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"Charts of the Week"

One of our financial advisors recently asked if I would send over some investment advice to his college-age son who has become very interested in the markets and reads our commentaries each day. I get emails like this one from time to time and it is always very strange since it was not that long ago that I was on the opposite end of those inquiries. As I often tell people, practically everything I know about the financial markets I learned *after* leaving school, and one of the best decisions I ever made when first learning was to pick the brains of those who knew more than I did (and back then pretty much everyone knew more about the markets than I did). Because of my own experience, I always give these kinds of requests my utmost attention since you never know how something you may say to someone may impact his or her life. I will be forever grateful to those who have helped me out, people like Jeff Saut who did not have to go out of their way to help me and yet did so anyway. I know Thanksgiving was a couple of weeks ago, but I am very thankful for Jeff and everyone else who has helped me by sharing their knowledge and would like to follow in their footsteps by doing the same.

The first thing I stressed to the financial advisor's son in my reply was that learning never ends. The financial markets are ever-changing, so the education process is definitely one of those cases where the journey is more important than the destination. I certainly do not claim to have all the answers (or even most) and told him so, but I did provide a few "lessons learned" from my journey up to this point that I hoped would make his own a little easier. Since this month marks the three-year anniversary of the inception of *Charts of the Week* and because one of my goals in doing this weekly report has always been to help readers navigate the markets as best I can, I thought it would be a fitting time to reproduce some of those lessons I have gleaned from others and stumbled upon myself so far (in no particular order).

1. The best investment you can ever make is in yourself. Learn as much as you can and never stop.

2. Cut your losses before they get too big and let your winners run. That is the "secret" to investing but yet it is the hardest thing to do consistently.

3. Long-term moves in the financial markets are produced by economics and fundamentals; short-term moves, however, are produced almost exclusively by news flow, sentiment, and technical levels on the price charts.

4. You don't have to get it perfect to make money in the long run. There will always be missed opportunities and what looks obvious in hindsight was almost certainly not so obvious at the time. The "perfect is the enemy of the good" when it comes to investing. If you get it mostly right you'll probably be ok.

5. Priority number one should be to manage risk. It does not matter how strongly you feel about an investment, if it goes against you then that is a sign that you are wrong. The first loss is usually the best loss, and it's always easier to get back in than it is to get back out. Or said more eloquently by Larry Hite: "I have two basic rules about winning in trading as well as in life: 1. If you don't bet, you can't win. 2. If you lose all your chips, you can't bet."

6. There is no "Holy Grail" of investing. No collection of indicators or data will guarantee a winning investment. Therefore, spend more time learning when to get out of a position than trying to find the perfect time to get in.

7. New information is not inherently "good" or "bad." What matters is how new information is perceived relative to expectations. "Bad news" can be good if it's better than originally feared and "good news" can be bad if it's not good enough.

8. The financial markets will often do whatever will confuse the most people. When everyone is on one side of the boat, it's probably a good time to start looking for a way off the boat. Relatedly, major uptrends often begin when sentiment can't seem to get any worse; major downtrends often begin when sentiment can't seem to get any better.

9. Price moves often start before the reasons are clear. "The market" knows more than we do, so let the market do your thinking as much as possible.

10. Opinions only make you money when confirmed by the market; only price pays.

11. Hope is not an investment strategy. By the time you have lost enough that you find yourself hoping or even praying that an investment will go back up, it's probably a sign that you should have already gotten out.

12. Getting investment ideas from someone else should be the start of the decision-making process, not the end (tips are for waiters).

13. Asset prices always go higher than you think they will and lower than you think they will. Never buy something just because you think "it can't go down further" or sell something because you think "it can't go any higher."

14. Conditions are never all good or all bad. If you're waiting for all the risks to go away before investing you will never own stocks again.

15. It is very easy to sell fear and many people in this business take advantage of that fact. Always question the motives of anyone providing investment advice and information, especially when they're predicting the end of the world.

16. Many of the "hot topics" being discussed on any given day are just noise. Try not to inflate the unimportant.

17. Try not to let political opinions get in the way of your portfolio. The integrated global economy we live in is bigger than politics. Also try to "think globally" when investing.

18. When the reason you bought a stock no longer applies, it's probably a good idea to get out of that stock.

19. The U.S. stock market has survived world wars, the Great Depression, bubbles, crashes, political crises, the Financial Crisis, etc., and there is nothing to suggest that its resiliency will not continue in the future. If it does not continue, than we probably have bigger things to worry about than the stock market.

Again, I am not trying to break new ground here or imply that these are the only lessons one needs to know, but they have helped guide me and I hope they can help you too going forward.

As for the stock market, yes, the session yesterday was bad and likely surprised many who believed we were done with the 3% down days for a while. The fact that we got weakness was not too much of a shock – there is still concern among investors with respect to trade, global growth, the Fed, etc. and after a 6% gain in six sessions for the S&P 500 some retracement was likely. The extent of that weakness, though, did catch us and most everyone else off guard, and may have been exacerbated by the fact that the markets are closed today for a national day of mourning to honor President George H.W. Bush. Given all the uncertainty and the sharp up-move that preceded yesterday's sell-off, many traders may have taken their profits on the first sign of weakness, knowing they would not get another chance to do so until Thursday. And once that selling began and support around 2750-2760 was taken out, it turned into one of those downward spiral days that have become all too common. It certainly felt like two days' worth of selling instead of just one at least.

I continue to view the wide range between 2603 and 2815 as a battleground between the bulls and bears where pretty much anything is fair game, but, ideally, the S&P 500 will not fall back under the 2670-2685 support zone. As we have mentioned, the broad stock market has already carved out what looks to us to be a decent bottom sequence, so we do not need another retest to further confirm it. I will now be watching for that 2670-2685 area to once again provide support and will view it as a red flag if it does not. To paraphrase one of my "rules" above, opinions are meaningless if not confirmed by price so even though we've been treating this as a bottom for stocks, we will have to adjust if the market gives us enough reason to do so.

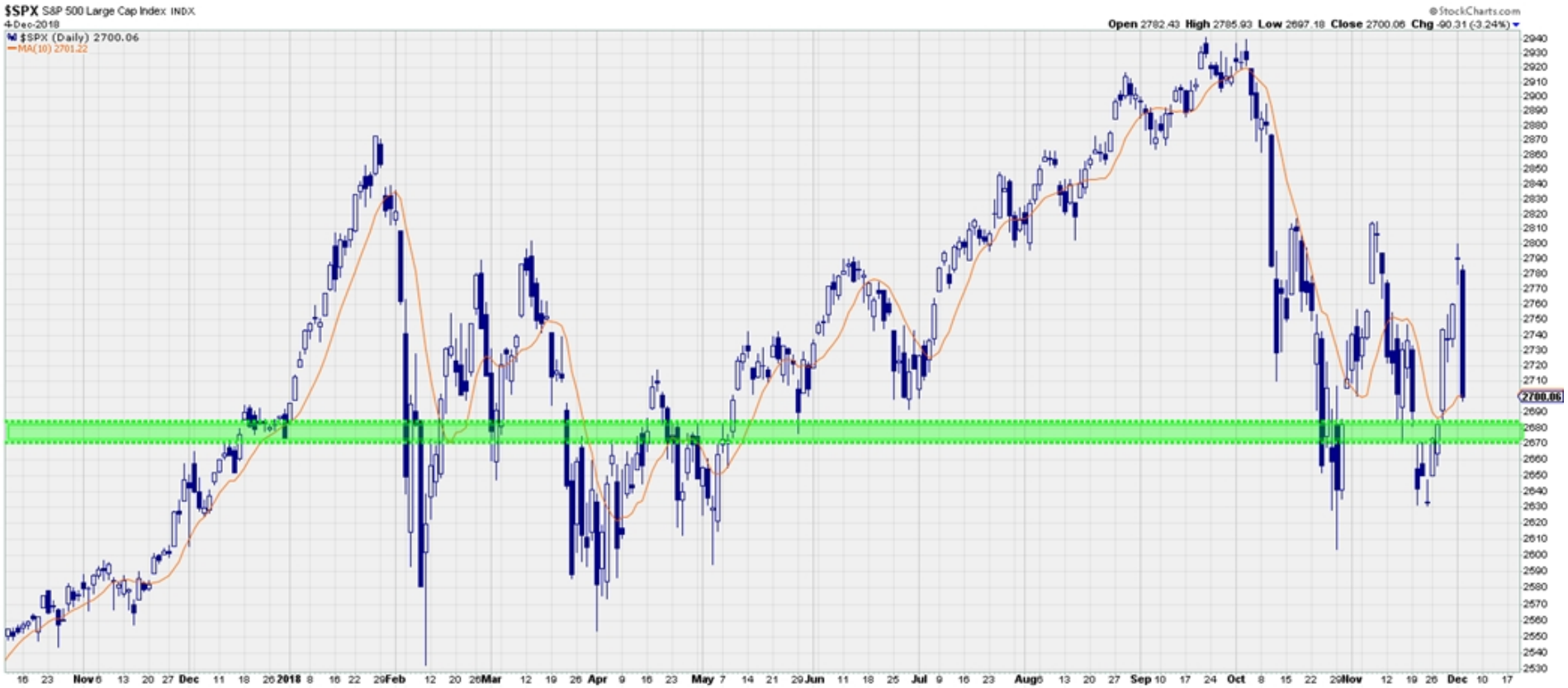
And with that . . . here are the Charts of the Week . . .

S&P 500 Sector View

Source: Stockcharts.com

What Now?

Yesterday's weakness escalated quickly once support around 2750-2760 in the S&P 500 was violated. The index ultimately pulled all the way back to around its 10-day moving average, which has been a very important line in the sand over the last few months (orange line). Now, I am counting on the area around 2670-2685 to help boost the S&P back up once the markets reopen on Thursday. That zone has a history of importance over the last year (green shaded box).



Source: Stockcharts.com

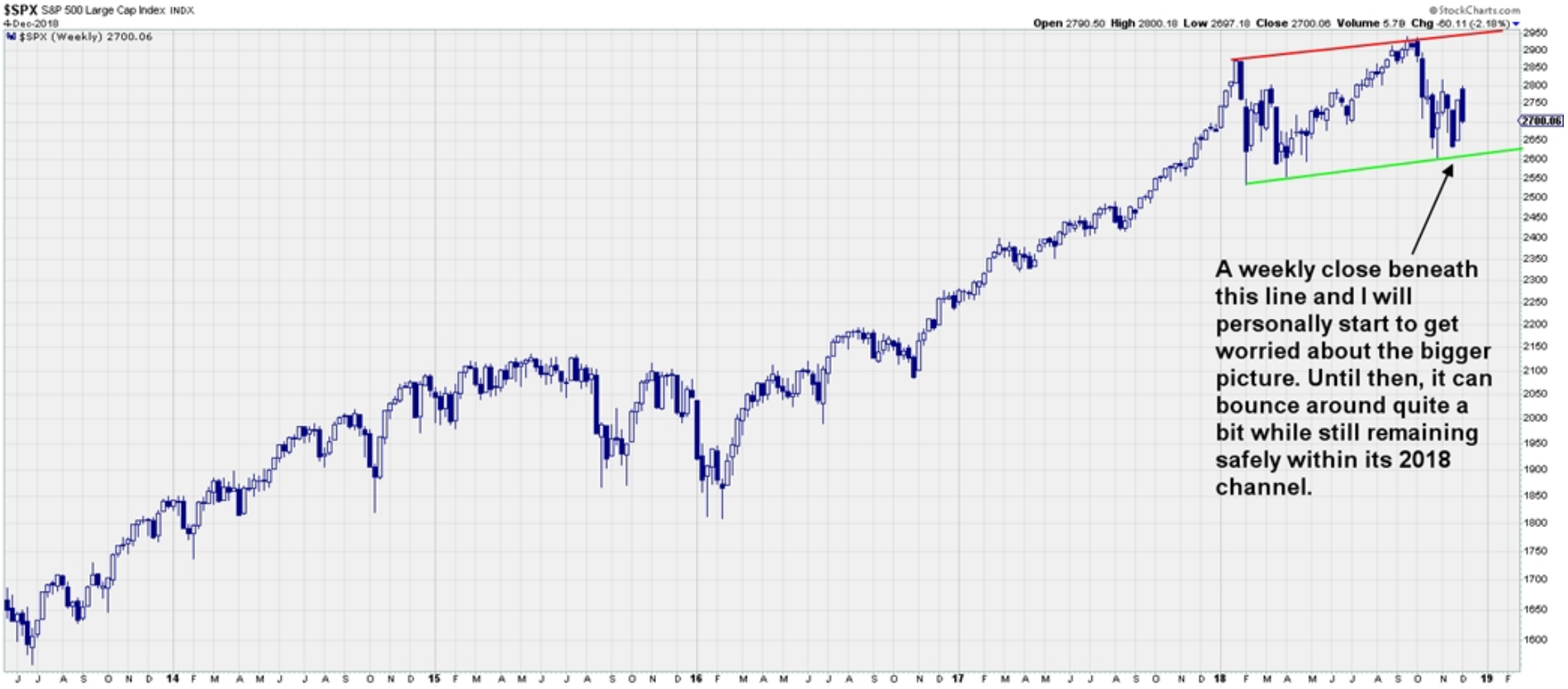
The Grind Continues

Last Wednesday I wrote that I expected a slow, grinding recovery off of the recent lows, similar to what we got after the January-February correction. At first, it looked like I was dead wrong as the major indices blasted off on what was perceived as positive news on trade and the Fed, yet yesterday's sell-off takes the S&P 500 back into the middle of the battleground zone that remains up for grabs. It would not surprise me to see the bouncing around continue unless more definitive action on trade is witnessed, with some sort of consolidation pattern a possibility before getting another breakout to make the market's next direction clearer. It's still early, but I am watching the lines on the chart below to see if they will produce the kind of coiling action that is typical of consolidations. The red line would be expected to be resistance, while the green line would be expected to act as support.

Source: Stockcharts.com

The Bigger Picture

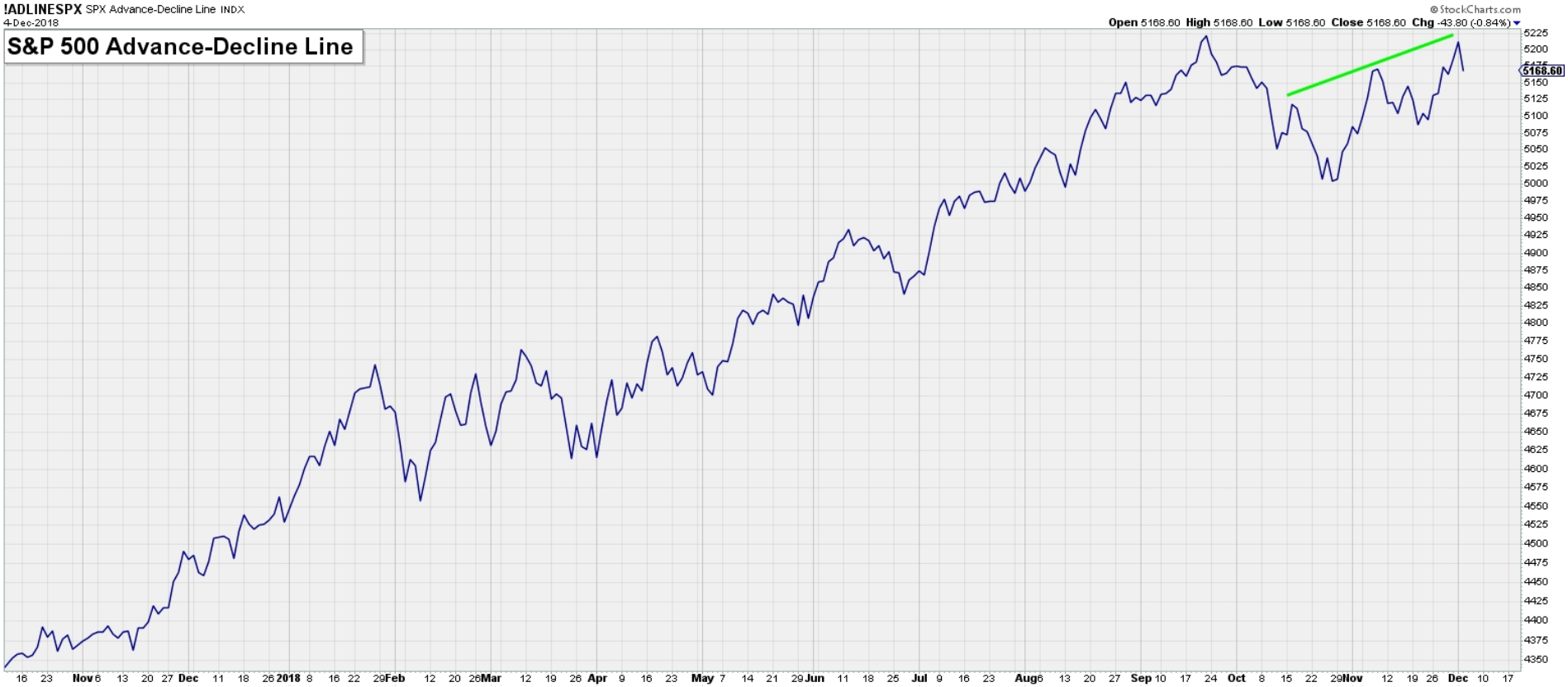
Looking at the bigger picture, we have actually seen a fairly clear price channel develop in the S&P 500 during 2018 when connecting the major highs and the major lows (red and green lines). For me, at least, this makes the decision process pretty easy as long as that price channel continues to hold – if the index remains above the green support line, I am ok to deferring to the upside, with the expectation that stocks will eventually go higher. However, if the S&P 500 ends up closing below that green support line, particularly on a weekly closing basis, I will personally start to get more concerned about the health of the U.S. stock market and it would likely be wise to take more defensive action at that stage depending on the account goals/risk tolerance.



Source: Stockcharts.com

Breadth Continues to Improve

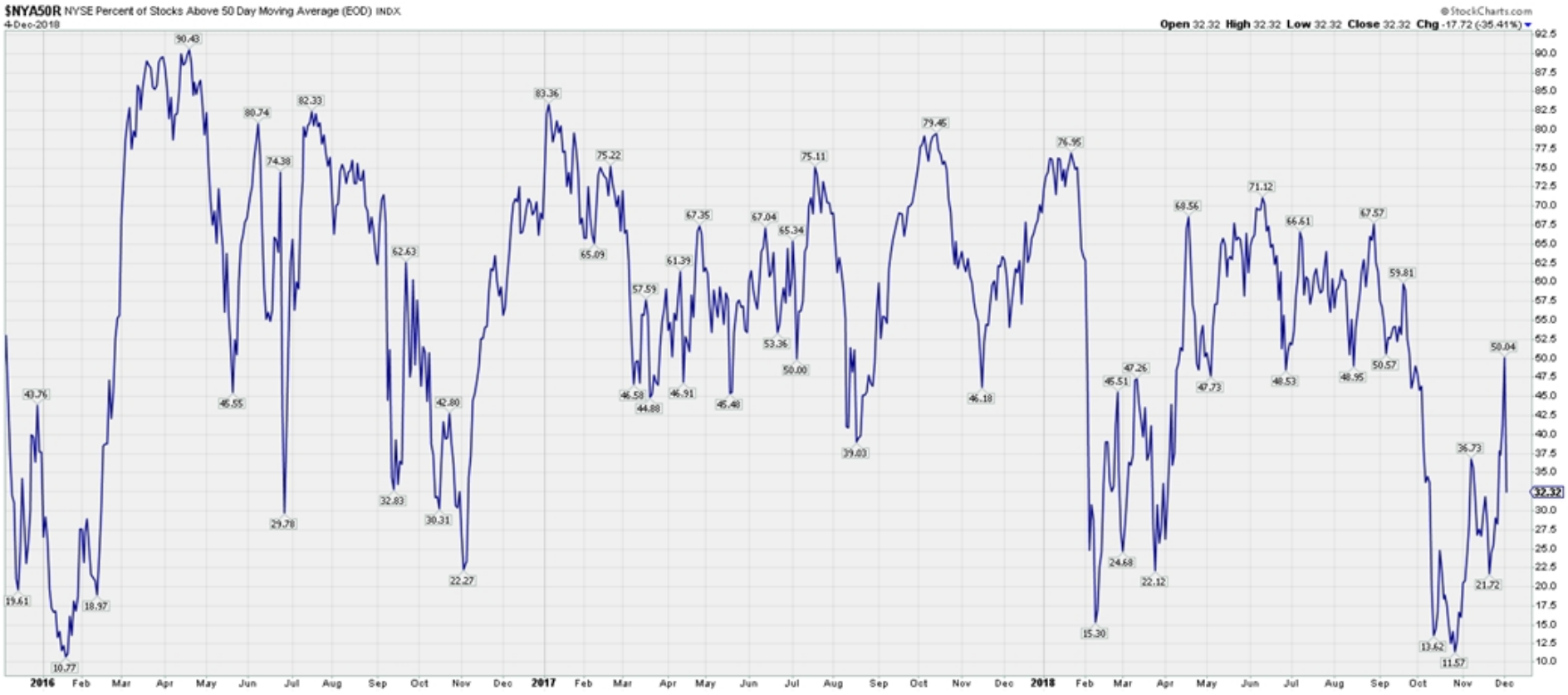
One thing worth noting is that up until yesterday's bad session, conditions were improving under the surface of the market. This improvement can be seen in indicators like the S&P 500's Advance-Decline line, which had almost broken out to a new all-time high despite the S&P 500 itself being nowhere close to doing so. This at least shows that more S&P 500 stocks have been advancing lately than declining.



Source: Stockcharts.com

Yesterday Was Bad

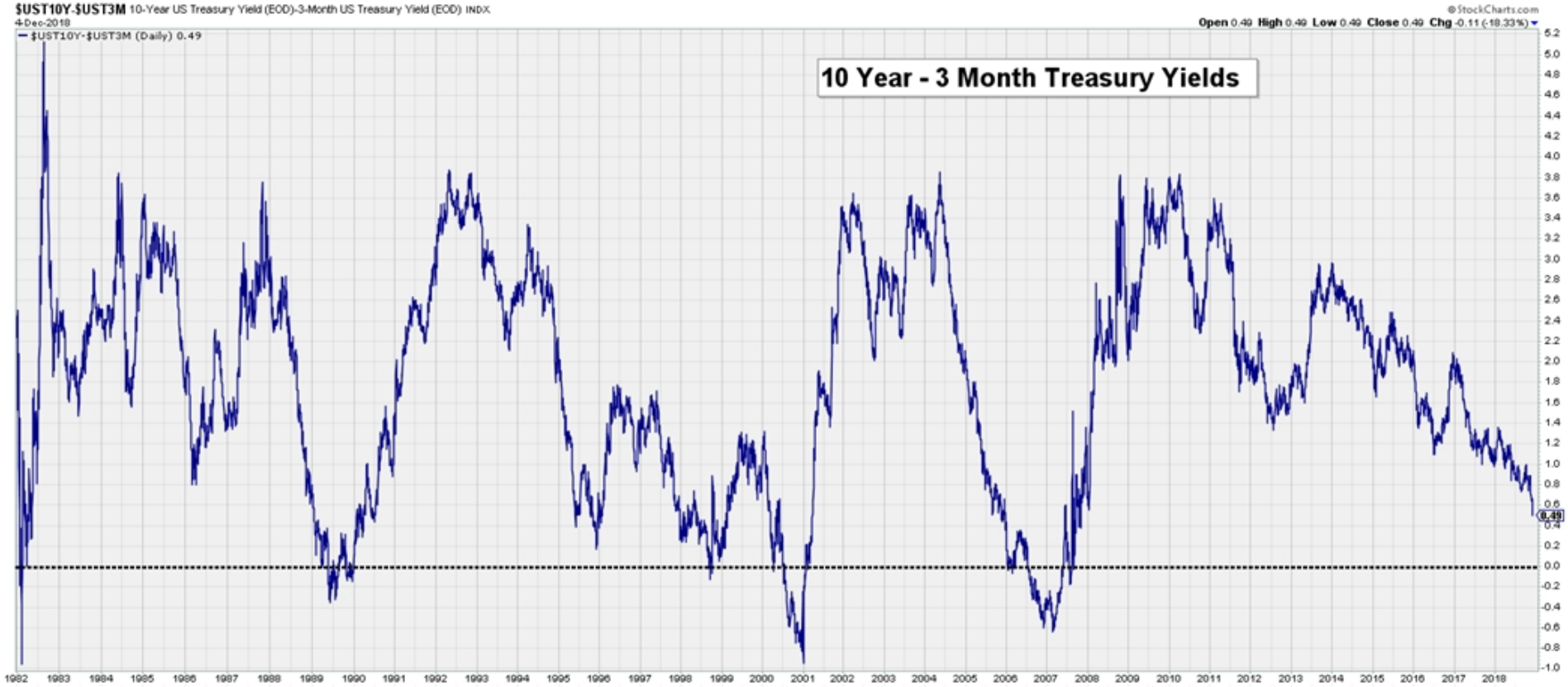
The improvement in breadth can also be seen in the percentage of stocks on the NYSE above their own 50-day moving average. This measure of breadth bottomed out around 11% in late October but had jumped to over 50% after Monday's session. However, after yesterday's bad day, that percentage fell all the way back down to 32%. That is around the mid-point of the recent action, but obviously we want to see both breadth readings and the major indices rally back up together.



Source: Stockcharts.com

Yield Curve Back in Spotlight

The sell-off in stocks yesterday was partly attributed to further deterioration in the yield curve, particularly the fact that the yield on the 5-Year U.S. Treasury fell below the yields on the 2- and 3-year U.S. Treasuries. That prompted scary headlines everywhere that the yield curve had "inverted," but as we have written before, the measure of the yield curve we follow the most closely is the spread between the 3-month and 10-year and it remains 49 basis points away from inversion. It is getting "closer," and is certainly worth monitoring since it has a very good track record of signaling a recession could be on the way (with some delay), but we still believe it's too early to head for the hills considering we saw something similar back in 1995 when the spread got less than 20 basis points away from inverting but never did. And the stock returns after that point were pretty good.



Source: Stockcharts.com

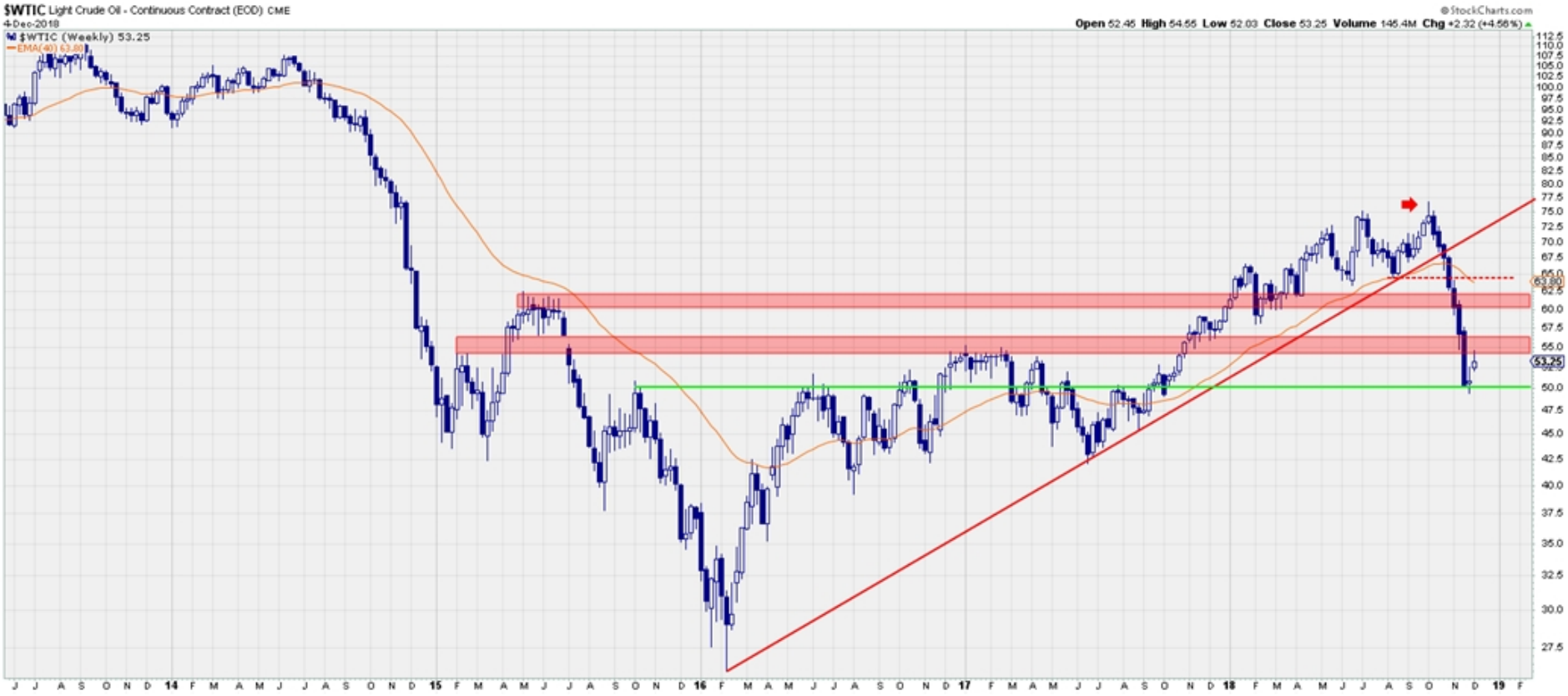
10-Year U.S. Treasury is Key

Here is an update of the long-term chart of the 10-Year U.S. Treasury yield that I have included a few times before. Like magic, the 10-year hit resistance right in the 3.20-3.25% zone that was implied by the long-term resistance line connecting the major highs going back to the early 1980s. The 10-Year has since pulled back to 2.91% and there will likely continue to be concerns about the yield curve as long as the shorter-term Treasuries continue to gain ground compared to intermediate and longer-term Treasuries like the 10-year.

Source: Stockcharts.com

The Drop in Oil Has Not Helped

Falling oil prices send a mixed message when it comes to the stock market. While it does provide a small boost to consumers in the form of lower gas prices and helps lower costs for some companies, over the last few years at least the U.S. stock market has tended to perform better when oil prices are rising, not falling. Obviously, lower oil has been a strain recently on the Energy sector, and it's going to require WTI to get back above $55 for me to think we may have seen a bottom made. Right now the zone around $50 is providing some support, but a bit of damage has been done and oil does remain a question mark for now.



Source: Stockcharts.com

To End on a Good Note

After a day like yesterday we could all use a laugh, so I thought it would be a good idea to bring back THE most popular chart produced in the three years of doing the Charts of the Week. It was originally intended to be the Loch Ness Monster, but after hearing people refer to it as the "dinosaur" chart for the last couple of years I guess we'll give the people what they want and call it a dinosaur. It made its appearance in August 2016 and soon ushered in one of the greatest runs in stock market history. So anytime lines on a chart start to get you down, just draw a "dinosaur" on it to remove your frown. I think I'll add that to the "lessons learned."

Source: Stockcharts.com

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