Monthly Commentary

May 22, 2016

SELECTOR
Real-Time Money Management

"Good investors gather information, put that information into current and historical context, then make sound decisions."

Equity markets are re-setting. Yes, again. One month ago the S&P 500 Index had pushed north of the 2100 level, in a solid rally from the February 2016 lows. This was the fifth time the S&P 500 Index had risen above 2100 since February of 2015. A breakout to new all-time highs was just one percent away. The technical picture was relatively solid for Large Cap domestic equities, with the exception of the multiple failures to punch through the resistance over the past 14 months. Moving averages, trendlines, and momentum indicators were stacked in the proper order and appeared to be coordinated. Market breadth was expanding to include both Mid Cap and Small Cap domestic equities. But there was no joy in Mudville. Again.

Fortunately, unlike the poem, the Mighty Casey has several 'at bats' awaiting him in this very long game. And that being said, the pullback over the past four weeks has been measured, perhaps even somewhat reluctant in nature. While short-term trendlines and moving averages were broken across the board, long-term moving averages remain intact at this writing for Large Cap and Mid Cap equity indexes. It could be pointed out that these indexes had already rebounded more than 15% from those February lows and markets were due to 'exhale.' Additionally, the Volatility Index continues to hover in the mid-teens, indicating that institutional investors do not appear to be fearful of additional protracted downside action.

It seems that the biggest hazard that equity markets face today is the possibility of becoming irrelevant. Stock markets traditionally represent opportunity, even with its accompanying risk. For the past fifteen months this market has produced very little opportunity or risk. Not unlike a fifteen inning ballgame, the crowd is just waiting for it to end. And the TV audience went to bed an hour ago.

International equity markets have been mirroring recent domestic equity market action. Both developed and emerging markets equities have pulled back from recent rally highs, but not in dramatic fashion. More importantly, both of these markets successfully defeated long-term downtrends in the course of their Spring Rallies. While a period of base-building would be beneficial, they are no longer experiencing oppressive selling pressure from above.

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Some of the most interesting stories are coming from the industry sectors. The basic materials sector staged a rather dramatic breakout before consolidating those gains in May, and remains positive. The energy sector did manage to break a long-term downtrend during the Spring Rally and, like the basic materials sector, is consolidating gains atop rising moving averages and trendlines. Financials were contained by a long-term downtrend, but managed to recapture both their 50 and 150-day moving averages. Technology stocks remain contained in a high-level trading range, like the consumer discretionary and utilities sectors. Healthcare stocks broke a long-term downtrend and have regained their 50 and 150-day moving averages. Consumer staples and real estate sectors both made clean breakouts to new highs before pulling back last week. So while the condition of the forest appears unchanged from a distance, an analysis of trees paints a pretty healthy picture.

The bottom line is that there are just too many positives outweighing the negatives. It may appear that the war between the Bulls and the Bears is at a standstill, but important battles have been won by the Bulls this Spring. Neither Bulls nor Bears make money in a sideways market, but I would hate to be a Bear right now, given all of the technical improvement that occurred the last three months. This leaves me in the improbable role of preaching for more patience, which those who know me well know is not my normal wheelhouse.

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Sources: Bloomberg, Marketwatch.com, StockCharts.com