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VOLATILITY IS INCREASING, BUT THE MARKETS REMAIN IN A TRADING RANGE.

In our last Market Comment we suggested that the markets would remain in a trading range for a few months. The S&P 500's trading range, which began in March, is bounded by the all-time high at 2,401 and the late March pullback low at 2,322.

The last two weeks saw an increase in volatility. The S&P 500 has moved towards the top of its trading range and the previous all-time high, including a very distinctive "gap up" as the markets rose. We said previously that when the S&P 500 approached 2,400 it would be important to assess the current strength of New York compared to its status at the beginning of March when the all-time high was made.

The report card is mixed. The NASDAQ and the Russell 2000 have moved beyond their previous highs, and the daily advance/decline line is making new highs. Sentiment indicators, as measured by the Investors Intelligence survey, shows that investment advisors are bullish, but not over-enthusiastic. The S&P 500 has managed to stay in touch with its 50-day Moving Average, which continues to slope upwards. At the same time, there is a negative divergence in the S&P 500's internal momentum, there are fewer NYSE stocks making new 52-week highs and the percentage of stocks above their respective 50-day Moving Averages is less than in early March.

Toronto remains in its own trading range which has lasted for four months. The S&P/TSX Composite Index is bounded by 15,943 on the upside and 15,241 on the downside. The Index continues to stay close to its 50-day Moving Average, which has flattened out due to the recent trendless action. We have repeatedly stressed the importance of the big Banks to Toronto's fortunes. All six major Banks are in corrective modes. However they are approaching oversold status and their respective 200-day Moving Averages. While other sectors such as Materials and Consumer stocks are performing relatively well, <u>the S&P/TSX Composite Index still needs the Banks to turn around</u> before we can expect to see a challenge of the top of the trading range.

With over two months of sideways movement behind it, the S&P 500 is going to eventually break out of its trading range. The NASDAQ's ability to sustain its recent breakout to new highs and the S&P 500's strong move upwards in the last two weeks following its visit to the lower boundary of the trading range, makes a plausible case that the eventual breakout will be to the upside. But the proof will be in the pudding – and <u>that requires a sustained move above 2,401. We are not there yet</u>.

<u>There is still a downside risk</u>. This mild pullback/consolidation could continue for some time and re-test the lower end of the trading range at 2,322. A move below this level would create an A-B-C down-up-down pattern on the S&P 500's chart from the March high. This would complete a mildly corrective/consolidation pattern. We see the maximum downside risk in this scenario to be the rising 200-day Moving Average, i.e., the mid- to high-2,200s.

The markets remain in a waiting game. In both New York and Toronto there are clear parameters to determine whether the markets' next move will be a resumption of the major bullish up trend or a continuation of a consolidative and mildly corrective period.

We retain our "long-term optimistic and short-term cautious" view of the markets. Our analysis continues to be that the bull's huge gains in 2016 and early 2017 now require an extended period of time to rest and prepare for the next major up move. Protecting profits is our preferred investment scenario.

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S&P 500

By the end of last week the S&P 500 had made an “M” shaped formation on its chart by approaching the 2,400 level, very near the previous all-time high in early March. This move to the top of the trading range took the S&P 500 above its 50-day Moving Average and kept this Moving Average rising.

Good support remains at 2,320, which came very close to being re-tested in mid-April. Below this there is support at 2,300 (the one-third retracement of the November to March advance), and further support around 2,250 which is the location of the lower line of the trend channel and the rising 200-day Moving Average. The 2,245/2,250 area is also the one-half retracement level.

Any sustained move above 2,400 would be bullish. If the pullback/consolidation continues, a re-test of 2,320 is likely. This level is vulnerable to downside penetration in the final stages of a pullback.

We expect that the consolidation will continue and that 2,320 will be tested again.

S&P/TSX Composite Index

In the last year, the S&P/TSX Composite Index has found support at its lower trend channel line on three occasions – all of which stopped minor declines. Last week the trend line was tested again, just above 15,400. Below this level is the 15,200 to 15,300 support zone, which remains a critical second band of support.

The S&P/TSX Composite Index continues to move sideways within its trading range. Over the past four months the Toronto market has yet to reach a fully oversold status and this may be necessary in order to reach the end of the consolidation period. The rising 200-day Moving Average is at 15,100.

With continued weakness in the Banks the lower end of the S&P/TSX Composite Index’s trading range remains vulnerable. The downside risk is a decline into the 14,000s and a retracement of at least one-third of the gains made in the huge 2016/17 rally.

Dow Industrials

For over a year the Dow Industrials has risen in a series of "steps": periodic modest corrections were followed by horizontal moves. When the Dow Industrials was in the midst of another of these modest pullbacks a month ago, we concluded that holding the 20,400 level was important. If successfully held, this level could be the launch pad for new all-time highs.

The Dow Industrials briefly probed below 20,400 in mid-April, created an oversold condition and then soared quickly back towards the 21,000 level. The 50-day Moving Average remains sloping upwards.

We see two possible immediate paths for the Dow Industrials. On the downside the Dow Industrials could pull back further to the one-third retracement level of the November to March rally, which targets about 20,100. As to the upside, the Dow needs to exceed its all-time high of 21,169 to confirm that the corrective period has ended.

The Dow Industrials should have one further pullback that takes the Index back towards the 20,100. This would complete an A-B-C down-up-down corrective pattern.

FTSE

Our view a month ago was that the London market was "headed into more turbulent waters." We noted that the FTSE had formed a "rising wedge" after a strong rally and that this is often a sign of the end of an up move. We forecast that the FTSE would pull back through its 50-day Moving Average and the 7,250 level, with an eventual downside target of 7,065.

The FTSE has corrected as we expected. Support was found at 7,100 (the level which stopped a decline at the end of January) and then the FTSE bounced back to its now-flattening 50-day Moving Average at 7,300 before declining again. This is classic corrective behaviour.

The issue now is whether the decline is over. At 7,100 the FTSE was quite oversold but it is possible that there will be one more re-test of that level. The rising 200-day Moving Average is at 7,030, just below our Head and Shoulders target of 7,065.

We expect that the FTSE will test the 7,030 to 7,100 zone shortly and the bullish forces need to make a stand in this area. The bulls will re-assert control if and when the FTSE makes a sustained move above 7,400.

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