Market Monitor

Version 2019-03

Written by Rob Bernstein

March 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.

I continue to make adjustments to the *Market Monitor* in order to better communicate what is happening in the market and to provide you valuable tools that support your investment decision making process.

This week I have added two new sections that I hope will enhance the value of the *Market Monitor* to you as an investor. First, I have added an Early Warning Model (see page 7) that is designed to give investors clues to when the market has gone too far in one direction. It an assessment of the potential for a mean reversion move, as well as, a guide for allocating new money into the market. Generally the market is like a pendulum and tends to swing too far in one direction before trending back the other way. The Early Warning Model is designed to identify time periods when the potential for a move in the other direction is high.

Second, I have added an Overall Assessment page (see page 9) that provides an evaluation of both the stock and bond / income environments. Included is a Dynamic Equity Allocation Model that is intended to be used as a general guide for the equity portion of your portfolio. Although it is not designed as an investment recommendation, it can serve as a guide to allow you to compare to your own investment allocations to that of the model.

I appreciate the feedback that I have received over the last few months as I continue to adjust this newsletter. It gives me valuable input so that I can provide what is most useful for you. If you have additional feedback on the new items added this month, or any other thoughts, I would like to hear them. Please email me at rob@rgbcpapitalgroup.com.

I will be holding a webinar on Saturday, April 6, 2019 at 9:00 am PDT to review the concepts outlined in the *Market Monitor*. If you would like to participate in the webinar called Managing Equity Risk in Uncertain Times, please register at: https://zoom.us/webinar/register/WN_vJPvhrnBRWmjG2CY6Uf79Q. Registration is required. If you are unable to participate, the webinar will be recorded and I will provide the link to the recording in next month's *Market Monitor*.

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 (trend, momentum, mean reversion, and sentiment) 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. Using multiple indicators 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	Sell	Negative	-3.6%
Momentum Analysis:			
Short-Term Momentum Model	Hold	Neutral	14.3%
Intermediate-Term Momentum Model	Buy	Mod Positive	13.5%
Long-Term Momentum Model	Buy	Positive	15.5%
Fundamental Analysis:			
Economic Model	Buy	Mod Positive	10.5%
Earnings Model	Buy	Positive	11.8%
Monetary Model	Hold	Neutral	5.4%
Inflation Model	Buy	Positive	13.2%
Valuation Model	Hold	Neutral	6.1%
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	Sell	Overbought	-4.3%
Long-Term Overbought/Oversold Signal	Sell	Neutral	NA
Investor Sentiment Analysis:			
Short-Term Sentiment Model	Hold	Neutral	6.3%
Intermediate-Term Sentiment Model	Sell	Negative	-11.9%
Long-Term Sentiment Model	Sell	Negative	-3.3%
		The Weight of the Evidence Average:	**5.7%**
		S&P 500 average gain/annum from 11/16/1979:	**8.7%**

(Source: Ned Davis Research)

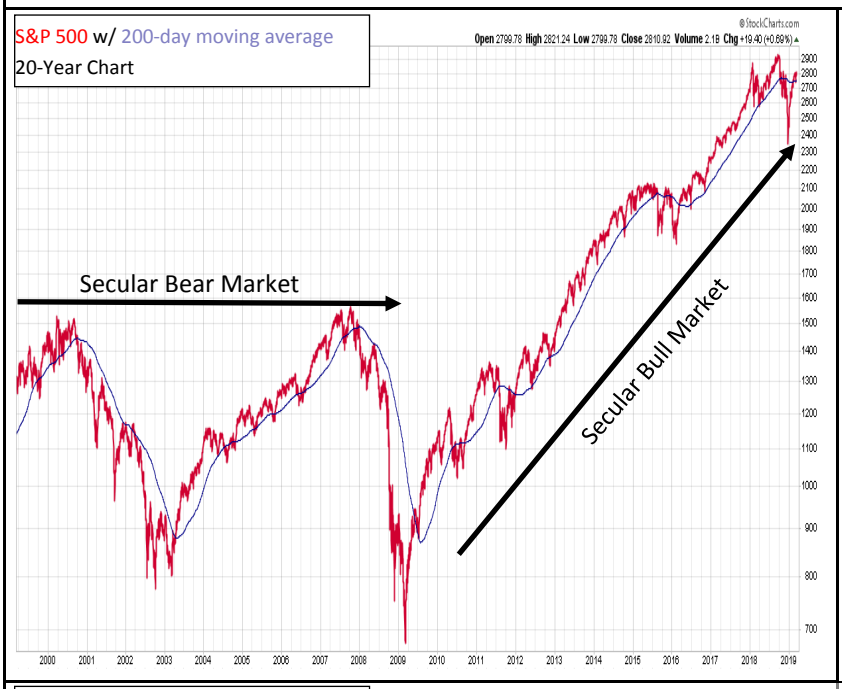
Summary: The stock market scorecard continues to signal a significant amount of green. While certainly positive, the historical returns of the market when in this configuration is not particularly strong at 5.7% annually. The one item that jumps out is that the early warning indicators continue to suggest that some caution is warranted.

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.

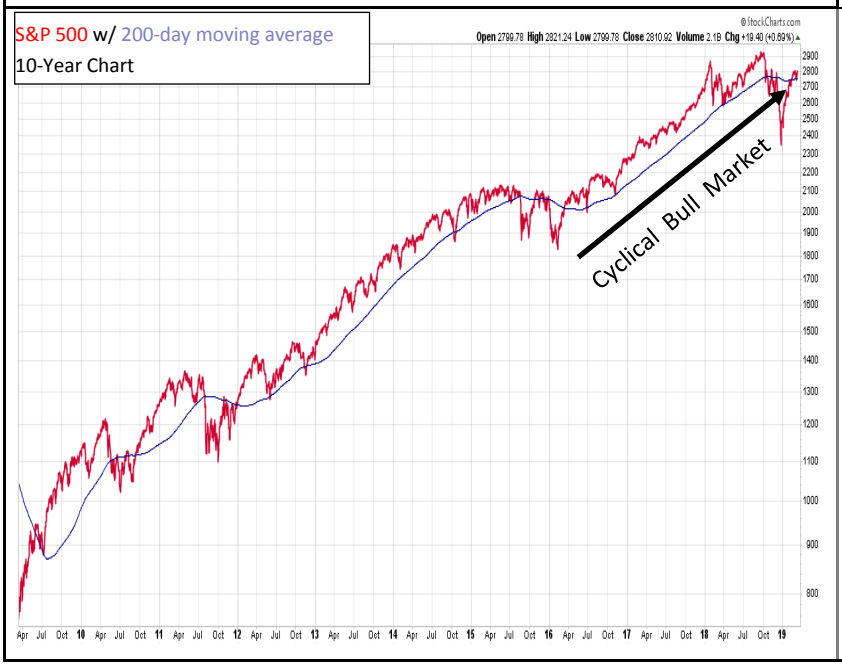
- **Secular Cycle**—Secular (long-term) bull markets are defined by above average returns over an extended period of time. Secular bear markets are defined by long-term periods of flat or declining prices (i.e. below average returns). Secular cycles tend to last from 5 to 25 years.
- **Cyclical Cycle**—Cyclical bull and bear markets are shorter trends within the context of secular (long-term) trend. There can be several cyclical bull and bear markets within a secular bull/bear market. For purposes of this report we will define a cyclical bull market as a rise of 30% over 50 calendar days or a rise of 13% after 155 calendar days. A cyclical bear market is a 30% decline over 50 calendar days or a 13% decline after 145 days.

While we don't make investment decisions based on secular and cyclical cycles, it is helpful to evaluate current market conditions within context of the predominate trend.



Bull Market

Secular Cycle: The primary, long-term trend of the market remains up. The secular bull market started in 2009 at the conclusion of the Financial Crisis and remains in tact.

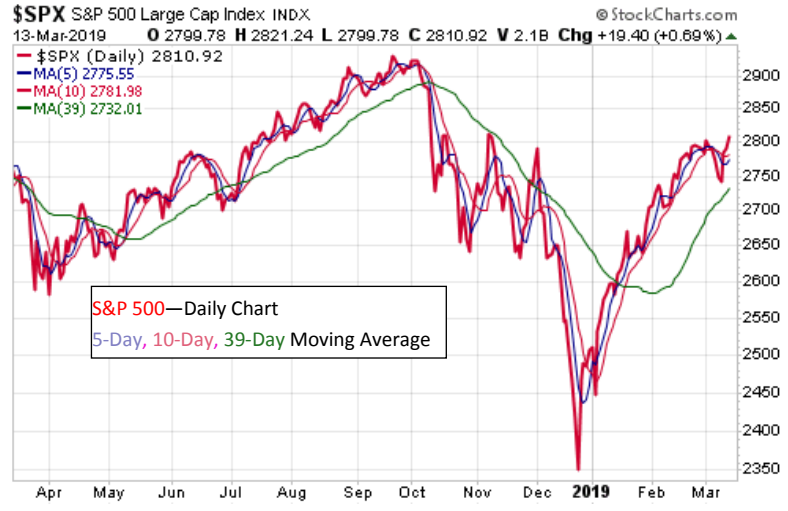


Bull Market

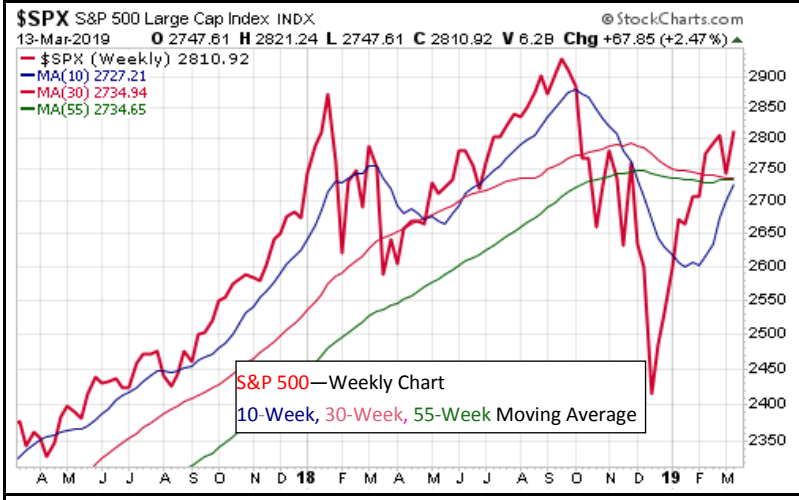
Cyclical Cycle: The primary cyclical trend of the market remains up. While volatility picked up at the end of 2018 it did not meet our criteria for a cyclical bear market. The S&P 500 is down -4.1% since its 2018 peak.

Stock Market Environment
Trend Analysis—One Year Charts

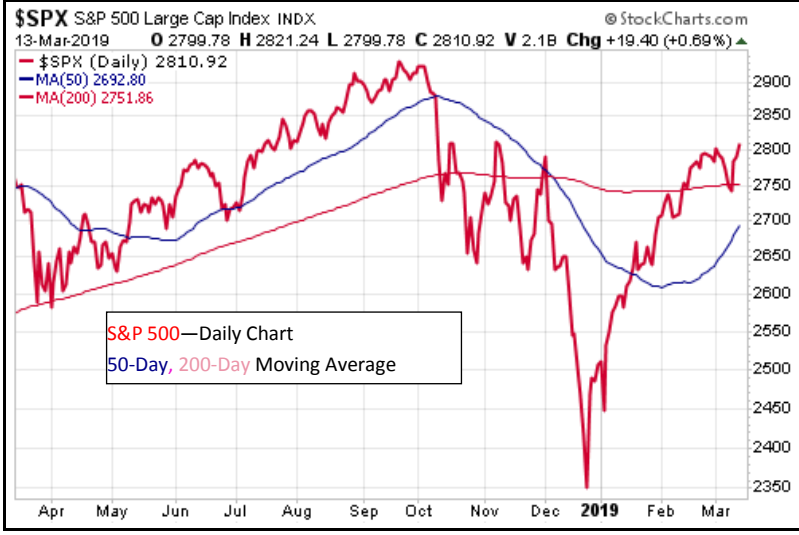
Trend Analysis:	Signal	Indicator	Historical Return
Short-Term Trend Rating	Buy	Positive	NA
Intermediate-Term Trend Rating	Buy	Positive	NA
Long-Term Trend Rating	Sell	Negative	-3.6%



While the short-term trend of the S&P 500 Index started to turn down at the beginning of March, it reversed course and is trending above its 5-day, 10-day and 39-day moving averages. The 5-day and 10-day moving averages which turned down briefly, bottomed and are now trending up again.



The intermediate-term trend of the market remains up. The S&P 500 Index (weekly chart) is trending up above its 10-week, 30-week and 55-week moving averages. The 10-week moving average is trending up; the 30-week moving average is in a slight downtrend; and the 55-week moving average is flat. This is not an extremely strong configuration but certainly positive.



The long-term trend of the S&P 500 has improved as the 50-day moving average bottomed and has turned up. However, the long-term trend remains down until the 50-day moving average crosses back above the 200-day moving average.

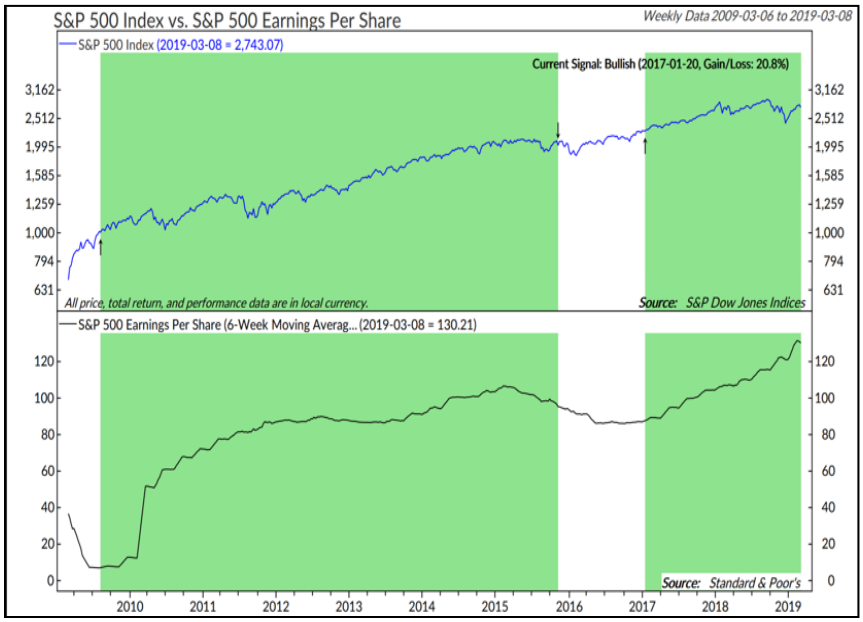
Stock Market Environment
Momentum / Fundamental Analysis

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

Short-term momentum dipped a little this month while both intermediate– and long-term momentum remained positive. This isn't all that surprising as the market pulled back a little during the first part of March after the surge off the December 24th lows. Both the intermediate- and long-term momentum models are based on the strength of 157 sub-industry groups which is down to 67% (indicating that 67% of the industry groups are demonstrating a healthy technical pattern) from 73% last month.

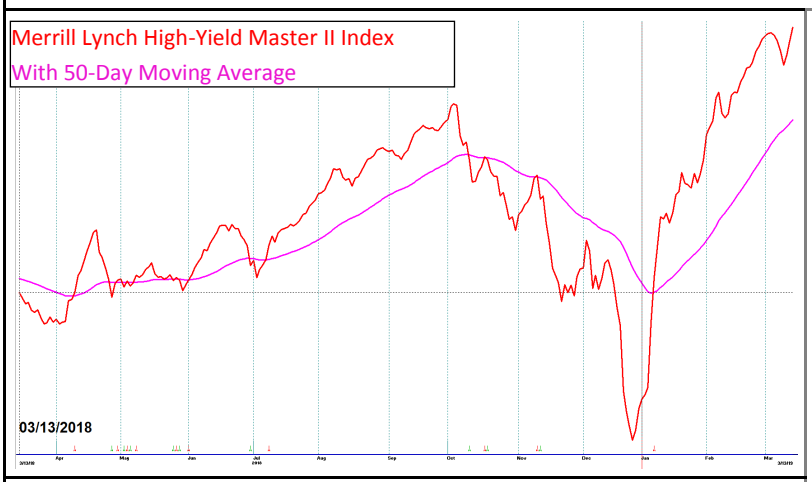
	Signal	Indicator	Historical Return
Fundamental Analysis:			
Economic Model	Buy	Mod Positive	10.5%
Earnings Model	Buy	Positive	11.8%
Monetary Model	Hold	Neutral	5.4%
Inflation Model	Buy	Positive	13.2%
Valuation Model	Hold	Neutral	6.1%

The fundamental background continues to support a favorable environment for stocks. Earnings growth continues to steadily climb (see 6-week moving average of S&P 500 Earnings Per Share — bottom half of chart below) and there continues to be little signs of inflation. In fact, the NDR inflation model continues to indicate a drop in inflationary pressures. While the overall economic environment is generally positive here in the United States, there continues to be a concern around growth globally. If the global economy slows it would most certainly impact our domestic economy. The other item to keep an eye on is the on-going trade negotiations with China. While the news headlines indicate progress, there is still no deal.

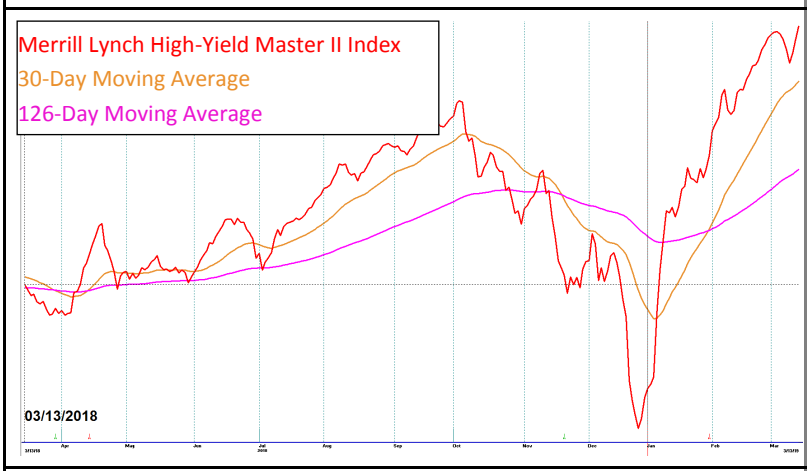


Stock Market Environment
Credit Conditions Analysis

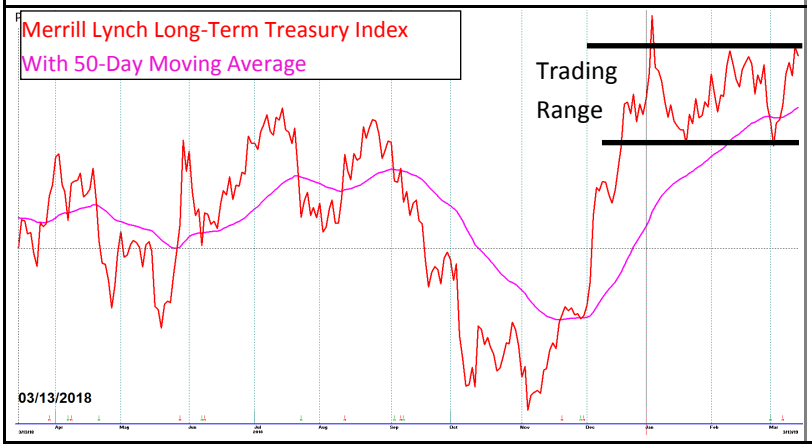
Junk bonds are one of the best indicators of overall market sentiment. When risk rises, junk bond prices fall as investors demand a higher yield to compensate them for the additional risk (remember bond prices fall as yields rise). When risk subsides, junk bond yields tend to fall given more favorable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



Junk bonds are in a strong uptrend and firmly above their 50-day moving average indicating a positive market environment.



On an intermediate-term basis, the junk bond index is also in a positive configuration trending above its 30-day and 126-day moving averages.



Long-term treasuries have settled into a trading range starting in 2019. There is no indication of a flight to safety in the current market.

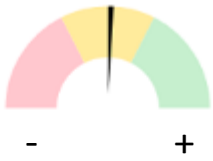
Summary: The junk bond indicator is indicating a positive market environment on both a short– and intermediate-term basis. The long-term credit conditions index (not shown) also remains firmly positive.

Stock Market Environment
Early Warning Model

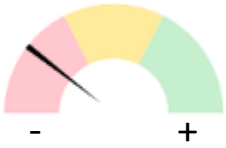
The Early Warning Model is designed to give investors an indication when the market has gone too far in one direction and is ripe for reversal in trend based on overbought / oversold and investor sentiment indicators. Like a rubber band that has been stretched too far, the market tends to snap back towards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

Trend Reversal—Overbought / Oversold

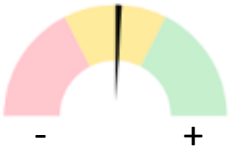
Short-term



Intermediate-term



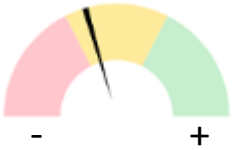
Long-term



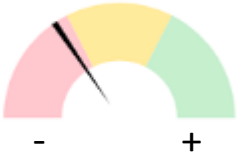
The overbought / oversold indicators were all negative heading into the month and did a good job warning us of a potential pullback in the market. Therefore, it is not surprising that the market pulled back a little bit earlier this month. This pullback has relieved the strongly overbought condition that existed with only the intermediate-term indicator still flashing a warning sign.

Investor Sentiment

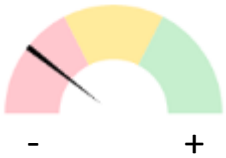
Short-term



Intermediate-term



Long-term



Investors tend to get overly optimistic when the market trends higher. History suggests that this is typically when the market reverses. While the recent short-term decline worked off some the optimistic outlook, it would not take much to put these indicators back in the red.

Summary

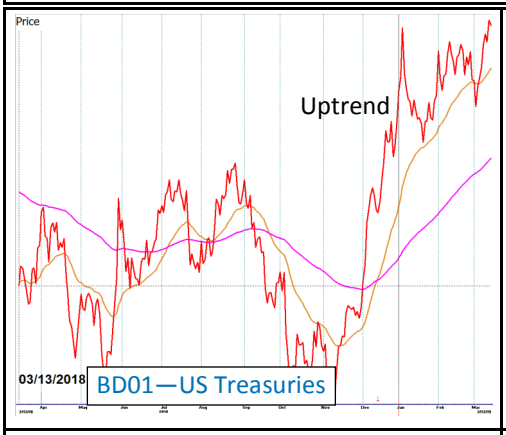
Mean Reversion Potential Neutral

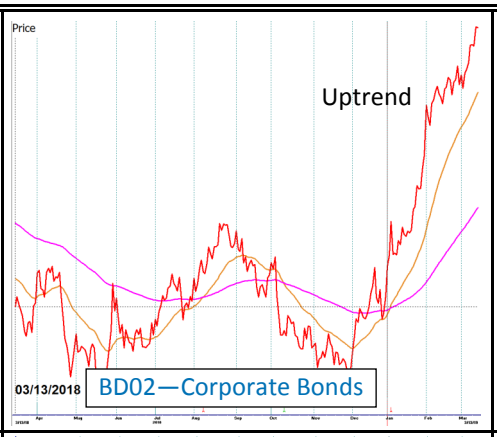
New Investment Rating Hold

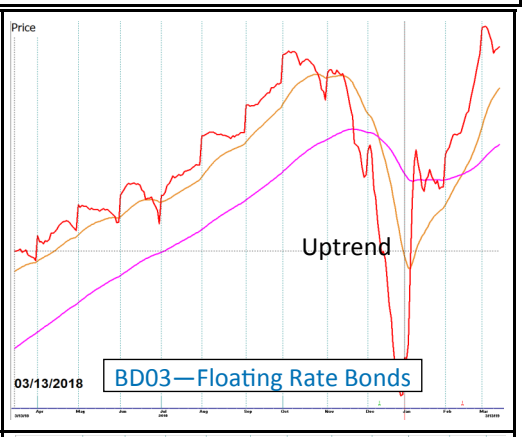
Overall, the early warning model is now neutral and has backed off the negative reading. However, the environment has not improved enough to add new money into the market at this time.

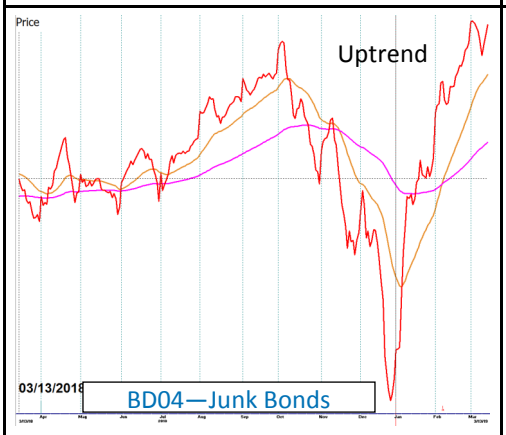
Bond / Income Environment
Overall Assessment

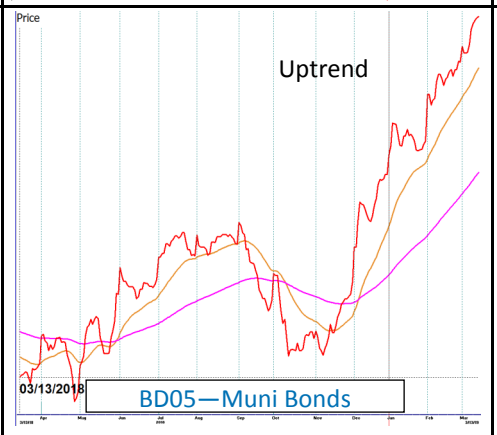
The following charts represent 10 groups that encompass a large portion of the bond / income environment. Each group is the average of 10 large mutual funds and plotted with its 50-day moving average to help us visualize the trend.

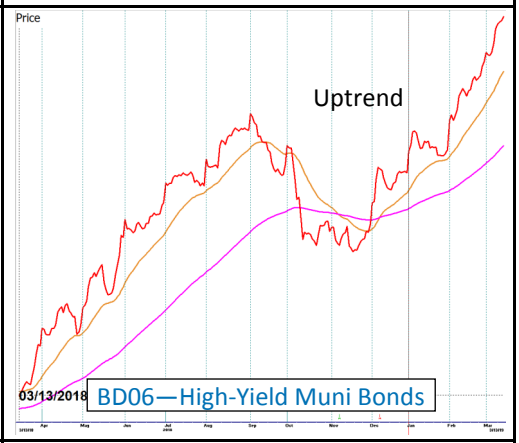


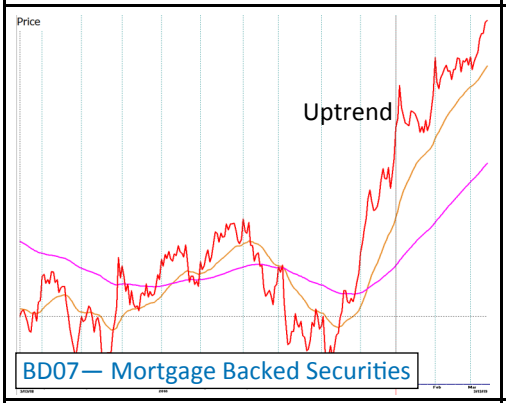


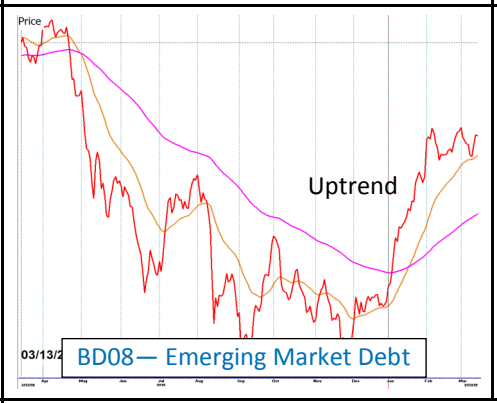


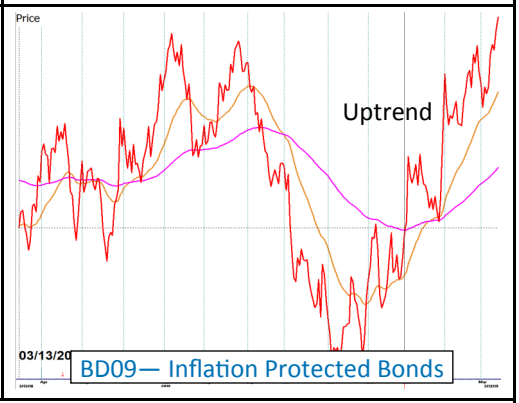


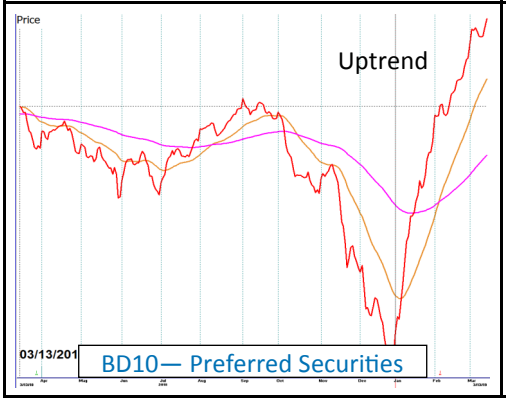












All the 10 bond / income bond groups are currently in uptrends. The best performing groups on a risk-adjusted basis are:

Symbol	Description	Ann. Return*	UI*	UPI*	Max Draw Down*
BD-10	Preferred Securities	28.1%	0.07	292.51	-0.22%
BD-02	Corporate Bonds	17.6%	0.10	114.76	-0.28%
BD-06	High-Yield Muni Bonds	13.6%	0.09	79.94	-0.24%
BD-04	Junk Bonds	19.9%	0.20	68.92	-0.60%
BD-05	Muni Bonds	9.3%	0.10	31.03	-0.25%

*Calculations for 1/10/19—3/13/19 and returns are annualized returns for this period.

Equity and Bond / Income Environments
Overall Assessment

Overall Assessment: The weight of the evidence is pointing to a positive market environment. Both the technical and fundamental indicators presented in the *Market Monitor* point to a positive stock market environment. This is also reflected in the bond / income groups where both interest rate sensitive and economically sensitive bonds are in low volatility uptrends. It appears that the small decline in early March may be the extent of the current pullback as investors who missed the rally off the December lows "buy the dip".

Dynamic Equity Allocation: The Dynamic Equity Allocation Model is based on a weight of the evidence approach using the indicators described in the *Market Monitor*. It is designed as a guide to overall market exposure and is not an investment recommendation.

Equity Allocation Models	Model Rating	% Equity Allocation
RGB Market Trend Model		16.7%
RGB Market Momentum Model		18.1%
RGB Fundamental Factors Model		18.4%
RGB Credit Conditions Model		25.0%
Model Equity Allocation:		78.1%

Bond / Income Allocation

The bond / income environment is extremely positive with all groups providing positive returns. Focus the conservative portion of your portfolio on the groups providing the best risk-adjusted returns listed on the bottom of page 8. During environments like this, the goal is to be invested and set stops to limit drawdown when the market does turn down.