Strategy

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Technical Strategy

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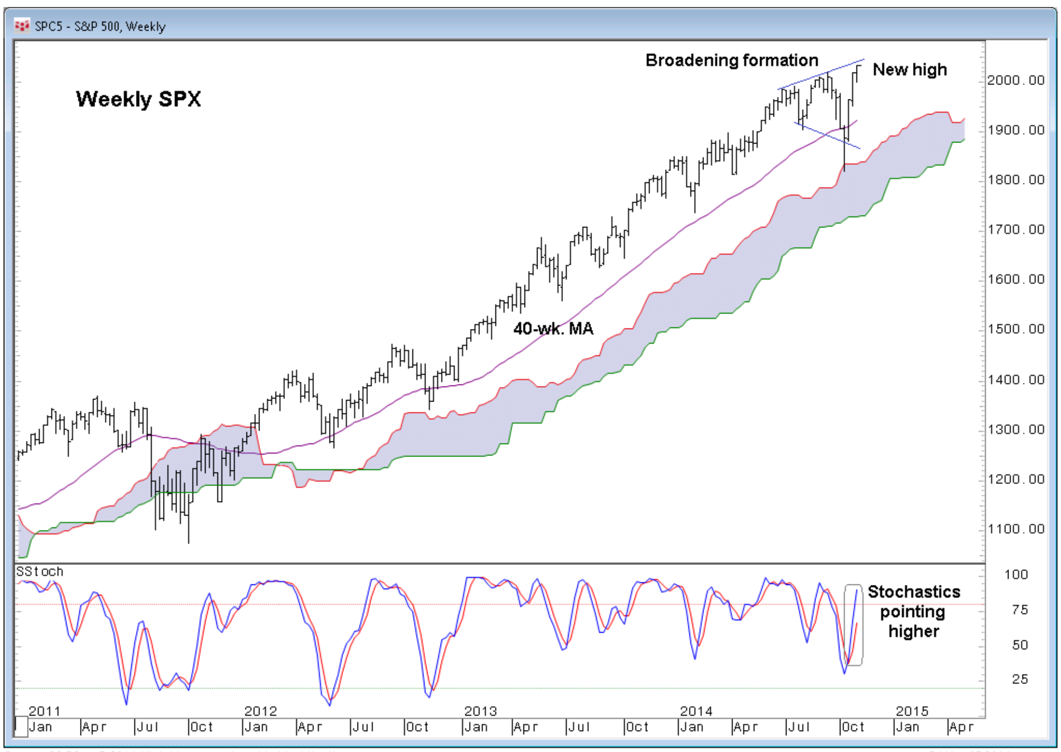
Global Technical Strategy

Broadening Formation

The S&P 500 Index (SPX, 2031.92) reached a new all-time high last week as it confirmed its breakout above resistance at its September highs. The breakout yields a measured move target of approximately 2100, about 3% above current levels, with an intermediate-term time horizon. We hold a bullish outlook for Q4 given the breakout and the breadth behind it, not to mention the positive seasonal influences that tend to arise in December. However, we hold a more cautious view beyond year-end because the broadening formation on the accompanying weekly chart could give way to a significant downmove in early 2015. When the weekly stochastics roll over and fall back below 80%, we would be more inclined to take profits, noting that the SPX is well above support defined by the weekly cloud model (currently near 1840-1850). In the meantime, we would seek out stocks that are breaking out or have recaptured momentum after becoming very oversold. A pullback does not appear imminent because short-term momentum is strong, but we expect signs of short-term exhaustion per the daily stochastics and/or the DeMark indicators toward the end of the week, which we will note in our daily *Technical Playbook*. This would position the SPX for a pullback ahead of Thanksgiving week.



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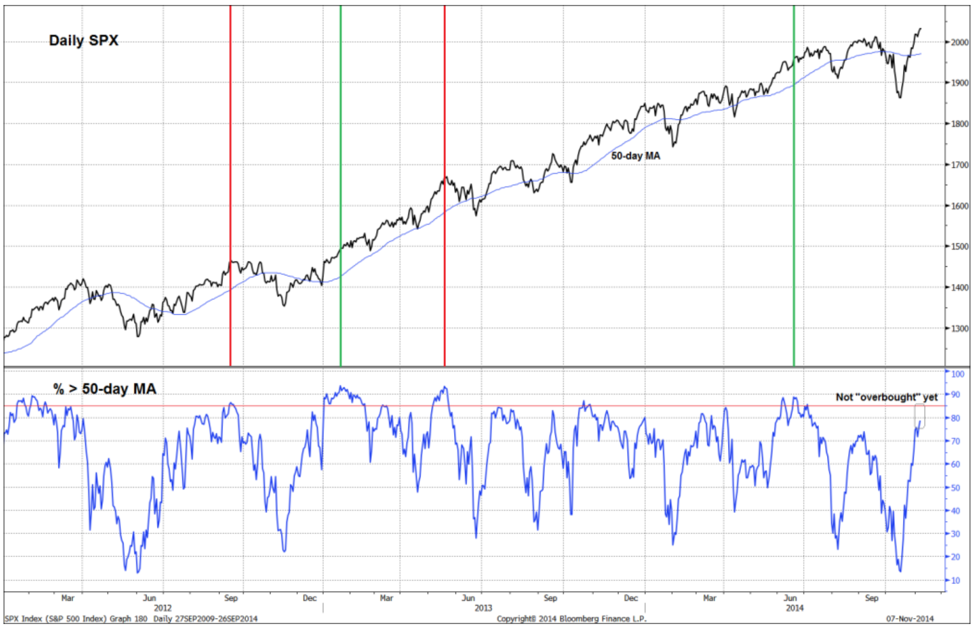
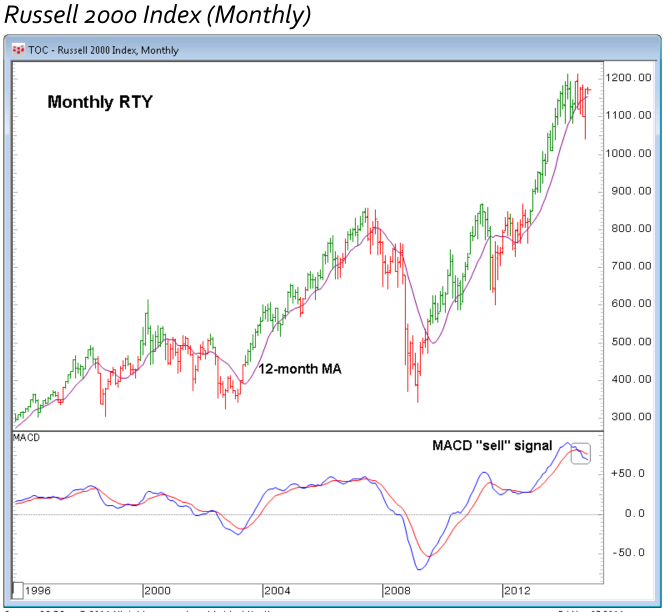
The breadth behind the rally in the SPX has been impressive, with about 60% of its constituents having climbed back above their 50-day moving averages since the mid-October low. This may seem "too far too fast," but there is room for breadth to expand per the following percentage of stocks above their 50-day moving averages. Peaks in this oscillating indicator of breadth tend to occur above 85%, and the current reading is 79%. Also, peaks do not always translate into market tops – note the SPX forged higher after two of the four instances of 85%+ readings since mid-2012.

S&P 500 Index with Percentage above Their 50-Day MAs (Daily)



The Russell 2000 Index (RTY, 1173.32) has recaptured positive short-term momentum along with the SPX, but its loss of *long-term* momentum has been significant. The monthly MACD indicator has been on a "sell" signal since August, denoted by the red price bars pictured below. The average duration for a monthly MACD sell signal is about 8.5 months, which equates to next March-April, thereby increasing risk in Q1 of 2015.

Russell 2000 Index (Monthly)



Emerging markets have lagged the U.S., but oversold conditions have generated stabilization nonetheless. The iShares MSCI Emerging Markets ETF (EEM, $41.22) has held up above important support near $40.40, based on a Fibonacci retracement level. The upturn in the weekly stochastics from oversold territory supports more of a relief rally, but we would be a more interested buyer on a breakout above the 200-day (~40-week) moving average. This would reflect improved momentum and would target resistance near $45, which was tested unsuccessfully in September.

iShares MSCI Emerging Markets ETF (Weekly)

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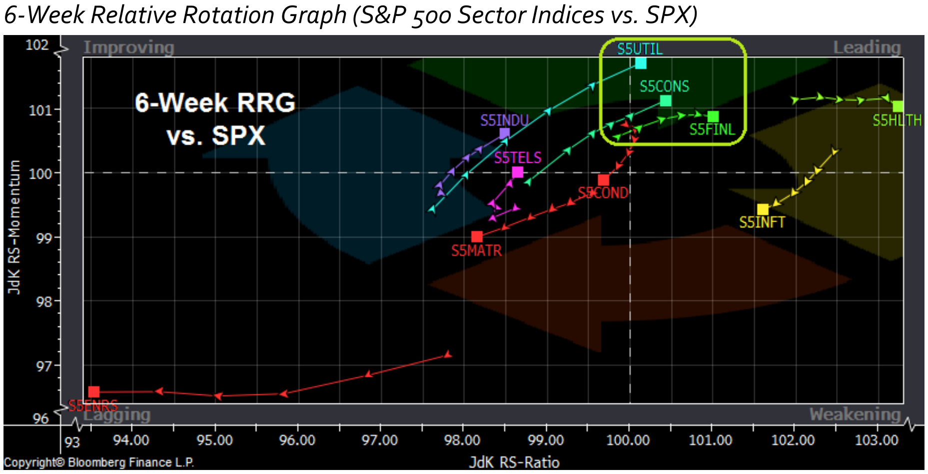
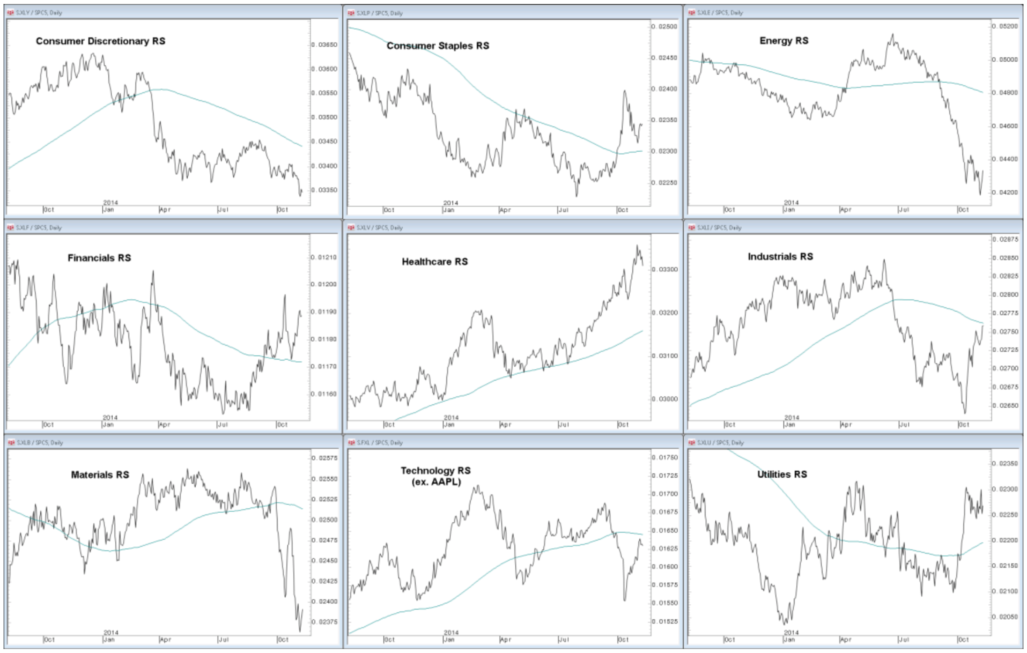
On the U.S. sector front, healthcare finally appears to be losing momentum versus the SPX. The following Relative Rotation Graph (RRG) still has healthcare in its Leading quadrant, but it has seen a downtick that makes it less compelling. The clockwise trajectory of the RRG favors consumer staples, financials and utilities, which would be in following with downside follow-through in the 10-year Treasury yield (see page 5). Note that the sectors in the Leading quadrant of the RRG also happen to be the only ones above their 200-day moving averages versus the SPX, based on the ratios on the following page. The industrial and telecom sectors hold promise, but we think it is too early to look for sustained outperformance from them.

6-Week Relative Rotation Graph (S&P 500 Sector Indices vs. SPX)



U.S. Sector Relative Strength (ETFs vs. SPX)

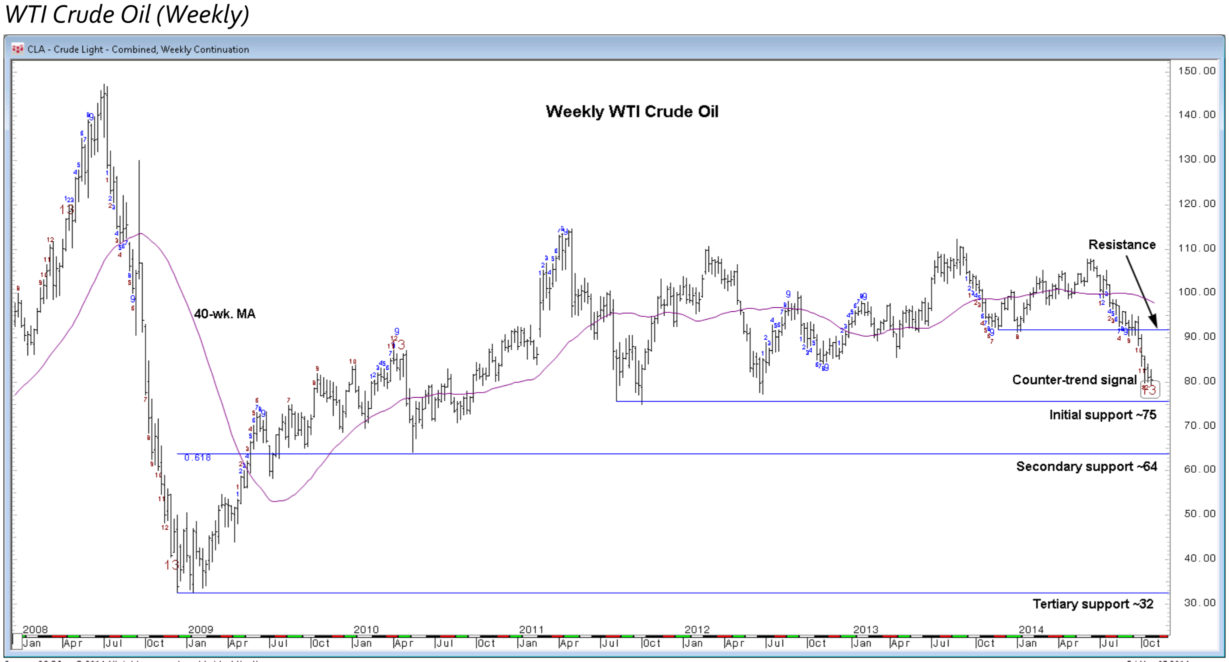


Source: CQG 11/7/14

Technical Outlook – Commodities

WTI crude oil futures ($78.65/bbl.) have broken down below the widely-watched $80/bbl. level. We are no longer convinced of the importance of this level, however, having discovered that the chart that showed support there was not the standard rollover contract. The chart we show below is the equivalent to Bloomberg's generic contract, which is likely a more reliable view of historical support, and it shows $75/bbl. as being more important than $80/bbl. In addition, it also shows a new DeMark "13 buy" signal that raises the possibility of stabilization in the weeks ahead. We are still not willing to advocate counter-trend positions, but the risk/reward is getting more favorable for crude oil with initial resistance near $87/bbl.

WTI Crude Oil (Weekly)



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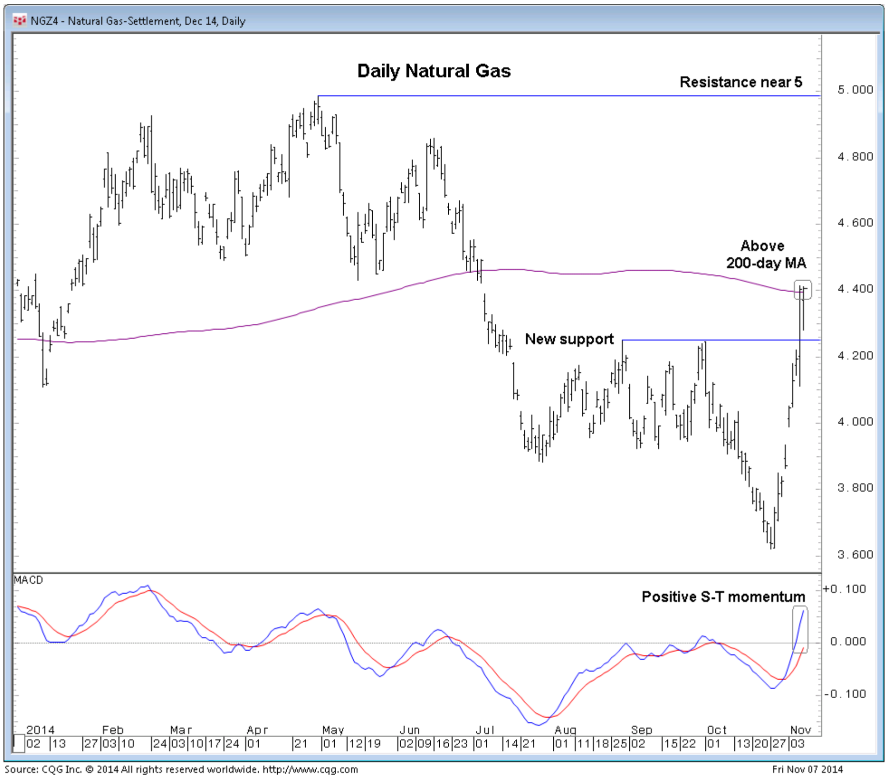
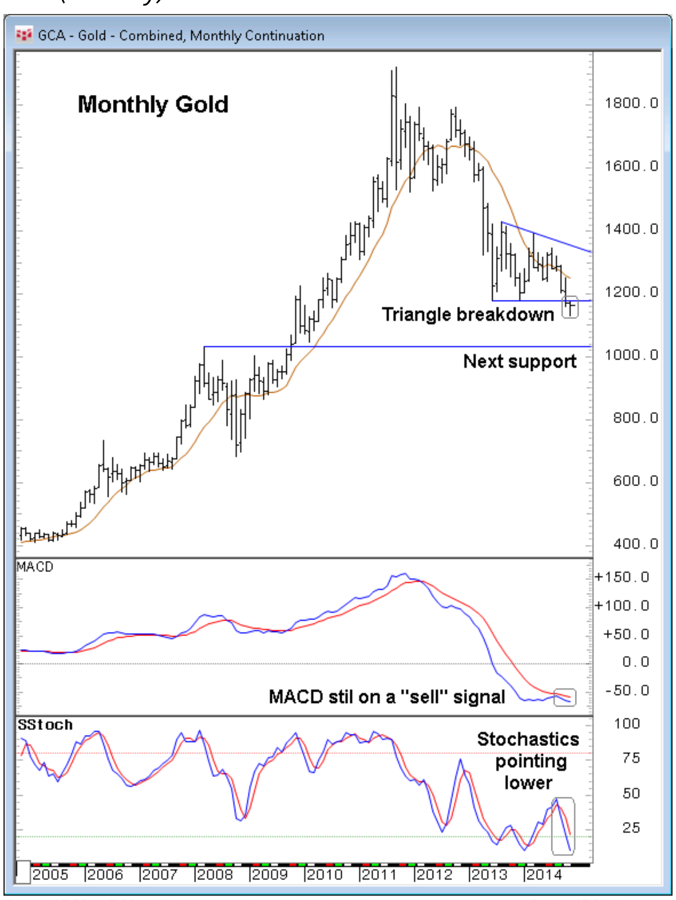
Natural Gas (Daily)



Natural gas futures ($4.421/MMBtu.) exceeded their 200-day moving average last week after a nine-day rally of more than 24%. The reversal was abrupt, making October a shakeout (in hindsight). We expect positive follow-through because there are now MACD "buy" signals on the daily and weekly charts. The next resistance for natural gas is near the psychologically significant $5.00/MMBtu. level, and the breakout point near $4.25/MMBtu. is now initial support.

Gold (Monthly)

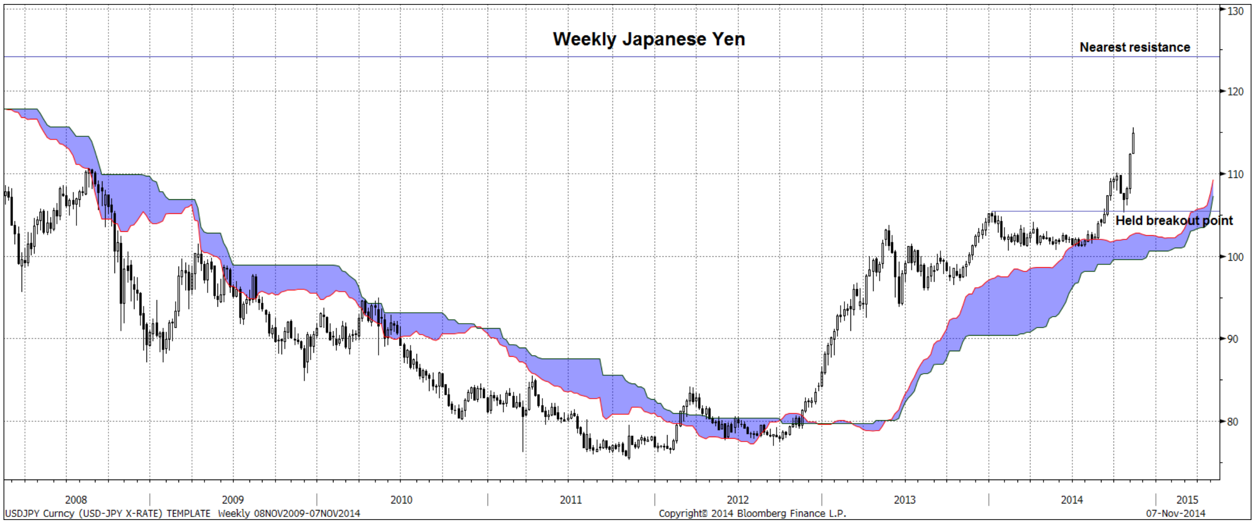


Gold futures ($1169.80/oz.) confirmed their breakdown below important long-term support near $1185-$1200/oz. last week despite Friday's 2.4% rebound. We expect the relief rally to persist, but would ultimately view it as a selling opportunity. Long-term momentum is negative, based on the monthly MACD indicator, and the breakdown increases the risk of downside follow-through to next support near $1000/oz., based on a Fibonacci retracement level and former resistance. Initial resistance can be gauged by the 50-day moving average (not shown), currently near $1225/oz., where we would reduce exposure to gold.

Technical Outlook – Currencies

The Japanese yen (114.60) continues to weaken against the U.S. dollar, having seen immediate follow-through after its 2.9% breakout move on Halloween. The long-term uptrend appears to have staying power, with the support of the weekly cloud model and our intermediate- and long-term momentum indicators. There are no signs of short-term exhaustion at this time, so we expect the yen to weaken for a couple more weeks before a counter-trend move unfolds. The next major resistance for USDJPY is at the 2007 high (124.14), which reveals the potential for follow-through, and initial support is near the latest breakout point of about 110.

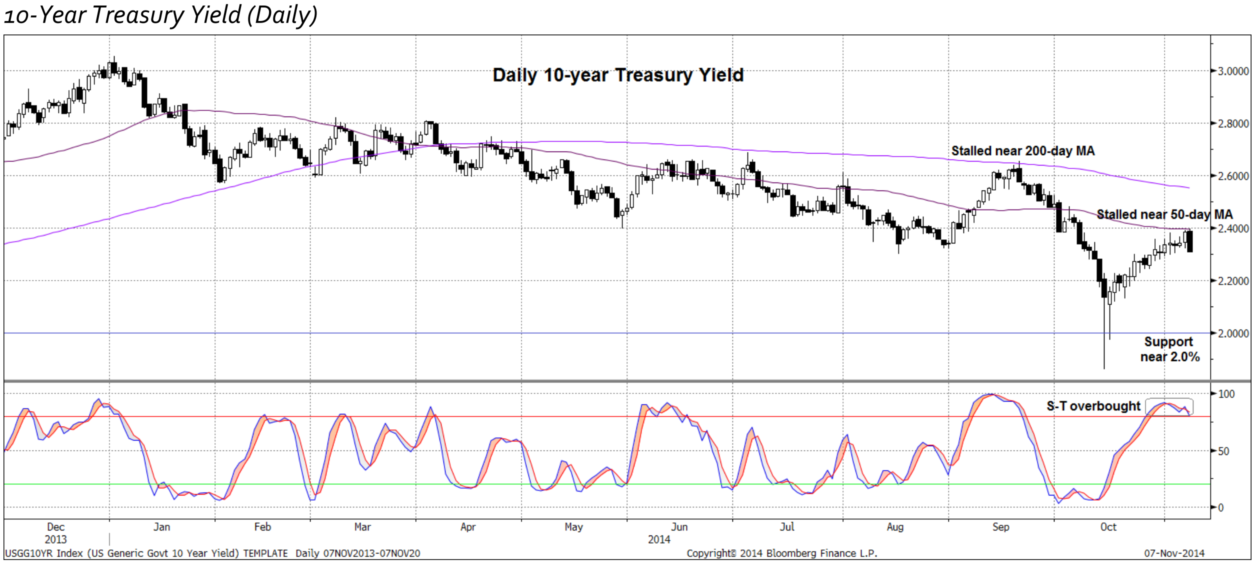
Japanese Yen (Weekly)



Technical Outlook – Treasuries

The 10-year Treasury yield (2.2976%) stalled near its 50-day moving average after gaining more than 50 bps in less than four weeks. The rally appears to be a counter-trend move, with a lower high likely to be established upon downside follow-through this week. Friday was an "outside-down" day and short-term overbought conditions support a decline in the 10-year Treasury yield. Important support is near 2.00%, which we think is in store for a retest before year-end. A breakdown would target 1.60%.

10-Year Treasury Yield (Daily)



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