Leavitt Brothers

Weekly

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For three days last week (the market was closed Monday), it was the same old, same old. Wall Street was quiet. The ranges were small, and the activity level was very low. There just wasn't anything going on. All types of stats were circulating as evidence the current volatility reading was historically low. These included: the number of days without a 1% move, the number of days the S&P closed within 1% of its all-time high, and the tightest range over a 2-month period. There were others, and many of them were preceded with "this hasn't happened in 20 years" or "this has only happen 5 times since 1920."

Then Friday happened.

Mario Draghi, president of the European Central Bank (ECB) said interest rates would continue to be held at record low levels, but a decision was made to to refrain from adding any new stimulus. Draghi said the ECB was considering its options, but there were no commitments and no hints of future action. The ECB wasn't taking the punch bowl away; they just weren't going to commit to spiking it more than it already was.

Most of the Asian/Pacific markets posted moderate-to-large losses. Europe followed suit with even bigger drops. Futures in the States pointed towards the biggest gap down since the Brexit vote.

The market was finally going to be jerked awake. After two months of very little movement, everyone who's close to the market was sitting at attention. So much pent up energy. So much pent up anxiousness. What would happen?

The indexes gapped down and proceeded to sell off at a steady pace until the middle of the afternoon when the market flattened out. Then the bottom fell out into the close. Everything finished down and near their lows. The losses were the biggest in two months. The intraday range was the biggest it's been in even longer. The S&P had gotten in the habit of sitting in 10-point daily ranges...Friday saw the index moving 10 points almost every hour.

Friday was shocking, only because it was so different than what Wall Street had become accustomed to.

For the bulls who are fully invested, it's a good thing what took place happened on a Friday because there certainly would have been follow through if it was midweek. There still could be, but it's at least possible the market reverses Monday. Wall Street has a tendency to forget things over the weekend. It also could reconsider and do the opposite on Monday.

Here's my most dominate thought/concern. Here's what I'm wondering.

There's no question the market overdoes things in the near term. There was so much pent up energy heading into Friday as a result of the listless activity the previous two months that it's entirely possible selling begot more selling which begot more selling, and instead of rational minds prevailing, it was sell first and figure things out later. If this was the case, that Friday was just a huge momentum day where the bulls were not going to come up for air until the closing bell, there may not be much follow through early next week. Remember, there was only two days of selling after the Brexit vote.

But what if markets around the world really are addicted to low interest rates and lots of government stimulus to keep things going? And when rates move up and stimulus is pulled back, everything will need to make a big adjustment to the new reality. If this is the case, it's hard to say where the market will bottom in an attempt to make this adjustment. It would be a new normal.

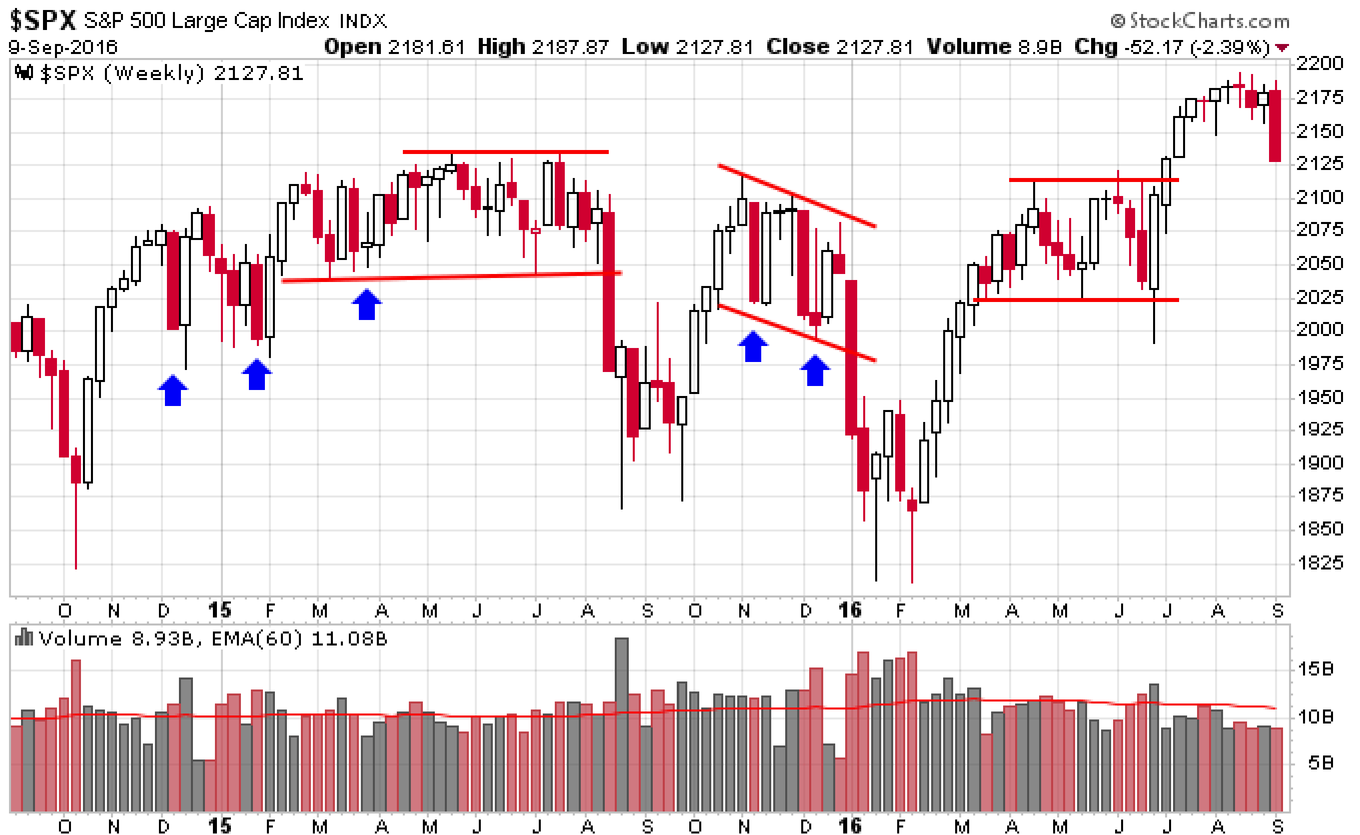
But I'm getting way ahead of myself because governments and central banks are not going to let it happen. If rates are moved up, they'll be moved up very slowly. And if stimulus is removed, it too will happen at a slow-enough pace as to not be extremely noticeable. And if the markets started selling off hard, central banks were certainly halt their activity and possibly reverse course.

Doncha wish the market would move based on how well businesses were doing and not based on decisions made by small groups of people (elected or not doesn't matter)? The market was quietly acting just fine heading into Friday, and a single decision made in Europe sent the S&P down 50+ points. Things can change fast.

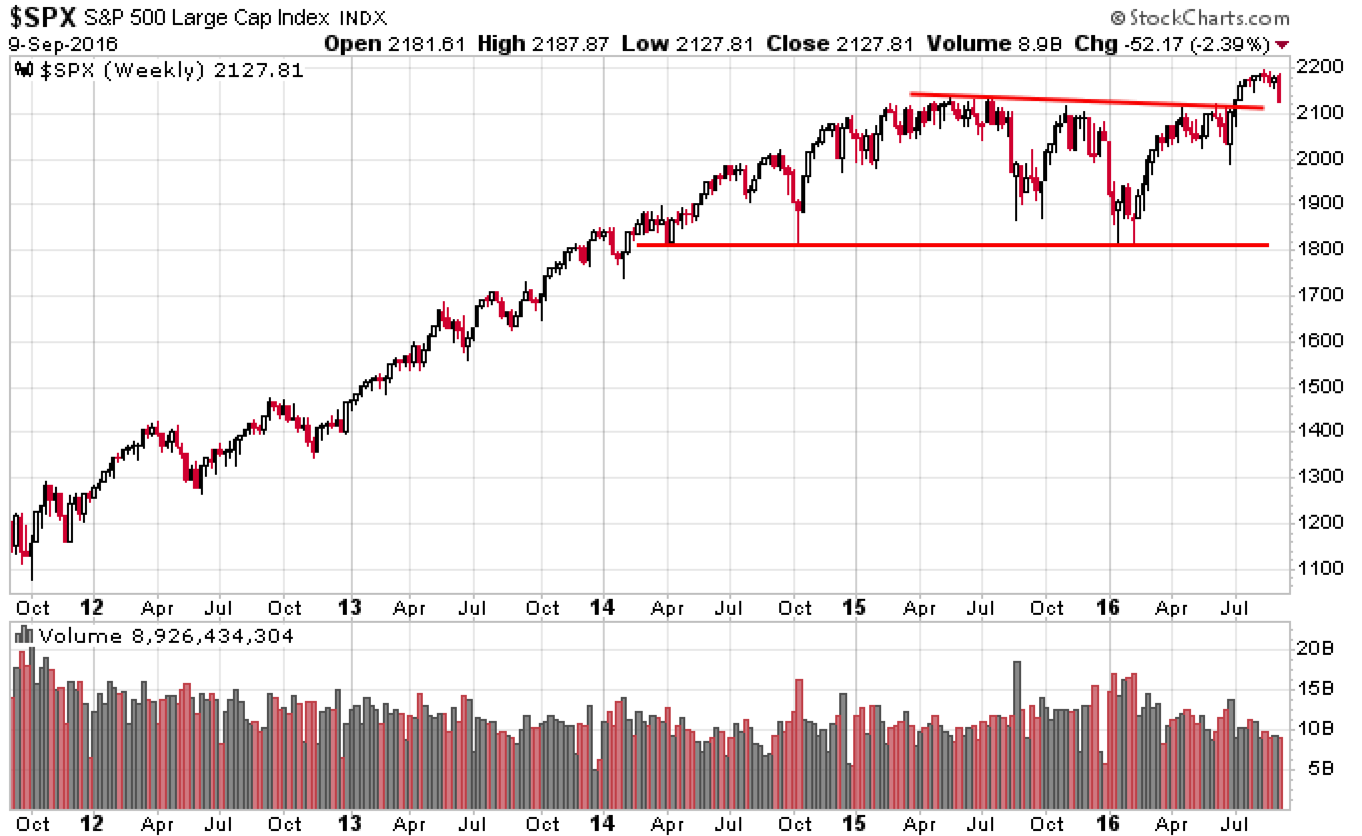
Heading into next week -> continue selling off hard or quickly realize - like the Brexit vote - that the news was not a big deal and the reaction was overdone. Let's get to the charts and see what they say.

Indexes

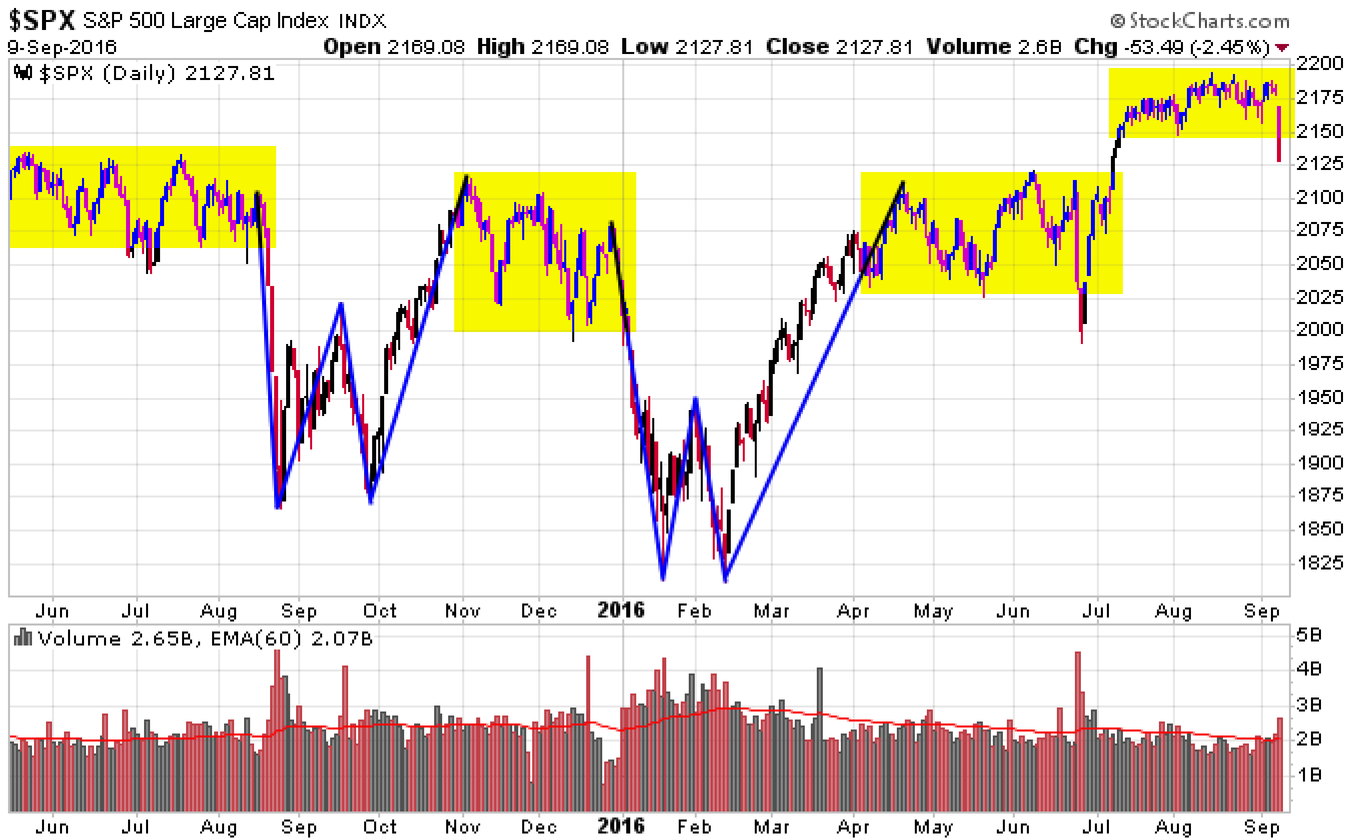
The S&P 500 Weekly: Kaboom! After several small range weeks and no big down weeks, the S&P posted a 2.4% loss. Before we get too frantic, let's remind ourselves there have been many instances over the last two years where big down weeks were either followed by big up weeks or big up weeks were delayed a week. I don't know what will happen next week - last week's candle certainly jerks the market out of its comfort zone - but overall I don't think it's reason to assume anything has changed with the long term.



The S&P 500 Weekly: Here's a zoomed out shot of the weekly. It puts in perspective the breakout and lack of follow through from the 2+ year, 300-point pattern. Traders need to be selective with what they play, but they shouldn't stress too much because the long term remains in good shape.



The S&P 500 Daily: A very quiet market has been jerked awake by a sudden plunge to the downside. It's very reminiscent of the post-Brexit move, which makes we wonder. What's worse for Europe? The UK leaving the EU or the lack of clarity regarding future stimulus? It almost makes me laugh. Was Friday a massive over-reaction? It could have been...but keep in mind over-reactions can last a few days before calmness prevails. Manage your positions wisely. Do not negotiate. But in the back of your mind you should be contemplating the possibility that a bottom will be put in place in the next couple days. If it happens, what will you do?

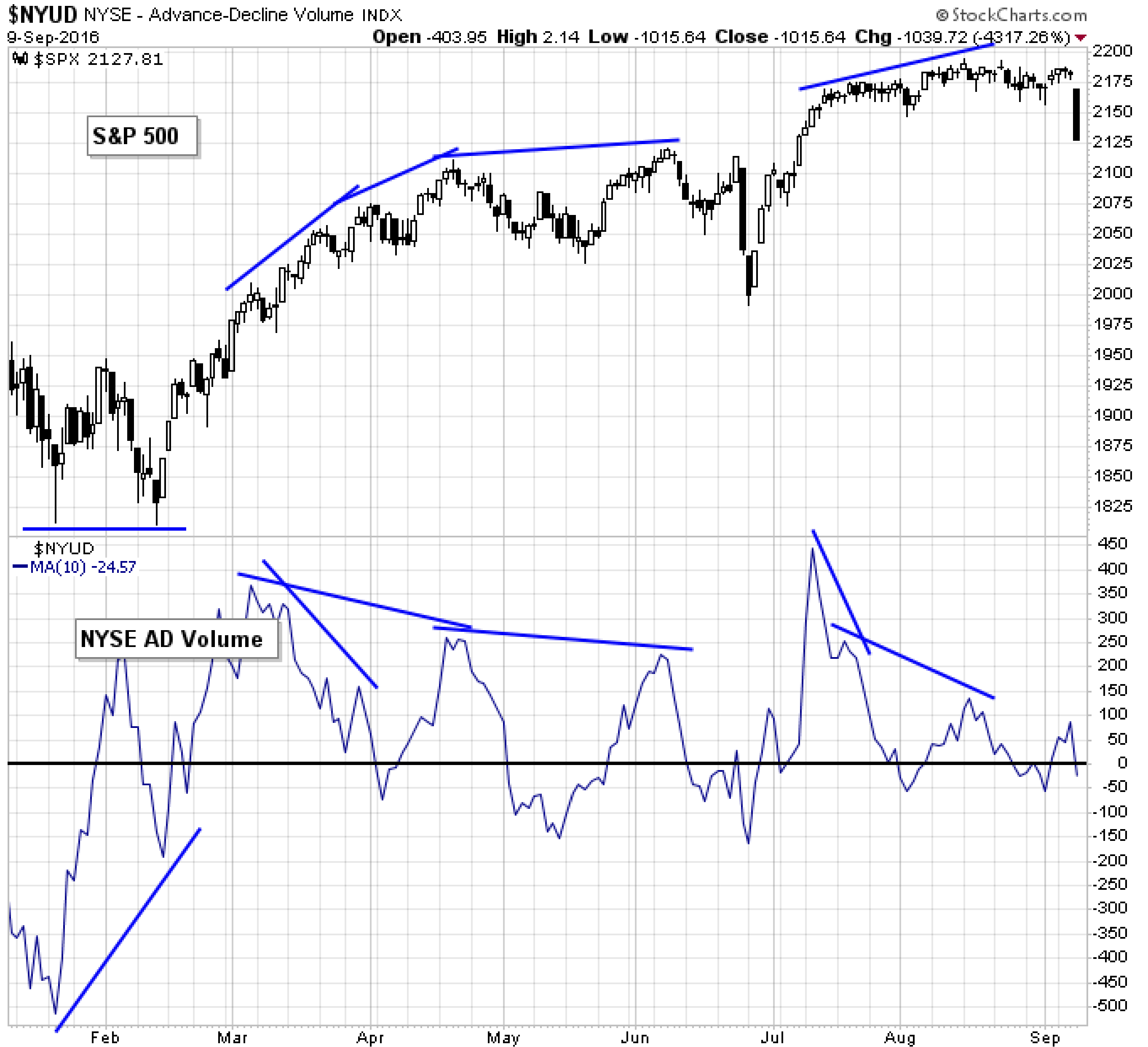


Indicators

S&P 500 vs. 10-day MA of NYSE AD Line: The market had been flat over the last several weeks, and the 10-day of the AD had been flat too. There were no warnings that, from a technical standpoint, a drop was coming. But it happened anyways due to news (news trumps the charts). Going forward, a minor drop below 0 is permissible. A bigger drop - below the obvious lows of the last six months - will lead to more losses and damage that will take time to repair.

S&P 500 vs. NYSE Cumulative AD Line: There were no technical warnings from the cumulative AD line. The strength off the February low has been well supported, so as long we don't get additional follow-on bad news, I would not expect the market to drop much.

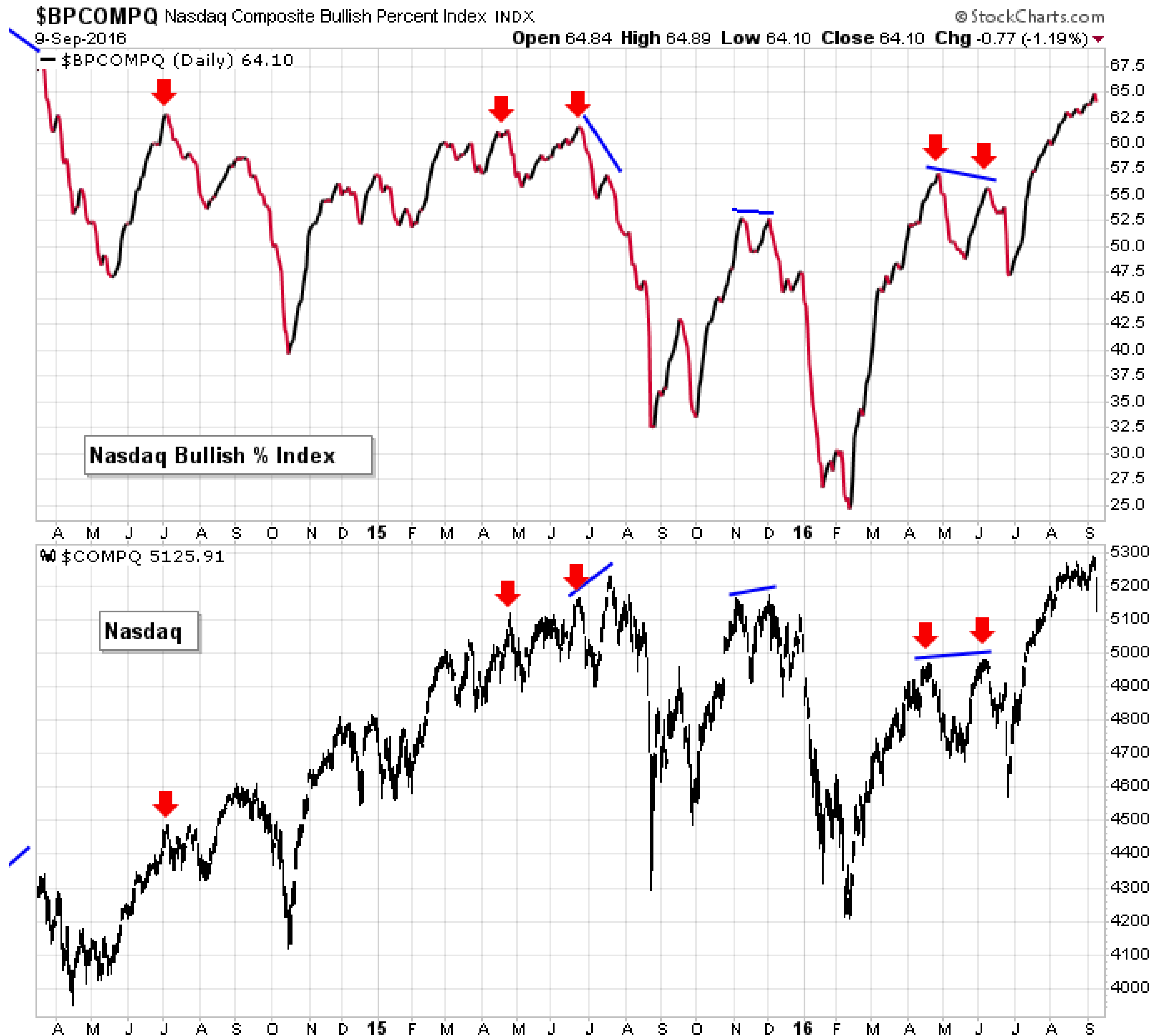
S&P 500 vs. 10-day MA of NYSE AD Volume Line: The AD volume line, which allows high-volume stocks to have more influence, looks very similar to the AD line above. A flat market flattened out this indicator, and there were no technical warnings.



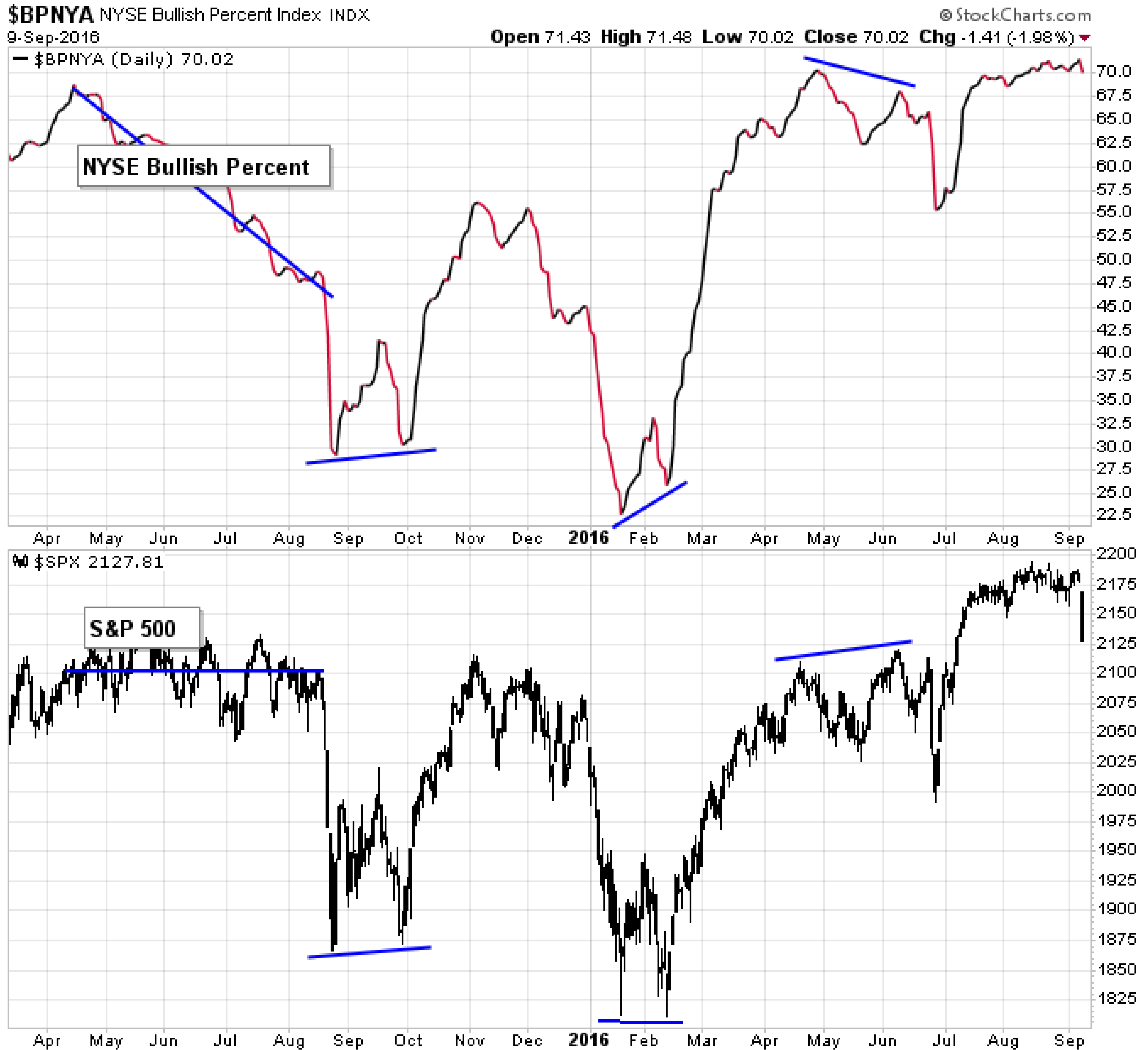
S&P 500 vs. NYSE Cumulative AD Volume Line: The cumulative AD line, which typically trends down or least puts in a lower high before a top is put in place, offered no such warnings. The drop was news-induced, and without more bad news, the market should right itself soon.

S&P 500 vs. NYSE New Highs: Declining new highs have been our radar for two months. I didn't consider it a big concern because the day-to-day prints were still pretty good. The market was flat anyways and not deserving of many new highs printing. Now we look for a spike bottom. Previous lows closely coincided with market lows.

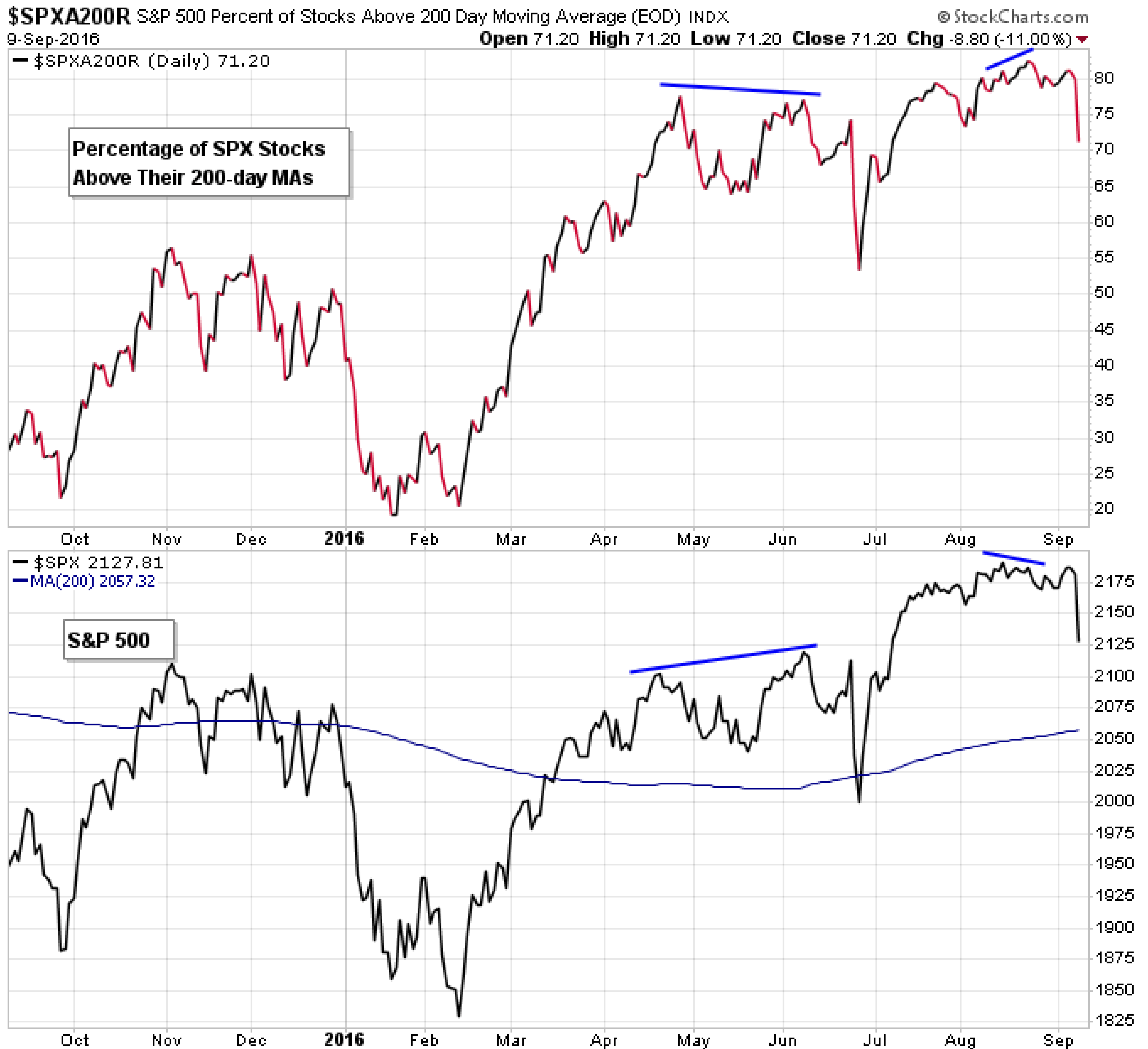
NASDAQ vs. NASDAQ Bullish Percent: There were no warnings of an impending drop from the Nas bullish percent. There was no double top or negative divergence; heck, there wasn't even a single top. Despite Friday's drop, from a technical standpoint, the market is healthy.



S&P 500 vs. NYSE Bullish Percent: No warnings here either. The NYSE bullish percent had flattened out with the market. If beneath-the-surface weakness was brewing, this indicator would have been trending down the last few weeks.

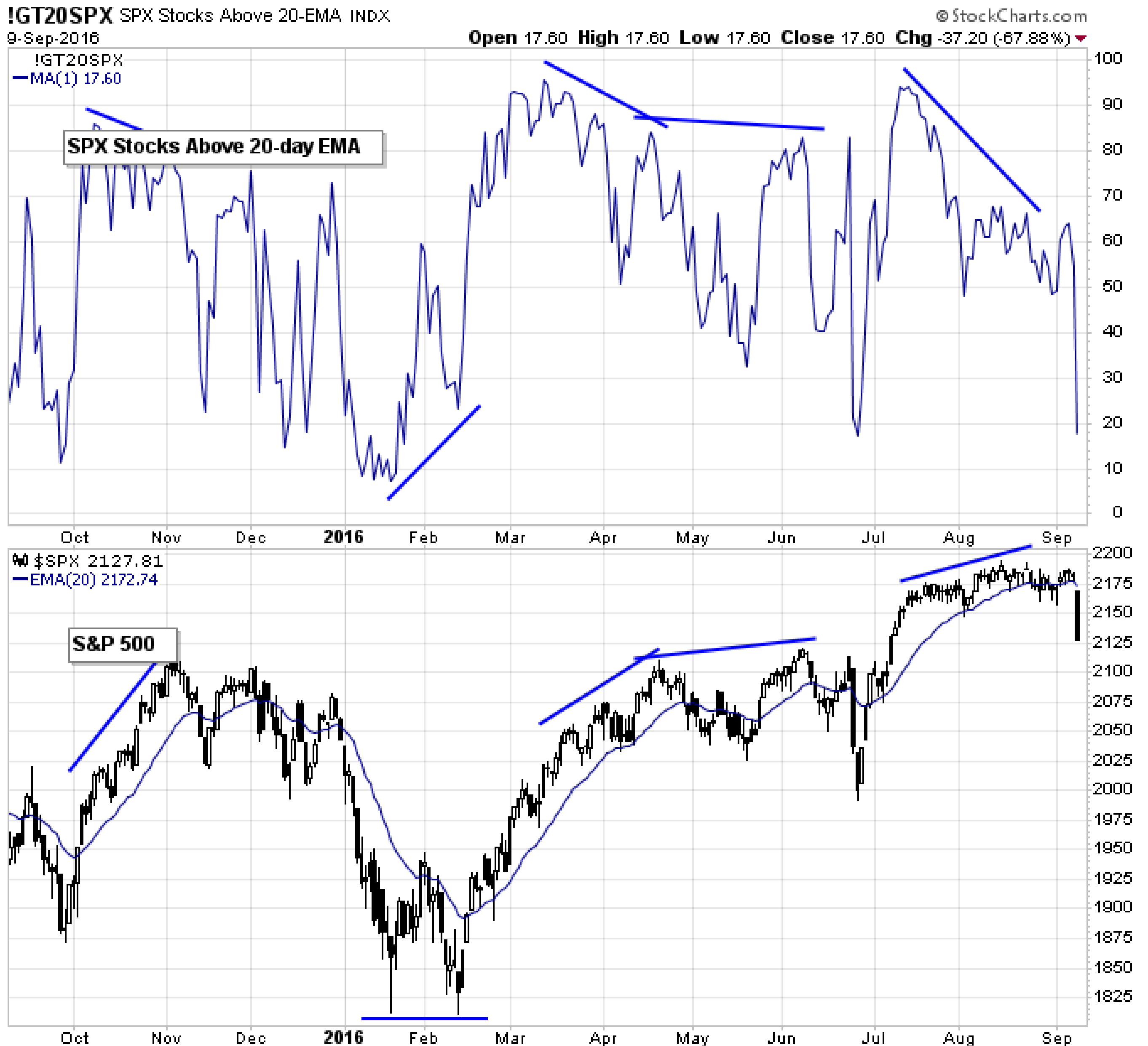


S&P 500 vs. Percentage of SPX Stocks Above 200-day MA: Friday's 53-point SPX plunge dropped the percentage of SPX stocks above their 200-day MAs from 80% to 71%. That's a big drop, but it isn't unprecedented. For now I'd consider it normal, but I'll get concerned if it either continues down without being able to bounce much or if it struggles to get back to high during the next market rally. This latter situation would suggest many stocks suffered during the drop and not all recovered during the follow-on bounce.

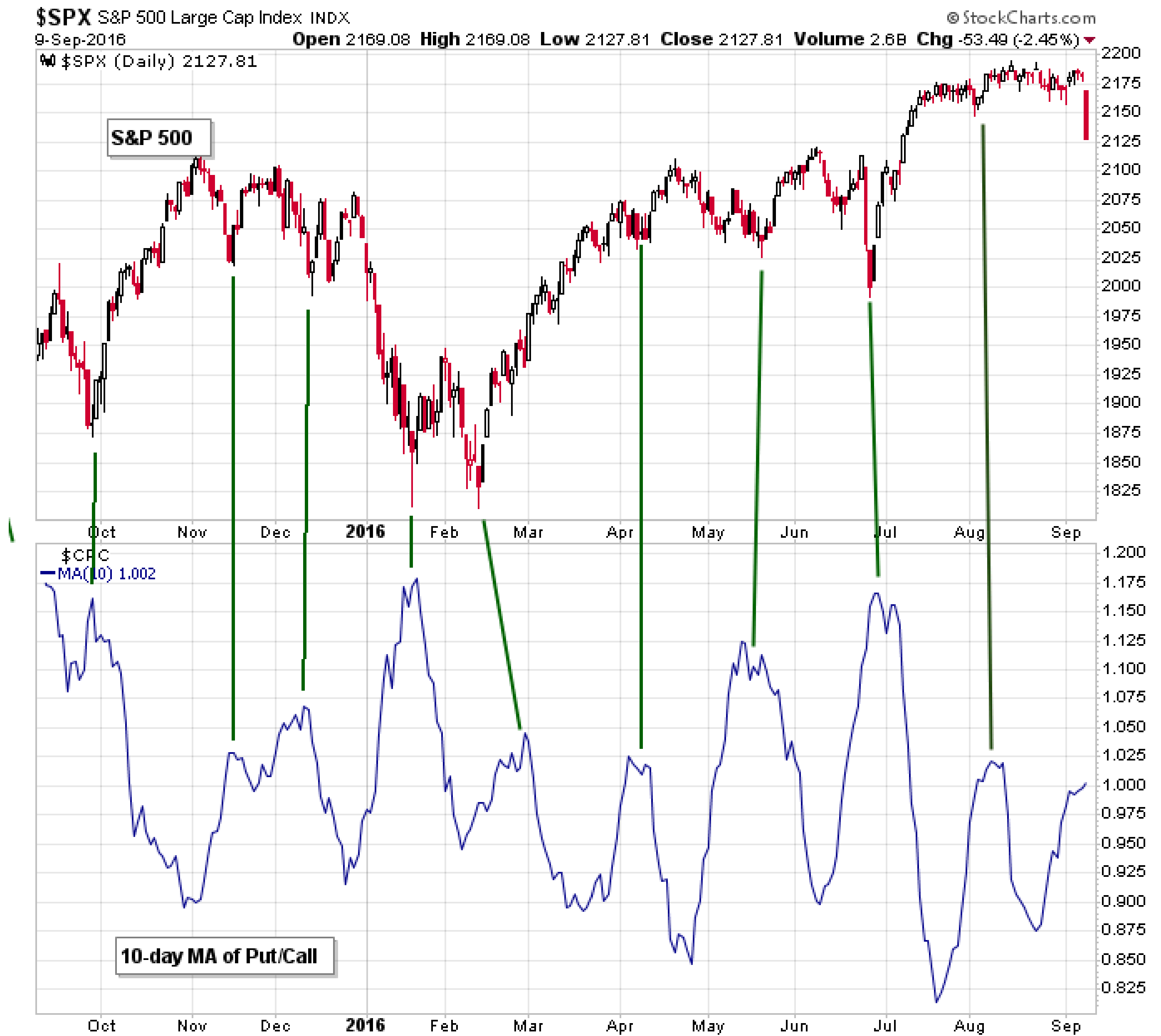


S&P 500 vs. Percentage of SPX Stocks Above 50-day MA: This is the single-biggest warning we've gotten the last 6-7 weeks. The percentage of SPX stocks above their 50-day moving averages has been declining and has shown almost no sign of life. The Brexit bottom was very quick. The January/February bottom required more time and a positive divergence. I can't say one is more likely than the other. But I will say the indicator could easily drop more before truly being oversold.

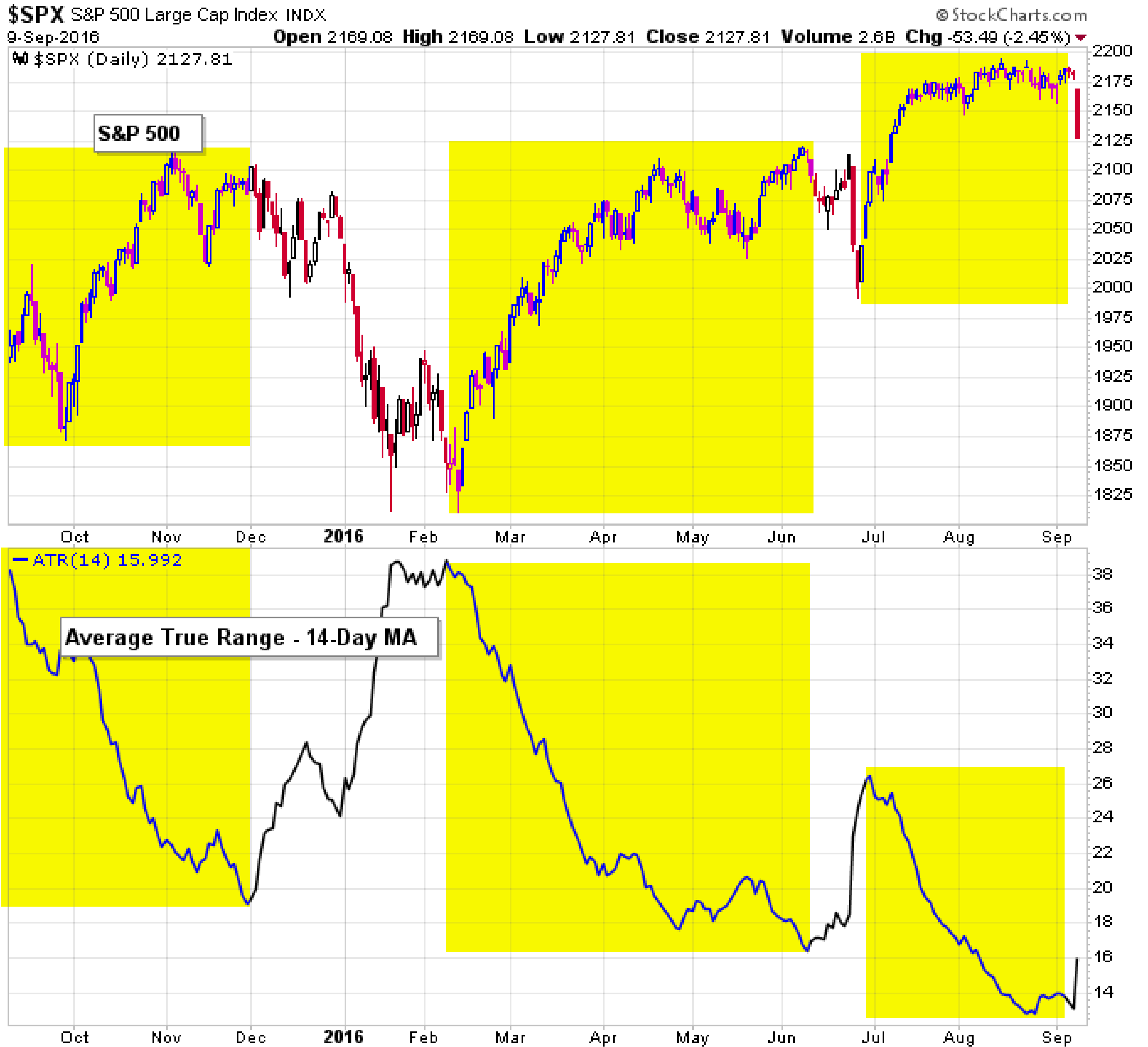
S&P 500 vs. Percentage of SPX Stocks Above 20-day EMA: The percentage of SPX above their 20-day MAs also issued a warning, but I somewhat wrote it off. The S&P has been flat and range bound over the last two months, so naturally the 20-day EMA was flat. I expect the percentage of SPX stocks above and below their own 20's to be 50/50. Said another way, if the market moves up, consolidates and then moves up again, this indicator will move up, pullback and then move up again. Hence why the decline off the high and the recent 50-60% readings weren't a concern.



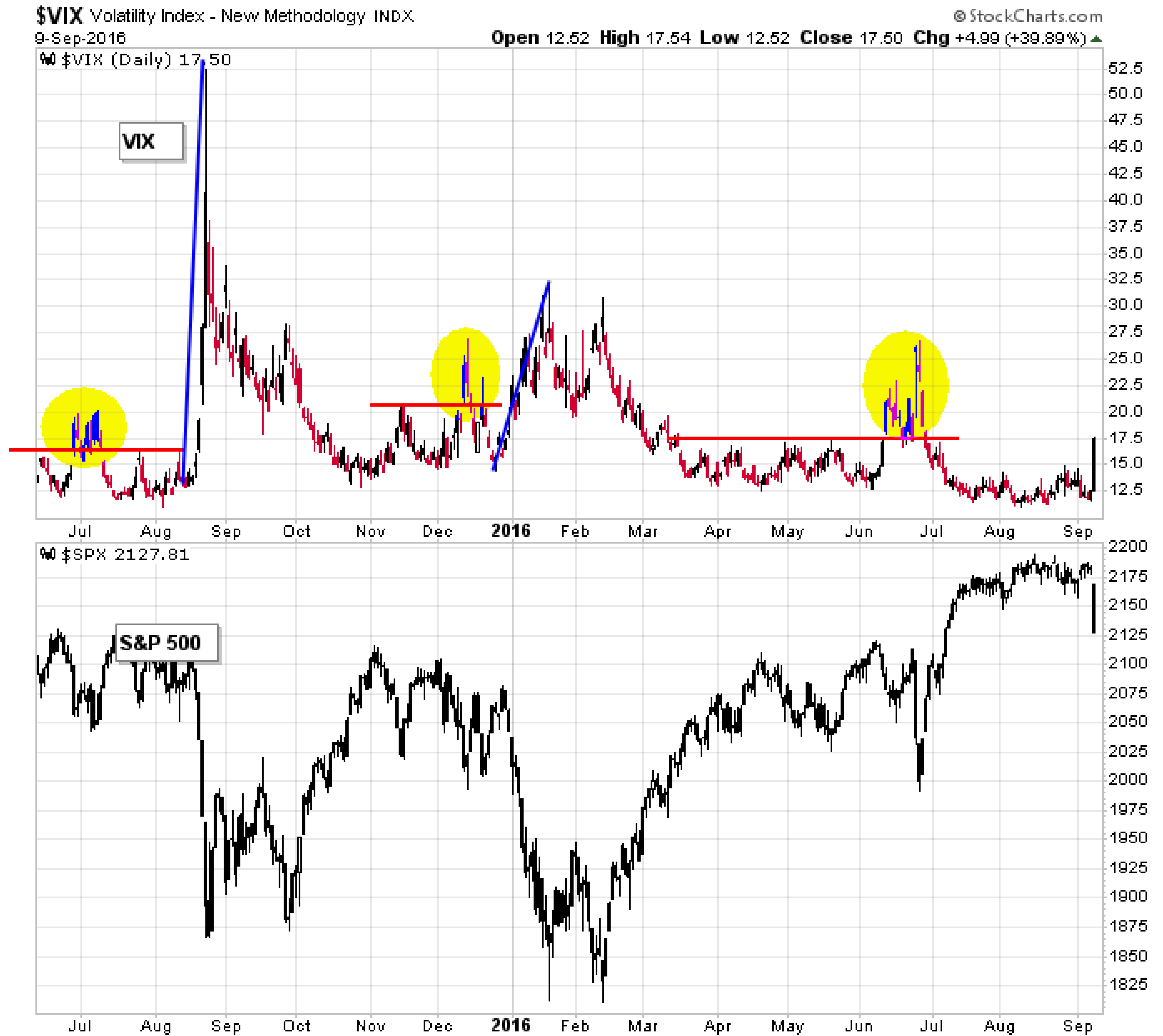
S&P 500 vs. 10-day MA of Put/Call Ratio: Because of the flat market, the put/call hasn't been useful lately. Perhaps now it'll provide a helping hand. Market bottoms tend to coincide with the PC rolling over.



S&P 500 vs. 14-day Average True Range: Typically the ATR gives a slight warning of trouble by moving up ahead of time. Not this time. There was nothing to warn of. The market was suddenly hit by a news item that was not priced in. From a technical standpoint, the market isn't in bad shape.



S&P 500 vs. VIX: Here we go again. The first jump from the VIX is the warning; the second is the real move that coincides with the market selling off hard. It's what happened in last August and January.



The Bottom Line

Friday's plunge was a shock - unexpected and virtually out of the blue.

Most technical indicators were in great shape and didn't warn of trouble brewing.

Key groups (not shown above) were doing well. These included financials, tech and energy.

Many key leadership stocks had hit all-time highs recently.

Tops take time to form, and there are typically tell-tale signs that slowly pop up over the course of several weeks. There weren't any heading into Friday, which makes me wonder if a top really is in place.

I'm thinking further downside momentum could certainly take place early next week, but absent more negative news, I don't think a drop will last long or go far. At least that's what the technicals tell me. This doesn't mean I'm going to be scaling into positions Monday morning. But it does mean I'm reminding myself the move down may be short-lived and I shouldn't overstay my welcome on the short side. Be ready for a bounce. If the bounce fizzles, fine. We may have a bigger down move coming. But for now I'm not looking for a full-blown correction.

Have a great week.

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