PHASES & CYCLES®

**THE MARKETS ARE ACCELERATING AND BECOMING OVERBOUGHT.
A REST PERIOD IS APPROACHING AND
WILL OPEN THE WAY TO FURTHER UPSIDE.**

Another week passes, and more new all-time highs were achieved in many major market indices in New York, including the S&P 500, the Dow Industrials and the NASDAQ. Toronto's S&P/TSX Composite Index, which went in the opposite direction to the S&P 500 for much of 2017, has now caught up to the rest of the bulls and finally made a new all-time high late last week. The bullish tailwinds are powerful, but as the weeks and months go by without a correction the question keeps being asked – how long can this advance last?

The weekly charts of the S&P 500 and the Dow Industrials share a similar characteristic – their advances are confined within broad upsloping trend channels going back to 2016. Price-wise the S&P 500 and the Dow Industrials are just slightly above the mid-points of their respective trend channels. The potential exists for these indices to rise towards the upper trend line in the channel before price resistance is encountered. In other words, the current advance has the potential to move higher, perhaps by about 5% in the case of the S&P 500, before an identifiable pullback.

But some dark clouds are appearing in this sunny forecast. First, the S&P 500 is increasingly stretching away from its rising 200-day Moving Average, and at some point it will want to move closer to this Moving Average. Second, while the advance is accelerating to the upside, the percentage of NYSE stocks above their respective 50-day Moving Averages has fallen off through October from a high of 80% to the current level near 65%. As indices move higher, more stocks are pulling back. Fortunately, the daily NYSE advance/decline line remains in good shape. Third, internal momentum indicators have begun to lag and small negative divergences are appearing. Fourth, some sentiment indicators are starting to turn more bullish. The Investors Intelligence survey of investment advisers currently shows over 62% bulls, the highest figure since late February. What followed in March and April was a modest pullback for the S&P 500.

Our headline in the last Market Comment of mid-October was "a consolidation or minor pullback would be welcome and healthy for the markets." Some major market indices – notably the S&P 500 and the Dow Industrials – have had mini-consolidations as they advanced. These consolidations appear on charts as multi-day sideways or slightly downward moves, commonly referred to as "flag patterns", and then the advance resumes. The same pattern is seen in numerous individual stock charts. This is a bullish pattern and indicates that prices want to move even higher. But a more identifiable pullback – where the price action over a number of weeks would appear as a series of lower highs and lower lows – remains elusive. It does, however, remain a necessary requirement for the markets to keep their overall good health. As the markets get stretched and move into more overbought territory, the pullback possibilities are increasing.

Toronto's "great leap forward" continues but it is also a stretched market. We expected a pause in the S&P/TSX Composite Index before it made a new all-time high, but that proved unnecessary. Toronto, like the S&P 500, is now in a very large upward trend channel dating from September. The explosive rally of the past three months increasingly appears like a new major up leg, with potential for significant gains if the Index heads towards the top of its trend channel.

In sum, while the markets keep saying "I can move even higher than you might expect", they are increasingly overbought and the prospects for a pullback are getting stronger. With the bull market's strong foundations still intact any pullback on the order of 3-5% should be welcomed for its buying opportunities and not feared. Reinvigoration from time to time is needed.

Our List of Investment Ideas should be referred to for buying candidates.

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David Tippin, Ron Meisels

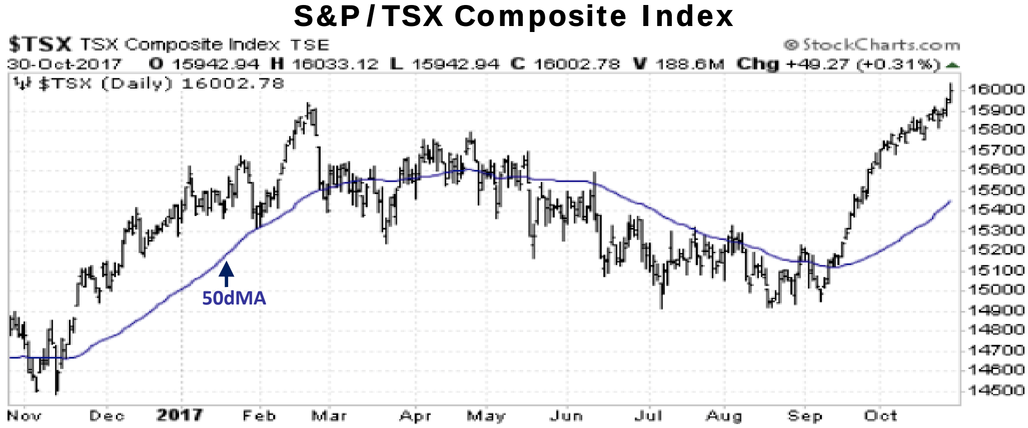
S&P 500

Two weeks ago we noted that the S&P 500 had broken above its shorter-term trend channel (see above) and observed that "this could be the beginning of an acceleration to the upside" with a minimum target of 2,650. Following this breakout the S&P 500 has risen further and is now over 165 points (6.8%) higher than its mid-August low. The Index is increasing the separation from its 50-day Moving Average and a small negative divergence in internal momentum has appeared.

Should the S&P 500 pullback from current levels, support exists in the 2,500 to 2,510 zone. This zone contains the all-important rising 50-day Moving Average and, as we have said in recent reports, the current bullish advance remains intact if the S&P 500 stays above this Moving Average.

The S&P 500's August to October price pattern has been strongly up. Despite some internal weaknesses there is further upside potential in the short-term. Until the price pattern is disrupted and a pattern of "lower highs and lower lows" appears, investors should stay with the uptrend.

S&P/TSX Composite Index



The S&P/TSX Composite Index has risen over 1,000 points (6.7%) in two months and made a marginal new all-time high at the end of last week. The 50-day Moving Average is moving rapidly upwards but the distance between the Index and the 50-day Moving Average remains considerable.

Our view remains that a major new up leg is underway, but with the Toronto market stretched and overbought from its recent exertions and very near an old high point, the prospects for consolidation or a minor pullback from current levels are considerable. The percentage of S&P/TSX Composite Index stocks trading above their respective 50-day Moving Averages has dropped in the past few weeks from 80% to 69%, mirroring the situation in New York.

There is room for a pullback into the mid-15,000s, nearer the 50-day Moving Average. But if the Toronto market manages to consolidate itself above 16,000 in the weeks ahead, the chances will increase that the S&P/TSX Composite Index is just going to continue to move higher. Whatever the short-term scenario, the overall outlook for Toronto remains extremely bullish.

Dow Industrials

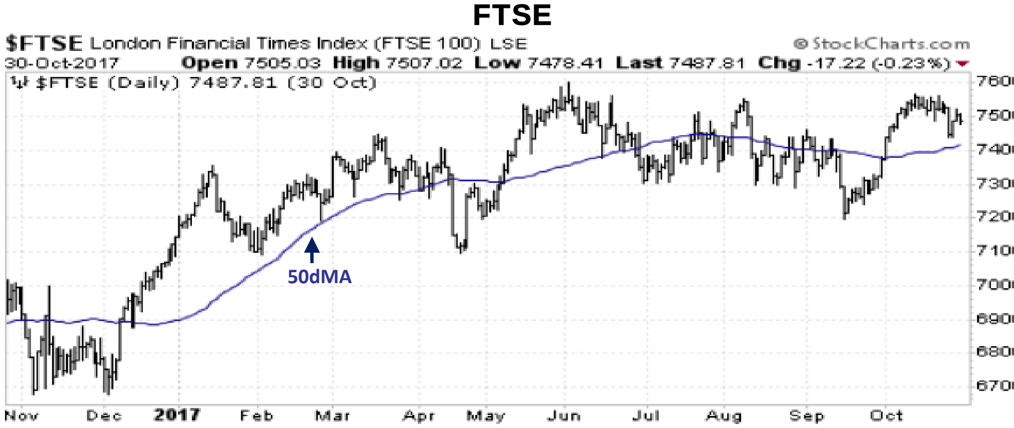
October, for the Dow Industrials, proved that an overbought market can just continue to move higher and become even more overbought. The Dow Industrials continued to make a series of new all-time highs on expanding volume and there was very little sustained selling pressure.

The growing distance between the Dow Industrials and its rising 50-day Moving Average is of increasing concern. The gap needs to be closed periodically for a healthy market. This can be done either through a sideways period where the Moving Average does the catching up, or by the Index pulling back towards the Moving Average (see September). Both options remain in play. The Dow Transports have already begun a minor pullback.

At the end of last week the Index was 1,000 points higher than its first line of support, the 50-day Moving Average. If the Dow Industrials returns toward the 50-day Moving Average (currently at 22,435) this would be a modest 4.3% pullback, well in line with our view that market risk currently involves only minor corrections. A further strong band of support exists from 21,600 to 22,200.

As the months go by the breakout over 19,000 nearly a year ago is proving to be a game-changer for the Dow Industrials. Upside potential remains massive. But the Index is increasingly vulnerable in the short-term to a minor pullback towards its 50-day Moving Average.

FTSE



One month ago we declared that the FTSE was embarking on another significant advance, which would be confirmed with a sustained move over short-term resistance at 7,461. The FTSE has done exactly that, moving up in mid-October to 7,565, encountering resistance and then pulling back to near its 50-day Moving average.

There is good support visible in the 7,410 to 7,450 area, which contains the 50-day Moving Average which is now turning upwards. The bullish outlook remains intact as long as the 7,200 level holds.

The FTSE contrasts currently with North American markets in that it is not overbought. There is room for considerable upside. We expect that the next move will be to exceed the mid-October high at 7,565 and then to challenge the previous all-time high at 7,599.

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