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the X-factor Report
by Lance Roberts

Market Strategies, Economic Analysis, Risk Management

Sell Off Raises Alert

I am still on vacation this week but I am been swamped with emails due to the late week sell off that took the markets back below the breakout level of 1850. Therefore, I just wanted to issue out a very short update.

The combined escalation of a potential conflict in the Ukraine and the rapidly deteriorating economic data coming out of China has weighed on the markets in the past week. Another concern is the upcoming meeting of the Federal Reserve this week and the potential for further reductions in the ongoing monetary interventions.

However, as I will show in the chart on the next page, the recent sell off has not changed the current trend of the market. However, the deterioration in the technical underpinnings is concerning.

The following excerpt is from John Murphy's weekly technical commentary:

"The weekly indicators for the S&P 500 were giving 'negative divergences' which also warned of a market pullback. Combined with increased tensions in the Ukraine and concerns about problems in the Chinese economy, it was no surprise then to see the markets fall sharply later in the week.

And some short-term technical damage was done. Chart 1 shows the Dow Industrials falling below its 50-day average (on rising volume). At the same time, the 14-day RSI line (above chart) slipped below 50. More importantly, daily MACD lines (below chart) turned negative for the first time since early January. I wouldn't be surprised to see the Dow retest its 200-day average and/or its February low. Chart 2 shows the S&P 500 falling back below its January high (also on higher volume) and threatening its 50-day line. Daily MACD lines turned down as well. [As shown on Wednesday, weekly S&P 500 MACD lines have been negative since January which makes this week's downturn potentially more serious]."

Inside This Issue:

Suggested Reading

- 5 Things To Ponder
- Market Internals Show Deterioration
- Fox Business: Margin Debt Rises
- Poll Shows Why QE Was Ineffective
- NFIB: Improvements End
- 10 Signs Of Stock Market Exuberance

Chart 1

Chart 2

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FEEDBACK

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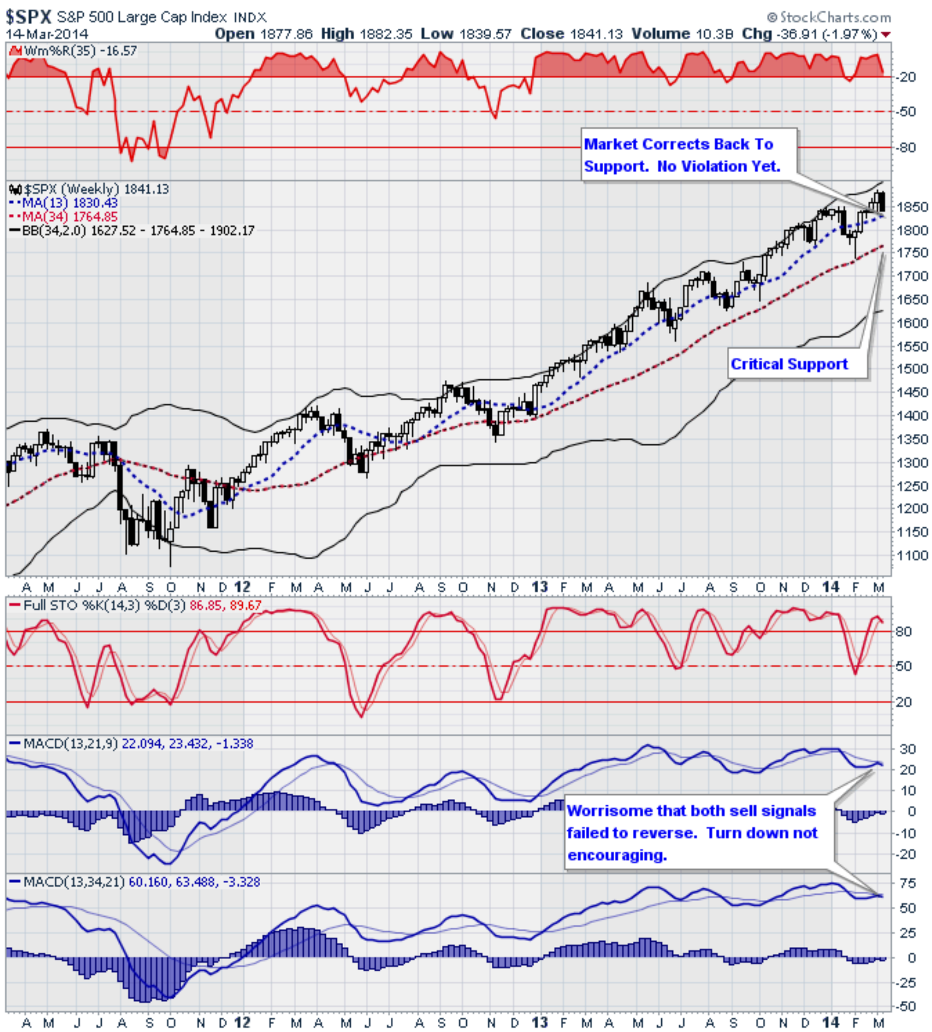
Bull Trend Still Intact – Concerns Rise

John's analysis above is very critical. As I have discussed recently these measures are indicative of the "patients" bill of health. Currently, the market has likely contracted a cold.

The chart below is my intermediate market analysis.



The market has currently only retraced back to its short term moving average which has been consistent support over the last year. However, what is disturbing is that both of the "sell" signals that were issued back in January failed to turn positive last week as they should have.

I upgraded the allocation model last week in anticipation that the signals would turn positive subsequent with the break out to new highs. Importantly, I also stated that there was *"risk"* to this upgrade and that more conservative investors may want to wait for confirmed "buy" signals before increasing exposure to *"risk"* assets.

Currently, nothing has occurred technically that would require a reversal of last week's allocation upgrade. However, the deterioration in the supportive structures of the market are extremely concerning. I will continue to monitor

SUGGESTED READING

Things You Need To Read

[5 Things To Ponder: Macro Investing Thoughts]

Great insights from Jason Zweig, Brett Arends, and others.

[Market Internals Show Deterioration, Trend Still Bullish]

A report discussing various measures of technical supports showing signs of deterioration.

[Poll Shows QE Ineffective]

A recent Bloomberg poll shows the QE only benefitted Wall Street but not Main Street.

[10 Warning Signs Of Stock Market Exuberance]

A recent discussion with a money manager spurred this discussion of signs of stock market exuberance. The same signs we have seen two other times over the last 15 years.

price action in the week ahead and a violation of support structures as identified above may require a reversal of recent actions.
This is part of investing. It is also part of managing "risk" in a very extended, over bought, and overly exuberant market.

One very positive sign is that money has been flowing back into bonds as investors seek *"safety"* over *"risk."* Last week brought yields on the 10-year treasury very close to our short term price targets. This drop in rates has provided a nice offset to recent equity volatility and is a main reason why we continue to recommend a full weighting to bonds allocations in portfolios.

The ongoing deflationary pressures in the economy continue to suggests lower interest rates in the future particularly as the Fed continues to withdraw support for the markets. This is a topic I will address more next week.

For now, no changes to portfolios are required. However, I do recommend an increased awareness to your portfolio over the next week as things continue to develop.

Have a great week.

Lance Roberts

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