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Long-Term and Short-Term Signals Suggest Caution Ahead

***e*Research Corporation** is pleased to provide an article by Keith Richards of **VALUETREND**.

In this article, Mr. Richards reviews his Bear-o-meter, and looks at both a long-term and short-term market signal that indicates investors should be cautious ahead.

The article is reproduced below, beginning on the next page, or you can go directly to it at the following link: ***http://www.valuetrend.ca/long-termed-short-termed-signals-suggest-caution/***

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Friday, September 15, 2017

Long-Term and Short-Term Signals Suggest Caution Ahead

By: Keith Richards (bio at end)

For those who follow this blog regularly, you may know that I follow two macro-market timing models.

One of these models is less of a "timing" model than a "risk vesus reward" model. It is called the "Bear-o-meter". It looks at big-picture factors like breadth, seasonality (**Thackray** and **Vialoux's** work), long-term trends, and sentiment. It does not tell you to sell or buy NOW. It gives you a heads-up, often months in advance, of a significant move. It is not great with near-term timing, and it is not supposed to be. Further, it only measures potential risk/return. As you know, risk and return are present on the markets at all times. A weak Bear-o-meter reading does not imply that return potential is gone. A strong reading does not rule out the risk.

The other model I use is a short-term timing model. It is designed to offer some guidance on the potential for a near-term move. It is pretty accurate. You can see about a year of the signals on the chart at the bottom of this blog. The system tends to catch many peaks and troughs. The down-side with the short-term timing model is that it does not signal macro moves. It does not tell us the extent of a move. We can get a sell signal and, thereafter, witness a 3% move. Hardly worth trading.

Here is a blog that I posted back in 2016 that explains the methodology of the two systems.

I use both models to give me a feel for what is going on. Obviously, a sell-signal on the short-timing model is more significant within a "high risk" Bear-o-meter environment. Again, though, the Bear-o-meter is a probability indicator, not a timing model. So, the signal on the short-timing model within a low Bear-o-meter environment can still just lead into a blip. But, the odds are, it will be a bigger than normal "blip" in a low Bear-o-meter environment.

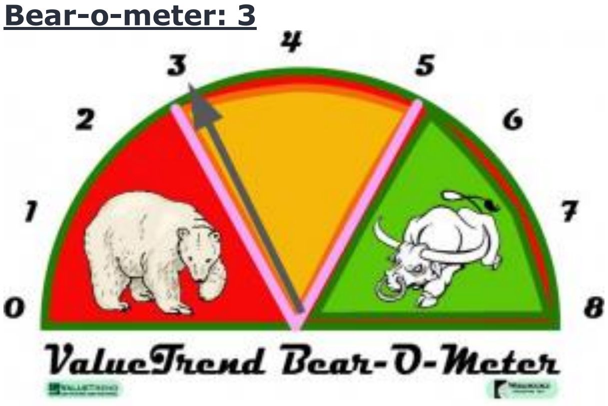
Whew! All of that sounds like a disclaimer, which I guess it is. I needed to put into context what I am about to tell you.

Which is that the market looks to be setting up for a correction within a cautious (although not high risk) Bear-o-meter reading.

Here are the details.

<continued>

Bear-o-meter: 3

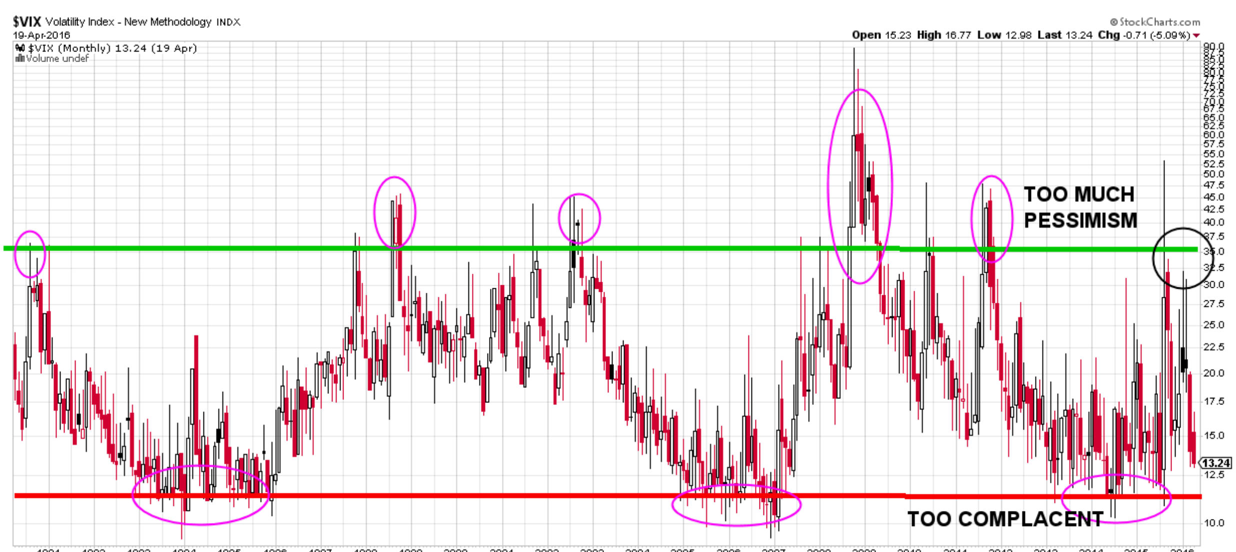


A reading of 3 was taken on September 7th. Most indicators within the model were neutral (such as breadth, one of the sentiment indicators) or bullish (trend). One of the sentiment readings is the VIX. It is still reading at higher risk (bearish) level, although it has been there for quite some time. Note that the VIX has a history of staying at the low extreme for many, many months – even a few years. It has been accurate in signalling eventual sell-offs, albeit away ahead of time!

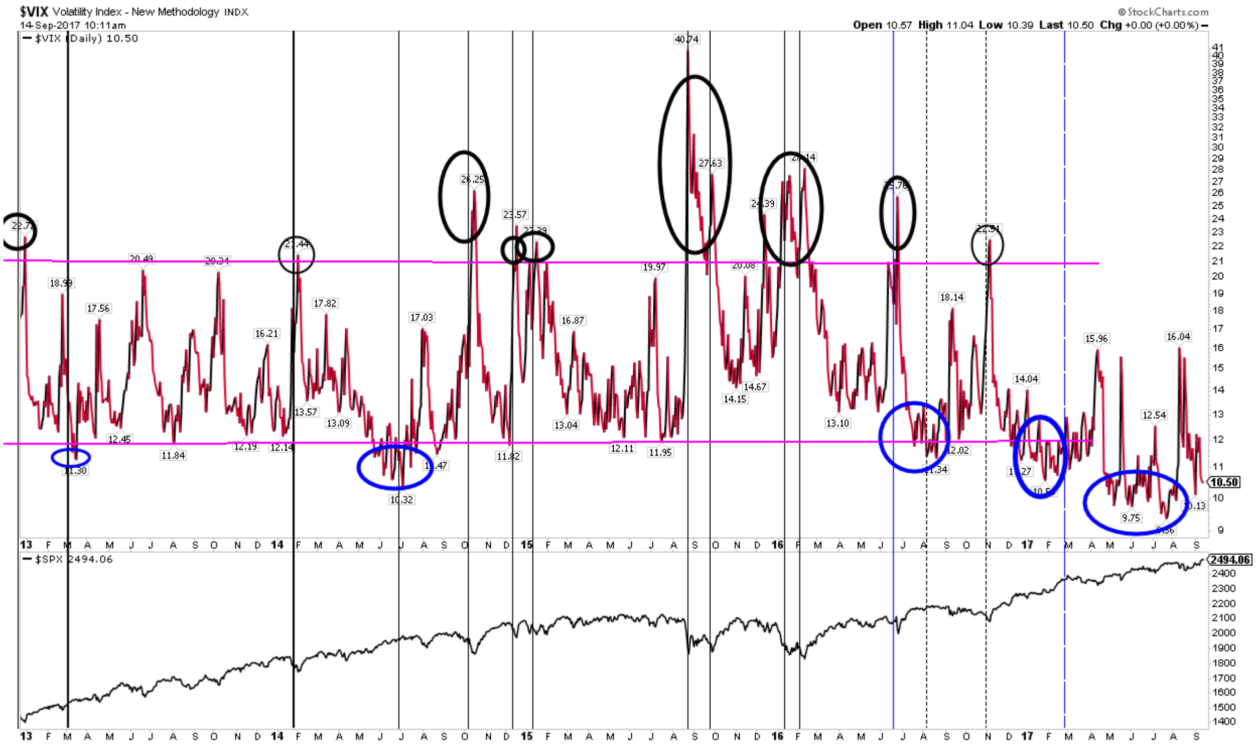
The long term VIX chart below shows a good signal ahead of the 1997-98 Asian Contagion (Russia near bankruptcy, etc.) sell-off.

The VIX was not at the lows before the 1999 tech peak and subsequent crash – so no signal there. I think that is because the tech stocks commanded a higher option premium in the late 1990s for the excitement surrounding them. The VIX normally tries to read complacency versus fear. But any form of volatility, even one passed on positive expectations, can increase option premiums to abnormal levels. The VIX is not as good a contrarian sentiment indicator in that environment.

Note that the VIX did provide good buy signals (green pessimism line) after the 1998, 2001, 2008, 2011, and early 2016 market sell-offs.



Note that the shorter-term chart of the VIX below does show you that the indicator sits at around 10 right now. I view anything below 12 as a negative point within the Bear-o-meter.



So, we have a low-neutral to cautious reading on the Bear-o-meter macro risk compilation—right on the line between neutral and high risk. This suggests holding stocks, but also holding some cash. It is not a "run for the hills" environment. But it is not a "sell the farm and buy stocks" environment either. Far from it.

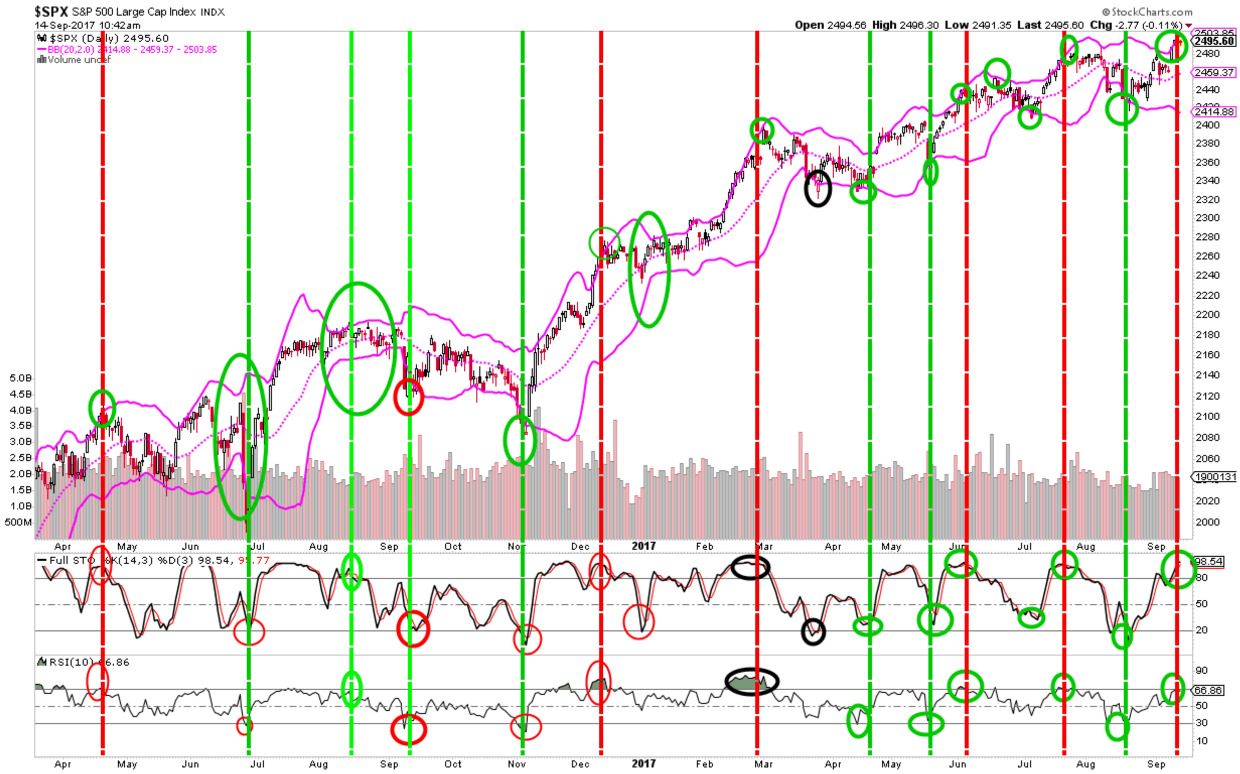
Short-Term Timing Signal: "Sell"

In order for a buy or sell signal to be initiated on the short-term timing model, you need all three indicators on the chart below to reach their respective overbought/ oversold levels.

In a nutshell: A sell is signalled by a concurrent overbought signal on RSI, an overbought signal on Stochastics, and a touch of the upper Bollinger Band.

A buy is signalled by an oversold signal on Stochastics and RSI and a lower Bollinger Band test.

Ideally, a hook from all three would occur before acting on a signal. Further, keep in mind that nothing is guaranteed to work, and you might get a false signal. Finally, the extent of a move might be minimal and not worthy of a trade—something you cannot measure ahead of time.



The chart above shows us the makings of a sell-signal right now. History of the system over the past 1.5 years can be seen by the red vertical lines, which line up the sell signals, and the green vertical lines, which line up the buy signals. Of note: The deeper the RSI or Stochastics signal, the better. They are reasonably deep (overbought) now. All things being equal, it is a good "sell" set-up. Traders should wait for a hook.

Conclusion

We are in a macro environment of poor return versus risk potential according to the Bear-o-meter.

We have a near-term sell signal, or close to it (wait for the hook to make it official) on the short-term timing model.

All in, it may be wise to maintain a cautious stance at this point. There may be a buying opportunity approaching.

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See **About The Author** below.

ABOUT THE AUTHOR

ValueTrend Founder and Owner, Keith Richards, has been in the securities industry since 1990. ValueTrend manages over $100 million through a discretionary investment service for high-net-worth clients.

Keith Richards has been in the securities industry since 1990 and is a highly regarded member of the small, exclusive community of Chartered Market Technicians in Canada. Mr. Richard's articles appear regularly in INVESTORS DIGEST, MONEYLETTER, GLOBE AND MAIL, and the TORONTO STAR newspapers.

His appearances on BNN Television have inspired producers to acknowledge him as **"one of [our] most accurate technical analysts."** Mr. Richard's first book, SMARTBOUNCE: 3 ACTION STEPS TO PORTFOLIO RECOVERY, is available in bookstores and directly through his blog page **www.valuetrend.ca/blog/**. His second book, SIDEWAYS: USING THE POWER OF TECHNICAL ANALYSIS TO PROFIT IN UNCERTAIN TIMES was released in late 2011. He has been critical of the commission-based, follow-the-pack approach to investing – where brokers succeed regardless of performance.

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