WELLINGTON SHIELDS & CO.
MEMBER NEW YORK STOCK EXCHANGE

EQUITIES PERSPECTIVE

March 2, 2018
DJIA: 24,609

They test … unless they don't. Violent declines are followed by violent rallies, and then less violent declines. The latter being the so-called "test" of the lows. Most washout or violent lows follow this script, but not all. Part of the script is that the rally from the "washout" low carries 50%-60%, which this one did. As it happens, the S&P rally carried back to the 50-day moving average, a natural resistance area and where the sharp advance did, in fact, stall for a few days. Now comes what you might call the nuanced part—last Wednesday and Thursday. A 300-point Dow rally Wednesday turned into a 160-point Dow loss at the close, seemingly a significant reversal, Fed minutes or no Fed minutes. How the market didn't follow through to the downside Thursday, we couldn't begin to guess, except the market didn't want to go down. Sometimes the market tells its own story. Friday saw a nearly 5-to-1 up day in terms of breadth, the best of the advance, and the follow-through and S&P move above the range Monday.

If a picture is worth a thousand words, to coin a phrase, that of the S&P Monday night was about as good as it gets—above the range and above the 50 day. We all started to miss Janet on Tuesday, but Powell's suggestion that rates will continue to rise should hardly have come as a surprise, especially to the tune of a 1% decline. Wednesday's 1%+ decline left the unusual pattern of back-to-back 1% up-days, followed by back-to-back 1% down days. The historical outcomes of this sequence were not good, but most occurred in bear markets. With the S&P above its 200-day moving average, this is not a bear market, so we're not inclined to take this as a major negative. It does bring the "test" back into play, but the pattern now is more than a little enigmatic. At a basic level, the upside momentum has been broken and the market is still working through stretched/overbought levels.

You could argue volume in the recovery has been suspect. While a textbook sort of worry, volume hasn't much mattered in recent years, at least when it comes to the overall market. For one thing, what volume? It was one thing when volume was NYSE volume, but these days there is more than one place to trade, not to mention options and ETFs. You might also look to margin debt or cash levels as a concern. According to the Wall Street Journal, debt as a percent of the value of stocks is above the prior peak from 2000. Meanwhile, the value of cash and free credits has dropped from 3.5% of the value of the shares to about 1.2%, the lowest in 15 years, according to SentimenTrader.com. We've long noticed these sort of macro numbers rarely seem to matter. When the market is in an uptrend, the money always seems to come from somewhere. Especially when it comes to margin debt—it's not the level that matters or an increase that matters, it's when there's a decrease that it's time to worry.

With all due respect to Madonna, it's still a Tech world. In last week's Barron's, however, Ed Yardeni made the case for Materials. It's not terribly complicated, of course—if you believe in a global synchronized economic expansion, you believe pricing power will bolster top and bottom lines. Throw in the tax cuts, possible government infrastructure spending and protection from dumping, and it all makes sense. The Materials sector is expected to have fourth-quarter earnings growth of 35%, according to the article, and expectations for the next 12 months are around 20%. The group as a whole is somewhat mixed, and this shows up in the neutral look of the Materials ETF (XLB-59). Individually, however, several charts stand out, including US Steel (46), Monsanto (123), Freeport (19), CF (42) and Eastman Chemical (100). As a group, Aerospace/Defense would still be our favorite.

These violent or washout sort of lows typically see everything rally, at least initially. Then comes the sorting. We're not surprised to see Netflix (290) and Amazon (1493) back to their highs, we are surprised to see Facebook (176) and Google (1070) lagging. That's a worry, possible regulation or whatever, it's early, but something to consider. Even more impressive could be Cisco (44) and Microsoft (93), both of which are right back without the volatility or beta of the FANGs. This is what leadership looks like. Meanwhile, if this is the much vaunted, at least by us, test of the lows, keep in mind it's not price but "selling" that matters. Even should prices go back to the lows, measures of selling should not—no 8-to-1 down days in the advance-declines, no going back to 1% of stocks above their 10-day moving average, and so on. Some time ago we predicted a trade war—just kidding. Where you're looking is never what causes problems. Like Tuesday's rate worry decline, this is just another excuse for the test.

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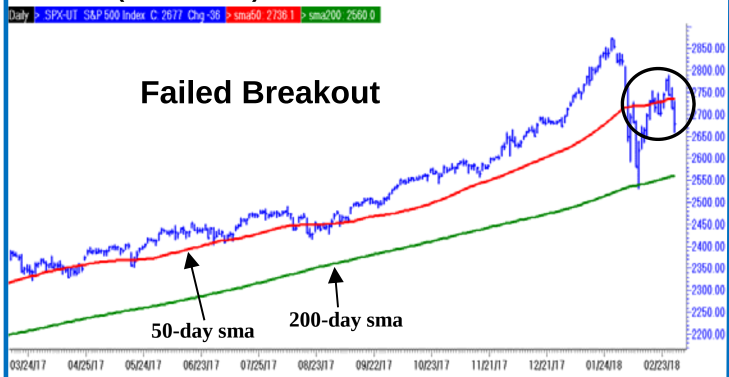
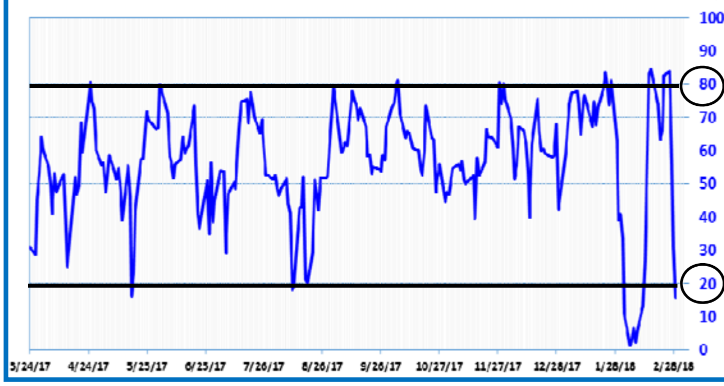
S&P 500 (SPX – 2678) – DAILY



NASDAQ 100 (NDX – 6751) – DAILY

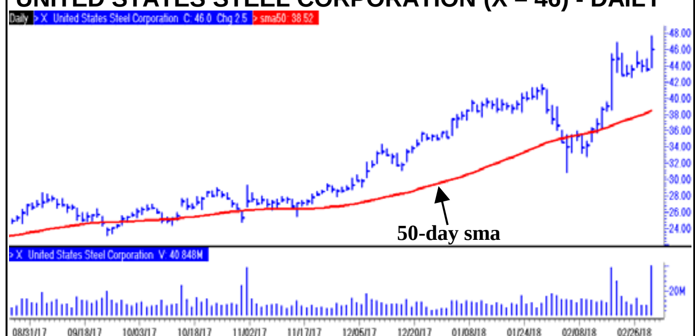
S&P 500 -% OF STOCKS ABOVE THEIR 10-DAY MA - DAILY



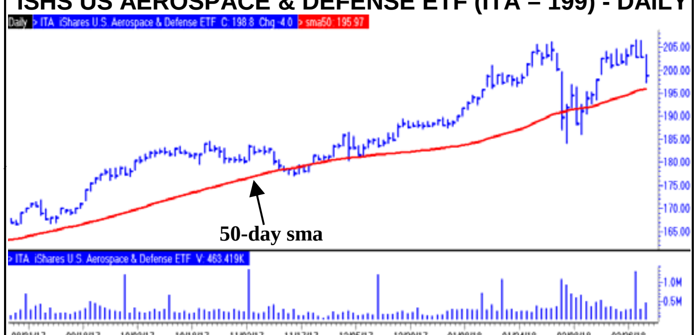
S&P 500 -% OF STOCKS ABOVE THEIR 200-DAY MA - DAILY

SPDR FUND MATERIALS (XLB – 59) - DAILY

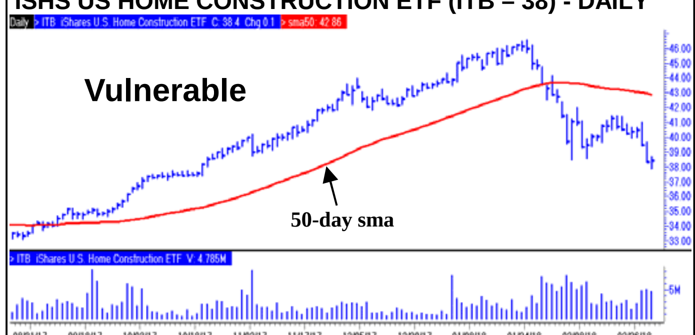
UNITED STATES STEEL CORPORATION (X – 46) - DAILY



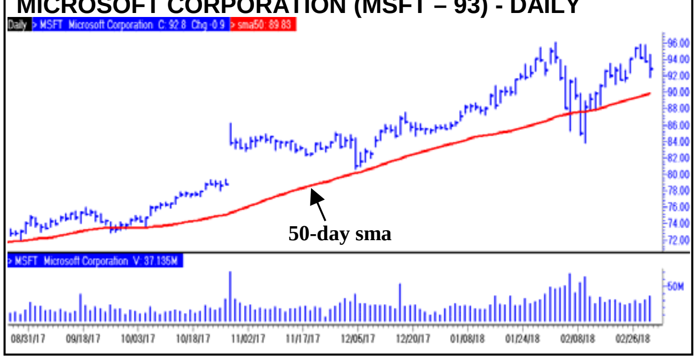
ISHS US AEROSPACE & DEFENSE ETF (ITA – 199) - DAILY



ISHS US HOME CONSTRUCTION ETF (ITB – 38) - DAILY



MICROSOFT CORPORATION (MSFT – 93) - DAILY



ALPHABET INC. (C) (GOOG – 1070) - DAILY