Leavitt Brothers

Weekly

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The market's 5-week win streak is over, and for only the second time this year the S&P has fallen three straight days. We knew it was coming. A lack of quality set-ups along with some declining breadth indicators told us a top was likely to be put in place soon. We didn't know if it would be last week or next week, but we did know we were in the later stages of a cycle, so a defensive posture was warranted.

Should the bulls be hugely concerned? Yes and no - it depends on their trading style. The internals on this move have been much stronger than the previous (October) rally. The AD line climbed to a higher level; the bullish percent charts have done better; new highs have expanded more forcefully; and the percentage of stocks trading above various moving averages has done very well. The market's breadth tells us participation on this rally has been much better than in October, and in most cases it’s been stronger than last summer when new highs were hit. A lack of participation was an issue last year, and it continued to be an issue on the last run up. But thanks to commodities doing very well lately - many have rallied 50 - 100% - strength on this most recent rally has been broad-based and well-supported. Contrast this to last year when the FANG stocks (Facebook, Amazon, Netflix, Google) and a handful of others did great while most stocks lagged. There's more support now. More stocks are participating. So the market isn't being pulled higher by a small number of companies doing the heavy lifting. Stocks "at the end of the bench" are pulling their weight.

Given broad-based participation, I'm tempted to say this rally has more upside to go. At the very least, it's not going to just roll over and die. Tops take take to form - several weeks and often a couple months - so even if a top was in place (or close to in place), expect a lot of up and down action; expect several attempts to run higher. It would take a pretty major news item to just suddenly change the relatively-good sentiment that currently exists.

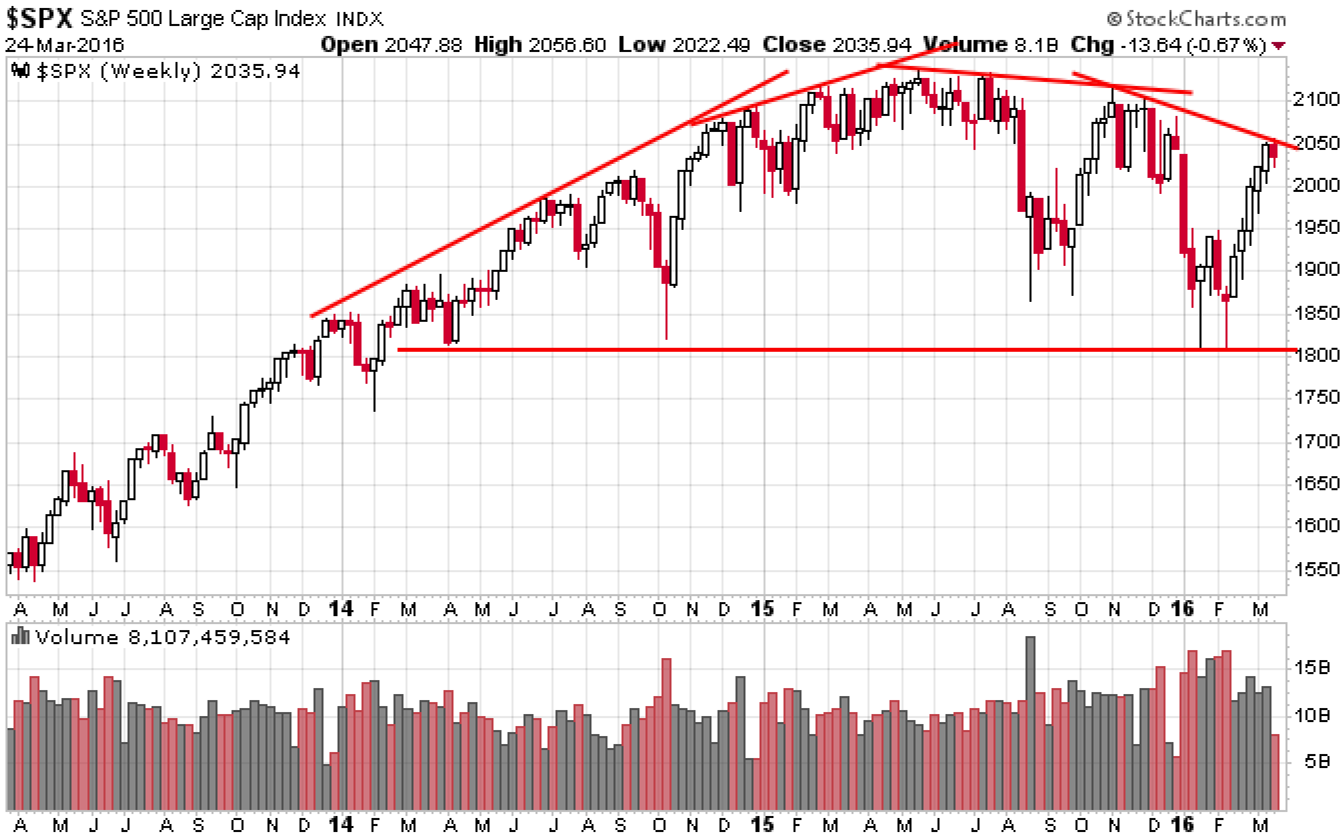
So to answer the question: Should the bulls be concerned. The answer is 'no' if they're looking at the intermediate term. Right now the uptrend deserves the benefit of the doubt, and even if the market was destined to fall, there will be second and third chances to exit. But the answer is 'yes' if they're shorter term oriented. The stocks that ran up the most off the February low are the ones that have fallen the most off their recent highs. If you want to survive in this business, you cannot allow solid profits to disappear simply because you want to "wait and see what happens." Especially after such a huge run and declining internals.

Looking forward, caution in the near term is still warranted. We don't have many good set-ups to play, so time is needed for the charts to reset themselves. Be defensive. Don't be a hero. Trades come in bunches. We go through periods where there is a lot going on...and then a period where the market needs to sort itself out. Right now it has to figure things out. Absent news, I think the market rests and then goes higher. But news (either more Fed talk about higher rates or another terrorist attack) could derail things. Let's get to the charts and see what they say.

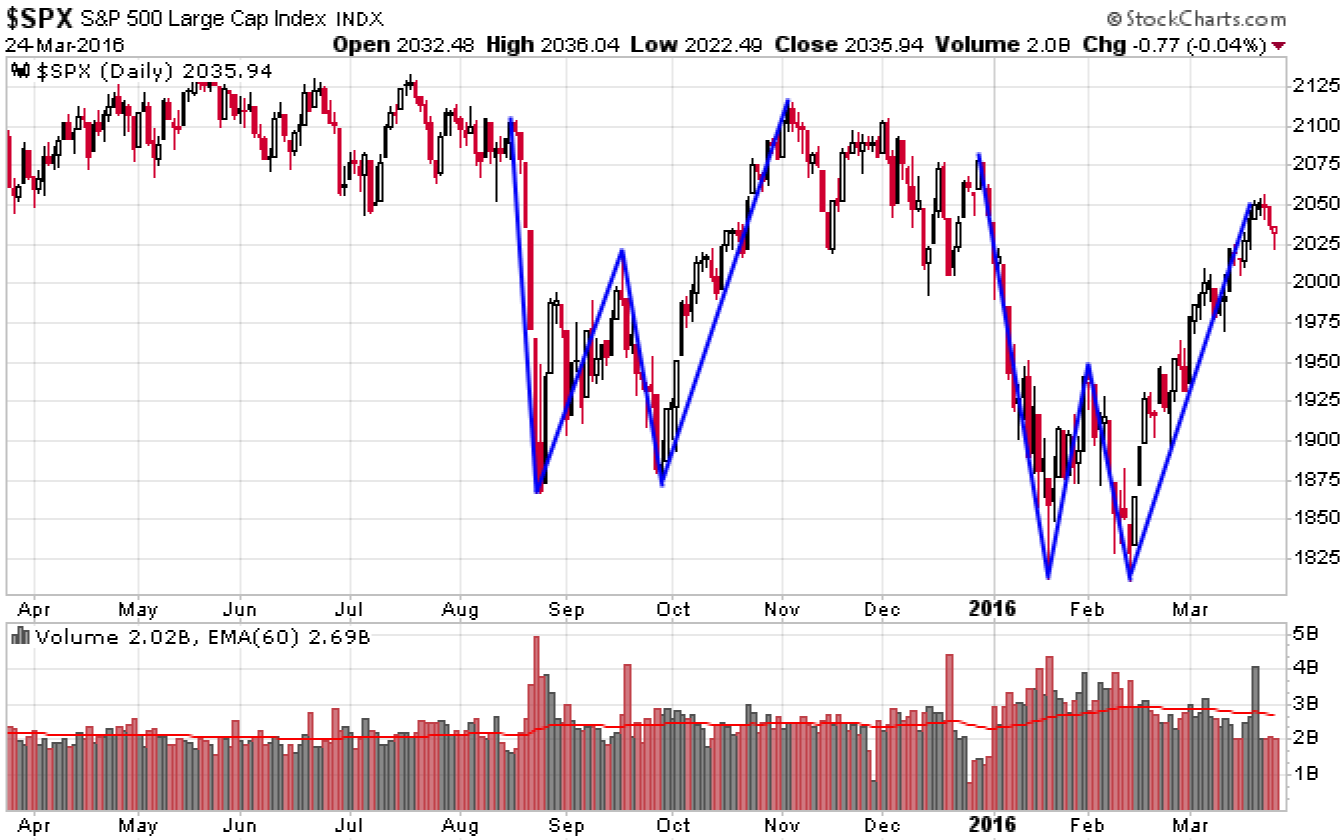
Indexes

The S&P 500 Monthly: As a point of reference, this pullback has been shallower than the two previous significant pullbacks that have played out since the 2009 bottom, but the S&P has spent more time below its 10-month MA. Hence the correction has been less intense but has lasted longer.

The S&P 500 Weekly: The market's 5-week win streak is over, but it's not like there was a mad run for the exits. The weekly range was small, and even accounting for the one less day of trading, volume was light. Absent bad news, worst case scenario looking out a couple weeks is choppy up and down movement.

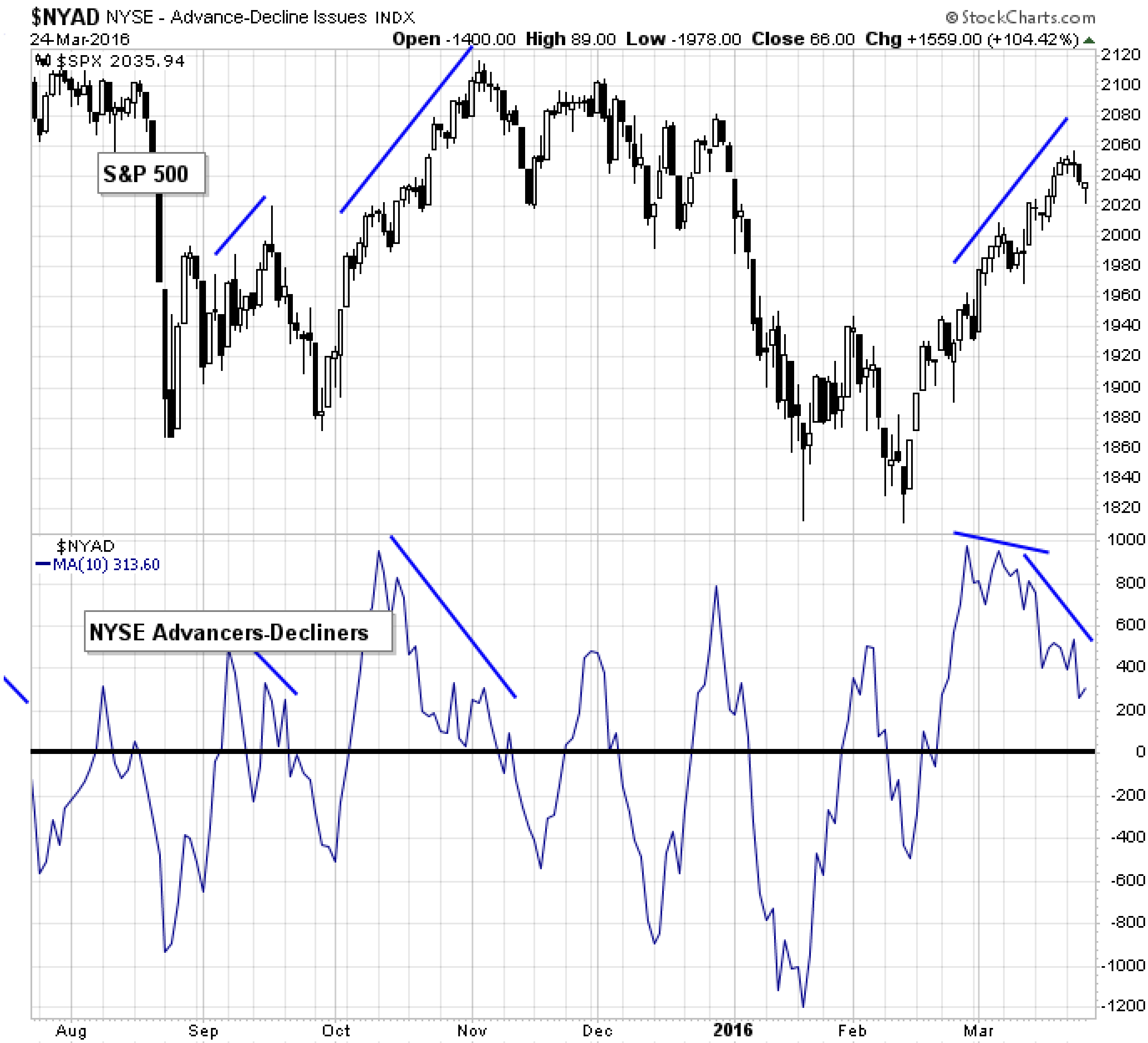


The S&P 500 Daily: A similar pattern has formed the last three months that formed last fall. It doesn't forecast anything going forward, but it's still fun to look at. There's a ton of resistance overhead every 25 points - 2050, 2075, 2100. The market will settle into a range sooner or later. It has either started or it'll start at a slightly higher level.



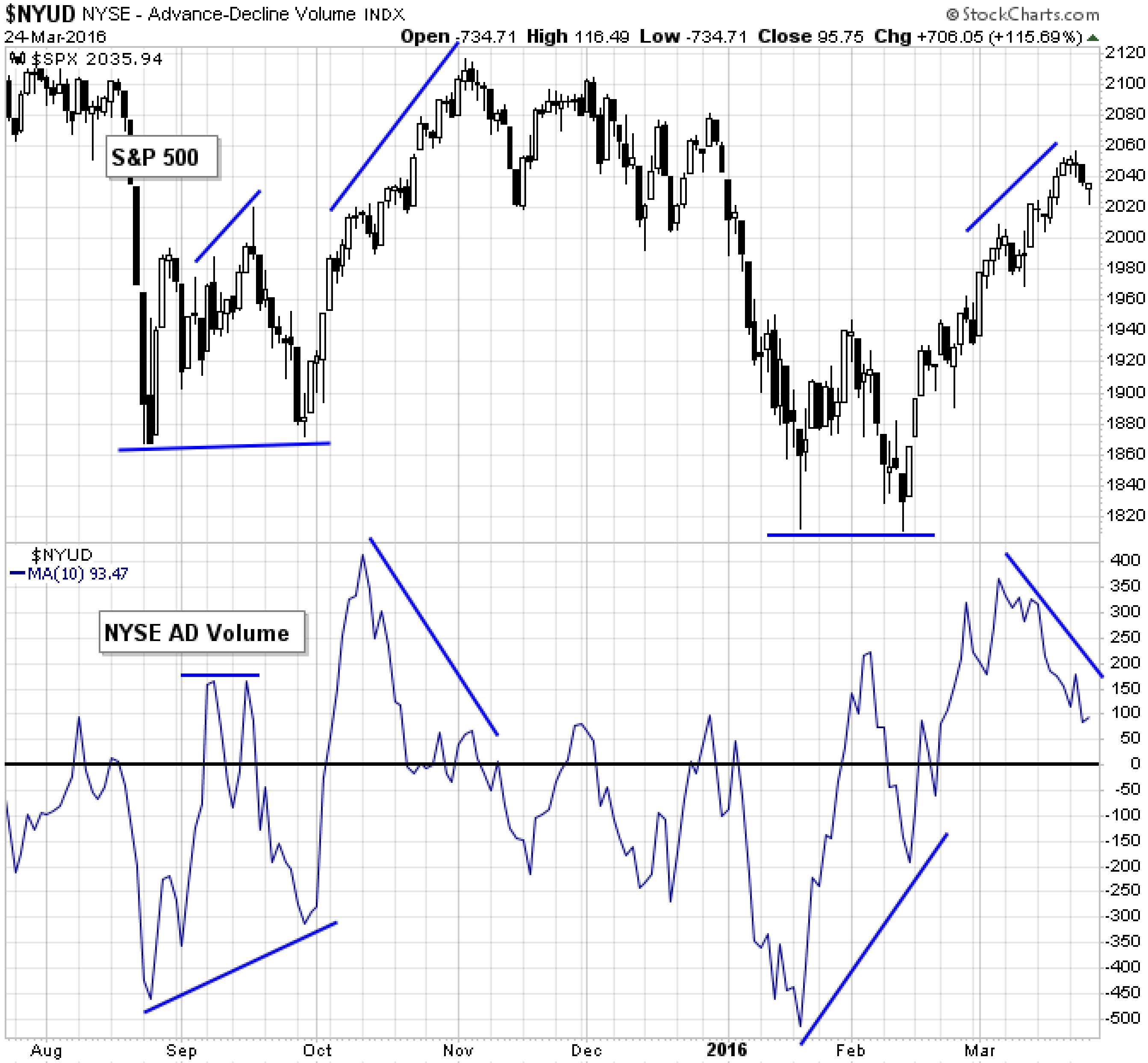
Indicators

S&P 500 vs. 10-day MA of NYSE AD Line: The 10-day of the AD line has been declining for almost three weeks. Advancers are still beating decliners, but the margin of victory is not what it used to be. This type of divergence almost always leads to a correction - even if it's just a minor correction that only lasts a week.

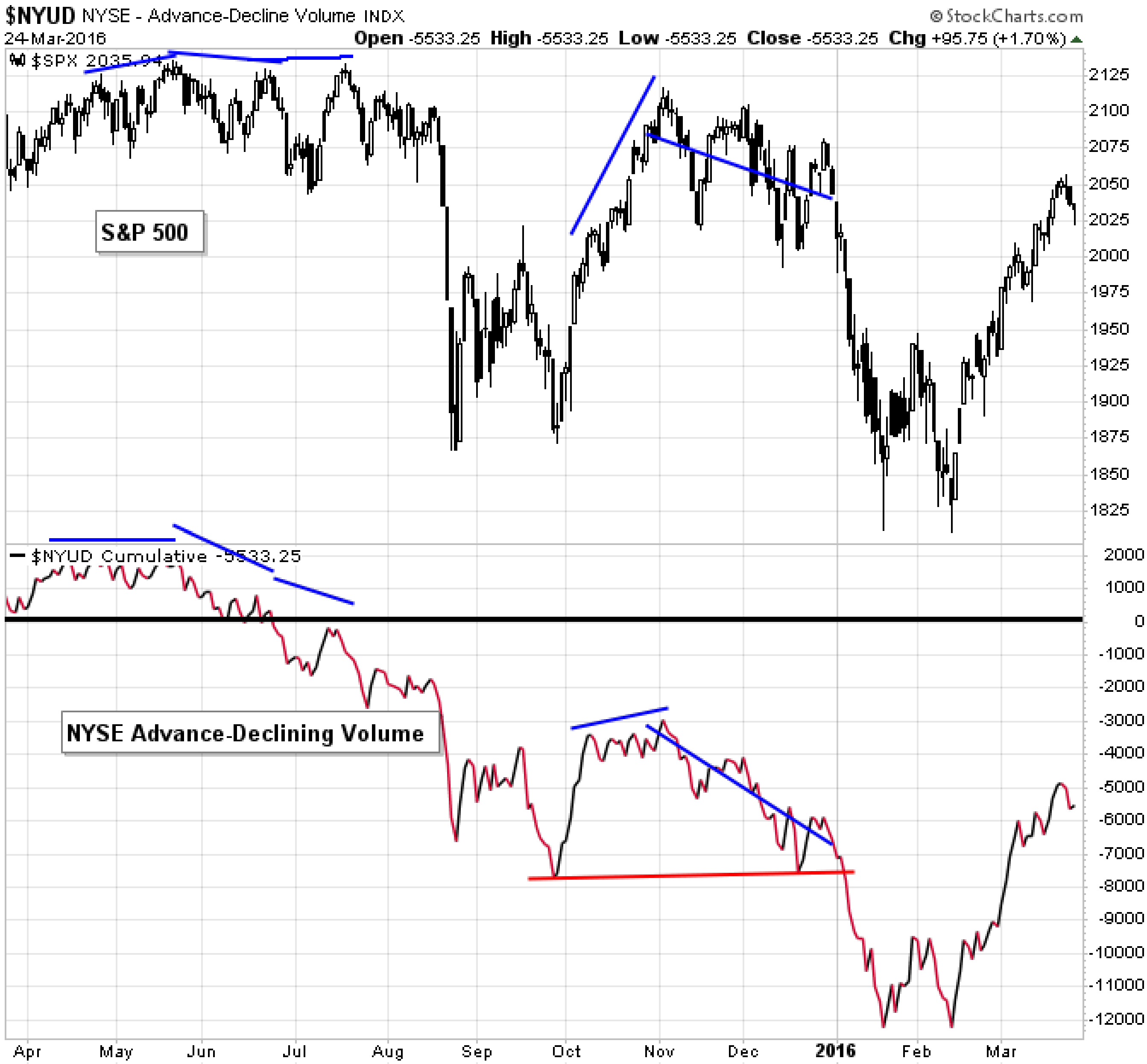


S&P 500 vs. NYSE Cumulative AD Line: The cumulative AD line reached a level not seen since last summer. Heck of a vertical move. It's one of the reasons the upside deserves the benefit of the doubt, even if the market does pull back in the near term.

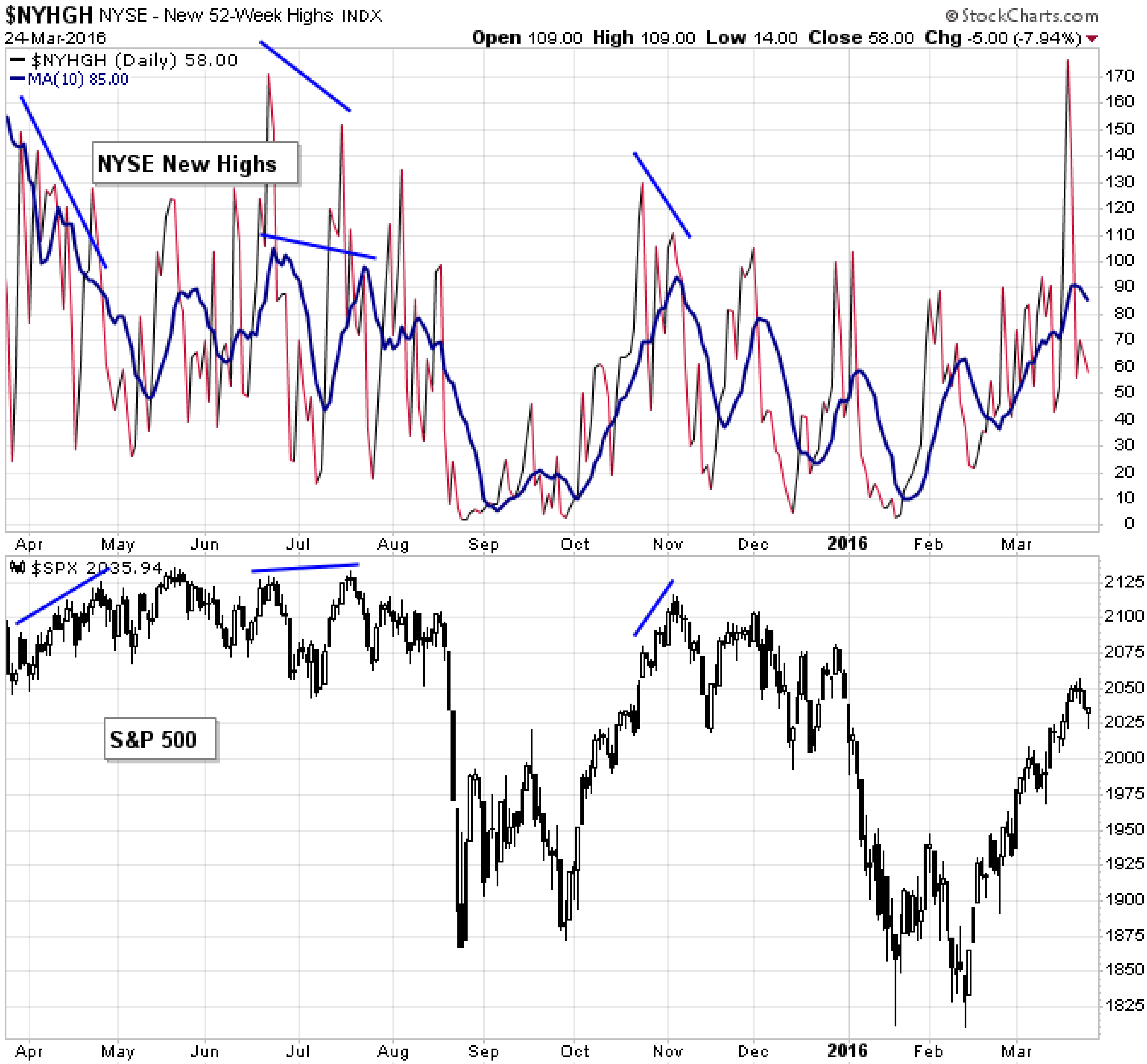
S&P 500 vs. 10-day MA of NYSE AD Volume Line: The AD volume line, which lets the high-volume, big caps do more of the talking, has also been declining since earlier this month. If this persists, the market will correct in the next couple weeks. The market can't run too much higher while things weaken beneath the surface.



S&P 500 vs. NYSE Cumulative AD Volume Line: Here's an example of the market doing much better on this rally than the last. The cumulative AD volume line continues to trend up, whereas the October rally saw the indicator flatten out after the first thrust. This is one of the reasons the bulls deserve the benefit of the doubt.

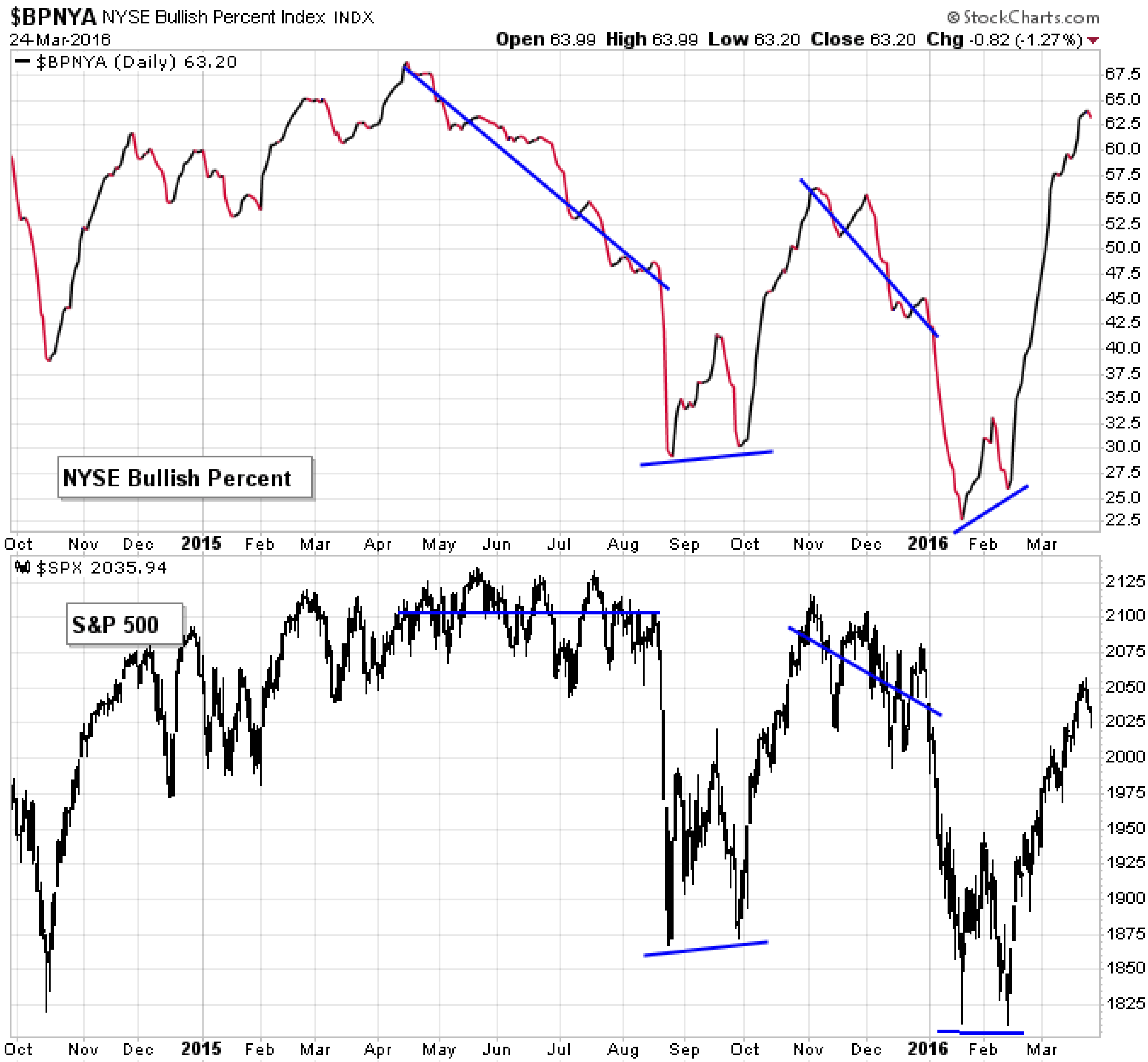


S&P 500 vs. NYSE New Highs: The spike in new highs two weeks ago was not matched last week, but new highs didn't completely disappear either. A continuation of the trend must be accompanied by elevated new high prints. Otherwise a warning will be flashed.

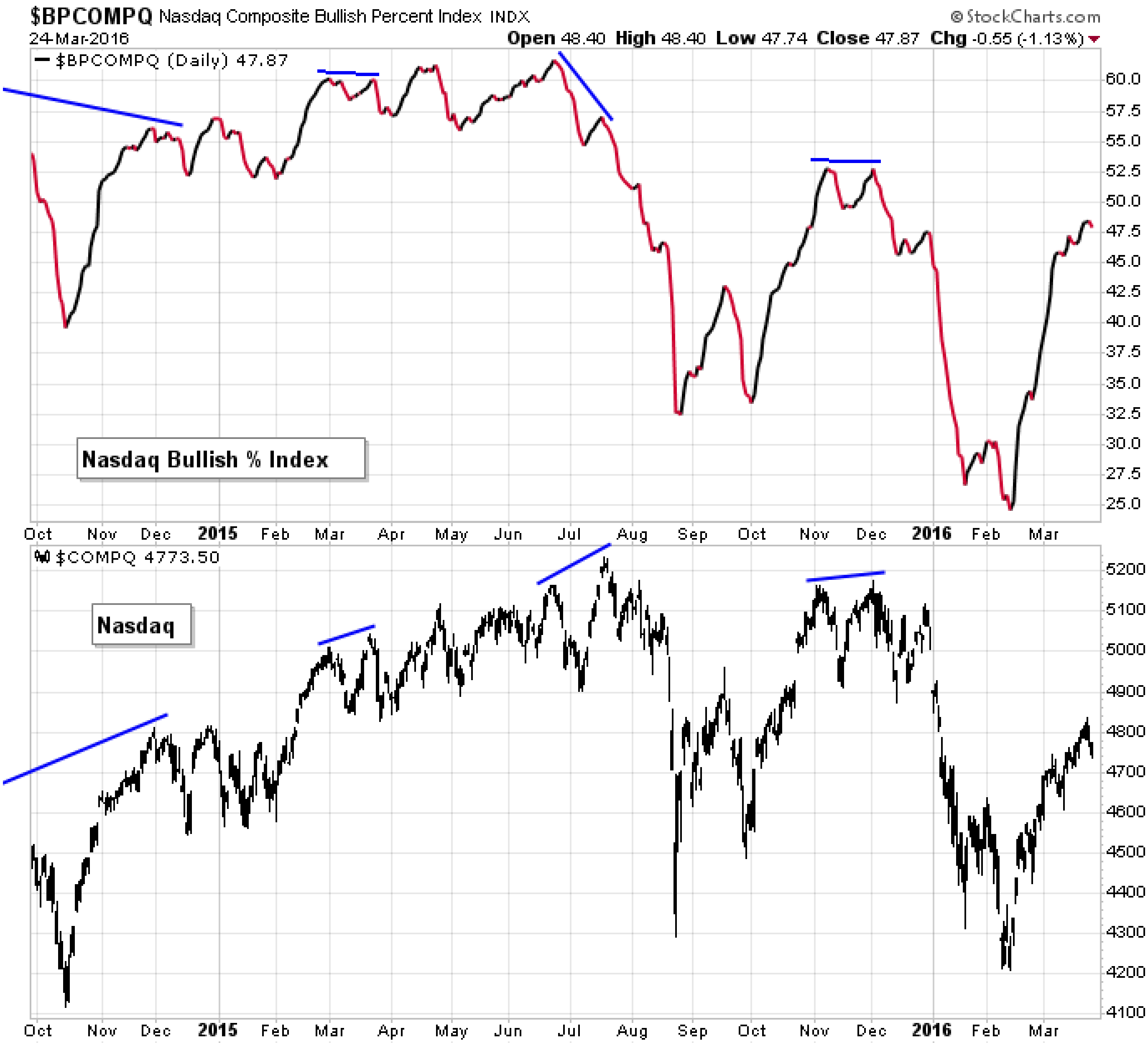


NASDAQ vs. NASDAQ New Highs New highs at the Nas are still very unimpressive.

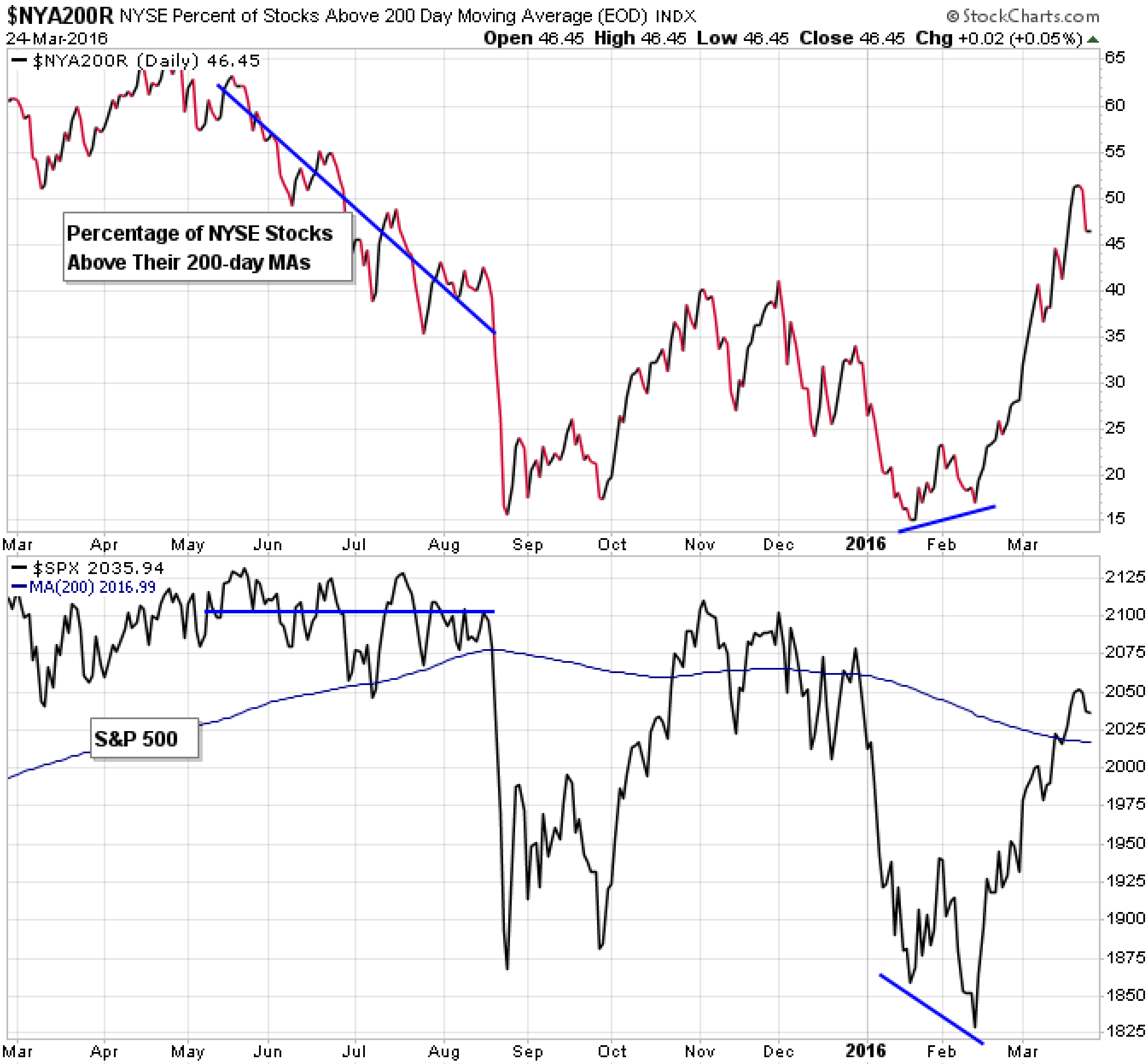
S&P 500 vs. NYSE Bullish Percent: The bullish percent chart at the NYSE continues to maintain a high level. It'll take some time for a negative divergence to form...and then whether this indicator dips a little or a lot will help determine how much upside the market has left.



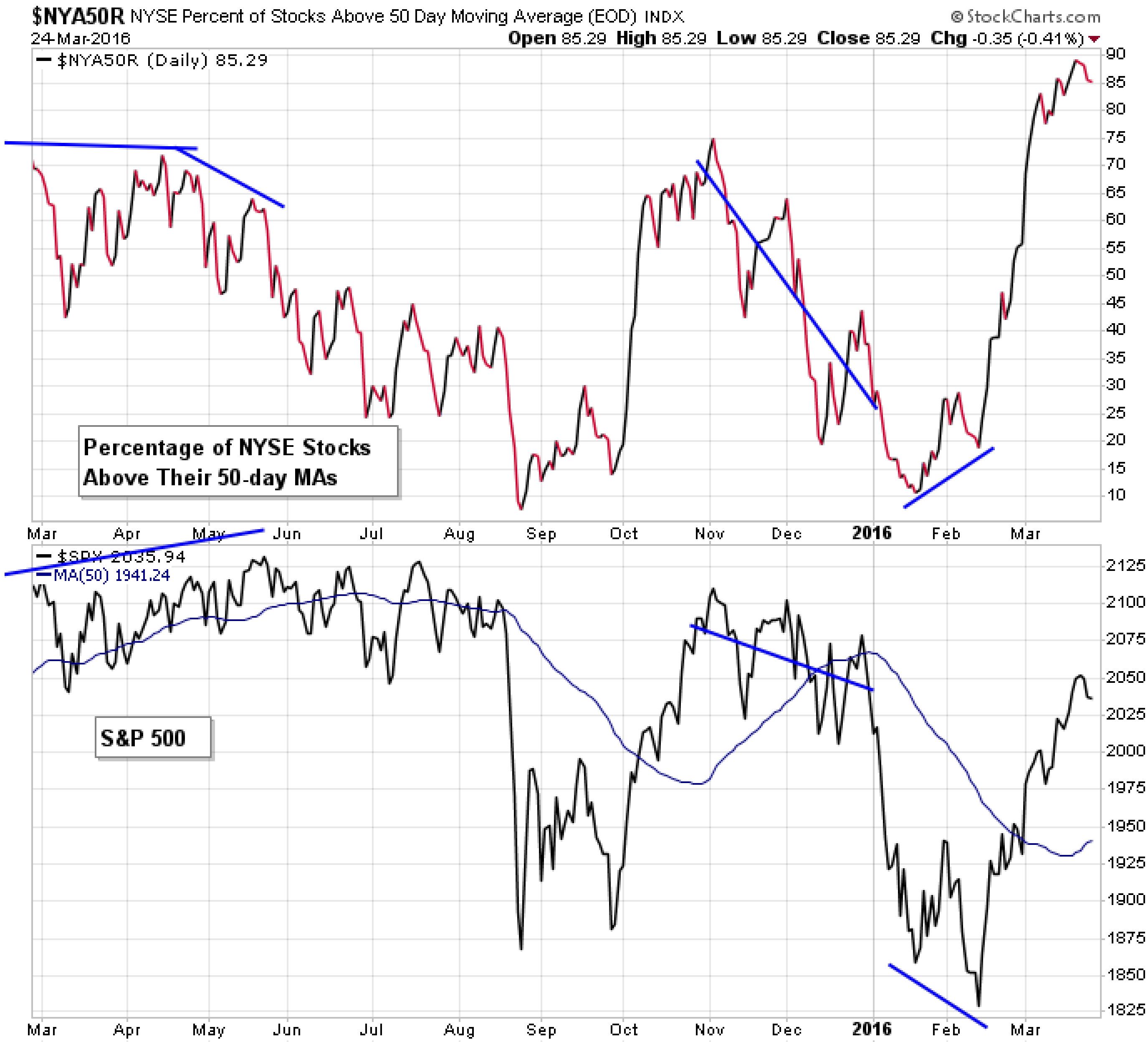
NASDAQ vs. NASDAQ Bullish Percent: The Nas bullish percent hasn't even reached the 50% level, so along with the lack of new highs, there's definitely some weakness in the index.



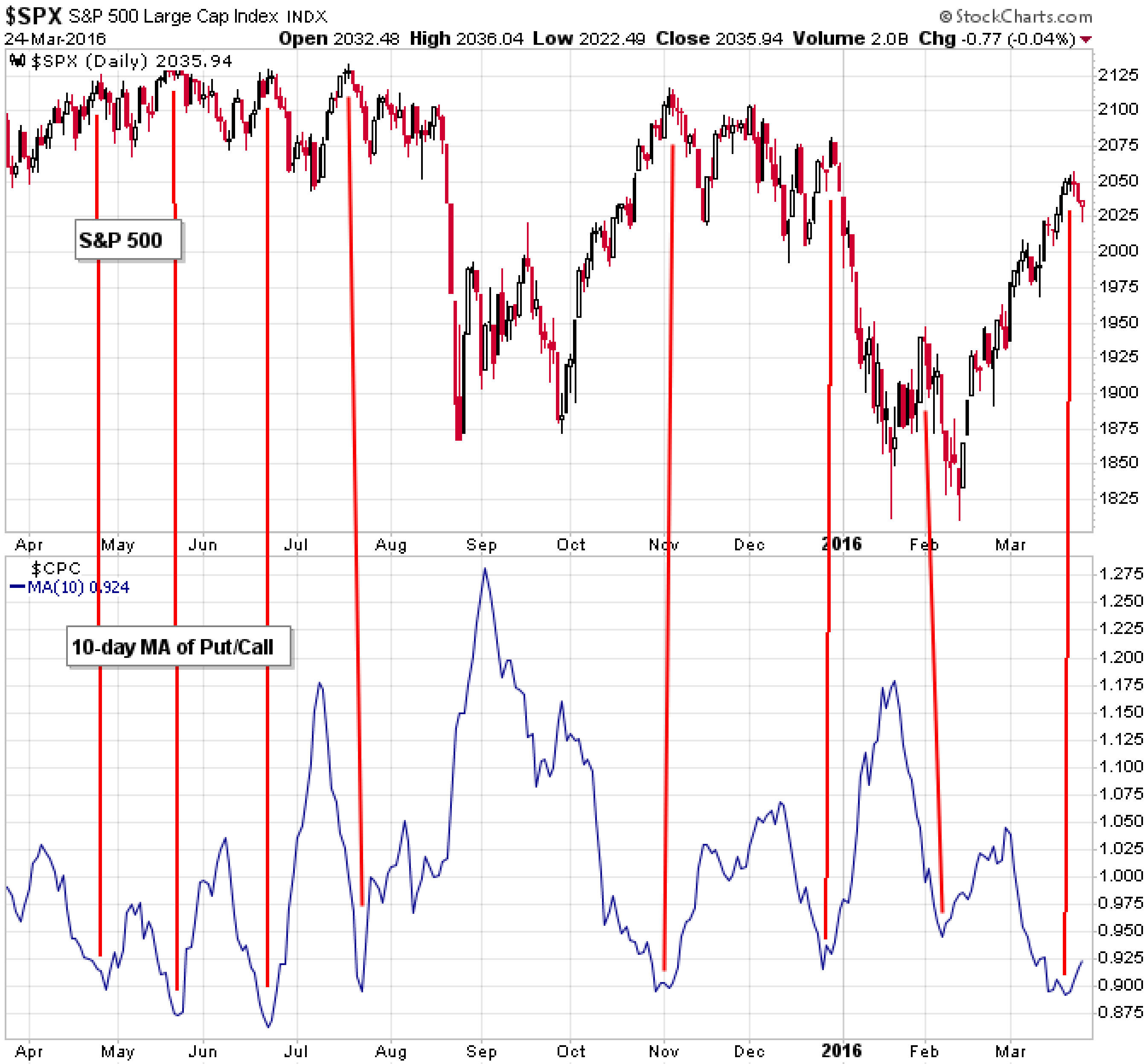
NYSE vs. Percentage of NYSE Stocks Above 200-day MA: The percentage of NYSE stocks above their 200-day moving averages peaked above 50% and then dropped back. Considering the level the market is at, this is an acceptable print. As a point of reference, the progress since mid-February has been much greater than during the October rally. As I said above, this rally has more broad-based support.



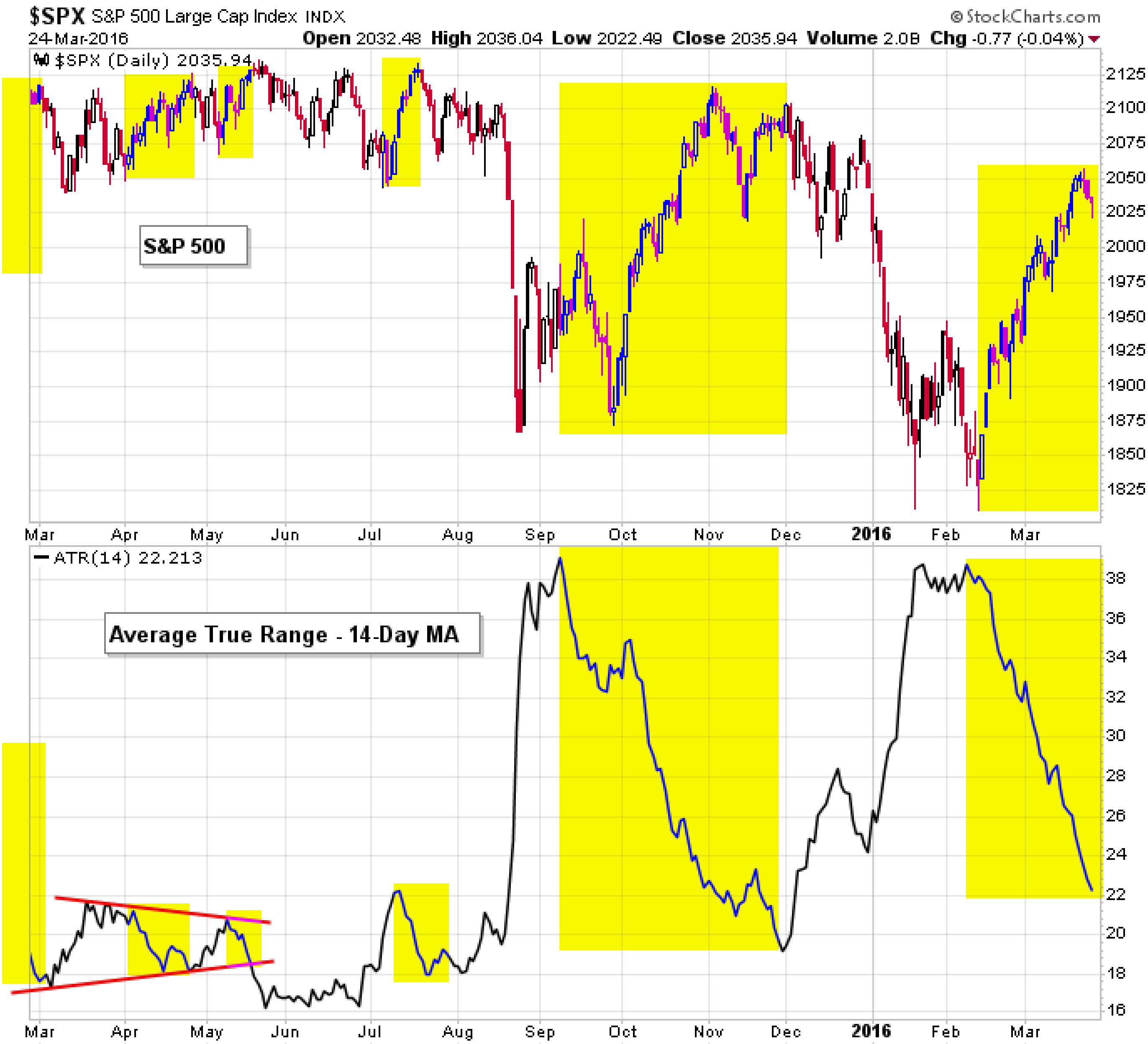
NYSE vs. Percentage of NYSE Stocks Above 50-day MA: A full 85% of NYSE stocks are above their 50-day moving averages - the highest level since early 2013. More evidence this rally has not lacked participation.



S&P 500 vs. 10-day MA of Put/Call Ratio: The put/call is starting to curl up - a reason to be defensive because a pullback is likely coming soon.



S&P 500 vs. 14-day Average True Range: The daily ATR continues to trend down - this is characteristic of an uptrend. When it curls up, the uptrend will be in jeopardy.



The Bottom Line

The S&P dropped 0.7% last week while the Russell 2000 fell 2%. The weakness of the small caps is notable.

Considering the S&P 500 and Nas printed higher highs, it's also notable several breadth indicators declined. The AD line, AD volume line and new highs all dropped. And the put/call has curled up.

I lean bullish overall - or at least I'm willing to give the bulls the benefit of the doubt - but in the very near term I question the upside potential (both in terms of time and points) until the charts, to some degree, have time to rest.

If we push higher now, I don't think the market goes far before topping. If the market can rest now and attempt to push higher in a couple weeks, then the stage will be better set for a legit leg up.

Right now I'm being defensive. The market has come a long way since bottoming last month. This isn't a time to back up the truck and aggressively take big positions. Trade but don't be a hero. The stage is not set for a big rally.

Have a great week.

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