Current trading strategy

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October is known as the "bear killer" month. Despite its reputation for big crashes, September is actually the historically worst month for negative returns. Last month proved that pattern to be true! October can indeed experience big selloffs – such as 1929, 1987, 2008. October can also be the capitulation point and/or turnaround point. Market selloffs in 1987, 1990, 2001, and 2002 turned around in October to begin long-term rallies. Today, we'll look at the technical picture – including Friday's break of 3600 by the SPX – and the recent Bear-o-meter reading for a picture of the current risk/reward tradeoff. Lets get started:

"Everybody in the world is a long-term investor until the market goes down."
—Peter Lynch, American investor, mutual fund manager, manager Magellan Fund at Fidelity Investments 1977–1990

Current Risk/ Reward tradeoff

Most of you are aware of my Bear-o-meter. Quick refresher: It measures various indicators on a purely quantitative (no emotion or opinion) basis to determine the relative risk vs return on the US stock market at any given time. The Bear-o-meter assigns points for each indicator, some being more important than others, under the broad categories of **Trend, Breadth, Value, Sentiment, Breadth-momentum and Seasonalit**y.

A score of 0-8 is assigned, where "8" is an uber-low risk/ high opportunity signal. A "0" is an uber high-risk/ low opportunity signal. There are 3 general zone, where 0-3 is unfavorable, 3-5 is neutral (and where the score tends to stay most of the time), and 5-8 is very favorable. If you type "Bear-o-meter" into the search engine of this blog, you will see that the meter has maintained a "high risk" rating each month since April 3, 2022. Its been accurate. You can learn to construct the meter yourself by reading Smart Money/ Dumb Money.

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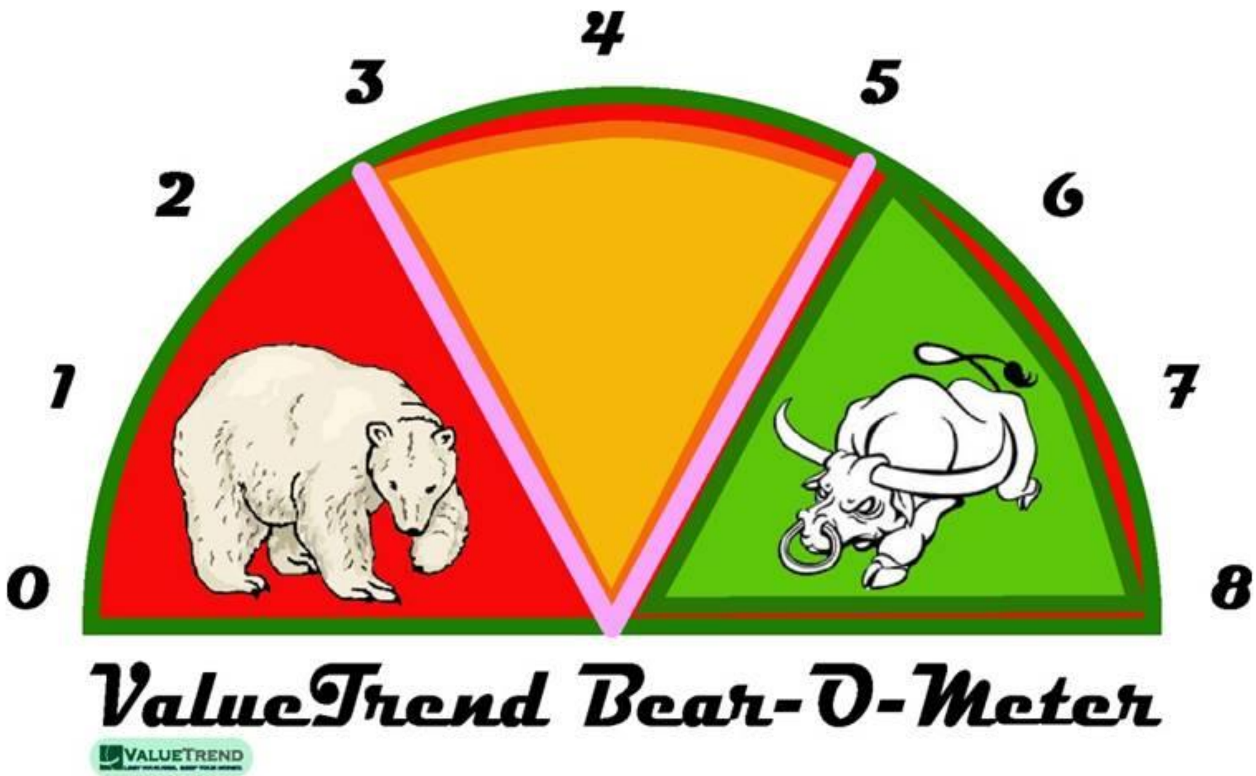
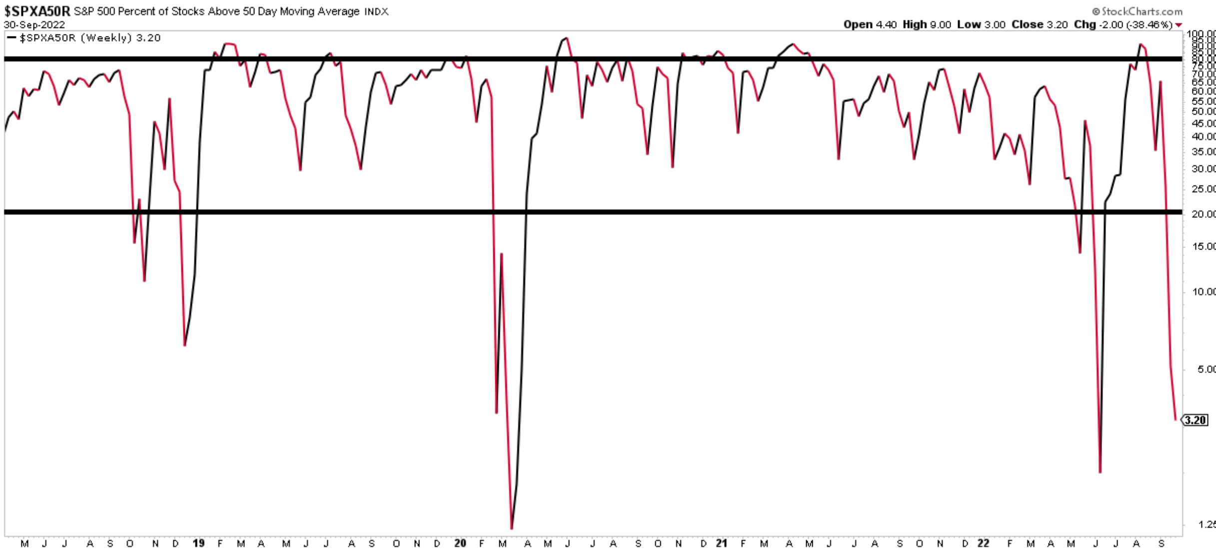


Ok, so where are we now? The Bear-o-meter, which reads the indicators from the last closing day (Friday Sep. 30th 2022 in this case) moved up 2 notches – a good sign. It currently sits at "2". The indicators adding to the increased score on the meter (from 0) since last month were the NYSE New High/Low indicator, and the % of stocks over their 50 day SMA's on the SPX (below). Both are severely depressed, which is a sign that the market is becoming oversold. Interesting as well, the Smart/Dumb Money scale from Sentimentrader.com is now well into the bullish zone – whereas last month it was only marginally positive. However, balancing those positives are the negatives we continue to witness in trend, seasonality, and most of the sentiment indicators – which are not quite at the capitulation point yet (beyond the Smart/Dumb indicator).



Technical analysis

The chart below shows us that negative moves (prior to counter trend rallies) have been around 10-13% except for the April-May selloff, which was almost 18% before a countertrend rally happened in May. That countertrend rally didn't bring the market back to the top of the trend channel (see my blue measurement line)–it only rallied about 11.5% before bottoming out in June. The June-August rally made up for May's wimpy efforts by reaching and briefly breaking the top of the trend channel. Right now, we are down about 12.7% since the last small rally in late August. We are also close to the bottom of the bear-channel. So, its getting closer to the timing of a rally, at least.

Meanwhile, we did see a break of 3600 support on Friday. Today I see the market opening marginally higher and a smidgen over 3600 again. I cannot tell you if we are in for a meaningful rally just yet – although some evidence suggests that we may have to wait a little more before such a rally happens (we shall see). We do have some of the conditions present now for that potential rally, including some of the factors noted above in the Bear-o-meter turning a bit more positive. Also – note the position of price in the channel (aka its near the bottom). That's a positive. RSI is showing a very good oversold signal. MACD has not hooked up yet. Keep n mind that MACD is a slower moving indicator – it is comprised of moving averages and their respective difference, which take a while to show on the oscillator.

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Conclusion & Strategy

All in, the technical profile and the Bear-o-meter both suggest the bear is not over yet. However, **there is a high potential for a decent rally soon**. We can choose to play that rally, and/or use it as an opportunity to sell into it. At ValueTrend, when we play short termed trading strategies, we tend to avoid individual stock risk and play index ETF's instead.

If 3600 is cracked and stays there, more downside to come. See my blog from Friday. Keep in mind…if 3600 + holds for a few weeks (at least 3) – there is potential that the market has bottomed. As such, I will re-visit the Bear-o-meter before the end of this month. ValueTrend will deploy cash on a more permanent basis (beyond a counter-trend rally trade in index ETF's, as noted above) ONLY IF the SPX remains over 3600 by the last week of October. I want to see a technical and risk signal that is neutral or bullish before deploying cash in quality stocks. Way too precarious to predict that happening from this vantage point, especially given the trend channel and continued risk ratings put out by the Bear-o-meter.

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