UBS

Equities Sales Trading Commentary

Technical Analysis

Weekly Comment

Global

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These are sales views based on Technical Analysis. They do not represent the UBS House View.

SPX Final Throw Over ... Low Momentum in Europe

- **US Trading**: Last week, on the back of the US budget resolution, the SPX extended its late August rally and hit new all-time highs, whereas the Russell-2000 and Nasdaq-100 refused to make new highs. It reflects an unchanged increasing selectivity and adds another divergence to the existing/intact non-confirmations in our breadth work, medium-term momentum studies, and on the volatility side (VIX posted another marginal higher low), which leaves the technical picture unchanged. With an intact momentum divergence trading in a wave 5 (lower degree), we see last week's bounce above the upper end of the June bull channel as a classic final throw over/blow-off instead of another sustainable momentum breakout.
- After yesterday's reversal candle (bearish engulfing) the SPX has generated a fresh momentum short signal, where a re-break below 2564 would be initially negative. Key trading support (last higher reaction low as stop loss for long positions) is at 2548 and 6559 in the Nasdaq (rolling over in our trend work), which we expect to be tested into early November, and where a break of 2548 would imply more weakness towards 2540/2518.
- **US Strategy:** With the late September breakout above 2509, the September rally has been significantly stronger than expected, particularly with respect to the seasonal cycles where September/October is statistically the most challenging time frame for equities. So where do we stay from a cyclical aspect and what can we expect for the rest of the year? Tactically, the SPX continues to trade in the time window of a multi-week cycle top where short-term we expect an initial pullback into early November followed by another bounce into later November. However, more strength into later November we would see more as part of a distributive top building process and a leading indicator of a somewhat more significant 3% to 5% pullback into late December/early January where we have our next bigger tactical low projection (4-month cycle) and buying opportunity for the next rally/bounce into later Q1. If we are correct, then one consequence would be that the classic year-end rally we already saw in September/October, so that into year-end/early January (which seasonally would be also very unusual), we could see surprising weakness and/or a washout before starting its next bigger bounce into later 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 should see further increasing selectivity and gradually rising volatility in the US and global equities.
- **European Trading**: With the (20-day) average true range at a 12-year low, and the Euro Stoxx continuing to trade sideways, Europe is close to a standstill. Again, after the stronger than expected September rally (DAX posted its 3rd strongest September since 1965!!), the move has been clearly losing momentum where selective new reaction highs (OMX, CAC, SMI, AEX) were based on weak momentum. In the bigger picture, Europe trades in wave 5 of the 2016 bull cycle, which confirms our underlying bullish bias into Q1. However, on a short-term basis, Europe remains overbought and with our daily trend work rolling over in more and more markets, we continue to expect a short pullback into early November, before we expect more upside/outperformance into later November (where we expect more EUR weakness). Euro Stoxx support is unchanged at 3555 to worst case 3520, as the setup for the next bounce into November, where we can see a test of the May high at 3667.
- **Inter Market Analysis**: From a trend perspective, our underlying views on the macro side are unchanged, where (in the 2016 boom and bust cycle) we remain bearish bonds and expect higher yields into later Q1, where we expect another bear leg in the US dollar into Q1 (we expect European yields to rise stronger than US yields) and where gold should remain a buy into November weakness for another bounce/rally into early 2018 and (after a late Q1 washout) ultimately into deeper/later 2018.
- Tactically, on a very short-term basis, US 10-year yields and the DXY are sitting at key levels. As long as we do not see a significant break of the early October high at 2.40% in US-10-year yields and 94.14 in the DXY, we still expect another near-term pullback in US yields and the DXY into early November before starting its real bounce higher, which should break 2.40% in US 10-year yields and where we expect the DXY heading towards 95 to 95.90 into later November.
- Gold remains a reflection of the DXY and US yields, where on a short-term basis we favour (pivotal support at $1260) another bounce towards $1320 but where into November we cannot rule out a short-term negative surprise on the way into another significant buying opportunity. So tactically we see gold more a sell into strength instead of chasing gold higher.

US Equity Market Update:

Chart 1.) S&P-500 Daily Chart

Chart 2.) S&P-500 with NYSE McClellan Oscillator Daily Chart

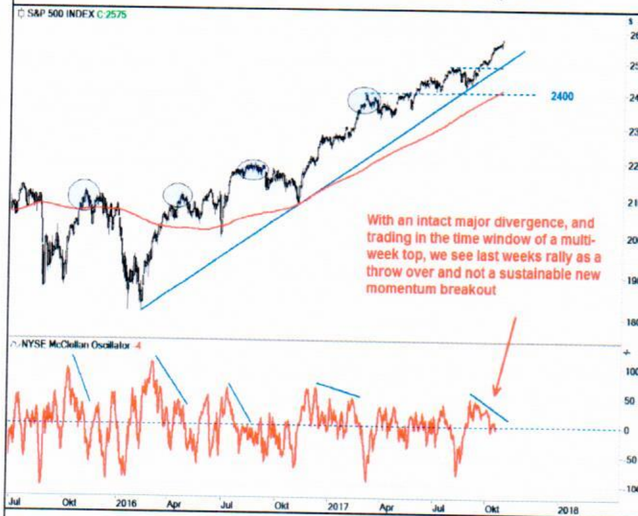


Chart 3.) Nasdaq-Composite Daily Chart

Key Reversal in SPX

Medium-term, the September breakouts to new all-time highs in the SPX, Russell-2000, and transport are bullish and confirming our underlying bullish view, which we had and continue to have into Q1. Having said that, despite last week's rally extension in the SPX and in the Dow Jones Industrial, our short-term view has not changed.

On the back of the US budget resolution, last week we saw another significant bounce and a new all-time high in the SPX, which extended its late August rally and even broke above the upper end of its June bull trend channel, whereas the Russell-2000 and Nasdaq-100 refused to make new highs. **The continued sideways trading and yesterday's weak session in the Russell reflects an unchanged increasing selectivity in the US, where on the one hand mega cap stocks are pushing the SPX and DJI higher, and in the broader market and most key sectors there has been a standstill since more or less early October**. The non-confirmation between the Russell-2000 and the DJI is similar to what we had in late July/early August, ahead of the multi-week consolidation/pullback pattern into later August. This adds just another divergence to the existing/intact non-confirmations we still have in our breadth work (contracting number of new highs), to medium-term momentum studies (NYSE McClellan Oscillator) and on the volatility side, where the VIX posted another marginal higher low where the non- confirmation versus the SPX remains intact, leaving the technical picture in the US unchanged.

With the late September breakout above 2509, the August rally has been significantly stronger than expected but we continue to see this rally and especially last week's bounce as a tactical overshooting into a multi-week top as the setup for an initial pullback into early November before starting another bounce into later November where we can still see marginal new highs; however, we would see that as part of a distributive pattern ahead of a somewhat more significant pullback into later this year and/or into very early January.

Conclusion: After yesterday's reversal candle (bearish engulfing) the SPX has generated a fresh momentum short signal, where a re-break below 2564 would be initially negative. Key trading support (last higher reaction low as stop loss for long positions) is at 2548 and 6559 in the Nasdaq (where our daily trend work is turning short), which we expect to be tested into early November, and where a break of 2548 would open the door towards more weakness towards 2540/2518.

US Equity Market Update:

Chart 4.) Russell-2000 Daily Chart

With the continued sideways trading, the Russell-2000 remains in neutral stance short-term with key support at 1491. With yesterday's bearish daily candle we anticipate a near-term test of 1491, where a break would complete a short-term top and suggest that a pullback to its late September breakout level at 1452 is underway.

Chart 5.) Russell-2000 versus Dow Jones Industrial

Tactically, and with the sharp rally of the DJI, we have a strong divergence forming in the DJI versus the Russell-2000, which is normally bearish short-term; we had a similar pattern in early August ahead of the multi-week consolidation/pullback pattern.

Chart 6.) Russell-2000 with New 52-Week Highs

Despite last week's bounce, the market breadth in the Russell-2000 has been coming under further pressure, which is negative.

US Equity Market Update:

Chart 7.) S&P-500 with Stock Trading Above 20-Day Moving Average

Chart 8.) S&P-500 with New 52-Week Highs

Chart 9.) S&P-500 versus VIX Index

The divergence in the number of SPX stocks trading above their 20-day moving average is a classic short-term momentum divergence, which should be the trigger for minimum a several day's lasting pullback into early November.

Regardless whether it's the Russell-2000, NYSE Composite or the S&P-500, in all market segments the number of new highs continues to deteriorate.

On the volatility side it is important to note that despite last week's strong 2-day bounce in the SPX, the VIX index has not made a new low, let alone that it hit another marginal higher low versus its previous weeks low, which is further extending the non-confirmation versus the SPX, which is tactically toppish.

Again, last week, we highlighted the 20-day average true range at multi-year extreme low reading's, which reflects a very low intraday volatility. Statistically, 54% of the 2017 trading days have finished within a 20bps range, which is an all-time record. The 30-day realized volatility is by far the lowest ever and last week's Thursday's intraday trading range in the SPX was the narrowest ever.

What does all this tell us? We are currently witnessing a historical extreme phase, with record complacency in the market and which we see as the "calm before the storm", so where in 2018 we can expect significantly higher volatility.

US Equity Market Update:

Divergences in Outperformers ... Watch Transport!

On the sector side we have no new signals, diverging to what we said last week. In the recent outperformers, SOX, BKX, HGX, DRG and BTK we have momentum divergences forming, which we see as a capping factor short-term. In the defensive camp, utilities continued to bounce but with a momentum divergence forming we would not chase the sector in absolute terms and take profits. Healthcare has been following more the risk curve and is short-term overbought. Together with a bearish divergence in our daily trend work and yesterday's reversal candle we would buy dips instead of chasing the upside. Consumer staples remain the weakest link in the defensive camp, where the sector refused to bounce. On the one hand we have a none confirmation forming in our trend work but also an intact down trend. Conclusion: As long as we do not see a break of 564 we remain on the side line and where a break of 551 would be trend continuation bearish.

Keep an eye on the transport sector. If we are correct that the market is vulnerable for a short-term pullback, then the DJT should be a leading indicator for this pullback. In this case last week's bounce should form a lower high, which pattern-wise would form a potential H&S top formation with key support at 9800/9764, and where a break of 9764 would imply weakness towards 9400.

Chart 10.) Dow Jones Transport (DJT) Daily Chart

Chart 12.) US Healthcare Index (DRG) Daily Chart

Chart 11.) Dow Jones Utilities (DJU) Daily Chart

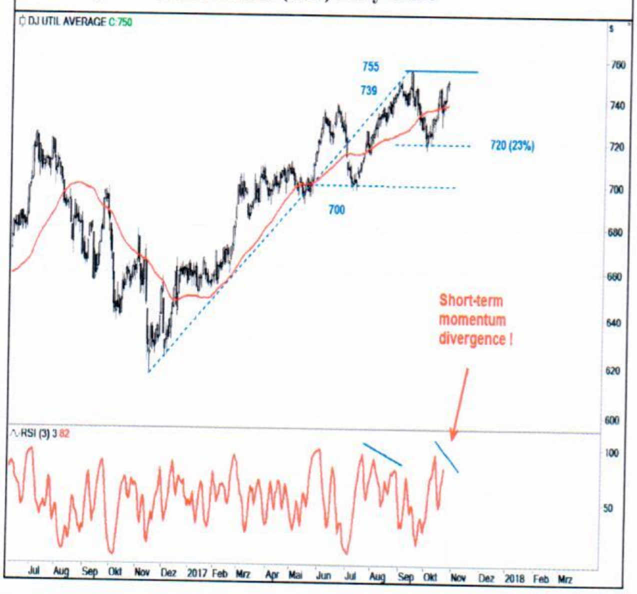


Chart 13.) S&P Consumer Staples Daily Chart

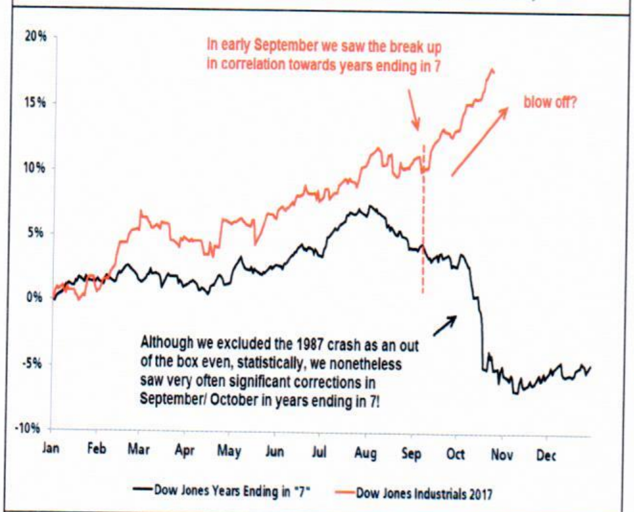
Equity Strategy Update:

Preponed Year-End Rally ... Where Are We Cyclically?

With the late September breakout above 2509, the September rally in the SPX has been significantly stronger than expected, particularly with respect to the seasonal cycle where September/October is statistically the most challenging time frame for equities. Also if we take into account the average of years ending in "7" (decennial cycle) and post-election years as part of the Presidential cycle, we had very often significant corrections in this time frame. **In the first 8 months of this year we had an amazingly high correlation of the Dow Jones Industrial versus the average of years ending in "7". In September/October this correlation has been obviously blown up. So although being underlying bullish with expecting cyclical themes to outperform in an intact reflation trend, tactically we have been surprised by the September breakout. So where do we stay cyclically and what can we expect for the last 2 months of the year, which statistically, are normally very strong?**

Although tactically we have been too cautious over the recent weeks, from a cyclical aspect the SPX continues to trade in the time window of a multi-week cycle top. **What we currently see is a strong right translation of the cycle top (due to the sharp rally trend) in the underlying 2-month cycle but this does not mean that we will not see any pullback at all**, since every cycle is only complete with an upward and a downward move. In this context, **we still expect an initial pullback into early November, followed by most strength into later November, which however, we would see as part of a distributive process and leading indicator of a more significant 3% to 5% pullback into late December/early January, which is our next bigger tactical low projection (4-month cycle) and buying opportunity for the next significant rally/bounce into later Q1.**

Chart 14.) DJI versus DJI in Years Ending in "7" (1900-2010)



Conclusion: Our key message is that from a cyclical aspect we remain underlying bullish but if we are correct with our short-term scenario, then one consequence would be that **the classic year-end rally we have already seen in September/October**, given the sharp rally of the last few weeks. Having said that, **this would also mean that into year-end/early January we could see surprising weakness if not even a washout before starting its next bigger bounce into later Q1**. From a seasonal aspect, this would be again a surprise but just the consequence of the surprisingly strong September/October. **Our medium-term to long-term view is unchanged, where later Q1 remains our preferred time window for an important and potential major market top of the underlying 2016 wave 5 bull cycle and in this context we would still use weakness into deeper/later Q4 to buy.**

Chart 15.) DJI versus DJI in Post-Election Years (1900-2013)

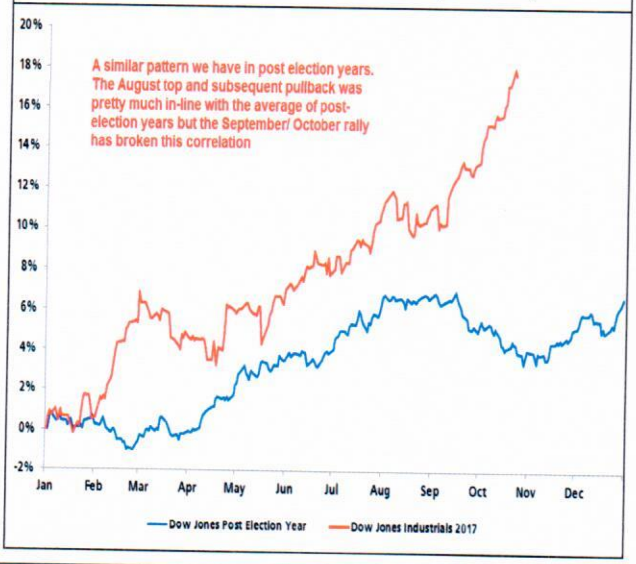
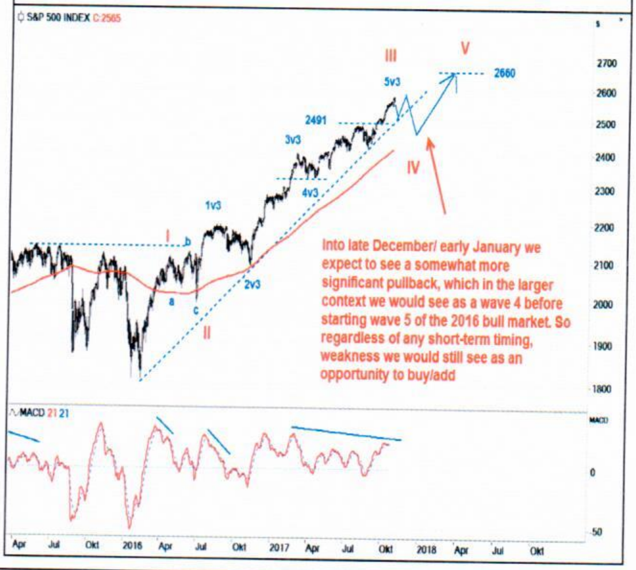


Chart 16.) S&P-500 Core Scenario (Daily Chart)



Inter Market Update:

Chart 17.) Trade Weighed Dollar Index (DXY) Daily Chart

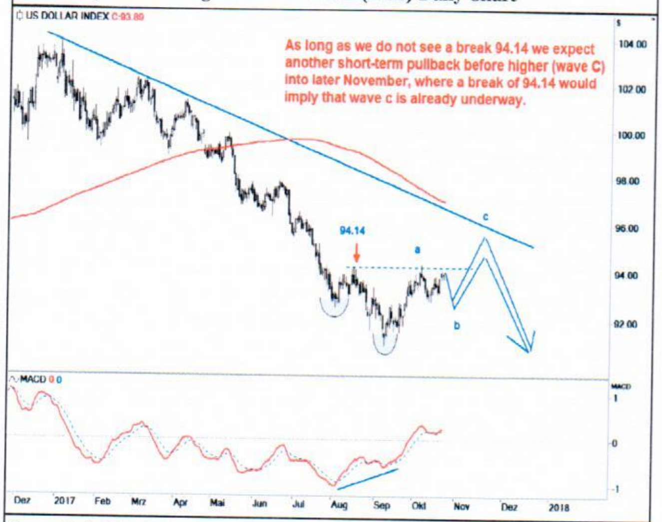


Chart 18.) US 10-Year Treasury Yields Daily Chart

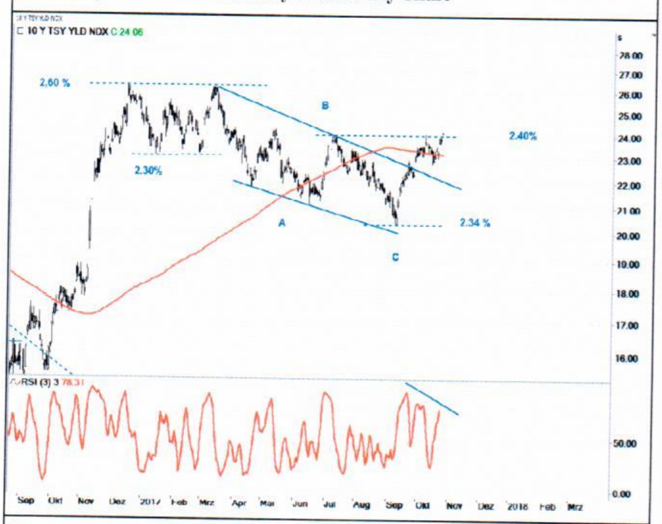
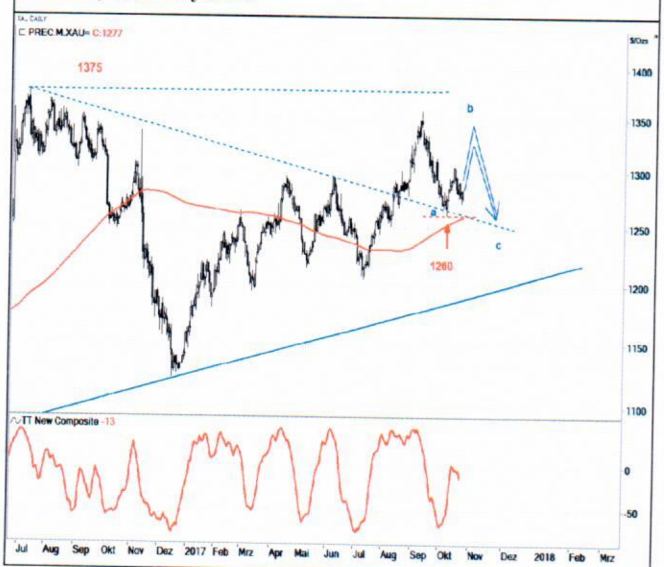


Chart 19.) Gold Daily Chart



DXY Sitting At Key Level!

From a trend perspective, our underlying views on the macro side are unchanged. In the 2016 boom and bust cycle we remain **bearish bonds** and expect higher yields into later Q1. **On the FX side** and after a tactical US Dollar bounce into all in all later November, **we expect another and very likely a final tactical bear leg in the US dollar into Q1**, which should be basically a reflection of our core view where we expect European yields to rise stronger than US yields, so where the US-German yield spread should further tighten.

The set up on the metals and commodity side is more complex. On the one hand, a potential final US dollar bear cycle should be still underlying bullish commodities (late cyclical sector themes) but higher interest rates should be at the same time headwind at least for gold, which at the end of the day means we see gold still more as a trading theme before into deeper 2018 (and after a potential tactical negative surprise in later Q1) we expect real bullish trend momentum coming into precious metals.

Tactically, on a very short-term basis, US 10-year yields and the DXY are sitting at key levels. **As long as we do not see a significant break of the early October high at 2.40% in US-10-year yields and 94.14 in the DXY, we are sticking to our recent trading call and expect another near-term pullback in US yields and the DXY into early November before starting its next bounce higher**, which should break 2.40% in US 10-year yields and where we expect the DXY heading towards 95 to 95.90 into later November.

Gold remains a reflection of the DXY and US yields, where on a short-term basis we favour (pivotal support/stop loss trigger for tactical bounce is at $1260) another bounce towards $1320 but where into later November we cannot rule out a short-term negative surprise on the way into another significant buying opportunity for moving higher into early Q1. So tactically we see gold more a sell into strength instead of chasing gold higher.

European Equity Market Update:

Lowest Price Volatility since 2005!

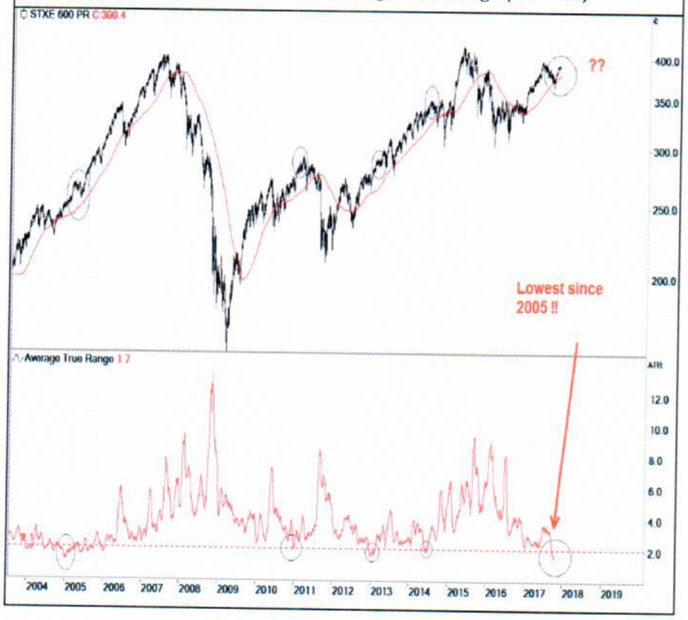
With the (20-day) average true range at a 12-year low, and the Euro Stoxx continuing to trade sideways, Europe is close to a standstill. Again, after the stronger than expected September rally (DAX posted its 3rd strongest September since 1965!!), the move has been clearly losing momentum where selective new reaction highs (OMX, CAC, SMI, AEX) were based on weak momentum. In the bigger picture, Europe trades in wave 5 of the 2016 bull cycle, which confirms our underlying bullish bias into Q1. However, on a short-term basis, Europe remains overbought and with our daily trend work rolling over in more and more markets, we continue to expect a short pullback into early November, before we expect more upside/outperformance into later November (where we expect more EUR weakness). Euro Stoxx support is unchanged at 3555 to worst case 3520, as the setup for the next bounce into November, where we can see a test of the May high at 3667.

Chart 20.) Euro Stoxx 50 Daily Chart

Euro Stoxx 50:

Pure sideways trading in the Euro Stoxx-50 last week, which leaves the tactical situation absolutely unchanged, and the index within its tiny trading range. Focus remained on the sector developments, where most of the cyclical camp continued to outperform despite the deteriorating momentum and a still medium-term stretched technical situation, which continues to weigh on the index momentum. Timing-wise, we continue to expect the current consolidation to extend into end October/early November. In terms of price, support at 3585 was confirmed last week and in case of a violation, focus would shift towards 3555/3520 as a setup for the next bounce into November.

Chart 21.) STOXX Europe 600 with Average True Range (20 DMA)



STOXX Europe 600 with Average True Range:

Similar as in the S&P 500, the 20-day average of the "True Range", which measures the degree of price movement (volatility), plunged in Europe to the lowest level since 2005. **In other words, the last four weeks have seen the quietest index trading in more than a decade.** In the midst of a bull cycle, as was the case in the period between 2004 and 2005, a trending market can go hand in hand with a longer period of low volatility but where nonetheless we saw a tactical set back. In 2011 and in 2014 the low true range was a good leading indicator for more significant corrections whereas in early 2013 the indicator failed. Generally, given the extreme overbought position in the US and the various none confirmations in our indicator work we see the low average true range as a clear warning indicator for a market pullback in the coming weeks.

European Equity Market Update:

Chart 22.) FTSE-100 Daily Chart

FTSE-100:

A second consecutive doji candle on a weekly chart basis leaves the short-term picture in the FTSE unchanged. The index continued to consolidate in a sideways manner below its overhead resistance at 7600. With the daily momentum in neutral territory and not yet at oversold levels, there is room for further near-term consolidation and we expect the real test at 7600 to take place later in Q4.

In the meantime, focus is on minor supports at 7485, 7440 and the 200-day moving average at 7365.

Chart 23.) DAX-30 Daily Chart

DAX-30:

Also, the cyclical exposed DAX posted a doji candle on a weekly chart basis and thus it continued to tread water at around all-time highs. At this stage, the current consolidation is developing sideways with minor support developed at 12909. A violation would suggest the start of a pullback and potential retracement move of the last wave towards 12600/12500 into late October/early November, before starting the next bounce into deeper Q4.

Chart 24.) Swiss Market Index Daily Chart

Swiss Market Index:

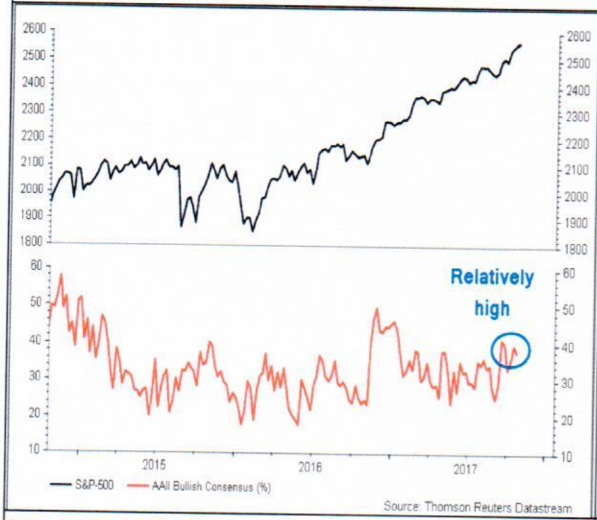
In line with most European markets, we have a sideways consolidation above the early August high developing. The August high at 9200 defines an obvious short-term key support, which held last week. With the daily momentum still at slightly overbought levels, further consolidation is required before starting the next move higher. The near-term risk in that scenario would be a re-break below 9200 and which would trigger a retracement move towards 9070.

STOXX Europe 600 Index Sector Overview:

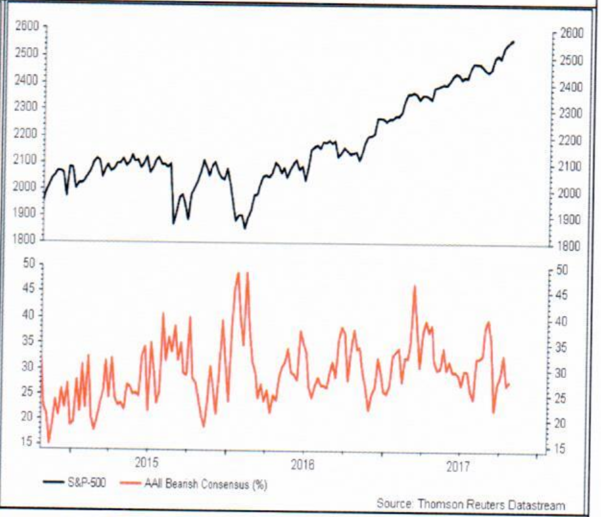
	RIC	Trading at	Trend (weekly MACD)	Rel. Strength according to the spread chart
Technology	SX8P	451.23	↗	Outperforming
Financial Services	SXFP	485.68	↗	Outperforming
Industrial Goods & Services	SXNP	534.14	↗	Outperforming
Basic Resources	SXPP	448.36	↗	Outperforming
Chemicals	SX4P	963.3	↗	Outperforming
Automobiles & Parts	SXAP	594.9	↗	Outperforming
Oil & Gas	SXEP	308.97	↗	Outperforming
Food & Beverage	SX3P	678.82	↗	Neutral
Constructions & Materials	SXOP	465.11	↗	Neutral
Insurance	SXIP	289.03	↗	Neutral
Healthcare	SXDP	751.94	↗	Neutral
Utilities	SX6P	305.61	↘	Neutral
Banks	SX7P	186.15	↘	Neutral
Retail	SXRP	303.47	↗	Underperforming
Media	SXMP	269.68	↗	Underperforming
Personal & Household Goods	SXQP	845.8	↘	Underperforming
Travel & Leisure	SXTP	251.87	↘	Underperforming
Real Estate	SX86P	168.5	↘	Underperforming
Telecommunications	SXKP	285.18	↘	Underperforming

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

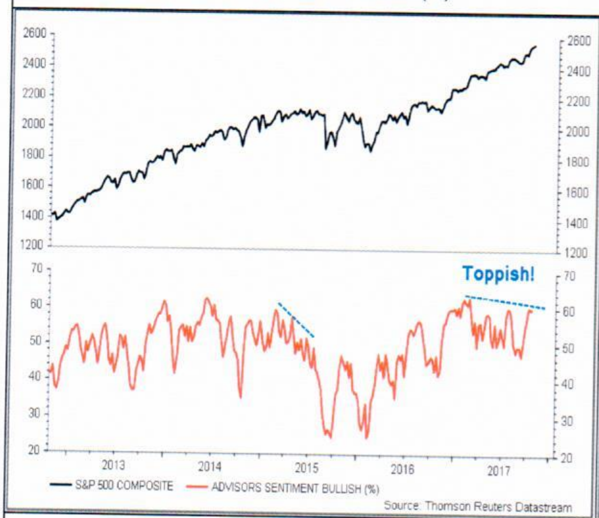
S&P 500 with AAII Bullish Consensus (%)



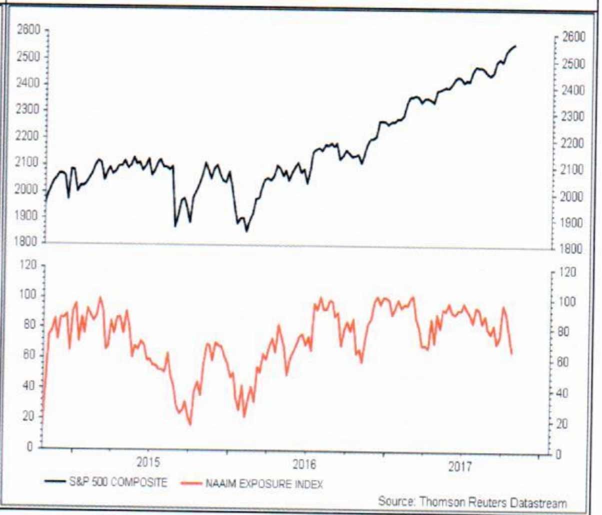
S&P 500 with AAII Bearish Consensus (%)



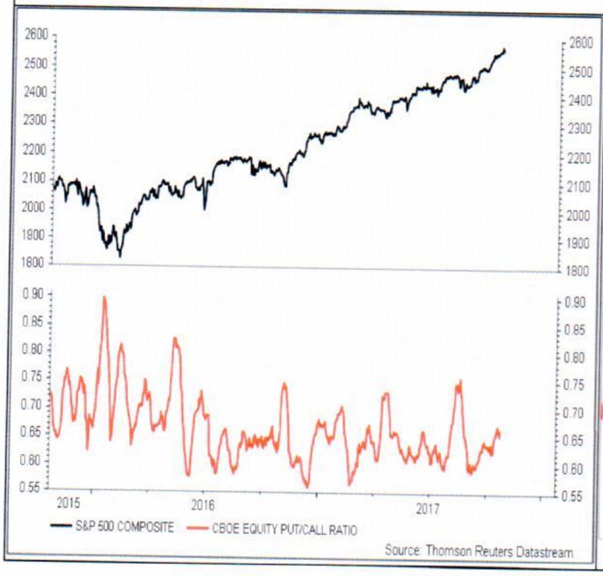
S&P 500 with INVI Advisors Sentiment Bullish (%)



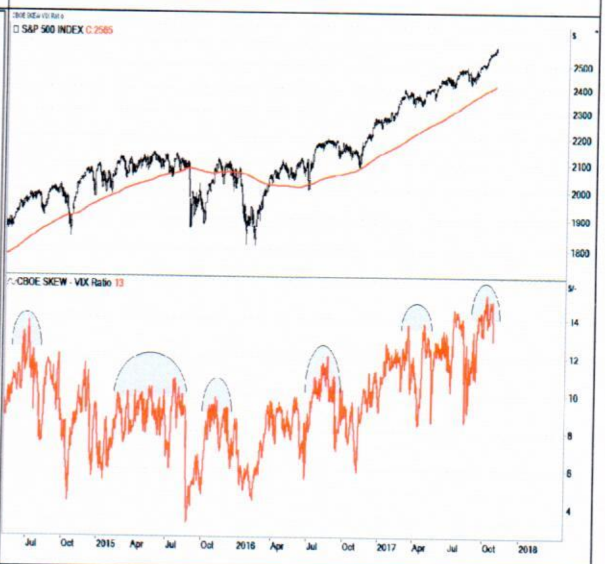
S&P 500 with NAAIM Exposure Index



S&P 500 with CBOE Equity Put/Call Ratio

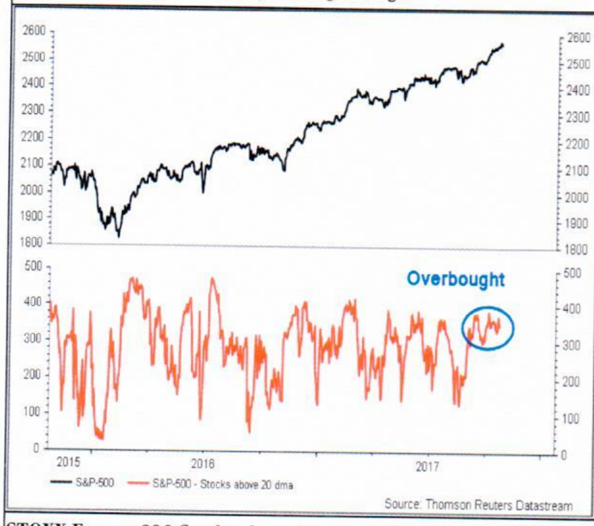


S&P 500 with CBOE SKEW/VIX Ratio

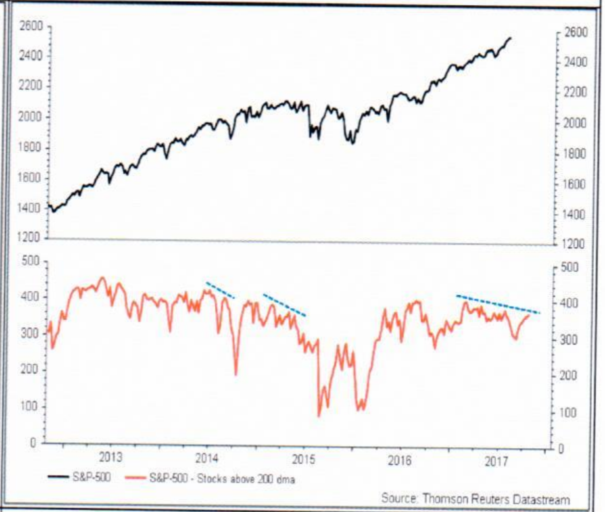


Weekly Technical Indicators: (Source: Pinnacle Data, Datastream) Charts: Tradesignal

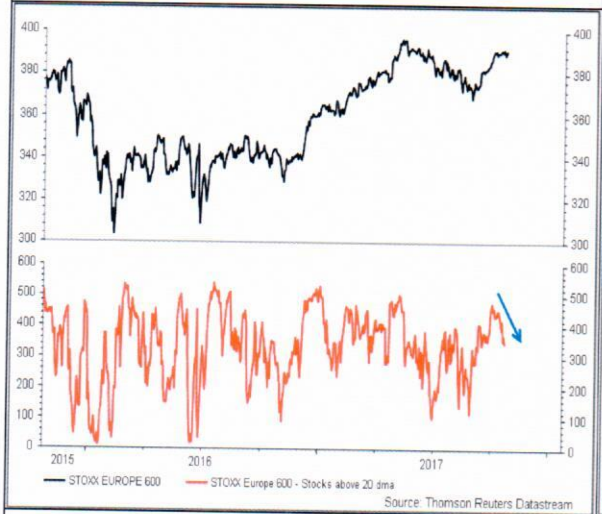
S&P 500 Stocks above 20 day moving average



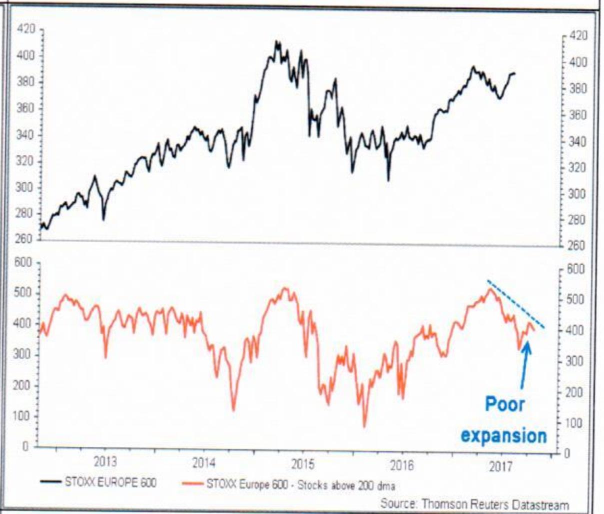
S&P 500 Stocks above 200 day moving average



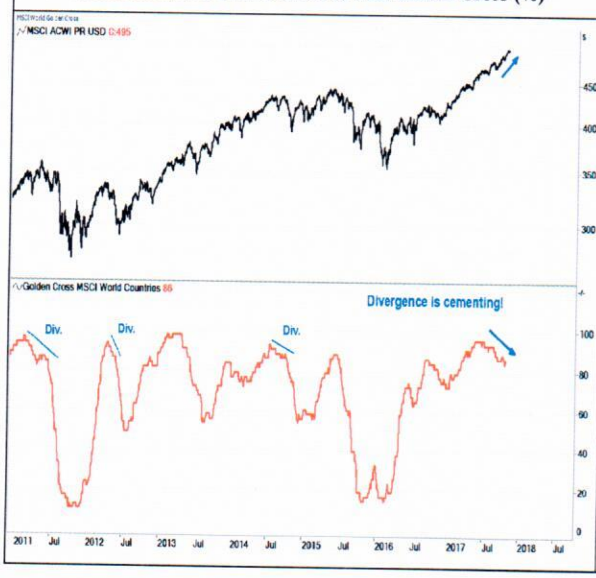
STOXX Europe 600 Stocks above 20 day moving average



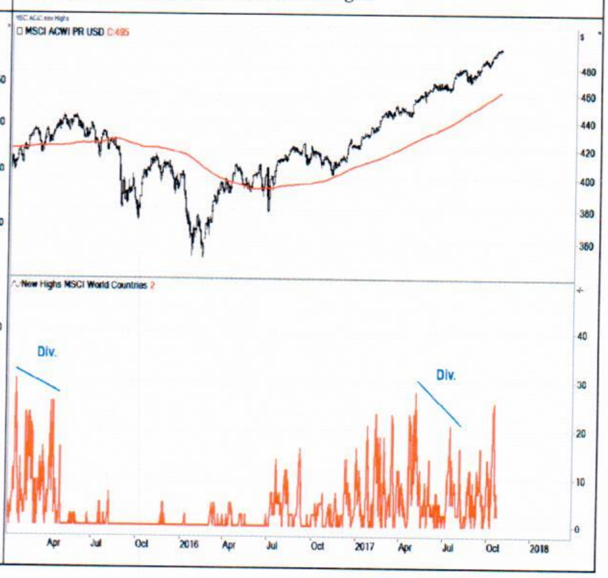
STOXX Europe 600 Stocks above 200 day moving average



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

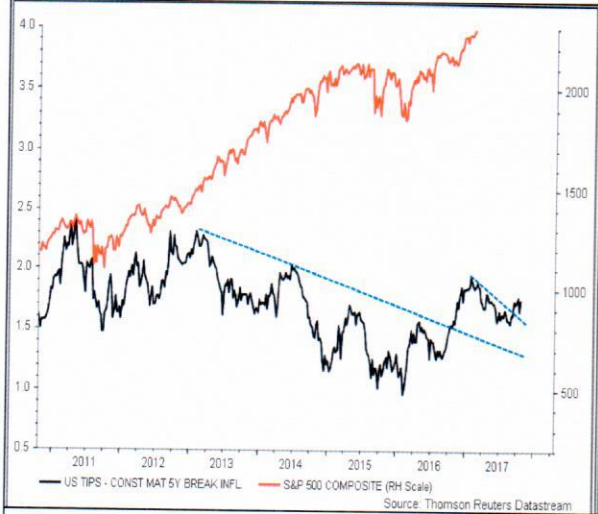


MSCI World Markets New 52-Week Highs

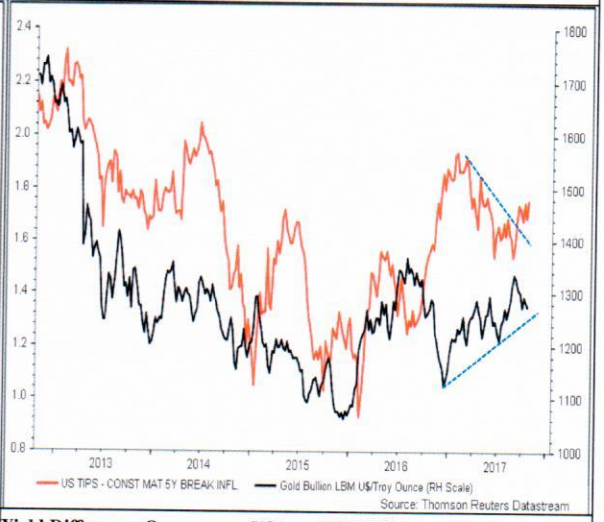


Weekly Technical Indicators: (Source: Pinnacle Data, Datastream) Charts: Tradesignal

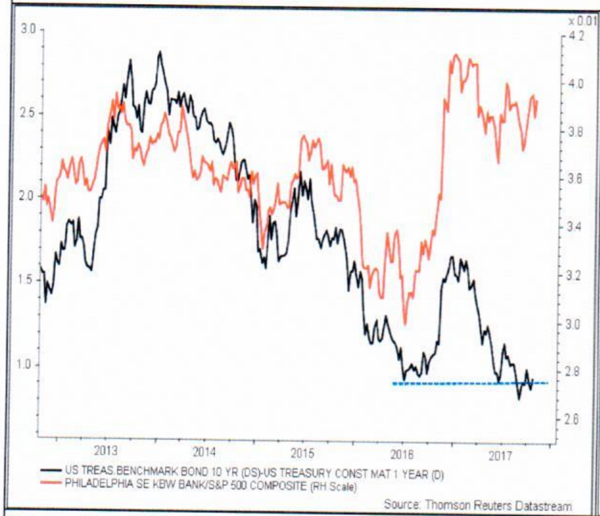
S&P 500 with Break-Even Inflation Rate



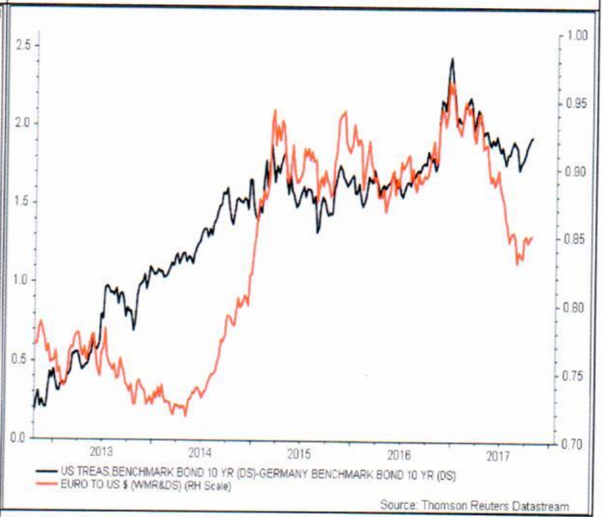
Gold with Break-Even Inflation Rate



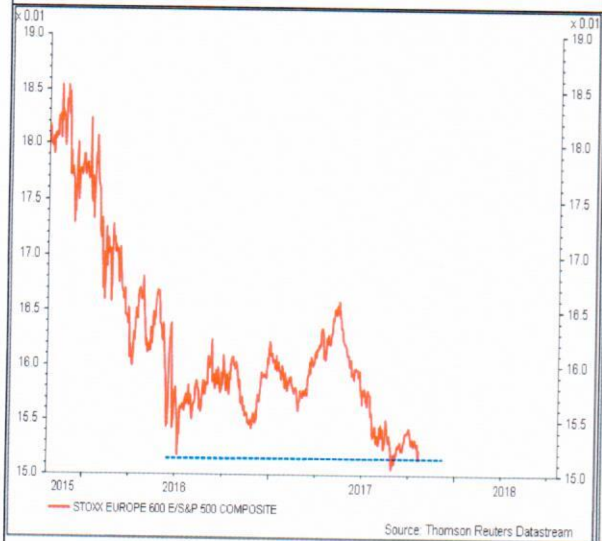
US Yield Curve versus US Bank Index (BKX)/S&P 500



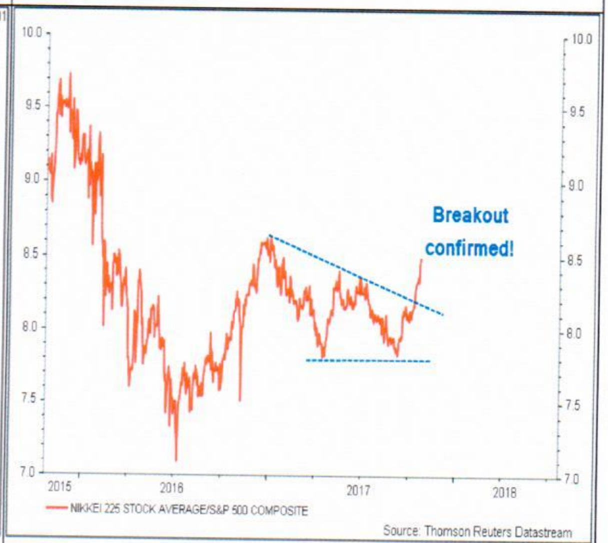
Yield Difference Germany vs USA and EURUSD



Relative Chart STOXX Europe 600 versus S&P 500



Relative Chart Nikkei 225 versus S&P 500



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