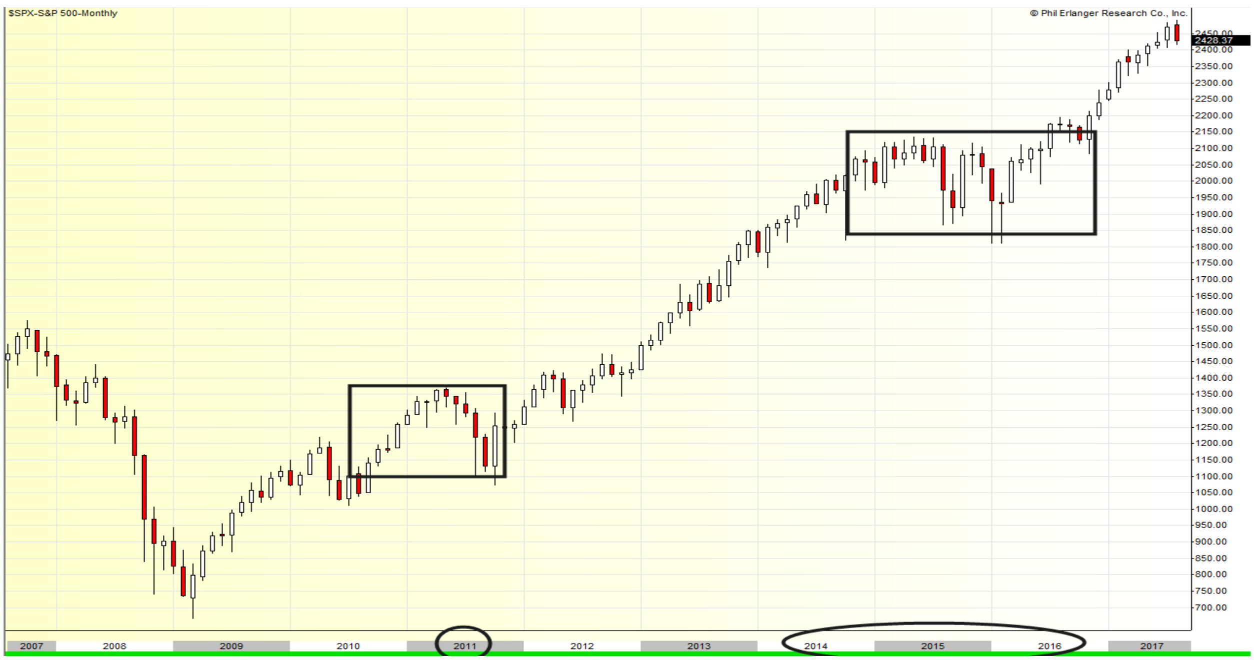
August Market Outlook Part 2, Technicals of Market

In this outlook, I will focus on technical/price analysis. Technical analysis is focused on the trend of prices, and is not concerned with what a company does, or its valuation.

Technical analysis is helpful in determining the strength of a trend. It is also very helpful in determining entry and exit points for buy, hold, or sell decisions.

The markets are up double digits so far this year, but the leadership in the markets is narrow, and many stocks are going sideways, or are bearish.

Below is a chart of this market cycle:



Source: www.erlangerchartroom.com

Let's review the chart:

- The bear market of 2008, 2009 bottomed in March of 2009. We are in the eighth year of this bull market.

  This market is up about 300% since the low of 2009. Most of the gains in this cycle have been made.

- The market stalled in 2011 due to: 1. Arab spring, several Middle Eastern and North African countries (Algeria, Libya, Egypt, Syria, Yemen, Saudi Arabia, Bahrain) demonstrated and demanded country leadership change. 2. Talk of Greece leaving the Eurozone, Grexit 3. The triple tragedy of Japan (earthquake, tsunami, nuclear plant damage and evacuation of area).

It was thought the global economy might enter a recession. It was touch and go. The market did struggle in 2011. The market did enter bear market territory briefly, it was down about 20% from peak to trough. It was not considered a true bear market because the economy did not go into a recession, and earnings help up.

- After 2011, the market continued its bull market and stalled in 2014, 2015, 2016.

- The markets struggled again starting in 2014. The dominant economic, investment trend in the 2000s was the emergence of China as an economic power. In 2015, I wrote an article about how the economic boom of China was reversing. Click here to read the article. Briefly, China realized they could not sustain their economic boom of exports, manufacturing and heavy spending on infrastructure and real estate. They wanted to focus and develop their service economy.

The Chinese economic shift caused commodity prices to collapse in 2014 including oil. The collapse in commodity prices caused recessions in many resource based economies (Canada, Brazil, Australia, New Zealand….).

The oil price collapse impacted our energy industry with many layoffs, and bankruptcies that caused credit spreads to widen, a red flag for the economy. Many of us thought the current economic and market cycle was close to ending and that the global economy would enter a recession and bear market.

The markets reflected an earnings recession during 2015, and 2016.

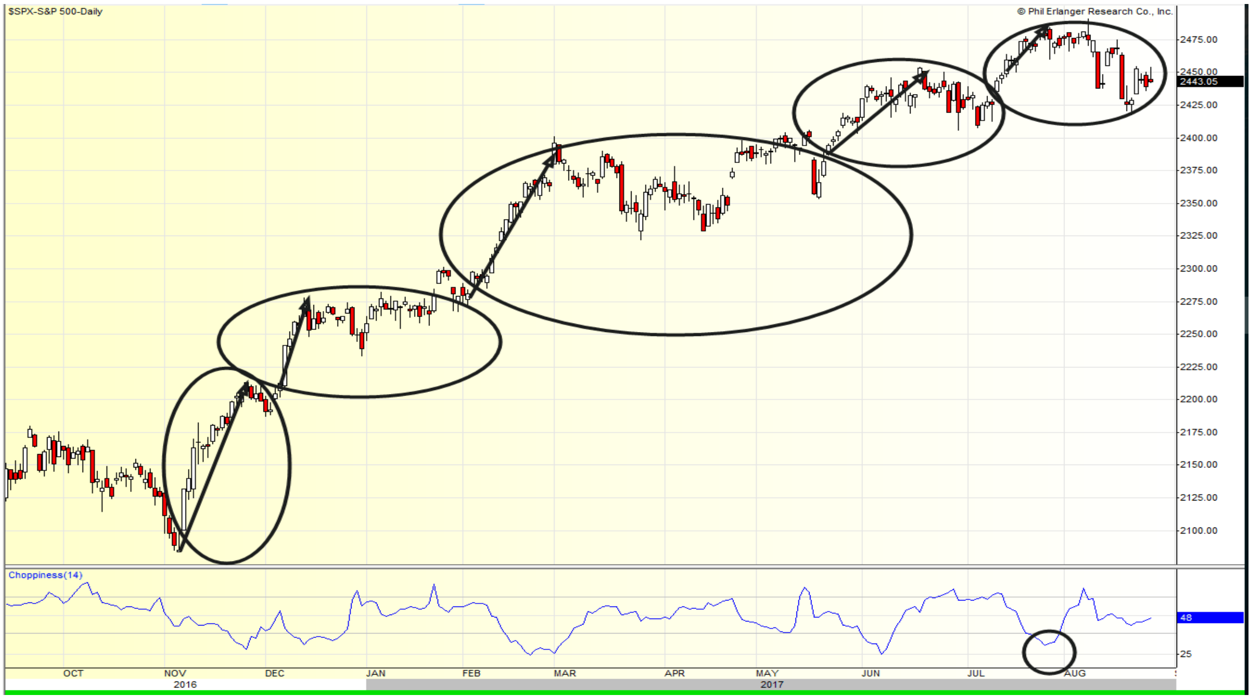
- The global economy was able to recover from the change in China's economy, and the commodity collapse. After the election, and evidence that the earnings recession was over, the bull market was able to resume.

One of the reasons for the strength in the markets is the market was able to break above long-term resistance, the 2,100 level. The market had lots of supply, resistance at 2,100. Investors and traders that bought at the 2,100 area were potential sellers, supply. For the period from 2014 to 2016 these participants were either breaking even or losing money, and they wanted out. Once those sellers were out, there were fewer sellers, supply above 2,100 so it was easy for the market to make new highs. This is normal behavior when new highs are made.

Let's take a closer look at the breakout, and the technicals for 2017.

2017 Technical Analysis of Market

Below is a chart of the market for 2017.



Source: www.erlangerchartroom.com

Let's review the chart:

- Once prices broke above 2,100, the market was able to make multiple new highs.

- Most moves consist of four to five "steps" within a move. I circled the "steps" (move and consolidation) within in a move. There are 5 steps in the current move. Also, notice that each move higher is normally less than the previous move. This move is probably close to running its course because of the five steps and also each move is less than the previous move.

  Count how many "steps" there are in the first chart on the first page. You should count five, another indication that this market is in its mature phase.

  The February move was based on announcements regarding the tax plans of the new administration. Although tax cuts could help corporate coffers in the short run, and we all as individuals like tax cuts, they do not have the positive economic impact that are touted.

  There is economic history of the impact of tax cuts, and the multiplier effect of tax cuts is small. Click here to read my research report on Trumponomics and Tax Reform.

- Another indicator that suggests this move is near its end is the choppiness indicator, bottom pane. When the indicators drops to the 30 level it normally means the current move has run its course. There have been five steps in this move with the choppiness indicator moving to the 30 area during the last step.

  The market may have peaked this year in July at around 2,480.

- Also, September and October are normally the weakest months of the year. Traders normally take profits in September after a summer rally. October is normally weak because mutual funds have to take their losses for reporting for the year by the end of October.

- If we do get a correction, a retracement could cause the markets to fall to the 2,330 level.

The market normally recovers by November. The market could get stronger toward the end of the year. Robo buying by hedge funds, high frequency traders and financial planners have been buying on dips, and could keep the markets from falling too much. Most of these buyers don't pay too much attention to valuations.

Growth Stocks and QQQ

The strength in the markets are growth, technology stocks. The NASDAQ 100, a.k.a. QQQ, is an index and is heavily weighted towards technology growth stocks. Below is a chart of the QQQ:

Source: www.erlangerchartroom.com

The QQQ chart basically looks like the previous chart:

- The chart has five steps

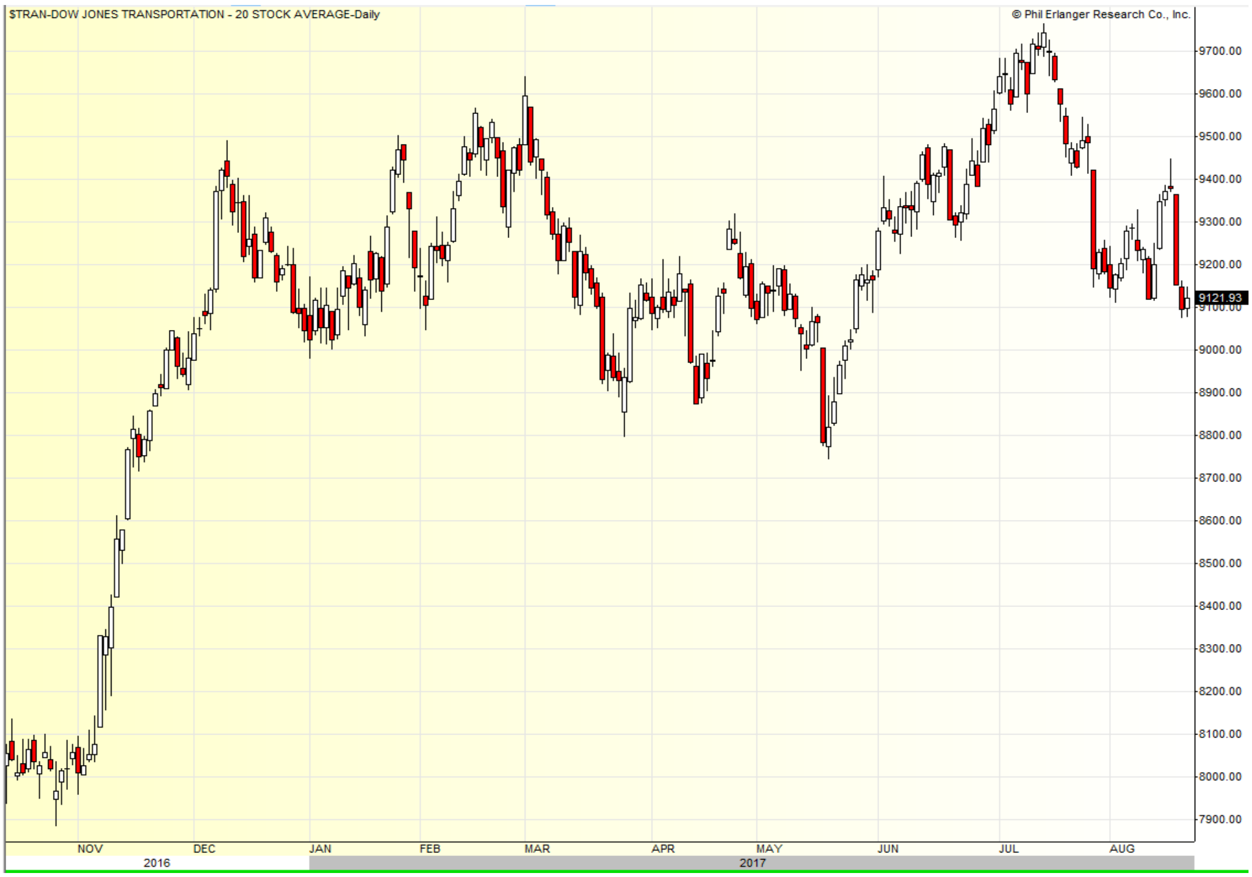
- Except for the first step, each step ascent is less

- The choppiness indicator peaked in step 5 in July

- The main difference of the two indexes is performance. The S & P is up about 10%. The QQQs are up over 20% as investors and traders have piled into technology, growth.

Transportation Index Technicals

Many stocks and indexes have had lackluster performance. Below is a chart of the Transportation Index:



Source: www.erlangerchartroom.com

The Transportation Index rallied on the news of the election. The index has gone sideways since.

Trends like this are called topping patterns and are bearish.

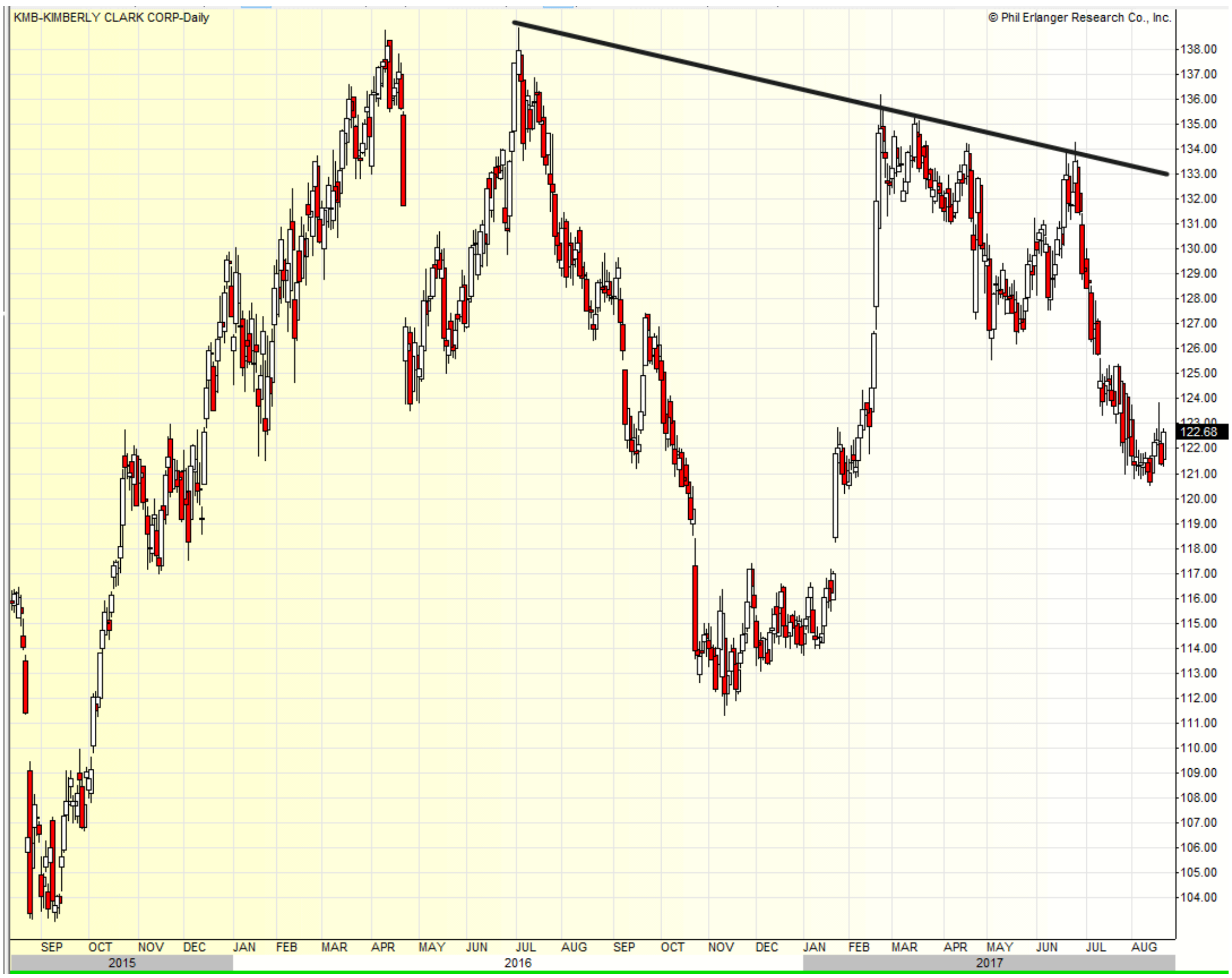
The reason why this chart is important is because of Dow Theory. One of the tenants of Dow Theory is that the Transportation Index must confirm the general market trend. When there is a divergence, then the trend of the market is suspect. Since the Transportation Index has a bearish topping pattern, this means the market's bullish pattern is suspect.

The reason for the confirmation tenant was that the economy could not be doing well if the transportation companies weren't doing well. Admittedly, in our service, knowledge based economy, transportation stocks aren't as important as they used to be.

Dividend Stocks

My clients and I own dividend stocks. They were the leaders in this market cycle, as retired investors need income. Dividend stocks became popular for retirees in this low interest rate environment.

Below is a chart of one of our holdings, Kimberly Clark, symbol KMB:



Many dividend stocks are slower growth companies, but they're attractive to investors that need income. Some investors left dividend stocks in favor of growth this year.

The stock is essentially the same price as it was about two years ago. Again, the trend is called a topping pattern, specifically a rounding top. This pattern is bearish. Participants are selling the rallies as evidence by the lower highs of the chart.

Summary

- This market cycle that started in 2009 remains in a bullish trend.

- We may see a selloff in the near-term, but buying the dips by robo buying could keep the sell-off in check.

- Not all stocks and indexes are bullish.

- There were several times in this market cycle that seemed like the market would turn bearish, especially 2011, and 2014 to 2016.

- Most economic and market cycles don’t last this long, but there are signs that this bull market is in its late stages (moves are less, “steps” rarely go beyond 5, valuations, topping pattern of many stocks and indexes, divergence with transportation index).

- Even though the bull market resumed this year, high valuations, the market is in the late stage of this market, and rising risks make me nervous.

  Be cautious, be patient, and be disciplined. Make sure you raise plenty of cash for the next market cycle.