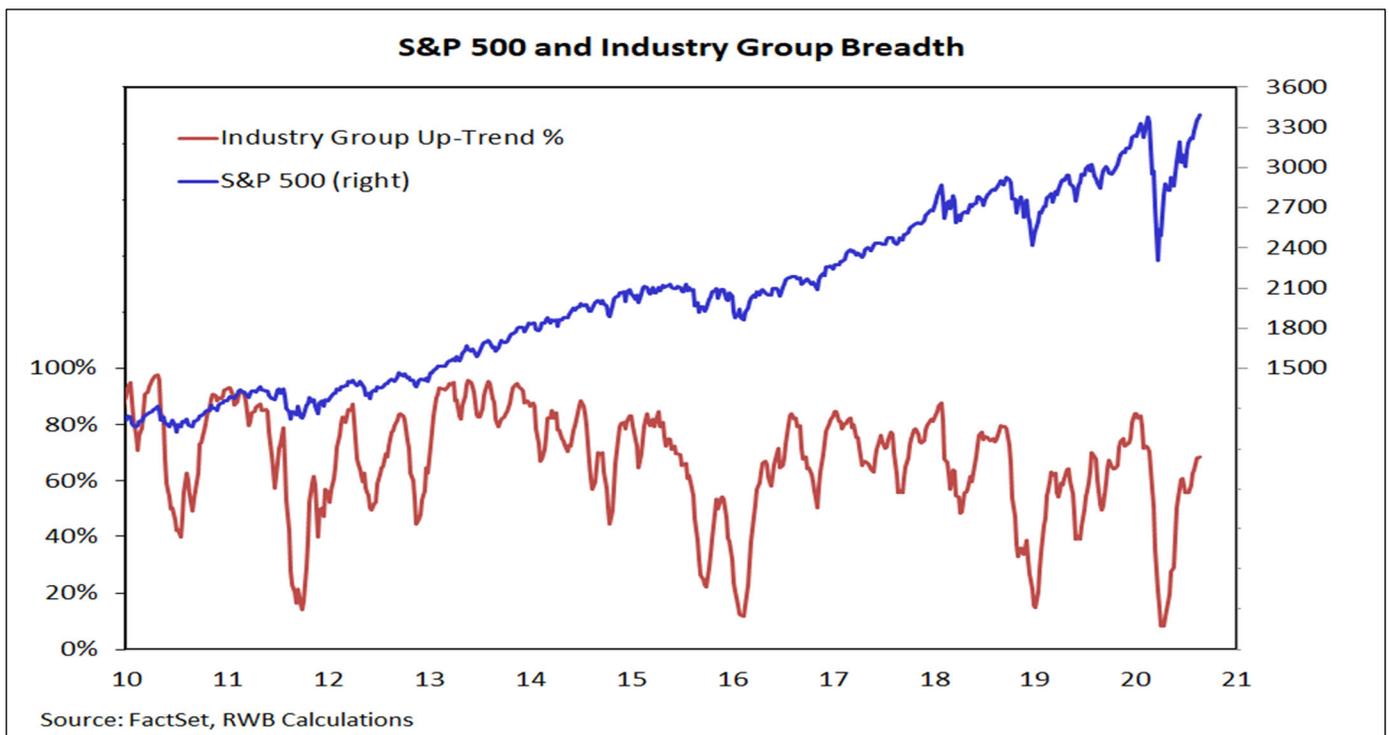
Please refer to Appendix – Important Disclosures.

## Despite Noise, Breadth Still Bullish

- Key Takeaways:**
- Industry group trends expanding; sector-level trends still supportive
  - Lack of new highs can make strength difficult to sustain
  - Confirmation of S&P 500 rally hard to find

Included in the mid-August update that moved the [overall weight of the evidence from bullish to neutral](#) was an upgrade of our view of the broad market (from neutral to bullish). This more constructive view of breadth trends has been challenged by near-term noise in some of the indicators. For example, the new high list has been getting narrower and the S&P 500 has been making new highs on days when more stocks have been down than up. With the outsized effect just a handful of stocks have on the index (the ten largest stocks in the index account for nearly 30% of the S&P 500 market cap, the highest level in 40 years and twice what it was just five years ago), momentum may be more important than breadth over the near term.

Even with these near-term hiccups, longer-term breadth trends remain strong. The breadth thrusts seen during the earlier stages of the rally off the March lows provide a tailwind into 2021 and the percentage of industry groups in uptrends continues to expand. We don't want to let the S&P 500 running ahead of the broad market obscure the fact that broad market trends are improving. With the overall weight of the evidence at neutral, some near-term consolidation would not be surprising at this point. But underneath that consolidation is evidence of improving trends that goes deeper than just a handful of stocks.



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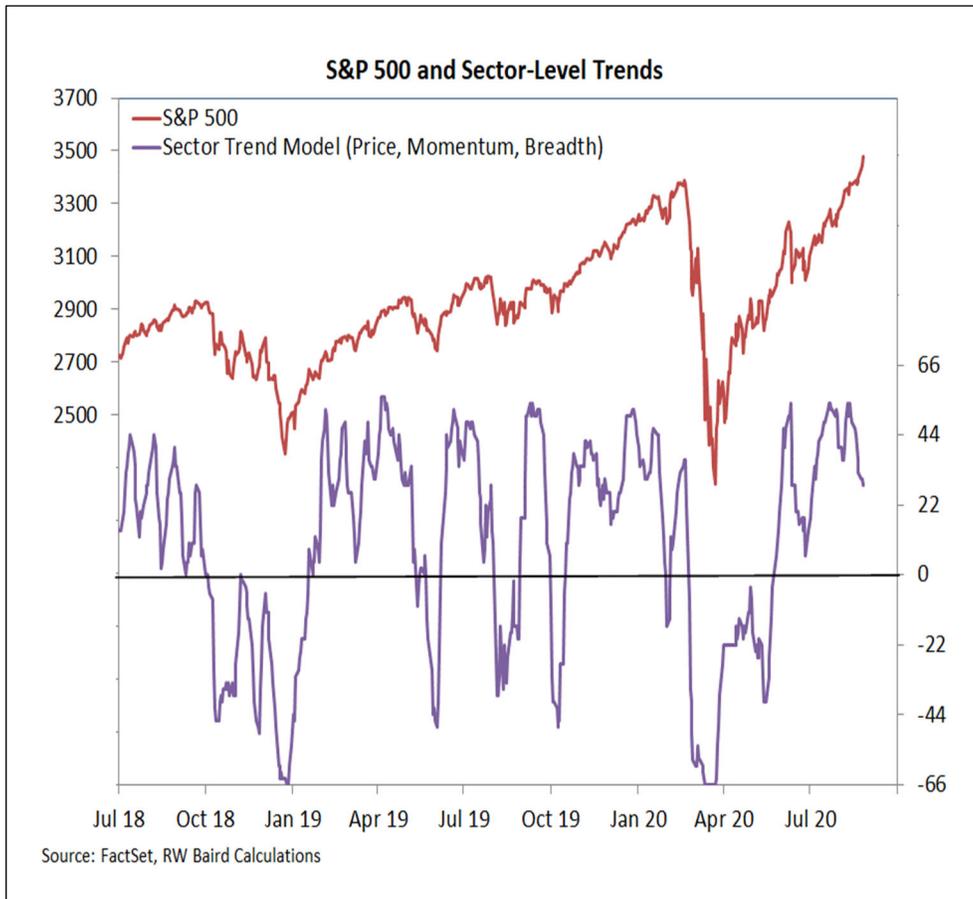
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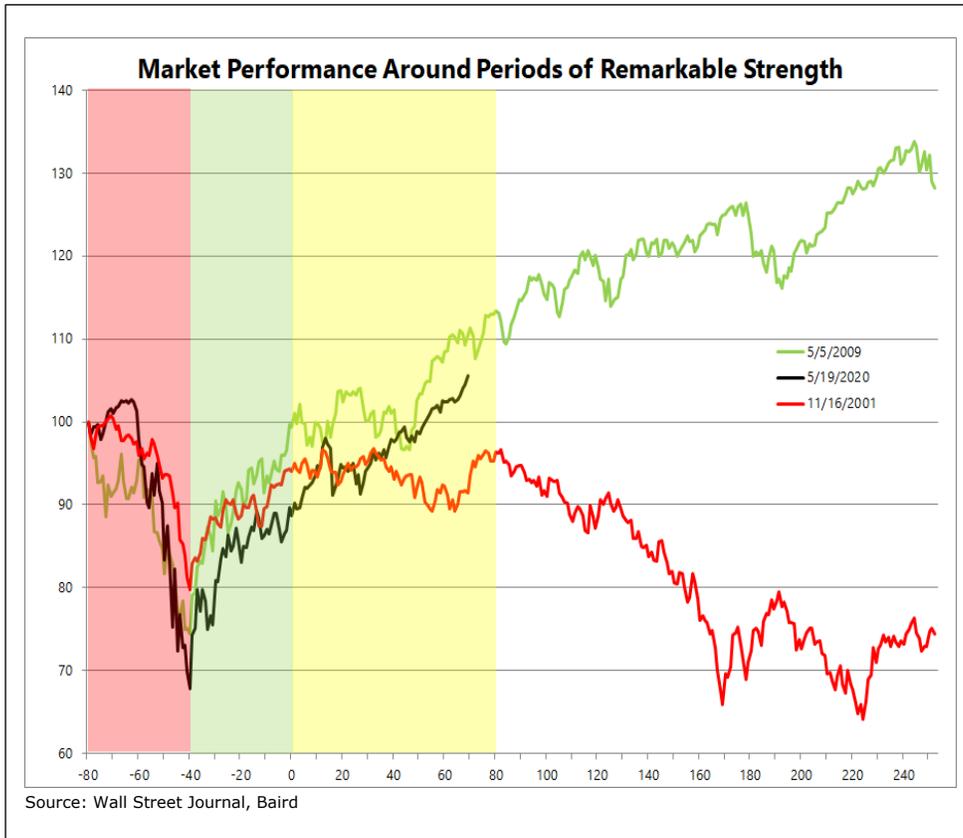
The shifts in market cap concentration over the past few years may add some noise to this relationship, but moves into record territory for the index are likely more sustainable over the near term if more than just a handful of stocks are making new highs of their own. There was an initial expansion in the new high list earlier this summer, but the latest move into record territory by the S&P 500 has come with the new high list contracting. In both 2015-16 and 2018-19, tests of new highs on the index that were not accompanied by an expansion in the number of stocks making new highs were rebuffed.



Our sector-level trend indicator can help distinguish between the noise of near-term hiccups and the news of more meaningful deterioration. While sector-level trends have cooled (especially in terms of momentum), the overall indicator remains in positive territory. Rallies can stall while sector-level trends are positive, but consolidation doesn't usually morph into correction when the underlying price, momentum and breadth trends are still strong. The pullback in this indicator bears watching, but at this point is not significant enough to merit action.

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The S&P 500 is more heavily dependent on just a handful of stocks than at any point in the past 40 years. The lack of new highs within the index may not be as much of a near-term limiting factor as it once was. Even still, the strongest rallies tend to come with broad confirmation. That the S&P 500 equal-weight index, the Broker/Dealer index and the German DAX all remain shy of their early-year peaks is a conspicuous absence of confirmation for the S&P 500. A lack of confirmation may lead to a divergence, but that is not the case right now. All three of these indexes are trending higher. New highs for any of them would be an endorsement of the strength being seen on the S&P 500. We are also watching the percentage of global markets in up-trends. This has cooled in recent weeks (even as the S&P 500 has climbed higher). If global participation narrows, the prospects for sustained US strength become more dim.



Given the comments about the importance of momentum versus breadth, we want to revisit a chart we've discussed in the past. The rally off of the March lows was one of the strongest ever seen. To some extent this was likely due to the intensity of the weakness that preceded the rally. We've highlighted two previous paths (2001 and 2009) as possible guideposts for 2020. As the rally has matured, it looks more like the 2009 example, where early momentum provided strength that led to more strength. We are approaching the point at which the 2001 rally ran out of momentum, rolled over, and eventually made lower lows. Nothing is on a pre-set course, but continued strong momentum could have 2020 following the path that emerged after the last recession.

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