

Technical Review & Outlook

November 16, 2017

BAIRD

Please refer to Appendix – Important Disclosures.

Market Messages:

- **Breadth Deteriorating but Not Breaking Down** – Minor breadth divergences that remain minor can represent opportunities. The risk is that minor divergences can morph into more significant divergences. All major divergences start small, but not all small divergences become significant. Right now, the decline in the percentage of stocks trading above their various averages constitutes a minor divergence that could easily be resolved without more significant index-level weakness.
- **New Leg Higher Should Come with Expansion in New High List** – For breadth to deteriorate at a time when the indexes have cooled off is not uncommon. The test will be if/when the indexes resume their up-trend. If that move is not accompanied by an expansion in the new high list and an increasing percentage of stocks in up-trends, the path for stocks could get rockier.
- **Sentiment Backdrop Becoming More Mixed** – There is still little evidence of any widespread pessimism, but there are signs that optimism has become less excessive. Representative of this shift in sentiment might be the recent readings from the NAAIM data – the Exposure index has dropped from 96% to 49% since the end of September, but median exposure has dropped only to 90% from 100%.

Technical Summary

Trend: Longer-term trends suggest cyclical rally remains intact

Momentum: Leading indexes have seen momentum contract

Breadth: Most areas of the market remain in longer-term up-trends

Sentiment: Surveys show shifting sentiment trends

Macro: Turns out that tax reform is hard

Key Near-Term Levels:

S&P 500 – S: 2530, 2450; R: 2600

Russell 2000 – S: 1475, 1425; R: 1515

10-Yr T-Note Yld – S: 2.20%; R: 2.60%

	Last	50-Day Average Level Direction	200-Day Average Level Direction	Close to 50-day	Close to 200-day	50-day to 200-day	High/Low 13-Wk 52-Wk	OB/OS Daily Weekly
S&P 500	2564.62	2542.59 Up	2438.01 Up	Pos	Pos	Pos		OB
Dow Industrials	23271.28	22857.62 Up	21568.94 Up	Pos	Pos	Pos		OB
Dow Transports	9440.87	9743.82 Up	9381.92 Up	Neg	Pos	Pos		OS
NASDAQ Composite	6706.21	6577.31 Up	6209.60 Up	Pos	Pos	Pos		OB
Russell 2000	1464.10	1478.08 Up	1414.12 Up	Neg	Pos	Pos		OS OB
Energy	508.52	512.07 Up	508.39 Down	Neg	Pos	Pos		OB
Materials	388.22	390.63 Up	369.54 Up	Neg	Pos	Pos		OS OB
Industrials	634.88	645.71 Up	618.53 Up	Neg	Pos	Pos		OS
Consumer Discretionary	682.87	672.70 Up	660.65 Up	Pos	Pos	Pos		OB OB
Consumer Staples	587.92	588.14 Down	595.39 Up	Neg	Neg	Neg		OB
Health Care	976.76	994.17 Down *	943.54 Up	Neg	Pos	Pos		OS
Financials	477.98	474.12 Up	451.77 Up	Pos	Pos	Pos		OS OB
Information Technology	1125.03	1078.58 Up	996.28 Up	Pos	Pos	Pos		OB
Telecommunications Services	141.29	153.10 Down	158.77 Down	Neg	Neg	Neg		OS OS
Utilities	327.70	318.11 Up	308.11 Up	Pos	Pos	Pos		OB OB
VIX	13.13	10.28 Up *	11.15 Up *	Pos	Pos	Neg		OS
10-Year T-Note Yield	2.34	2.31 Up	2.31 Down	Pos	Pos	Pos		OS OS
Gold	1277.70	1293.45 Down	1264.99 Up	Neg	Pos	Pos		OS
Copper	3.05	3.06 Down	2.79 Up	Neg	Pos	Pos		OS
US Dollar	93.73	93.26 Up	96.45 Down	Pos	Neg	Neg		OB
Crude Oil	55.33	52.10 Up	49.65 Up	Pos	Pos	Pos		OB

Note: data as of November 15 close. Source: FactSet

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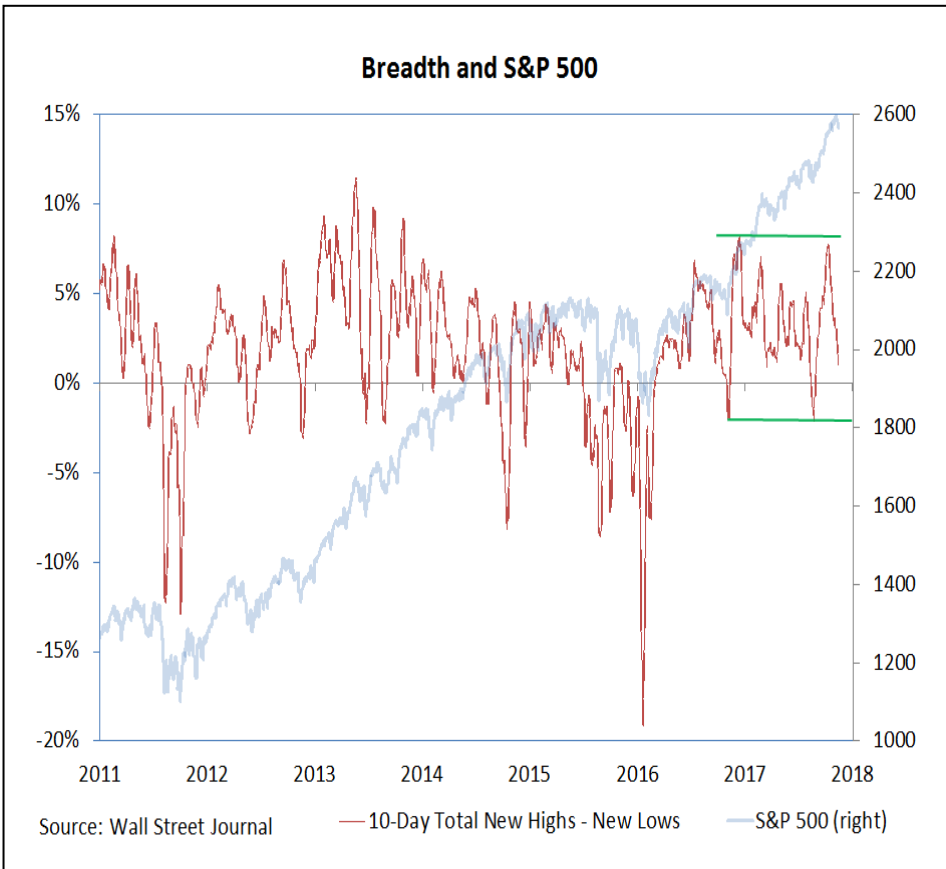
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The S&P 500 made a new all-time high in early November, but finished the first half of the month in the red. The percentage of stocks trading above their 50-day or 200-day averages has moved steadily lower since mid-October, and those peaks were hardly robust. At the mid-November mark only 68% of S&P 500 stocks were trading above their 200-day averages (down from 75% in mid-October and 82% earlier this year). Only 58% of stocks were above their 50-day averages, down from more than 75% in mid-October. On the NASDAQ, only 42% of stocks were above their 50-day averages. Issue-level trend deterioration as the indexes consolidate gains is not surprising. Longer-term breadth trends remain strong for now, and there is little evidence that a meaningful break down has occurred.



Source: StockCharts

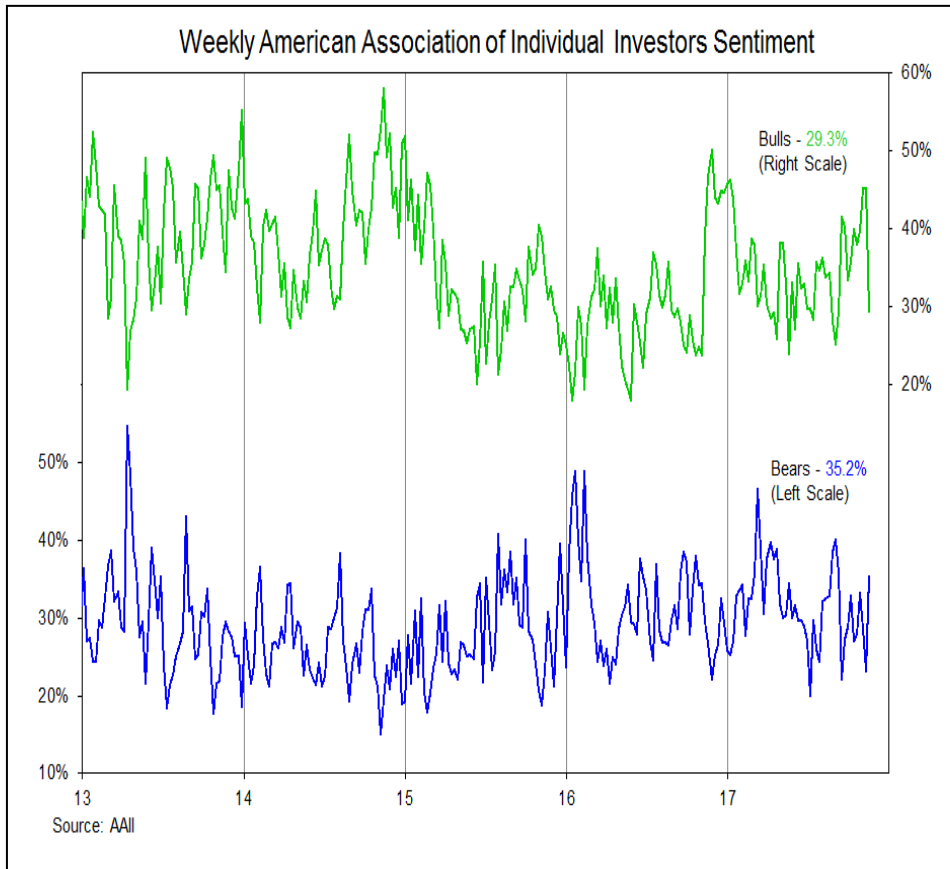
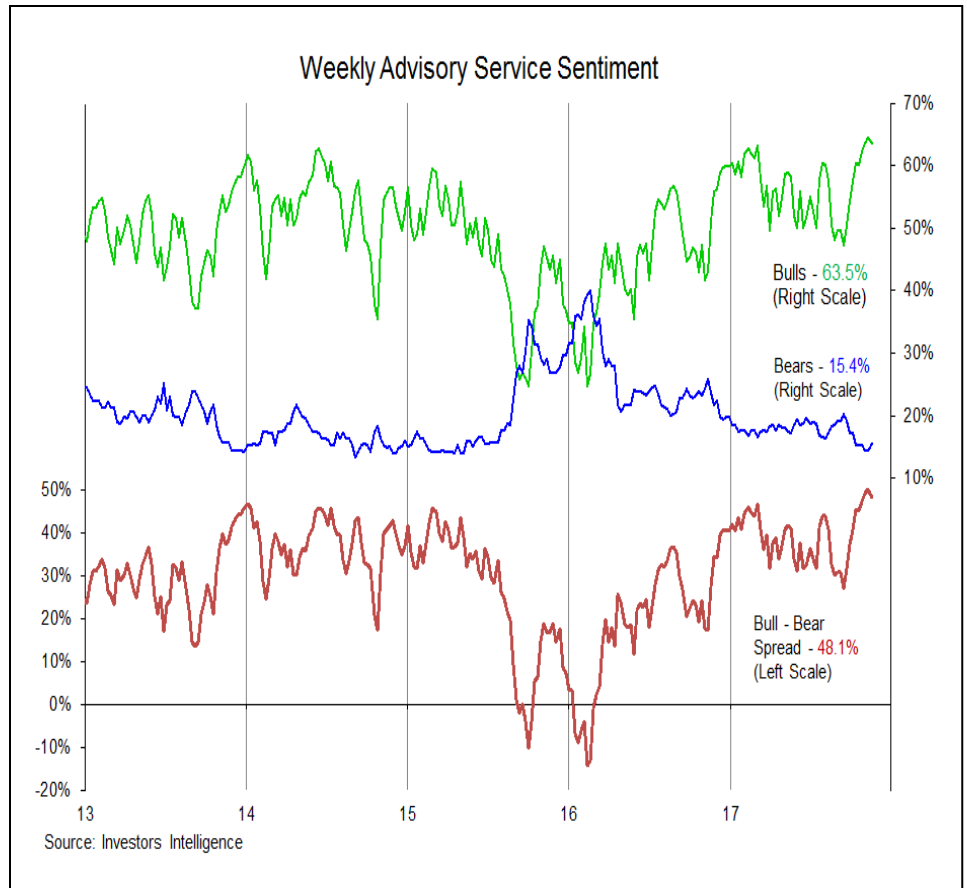


Source: Wall Street Journal — 10-Day Total New Highs - New Lows — S&P 500 (right)

The best test of broad market strength may come if/when the indexes complete their consolidation and attempt their next leg higher (the longer-term up-trends continue to get the benefit of the doubt). If there is not a meaningful expansion in the percentage of stocks trading above their various moving averages and an uptick in the number of stocks making new highs versus new lows, the sustainability of any index-level rally that does emerge could be called into question.

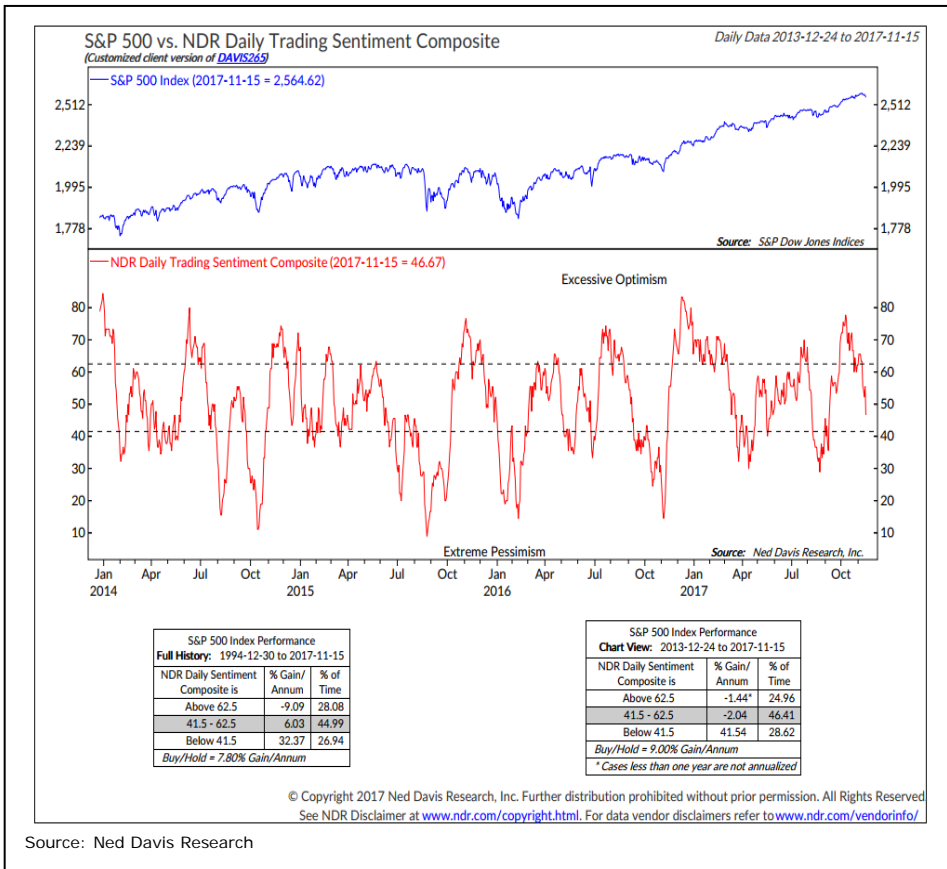
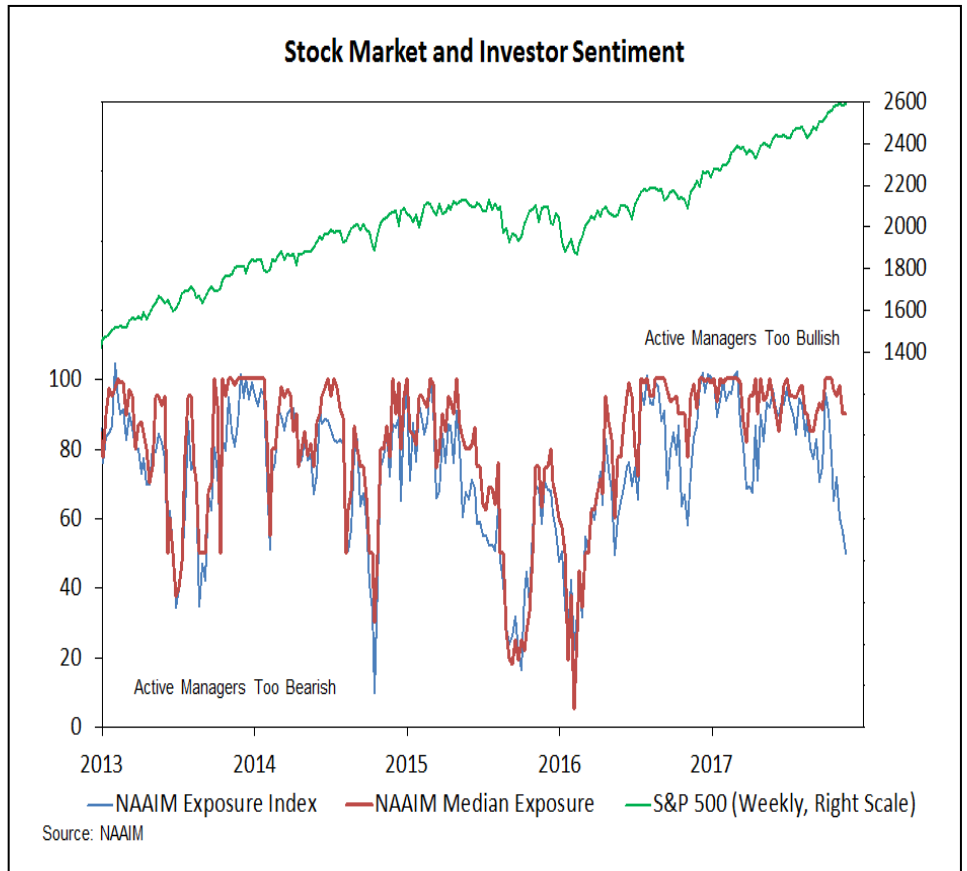
With the various sentiment surveys sending increasing mixed signals, it might make sense to review each in turn.

The Investors Intelligence survey of advisory service sentiment showed a slight down-tick in bulls and up-tick in bears this week. The bull-bear spread retreated from 50% to 48.1%. Still, this survey shows widespread and excessive optimism to a degree not seen in 30 years. Stocks have typically struggled to sustain upside progress when bulls have outnumbered bears by such a degree.



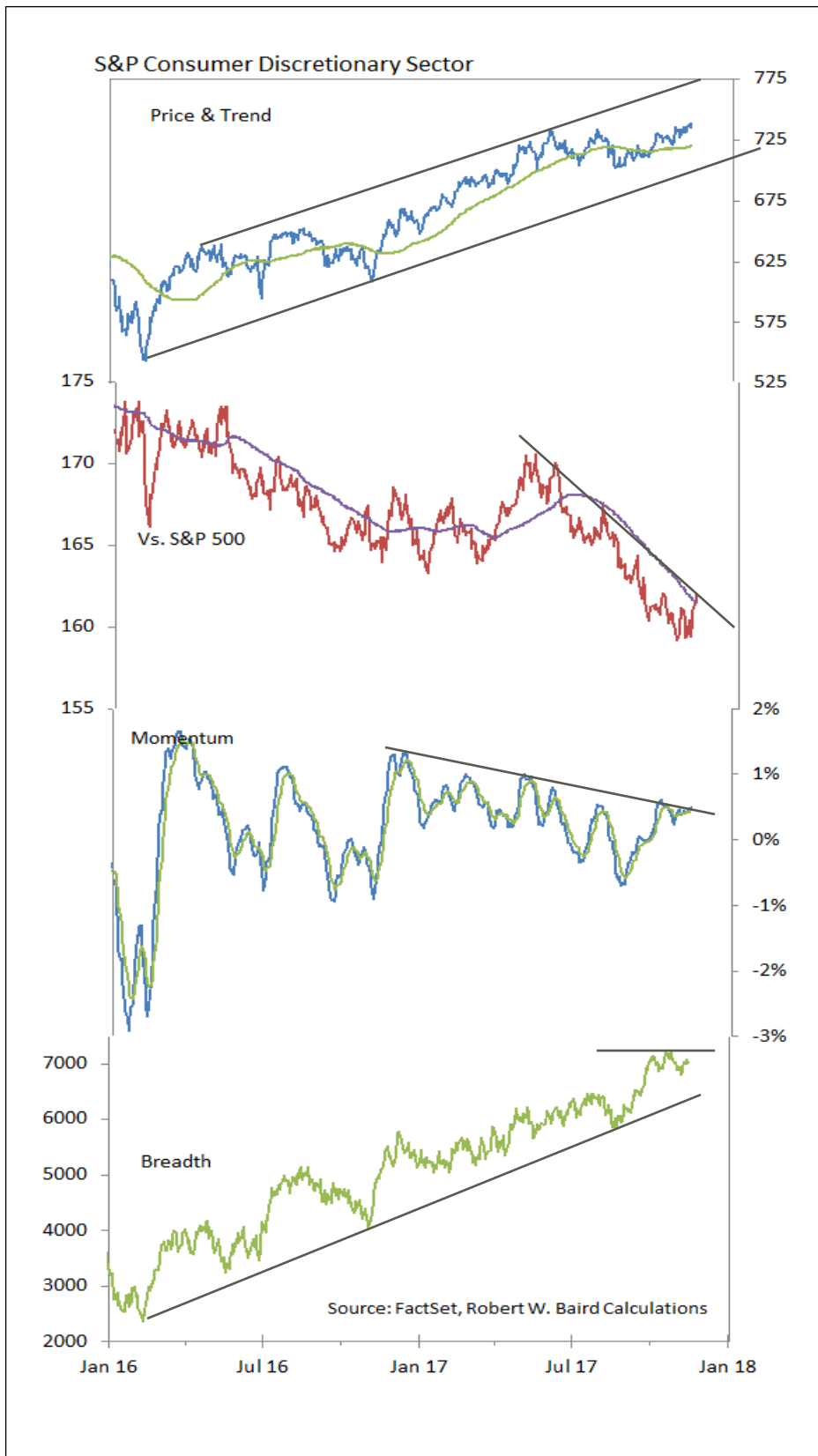
The AAI data had been moving toward excessive optimism as well. Coming into this week, Bulls were at their highest level of the year and Bears had dropped from 33% to 23% over the preceding two weeks. This week brought an abrupt change – Bulls dropped from 45% to 29% and are now outnumbered by bears (35%). We can tease about the fickleness of the AAI survey respondents and question the usefulness of the data but it does echo the shift seen in recent weeks in the NDR Trading Sentiment Composite (more on that below).

Before getting to the NDR Sentiment Composite, let's consider the NAAIM data. The NAAIM Exposure index fell again and is now at its lowest level since early 2016. While the Exposure index has moved from 96% in the final week of September to a sub-50% reading this week, the median exposure has hardly been reduced, falling only from 100% to 90%. The decline in the exposure index has been driven by a re-establishment in the bearish camp rather than bulls reining in their horns. While encouraged by seeing more skepticism, a drop in the median exposure level would give us more confidence that optimism has indeed been unwound.



The NDR Trading sentiment composite has been moving lower over the past month. So far, however, it does not show excessive pessimism and over the past four years, all of the net gains in the S&P 500 have come when this indicator has been in the excessive pessimism zone. In other words, while the sentiment backdrop is more mixed and moving toward a more constructive message, it is not there yet.

The Consumer Discretionary sector has moved to a new 52-week high today, making it the second sector (after Utilities) to make a new high. A look at the support indicators, however, paints a less constructive picture. On a relative price basis, the Consumer Discretionary sector has bounced, but it is too early to conclude that the longer-term trend there has shifted. Moreover, momentum continues to moderate and breadth has not confirmed the price highs. Consumer Discretionary continues to be ranked in the bottom half of our sector-level relative strength rankings, although it is seeing some improvement there.



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