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WHAT ARE THE MARKETS TELLING US?

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How to invest if the U.S. stock market is topping? We suggested in the January 11, 2018, *WILTW* that the S&P 500 was headed for a top. While it is too early to make a firm judgement, recall that parabolic increases are followed by parabolic declines—usually after a "failed rally."

The S&P 500 declined 3.85% last week from its all-time high registered on the previous Friday, January 26th. The prospect of a downtrend in the world's most-crowded stock market raises some important questions. Will falling U.S. stocks derail the bull market in commodities and the reflation markets? **Or, will capital leave the U.S. markets to seek greater opportunities in the longest-depressed markets?** If so, although counter-intuitive, will the increasing capital inflows into the E.U. and emerging markets further stimulate their economies and financial markets? **And, will this further stoke the rising global reflationary forces and stronger economic-growth relative to the U.S.?**

The global deflationary forces reversed starting in early 2016. This occurred while the U.S. dollar index (DXY) and U.S. Treasury bonds formed a huge multi-year top.

It is noteworthy that last week's plunge in the S&P 500 followed on the heels of a decisive breakdown in the DXY. In a January 25th *WILTW* article entitled **"The U.S. dollar bear market is confirmed. What are the implications?"**, we wrote: "A weak dollar has implications for almost every asset class, particularly because of the huge capital concentration in U.S. dollar assets."

As we have noted in the past, some of the most valuable clues regarding prospective market trends occur during periods of sharply-rising market volatility. **While more evidence is needed to gain confidence, last week's relative-performance measures suggest that a downtrend in U.S. stocks could further accelerate capital inflows into the longest-depressed markets and sectors**.

Is the shift in relative performance outlined below a harbinger of what will perform best in 2018?

Market	% Change Last Week	
Copper vs. S&P 500	+3.64	
WTI Oil vs. S&P 500	**+2.92**	
Gold vs. S&P 500	**+2.87**	
Nikkei vs. S&P 500	**+2.44**	
CRB Index vs. S&P 500	+2.41	
Hang Seng vs. S&P 500	**+2.28**	Breaking-out from a bottoming pattern.
Bovespa vs. S&P 500	+2.20	In the process of breaking out from a huge bottoming pattern.
Stoxx 600 vs. S&P 500	+0.78	
MSEMF vs. S&P00	**+0.56**	In the process of breaking out.
Copper	-0.36	
WTI Oil	-1.04	
Gold	-1.09	
10-Yr Note	-1.11	
30-Yr Bond	-2.69	
S&P 500	**-3.85**	

As shown in the following charts, **last week's sharp selloff in U.S. stocks coincided with the most broadly-synchronized breakouts, ever since the turnaround began in early 2016, in many of the major reflation-markets and indicators.**

We are especially intrigued by the charts showing **a sharp breakout in inflation expectations** (TIP-to-IEF ratio) and the decisive breakout in the MSCI Emerging Markets Index's (MSEMF) relative-performance measures. The breakdown in the UST 10-year note below its major 2000 uptrend line is highly significant.

This action appears to suggest that **the accelerating global reflation trends could now be the dominant force in the global financial markets.**

CHART 1: U.S. Treasury 10-Year Note – Weekly. We have discussed this chart regularly for many months. As noted, the 10-year note has breached the major 2000 uptrend-line. If the analysis of the chart pattern continues to play out, the 10-year is likely to fall to near the $116 area—down 3.6% from the current level. **If so, the downtrend in the 10-year note could further exacerbate the selloff in U.S. stocks.**

Source: StockCharts.com

CHART 2: Reuters/Jefferies CRB Index vs. U.S. Treasury 30-Year Bond with iShares TIPS Bond ETF (TIP) vs. iShares 7-10 Year Treasury Bond ETF (IEF) – Weekly. As mentioned above, last week's sharp selloff in U.S. stocks has coincided with the decisive breakout in these key reflation measures.

Source: StockCharts.com

CHART 3: HG Hang Seng (HIS) vs. S&P 500 [top]. MSEMF vs. German DAX – Weekly. As noted, the measures in the charts have registered a decisive breakout. This action indicates rising capital inflows into the previous longest-depressed markets. Further upward progress, if accompanied by falling U.S. stocks, would indicate rising investor confidence to invest in the previously long-neglected markets—**especially in relative-performance terms.**

Source: StockCharts.com

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