PHASES & CYCLES®

OUTLOOK FOR 2018:

AN EARLY PULLBACK WILL BE FOLLOWED BY MORE NEW HIGHS.
A MORE SIGNIFICANT CORRECTION COULD OCCUR LATER IN THE YEAR.

SEE PAGE 2 FOR OUR 2018 TARGETS.

To all our subscribers: the Phases and Cycles team wishes you a happy and prosperous 2018.

2017 in review: The year of major upside breakouts and new all-time highs.

A year ago we forecast that 2017 would be a year of new highs. So it was! From both long-term and intermediate-term perspectives, it was an exceptionally strong year, as the S&P 500 gained 20.4% for the year. The Index spent the entire year above its 200-day Moving Average and there were only 20 trading days when the S&P 500 closed below its 50-day Moving Average. The S&P 500 made three important upside breakouts: first above 2,300 in mid-February, second above 2,400 in late-May and third above 2,600 in late-November. No pullback exceeded 3.0%.

It was also a year when the major market indices in New York made a continuous stream of new all-time highs. The Dow Industrials and Transports, although diverging at times during 2017, ended up making joint new all-time highs in mid-December, meaning that as 2018 begins the Dow Theory confirms that the major trend remains up. The Dow Industrials was up nearly 26%. The NASDAQ (up 30%), NYSE Composite Index and the Russell 2000 made new all-time highs frequently. Late-December also saw new all-time highs in Toronto and London.

2017's bullish behaviour was part of the still-continuing "final up-leg" or "Leg-5" of this bull market that started in March 2009. This "final up-leg" began in February 2016 and by year-end 2017 had advanced from a low of 1,810 to the recent high of 2,695, a gain of 885 points or nearly 49%. All of the action on the S&P 500's daily price chart for the past 22 months is contained within a rising trend channel, supported by its rising 50-day Moving Average (see page 3).

Current status: New York is stretched and needs a rest.

The S&P 500 had a minor pullback in mid-August to just below its 50-day Moving Average. From that point to its most recent all-time high the S&P 500 has risen an impressive 278 points, or 11.5%. The Index has been very near the top of its rising trend channel for the past two weeks and, as we anticipated, is clearly encountering resistance in the high 2,600s. Internal momentum has lagged noticeably throughout December. The weekly S&P 500 chart shows an overbought condition and the percentage of NYSE stocks trading above their respective 50-day Moving Averages, while recovering in the past few weeks, still lags the S&P 500's advance.

In sum, the S&P 500 is getting ahead of itself. After such a rapid and extensive rise the Index needs a pause to refresh. There is ample room to do this by moving modestly down towards the mid-point of the trend channel, or by simply trading horizontally for a period of time and letting the upward trend channel play "catch up." With the 39-week cycle maturing in mid-January and the 70-day cycle maturing towards the end of the month, prospects are good for a pause/pullback early in 2018.

David Tippin, Ron Meisels

The bigger picture for 2018: a "three-peat" is unlikely for the bull market this year.

After two stellar years in 2016 and 2017, can the New York bull market deliver again in 2018? It is possible, for no other reason than this bull market's predominant characteristic for nearly nine years has been to "surprise on the upside." It has consistently exceeded expectations. Advances are longer and go higher than expected, and declines have tended to be shorter and shallower.

But our assessment is that 2018 is going to see a more volatile and uncertain market for two reasons. First, the upcoming year is the second year of the presidential cycle and has mid-term elections later on – historically this year tends to be a flat to weak one for New York. Second, the S&P 500's current "Final upleg" or "Leg-5" is 22 months old. This "Leg-5" historically consists of five "Parts". Part 1 advance (February to August 2016) was followed by short Part 2 correction of 5% (August to early November 2016) and a long powerful Part 3 advance to date. Conditions are ripe for a corrective Part 4 to begin, which should differ in character from Part 2 – perhaps by lasting longer and with less price damage. The major uptrend channel is bounded by 2,700 to the upside and 2,500 to the downside, which means that a relatively flat Part 4 can be comfortably contained within the channel. Following completion of Part 4, a final advance for this terrific Leg-5 should see yet more new all-time highs, **possibly towards 2,800.**

New York remains in solid shape as 2018 begins. Key indicators of market health such as price patterns, rising 200-day Moving Averages and a strong daily advance/decline line continue to be positive. But we expect 2018 to be more volatile – both up and down – than last year. New all-time highs will be achieved, but there is also an increased chance that New York will see a deeper corrective period near year-end.

Toronto: 2017 was a "game of two halves" but 2018 has considerable upside potential.

Following a quick rally to a new all-time high in February 2017, the S&P/TSX Composite Index declined for several months, losing 6.4%. However, the bulls were able to make a successful stand in the summer in the critical 14,900 to 15,000 zone. Then, the last four months of the year were solidly bullish, with an important breakout above 15,800 followed by a series of new all-time highs.

Toronto's internal momentum picture has weakened a little in the past six weeks even as new highs were made. But as long as most of the gains made in recent months are retained, the S&P/TSX Composite Index will remain in very good shape. Toronto has a history of out-performance in the final upleg of bull markets, so 2018 could be a very good year for the S&P/TSX Composite Index. **We expect to see more new all-time highs in Toronto, possibly towards 18,000.**

London: will prolonged consolidation lead to another upside breakout?

In early January 2017 the FTSE broke above its most recent high point at 7,130. For almost all of the rest of the year the FTSE traded within a tight 500-point range, bounded by 7097 and the 7599 all-time high made in early June. And just at year-end the FTSE finally poked its nose above 7,600. The pattern since April – sideways, but with a series of higher lows – is an "ascending triangle." This price pattern is typically bullish. It is a consolidation period that is usually followed by an upside breakout. The FTSE needs to get well into the 7,600s and stay there to confirm the breakout. January 2018 will be the defining month. If last week's breakout is confirmed then **the minimum upside target is 8,100**, a potential gain of over 6.5%. A sustained breakout to new all-time highs would also be bullish for New York, since London often leads New York.

S&P 500

In mid-December we suggested that the high 2,600s could be a "stalling point" for the S&P 500 due to the upside resistance posed by the upper line of its trend channel. This has proved to be the case, at least temporarily, as the S&P 500 ended the year in choppy fashion, with its internal momentum dropping off considerably.

The 2,600 level was an important breakout point in late-November. This means that the area between 2,600 and 2,700 could be the battleground in early 2018 as the bulls seek to defend the breakout point from bearish pressure. There is significant support at 2,550 and major support at 2,500. Any sustained upside move above 2,700 would be very bullish.

We expect that the S&P 500 will spend considerable time in January in the 2,600s. A choppy horizontal period – fulfilling our expectation of a modest pullback from current levels – would be an ideal refresher for the bull market.

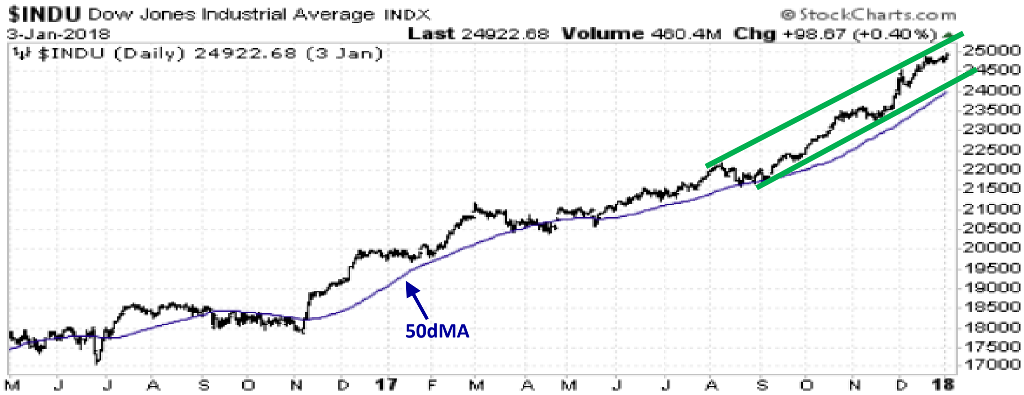
S&P/TSX Composite Index

Two weeks ago we said that "the S&P/TSX Composite Index's immediate battleground is the trading zone range. While any upside breakout would be very bullish it may be premature." Toronto made a new all-time high at year-end, right at the top of the trading range. But the S&P/TSX Composite Index is overbought and the internal momentum difficulties that we highlighted in December still persist.

The S&P/TSX Composite Index has good support at 15,800 and further support from a major up trend line at 16,200. The longer-term bullish potential for Toronto remains significant.

Despite its recent strength, the jury is still out as to whether the S&P/TSX Composite Index's next definitive move will be an upside breakout or a modest and healthy pullback toward the 15,600 to 15,800 area. New York's path in January will probably influence the outcome.

Dow Industrials



As the Dow Industrials approaches 25,000 it remains stretched to the upside and continues to butt up against overhead resistance posed by the upper boundary of its trend channel. Internal momentum has also weakened in the past two months, creating a negative divergence to the price rise. The Index is also the furthest away from its 50-day Moving Average (over 3.8%) since late-February. But the Dow Industrials continues to carve out a persistent pattern of higher highs and higher lows and until this pattern changes the trend remains up.

If the Dow Industrials starts to retreat from current levels, the first area of support is the early December low at 24,100. The rising 50-day Moving Average is just below this point and there is further support in the 23,200 to 23,500 zone, near the lower end of its trend channel.

The Dow Industrials' rate of advance accelerated in the last few months. The price pattern is strongly upward but at some point this Index is going to need a healthy correction. Any sustained move below 24,100 would be the signal that the rest period is underway.

FTSE

The FTSE declined from almost 7,600 to 7,300 in November. At the start of December we suggested that this decline was part of a larger multi-month consolidation process within a larger bullish advance. December turned things around, and at year-end the FTSE made several new all-time highs and was beginning to probe above 7,600, although on holiday-weakened volume.

The FTSE is moderately overbought after a 400-point advance. There is good support in the 7,400 to 7,500 area which contains the 50-day Moving Average. The early December low of 7,289 needs to be defended by the bulls, and below that there is further support at 7,200.

The key issue for the FTSE is its action around the 7,600 level. The most bullish outcome would be an immediate strong and sustained move above 7,600. A minor pullback and some backing and filling near this level would also be very acceptable as a way of working off the current moderately overbought condition. The most disappointing outcome would be a failure of the breakout followed by a deeper pullback into the lower half of the consolidation zone in the low 7,000s.

The FTSE has put the building blocks in place for a potential upside breakout from a six-month consolidation pattern. The near-term challenge is to establish a firm foothold above 7,600.

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