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S&P500 Index Analysis - this will come as a surprise to many....

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The interesting thing about yesterday's sharp drop is that, while it was obviously shocking to short-term bulls, like us, it did not cause any serious technical damage - although it will if it continues. What appears to be happening, although this is a tentative judgment at this stage, is that the market dropped yesterday to mark out the Right Shoulder of a small Head-and-Shoulders bottom, as we can see on the 3-month chart for the S&P500 index shown below. This view is supported by the recent volume pattern, especially the high volume on last Friday's rally. If this contention is correct then the market should turn up here, or soon, and advance to break above the neckline resistance of the pattern shown at about the 1945 level. This pattern projects a rally to the 2040 area, which is close to the Dome boundary shown on long-term charts.

Many short-term bulls were understandably "freaked" by yesterday's sharp drop but, as we can see here, it has not so far caused any serious technical damage, and a potential small Head-and-Shoulders bottom may be completing, an idea that is supported by the strong volume on Friday's rally. Obviously if this contention is correct, then it needs to turn up again now or soon. Fundamentally, what might cause the market to rally here, apart from a short covering panic? It would probably be the extrapolation that following NIRP in Japan, the Fed will abandon its projected rate rises and get ready for another massive QE. If the H&S bottom is valid, it projects a move to the 2040 area, near to the Dome boundary on long-term charts.

Fundamentally, what could cause the market to rally here, in spite of the tidal wave of bad news, beyond short covering? It will probably be the growing realization that the Fed is likely to abandon its projected rate rises, a development made much more likely by Japan's further NIRP adventures.

Supporting our contention that this nascent rally still has legs is the latest Smart – Dumb money ratio. Smart Money is still bullish and Dumb Money bearish, and we still have a long way to go before they cross over into the sort of readings that will presage a serious drop. Observe how the lines crossed over after the August – September Double Bottom on the Smart – Dumb chart below, and the market didn't top out until early November, when the Smart - Dumb ratios were where you would expect them to be. This chart by itself suggests that the market has quite some way to go on the upside before it rolls over again.

SMART MONEY / DUMB MONEY CONFIDENCE

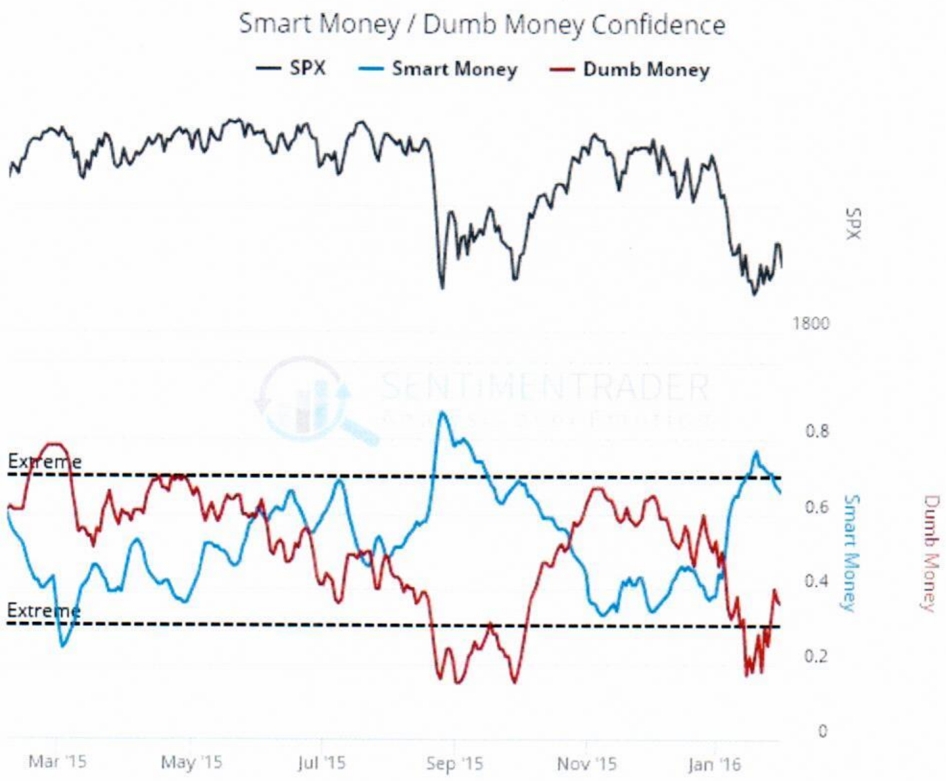

Chart courtesy of www.sentimentrader.com

End of update.

Posted at 6.20 am EST on 3rd February 16.