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BROAD MARKET update - RELIEF RALLY TARGETS ON S&P500 & VALUE LINE...

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While the longer-term outlook for the broad stockmarket remains awful, it looks like it is starting a relief rally to ease the current deeply oversold condition before its later turns down again and drops to new lows.

On the 6-month chart for the S&P500 index we can see that having touched its January lows exactly last Thursday, it is bouncing back from an intermediate Double Bottom, rather like the earlier one that formed last Fall, also visible on this chart, the difference this time being that any rally is likely to be stunted and rather short lived, for reasons that will become apparent when we look at another broad market index lower down the page. It is considered unlikely that it will rise any higher than the 1990 – 1995 area, at best. We were expecting a relief rally of this sort and now it appears to be starting. Once it looks like has run its course, it will present a shorting opportunity, with the banking sector, which is in severe disarray, being considered one of the best sectors to short on a relief rally. A rally of this kind will likely coincide with a reaction in the PM sector, which would also present us with a buying opportunity in this area.

The market is rising off another Double Bottom, like the one that formed last Fall, but this time there is less upside. Possible reason for a rally will be a policy reversal by the Fed, meaning a reversal of December's rate cut and more QE, in readiness for eventual NIRP. A rally from here is what we had expected.

On the latest 5-year chart for the S&P500 index we can see that, having broken down from a Head-and-Shoulders top, the market appears to be fooling around near the breakdown point. It wants to work off its current oversold condition before it drops further and looks set to bounce near-term. While a bounce as high as the Dome boundary looks possible on this chart, this seems highly unlikely from what we are seeing on other indices, like the Value Line Geometric Index, which we will now look at.

The Value Line Geometric Index, which is a more faithful representation of the market as a whole than the S&P500 index, partly because its approx. 1700 constituents are unweighted, looks far worse than the S&P500 index, as do other indices like the Russell2000, the Mid-cap, and the Wilshire 5000 indices. On its 5-year chart we see that it has broken down from a very bearish downsloping Head-and-Shoulders top, with a severe drop early in January. Now it looks like it wants to rally back to the underside of this top area to relieve its current oversold condition, before dropping away. Such a backtest is common following breakdowns from major top areas, and provides a superb shorting opportunity. If it does do this it will now rally up the 420 area, where the resistance is STRONG. Such a move implies that the S&P500 index will make it no farther than the 1990 – 1995 area, at best. A likely scenario is shown on the XVG chart.

Value Line gives us valuable clues regarding how far the market (and the S&P500 index) will rally. By the look of this chart, 420 and its done, as it will fail at the resistance at the underside of the H&S top shown. When we relate this to the S&P500 index, it gives a target for the relief rally in the 1900 - 1995 area. Value line shows us that the S&P500 is misleading and that the condition of the market is actually much worse than it appears on flagship indices like the Dow and the S&P500. The rot is also evident on other indices, like the Russell, the Mid-cap and the Wilshire 5000 Comp.

Value Line Geometric Index is also rallying off a Double Bottom, like the S&P500 index, as we can see on its 6-month chart below, and we can see the factors giving rise to such a rally – the oversold condition revealed by its MACD reading and the gap with its 200-day moving average, although because of the strong resistance at the underside of the Head-and-Shoulders top, it is not expected to do more than partially ease this oversold condition before it turns lower again.

Oil looks set to rally significantly in sympathy with the broad market short-term. We can hold existing long positions for this relief rally, and the idea is to dump them and reverse position once it has run its course.

End of update.

Posted at 7.10 am EST on 26th February 16.