Weekly Market Review

***e*Research Corporation** is pleased to provide a commentary courtesy of Urban Carmel of **The Fat Pitch.**

Detailed information on **The Fat Pitch** is provided at the end of the article. However, a brief overview is provided immediately below, with the article beginning on the next page.

WHAT IS THE FAT PITCH?

Specifically, the Fat Pitch on this site refers to two situations.

First: A Fat Pitch comes at a market turning point.
Second: The Fat Pitch is a favorable investing environment.

Objectives

The objective of The Fat Pitch is to provide a structured, quantitative, and empirical methodology for evaluating the state of the market. At any point in time, there are a variety of factors pulling on the market. We want to determine the relative importance of each factor in order to answer two questions:

(1) In which direction should we be investing in the market?
(2) Are tailwinds behind this direction or are headwinds picking up?

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Bob Weir, CFA
Director of Research

The Fat Pitch

March 24, 2017

Weekly Market Summary

Summary: U.S. indices have fallen nearly every day since the FOMC raised the federal funds rate on March 15th. This week, the SPX also experienced its first 1% daily loss in 109 days, bringing one of the longest such streaks in history to an end. There are a number of reasons to expect equities to be at or near a point of reversal higher. A retest of the recent high is likely.

That said, it is a good guess that the market's period of smooth, persistent strength over the past 4-5 months has come to an end. Higher volatility and more days with 1% losses (and 1% gains) lie ahead.

* * * * *

After a strong start to the year, the U.S. indices have turned weak. Since the FOMC raised the federal funds rate on March 15, SPX has closed lower 6 days and higher only once. The 13-ema is now declining, indicating that the intermediate trend is down. There has been no reversal in price, yet, but there are several reasons to believe that a reversal may be near.

On Tuesday, after 109 days, the S&P finally fell more than 1% during one trading day. This was the third longest streak without a 1% loss in the past 36 years.

The charts below look at the 5 prior times since 1980 that SPX went more than 95 days without a 1% fall. It is a small sample but there is a consistent pattern: the index rallies at least 2%-5% in the ensuing weeks. Within 2 weeks, SPX was back at its prior high 4 times. The one exception was 1993, which was also the only time that SPX was below its 50-dma; even then, it returned to its high within 2 months. In the other 4 instances, SPX was above its 50-dma, like now.

BW: You can enlarge any chart by placing the cursor on the chart and then <Ctrl-Click>.

Chart 1

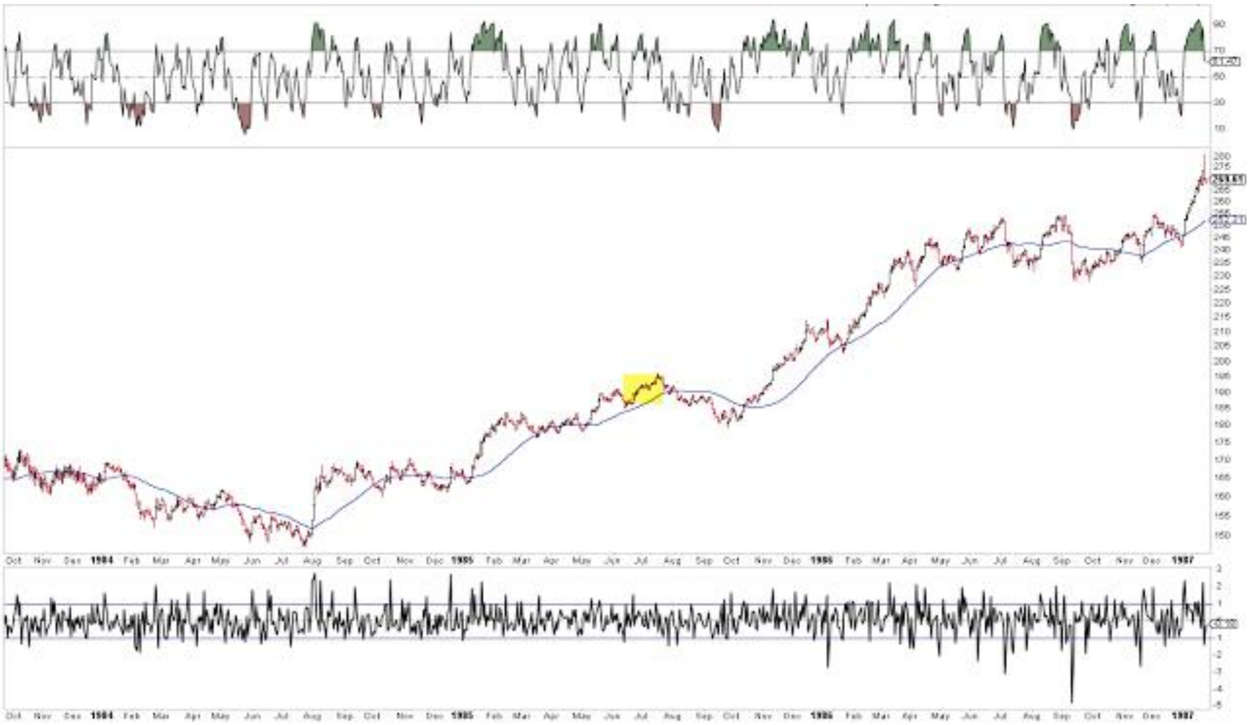


Chart 2

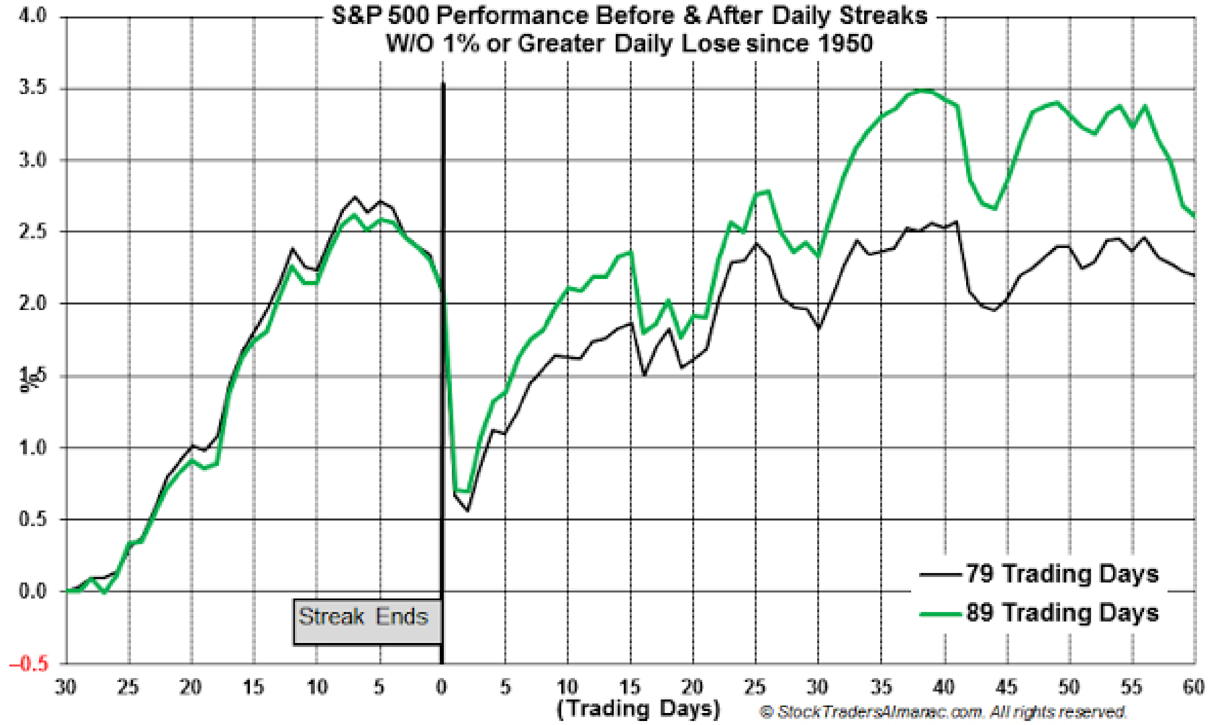
Chart 3

Chart 4

The Fat Pitch

The SPX is now less than 3% from its recent high (which was also an ATH). A rally like any of those in the prior 5 instances would put it back at its high.

Going back to 1950, there have been 15 instances where SPX went at least 89 days without a loss of 1% in one day. The pattern is essentially the same as that described above. On average, the index retested its recent high within 4-6 weeks (data from Stock Almanac).



The pattern is not only consistent but also logical: a long string of closes without a 1% drop indicates a strong trend. As we have noted many times before, trends tend to weaken before they reverse. In other words, momentum persists. So, a high retest within a few weeks would be typical.

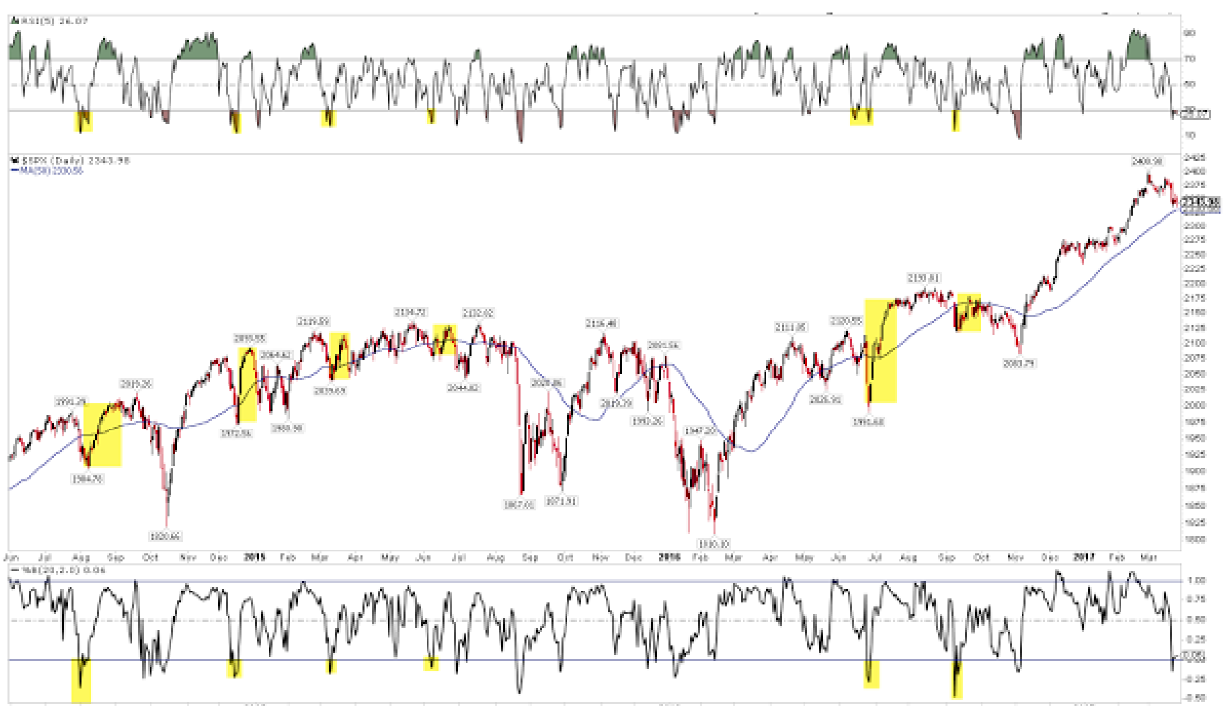
A couple of other indications make that likely now as well.

First, the DJIA closed lower 6 days in a row on Thursday. That is an unusual bout of weakness, happening only 9 other times in the past 5 years. In those other instances, the SPX went on to post a return more than 3 times the loss within the next 1-4 weeks (highlighted row). The index closed higher after 5 and 20 days nearly 80% of the time. This suggests a good upside edge heading into next week (data from @twillo1).

$SPY 20d Forward When $DJI Closes Down 6 Days in Row

		3 day			5 day			10 day			20 day		
Signal Date	Close	Highest Return	Lowest Return	Final Return	Highest Return	Lowest Return	Final Return	Highest Return	Lowest Return	Final Return	Highest Return	Lowest Return	Final Return
5/9/2012	123.09	0.2%	-1.2%	-1.2%	0.2%	-2.1%	-2.1%	0.2%	-4.4%	-2.6%	0.2%	-5.6%	-2.7%
5/18/2012	117.65	2.0%	1.7%	2.0%	2.2%	1.7%	1.8%	3.1%	-1.3%	-1.3%	4.1%	-1.3%	4.1%
7/12/2012	121.70	2.1%	1.4%	2.1%	3.2%	1.4%	3.2%	3.2%	0.3%	2.0%	5.3%	0.3%	5.3%
8/21/2013	153.36	1.3%	0.9%	0.9%	1.3%	-0.7%	-0.4%	1.3%	-0.7%	0.8%	5.2%	-0.7%	5.0%
10/16/2014	177.69	4.2%	1.2%	4.2%	4.6%	1.2%	4.6%	7.0%	1.2%	7.0%	9.6%	1.2%	9.6%
8/6/2015	201.71	1.1%	-0.2%	0.2%	1.1%	-0.2%	0.1%	1.1%	-2.1%	-2.1%	1.1%	-10.1%	-6.1%
8/25/2015	181.31	6.4%	3.8%	6.4%	6.4%	2.4%	2.4%	6.4%	2.4%	4.0%	6.9%	2.4%	3.9%
8/1/2016	214.58	-0.2%	-0.6%	-0.2%	0.6%	-0.6%	0.5%	1.0%	-0.6%	1.0%	1.0%	-0.6%	0.7%
11/3/2016	207.56	2.6%	-0.1%	2.6%	3.9%	-0.1%	3.9%	4.9%	-0.1%	4.9%	6.1%	-0.1%	5.2%
	Average	2.2%	0.8%	1.9%	2.6%	0.3%	1.6%	3.1%	-0.6%	1.5%	4.4%	-1.6%	2.8%
	Median	2.0%	0.9%	2.0%	2.2%	-0.1%	1.8%	3.1%	-0.6%	1.0%	5.2%	-0.6%	4.1%
	Pos	8	5	7	9	4	7	9	3	6	9	3	7
	Neg	1	4	2	0	5	2	0	6	3	0	6	2
	Total	9	9	9	9	9	9	9	9	9	9	9	9
	% Pos	89%	56%	78%	100%	44%	78%	100%	33%	67%	100%	33%	78%
	% Neg	11%	44%	22%	0%	56%	22%	0%	67%	33%	0%	67%	22%

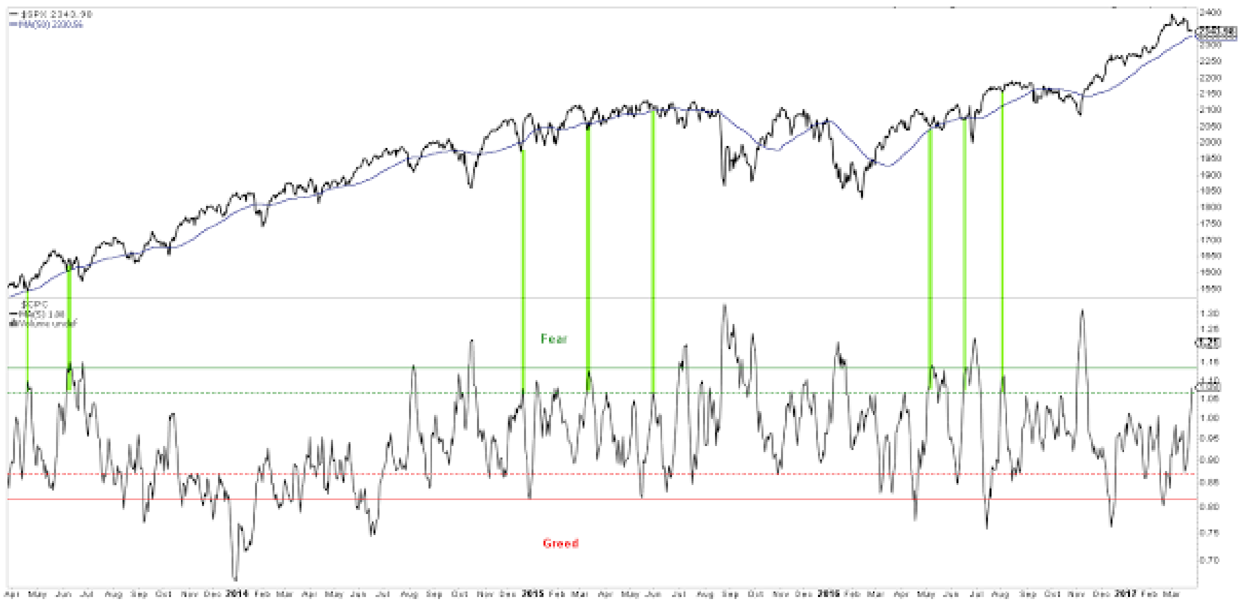
Second, SPX ended the week quite "oversold" as measured by its relative momentum (top panel) and its proximity to its lower Bollinger Band (lower panel). When this happens together for the *first time in an uptrend*, it normally leads price higher, even if the bounce ultimately fails. (Context matters: this combination under a flat or falling 50-dma usually leads to lower prices).



Third, SPX ended the week right above its 50-dma. That can often be an approximate area of first support (blue line). On further weakness next week, about 1% lower is the 2300 "round number" support area that was strong resistance for 2 weeks in late January and early February (green line). That would likely be a very significant area to look for a reversal.

Fourth, the volatility index, VIX, closed near its upper Bollinger on Thursday and Friday. It is near its highest level since the November election. In an uptrend, that is also most often supportive of a reversal higher in the SPX (top panel), even if the bounce ultimately fails.

Finally, the total put/call ratio jumped to its highest close (1.2) since the election on Friday, indicating heightened fear among investors. In the past 3 years, there have been more than 50 similar jumps in this ratio: SPX has closed higher within 5 days 92% of the time with an average maximum gain of 1.8%. The 5-day average put/call ratio is also the highest since November: in an uptrend, SPX most often moves higher.



Add to all of this that the upcoming week marks the end of March and the end of the first quarter, and there are a number of reasons to expect the weak intermediate trend to be near a point of reversal.

That said, it is a good guess that the market's period of smooth, persistent strength over the past 4-5 months has come to an end. Even strong uptrends like this one, and the one in 2013, eventually succumb to periods of weakness.

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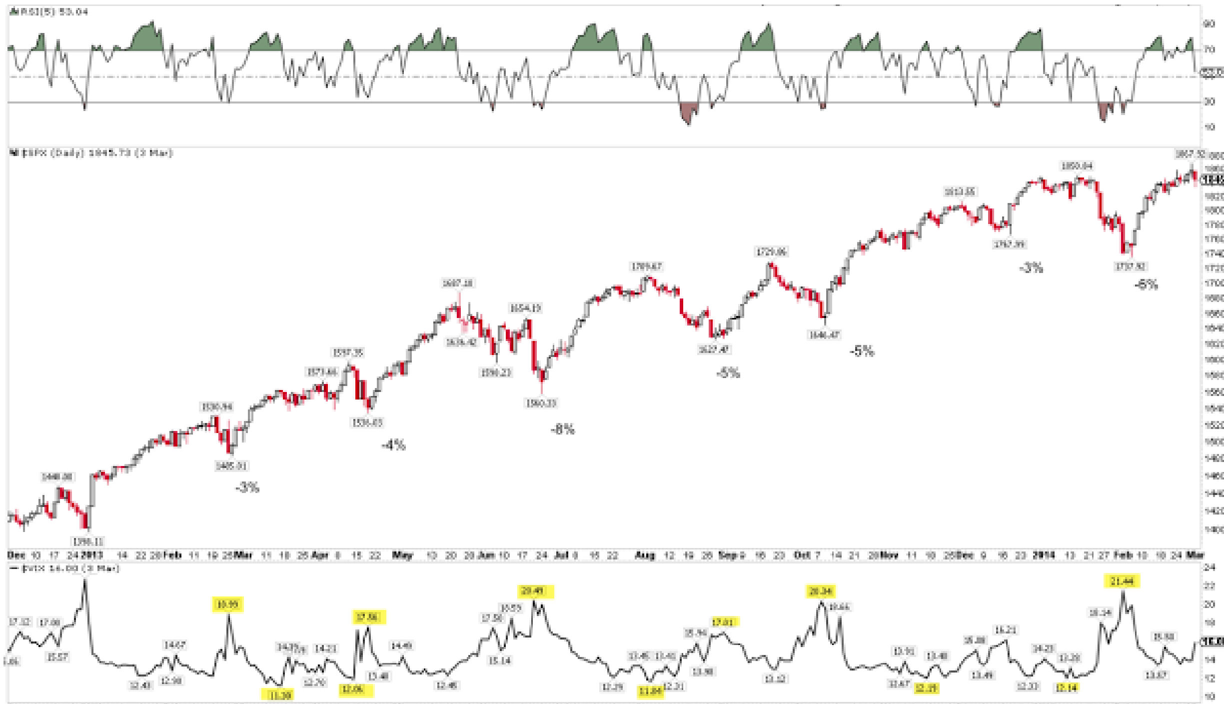
Recall that while SPX gained 30% in 2013, it also fell 3%-8% at six different points during the year, usually every other month (% decline indicated on the chart). The VIX started 2013 low like it has been so far in 2017 but shot to 17-20 multiple times during the year (lower panel; a full post on this is here).



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The Fat Pitch

So far in 2017, there has been just one day where SPX gained more than 1% and one day where it lost more than 1%. In the past 30 years, the only year even close to that low level of daily volatility was 1995. It is a good bet that many more weeks like the one that just ended lie ahead (data from Charlie Bilello).

S&P 500: Number of 1% Up and Down Days (1928 - 2017)

Year	1% Down Days	1% Up Days	Year	1% Down Days	1% Up Days	Year	1% Down Days	1% Up Days
1928	27	40	1958	5	13	1988	31	37
1929	48	66	1959	14	8	1989	14	26
1930	70	58	1960	17	14	1990	42	33
1931	97	69	1961	3	11	1991	25	34
1932	95	86	1962	34	24	1992	11	17
1933	75	87	1963	3	3	1993	7	10
1934	59	61	1964	3	0	1994	15	12
1935	40	51	1965	7	1	1995	4	9
1936	29	59	1966	25	16	1996	17	21
1937	62	55	1967	9	10	1997	31	50
1938	67	74	1968	9	10	1998	32	47
1939	52	52	1969	18	7	1999	40	52
1940	35	36	1970	33	30	2000	54	48
1941	29	25	1971	14	18	2001	54	51
1942	26	33	1972	6	4	2002	72	53
1943	17	25	1973	43	35	2003	37	45
1944	8	8	1974	67	47	2004	20	21
1945	21	25	1975	35	45	2005	17	13
1946	37	39	1976	14	25	2006	13	16
1947	30	30	1977	12	5	2007	34	31
1948	26	28	1978	24	19	2008	75	59
1949	15	17	1979	13	17	2009	55	62
1950	22	33	1980	37	43	2010	37	39
1951	17	19	1981	30	24	2011	48	48
1952	8	5	1982	38	44	2012	21	29
1953	16	8	1983	26	29	2013	17	21
1954	5	10	1984	16	25	2014	19	19
1955	19	23	1985	7	22	2015	31	41
1956	21	23	1986	25	35	2016	22	26
1957	25	17	1987	42	53	2017	1	1

Pension Partners — THE ATAC ROTATION MANAGER   @CharlieBilello

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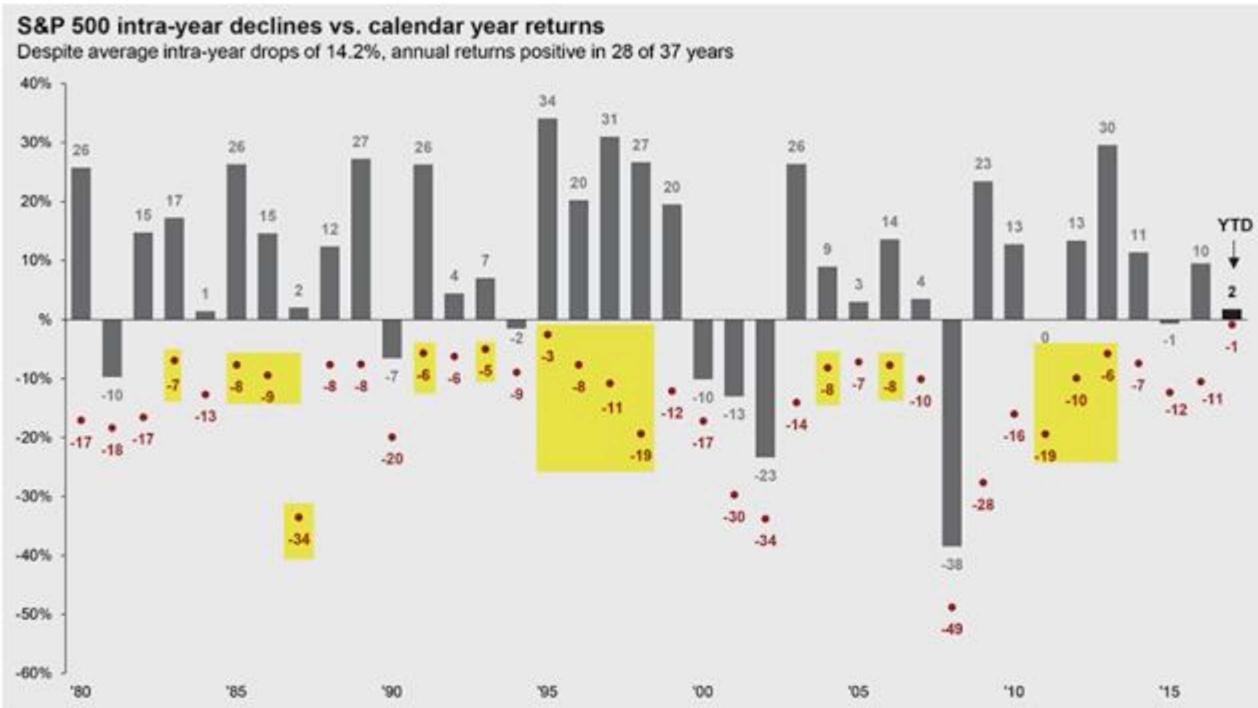
Also, recall that even in the market's best years, an intra-year drawdown of 7%-8% is normal.

The chart below highlights those years that, like 2017, started with gains in both January and February. The median drawdown was 8%. From the recent high in SPX, an 8% drawdown would return SPX to its early December level of 2200 (data from JPM).



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2016, except for 2017, which is year to date.
Guide to the Markets – U.S. Data are as of January 31, 2017.

J.P.Morgan

But, even if the index now fails to retest the recent high and, instead, falls further, the uptrend in the markets has most likely not ended.

Recall that SPX has now gone 95 days since the last 3% drawdown, the longest streak since the 150 days between July 2006 to February 2007.

The chart below shows the duration and magnitude of the current rally relative to other long streaks in the past 14 years (yellow highlighting equals the current rally).

The Fat Pitch

The message: momentum like this weakens before it reverses. In each of the cases highlighted above, after a 3%-5% drawdown, SPX either continued higher or retested the prior high before falling lower. Mid-2011, 2012, and 2014 are recent examples of the latter case (arrow marks the high retest that then led to a larger failure).

In summary, U.S. indices have turned weak since the rise in the federal funds rate on March 15th, but there are a number of reasons to expect equities to be at or near a point of reversal higher. A retest of the recent high is likely. That said, it is a good guess that the market's period of smooth, persistent strength over the past 4-5 months has come to an end. Higher volatility and more days with 1% losses (and 1% gains) likely lie ahead.

On the calendar this week: GDP is reported on Thursday and PCE is reported on Friday, which is also the end of the first quarter.

BW: Information on Mr. Urban Carmel and his blog, The Fat Pitch, follows on the ensuing page.

The Fat Pitch

WHAT IS THE FAT PITCH?

In baseball, a fat pitch is a hittable ball. The odds are in your favor. You might miss, but it is a situation where you should take a swing of the bat. If you swing at good pitches and avoid the crappy ones, you improve your OBP. Once on base, it becomes a running game.

The stock market serves a lot of curve balls. Now and then there comes a Fat Pitch, your odds-on opportunity to swing the bat. So, get on base and then manage your base-runners.

Specifically, the Fat Pitch on this site refers to two situations.

First: A Fat Pitch comes at a market turning point. It is an identifiable and quantifiable capitulation point where sellers or buyers have become exhausted and panic or euphoria is at an extreme. The Fat Pitch here is measured by a combination of (in no particular order): put-call, Trin, NYMO, sentiment, fund cash balances, major accumulation or distribution, volume, price relative to Bollinger bands, volatility, and consecutive days in a row in one direction. Swinging the bat without popping up is the hardest part.

Second: The Fat Pitch is a favorable investing environment. Old hands talk about there being only a few good times each year to be involved in the market. The remainder are unprofitable. I think this is correct. The Weekly Market Summary is intended to help discern when it is favorable to be long (or short) and when it is best to work on improving your French.

Every day, week, and year is a learning experience. The purpose of this site is to help refine what constitutes a Fat Pitch. Like baseball, you have to continue to work on your swing.

Our Objectives

The objective of the Fat Pitch is to provide a structured, quantitative, and empirical methodology for evaluating the state of the market. At any point in time, there are a variety of factors pulling on the market. We want to determine the relative importance of each factor in order to answer two questions:

1. In which direction should we be investing in the market?
2. Are tailwinds behind this direction or are headwinds picking up?

Every Friday we publish a Weekly Market Summary with green, yellow, and red lights on it. Green is good and red is bad. Everything on this site is in support of this market summary.

The little tabs across the top of the site (trend, breadth, etc.) mirror the different factors we follow to monitor the market. There is nothing here that does not fit with the methodology.

Anytime you want to understand why a factor is red or green, click on the tab and read the accompanying analyses. To the fullest extent possible, we quantify and use empirics to determine the state of every factor.

The Fat Pitch is authored by Urban Carmel, see below.

Urban Carmel

Strategy Consultant and Finance Commentator

Current	The Lewis Carmel Group
Previous	UBS Securities Indonesia, East Asia Hamon Asset Management, McKinsey & Company
Education	Wharton School, University of Pennsylvania

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