PHASES & CYCLES®

AN UP-MOVE SHOULD FOLLOW THE RECENT MODEST PULLBACK.
A MORE SUBSTANTIAL CORRECTION WILL OCCUR BEFORE MID-YEAR.

After an impressive four-month advance, March turned into a corrective month for the S&P 500 and most other major market indices. The NASDAQ held up relatively well. The downwards cyclical pressure we noted previously finally exerted some force on the markets. As we expected, declines were modest, the S&P 500 pulled back less than 80 points or just about 3%.

The pullback in March was a welcome and healthy tonic for this bull market. The percentage of stocks above their respective 50-day Moving Averages – an indicator of intermediate-term strength – tells the tale. During the November to March advance the NYSE percentage peaked at 83% and recently dropped back to under 45%. In Toronto the comparable figures are 82% and 41%. The selling pressure did precisely the job that we hoped to see in the short-term: wringing out some price excesses, setting up more oversold conditions, and increasing negative sentiment.

The short-term outlook: The S&P 500 pullback, which did not even get to the one-third retracement level of the previous rally, appears to be over. The S&P 500 traced out an A-B-C down-up-down correction that found support at its 50-day Moving Average. If the bounce off the 50-day Moving Average extends itself then we should see the S&P 500 challenge its previous all-time high of 2,401 soon. The November to March advance in the S&P 500 set very high readings in terms of internal momentum, the number of stocks making new 52-week highs, daily advance/decline figures, and positive sentiment. If and when the S&P 500 moves towards the low 2,400s we will pay close attention to the comparative status of these indicators.

Toronto's corrective period lasted nearly one month. The S&P/TSX Composite Index shed about 700 points, moving from the top of its trend channel to the bottom of that channel. The big Banks, which led the last rally, pulled back and contributed significantly to the overall Toronto market decline. The continued relative weakness of the Banks is contributing to the emergence of some intermediate-term "topping" behaviour in Toronto. Toronto's ability to continue to rally with New York depends on whether the Banks can launch a new up leg.

The outlook for the next few months: Leg-5 of the Bull Market consists of five Phases (up-down-up-down-up). Since February 2016 the S&P 500 has gained nearly 600 points (32.5%) as Phase 1 of Leg-5 of the current bull market. <u>We believe this phase is coming to an end</u>. A final rally into the low 2,400s could trace out an "M" or "double-top" pattern on the S&P 500's chart. At that point we expect that a more substantial correction – probably towards the 200-day Moving Average – is likely to occur as Phase 2 of Leg-5. Any decline below the low point of the recent pullback (2,322) should indicate the start of this Phase. Late April – early May would be the logical time to start this.

In sum, a normal and expected pullback occurred in March. The long-term bull market remains in good health. The next few weeks should see a rally attempt back towards the S&P 500's all-time high. In the low 2,400s we expect the markets will encounter headwinds and then correct more significantly.

The recent pullback is an opportunity to purchase a <u>small selection</u> of stocks (see our List of Investment Ideas). The setting of stops to protect profits will be of increasing importance as the spring season progresses. "Sell in May and go away" <u>for a short time</u> may be a good strategy to consider in 2017.

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S&P 500

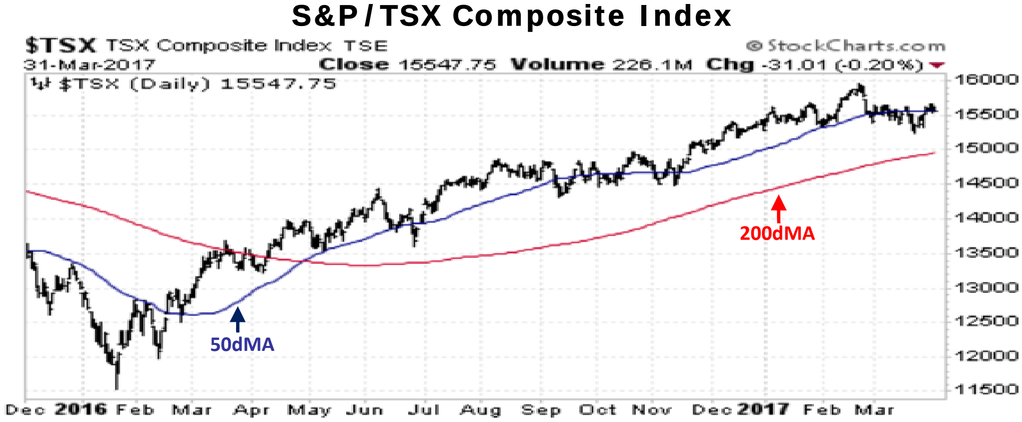
The S&P 500 has remained above its rising 50-day Moving Average for nearly five months and it provided support to the Index in the March pullback. From a modestly oversold condition the subsequent rally has been choppy.

A move above 2,390 would suggest that the S&P 500 is going to challenge its all-time high at 2,401. It is likely that negative divergences will appear in some indicators at that point, and then the question will be how well the S&P 500 can overcome these technical weaknesses and push higher.

Initial support exists at 2,320 and there is a strong band of support between 2,250 and 2,300. The rising 200-day Moving Average is currently at 2,215. This Moving Average has halted two previous declines in the past year.

We expect the S&P 500 will attempt a new all-time high above 2,401 but this new high will not hold. A correction back below the recent low at 2,322 should then occur.

S&P/TSX Composite Index



In our last look at the Toronto market we called attention to the critical support zone lying between 15,200 and 15,300. The S&P/TSX Composite Index continues to test this area.

Since mid-2016 the S&P/TSX Composite Index has corrected several times to just below its 50-day Moving Average, and then rallied to new highs. March saw the same type of corrective pattern, but Toronto is struggling to make a new all-time high. Bank stocks would need to end their recent weakness for this to happen.

Any move below 15,200 would signal the retest of the 14,500-14,750 area.

The S&P/TSX Composite Index advanced 4,412 points (38.2%) in the past fourteen months. It is time for a significant rest. The prospects of a corrective move back to and possibly below the 200-day Moving Average are increasing.

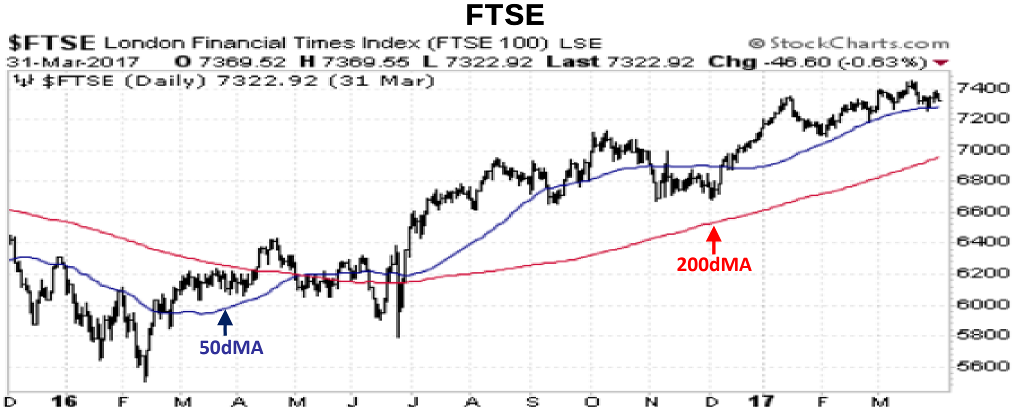
Dow Industrials

The Dow Industrials made a new high at the beginning of March and then gradually pulled back towards its rising 50-day Moving Average at about 20,400. The Dow Transports pulled back much more substantially; however the Dow Theory continues to confirm a primary bullish trend.

A move above 21,000 would indicate an attempt to set a new high above 21,200. Conversely a move below 20,400 suggests an extension of the pullback. Good support should appear in the 19,700 to 20,100 area. The top of this support range is a one-third retracement of the November to March rally. The bottom of the range is near the 50% retracement level.

The 20,400 area is key level. If it holds then new all-time highs are possible. If it breaks, a more extensive correction will be underway.

FTSE



Our assessment of the FTSE a month ago was that a healthy pullback should be followed by a move to a new all-time high. The FTSE, as has been its recent pattern, found support once again at its 50-day Moving Average and then pushed up in mid-March to a new all-time high at 7,447. The London market then did another pullback to its 50-day Moving Average.

After a very strong four-month rally of 768 points there are now signs that the FTSE is headed into more turbulent waters. The FTSE's chart pattern resembles a "rising wedge" which is often seen towards the termination of an advance. The mid-March high was made on declining internal momentum, leading to a negative divergence. And the pattern in March has traced out a potential "Head and Shoulders" formation, which will turn bearish on a sustained move below 7,250.

There is good initial support in the 7,250 to 7,280 zone. Below that support appears at the 7,100 level. The rising 200-day Moving Average is at about 6,960.

The FTSE may have some more limited upside in the short-term. But a move down through the 50-day Moving Average and the 7,250 level is likely. If this occurs, the Head and Shoulders target is about 7,065, which is also the one-half retracement area of the entire December to March rally.

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