ICAP Technical Analysis

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S&P 500 Update - Tuesday 13 September 2016

S&P 500

An Update

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Main Points

1. In terms of the technical picture, both the monthly MACD and the monthly DMI readings are at a major inflection point. Whether these readings 'kiss and diverge' or crossover back into bullish territory will likely determine the fate of the equity markets from here.

2. In terms of the entire advance up from the 665.75 low, the recent highs were enough to satisfy the requirements for a completed five wave pattern.

3. In terms of the advance up from the 1802.50 low I have a tough time coming up with a completed wave count for the S&P. While fifth wave failure is an option we are open to, key support will need to be broken to confirm such a scenario. If support can not be broken the short term trend will remain up.

4. To have a confirmed case of fifth wave failure the bears would need to take out two levels, 2026.00 and 1885.00. Bears have no case for a major long term top otherwise.

5. Make no mistake, the consequences of a breakdown in the up trend are huge. And not just in the context of what is happening here and now. A confirmed top would set off a multi-year decline at minimum in the bullish case and in the most bearish case a multi-decade slide.

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The Technical Picture - Observations

One of the big questions we set out to answer following the dump from 2134.00 to 1802.50 was whether the environment in the equity markets was more like that of 1998 or 2007. While the bounce off 1802.50 made it apparent that we are not in an environment like 2007, it still is not clear as to whether we should be using the price action from mid 1998 to late 2000 as our template. While the similarities to this time period are notable we know that history has more of a tendency to rhyme rather than to repeat exactly. Which bring us to the main point. The monthly RSI, MACD and DMI readings are all sitting at a major inflection point. The near term price action is likely to determine if a series of higher highs similar to those we experienced in 1999 and 2000 is possible or if the topping process is about to accelerate. I strongly suggest keeping a close eye on each of the three indicators listed below for clues as to whether the advance can continue.

See Chart on Page 3

Monthly RSI

Back when the S&P was testing the low 1800’s one of my primary concerns was that the monthly RSI reading could not take out 50. Much like mid 1998 this suggested a rally to new all time highs was still very much on the table (hence my call for a bear trap into the 1802.50 low). And just like 1998 this rally in the S&P has pushed the monthly RSI back to what has been both key resistance and then key support over the past several years. As we are now at the top end of this range (50 to 65) this is where RSI resistance should start to have an impact on the price action. And it is. The question now, will the monthly RSI consolidate at the upper end of this range while the market itself chops higher, like it did during the period between late 1998 and early 2000? Or will the bears be able to generate a faster start to the next downward phase of the long term wave count? To indicate a top of significant proportions is taking hold bears would need to take out the 50 level.

Monthly MACD

In August of 1998 the monthly MACD reading crossed into bearish territory only to recover a few months later and return to bullish territory. But the celebration was short lived. Just over one year later, in August of 1999 the monthly MACD reading slipped back into bearish territory. From there the bottom fell out. In 2007 there was no near death experience. Once the MACD reading crossed into bearish territory there was no looking back. The decline was fast and furious. Back to the present. The monthly MACD reading crossed into bearish territory back in March 2015. But it is converging once again. The question now, are we about to experience the ‘kiss of death’? In other words will the two MACD lines ‘kiss’ and diverge keeping the bearish trend alive? Or will the S&P be able to survive another near death experience? If the trend is shifting and further downside is ahead then the converging MACD lines should repel one another like similarly charged poles of a magnet. A bullish crossover on the other hand would imply it is time to party like it is 1999 all over again.

Monthly DMI

Like MACD, the monthly DMI reading is also sitting at a major inflection point. A crossover back into bullish territory would suggest further upside is ahead near term. Meanwhile, a divergence in favor of the bears would suggest a major top is taking hold. As one can see the DMI reading has been an excellent tool in confirming peaking action in both RSI and MACD terms. A bearish reading here would strongly suggest a major top is forming.

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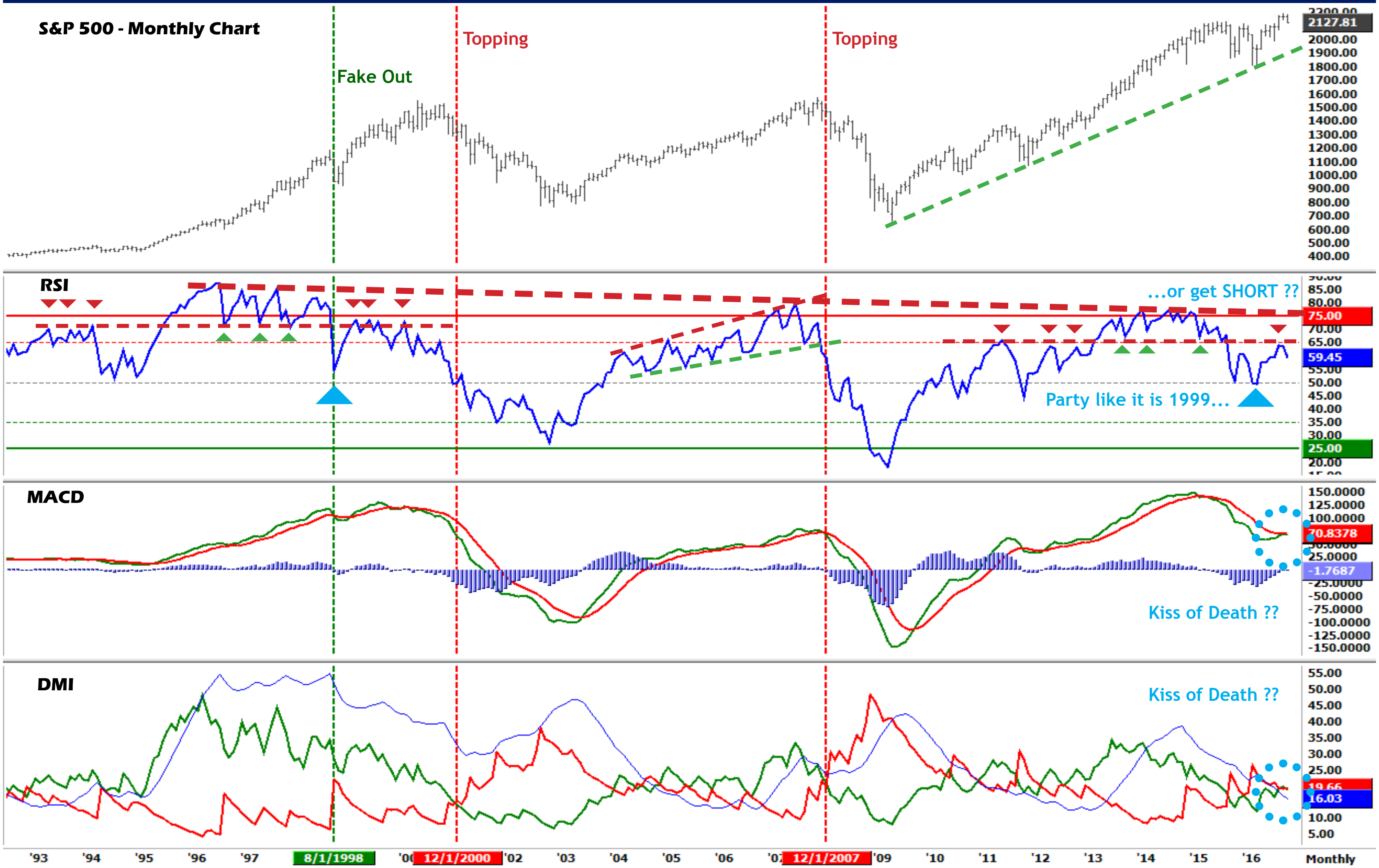

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The 665.75 to 2191.50 Advance

Since recovering from the 1802.50 neighborhood we have been forced to alter the wave count for this advance that began back at 665.75 (666.79 Cash). Instead of an ABC pattern the structure has morphed into a five wave move. While the change in wave count structure has bought the bulls more time, it does not change the fact that we are looking for a major peak and another multi-year, perhaps even multi-decade retreat in the equity markets. The question is still in the timing of such a peak.

Three options for a top

There are three options for us to entertain in terms how this all ends: 1) a subdividing fifth wave 2) a diagonal fifth wave or 3) a fifth wave failure. Pages 5 and 6 outline support for our bullish models. Pages 7, 8 and 9 review the consequences of a breakdown.

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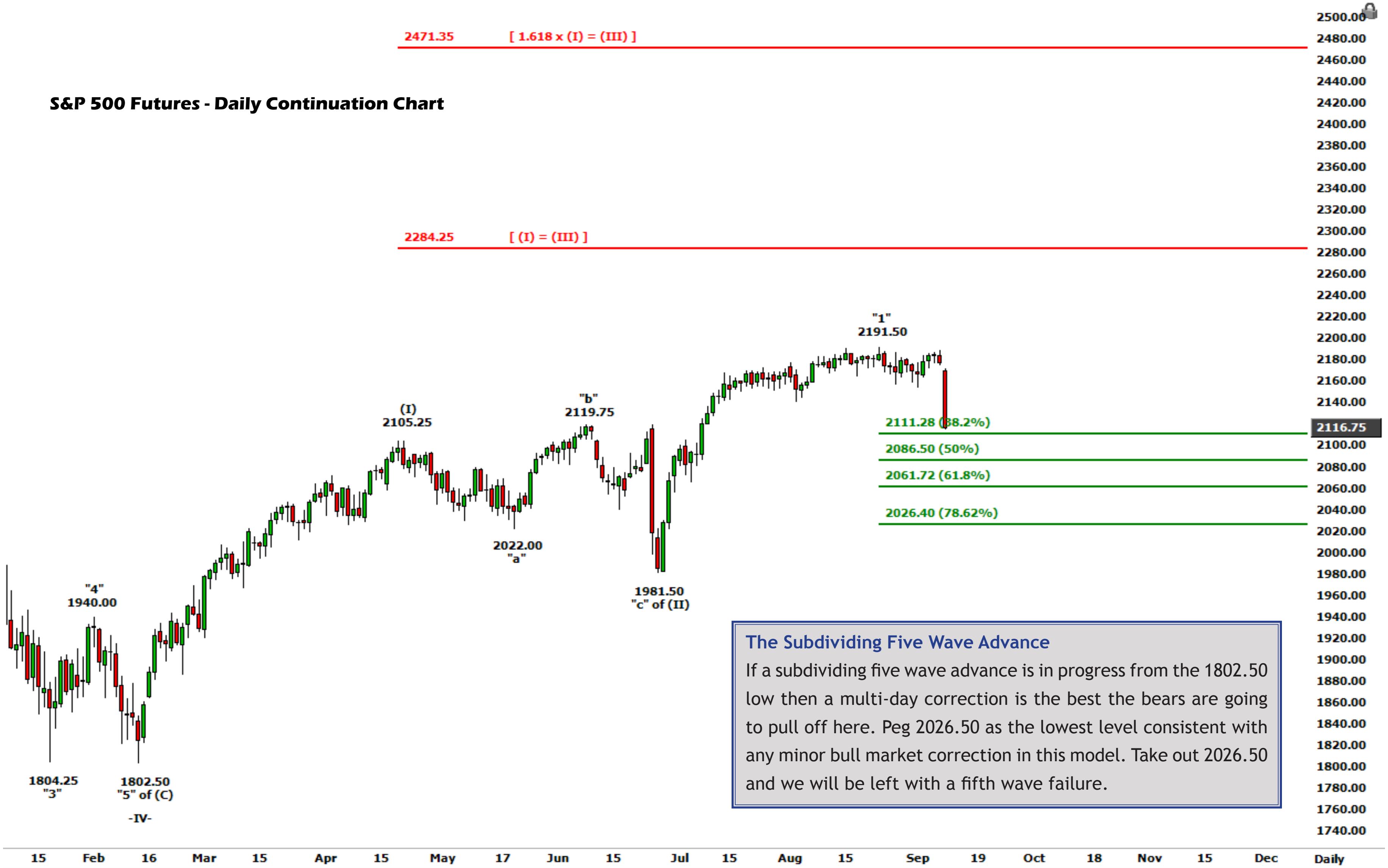

The Subdividing Five Wave Advance

If a subdividing five wave advance is in progress from the 1802.50 low then a multi-day correction is the best the bears are going to pull off here. Peg 2026.50 as the lowest level consistent with any minor bull market correction in this model. Take out 2026.50 and we will be left with a fifth wave failure.

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S&P 500 Futures - Daily Continuation Chart

The Diagonal Fifth Wave aka The Rising Wedge

Just like subdividing five wave model on the previous page 2026.50 also represents critical support for a diagonal fifth wave. The difference between the diagonal fifth wave and a subdividing five wave advance is that in a diagonal fifth wave we are only looking for one final, marginally higher high versus a series of higher highs. Take out 2026.50 and we will be left with a fifth wave failure.

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The Big Picture - Consequences of Peaking Action

1. To fully understand the consequences of peaking action we must review the price action in context of the entire move up from it's origin ...in 1870.

2. We can derive two possible wave counts for the S&P based on the price action up from the lows of 1870.

3. But we can draw only one possible conclusion from these long term wave counts, no matter the model, bullish or bearish.

4. That conclusion, a top if not already in place is rapidly approaching.

5. Both the long term bullish and bearish models suggest a peak from the 2215-2983 neighborhood will result in a multi-year retreat.

6. In the most bearish case, a complete five wave move will mark the start of a multi-decade sell off that retraces a majority of the advance that began back in 1870.

7. To trigger a meltdown bears would need to take out 1885.75.

8. Bears have no case otherwise.

Pages 8 and 9 revisit our long term wave counts for the S&P

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S&P 500 - Monthly Chart

log scale

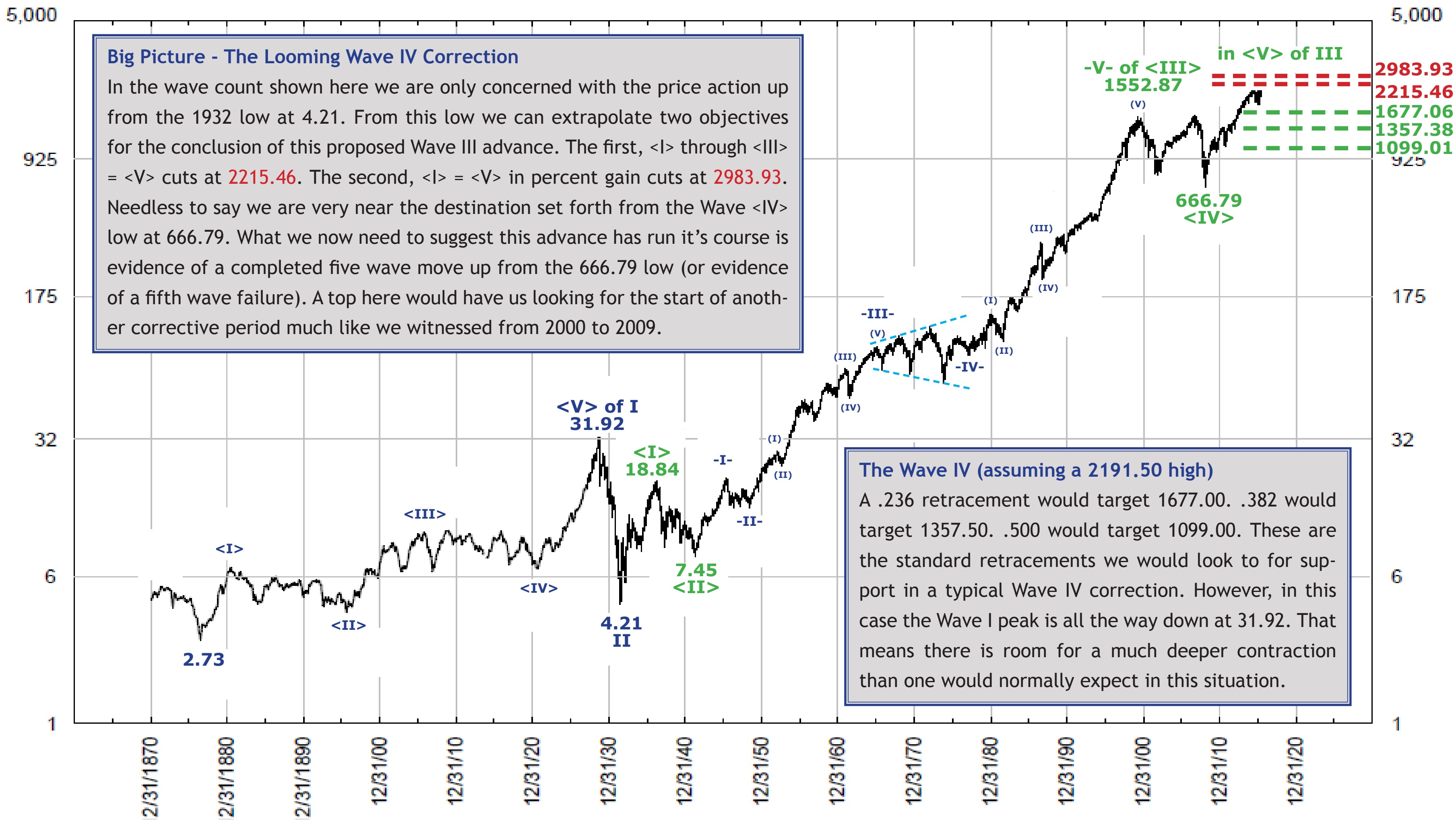

Chart Courtesy of thechartstore.com

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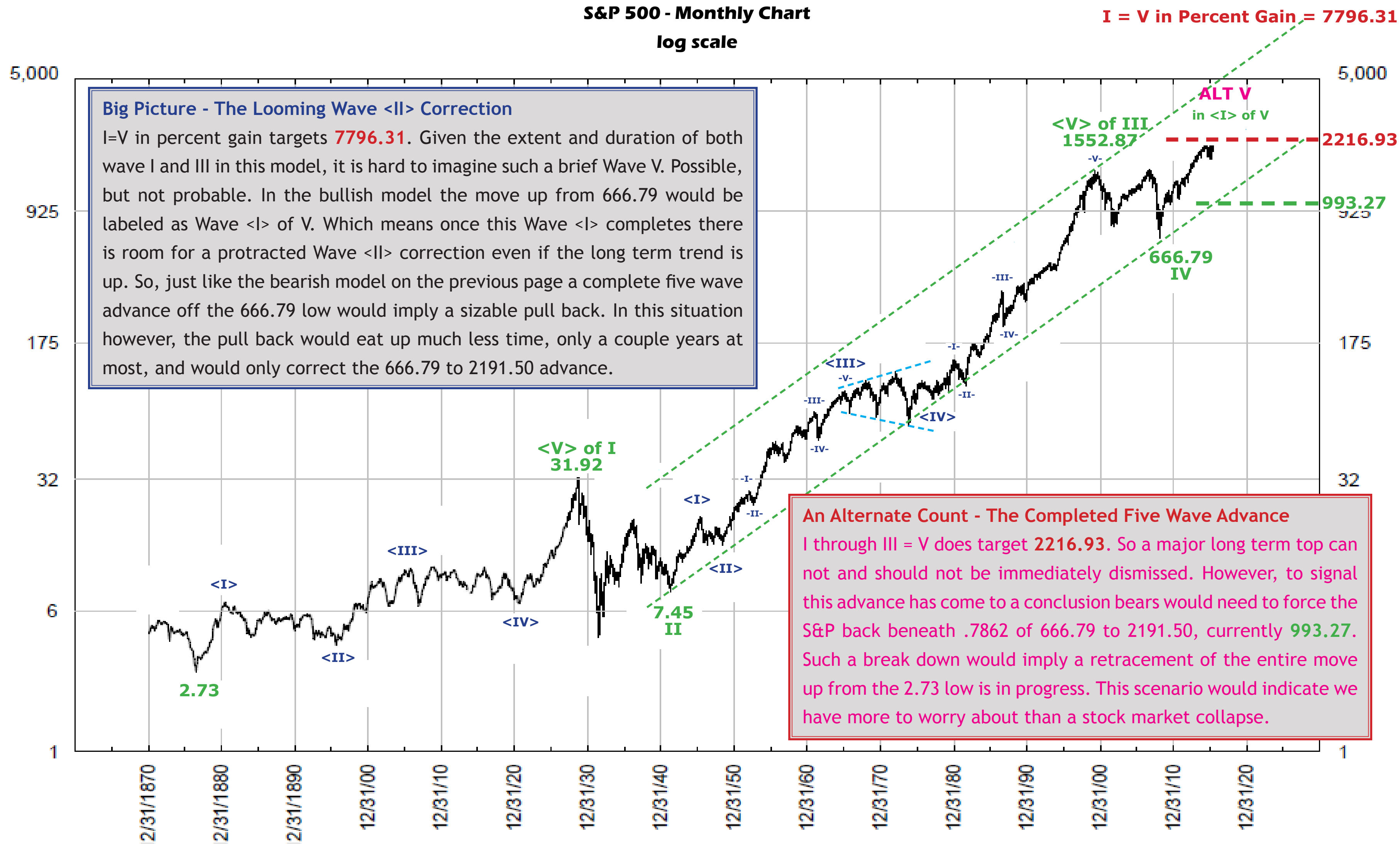

Chart Courtesy of thechartstore.com