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The FRED Report – Monthly Review

Monthly Research Piece: The Efficacy of Indexation — A Case Study
by S-Network Global Indexes

Key			
Positive	Negative	Neutral	Highlight
↑	↓	↔	Change

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Summary of Monthly Piece

ASSET CLASSES:

STOCKS:

Rating the Three Market Principles:
As readers know, we break the stock market down into three basic market principles: (a) Sentiment, (b) Internal Momentum, and (c) External Momentum. I will review these here.

Sentiment: *We use two indicators to measure sentiment. These are options activity and certain sentiment polls. For options, we use total CBOE volume and take the figure directly from the CBOE website. For our sentiment poll numbers, we prefer using % Bears from Investors Intelligence. We use only the % Bear's number because, in our opinion, the bears almost always act. It is rare to find a complacent bear. Sentiment is what we call a "Condition Indicator". By this, we mean it has nothing to do with timing trades – rather it is part of the overall mosaic of market activity.*

Our current reading of the sentiment indicators is NEGATIVE. %Bears is falling off again, and after less of a rally than the last correction. The indicator rose a bit since last November, but not enough for us, and current data is weakening again. The Put/Call indicator is negative as well. In January, it was in areas marking major bottoms, but it has weakened since – it is now in sell territory once again. **We rate sentiment negative here because the intermediate sentiment indicator did not advance much during the correction and Put/Call has moved back into sell territory after a big spike at the end of 2018. %Bears may indicate long-term complacency, a big negative here. Put/Call is also showing some complacency.**

Internal Momentum: *We use several Breadth indicators to measure internal momentum. We publish three indicators in this Monthly Review: The McClellan Oscillator, an Indicator of New Highs on the NYSE vs. New Lows, and our own breadth oscillator – called **Fred's Breadth Oscillator**, or FBO. The McClellan gives great trading signals, while the last two are also "Condition Indicators".*

Our current reading of the internal momentum indicators is NEUTRAL. The daily FBO made new highs and is pulling back. It has hit bear parameters suggesting a retest is possible. It has given strong buy signals and is now short term neutral. The weekly FBO remains in a downtrend in spite of all the breadth, so the next pullback will be interesting. The McClellan Oscillator also hit bear market parameters, before giving a breadth surge. New Highs/New Lows hit the lowest level since 2008, suggesting more downside is possible after this oversold rebound. This indicator has improved, but still has some caution flags. This combined picture from these indicators could change but until it does, it is neutral to negative intermediate-term, implying caution until we see the first pullback. Rather confusing and we will discuss on Thursday's call.

External Momentum: *We use several price indicators to measure this, and these are primarily tactical indicators. We use the 5 and 20 period moving averages, and a simple crossover to determine trend. We use Stochastics, another standard indicator, to measure overbought/oversold levels, or as we prefer to consider them, areas of risk and reward. The one criticism of Stochastics is that they are too sensitive, so we also have our own Price Oscillator we publish, called **Fred's Price Oscillator, or the FPO**.*

Summary of Monthly Piece…. continued

Our current rating of the External Momentum indicators is NEUTRAL. Weekly indicators have advanced and most are now overbought. Monthly and Quarterly indicators are neutral, as the extreme oversold is resolved. We recommended buying attractive units in the last monthly, and the prudent thing for advisors to do is continue to add money, but with the realization that prices could come down again – buy stuff you like but be prepared to add on a pullback.

CONCLUSION: SPY is rallying in the first part of 2019, per our yearly forecast, and indicators are short-term overbought. The rally has been very strong in terms of breadth, a plus, but weekly indicators are still in downtrends despite the breadth surge readings on the daily indicators. The market resolved the oversold conditions on this rally. As of now, we are prepared for another decline that should complete a bottoming formation – but advisors have some good investments at attractive prices.

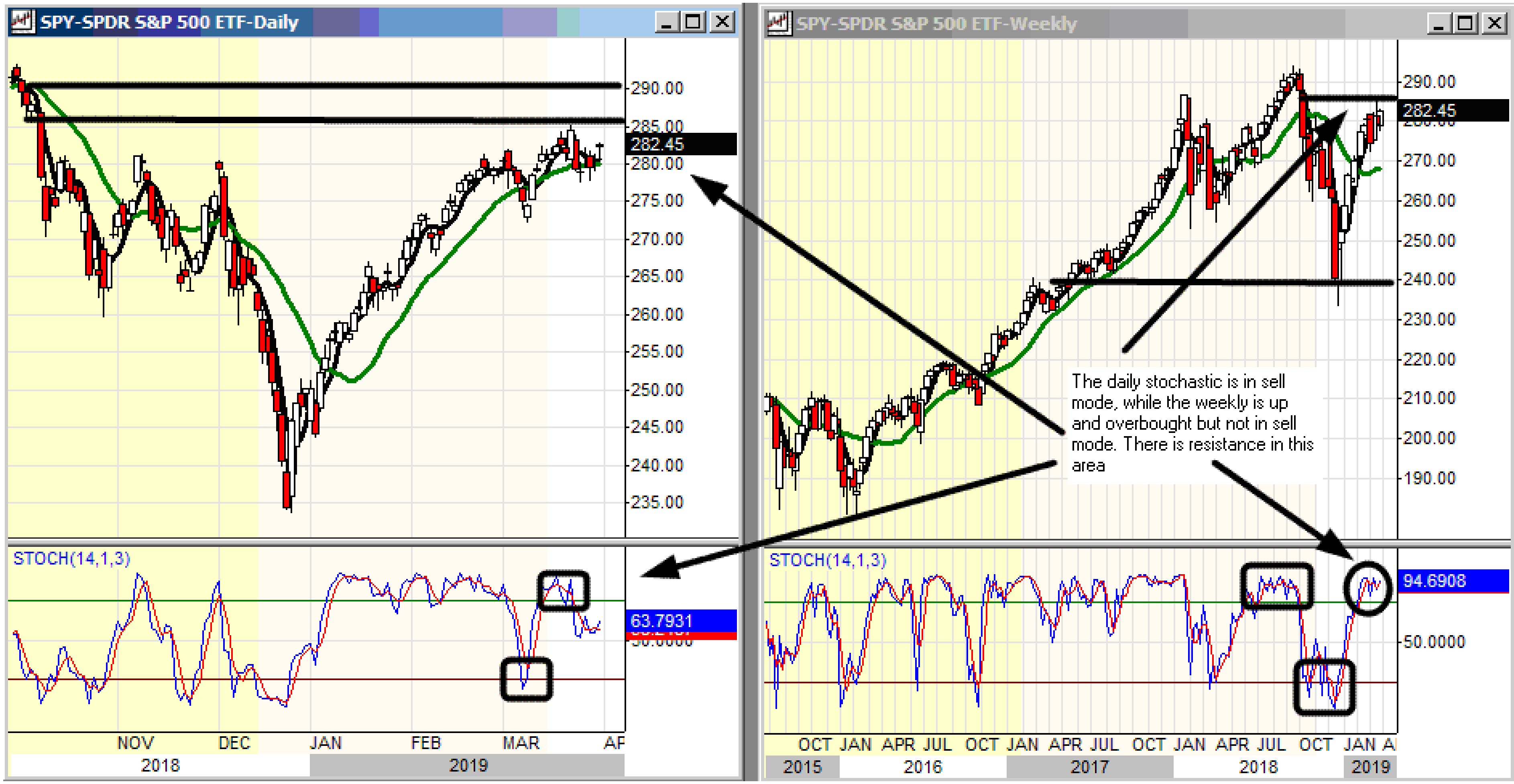
FIXED INCOME: TLT has rallied sharply but is still not a breakout. Below 122 should end the rally. LQD has rallied as well. HYG and various junk bond ETFs rallied to resistance. We continue to be cautious on bonds, and use alternatives such as PCEF, VRP, CWB, and dividend stock ETFs. After this rally, we will expect a move to 105 on TLT. The next drop on TLT should test our target area of 105, after which little may happen. Accumulation models improved and the next drop in TLT should be the last for a while. If 105 is tested, that should be the end of the correction for a while. Watch TYX, as it could lead TLT in 2019.

COMMODITIES:
Commodities, especially oil, have bottoming signs, and are in resistance. GLD hit our 126 target and has started to sell off. Industrial metals (DBB) have pulled back, but from high levels. Our favorite broad-based Commodity Index ETF, DBC, has rallied into the first quarter of 2019. Targets are 18. Watch Oil via USO and DBC carefully. These could suggest a rally in the oil stocks. There are short-term bottoms in place on oil and DBC, but we are entering a period of seasonal weakness on oil – consolidation is possible.

INTERNATIONAL:
International markets are interesting. Emerging markets have tested our downside targets and have bottoming indications that may take several more months to be fully realized. Developed markets now look weaker than emerging markets, and our biggest fundamental concern is the German banking system. The Dollar Index (DX#F or UUP) may surprise us with a rally in the first part of 2019. The Yen has started to build a base. The big risk in currencies is more upside in the Dollar if European financials have trouble, as that would hit the Euro. FXE could then test 105, where we would buy it. The trade news has been disconcerting but should improve in 2019. This may be "baked" in, however. We could see a "sell on the news" decline.

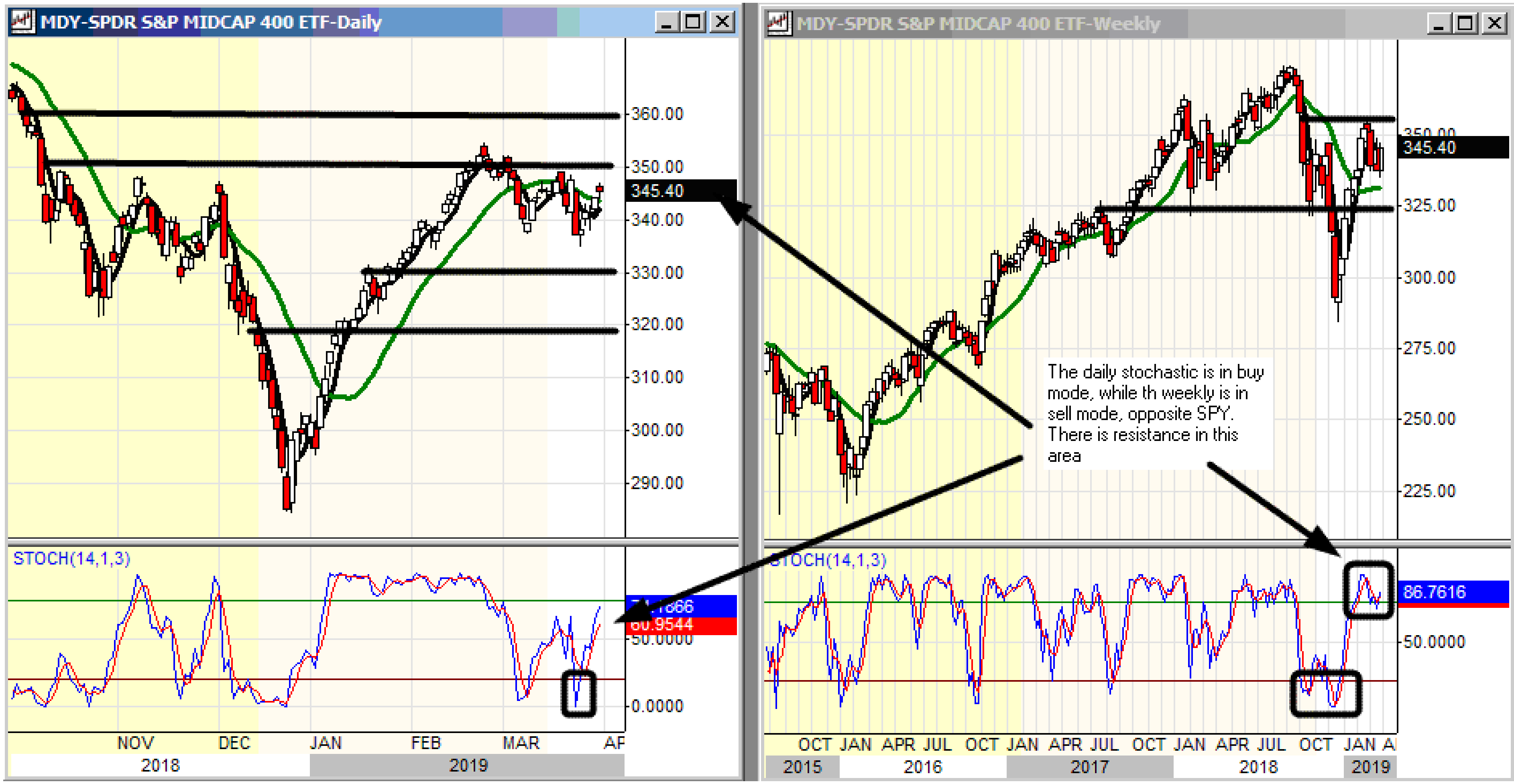
SECTORS:
We are overweight XLF, and XLV. These still have strong accumulation models. **We are underweight XLP and IYZ,** which hit downside targets for 2018 but remains an underperformer. XLP is a range. XLRE has strong accumulation models and broke out to the upside – we are an Equal Weight. IYW is everybody's favorite overweight, but we are seeing some key stock weakness – New leadership is needed and is showing up. XLB has weakened and we are an Equal Weight. XLI still has strong accumulation, but price is lagging. We continue to hold investment positions. Two long-term equity trend systems are positive and two negative suggesting a neutral stance. XLU has broken out, and is outperforming fixed income, per our report on this. This does NOT mean that dividend stocks will outperform the equity markets, however. XLP rallied back to resistance and failed. We are an underweight, as this may be a range for the first part of 2019. Oil declined more than expected, XLE broke through the bottom of the trading range, and the rally back has been weaker than we would like to see.

Market Review: Price Charts – SPY – SP 500 ETF



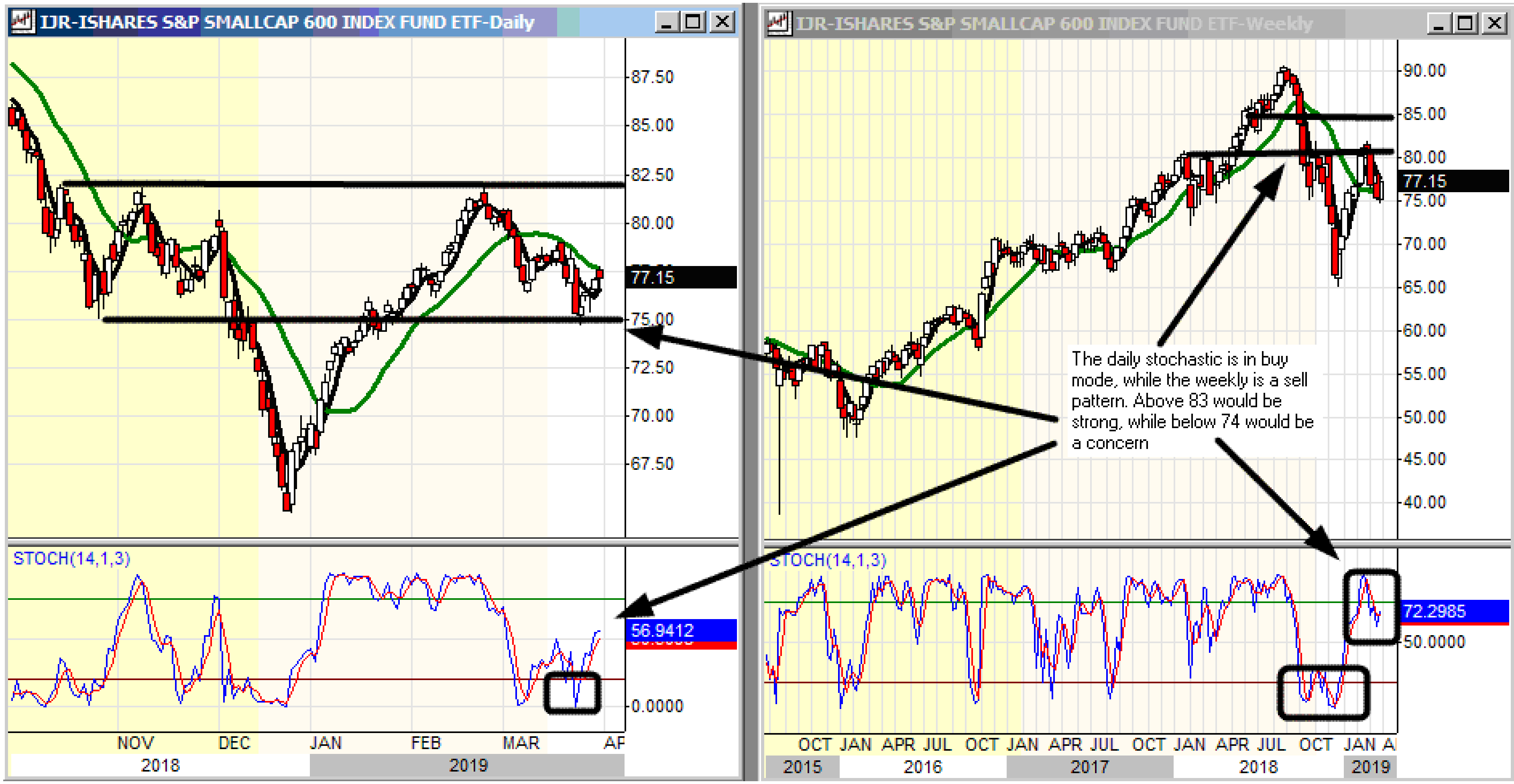
SPY has rallied up to 280 to 285 resistance: SPY rallied off the lows and has corrected the deeply oversold condition we noted at the beginning of January. The weekly stochastic and other indicators are overbought but have not given sell indications. Traders have sold positions, while we maintain investment positions, and continue to add stocks that look attractive. The reason for this is that not all stocks will retest the lows or pull back much when and if a retest occurs. Trend systems are neutral, with SPY positive but IYT and IJR negative. This suggests buying in large cap stocks, and we will watch indicators on those indexes for trading signals.

Market Review: Price Charts – MDY – MidCap SPDRS ETF



MDY is now slightly weaker than Large Cap, based on the stochastics: MDY has a daily stochastic buy, while SPY is in sell mode. The weekly is opposite as well. Small Cap is still weaker than all other indexes and has negative trend systems. MDY could retest 325 intermediate support, and although the rally from January's low has been strong there are signs of weakness now. MDY should hold 325 on a pullback from this area, although a retest of 290 remains possible. We would be a bit cautious on this ETF, more so than on SPY at this time.

Market Review: Price Charts – IJR – IShares S&P SmallCap 600 Index ETF

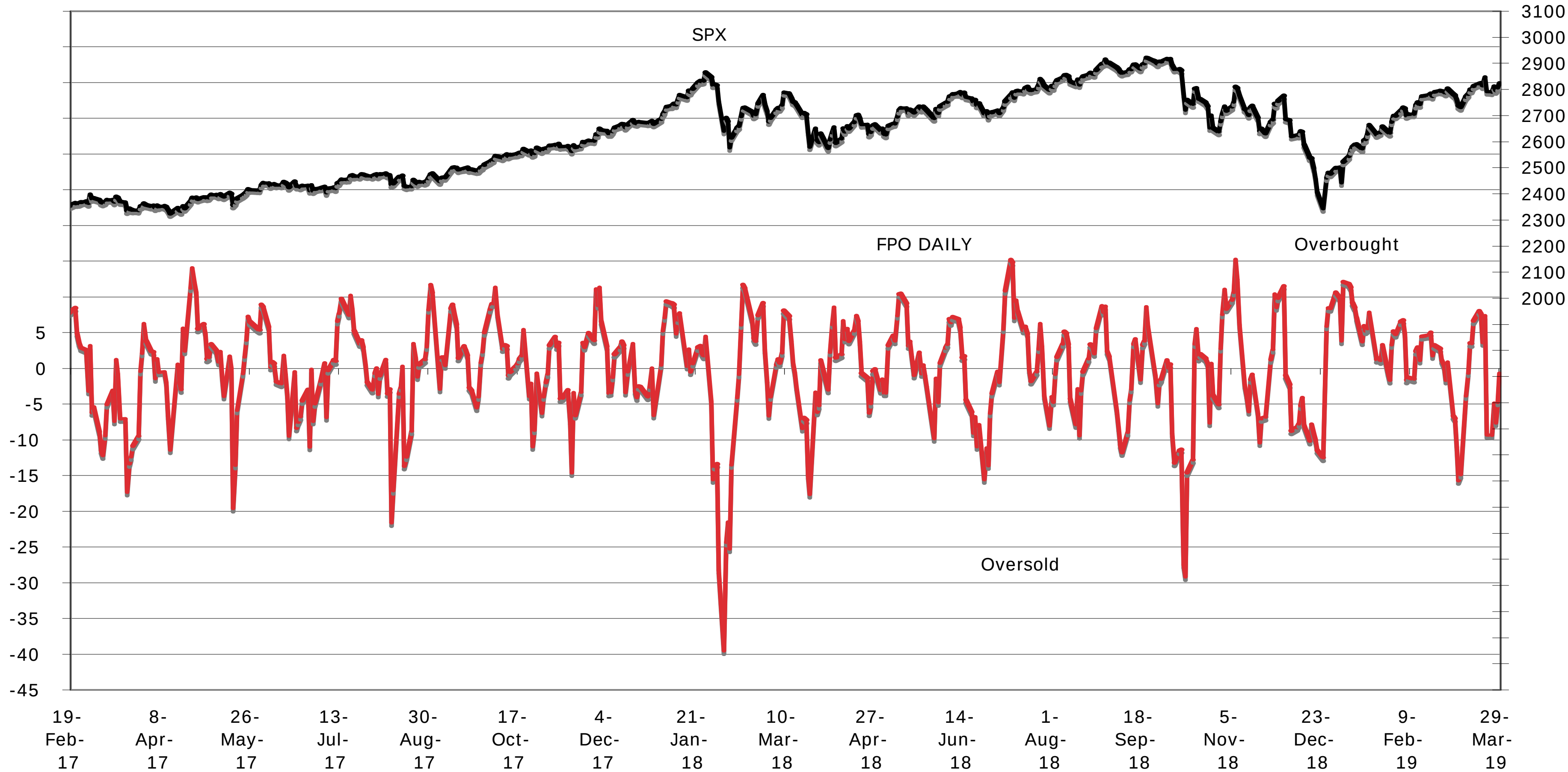


The Small Cap ETF has rallied to a resistance area: Stochastics are mixed, with a daily buy signal, and a weekly sell. Long-term trend systems remain negative on IJR, so there should be relative under performance at least. The weekly low around 75 must hold, otherwise this could test back to 70 or even 65. A breakout above 83 would suggest this is a Head and Shoulders bottom that is breaking out on the upside. This is an inconclusive pattern, but the long-term trend system went negative in summer 2015, before the last election

Market Review: Price Charts – IYT – Transportation

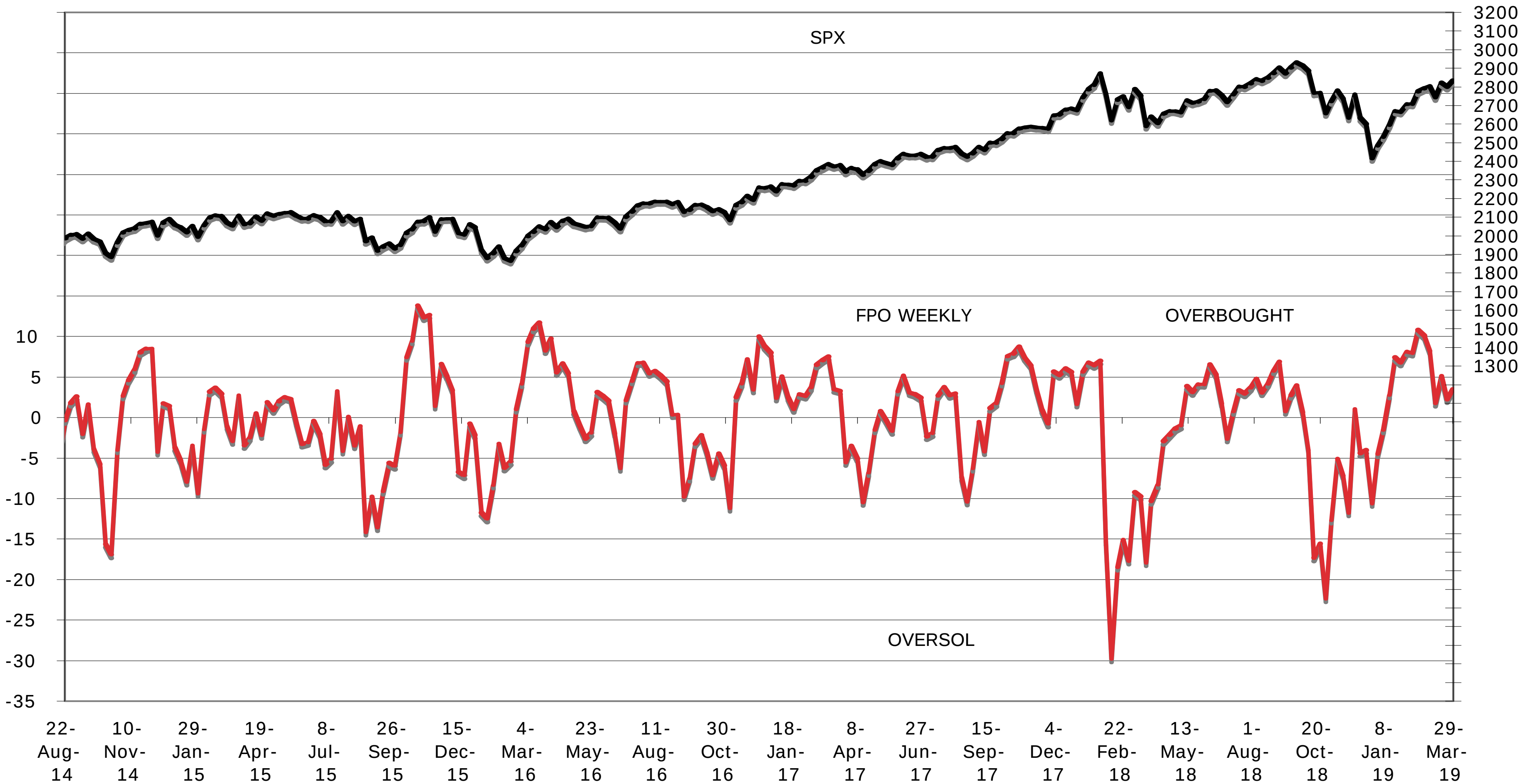
<u>IYT broke 180, and while it has moved back above it, it is weaker than the broader averages:</u> This index is our favorite measure of economic strength. IYT was trading slightly better than the popular averages – but now is trading slightly worse than SPY. IYT went below 180, then 170, breaking support, and while it moved back above these areas, there are concerns. We prefer to see robust leadership in the Transportations, so if these resume their lead 2019 it will be a strong indication. So far, they are trading a bit weaker. This index is one of the reasons we are being a bit defensive here. The Trend System on IYT is negative. Like IJR, this went negative in 2015.

Market Review: Price Charts - Daily - Fred's Price Oscillator



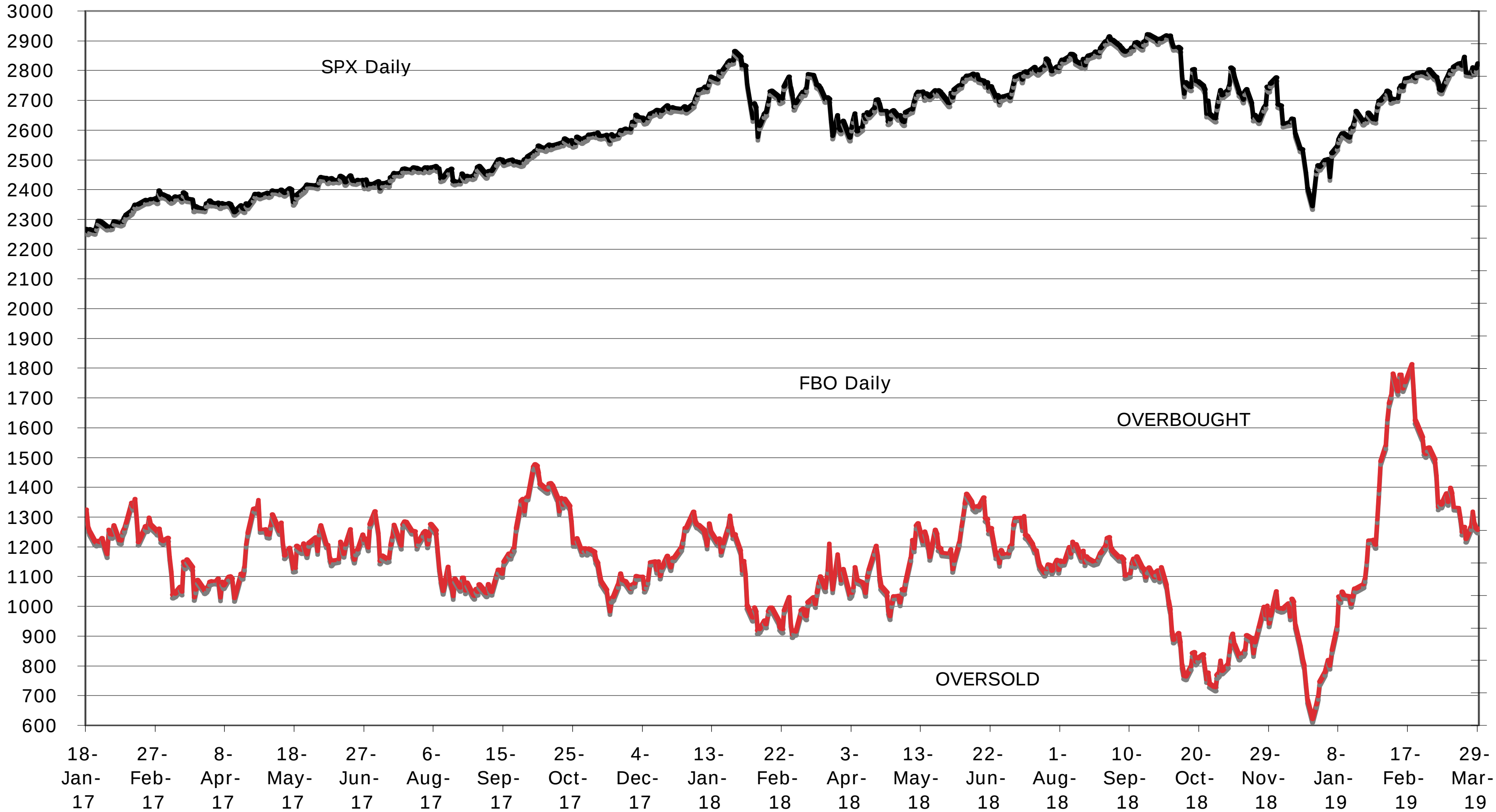
The daily FPO is in buy mode: This indicator has given a slight buy signal, suggesting some upside from this area. Trend Systems on SPY remain positive so this could challenge resistance in the 290 area, but unless IJR, MDY, and IYT start to go this will be vulnerable if it becomes overbought.

Market Review: Price Charts – Weekly – Fred's Price Oscillator



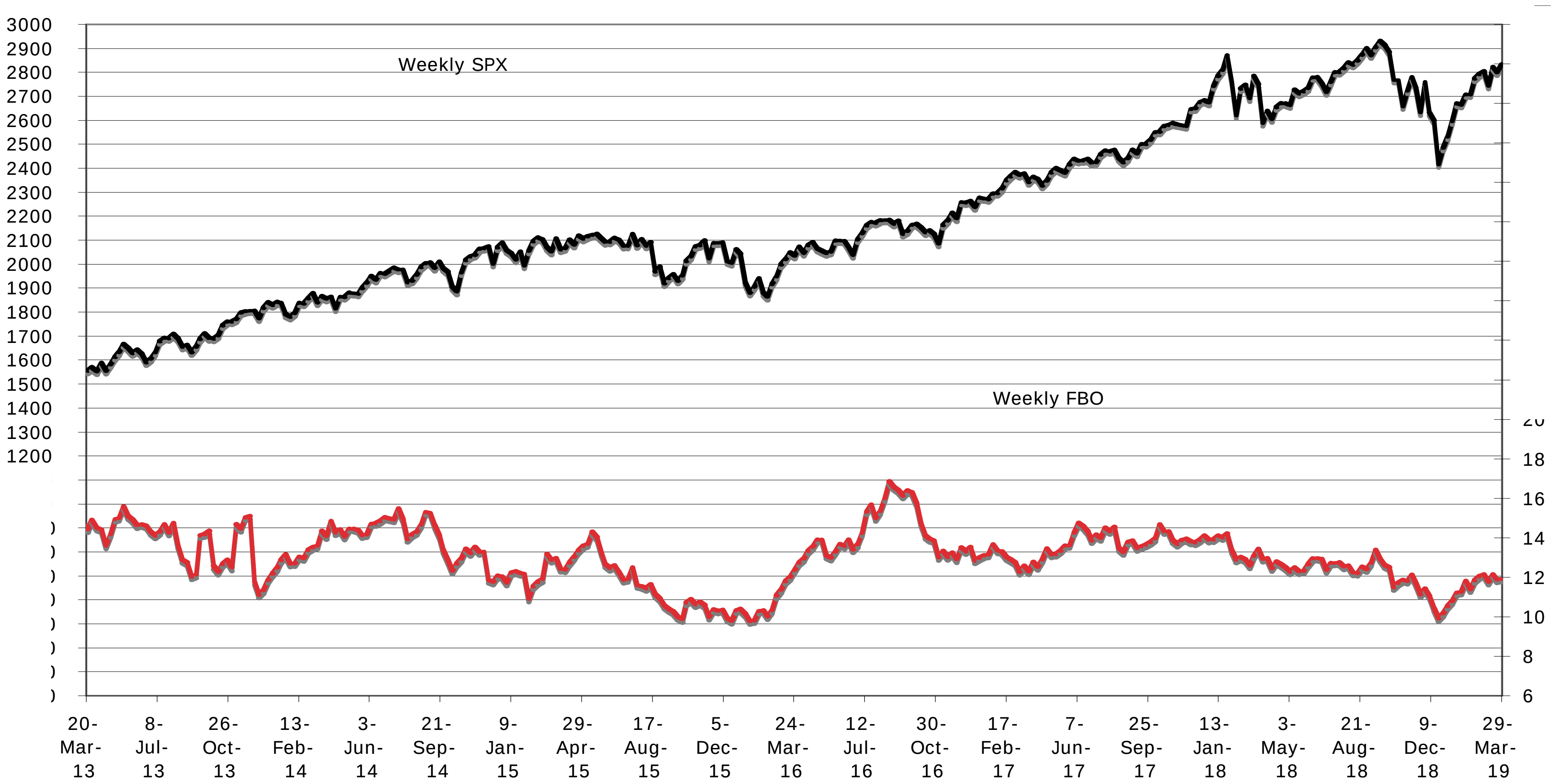
The Weekly FPO pulled back to -20, which set up a divergence for a rally: The weekly FPO pulled back enough to set up a multi-month advance. The rally has progressed from January into April. After this rally, we should see another pullback that could test the low of this move. This is not necessarily negative for the year but implies a bit more choppiness after this rally ends. The large caps are trading much better than smaller caps, and this indicator is neutral to positive, but with concerns as this rally ends.

Market Review: Internal Momentum – Daily Fred's Breadth Oscillator



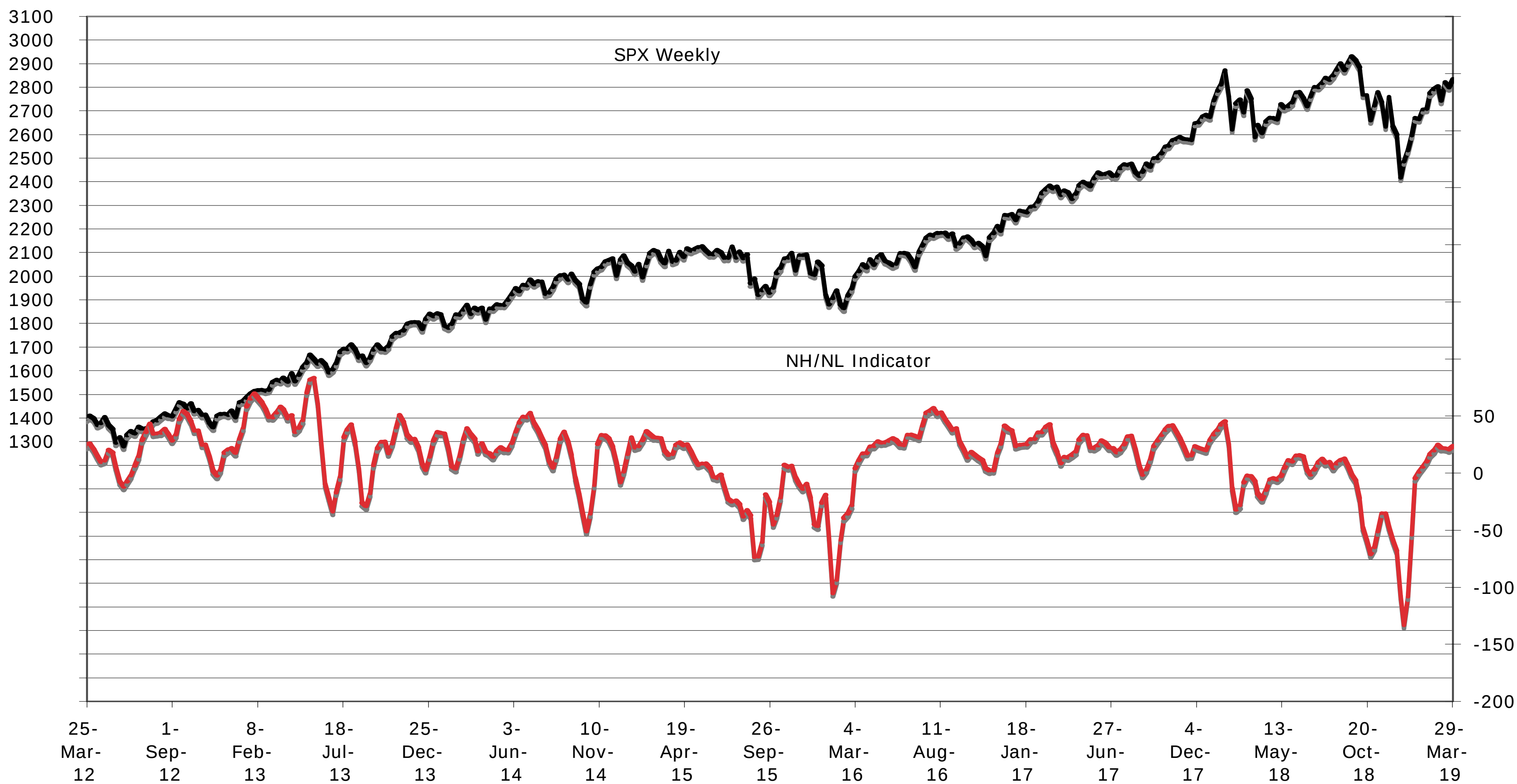
The daily FBO hit new 2-year lows but rallied strongly since: The daily FBO became oversold, worse than after the 2016 correction. That level is consistent with where the market bottomed in 2016 just before the election. This suggests a good bit of upside was possible from the low, and that has occurred. The current rally suggests higher highs after a pullback, so the message from shorter-term breadth indicators is complex. Some caution is in order now, and we'll watch the first pullback.

Market Review: Internal Momentum – Weekly Fred's Breadth Oscillator



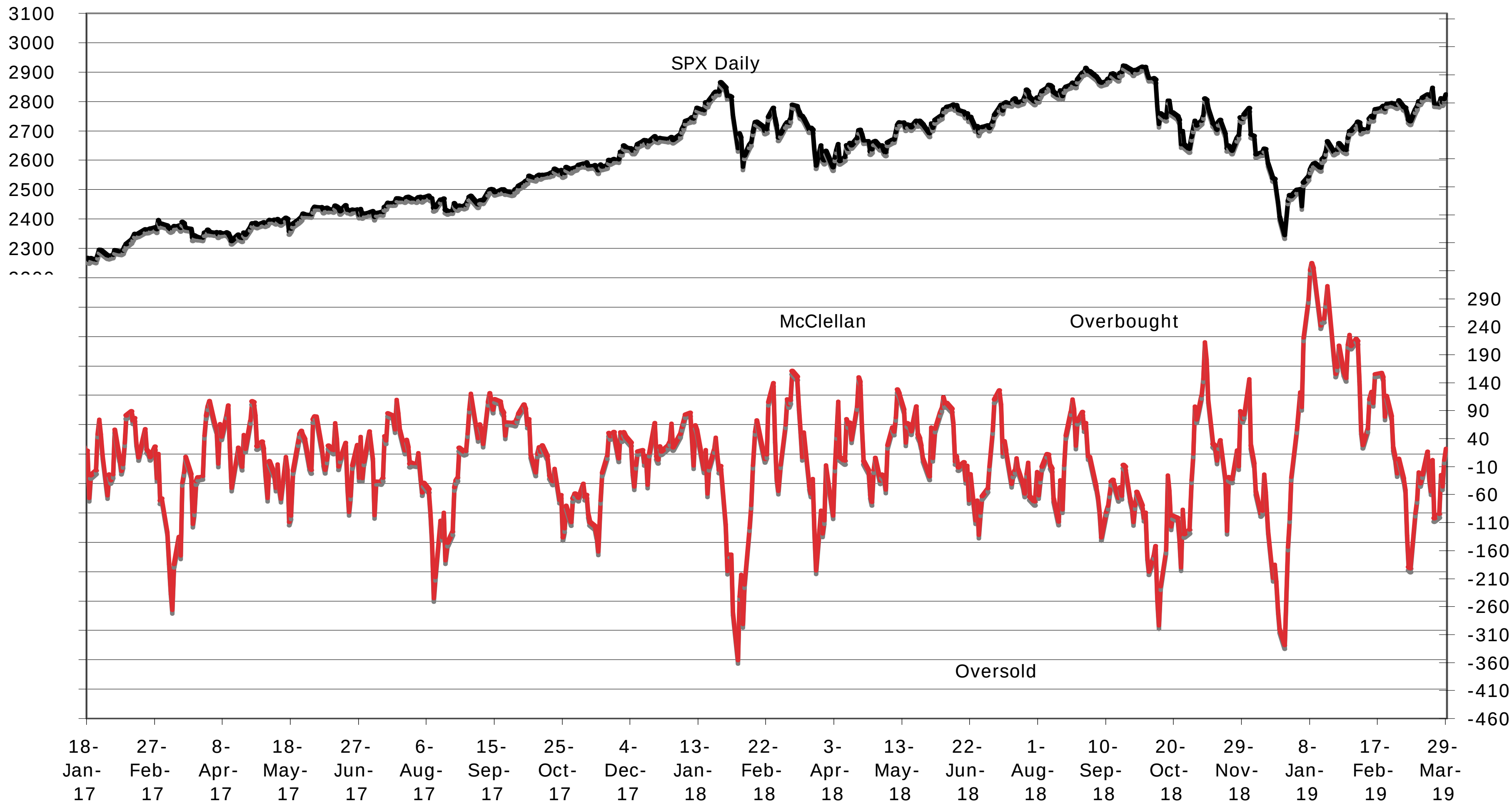
<u>The Intermediate FBO remains negative</u>: Weekly breadth momentum is still lagging –it is still a downtrend in spite of recent strength. Notice that price retested the last time these levels were struck in 2015, 2016 - this is part of a bottoming process but does not preclude a retest. When combined with New Highs/New Lows, this suggests problems after this rally. Caution flags are out, and traders should be defensive, but the environment still is attractive for investors.

Market Review: Internal Momentum – Fred's New Highs/New Lows Indicator



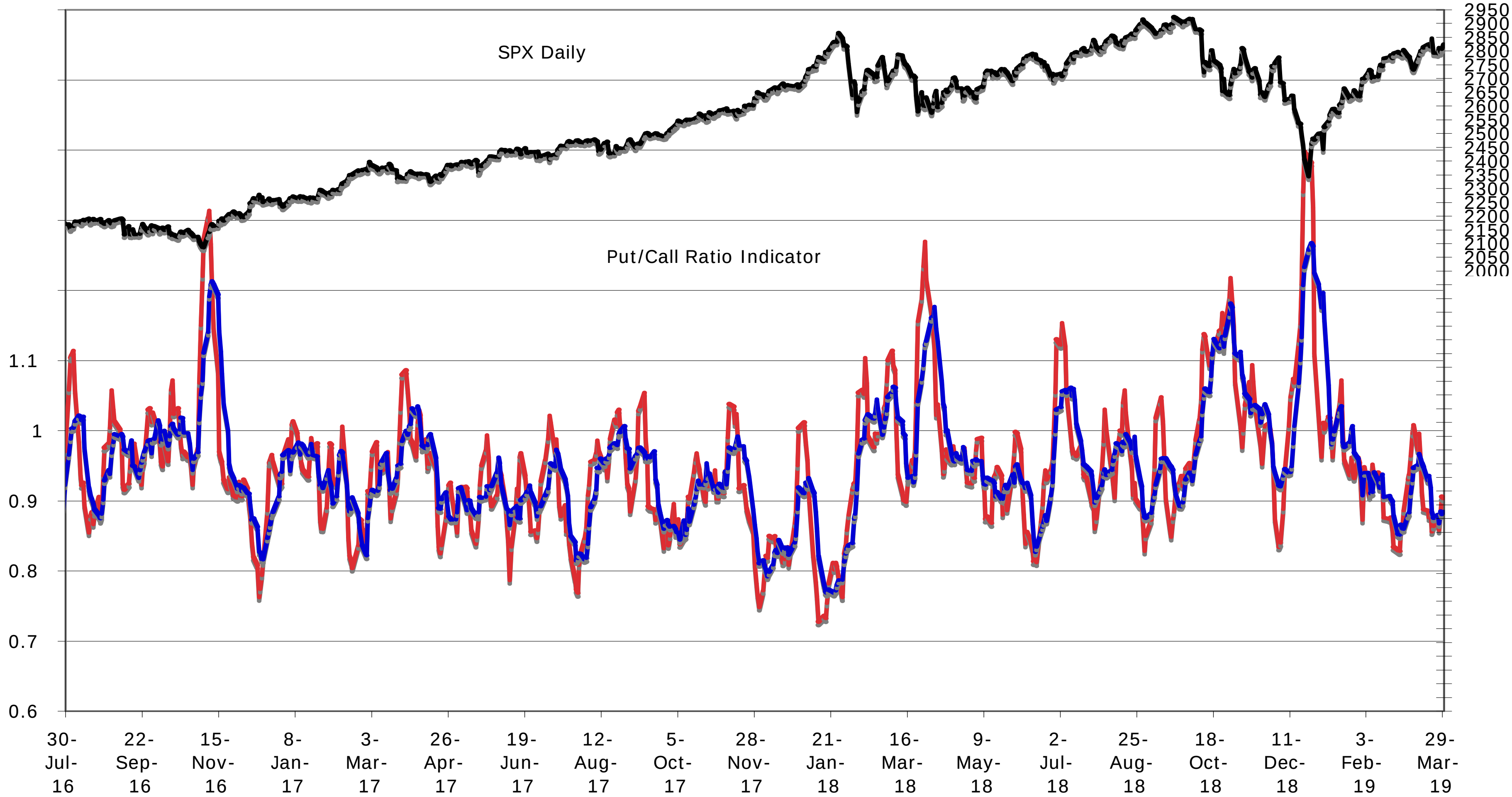
New Highs/New Lows has had a substantial rebound: This tool measures the difference between the amount of new highs and new lows on the NYSE. It fell off as the market corrected in February, after beginning to weaken before this last correction started. Remember that this is a leading indicator that often goes negative first. NH/NL hit October 2008 levels, consistent with a bottoming pattern that lasts for several months, which would include a strong rally, which we have had. Now, a pullback could occur. Daily new lows are expanding once again, a concern.

Market Review: Internal Momentum – McClellan Oscillator



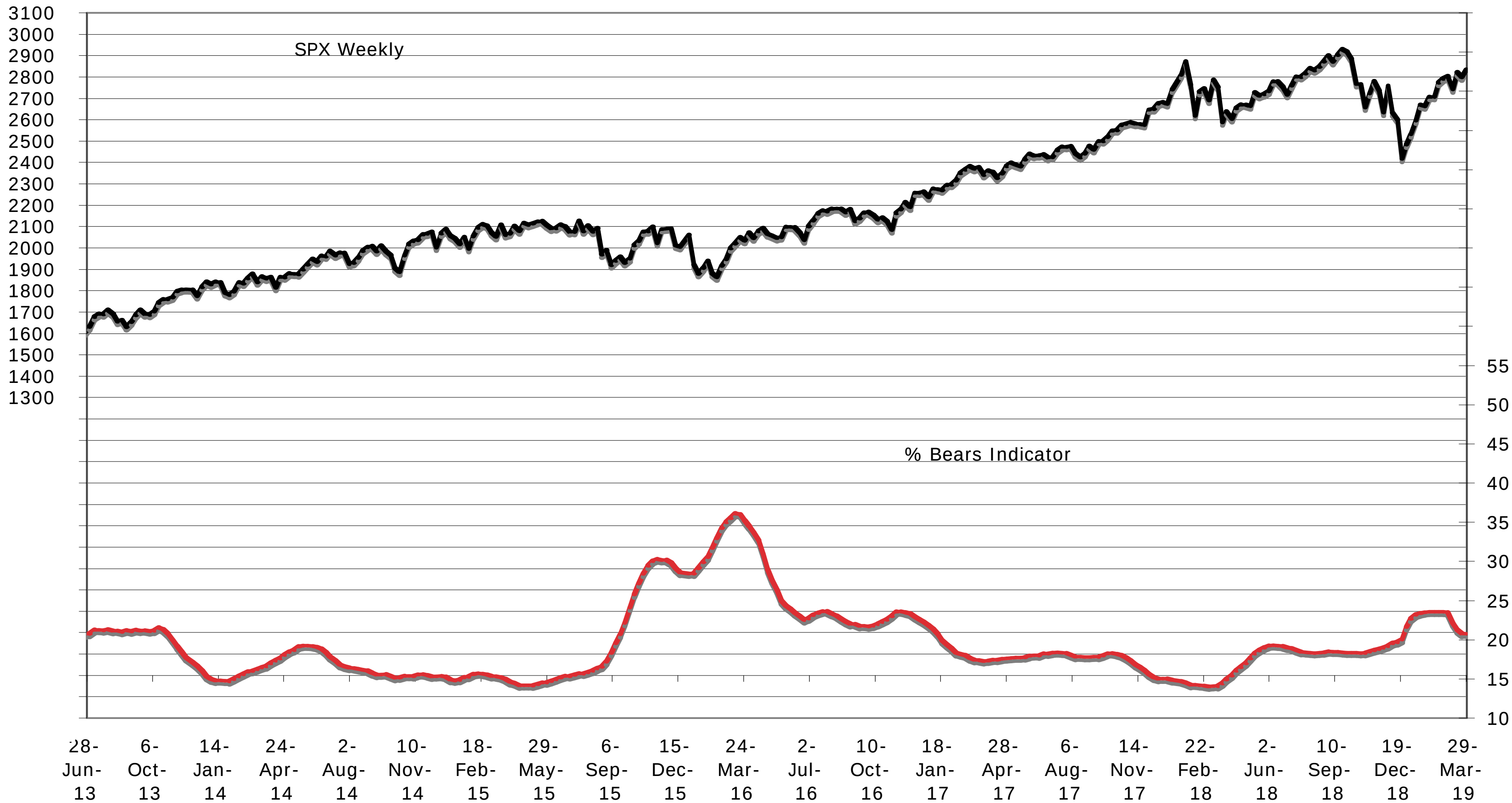
<u>The McClellan Oscillator made two-year highs, before moving below -300</u>: The McClellan has been confusing, suggesting both a rally and more decline. Much below -300 suggests a complex bottom with a divergence, not unlike what happened in February 2018. Now it has given another surge to multiyear highs. Breadth tools in this report suggested an advance for the first part of 2019 (which is happening), followed by more correction and pullback. We will watch for the next sell signal on this indicator, which is a short-term bottom again. This is unusual!

Market Review: Sentiment – Put/Call Ratio



The Put/Call ratio has moved into slight sell territory: Sentiment indicators are "condition" indicators for us, and not timing tools. Put/Call is more of a short-term indicator. This indicator suggested a rally should occur but did not preclude a complex bottom. See the spike up in October 2015 as an example of this. Note that this has already moved into sell territory. Right now, my sentiment tools suggest complacency. Put/Call has had some extremes of late, and this is not a serious sell, but it does suggest some caution.

Market Review: Sentiment – Investors Intelligence % Bears Indicator (moving averages)



Investor's Intelligence %Bears indicator is still weak long-term: This indicator has had a rise as market behavior turned negative last year, but the rise has been less, and it still suggests caution intermediate-term. The pattern in 2015 is what usually happens at major bottoms, and %Bears did not move up earlier in 2018. While it has had a rise, this has been less than robust, and recent data suggest a downturn in the indicator is starting. Ideal is to see the market advance, and %Bears rise on that advance. While this happened, the data is weakening already, a concern. Overall, the indicator still suggests complacency and complacency can bring surprises.

Other Markets: Bonds – TLT – iShares Barclays 20+ Year Treasury Bond

The TLT has approached resistance in the 127 to 128 area: TLT has continued to advance and is stronger than we expected. Indicators such as accumulation models are suggesting 2016 was a major peak in bonds but the models have suggested TLT consolidate. Last month, we thought TLT could rally to test 120 or so and it has exceeded this but should not exceed 127. There has been a monthly stochastic buy signal on this and it is now overbought but not in sell mode. A break of 122 would tend to confirm this advance is over, and target 118. Below that would target the 112-area. This could go into a range but note the pattern on this is one of consistent lower highs and lows since 2016.

Other Markets: Bonds – BWX – SPDR Barclays Capital Intl Treasury Bond

<u>The BWX held 27-area support</u>: BWX broke the 27-area support and revalidated this, but not by much, as of this writing. The first weekly stochastic buy failed, but the second produced a rally. Now, the weekly is in sell mode, once again. The intermediate trend remains up as long as BWX is above 27. See FXE (p. 22) as it weakened. Further dollar strength in 2019 is a concern, and we continue to watch for a surprise rally in the dollar, though. This could have a difficult summer.

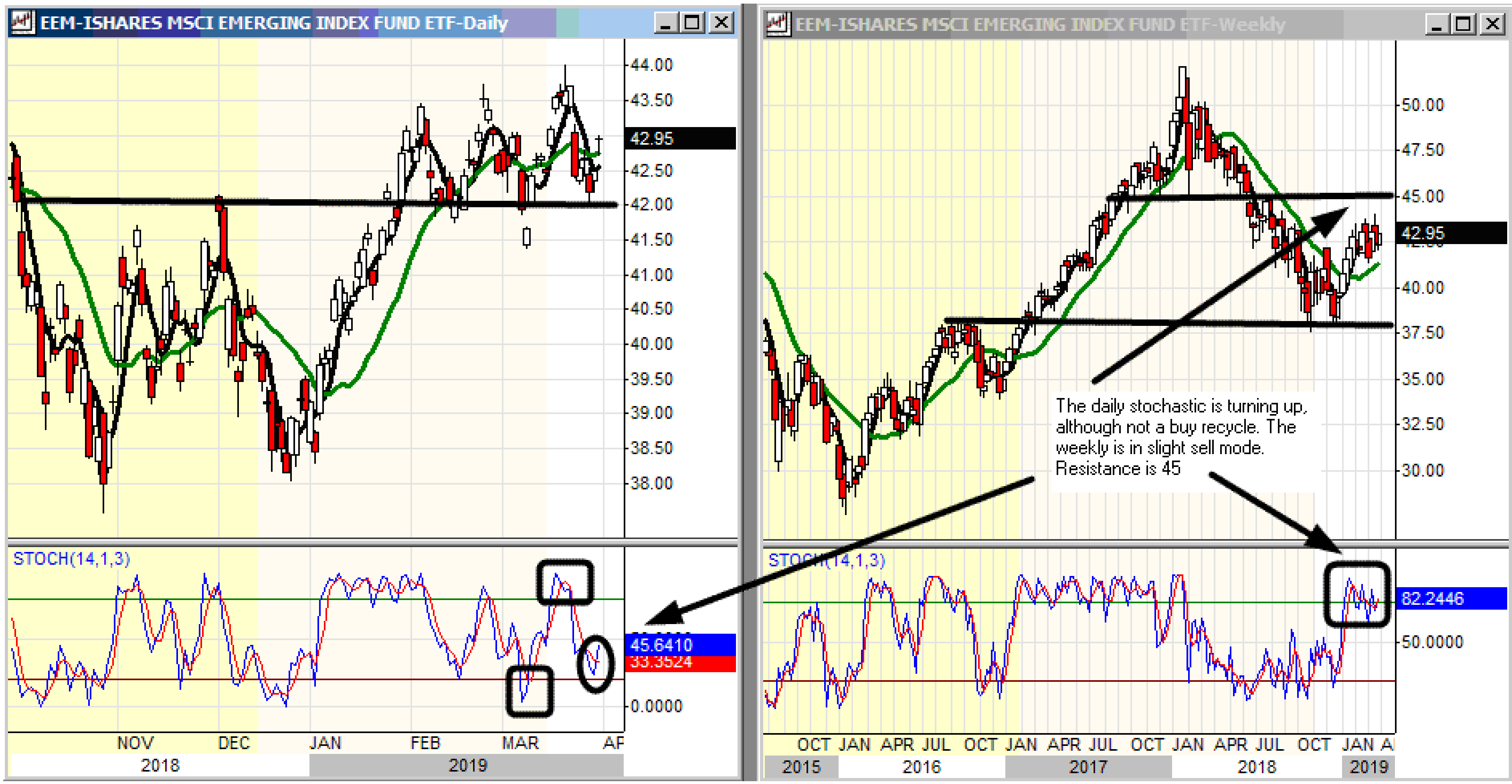
Other Markets: Bonds – LQD – iShares iBoxx $ Invest Grade Corp Bond

The Corporate Bond ETF rallied with TLT and could test 120 or so: LQD broke the 116 area in August, confirming greater weakness than TLT. The last rally attempt exceeded 116. It is interesting that this did not gap up along with TLT, suggesting the latter was in "flight to quality mode". This continues to advance and is challenging 120. Support is now 116, and this could be a 116 to 120 range. Our concern for 2019 is still a stronger than anticipated economy, and a rate rise later in 2019.

Other Markets: Bonds – HYG – iShares iBoxx $ High Yield Corp Bond

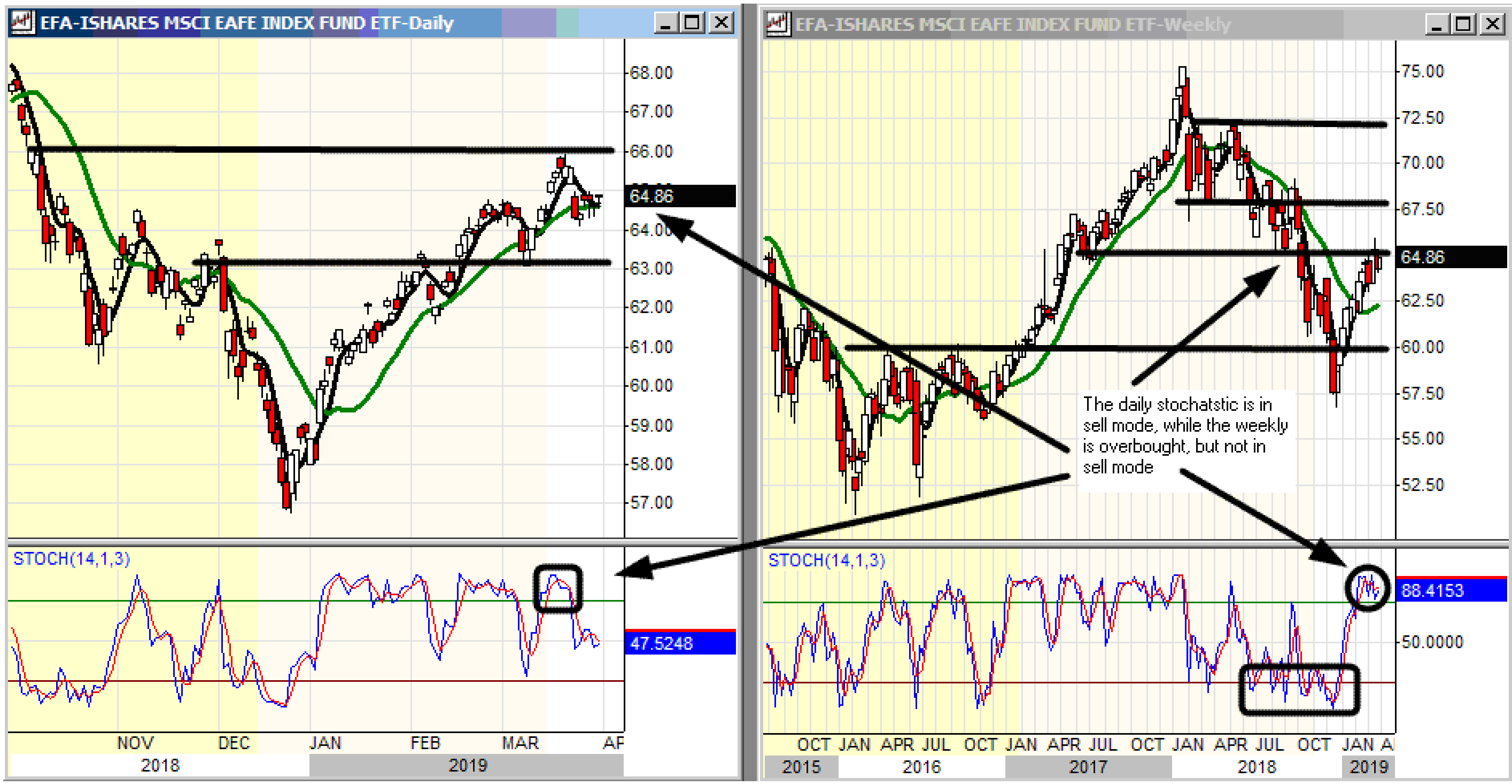
<u>The High Yield Bond is testing the upper end of the 85 to 87 area range again</u>: HYG is testing the 85 – 87 area resistance. The stochastics have produced lower highs on the buy signal noted last month. Support is the 83 to 80 area held. We think that ALL rates, including high yield, are in danger of a stronger economy than most are projecting in the second half. Below 85, then 84 would be a concern and suggest lower prices.

Other Markets: International – EEM – iShares: MSCI Emerging Markets



EEM retested the 37 area and may build a Head and Shoulders bottom: EEM double bottomed at our 37 to 38 downside targets. The stochastics are in slight buy mode on the daily and entering sell mode on the weekly. This should have a significant rally in 2019. This basing pattern could take several months, however. EEM has a chance of being the best international area in 2019, but it could test 40 first. International looks less attractive than the U.S., especially in the first half, but this looks better than Europe.

Other Markets: International – EFA – iShares: MSCI EAFE Index



The EFA has rallied back but now looks worse than EEM: EFA has weakened more than EEM and is now a worse chart. EFA should be held by 64 to 67 resistance. We realize that we are technicians, but charts can sometimes point out problems in the fundamentals before they are apparent, and we remain concerned about European Financials and Deutsche Bank. This could be where the market problems occur in 2019. Above 65 would improve this chart, and a test of 67.50 would then occur, but unless it moves through that area this is a weak chart.

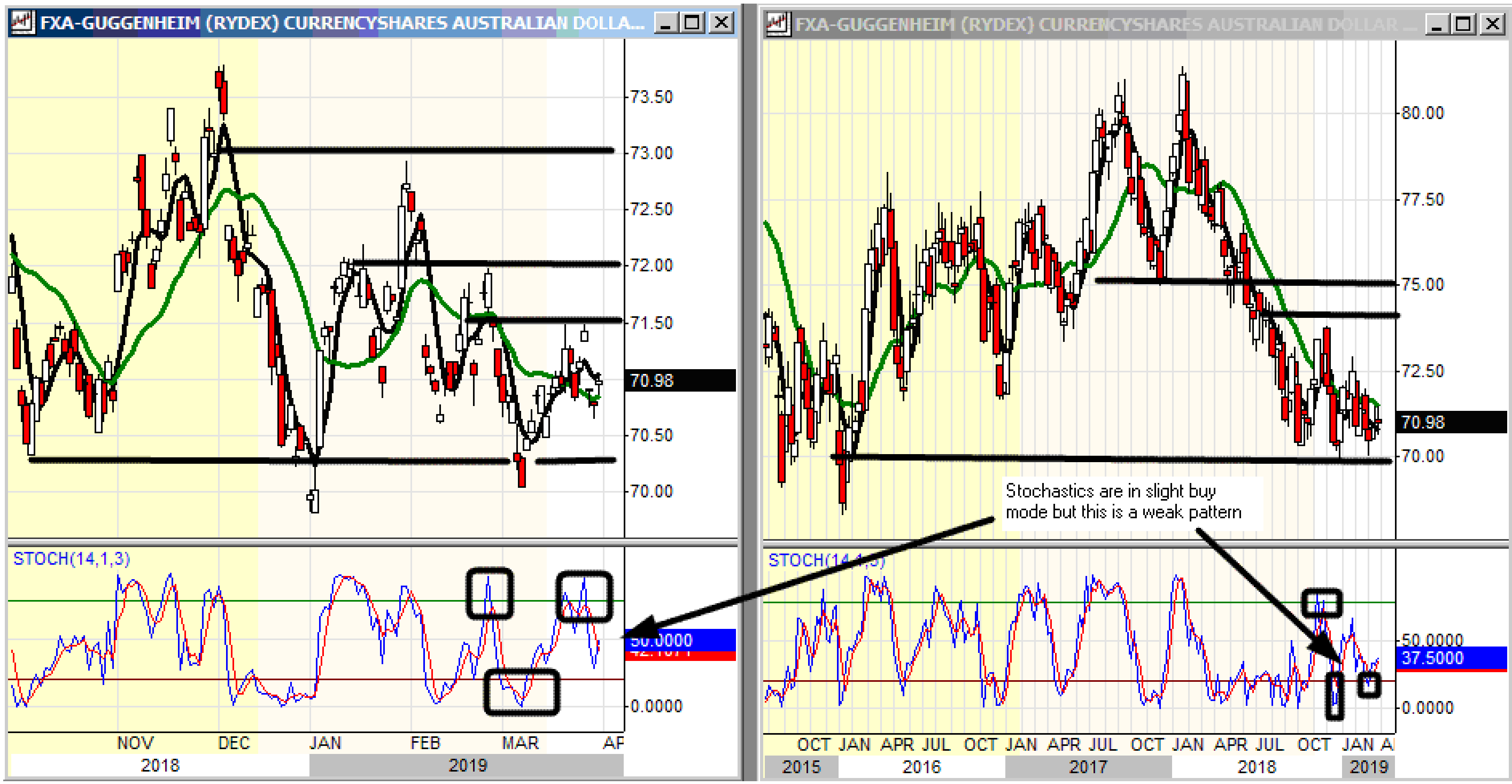
Other Markets: Currencies – FXE – CurrencyShares Euro Trust

<u>We have concerns that FXE could have a sharp breakdown</u>: FXE is a base and challenging 107-area support. The daily stochastic is in sell mode, and this has made lower highs, a concern. FXE is holding support but is actually weaker than we would like to see. Watch the dollar (see p. 25), as we remain concerned that it could have a surprising rally in the first part of 2019, as sudden problems in the European financials could cause a spike down in FXE. We would look to be buyers of FXE in that event.

Other Markets: Currencies – FXY – CurrencyShares Japanese Yen Trust

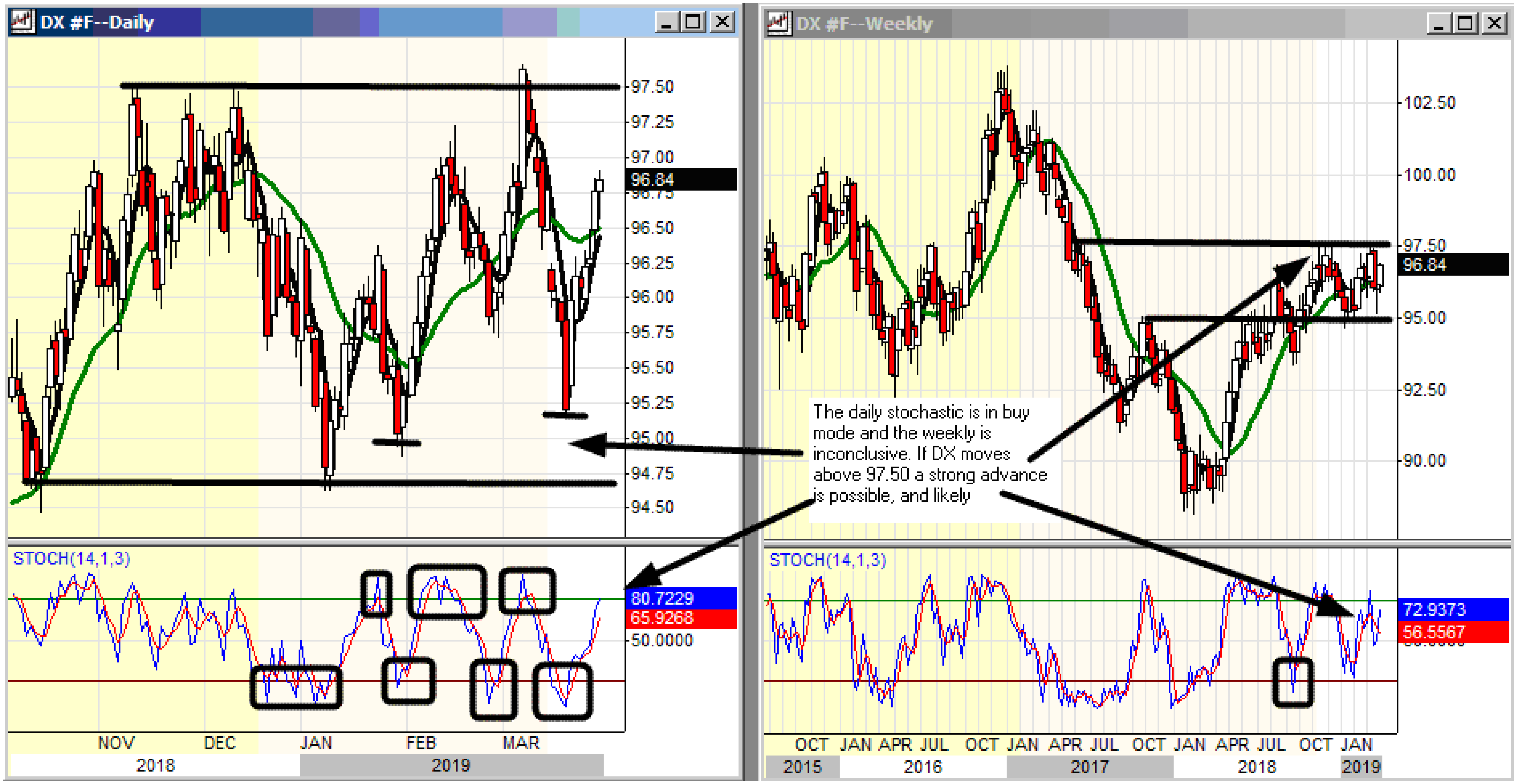
<u>The Japanese Yen ETF is building a base, and the short-term chart is improving</u>: FXY tested the 86-84 short-term support and rallied. The test of 84 is a success and FXY advanced to test resistance I the 89 to 90-area. Now, FXY pulled back again as the weekly stochastic rendered a sell signal. So far, it has made higher lows and held 85-area support. Our big concern is that the dollar surprises us by rallying in the first part of 2019. This European turmoil could cause this, and affect FXY as well, but it looks like the effect on FXY will be much less.

Other Markets: Currencies – FXA – CurrencyShares Australian Dollar Trust



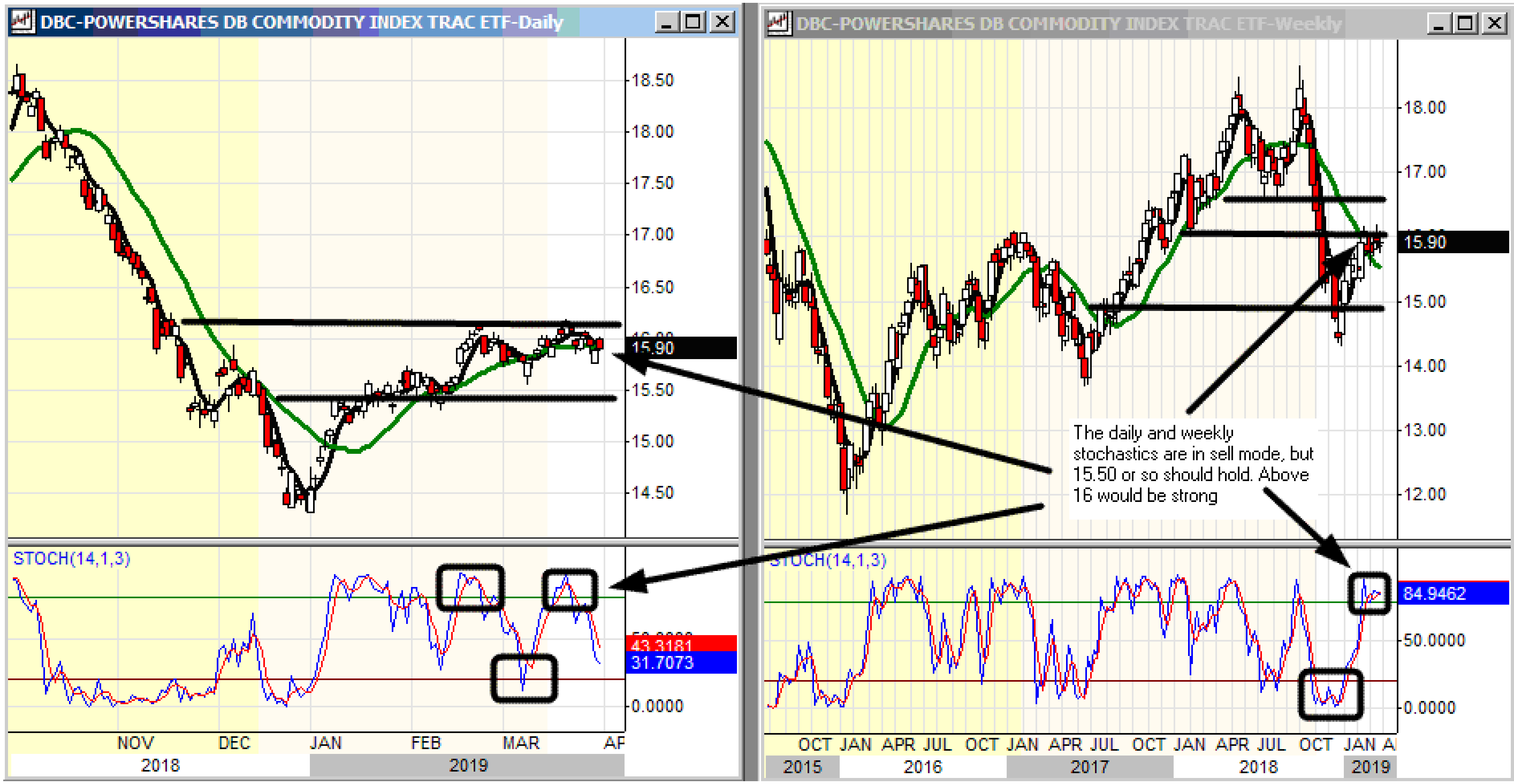
The Aussie Dollar tested the bottom end of support at 70, and we had an aggressive buy there: This currency trades with gold most of the time. We thought FXA probably would undergo a period of basing and it moved up through the intermediate-term base. The daily stochastic is up, and the weekly is in buy mode. Traders sold FXA around 80 ten months ago, and we recommended buying it back last month at 70. A test of 74 to 75 was likely but is now less so as gold hit targets and declined. Traders sold out of this last month, and for now we would stand aside, as Harry Kipper used to say!

Other Markets: Currencies – DXY – US Dollar Index



The Dollar may surprise us by breaking out above 97.50: Our forecast has been that the dollar was going to decline in the first part of 2019, but there could be a surprise rally - our biggest concern for the dollar is a rally based on European financial weakness, so we would not be short this move. Note that it has made higher lows on corrections throughout 2019, and a breakout of this range targets 100 to 102 at least.

<u>Other Markets</u>: Commodities – DBC – PowerShares DB Commodity Index



<u>DBC is fully testing resistance in the 16-area:</u> DBC broke out above 17.50 last year and then gave it all back. The daily stochastic is in sell mode, and the weekly stochastic is also. DBC should have a better year in 2019. A period of basing is not out of the question here, but this should have a better year after basing action occurs. Support at 15.50 should hold, if not we would have some concerns. Above 16 would be quite strong.

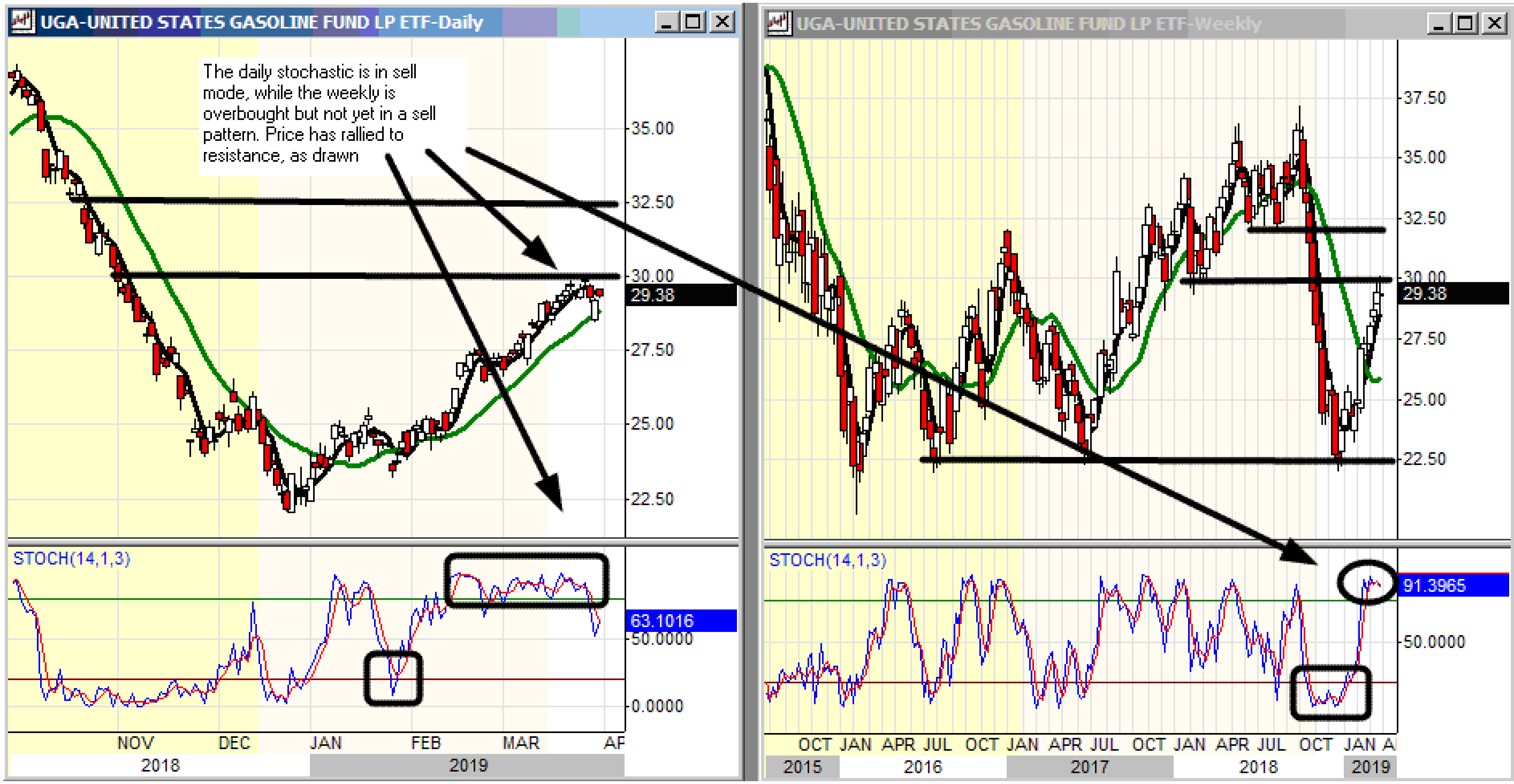
Other Markets: Commodities – GLD – SPDR Gold Shares

GLD hit our 126-area target for 2019 and is starting to sell off: GLD broke above our 126-area target for 2019 and is starting to sell off. This has been a bright spot in the commodities, but the move may have ended, at least for a while. We note that FXA normally follows GLD and has not – this was a trading opportunity, but we mention elsewhere in this report that profits should be taken. Support is now 120 to 117.50 or so short-term. We note that our accumulation models did not confirm this advance in GLD, so traders should be careful in here, and have mostly sold. Short-term oversold, and could bounce, but we are not long-term confident.

Other Markets: Commodities – USO – United States Oil

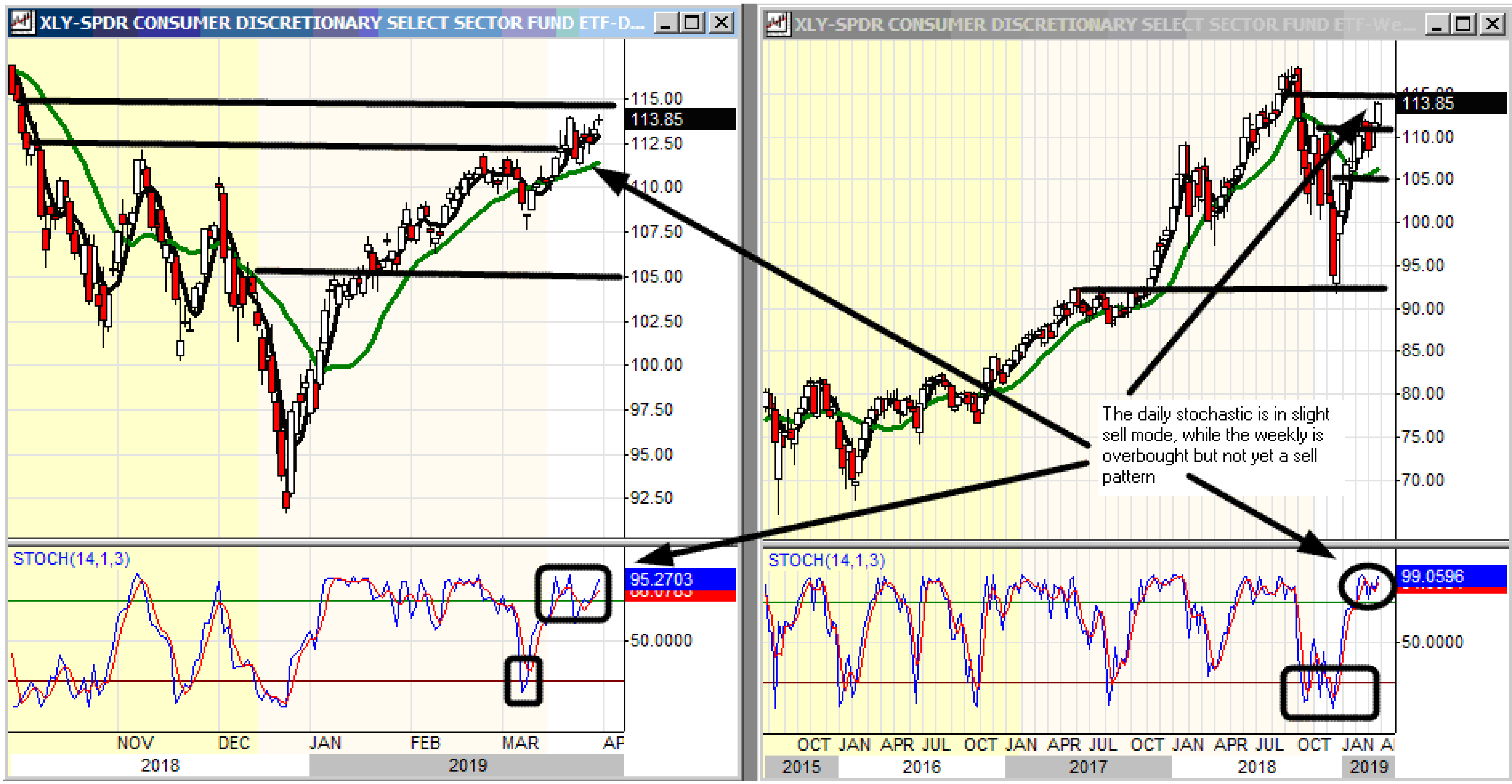
USO has made a Head and Shoulders bottom in this area: The weekly stochastic is in buy mode, and USO rallied to resistance, although not as robustly as would be expected if this was a lift off pattern. The seasonally favorable fall rally did not occur in 2018. WTI Crude hit 2018 targets, sold off, and was down longer than expected although it has started to rally. Oil has now in a period of seasonal weakness so may consolidate and or sell off. It is still trading up, however, and seasonals may mean less this year. Resistance from 12 to 13 is being tested.

Other Markets: Commodities – UGA – United States Gasoline Fund



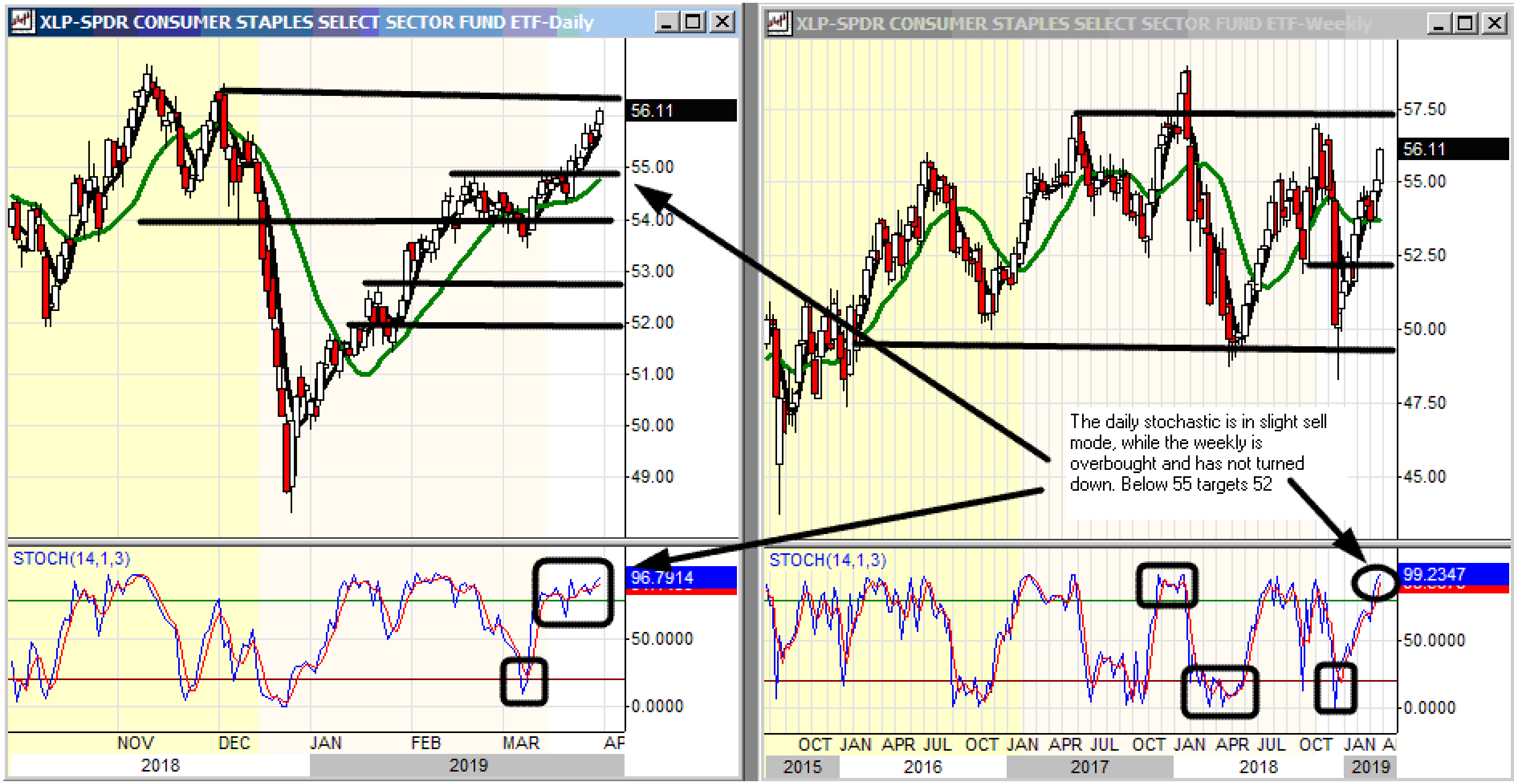
UGA also dropped, but it held support at 22.50: The break of 30 led to a sharper decline near 22-area support. This has rallied back to 30, which is now resistance. The daily stochastic is now in sell mode, and the weekly is overbought but has not turned down. UGA has a Head and Shoulders bottom and this rallied fulfilled the measuring objective. Above 30 targets 32.50 on UGA, but this is unlikely now. This should see some consolidation over the next few months, while stochastics recycles.

ETF Sector Charts: Consumer Discretionary (XLY)



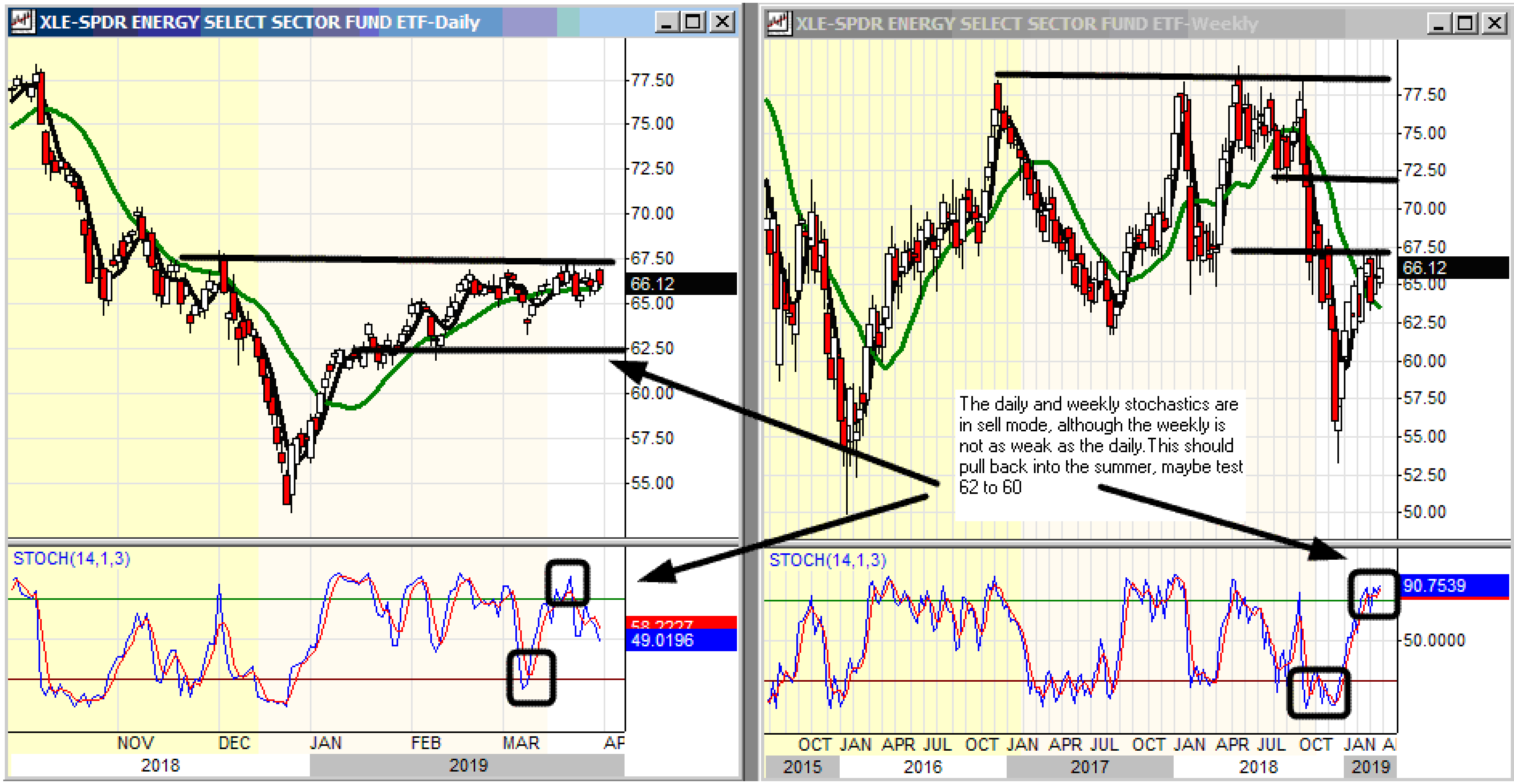
<u>Consumer Discretionary is through 112-area resistance and should test 115:</u> The short-term held 90-area intermediate support as drawn. AMZN continues to have problems, but it has improved since early March. XLY is a strong equal weight but we are concerned that AMZN will continue to go sideways. It has not made new highs as the market advanced. XLY is acting well and has moved through 112 resistance as the market has rebounded, in spite of this but it may not continue. Other stocks in the sector are acting reasonably well, given the overall market action. Below 112 again would target 105. This is a potential overweight in 2019, but after a pullback. EQUAL WEIGHT

ETF Sector Charts: Consumer Staples (XLP)



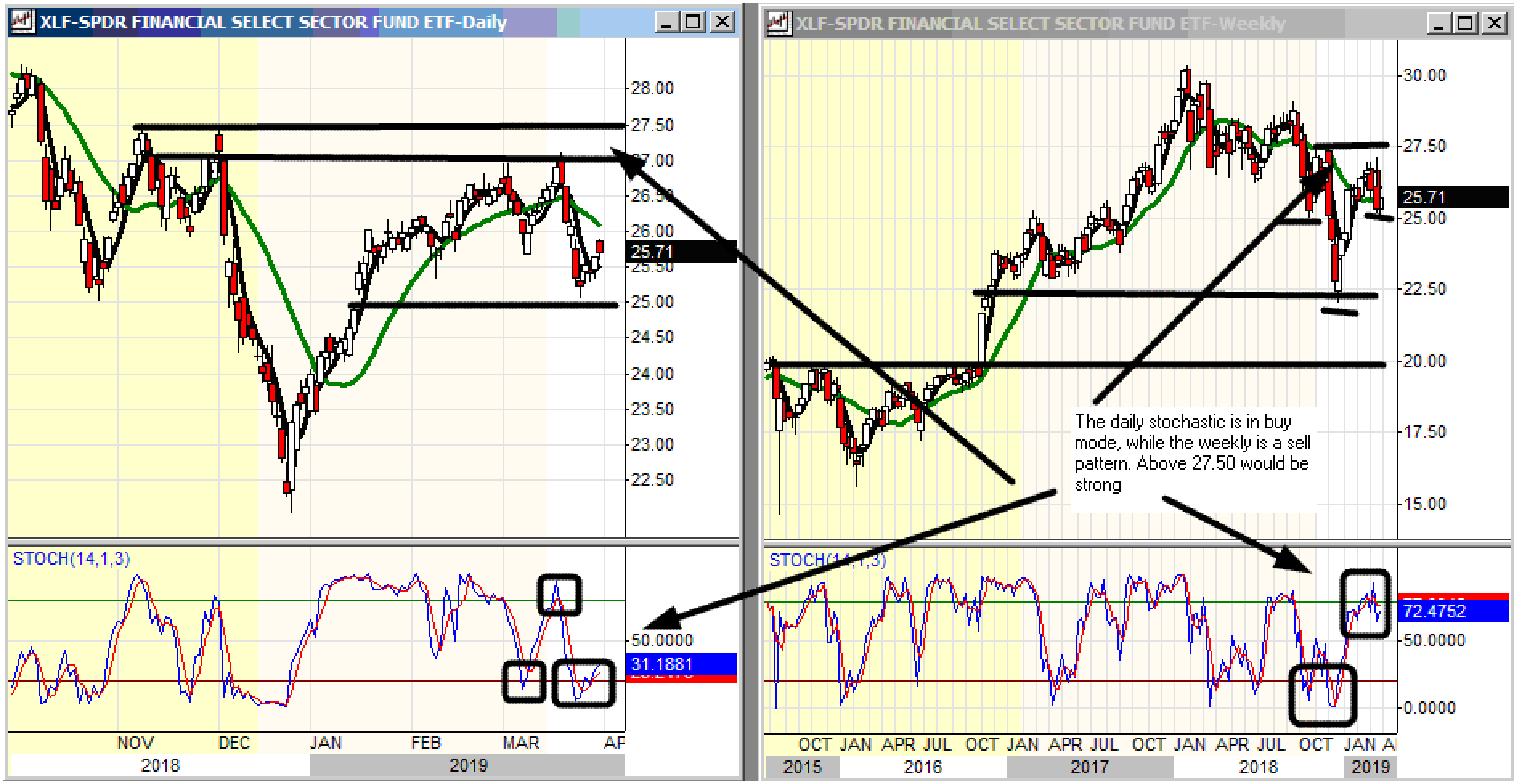
<u>XLP is weak compared to strong sectors and it is a multi-year trading range:</u> XLP retested major support at 50. Resistance at 57 held it back. This defensive sector may lag once again, as stocks should rally in the first part of 2019. Below 55 again targets 52 and would make this one of the weakest sectors. This sector is stabilizing but it may not be an out performer for 2019. We made this an under weight in January, as it should under perform either in an advance, or after a retest/pullback. UNDER WEIGHT

ETF Sector Charts: Energy (XLE)



<u>XLE has rallied back to test 67 to 68 resistance</u>: The daily and weekly stochastics moved into sell position over the last few weeks. XLE has rallied back above 65, but it is still weaker, and we should be cautious here, as oil has moved into a period of seasonal weakness. We note that every firm was forecasting $80 oil, but this has likely changed. We think a move back to $72 on oil is more likely from current lower levels per our yearly forecast. XLE is challenging the 67 to 68 resistance as drawn. This range may consolidate until hotter weather in the summer.
EQUAL WEIGHT

ETF Sector Charts: Financials (XLF)

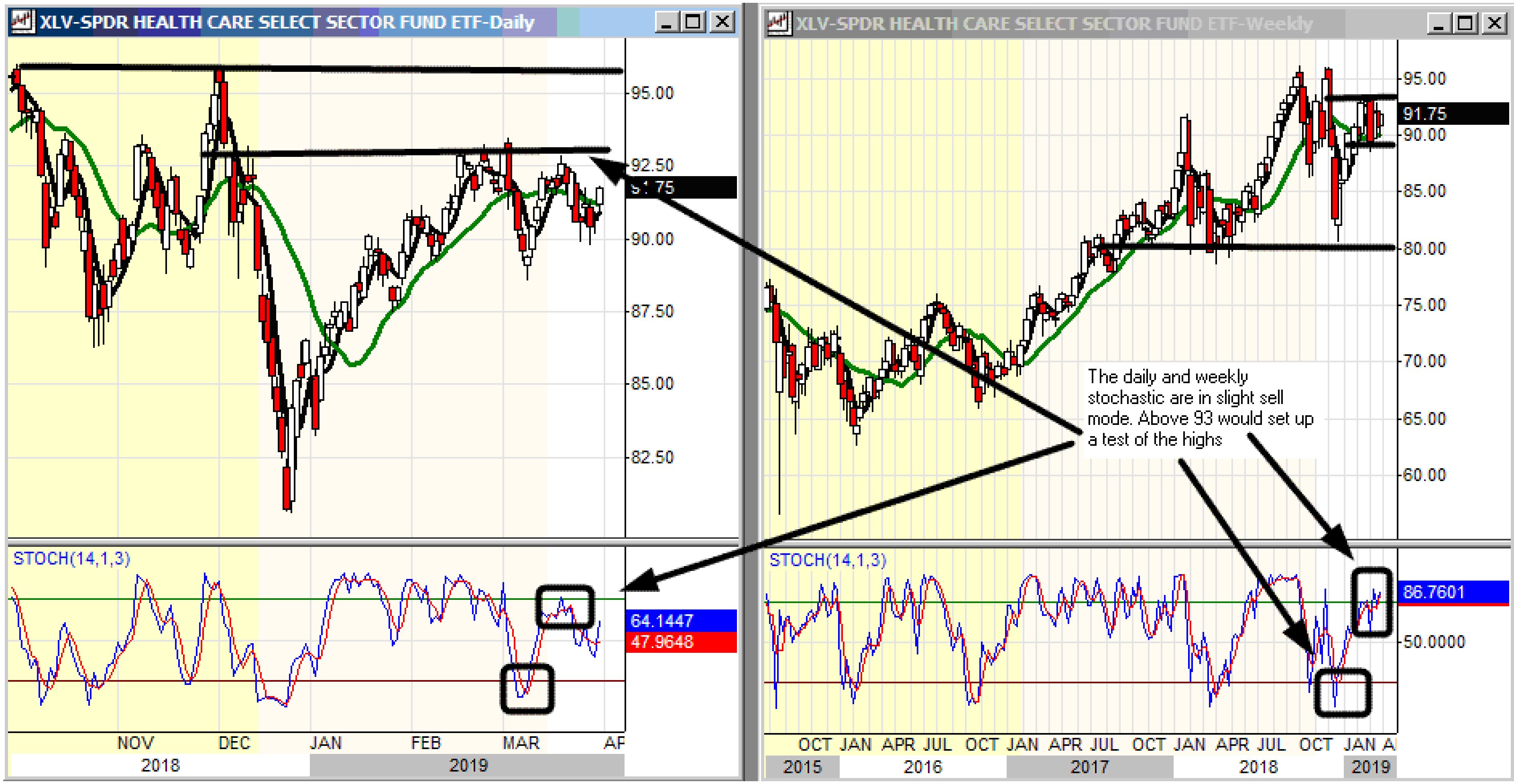


XLF retested the 25-area support and above 27.50 would be strong: The daily stochastic is in buy mode with more to go, while the weekly is a slight sell signal. XLF is above 25, which looks strong. Everyone was bullish on this sector, so part of the 2018 decline may have been the realization that positives were baked in. The accumulation model on XLF has improved enough to make this an overweight. TLT rallied more than expected but now looks ready to start another decline, as it met upside projections, is overbought, and starting to correct. We believe this will be a leading sector in 2019. In addition, this could be an inverse Head and Shoulders, as drawn. Above 27.50 would confirm that interpretation. OVER WEIGHT

ETF Sector Charts: Real Estate (XLRE)

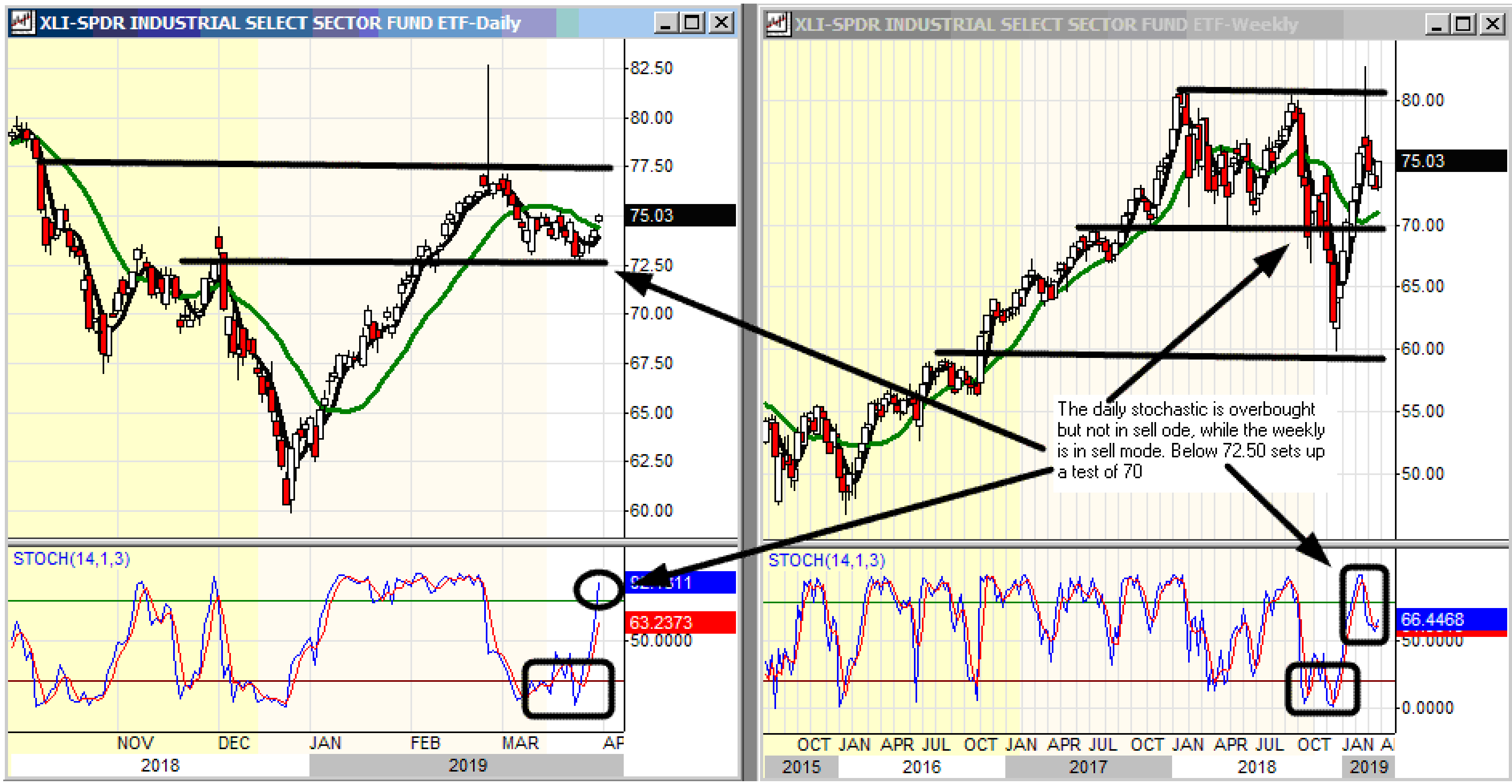
XLRE may be starting a significant advance, per our notes in the January Sector Review: The daily stochastic is in slight sell mode, and the weekly stochastic is overbought, but not in sell mode. The daily chart held 30 – 29, rallied back to 33 to 34 area resistance, and moved back down to the bottom in December. Overall XLRE has made no net progress since 2016 relative to SPY, a key reason we had been underweight the sector. In January, accumulation models suggest it could break out of the top end of the range and stage a significant advance. This was confirmed by February's data, and still looks to continue. We raised XLRE to an equal weight in January, and the breakout continued – slow but sure so far. If XLRE holds 34 as the daily recycles it would be added confirmation. EQUAL WEIGHT

ETF Sector Charts: Health Care (XLV)



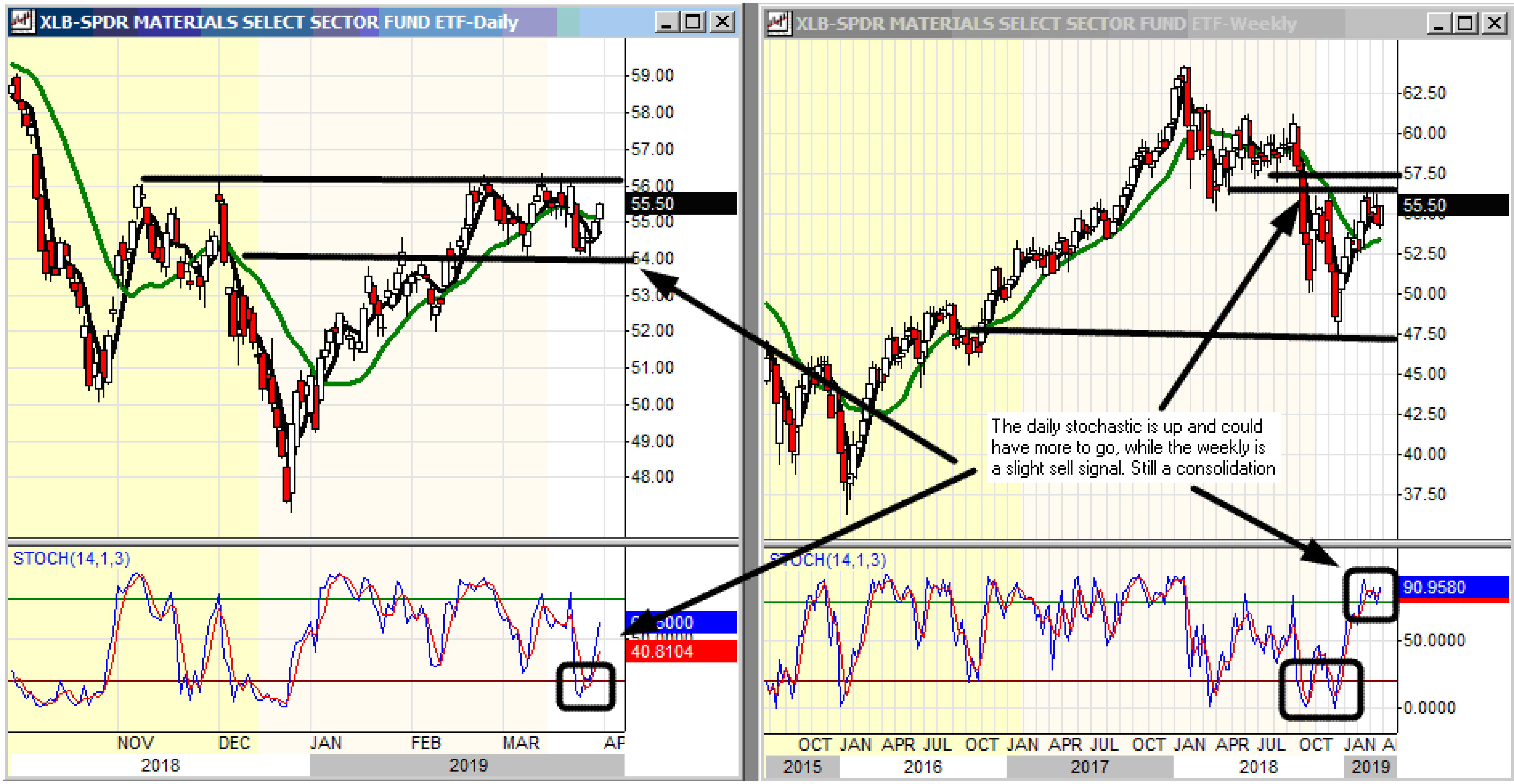
XLV has held up well in the recent corrective behavior and remains a strong sector: XLV held 80-area support and showed relative strength vs. the 2018 low. This was a stair step up pattern and it still made higher lows, unlike some other sectors. It remains attractive, and it is a slow advance. There is strong improvement in some areas of healthcare, such as Pharma, and Biotech is coming on as well. As long as XLV can stay above 85, we could see continued acceleration in this unit, and this looks set to lead in 2019. A move above 93 targets 112. The only problem with XLV is it is “newsy” so it may have trouble, as we get closer to 2020. OVER WEIGHT

ETF Sector Charts: Industrial (XLI)



<u>XLI still has a strong accumulation model, and the chart has improved over the past four months:</u> The stochastic pattern is similar to other sectors but a little weaker, and the price pattern is at resistance, pulling back, but still strong. This tested the 77-area resistance and should hold 70 on a pullback. The accumulation model remains very strong, enough to say this is a strong equal weight, but the accumulation model is not a timing tool and has taken a while to produce anything of note. No big changes here. EQUAL WEIGHT

ETF Sector Charts: Materials (XLB)

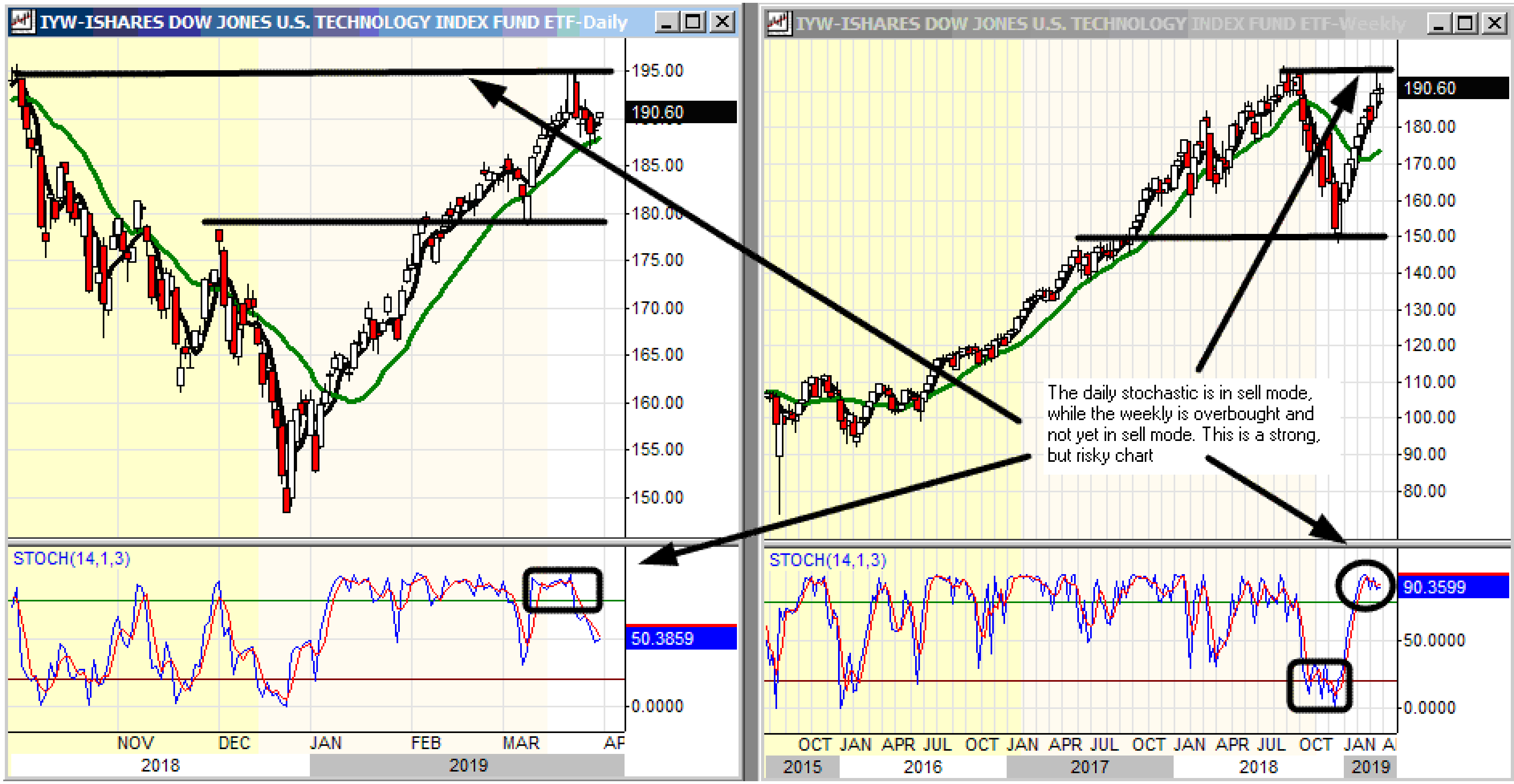


<u>XLB broke support in the pullback, but back above 57.50 would repair this:</u> XLB weakened and while the accumulation model is still strong, the test of 50 or so is not a surprise. This is more of an infrastructure play to us, and we expected legislation on an infrastructure build in 2018, but that did not happen. This is another example of a sector that has a strong accumulation model but continues to lag. We have to see improvement before warming to this again. Watch this sector carefully as it could do much better in 2019 than the chart suggests at this time. This should have moved back above 57.50 by now. It remains a consolidation, so no big changes this month. EQUAL WEIGHT

ETF Sector Charts: Utilities (XLU)

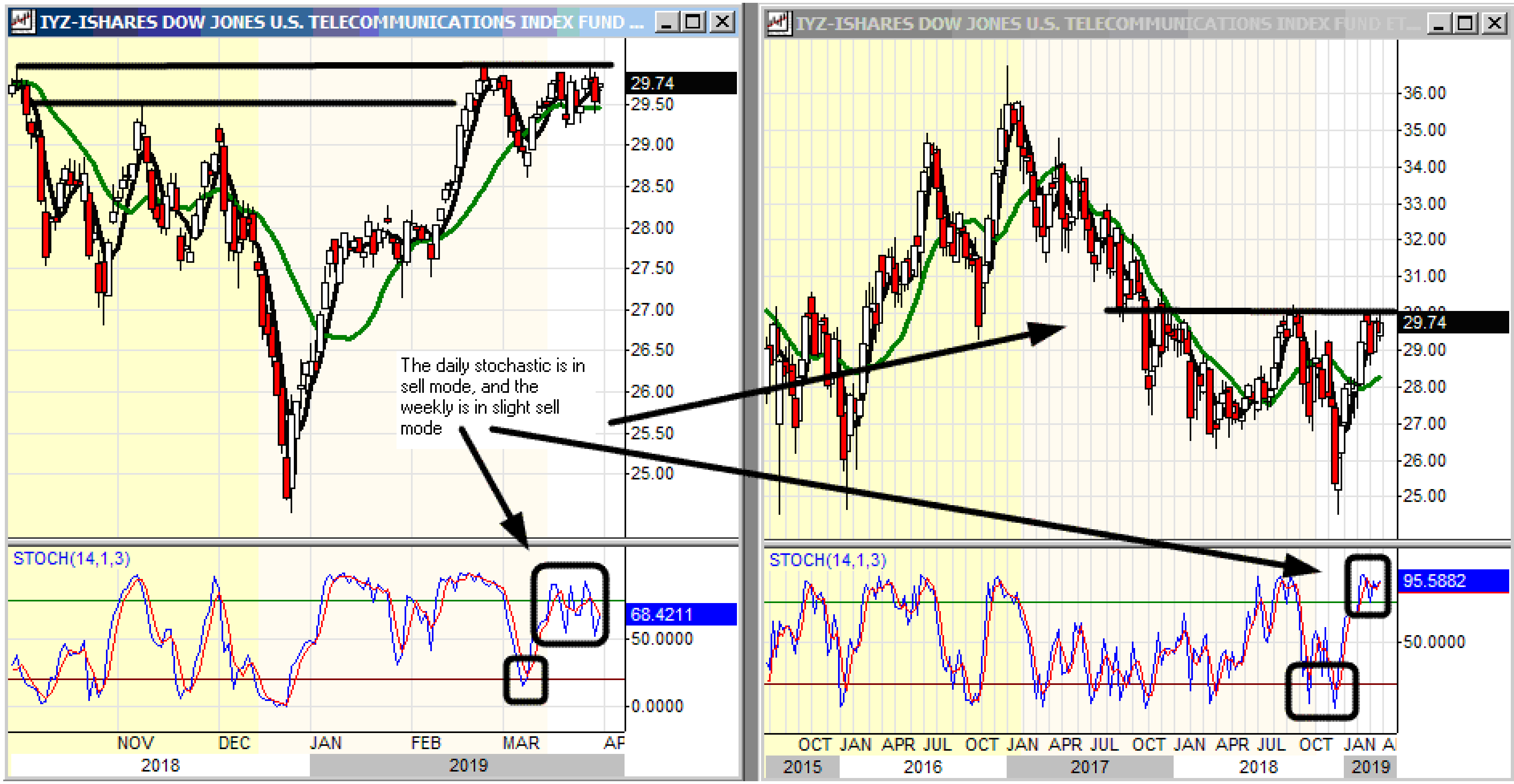
<u>XLU has broken out above 57</u>: This is a breakout above resistance at 57. One of the peculiar things about this market is defensive stocks are doing better than we expected. Income Investors buy this on pullbacks. XLU performed well in the recent market pullback. We think that institutions are slowly adding stocks and selling bonds for income. Stock investors, we will remain an equal weight for now. This might perform well in a pullback or correction, but probably will not lead the market for all of 2019. EQUAL WEIGHT

ETF Sector Charts: Technology (IYW)



IYW held support at 150 and is now testing resistance as drawn: We have long-standing concerns about IYW. Most strategists are overweight the sector, and many individuals have embraced this – and it worked for much of 2018. Some key stocks such as AAPL are not making new highs, suggesting a leadership change. This is positive but may lead to weakness in IYW for a while. Accumulation models for IYW and XLK are weak but improving during this price strength but are neutral on other tech weighted indexes such as QQQ. IYW may be undergoing a switch to newer leadership. The good news is that some of the less usual stocks we show in the Sector Review have done better than AAPL and continue to trade well. We thought there would be signs of new leadership in Tech and this is in fact occurring – we have a good representation of this in the stocks in the Sector Review. EQUAL WEIGHT

ETF Sector Charts: Telecom (IYZ)



IYZ is testing 30-area resistance once again: We have been underweighting this sector and this has been working for us. IYZ broke the 27-area support but is back above it. The last weekly buy on stochastics suggested there was more to go, but this became overbought and IYZ still has not made it through 30. Maybe this rally will do it, but we are not holding our breath. The trading action still looks like this could fail here at 30. A move above 30 would improve this chart, but key stocks like T and CTL are still weak. We continue to feel there is limited downside, but the upside potential is less than other sectors. This may be a place to hide if there is a market correction, and these stocks are buyable for income. UNDER WEIGHT

Research Piece: The Efficacy of Indexation — A Case Study by S-Network Global Indexes

This month's extra research piece is by an Index Provider, a key participant in the modern stock market that is often overlooked. We all trade ETFs, and The FRED Report has focused on ETFs since we began publication. However, little thought is given to the underlying indexes, how indexes are developed, and why an ETF is created to mirror an index. Remember, all ETFs exist to mirror an underlying index. Often, these indexes are created to exploit a particular factor. Indexes measure all sorts of market phenomena – and in the case of ETFs the quality of the index is paramount when looking to exploit a factor.

The first ETFs were all like SPY, which simply duplicated an already popular index, the S&P 500. This was popular because there were already index mutual funds. The most popular stock index future was the S&P 500 as well as stock index options. As fund companies snapped up the most common indexes, the importance of Index providers increased. This led to smart beta as well. As more ETFs come to market, indexes have to be created and tested – a process that is not examined or understood by most financial advisors. We are fortunate to have Patrick Shaddow and the S-Network Global Indexes' team write us a case study about this process. His company created the index for one of my favorite ETFs for income, PCEF. We hope this will shed some light on this process for subscribers.

Over the past twenty years indexation has expanded its share of the asset management market relentlessly. Driven in large part by the advent of ETFs, the characteristics of indexation have changed markedly throughout this growth period.

There are some 2,234 exchange-traded products listed with approximately $3.77 trillion in assets under management (AUM)[1]. Of these, over one thousand niche indexes, including single and multi-sector, country, thematic, single and multi-factor, and commodity ETFs held well over one trillion dollars in total assets.

Smart Beta ETFs and ETPs, which embrace a number of the aforementioned categories garnered 10.1% growth in the month of January 2019 alone and total assets now exceed $700 billion. This marked the 36th consecutive month of net inflows into Smart Beta exchange-traded products[2].

Below is a general breakdown of the ETF industry:

**ETFs only, no ETNs*	**Size & Style**	**Sector & Industry**	**Region & Country**	**Theme**	**Fixed Income**	**Commodities**	**Total**
Beta	137	203	179	42	204	26	**791**
Enhanced	567	136	63	82	82	32	**962**
Active	73	13	2	10	95	3	**196**
Total	**777**	**352**	**244**	**134**	**381**	**61**	**1949**

Sourced from ETF Action (www.etfaction.com), accessed March 28, 2019

[1] Source: www.etfaction.com, accessed March 28, 2019
[2] Source: https://finance.yahoo.com/news/etf-trends-seen-10-old-180006268.html

In many respects, these niche indexes provide desired exposures that, when integrated into a diversified portfolio, provide opportunity to enhance performance and diminish risk.

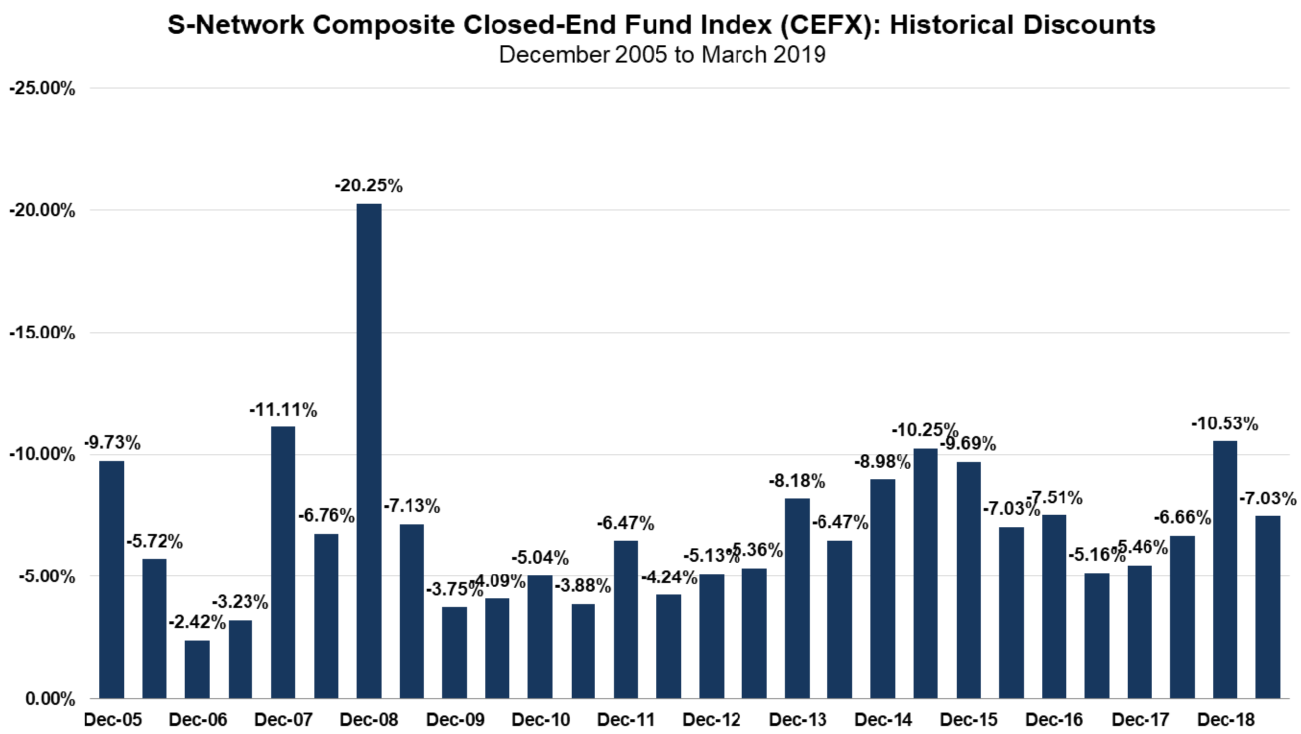
To illustrate the benefits of niche indexes, we would like to examine the specific characteristics of the S-Network Composite Closed-End Fund Index (CEFX). CEFX comprises a total of 135 individual closed-end funds that offer high dividend payouts. As of March 31, 2019, the index was yielding approximately 7.9% per annum and served as the basis of an ETF offered by Invesco PowerShares — the Invesco CEF Income Composite ETF (PCEF) which holds over $700 million in assets.

Why Closed-End Funds

The most unique characteristic of CEFX lies in the exposure it provides — Closed-End Funds (CEFs). Closed-end funds are 40-Act mutual funds that trade on recognized stock exchanges. Altogether, CEFs hold approximately $275 billion in assets[3], with roughly 60% pursuing yield-oriented strategies, including fixed income and covered call writing. Unlike ETFs, CEFs are closed to fresh contributions and redemptions. Capital held by CEFs is permanent, which gives CEFs a tactical advantage over open-end mutual funds, which offer daily contributions and redemptions at the funds' Net Asset Values (NAVs).

For example, because CEFs are not required to make redemptions, they needn't hold cash in reserve for such occasions. By the same token, they can invest in less-liquid securities, which in the case of bonds may be held to maturity, making them less subject to the ups and downs of market turbulence. Most CEFs are actively managed, which is another important characteristic, because the managers may employ proprietary investment strategies aimed at enhancing yield. Many CEFs employ leverage whereby they borrow against their assets to buy additional assets in order to enhance yield.

A possible downside of CEFs is that they often trade at discounts to their NAVs. These discounts occur precisely because the CEFs do not offer redemptions at their NAVs. But there is also opportunity to be found in these discounts. In turbulent markets, the discounts tend to widen. But then, when market stability is restored, the discounts tend to narrow. However, buying yield oriented funds at a discount actually increases the yield on their market prices and can provide additional returns when discounts narrow.



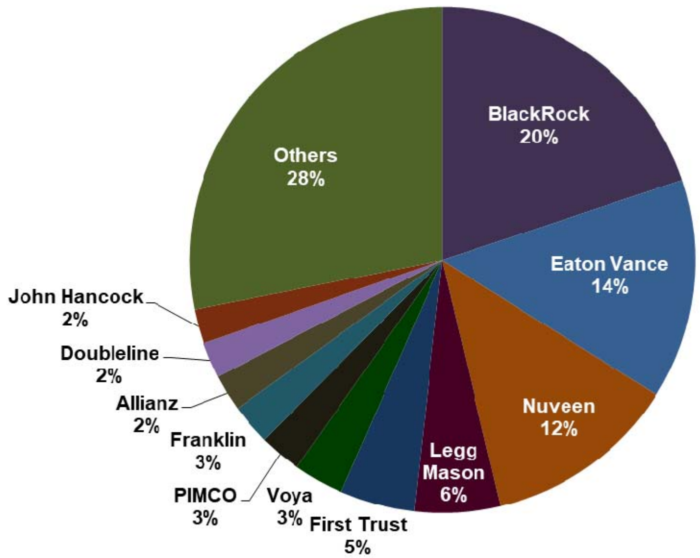
[3] Source: https://www.ici.org/pdf/per24-02.pdf

Diversifying Risk

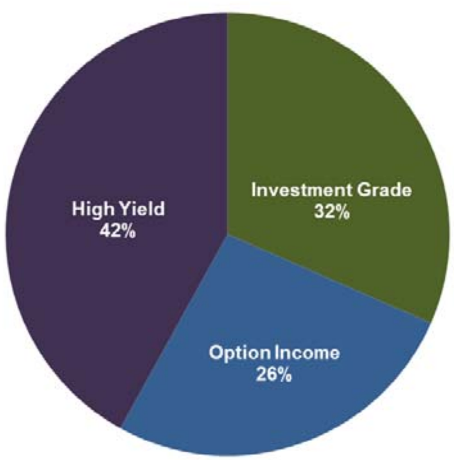
The biggest problem with CEFs, however, is the age-old investment problem of picking the right CEF to include in one's portfolio. A CEF that cuts its dividend, for example, is likely to experience a decline in price, thus negating the higher yield that the CEF may have provided.

The chief benefit of CEFX is the diversification it offers. Since CEFX contains 135 separate CEFs, an investor seeks higher yield by employing 42 separate management companies, including many of the most prominent names in the asset management industry, such as BlackRock, Eaton Vance and Nuveen. Each manager employs their own unique investment strategy. Simply put, it would strain credulity to believe that 42 different managers — all highly skilled and supported by sophisticated data and analytic systems — could all get it wrong at the same time.

S-Network Composite Closed-End Fund Index: Manager Distribution



S-Network Composite Closed-End Fund Index: Sector Distribution



But the diversification principles that underlie CEFX do not stop with managers. Included in CEFX are 41 funds that specialize in investment-grade fixed income, 59 funds that specialize in high-yield fixed income, and 35 funds that pursue option income or covered call strategies. Included in this diversified investment mix are certain high-yielding instruments that fit well into the CEF structure, such as bank loans, emerging-market bonds and, in the case of option income CEFs, global stocks.

This diversification policy is built into the rule set of CEFX, so that individual CEF risk is substantially mitigated. Of course, diversification comes at a price. It is certainly possible to get lucky, pick a single CEF and enjoy a slightly higher yield than CEFX offers. That is a personal decision based on risk preferences and the analytic resources at one's disposal.

Constituents Chosen Based on Objective Criteria

As a composite index, CEFX includes every US-listed CEF over a certain size — AUM greater than $100 million — that fits into its sector selection criteria. Further screens are applied to define criteria for liquidity, expense ratio and discount/premium to NAV. The index rules governing all of these factors that are applied to the selection of constituent funds provide another valuable dimension of risk mitigation.

Index performance can be compromised, however, through high levels of turnover. This is especially true in the CEF market, where liquidity is often limited. To deal with this factor, CEFX employs buffers that prevent high turnover rates related to its quarterly reconstitutions. For example, a CEFX constituent must have $100 million in AUM to be selected for inclusion in the index, but once in the index, the constituent's AUM must fall below $75 million to be dropped from the index. Buffers for liquidity are also applied. As a result, CEFX has maintained very low turnover rates throughout its history, thereby mitigating performance drag.

Importantly, CEFs with high expense ratios are excluded from the index, using a dynamic threshold based on the 30-day LIBOR. This keeps the expense ratios — including the cost of leverage — from exceeding industry norms by an excessive amount.

Capitalizing on the Discount

The CEFX rules for selection produce a dependable and cost-efficient index. Rules governing the weightings of CEFX constituents are also applied. Unlike most stock market indexes, which weight constituents based on their market capitalizations, CEFX weights its constituents based on their Total Net Assets. Since most CEFs trade at a discount to NAV, this weighting methodology produces a more accurate representation of the holdings while a traditional market cap weighting would favor CEFs selling at premiums or rich relative valuations

CEFX also builds a smart beta component into its weighting methodology. Simply put, weights are adjusted (at quarterly rebalancings) to give the CEFs with the highest discounts the highest weights and to reduce the weights of CEFs trading at a premium to NAV. This is a technique often used by professional CEF investors, because CEFs trading at a discount tend to revert to the mean.

Discount/Premium	**Threshold**	**Adjustment Factor**
Discount	d >= 6%	1.3
Discount	3% > d > 6%	1.2
Discount	0% > d > 3%	1.1
Premium	0% > p > 3%	0.9
Premium	3% > p > 6%	0.8
Premium	p >= 6%	0.7

What Does It All Mean?

The overall architecture of CEFX uses custom rules-based indexing technology to capitalize on the advantages inherent in CEFs, while diminishing the impact of their flaws. Accordingly, CEFX is complex from a methodological standpoint. But what is the result of all the complexity?

CEFX offers a yield of approximately 7.9% in an environment where yields over 3% are persistently hard to attain.

CEFX is but one example of how indexation can provide important disciplines to improve performance and mitigate risk. At S-Network, we have developed a number of indexes that rank among the best performers in their respective sectors. Many S-Network indexes mirror the best investment practices of leading active managers, only without the subjectivity.

With the recent growth of SMA platforms, indexes create a new opportunity set for growth. When integrated into a financial practice, custom indexes can help financial strategists and wealth managers build a solid platform for generating success.

About S-Network Global Indexes

S-Network Global Indexes, Inc. is a publisher and developer of proprietary and custom indexes. S-Network began publishing indexes in 2006 and currently publishes over 300 indexes, which serve as the underlying portfolios for financial products with approximately USD 7 billion in assets under management. S-Network indexes, which are supported by a state-of-the-art technology platform, are known for their transparency and efficiency.

Below is a listing and definition of various proprietary and non-proprietary technical indicators we rely on during our analysis of the markets:

Moving Averages:
Moving averages are one of the building blocks of Technical Analysis, and there are almost as many ways to use this indicator as there are technicians.

At the FRED Report we teach and use a dual moving average crossover system to determine trend. Our favorites are the 5 period and 20 period moving averages. We consider the trend to be up if the 5 is above the 20, and down if below it.

Stochastics:
The Stochastic Oscillator is one of the commonly used momentum oscillators and is standard on charting programs. There are two lines on the chart below, %K and %D.

%K is the faster of the two lines and represents a mathematical formula that *measures where the current close is in relation to the trading range of the last "X" periods of time*. We use a 14-period look-back, so in plain English %K says where the current close is in the trading range of the last 14 days, expressed as a %.

At the FRED Report, we use it somewhat differently than is commonly taught. The standard way to use the indicator is to register a buy signal when it moves below, and then above, 20 (the lowest 20% of closing prices in the last 14 days). A sell signal is when the indicator moves above, and then below 80 (the highest 80% of closes over the last 14 days).

The other line, %D, is a 3-period moving average of %K. We have found that the Stochastic is sensitive, so we advocate taking signals only in the direction of the trend. When looking at the standard FRED report chart, this would mean taking buy signals when the 5 is above the 20 and sell signals when the 5 is below the 20 but using a different technique to exit positions. The reason for this is the Stochastic is quite sensitive, and can give early indications, especially in new trends. It also can get "stuck" in the direction of trends, which connotes strength and not weakness. Another, preferred interpretation is to use the indicator to measure risk. An example: buy in an uptrend, not when the stochastic is at 90% but rather wait until it falls below 50%, This way, even if a stock, commodity, or ETF does not give one of the "classic" signals, you can still use the indicator to assess risk, and leg into positions.

Fred's Price Oscillator (FPO):
This is an oscillator that I invented, using a combination of high, low and closing prices. Unlike the Stochastic, which is sensitive, this indicator is designed to be less sensitive. Other than that, it is, of course, proprietary, so we do not disclose much about the construction of the indicator. One of the characteristics of the tool is that when the Oscillator moves below/above -15/15 the market often creates a divergence. For those of you who do not know that term it means that price will make a new low/high and the oscillator will not confirm it. That is usually the sign of a turn. On sharp strong market moves, a couple of these divergences can occur. We use weekly data in our examples for you, as we have that data going back to the 1970's on the SPX, and farther on the Dow Industrials, which work the same way. We would note that we keep FPO's on the commodities, but rarely publish these, as most subscribers are interested in stocks. Like most oscillators it is most useful at bottoms, so our examples show bottoms. We can, and will, show some analysis of tops as they occur.

Fred's Breadth Oscillator (FBO):
This is an Oscillator that I invented. Unlike the McClellan Oscillator, which is sensitive and gives a lot of signals, this tool is more of a trend following indicator. It is proprietary to the FRED report, so we do not disclose much about the construction of the tool. It generally moves between 12 and 18. Moves below 12 or above 18 imply a divergence bottom or top is coming with high probability. This tool works best at extremes, and patterns can be significant. It also gives clearer signals at bottoms than tops, although when tops are perceived to be occurring, we will publish these charts, appropriately annotated. The FBO is only useful on the stock market, where advance/decline data is published.

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