PHASES & CYCLES®

ONE PANIC PHASE HAS ENDED.
THE RECOVERY RALLY CAN STILL GO HIGHER
BUT MORE SELLING PRESSURE WILL EVENTUALLY APPEAR.

Our mid-March Market Comment and last week's *Ron's Brief # 20-10* described our expectations for the overall path that this <u>bull market corrective phase</u> will likely take: an initial down-leg "A" followed by a partial recovery period "B" and then a second down-leg "C" as the final decline. We suggested that this correction would be complex and volatile, with a number of mini-rallies and pullbacks, part of a larger and time-consuming process to get to the final bottom. One or more re-tests of the "A" low point could occur, with no guarantee that the initial re-test will be successful.

The S&P 500 low at 2,192 on March 23 was almost assuredly the end of "A". The evidence: high volume selling and huge daily trading ranges; fewer stocks made new 52-week lows; an improved breadth picture as the daily advance/decline line did not break below its last major low in December 2018; better internal momentum in some stocks and in several major market indices; and a break of the S&P 500's falling channel. The S&P 500 made a "failed breakdown" below its December 2018 low and then quickly moved higher. The 2,100/2,200 zone is also an area of long-term support.

The subsequent recovery from extreme oversold status has quickly re-traced just over a third of the S&P 500's 1,200 point "A" decline, more evidence that the 2,192 low was a significant stop in this ongoing correction. The recent "B up" phase – the counter-move in a major correction – is a period when bargain hunters face off with short sellers and those who want to limit previous losses. It can be very choppy and unpredictable, with optimism at a possible recovery giving way to pessimism as further selling appears. This inherently unstable recovery phase has the potential to reach as high as 2,800 on the S&P 500, the one-half retracement level.

Some market analysts have already suggested that the entire correction is now over (and the Wall Street Journal even claims it's a *new* bull market!). But there is a strong historical tendency for successive major corrective moves to not repeat their price patterns. The last major correction in late-2018 was sharply "V-shaped". A potential "V" began to form last week, but we doubt this is going to be a simple repeat of 2018 and the immediate start of a new major up leg. <u>We think this recovery rally will prove to be a trap for over-eager bulls</u>, giving way to a final "C" decline. We continue to expect that this correction will be elongated, likely a new variation of the extended correction patterns that occurred in 1929 and 1987 – it will rhyme, but not repeat.

The recovery phase should extend into April and then be followed by a re-visit towards the area of last week's lows. At that point the VIX and internal momentum indicators should provide less extreme readings than recently. If and when more new lows are made we expect not only a declaration of victory by the bears but a throwing in of the towel by some nervous bulls. These developments should signal that the <u>old</u> bull market is getting ready to start a new up-leg.

Toronto's S&P/TSX Composite Index re-traced all of its gains made since 2016 and then bounced off support in the 11,000 to 12,000 zone that dates all the way back to 2010. With no clear leadership and much damage to repair, Toronto's recovery efforts should run into strong headwinds and we expect an eventual re-test of the March lows.

In sum, as we said last week, <u>we're not there yet</u>. The initial panic dumping of stocks may be behind us, but this does not preclude more selling in the weeks ahead. Recovery rallies in the "B" phase are not ones in which longer-term investors should have confidence. The bull market has been seriously damaged and it will take some time to do the necessary repair work and for the markets to complete a bottoming process.

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S&P 500

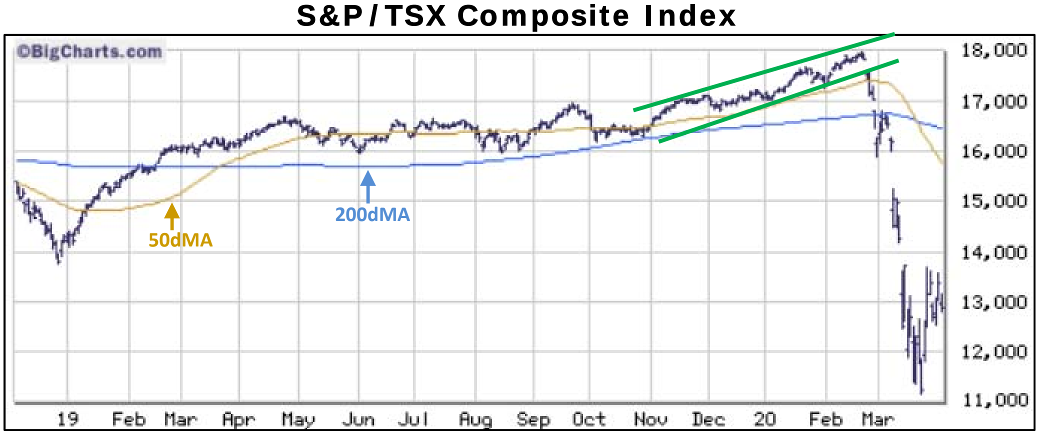
Nearly two weeks ago the S&P 500 tried to stop at its major December 2018 low at 2,346. The test failed for a few days and the S&P 500 plunged to a new correction low at 2,192. Internal momentum and breadth improved and fewer stocks made new lows. The Index then rapidly reversed course and began to rally. What looked like a huge break down reversed course and quickly turned into a sharp rally.

The recovery rally, led by the more defensive sectors such as utilities, has already pulled back over one-third of the decline. The 2,650 area poses immediate upside resistance. If the S&P 500 is able to move through this level and stay above it then the one-half retracement level near 2,800 looms as the next upside target. At that point the S&P 500 will encounter the sharply declining 50-day Moving Average.

In keeping with our view that the "B recovery" phase could consist of several choppy rallies and pullbacks, it is likely that the S&P 500's upside probe over the next few weeks will not be straightforward. A minor pullback to the 2,300/2,400 area could be part of the overall recovery phase.

The "A down" phase of the S&P 500's correction ended with a failed breakdown, confirming that this first phase of the correction is over. The recovery rally still has further upside potential. But we expect that short-term buying power will be overcome in April and the S&P 500 will resume its decline, eventually approaching the recent lows.

S&P/TSX Composite Index



Two weeks ago we said that the S&P/TSX Composite Index should find some initial support in the 12,000 area, and that the Index would need to do a lot of work to defend that area.

Toronto pushed down through the 12,000 level, eventually making a spike low at 11,172. At the low, less than 5% of S&P/TSX Composite Index stocks were trading above their respective 200-day Moving Averages, but a small positive divergence in internal momentum could be seen. From this oversold condition an attempt at a recovery rally has now started. This rally has retraced just over one-third of the decline. With the big Banks and the Energy sector still trying to find a footing, there is no obvious leadership to sustain a rally. Golds cannot do the heavy lifting by themselves. This means that the maximum upside target for this recovery phase is likely the area between the 50% retracement level (about 14,500) and the two-thirds level (near 15,500).

We expect the recovery phase of this correction will run out of steam. The S&P/TSX Composite Index needs further base-building and a return to test the spike low in the low 11,000s area is likely in the weeks ahead.

Dow Industrials

The Dow Industrials all-time high in mid-February was accompanied by a major negative divergence in internal momentum. By late-February the Dow Industrials was already correcting, as we noted at the time. We suggested a likely re-test of support at 25,000.

The Dow Industrials broke down through several supports in the 27,000 to 28,000 area, including its 200-day Moving Average and then tried to make a brief stand near 25,000. This failed, as did further support at 21,700 and the Dow Industrials quickly fell to its spike low in late-March at 18,214.

Internal momentum showed improvement at the low and last week's rally retraced just over one-third of the decline. The maximum target we see for this recovery attempt is a 50% retracement, which targets the 24,000 area.

The Dow Industrials may continue to track higher for a while but the Index needs more time to base build. A re-visit back towards the March low seems inevitable.

FTSE

The 7,000 level served as a floor of support for the FTSE for over a year. Once this was penetrated in late-February the selling floodgates opened. The next support area near 6,500 offered some minor resistance to the downtrend in early March, but after that was overcome, the waterfall decline accelerated finally stopping at 4,899. The 4,800 to 5,000 area is a long-term support level dating back to 2010/11.

At its lowest point in mid-March the FTSE reached oversold levels even more extreme than the market lows in 2008/09. But the daily advance/decline line held up well, not dropping below its late-2018 lows. Some quick re-tests of the 4,900 level generated some small positive divergences in internal momentum and were followed by a recovery rally on unconvincing volume that retraced one-third of the decline.

If the recovery rally extends, the FTSE could eventually move back towards the 50% retracement level near 6,300. At some point there should be another re-test of the 4,800 to 5,000 zone. If that occurs, some larger internal momentum divergences should arise, which would be one building block for a more sustainable rally.

We expect the FTSE's current recovery rally to peter out. More repair work is needed and a move back towards recent lows would be part of that process.