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WHAT I LEARNED THIS WEEK

Excerpt from April 12, 2018

4 Time is running out to prepare for the next leg down in the coming bear market.

In *WATMTU* February 4, 2018, we asked the question: **"How to invest if the U.S. stock market is topping?"** We quote from the article, as follows: "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 opportunity in the longest-depressed markets?"

In that article, we also noted that while more evidence was needed to gain confidence, relative-performance (R/S) measures and long-term momentum suggested **a downtrend in U.S. stocks could further accelerate capital inflows into the longest-depressed markets and sectors.**

It has been eleven-weeks since the S&P 500 peaked on January 26th. Since then, the S&P had two sharp declines—an 11.8% plunge after the January top and an 8.9% selloff from the March highs.

As discussed regularly for several weeks, the intense volatility in the markets continues to reveal important clues regarding the true underlying trend and momentum in the markets. We are intrigued by the mounting evidence that supports the view that **capital will increasingly seek greater opportunity in the markets and sectors that massively lagged U.S. stocks during the previous deflation era from 2008 to 2015, especially commodities.**

Consider the following:

Equity and Commodity Markets	**% Change Since Jan. 26th**
German DAX Comp	-7.55
MSCI Emerging Markets (MSEMF)	-6.96
S&P 500	**-6.94**
MSCI World ex-USA (MSWORLD)	-6.78
Toronto TSX Comp	-5.84
HK Hang Seng (HSI)	-5.38
Australian ASX All Ords Comp	-3.88
Copper	-3.09
DJ Aussie Small Caps Index	-2.39
S&P GSCI Industrial Metals Index (GYX)	-2.10
Reuters/Jefferies CRB Index	-0.26
Gold	-0.21
S&P GSCI Commodity Index-Spot (GNX)	+1.27
Brazilian Bovespa	+1.87
WTI Crude Oil	+2.00
Bond Market Indicators:	
iShares JPMorgan USD EM Bond ETF (EMB)	-3.01
iShares iBoxx IG Corp Bond ETF (LQD)	-2.87
UST 30-Year Bond	-2.08
iShares iBoxx HY Corp. Bond ETF (HYG)	-2.01
UST 10-Year Note	-1.10
TIP vs. IEF	**+0.91**

As shown in the above table, **nearly every key commodity measure has significantly out-performed the S&P 500 since this index peaked in January.** We are especially intrigued by the message suggested by the relative out-performance versus the S&P 500 of the natural resource-heavy indexes such as the Brazilian Bovespa and the Australian Small Caps. And also, the large out-performance of the GSCI Commodity Index and the GSCI Industrial Metals Index.

The message from the commodity markets is further supported by the TIP-to-IEF ratio. **The rising trend in this key bond-market measure suggests that investor expectations regarding inflation are rising.** The ratio is trading near its bull-market highs, despite the volatility in the stock markets. Notably, the TIP-to-IEF ratio has advanced 0.91% since the January 26th top in the S&P 500.

Experience and history suggest that markets and sectors that exhibit positive R/S during periods of elevated market-volatility **often feature strong absolute performance during periods of subsequent falling market-volatility.** In other words, R/S trends during elevated volatility can often **reveal the shift in investor asset-preference and the next market leaders and laggards.** The mounting evidence suggests that commodities, and commodity-related equities and markets, are likely to be among the market leaders in the coming months and years.

This view is further supported by the long-term downtrend in the U.S. dollar index (DXY), which has **historically correlated strongly with rising commodity prices.** The euro accounts for nearly 58% of the weighting in the DXY. As discussed previously, the DXY continues to test the key 2011 uptrend-line. As shown in Chart B, the euro's technical-profile appears increasingly bullish.

CHART A: S&P GSCI Commodity Index-Spot (GNX) [top] and GNX vs. S&P 500 (SPX) – Weekly. The GNX peaked at 463.45 on January 26th, coincident with the top in the SPX. While the SPX is trading 8.03% below the January peak, the GNX has registered new bull-market highs and is trading 0.20% above its January top. As noted by the green arrows in the lower chart, **the GNX-to-SPX ratio may have formed a bullish double-bottom.**

Source: StockCharts.com

CHART B: Euro – Daily and Monthly.** The first chart shows that the euro is forming a similar consolidation pattern as the one in 2H-2017.

A breakout above the 2018 downtrend-line could spark a huge rally, shown in the lower chart. Notably, the euro's 200-day moving-average (MA) and the weekly MA ribbon (not shown) are rising strongly. Moreover, the 60-month MA is in the process of turning upward for the first time in many years. The technical profiles of these momentum measures are a powerful clue that the euro is likely to surge strongly above the 2008 downtrend-line.

Source: StockCharts.com

CHART C: German DAX vs. S&P 500 (SPX) – Weekly. As shown in the first chart, the DAX-to-SPX ratio has turned-up sharply from a likely "false-breakdown" below the multi-year lateral support area. While the DAX has modestly lagged the SPX since the January peak in the S&P, the DAX-to-SPX ratio has advanced 5.20% since the March 13th "failing-rally" high in the S&P 500. Last decade's massive uptrend in this measure traded closely with the bull-market in the euro and the downturn in the DXY's 15-year cycle.

Source: StockCharts.com

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