Junk Bond Strength Is Bullish For Stocks

***e*Research Corporation** is pleased to provide a weekly commentary, authored by Tom McClellan, entitled "The McClellan Chart-In-Focus", which is a free technical analysis article published each week.

In this article, Mr. McClellan shows why the strength in junk bonds is a positive indicator for strength in stocks.

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Bob Weir, CFA
Contributing Analyst

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The McClellan Chart-In-Focus

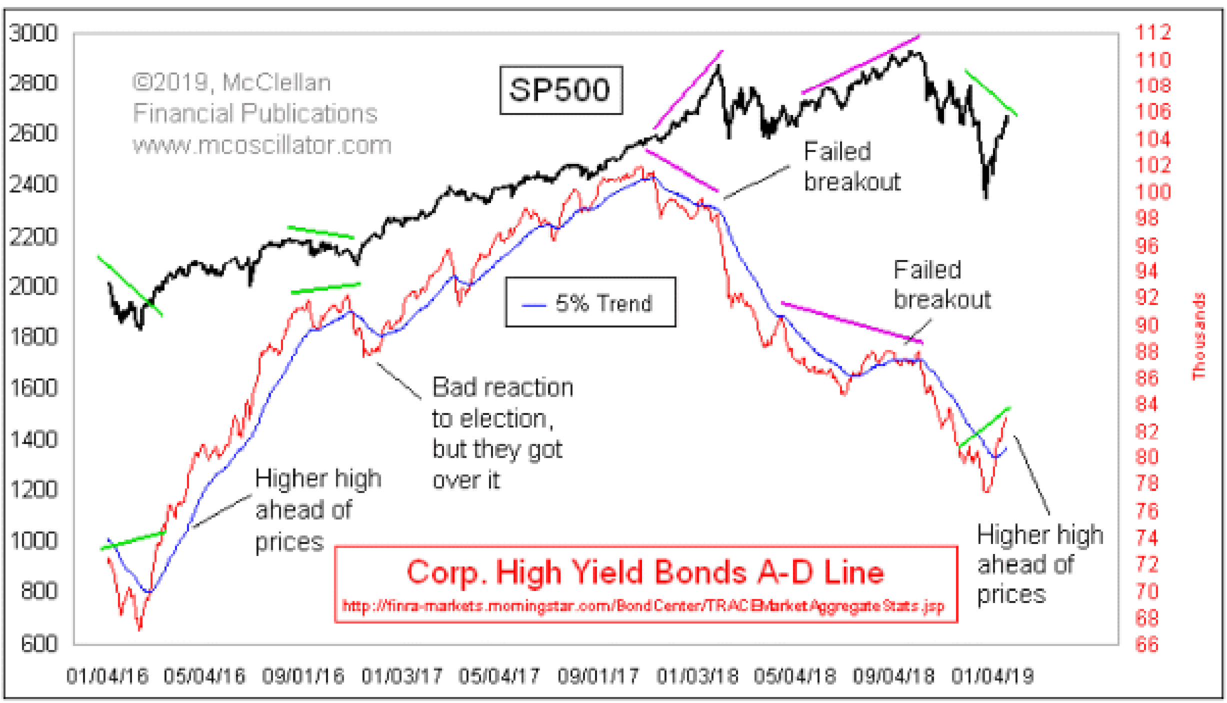
by Tom McClellan (bio at end)

Junk Bond Strength Is Bullish For Stocks

High-yield bonds, or "junk" bonds, are corporate bonds, but they trade a lot more like the stock market than they do like T-Bonds. What is more, they are much more liquidity-sensitive than most stocks, and so when liquidity turns bad (or good), it often shows up first in the behavior of junk bonds.

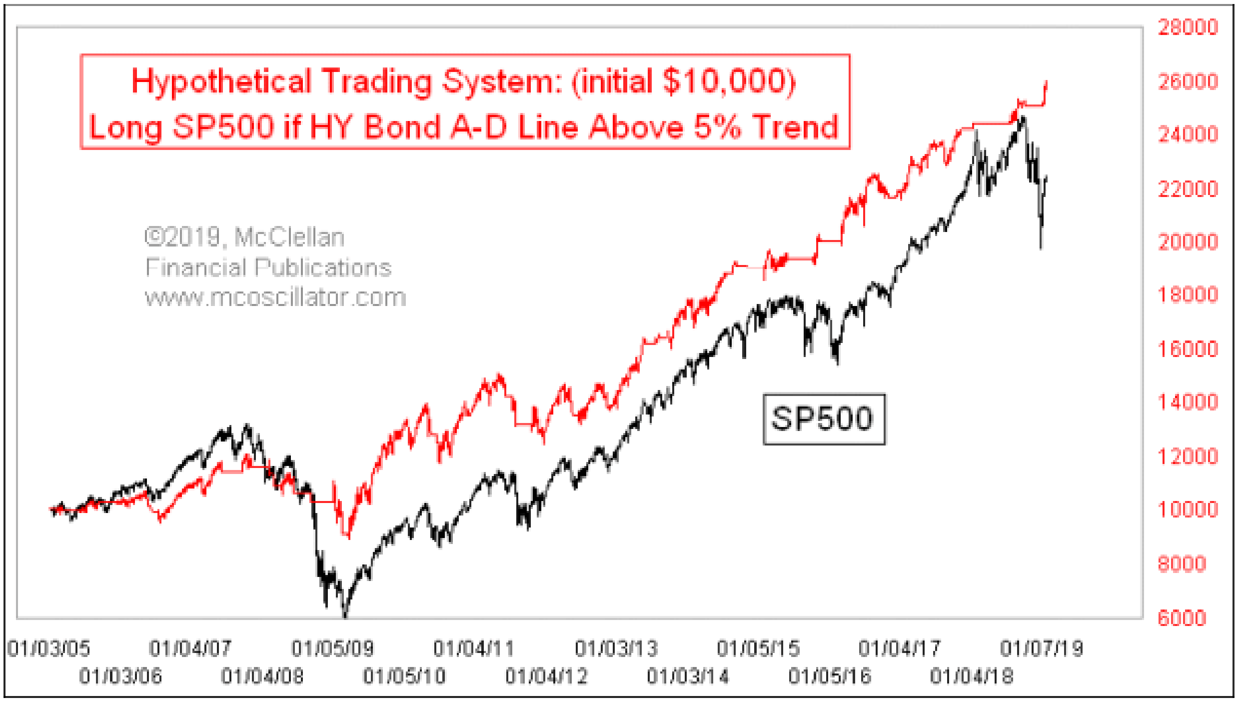
FINRA publishes each day the Advance-Decline (A-D) data for corporate bonds, breaking them down into different categories. This week's chart features a cumulative Daily A-D Line for FINRA's "high yield" category. I don't know how they make their determinations of which bonds fit into which groups; that is up to FINRA, and is not something I can control so I don't worry about it. But I really do appreciate them making these data available, because of what a great indicator this A-D Line is.

It told us ahead of the January 2018 market top that there was trouble brewing. Even the NYSE's A-D Line failed to show us a divergence ahead of that one. And this A-D Line iterated that liquidity problems were present at the October 2018 price top.



Now we are seeing a much different message. Junk bonds have led the way higher coming out of the December 24 bottom, moving up above the 5% Trend, and now making a higher high ahead of prices. It did this same behavior back in early 2016, correctly telling us then that liquidity had been restored after the ugliness of late 2015 and January 2016.

Having a strong A-D Line for high-yield bonds is a message of strength for the stock market. To demonstrate this, here is a hypothetical trading system that goes long the SP500 if this A-D Line is above its 5% Trend, or out to cash if it is below that EMA:



This is not an actual equity curve, and not an ideal trading system. It exits early at tops, and has a delay getting back in after bottoms. And I did not make allowance for commissions, dividends, interest on cash, or other factors that are important in a trading system design. I would not recommend anyone actually trade based on just this signal. I am just featuring it here to help reveal how important it is for the health of the SP500 to have junk bonds showing strength like they are showing now.

Tom McClellan, Editor,

The McClellan Market Report

BW: Information on Tom McClellan and *The McClellan Market Report* and *The Daily Edition* is provided on the following page.

ABOUT THE AUTHOR

Tom McClellan

Tom McClellan has done extensive analytical spreadsheet development for the stock and commodities markets, including the synthesizing of the four-year Presidential Cycle Pattern. He has fine-tuned the rules for inter-relationships between financial markets to provide leading indications for important market and economic data.

Tom is a graduate of the U.S. Military Academy at West Point, where he studied aerospace engineering, and he served as an Army helicopter pilot for 11 years. He began his own study of market technical analysis while still in the Army, and discovered ways to expand the use of certain indicators to forecast future market turning points.

Tom views the movements of prices in the financial market through the eyes of an engineer, which allows him to focus on what the data really say rather than interpreting events according to the same "conventional wisdom" used by other analysts.

In 1993, he left the Army to join his father in pursuing a new career doing this type of analysis. Tom and his Father spent the next two years refining their analysis techniques and laying groundwork.

In April 1995 they launched their newsletter, The McClellan Market Report, an 8-page report covering the stock, bond, and gold markets, which is published twice a month. They utilize the unique indicators they have developed to present their view of the market's structure as well as their forecasts for future trend direction and the timing of turning points.

A Daily Edition was added in February 1998 to give subscribers daily updates on their indicators and also provide market position indications for stocks, bonds, and gold. Their subscribers range from individual investors to professional fund managers. Tom serves as editor of both publications, and runs the newsletter business from its location in Lakewood, WA.

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