Market Monitor

Version 2020-02

Written by Rob Bernstein

February 12, 2020

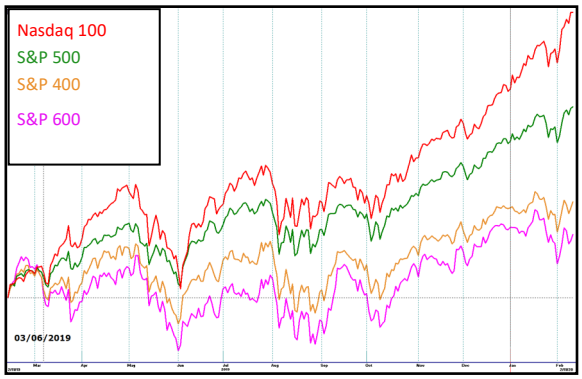
The *Market Monitor* newsletter is intended for individual investors with a desire to manage the conflicting goals of managing risk and earning a fair return by providing a unique perspective of general market conditions.

I am publishing the *Market Monitor* a day early this month as it is my 20th wedding anniversary today. I thought being with my wife, Lois, this evening might be a better way to spend this important day rather than writing an investment newsletter.

The market started 2020 in an strong uptrend. Strong uptrends are usually formed through a series of strong up legs followed by weaker down legs followed by stronger up legs. Therefore, it is not surprising that the market retreated during the last two weeks of January. The primary cause for the decline is the coronavirus outbreak in Wuhan, China that has impacted over 43,000 people worldwide and killed more than 1,000. The global economic impact of the virus is currently unknown, but the massive quarantine taking place in China will certainly have an impact on its economic output. The US economy is less vulnerable to the impacts but certainly not immune as our economy relies on the flow of goods into and out of China.

While the market has recovered some of the approximately 3% decline during the first part of February, it is far from clear that we have seen the last of the impact of the coronavirus on the stock market. Usually these types of events are short-lived, but we just don't know how long the uncertainty will prevail.

Despite the coronavirus, the markets are at or near all-time highs, at least for the time being. However, I don't think the market is as rosy as it may appear. Investors are pouring money into large-cap, growth and technology stocks which represent the largest capitalized stocks in the S&P 500. This includes Microsoft, Apple, Google, Amazon and Facebook. Comparing a chart of the Nasdaq 100 (large-cap, growth / technology stocks) to the S&P 500 (large-caps), the S&P 400 (mid-caps) and the S&P 600 (small-caps), you will see the divergence that has been created over the last six months. This is not an indication of a strong, broad market advance.



The recent uncertainty associated with the coronavirus has driven Treasury yields down which has helped buoy the bond / income groups that we track. Investors looking to take some risk off the table but want to continue to maintain exposure to the market with less volatility should look at the excellent risk-adjusted returns of these bond / income groups on page 8.

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	9.7%
Momentum Analysis:			
Short-Term Momentum Model	Sell	Negative	-19.7%
Intermediate-Term Momentum Model	Hold	Neutral	6.8%
Long-Term Momentum Model	Buy	Positive	15.7%
Fundamental Analysis:			
Economic Model	Buy	Positive	11.5%
Earnings Model	Hold	Neutral	10.9%
Monetary Model	Buy	Positive	18.7%
Inflation Model	Hold	Neutral	6.4%
Valuation Model	Sell	Negative	1.8%
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	Buy	Positive	NA
Investor Sentiment Analysis:			
Short-Term Sentiment Model	Hold	Neutral	7.0%
Intermediate-Term Sentiment Model	Hold	Neutral	11.1%
Long-Term Sentiment Model	Hold	Neutral	2.0%
The Weight of the Evidence Average:			7.09%
S&P 500 average gain/annum from 11/16/1979:			8.92%

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 Stock Market Scorecard has deteriorated a bit over the last month with the short– and intermediate-term momentum indicators both declining. On the positive side, the small correction at the end of January has tempered investor sentiment, which alleviates some risk of a sudden, steep selloff.

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 uptrend remains intact. The S&P 500 Index continues to reach new highs and is trending above its 200-day moving average.

Bull Market

Cyclical Market Cycle: The cyclical market environment remains strong with the Dow Jones Industrial Average in a strong uptrend.

Stock Market Environment
Momentum / Fundamental Analysis

	Signal	Indicator	Historical Return
Momentum Analysis:			
Short-Term Momentum Model	Sell	Negative	-19.7%
Intermediate-Term Momentum Model	Hold	Neutral	6.8%
Long-Term Momentum Model	Buy	Positive	15.7%

The model we use to track short-term momentum is based on a trend and breadth indicator of a universe of large-, medium- and small-cap stocks. This particular indicator has deteriorated over the last two months with the indicator moving from 'Positive' in December to 'Neutral' in January and is now 'Negative'. While the short-term momentum indicator is negative, it is not negative by much and it wouldn't take much to turn back to 'Neutral' or even 'Positive'. The intermediate- and long-term momentum models have held up better but are also starting to show signs of deterioration. Bottom line is that the current uptrend is starting to lose some of its energy. If this uptrend is to continue, we would expect to see some oomph develop to support the uptrend.

	Signal	Indicator	Historical Return
Fundamental Analysis:			
Economic Model	Buy	Positive	11.5%
Earnings Model	Hold	Neutral	10.9%
Monetary Model	Buy	Positive	18.7%
Inflation Model	Hold	Neutral	6.4%
Valuation Model	Sell	Negative	1.8%

Economic Model: The economic model, a proprietary model developed by Ned Davis Research based on 15 economic indicators, remains in bullish territory.

Earnings Model: We are starting to see a turn around in earnings growth. The decline in earnings witnessed last year appears to have abated and earnings are starting to grow again.

Monetary Model: Both monetary models that are used for this report are indicating favorable conditions.

Inflation Model: Last month I noted that while inflation remains low, we are starting to see a rise in inflation. The trend has continued as inflation has continued to trend back to more normal levels. While we are starting to see an increase in inflation, the current readings are far from levels that would cause the Fed to start acting in a manner to slow the economy.

Valuation Model: The different valuation models that we use in the *Market Monitor* continue to point to fairly expensive stock prices. Generally, future gains in the stock market are muted when valuations become too high.

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	9.7%

The short-term (0 to 3 weeks) trend of the market is up. While the S&P 500 Index entered a short-term decline during the last two weeks of January, the index has recovered those losses and resumed trending up. It is currently trending above its rising 5-Day, 10-Day and 39-Day moving averages.

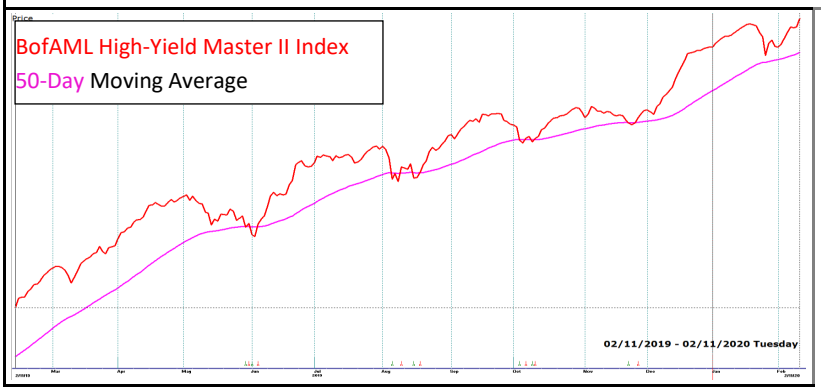
The intermediate-term (3 weeks to 6 months) trend is clearly up and has been in a solid uptrend since last September. The weekly chart of the S&P 500 Index is trending above its rising 10-Week, 30-Week and 55-Week moving averages. The index bounced off the 10-week moving average at the end of January, but never broke below that level.

The long-term (> 6 months) trend of the market is also up. The S&P 500 Index is trending above its rising 50-Day and 200-Day moving averages.

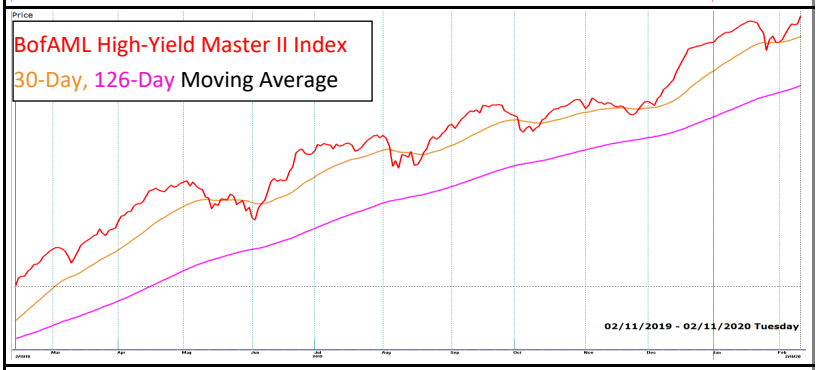
Stock Market Environment
Credit Conditions Analysis — One-Year Charts

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.

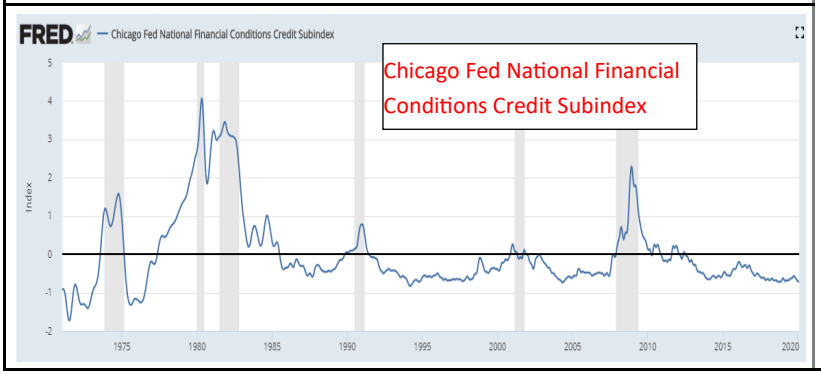
Credit Conditions Analysis:	Signal	Indicator	Historical Return
Short-Term Credit Conditions Model	Buy	Positive	NA
Intermediate-Term Credit Conditions Model	Buy	Positive	NA
Long-Term Credit Conditions Model	Buy	Positive	NA



Short-term Credit Conditions: The BofAML High-Yield Master II Index declined along with stocks during the last part of January but did not cross below its 50-Day moving average. This is a bullish sign for junk bonds and equities.



Intermediate-Term Credit Conditions: On an intermediate-term basis, junk bonds remain positive. Both the 30-Day and 126-Day moving averages remain in steady uptrends indicating that the market is still favorable for risk assets.



Long-Term Credit Conditions: Long-term credit conditions remain favorable and are showing no sign of a recession in our future. Readings below zero indicate that credit conditions are looser than average, while reading above zero indicate credit conditions that are tighter than average. The current reading is –0.73.

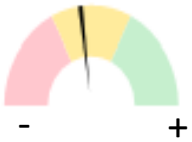
Summary: Credit conditions remain extremely strong across all time frames which bodes well for both bonds and stocks.

Stock Market Environment
Early Warning Model

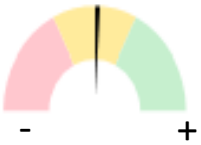
The Early Warning Model is designed to give investors an indication when the market has gone too far in one direction and whether it's ripe for a reversal in trend based on overbought / oversold and investor sentiment indicators. Like a rubber band that has been stretched too far, the market tends to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

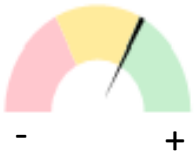
Short-term



Intermediate-term



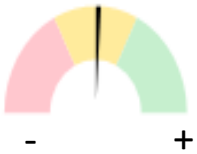
Long-term



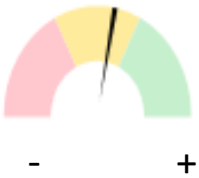
The market is currently neither overbought nor oversold across the three time frames we use for our analysis. This means that market movements will be driven by normal market forces, as opposed to a mean reversion move.

Investor Sentiment

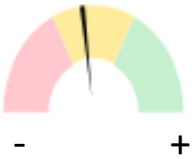
Short-term



Intermediate-term



Long-term



The downturn in the market during the last two weeks of January has worked off the extremely positive mood on Wall Street. While investors are not overly bearish, their mood has certainly become less optimistic.

Summary

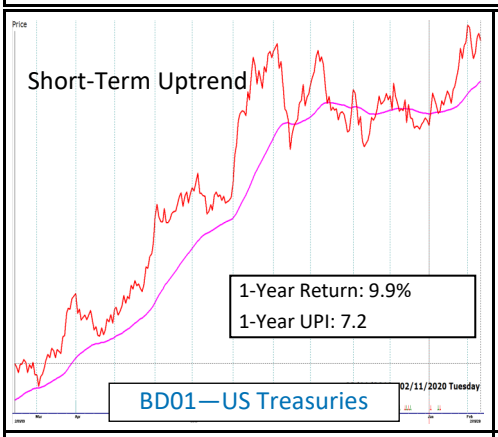
Mean Reversion Potential	Neutral
New Investment Rating	Buy

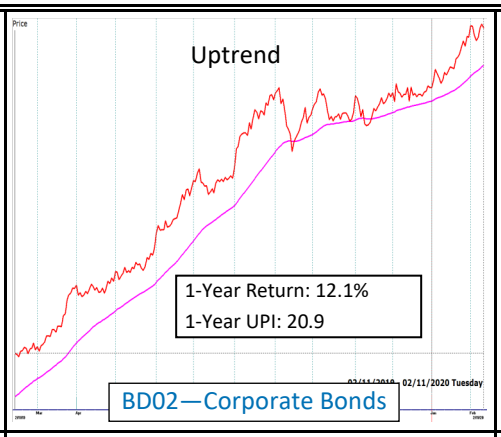
Our Early Warning Model did a good job of indicating that the market was a bit extended last month and the probability of a mean reversion move to the downside was elevated. The model is now neutral.

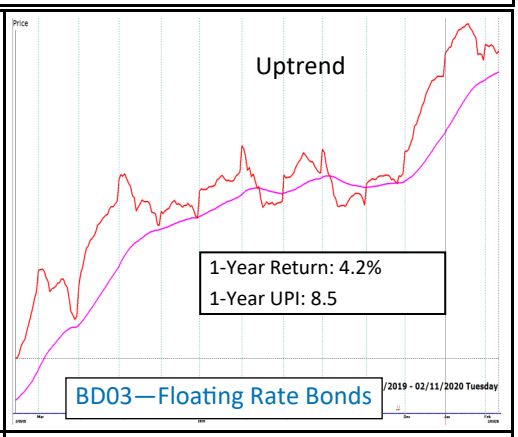
The Early Warning Model is a tool designed to provide an indication when the market has moved too far in one direction, which in our view, means the probability of a counter trend rally is above average. The Mean Reversion Potential, based on the trend reversal data displayed, is a belief that prices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

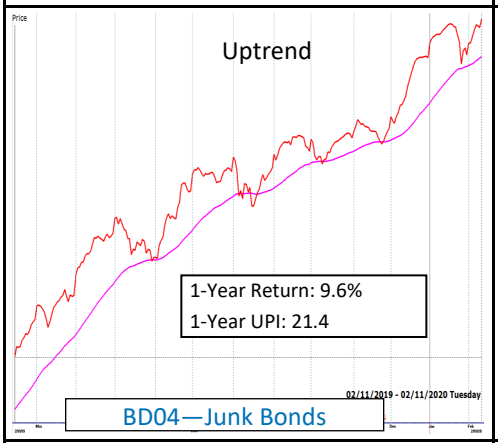
Bond / Income Environment
Overall Assessment

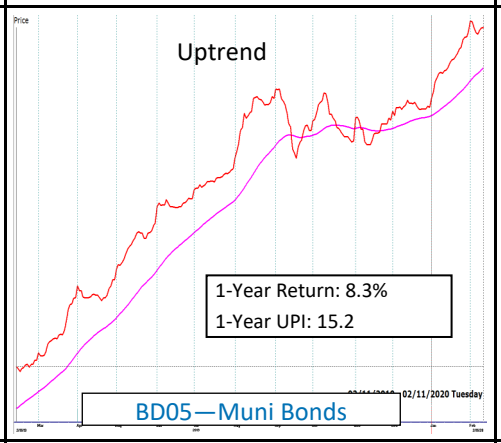
The following one-year charts represent 10 groups that encompass a large portion of the bond / income environment. Each group is an equally-weighted composition of representative mutual funds. Each group is plotted with its 50-Day moving average to help visualize the trend.

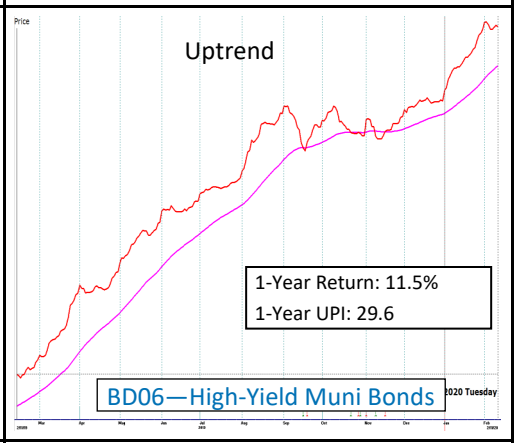


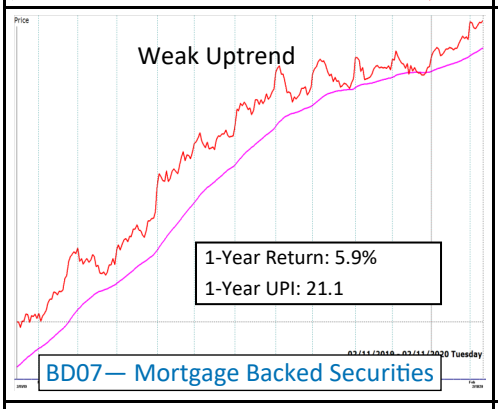


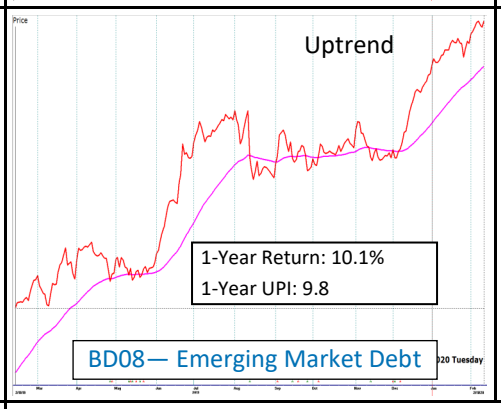


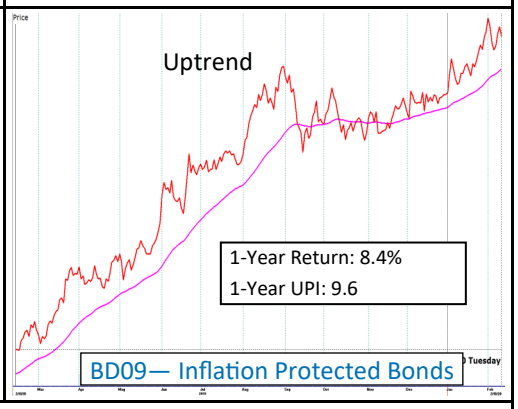


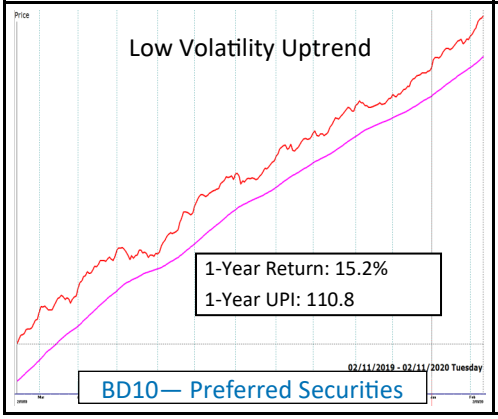












The bond / income environment remains positive. Both interest rate sensitive and economic sensitive groups are trending up. Interest rates have dropped over the last month providing support for bonds of all types. Preferred Securities (BD10) continue to provide the best risk-adjusted returns. The current trend, which has been in place for over a year now, is trending up at a 15% annualized return on extremely low volatility.

Equity and Bond / Income Environments
Overall Assessment

Overall Assessment: Overall the stock market environment remains strong but I am starting to see some cracks. While the trend of the stock market remains up, the energy behind the uptrend is starting to wane. This doesn't mean the uptrend will falter immediately, however it is something to keep an eye on. With credit conditions remaining strong, I believe that any pull backs are still good opportunities to get money invested that has been sitting on the sidelines.

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 decreased slightly this month to 77.5%. Previous readings are January: 83.1%; December: 89.8%; November: 85.6%, October: 69.8%, September: 93.3%, and August: 60%.

Equity Allocation Models	Model Rating	% Equity Allocation
RGB Market Trend Model		25.0%
RGB Market Momentum Model		12.5%
RGB Fundamental Factors Model		15.0%
RGB Credit Conditions Model		25.0%
Model Equity Allocation:		77.5%

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

Remain focused on the economic sensitive bond groups which will provide the most upside potential as long as the overall economy remains strong. Remain focused on those groups that are providing the best risk-adjusted returns (i.e. UPI). Both Preferred Securities (BD10) and High-Yield Muni Bonds (BD06) are providing reasonable returns on very low volatility.

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.