Leavitt Brothers

Weekly

Jason Leavitt
jason@leavittbrothers.com

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We entered this week with the market very much in panic mode. To virtually everyone's surprise, the people of Great Britain voted to leave the European Union.

The Asian markets got hit hard. Japan fell 10% after the results of the vote were known (10% - that's like the S&P 500 dropping 400 points; that's 4X bigger than the Flash Crash). European markets got clobbered. The strongest (Germany, France) and the weakest (Greece, Italy, Spain) fell double digits. S&P futures in the US fell over 100 points - enough to trigger the 5% limit which halts the market.

The vote was a shock. Everyone was running around not sure what to think or do, and dire predictions were everywhere. Some said another Financial Crisis would unfold. Others said the dissolution of the EU was pretty much irreversible. Still others pondered the biggest world structural change since Berlin Wall came down and the USSR fell. CNBC feed the hysteria with "markets in turmoil" segments. It was hard not to get caught up in the hoopla.

My thought was very simple and direct. The UK leaving the EU was no big deal, and unless additional countries followed suit and put the wheels in motion to also leave, the market would eventually firm, and it would be back to business as usual.

The UK has the 5th largest economy in the world...it has its own currency...London is a major financial hub...it is a military and diplomatic force. I could go on. The UK is strong and perfectly capable of thriving without the safety of the EU. I felt if them leaving was contained, if no other countries followed, then the whole thing would blow over.

When the week started, there was no reason to buy - too much uncertainty. If you're just a couple days early, you could quickly have a big loss on your hands. The internals had deteriorated and needed to fall further to reach oversold levels. I felt if this could take place at the same time no additional negative news came out of Europe, the stage would be set for a rally.

It turns out the internals didn't have a chance to drop much further. A weak day Monday was all the follow through selling that took place. An absence of negative news was all the bulls needed to come back to the table and buy stocks at discount prices. What followed was an historic move.

The S&P 500 posted three consecutive 20+ point up days for only the third time since the late 90's. The VIX posted its biggest 4-day drop since 1990 - a huge sudden reversal and complete crush of volatility.

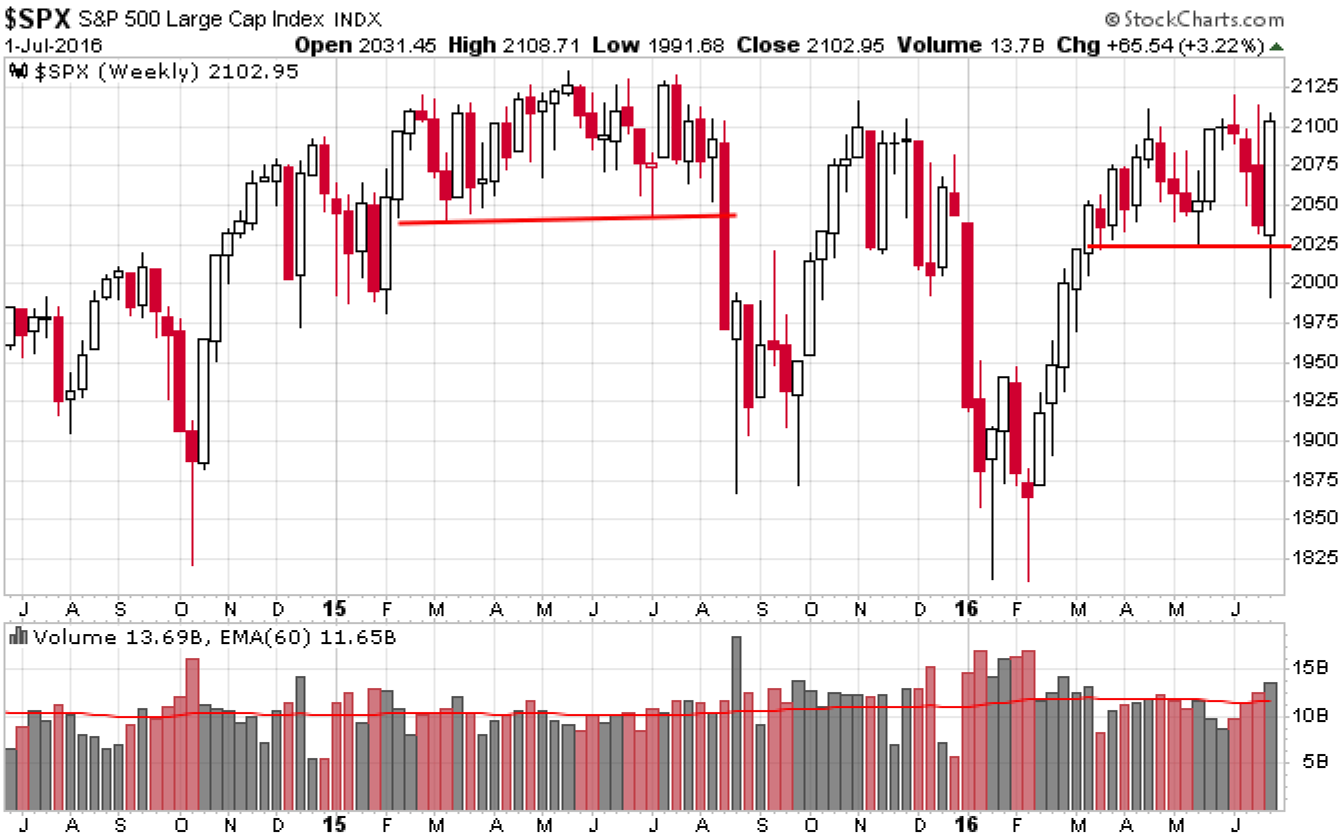
A lot of structural damage was suffered after the Brexit vote - the kind of damage that takes time to recover from. A bounce from such a situation typically gets sold into. Even if the market was strong, a double bottom could reasonably be expected. But the market had other ideas. It rallied just as fast as it fell, and as of Friday's close, the S&P was less than 15 points from its pre-Brexit vote print.

A big up day off a depressed level is easy. A second up day isn't very hard either - there will always be bottom-feeders looking for bargains and panicky shorts afraid to give profits back. But getting additional upside on a third or fourth or fifth day takes real buying from institutions. That's what happened at the end of last week. We got real buying - buying that leads me to believe as long as no negative news comes out of Europe, the structure of the consolidation pattern remains in place, and new highs are very likely to follow.

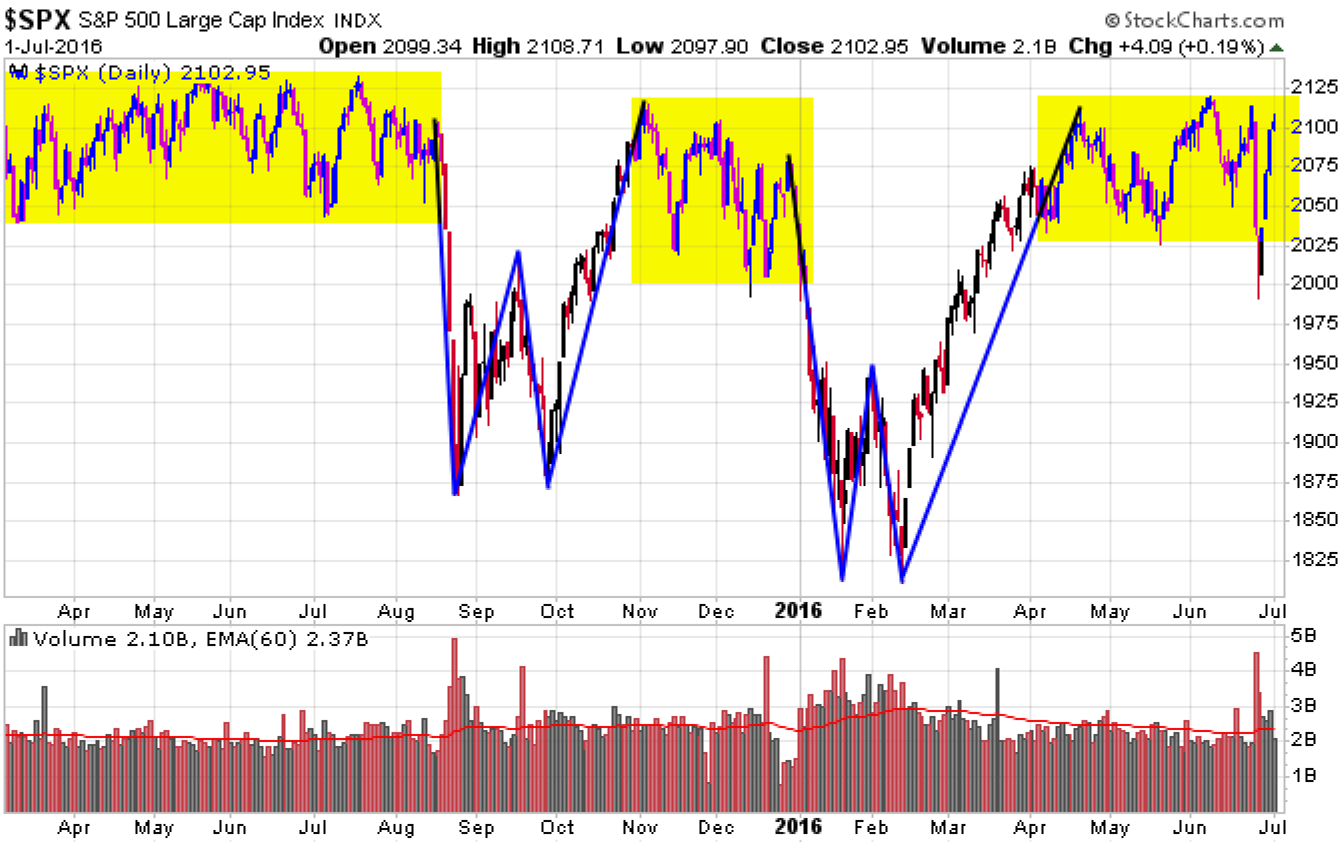
This is my stance right now -> the market is consolidating within an uptrend. News can trump the charts, but as long as there's no negative news, the path of least resistance is up. Let's get to the charts.

Indexes

The S&P 500 Weekly: A huge and very impressive weekly candle for the S&P. But until we get a clean breakout to new highs, I'm still going to consider this to be a sloppy consolidation pattern.

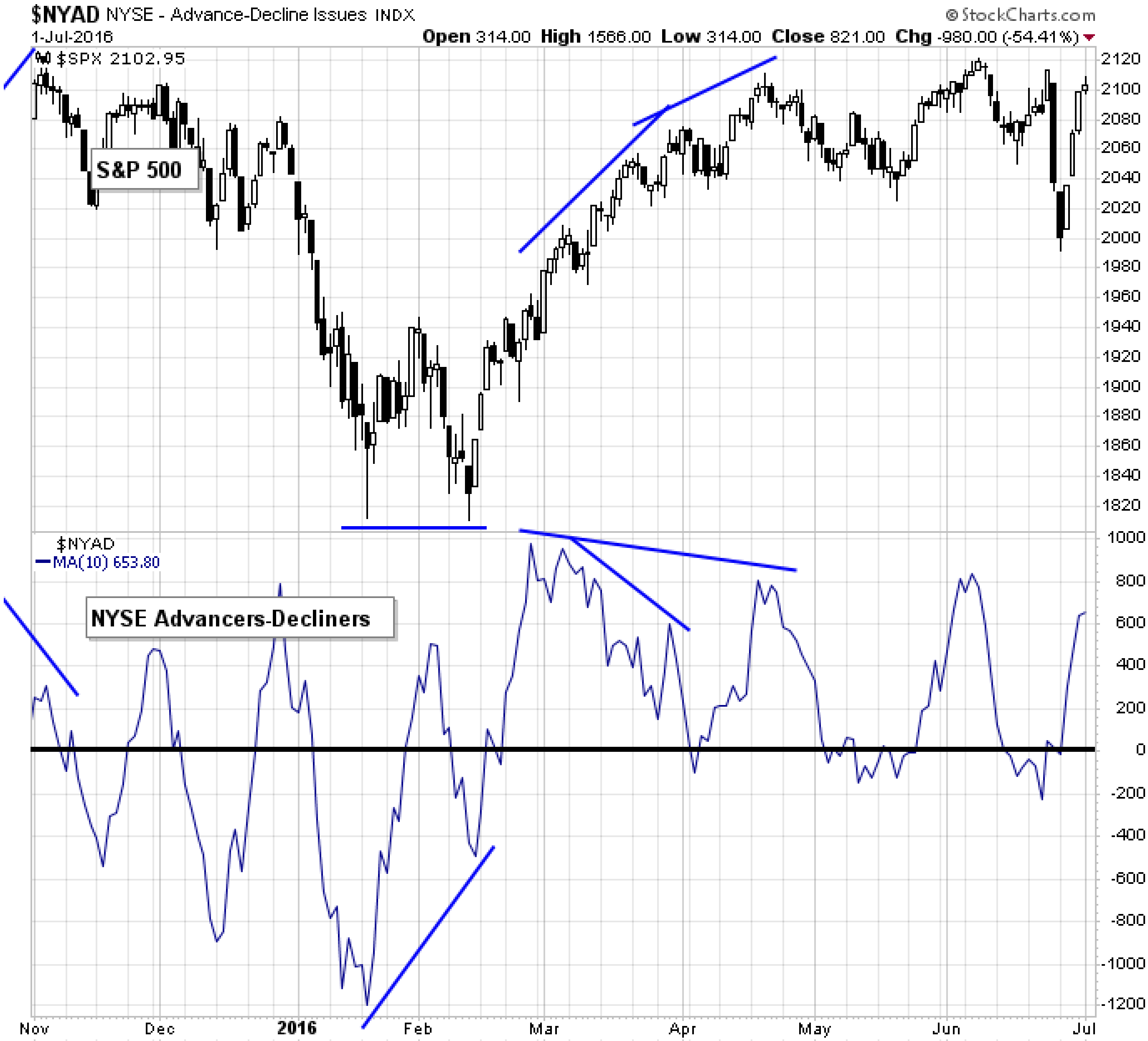


The S&P 500 Daily: Other than Monday's sell-off and Tuesday's recovery, the S&P has been range bound for three months. Nice recovery. Now breadth will tell us if strength is building or receding, and this will tell us what the next move is likely to be.



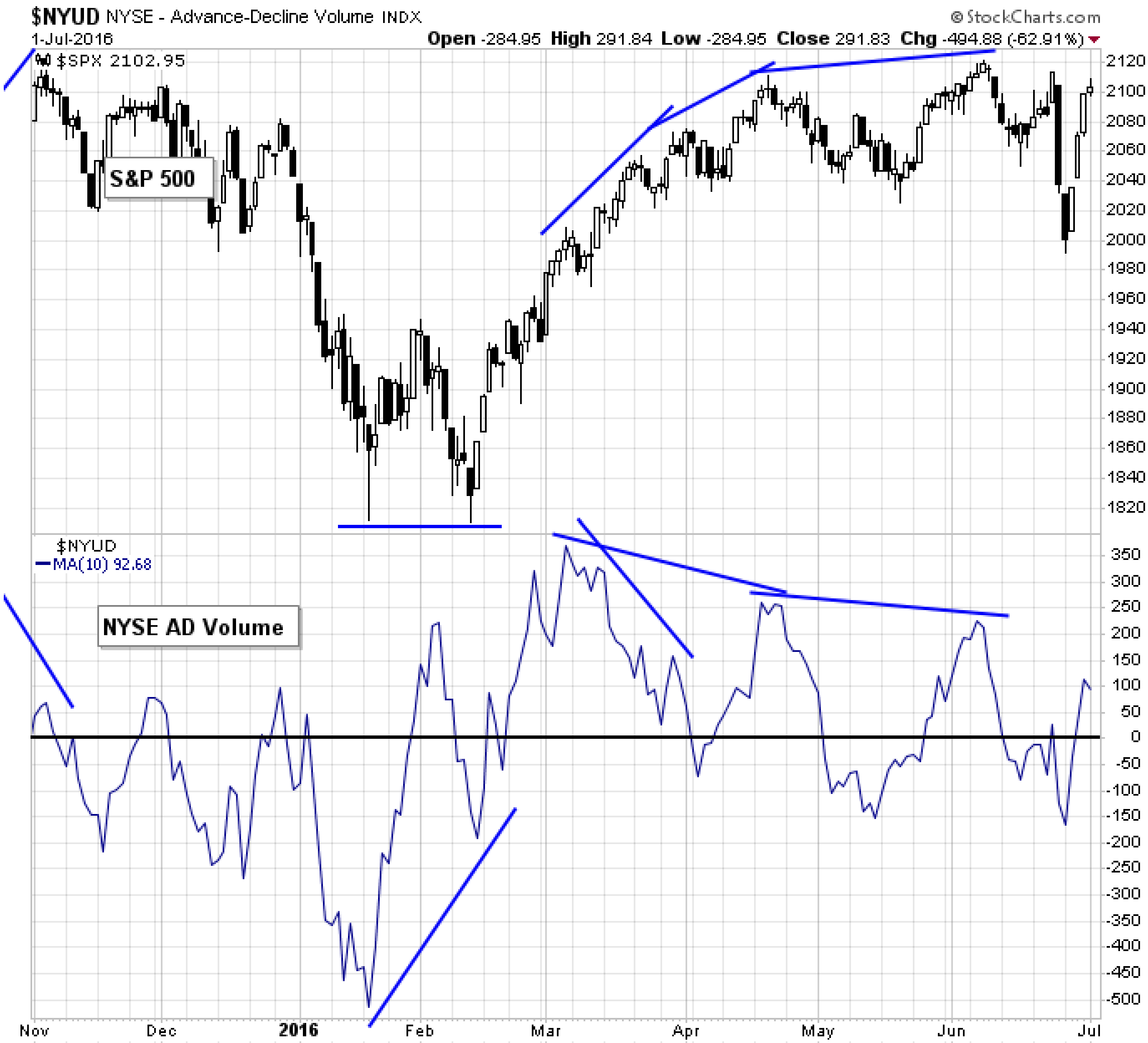
Indicators

S&P 500 vs. 10-day MA of NYSE AD Line: The 10-day of the AD line barely moved down after the Brexit vote and then quickly jumped this past week. Now it's approaching overbought territory - the sign of a healthy market. This tells us to expect higher prices, even if they temporarily back off.



S&P 500 vs. NYSE Cumulative AD Line: The lack of downside movement from the AD line and then sudden jump helped the cumulative AD line stay within range and then break out to a new high. This indicator has told us all along the market was strong.

S&P 500 vs. 10-day MA of NYSE AD Volume Line: The AD volume line, which allows the higher-volume stocks to have more influence, also held up well and then moved up this past week. It's not as strong as the AD line, which tells us the small caps are leading the large caps - not a bad thing.

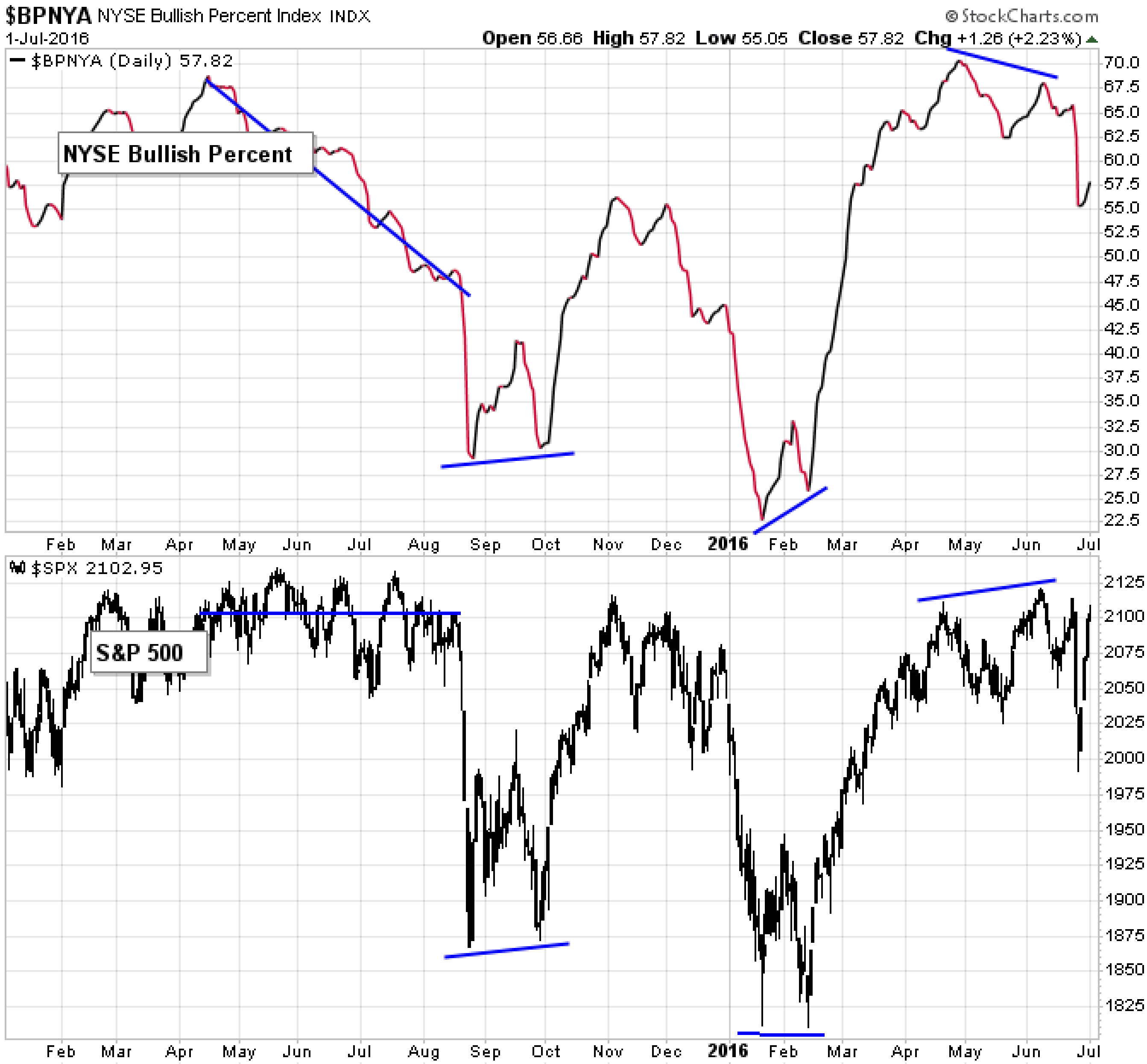


S&P 500 vs. NYSE Cumulative AD Volume Line: Unlike previous consolidation periods, where the cumulative AD volume trended down and led to sizable market drops, the indicator has stayed within range and is now just a good day or two away from a new high. This too has told us the underlying strength of the market is very good.

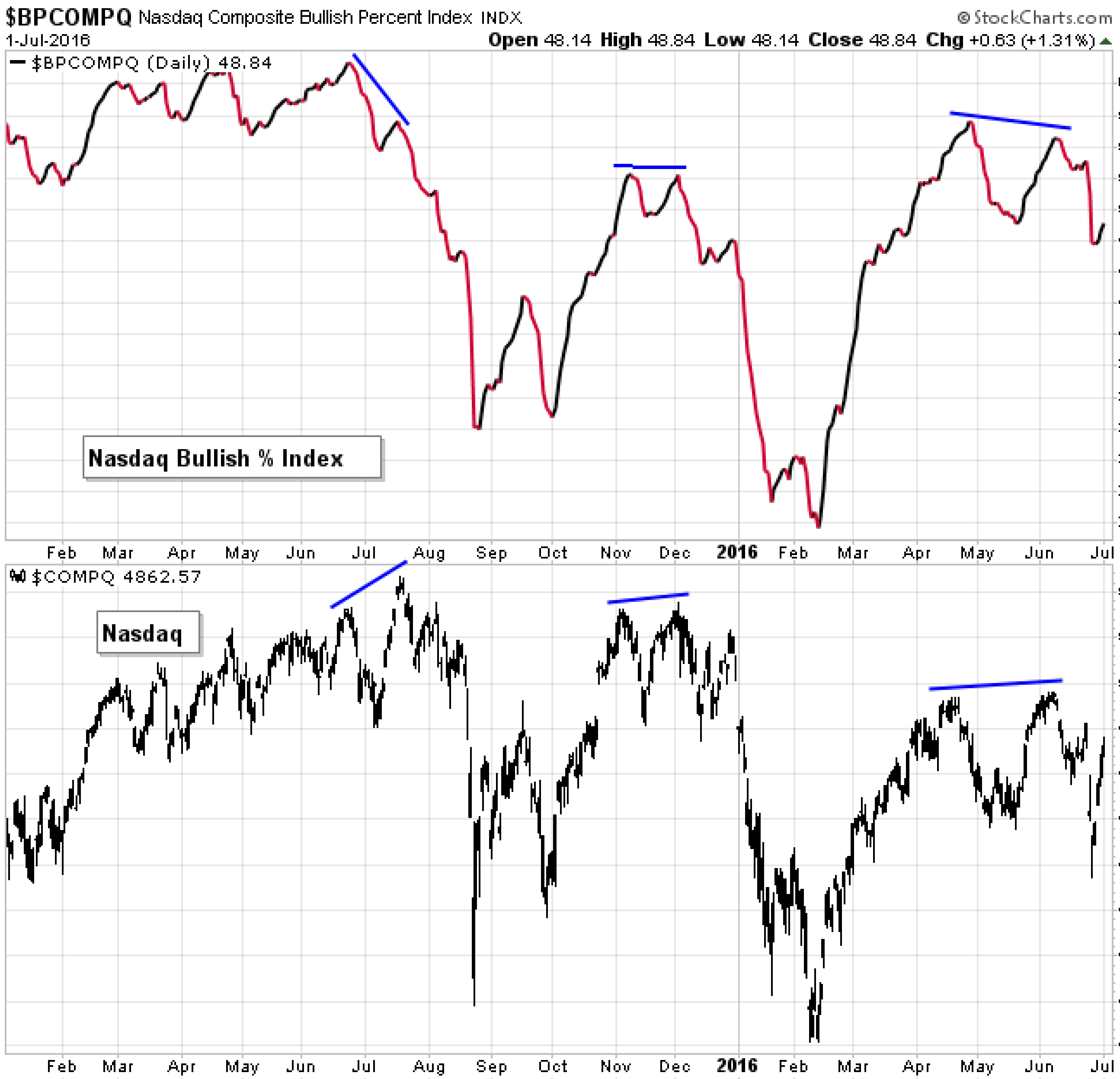
S&P 500 vs. NYSE New Highs: New highs at the NYSE held up when the market collapsed and then surged when the market rebounded. Another sign of a strong market.

NASDAQ vs. NASDAQ New Highs New highs at the Nas, which have lagged the NYSE, also jumped to a higher high last week.

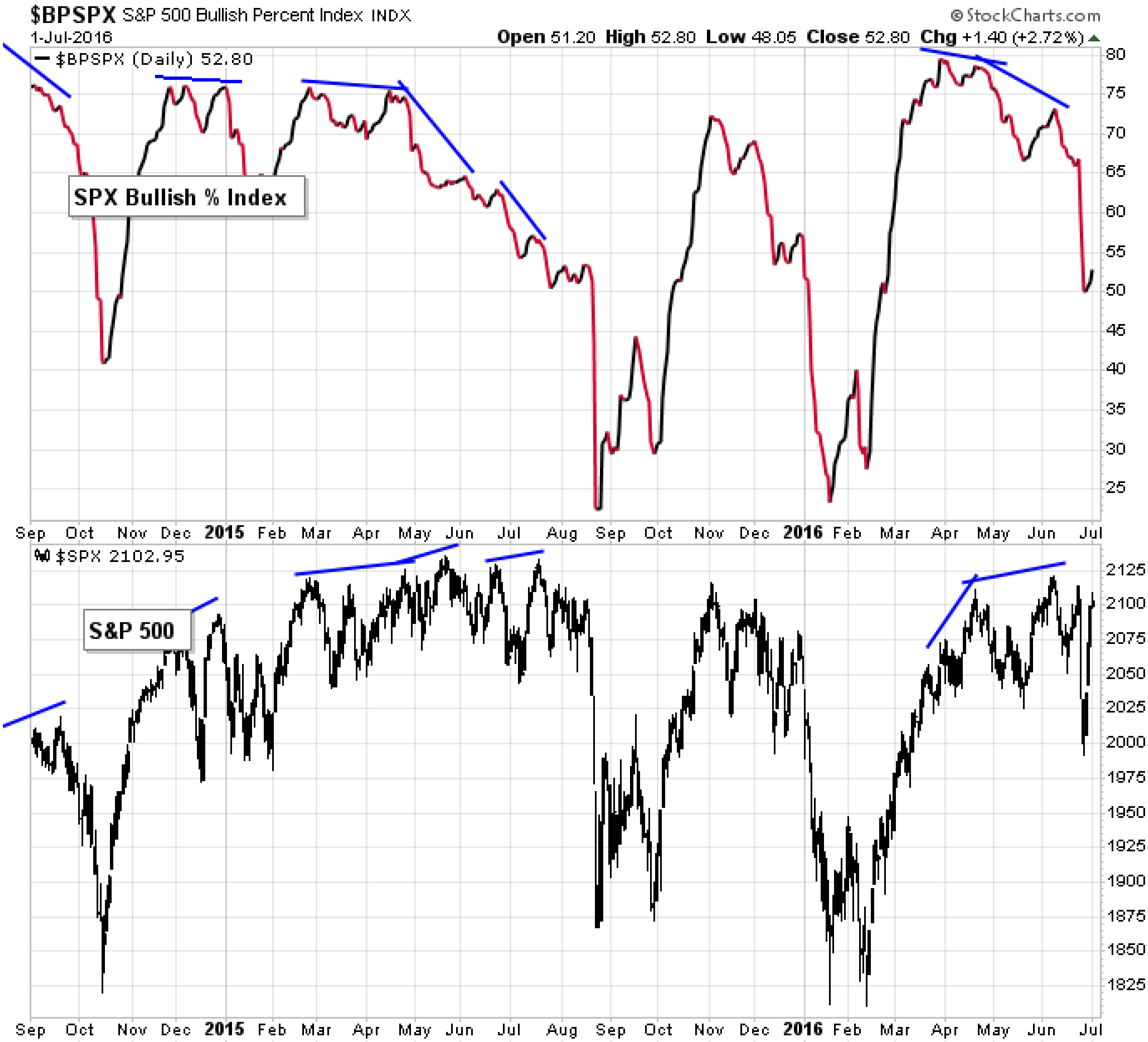
S&P 500 vs. NYSE Bullish Percent: The NYSE bullish percent chart diverged from the price action and helped pick the early-June high. Now, after falling and taking out its May low, it's trying to curl up. The bulls will want to see rapid improvement here. Failure to get back up into the mid-60's range would be a warning.



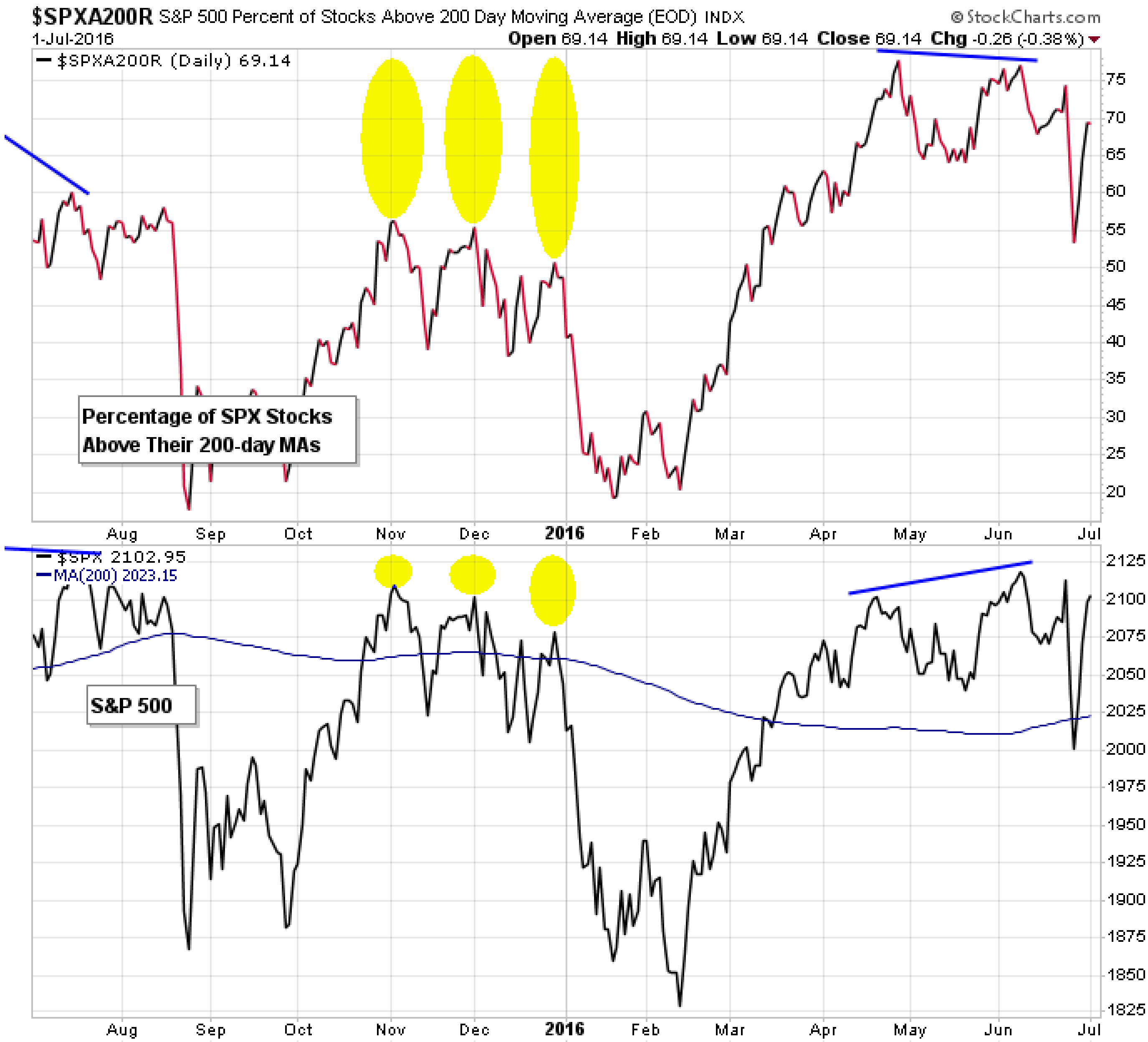
NASDAQ vs. NASDAQ Bullish Percent: The Nas bullish percent also divergence from the underlying price action, and it too is now trying to curl up. A healthy bounce is needed to confirm the post-Brexit losses have been absorbed and it's back to business as usual.



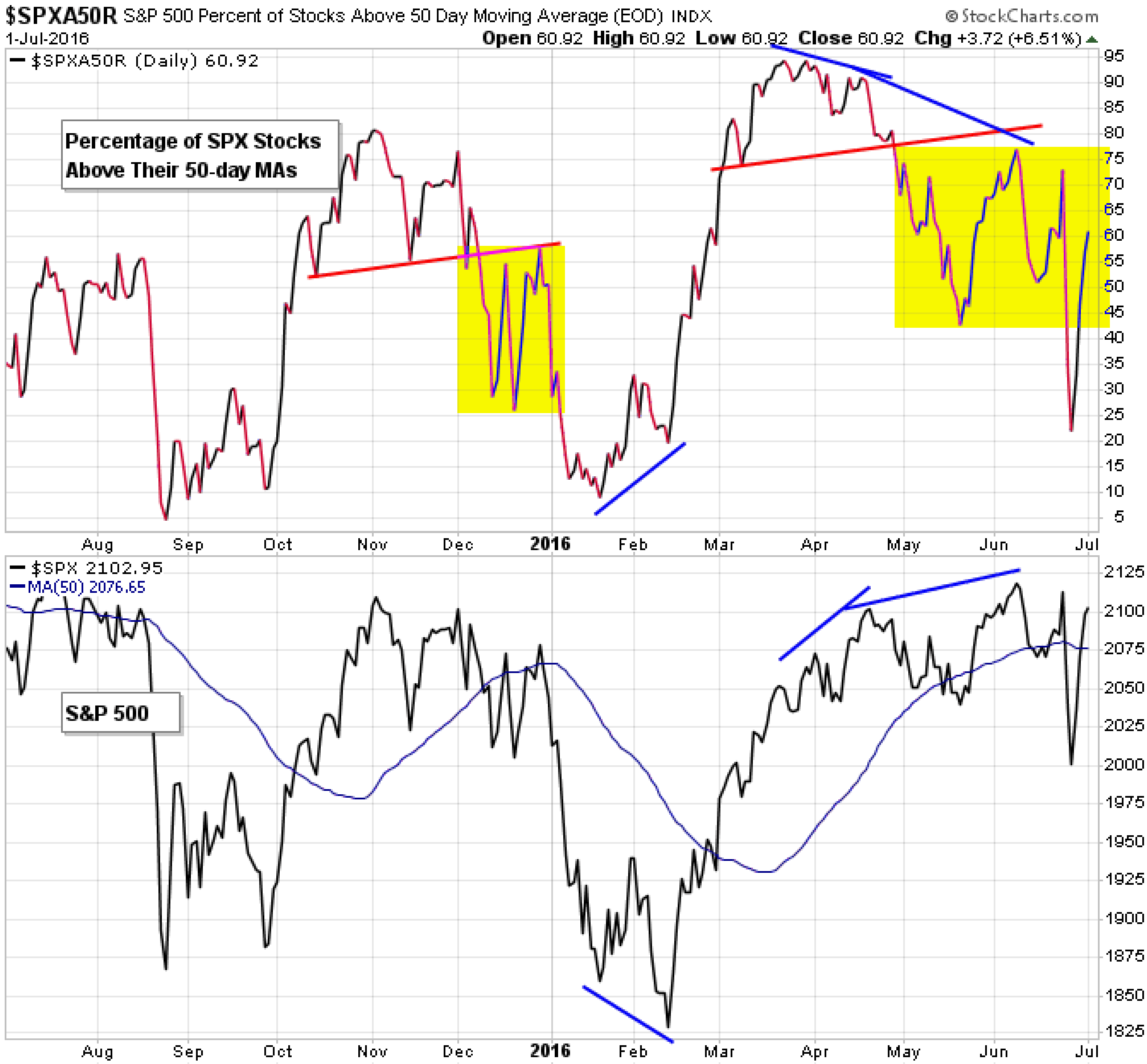
S&P 500 vs. SPX Bullish Percent: The S&P bullish percent is more ominous than the NYSE and Nas versions. It fell much further and will therefore take much longer to re-establish an uptrend or get back inside its recent range. If it pauses here, like in December when it failed to move up, it'll be a big warning.



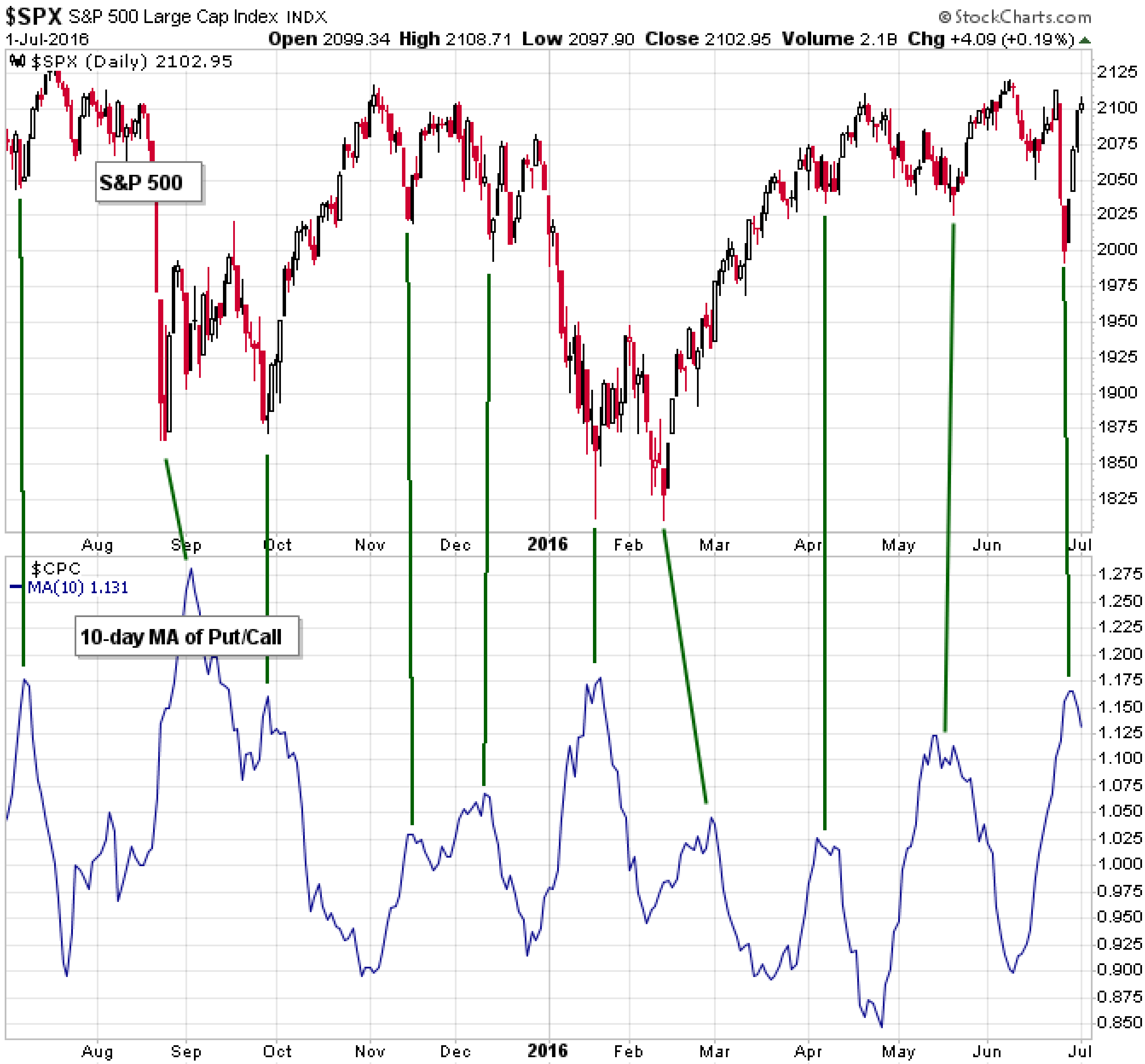
S&P 500 vs. Percentage of SPX Stocks Above 200-day MA: The percentage of SPX stocks above their 200-day moving averages plunged but quickly recovered back to its range. As long as it can hold the range and not trend down, the market will be supported.



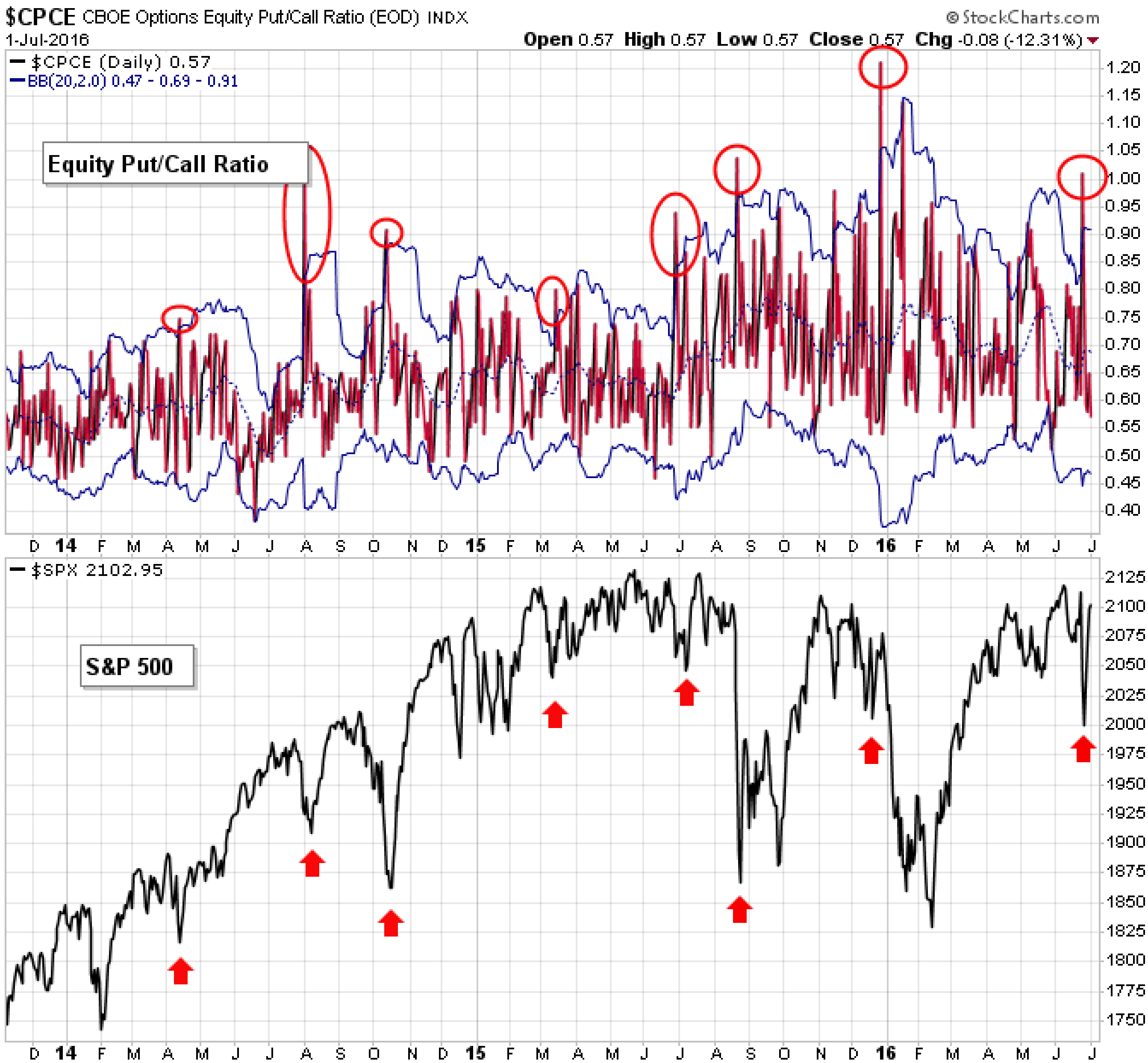
S&P 500 vs. Percentage of SPX Stocks Above 50-day MA: The percentage of SPX stocks above their 50-day MAs started warning in May that trouble was brewing. The early-June bounce that put in a lower high was another warning. Then Brexit happened. Now the indicator is bouncing, but it's not impressive enough. The bulls need this indicator to sit at a high level. Failure to do so would limit the market's upside.



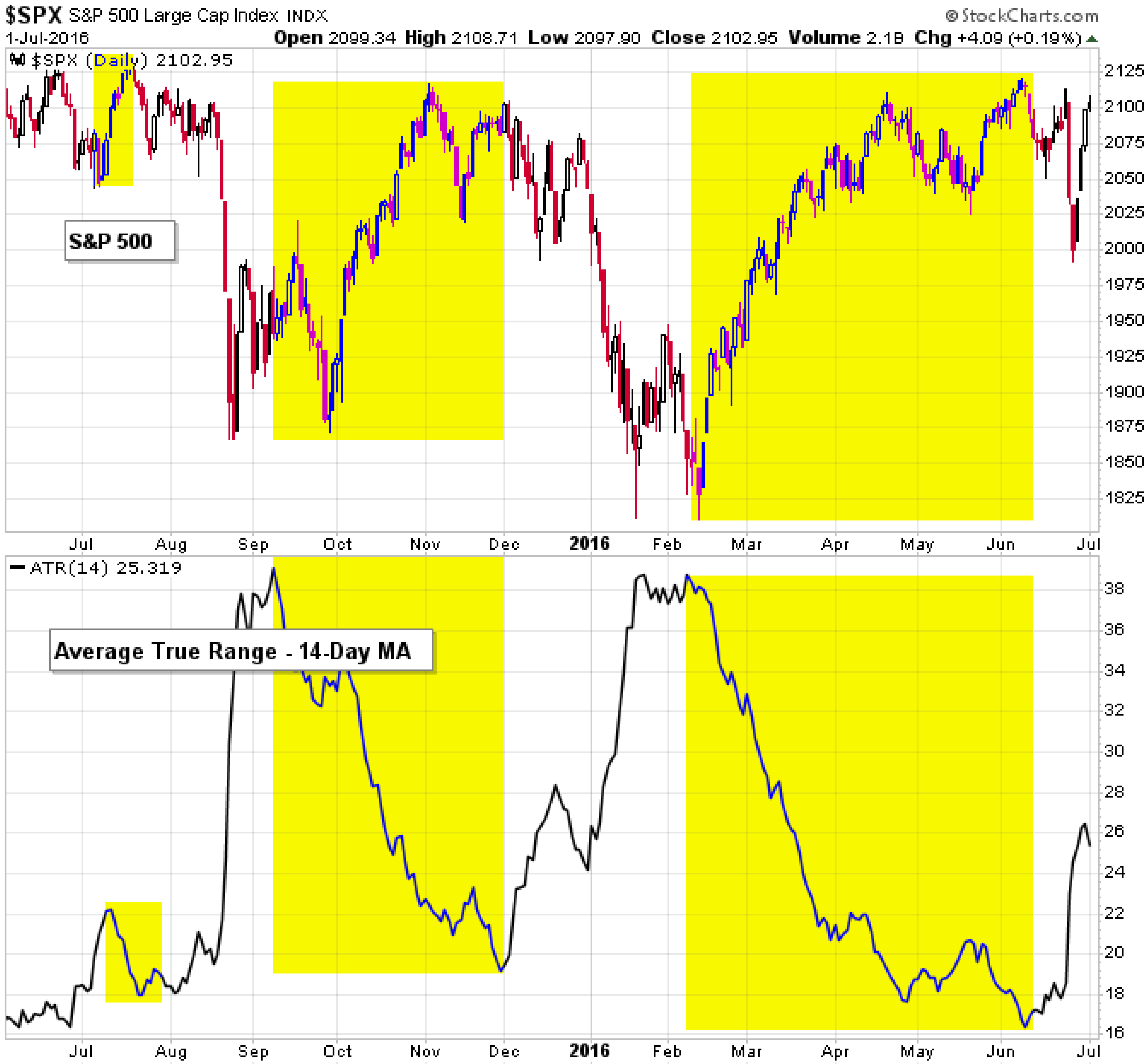
S&P 500 vs. 10-day MA of Put/Call Ratio: The put/call ratio tends to trend down while the market moves up. At the end of last week the PC started to roll over. To support further upside, we'll want to see the PC drop.



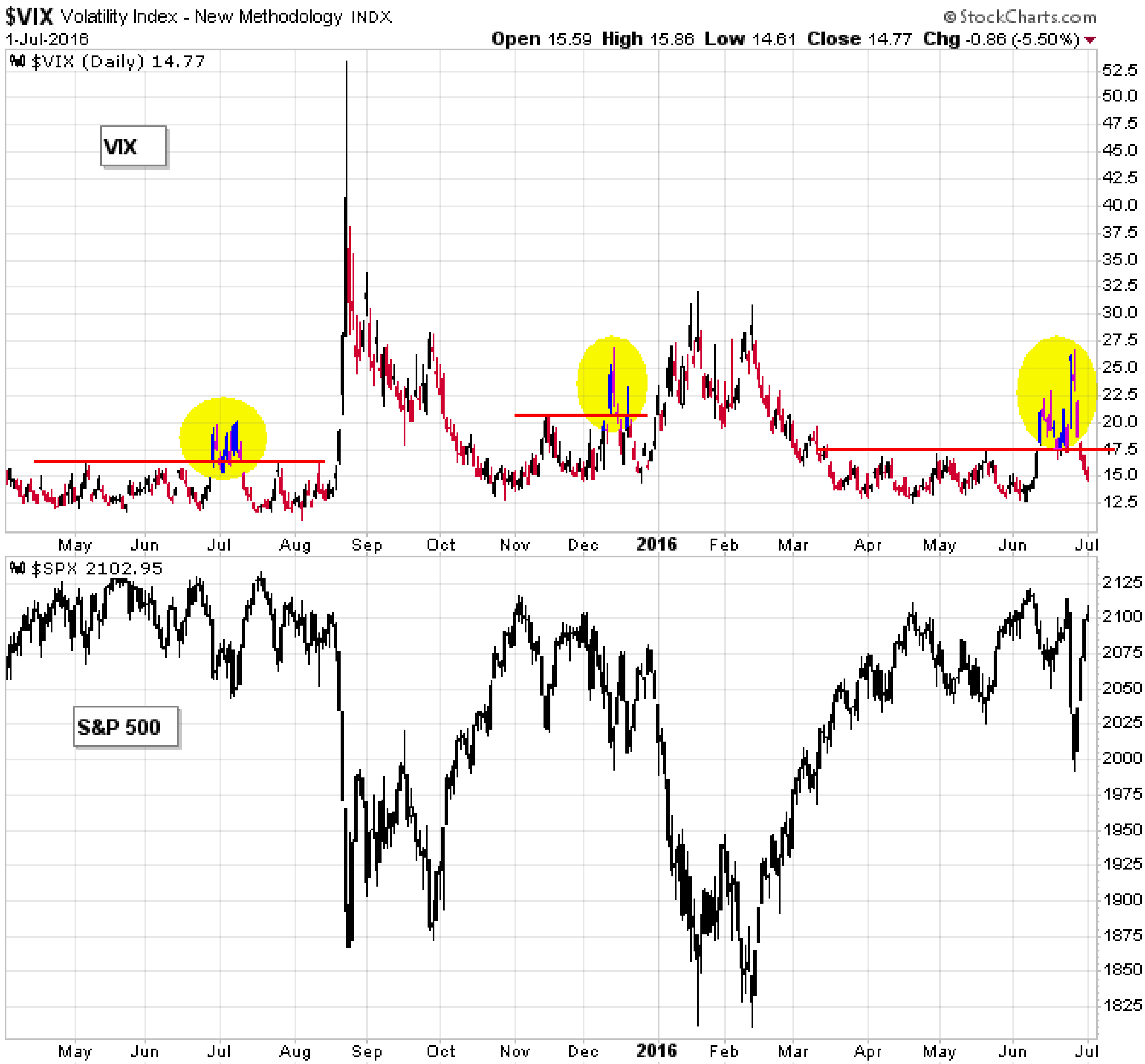
S&P 500 vs. Equity Put/Call Ratio: The equity put/call was posted last week, so this is just a quick update. Once again, a spike outside the top Bollinger Band produced a bounce. We don't get many signals from this, but it's worth keeping on the radar because when we do get a signal, it's often a good one.



S&P 500 vs. 14-day Average True Range: No surprise volatility exploded after the Brexit vote. Now the bulls will want to see it quickly drop because high volatility during consolidation periods tends to lead to corrections, not rallies.



S&P 500 vs. VIX: The movement of the VIX tells the bulls to not relax yet. Spikes that take place while the market is range bound often lead to corrections. We'll see. At the very least, don't assume the coast is clear.



The Bottom Line

The market followed through to the downside this past Monday and then staged a very impressive rally.

Several breadth indicators (AD line, AD volume line, new highs) are doing great. Others (bullish percent charts, percentage of stocks above certain moving averages, put/call, ATR) have reversed or are in the process). As long as they continue to improve, the market's upside will be supported.

The market dodged a bullet. It could have collapsed. It could have rolled out a list a reason to drop (declining earnings, higher rates, etc, etc), but it only fell for two days and then quickly recovered. When the market holds firm in the face of bad news, the path of least resistance is up.

My bias is to the upside. Unless we get negative news from Europe, we're going to new highs.

Have a great week.

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