Leavitt Brothers

Weekly

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As the bearish warnings mount, the market remains in range.

On the surface the indexes seem to be doing fine. A summer range was followed by a 4-week rally at the end of June and beginning of July, and since, the indexes have formed another range. There's nothing wrong with the market alternating between moving up and consolidating. In fact that's the definition of an up-trend. Move up, rest for a few weeks or months to consolidate the gains and absorb news headlines and then move up again. As long as the internals and other factors remain positive or constructive, I'd consider this to be characteristic of a strong and healthy market.

But the breadth indicators are not holding up, and other factors are starting to hint at beneath-the-surface weakness.

Several breadth indicators have been declining for a couple months and others have recently fallen to levels not seen since last winter. It's normal for indicators to cycle up and down while the market alternates between moving directionally and resting. But when they cycle below lows proven to motivate buyers to step in, we have to consider the possibility a character shift is underway.

New highs have been declining since early July. The percentage of S&P stocks above their 50-day moving averages has been declining for 2+ months. The 10-day of the AD line has taken out all its lows going back eight months. If the market was strong, if the market was healthy, these conditions would not exist.

Under normal circumstances I'd say the market is likely to correct here. Not enter full-blown downtrend mode. Just correct. You know, fall 5%, cause a little fear to bubble up, let the charts reset. But this is not a normal circumstance. This is an election year, and we're less than a month from Election Day. With a Democrat currently occupying the Oval Office and a women being Fed Chairman, there is virtually zero chance the market sells off hard the next couple weeks. Something major would have to happen in the world that would override the government's ability to keep things under control. Brexit didn't do it. Talk of the entire EU unraveling didn't do it. A lack of stimulus commitment from the ECB couldn't induce much selling pressure. It would take something much bigger and completely out of the government's control for the market to fall ahead of the election. Is this a political statement? Yes, but I'm not takings sides and it's appropriate given the situation.

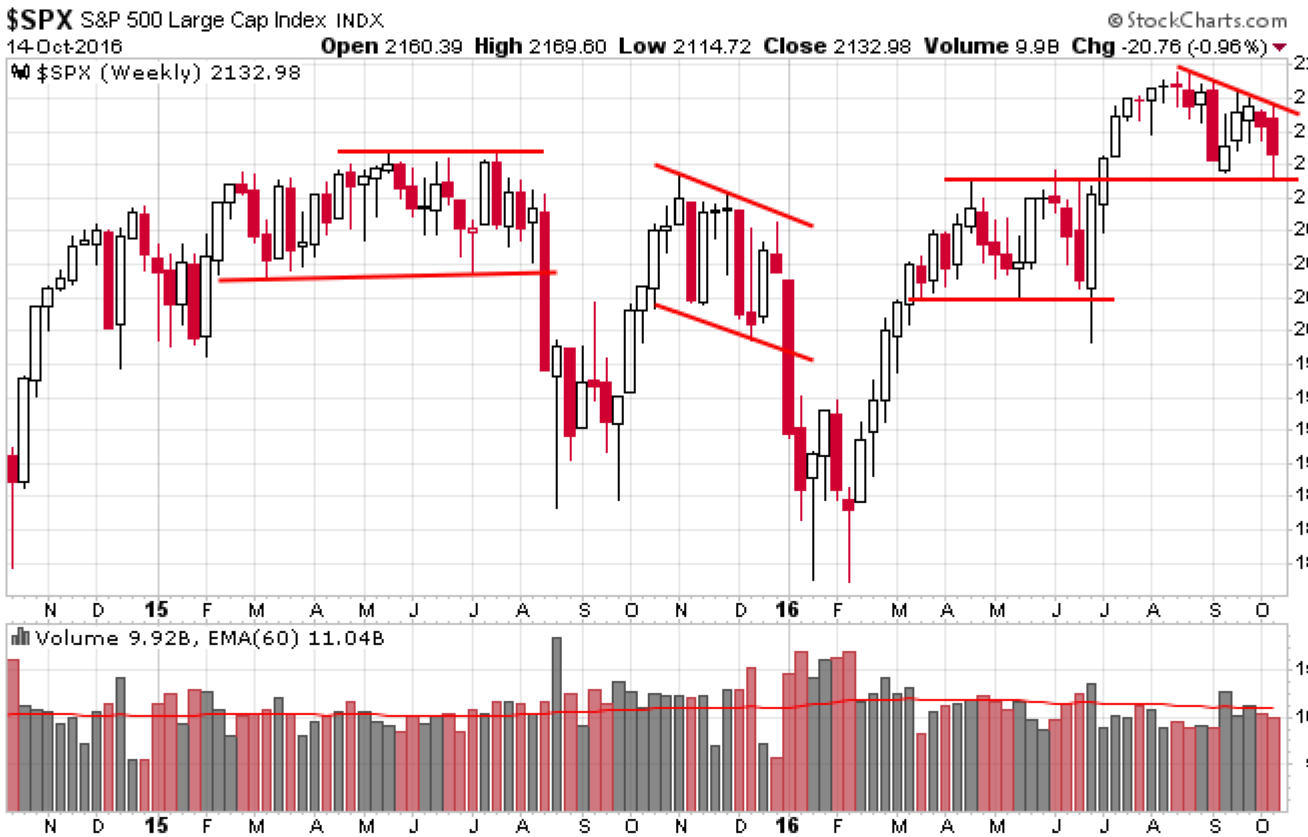
So we're in a situation where if the technicals were in control, the market would pull back some - not necessarily a lot, just enough to be noticeable and uncomfortable if you're long. But the government has an incentive to prevent this from happening. This lead us to two different scenarios.

If the government can prop things up until the election (3 weeks and a couple days), it would give the technicals time to completely cycle down, reset and start to move up again. Essentially the market's hand would be held until it was able to operate on its own again. Scenario number two is the market continues to deteriorate beneath-the-surface while being propped up. Then, at a later date, this bearishness would suddenly explode - literally, as if there was tons of pent of pressure that needed to be released.

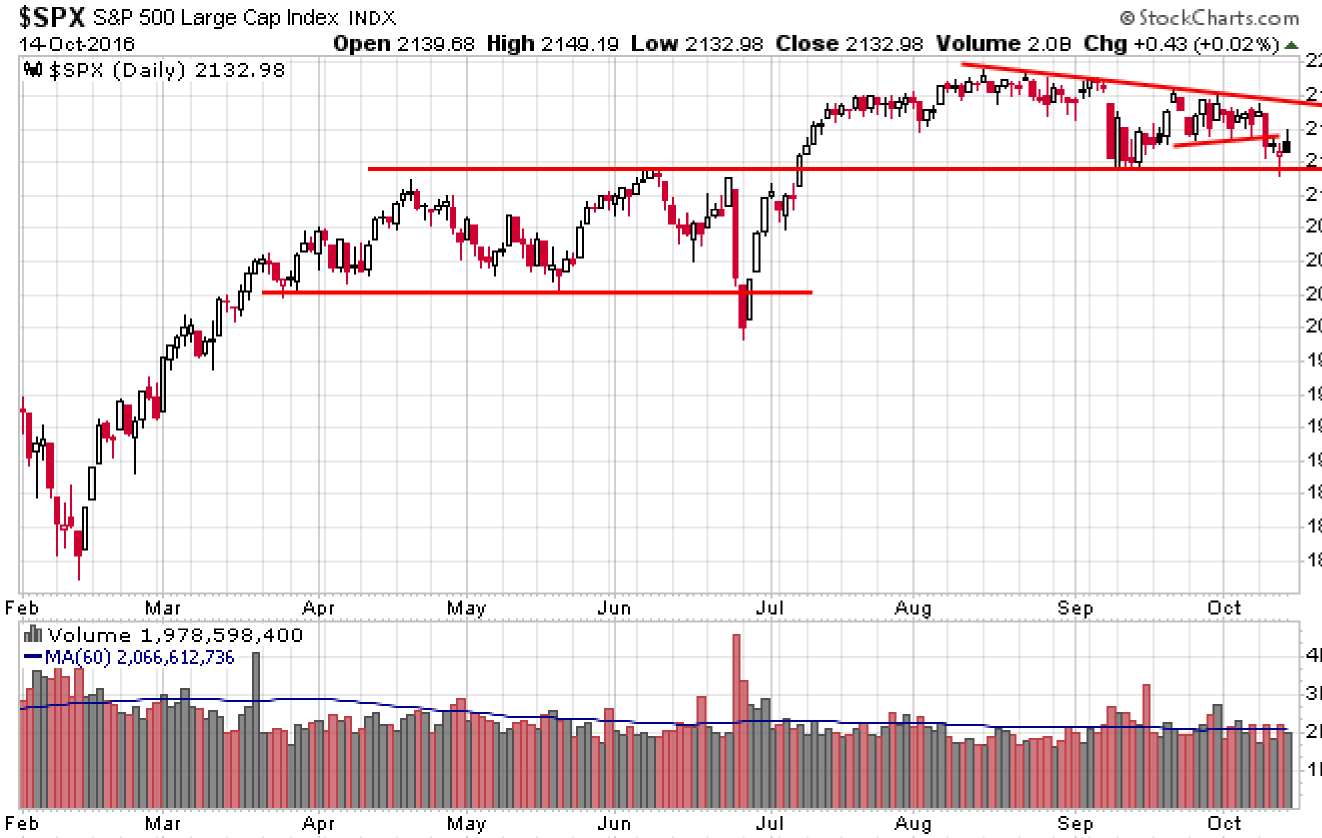
This is where I see things now. A drop would allow the market to let out some steam and reset for a move up into the end of the year, but the government isn't going to let it happen. So we have to wonder if some outside interference will be a nonevent or lead to an even bigger drop later. Let's get to the charts.

Indexes

The S&P 500 Weekly: Compared to previous ranges, there's nothing outstanding about the current one. Price is being compressed by converging trendlines...there are lots of overlapping candles...and even if support is taken out, you have to consider the possibility a flag-type pattern forms before a directional move takes shape. I like weekly charts because while the dailies often jump around and gap, the weeklies are smooth and tell the real story. This chart tells us the market is in consolidation mode.



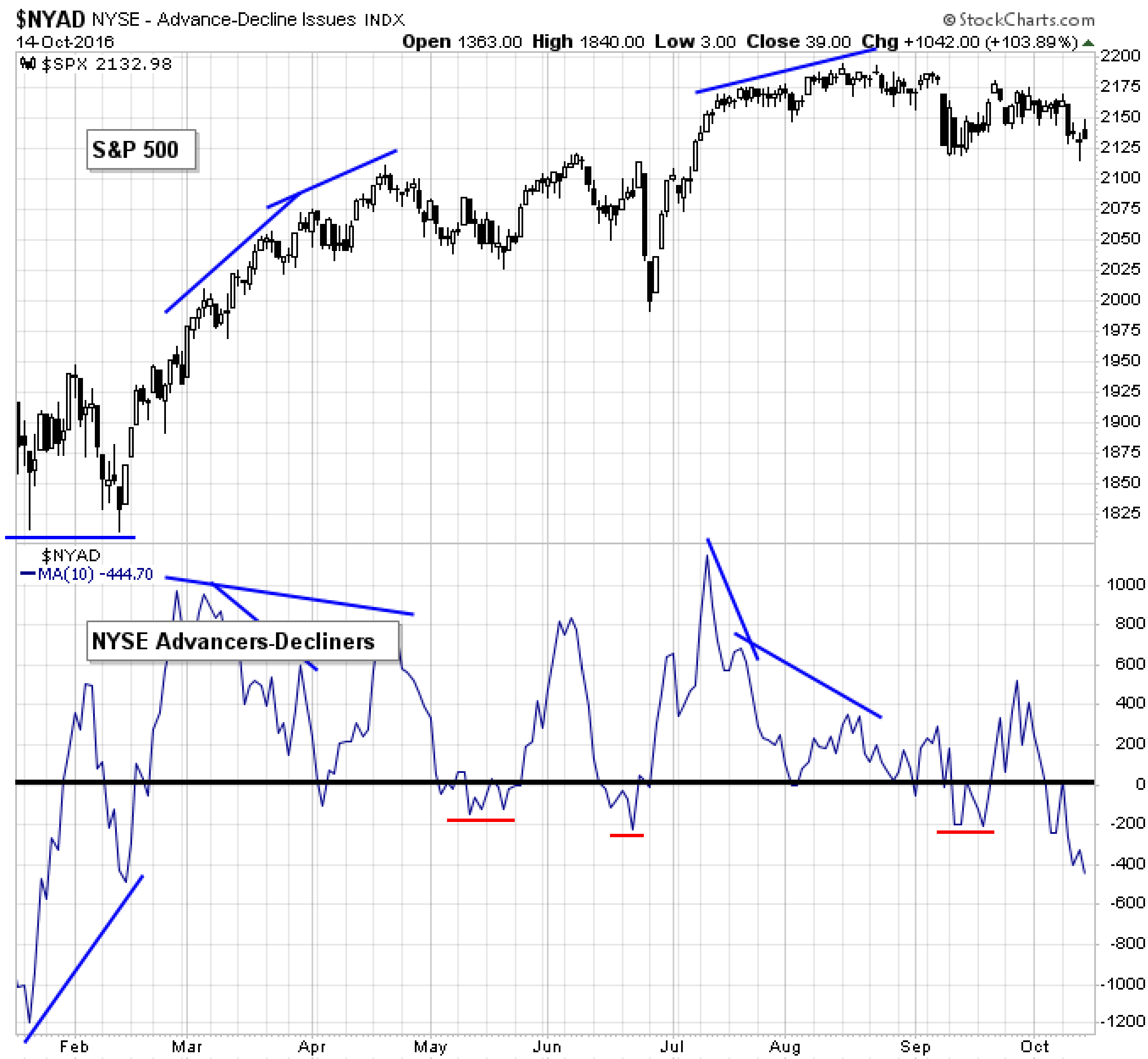
The S&P 500 Daily: Boring. Allowing for a little wiggle room, the range remains in place. I don't sense pressure is building, so I'm not super confident there will be an explosive breakout in either direction.



The Russell 2000 Daily: The Russell small caps are also range bound, but they have a different look and feel to them. First volatility expanded, now it's contracting. To a much greater degree, this hints pressure is building.

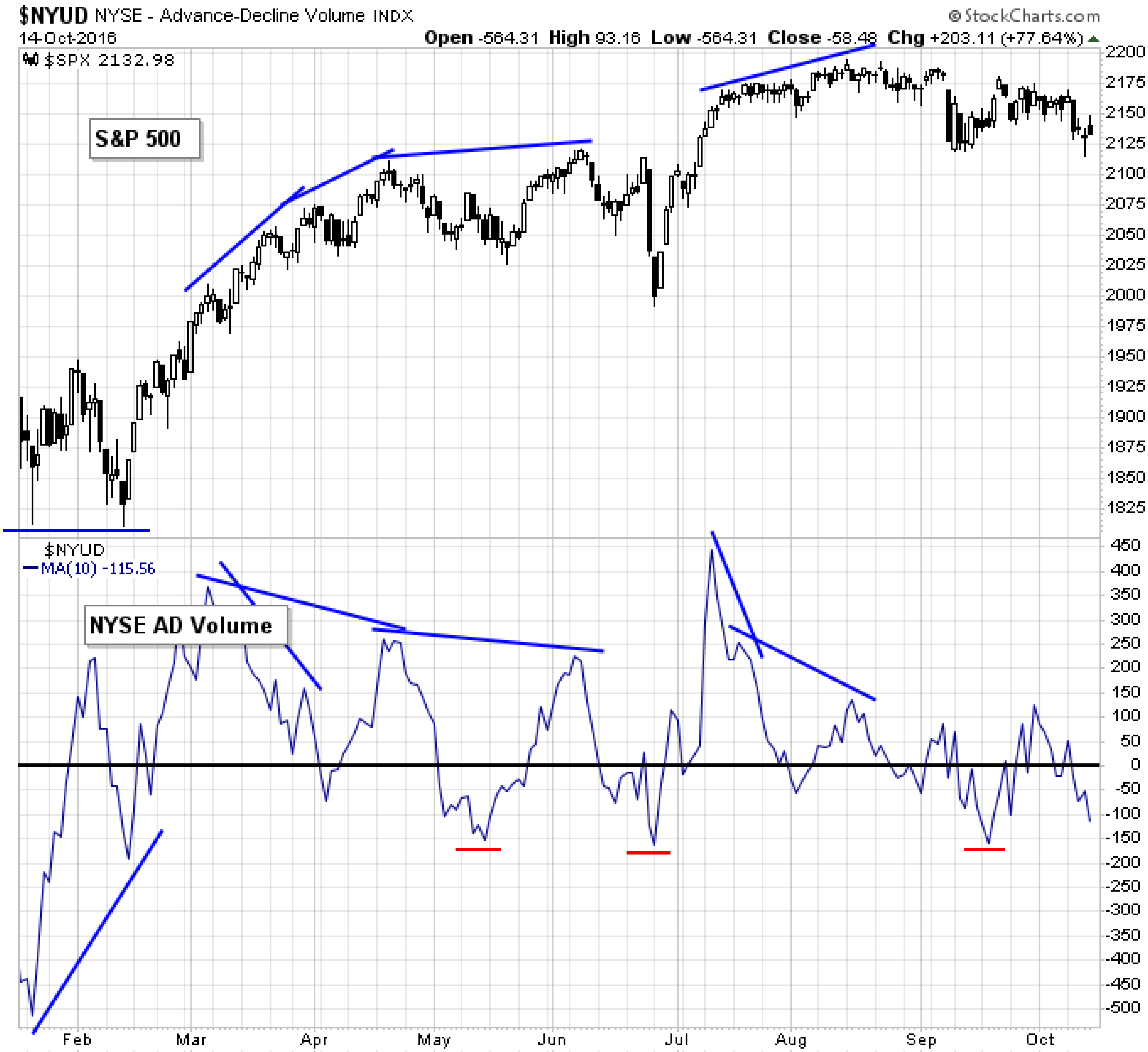
Indicators

S&P 500 vs. 10-day MA of NYSE AD Line: The 10-day of the NYSE AD line has dropped to a level not seen since February, when the S&P lost almost 150 points in nine days. Within an uptrend, this indicator should cycle between a high print and a neutral print, but there have been no high prints for three months, and we just got the lowest print in eight months. At this point, I'd rather the market not firm and move up. I'd rather the AD line washout first, shake the weak hands out of the market and then attempt to move up. Said another way, I'd rather get an oversold reading than a bounce from the current level.



S&P 500 vs. NYSE Cumulative AD Line: The cumulative AD line tells us this is just a pause within an uptrend. Unlike the summer of 2015 when this indicator trended down, it's currently flat and not suggesting anything worse than a neutral situation.

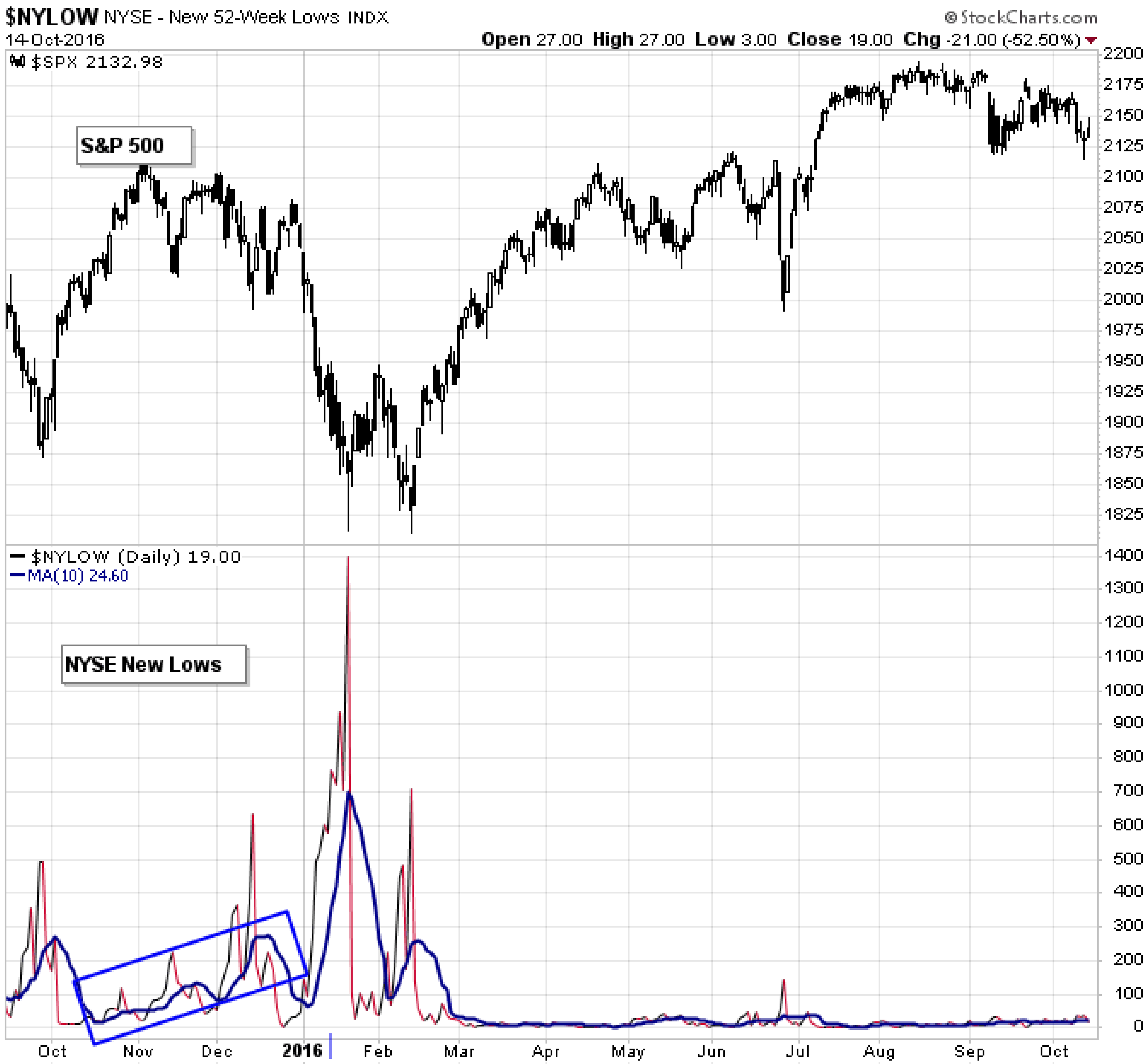
S&P 500 vs. 10-day MA of NYSE AD Volume Line: The 10-day of the NYSE AD Volume line is very neutral. Lows going back to the summer have held, but there have been no high prints. Very noncommittal. Nobody has been able to take control for long. Money flows into stocks...and then out of stocks. Nothing has been sustained.



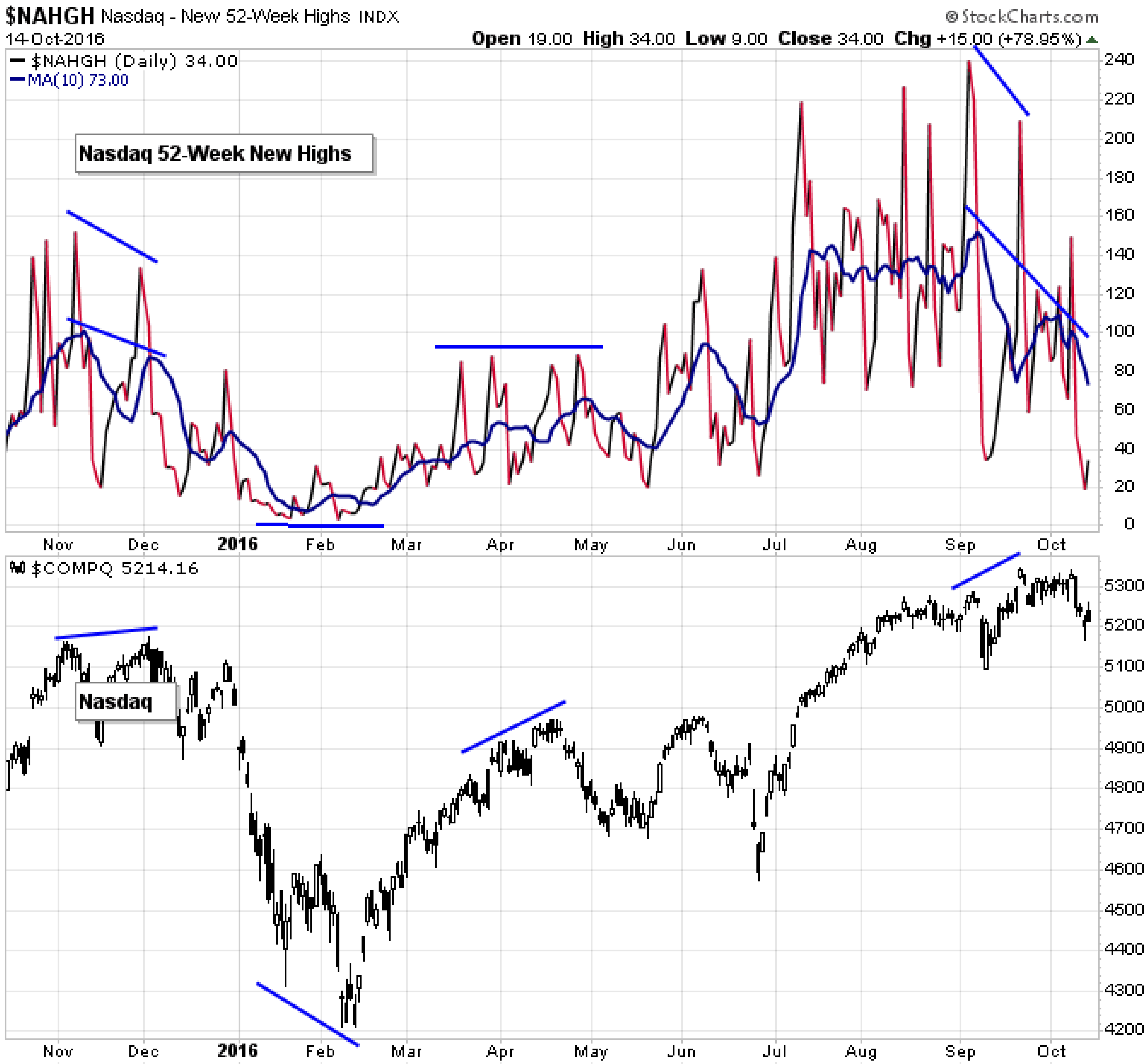
S&P 500 vs. NYSE Cumulative AD Volume Line: No surprise here. With the 10-day of the AD Volume line being very neutral, the cumulative version of the same data is neutral too.

S&P 500 vs. NYSE New Highs: During the entire range that has extended back to the beginning of July, new highs have steadily declined. So there's no subtle, beneath-the-surface strength. There are virtually no outliers. There's no group quietly going about its business independent the overall market. I don't consider this to be a good thing. The market can continue to trade in a range for as long as it wants, but until I see new highs tick up, I'll question the market's upside potential.

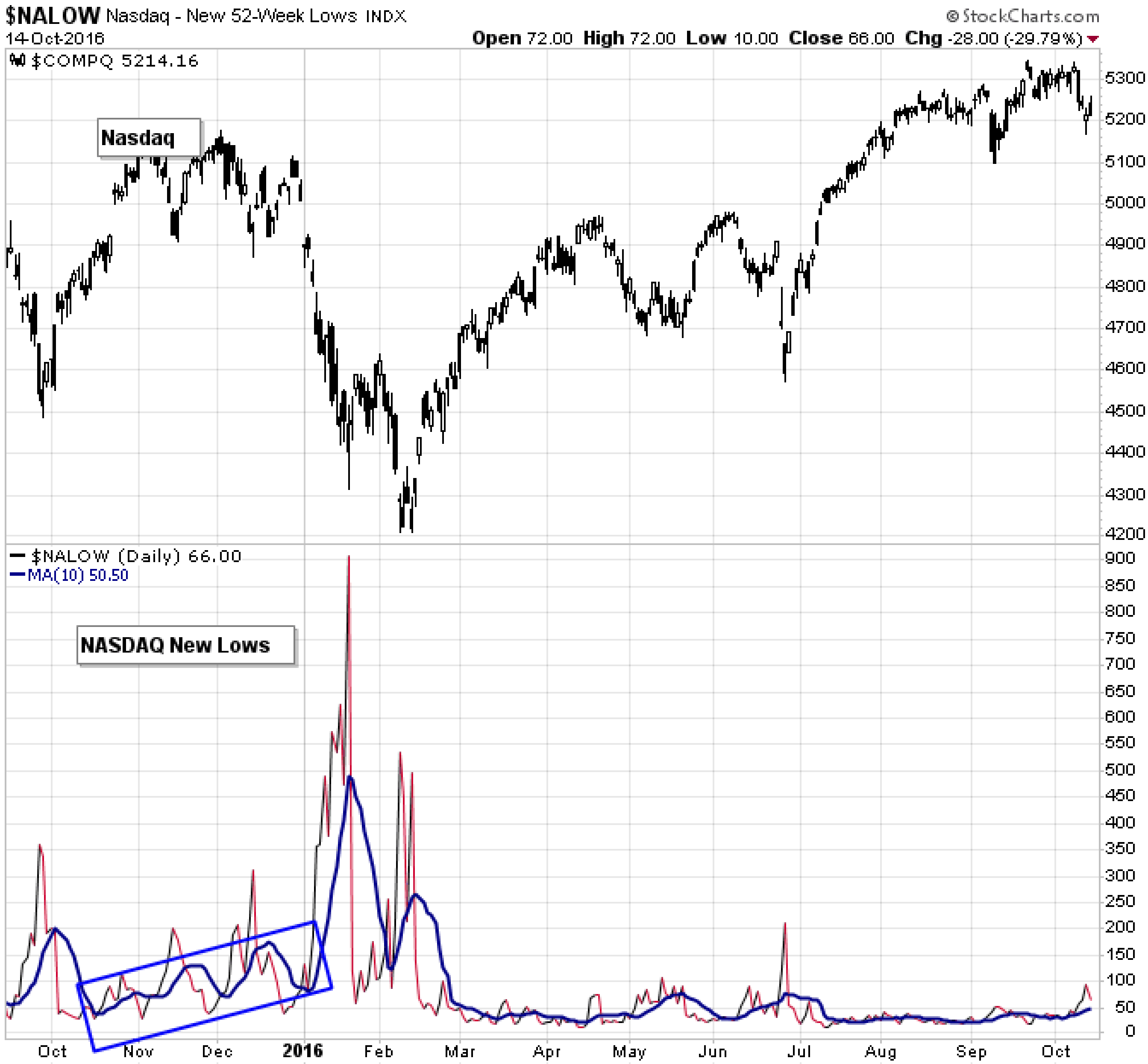
S&P 500 vs. NYSE New Lows: New highs are not hinting at strength, but new lows are not hinting at weakness either. If there truly was weakness brewing beneath the surface, new lows would be quietly moving up like last November and December. But it's not happening.



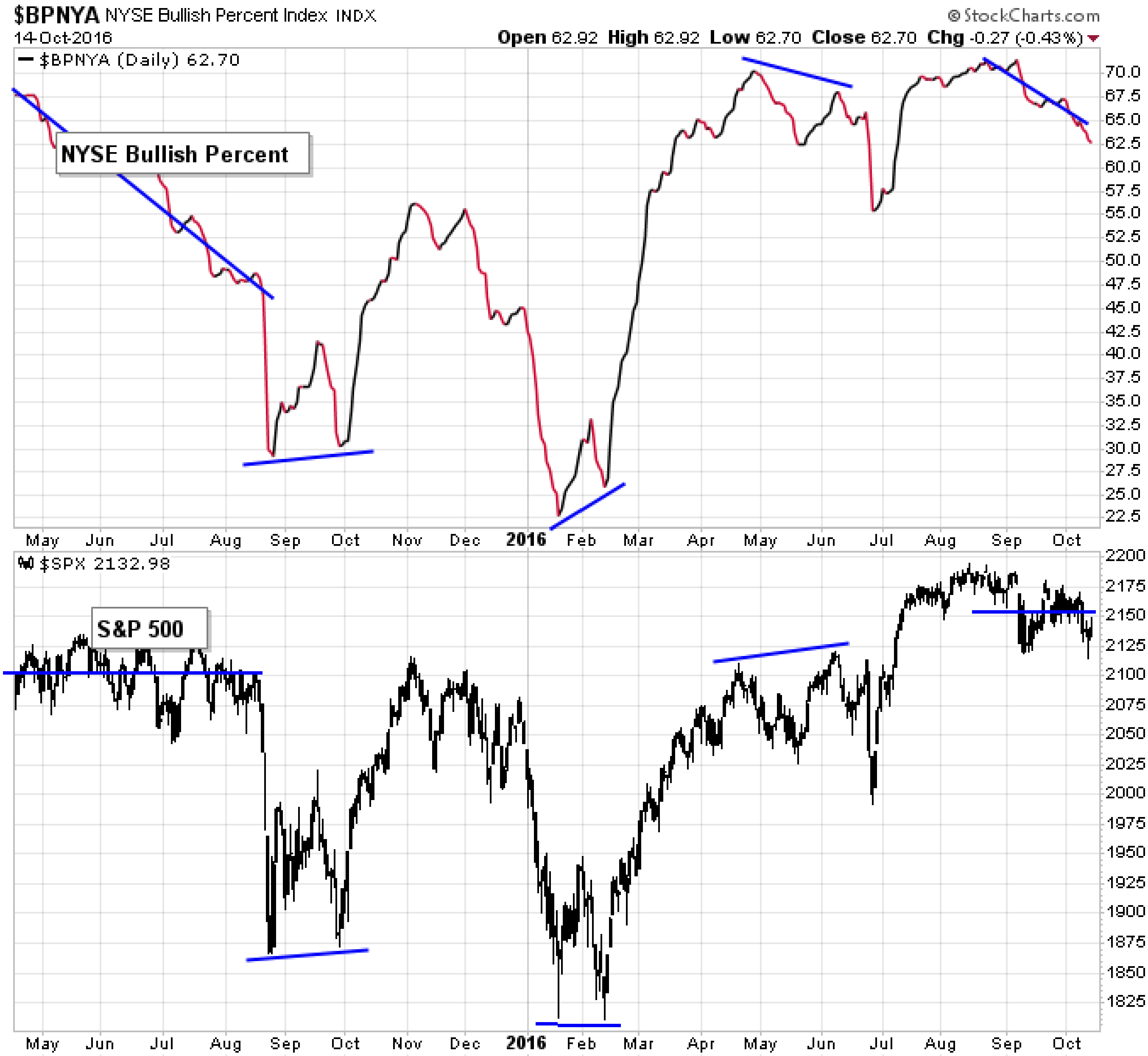
NASDAQ vs. NASDAQ New Highs New highs at the Nas have also been declining, yet the Nas seems unaffected.



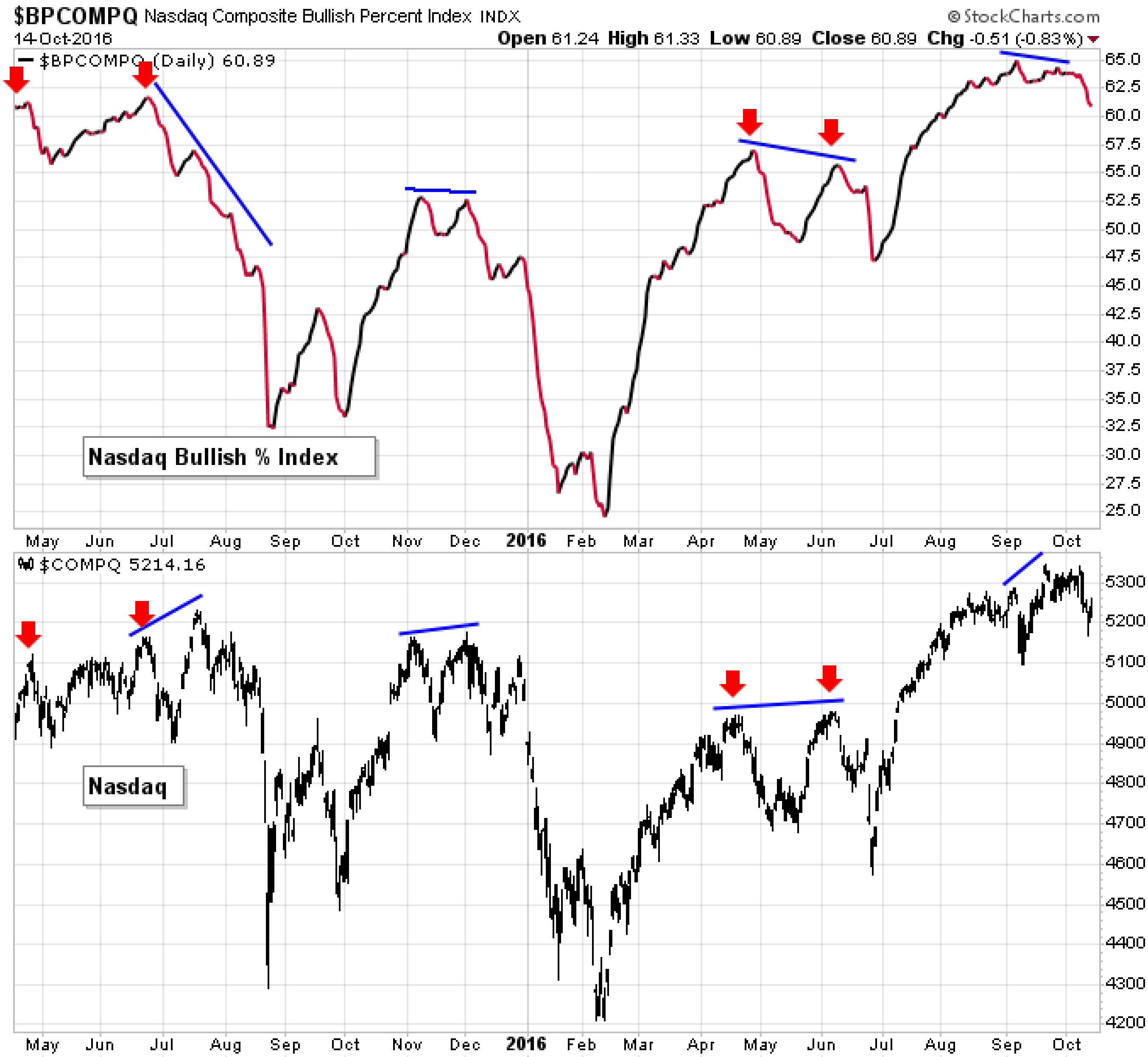
NASDAQ vs. NASDAQ New Lows: Unlike at the NYSE, new lows at the Nas have started to tick up. It's notable but not a concern yet. There are many stocks at the Nas that don't deserve to be publicly traded companies, and when they drop to new lows, it's not necessarily reflective of the overall market. But if the trend continues....



S&P 500 vs. NYSE Bullish Percent: The bullish percent at the NYSE has been trending lower for almost two months. This took place May-July of 2015 before the bottom fell out. The trend is notable, but the absolute number is still pretty good.

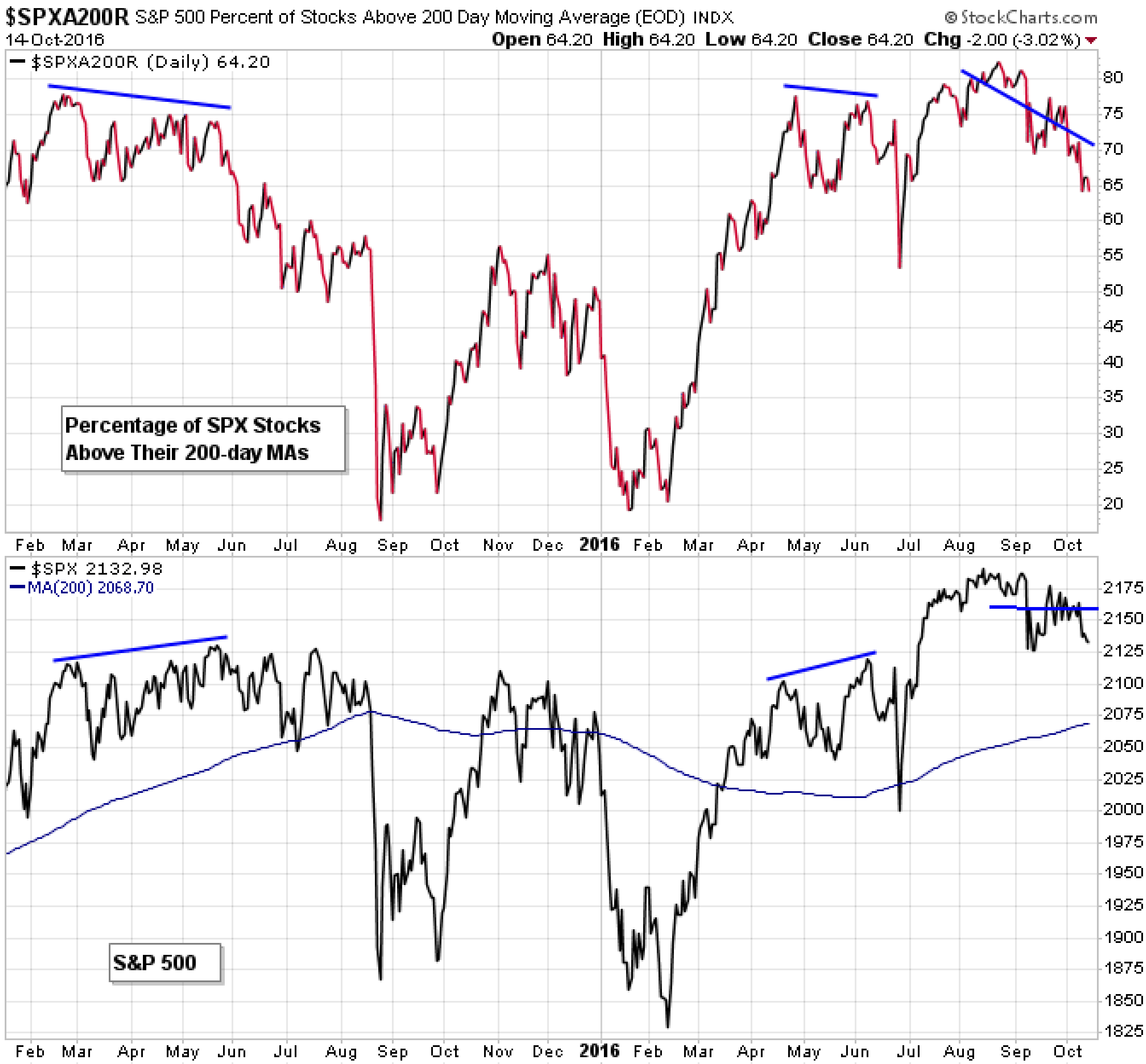


NASDAQ vs. NASDAQ Bullish Percent: The Nas bullish percent is starting to move down, although it's still at a high level.

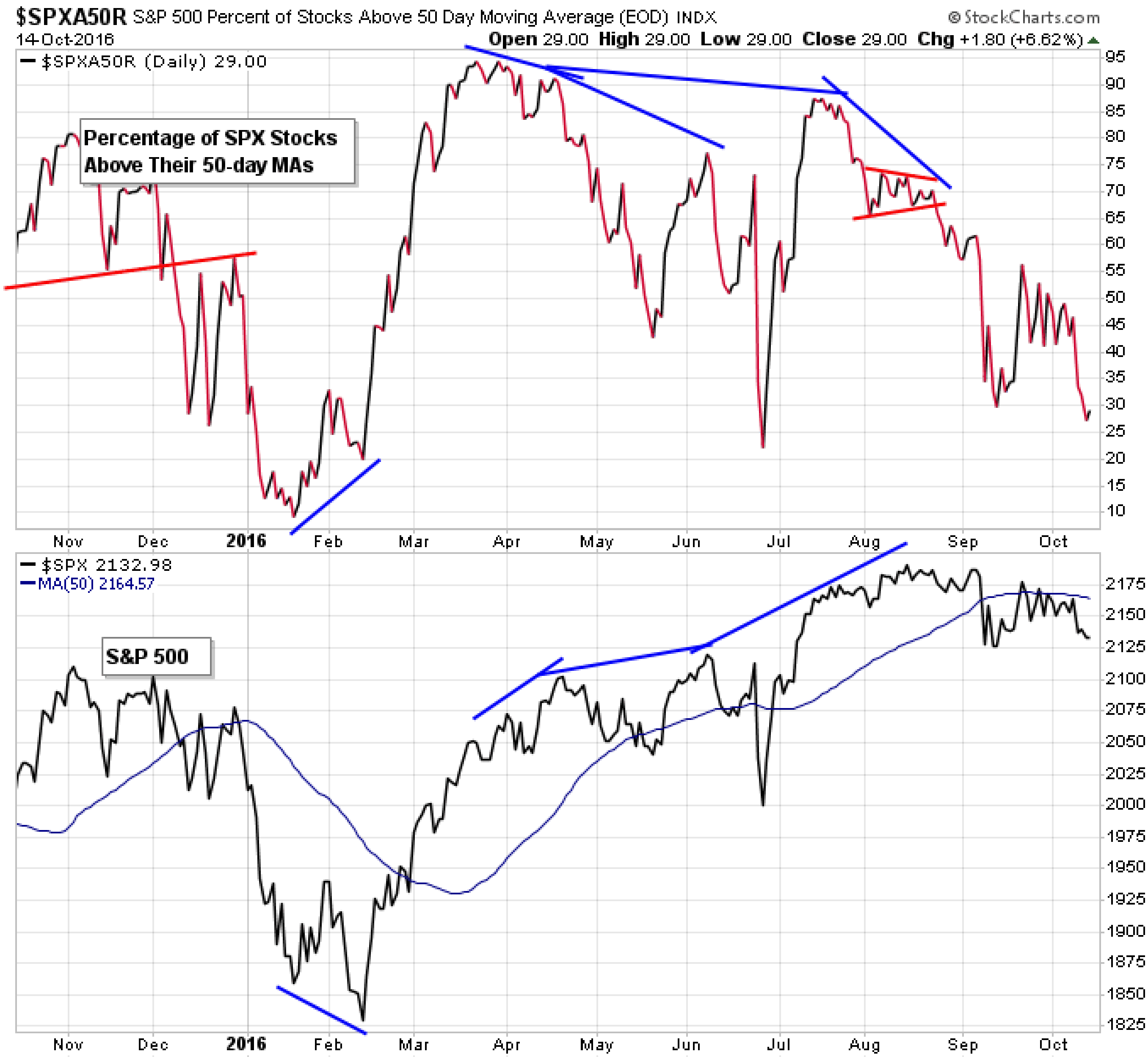


S&P 500 vs. SPX Bullish Percent: At the S&P, the bullish percent is in full downtrend mode. If the market attempts to bounce but this indicator fails to match the movement, the market won't go far.

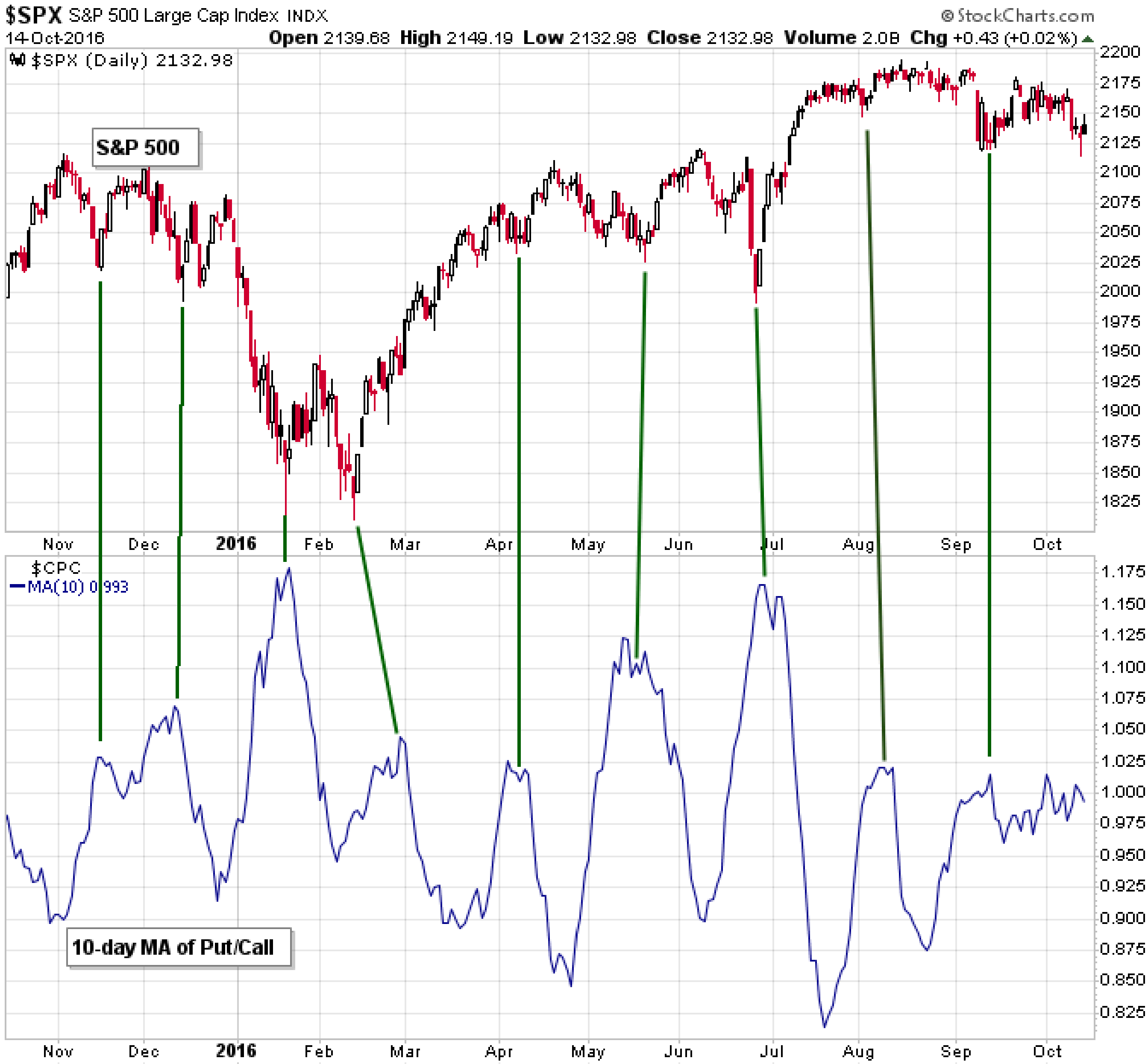
S&P 500 vs. Percentage of SPX Stocks Above 200-day MA: The percentage of S&P stocks above their 200-day moving averages has been declining for almost two months and has dropped to its lowest level since June. The absolute print is still very good, but the trend is troublesome.



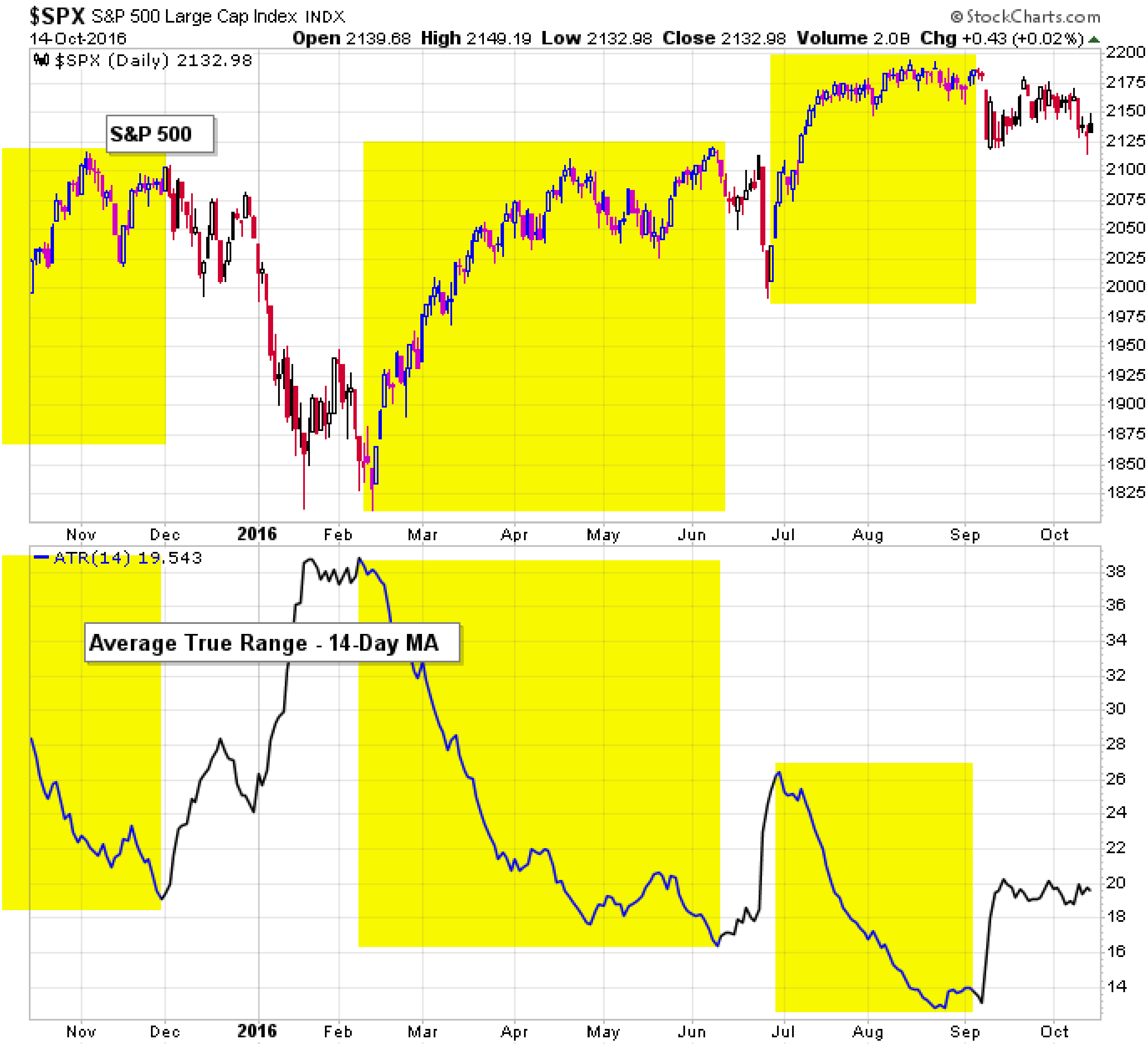
S&P 500 vs. Percentage of SPX Stocks Above 50-day MA: The percentage of SPX stocks above their 50-day MAs continues to decline and is now at its lowest level since the June Brexit plunge. At this point I'd rather get a complete washout before the market attempted to move up.



S&P 500 vs. 10-day MA of Put/Call Ratio: The put/call isn't cycling up or down and therefore isn't hinting at what the next move is likely to be.



S&P 500 vs. 14-day Average True Range: The ATR has flattened out. It's not signaling expanding or declining volatility, so it's not offering a hint of the next move.



Other

US Dollar Daily: Since the beginning of October, the US dollar has moved virtually straight up and is now at its highest level since March. A high dollar level is tough to deal with on many levels, and it puts the Fed in a corner. They should have raised rates over the summer when the dollar was much lower. Now they run the risk of throwing a little gas on an already-burning fire. Keep an eye on this. It will be difficult for the market to move up in the face of a rallying dollar.

US Dollar Weekly: The weekly is much more scary. If a strong dollar hurts multinationals and puts the Fed in a tight spot (raising rates and a stronger dollar accomplish the same thing, so if the Fed raises rates while the dollar is moving up, it's like raising rates twice as much). What if this classic rectangle pattern breaks out and runs. The size of the pattern measures up to 108; a measured move takes it to 120. Either one would crush the market.

The Bottom Line

The market remains in range, but beneath the surface, warnings are brewing. If left alone, the market would correct, rest and then figure out what it wants to do next. But we're three weeks from an election, and I don't think the government is going to let it happen.

This puts us in a situation where the market will either have some time to sort out its short comings or bearish pressure will continue to grow, eventually leading to an explosion at a future date.

And if the dollar breaks out, it'll be Katie bar the door. I would not want to be long.

Things are going to get much more interesting in the coming months.

Be conservative. This is not a time to swing for the fences.

Have a great week.

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