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THE S&P 500'S RECENT STRENGTH IS UNDERGOING AN IMPORTANT CORRECTIVE PERIOD WITHIN THE CURRENT BULL MARKET.

Our Market Comment in mid-July made two major points. First, the overall bullish uptrend remains in remarkably good health. The S&P 500 recently hit many all-time highs, the wave structure is positive and there are considerably higher upside price targets. Breadth and volume indicators provide further support. Second, cyclical evidence suggested that "a lessening of upside momentum at some point should be expected" and we pointed to the late summer period as the time which could see the S&P 500 become more moderate and choppy. We also drew attention to the sizeable gap between the Index and its 200-day Moving Average, suggesting that a narrowing of this gap would be a "healthy development."

The New York market's positive picture has deteriorated since mid-July. The S&P 500 made another new all-time high as the month neared its end, but on noticeably declining internal momentum and with the number of NYSE stocks making new 52-week highs failing to keep pace. We expected that the influence of the *down phase of the 39-week cycle would* "become more pronounced" and this combination of factors, along with the *seasonal weakness* that often appears in pre-election years, was enough to tip the S&P 500 into corrective mode. At the end of last week the S&P 500 had shed 4% overall and then, Mr. Trump executed a coup-de-tête (tariffs) and Monday the market sold-off another 4%!

The S&P 500 gained nearly 300 points (±10%) from June 1 and the advance from the late-December low totalled 29%. After nearly two months of strong rallying with only very minor pullbacks, a retreat of greater consequence – in both time and price – is no surprise. Last week's and Monday's action was a typical "selling climax": there were ten times more declining stocks than advancing stocks (10 to 1 ratio), there was ten times more volume by declining stocks than advancing stocks, and the Volatility Index (VIX) quickly shot up to 24.81, which is a typical sign of capitulation and a "selling climax". And encouragingly the bears have quickly come out of hibernation, proclaiming a major top/big correction and pushing put/call ratios to levels not seen since last December.

We expected a weaker period heading into late summer/early autumn and it has arrived. The S&P 500's strong overall performance means <u>there is plenty of room to accommodate more weakness without disrupting the overall bullish uptrend</u>. Last week's evidence suggests the corrective period will be more volatile than we anticipated but the outcome should be the same: a multi-week period of uncertainty with one or more re-tests of supports into a September cyclical low.

Toronto's S&P/TSX Composite Index never caught up to the S&P 500 to the upside. With leadership faltering, upside internal momentum fading, and overhead resistance looming, Toronto has slid downhill. But the declines are modest (less than 3% to date) and there is good nearby support. We expect that a re-visit of the early June low at 15,960 will be needed to test the S&P/TSX Composite Index's bull market credentials.

The recent aggressive selling has pushed the S&P 500 into correction territory. The S&P 500 has ample credit in its bullish bank – a strong underlying uptrend and many zones of nearby support – to withstand this latest attempt by the bears to wrest control of the New York market. A period of volatile rallies and pullbacks can be expected at least through Labour Day. Turnaround time to the upside should be in September when an oversold condition peaks and cyclical pressure eases.

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S&P 500

The S&P 500's June/July rally tracked along the upper boundary line of its short-term trend channel. The pullback took the Index back past the bottom of this channel, towards the rising 200-day Moving Average. At the end of last week the S&P 500 was already moderately oversold and the "tariffs" made it into a "selling climax".

The one-third retracement of the June/July rally was hit last week and the one-half retracement target of 2,880 was reached on Monday. Further support can be seen near 2,820, and at the 200-day Moving Average near 2,790, but a retracement to the 1/3 target of the whole January-July move (2750) should be a maximum. Initial overhead resistance should be encountered at 2,965 and then all the way up to the recent all-time high at 3,028.

The gain of 11% in seven weeks was unsustainable, especially as internal momentum failed to keep up. The first phase of a corrective period occurred last week. An attempt at recovery should develop shortly. Ideally the 2,790-2750 area should be the limit of the downside activity.

S&P/TSX Composite Index

Our conclusion in mid-July was that the S&P/TSX Composite Index was locked in a short-term range bound bull/bear battle between a recent low at 16,268 and the all-time high at 16,672. That battle continued until late last week when selling pressure seemed to have pushed the Index down below its 50-day Moving Average.

The S&P/TSX Composite Index has struggled to move higher since the all-time high was made in late-April. Internal momentum is weakening and the major uptrend line from the late-December low is now broken. With last week's pullback, the last three months increasingly look to be part of a larger A-B-C down-up-down corrective move. The recovery "wave B up" of this corrective pattern was completed at 16,641 on July 10 and Toronto is now in the final "wave C down." If this is the case, a move back down to the early June low at 15,960 is likely. This would also be a one-third retracement of the entire December to April advance.

There is important support in the 15,700 to 15,900 area, including the gently-rising 200-day Moving Average. It will take a sustained move above the recent trading range (i.e. above 16,650) to indicate that the selling pressure has been overcome.

The S&P/TSX Composite Index needs a rest after its strong performance in early 2019. This corrective phase, which now seems well progressed, is healthy and welcome. When it ends – probably within the next month – the stage will be set for a new up leg that will take Toronto to a new all-time high above 17,000.

Dow Industrials

Our forecast one month ago suggested that the Dow Industrials was on the verge of a challenge of its previous all-time high made last October. The Dow Industrials succeeded in making a new all-time at 27,398 in mid-July, but the rest of the month was spent in pullback mode.

When the Dow Industrials hit its previous peak in late-April it did so by tracing out a "rising wedge" pattern on its daily chart, and quickly corrected when that wedge was broken to the downside. The pattern was repeated in the last two weeks. At the end of last week the Dow Industrials had lost over one-third of its June-July gains and on Monday reached the 50% retracement level at 25,550.

The critical downside levels for the Dow Industrials are the early-June low at 24,680 and major support near 24,200. The pattern of higher highs and higher lows remains in force as long as the early-June low is defended. With last week's decline there is now a zone of overhead resistance from 27,000 back to the all-time high at 27,398.

The Dow Industrials is near a truly oversold position, while maintaining the overall bullish uptrend.

FTSE

We noted a month ago that the FTSE was rapidly improving, with the Index rallying strongly to overhead resistance near 7,530. July saw the FTSE briefly probe above this point, then consolidate, and finally move to a new recovery high at 7,727. Internal momentum did not keep pace with this move and on Monday the FTSE sold off, quickly shedding one-half of the June-July rally and moved back to the 7,200 level.

All of the FTSE's action since late-December continues to be contained within an upward sloping trend channel. There is initial support at 7,300 and below that in the 7,150 to 7,200 zone, which contains the now-rising 200-day Moving Average.

The FTSE is not yet fully oversold so a period of further downside pressure in the coming weeks can be expected. The overall bullish picture and pattern of higher highs and higher lows remains intact as long as the 7,080 level is protected. It will take a move back above 7,727 to indicate that the bullish advance is resuming.

The London market will need some time to recover from the quick sell-off. The FTSE should trade in a series of rallies and pullbacks between 7,150 and 7,700 in order to find its feet.

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