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Is a U.S. market correction coming in the summer?

Canadians still hold plenty of U.S. exposure


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To answer the question many investors are surely asking themselves, it's true that the U.S. markets may be getting ahead of themselves. At ValueTrend, we still hold plenty of U.S. exposure, and expect to keep that exposure until the "best six months" period ends in May. Even so, we are concerned that there is potential for a significant correction over the summer on North American markets.

At the same time, some of the other world indexes seem to be breaking out of base formations Perhaps it will be a good time to diversify a bit of our capital away from the U.S. market as we enter the "Sell in May and go away" seasonal period.

Keep in mind that the U.S. market does influence most world indexes (put another way, the U.S. market is the tail that wags the dog). Still, it doesn't hurt to add some diversity in what may prove to be better opportunities within our portfolios.

I should note here that we haven't yet moved on a transition into these ideas- given that we still expect U.S. markets to perform well for the next month or two. But we do expect to rotate at least some capital into the ideas below when we reduce our North American holdings.

Let's take a look at a few examples of attractive international stock charts—indexes that were out of favour and now appear to be in better shape.

Please go to my blog at http://www.valuetrend.ca/international-opportunities/ to view the charts underpinning the ideas in this column.

Europe: A lovely breakout on the **iShares S&P Europe ETF** (IEV-TSX, $41.71) suggests a $45-a-share target. The German index looks particularly interesting right now – although the next level of overhead resistance isn't too far away.

Emerging markets: It's hard to paint the emerging markets with a broad brush. After all, there is so much diversity in productivity, economic states of development, and chart formations that it's probably best to buy individual country ETFs rather than a more general, emerging-markets ETF. Nonetheless, the broad **iShares MSCI Emerging Markets Index ETF** (EEM-NYSE/ARCA, $39.31) chart does show some promise given the nice base breakout recently. Overhead resistance isn't too far away – so I'd probably pick the index apart a bit and buy the better-index ETFs that comprise this one.

For example, I quite like Brazil. This market looks to have much higher resistance levels—offering the potential for more upside.

Shanghai: Despite worries surrounding U.S. President Donald Trump's trade negotiations with China, the Shanghai Stock Exchange continues to motor along.

I recently listened to an economic commentary with Benjamin Tal of CIBC, an economist who I hold in high regard. He felt that many of Mr. Trump's policies could be accomplished (for example, "the wall", immigration policies, etc).

However, it will be quite difficult to change the new economic reality of free trade, and bring back American unskilled labour.

China, India, and other emerging markets will likely continue to supply much of our low-skilled labour for the foreseeable future. The Shanghai chart agrees with that assessment -it suggests a potential return of up to double-digit percentages over the coming months.

North America

As far as North American stocks, here are a few of the recent positions we have been buying and selling in light of a potentially changing environment for North American markets over the summer.

To start, I'd like to offer some cautionary notes on a sector widely held among Canadian investors. Recently, I have become a little concerned about the Canadian banks. The big Canadian banks are looking technically precarious right now. Using the **BMO S&P/TSX Equal Weight Banks ETF** (ZEB-TSX, $27.50) shares as our proxy, we can see that the sector is suffering.

A double top formation on the daily chart was verified by a neckline break of $28. The ETF is now testing support at around $27.

If that level doesn't hold, the Canadian banks could enter into a new world of pain. Volume on the topping formation is high, which suggests that this top may be the real deal. The volume is unique to the ETF, but ZEB is owned by many investors who want exposure to the sector—so the higher volume is indicative of the changing viewpoint on the sector.

Watch $27 carefully on this ETF – a break would be quite bearish.

The U.S. banks have been hit as well. However, the technical formation that I see on the sector does not yet look like that of a typical top. It simply hit a peak, and fell. There was no "complex" action of a market that is struggling to find new highs like there is in a double top (as in the case of Canadian banks) or a "head and shoulders" or rounded top-type occurrence.

The daily chart below shows a pretty clean peak, and then a decline to pretty much exactly the prior level of support, and a clean bounce from that level – so far.

Further, there was no negative divergence on momentum indicators – as I noted there had been on the Canadian bank stocks. My conclusion is that the technical profile for U.S. banks, despite the clear sell-off that occurred in tandem with the Canadian banks, does not look like a topping formation.

Seasonally, U.S. banks should have more than a month of upside left in them—they can be strong well into May. Interestingly, seasonal patterns show us that a sell-off can indeed occur in the late part of March.

I've circled it on the chart below. Coincidence or not, the recent sell-off occurred on schedule according to the seasonal chart – and the point has been a good spot to enter for a final thrust on that sector historically.

The current technical profile on the daily chart lines up with this seasonal tendency. We are taking a short-term (one to two months) trade on the sector via the **BMO Equal Wt U.S. Bank ETF** (ZUB-TSX, $24.83), which is currency hedged. There are many U.S. bank ETFs, and the big guys tend to move along with the group, so choose your favourite bank or ETF if you wish to take advantage of this possible opportunity. Seasonal studies suggest bonds are strongest over the summer. The **Long U.S. treasury ETF** (TLT-NASDAQ, $123.09) looks interesting at this point. It's been basing between $116 a share and $122. Meanwhile, momentum studies are diverging bullishly- momentum is rising despite a sideways pattern.

Cash flow is slowly turning around after the big sell-off last year, a good sign – this means that some investors are starting to buy back into this asset class. One could consider an entry on this ETF if it goes back to $116 – or if it breaks through about $122 on volume.

To me, it looks like a decent risk-reward trade if either of those scenarios develop. In fact, the Canadian bond market looks like it's already breaking that base. Take a look at the **Canadian Core Bond ETF** (XLB-TSX, $51.81) below. It's broken out of the consolidation lid at $23.50 and looks to target the old highs of $25.

The pattern exhibited rising troughs during the consolidation – another positive sign. Moneyflow is turning around, momentum has been moving up. All looks OK thus far for the Canadian bond market and the XLB ETF.

Perhaps what I am proposing are not big-profit trades, but they may well be decent hiding spots considering the potential for stock market volatility this summer, and the favourable risk-reward profile of bonds at this time.

Keith on BNN

I'll be on MarketCall Tonight on Wednesday, May 3 for the 5:30 p.m. show. Phone in with your questions on technical analysis for Keith during the show. Call toll-free to 1-855-326-6266 or email your questions ahead of time (specify they are for Keith) to marketcall@bnn.ca

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