WELLINGTON-ALTUS
PRIVATE WEALTH

SCHENK WEALTH MANAGEMENT

MARKET WATCH: CORRECTION UNDERWAY: 09.18.20

Peter Schenk - 778-400-2813: peter.schenk@wprivate.ca
Matthias Raps - 778-400-2812: matthias.raps@wprivate.ca
Marc Vella - 778-400-2815: marc.vella@wprivate.ca

"About twice a year we forget that markets do this about twice a year." – *Morgan Housel*

Bottom Line:

Our Primary Trend Indicator is not designed to pick up short-term market pullbacks, and it remains positive overall. Also, our main Buying Power Indicator has recently flipped positive. Other supporting medium-term trend indicators are more sensitive, but the majority remain bullish. As long as the majority of indicators are bullish, the current decline is viewed as a correction within a bigger uptrend (bull market environment).

In the Markets

Forgive me but today's notes are focused on some technical observations. With historically-unprecedented government involvement in financial markets painting a murky picture and with the incredibly divisive US election just around the corner causing further chaos in the world's largest economy, technical observations are about all we have.

The character of the stock market changed in January 2018 as the swings got bigger and bigger, with new highs and lows interspersed. The chart below shows that period for the S&P500. The question now is whether the current correction is the start of a new major swing lower. For now, I don't think so. Let's review a few reasons why I think that.

First Some History

2020 alone had been unprecedented, with one record of market volatility after another falling in the dustbin of investor history. As far as records go we know that September is, historically, the worst month of the year. The table below, shared by market historian Wayne Whaley, shows the outcomes of the upcoming week, over the last thirty years. The data shows that next week is also the worst week in September having produced only six up weeks in the last thirty years. Could next week be the seventh? Current market action suggests that is unlikely.

THE S&P FROM SEPT19-26 - LAST 30 YRS

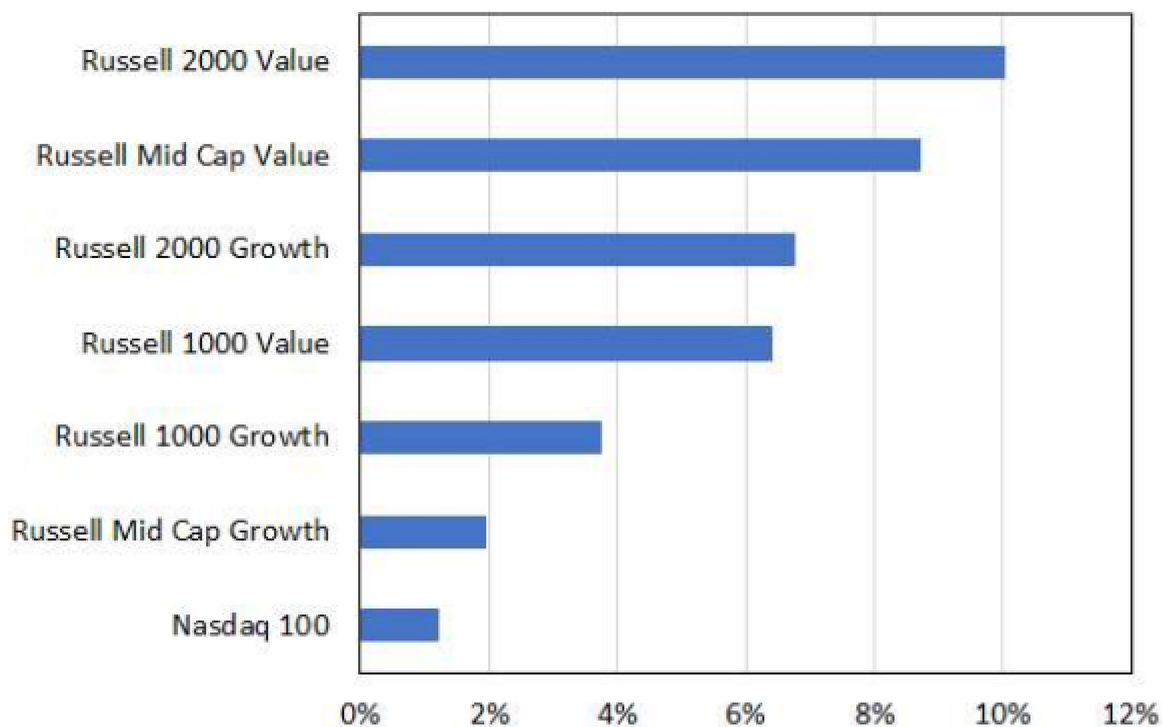
	S&P PRICE ON		SEP19-26
YEAR	SEPT19	SEPT 26	PCTCHG
1990	316.60	305.06	-3.64
1991	387.56	386.49	-0.28
1992	422.92	414.35	-2.03
1993	458.83	457.63	-0.26
1994	470.85	460.82	-2.13
1995	584.20	581.41	-0.48
1996	683.00	685.86	0.42
1997	950.51	945.22	-0.56
1998	1020.09	1044.75	2.42
1999	1335.42	1277.36	-4.35
2000	1459.90	1427.21	-2.24
2001	1016.10	1007.04	-0.89
2002	843.32	854.95	1.38
2003	1036.30	996.85	-3.81
2004	1128.55	1110.11	-1.63
2005	1231.02	1215.63	-1.25
2006	1318.31	1336.34	1.37
2007	1529.03	1525.42	-0.24
2008	1255.08	1213.27	-3.33
2009	1068.30	1044.38	-2.24
2010	1125.59	1148.67	2.05
2011	1204.09	1162.95	-3.42
2012	1461.05	1433.32	-1.90
2013	1722.34	1698.67	-1.37
2014	2010.40	1982.85	-1.37
2015	1958.03	1931.34	-1.36
2016	2139.12	2146.10	0.33
2017	2506.65	2496.84	-0.39
2018	2907.95	2905.97	-0.07
2019	3006.79	2977.62	-0.97
		#UP-DN =	6-24
		AVG%CHG=	-1.07
		MED%CHG=	-1.11

Rotation

Sector rotation is the movement of money invested in stocks from one industry, or even one market, to another as investors and traders anticipate the next stage of the economic cycle.

We've had small glimpses of rotation in the market since the March lows, but they all lasted for a couple of days, then the big tech names took over again. This time seems different.

Below you can see the returns from various markets since July 13th (selection bias to be sure but it makes the point). Since July, strength has been found in basic materials and other cyclical businesses which we've discussed before. They also tend to be cheaper of late and thus found in the "Value" indexes. We can see that the value and smaller company indexes have done well since July, and the former market leaders consisting of high growth and technology companies, the Nasdaq 100, has struggled over the last couple of months.



Rotation away from Technology

The move out of technology companies can be seen in the next chart. The top pane shows the Technology Sector Index (XLK, NYSE) in the top pane. The fact that it has now crossed below the dotted 50 Day Moving Average increases probability of further downside.
The bottom pane shows XLK relative to the S&P500, the broader market of stocks. This too is now showing early signs of a change in character in the strength of this year's leading sector.

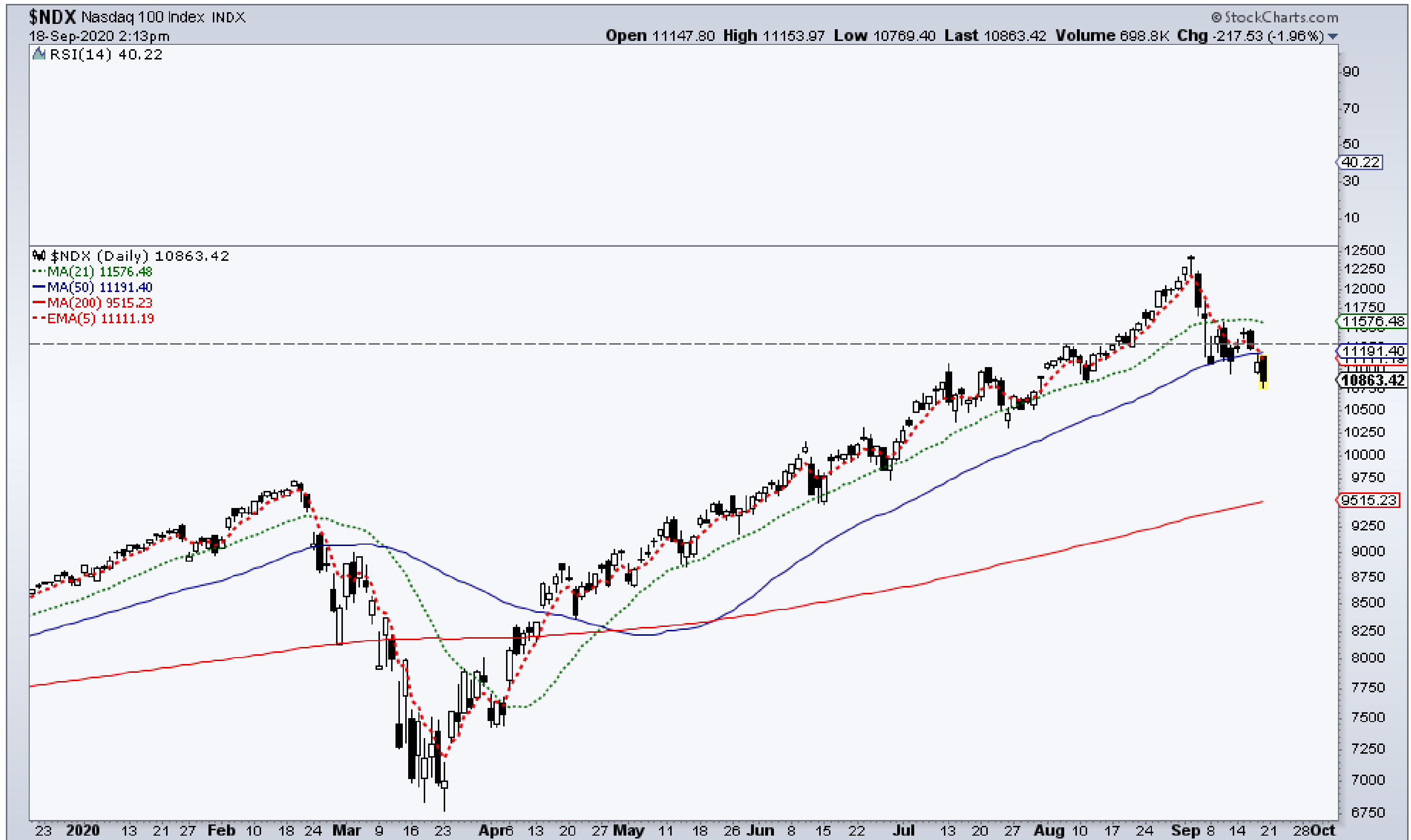
We have taken steps to reduce our exposure to technology, taking profits in names like Amazon and Paypal while attempting to position for what looks like the next phase as the market expands into things that hurt when you drop them on your foot (sorry, it's a saying by Dennis Gartman when referring to commodities and industrials.)

Some Indications Suggesting This Won't be a February-Type Top

Levels of importance

First let's look at the battle to keep the uptrend alive. The pause in the trend in June saw the S&P500 drop below the dotted green trend line which is the average price of the market over the last 21 days (21 Day Moving Average). Now, however, we see the market drop below the February highs, and also below the 50 day moving average the blue line.

We see the same thing on the Nasdaq 100 index (next page) which is the index that has been the strongest this year and holds all the names that have been leading the market, namely big technology. A drop below that level is likely to start a little more selling by funds that are effectively run by computer programs in the coming days.



In fact, going back to the S&P500 (below), the flagship of global stock benchmarks, it seems likely that the 200 Day moving average is beckoning. With weak seasonals, the worst week of the month coming next week, a break below the 50 day moving average (DMA), some further weakness should be considered likely. The 200 DMA also roughly aligns with a 38.2% retracement of the advance from the March lows, and this level is also a relatively important mathematical level that often acts as a magnet for market watchers.

A pullback to this level should however also be considered normal as the first break over the 200 DMA, which came in May, is often retested.

Evidence

You can always find things to complain about in the markets and frankly, a prudent money manager should always be somewhat worried. However, how do you know when to convert that worry into action of, say, reducing client exposure to stocks?

Look at the evidence. Market breadth, which uses many tools to measure the health of the market, like the bedside chart of a heart patient (do they still do that or is that just on TV?), can tell us a lot about the health of the stock market. It is the pulse and blood pressure of the market and can tell us when the patient's risk is high enough to take action.

New Highs vs. New Lows

Below you see a chart that shows the US stock market in the top pane (S&P500) and what we call "high/low" lines for various parts of the broad market, starting with the Nasdaq 100, this year's leader by far, the big stocks in the S&P500 below that, and the mid-sized and smaller companies index.

The lines measure stocks hitting new 52-week highs in the market, or 52-week lows. If there are more lows than highs, the black line turns down. The pink line is simply a ten-day average price (10 DMA) of the black line. If the

black line is rising, that means there are still more highs being made than lows. It's important to note that this is part of our Primary Trend Indicator as well as one of my measures of Buying Power. The line has been rising a bit slow this year, but the point is, it is still rising. You can see rather clearly in February/March of this year when the black line turned down, indicating more stocks were hitting new 52-week lows than 52-week highs, and it actually crossed the pink 10 DMA line as the market decline was picking up steam.

Today, both lines are still rising for all of the broader markets, and the black line is above the pink line. Not time to panic. Yet.

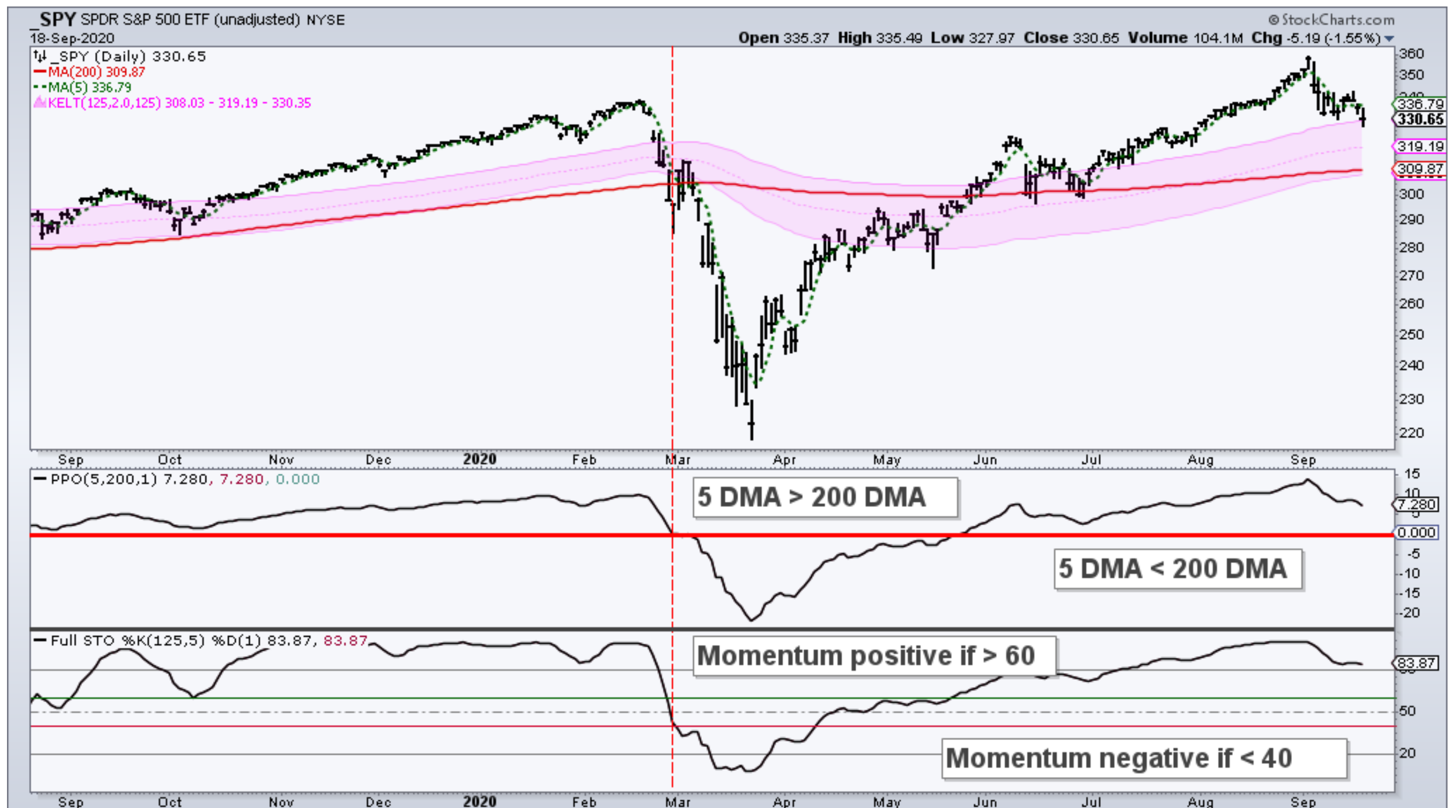
Basic Trend Evidence

The chart shows our Three Trend Indicator Model with the S&P500 in the top pane. To oversimplify it, the pink section reflects market volatility. If we are above it, it's a positive sign.

The second pane is a simple trend observation. If the black line drops below the horizontal red line, this means the 5 Day Moving Average has dropped below the 200 Day Moving Average so the odds that a short-term downtrend may give way to a bigger decline increases. This indicator turned positive on May 29th, which means the 5 Day Moving Average moved above the 200 Day Moving Average.

The bottom indicator reflects the market's internal strength. Developed by George C. Lane in the late 1950s, this Oscillator follows the speed or the momentum of price. As a rule, the momentum changes direction before price. As such, bullish and bearish divergences in the Stochastic Oscillator can be used to foreshadow reversals. It moved above the important 60 level on May 21st so all three of these trend indicators are bullish.

These trend indicators also provide clear signals to watch going forward: a move below the lower pink channel, a move where the 5 Day Moving Average drops below the 200 DMA or the lower momentum oscillator moving below 40 are signs to watch. A clear signal would emerge should two of the three trigger.



Conclusion

Sorry for all the chart talk but it seemed necessary. Our view remains, based on weight of the evidence, that major US and Canadian stock markets go higher this year. In the short term however, we are going through some corrective action.

This is probably the best for the market as short term stock market decline could be the pause that refreshes.

I've shared only a couple of quick observations and indicators here. Anyone interested in going through an extensive list of indicators and charts, feel free to reach out. We'll set up a Gotomeeting and spend some time reviewing how our indicators affect our decisions on where to invest your money.

We remain completely open to any eventuality that the markets bring. Our strategies, tactics and tools will help us to successfully navigate whatever happens as we focus on monitoring supply and demand signals that the market provides us.

Have a very good weekend, please call or email with any questions, and we'll be in touch with you soon.

Peter Schenk
CMT, CIM | Portfolio Manager

Words we live by:

"Deliver to the world what you would buy if you were on the other end. There is huge pleasure in life to be obtained from getting deserved trust. The way to get it is to deliver what you would want to see if you were on the other end."

-Charlie Munger

"Strive not to be a success, but rather to be of value."

-Albert Einstein