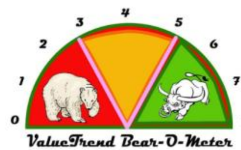

Sell in May and go away? Bear-o-meter says "yes"!

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Before I get to the new Bear-o-meter reading, I thought I'd post an interesting chart created by Jason Castelli, Technical Analyst with Raymond James. For the record, Jason notes that he didn't re-capitalize the index (a feat that would be cumbersome, and likely inaccurate even if attempted). As Jason notes:

While the chart is not a perfect representation (based on price rather than market cap weighted) it does speak to how the breadth of the rally has been narrowing, which is something I highlighted in prior emails. The S&P 500 price level less AMZN in the top panel looks considerably different that the actual S&P 500 in the lower. This chart is for illustration purposes as it places a heavier importance on AMZN than actually exists in the broader market.

I post this chart because it ties into some of the observations I made when running through the Bear-o-meter compilation. Market breadth, or participation, is one of those factors. I'll be visiting the subject of breath below. Jason's re-worked SPX chart shows us that broad participation in this rally looks weak if you remove AMZN, even if the chart isn't entirely accurate.

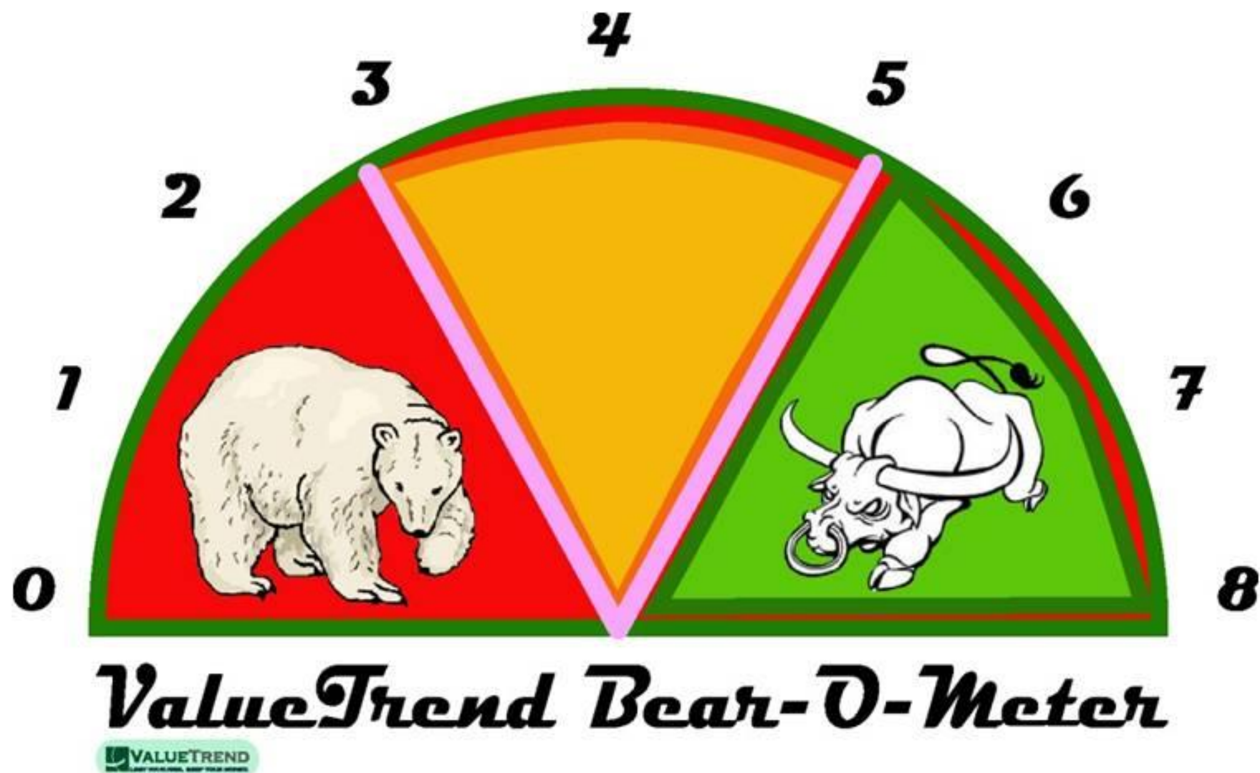
As a refresher (you don't need to read this if you follow this blog regularly):

The Bear-o-meter is a risk/ reward indicator. It's a compilation of 12 indicators falling under 6 general classifications:

- ***Breadth:*** *This is an indication of the market's "conviction" – it measures things like the movement of the Dow Industrial stocks vs. the Dow Transports, and the cumulative number of advancing stocks vs. declining stocks on an index. More participants in a move, be it up or down, means more conviction by market participants in that move.*
- ***Trend:*** *Moving averages tend to indicate how strong a trend is, depending if the market is above or below the given moving average. The longer the moving average, the more significant that average is in determining the strength of the trend.*
- ***Breadth momentum:*** *Sometimes, when too many stocks are moving up or down too vigorously, we have a problem. Breadth momentum looks at things like the total number of stocks making new highs vs. new lows, and the number of stocks above or below their moving averages. If they go over or under certain numbers, we get overbought/oversold indications. I find breadth momentum more telling of forward looking risk than standard momentum indicators like RSI and ROC- which simply focus on overall index price moves. That's because breadth momentum shows the internal convictions of the markets by examining the individual participation of a move more closely.*
- ***Sentiment:*** *Sentiment looks at fear and greed. Its a contrarian indicator. Too much bullishness is bad. Too much fear is good. I'm looking for extreme ends of those two market attitudes. A good sentiment indicator like the VIX or the put/call ratio can give us a heads-up of irrational exuberance or despondency by market participants.*
- ***Seasonality:*** *Season studies were first conducted by Yale Hirsch, founder of the Stock Traders Almanac. Canadian analysts Brooke Thackray and Don Vialoux took up the gauntlet for seasonal studies here in Canada. All of these analysts have proven the statistical relevance of reducing equity exposure in the summer months and re-entering the market in the fall. It doesn't work every year. But, it works well enough to be a factor in the Bear-o-meter.*
- ***Valuation:*** *As a Technical Analyst, I try not to spend too much time examining market valuations. However, one indicator remains a reasonably good longer termed indicator of relative market value. That's be the good old PE ratio on the S&P 500. Too high, and its an extended market. Too low, its undervalued. The problem with the pE ratio is that its really not a good timing factor. Markets can remain overvalued for extended periods of time. But, its still a factor that should be noted, as valuations will at some point regress to their longer termed mean average. Hence, I use it as one factor in the Bear-o-meter.*

Where the Bear-o-meter stands today

As many of my regular readers know, the Bear-o-meter assigns risk on a scale of 0-8. A reading of 3 or under is generally a higher risk market. A reading of 3-5 is about "average" for a risk/reward trade-off. Anything 5+ is considered lower than average risk. Last month's reading came in a t a very neutral level of "4". Risk and reward were about even. Most measurements of the Bear-o-meter fall into this neutral zone (Star Trek reference unintended). The current reading of the Bear-o-meter is "1". This suggests the market presents a less attractive risk/reward trade-off at this time.



Hate to say it, but you've got bad breadth

Beyond seasonality, the big loss of Bear-o-meter points came in from market breadth. As noted on Jason Castelli's chart above, the market's rally since the March low point has been on a pretty narrow group of stocks. This can be seen in the percentage of stocks in the S&P 500 over their important moving averages. While the % over their 50 day SMA did rise from an oversold level of only 5% last month to 58% this month – the number of stocks over their 200 day SMA's remains below 25% within the index.

New high/New low ratio shows a break even number of stocks making new high vs. those making new lows. This is another indication that not all ships are rising with the tide, as is said.

The most distressing of the indicators was the Industrial stocks (INDU) vs. Transportation stocks (TRAN) reading. This comparison comes from Dow Theory, which states that these two averages should confirm each other. While we don't have outright divergence, we do have a vastly under performing transportation sector compared to the industrial sector. The chart below illustrates this discrepancy. Transports are the black line–note the monstrous decline vs the industrial line, in red.

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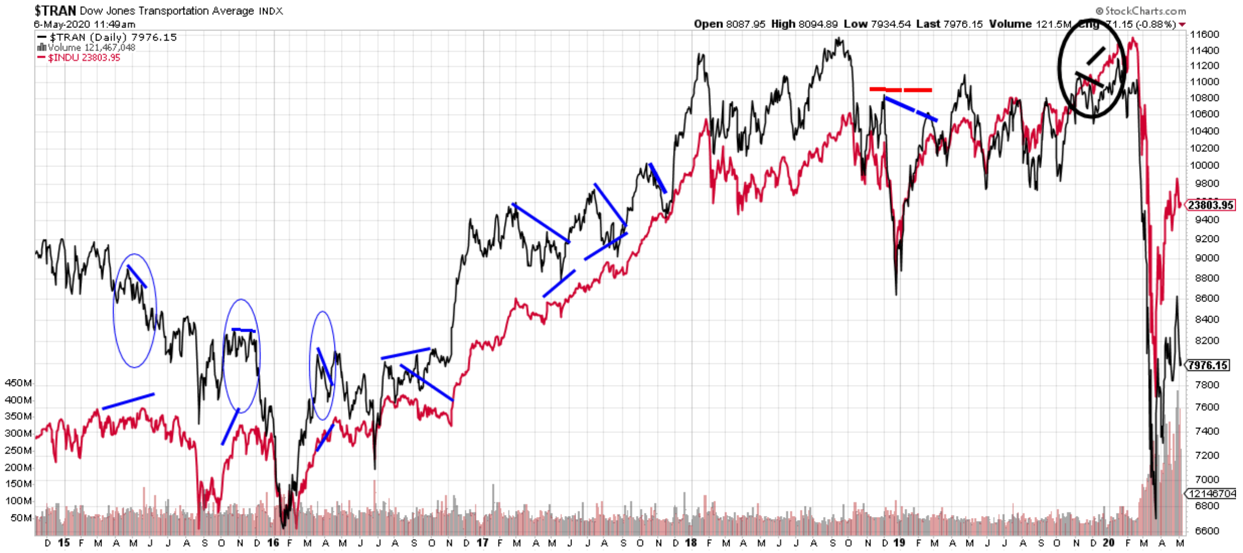

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