HUMBLE STUDENT OF THE MARKETS

***e*Research Corporation** is pleased to feature an article by Cam Hui, CFA who offers investment and trading insights on his website, **HumbleStudentOfTheMarkets.com**

Mr. Hui posts a market comment on the weekend plus one or two articles of interest during the week.

His subscription service includes annual, monthly, or daily pass options, and is focused on building a community of like-minded individuals with a common interest in investing and trading.

Today's article begins on the following page, and is entitled:
Mid-Week Market Update: Why The S&P 500 Will Not Get To 2400 (In This Rally)

You can access his website and subscribe to his service at the following link:
www.humblestudentofthemarkets.com

***e*Research** was established in 2000 as Canada's first equity issuer-sponsored research organization. As a primary source for professional investment research, our Subscribers (*subscription is free!!!*) benefit by having written research on a variety of small- and mid-cap, under-covered companies. We also provide unsponsored research reports on middle and larger-sized companies, using a combination of fundamental and technical analysis. We complement our corporate research coverage with a diversified selection of informative, insightful, and thought-provoking research publications from a wide variety of investment professionals. We provide our professional investment research and analysis directly to our extensive subscriber network of discerning investors, and electronically through our website: www.eResearch.ca.

Bob Weir, CFA
Director of Research

Note: All of the comments, views, opinions, suggestions, recommendations, etc., contained in this Article, and which is distributed by *e*Research Corporation, are strictly those of the Author and do not necessarily reflect those of *e*Research Corporation.

Wednesday, February 15, 2017

Mid-Week Market Update

Why The S&P 500 Will Not Get To 2400 (In This Rally)

BW: To enlarge any chart in this report, place the cursor on the chart and <Ctrl-Click>

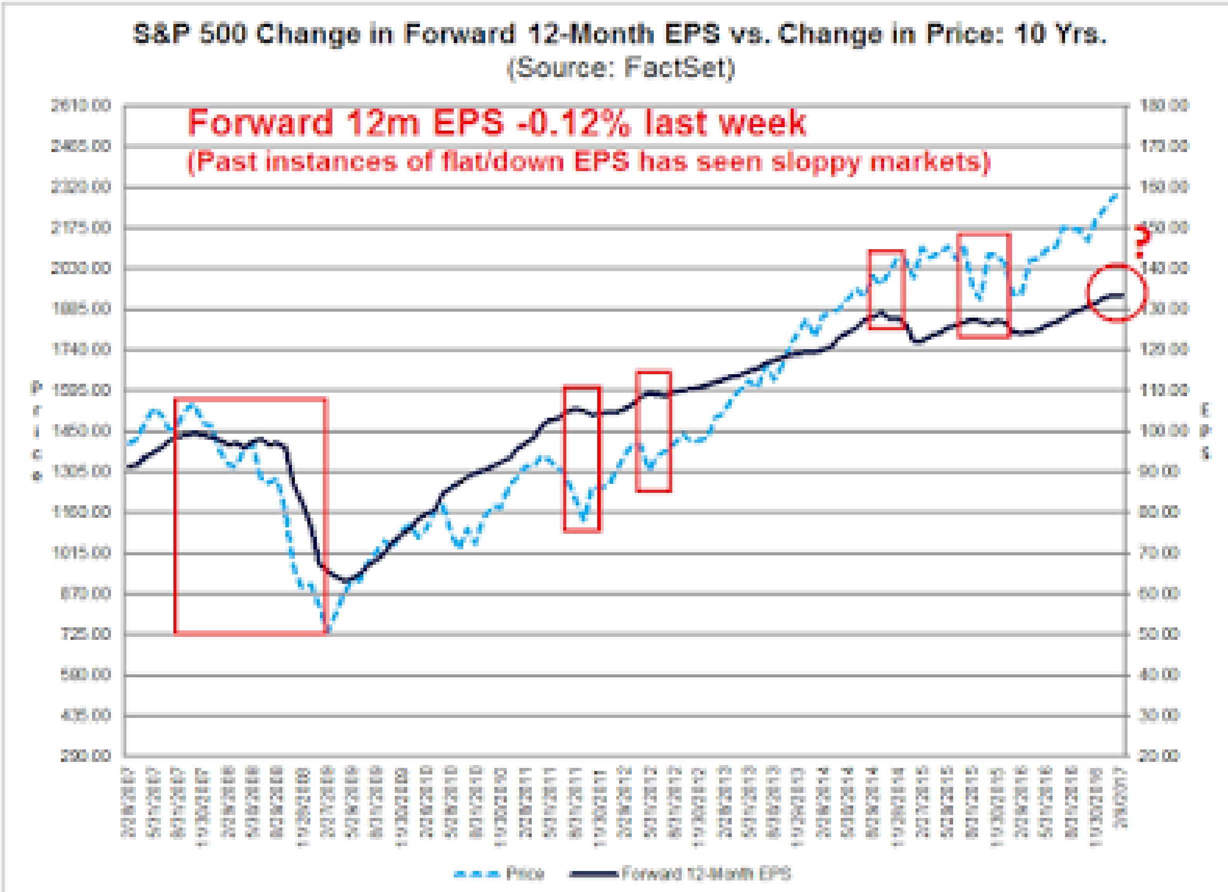
As the major market averages make new all-time highs, I conducted an informal and unscientific Twitter poll. I was surprised to see how bullish respondents were.

Let us just cut to the chase - forget it.

Neither the fundamental nor the technical backdrop is ready for an advance of that magnitude (to 2,400).

Even though the earnings and sales beat rates for Q4 earnings season is roughly in line with historical averages, FactSet (see chart, next page) reports that the 12-month forward EPS growth is stalling. Past episodes have seen stock prices struggle to make significant advances under such conditions.

<continued>



In addition, the technical condition of the market shows that it is vulnerable to a pullback.

Breadth Deterioration

This rally has raised a number of red flags.

Schaeffer's Research pointed out that the advance has been accomplished on deteriorating breadth, as measured by 52-week new highs (next two charts).

<continued>

If history is any guide, expect subpar returns pattern for the next couple of weeks.

<continued>

S&P 500 Anytime Since March 2013

	2-Week Return	1-Month Return	3-Month Return	6-Month Return
No. of Returns	965	954	912	849
Average Return	0.42%	0.88%	2.42%	4.60%
Median Return	0.48%	1.00%	2.88%	5.38%
Percent Positive	60.3%	65.0%	77.1%	82.0%
Std. Deviation	2.33%	3.12%	4.28%	5.55%

S&P 500 After All-Time High

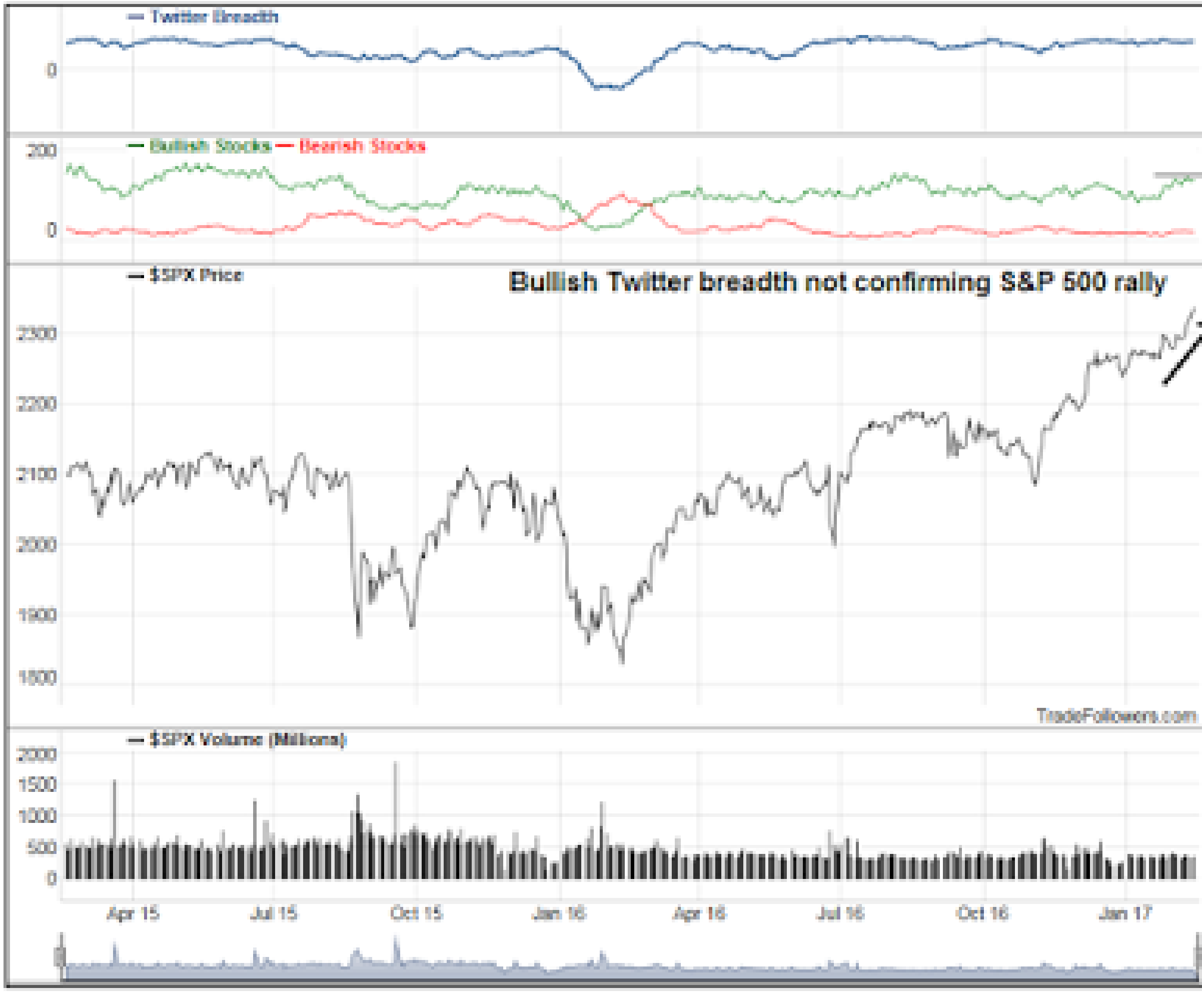
	2-Week Return	1-Month Return	3-Month Return	6-Month Return
No. of Returns	130	128	119	117
Average Return	0.12%	0.09%	1.83%	4.95%
Median Return	0.39%	0.45%	2.28%	5.80%
Percent Positive	60.8%	57.0%	75.6%	90.6%
Std. Deviation	1.51%	1.99%	2.29%	3.64%

S&P 500 After All-Time High & Weak Breadth

	2-Week Return	1-Month Return	3-Month Return	6-Month Return
No. of Returns	17	15	14	12
Average Return	0.11%	0.20%	0.88%	2.84%
Median Return	-0.16%	0.02%	0.55%	5.84%
Percent Positive	41.2%	53.3%	50.0%	58.3%
Std. Deviation	1.09%	1.78%	3.02%	5.44%

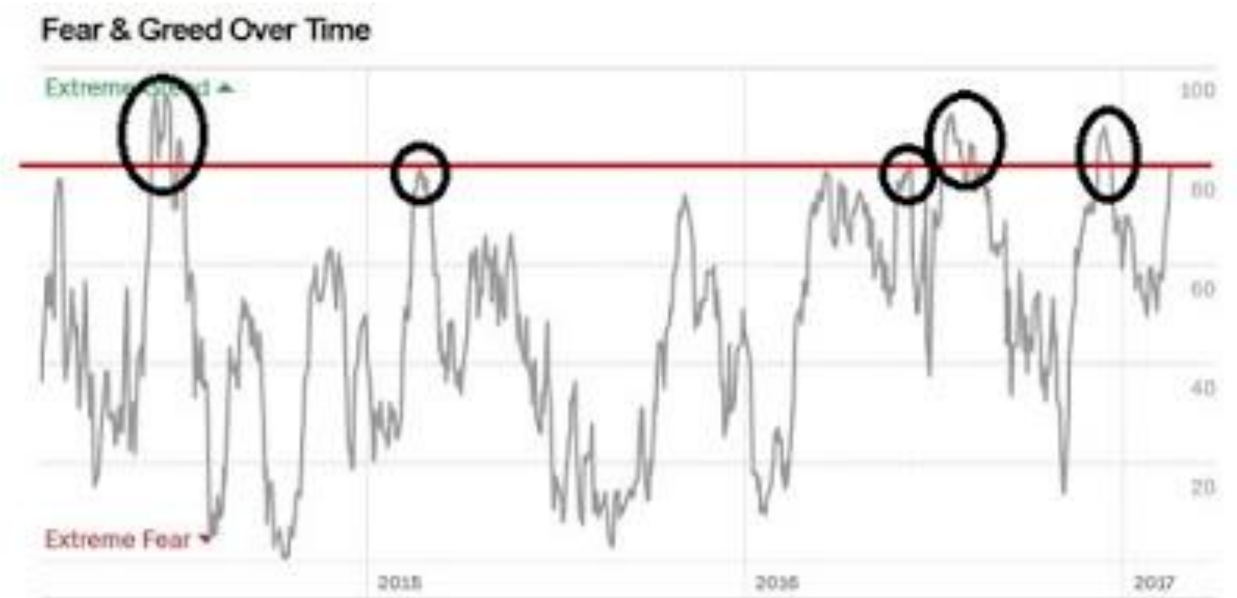
<continued>

Independent of the analysis from Schaeffer`s, this chart from [Trade Followers] shows that bullish Twitter breadth is also not advancing even as the market made new highs, indicating a different form of negative breadth divergence.



Sentiment Too Bullish

In addition, there are numerous instances of excessively bullish sentiment, which is contrarian bearish. The CNN Money [Fear and Greed Index]() is at a level where stock prices have shown difficulty rising in the past.



<continued>

The CBOE put/call ratio has fallen to levels that can only be described as giddy. Urban Carmel observed that short-term returns tend to be negative after such readings.

> **Urban Carmel** @ukarlewitz
>
> Equity only put/call 0.53. Last 2 years, $SPX closed lower within next 5 days 14 of 16 times (88%); avg max loss 0.8% vs avg max gain 0.3%
>
> > **Urban Carmel** @ukarlewitz
> > Equity only put/call 0.53. Last 2 years, $SPX closed lower within next 5 days 15 of 18 times (83%); avg max loss 1% vs avg max gain 0.2%...

The option market is flashing other anomalous signals. Even as stocks rose today, both the VIX Index rose and the VIX term structure, as measured by the VIX/VXV ratio, flattened. Such behavior by the VIX is normally a sign of rising caution. I did a study that went back to November 2007, when data for the VXV was first available. I found 117 non-overlapping similar instances. As the table below shows, historical returns were disappointing for the following week.

When the S&P 500 and VIX Index both rise and VIX term structure flattens
(November 2007 to February 2017)

	1	2	3	4	5	10	20
S&P 500 and VIX rising & VIX term structure flattens , non-overlapping periods (N=117)							
Median return	-0.26%	-0.34%	-0.32%	-0.29%	-0.25%	0.00%	0.68%
% positive	33.3%	36.8%	39.3%	41.9%	44.4%	50.4%	55.6%
Anytime S&P 500							
Median return	0.06%	0.14%	0.22%	0.26%	0.32%	0.58%	1.13%
% positive	53.9%	56.1%	57.1%	56.1%	57.4%	59.1%	62.5%
Difference							
Median return	-0.32%	-0.48%	-0.55%	-0.56%	-0.57%	-0.58%	-0.45%
% positive	-20.6%	-19.4%	-17.7%	-14.3%	-13.0%	-8.7%	-7.0%

Overbought Markets

As stock prices have risen, it is no surprise that most overbought/oversold models are showing overbought readings. Consider, for example, this chart from [Index Indicators](#) of the 5-day RSI above 70, which is a short-term (1-2 day) trading model

This chart of net stocks at 20 day highs-lows, which is a model with a longer-term (1-2 week) time horizon, is also in overbought territory.

Overbought readings like those are to be expected as the market advances. There is nothing that says overbought markets cannot stay overbought. However, an alert reader sent me the following chart, which showed that the NASDAQ 100 is reaching overbought levels not seen since 1999, which was the top of the Tech Bubble.

<continued>

Don't Get Too Bearish

Despite the combination of overbought and excessively bullish sentiment readings, my inner trader is not wildly bearish. ***Anecdotal evidence from independent sources of discussions with investment managers indicates that there is a lot of nervousness beneath the surface. This suggests to me that while stock prices may pull back in the near-term, any correction is likely to be shallow and should be bought.***

Be cautious, but don't go overboard on your short positions. My inner trader remains in cash and he is inclined to stay on the sidelines, for now.

Regards,

Cam Hui

Humble Student of the Markets, Inc.

*e*Research Disclaimer

*e*Research Disclosure Statement

***e*Research Corporation** was established in 2000 as Canada's first equity issuer-sponsored research organization. As a primary source for professional investment research, its Subscribers (subscription is free!!!) benefit by having written research on a variety of small- and mid-cap, under-covered companies.

*e*Research also provides unsponsored research reports on middle and larger-sized companies, using a combination of fundamental and technical analysis.

*e*Research complements its corporate research coverage with a diversified selection of informative, insightful, and thought-provoking research publications from a wide variety of investment professionals.

*e*Research provides its professional investment research and analysis directly to its extensive subscriber network of discerning investors, and electronically through its website: www.*e*Research.ca.

*e*Research does not manage money or trade with the general public, provides full disclosure of all fee arrangements, and adheres to the strict application of its Best Practices Guidelines.