LB Weekly

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2016 is in the books. It was a year of overcoming big hurdles and not only living to tell about it, but performing well enough to register across-the-board all-time highs. All the indexes posted healthy gains, and when referenced from the early-year lows, the moves were even more impressive.

The year started with rates having just been moved off their prolonged historically low level for the first time since 2009. January wasn't just a bad month, it was the worst January in history. The S&P 500 had never started a year as badly as 2016 started, so those who believe the month was a good tell for the rest of the year were expecting at least a down year. But Wall Street had other ideas. A double bottom in January and February set the stage for a solid rally into the summer, one that put the market back in positive territory and not far from its high.

After a couple range-bound months, the next hurdle to overcome was news the UK had voted to leave the EU. The market's knee-jerk reaction was to sell off hard, but for reasons we can guess - among them the reality that the UK is a rock-solid country that will remain a close friend, ally and trading partner whether they're part of the UK or not - it only took four days to recover two days of stiff selling, and after pausing, the market legged up into new high territory.

Then focus shifted to the US election. Three months of slightly-downward sloping movement was temporarily interrupted in early September when the ECB announced they were not committing to further stimulus. This was important because between stimulus and the devaluation of currencies across the globe, there's no question that removing the punch bowl could potentially influence the world economies and markets. But this news item was quickly brushed aside and focus turned back to the election.

It was a battle between two disliked and disrespected candidates. The weekend prior to the election, the FBI said it would not pursue charges against Clinton. The market rallied Monday and Tuesday. Then Trump won, and the market continued to move up. Given the market rallied into anticipation of Clinton winning and then continued rallying when Trump won, we can only conclude the market didn't care who won, it just wanted a winner (ergo, it did not want a repeat of Bush/Gore).

The market then rallied into the middle of December before settling into range to finish the year. Every index moved to a new all-time high. Every single one.

Big caps, small caps. Tech stocks, non tech stocks. The extent of the rally caught many by surprise. It was a lock-out rally that offered no second chances to get on board once the train left the station. And when the year ended, the Dow had posted it single-biggest post-Election rally since 1928.

So the year started with the worst January in history and ended with the best post-election rally in 88 years. In the end the S&P moved up 10% and paid its usually 2.something percent dividend, which is a very average and typical year.

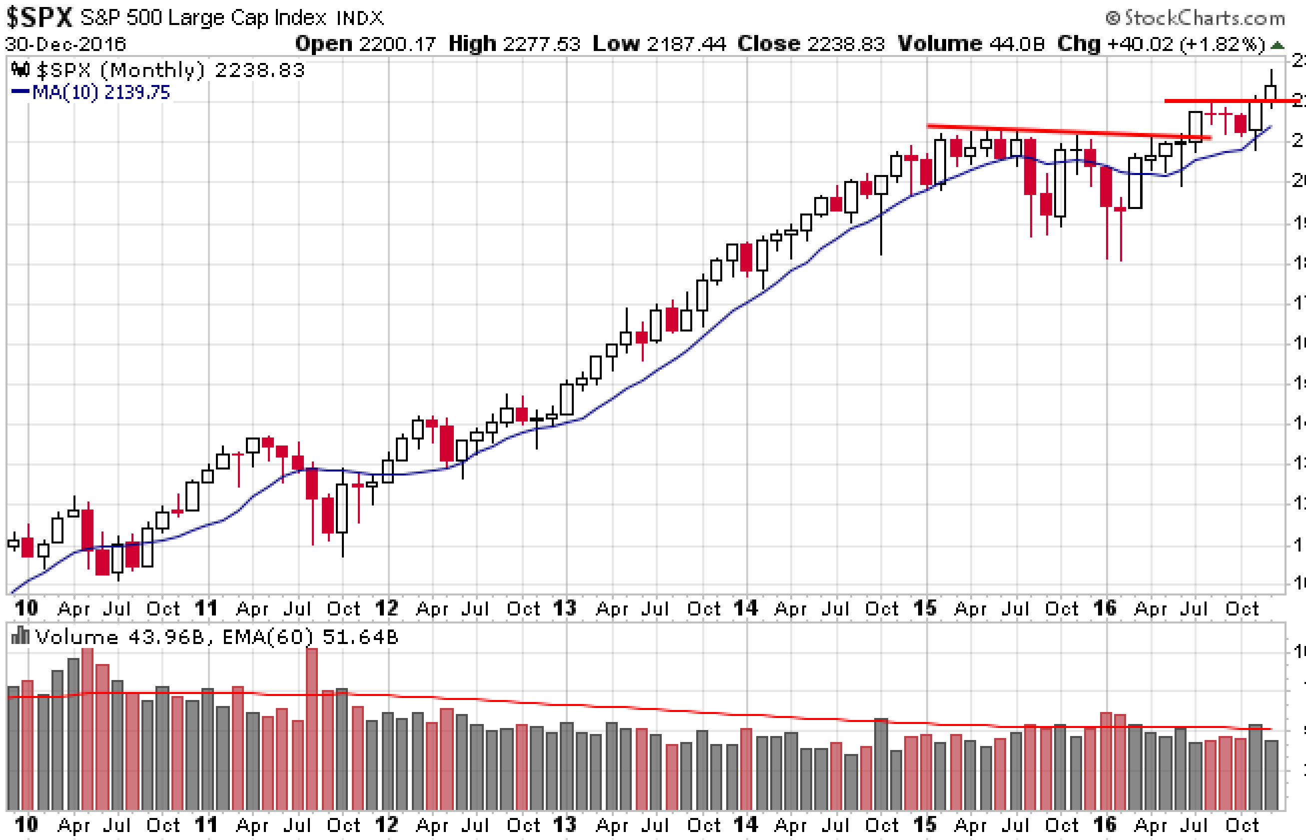
From a technical standpoint the market is doing great and is well supported. Long term breadth indicators do not hint at anything major brewing. On an intermediate term basis, I can definitely argue a continuation of the current grinding range or a mini correction is in the cards because there's been some beneath-the-surface deterioration. Namely, the participation rate has not been as good as during the previous rally.

So the trend is up, and I expect it to remain up. If a top was going to form, at the very least we have several months of up or sideways movement ahead because tops take time to form. Typically longer term indicators diverge from the price action before the market rolls over, and those indicators are fully supporting the market's trend. An early-year shake-out should be bought, and for now I have no reason to abandon my SPX 2300-2400 target.

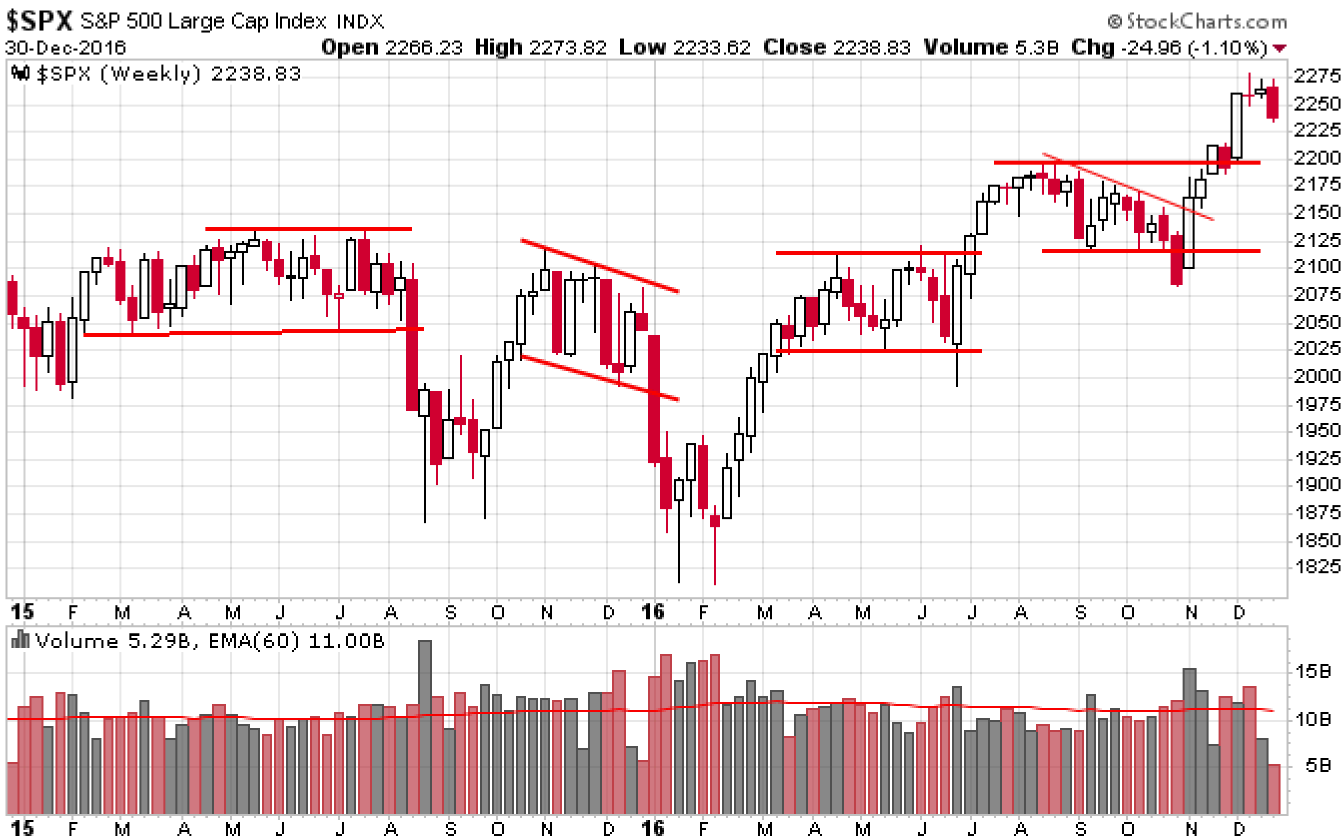
Let's get to the charts and indicators and see what they say.

Indexes

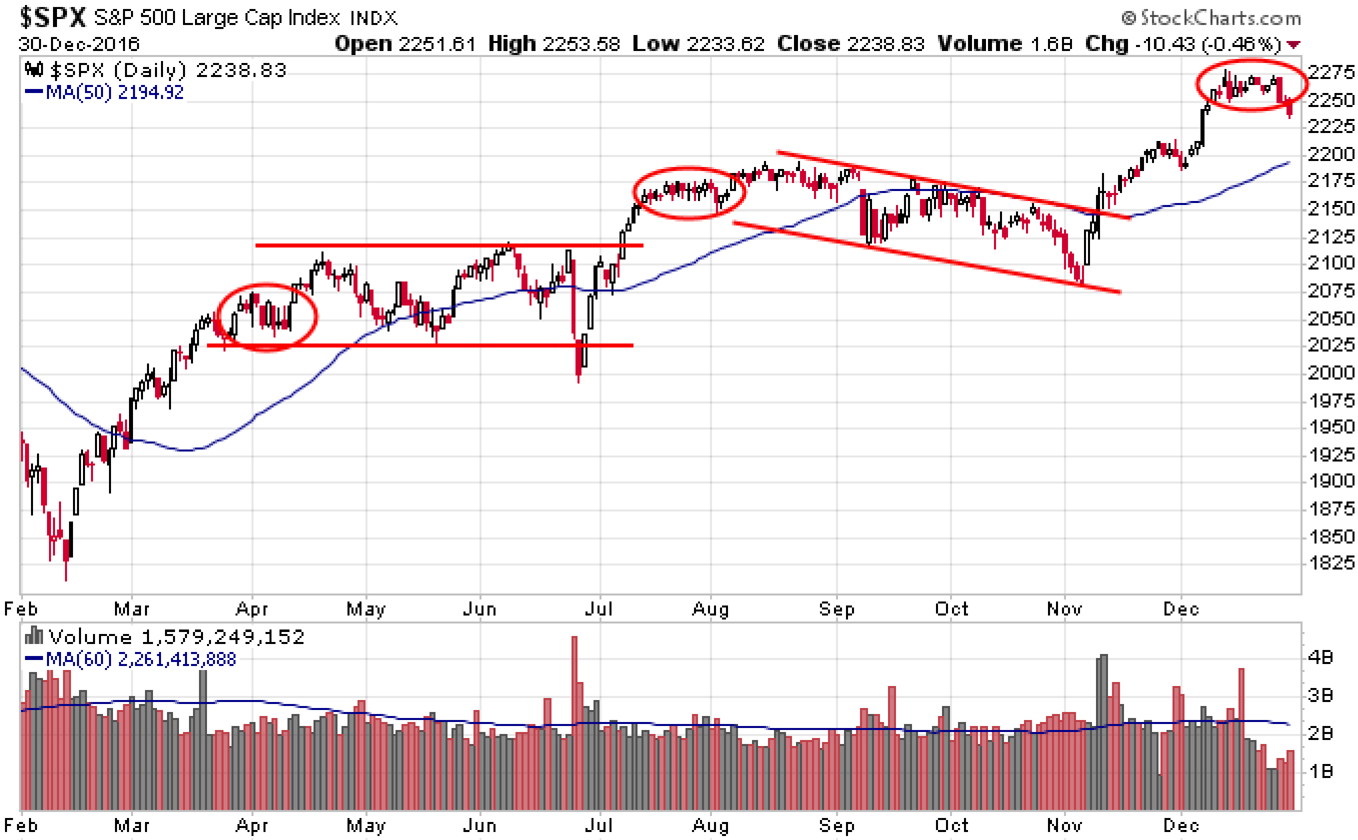
The S&P 500 Monthly: The final monthly candle of 2016 is complete. The S&P moved to a new all-time high but closed off the high. We don't trade off this chart because it takes too long for each candle to form. Our only conclusion right now is that the overall trend is solidly up.



The S&P 500 Weekly: The market finished the year with its biggest down week since the election. Does it mean anything? Historically the last 5 days of a year and the first 2 of the next year combine to hint at what's to come, but the last two years haven't followed the historical precedent. During the year we got three runs - off the February bottom, off the June low, off the November low. Otherwise the market has spent much more time being inconsistent than trending...which is actually pretty normal. Considering the move off the November low, it's time to fall into one of those inconsistent ranges, isn't it?



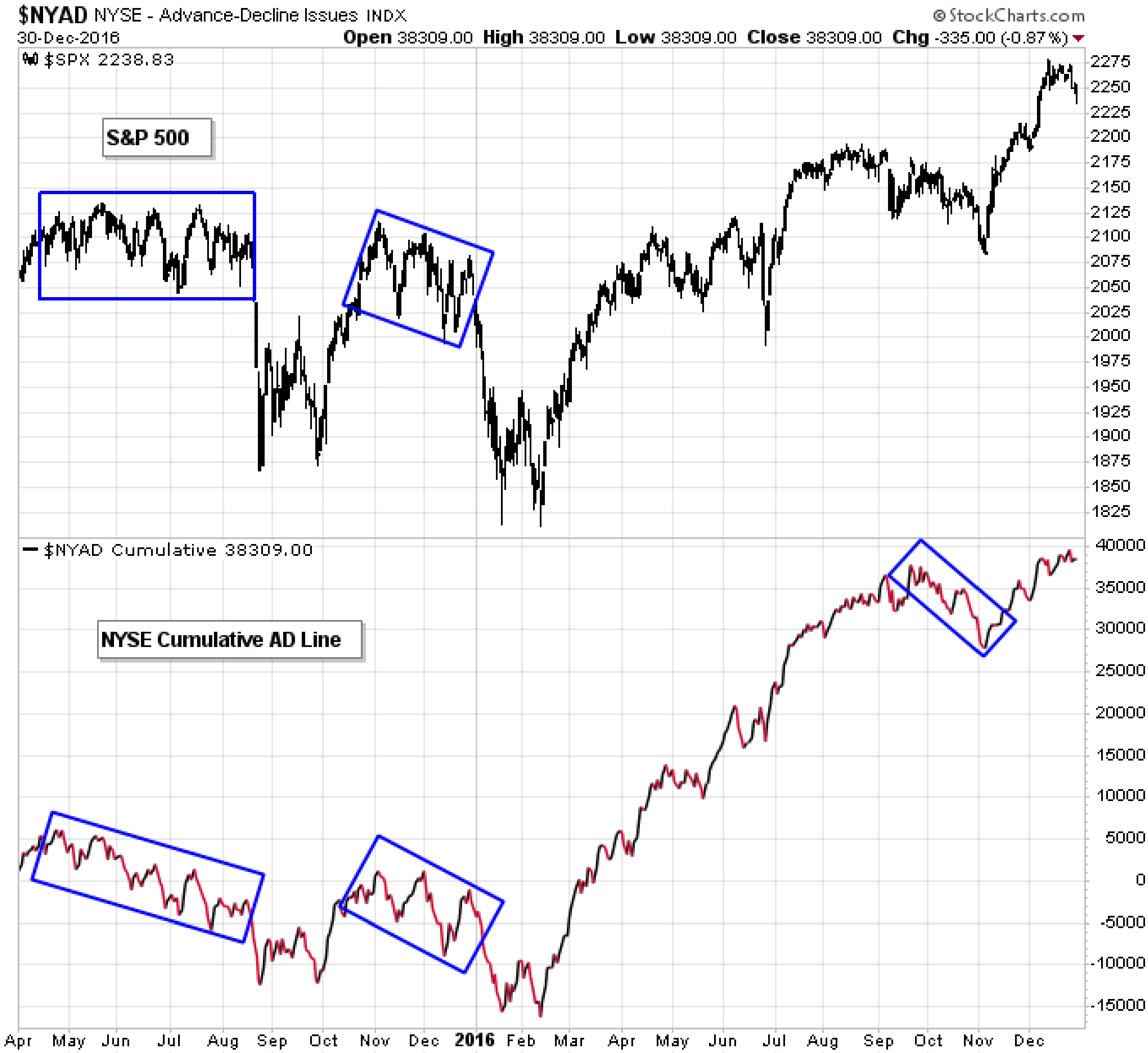
The S&P 500 Daily: Up, over, up, over, up. Other than the post-Brexit move, this year's movement has been orderly. A drop to the 50 near 2200 should not surprise anyone.



Indicators

S&P 500 vs. 10-day MA of NYSE AD Line: A divergence between the S&P and the 10-day MA of the NYSE AD line has led to a minor drop (so far). Cycling down to zero is normal; now the indicator is trying to bounce. If successful, there won't be much more downside movement. If not successful, a bigger or more-prolonged drop is likely to play out. This indicator will be very telling.

S&P 500 vs. NYSE Cumulative AD Line: Consistent prints above 0 have kept the cumulative NYSE AD line near its high, and since a couple months of down-sloping movement is typically required before a legit correction takes place, we can feel comfortable a top is not forming right now.

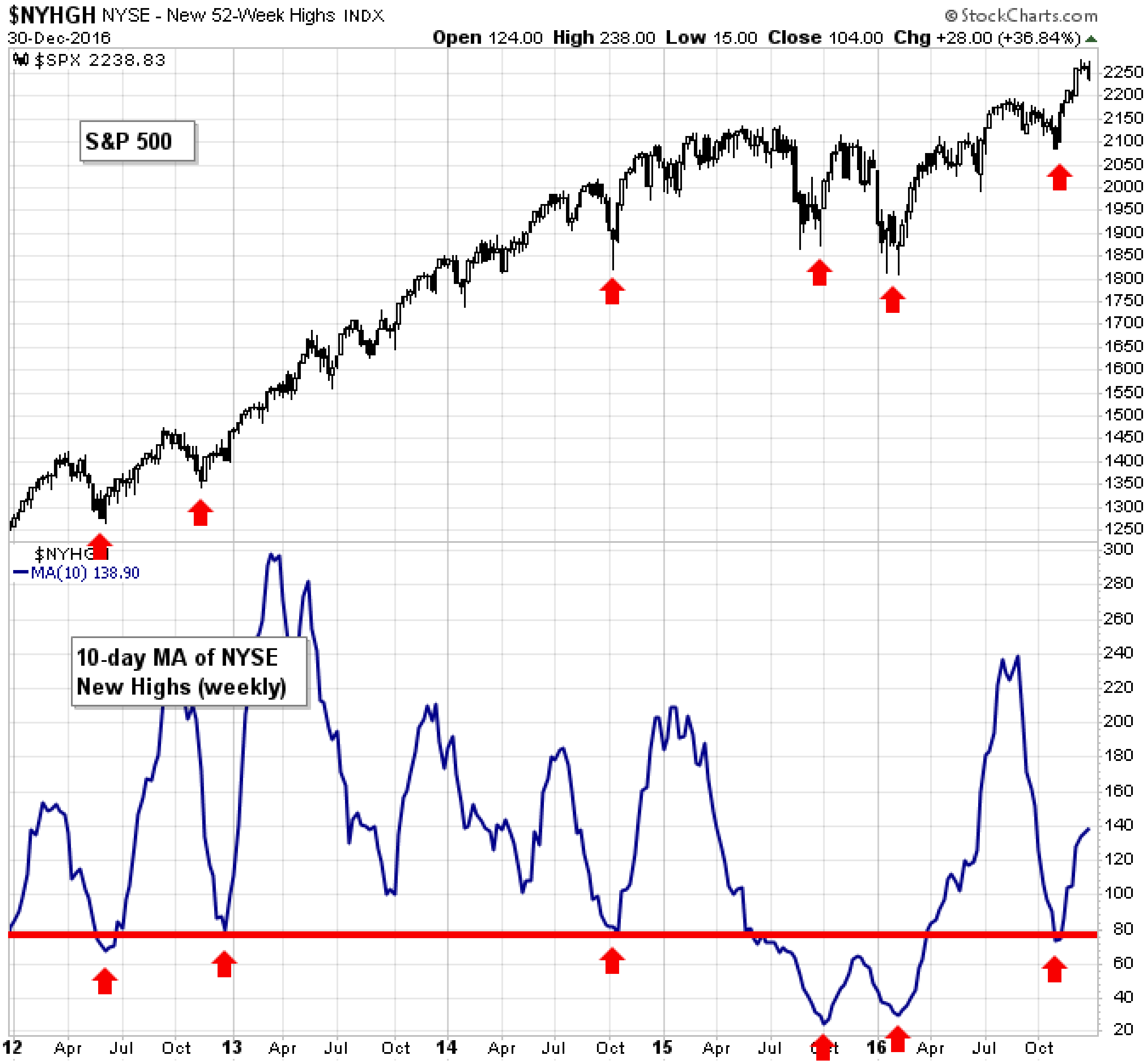


S&P 500 vs. 10-day MA of NYSE AD Volume Line: A similar divergence formed with the AD volume line, which now sits at 0. A bounce will lead to the market legging up again, but prolonged time down here or a deeper penetration will result in an extended rest.

S&P 500 vs. NYSE Cumulative AD Volume Line: The cumulative version of the AD volume line has stalled but is still in great overall shape. It will take a couple months of declining values for the market to experience anything but a little hiccup, so our bias remains up.

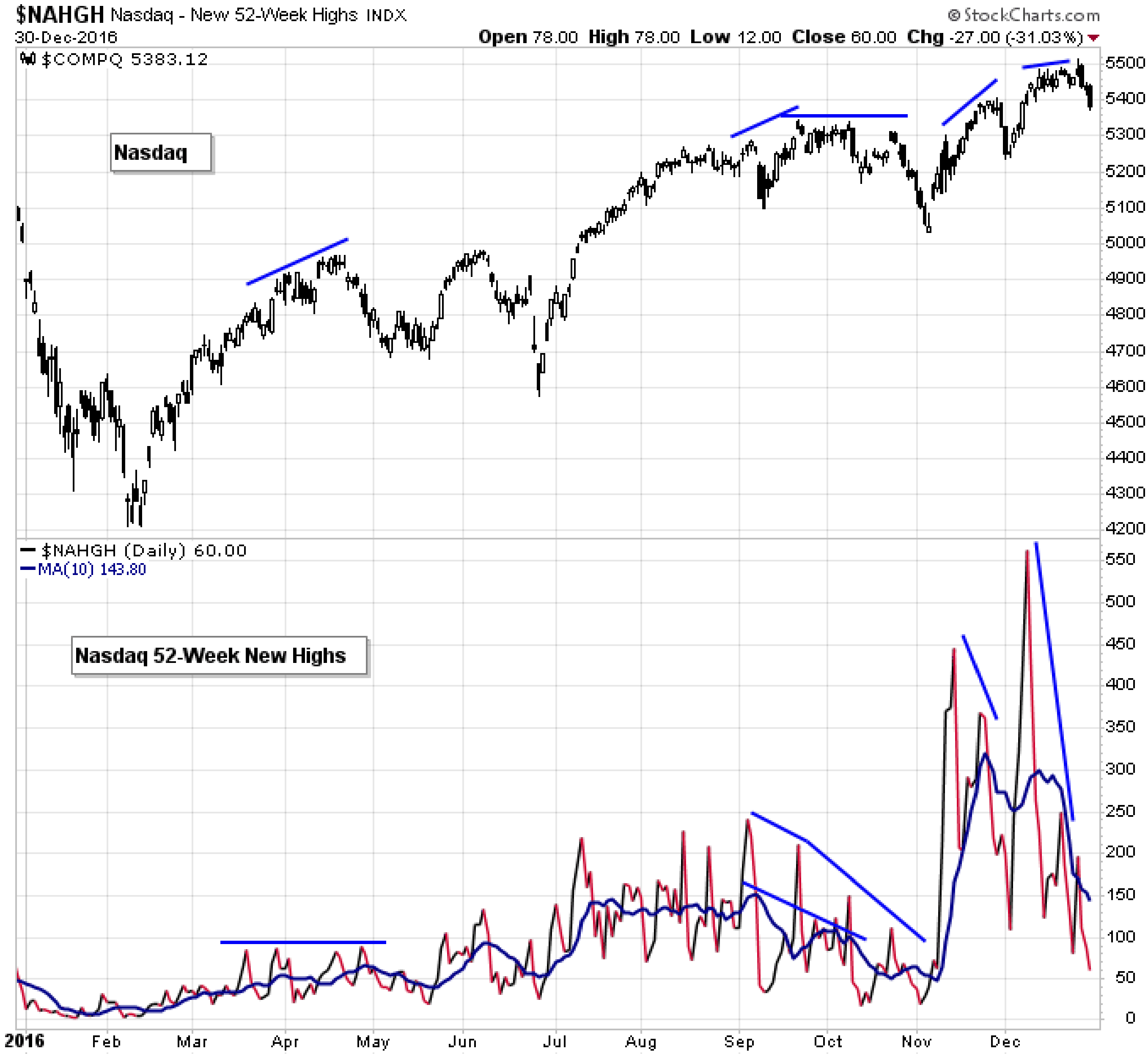
S&P 500 vs. NYSE New Highs: It's not a surprise new highs at the NYSE have fallen off. It's what you'd expect when the market trades in a range for almost three weeks. But if the market attempts to leg up early next year, we'll want to see immediate expansion here. Failure to do so would hint at less stocks participating in the move and limited upside for the overall market.

S&P 500 vs. NYSE New Highs (weekly): Weekly new highs are starting to roll over but are still in good shape overall. As long as it stays above 0, the market's trend will be supported. It's when this indicator drops below 0 that extended pullbacks play out.



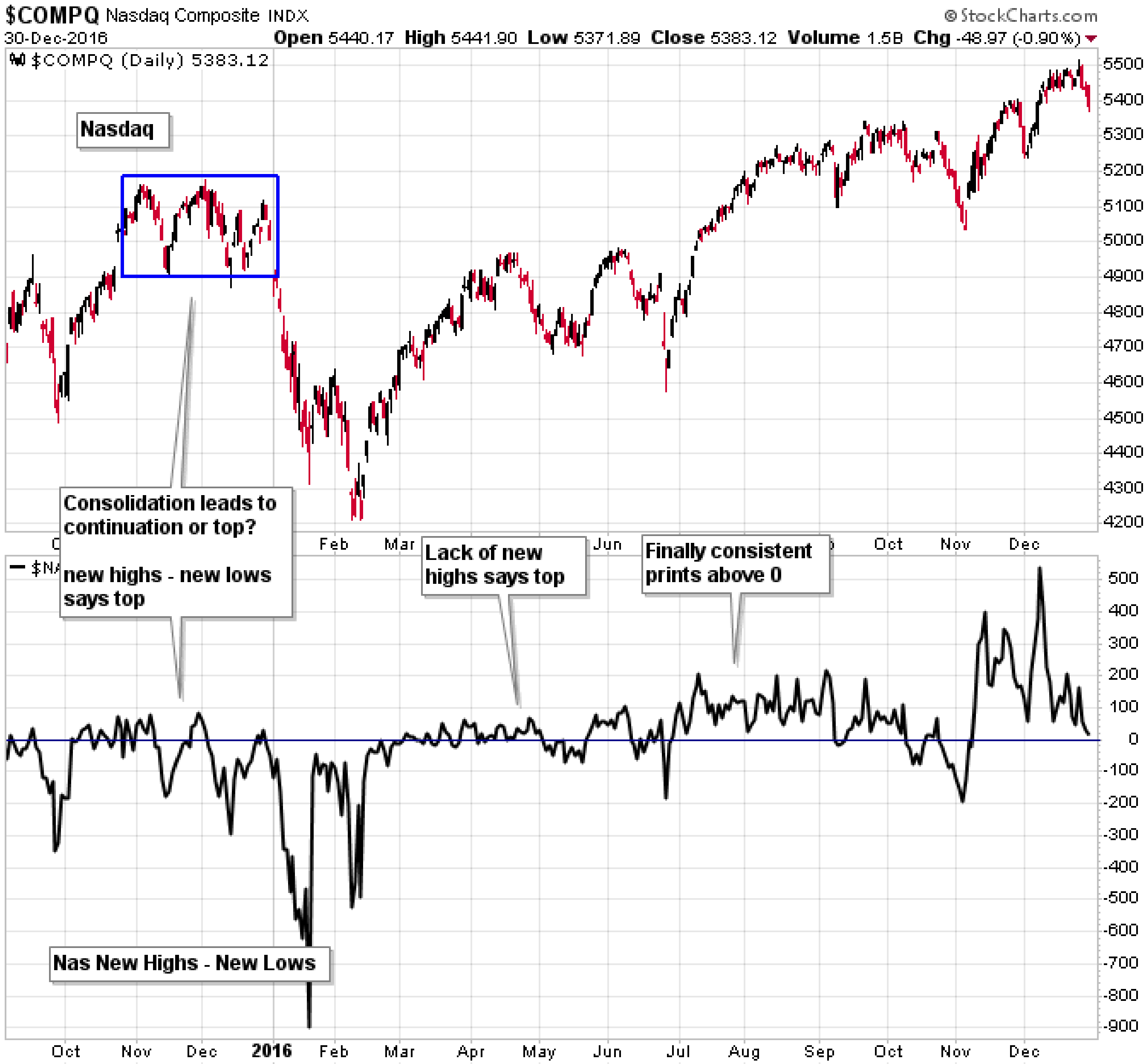
S&P 500 vs. NYSE Highs-Lows: High 'minus' lows at the NYSE remains above 0. Until we get penetrations similar to last November and December, the market's uptrend will be supported.

NASDAQ vs. NASDAQ New Highs: New highs at the Nas have also fallen off. This is fine for now, but when the market attempts to leg up again, we'll want to see quick improvement.

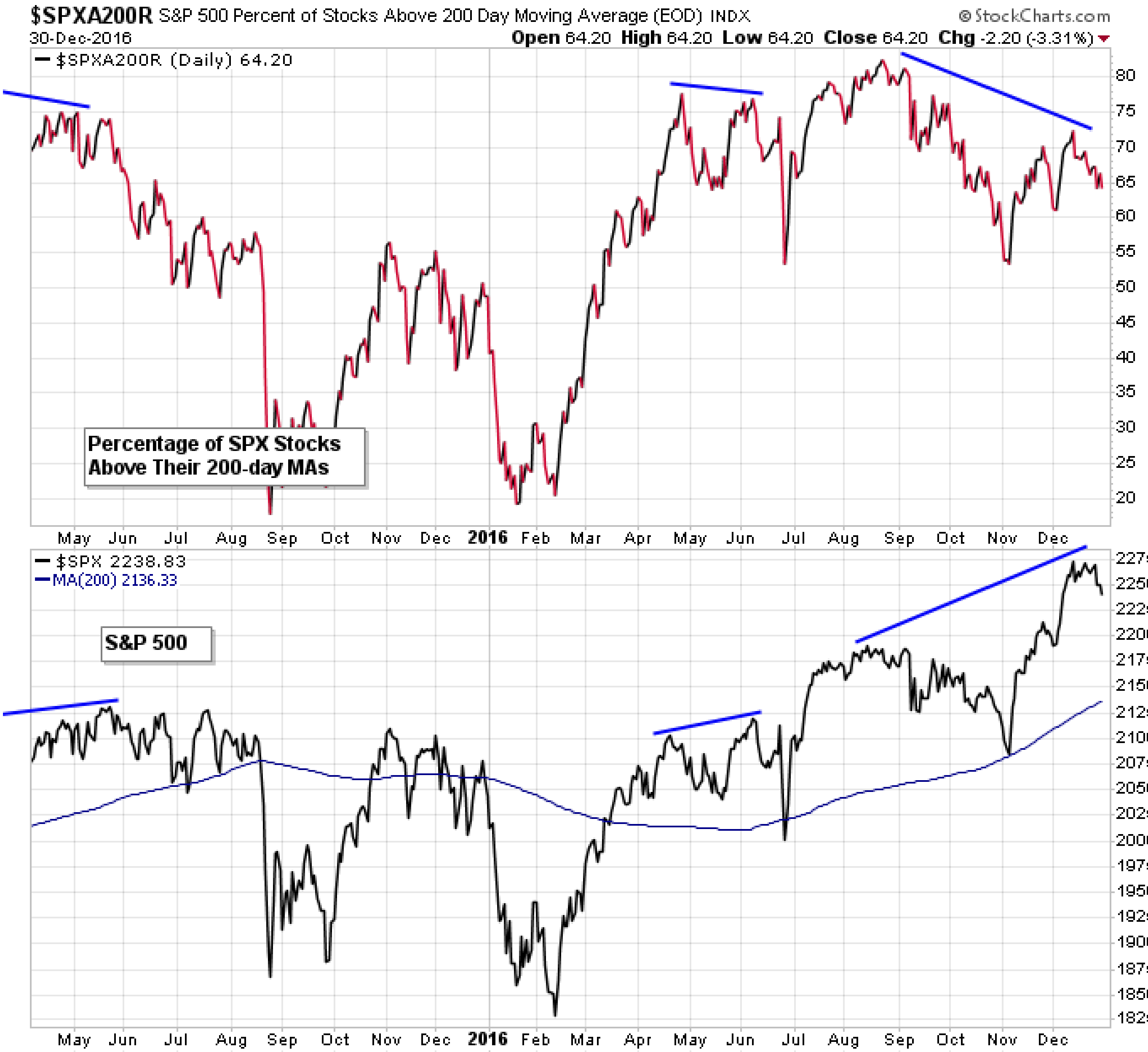


NASDAQ vs. NASDAQ New Highs (weekly): Weekly new highs are getting extended but unlike at bottoms, when an extreme print often leads to a reversal, high prints are a sign of strength that should continue for at least a few months.

NASDAQ vs. NASDAQ Highs-Lows: Consistent above-zero prints from the Nas highs-lows charts is a sign of strength. So far, so good. It's not until this indicator hovers around 0 or drops below it that the bulls should worry about a top forming.

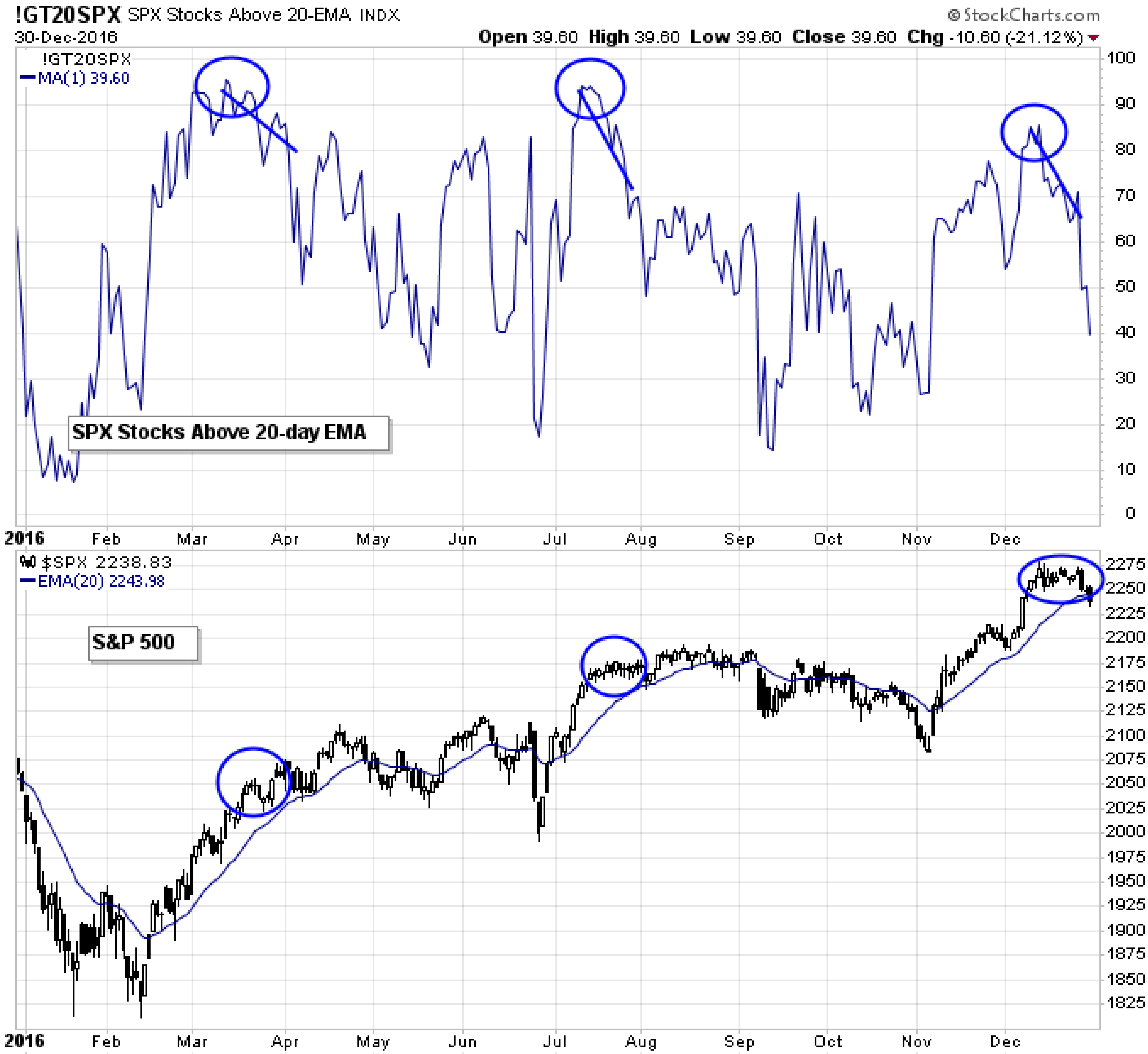


S&P 500 vs. Percentage of SPX Stocks Above 200-day MA: The percentage of SPX stocks above their 200-day moving averages is maintaining a decent level but has still diverged from the underlying index. Less stocks participated in the post-election rally than the post-Brexit rally. It's a concern. If the market moves to another new high, this indicator must move up.

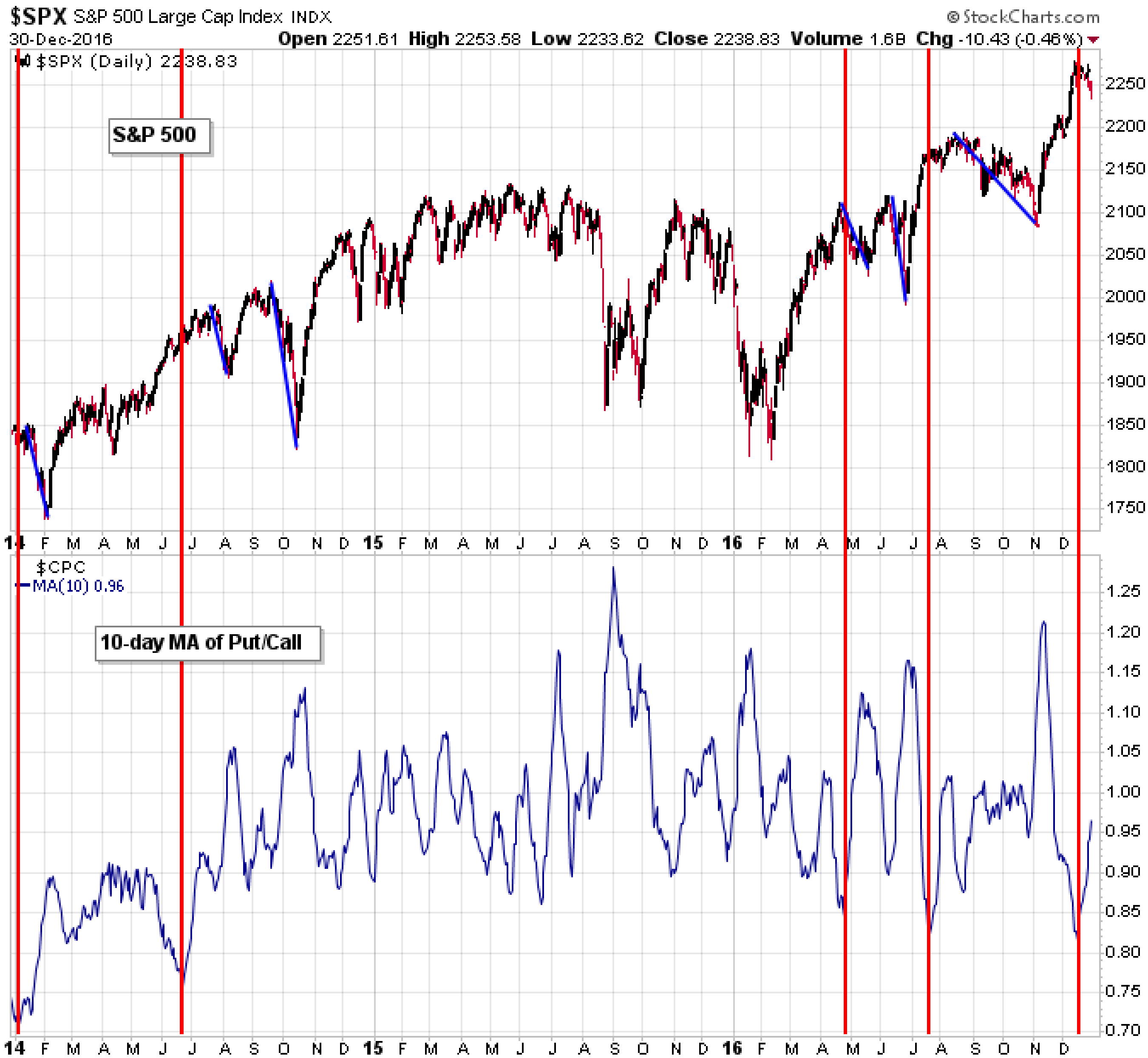


S&P 500 vs. Percentage of SPX Stocks Above 50-day MA: Ditto with the percentage of stocks above their 50-day MAs - decent level but less stocks are participating. The drop from 85% to 70% doesn't seem like much, but 15% of 500 stocks is 75 - 75 less stocks are above their 50-day MA right now than over the summer.

S&P 500 vs. Percentage of SPX Stocks Above 20-day MA: Tops in the percentage of SPX stocks above their 20-day EMAs have coincided with the beginning of multi-month resting periods. It's something to keep in mind.



S&P 500 vs. 10-day MA of Put/Call Ratio: Each time the 10-day of the put/call has fallen to a low level and turned up, the market has corrected within a month.



US Dollar: The dollar has stalled with the overall market. In my opinion, this is one of the big stories heading into 2017 - the strong dollar. How much stronger will it get? Target 108? Target 120? Combined with rising rates, is there a threshold that once crossed will be too much for large corporations to absorb?

The Bottom Line

The overall market looks fine. The trend is up, and the indicators support the price action. I would expect new highs once the current soft patch ends.

In the near and intermediate terms, you could argue for a continuation of the pullback that started last week. The AD and AD volume lines have dropped; new highs have dropped; and the percentage of stocks above various moving averages hasn't matched previous high prints.

So perhaps more weakness to start the year and then another rally to new highs.

The calendar is flipping to a new year, which isn't a major news event per se, but it can act like one. Despite what the charts and indicators suggest, you never know if investors will suddenly buy or sell. Be aware the unexpected can happen simply because it's a new year. Traders' accounts all go back to zero and everyone starts over.

I like the market and therefore will maintain my bullish bias and will continue looking beneath the surface to find the bull markets among the groups. If a top is to form, I'm super confident hints will be offered, and we'll have plenty of time to react. For now, bias remains up.

Happy New Year. Have a great week.

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