S&P 500 Technical Analysis Review 09-10-20

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A technical review of the S&P 500 using daily, weekly, and monthly charts to determine overbought, oversold, and risk/reward scenarios for carrying equity exposure.

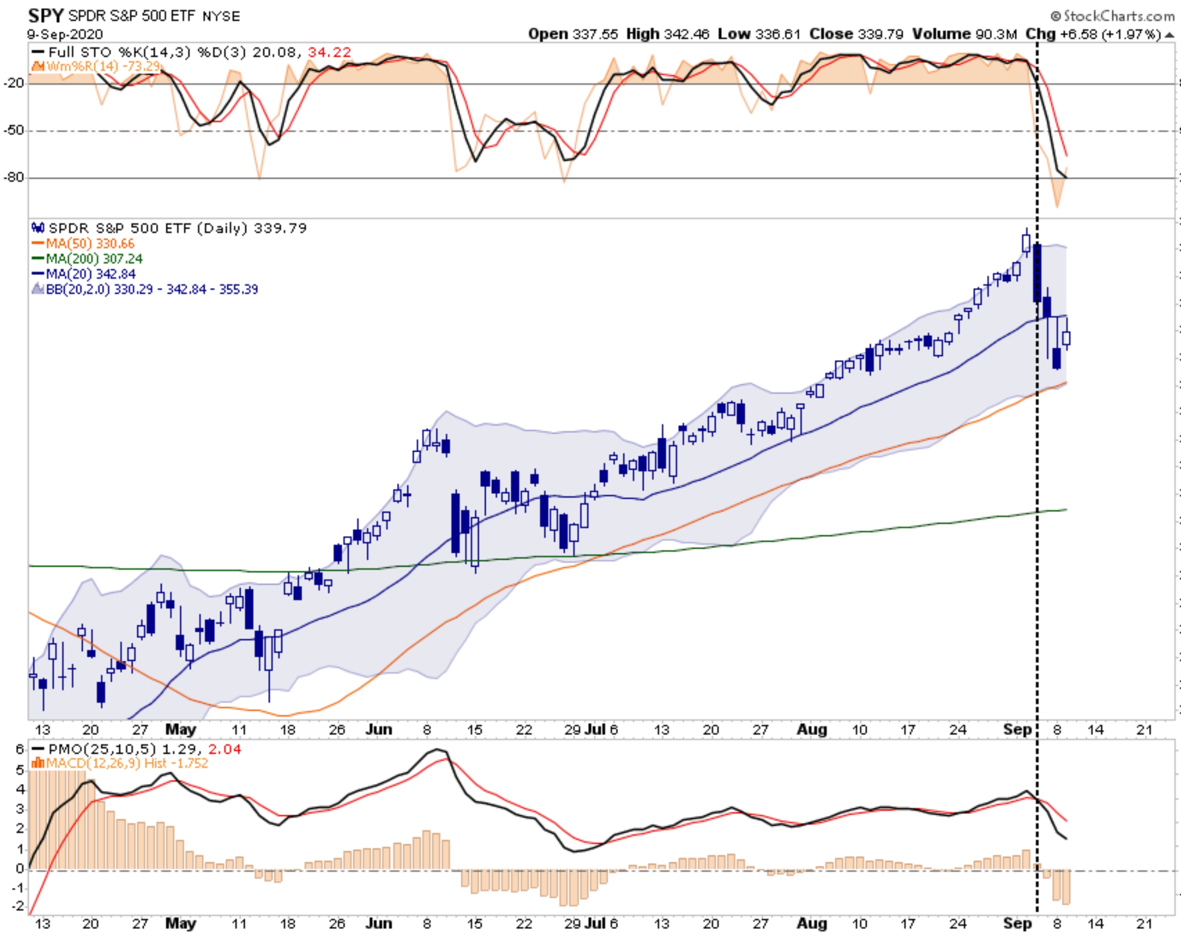
Over the last couple of weeks, we have discussed the probability of a 5-10% correction in the market. Via *?**Winter Approaches:?***

> *"A correction of 5-10% has become increasingly likely over the next few weeks to two months.* ***While a 5-10% correction may not seem like much, it will feel much worse due to the high level of complacency by investors currently.***"

So, did the *"sell-off*" over the last few days resolve the overbought technical conditions? More importantly, was the rally yesterday sustainable? Or is there more correction potentially coming?

For those answers, let's take a look at the charts. (Be sure and review the *Major Market Review* each week for updates)

Daily

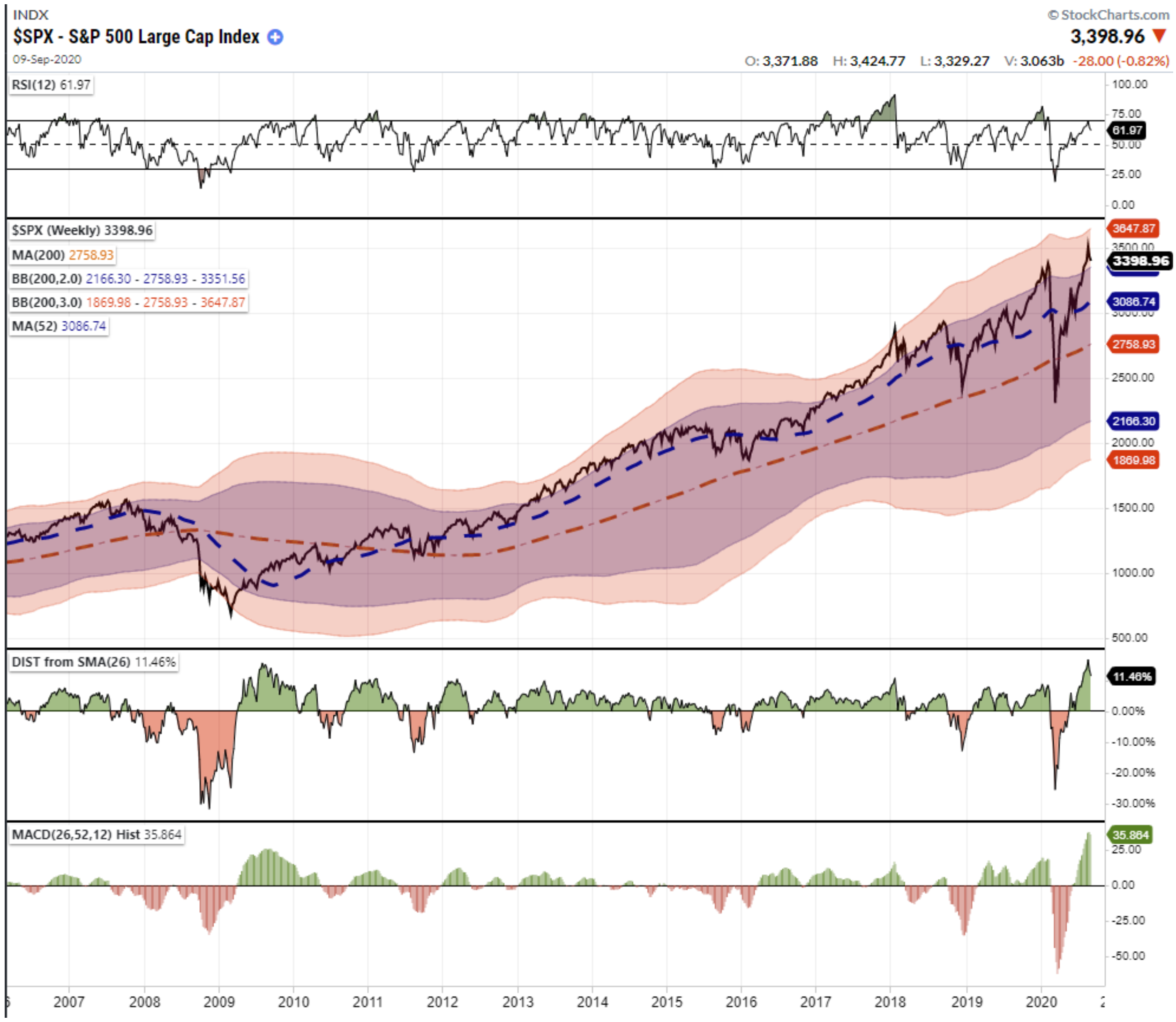


- The sell-off of the S&P 500 broke the 20-dma and essentially tested the 50-dma. It also pushed toward the 2-standard deviation band of the 20-dma. This set the market up for a bounce yesterday.
- However, the bounce did not reverse the current sell signals.
- The market is reasonably oversold very short-term so a follow-through rally will be critical before taking on additional equity exposure.
- As shown the market failed at the 20-dma yesterday, which suggests we could see more weakness by the end of the week. A test of the 50-dma is very likely.
- While we have added some exposure to portfolios recently, we have done so very cautiously with tight stops. We will also add a short-hedge back to our portfolio if the market rallies back to the 20-dma and fails a second time.

Daily Overbought/Sold

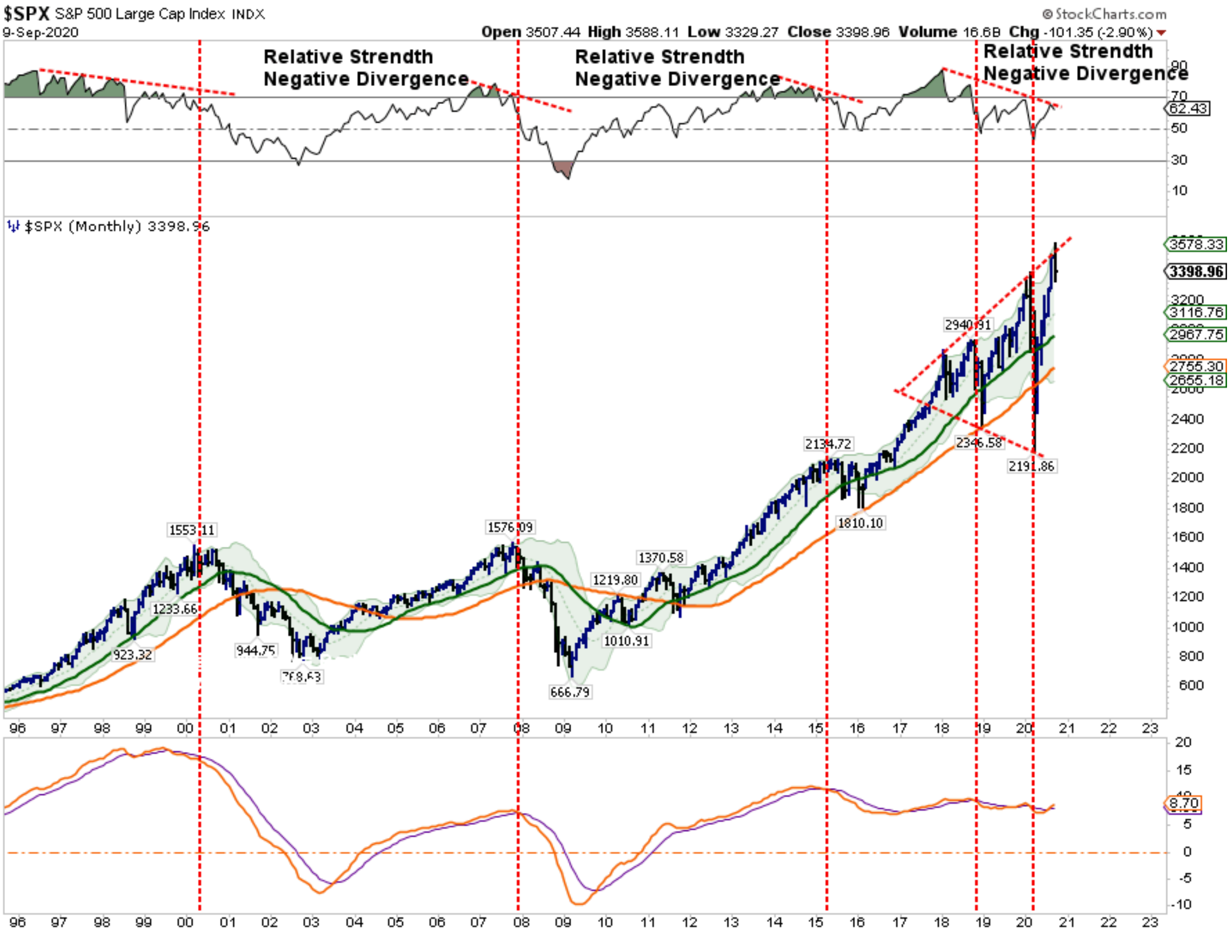
- *The chart above shows a variety of measures from the number of stocks above their 50-dma to momentum and deviation from intermediate-term moving averages.*
- *The sell-off did reverse some of the very short-term overbought conditions, which gave support to the rally yesterday.*
- *However, most other measures still remain overbought short-term suggesting we could see more selling pressure on stocks near-term.*
- *Be patient. We are likely going to have a series of corrections back to support that allow for **better entry points to add positions.***

Weekly



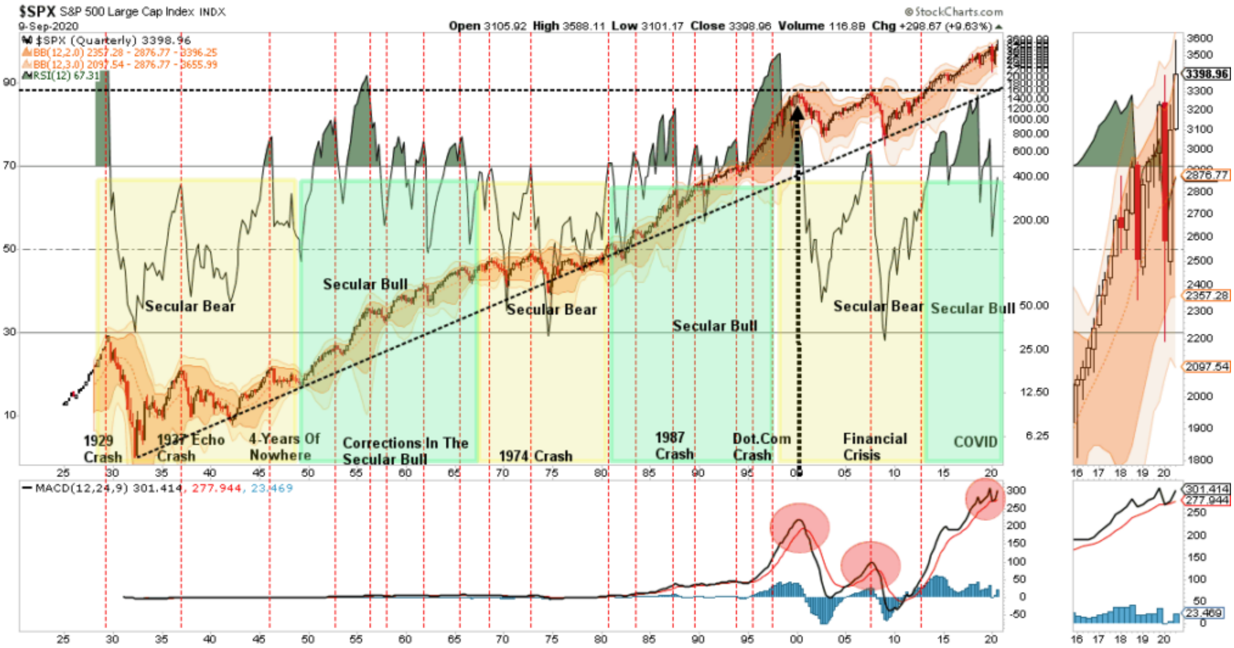
- *On a weekly basis, the market backdrop remains much more bearish.*
- *The market is very extended, overbought, and deviated on an intermediate-term basis.*
- *The correction barely moved the needle of a market trading 3-standard deviations above the long-term moving average.*
- *Read **"A Tale Of Two Bull Markets"** for more explanation and detail on this and other relevant charts.*
- *Remain patient. Odds are high there is more downside risk particularly if the economy begins to show signs of weakening again.*

Monthly



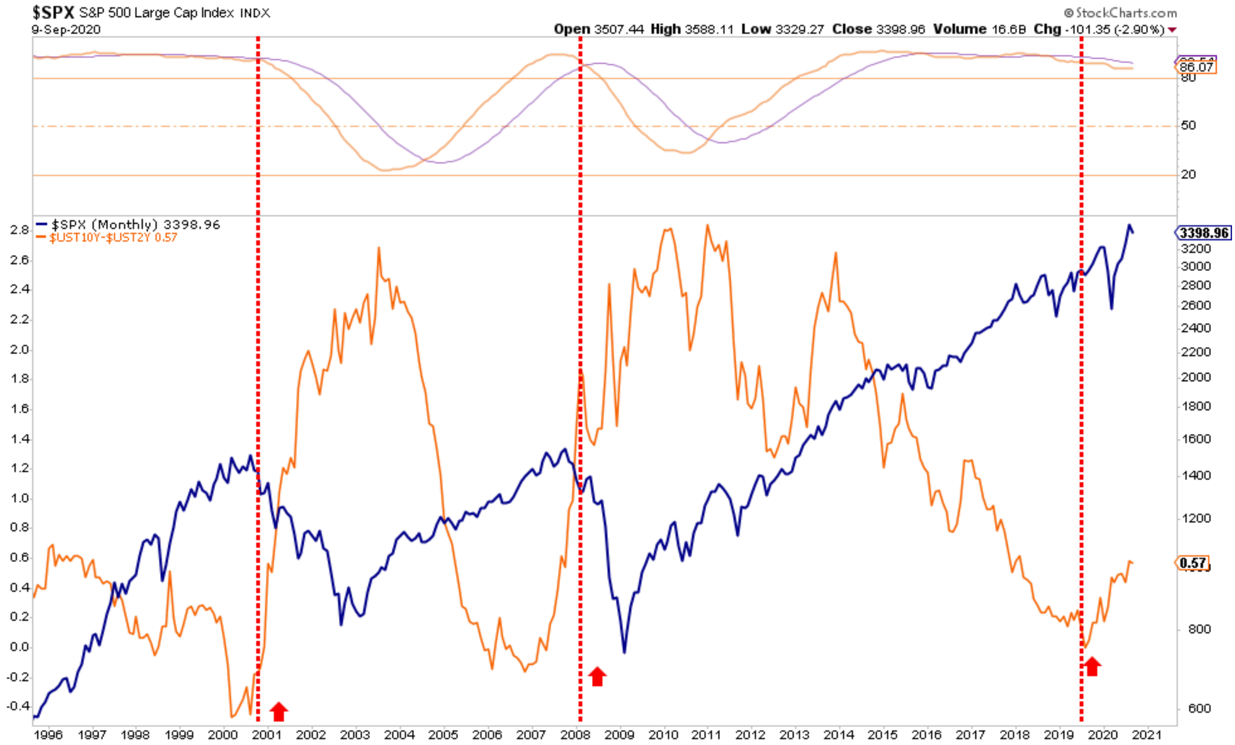
- *On a monthly basis, the bearish backdrop is evident.*
- *First, from an investment standpoint, look at the previous two bull market advances compared to the current Central Bank fueled explosion. The current extension failed at the top of the rising upper-trend line* ***forming a "megaphone" pattern.***
- In that article, I explain what the technical significance of this pattern is.
- *Secondly, the market is trading* ***MORE THAN 2-standard deviations above the long-term mean*** *which was ideal for a larger corrective decline.*
- *The good news, however, is that a monthly BUY signal was triggered with the liquidity fueled advance. Normally these signals are slow to turn, however, in recent years these signals are triggering much more often due to the increased volatility.*
- ***Importantly, MONTHLY data is ONLY valid at the end of the month.*** *Therefore, these indicators are VERY SLOW to turn. Use the Daily and Weekly charts to manage your risk. The monthly and quarterly chart (below) is to give you some ideas about overall risk management.*

Quarterly



- As noted above, this chart is not about short-term trading but long-term management of risks in portfolios. This is a quarterly chart of the market going back to 1920.
- Note the market has, only on a few rare occasions, been as overbought as it was earlier this year. The March decline and rebound were so fast that it barely registers on the chart. It also did very little to reduce the long-term risk of a larger decline during the second-half of the current ful-market cycle.
- Secondly, in the bottom panel, the market has never been this overbought and extended in history, previous corrections last much longer than one month and were very brutal to investors before conditions were reversed.
- As an investor it is important to keep some perspective about where we are in the current cycle, there is every bit of evidence that a mean-reverting event will eventually happen. Timing is always the issue which is why use daily and weekly measures to manage risk.
- Don't get lost in the mainstream media. This is a very important chart.

S&P 500 vs Yield Curve (10yr-2yr)



- *The chart above compares the S&P 500 to the 10-2 year yield spread.*
- *The relationship between stocks and bonds is the visualization of the "risk/reward" trade-off.*
- *When investors are exceedingly bullish, money flows out of "safe" assets, i.e. bonds, into "risk" assets, i.e. stocks.*
- ***What the chart shows is that when the yield-spread reverses, which is normally coincident with the onset of a recession,** such tends to mark peaks of markets and ensuing corrections in stock prices.*
- *While markets have defied the "reversion" of the yield-curve currently, due to massive amounts of stimulus and interventions, you should not become complacent this will continue to be the case.*
- *The average recession last 12-18 months and bear markets tend to co-exist during that time frame.*
- *The END of bear markets occurs when the yield spread peaks and begins to decline. That is not happening currently.*
- *Pay attention, all of the market indicators currently suggest risk outweighs rewards and patience will likely be rewarded with a better opportunity to add exposure.*
- *As with the Monthly and Quarterly charts above, this is a "warning" sign to pay attention and manage risk accordingly.*