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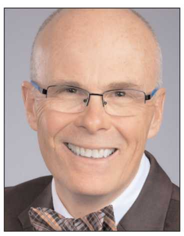
BREAKING OUT

Tech signs point toward a bullish market



Keith Richards

There are signs pointing towards a bullish market right now. The main ones are:

Evidence of a new uptrend: The recent break over the old highs of the mid-2,900s on the major U.S. stock market index, the S&P 500, shows us that we are no longer contained in the 18-month sideways trading range that both Canadian and U.S. major markets have been trapped in. I verify upward trends by both new highs and by the last trough on a weekly chart being higher than the prior trough. In this case, we saw a "higher low" in May of this year, after the washout last December.

Evidence of market strength: A market that remains above the 200-day Simple Moving Average (SMA) is considered a strong market. We are witnessing that condition right now on the S&P 500.

At ValueTrend, we had concerns about the S&P 500 failing at the old highs – which it had some three times over the past 18 months. Time after time, the S&P 500 would get into the mid-2,900s, and promptly roll over to decline again.

That fear was eliminated when the market took out 2,950 and stayed above that level for several weeks. My three-bar rule confirmed that the recent breakout is legitimate. The three-bar rule, which I cover in my book *Sideways: Using the Power of Technical Analysis to Profit in Uncertain Times*, states that mid-to-long-termed investors can identify if a breakout is legitimate by counting three bars (three weeks on a weekly chart). If the market stays above its old highs for that period of time, you are most likely seeing a legitimate breakout.

It's not always correct, but the rule has served me well by avoiding buying when any security is just spiking through an old point of selling pressure before it turns down. Combined with the adherence of the S&P 500 over its 200-day Simple Moving Average, the case for a bull market trend resuming is good.

For this reason, we reduced our cash holding from (then) an equivalent of 26 per cent cash to (now) 16 per cent cash in our conservative equity platform.

When markets were clearly trading sideways, my system forced me to take a cautious stance. Caution is our middle name, and I never regret putting safety ahead of risk, even at the expense of underperforming the market for a while.

Despite the probability of decent market trends, I still think it's prudent to hold a bit of cash for a few reasons.

Seasonality suggests that markets can often be volatile until late October. This tendency doesn't always show up, but the long-term data demonstrates that if a sizable correction or crash is going to occur, it will more often than not occur within the May-to-October period. At ValueTrend, we always hold a little cash over the summer, along with rotating into lower-risk sectors of the market such as staples, REITs, and utilities.

We are seeing some signs of "risk-on" again – which is good, so long as it doesn't run away on itself. Too much risk-on indicates that market adherents are overly optimistic –something that typically occurs before a correction. There are early signs of that potential.

Signs of risk-on

The long bond, as tracked by the **iShares 20+ Year Treasury Bond ETF** (TLT-NASDAQ, US$131.79), hit old resistance after reaching an extremely overbought condition, and has been reversing downward in price a bit lately. A rising long bond price is indicative of a flight to safety.

Conversely, if bond prices decline, it indicates a flight to riskier assets and away from safety. That's a good thing, but you don't want it going too far towards "caution into the wind". Note the downward turn on the TLT chart below.

Some indicators I watch suggest an overbought condition. For example, the percentage of stocks over their 50-day SMA is a breadth indicator. Breadth is another way of saying wide distribution of stock movement – that is, the market is moving on a broad number of stocks, and not just a few concentrated sectors. You want breadth to be positive, but signs of "too much" participation can often signal near-termed pullbacks.

Some indicators, like the VIX (volatility index) and the CBOE put-to-call ratio are nearing, but not officially in, "complacent" territory, but they may get there if things continue as they have. The VIX is indicated as "too complacent" when below 12.

In 2017, it stayed below 12 for most of the second half of the year. It was a party that looked to never end. Until it did – as 2018 and half of 2019 (up until the recent breakout) brought with it a go-nowhere market.

The ratio of "smart money" versus "dumb money" confidence levels is into bearish levels.

Smart money includes institutional investors, commercial hedgers, etc. Dumb money consists of, well, you and me. We are retail investors, and, sorry, but we are considered "dumb money".

And while you – who read *Investor's Digest*- are likely not quite so dumb as the rest of the folks that make up our otherwise fine fellow investors – there are enough retail investors out there who do the wrong thing at the wrong time to pay attention to their moves. And right now, they are bullish – while institutional investors are becoming cautious. In the past, this has led to poor market returns more often than not.

Conclusion

With the new highs on the market, we're back to bull market status…Something the market has NOT been in since the end of 2017. A bull market is comprised of higher highs and higher lows. Recall —we had no new materially higher highs and higher lows over the past 18 months. We now have those conditions in place–higher highs, higher lows, and the market is over its 200-day SMA. And that's all very bullish.

Yes, there are signs of this market being overbought. That, and market sentiment seems pretty complacent. Plus there's that seasonal stuff…But the trend is the trend. Thus…I'm in, but I have a bit of cash. Just in case.

Keith at the Toronto MoneyShow

I'll be speaking on Friday, Sept. 20 at 4:15 p.m. at the Toronto MoneyShow, being held at the Metro Toronto Convention Centre. This year, I will be presenting some strategies taken directly out of our VTAGS (ValueTrend Aggressive Growth Strategy) platform. I think you'll find it informative!

Keith on BNN Bloomberg

Keith appears regularly on BNN Bloomberg's *Market Call* to answer viewer questions on the technical analysis of stock trends, and to provide unique insights on the factors of technical analysis used in successful investment management. His next appearance will be on Thursday, Aug. 29 at 6 p.m. (Note: Times and dates may be subject to change.)

If you have questions about the technical analysis of stock trends for individual stocks, be sure to phone in with your questions for Keith during the show. Call toll-free at 1-855-326-6266 or you can also email your questions ahead of time (specify they are for Keith) to marketcall@bnnbloomberg.ca.

Keith Richards is Chief Portfolio Manager & President of ValueTrend Wealth Mgmt. He can be contacted at info@valuetrend.ca. He may hold positions in the securities mentioned. The information provided is general in nature and does not represent investment advice. It is subject to change without notice and is based on the perspectives and opinions of the writer only. It may also contain projections or other "forward-looking statements". There is significant risk that forward-looking statements will not prove to be accurate and actual results, performance, or achievements could differ materially from any future results, performance, or achievements that may be expressed or implied by such forward-looking statements and you will not unduly rely on such forward-looking statements. Every effort has been made to compile this material from reliable sources; however, no warranty can be made as to its accuracy or completeness. Before acting on any of the above, please consult an appropriate professional regarding your particular circumstances.