Leavitt Brothers

Weekly

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The Energizer Bunny market continues. Despite the market spending most of its time trading in tight ranges, new highs continue to be put in place. In fact the S&P 500 has put in a higher high six straight weeks. The intraday and intraweek movement feels very sluggish, but the net is a market that continues to move up.

When the market trends, our job is plays stocks in the direction of the trend. There are no exceptions. The trend really is your friend - even if it doesn't make sense. Many famous quotes come to mind with regards to trading what is happening instead of what you think should happen. John Maynard Keynes said: "Markets can remain irrational for longer than you can remain solvent." It's true, and unless you're managing a billion dollars and have to slowly scale in and out (by the way, a billion dollars isn't a lot of money), there's no reason to do anything other than go with the flow.

Trading is a game of follow the leader, and we aren't the leaders. We're the followers. We see where the market is headed, and we go with the flow. Trading opposite the trend is like trying to fly a kite opposite the wind. Not wise. Or perhaps that's not a great analogy. A better one is it's like trying to sail a boat into the wind. This is possible, but it's much harder and takes much more time.

With the market in trend mode, our second job is to assess the staying power of the trend. The breadth indicators are very helpful here. If the market presses higher, but there's deterioration beneath the surface, odds favor a pullback. Not a downtrend. Not the end of the trend. Just a near-term pullback that allows the charts to reset. Right now breadth is good. The advance/decline line, new highs, bullish percent charts, percentage of stocks above various moving averages - they're all doing "well enough." They don't have to be in full-blown rally mode. They just have to kind of/sort of support the movement and not issue any major warnings.

We can also assess the psychology of the market. Are proverbial taxi drivers offering stock advice (too much euphoria), or is Wall St. generally in a state of disbelief? Gauging sentiment offers longer term clues. Right now, despite news highs being made weekly, sentiment leans to the downside. Besides the likes of George Soros, Stanley Druckenmiller, Carl Icahn and others sounding alarm bells, many "numbers" point towards this being a hated rally where the participation rate is low. The AAII bulls (shown below) are still at a low level. Money is still flowing out of stocks and into bonds (also shown below). Gold and silver, which have much more to do with the health of the worldwide financial system (not inflation or the dollar), continue up. The current rally is taking place while traders and investors generally don't believe. Imagine if they suddenly jump on board! My SPX 2300-2400 target will be nothing more than a sign post on the way to much higher prices.

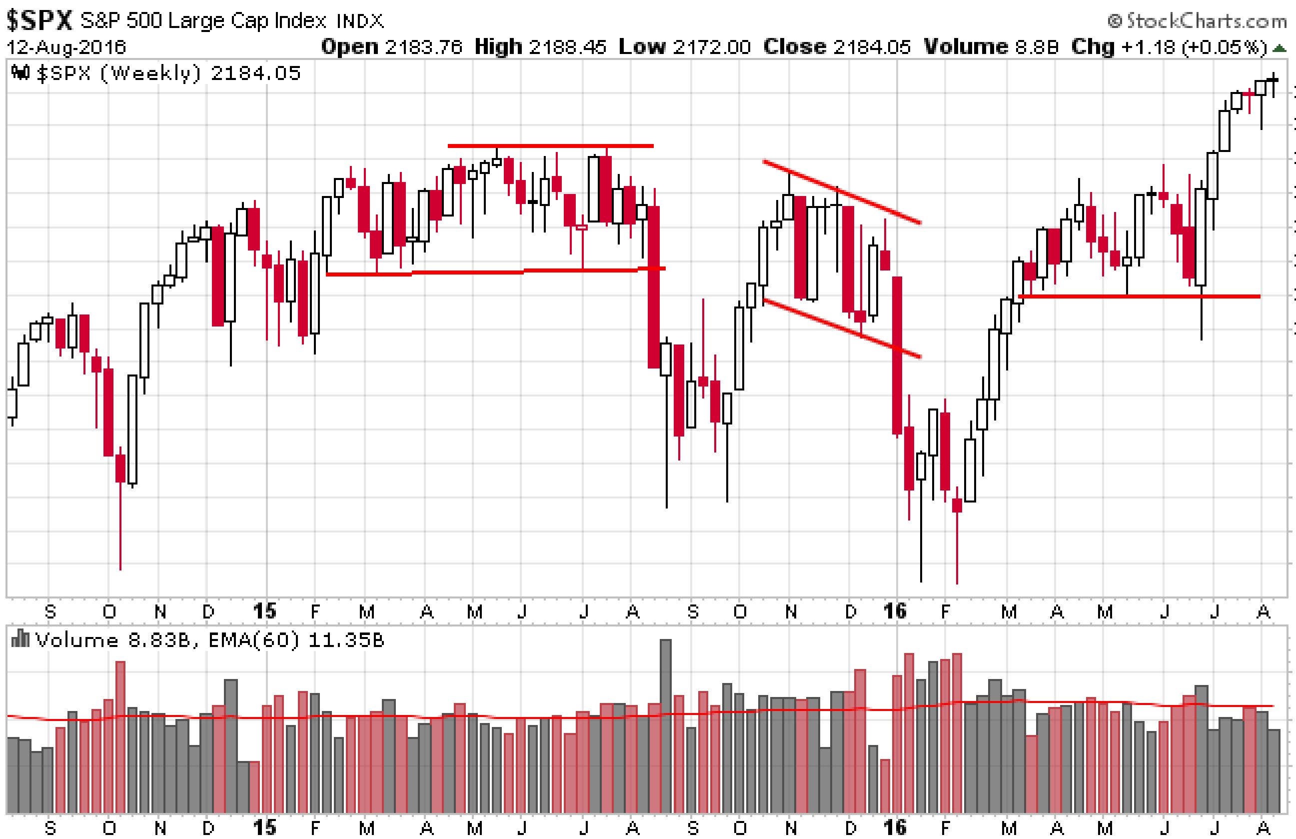
Even quant studies support higher prices. According to Ryan Detrick, when the market is up 6% or more with 100 days to go in a year, a gain has been posted the rest of the year 36 out of 40 times. And only once did the market drop enough the last 100 days to turn to market negative for the year (that was in 1929).

Here's another one from Detrick. Over the last 50 years, the market has made a new high during August of an election year four times. The first three times resulted in the rest of the year being up 6.3%, 10.9% and 5.2%. This year is the fourth year.

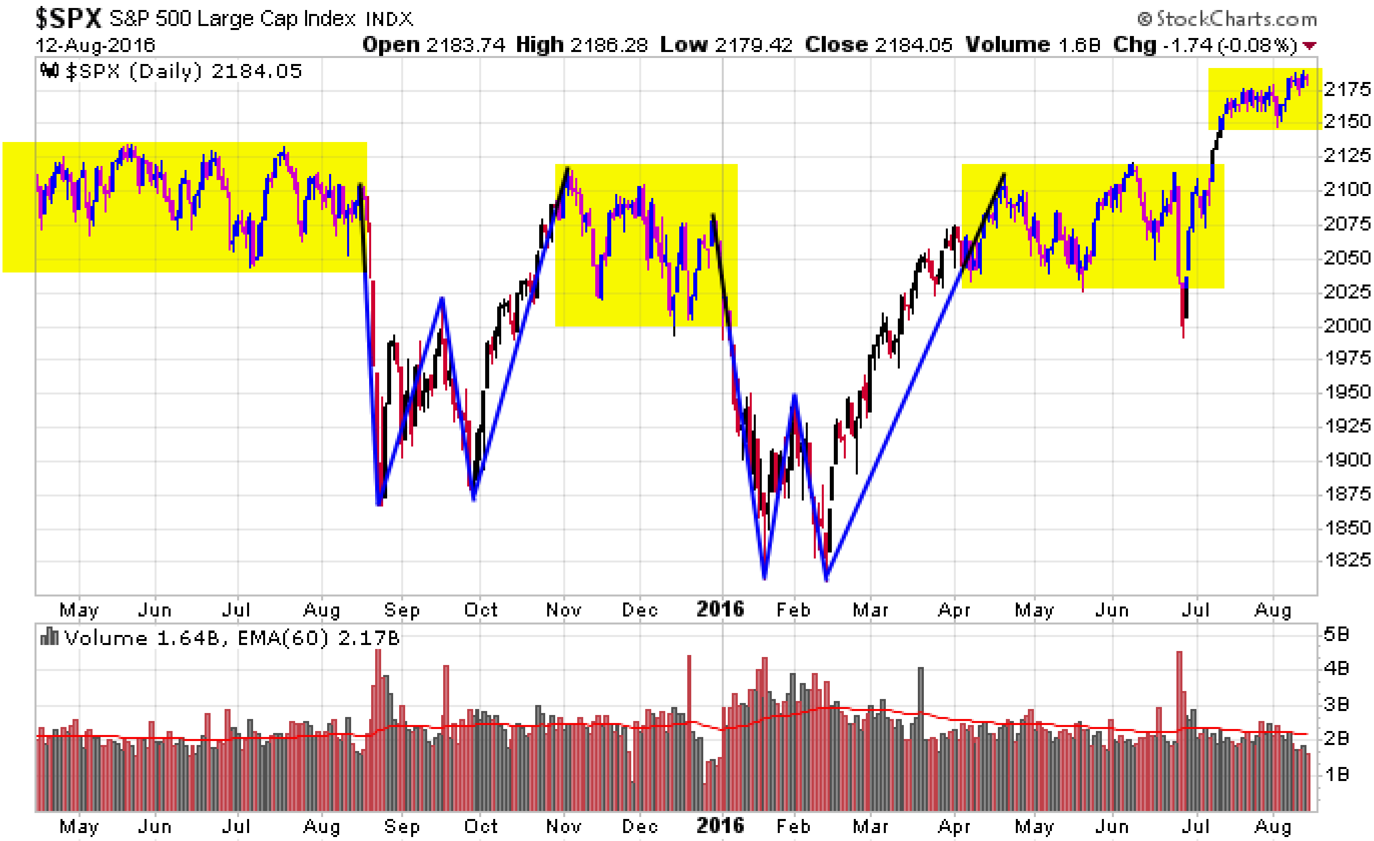
Whether you look at the trend, the market's breadth, sentiment or historical precedent, everything points towards higher prices going forward. For the market to change, something has to happen to jerk the market off its current course. Absent something major (and no, a single rate hike is not major) prices are very likely to continue up. Let's get to the charts.

Indexes

The S&P 500 Weekly: Six out of seven up weeks. Six consecutive weeks of higher highs. Previous vertical rallies (October/November 2014, October 2015) led to choppy trading which eventually resolved down. The February/March/April 2016 rally led to a rest and then another surge. Something changed. Respect it. Don't fight it.

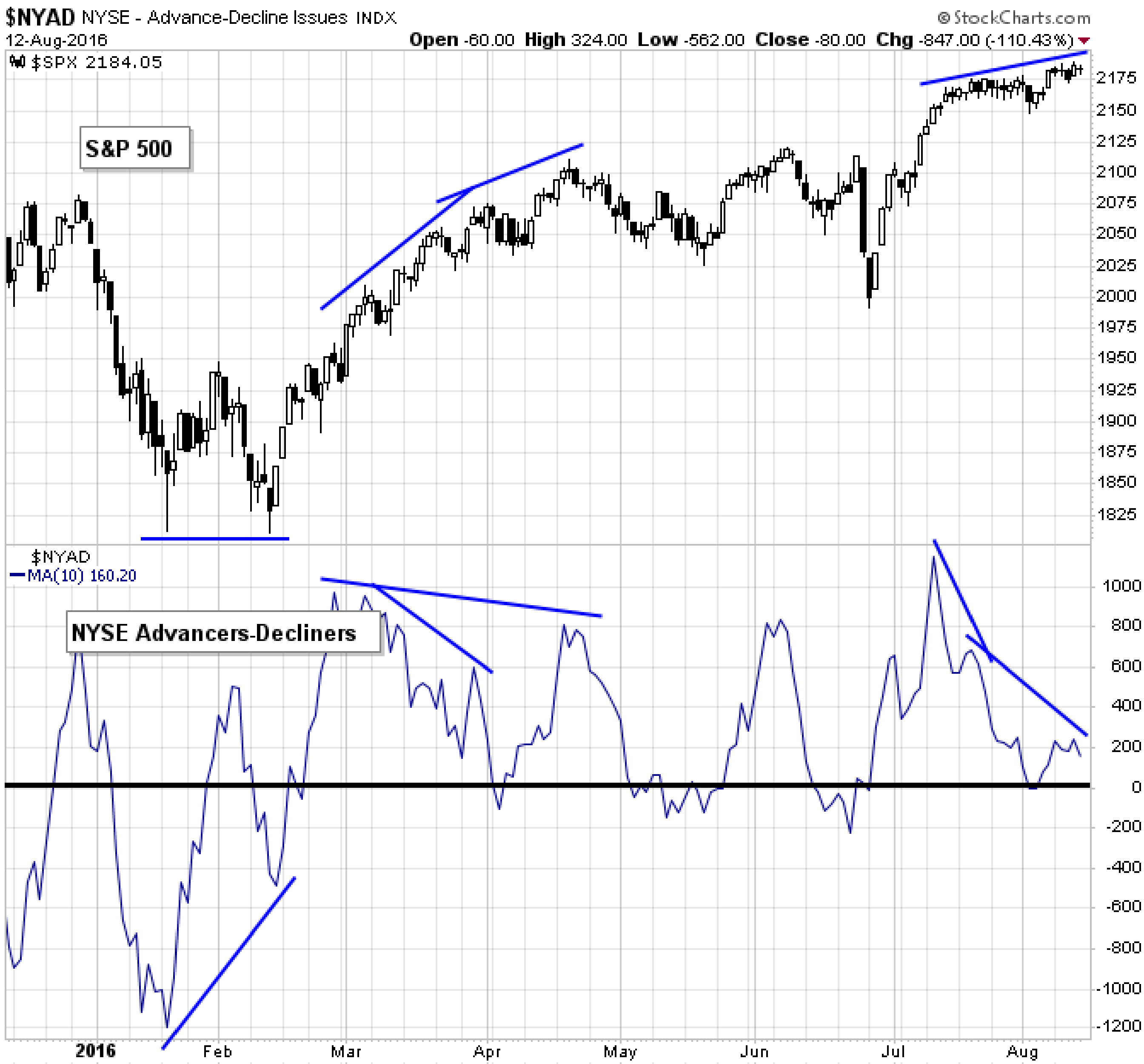


The S&P 500 Daily: From one tight range to an even tighter range. But for what it's worth, volume is declining. Clearly there's a breakout from the 2125 area. I wish there was more follow through before settling into another consolidation pattern. In my eyes, the trend is up and dips are buyable. Even if a top was being put in place, I take comfort knowing tops take time to form. There's time to change my tune if the action and indicators suggest it.



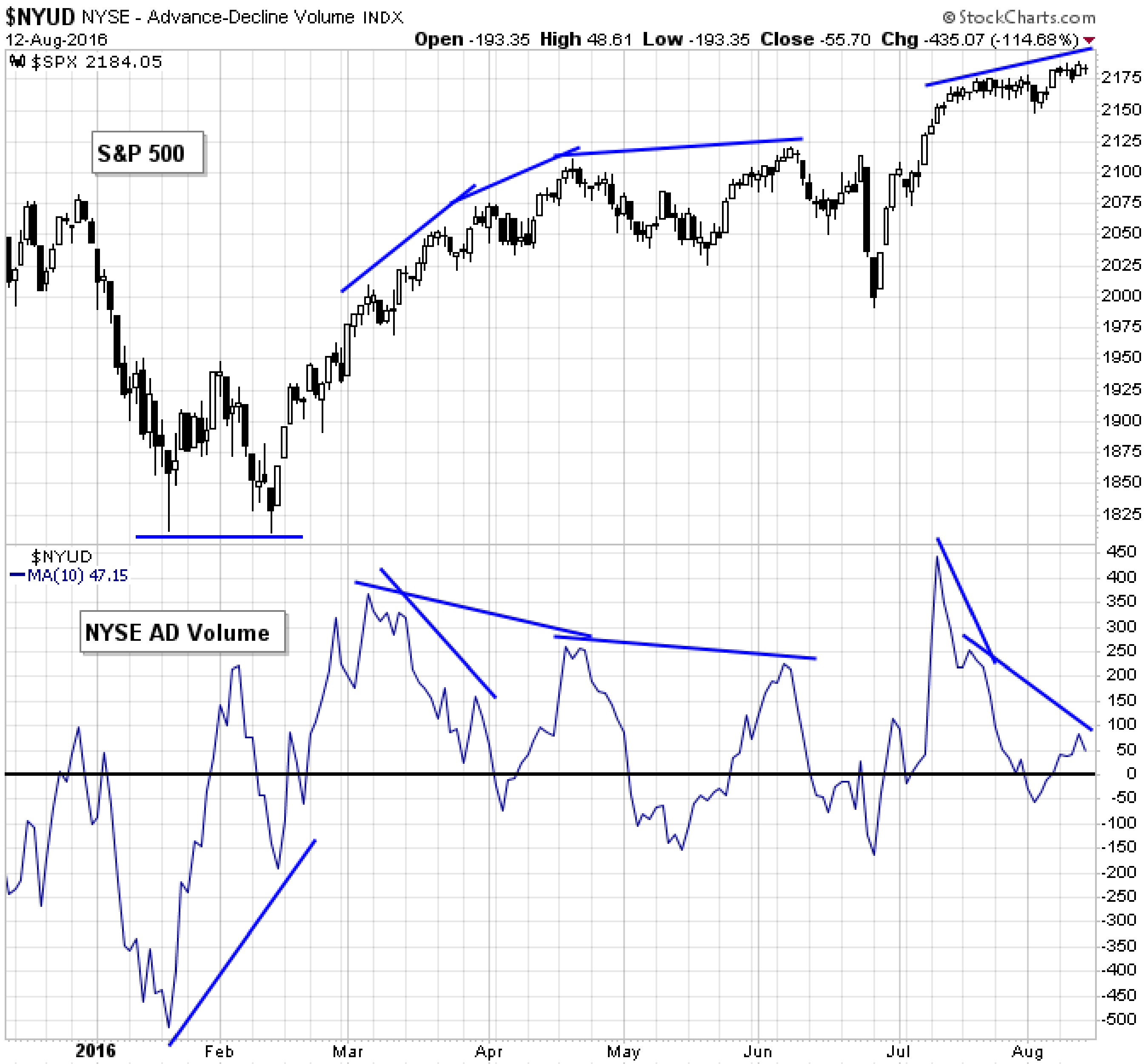
Indicators

S&P 500 vs. 10-day MA of NYSE AD Line: Over the last month the S&P is up a small amount, so despite the negative divergence here, it's not a surprise the 10-day of the AD line is a little above 0. If the market actually made a rally attempt, I'd want to see immediately improvement here, but for now I'm ok with what's taking place.



S&P 500 vs. NYSE Cumulative AD Line: Consistent AD prints above 0 have kept the cumulative AD line in stealth mode. There are no warnings here. Compare the current action with the multi-month divergence that took place last summer, and you can't come to any conclusion other than that the movement of the market being well supported.

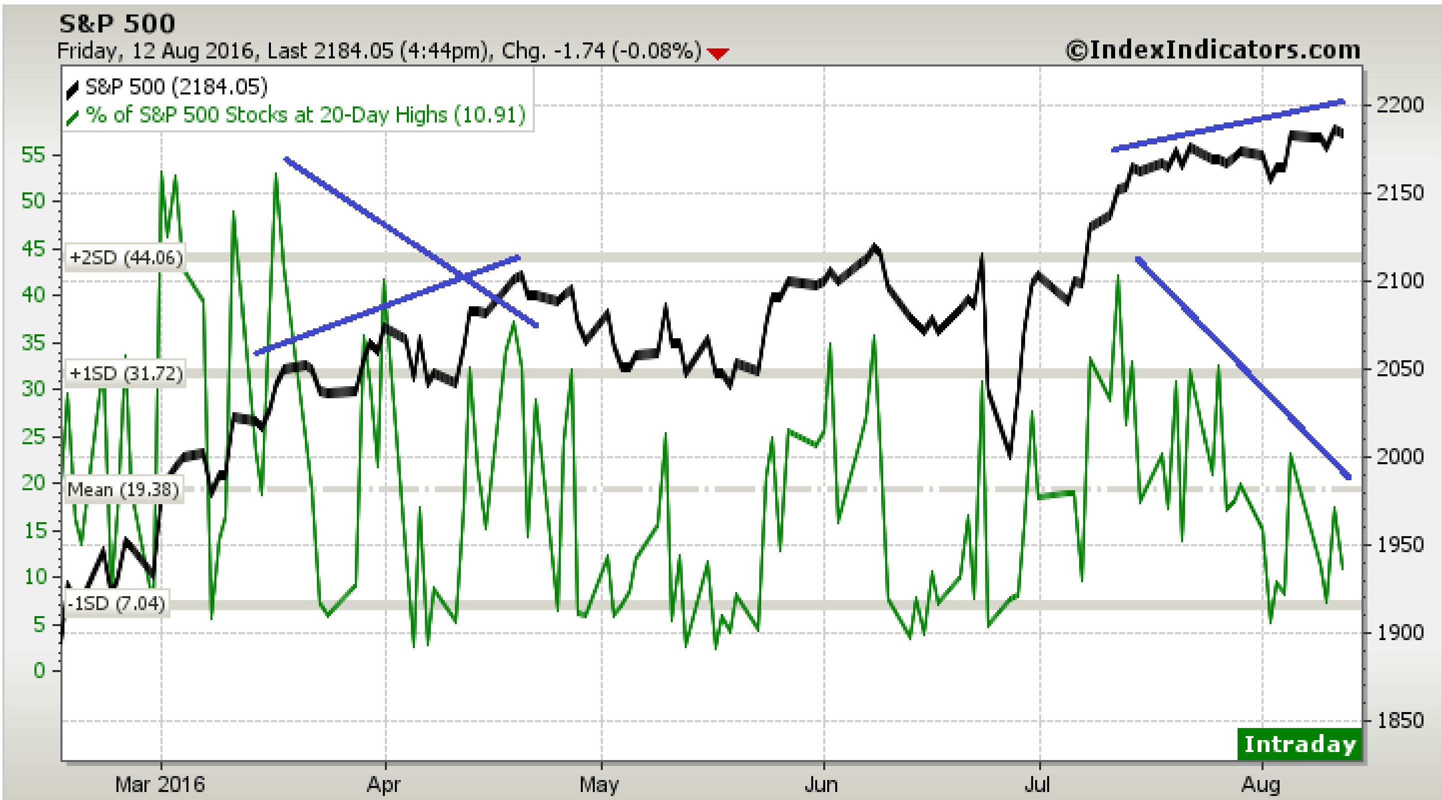
S&P 500 vs. 10-day MA of NYSE AD Volume Line: The AD volume line, which lets the high-volume stocks have more influence, is acting the same as the AD line - a little above 0 to match the market's slight gain over the last two weeks. I'm okay with the divergence.



S&P 500 vs. NYSE Cumulative AD Volume Line: If you're looking for beneath-the-surface warnings that trouble is brewing, you won't find it with the cumulative AD volume line. Unlike last November and December, when the indicator trended down before the January swoon, there are no signs of weakness here.

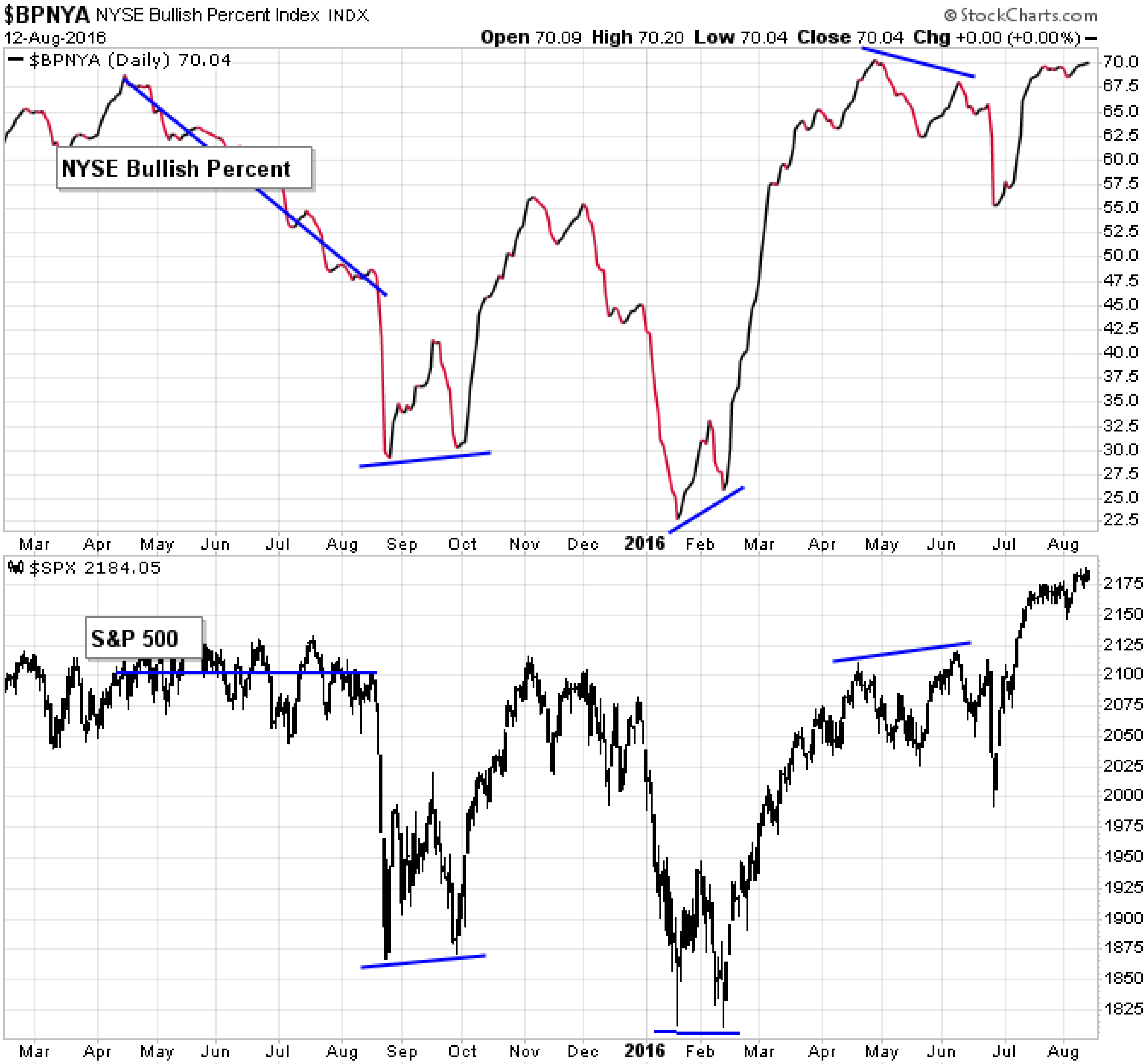
S&P 500 vs. NYSE New Highs: Less stocks have made new highs lately relative to a month ago when the S&P moved to a new all-time high. I'm not overly concerned because the market has been slow and we've gotten steady prints for six weeks.

S&P 500 vs. Percentage of SPX Stocks at a 20-day High: Another look at new highs - instead of comparing 52-week highs with previous prints, here we compare the S&P with 20-day SPX highs. Despite the market slowly grinding up (it's made a higher high six straight weeks), the number of stocks hitting 20-day highs has been declining. This is either the calm before the storm or a slight warning stocks are losing their momentum. In either case, if the market jumps, we'll want to see this indicator quickly break it's downtrend.

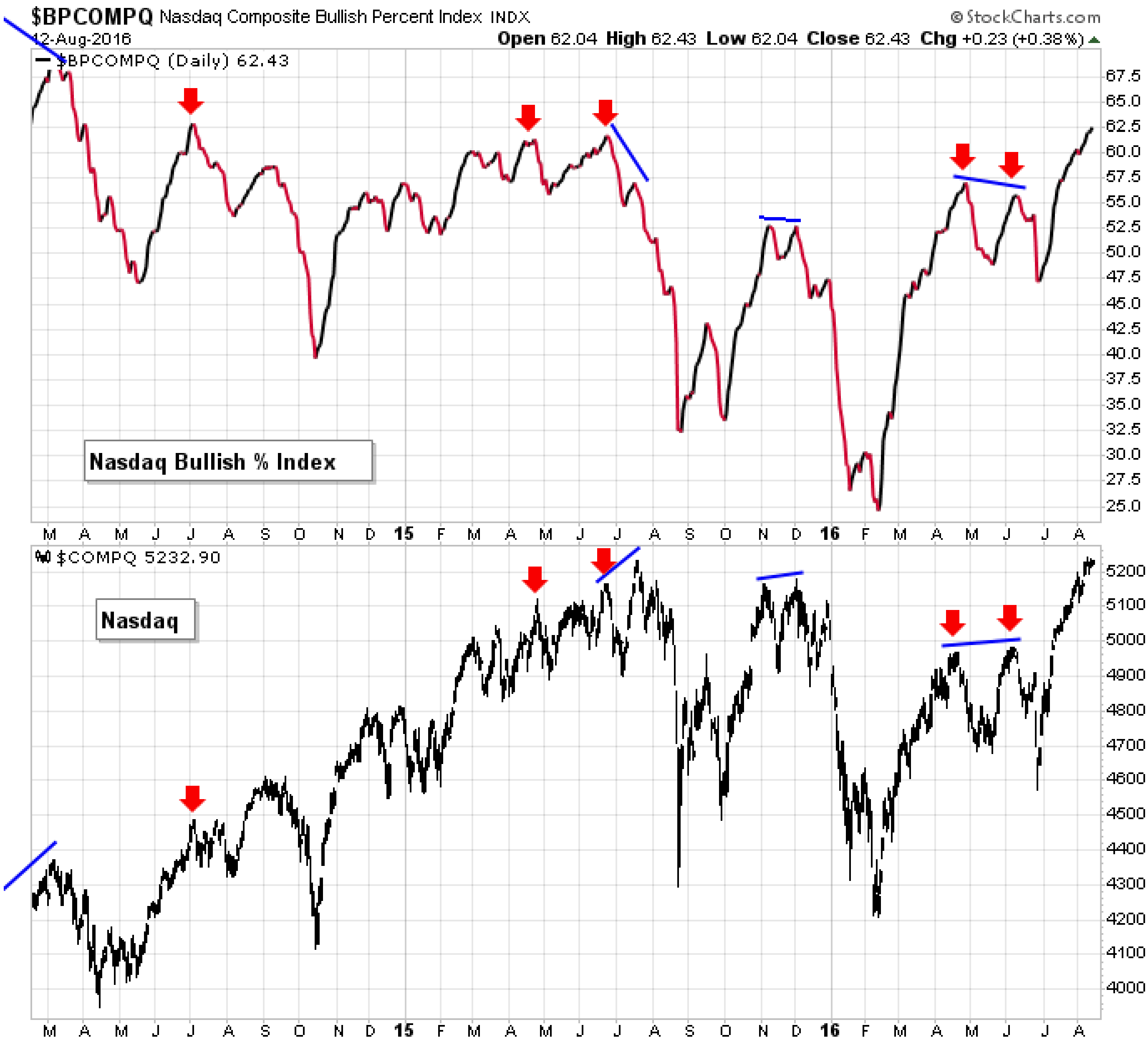


NASDAQ vs. NASDAQ New Highs New highs at the Nas haven't matched their early-July spike, but they're still registering at a healthy level.

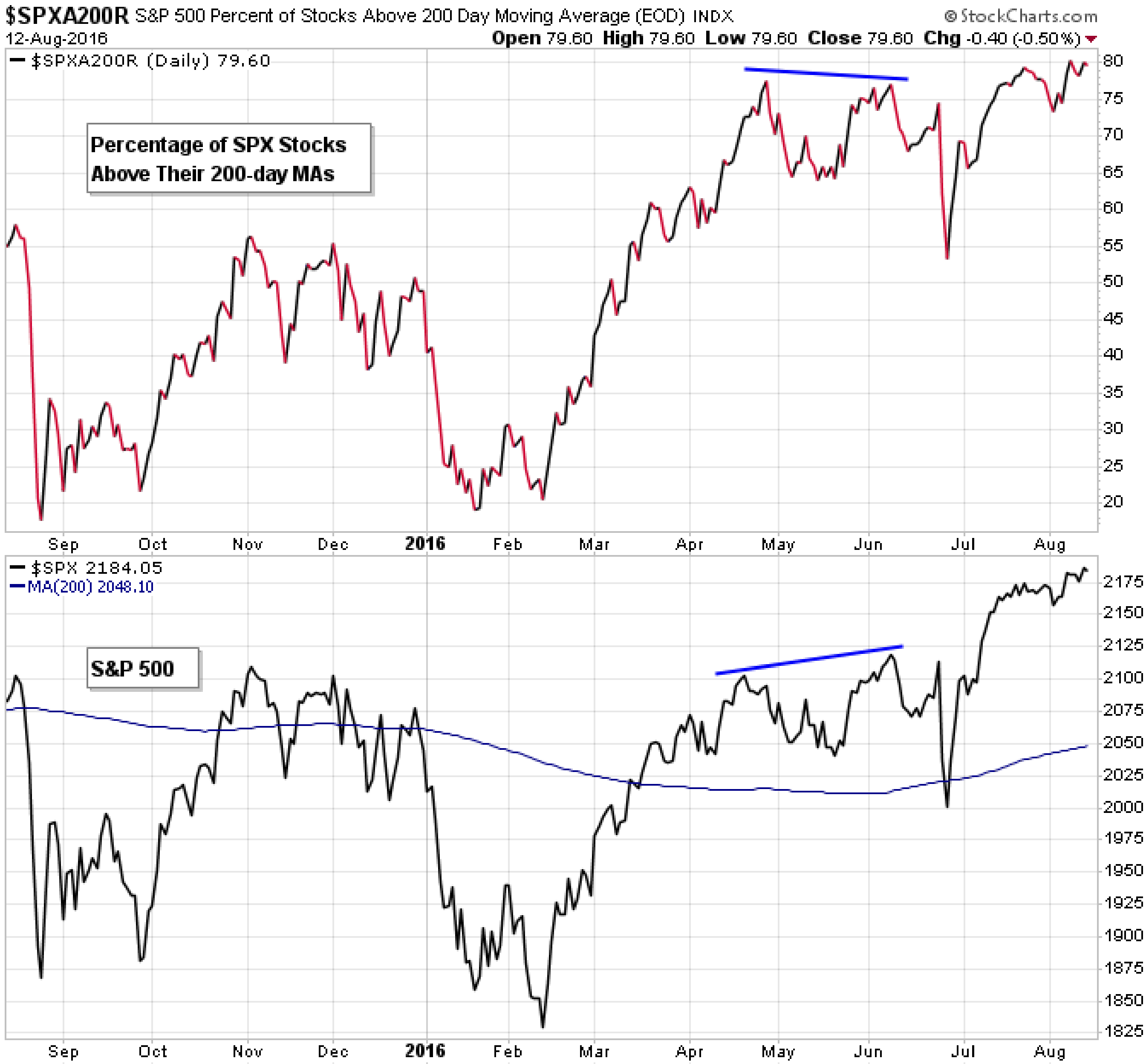
S&P 500 vs. NYSE Bullish Percent: The bullish percent at the NYSE remains steady. It's not improving or offering any warnings. It's just sitting there while the market mostly trades range bound.



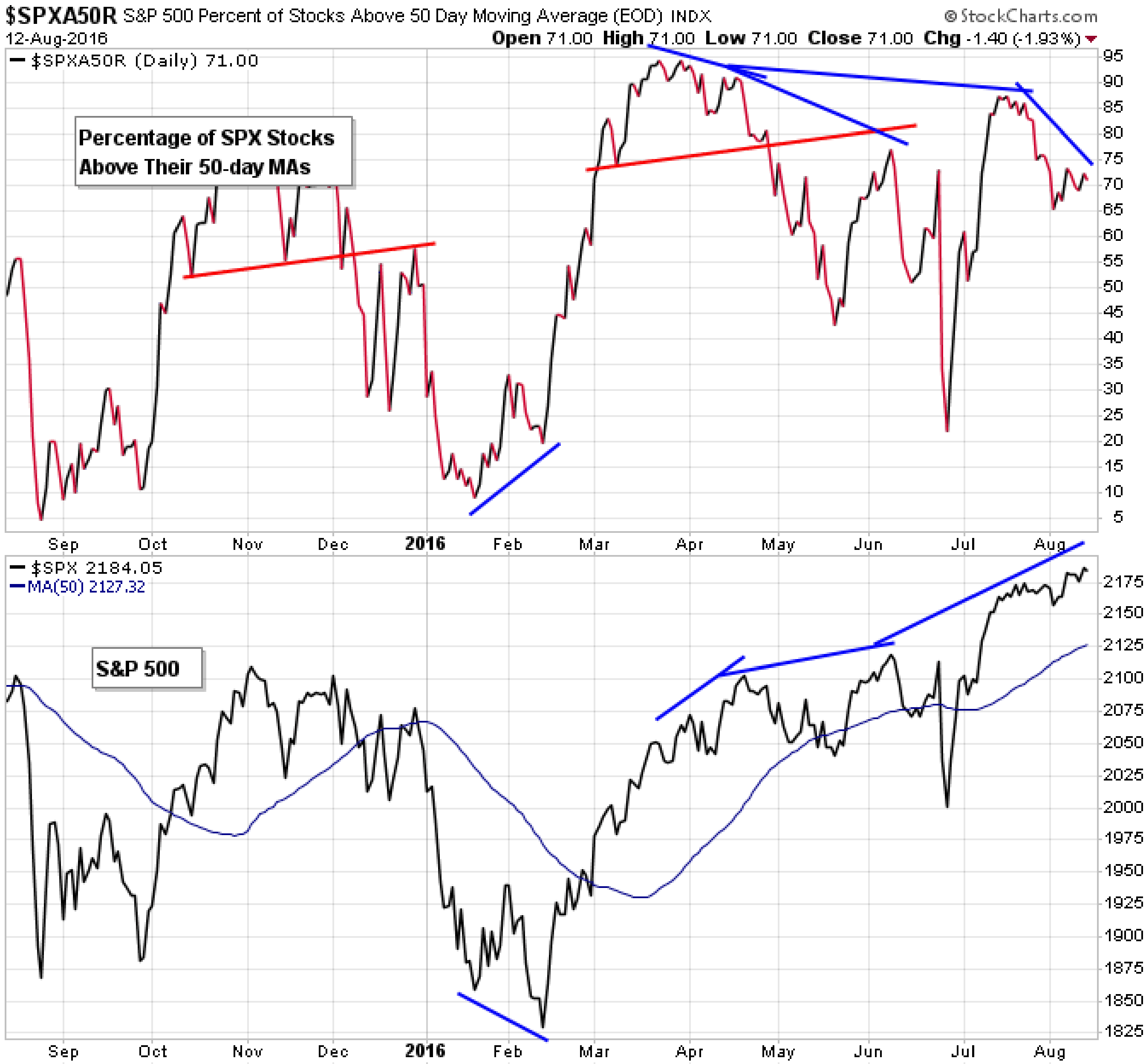
NASDAQ vs. NASDAQ Bullish Percent: The Nas bullish percent continues to trend up. This area in the low 60's has turned the indicator around in the past, so it's something to keep an eye on. Otherwise the Nasdaq's strength is well supported.



S&P 500 vs. Percentage of SPX Stocks Above 200-day MA: The percentage of SPX stocks above their 200-day moving averages is holding steady. With the market trading slowly, I wouldn't expect any extreme improvement. The fact that the indicator isn't falling is good enough - it tells me internally the market remains well supported.

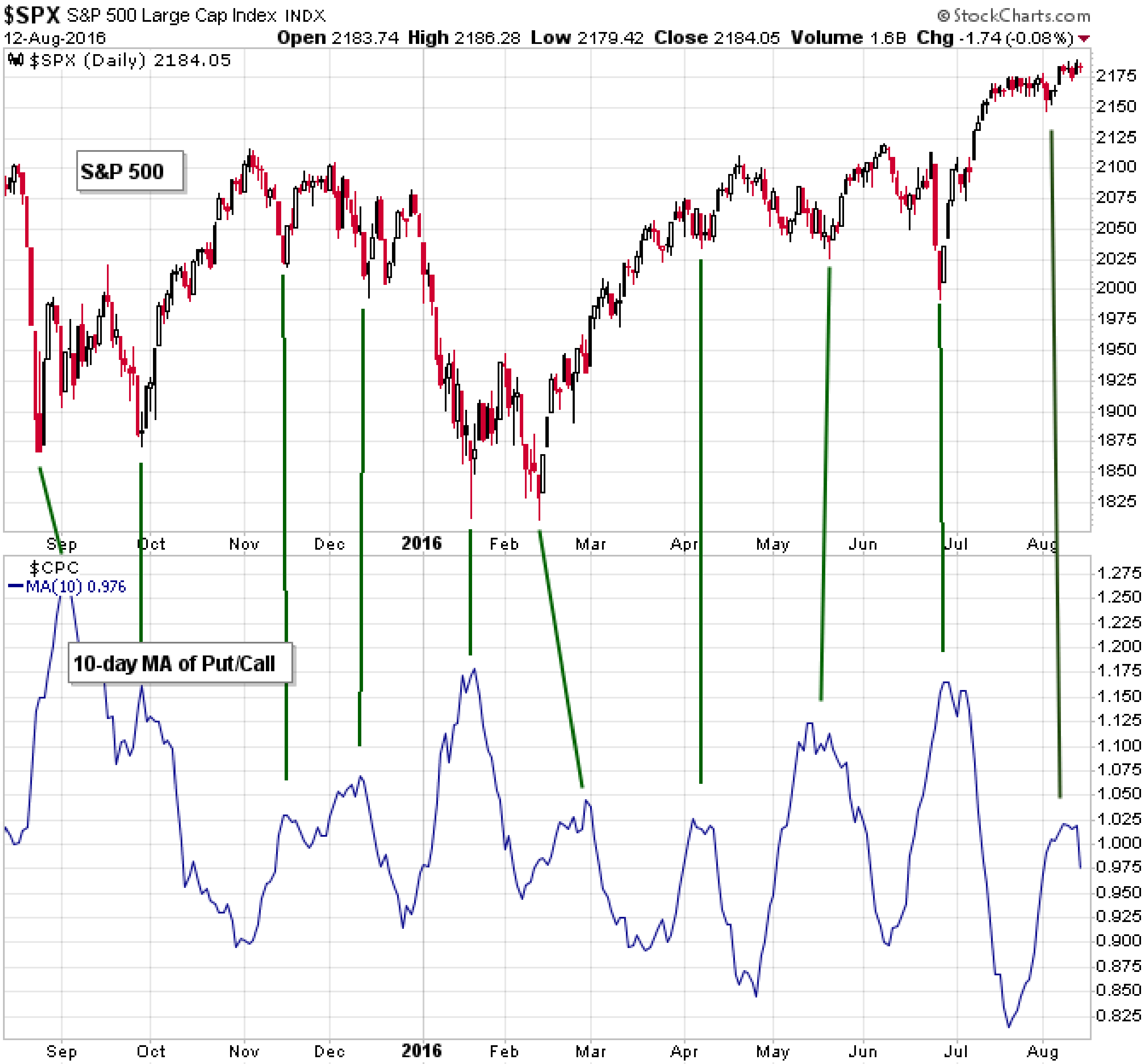


S&P 500 vs. Percentage of SPX Stocks Above 50-day MA: The percentage of SPX stocks above their 50-day moving averages has declined. The longer the market trades quietly in a range, the further this indicator will drop because the 50's of individual stocks will flatten out. Keep an eye on this. If this indicator drops to a lower low, the market probably won't leg up until it recovers.



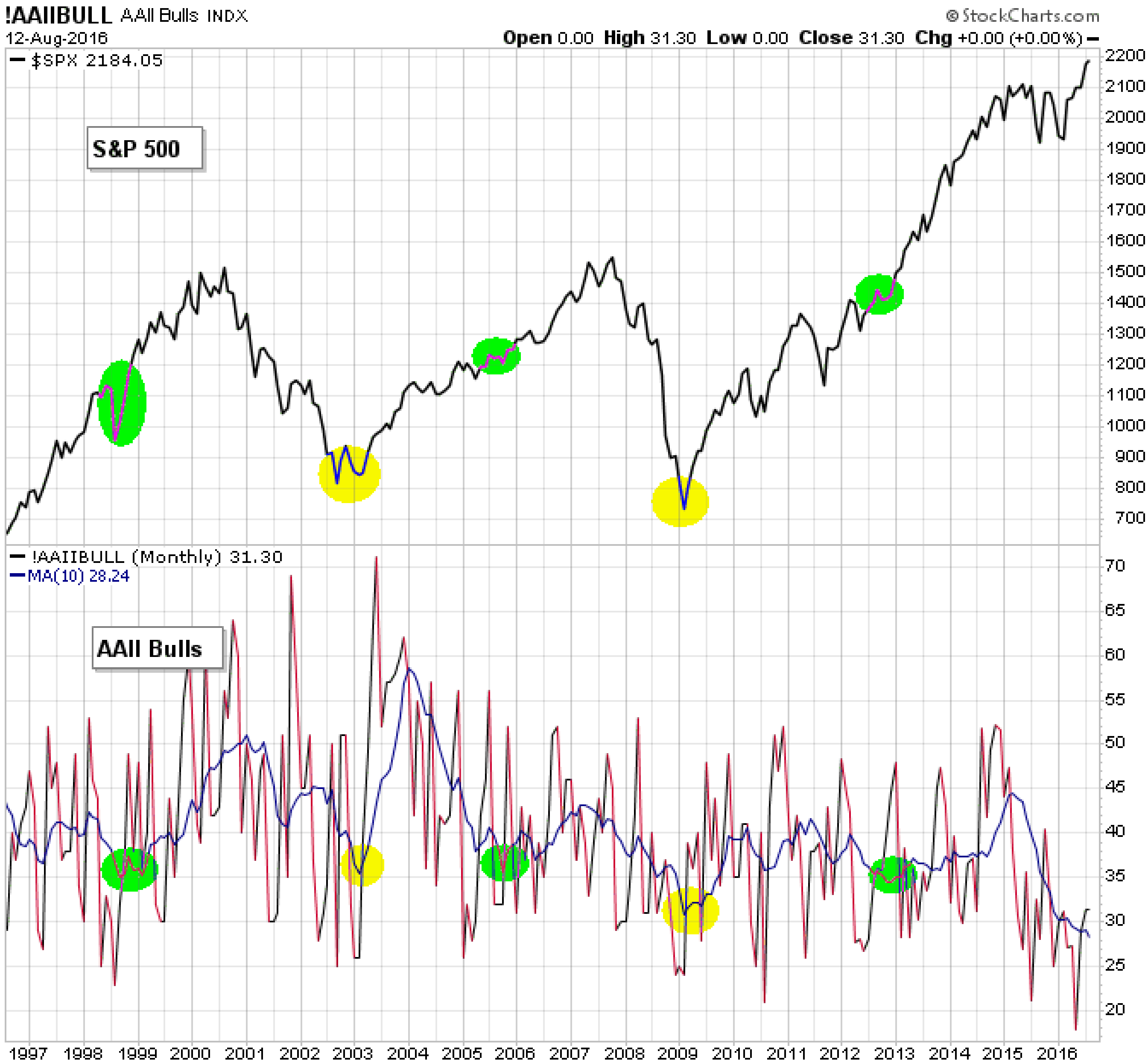
Percentage of Nas 100 Stocks Above Their 50-day MAs/Percentage of Nas 100 Stocks Above Their 200-day MAs vs the Nasdaq: The percentage of NDX stocks above their 50 continues to decline relative to the percentage of NDX stocks above their 200. Given the Nas has been trending up, this divergence is definitely notable. If the Nas was flat, I wouldn't care - I would just say the indicator is cycling down within a bigger uptrend - but since the Nas is moving up, this does tell us the participation rate is declining.

S&P 500 vs. 10-day MA of Put/Call Ratio: The put/call is rolling over. This typically coincides with the market legging up. It's kind of happening in slow motion, and with the indicator starting at a low level, you have to wonder how much downside there is. For now it supports the market's trend.

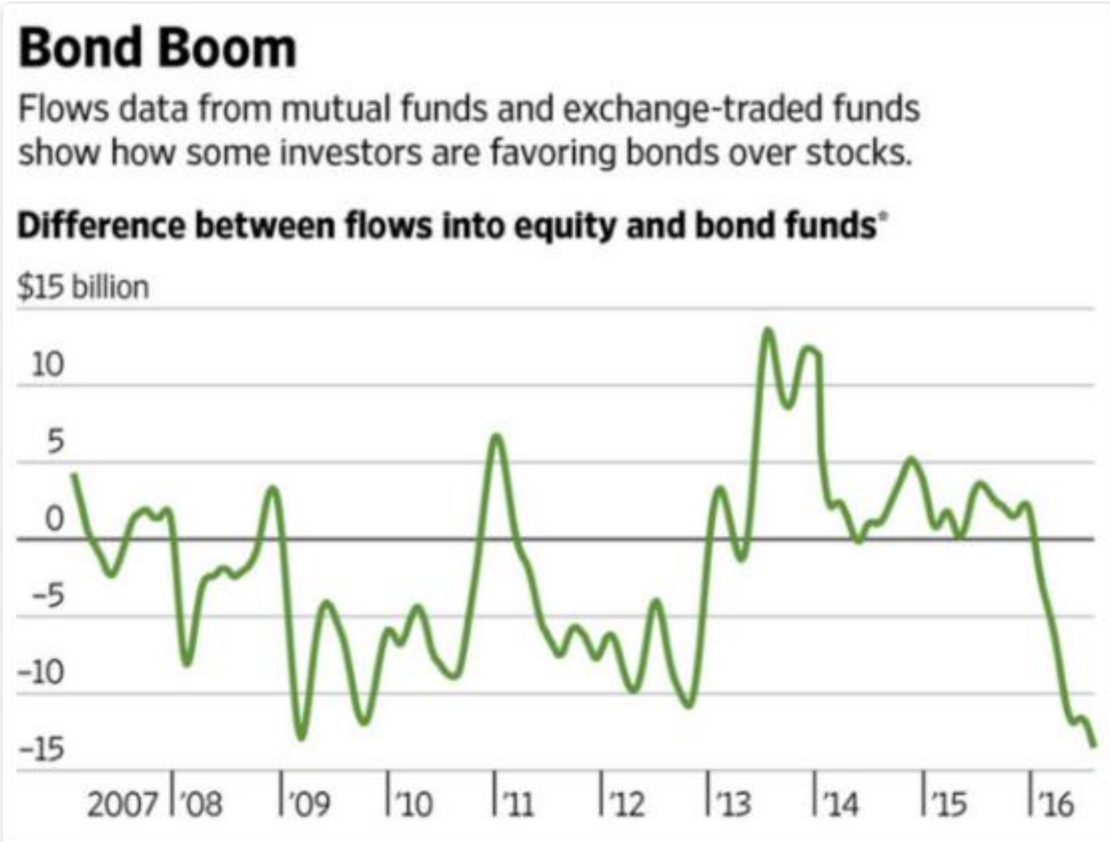


S&P 500 vs. 14-day Average True Range: Given the market's slow action, it's no surprise the ATR continues to trend down...and this fully supports higher prices. Markets move up on low volatility and move down on surging vol.

S&P 500 vs. AAII Bulls: Here's the AAII chart I referenced in the intro. This is a hated rally where the 10-day of the AAII bulls is at its lowest level in 20 years. Imagine that. Investors were more optimistic at the lows of the dot-com bubble bursting and during the Financial Crisis than they are right now.



Equity vs. Bond Flow: And here's a chart of equity purchases vs bond purchases. Despite the stock market trend, money is rotating out of the market and into bonds. What if investors realize they're wrong and money rotates back to stocks?



The Bottom Line

The market remains in good shape. New highs continue to be made, and most indicators support the action. There are a few shorter term divergences, but for most part, the market's strength is supported.

If the market legs up, we'll definitely want to see some improvement from a few indicators, namely the percentage of stocks above their 50-day moving averages and the number of stocks at a 20-day high.

But if the market wants to continue trading quietly in a range, I'm not going to be overly concerned about a few divergences.

Trading has been very slow, and I'm not expecting it to pick up in the near term. We get the FOMC minutes this coming week, which could shed some light on the odds of a September rate hike, but otherwise, the market will move when it's ready. And right now it doesn't seem ready.

I have no reason to abandon my SPX 2300-2400 target, and in fact the closer we edge up to 2300, the market I'll be looking for 2400 and higher.

Have a great week.

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