Leavitt Brothers Weekly

Sunday, March 20, 2016

For the first time since the October 2015 rally and only the second time since the October 2014 rally, the market has moved up five consecutive weeks. To say Wall St. feels good right now would be an understatement. As is always the case, some groups have done better than others, but a trader could have closed his eyes and bought almost anything the last month and made money. Even the Wal-Marts and AT&Ts of the world have done well. Aside for a few biotech blowups, trading the last month has been as smooth and stress free as it's been in a while. But some cracks are starting to form.

The S&P has rallied 240 points in six weeks. This matches the last two big rallies, and at the very least tells us to be a little more careful. During a big run, a rising tide raises all ships. You could buy almost anything and make money. But as the move matures, a rising tide ceases to raise all ships. Crappy companies get left behind, and moderately strong companies do okay but still lag. Only the truly great companies, or the sectors that have prevailing winds at their backs, continue up. We're getting to this situation. Maybe this coming week. Maybe the week after. Sooner or later - this rally isn't going to continue uninterruptedly - the market will correct, and when it does, we'll get a glimpse of what's going on beneath the surface.

Best case scenario is some up and down movement that causes little damage and leads to a subsequent breakout and rally to the highs. Worst case scenario is some up and down movement that resolves down. In both cases, absent a major event in the world that changes everything, there should be some back and forth action. Tops and consolidation patterns are choppy and full of debate. Late comers desperately buy dips while those sitting on big profits cash out. There are usually many conflicting opinions and conflicting news headlines. It's easy to get lured to the bulls' camp on the way up and become a non-believer on the way down.

Typically two things will tell us what's likely in store: 1) the internals and 2) the leadership.

If the market chops around, I'd expect the internals to chop around. But if there's a subtle hint of weakness by way of the decliners steadily beating advancers or a pickup in new lows or deterioration in the number of stocks above several moving averages, we'll take this as a hint the smart money is unloading while the indexes paint a neutral picture. But if the opposite takes place, if the internals act well, we'll assume money is coming in and accumulating stocks, and the next likely move is going to be up.

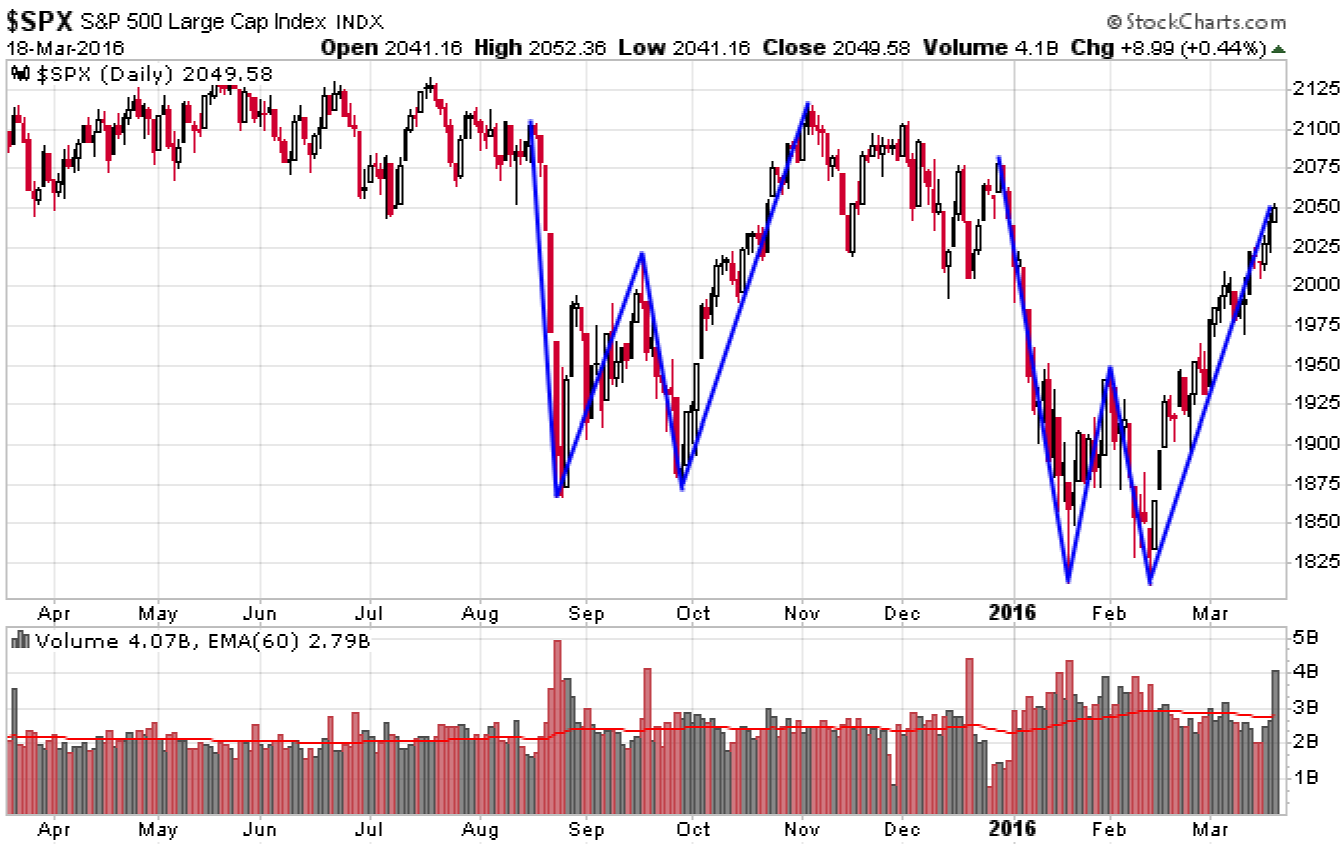
Leadership is important. What leads and what lags will tell us what Wall St's risk appetite is. Does Amazon lead or does AT&T lead? Does Netflix lead or does Wal-Mart lead? The answer will tell us if investors are ready to put higher rates in the US and questionable economic conditions worldwide aside and take a chance.

Let's get to the charts and see what they say.

Indexes

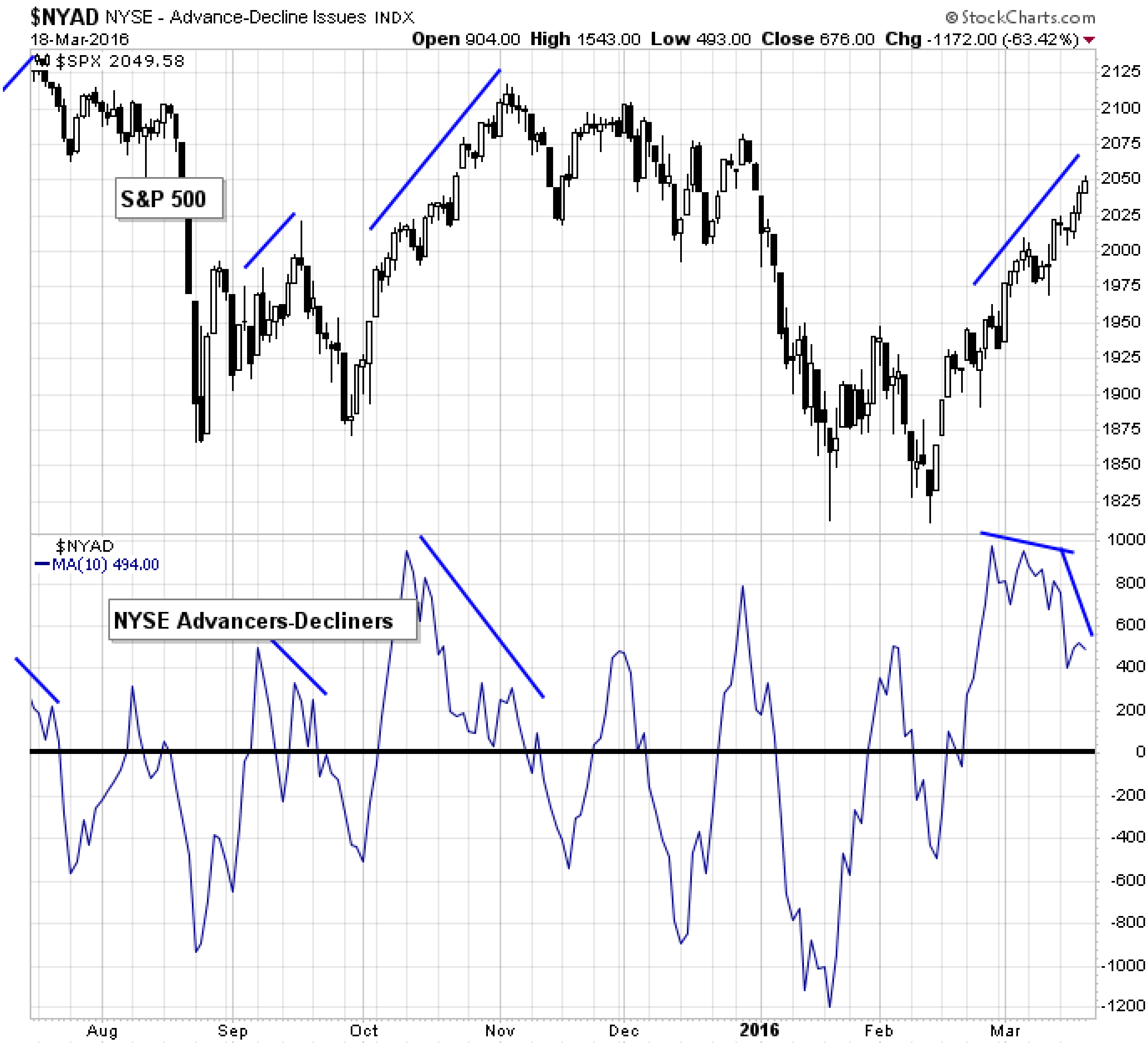
The S&P 500 Weekly: Maybe the S&P is forming a big top; maybe it's consolidating within one of the best bull markets in history. There's no sense guessing. A 300-point range has formed, and until the pattern forcefully breaks in one direction or the other, it's best to play the range and not think too much. We've gotten a lot of good shorts off on the sell-offs and even better longs on the rallies. I'd rather keep playing it as-is rather than guess what comes next.

The S&P 500 Daily: The movement of the S&P this year very closely matches what took place last August/September/October. It paints a pretty picture, but this type of backward pattern matching rarely works for predicting future movement. For now, let's respect the price movement but mentally prepare ourselves for an overdue rest. The market can't continue up uninterruptedly for too much longer.

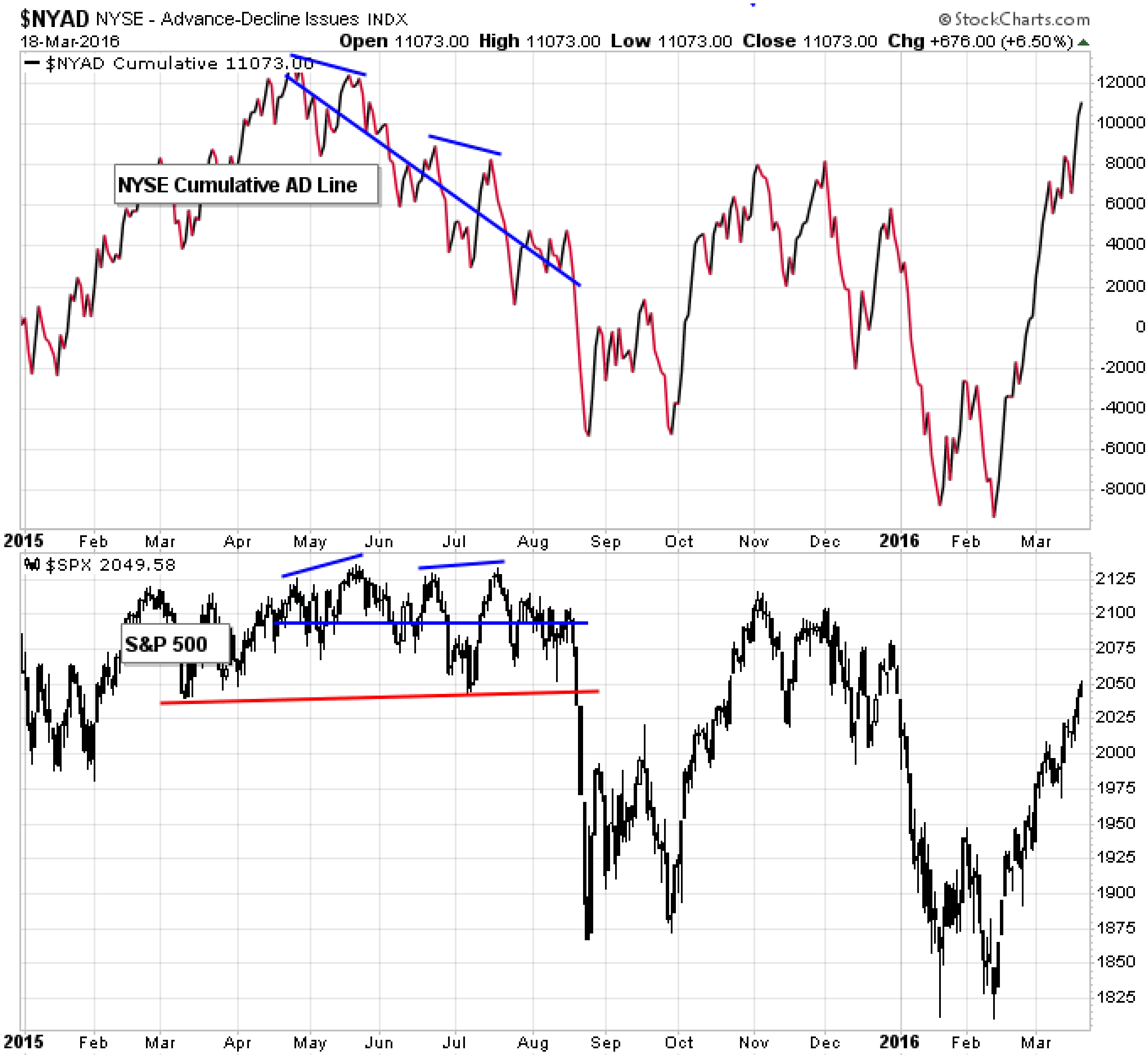


Indicators

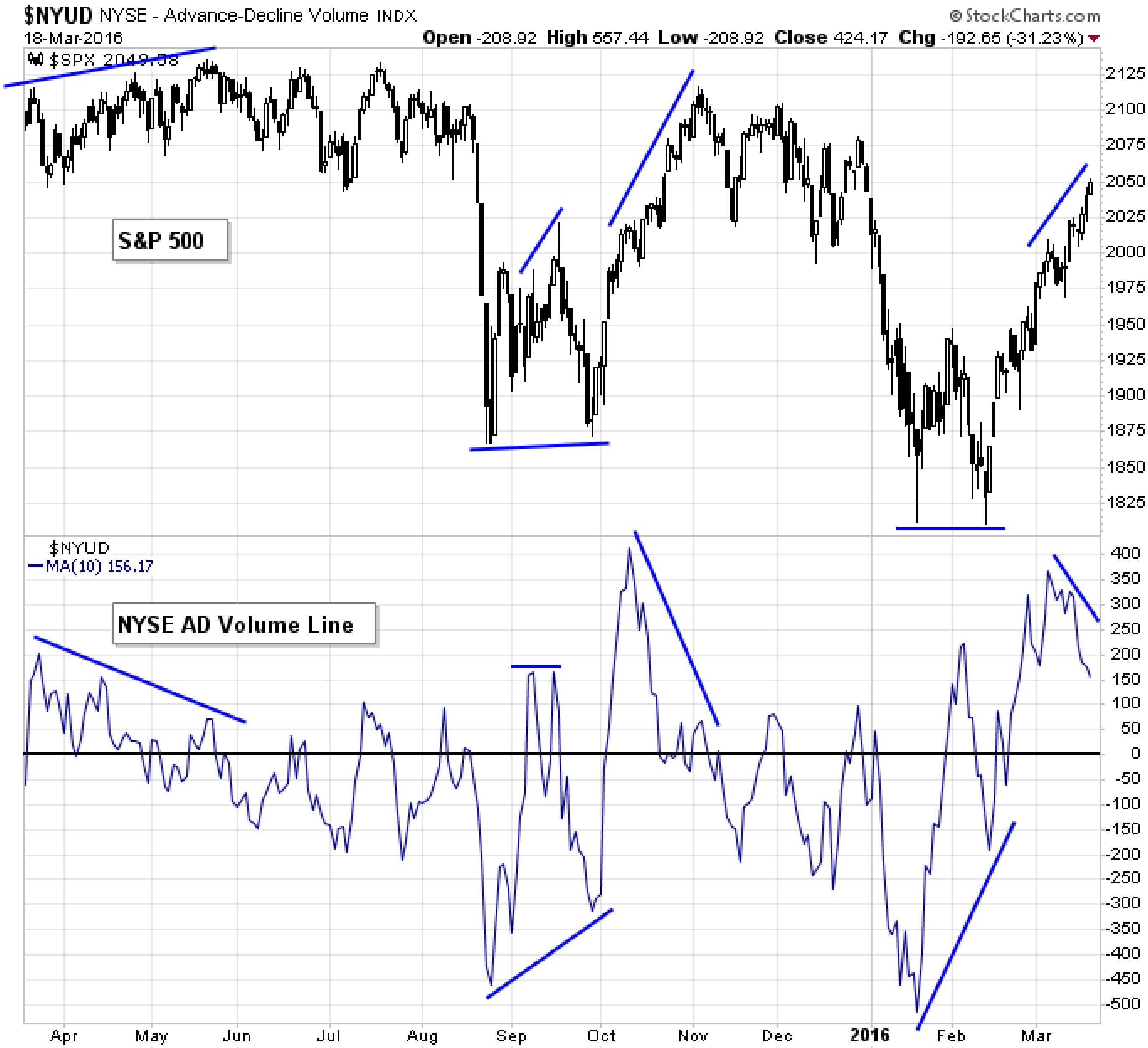
S&P 500 vs. 10-day MA of NYSE AD Line: With such an elevated level hit and maintained a couple weeks ago, we knew we'd eventually get a negative divergence between the S&P and 10-day of the AD line. We're getting one now. This isn't an extremely sensitive indicator - it can last a few weeks before playing out - but it's good to keep in the back of your mind if you plan on initiating new longs.



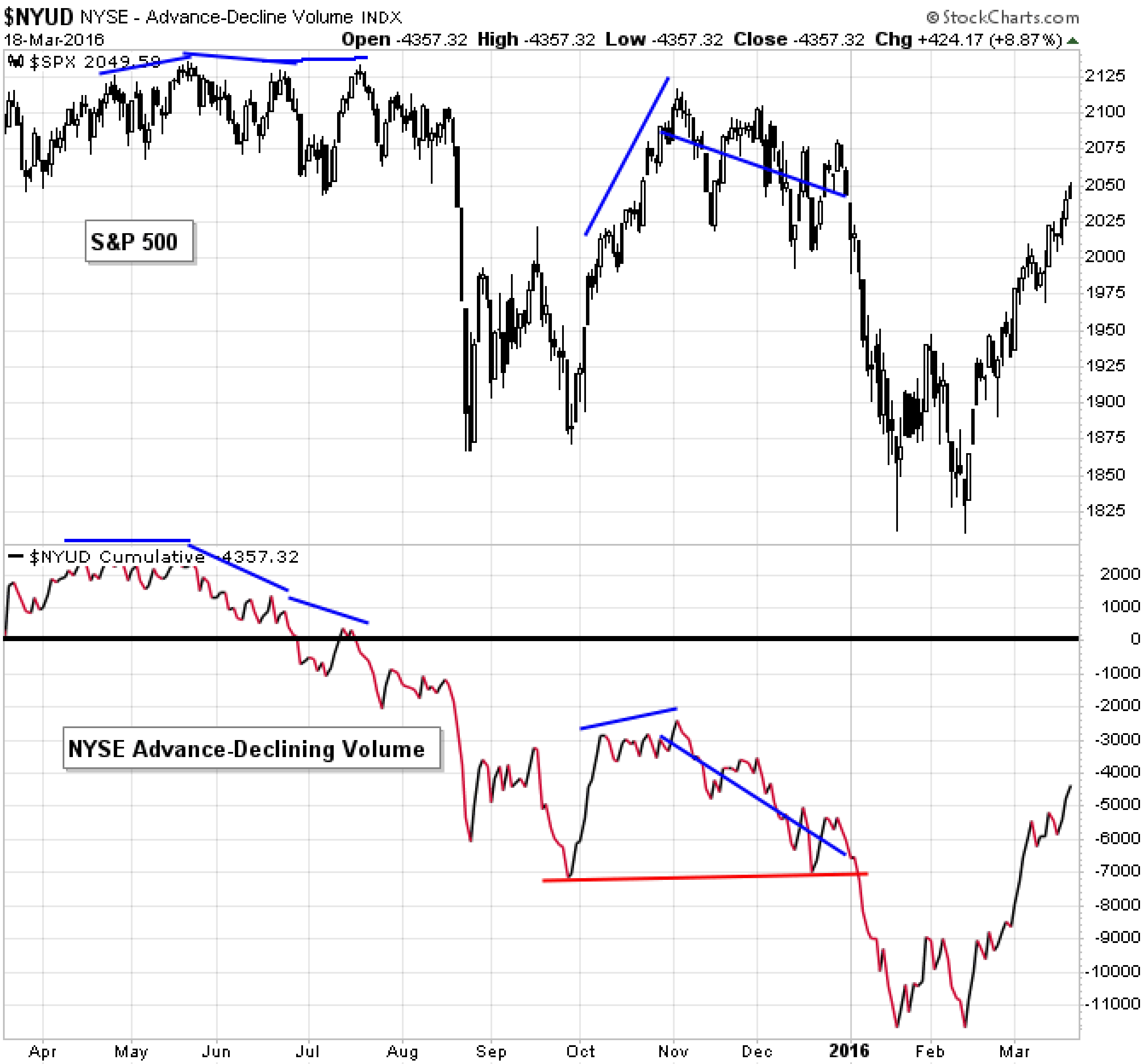
S&P 500 vs. NYSE Cumulative AD Line: The cumulative AD line has easily taken out its high from the October rally, so this move, although percentage wise is nearly identical, has greater support.



S&P 500 vs. 10-day MA of NYSE AD Volume Line: The AD volume line is also diverging from the S&P, but it too can persist for a few weeks before pulling the market down. A top is near. Maybe not next week, but soon. At this juncture, it would not be wise to chase stocks higher unless you're prepared for potentially short holding times.



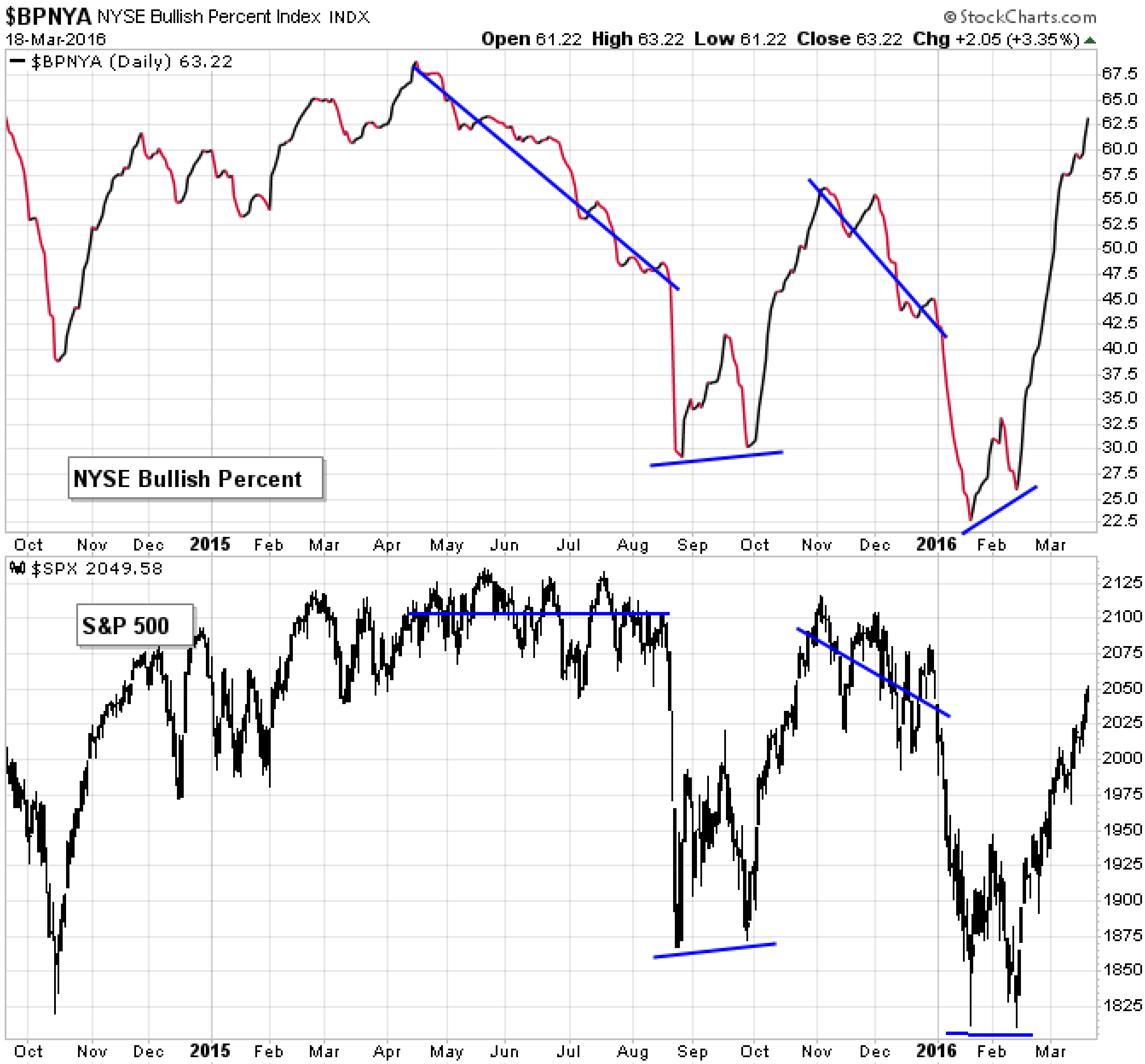
S&P 500 vs. NYSE Cumulative AD Volume Line: Unlike last October, when the cumulative AD volume line surged and then settled into a tight range for a couple weeks, the indicator currently continues to impressively move up. This bodes well for the upside, even if the market rests in the near term.



S&P 500 vs. NYSE New Highs: New highs at the NYSE spiked to a 52-week high - pretty darn good considering the S&P is still 80 points from its own new high.

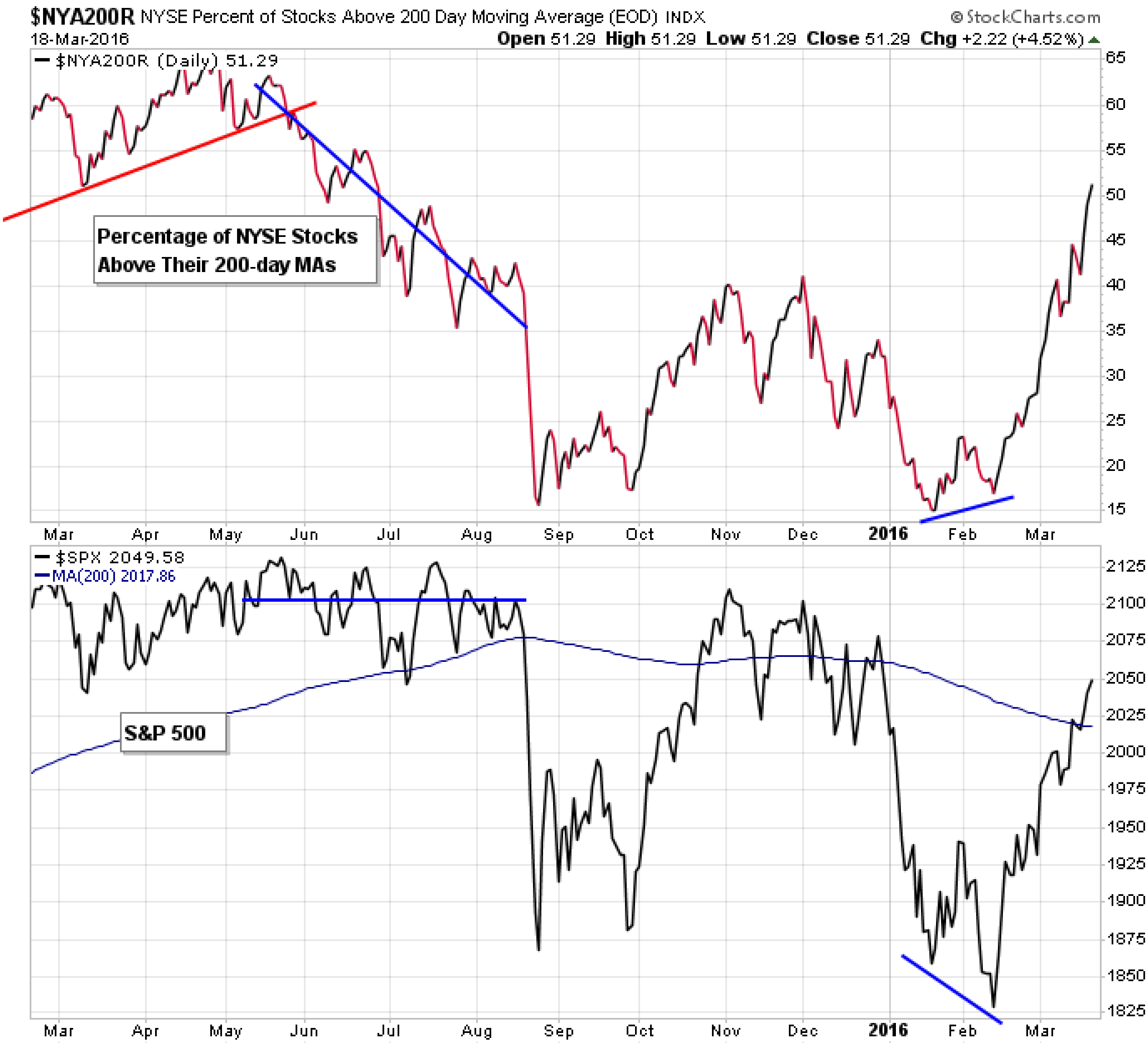
NASDAQ vs. NASDAQ New Highs: New highs at the Nas, which have lagged, finally shot up last week. The bulls will want to see this continue if the market continues pressing higher. A lack of new highs here would be a warning.

S&P 500 vs. NYSE Bullish Percent: The NYSE bullish percent index continues up and tells us strength is broad-based - exactly what you want to see if you're looking for a continuation of the move off the February low.



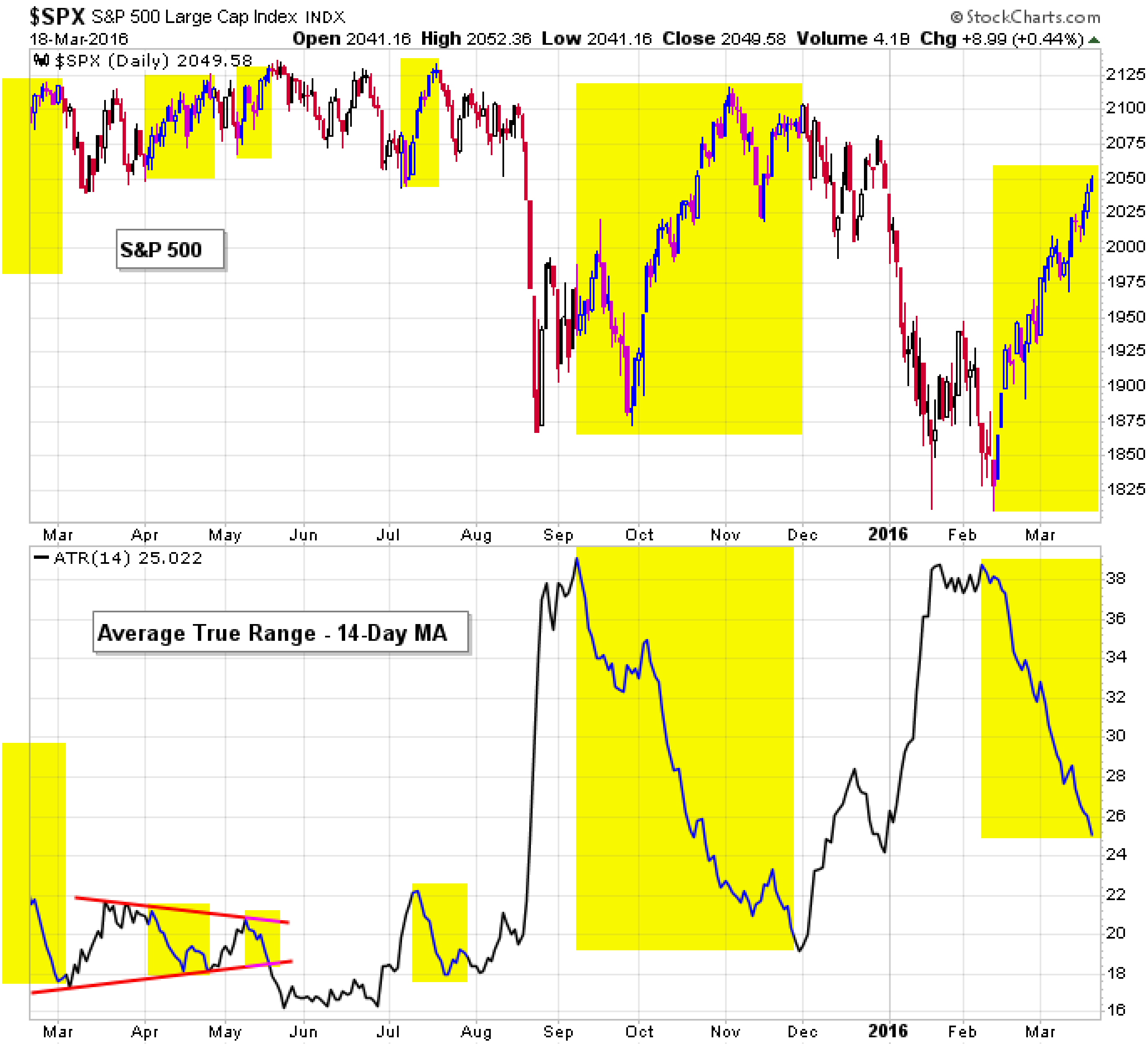
NASDAQ vs. NASDAQ Bullish Percent: The Nas bullish percent has lagged, but considering the Nas itself has lagged, a negative divergence is not forming. The bulls will want to see continued improvement. If the Nas bullish percent starts to fade, a warning will be flashed.

NYSE vs. Percentage of NYSE Stocks Above 200-day MA: The S&P moved above its 200-day MA, and the percentage of NYSE stocks above their 200-days has moved above 50%. In my eyes, this is sufficient progress for now, but it must continue.



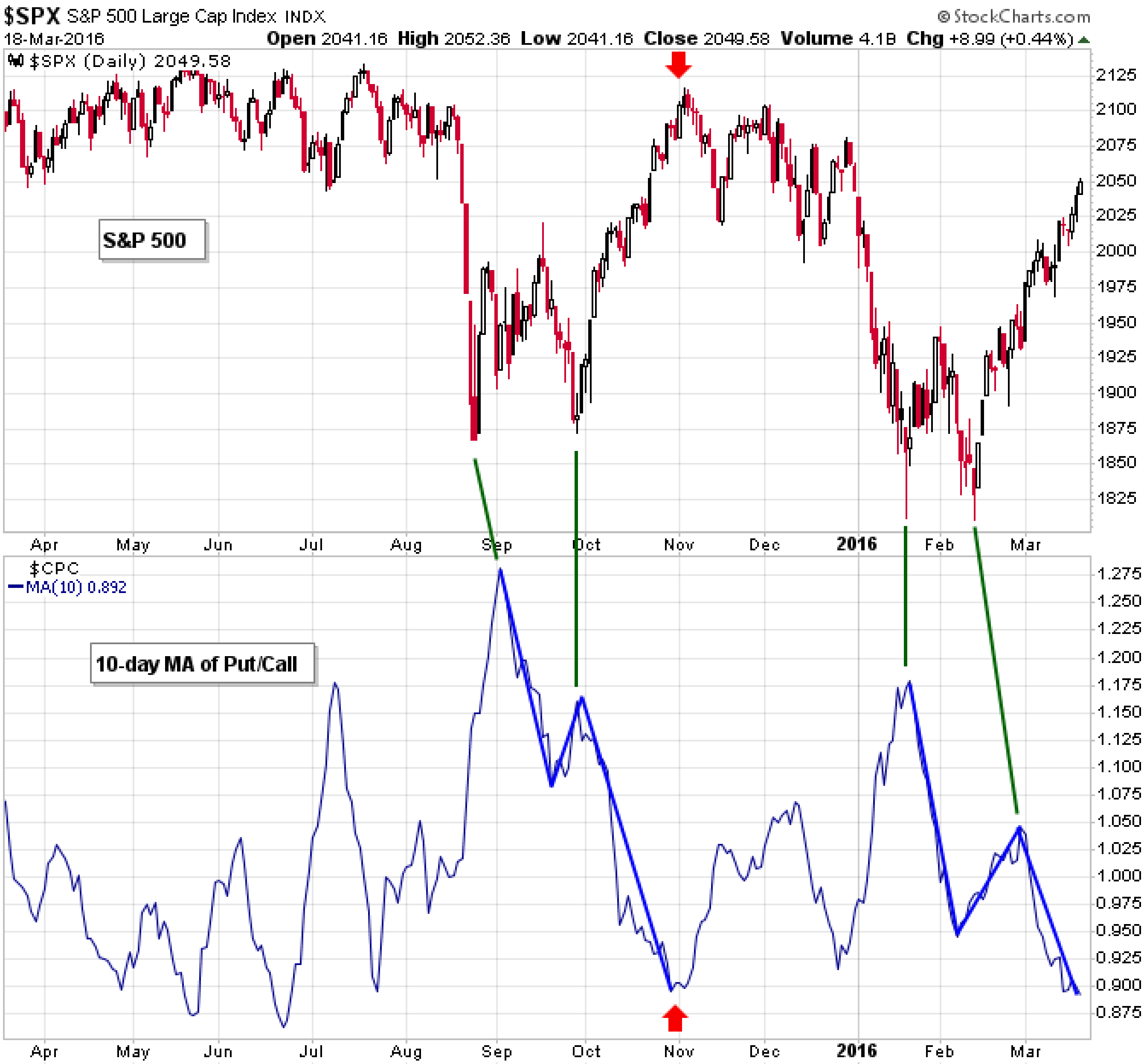
NYSE vs. Percentage of NYSE Stocks Above 50-day MA: The percentage of NYSE stocks above their 50-day moving averages has printed its highest level in two years. The big problem we had last summer was the lack of participation. This doesn't seem to be an issue now. Participation is excellent.

S&P 500 vs. 14-day Average True Range: The average true range, my measure of volatility, continues down - this is characteristic of an uptrend, and it supports the market's strength. If it curls up, the story changes some, but for now this indicator tells us to look for further gains.



S&P 500 vs. VIX: The VIX, another measure of volatility, has fallen to a level not seen since early-November - the last market top. The nature of the VIX is it could flat-line down here for a long time, so a low print means little. If it moves up, we'll need to reconsider.

S&P 500 vs. 10-day MA of Put/Call Ratio: The put/call ratio continues down. Until it curls up, the market's upside will be supported.



US Dollar: Somehow, with many countries around the world devaluing their currencies and executing some sort of QE, the dollar has held steady for the last twelve months (instead of continuing up). A declining dollar will help the market a lot - commodities get a boost, and multinationals have less currency risk exposure.

The Bottom Line

The market is doing well. It has posted a solid rally since bottoming in February, and unlike the last semi big move (October), this rally is well-supported. The AD line, the AD volume line, and the percentage of stocks above certain moving averages tell us the strength is broad-based, unlike 2015, when it was concentrated is a small handful of stocks.

But let's not get too giddy. After a month of many good set-ups, we're running low on quality plays. Given the gains in place, the lack of a correction up to this point, the start of a few negative divergences forming and the lack of decent set ups, it would not be wise to push it right now.

My guess is we have a pullback coming - maybe this coming week, maybe not until the following week - but the pullback will be bought and a higher high likely to be put in place. At that point we'll see if the indicators still support the strength.

I'm optimistic higher prices are coming, but in the near term I'd hesitate to be overly aggressive.

Have a great week.

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