Hunting for a bottom in a whoosh

The sharpness of the drop over the past three weeks is breathtaking, and likely to get worse on the back of some Tech earnings releases. We anticipated a correction to relieve the excesses that were apparent in September, but the decline has been sharper than we expected as the negative momentum has taken on a life of its own. Clearly, we were overly optimistic regarding the market impact of worsening trade and interest rate battles, and history suggests the technical damage will take time to repair.

Should close week as oversold as 2016 market lows. Unfortunately, the three main fundamental reasons for the decline that we underestimated are still not close to resolution: the US mid-term election isn’t until November 6, President Trump has put the Fed in a no-win situation, and the threat of trade war escalation with China is having an important impact on forward growth expectations. That means the only factor that could generate any kind of stabilization is when the market gets oversold enough, and judging by the futures, our indicators should close out the week at extreme oversold levels that rival the 2016 market lows.

The whoosh lower is going to confirm our favored intermediate-term indicator is at an oversold extreme. Obviously, we are in a market that is going to go lower as it hunts for a bottom, but when the 14-week stochastic for the SPX reaches this oversold on a weekly basis, it typically surrounds the close proximity to an intermediate-term low (Figure 1). Again, it isn’t meant to be a bottom tick signal (obviously), but as painful as the market melt has become, it suggests further weakness should be made up in a bounce in coming weeks/months.

Figure 1: Our favorite oversold indicator reaching early 2016 levels
The market lacks a catalyst, which leaves “oversold” as the only reason to hit a near-term bottom. There are three catalysts that could lift stocks from the current rout: (1) Republicans hold the Senate in the mid-term election, (2) the Fed adopts a more dovish “data driven” stance, and (3) there is a resolution to the Chinese trade situation. Since none of these appear imminent, the bottoming process is going to feel awful – like it always does. According to our partner Jason Goepfert at Sundial, when not in a recessionary environment, it takes a median 71 days to regain new high ground following a 9% correction, which pushes out our S&P 500 (SPX) 3,200 target into next year. There are many macro themes and geopolitical risks that could explain the correction, but ultimately, we believe it came from excessive optimism, historically low volatility, and an extreme overbought condition. These conditions have been relieved, our positive fundamental thesis remains in place, and our key tactical indicators are at levels that suggest proximity to an intermediate-term low.
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Date and time of first dissemination: October 26, 2018, 06:32 ET
Date and time of production: October 26, 2018, 06:32 ET

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<th>IB Clients</th>
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*Total includes stocks that are Under Review

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