Leavitt Brothers

Weekly

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To the surprise of almost the entire world, Great Britain has voted to leave the European Union.

The EU is a 28-member block that enabled people, products and services to flow freely between member states. Laws and policies were adopted, and in some circumstances, the block negotiated treaties, business transactions, etc as a whole instead of as individual countries. It was not the United States or Europe, but each country did lose some of its sovereignty.

The formation of the block can be traced back to the 1950's - not long after the end of WWII. It has evolved, and many new member states have been added since its inception. There were benefits to membership but also drawbacks.

Great Britain decided by a 51.9/48.1 vote that drawbacks were too great, and they were going to leave the block.

This is a big deal. In fact I'd say it's a huge deal. It's much bigger than the Fed tinkering with interest rates or other monetary policies that are temporarily put in place. In fact I'd even argue it's bigger than the presidential election in the US. Checks-n-balances in the US limit a president's power, and whoever is president may only hold the office for four years. But leaving the EU? I'm not going to call it permanent, but with regards to how long we can realistically look to the future and plan, this will be in place for several decades. I don't know where it ranks with the fall of the USSR or the Berlin wall, but it's up there in that realm.

Great Britain will be just fine on its own - even if Scotland votes for independence, which is very possible considering the country overwhelmingly voted to remain in the EU. It's has the 5th largest economy in the world; it's a military power; it's a diplomatic juggernaut; and it will remain Europe's bridge to the US. They will be fine, even if they do have a recession in the near term, and the divorce is a little messy.

The bigger risk, the bigger fear, is the entire EU unravels. There are many countries that "put up" with their membership and aren't exactly thrilled to be there. Who's next? Will Italy leave? Will France leave? There are already people in numerous countries calling for a similar referendum.

If Britain's exit is isolated, things will get a little messy, but overall it will have virtually no effect on the rest of the world. But if the entire EU dissolves, a major structural change will take place - a change that hasn't happened since WWII.

I'm not an economist, and I don't have knowledge and understanding of geopolitics that you don't already have. I'm not going to pretend like I do. I can, however, look at how markets around the world reacted.

The Asia/Pacific region suffered stiff losses, but they weren't extreme. Japan, which dropped almost 8% and was halted at least once during its trading session, posted what would be considered a very noticeable loss. Otherwise most other countries dropped 1-3%, and it's notable China only fell 1.3%.

Europe suffered much bigger losses. Greece got destroyed (down 13.4%). The country is on life-support. I'm sure there's speculation if the EU unravels, perhaps the eurozone (a monetary union of 19 of the 28 EU members) would follow. Spain and Italy, countries that have been speculated to be following in Greece's footsteps, dropped more than 12%. After that, Germany and France suffered 7-8% losses. Most of the rest of Europe dropped 3-6%. I find it interesting the biggest losers where the strongest countries (Germany, France) and the weakest countries (Greece, Spain, Italy). It's also worth noting the UK only dropped 3.2%.

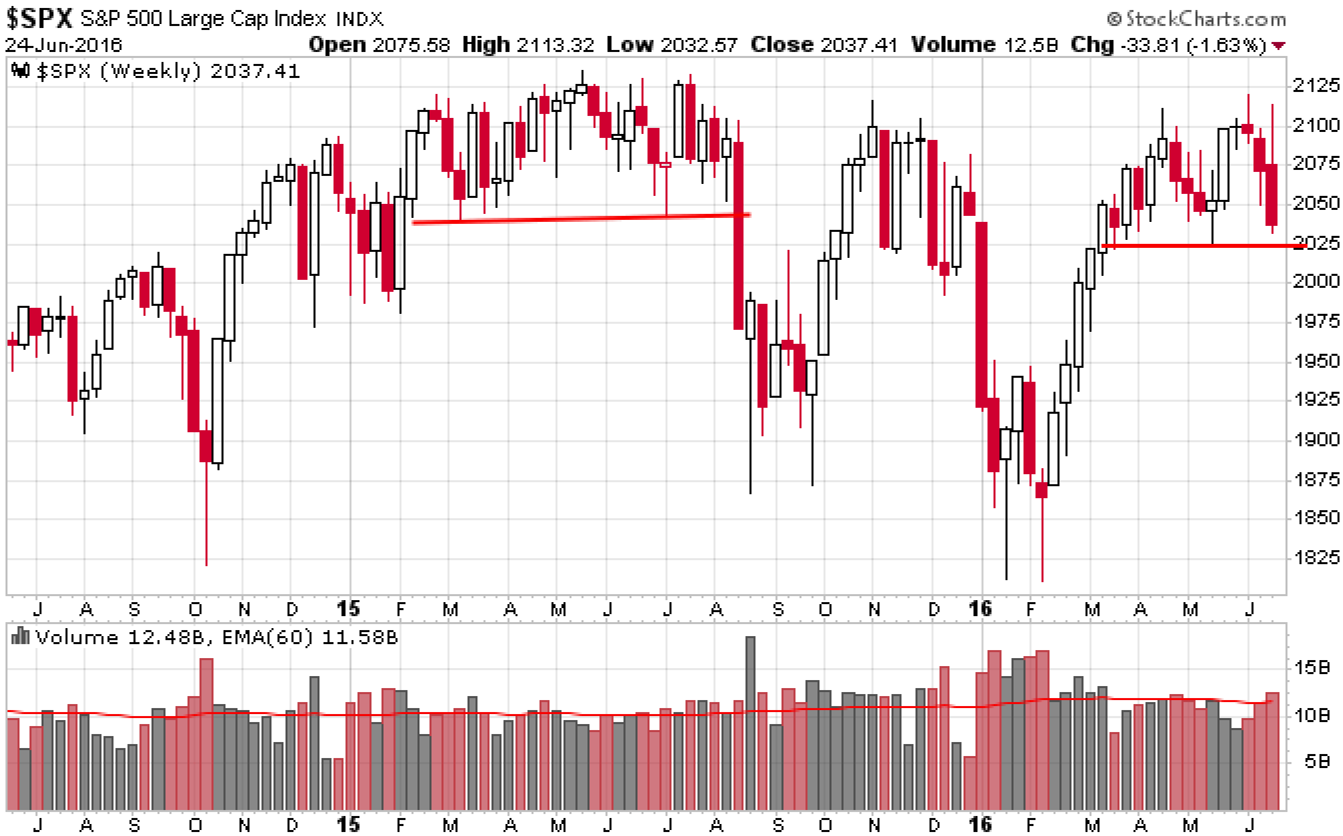
The US suffered its biggest loss of the year. It was bad, but it wasn't catastrophic. Considering S&P futures went limit down on Thursday night and were halted, to post a 3% loss isn't horrendous.

News can come out this weekend that other EU countries will have their own referendums. If so, the market could tank again Monday. But absent these types of headlines, I think it'll be back to business as usual in the US. This really shouldn't affect us too much. Despite comments from Obama prior to the vote, the US and UK will continue to have a great relationship on many fronts. In the long run I don't think the vote changes anything. But we don't trade in the long run (looking out several years). We're mostly looking out several weeks and months.

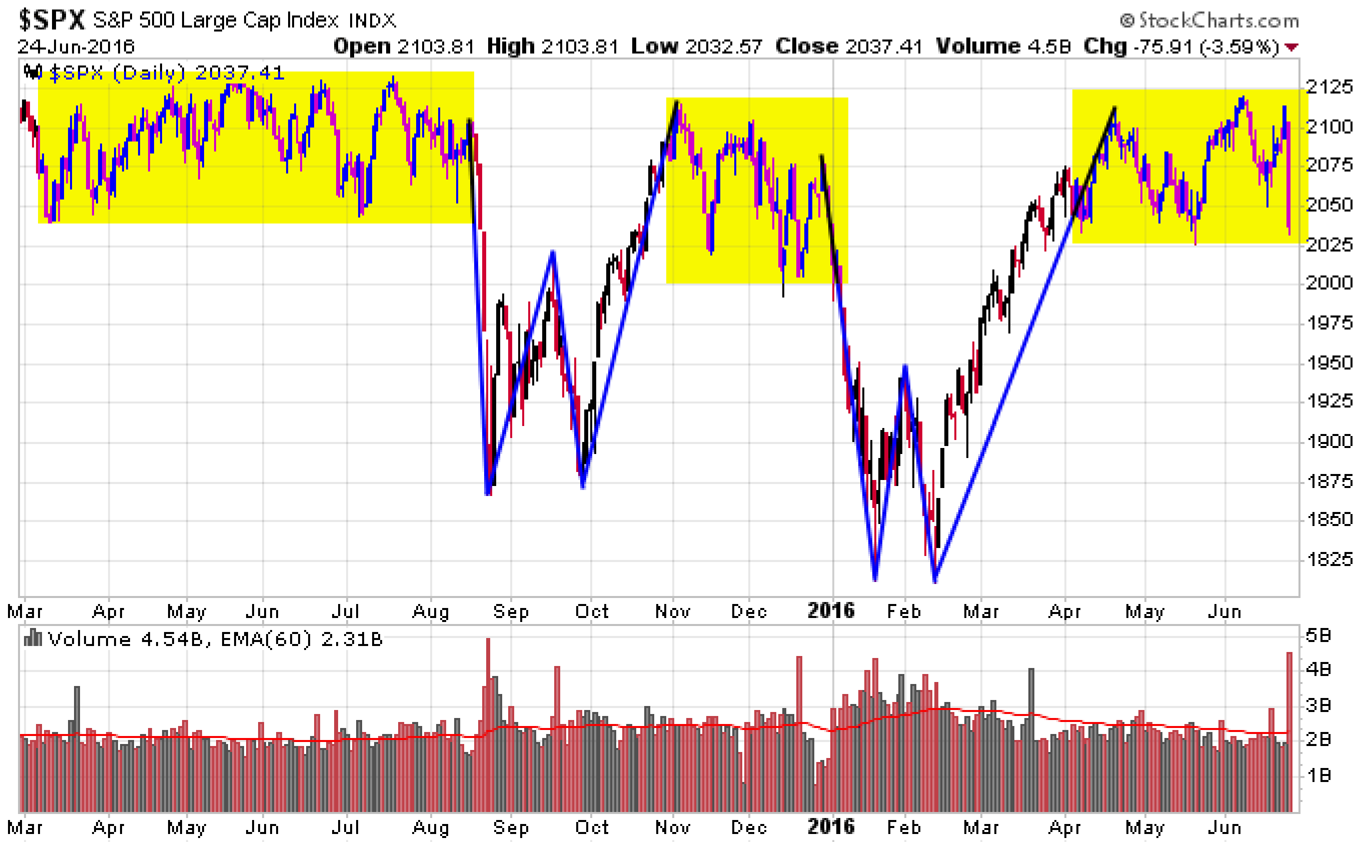
Let's get to the charts and see what they say. How much damage did Friday's drop do?

Indexes

The S&P 500 Weekly: Three weeks ago the S&P pushed to a higher high, but the gains didn't last. Another attempt rally attempt was made last week, but it didn't last either. Now we have three consecutive down weeks and two long tails on the weekly candles. Overall I still consider the market to be in consolidation mode. In fact other than a few brief ups and downs, it's been in consolidation mode for 18 months.

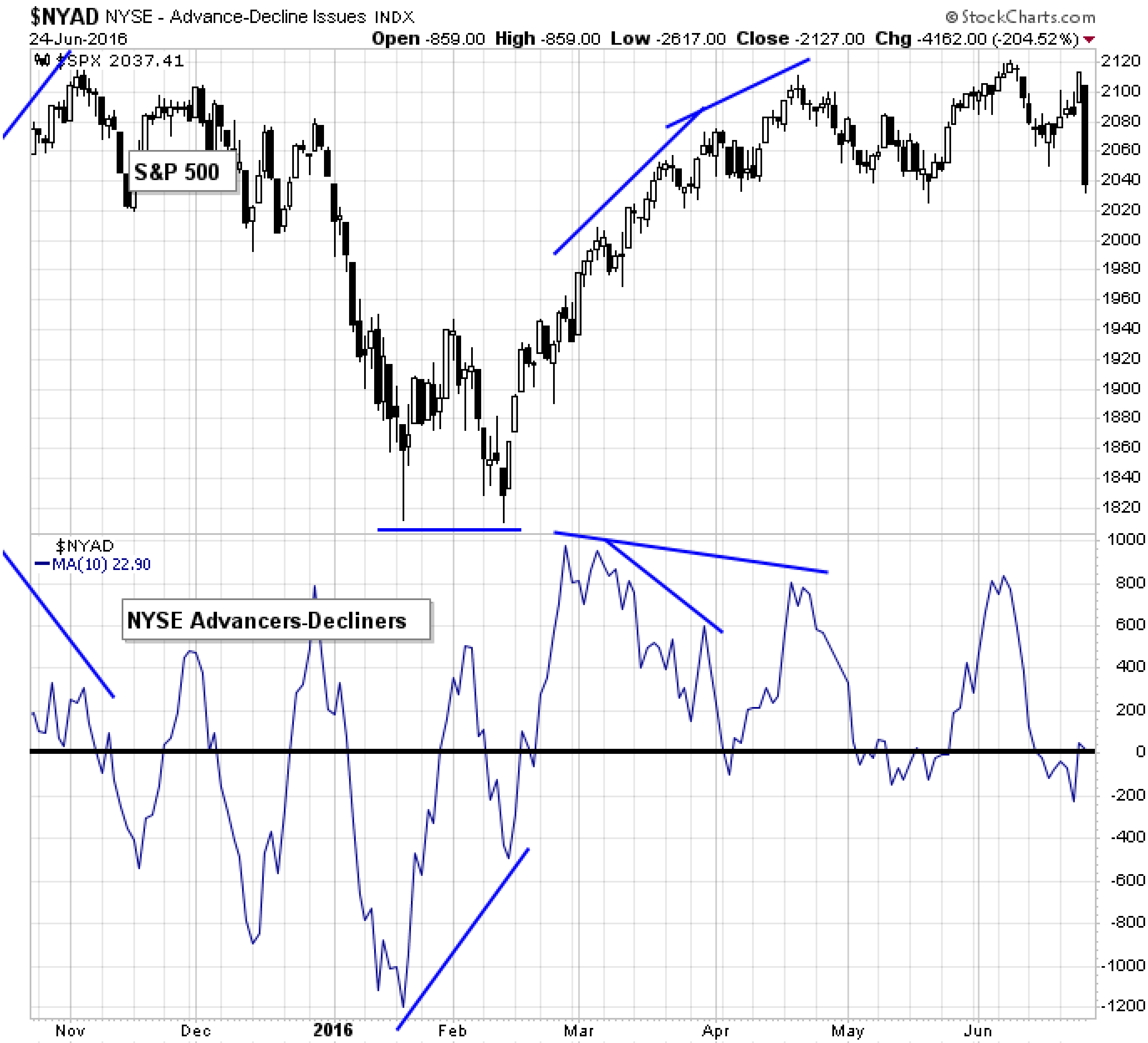


The S&P 500 Daily: Despite Friday's big move down, the S&P remains range bound. And the sharp move down isn't anything new. It happened both during the November/December consolidation and last summer. But there is a little sense of urgency right now. The bulls have their backs against the wall, and we're more likely to see negative news headlines than positive. I've said for a week to scale back and limit exposure ahead of the Brexit vote. If you did that, you're in good shape. Now we have to let the dust settle.



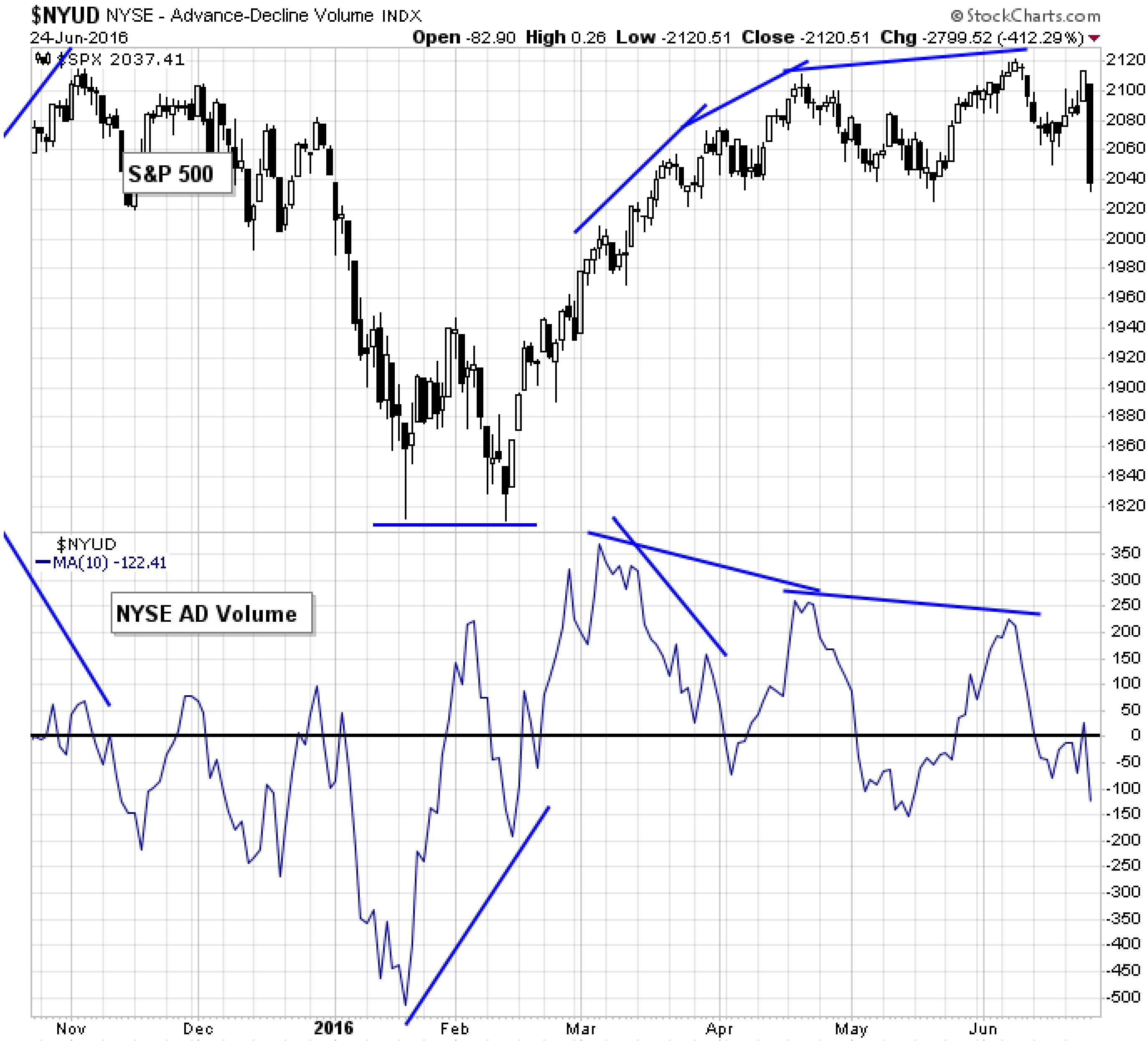
Indicators

S&P 500 vs. 10-day MA of NYSE AD Line: It's going to take more than one big down day to tank the 10-day MA of the AD line, which has been neutral the last two weeks. And besides, this indicator doesn't tell us the severity of the situation. Whether a stock closes down 1% or 3% doesn't matter; there is no additional downside pressure on the indicator due to the greater loss. For now this is neutral and salvageable (it's the 10-day MA for a reason; it supposed to step back and give us a slightly bigger picture while not weighting an individual day too much).



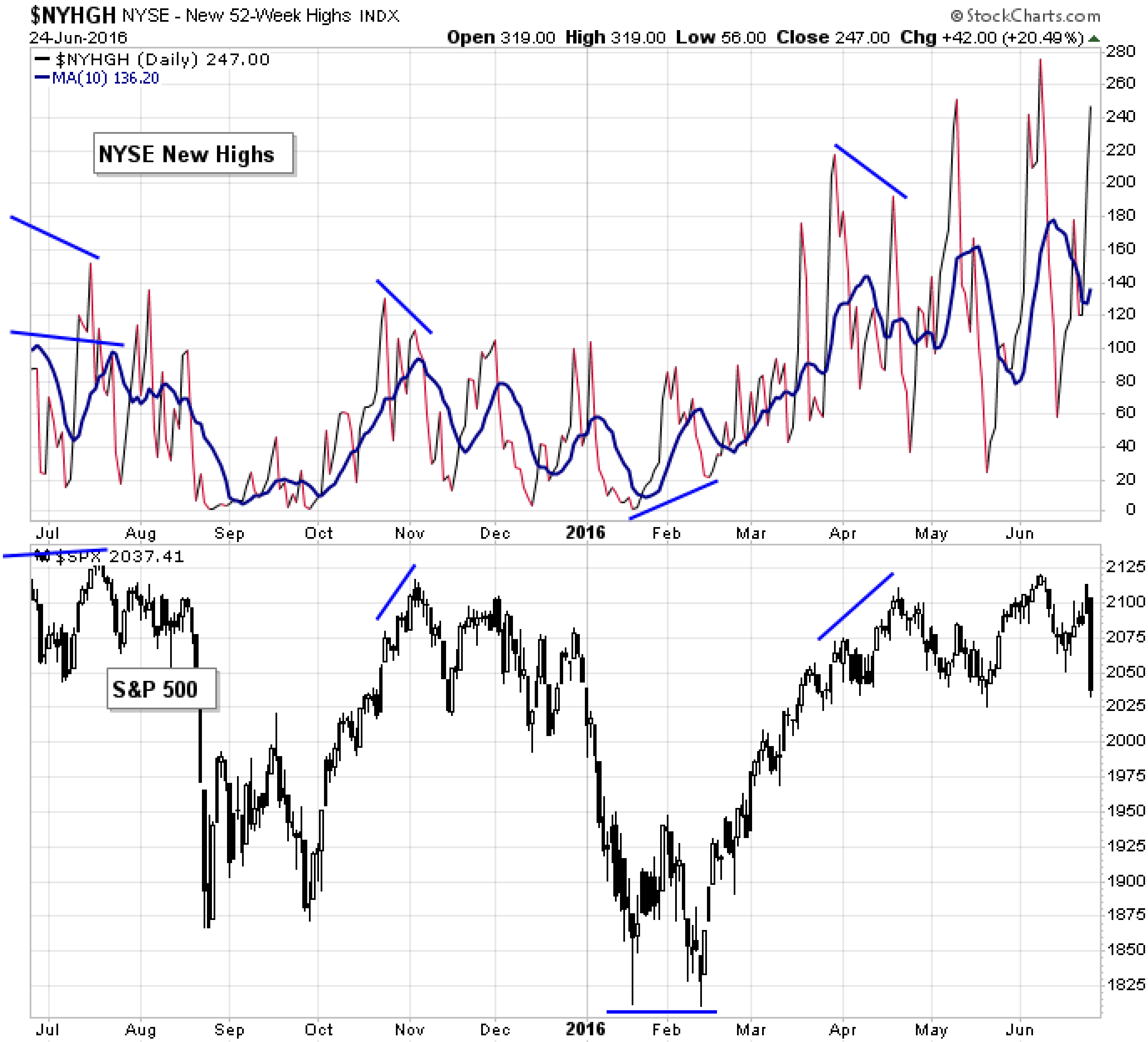
S&P 500 vs. NYSE Cumulative AD Line: The cumulative AD line remains in great shape. It will take more than a single big down day to reverse the strong trend. Unlike last summer when the indicator trended down, there are no warnings here. As long as there isn't additional fallout from the Brexit vote, this indicator tells us the market is pretty strong internally.

S&P 500 vs. 10-day MA of NYSE AD Volume Line: Like the AD line, the AD volume line has been somewhat neutral lately, and it'll take more than a single down day to change this. This doesn't mean I'm super bullish; it just means this indicator is doing just fine, and barring a repeat of Friday, the market has the internal strength to absorb the bad day.

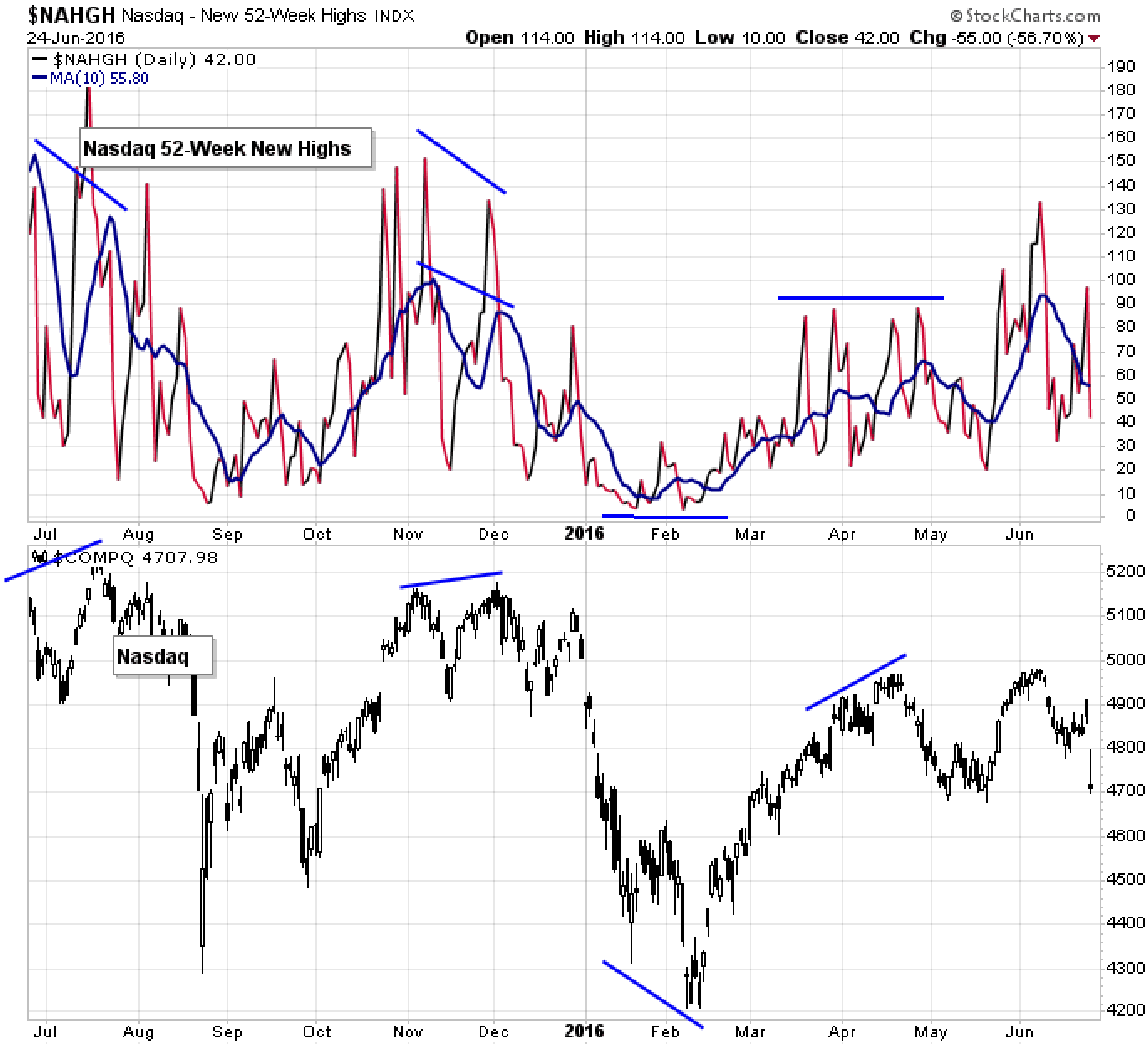


S&P 500 vs. NYSE Cumulative AD Volume Line: The cumulative AD volume also remains in decent shape. Typically there's deterioration before a market top forms. If this holds true, even if a top was destined for form here, it'll take some time.

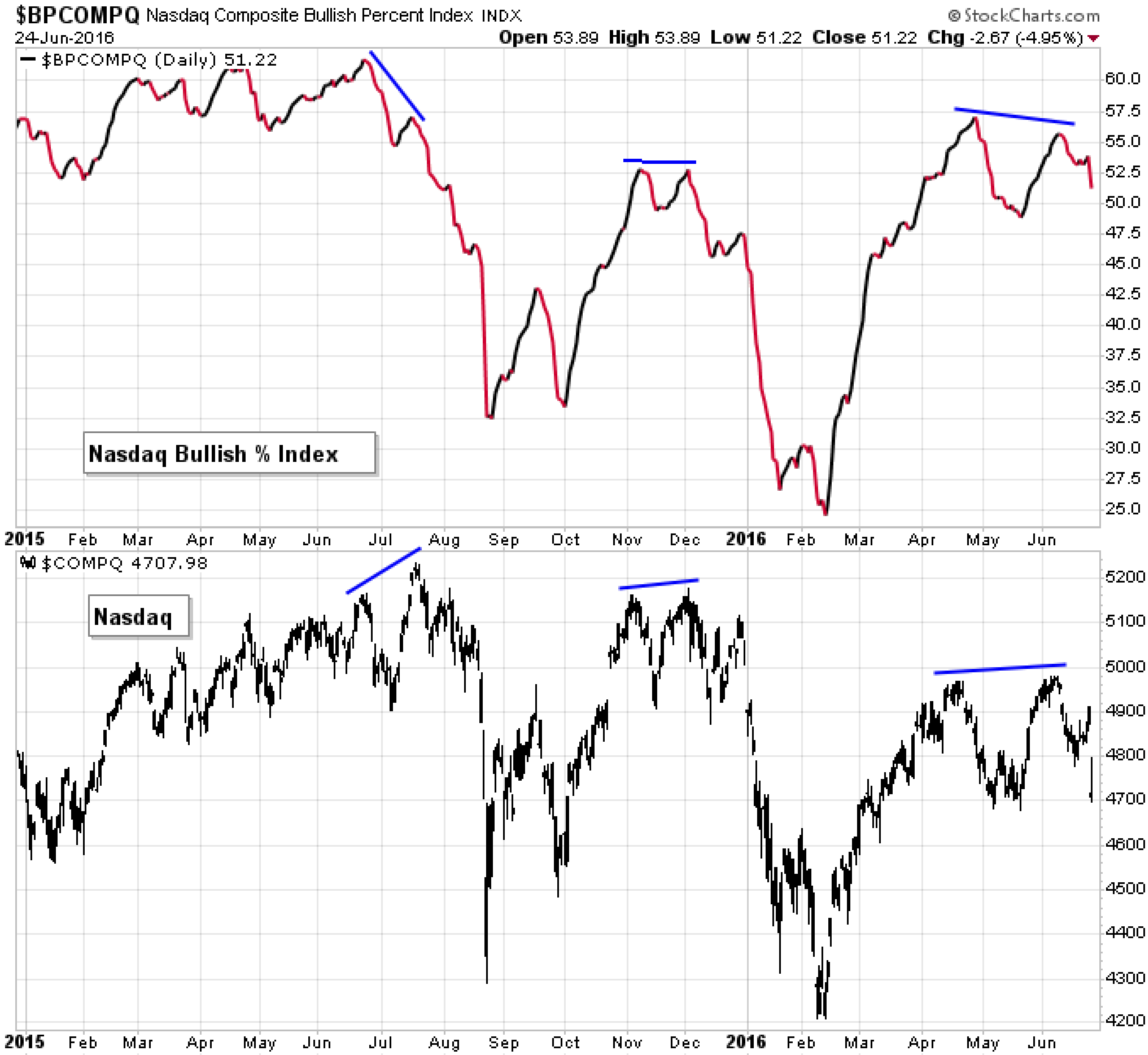
S&P 500 vs. NYSE New Highs: Friday's big down day is notable, but there are no warnings from the NYSE new highs. High highs on both the day-to-day print and the 10-day MA were put in place, and then Friday happened. Per this indicator, the market is doing fine internally. The question is whether bad news will continue to hit the wires...because news trumps the charts.



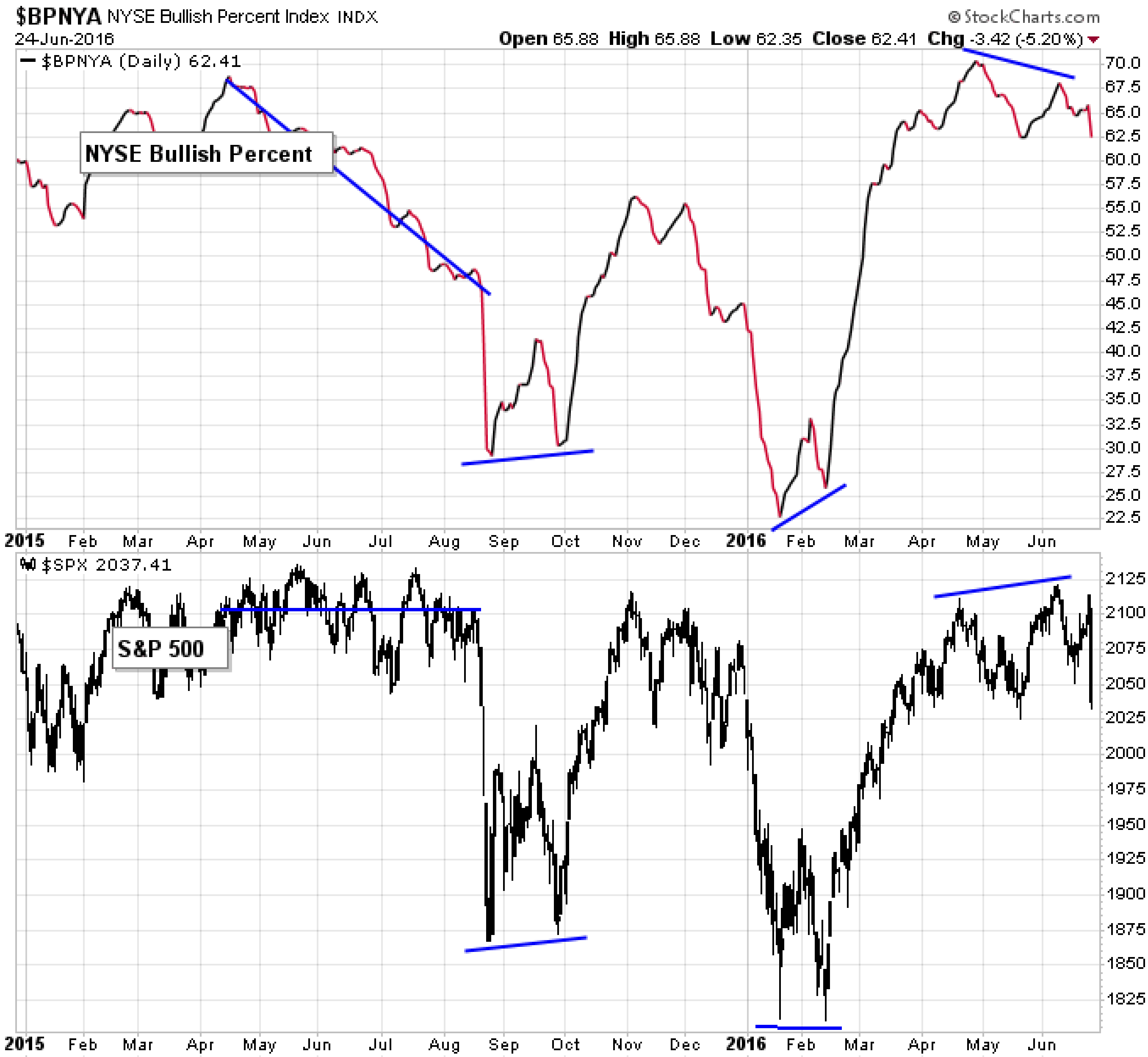
NASDAQ vs. NASDAQ New Highs New highs at the Nas jumped to their highest level since December but has since dropped back into their range. The 10-day is still printing higher highs and higher lows, but the next rally attempt, assuming there is a rally attempt, is likely to produce a negative divergence.



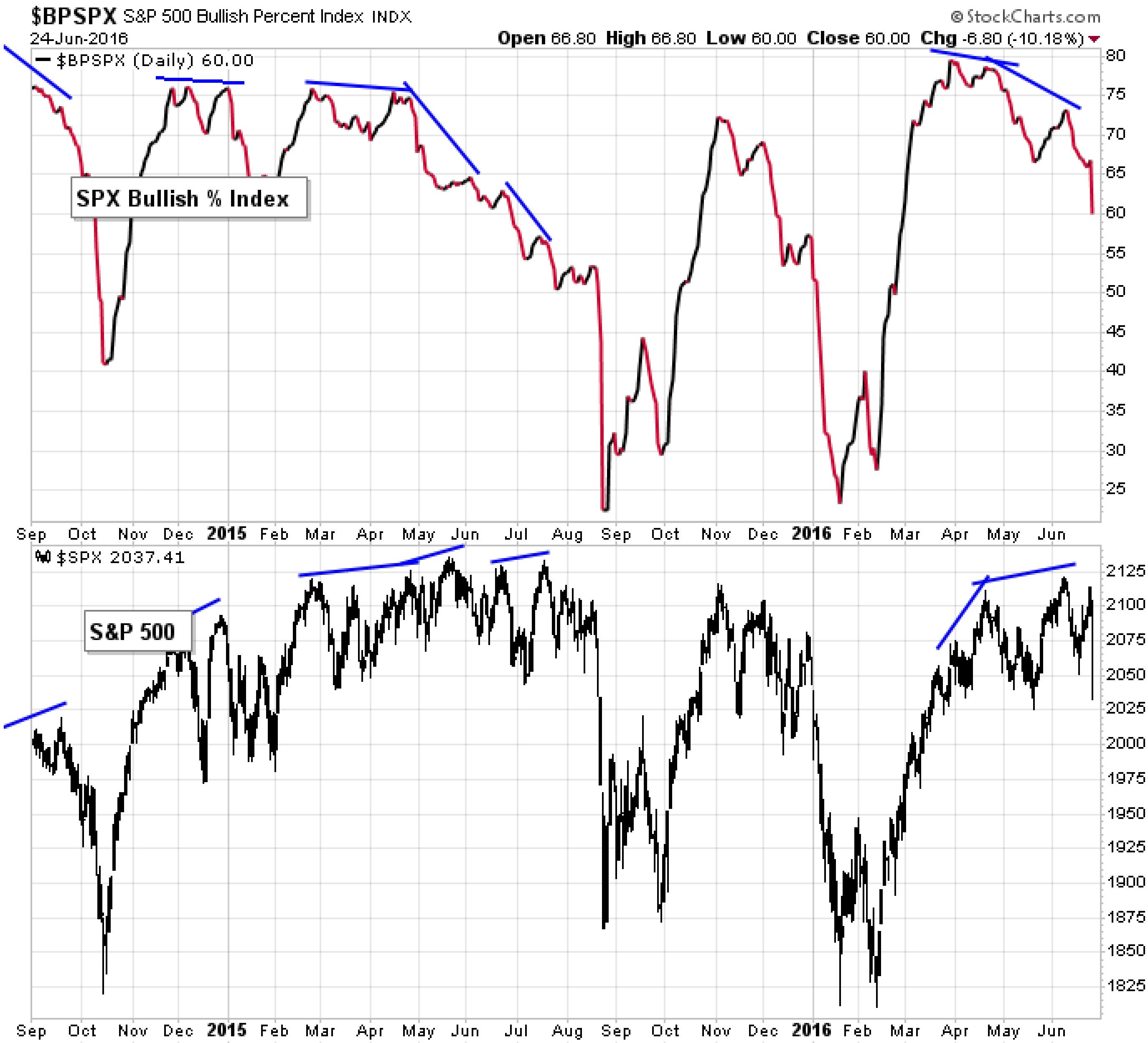
NASDAQ vs. NASDAQ Bullish Percent: The negative divergence between the Nas and Nas bullish percent is still playing out. If the indicator can right itself and hold the May low, the market should hold up. But if it takes out that low, we're likely to get a much deeper correction.



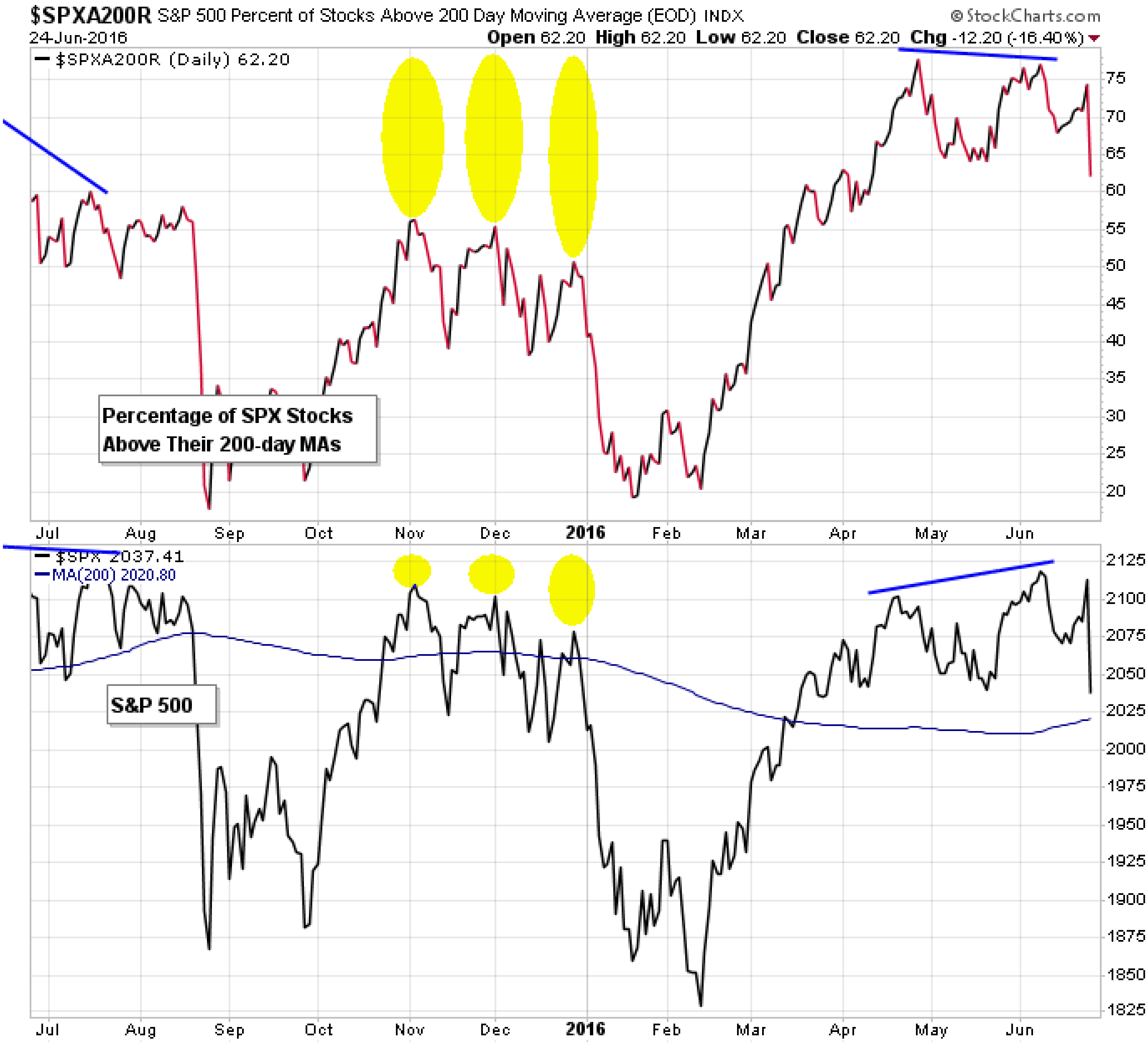
S&P 500 vs. NYSE Bullish Percent: The market is also working off a negative divergence at the NYSE, albeit at a much higher level. Still the bulls want to see the May low hold. Otherwise a mini downtrend will be in place.



S&P 500 vs. SPX Bullish Percent : The S&P bullish percent also did a double negative divergence. Even before the Brexit vote, the warnings were there the market was weakening internally.

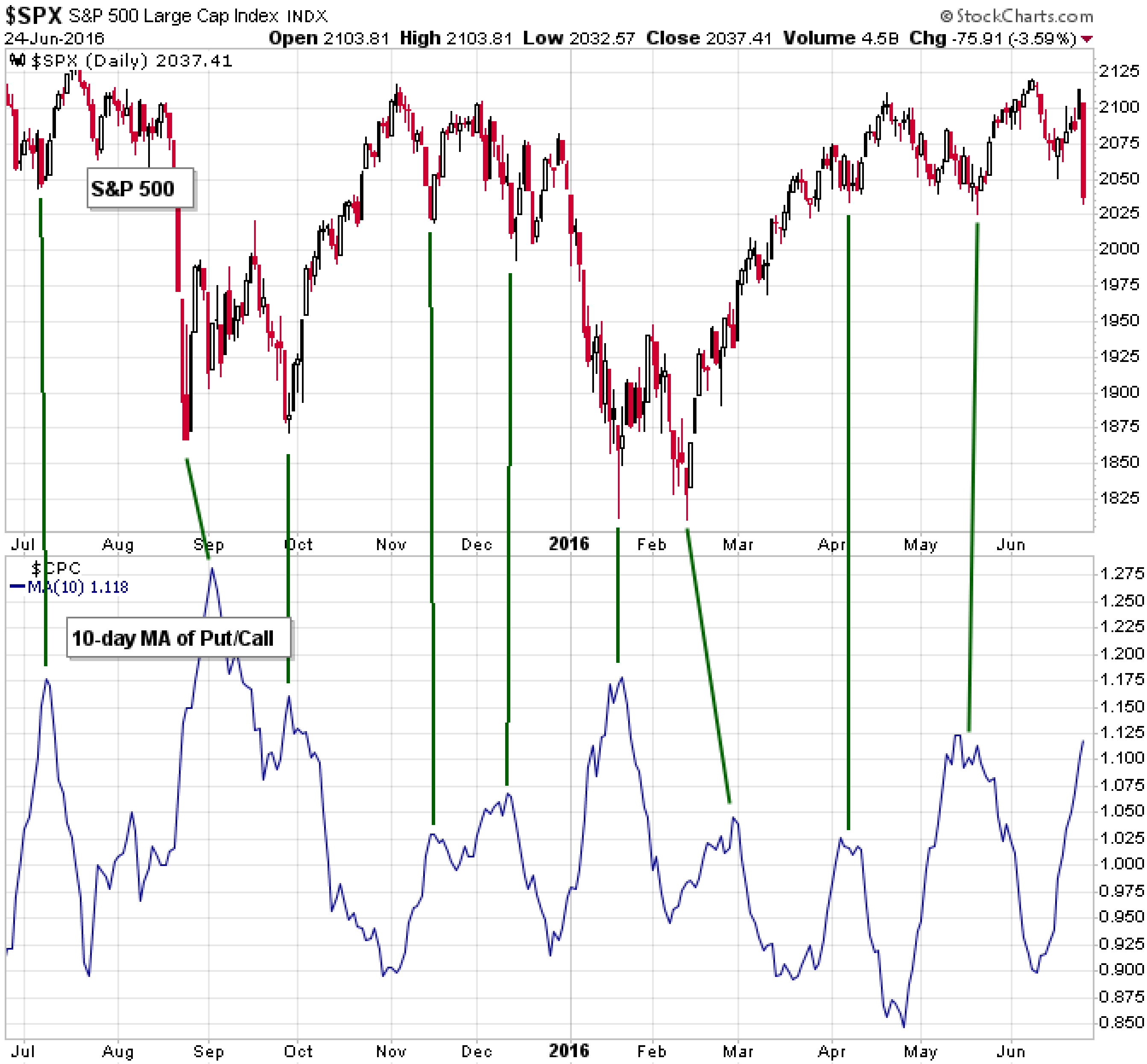


S&P 500 vs. Percentage of SPX Stocks Above 200-day MA: An early-June divergence told us trouble was brewing, and with Friday's big move down, the percentage of stocks above their 200-day MAs has dropped to its lowest level since early April. It's salvageable, and it's acting much better than it did in November and December...but it'll need to right itself quickly. Otherwise Friday is likely just the beginning.

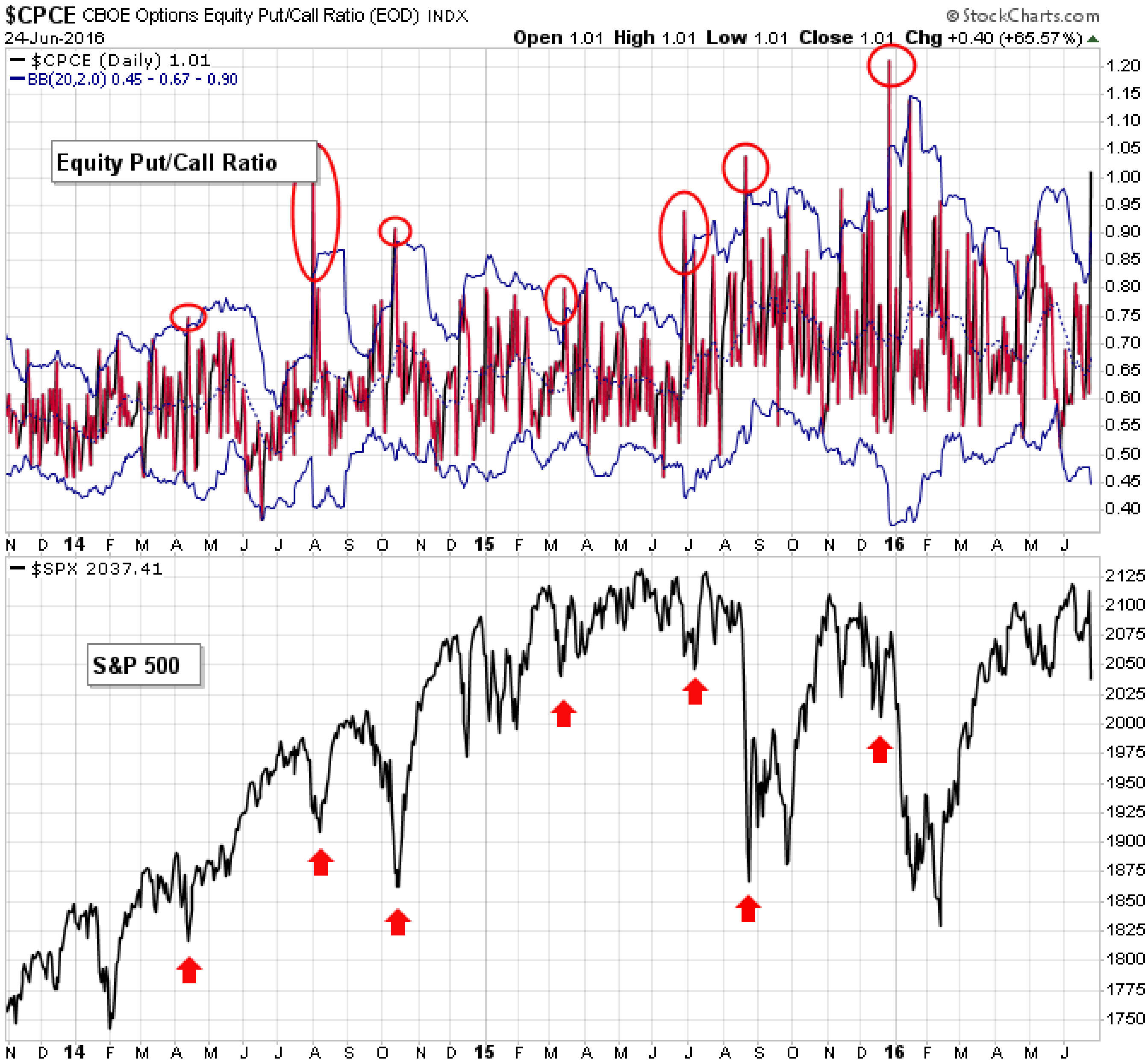


S&P 500 vs. Percentage of SPX Stocks Above 50-day MA: The percentage of stocks above their 50-day MAs diverged from the price action twice and is now at its lowest level since mid February. This indicator has been warning us for almost two months that less stocks were participating. Now it'd be beneficial to get a washout instead of trying to reverse in no-man's land.

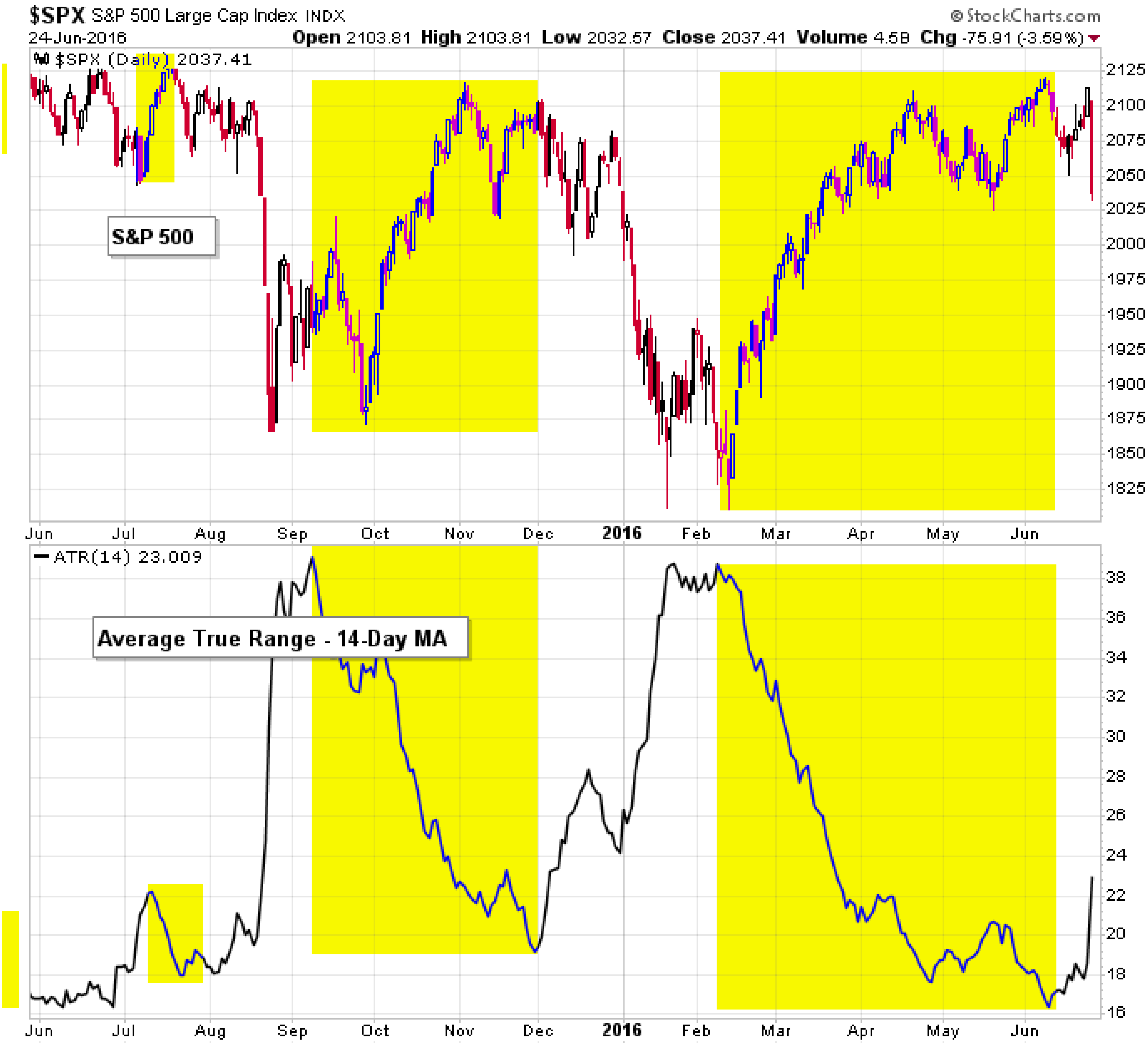
S&P 500 vs. 10-day MA of Put/Call Ratio: Oddly enough, while most indicators didn't hint at the Brexit vote, the put/call stayed in its uptrend, despite the S&P bouncing from 2050 to 2125. This was likely due to investors buying a little downside protection. Now we'll need the PC to curl up to hint a bottom is near.



S&P 500 vs. Equity Put/Call Ratio: With the market tanking Friday, the equity put/call spiked, but previous spikes above the upper Bollinger Band have signaled short-term oversold levels and have led to bounces. The bounces didn't always last long, but they did happen.



S&P 500 vs. 14-day Average True Range: I would have consider the movement of the ATR is be normal for a market that's consolidating within an uptrend, but with Friday's big spike, and the May high taken out, this indicator has suddenly come into play. If the market bounces around in an attempt to digest Friday's loss, but the ATR trends up, the path of least resistance will be down.



S&P 500 vs. VIX: I've warned for two weeks a spike in the VIX while the market calmly trades in a range is a warning. In the past it has led to sell-off 4-6 weeks later. We now have an even bigger VIX spike. If the indicator stays elevated, odds heavily favor a move down.

A Few Extra Charts:

US Dollar: Even though the pound got crushed (biggest single-day drop ever and lowest level since the mid 80's), the dollar only jumped 2.2% and is no higher than it was two weeks ago and last month and back in April. This isn't exactly the flight to safety one might expect - even though Friday's move was pretty big.

Crude Oil: Perhaps in anticipation of a recession and softer demand that comes with it, oil dropped 5.1% Friday. This isn't horrible - oil is still trading in a range - but many oil stocks took even bigger hits. There will be some good buys from this group but not yet.

Gold: Gold, considered a safe-haven in a time of crisis, jumped Friday but didn't bring any new buyers to the table after the gap up (the gap isn't shown here because this chart has pre-market data, but trust me when I say gold closed lower than it opened on Friday). In my eyes, the trend remains. I'm not going to chase breakouts, but I will continue to buy dips.

The Bottom Line

Not only did the market take a big dive last week, several indicators, which had been warning trouble was brewing, dropped to levels not seen in a couple months...and in all cases there's room to move before falling to extreme levels.

If the market was left completely alone, I'd say more downside is coming...and it wouldn't be a bad thing. The charts could reset and build bases that would support the next rally attempt.

But we don't live in a world that is absent major news, and news trumps the charts.

If no news comes out this weekend, it could be viewed as being positive, and the market could have a relief bounce. But if negative news comes out (Scotland wants to leave the UK, or other EU countries are likely to have their own referendums), I don't see the selling pressure subsiding.

Risk is elevated right now. Volatility is likely to remain high. News can hit at any time that drives the market one way or the other. This is definitely not a time you can sit back with some positions and let them go for a few weeks. You'll need to be a little more active

Have a great week.

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