Technical Analysis

Weekly Comment

Global

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Contrarian Sentiment in the US ... Watch Bonds!

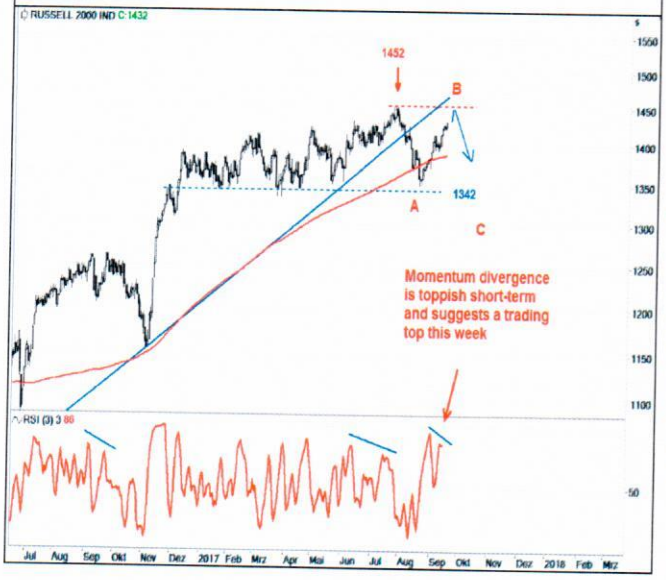
- **US Trading**: Last week we said it is likely to see more strength into triple witching but where even a marginal new breakout in the SPX would not change our view that, a) we do not expect the market starting a new broader breakout campaign, and b) we still expect the risk of another short pullback into later September/first half October before starting the next bigger market bounce. With last week's break of the early August high at 2491, the underlying technical/tactical picture has not changed. With the low momentum breakout in the SPX we have a further growing number of non-confirmations in our indicator work. On the volatility side, we have an intact divergence in the VIX versus the SPX. The Russell Vola Index has reached an all-time low, and together with our sentiment work heading into pure contrarian territory we continue to see the market vulnerable for a pullback, where we reiterate last week's trading call not to chase the SPX above 2500.
- With the break of 2941 the SPX is heading towards its next resistance zone at 2502/2521 but with our cyclical projection of a minor top we see the SPX moving into a trading top early this week as the trigger for a down leg into early October. A re-break below 2491 would be initially negative and imply a test of the 2016 trend support at around 2450 and worst case a pullback towards 2400/2380 into late September/early October. Sector wise, with rates on the macro side starting to rise, we see a new rotation starting. Oil stocks have broken their 2016 bear trend, (bullish medium-term) and banks have also broken their early August down leg, whereas in the defensives camp we have a big reversal in utilities underway as well as we see consumer staples and healthcare vulnerable for a pullback.
- **US Strategy:** Generally, although the break of the SPX August 8th top at 2491 triggers a new medium-term long signal in our cyclical model into Q1, this does not mean that on a short-term basis we will not see a tactical pullback. In the NDX, we still expect a wave C pullback leg, which in the SPX could have a similar character but where with new signs of a rotation on the sector front (banks should profit from higher yields) we see the SPX relatively well supported short-term. So, although we see the US market short-term vulnerable for a pullback into minimum first half October, we remain underlying bullish into Q1, which was and remains our preferred time window for an important and major market top of the underlying 2016 wave 5 bull cycle, and where ahead of this potential top we could see further increasing selectivity in the US and global equities.
- **European Trading**: On track with our mid-September bounce call, we have seen a classic oversold bounce in Europe over the last three weeks, which has produced selective new highs in the FTSE MIB, OBX, ATX, and where the DAX outperformed but where in most other headline indices we clearly expect a lower high forming as the setup for another pullback into first half October. After reaching our 3500 bounce target, we can see the Euro Stoxx overshooting towards 3550, which we nonetheless see as the basis for a pullback into first half October where we expect worst case a re-test of the September low at 3362. In the DAX, we continue to see a higher low forming into October as the setup for another bounce into November where we generally see Europe outperforming and profiting from a potential multi-week EUR pullback on the FX side. Our focus on the sector front remains on buying the dips in cyclicals and financials against selling defensives.
- **Inter Market Analysis**: The break of the mid-June low at 2.10% in US 10-year yields we saw as a temporary undershooting; and with a bearish pattern setup in the JP Morgan bond index and most European bond markets, we still see the risk of another significant move higher in yields into later 2017/Q1 2018. With last week's strong bounce in US 10-year yields above 2.20% we have increasing evidence that a more important tactical yield bottom is forming. We would use any near-term strength in bonds to sell and where rising yields into deeper Q4 we see as headwind on defensive sectors and yield sensitive themes.
- Gold is pulling back to its last major breakout level at $1300. On a very short-term basis, gold is increasingly oversold so we should see a new bounce starting but we would use strength and best case a new reaction high into first half October to take profits, since we expect further weakness into deeper Q4 on the back of a USD bounce and rising yields.
- We continue to see the US dollar in a tactical basing process of its 2017 bear cycle with divergences forming in the EUR, AUD, CAD, and GBP heading into resistance. Despite the risk of a final undershooting short-term, we see the USD close to start a multi-week rebound (EUR key support at 1.1820 as trigger for pullback) into November before starting its potential final down leg as part of a major bottom forming in later 2017/Q1 2018. Again, the worst of the USD bear is over!

US Equity Market Update:

Chart 1.) S&P-500 Daily Chart

Chart 2.) Nasdaq Composite Daily Chart

Chart 3.) Russell-2000 Daily Chart



Minor Top Projection This Week

It was a tactical key call of our 2017 strategy to expect the SPX to move into a deeper summer top followed by a multi-week and more significant 5% to 7% pullback into early Q4 before starting a final rally leg into year-end and Q1, which was and remains our preferred window for a major market top of the 2016 wave 5 bull cycle.

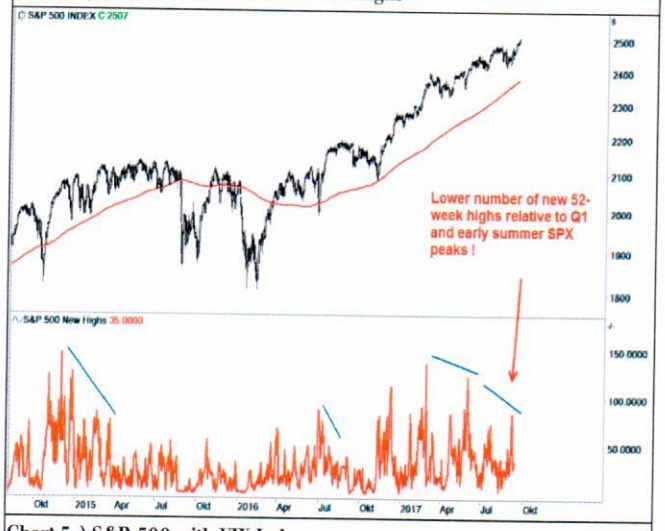
In mid-August, the US market was short-term oversold and we expected a bounce into September, which pattern-wise should represent a wave b as part of a corrective a-b-c pullback. In this context, the strength and new all-time high in the SPX was a surprise for us, whereas the Nasdaq and Russell-2000 we still see trading in corrective patterns, and where we still expect a second pullback leg (wave C) developing into minimum early October.

Timing wise we said last week that we can still see more strength into triple-witching, but where even a marginal new breakout in the SPX would not change our view to still see the risk of another short-term pullback event into first half October before starting the next bigger market bounce. Despite the break of the early August high, **we have a further growing number of non-confirmations** in our indicator work where on the breadth side the number of new 52-week highs remains weak. **On the volatility side, we have an intact divergence in the VIX versus the SPX, which together with a new all-time low in the Russell Volatility Index is a high conviction setup for moving into a tactical top.** More importantly, **with the bounce of the last 2 weeks we got a huge capitulation in the bear camp,** where the **AAII Bearish Consensus plunged to a multi-year low and where put/call ratios have reached extreme territory as well.** With this setup, we have quite a consistent picture on the sentiment side, which is clearly contrarian and suggests that the risk/reward to chase the market on current levels is poor. We reiterate our last week's trading call and would not chase the SPX above 2500. **However, with a new rotation on the sector side (strength in XOI and financials) the SPX is well supported so that also a second potential pullback leg into October will very likely be shallow, instead of getting our previously expected 5% to7% pullback.**

Conclusion: After the break of 2941, the SPX is heading towards its next resistance at 2502/2521 but with our cyclical projection of a minor top we see the SPX heading into a trading top early this week as the trigger for a down leg into early October. A re-break below 2491 would be initially negative and imply a test of the 2016 trend support at around 2450 and worst case a pullback towards 2400/2380 into late September/early October.

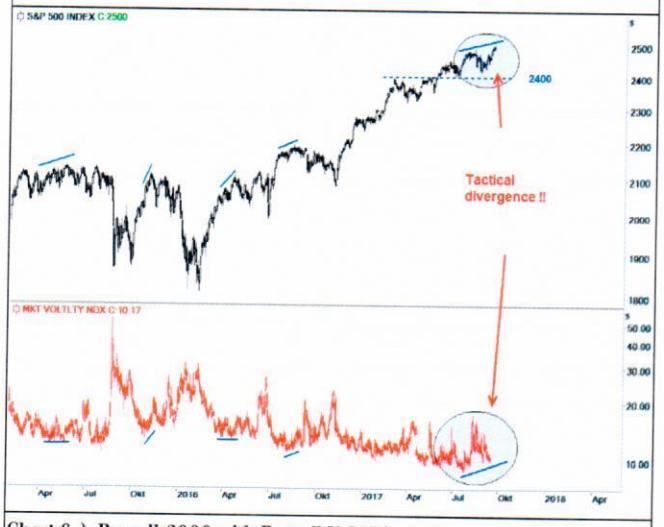
US Equity Market Update:

Chart 4.) S&P-500 with new 52-Week Highs



With the weak number of new 52-week highs in the SPX, the market breadth remains selective, which is usually toppish tactically.

Chart 5.) S&P-500 with VIX Index



With an intact divergence in the VIX index versus the new SPX high and a SKEW/VIX ratio near record highs we have a high conviction pattern setup for a near-term top and subsequent pullback.

Chart 6.) Russell-2000 with Russell Volatility Index

With last week's continued bounce, the volatility in the Russell-2000 has been imploding below 15 and factually to a new all-time low. **A break below 15 was in the past a signal that a rally in the Russell was actually in its late innings.** With a new all-time low we get further evidence that even short-term, the market should be near to an important top so we would not chase the market higher.

US Equity Market Update:

Chart 7.) S&P-500 with AAII Bearish Consensus

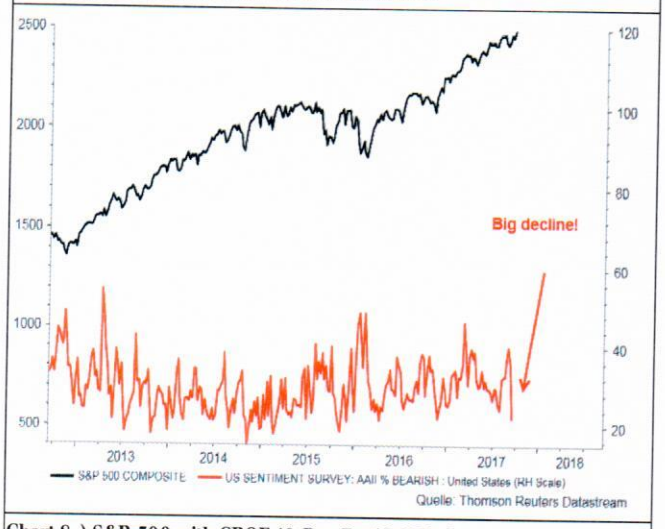


Chart 8.) S&P-500 with CBOE 10-Day Put/Call Ratio

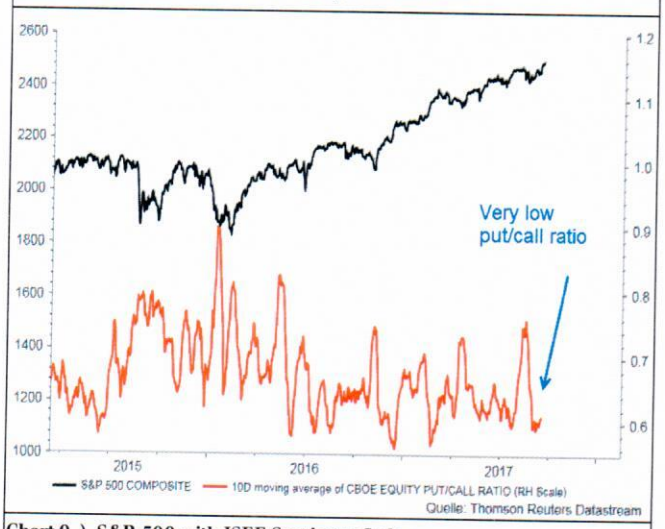
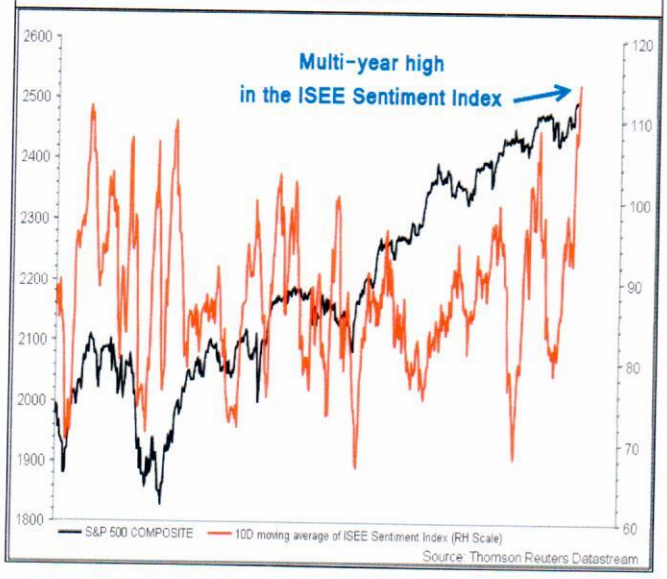


Chart 9.) S&P-500 with ISEE Sentiment Index



Sentiment at Contrarian Levels

Over the last two weeks, we saw a big shift in investor sentiment, which fits the new all-time low in the Russell volatility index. The AAII bearish consensus plunged to 22%, which is near to a multi-year low, and the picture gets an even more consistent setup especially on the flow side, where the CBOE put/call ratio is still at very low levels. More importantly, **the ISEE (International Securities Exchange) is publishing a put/call ratio, which only measures the flow in retail options, excluding thus the market makers and firms, delivering therefore a "cleaner" market sentiment. Last week the ISEE sentiment index hit a multi-year high that underpins the washout/capitulation in the bear camp and the big increase in bullishness/long positioning let alone that we have no real or significant hedges left in the market.** Generally, this kind of sentiment is not necessarily immediately bearish since sentiment indicators have actually nothing to do with short-term market timing. However, this clearly suggests that the market is vulnerable for negative surprises, and if we look at the confluence of signals in our indicator setup we see the market - even from a short-term timing aspect, toppish.

US Equity Market Update:

Watch Defensives ... XOI and BKW Breaking Out

Over the last few weeks we had a very uninspired/uneven sector picture with intact outperformance trends in late cyclical miners and steel, and on the other hand strong rebounds in healthcare/biotech and in utilities in the defensive camp, whereas in most other key sectors we had no clear signals. **This is beginning to change where last week's strong bounce in US yields is playing a key role. Although short-term rising rates can create some market volatility, it should finally support the market into a potential October pullback via banks profiting from rising yields. With the break of the short-term downtrend the BKX has triggered a new buy signal, which underpins our underlying bullish bias on banks. So short-term banks are overbought and we can see a pullback but we would use any weakness into October to buy/add.** Also important is the breakout in the oil sector where the **XOI has broken its 2017 downtrend**. Despite the negative surprise into deeper summer we did not capitulate on this trade, where apart from the late cyclical outperformance in miners and steel, the outperformance in the energy complex has been largely missing. On a short-term basis, the XOI is overbought and we can see a pullback into October but after the break of the 2017 downtrend, the sector should have good support and form a higher low as the setup for more strength into year-end and into Q1.

Defensives remain a mirror of the bond market, where **in the overbought utilities yesterday's break of its key support at 739 has completed a bigger price top, which is short-term bearish**. Healthcare is overbought as well and a break of the big resistance at 552 is in our view unlikely. Finally, we have consumer staples, which continue to underperform and where the key support at 560 is unchanged. With yields starting another significant up-leg into later 2017 and into Q1 2018, our bearish view on defensives remains one of our key positions on a 4- to 5-month basis.

Chart 10.) US Banking Index (BKX) Daily Chart

Chart 11.) US Oil Index (XOI) Daily Chart

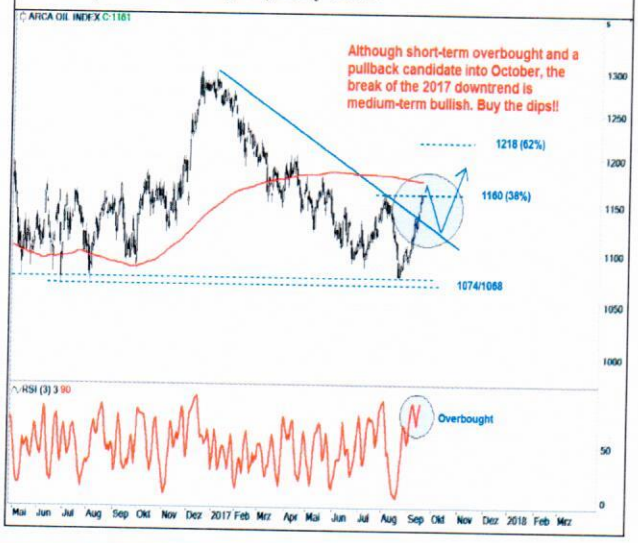


Chart 12.) Dow Jones Transport Daily Chart

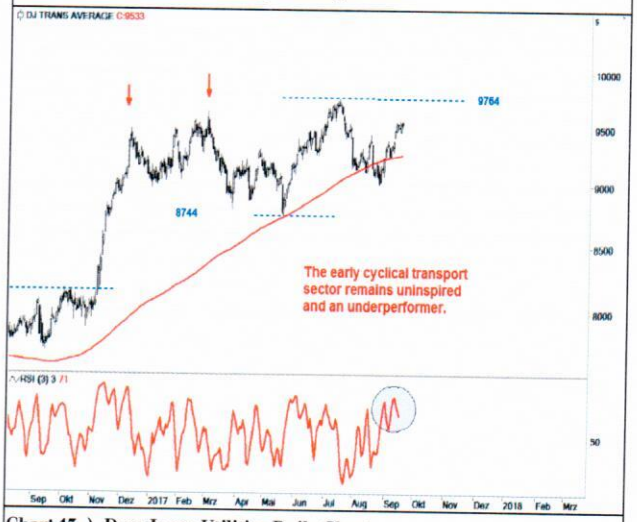


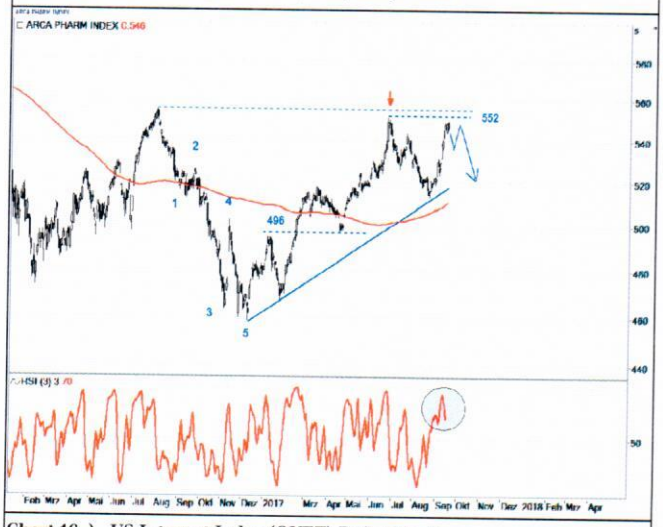
Chart 13.) Dow Jones Utilities Daily Chart

US Equity Market Update:

Chart 14.) S&P Consumer Staples Daily Chart

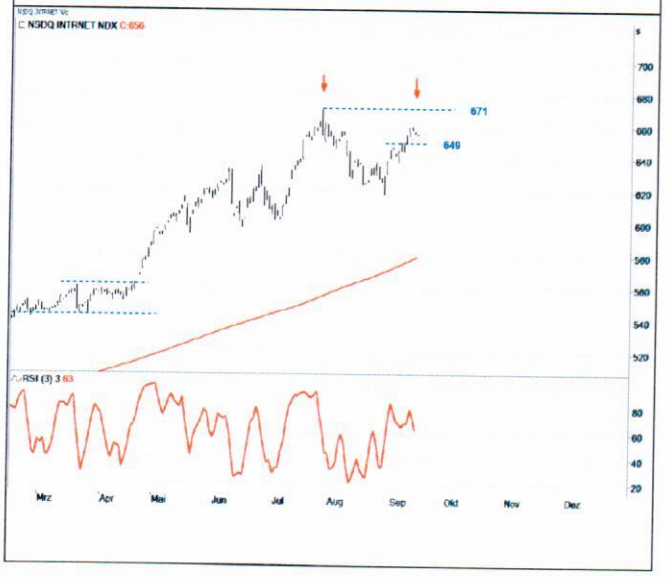
In consumer staples, we continue to see any bounce as limited and with expecting rising yields in the US we think it's just a question of time before seeing the break of 560, which is a big and obvious key support.

Chart 15.) US Healthcare Index (DRG) Daily Chart



Short-term overbought and heading into resistance. We do not expect healthcare to break its massive 552 resistance short-term. On the contrary, with expecting US yields to rise we see the DRG at risk of starting minimum another underperformance phase into later Q4 and into Q1.

Chart 16.) US Internet Index (QNET) Daily Chart



In the technology field we have a selective picture as well. On the one hand we have a **new breakout in early cyclical semiconductor stocks**, which is confirming the new SPX high and is therefore **bullish**, which we see as **confirmation of our underlying bullish view into Q1 2018**. However, **on a very short-term basis we see ironically relative weakness coming into mega cap internet stocks** where the **QNET index** we see **at risk of forming a lower high** versus its early August peak. Together with a momentum divergence forming, we expect near-term weakness in this key sector, which should weigh on the Nasdaq Composite.

Inter Market Update:

US Dollar Tactically Basing for Rebound into November

On the macro side the broader picture and our underlying views have not changed. On the FX side, on a short-term basis, the down trend in the US dollar remains intact, and as long as we do not see a break of 92,50 we still see the risk of a final but selective US dollar undershooting into later September (worst case early October), as the basis for starting a multi-week tactical rebound into October/November, before we expect a final down cycle starting into year-end/Q1 2018. **Again, with our monthly and weekly indicators hitting oversold extremes and a major divergence forming in our daily trend work we think the worst of the 2017 bear cycle is behind us but what is missing to call a major US dollar bottom is a multi-month basing process** where we should minimum see a classic double forming if not even see another new DXY low but in this case we would also see none confirmations forming on the upper time frames. **Tactically, a potential multi-week corrective US dollar rebound from October into November will be very likely a big game changer for the relative performance in global equities, where Europe and Japan should outperform short-term whereas in Emerging Markets and the metals complex (gold) we have the risk of seeing a negative surprise.**

Conclusion: We continue to see the US dollar in a tactical basing process of its 2017 bear cycle with divergences forming in the EUR, AUD, CAD, and GBP heading into resistance. Despite the risk of a final undershooting short-term, we see the USD close to start a multi-week rebound (EUR key support at 1.1820 as trigger for pullback) into November before starting its potential final down leg as part of a major bottom forming in later 2017/Q1 2018.

Chart 17.) Trade Weighted US Dollar (DXY) Daily Chart

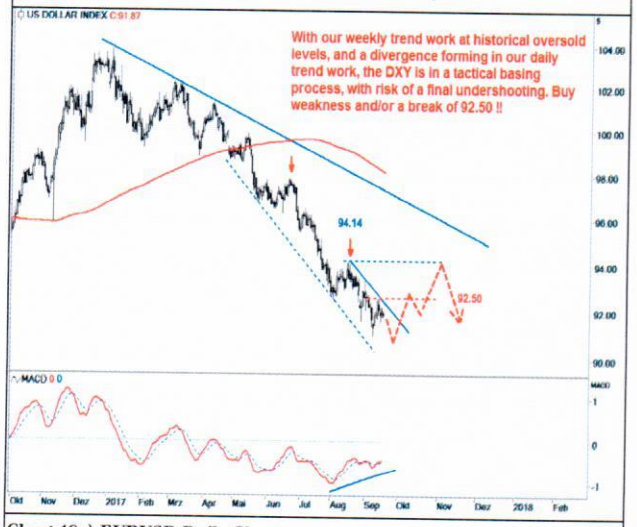


Chart 18.) EURUSD Daily Chart

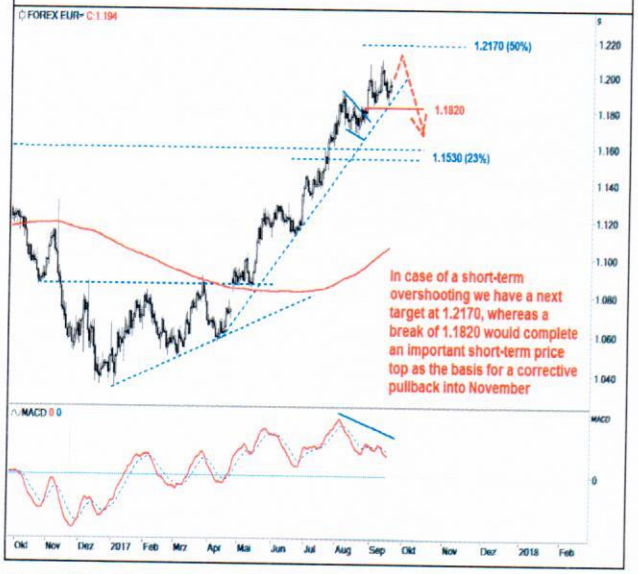


Chart 19.) GBPUSD Daily Chart

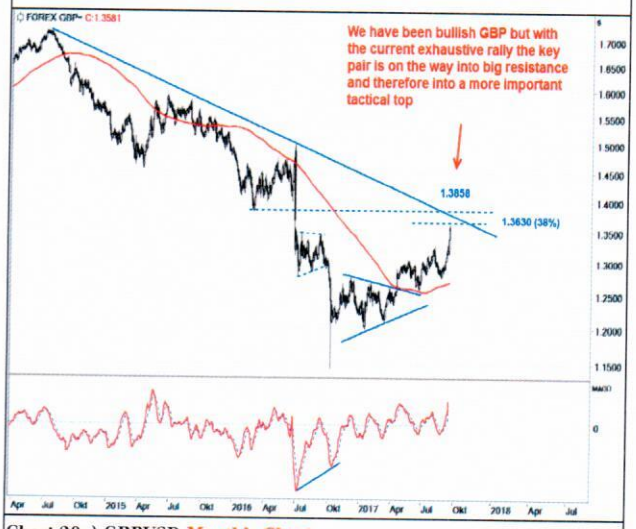
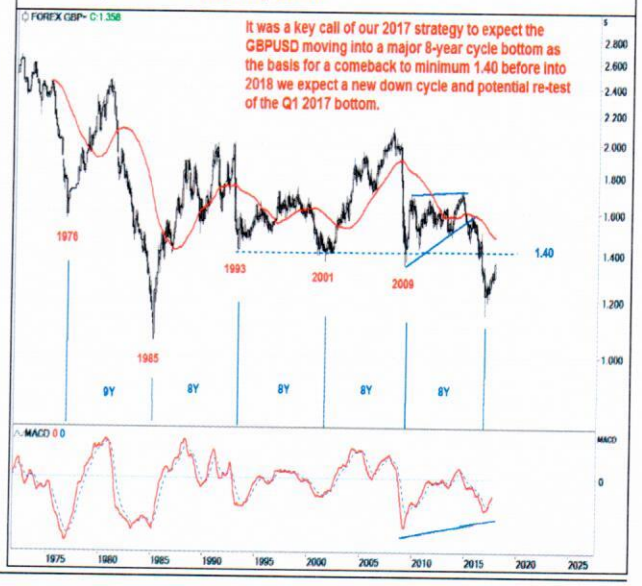


Chart 20.) GBPUSD Monthly Chart

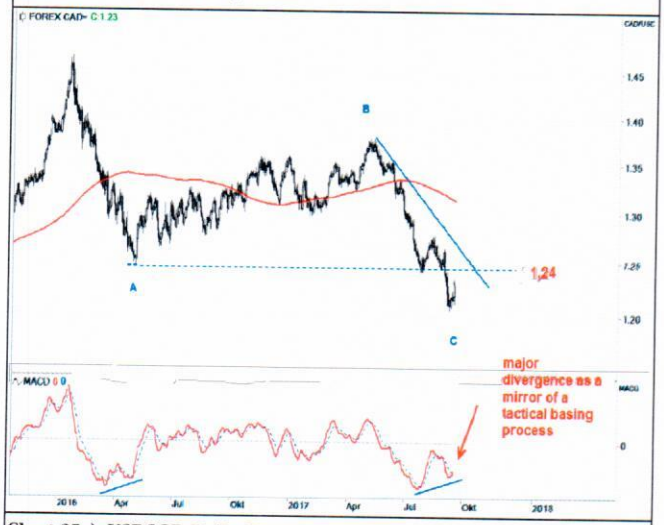


Inter Market Update:

Chart 21.) AUDUSD Daily Chart

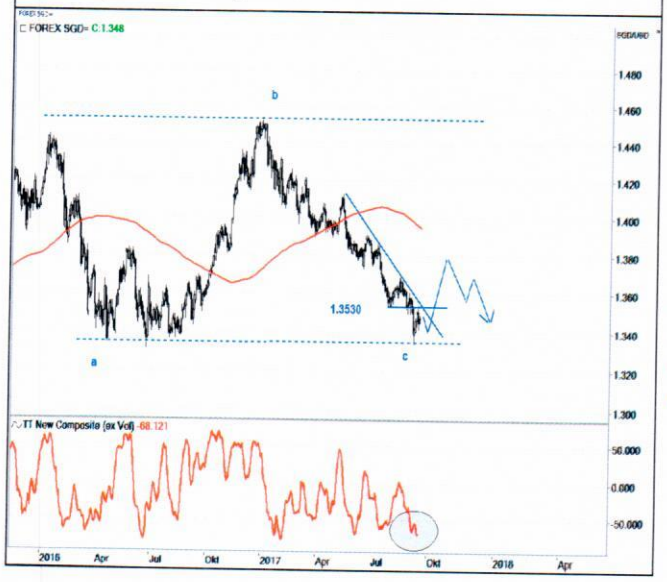
With a major divergence in our daily trend work the AUD looks tactically toppish. We expect a pullback into deeper Q4 before starting another and potential final up-leg into year-end, which could finally complete the 2016 corrective a-b-c rebound cycle in the AUD.

Chart 22.) USDCAD Daily Chart



Similar picture in the CAD, where we have a big divergence forming as evidence that a bigger tactical low is underway. We would use dips to buy

Chart 23.) USDSGD Daily Chart



Also in the Asian/EM complex we expect a bigger US dollar rebound starting, where in the current set up the SGD and TWD are basing on key support and where we also see in other key pairs such as the RUB, INR and TRY a significant tactical base forming.

Generally, from a macro standpoint, a bigger US dollar bounce versus EM pairs is latently bearish the MSCI Emerging Market, where we still see the risk of a short but potentially sharp washout into early Q4, whereas the Nikkei-225 normally profits from weakness in the EM segment and from a bouncing US dollar (weak JPY) and rising US rates.

Inter Market Update:

Global Bonds with Bearish Pattern Setup ...

Strategically, the summer 2016 low in US and European yields we saw and continue to see as a major low in the context of a multi-year secular basing process where the 30-year cycle in US yields is bottoming out for a significant rise in yields into particularly the next decade.

Tactically, after the vertical Q4 move higher in US yields, we expected a corrective multi-month Q1 mean reversion pullback in US 10-year yields towards 2.00% before starting its next up-leg into later 2017 and into early 2018, where we see a major tactical top forming of the 2016 recovery cycle. Within this corrective pullback, the last down leg from its early July high into September, and the break of the mid-June low at 2.10%, was a surprise to us but as we said last week, we clearly see the breakdown into mid-September as a tactical undershooting in yields instead of seeing this as part of a major reversal. In this context we are sticking to our underlying call/view where we still expect to see minimum one more significant up-leg in US yields, as the final act in the 2016 boom and bust cycle.

With last week's strong bounce in US 10-year yields above 2.20% we have increasing evidence that a more important tactical yield bottom is forming, which also lowers the risk to see another and final undershooting below 2.00%. Having said that, even if we were to see this undershooting, we would use any near-term strength in bonds (pullback in yields) to sell since our view is unchanged to see a move higher in US 10-year yields towards 2.60% to 2.80% into Q1 2018 where we have our next bigger medium-term cycle top projection in our cycle model.

Generally, if we look at the pattern set up in global bond markets, a move higher in yields would imply the breakout of very big and multi-month lasting breakout patterns. From a momentum standpoint, the breakout of such patterns or a break of long-term down trends such as in the German Bund and/or the CH 10-year yield suggests a significant and high momentum move, which we think will create higher cross asset volatility and where into initially deeper Q4 we see rising yields as clear headwind on defensive sectors and yield sensitive themes such as gold.

Chart 24.) US 10-Year Treasury Yield Daily Chart

Chart 25.) JP Morgan Global Bond Market Index

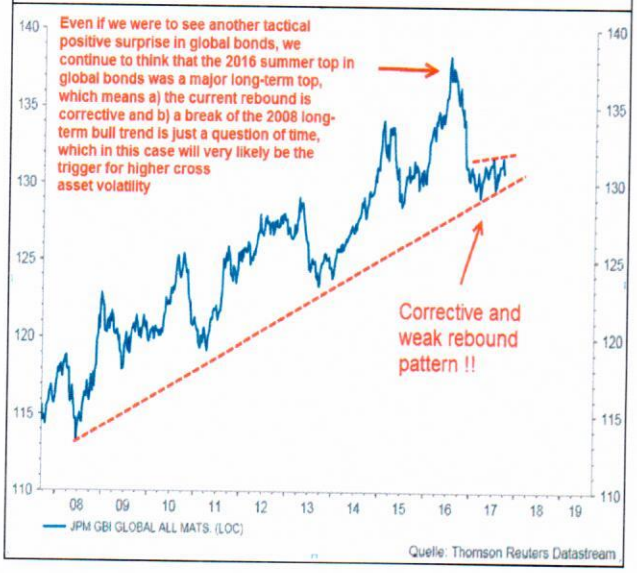
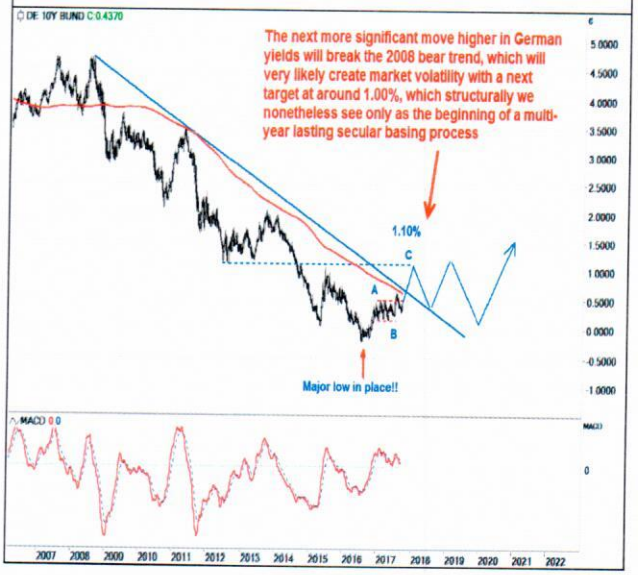


Chart 26.) German Bund 10-Year Weekly Chart

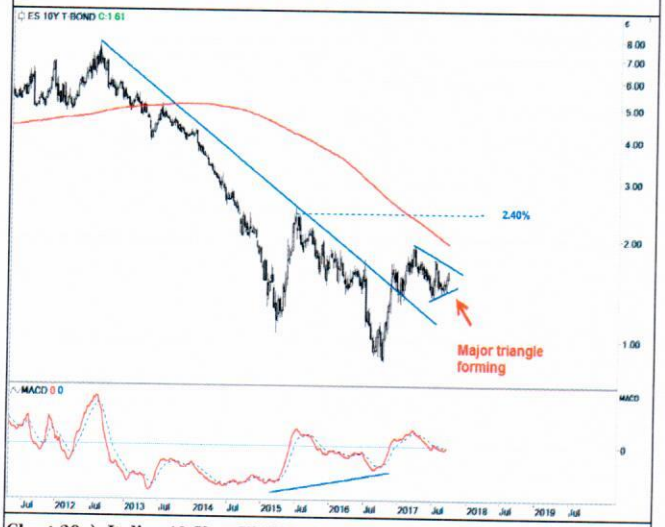


Inter Market Update:

Chart 27.) Swiss 10-Year Yield Weekly Chart

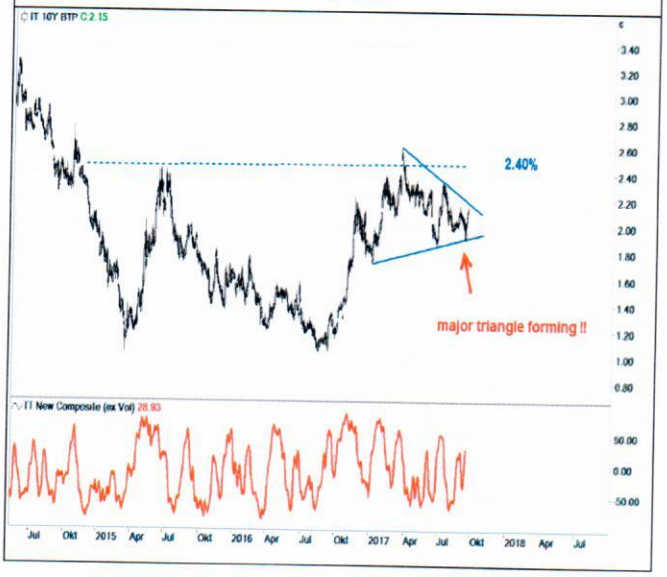
Swiss 10-year yields are moving sideways in a multi-month range bound pattern. A break of 0.00% (what an irony) would be aggressively bullish yields and suggest a move higher towards 0.40%.

Chart 28.) Spain 10-Year Yields Daily Chart



Keep an eye on the periphery in European bond markets where we have the Spanish and Italian 10-year yield trading in huge multi-month consolidation patterns, which normally have a clear trend continuation character so which suggests another significant move higher is yields. Initially this will be maybe perceived as bullish Europe and a reflection of the improving fundamental picture but **further down the road we see Spanish yields at 2.40% and Italian yield heading towards 3.40% as clear headwind for Europe, and translated into equities the beginning of the end of the 2016 wave bull cycle.**

Chart 29.) Italian 10-Year Yield Daily Chart



Inter Market Update:

Chart 30.) Gold Daily Chart

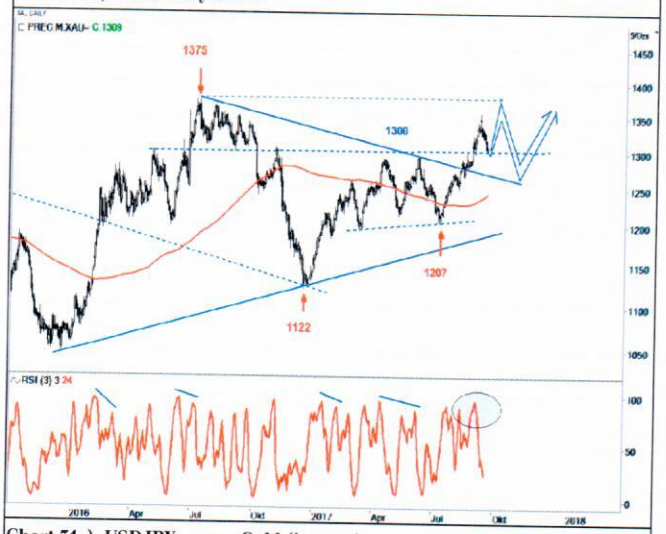


Chart 31.) USDJPY versus Gold (inverse)

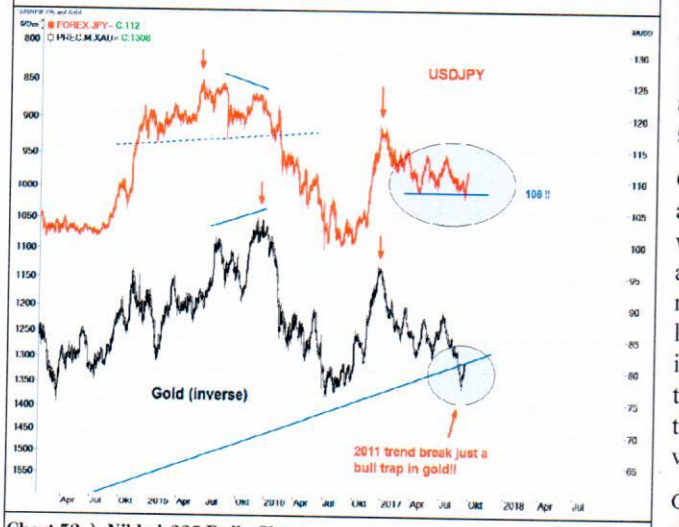


Chart 32.) Nikkei-225 Daily Chart

Tactical Gold Top Forming

Last week, and although gold has broken its 2011 long-term bear trend, we highlighted the yellow metal as increasingly overbought but where on a short-term basis we would actually need to see a classic momentum divergence forming as evidence that a more important top is forming, and as the set-up for a corrective pullback into deeper Q4, which should be mainly a reflection of a bouncing US dollar and rising interest rates on the macro side. With last week's weakness, the yellow metal is pulling back to its last major breakout level at $1300, which is a first big support. On a short-term basis gold is increasingly oversold where a bounce shouldn't be too far away and if we are correct and we see a pull-back (wave C) in global equities we should indeed see gold profiting from a risk off environment into early October.

Conclusion: Strategically we remain bullish gold (YTD up 12.9%) but from a trading aspect we reiterate our last week's call and would use strength to take profit since into deeper Q4 we expect a pullback that can reach levels at around $1250 before we expect another rebound starting.

Generally, with gold having broken its 2011 bear trend and the Nikkei-225 sitting at its 2016 bull trend support we discussed last week the macro correlation of gold against the USDJPY and the Nikkei-225, which is normally very tight. Last week we said that one is very likely wrong here so either the trend breakout in gold is/was a false breakout or the USDJPY and therefore also the Nikkei-225 are trading on too high levels, so where the risk of a breaking its 2016 bull trend in the Nikkei-225 would then be quite high.

Over the last 5 trading sessions we have seen a relatively sharp reversal in gold and a dramatic and very sharp rally in the Nikkie-225, which clearly defended its 2016 bull trend. It was our expectation to see the Nikkei moving into a late Q3/early Q4 buying opportunity but from a pure timing standpoint, and taking into account the breakout in gold, we are surprised about the sharp rally in Japan. However, the risk to see another pullback (wave C pullback scenario) is still not off the table. Keep in mind, so far, gold has been just pulling back to its broken 2011 bear trend, where we would normally expect another near-term rebound in gold. If so, it should bring us in the short-term overbought Nikkei-225 also a near-term pullback. However, with expecting US interest rates to start another significant move higher into later Q4 and ultimately into Q1, we are sticking to our latently medium-term call and would use weakness in Japan to buy where into deeper Q4 a test of the 2015 top at 21000 is actually just a question of time.

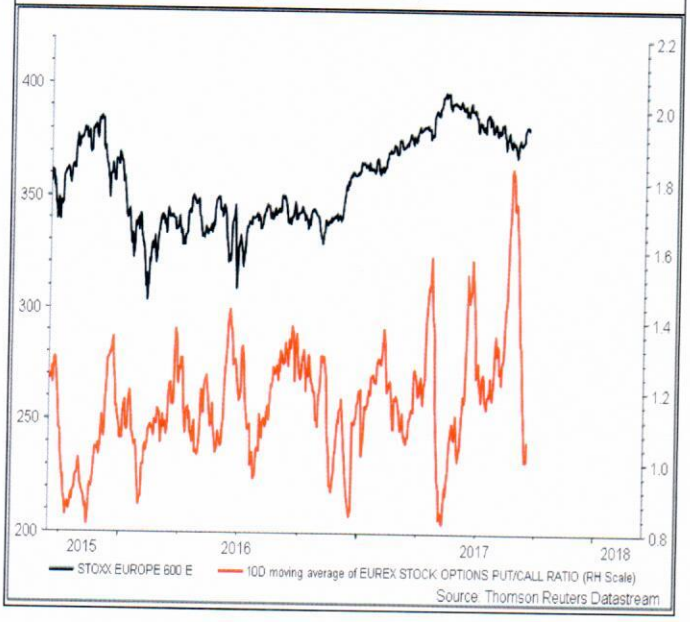
European Equity Market Update:

Lower Rebound Top Expected in Euro Stoxx ...

On track with our mid-September bounce call, we have seen a classic oversold bounce in Europe over the last three weeks, which has produced selective new highs in the FTSE MIB, OBX, ATX, and where the DAX outperformed but where in most other headline indices we clearly expect a lower high forming as the setup for another pullback into first half October. After reaching our 3500 bounce target, we can see the Euro Stoxx overshooting towards 3550, which we nonetheless see as the basis for a pullback into first half October where we expect worst case a re-test of the September low at 3362. In the DAX, we continue to see a higher low forming into October as the setup for another bounce into November where we generally see Europe outperforming and profiting from a potential multi-week EUR pullback on the FX side. Our focus on the sector front remains on buying the dips in cyclicals and financials against selling defensives.

Chart 33.) Euro Stoxx 50 Daily Chart

Chart 34.) EUREX Stocks Option Put/Call Ratio



Euro Stoxx 50:

A marginal extension above our 3500 bounce target lifted the index above its May downtrend and the fast daily momentum into overbought territory. The break of the downtrend will provide support during another pullback, which is looming according to the toppish daily momentum.

We continue to anticipate an early/first half October cycle low posting a higher low as part of a bottoming for the expected Q4 rally, which should be led by cyclicals and financial sectors where we have already seen selectively breaks of the 2017 pullback trends.

Conclusion: The current short-term elevated situation on the indicator side suggests poor risk/reward in the period immediately ahead and we still expect another cycle low developing into early October as the next buying opportunity.

EUREX Stocks Option Put/Call Ratio:

The late August reaction low coincided with a huge spike in the EUREX put/call ratio, and which signaled us the bounce of the last 3 weeks. Since then, the STOXX Europe 600 has bounced almost 4%, which however caused a big plunge in the put/call ratio to its lowest level since June. Within three weeks, this sentiment measure moved from one extreme into another, which de facto represents a very sharp shift of investor sentiment. However, when investors are getting very quickly very bullish, the risk is high that the Euro Stoxx is forming a lower bounce high, which at the end of the day implies that we will very likely see another significant down test into early Q4.

European Equity Market Update:

Chart 35.) FTSE-100 Daily Chart

Chart 36.) DAX-30 Daily Chart

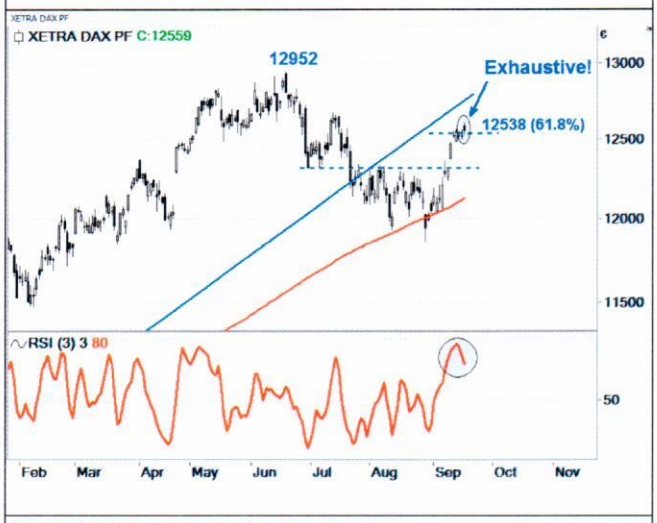


Chart 37.) Swiss Market Index Daily Chart

FTSE-100:

A rally to a fresh multi-month high of the Pound weighed heavily on the FTSE-100, which underperformed last week and fell below its minor support at 7300. The most recent technical development is shifting the tactical focus back to the major support area at around 7100, where we can expect some buying support coming later in Q3/early Q4, where we continue to see the next contrarian entry point.

DAX-30:

The outperformance of most cyclical themes and in particular, the auto sector were the major forces behind the outperformance of the DAX since its late August reaction low. The 61.8% retracement of the previous decline at 12538 has been approached and the first signs of deteriorating momentum is becoming visible. As stated already last week, the significant rally leg of the DAX implies that the likelihood is high that the corrective wave 4 low in the DAX is in and so the next pullback will post a higher reaction low, ideally into early October.

Support for pullbacks is at around 12320 and our focus remains on accumulating FX sensitive cyclicals such as autos, chemicals and industrials.

Swiss Market Index:

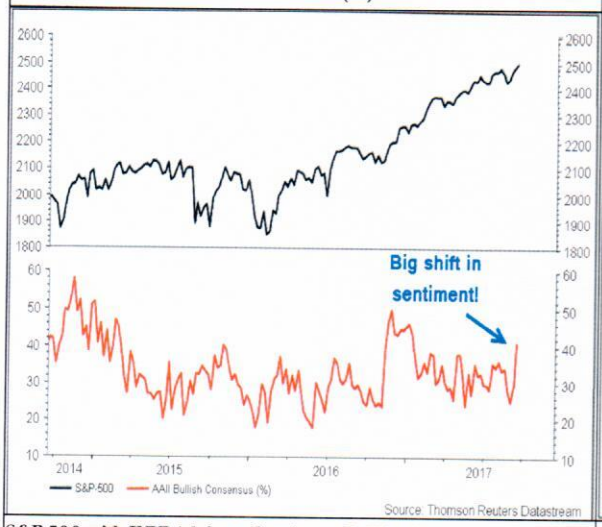
As expected, last week's bounce remained below 9150/9200, which keeps the index caught within its intact multi-month trading range. The very short-term situation is becoming overbought and so another corrective pullback starting from the overhead resistance area is favored. Timing-wise, we continue to expect the real breakout attempt to take place in Q4 and for the time being focus remains on accumulating financials and cyclicals into a looming pullback.

STOXX Europe 600 Index Sector Overview:

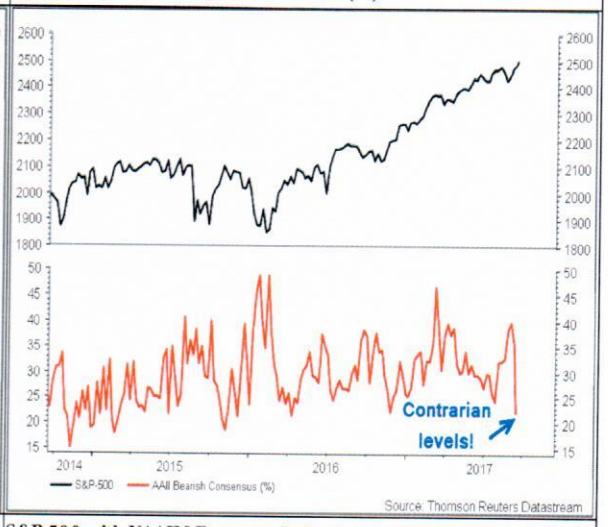
	RIC	Trading at	Trend (weekly MACD)	Rel. Strength according to the spread chart
Utilities	SX6P	301.64	↗	Outperforming
Basic Resources	SXPP	426.56	↗	Outperforming
Automobiles & Parts	SXAP	578.9	↗	Outperforming
Technology	SX8P	434.02	↘	Outperforming
Financial Services	SXFP	474.6	↘	Outperforming
Industrial Goods & Services	SXNP	519.52	↘	Outperforming
Banks	SX7P	183.5	↘	Outperforming
Chemicals	SX4P	912.62	↘	Outperforming
Oil & Gas	SXEP	295.04	↗	Neutral
Food & Beverage	SX3P	658.5	↘	Neutral
Constructions & Materials	SXOP	460.63	↘	Neutral
Insurance	SXIP	278.11	↘	Neutral
Real Estate	.SX86P	169.89	↘	Neutral
Personal & Household Goods	SXQP	849.27	↘	Underperforming
Travel & Leisure	SXTP	247.9	↘	Underperforming
Healthcare	SXDP	741.89	↘	Underperforming
Telecommunications	SXKP	286.69	↘	Underperforming
Retail	SXRP	300.65	↘	Underperforming
Media	SXMP	263.39	↘	Underperforming

Weekly Technical Indicators: (Source: Pinnacle Data, Datastream) Charts: Metastock

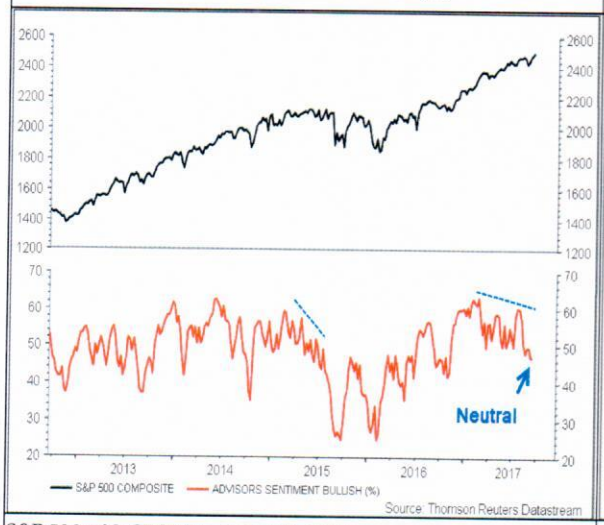
S&P 500 with AAII Bullish Consensus (%)



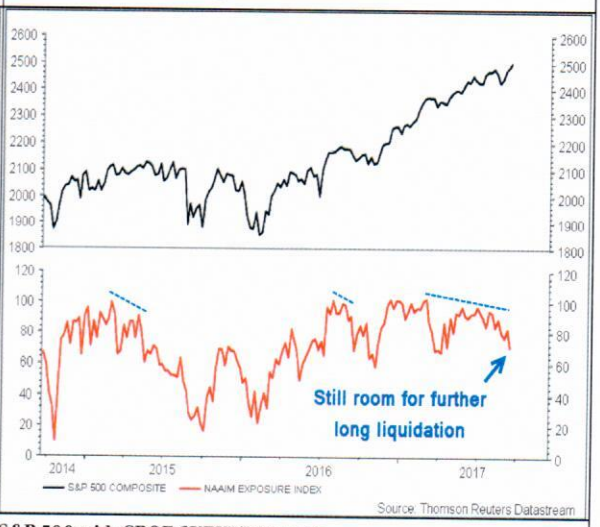
S&P 500 with AAII Bearish Consensus (%)



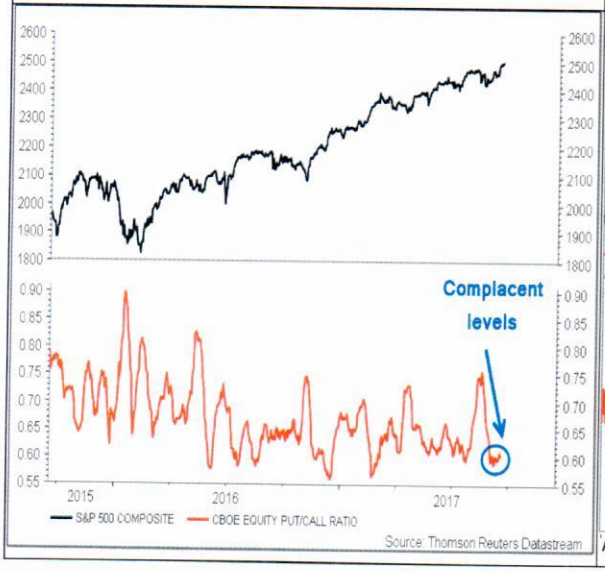
S&P 500 with INVI Advisors Sentiment Bullish (%)



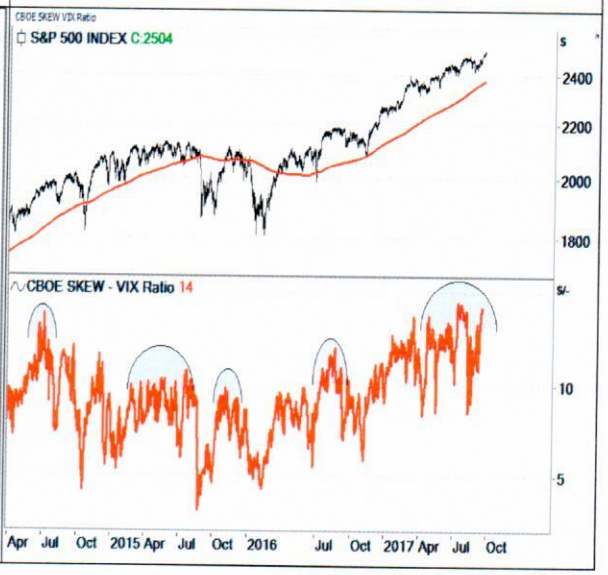
S&P 500 with NAAIM Exposure Index



S&P 500 with CBOE Equity Put/Call Ratio

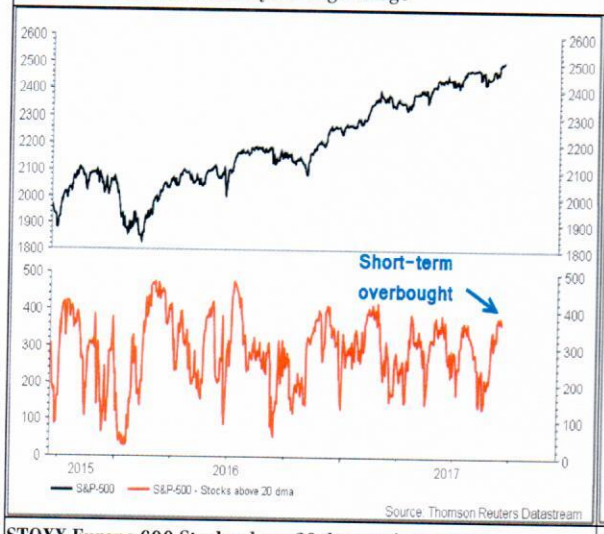


S&P 500 with CBOE SKEW/VIX Ratio

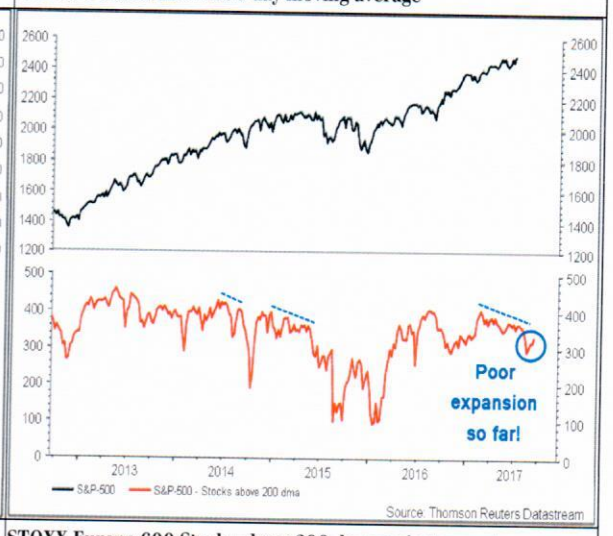


Weekly Technical Indicators: (Source: Pinnacle Data, Datastream) Charts: Metastock

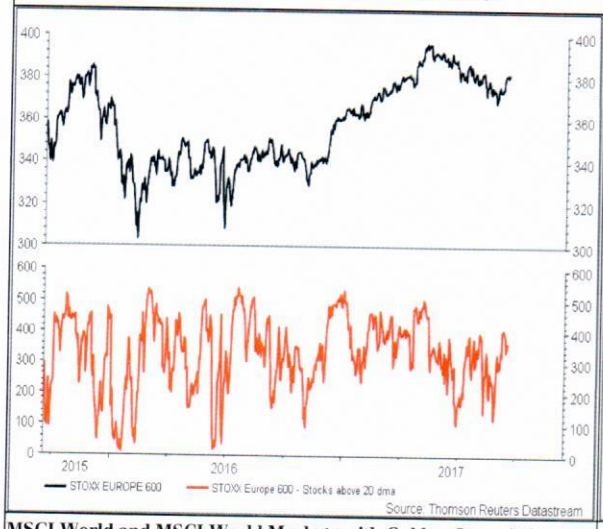
S&P 500 Stocks above 20 day moving average



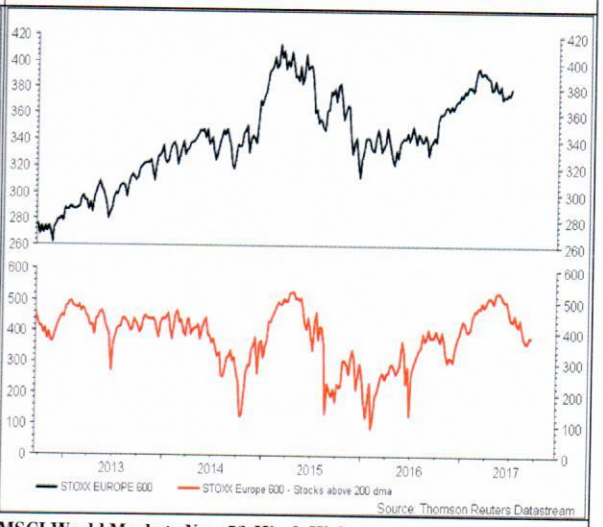
S&P 500 Stocks above 200 day moving average



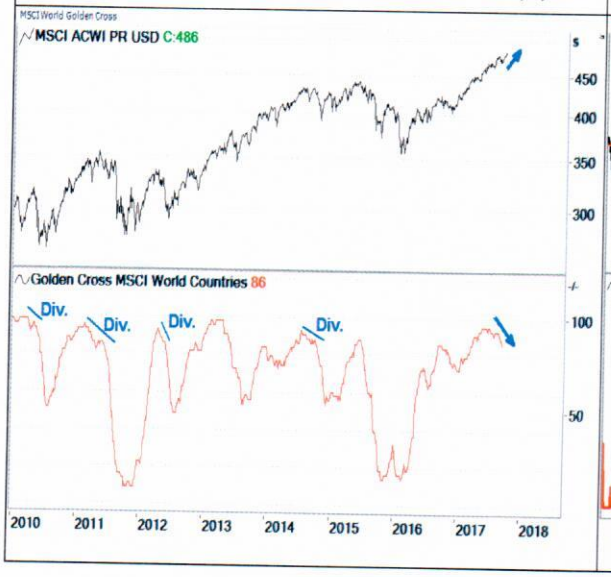
STOXX Europe 600 Stocks above 20 day moving average



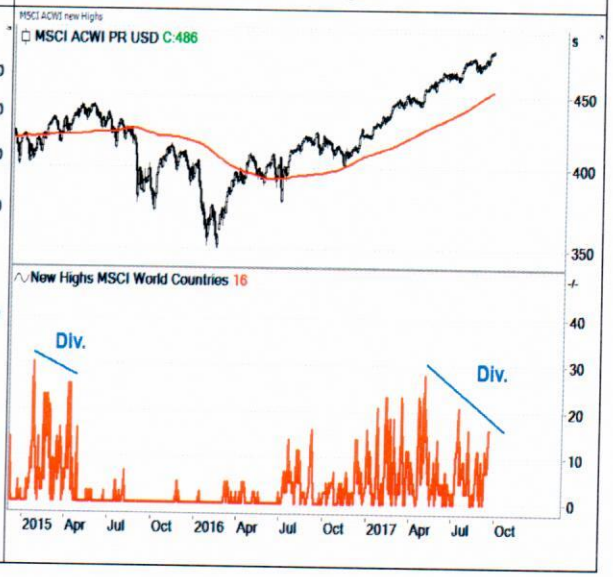
STOXX Europe 600 Stocks above 200 day moving average



MSCI World and MSCI World Markets with Golden Cross (%)

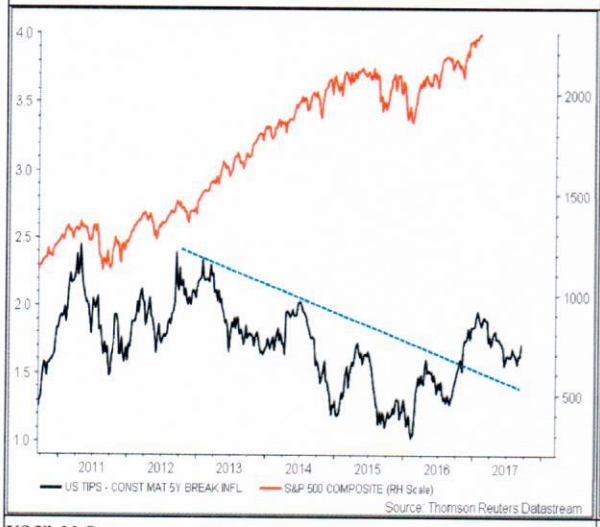


MSCI World Markets New 52-Week Highs

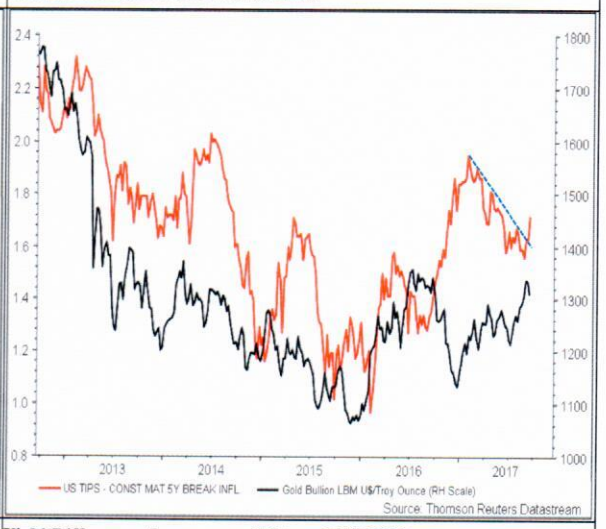


Weekly Technical Indicators: (Source: Pinnacle Data, Datastream) Charts: Metastock

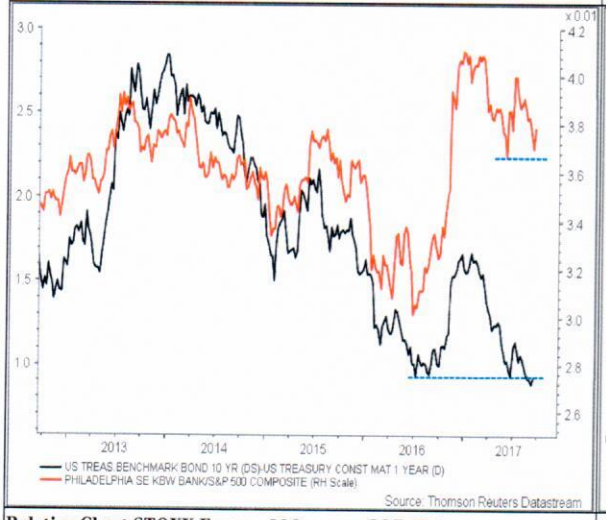
S&P 500 with Break-Even Inflation Rate



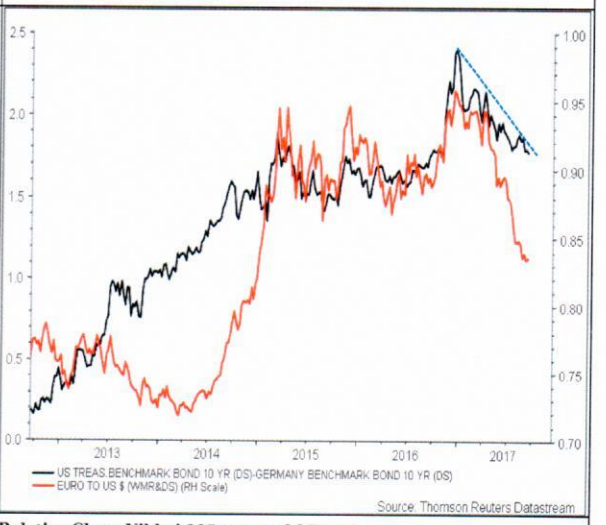
Gold with Break-Even Inflation Rate



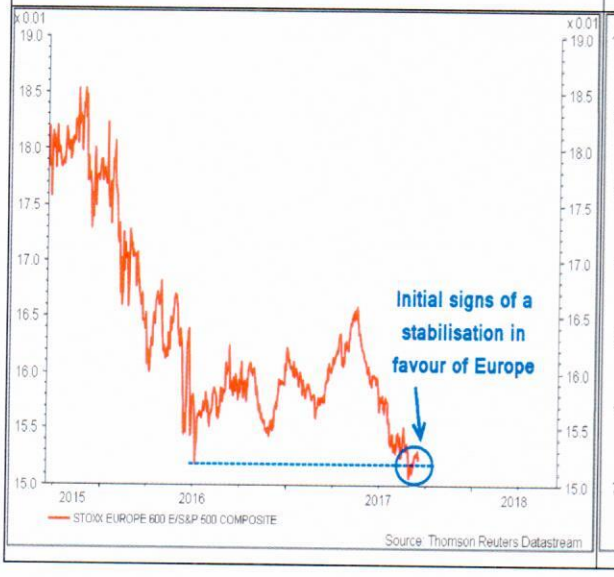
US Yield Curve versus US Bank Index (BKX)/S&P 500



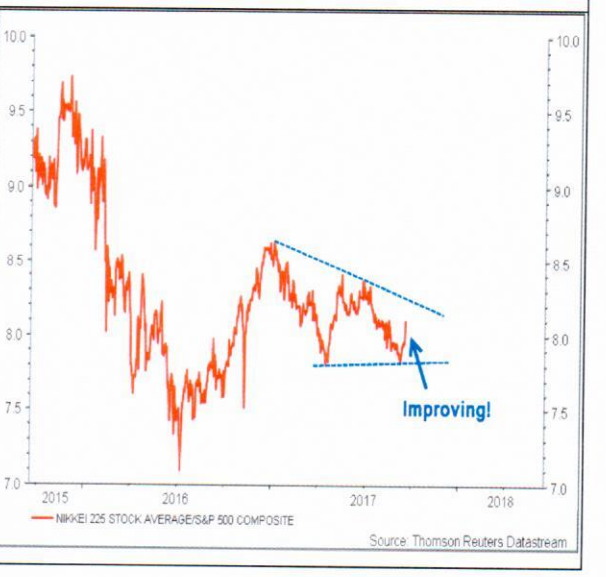
Yield Difference Germany vs USA and EURUSD



Relative Chart STOXX Europe 600 versus S&P 500



Relative Chart Nikkei 225 versus S&P 500



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