Market Observations as of Feb 9, 2018

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

Volatility is back! The 14 month rally since the US Election seems to be over or at least taking a break. The volatility we saw return to the markets on Friday (Feb 2nd) of last week, ended up just being a clue and warning for this week. Some were caught surprised by the drop this week, while others have been waiting for a 'correction' for a while. Usually the markets seem to correct a little bit every 9 to 12 months on average.

Markets do not move in a straight line but in waves (or phases) with periods of Expansion (trending) and Contraction (non-Trending). You can see behavior on all time frames (since the markets are fractal). On monthly and quarterly charts these waves may cover over decades, on weekly and daily charts over weeks or months, and on intraday charts with waves lasting minutes or hours. One way to visualize this concept is to think of a rubber band being wound up, and the more energy (time) that is stored up, the more there is to release. We had 14 months of winding, so there was some energy to release. This is the natural behavior of the markets.

We saw 'Volatility' both in the size of price swings (range) and in Options pricing (VIX) expand this week to levels not seen since late Aug 2015.

The breadth of the decline this week was wide and included most all sectors, so there were few places for the bulls to hide. The typical 'flight to safety' strategies (move cash into Utilities, Consumer Staples, Gold) did not do so well this week, so cash may have been the best place to be for many.

One of the amazing & rare things about this week is that the bearish move was worldwide with most countries and markets declining 10-11%. With Trillions of QE yet to be un-wound, rising interest rates amplifying US Govt. Debt, while congress continues to spend like there is no limit (they just keep raising the limits) have all combined the week to put some serious monetary and economic fears in front of traders, tax payers and a new Fed Chair.

One easy way to recognize what stocks and sectors are stronger, or weaker, when everything seems to have gone down this week, is to see how much or their recent profits have been 'given back'. Compare the current price, to when that stock (or EFT or Index) was last trading at that same level. Stronger stocks may have only given back a week of their recent gains, while the indexes have mostly given back all of their December and January gains, and weakest stocks have given back 6 months of their recent gains. This is one way to see relative strength. Another way is to see if price remained above their 50 day SMA (when many have fallen below) and if that 50 day SMA is still below the 20 day SMA, and are they still sloping upwards to the right or have turned downward. Each of these simple methods only require a glance of your charts (with practice), and can help you quickly recognize stronger (and weaker) stocks within their sector or index.

Why did the markets drop this week? Well I have heard every excuse imaginable, and most do not stand up to the data test. None were a 'surprise' and most were the results and not the cause. It is likely impossible to prove the specific 'cause', so we do not spend time dwelling on answering the 'why' questions … although there is no shortage of possibilities.

A very interesting 'event' we saw this week was when the Algos (computers) created a high speed 'flash crash' on Monday (Feb 5th) afternoon, that only lasted about 12 to 14 minutes, but saw some of the fasted moving markets I have ever clocked. Most of Monday saw orderly selling, until the last hour, when at 3:04pm ET a high speed acceleration occurred selling for 6 minutes and then rally back up for 6 minutes, to return back where the markets were at before the 'flash' began. A tick-by-tick study of this event seems to show the VIX crossed above 30% (for the first time in 2 years) at 3:03pm ET, and the S&P and Dow Futures started high speed selling 45 to 50 seconds later. A minute after than the indexes and big stocks all dropped as well (3:05pmET). I studied 23 charts, tick by tick, and saw a similar pattern of brief support found at 3:00 pm ET, with a bounce the next 3-4 minutes, then a fast break down starting between 3:04pm and 3:06pm on different charts. The VIX crossing above 30% seems to be the initial trigger (maybe the Algos were programmed to trigger on this>>>???) since it occurred first. The VIX totally broke apart, without the ability to track after 3:04pm ET once the Algos kicked in with their selling. Below I've include two 1 minute charts to show this flash crash sequence of events, and how the Dow dropped 795 points in 6-7 minutes, and then bounced back up the same amount just as fast. When this happened, the Bid-Ask spreads became extremely wide as buyer backed away completely from markets, and stopped were filled with huge slippage, and quotes & orders lagged for a minute or more. If you ever see this happen, realize that what you are seeing is likely 'lagging' a fair bit after reality, and placing any order in this high speed environment is very risky. It is best to just step aside if you see this happen, since there is no way you can catch up with the computers orders or filled stream of data. Even after this flash was over (at about 3:17pmET) the VIX never did stabilize the rest of the day (43 minutes) until the close.

After the close on Monday (Feb 5th) the various ETFs and ETNs that are based upon the VIX had to do their daily adjustments (re-correlation). With the VIX increasing by over 215% in one day (vs. the prior day's close) this required very significant adjustments. Depending upon their structure, these adjustments forced a number of trades in the futures (after hours). These adjustments put pressure on the futures markets where we saw huge swings in the overnight hours after Monday's close. For example, the Dow Futures (YM) dropped an additional 900 points in the seven hours after the US Markets closed Monday night. This overnight low (YMH8 @ 23,088) was not exceeded the remainder of this week. That evening Credit Suisse announced they were closing the XIV by Feb 20th. Contrary to the media, these derivatives on the VIX did not cause the market drop Monday, but they sure did amplify its impact the drop had 'after' the close on Monday.

We have seen some wild things occur this past week, and this may have stopped you out of some or most long positions, and that is exactly what the stops are there for, to protect your capital.

Volatile markets can provide opportunities for bearish positions, and in time, eventually could present new entries for bullish positions. Volatility can increase very fast, but it usually decreases much slower, as time is needed to rebuild 'stability' to markets. Extra caution is wise after such events, since there is no way to know if the bottom is in, until well <u>after</u> it has occurred. If you are agile (and experienced) then volatile markets can provide some great short term opportunities. But volatility also amplifies the importance of always managing your risks, so never ignore your risk rules, regardless of the market type.

There are lots of other great examples of events this week, but this weekly document is already becoming a bit too long to read or write. So I encourage you to study the charts on your own, and build up you skills of reading the behavior of the markets at the Right Edge of the chart.

Now, let's look at some charts.

S&P 500 weekly chart as of Feb 9, 2018 – We see the S&P has delivered two down weeks, with this week the largest. Also this week has a long wick on the bottom of the candle indicating a bounce off of some support during the week.

S&P 500 daily chart as of Feb 9, 2018 – On the daily chart we see that the 20day SMA was broken last Friday (Feb 2nd) and this Monday (Feb 5th) the 50 day SMA was broken below as well as the (Grey) 6 month trend line support. Tuesday broke below the (Red) 24 month Trend line and bounced. Wednesday tested the 50 day SMA (Blue) as Resistance and failed there. Thursday's drop crossed and closed below the (Red) Trend line and Friday tested the 200 day SMA (purple) and bounced. The week ended with the S&P giving back Jan and Dec gains and returned to the level is was at in late Nov.

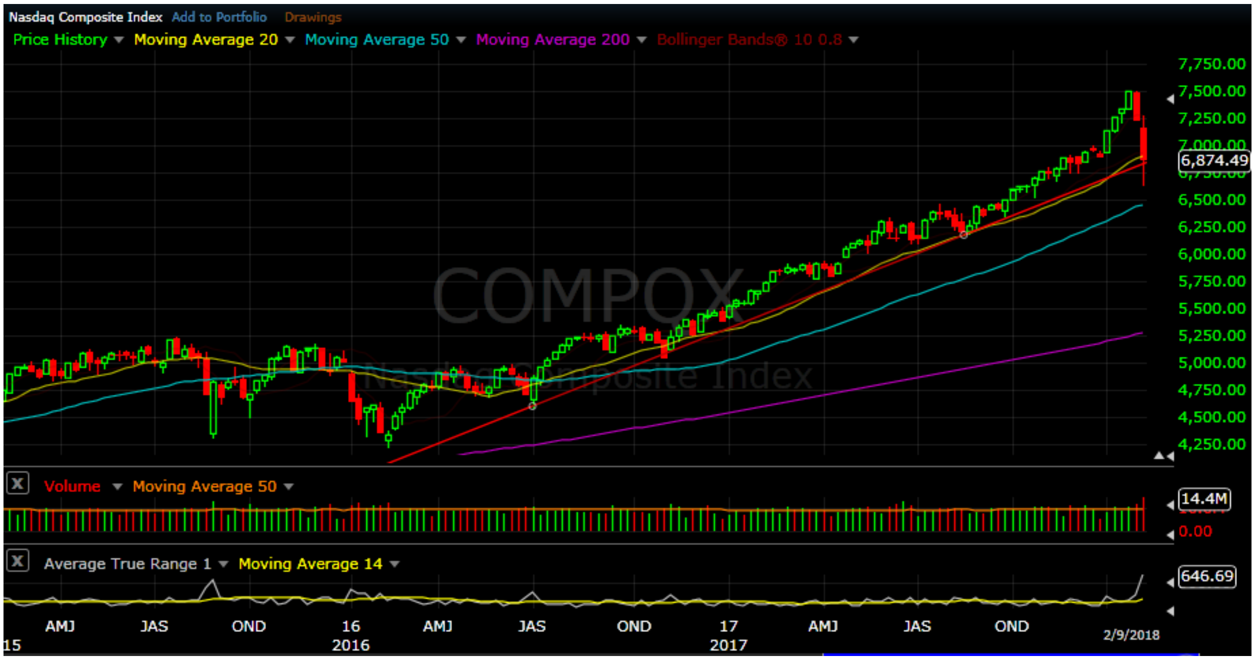
DJIA weekly chart as of Feb 9, 2018 – The Dow crossed below its 20 week SMA and its (Red) trend line then bounced to close near its 20 week SMA. The weekly candle shows a long lower wick.

DJIA daily chart as of Feb 9, 2018 – Here we see similar to the S&P, the Dow broke support at its 20 day SMA, its 50 day SMA and its 2 year Trend Line (Red) during this week, with a bounce Friday to close the week where it was at back on Nov 29th.

DJIA 15 min. chart as of Feb 9, 2018 – On the 15 min chart for the Dow, we see the 'flash crash' I described above on Monday (Red Arrow) when the Dow dropped nearly 800 points in 7 minutes. After the 900 point drop in the Dow futures overnight session, the Open on Tuesday (Yellow arrow) was down over 260pts from the prior day's close.

We also see somewhat steady selling most on most of Friday, Monday and part of Tuesday, as the PINK line shows, with the exception being the flash crash the last hr of Monday, and the wild open on Tuesday straying well below this Pink trend line. The bounce late Tuesday ended early Wednesday as the Green line high-lights. The next steady selling started late on Wednesday and persisted thru Thursday and the first half of Friday (Grey line), with a bounce the last half of Friday.

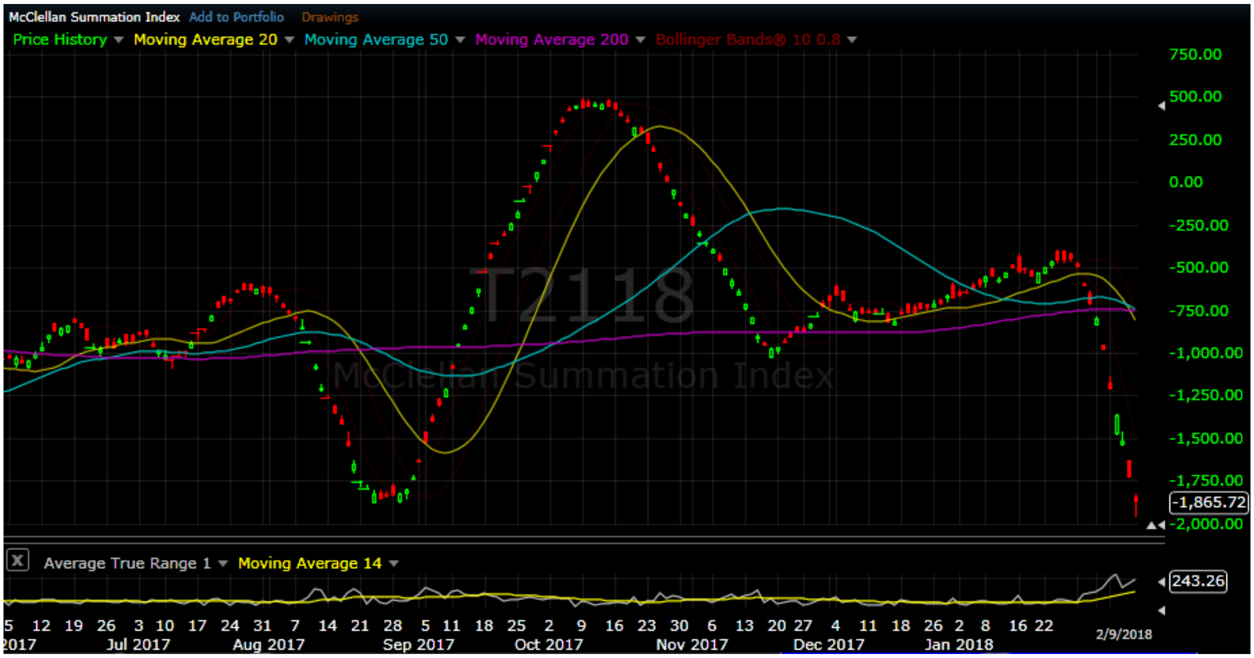
The Wave down, then up and then back down to lower lows, formed a common correction pattern that seems to happen more often than not. It does not mean that this correction is over. The dip buyers on late Tuesday and early Wednesday may have been surprised if they thought the selling was over. Remember, anything can happen.



Nasdaq weekly chart as of Feb 9, 2018 – The Nasdaq also painted two down weeks, with this week having a long wick under its candle piercing the 20 week SMA and Trend Line (Red).

Nasdaq daily chart as of Feb 9, 2018 – We see the similar daily wide oscillations this week as we saw in the other indexes, with the close this week at levels last seen Dec 16th. Note how the 20 day SMA (Yellow) has turned downward, the 50 day has become flat, and the 200 day SMA remains sloped upward.

Russell 2000 daily chart as of Feb 9, 2018 – The Russell also had a rough week, ending this week at a level from early-mid November. The 20 day SMA broke on Jan 31st, the 50 day SMA broke on Feb 2nd, the 2 year Trend Line (not shown) on Thursday this week, and the 200 day SMA (Purple) was pierced during Friday.



McClellan Summation Index daily chart as of Feb 9, 2018 – We see the continued acceleration downward for 7 days after the drop below the 50 day SMA. Note the wide spacing between the daily candles, suggesting a much accelerated move.

VIX monthly chart as of Feb 9, 2018 – We see 10 year of the VIX, and the relative spikes during this period. This past week was not as high as some of the VIX spikes over the past decade, but it was maybe the 3rd largest.

VIX daily chart as of Feb 9, 2018 – We can see on the daily chart how the largest move up was on Monday with a 215% increase, which was magnified significantly by the 14 minute flash crash the last hour of Monday. The Tuesday spike high was in the first hour after which the VIX slowly drifter down only a little. We can see wide oscillations the rest of the week.

VIX 1 min. chart as of Feb 5, 2018 – This 1 minute chart of the VIX covers the last 2 hours of trading on Monday Feb 5gh. This helps us see the steady climb in Options Volatility the hour before Noon PT (3:00pm ET) that continued the next 5 minutes increasing each minute. At 3:03pmET (12:03pm Pacific) at the Orange arrow the VIX crossed above 30.0% for the first time in about 2 years, and this appears to be a ‘trigger’ event for the Algos, that started heavy selling 30-40 seconds later. Once the Algo selling picked up in speed by 3:06pmET the VIX could no longer compute reasonable values as the bids dropped away and spreads for stocks and options became huge. We see this VIX chart show many gaps, or freeze (yellow dash line levels) and oscillate wildly through the rest of the trading session (54 min.) It was this uncertainty in computing the VIX the last 55 minutes of Monday, that then created problems for the VIX based derivative ETFs and ETNs that must re-balance each evening.

DJIA 1 min. chart as of Feb 5, 2018 – Here we have a 1 min chart of the Dow, covering the last two hours of the market hours on Monday. Support (Red line) was established at 3:00pm ET (12:00pm PT) and bounced the next three minutes, then began to drop at 3:04pm ET (12:04pm PT) to break below this support (Orange arrow) and drop 795 points in under 7 minutes, and then bounce almost exactly 795 points the next 7 minutes. This equates to 6,814 pph (Points per Hour) velocity for the Dow, one of the fastest rates of change I have ever measured. Now it only lasted 14 minutes, and some minutes were faster than others, but this still shows a rate that is clearly driven by automated computer trading.

You may have see the consequences of this 'flash crash' if you were watching the markets at the time, and saw either delayed quotes, very wide spreads between the bids and offers, or large slippage between where a stop order was triggered vs. filled. The remainder of the day, after this flash was over, the markets remained 'stunned' with slow data and wide bid – offer spreads as folks tried to assess what had just happened.

Gold daily chart as of Feb 9, 2018 – Gold wan not a haven this week, as it fell breaking below its 20 day SMA and closing near $1318.

Oil daily chart as of Feb 9, 2018 – Crude Oil fell 4 of 5 days this week, after delivering a new high Jan 25th. Oil broke below its 20 day SMA on Monday (Feb 5th), below its 6 month trend line support (Red) on Wednesday, below its 50 day SMA on Thursday and below its prior Resistance Nov High on Friday this week. This certainly put pressure on the Energy sector as well this week.

TLT daily chart as of Feb 9, 2018 – The 20 yr Bonds fell this week as well.

US Dollar Index daily chart as of Feb 9, 2018 – The US Dollar rallied only a little this week, and barely crossed above 90, returning to where it was in middle January.

DJ Transports daily chart as of Feb 9, 2018 – The Transports began to break down over two weeks ago, and spent all of this week below its 50 day SMA. This index gave back all of its December and January gains.

XLE daily chart as of Feb 9, 2018 – We noted the weakness in the Energy sector last week with both the gap down on Tuesday (Jan 30th) and the large break down (large range day) on Friday (Feb 2nd). This sector seemed to turn downward almost 3-4 days before most of the other sectors. This week we saw the drop continue for a second full week giving back all the gains for months. On Friday we had the lowest close since September 19th 2017.

XLF daily chart as of Feb 9, 2018 – The XLF gapped down Monday and spent most of this week below its 50 day SMA (Blue) and ended the week with a close near that of Dec. 14th.

XLV daily chart as of Feb 9, 2018 – The XLV also spent most of this week below its 50 day SMA (Blue) and ended this week at a level it had back on Dec 7th 2017.

QQQ daily chart as of Feb 9, 2018 – The QQQ gave back its gains since Dec. 29th this week and ended the week below both its 6 month (Orange) and 2 year (Red) trend lines.

SOXX daily chart as of Feb 9, 2018 – The SOXX spent the week below its 50 day SMA and gave back all of its gains since Dec 29th.

XLU daily chart as of Feb 9, 2018 – We saw the XLU cross below its 50 day SMA back on December 15th where it has been a rare bearish trend during December and January. We saw a horizontal pause in the bear trend during the latter half of January, then a clear break of January Support Monday of this week. This was not a place to find 'safety' this week.

XLP daily chart as of Feb 9, 2018 – The XLP had a brief rally in late January, to then break down below its 20 day (Yellow) and 50 day (Blue) SMAs last week that dropped below January support this week. Value has returned back to those from mid November.

XME daily chart as of Feb 9, 2018 – The XME metals and mining sector turned bearish early as well, with a break below its 20 day SMA (Yellow) on Jan 30th and breaking below its 50 day SMA (Blue) at the beginning of this week.

Now let’s look at some stocks to see what those charts may tell us about this wild week. Due to their large size and market significance, we will start with the F.A.N.G. stocks.

AAPL daily chart as of Feb 9, 2018 – Since breaking below its 20 day and 50 day SMAs on January 24th and 25th, Apple has continued to decline with a brief show of support at the prior Resistance (Yellow line) from Sept 1st highs. This support (Yellow line) broke hard on Friday of last week and nearly fell to its 200 day SMA (Purple) last week. This week we saw price break below the 200 day SMA to next find support near $155 (Pink line) that held on Thursday’s close. Friday saw a large drop to $150.24 and bounce to end the day and week at $156.41 just above the $155 support (Pink) line. The large wick under Friday’s candle shows the exhaustion type bottom. Only time will tell if this was the low, or not.

FB daily chart as of Feb 9, 2018 – FB gave back all of its gains the past few months as it ended the week near $176 which was Resistance on July 27th gap day and October 17th close (Grey line), and then acted like Support in late December and mid January. The 200 day SMA was briefly crossed on Friday which was also near Support from Oct 25th and December 5th (Yellow line).

AMZN daily chart as of Feb 9, 2018 – Amazon was one of the FANG stocks that actually held up well this week. Note how it did cross below its 20 day SMA this week but not its 50 day SMA. The week ended with gains only since Jan 22nd being returned.

NFLX daily chart as of Feb 9, 2018 – Netflix is also a FANG stock that did relatively well this week, Respecting Support (Purple line) from the post earnings gap day low on Jan 23rd. The 20 day SMA was broken on Friday, but this seems less significant since the gap day support (Purple) was respected at the close.

GOOGL daily chart as of Feb 9, 2018 – Alphabet gapped down after earnings on Feb 2nd, and this week continued to drop as it crossed below its 50 day SMA on Monday and remained below all week. Thursday saw prior Resistance from mid October (Yellow line) break as new Support as price nearly touched $1,000 and its 200 day SMA. The Whip-saw on Friday did briefly break below the $1,000 and

200 day SMA support levels just to next bounce back up and close the day and week at $1,046.27. GOOGL returned its gains since Dec 7th.

NVDA daily chart as of Feb 9, 2018 – NVDA reported earnings on Feb 8th after the close and saw a positive response in the afterhour's market that traded as high as $248.74. At the opening bell on Friday (Feb 9th) trading started back down at $237.89 and fell with most of the markets the first half of the day to a low of $217.52 then bounced the last three hours to close the day and week at $232.08. The week was relatively flat closing down less than half a dollar from the prior week's close, yet also had some wild swings in-between. Gains since Jan 21st have been returned as of the end of this week.

MA daily chart as of Feb 9, 2018 – One of the stronger stocks we have been watching that also did relatively well this week is MA. It did gap up a little on Feb 1st after earnings and held to a similar range on Friday last week. MA broke below its 20 day SMA (Yellow) this week but seemed to also respect its 50 day SMA as support. MA gave back gains since Jan 17th this week.

SQ daily chart as of Feb 9, 2018 – SQ broke below its 20 day SMA at the beginning of this week and remained below all week. It also closed below its 50 day SMA on Thursday.

Others in the sector (V, AXP) did not do so well this week, crossing and remaining below their 50 day SMAs.

GS daily chart as of Feb 9, 2018 – GS gave back its gains from the prior two weeks this week, and has returned to the range it was in during early December.

BA daily chart as of Feb 9, 2018 – BA is another strong stock that held up rather well this past volatile week, remaining above its 50 day SMA and its 1 year Trend Line (Red). BA returned gains since Jan 12^{th} this week.

LMT daily chart as of Feb 9, 2018 – Another strong stock that held up well this week is LMT. We can see it too remained above its 50 day SMA as it returned gains since Jan 26th this week.

CAT, DE, X and SCCO have each given back all of their 2018 gains and a little part of their December 2017 gains. They are all below both their 20 day and 50 day SMAs.

LVS daily chart as of Feb 9, 2018 – LVS crossed below its 20 day SMA (Yellow) on Monday and remained below this level all week. The 50 day SMA was crossed early on Tuesday, then again crossed below and closed below on Thursday. Friday remained below the 50 day SMA as it swung down to find support near $68.13 then bounced back to end the day and week at $71.00 returning gains since Jan 12th.

** Now for something a little different, since we have seen a bearish market this week. Let's walk thru the sequence of events with a recent example of a bearish trade & entry to see what was observed, when, and then acted upon. This is not a trade recommendation, but an educational example of a sequence of events to show how a top down market process, chart reading skills, and a well tested written trading plan can expose a trade opportunity and conditions for entry of a bearish position.

At about 10 minutes after the open on Feb 2nd, a quick look at a dozen or so sectors revealed that the weakest was the Energy sector. (* This is a common practice of mine, several times each day that takes just 5-10 seconds to do.) I noted a gap down in the XLE sector. This then led me to next look at a few main stocks within this sector and quickly noticed that XOM had gapped down at the open on earnings. Below is a 5 min chart with the pre market trading (shaded grey area to the left) followed by the opening and 3 ½ hours of trading on Feb 2nd.

XOM 5 min chart as of Feb 2, 2018 – In the above chart, you can see when XOM reported earnings before the open at 5:00am Pacific time (White arrow) and the gap down open at 6:30am PT. Note the first support (Yellow arrow & line) occurred at about 20 min after the open. This support was not defined until about 10-15 min later when it became clear that the low at the yellow arrow could now become the first area of support for today. (I wait for 3 periods to pass before drawing the line.) This level (Yellow line) was drawn at or after 7:10am PT. This support level was retested and briefly broke later at 8:20am PT (Orange arrow). You see this support level (Yellow line) retested several times over the following hour and a half and eventually it clearly broke at 10:00am PT (Red arrow). This provided me with sufficient clues at this time that support was breaking down and that the odds were increasing that lower lows could be more likely to follow.

We then established our initial stop location (per our written plan) and our maximum position size (that respected our risk rules and limits) and rounded the number down to establish the order size for our trade entry order, and executed the trade.

This is a pattern I call a 'Gap-n-Go' that I've shared in past publications of this weekly document. This time, however, it is a bearish example. The gap down (post earnings) gave clues to continue with more bearish pressure as over time more and more participants will eventually decide to sell. Participants may be either selling to exit their long positions, or selling to enter short positions. The key is that both groups are doing the same thing, at slightly different delays in reaction time, to put more pressure on price as what little demand remains is satisfied.

As a swing trader, I look for sufficient evidence to confirm a little better odds of a possible move my way, while also not waiting too long which can reduce potential rewards and increase risks. Each trader should clearly decide what they are comfortable with in this trade-off and then focus on consistently using that set of conditions for their 'action' point or trigger.

Now let's see what XOM did this week.

XOM daily chart as of Feb 9, 2018 – XOM continued down every day this week, as the broad markets, oil, and the Energy sector all broke down this week. Thursday's support and close was right at the prior support level (Yellow line) from Aug 2017 lows (Yellow arrow) of $76.05. Friday saw XOM break down below this support to a low of $73.90, and then bounced the last two hours on Friday to close the day and week at $75.78.

All we need to do is continue to follow our plan as we manage this trade and exit when our exit criteria tells me it is time to do so.

Not every trade works in our favor. In fact, up to half may not go our way. But the key is to have a consistent method (written plan) that helps to define how we will both keep our losses small, and allow for winners to go as far as they may and let the market show us when it is 'done'. The objective is to keep the overall losses smaller than the overall winners – over time. And keeping good records ensure we are meeting our objectives.

I hope this helps show at least one way that one can be objective in how they use the data in the markets / charts to make their trading decisions.

A volatile week like we just saw is a great reminder of how much of the markets appear to act upon emotions, fear, greed, panic, and those emotions will usually cause folks to make poor trading decisions. If you have a written and well tested plan, with a positive expectancy, that over time you have built confidence upon and can be disciplined in following it, then you can be well protected when the markets change their character. We prepare for a variety of conditions, and then let the markets tell us what to do.

Trade Smart,

CJ