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THE RALLY CONTINUES

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The rally continues, as the S&P 500 Index gained for the seventh week out of the past eight, while the Dow Jones Industrial Average, Russell 2000 Index, and Nasdaq all closed higher for the eighth consecutive week. Sparking the rally this week were Washington striking a deal to avoid another government shutdown and hopes that President Trump might push back the March 1 deadline on higher tariffs on Chinese goods.

With the S&P 500 off to its best year’s start since 1991, how much further can things go? This week we’re going to take a look at market sentiment, which can play an important part in determining how long the bull will run.

ABOVE THE 200-DAY

As Figure 1 shows, the S&P 500 finally closed above its 200-day moving average for the first time since early December 2018. Since October, the index hasn’t stayed above this long-term trend line for more than a few days. Given the S&P 500 has now bounced more than 18% from the December 24 lows, some type of consolidation or maybe another pullback would be normal.

WILL THE 200-DAY MOVING AVERAGE HOLD THIS TIME?

Source: LPL Research, Bloomberg  02/15/19
All indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. All performance referenced is historical and is no guarantee of future results.
As we discussed in That Was The Easy Part, a retest of the December 24 lows likely won’t happen. Historically, you see retests at major market lows, but this could be one of those rare times that we don’t. Two main reasons are:

- On January 18, 2019, more than 70% of the S&P 500 components made a new 4-week high, and the returns after such a rare blast of strength have been quite impressive 3, 6, and 12 months later.

- We saw two 90% up days coming off the December lows, on December 26 and January 3. This means that 90% of all stocks on the New York Stock Exchange were higher and 90% of the volume was also higher on those days. When we see two strong days like that so close together coming off a low, continued future gains without a rest is likely, in our view.

CHECKING IN ON SENTIMENT

The overall technical backdrop continues to look strong, but one other substantial positive is that investor sentiment is still not near areas we would consider to be a major warning sign.

History has shown that the crowd can be right during trends, but it also tends to be wrong at extremes. This is why sentiment can be an important contrarian indicator. If everyone who might become bearish has already sold, only buyers are left. The reverse also applies.

On multiple levels, we see increasing optimism—but not at levels that have shown it paid to be contrarian. In fact, with a more than 18% bounce off the December lows, we are quite surprised there isn’t more excitement.

- The Bank of America/Merrill Lynch Global Fund Manager Survey had the highest number of investors “overweight cash” since early 2009. Additionally, investors with an “overweight global equities allocation” sank to the lowest level since September 2016. This shows managers aren’t giddy over the good start to the year and suggests there could be potential cash on the sidelines waiting to come in.

- The CNN Money Fear and Greed Index hit single digits back in December, but has bounced to only 64 recently (on a 0–100 scale), again suggesting overall optimism isn’t near previous warning signs.

- The National Association of Active Investment Managers (NAAIM) Exposure Index was recently over 80 for the first time since October, but again this has peaked much higher in the past.

- The number of bulls in the weekly American Association of Individual Investors (AAII) Investor Sentiment Survey has been beneath 40% for 14 consecutive weeks, the longest such streak since last spring, when the first 10% correction in nearly 18 months occurred. What is so interesting about it this time around is bulls aren’t springing into the picture even after week after week of gains.

- Investors continue to pull money out of equity mutual funds and equity exchange-traded funds (ETF). In fact, according to weekly data from the Investment Company Institute (ICI), only seven weeks over the past year have seen inflows into U.S. domestic mutual funds and ETFs. Additionally, the week of the December 24 lows saw the largest weekly outflows of funds since February 2018. We would expect to see more inflows and optimism before an ultimate market peak could take place.
CONCLUSION

The rally continues, and although we see many signs potentially indicating new highs for equities later this year, some type of market consolidation or pullback could be due. We have an improving technical backdrop that should support any pullback as a buying opportunity, and overall sentiment is still a long way away from what we’d call over-the-top and troublesome from a contrarian point of view. We believe the combination of fiscal policy, optimism over a potential U.S.-China trade deal, and our expectation for steady earnings growth is strong enough to support further gains for stocks throughout 2019. We reiterate our year-end fair value range of 3000 for the S&P 500 from our Outlook 2019 publication.

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INDEX DESCRIPTIONS

The Standard & Poor’s 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.