Leavitt Brothers

Weekly

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Heading into this past week, we fully recognized the intermediate term uptrend but were skeptical it could continue for long or go much further without a rest that allowed the charts to reset and the indicators to cycle down.

The quality and quantity of trading set-ups had been declining...the breadth indicators were diverging from the underlying price action...the market had traveled far in a relatively short period of time. It felt like the market was somewhat running on fumes, and asking it continue much higher was asking quite a bit.

What we got was four out of five up days and a pretty solid gain on weakish volume. I'm not going to say the buying was relentless, but it's been over a month since the last noticeable pullback. Every little dip gets bought.

Janet Yellen soothed Wall St's fear by talking very dovishly about future rate increases. It seems like she'll say anything to make the market happy. If the employment situation supports higher rates, she'll talk about political and economic issues abroad. If the world is a calm and happy place, she'll cite a lack of inflation as a reason to "continue monitoring the situation." Whatever happens, she'll grasp at something that enables the Fed to keep rates as low as possible for as long as possible. I'm not taking sides in the debate, but I will say that fighting the Fed is a bad idea. If rates are to be kept low for a while, it would not be wise to assume the market is going to fall apart, even if the list of reasons it should is very long.

We must respect the trend because the US market is by far the strongest market in the world and money, to some degree, needs to find a home. One day we wake up and see big losses in Asian...and the US market shakes them off. The next day there are problems in Europe...and the US market shakes them off. Oil has now fallen eight consecutive days...and the market just shakes it off.

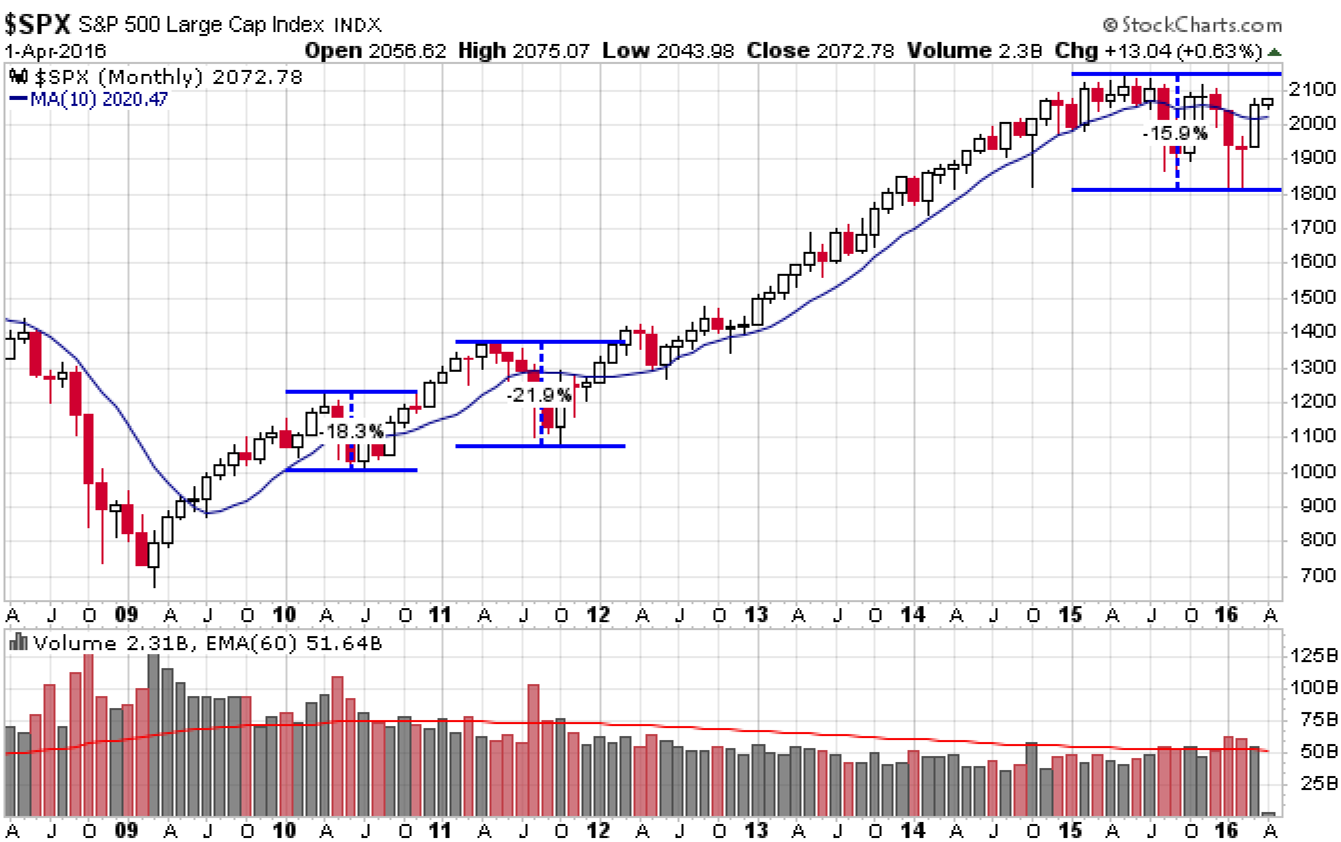
You have to admit, the US market is very resilient. Everything thrown its way has been absorbed relatively easily. Trade what is happening, not what you think will happen or should happen. Many bears have gone broke because they didn't think high prices could get any higher. Many traders have sat on the sidelines, in denial, because they just couldn't pull the trigger and jump on a trend that was in place and acting well.

I'm not suggesting you throw all caution to the wind and get long...but you do have to ask yourself some tough questions. The S&P has rallied 260 points in seven weeks. Oil rallied 50% off its low. Many gold stocks rallied 50-100%. It's been the best trading environment we've had in over a year. If you're not up a decent amount, figure out what went wrong. How are you making decisions? Where are you getting information and opinions from? Why have you been looking short or just as bad, why haven't you been long. A good honest look at the last two months will reveal some weaknesses that need to addressed...so the next time you'll better be able to take advantage of opportunities.

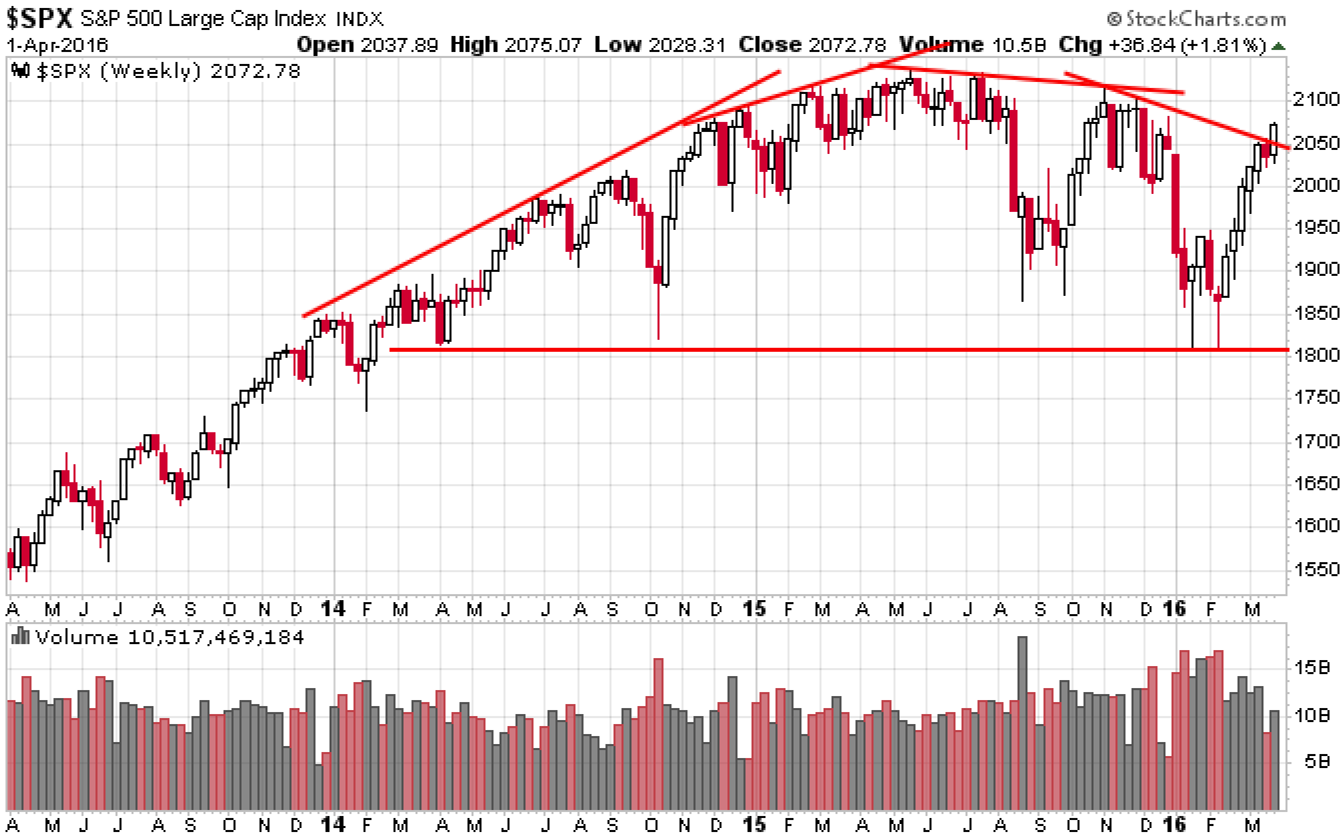
Looking forward, the quality and quantity of trading set-ups are still not very good. I'm not energized by the limited number of decent set-ups we have. The breadth indicators are still diverging from the underlying price action, so despite last week's strength, despite the higher highs, there's a little trouble brewing under the hood. Overall I like the action, but over the next week or two, I remain skeptical.

Indexes

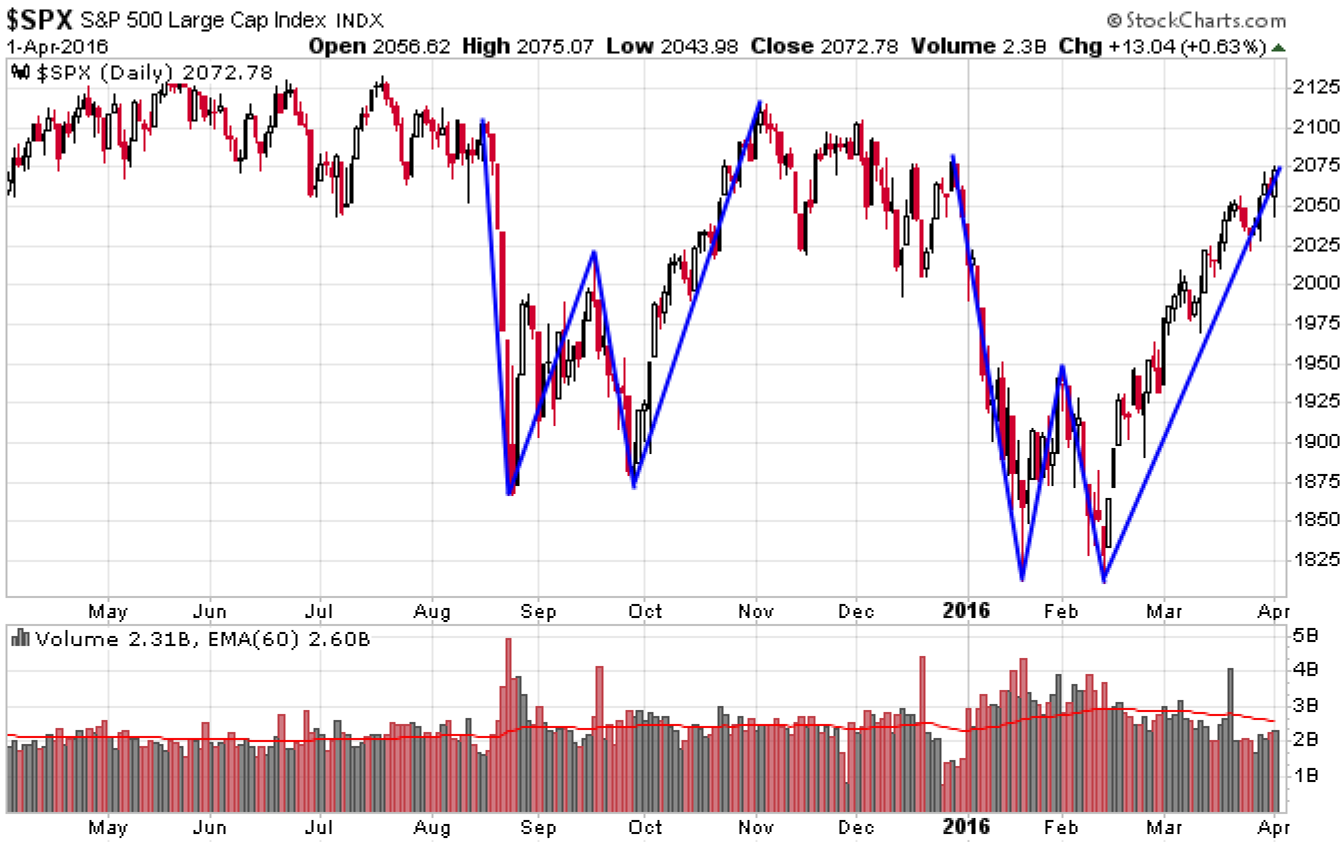
The S&P 500 Monthly: Since bottoming in 2009, the S&P has experienced three significant pullbacks. The current one has been the shallowest but has lasted the longest. It puts things in perspective, doesn't it? Long term I consider the market to be in a consolidation pattern within an uptrend. Based on this chart, nobody can argue a downtrend is in place.



The S&P 500 Weekly: The weekly S&P is attempting to invalidate a rounding top pattern. The index has rallied 260 points off its low and has moved up 6 of the last 7 weeks. Heck of a run - the single most impressive run we've had in several years. Dead cat bounce within a downtrend? In my eyes, the bulls deserve the benefit of the doubt.



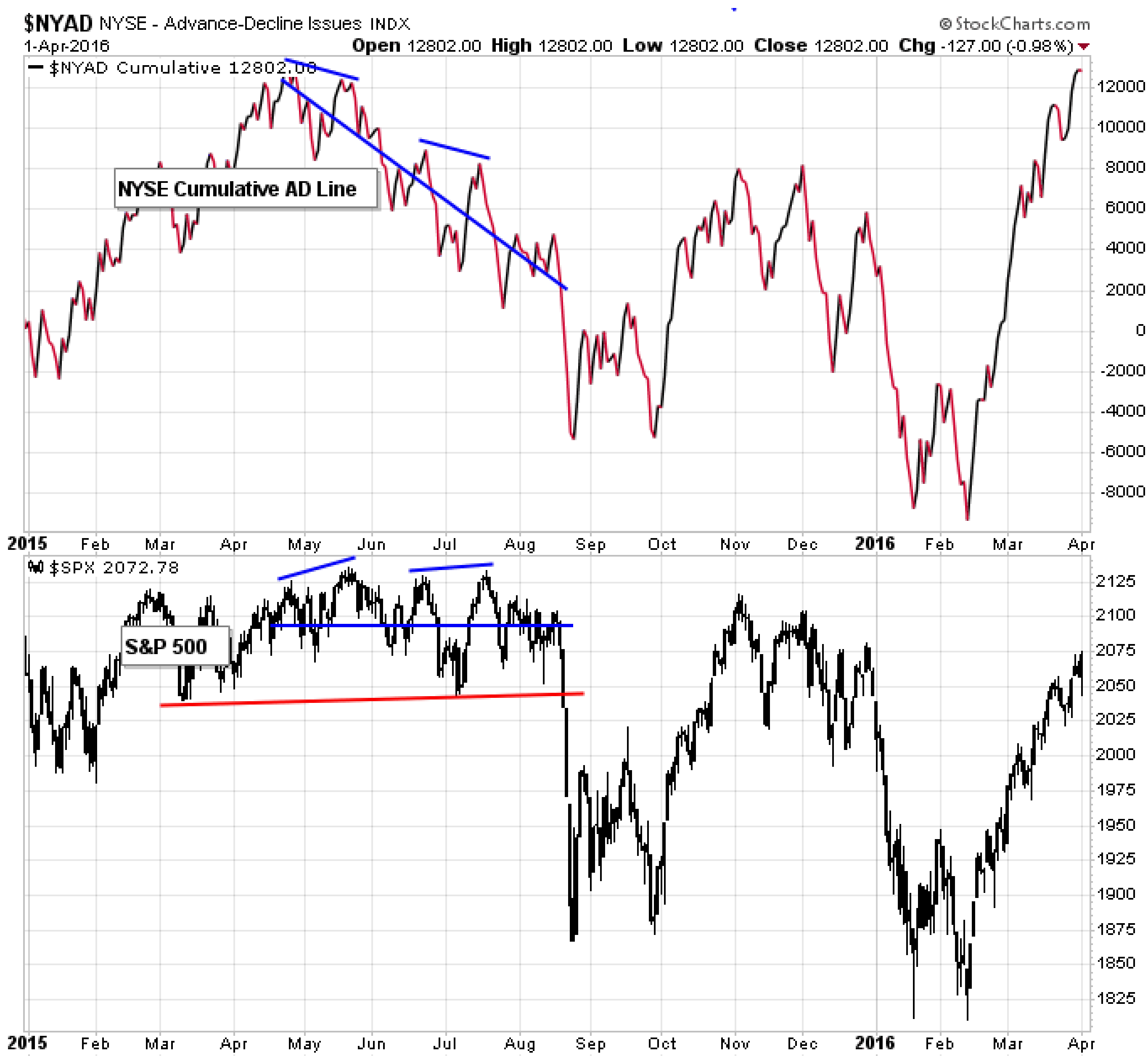
The S&P 500 Daily: The S&P has repeated its W pattern from the fall - not that it means anything. Best case scenario going forward is the market continues up - although there's a ton of resistance overhead between the current level and the high. Worst case scenario is some up and down movement that shakes the tree in both directions. Tops take time to form, so even if a high is established soon, it'll take a month of false moves in both directions before a move down materialized.



Indicators

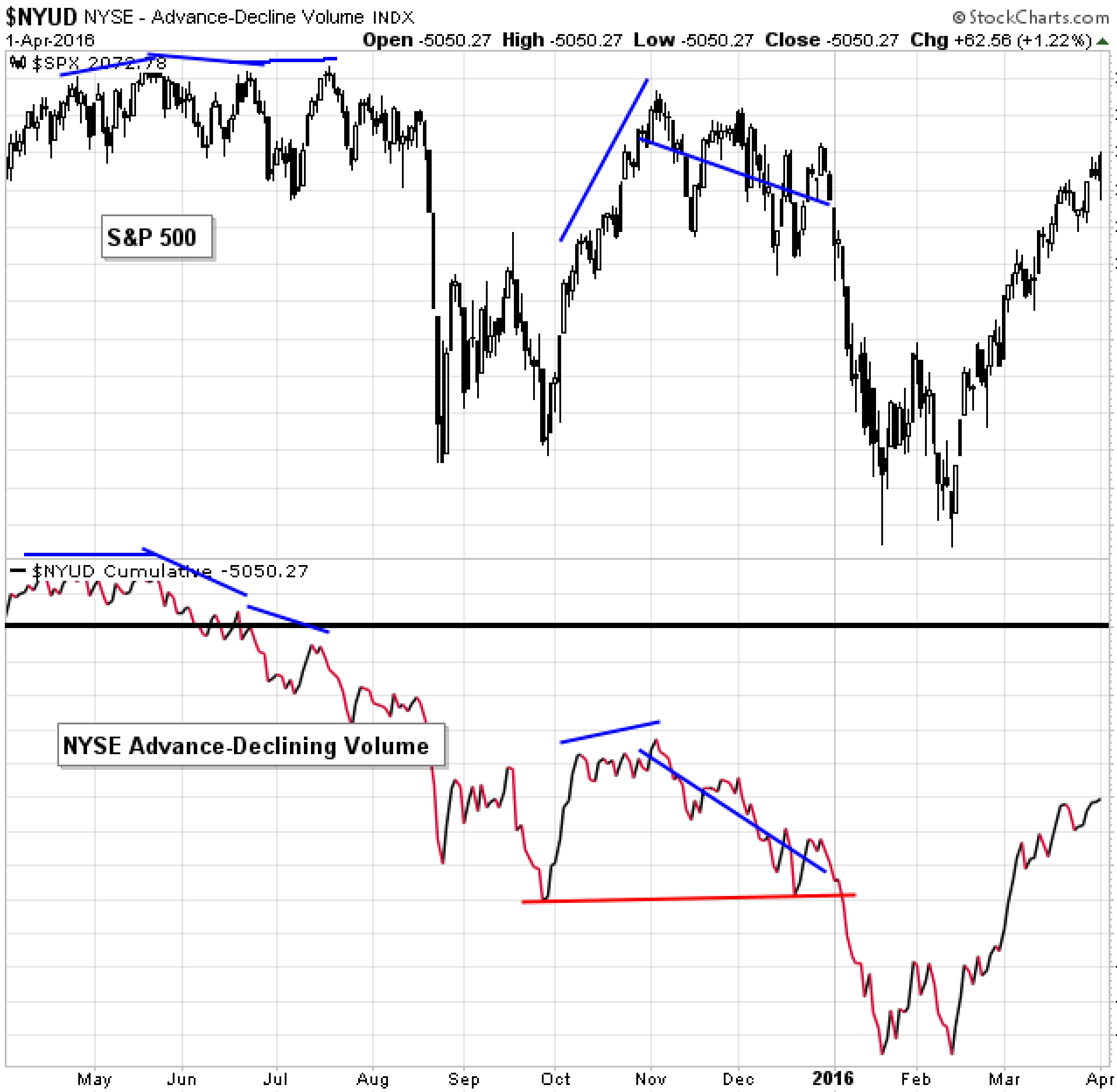
S&P 500 vs. 10-day MA of NYSE AD Line: Higher high for the S&P 500, obvious lower high for the 10-day MA of the AD line. This divergence is not extremely sensitive - it can last several days or upwards of two weeks - but in all cases the market does correct. Be careful going long here. The upside is likely limited in the near term until this divergence works itself out.

S&P 500 vs. NYSE Cumulative AD Line: The consistent AD prints above 0 have put the cumulative AD line at its highest level since last spring. Not only has the current rally been much stronger than the October rally, it's also come with much broader strength. Instead of a small number of stocks doing the heavy lifting, many stocks are participating.



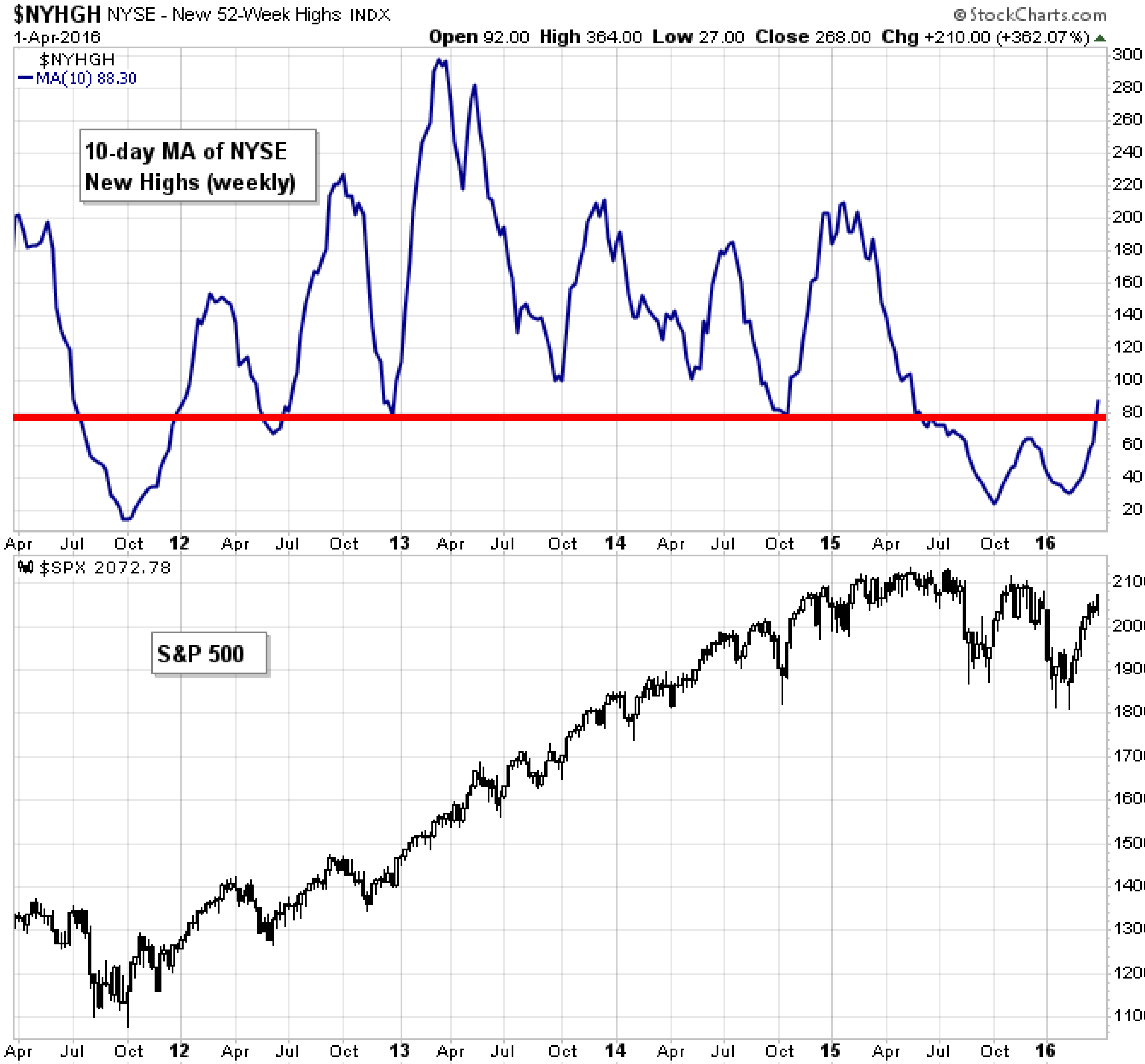
S&P 500 vs. 10-day MA of NYSE AD Volume Line: The AD volume line, which lets the high-volume, big caps do more of the talking, is also diverging from the underlying price action. This tells us the rally is mature and is not likely to last much longer. Tight stops are warranted on long trades.

S&P 500 vs. NYSE Cumulative AD Volume Line: The cumulative AD volume line is doing better than October but has otherwise under-performed. The S&P is close to matching its summer highs while this indicator isn't close.

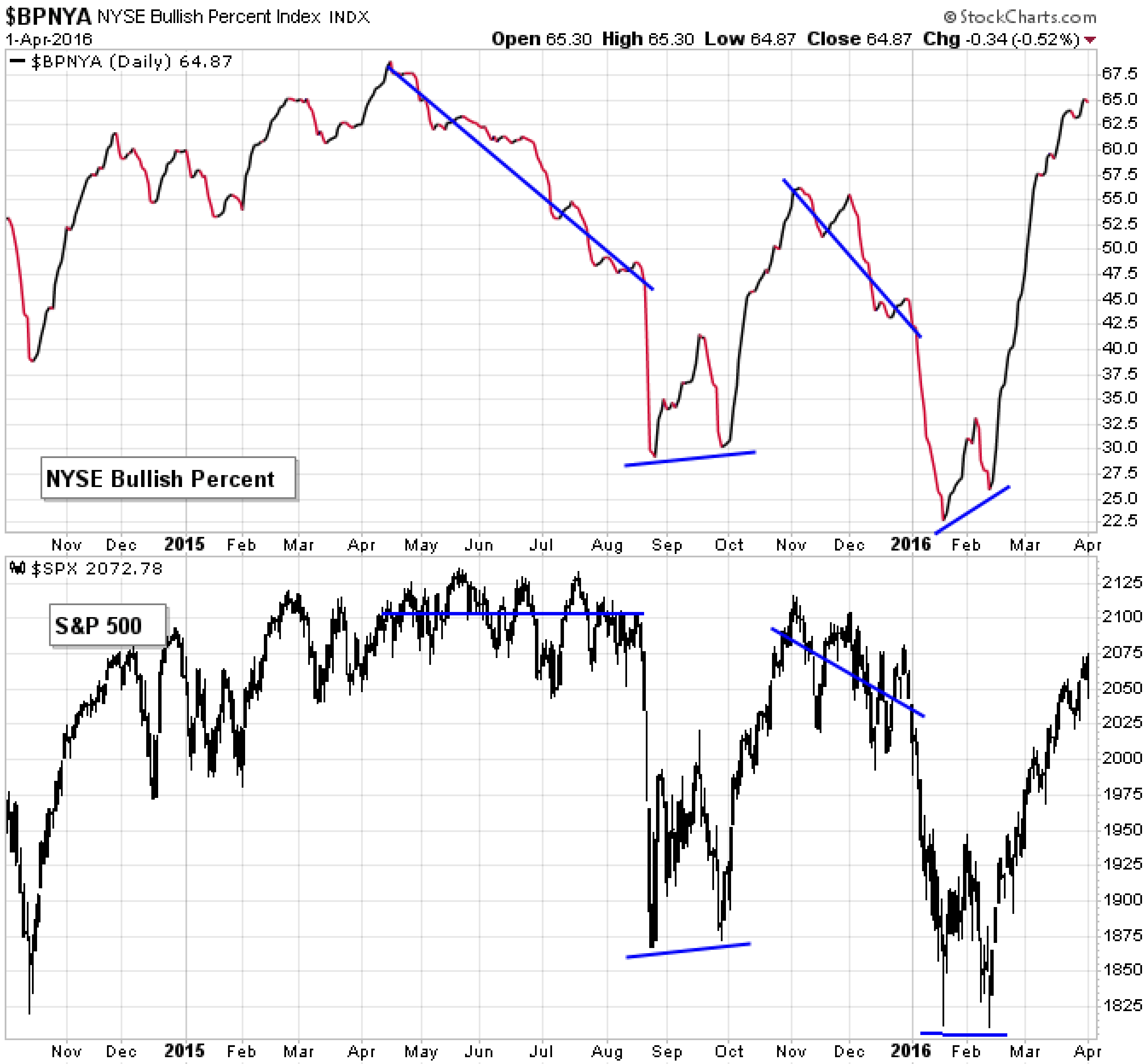


S&P 500 vs. NYSE New Highs: New highs at the NYSE have spiked to their highest level since March 2015, and the 10-day has moved to a 12-month high. This supports the market's strength, but it has to continue. Failure to continue printing new highs while the market pushes higher would be a warning.

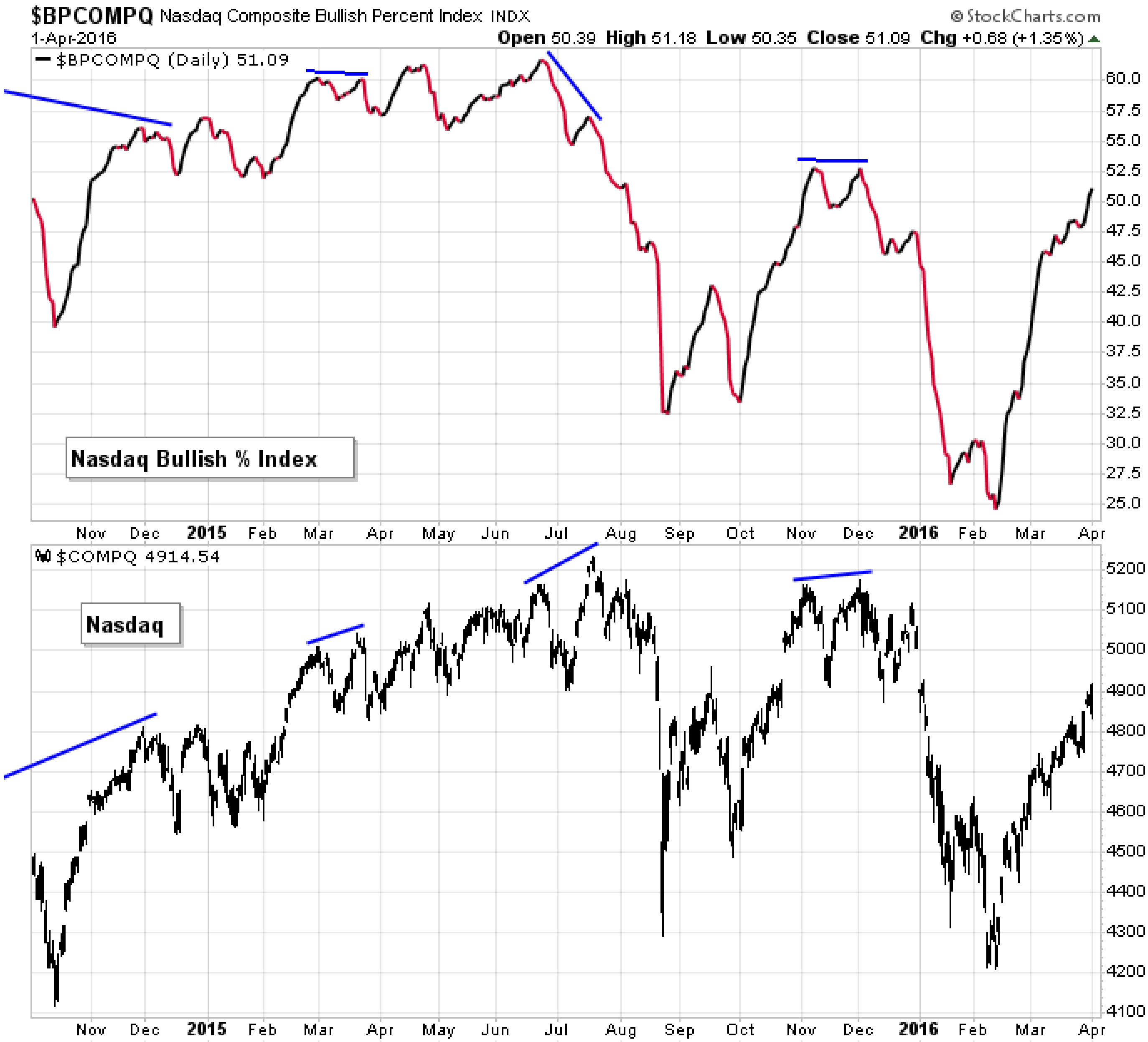
S&P 500 vs. NYSE New Highs (weekly): As a point of reference, the weekly new highs chart below (smoothed with a 10-day moving average) shows us how new highs print in an uptrend vs. a choppy range. For bulls looking for the S&P to breakout and rally to 2200 or 2300, the indicator is not out of the woods yet. It needs to act like it did 2012-2014, not like the last twelve months.



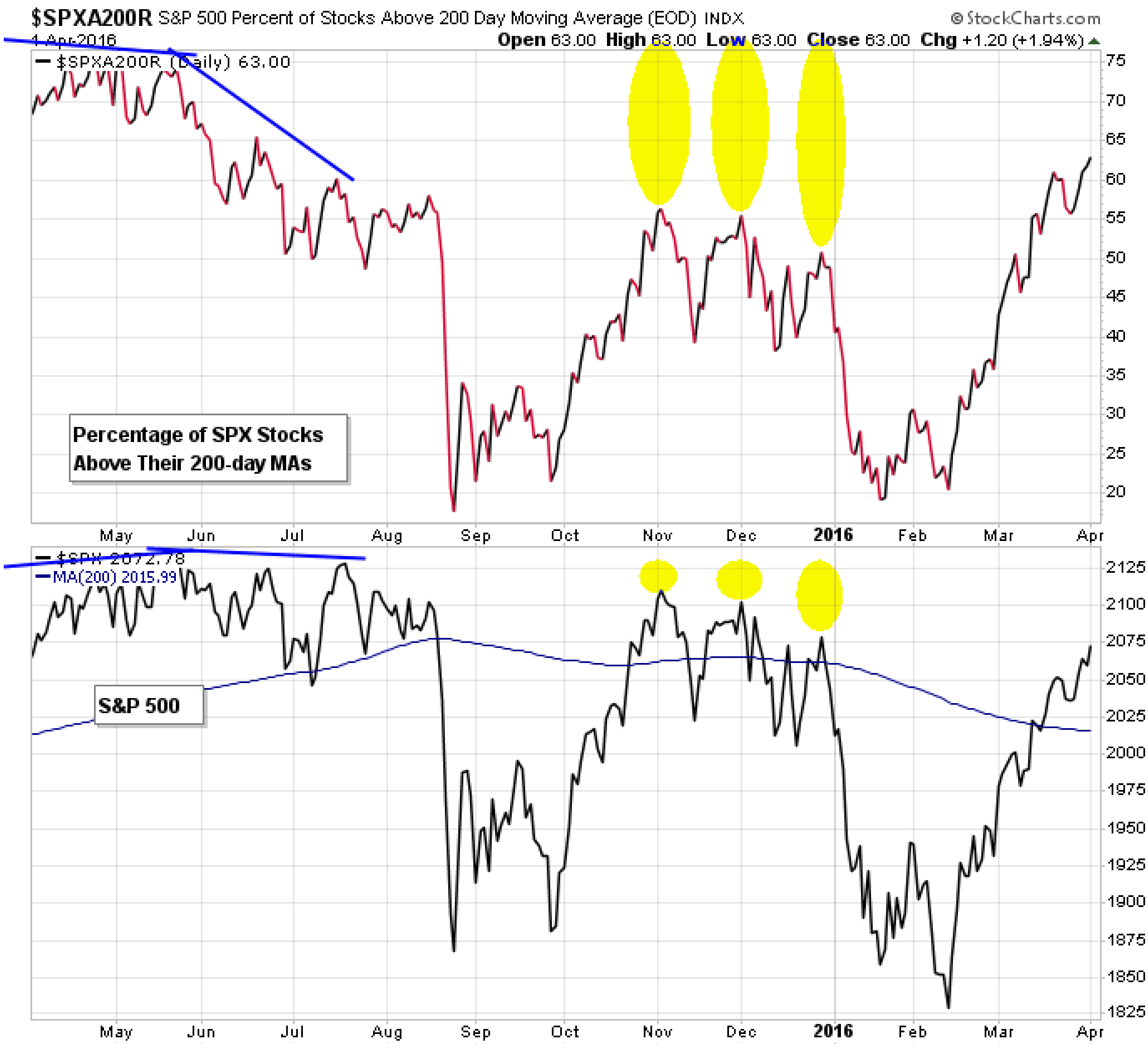
S&P 500 vs. NYSE Bullish Percent: The NYSE bullish percent continued to press higher last week. Without a divergence forming, the bulls can be justified in hanging on a little longer.



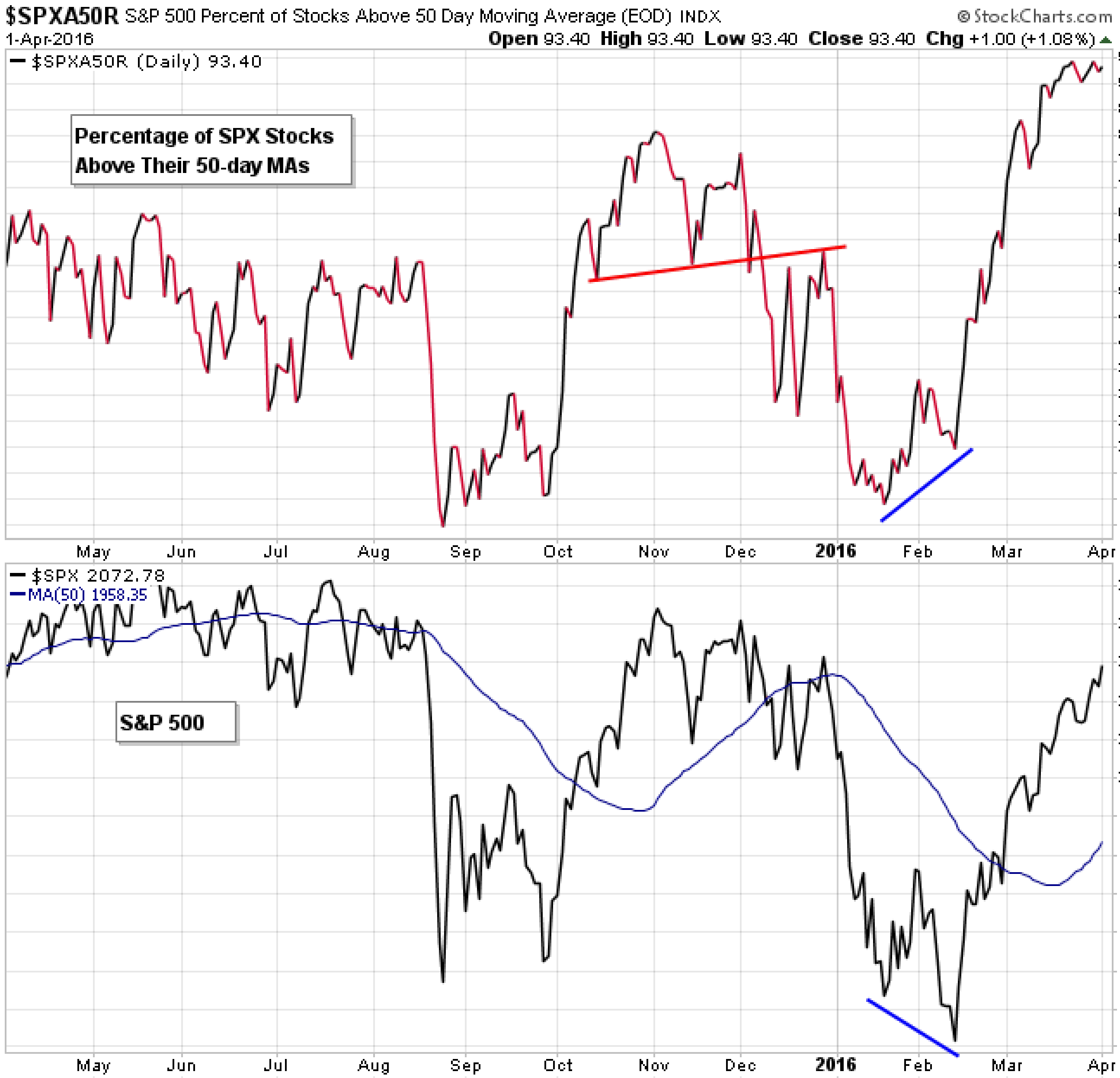
NASDAQ vs. NASDAQ Bullish Percent: The Nas bullish percent, which has lagged its NYSE peer, made solid progress last week.



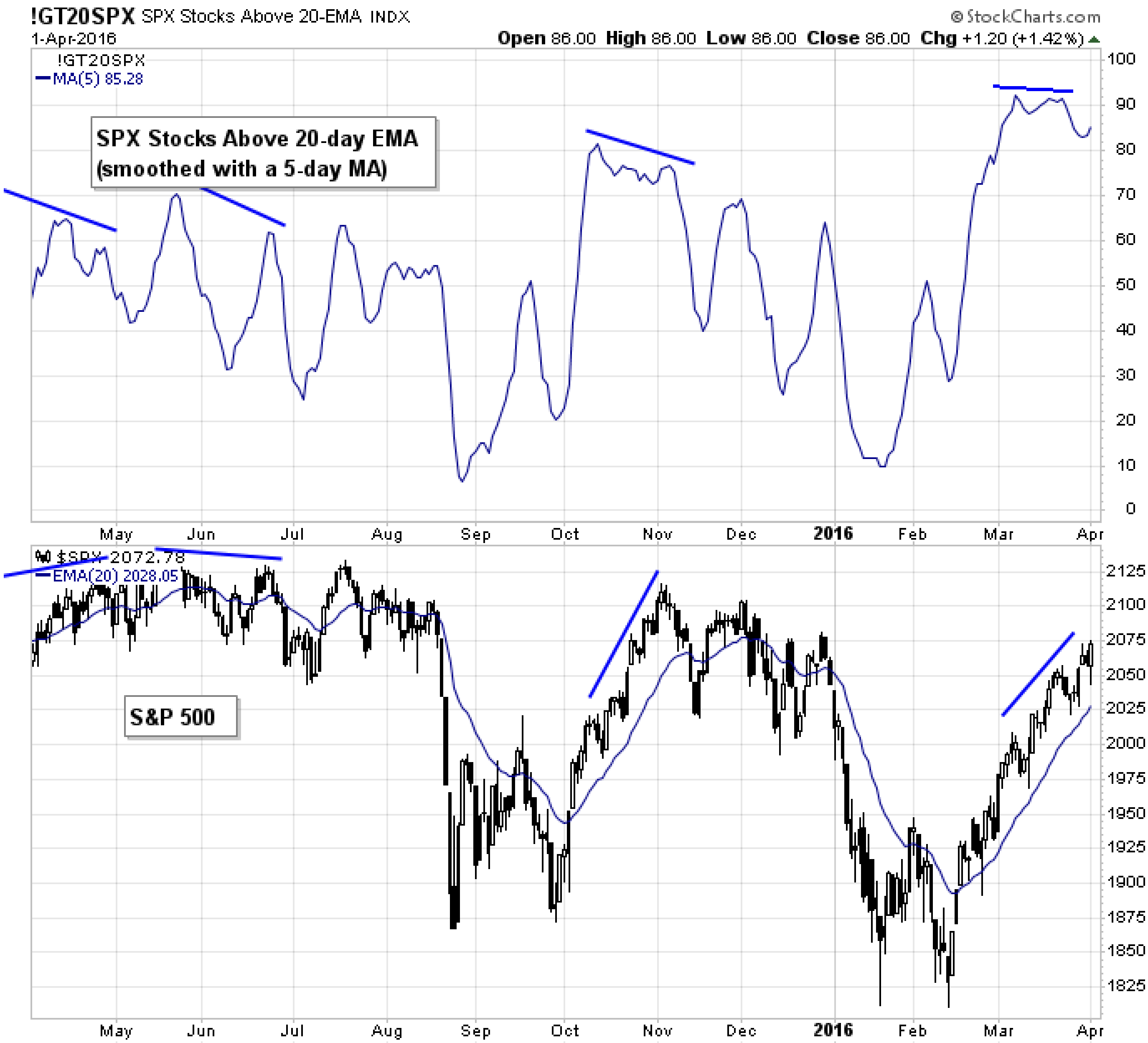
S&P 500 vs. Percentage of SPX Stocks Above 200-day MA: The percent of SPX stocks above their 200-day moving averages continues to improve. The October rally went for about 225 points, but only 55% of stocks got above their 200-days. This rally has seen that level taken out - a sign strength is more broad-based.



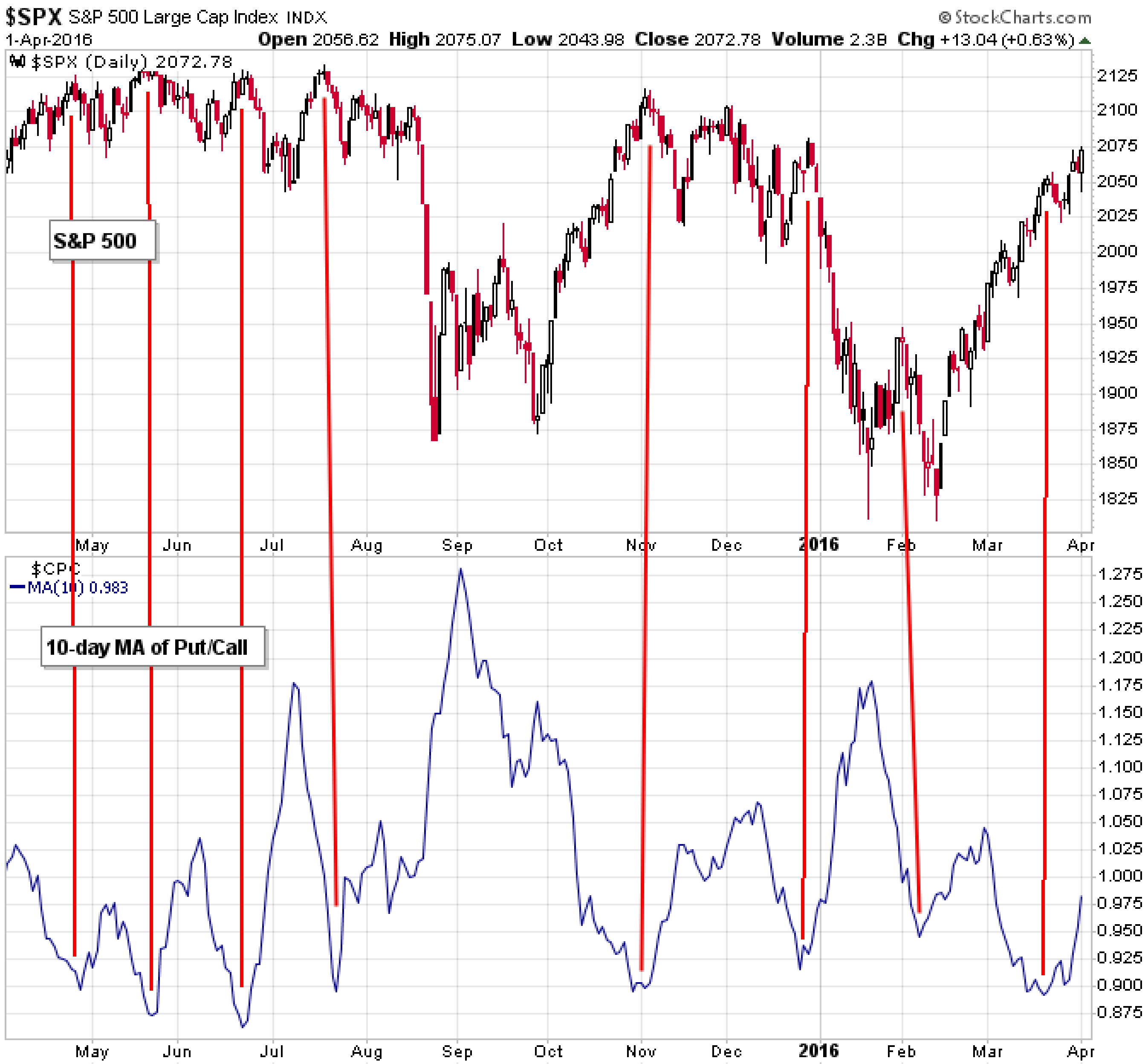
S&P 500 vs. Percentage of SPX Stocks Above 50-day MA: The percentage of SPX stocks above their 50-day moving averages reached a level not seen in many years. Looking back, the results are mixed. Sometimes the market corrected; other times it continued to press higher for several weeks before correcting. At the very least, we need to be a little more careful up here.



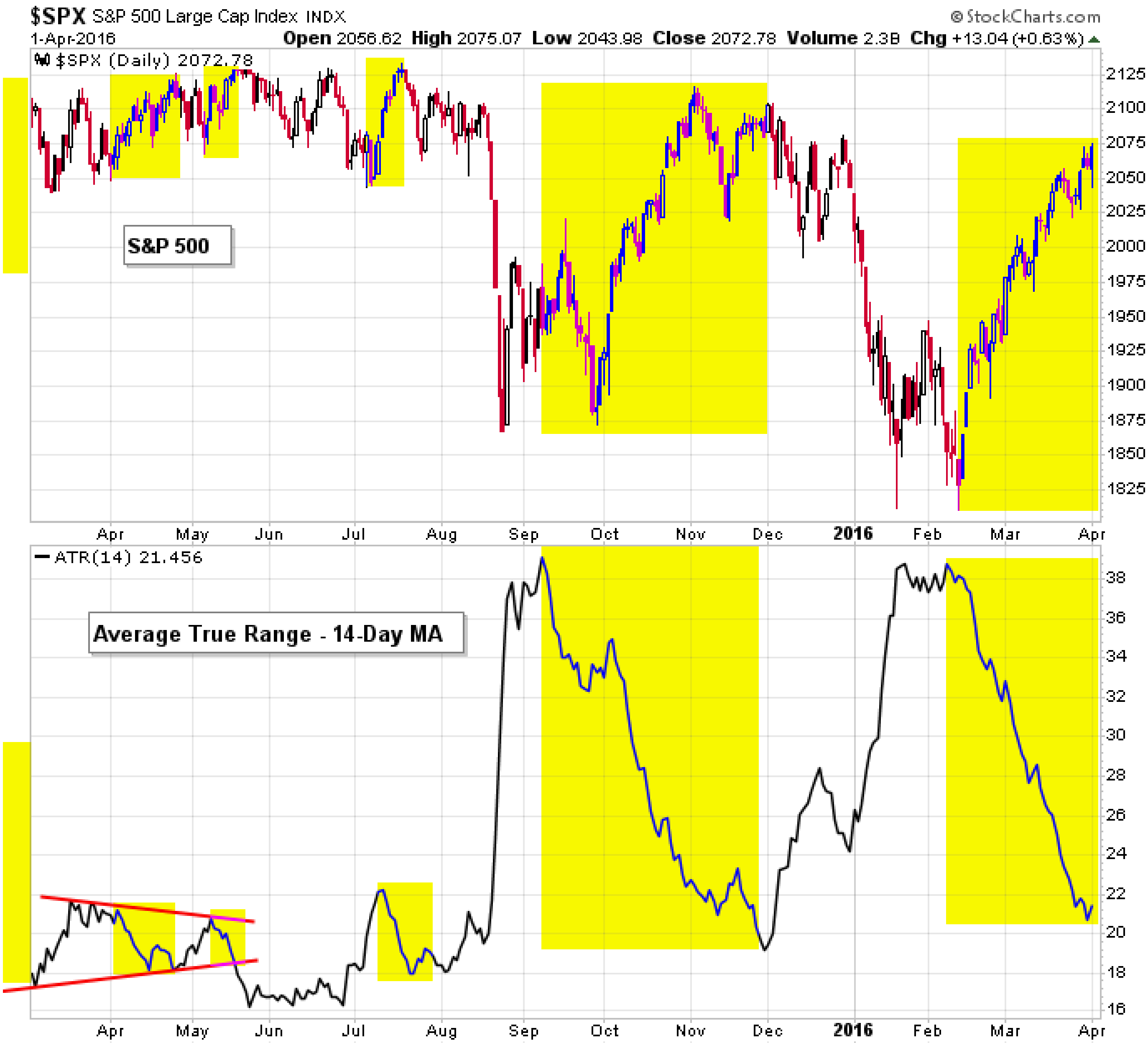
S&P 500 vs. Percentage of SPX Stocks Above 20-day EMA: The 90 level hasn't been visited since 2014. It's a definite sign of strength, but is it also a sign of "too much, too fast." In my opinion, a rest is warranted.



S&P 500 vs. 10-day MA of Put/Call Ratio: The put/call, which has been trying to curl up for two weeks, has finally made the turn. Bottoms in the PC tend to coincide with local market tops, so be careful on the long side right now.



S&P 500 vs. 14-day Average True Range: The market rallies on declining volatility and falls on expanding vol. The fact that vol, as measured by the 14-day ATR, continues to fall supports the market's trend.



S&P 500 vs. 20-week Average True Range: But if the S&P is going to break out from this consolidation pattern, the longer term 20-week ATR will need to roll over and drop. Failure to do so would not support a sustained rally.

The Bottom Line

The market is doing well, but there's a little trouble brewing under the hood - not the kind of trouble that spells doom, the kind of trouble that tells us to be careful in the near term.

Some indicators have reached extreme levels - levels not seen in a couple years. Other indicators are diverging from the price action - a sign breadth is declining and the rising indexes aren't fully supported.

I like the market and think the bulls deserve the benefit of the doubt, but I'd be a little defensive in the near term.

Have a great week.

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