Leavitt Brothers

Weekly

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The bears finally got a little follow through. For the first time since the market bottomed in February, back-to-back losses have been recorded on the weekly charts. It wasn't a convincing or dominating victory for the bears - the S&P only dropped 3 of 5 days and only lost 8 points for the week - but it was still more relief than they've gotten in almost three months.

We got a robust move off the February low. It was a one-way ride up, and there was little doubt who was in control. The move pushed many breadth indicators to extreme levels and hinted that the rally was different than the October rally. Then, over the last eight weeks, the market flattened out, and the bulls and bears have fought equal battles - four up weeks and four down weeks and virtually no net change has put the market at the same place it was the third week of March. Essentially a 6-week directional move has been followed by a range lasting the same amount of time. In the grand scheme of things, this is perfectly normal and acceptable movement. The market spends more trading in ranges than it does moving directionally.

The breadth indicators told us this was the likely coarse. The AD line and AD volume line started diverging from the underlying price action in early-March. This development doesn't tell us a move is over; it just tells us a rest is needed, and entering new positions carries less-favorable risk/rewards. This is a trap many traders fall into. They enter at a time the market needs a rest, and then at a future date when the market bottoms and begins to move up, they can't buy because they're sitting in losses.

New highs continued to expand - lending evidence the overall uptrend was still in good shape - and then diverged in early-April (the market pushed to a higher high while the new highs put in a lower high).

The percentage of stocks above their 200-day moving averages continued to expand - another good sign - but the percentage of stocks trading above their shorter term 50- and 20-day MAs started to roll over - another sign the market likely needed to rest in the near term.

Guessing what the market will do week to week and month to month will lead to a very short and stressful life. But reading the hints from a couple very basic indicators will put the odds heavily in your favor. The market either trends or it chops. Within a trend, the indicators tell us what the staying power of the trend is...how much meat is on the bones...whether we're near the beginning of a move or the end. Within a range, the same breadth indicators tell us if the "smart money" is quietly accumulating stocks or dumping them.

Right now I consider the market to be resting within an intermediate term uptrend. Earnings season is winding down, and the latest employment numbers are out of the way. The volume of bearish talk has increased lately, with legendary hedge fund manager Stanley Drunkenmiller saying "the chickens are now coming home to roost," and many others using the "sell in May and go away" adage to support their bearish stances. This provides a perfect platform to rally prices.

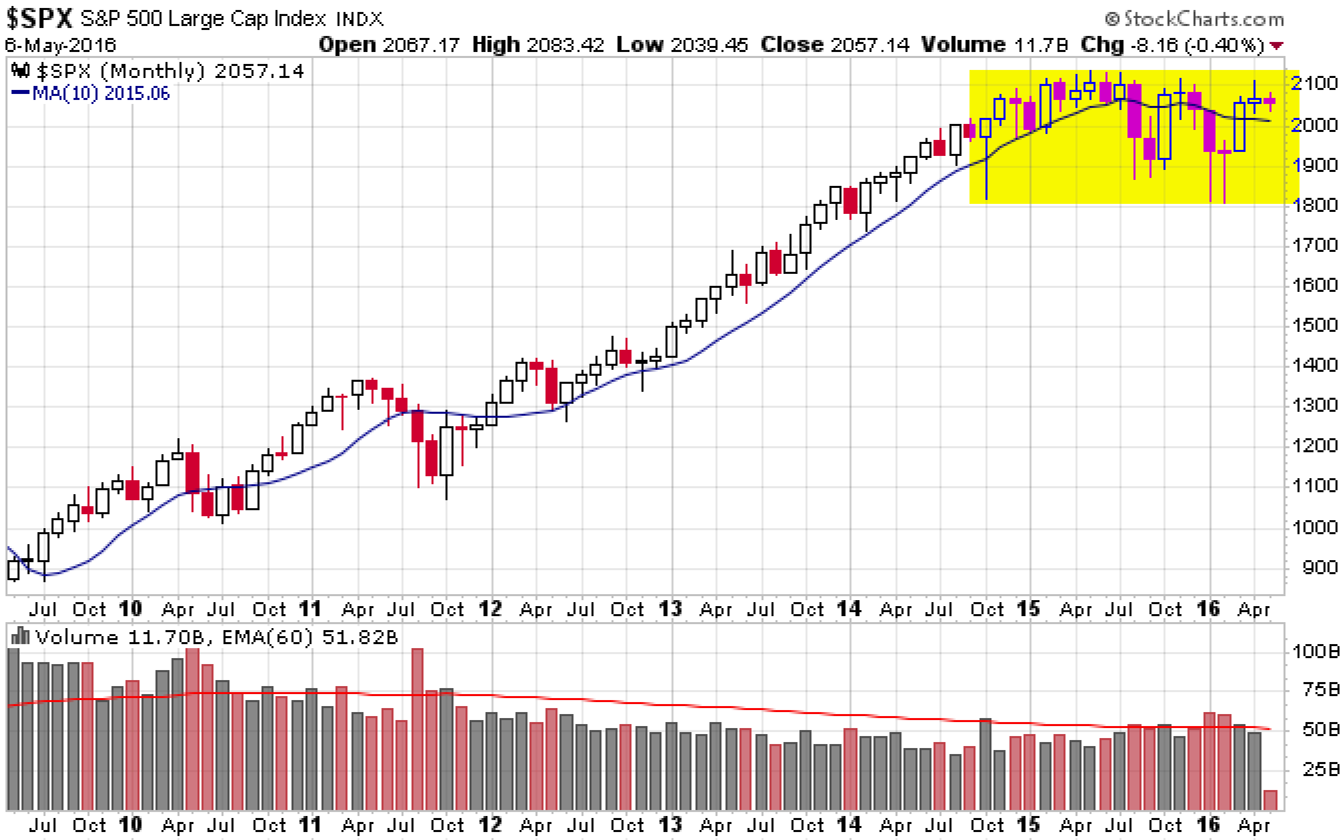
Sorry, that's just the way things go. When too many get stacked on one side of the market, moves that don't make sense play out.

Will the indexes rally up to new highs soon? I don't know. But given the backdrop, it's a definite possibility, and it's good reason to not get overly bearish.

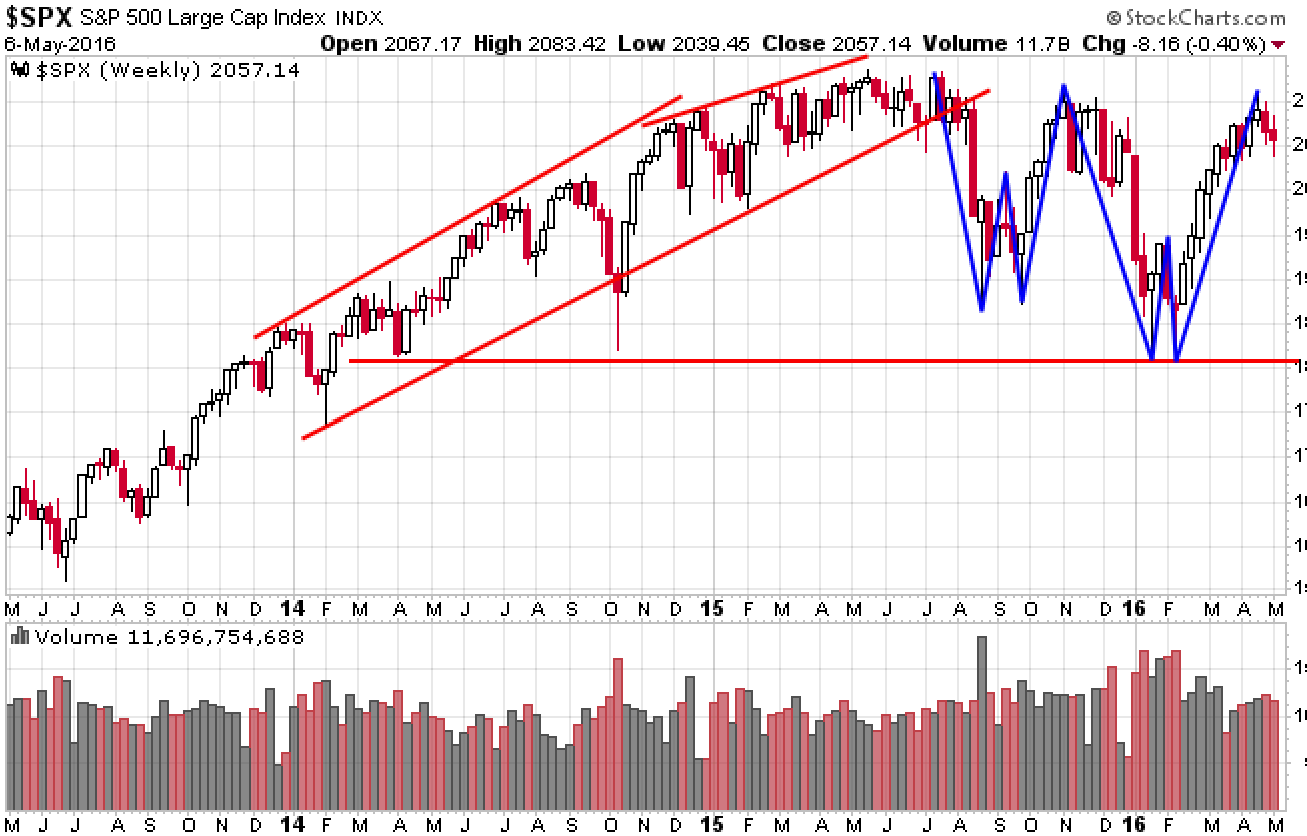
Let's get to the charts and see what they say.

Indexes

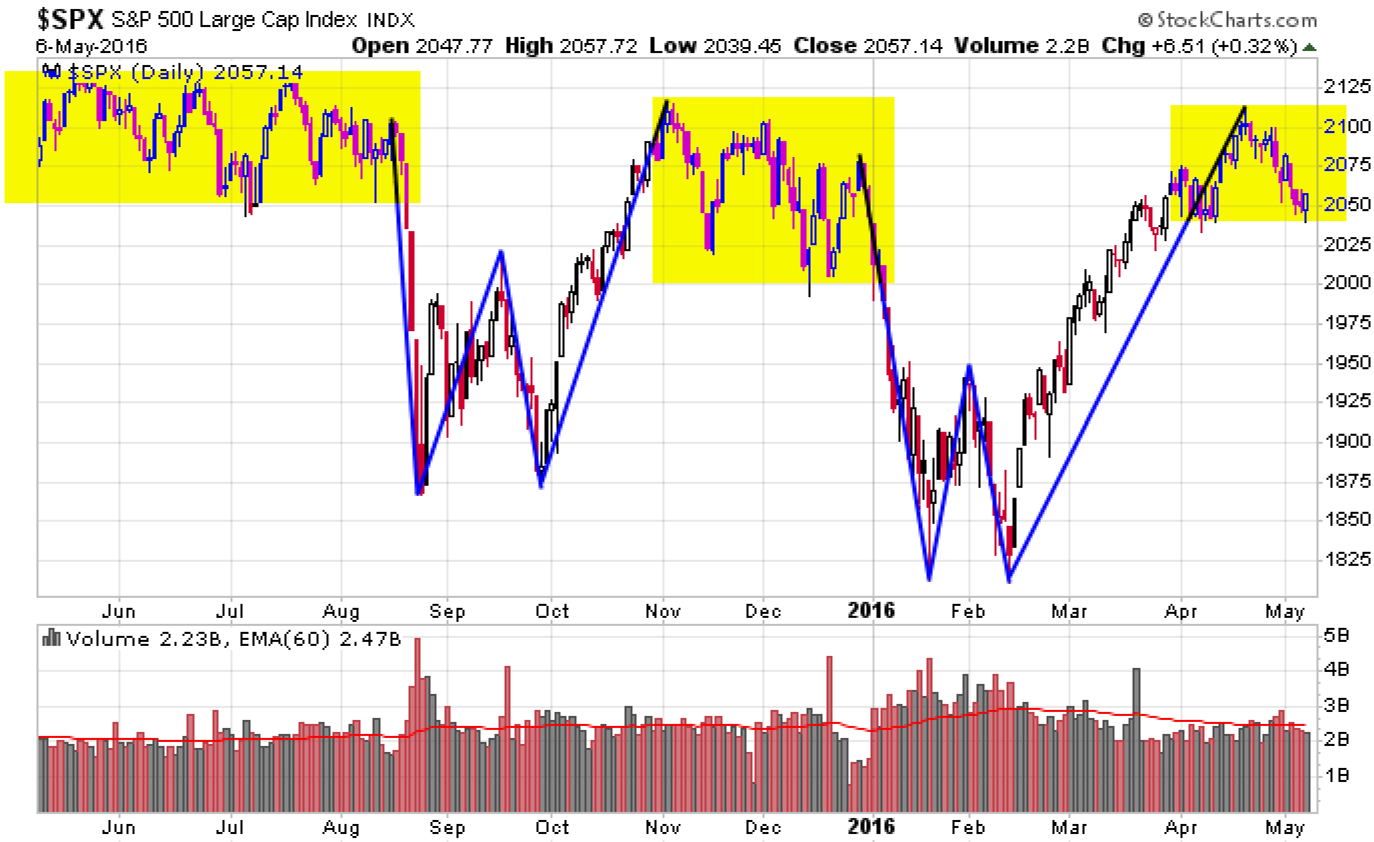
The S&P 500 Monthly: A quick reminder of the big picture. A 6-year bull run has been interrupted by an 18-month range. Within the range there are swings that can be played in both directions, but overall there's nothing wrong here.



The S&P 500 Weekly: For the first time since the February bottom the S&P has dropped two consecutive weeks. But for those that watch the intraday action very closely, they'll be surprised to see how little damage has been done the last two weeks. This is such a minor dip.



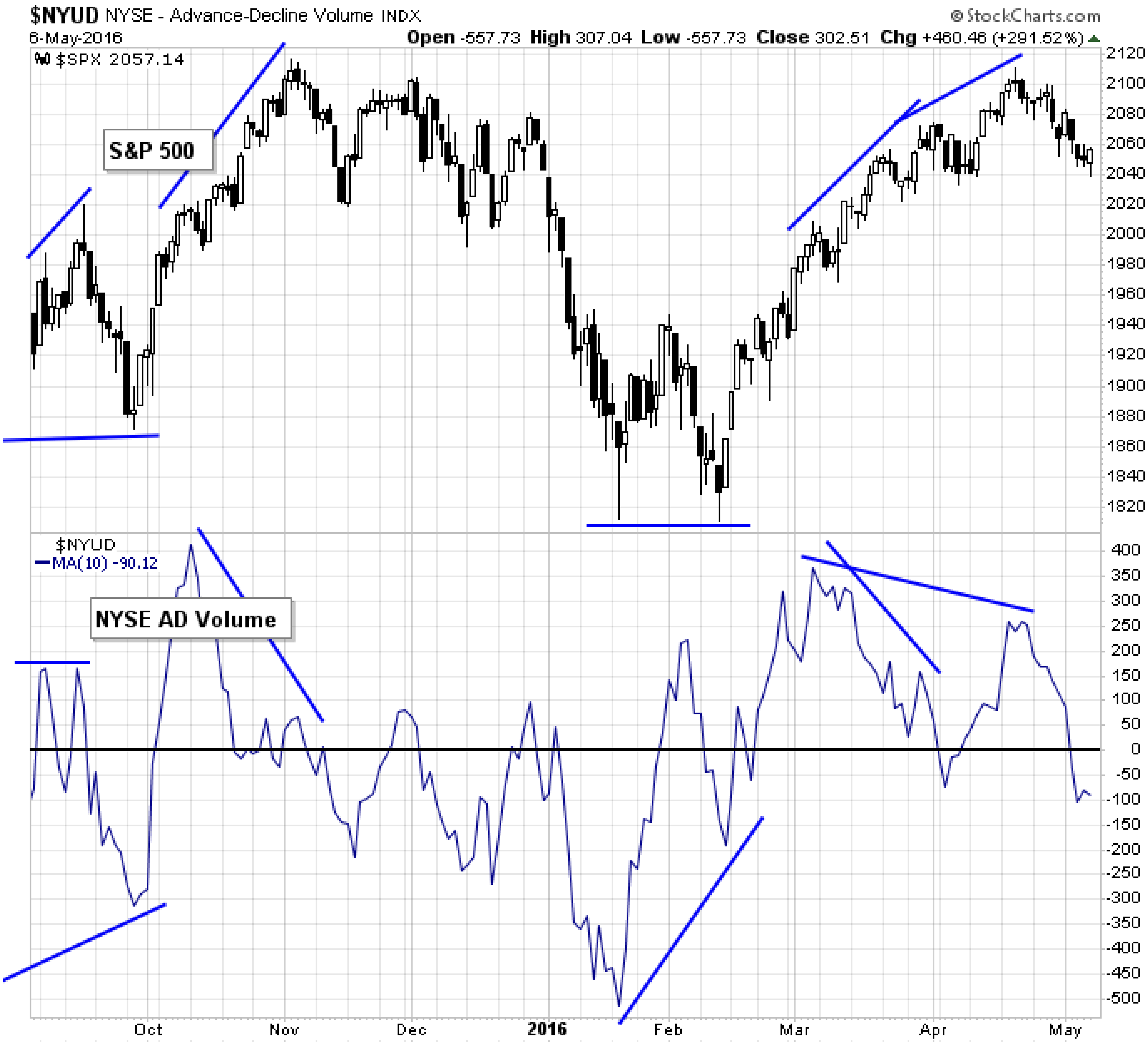
The S&P 500 Daily: The S&P has officially given back its April run up. Tops take time to form, so it would be somewhat uncharacteristic if the market continues south without at least one failed rally attempt.



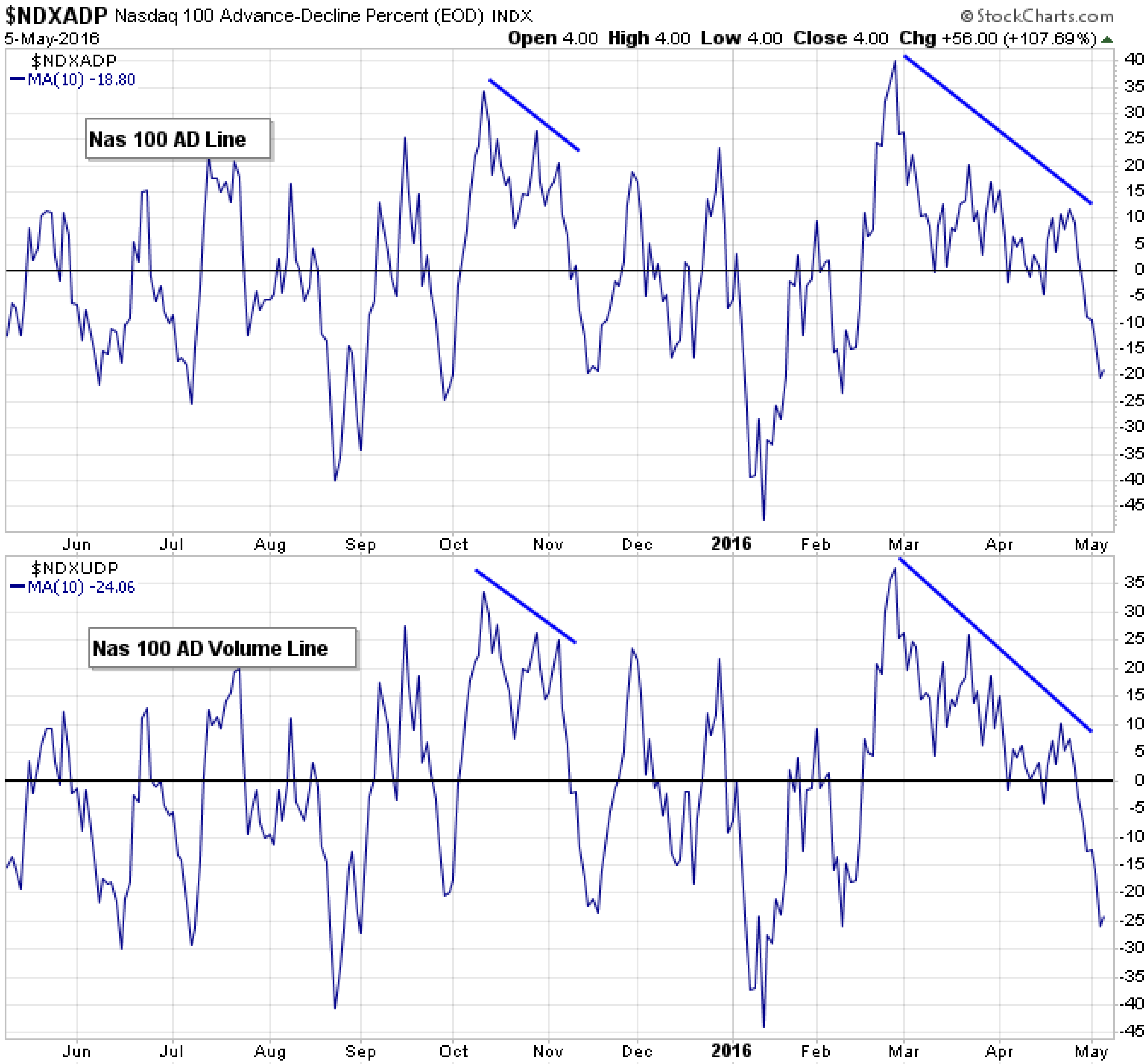
Indicators

S&P 500 vs. 10-day MA of NYSE AD Line: The March divergence led to a 2-week pause, and so far the mid-April divergence has led to a very moderate pullback. The AD line has matched its most recent low and would be supportive of a market bounce. If this level holds, I'll still consider recent action to be a "pause within an uptrend," but if the indicator penetrates 0 by much, it'll hint at something worse brewing beneath the hood.

S&P 500 vs. 10-day MA of NYSE AD Volume Line: The AD volume line, which lets the high-volume, large-caps have more influence, has moved similarly to the AD line - same divergences and now trying not to fall much below 0. This is an important place. The market needs to bounce or else the drop off the high can double up and take the S&P down to 2000.



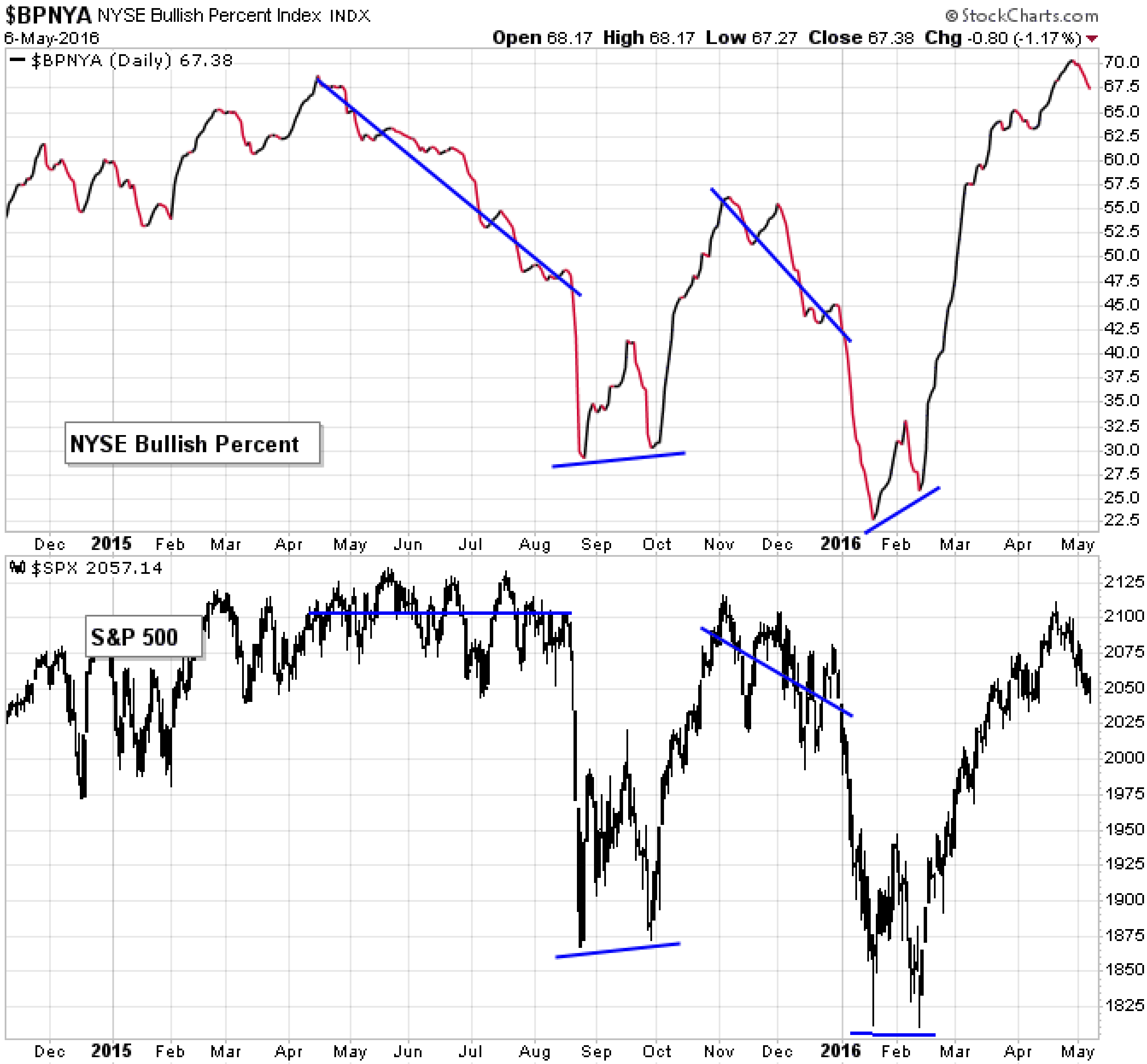
The **AD Lines and AD Volume Lines** for the small caps ($SML) and mid caps ($MID) are similar to above, but at the **Nas 100**, the picture is much less constructive. A bigger penetration of 0 tell us the Nas has crossed a threshold and isn't likely to recover until there's some sort of washout. It's something to keep in mind. If the rest of the market attempts to move up, but the Nas continues to bleed, the rest of the market won't go far.



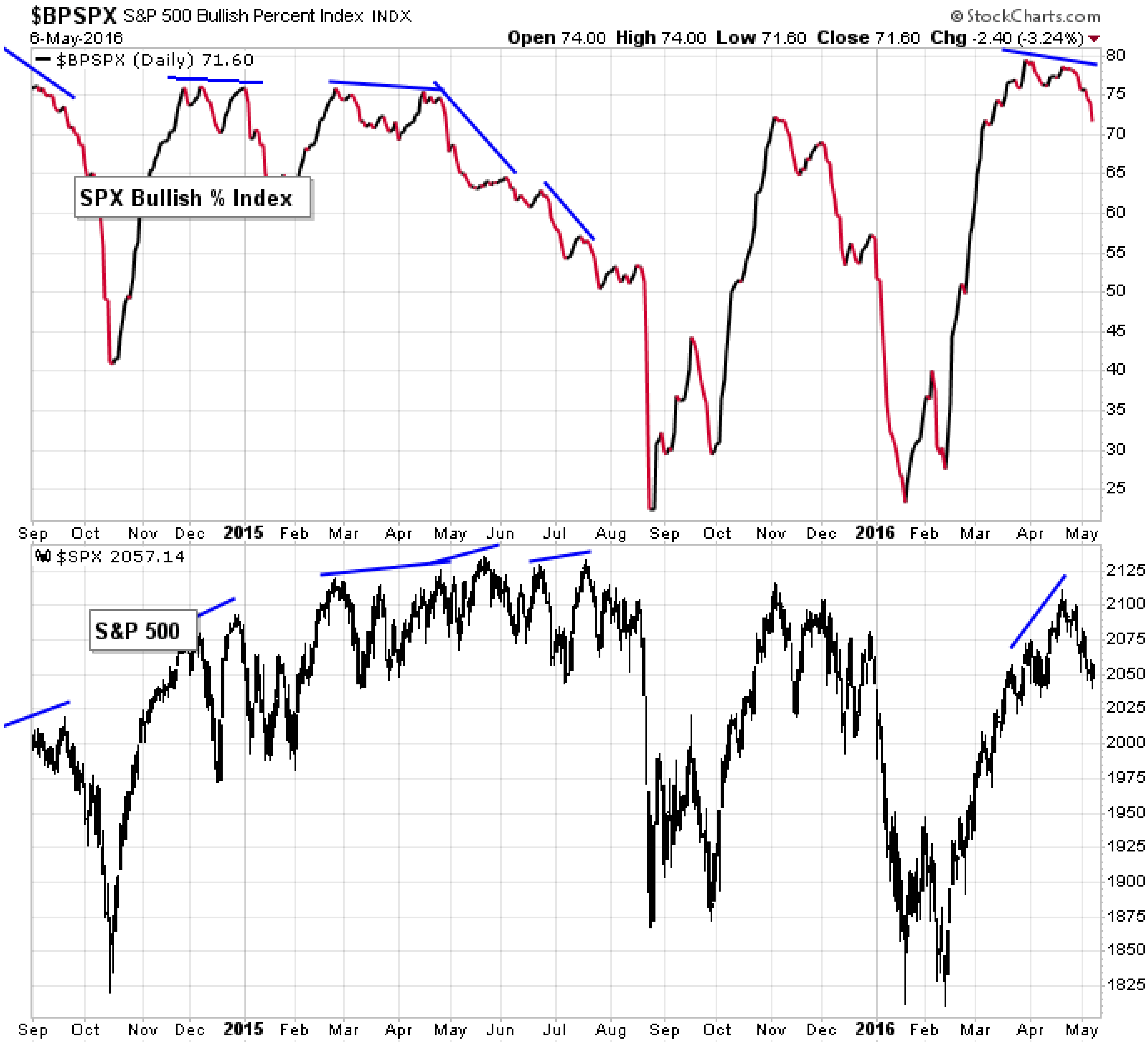
S&P 500 vs. NYSE New Highs: New highs at the NYSE printed its highest level in 14 months on Friday, so despite breadth being neutral the last two weeks (virtually the same advancers and decliners), there are still pockets of strength.

NASDAQ vs. NASDAQ New Highs: But new highs at the Nas continue to lag.

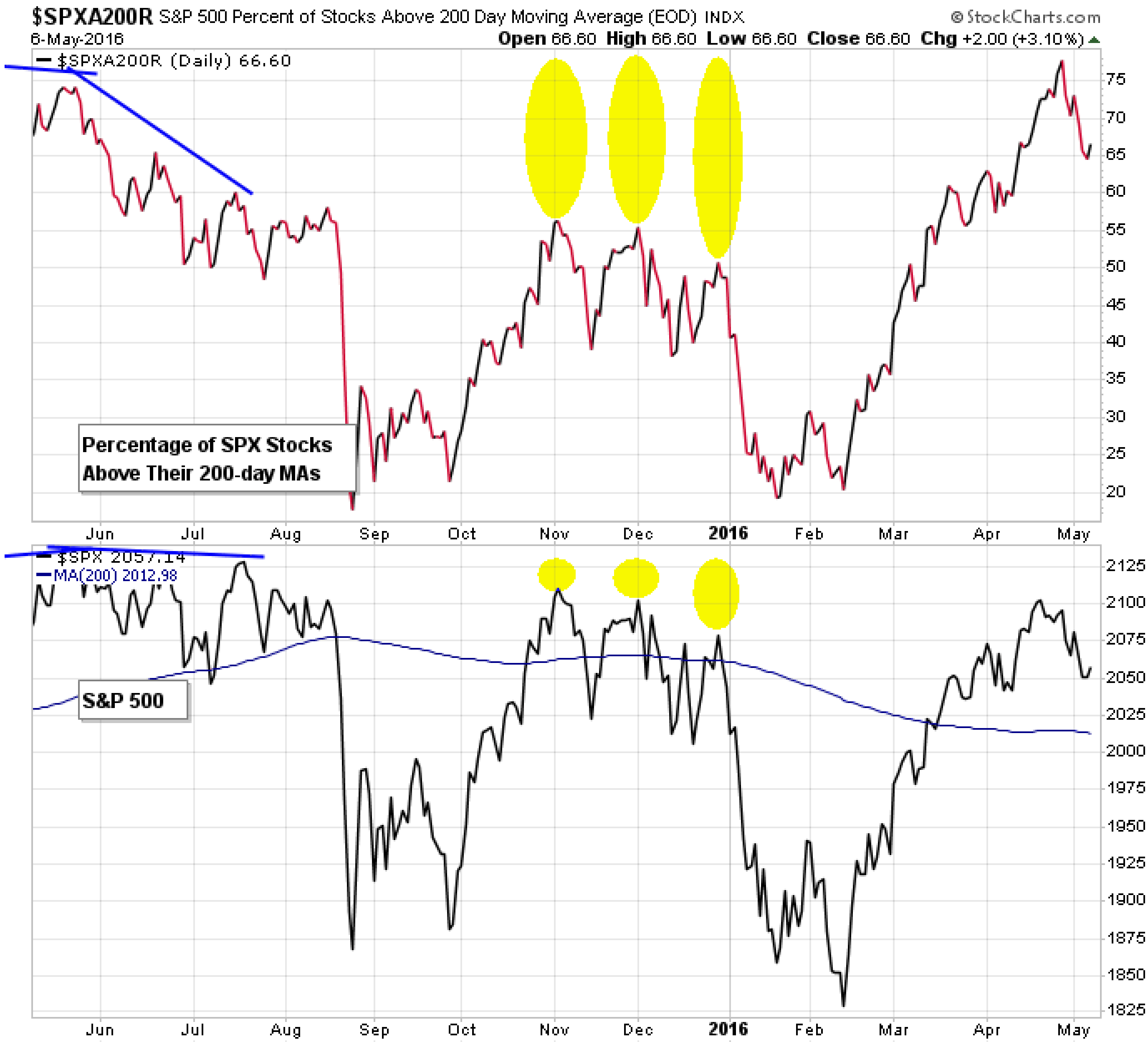
S&P 500 vs. NYSE Bullish Percent: The bullish percent at the NYSE is rolling over. It's rare for the indicator to just reverse and head south, so even if a top was forming, at the very least there should be one more rally attempt and a lower high.



S&P 500 vs. SPX Bullish Percent: The bullish percent at the S&P has already put in a negative divergence, albeit at a very high level.

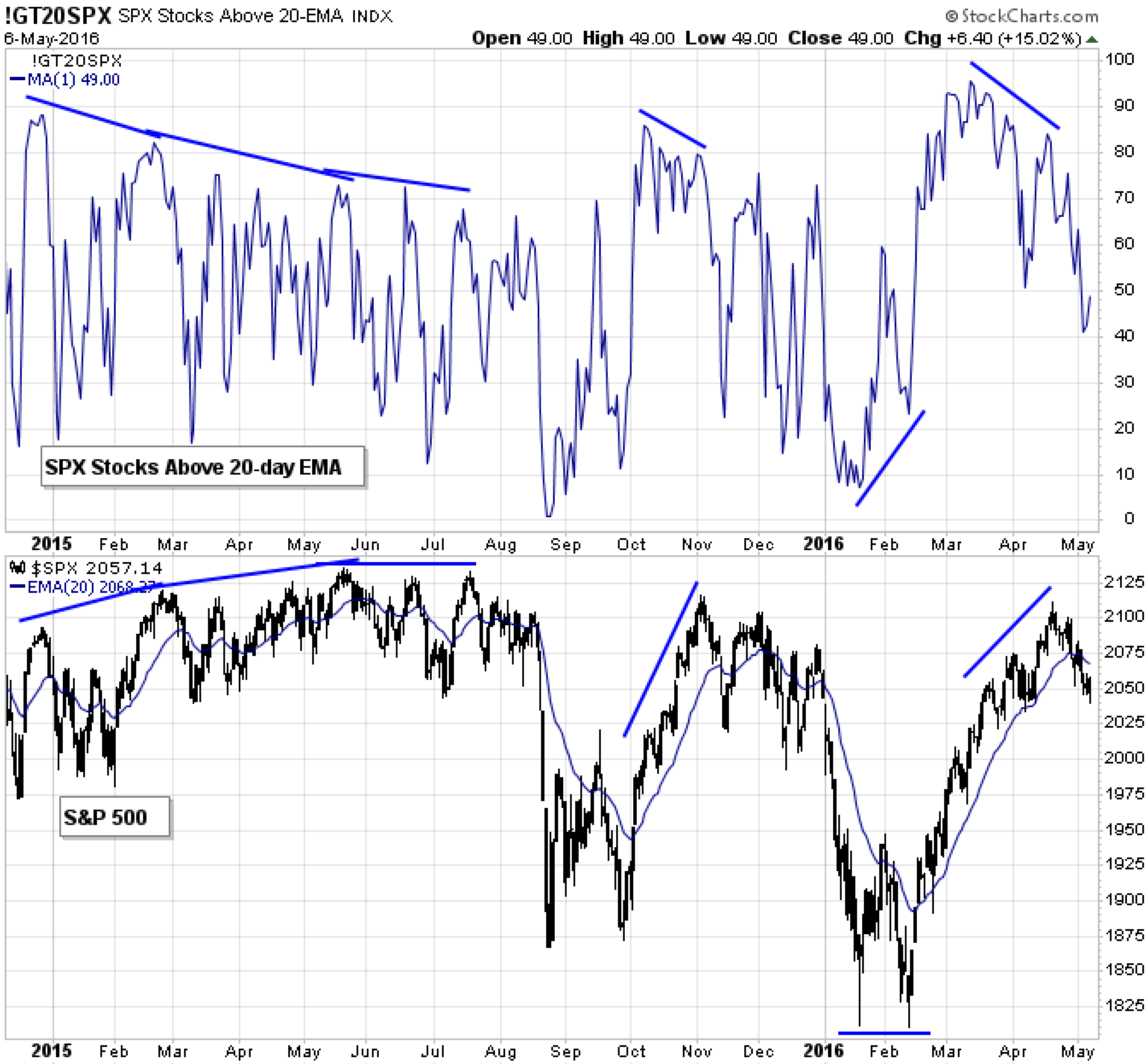


S&P 500 vs. Percentage of SPX Stocks Above 200-day MA: The percentage of SPX stocks above their 200-day moving averages has declined but hasn't completely plummeted. I'd consider this a normal and healthy drop and not yet a warning of something bad brewing beneath the surface.

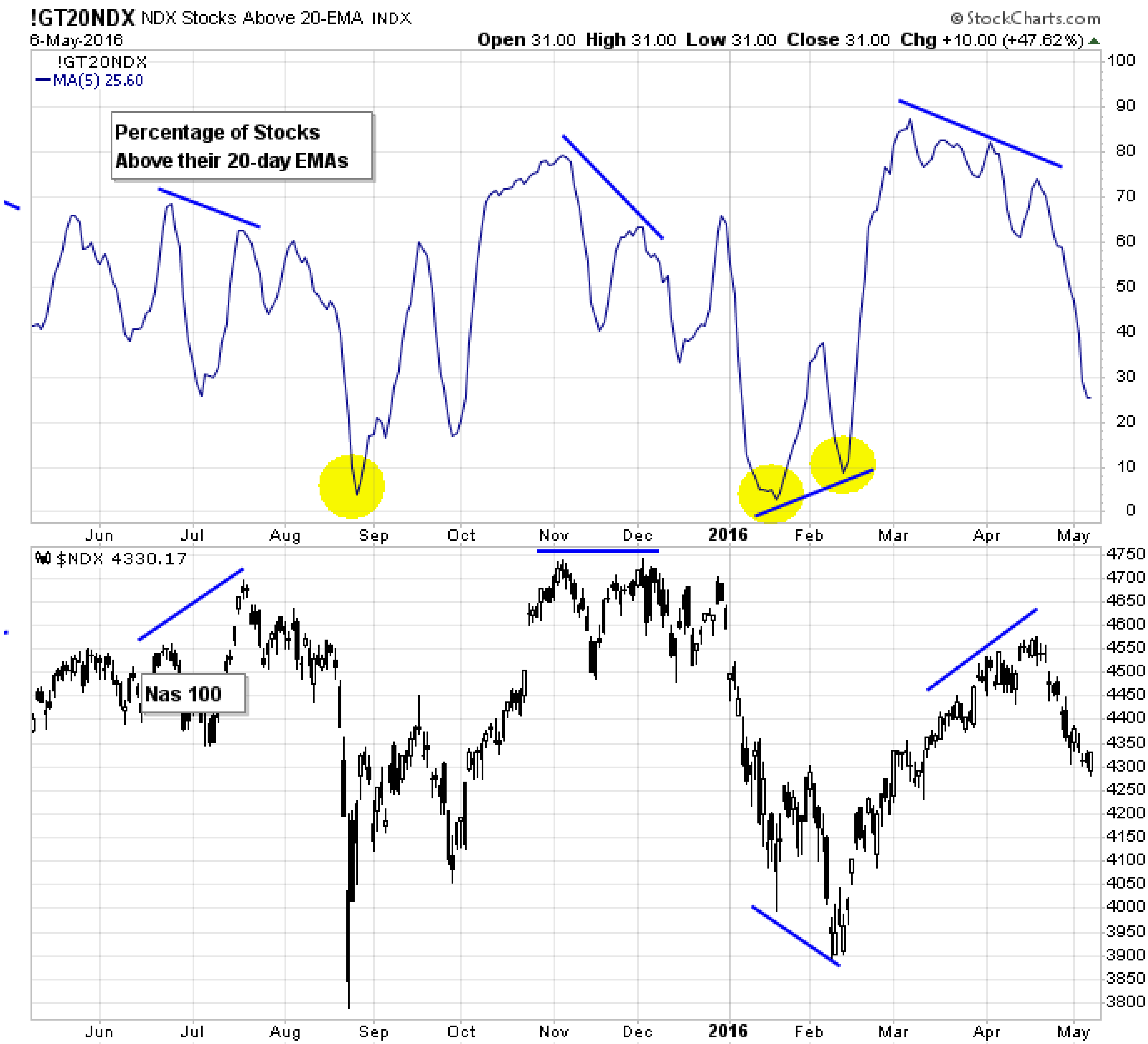


S&P 500 vs. Percentage of SPX Stocks Above 50-day MA: The percentage of SPX stocks above their 50-day moving average put in a negative divergence in mid April and continues to head south. Bounces can happen quickly - that's exactly what we'll want to see if the market attempts to rally next week.

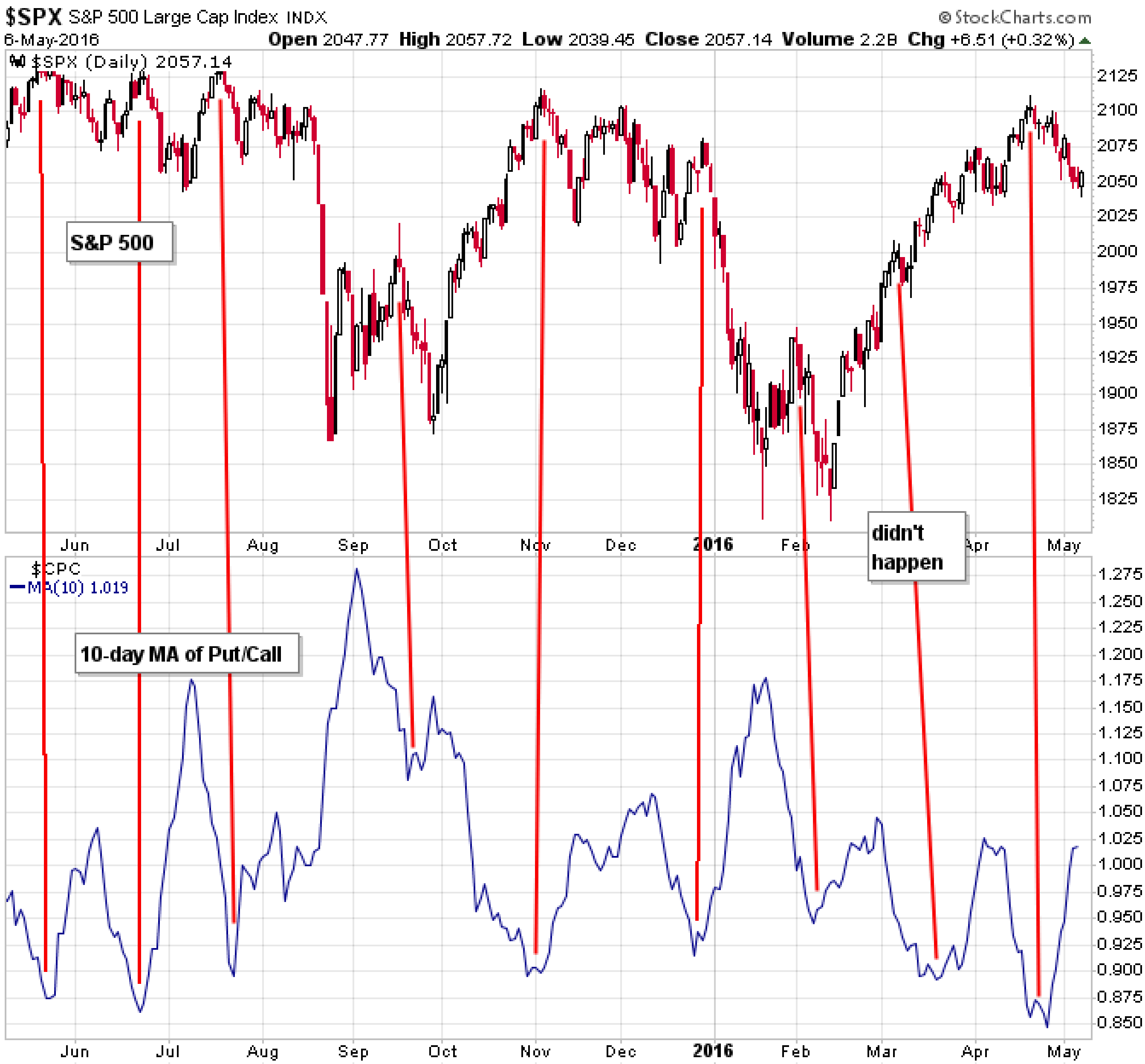
S&P 500 vs. Percentage of SPX Stocks Above 20-day MA: The S&P is 20 points below its 20-day EMA, so there's no surprise only 43% of SPX stocks are above theirs. This indicator is very prone to sudden moves in both directions, so any rally attempt next week must be accompanied by a quick reversal here.



Nas 100 vs. Percentage of NDX Stocks Above 20-day EMA (smoothed with a 5-day): Divergences between the Nas 100 and the percentage of Nas 100 stocks above their 20-day EMAs have been pretty good pin-pointing reversals. If you're looking for a bounce right now, it'll happen without a divergence or a washout. This indicator has fallen but hasn't fallen enough to suggest longs were dumping at any price.



S&P 500 vs. 10-day MA of Put/Call Ratio: More times than not tops in the put/call tend to closely correlate with market bottoms. Now we look for the reverse. If Friday's strong finish is the beginning of a bounce, we'll want to see the PC roll over.



The Bottom Line

The S&P 500 rallied almost 17% off its February bottom, and as of last week's low, had fallen 3.5% off its high. Not exactly a massive pullback.

The market seems to be at an important level...possibly an inflection point.

Many indicators have fallen enough to support a bounce, but none have fallen enough to suggest pain was felt and bulls were running for the exits.

From this level, I can see rallying (and you know rallies tend to last longer and go further than anyone expects) or a downside air pocket being hit and the indexes heading south for several days of intense selling.

My bias is to the upside. I slightly favor a bounce here but will be very quick to abandon my view if I'm wrong.

I'm not sure this is a good time to dig in and defend a position. Be open-mined. Be flexible.

Have a great week.

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