Market Observations as of Feb 2, 2018

By Carl Jorgensen - For Objective Traders - For educational purposes only. Not Financial Advice.

This week we finally saw some volatility return to the markets with a 'correction' to the overextended condition we have seen expand during the first four weeks of 2018. This weekly correction was not big enough to send panic into the markets as the weekly changes were about -4% or less for all the major indexes. The Dow dropped -4.1%, the S&P -3.9%, the Nasdaq composite -3.5%, and the Russell 2k -3.8% for this week (Jan 26th close – vs – Feb 2nd close).

This type of a small correction is a healthy part of any rally, and so far has not affected the longer term trends. A look at the weekly charts shows us that the trend lines for the bullish trend (since the Nov 2016 US Election) in each of the indexes have not been broken yet.

Remember, markets do not move in a straight line, but in a series of expansions and contractions. Markets are also fractal, in that we see similar patterns and behaviors on different time frame charts (monthly, weekly, daily, hourly, 10 minute, etc.). A change in trend starts from the inside out, with the shorter tern charts confirming the change first, followed by the next larger time frame chart. Markets also move down much faster than they move up. A careful study of many charts will confirm these tendencies. Looking at longer term charts can help us keep these behaviors in proper context.

This week's minor market correction seemed to be more of an overdue oscillation (relaxation) of momentum, than a being triggered by a slew of bad earnings reports, a FOMC surprise, or some political event. The 'why' is usually impossible to prove, and this week there seems no 'clear' correlation to a specific 'trigger' event. Even the jobs data on Friday morning was strong with increasing wages. Yes, Apple reduced its numbers for the model X iPhone, but that was no surprise either. It is natural to want to find an answer or 'reason' why the markets do what they do, but that actually rarely is possible to know as a fact. I find my time is much better spent carefully studying the action of the charts as they reveal the actions taken by the market participants, regardless of 'why' they each decided to do what they did. Markets are driven by people making decisions (even HFT Quants & their computers are programmed by people making decisions), and those decisions are not always perfect, logical or objective. Let the talking heads on TV spew out their 'reasons' why the markets did what they did, since that is what they are being paid to do. They are rarely right, and are always late. They are not paid to be correct, just to entertain. So I find it best to ignore the 'noise' and make my own decisions based upon what I see in the charts.

We saw lots of Market Breadth participate in this week's minor 'correction'. Most all sectors showed a drop this week, some more than others. Typically, when markets sense worry or fear it can spark a rotation into consumer staples and Utilities. We did not see that this week. Even Oil and Gold were down this week, as the dollar remained weak. Making comparisons and noting the strongest and weakest stocks and sectors, even in the context of an overall bearish week, can provide us with useful clues.

The Financial sector remained mostly horizontal this week until Friday, when most of its components dropped but not as much as did most of the overall markets. This shows some 'relative strength' by holding value all week and then only giving back a small amount on Friday when compared to the overall indexes or other sectors.

We know that the F.A.N.G. stocks have often been leaders the past two years, and represent a very large portion (weighting) of the Nasdaq and other indexes. Therefore, how they act can have a large impact on the overall markets. With many of these key stocks reporting this past week, there was plenty of potential fuel for the markets to move. However, what we saw was a market in the mode that 'all news is bad news' – meaning - even good earnings beats were sometimes met with stock price drops. Although financial information is important to measure a companies' value, the markets are made up of participants that may operate on other factors than the financials. Some may be rational and some may not.

Also, with a broad range of market participants, each one may take action with a different reaction speed or time delay. News can take a little time to digest and then be acted upon. News can affect not only the company that it is about, but also others in that same sector. Also, the weight of the news can be different based upon the overall context of the markets at that time it comes out. Therefore, it is important to keep in mind that 'Anything can happen', since some news is part of a scheduled event (i.e. Earnings) and other news could be some random announcement (ref. Steve Wynn allegations a week ago).

What will happen in the markets next? I do not know. The good news is, I do not need to know.

I can image a few different scenarios that might be likely to happen next (based upon past chart observations) and have an action plan ready to go for each. Once specific confirmation is observed (in the charts) as to what scenario applies, I simply operate per that part of my plan. Scenario 'A' could be – markets slowly rally back up to prior Resistance (highs) – maybe pause there before breaking above to new highs. Scenario 'B' could be – Markets oscillate up and down for an extended period in a range before eventually breaking above resistance to new highs. Scenario 'C' could be – Markets only briefly pause then continue to break down quickly to lower levels to find support at a lower level and bounce a little bit. There could be many variations of Up, Down, or Sideways, but this should give you an example of what to think about. The purpose of the imagination exercise is to establish in advance some key levels where you would be able to decide what scenario turns out to actually occur. Setting alerts at some key levels is one way to reduce the odds of missing the event when it happens.

Now let's look at the charts to see what they are telling us.

S&P 500 weekly chart as of Feb 2, 2018 – We can see that the gains from the prior 2 to 2½ weeks were given back this week. We can also see a spike in the 'True Range' for this week that is not as tall as either the 'Brexit vote' or 'US Election' spikes from 2016 (lower white line in chart). Important to note is that the trend line support (Red or Grey) for the past year is not even close to being tested this week. Also the dip this week was not even close to testing the 20 week or 50 week SMAs.

S&P 500 daily chart as of Feb 2, 2018 – Here we see only a tiny bearish candle on Monday, but it is followed by a gap down Tuesday and a huge candle on Friday. At the open on Friday, the 20 day SMA was quickly broken below. Also, the trend lines and 50 day SMA have yet to be close to being challenged as the S&P remains up for the year.

DJIA weekly chart as of Feb 2, 2018 – Similar as we saw in the S&P, the Dow also gave back the gains from the prior 2½ weeks this week, while the Trend line (Red) and SMAs have yet to be tested.

DJIA daily chart as of Feb 2, 2018 – Similar to the S&P, the Dow also was quiet on Monday, followed by a gap down on Tuesday, then a Break down below its 20 day SMA (Yellow) on Friday.

NASDAQ weekly chart as of Feb 2, 2018 – The Nasdaq gave back gains from the prior 2 weeks this week. It too has yet to even come close to testing its Trend Line (Red) or 20 week SMA.

NASDAQ daily chart as of Feb 2, 2018 – Like the other indexes, Monday was an inside narrow range down day while Tuesday gapped down at the open to kick off the week of selling, that mostly occurred on Friday. On Friday the Nasdaq broke below its 20 day SMA and its 7,374 support level from the prior 7 days.

IWM daily chart as of Feb 2, 2018 – The Russell broke down Tuesday as well. Since it has been the weaker index for a year or more, it broke below its trend line support (Orange line) at the open on Tuesday and below its 20 day SMA on Wednesday, and below its 50 day SMA on Friday. Unlike the other major indexes, the IWM has given back all of its 2018 gains, is below both its 20 day and 50 day SMAs, and has now returned to the range it was in during December 2017.

NYSE Advance Decline Line daily chart as of Feb 2, 2018 – Each day this week we saw a reduction in Market Breadth as selling was broad.

McClellan Summation Index daily chart as of Feb 2, 2018 – We see a negative acceleration each day this week as bearish breadth increased more each day.

VIX daily chart as of Feb 2, 2018 – Here we can see 15 months of the VIX, and how the spike this week was not too significant when compared to Nov 2016.

VIX daily chart as of Feb 2, 2018 – Here we see the past six months of the VIX, and how it shows us market 'expansion' of volatility Mostly on Monday and Friday. Note how most market indexes show a small bearish 'inside' day on Monday of this week, while the VIX was suggesting increasing worry on that day (a clue).

US Dollar Index weekly chart as of Feb 2, 2018 – Note the peak in December of 2016 just after the US election, then a clear decline to the 200 week SMA with a bounce in Sep-Oct 2017 followed by the next decline to break below 90 last week when this index delivered multi-year new lows.

US Dollar Index daily chart as of Feb 2, 2018 – The ETF ‘UUP’ is another way to look at this index (as we did last week). Note how it did not bounce much Friday when the markets were breaking down hard.

GLD daily chart as of Feb 2, 2018 – Gold was mostly flat this week, with only a small break down on Friday to end the week just barely below its 20 day SMA. Note how the 20 day SMA is flattening out as positive ended 7 days prior.

OIL daily chart as of Feb 2, 2018 – Oil remained in a horizontal \$3 range this week, supported by its 20 day SMA and remaining under the highs of Jan 25th.

TLT daily chart as of Feb 2, 2018 – We saw a break below support (Grey line) on Tuesday, then a small bounce on Wednesday when the FOMC released its (no surprise) notes. Even with no interest rate hike from the FOMC, the markets acted on Thursday and Friday as Bonds broke down. Increased interest rates and some inflation is the natural and expected affects of a growing economy, so it should not be a surprise to anyone who has been watching the economy grow (slowly) worldwide.

DJ Transports daily chart as of Feb 2, 2018 – The Transports started breaking down almost two weeks ago, as oil prices peaked at new highs. No surprise since fuel is the largest expense for most all transportation modes. This break down continued this week as the sector index broke below its 20 day SMA and nearly reached its 50 day SMA on Friday.

XLE daily chart as of Feb 2, 2018 – The Energy sector ETF dropped a little on Monday to test support at the 20 day SMA and the prior week's lows. Tuesday saw a gap down with most all the market sectors taking the XLE below its 20 day SMA that day. On Friday another strong move down took the XLE to close the week just below its 50 day SMA.

XLF daily chart as of Feb 2, 2018 – The Financial sector is another key area to see confirmation in an economic cycle. This sector actually held up rather well and recovered its small drop on Tuesday by the close on Thursday. Friday, however, saw enough selling to take the XLF down to close the week just below its 20 day SMA (Yellow).

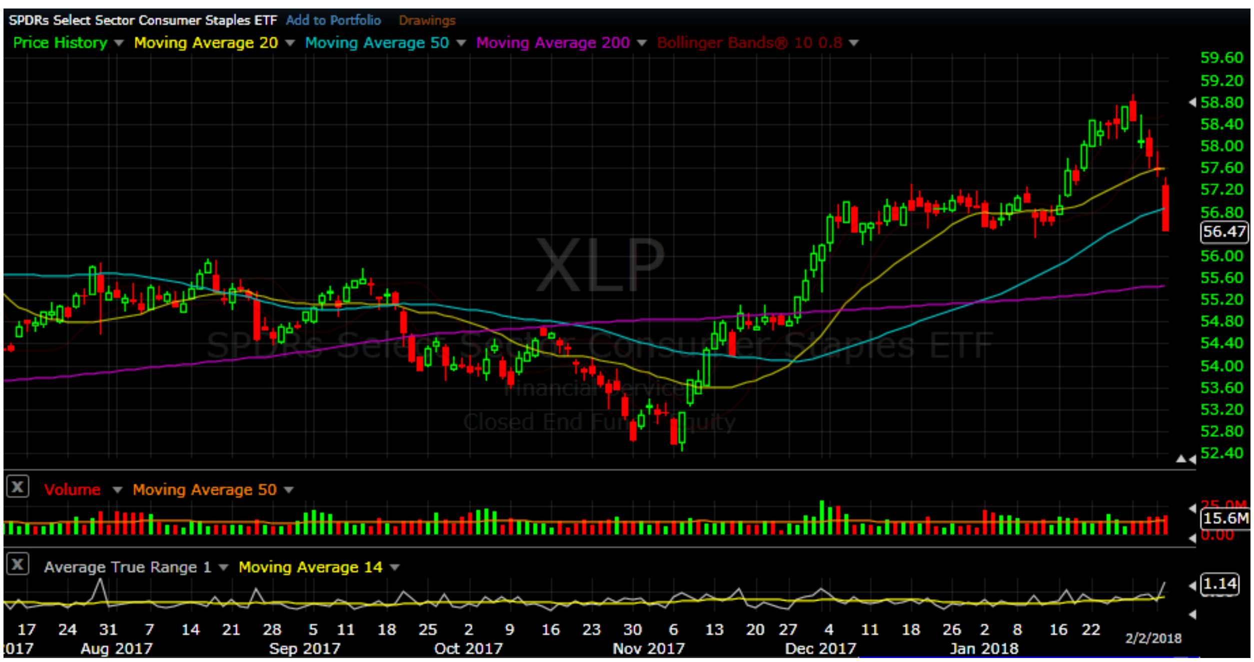
XLV daily chart as of Feb 2, 2018 – The Healthcare sector saw strong move down all week, mostly on Wednesday. The week closed down 5.1% for the XLV.

The IBB delivered new Highs on Monday, but then dropped hard the remainder of this week, closing the week down 5.0% from the prior week.

QQQ daily chart as of Feb 2, 2018 – The tech heavy QQQs were down most days this week to cross below its 20 day SMA on Friday. The Qs closed down -3.7% for the week.

SOXX daily chart as of Feb 2, 2018 – The semiconductor sector showed some strength in December and January, but gave back a fair bit of its gains on Jan 25th and this week on Friday. This sector is now below its 20 day SMA, below its Nov highs Resistance (Grey line), and has given back all of its 2018 gains.

XLU daily chart as of Feb 2, 2018 – We saw the Utilities sector remain mostly horizontal this week until Friday when it broke down too and delivered new lower Lows. Although Utilities did not drop as much this week when compared to other sectors, it did drop lower.



XLP daily chart as of Feb 2, 2018 – Typically, when markets sense some worry or fear it can spark a rotation into consumer staples and Utilities sectors. We did <u>not</u> see that this week. The XLP has now given back all of its 2018 gains as it closed below both its 20 day and 50 day SMAs this week.

XME daily chart as of Feb 2, 2018 – This sector was one of the strongest bears this week. Checking sectors each day can help to reveal who is the strongest and weakest. The XME closed this week below the prior week's support, below both its 20 day and 50 day SMA, and has given back all of its 2018 gains plus some.

Now let's look at a few key stocks for this week.

AAPL daily chart as of Feb 2, 2018 – Apple reported earnings after the close on Thursday and we can see the negative reactions on Friday. Note how AAPL has been moving down over the past two weeks since making new highs briefly on Jan 18th. AAPL also broke below both its 20 day and 50 day SMAs last week and then broke below its trend line support (Red line) on Tuesday of this week. Not only had AAPL given back all of its 2018 gains last week, but broke below its Sept 1st (Yellow line) highs Support that was respected this Tuesday just to break below on Friday of this week. Apple ended the week nearly at its 200 day SMA. This was a nice short, for those who may have sold the break below the 50 day SMA. For me, the breaking of the Red Trend Line Support (in place since the US Election) was the final confirmation of the end of the bull trend for Apple. The future could be more bearish action or horizontal chop action, or even a bounce. Anything can still happen. For now, my plan prevents me from playing apple as a bullish trend following trade … since I have chosen to respect the odds - which now do not justify the risk.

FB daily chart as of Feb 2, 2018 – FB delivered new highs on Thursday after reporting earnings after the close on Wednesday. FB broke above its prior Resistance (Purple line) on Thursday as well. Friday was an inside day as not all of Thursday's gains were returned and prior Resistance remains as new Support (Purple line). This is a sign of great bullish strength when seen in the context of Friday's markets.

NFLX daily chart as of Feb 2, 2018 – The Gap from last week, and its support (Purple line) remain as support as NFLX delivered new highs on Monday. The week ended with more than half of these gains retained, and that is a strong bullish clue in the market context this week.

GOOGL daily chart as of Feb 2, 2018 – Alphabet remained quiet and horizontal all week until earnings Thursday after the bell. Friday saw a gap down of over -5% for the day after an earnings 'miss'. A little more than half of 2018's gains were given back by this reaction.

NVDA daily chart as of Feb 2, 2018 – NVDA delivered new highs on both Monday and Wednesday this week. Most of the week was in a narrow range until breaking down on Friday. The drop on Friday was relatively small as NVDA respected its 20 day SMA support. Stocks showing relatively small dips on Friday this week, tend to give us clues as to their relative strength as bulls. NVDA is scheduled to report earnings on Feb 8th after the close.

INTC daily chart as of Feb 2, 2018 – Intel gapped up after earnings late last week to deliver higher highs that continued into Monday of this week. Tuesday saw the sector and this stock start to fall back. We see in this chart how INTC broke below its Gap day support (Purple line) on Wednesday, and then continued down the end the week nearly filling the gap. INTC remained above both its 20 day and 50 day SMAs this week, but is no longer showing much strength as the 20 day and 50 day SMAs have been doing the horizontal dance form nearly two months, telling us there is not much of an overall trend going on. Being stopped out when the gap day support was broken (Purple line) allows one to keep some profits since the 20 day and 50 day SMA break out (Blue arrow).

MA daily chart as of Feb 2, 2018 – MA has been a slow and steady trending stock this year that has remained relatively strong this week. Earnings were reported before the open on Thursday with a small 'miss', yet prices gapped up a bit to new highs. Most of the Thursday's gains were given back on Friday, but the week still closed up a little, and that's impressive given both the sector and overall market behavior on Friday.

SQ daily chart as of Feb 2, 2018 – Square held up rather well this week compared to the general markets. However, it did give back most of the prior week's gains this week as it remains above both its 20 day and 50 day SMAs.

X daily chart as of Feb 2, 2018 – US Steel and the sector broke down hard on Tuesday after delivering a higher high on Monday. Tuesday saw X break below its 20 day SMA, and Friday below its 50 day SMA as all of 2018's gains were given back.

SCCO daily chart as of Feb 2, 2018 – Like US Steel, SCCO also saw strong selling on Tuesday as the 20 day SMA was broken at the open. Thursday saw SCCO test prior support (20 day) as new Resistance before breaking down hard on Friday. The week ended above its 50 day SMA, but all of 2018's gains have been given back.

CAT daily chart as of Feb 2, 2018 – CAT started the week Monday below its 20 day SMA, where it remained all week. The week ended down -5.7%, with all of 2018's gains being returned while not yet testing the 50 day SMA.

DE daily chart as of Feb 2, 2018 – DE has held up better than CAT so far this year, with only dropping -3.8% for the week. It did close below its 20 day SMA on Wednesday and Friday. DE has kept about half of its 2018 gains.

HD daily chart as of Feb 2, 2018 – HD saw a quiet Monday, followed by a gap down and very High speed whip (HFT-Quant) down a minute after the open that recovered nearly completely in under a second. It makes for a wide range candle on Tuesday that I choose to ignore, since it was likely a computer spasm. Thursday saw a test of support at the 20 day SMA, and then a wide range down day on Friday with most all of the markets participating. The 50 day SMA is now about where 2017 ended.

BA daily chart as of Feb 2, 2018 – Boeing gapped up Wednesday after a small earning 'miss' that morning before the open. Support on the gap day was near the prior Resistance from Jan 17th highs (Purple line). That level was respected Thursday, but broken on Friday. The week ended up +1.7% even with the relatively small drop on Friday.

LVS daily chart as of Feb 2, 2018 – LVS reported earnings last week on Jan 24th, but Monday saw a large swing up to higher highs, followed with a slow drop the rest of the week to end the week nearly down only a few cents. Possibly the negative news on WYNN on Jan 26th caused some rotation out of WYNN and into LVS on the following Monday Jan 29th? The large volume seems to suggest this is possible.

ADI daily chart as of Feb 2, 2018 – The Cup-n-Handle patter we saw about three weeks ago, showed signs of weakness last week as price dropped back to test new Support (Beige line) and the 20 day SMA. This week, at the open on Tuesday, we clearly saw the break below both Support (Beige line) and the 20 day SMA, signaling a Failed Cup-n-Handle pattern. No pattern works all the time and ADI is one example of a failure. We gave ADI time and room to rally after its Break Out on Jan 16th. Also, we know that a dip (soon after the initial break out) to retest prior Resistance as new Support is a common (but not required) trait of this pattern. However, once that support was broken on Thursday Jan 25th, we exited the position. We were patient until that Support was broken. Note how this same Support line was again clearly broken on Tuesday morning this week and continued down to end the week below its 50 day SMA.

This week likely gotten a lot of Traders excited or worried, as the markets sank with conviction on Friday. Do not worry. Stick to your plan and your stops. If you were stopped out, per your plan, then congratulate yourself for sticking to your plan. This is what having a plan is for, so you do not panic, and simply follow what you decided BEFORE you entered each position.

If you entered a position without a written plan, then you are simply gambling with your capital and open to all sorts of emotional errors. A plan defines your process, and includes clearly identified stops and position size criteria, so that you know before you enter each trade, exactly what is being risked. The plan does no good if you don't follow it.

Trade Smart.

CJ