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The FRED Report – Monthly Review

Monthly Research Piece: Bullish Exhaustion = Pullback or Consolidation

By Cam Hui - Humble Student of the Markets

Key			
Positive	Negative	Neutral	Highlight
↑	↓	↔	Change

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Summary of Monthly Piec

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 NEUTRAL/POSITIVE. %Bears is almost at 30. It is normally in the 30's at bottoms and was over 40 at peak bearishness in 2022. The increase in %Bears happened in a short time. Normally this takes longer in a decline to get to these levels. It has stayed up on the April rally, a big plus. The Put/Call indicator had a spike, and is back down, a neutral rating, but markets have rallied for a while after a spike such as we have had. We have discussed this in various venues. **We rate sentiment NEUTRAL/POSITIVE here because the intermediate sentiment indicator is at intermediate bottoming levels and Put/Call had a panic spike but is back down. This set-up is associated with major trading bottoms, and intermediate rallies.**

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 has been volatile, with big swings up and down, and it confirmed the Zweig Breadth Thrust. At the same time, it is overbought. **The McClellan Oscillator** is positive, and oversold enough to suggest a summer rally. **New Highs/New Lows** had a sharp rally, a big positive. The **weekly FBO** is still diverging from price and has been since 2022. The combined picture from these indicators is intermediate term is neutral to positive overall.

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 POSITIVE. Daily indicators are overbought, many in slight sell mode. **Weekly indicators** are overbought. Most of these indexes have rebounded, and individual stocks have started to rally. Accumulation has improved. XLF and XLI still have favorable intermediate charts.

CONCLUSION: Equities fell a bit more than anticipated after surprising news. However, the market bottomed and started what should be the expected summer rally. Stocks could consolidate for the first part of June, and then advance. Intermediate sentiment suggests a strong rally. Is likely.

FIXED INCOME: TLT is still basing. MUB, LQD, and HYG have bottoming formations, and are stronger than TLT. MUB is weaker than we would like to see. First targets in the 92-area have been hit. We are still on a buy signal. TLT should still challenge 95 or better by July. The 30-year tested 51 resistance, and has backed off, but the risk is a breakout in rates from July to October.

COMMODITIES:

Oil and Gasoline start positive seasonality in June. Watch oil via USO, UGA and DBC carefully. The oil stocks have been weak due to negative seasonality through May. Indicators suggest an advance is imminent. UGA held support, as did USO and nearby futures. GLD and SLV have rallied, but Accumulation Models remain relatively weak. These may have peaked, and have started consolidations at least. Industrial Metals (DBB) have perked up. Our favorite broad-based Commodity Index ETF, DBC, is still in the range, but doing worse than expected. Agriculture normally makes a seasonal low in October, and we are now seeing improvement in these markets. These markets normally bottom in October/November and peak in July. Watch SOYB, as it is the smallest crop, and it often rallies first.

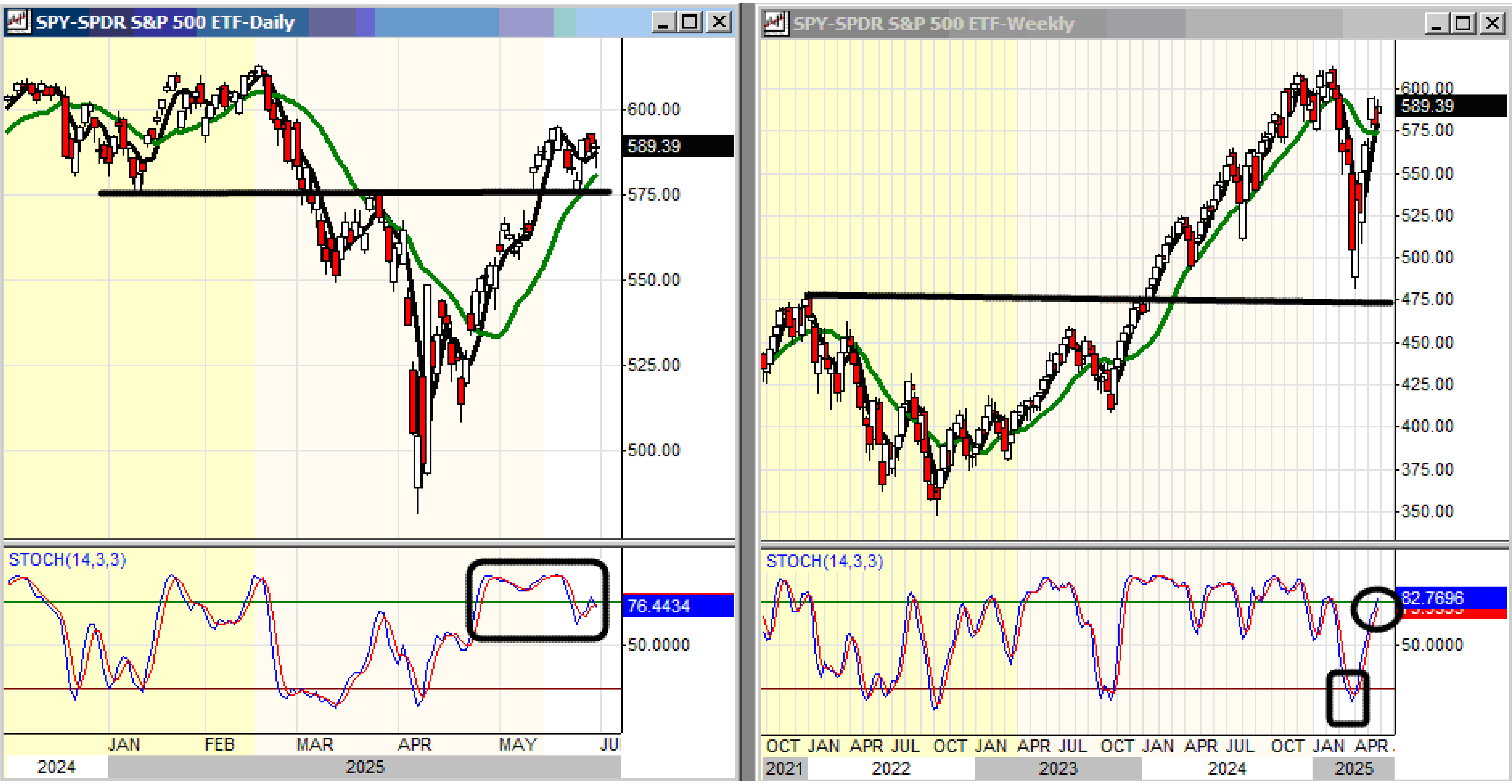
INTERNATIONAL:

International markets are advancing. Emerging markets now have weaker accumulation models than EFA does, and EFA gapped above resistance. China has hurt Emerging Markets, but Accumulation was picking up. Chinese prices have improved. Developed markets still look better than emerging markets short-term, and while Europe is doing well now this may not last through 2025. The Dollar Index (DX#F or UUP) is a consolidation for now, and it is at the bottom of the range. The Yen looks more like a bottom and could move into a range. We are still recommending individual European ETFs. Watch EWL, our favorite, but EWG is starting to perform well also. It was a multiyear breakout before the recent market turmoil. Japan and India are long-term favorites but could consolidate, although India has held the bottom of the range.

SECTORS:

We are overweight XLI and XLF. These have strong accumulation models and intermediate charts are better than most of the sectors. XLV is a bit weak. **We are underweight XLRE and IYZ, although they are improving.** XLU is performing well but may consolidate – it is defensive and strong right now**.** We keep XLRE as an Underweight as it is a downtrend in spite of the recent strength in this market turmoil. Banks are a concern and may be a crowded trade. Insurance and Credit Cards look strong and XLF is holding near all-time highs. IYW pulled back sharply, but it has revalidated support. Accumulation has improved on the rebound in IYW and QQQ, suggesting there is some improvement, although rotation out of the sector continues. Small Cap is showing Accumulation but price is weak. MDY and IJR have bottoming formations. Large Cap High Relative Strength Tech is a hold. XTN is weaker than we would like to see and there is a Dow Theory sell signal, a concern although we do not use Dow Theory per se. XLE should rally into summer. XLB is weak, and accumulation is weaker than other strong sectors. It is pulling back now. XLP is trading well, and dividend stocks are improving. The narrow market was improving prior to this break, and intermediate-term Breadth Momentum is weak, a concern. We did have a Zweig Breadth Thrust, an indication the market will do well in 2025, in line with our forecast. We continue to use RSP. We have added satellite positions in XLG for aggressive investors. We are recommending VBR and XMHQ for those wanting to add Small and Mid. We recommended adding in mid-April

Market Review: Price Charts – SPY – SP 500 ETF



SPY rallied and is through 575: Accumulation models on the stock indexes .have improved over the last month This held the 575 support and is building a short-term consolidation. The daily stochastic is in sell mode and the weekly is overbought. Intermediate-term Breadth indicators improved – we had a Zweig breadth that suggests prices will be higher at yearend. The rally we thought would begin in March began in April. Tariff news surprised not only us but others looking for this as well. We believe our forecast summer rally has started.

Market Review: Price Charts – MDY – MidCap SPDRS ETF

MDY has also advanced: MDY is still weaker than SPY is, despite the latest advance. The daily stochastic is in sell mode, and the weekly is overbought. The pattern relative to SPY is still weak, but could be building a Head and Shoulders bottoming pattern. Look at XMMO, XMHQ, and DON as stronger alternatives to invest in Mid Caps. We expected an advance in March but it happened in April instead. We bought the last weekly recycle. Back above 560 to 575 would suggest a strong summer.

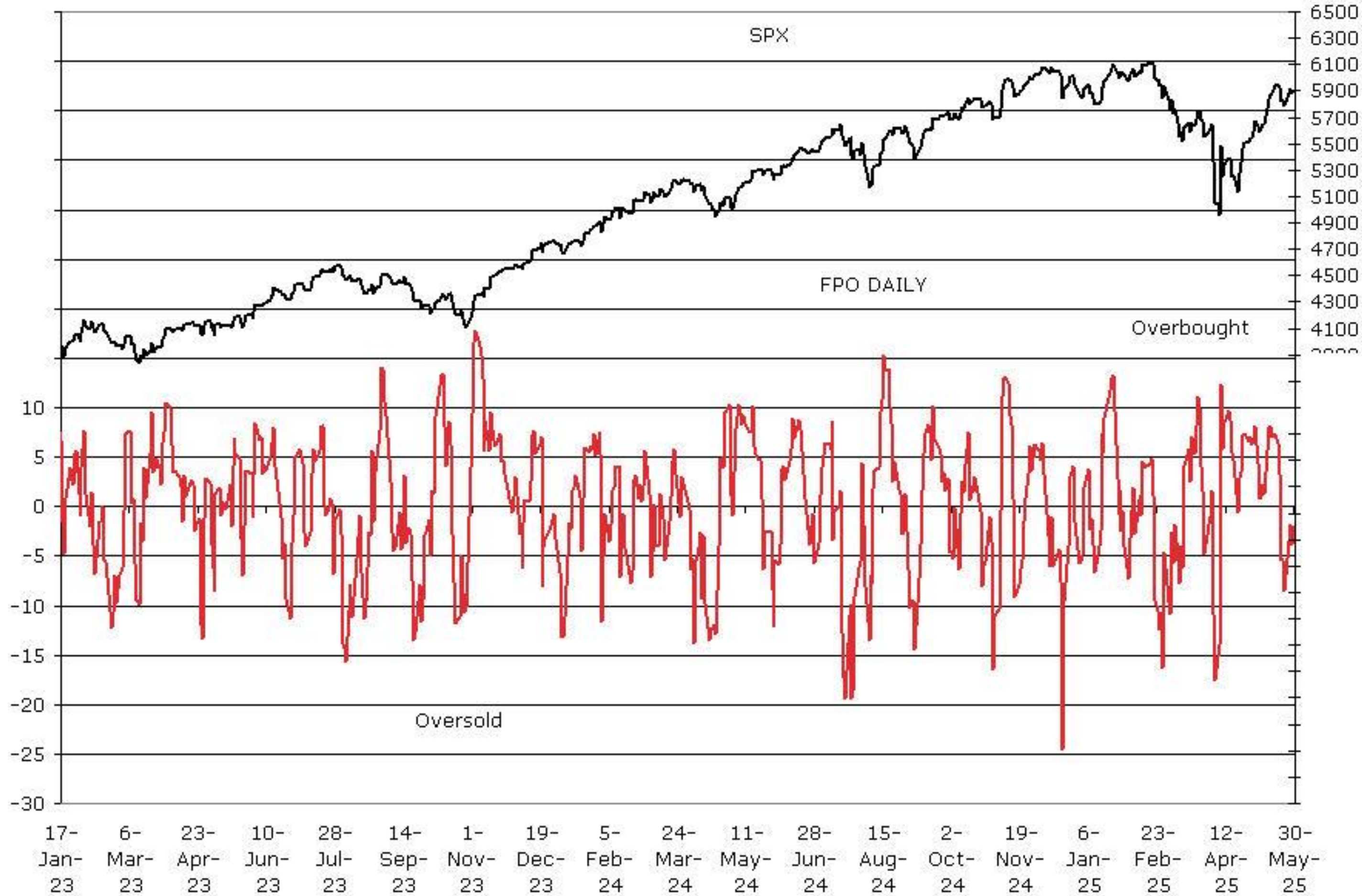
Market Review: Price Charts – IJR – IShares S&P SmallCap 600 Index ETF

Small Cap has rallied but still is weaker: The daily Stochastic is in sell mode, and the weekly is in buy mode. Smaller Cap names are still the weakest in terms of price, but accumulation has improved on this decline. IJR may be forming a Head and Shoulders bottom, as drawn. Value is outperforming here, unlike the large caps. Watch VBR, it is stronger than this, and IWM. Small Cap could still perform well in 2025, as it has an improving pattern. Above 105 signals recovery and above 107 should signal new highs.

Market Review: Price Charts – XTN – SP Transportation Index

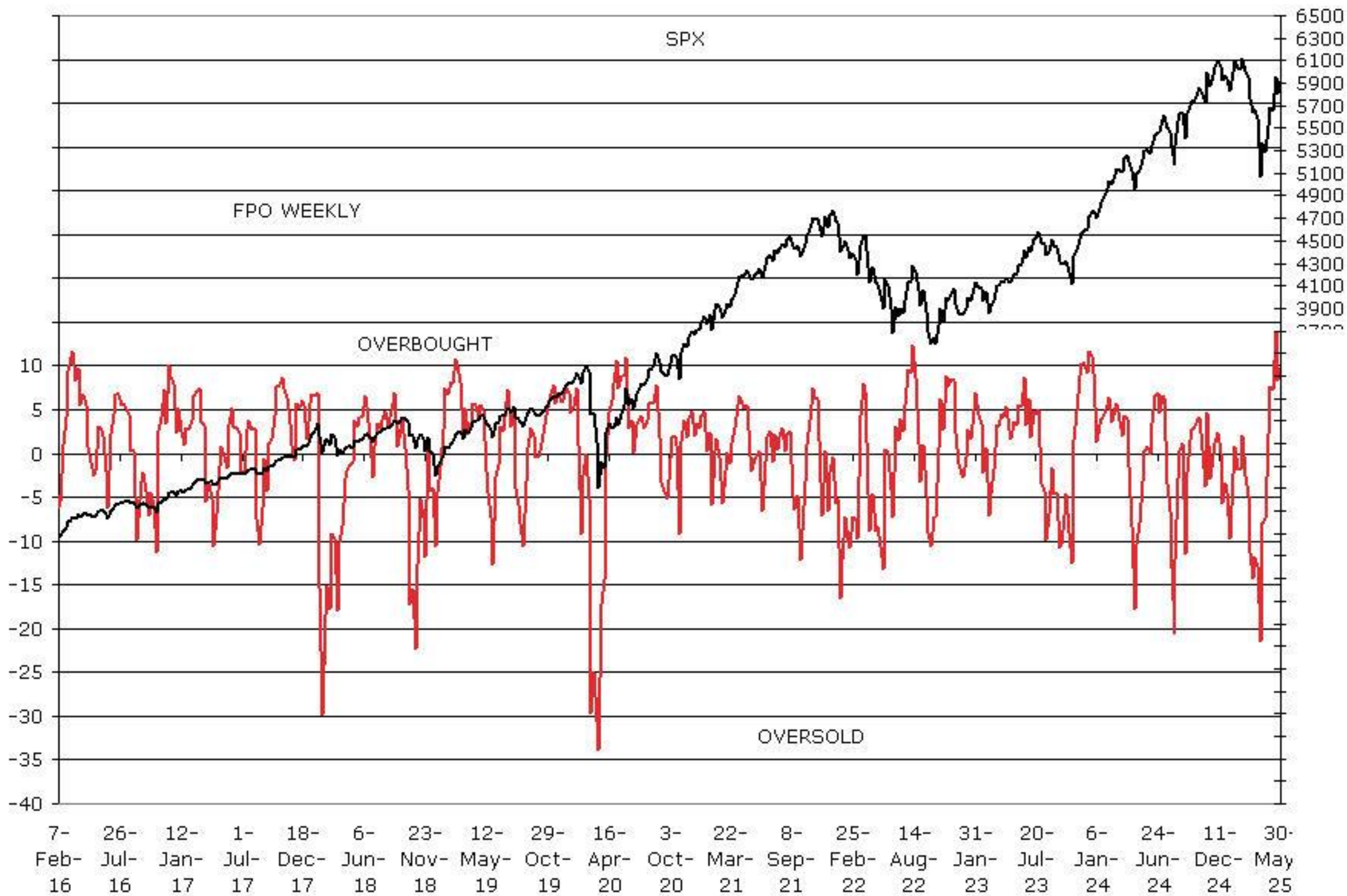
<u>XTN has rallied as well</u>: As we have said for years, our favorite indicator of economic strength is the Transportations. Indeed, when the Transports lead, the market is generally strong. For just one example, the Transports made new highs before the Industrials off the bottom in 2020, and there are many other examples. Transports have been weaker since 2021. The daily stochastic is in sell mode and the weekly is in buy mode. Transports This might also be building a Head and Shoulders bottom, but with a higher right shoulder, a positive sign.

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



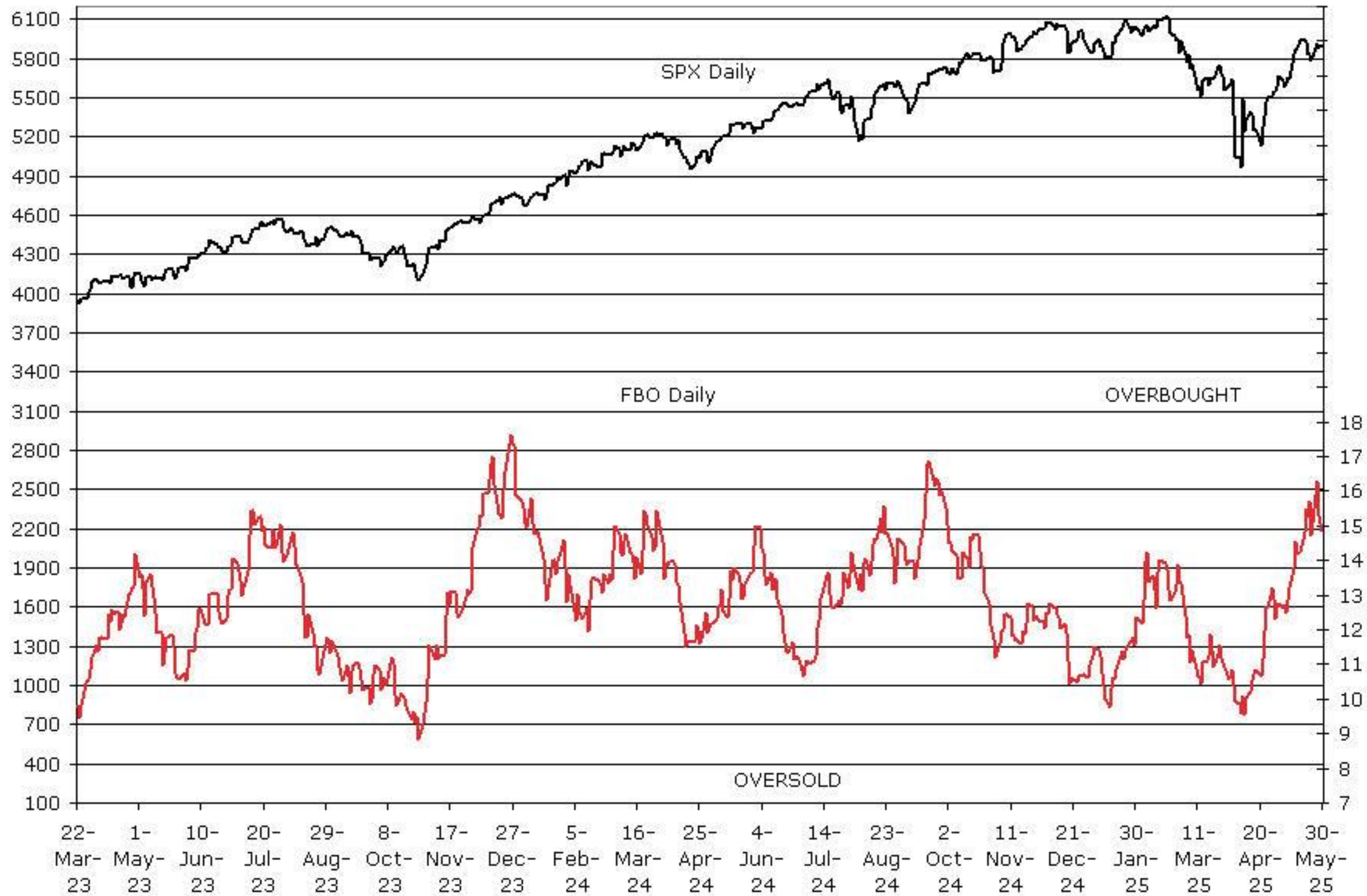
The daily FPO is slightly oversold: This indicator has pulled back, and is in buy mode. The pattern on this indicator suggests upside from here. The market has revalidated support. SPY held the 500 to 485-area we mentioned in our alert and rallied. This rally may be the start of the summer advance we have been forecasting. The move above the 575 area suggests new highs. Some more consolidation is possible, but this market looks primed for a summer rally.

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



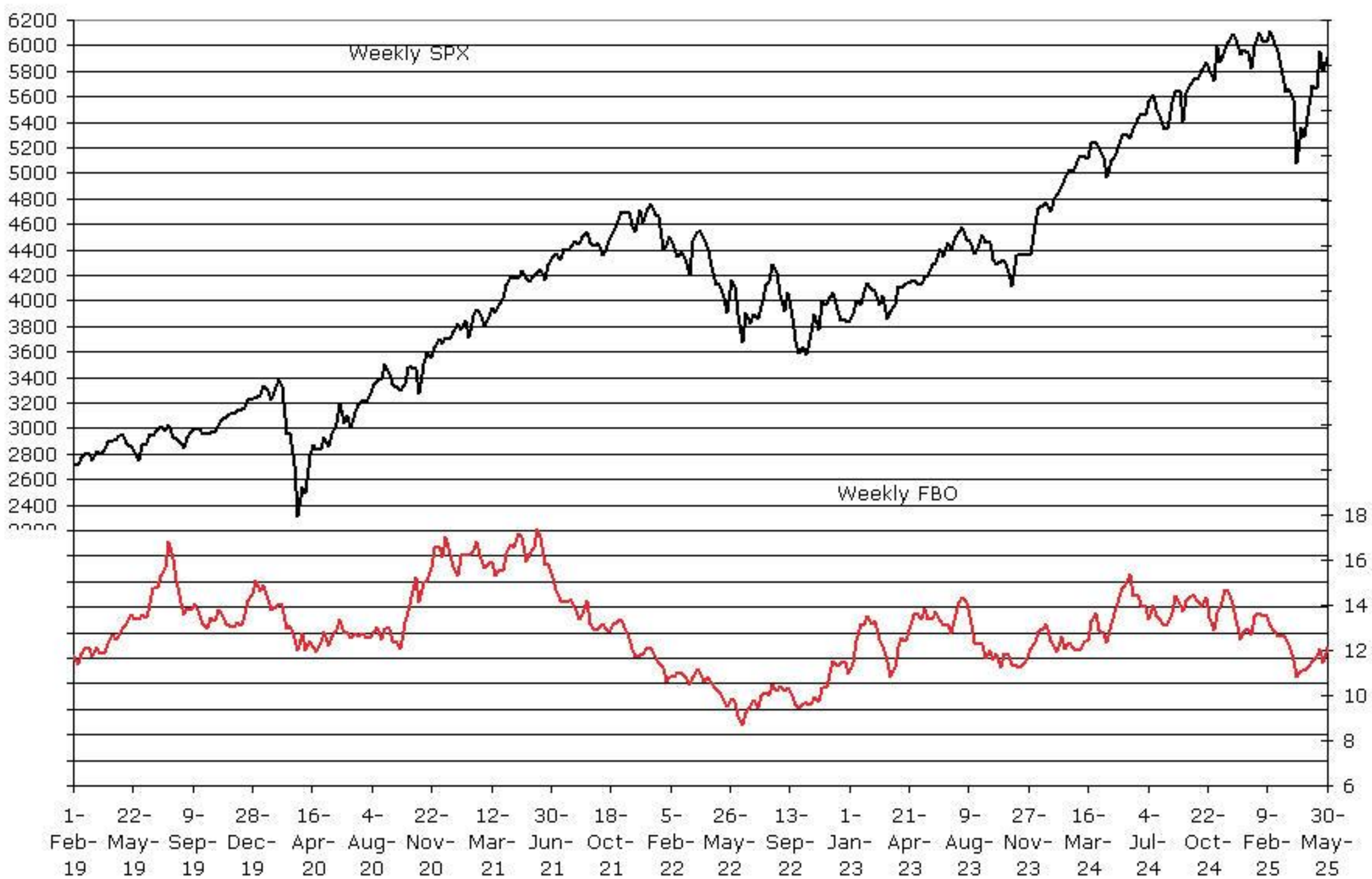
The Weekly FPO has also rallied: This indicator has had a thrust up that looks positive. Stocks had been acting about as expected until the tariff news. The weekly FPO has shown enough momentum on this advance to suggest further upside. While there could be some consolidation and pullback in this indicator over the next two weeks, afterward we expect a rally into July/August. The summer rally is one of the more reliable seasonal advances.

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



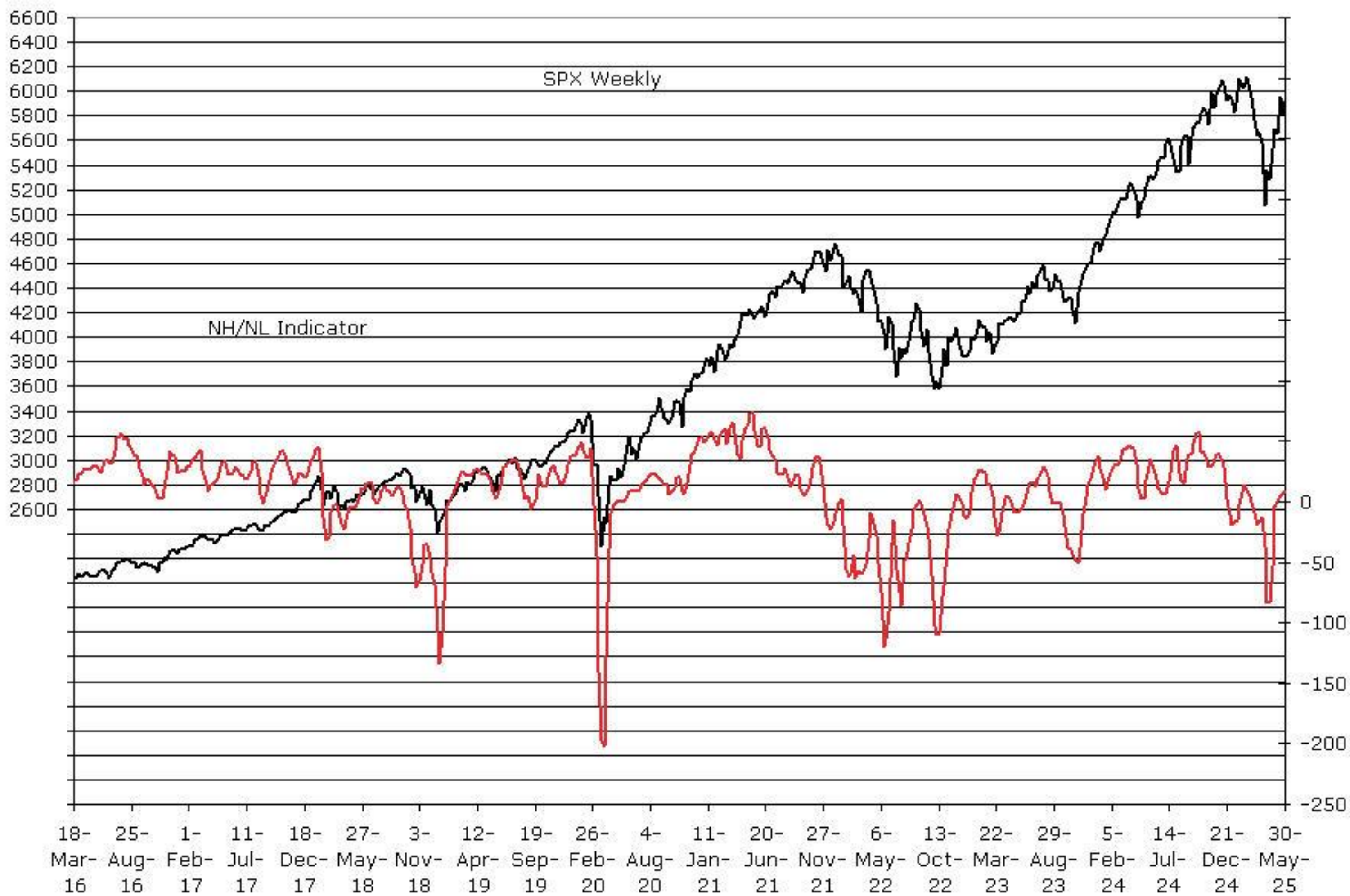
<u>The daily FBO has had a breadth thrust</u>: This indicator was lagging the Zweig breadth indicator, which is normal. Now it has confirmed this and suggests continued strength in 2025. We recommended adding money at 500 on SPY. This had a pullback on the last decline and held support in the 9-area, a move we expected. We have had stronger breadth recently, and last month we suggested this indicator should make new highs on this rally – at least 15 and hopefully higher. This happened, so we grade this bullish.

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



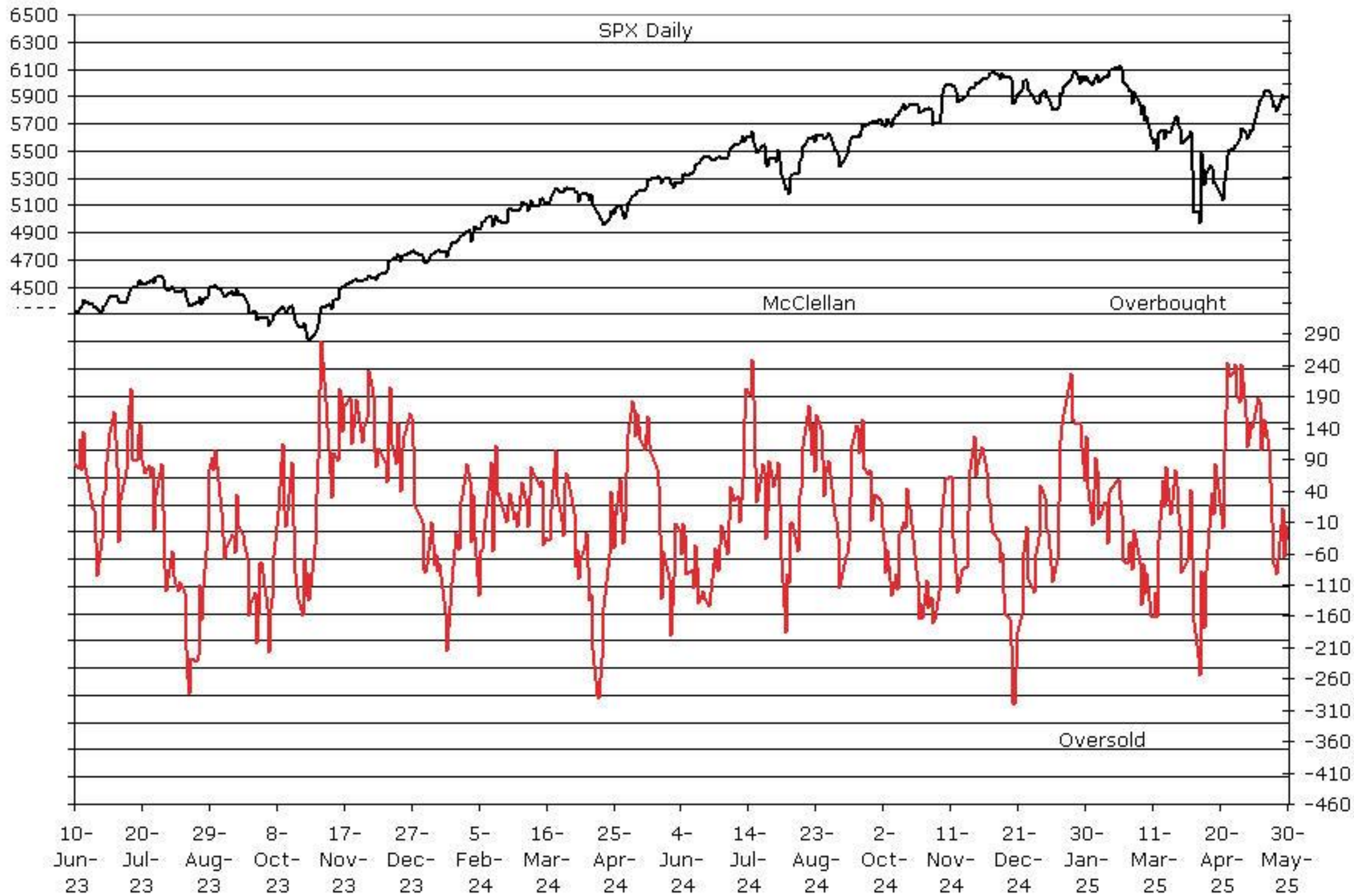
The Intermediate FBO is still weak: Weekly breadth momentum rallied from oversold after breaking the lows from 2016 and 2018. This is positive, but it has been weak since the low in 2022. Normally this indicator bottoms for a while before a significant advance in price, and the advance continues, but the indicator continued to make lower highs. The indicator has held some support but needs to move above the 13-area by the end of summer 2025, or we will have some concerns for the second half of 2025.

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



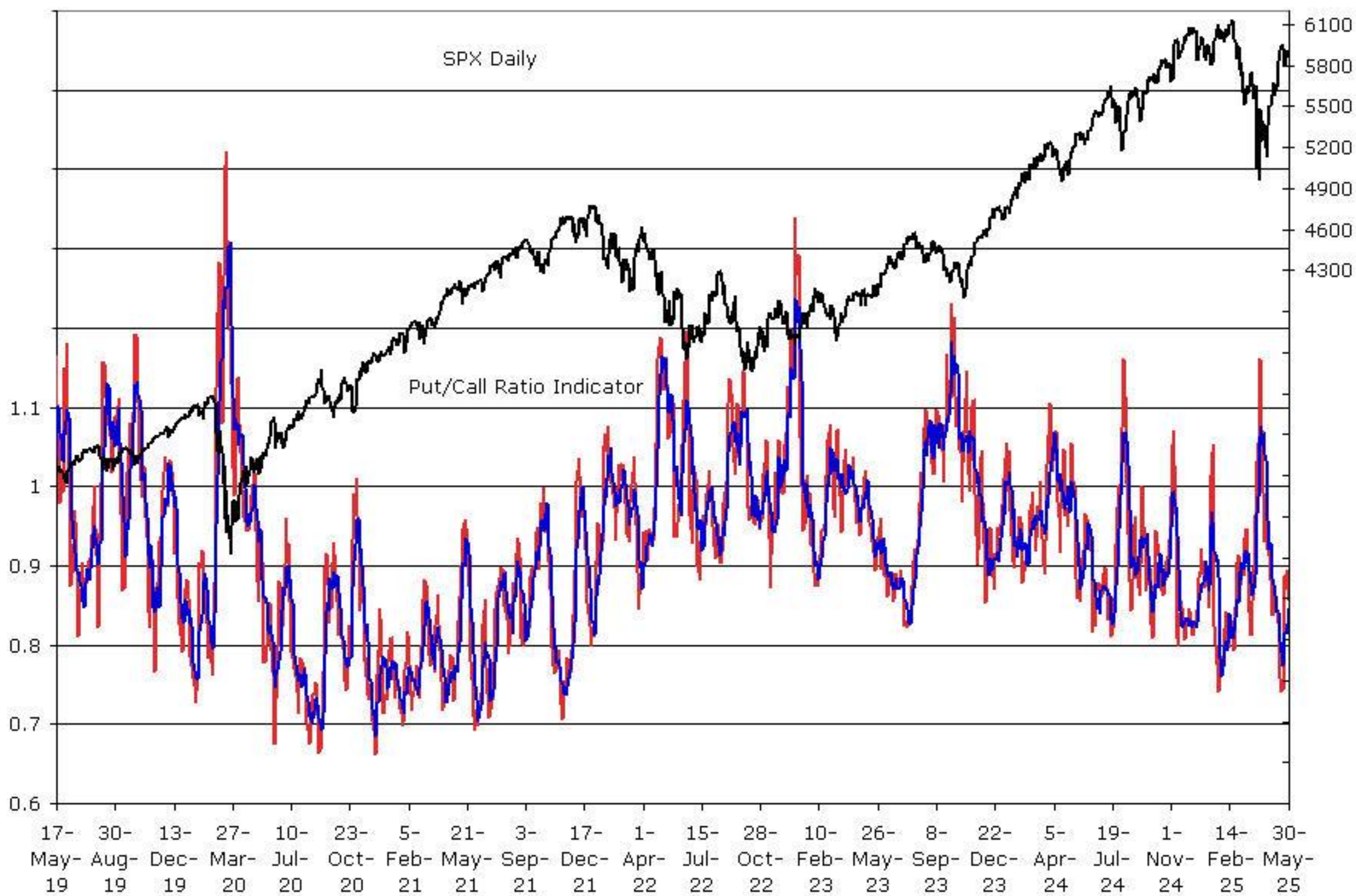
New Highs/New Lows has been weak since 2022: This tool measures the difference between the number of new highs and new lows on the NYSE. This broke down hard before the market peaked in 2021. This indicator improved a bit in 2024, but started to weaken in 2025, forecasting the recent pullback. In some ways, this is actually stronger now, as New Highs New Lows did not make big new lows on the last pullback, and it had a sharp rise on the April rally. This is improving, but still neutral.

Market Review: Internal Momentum – McClellan Oscillator



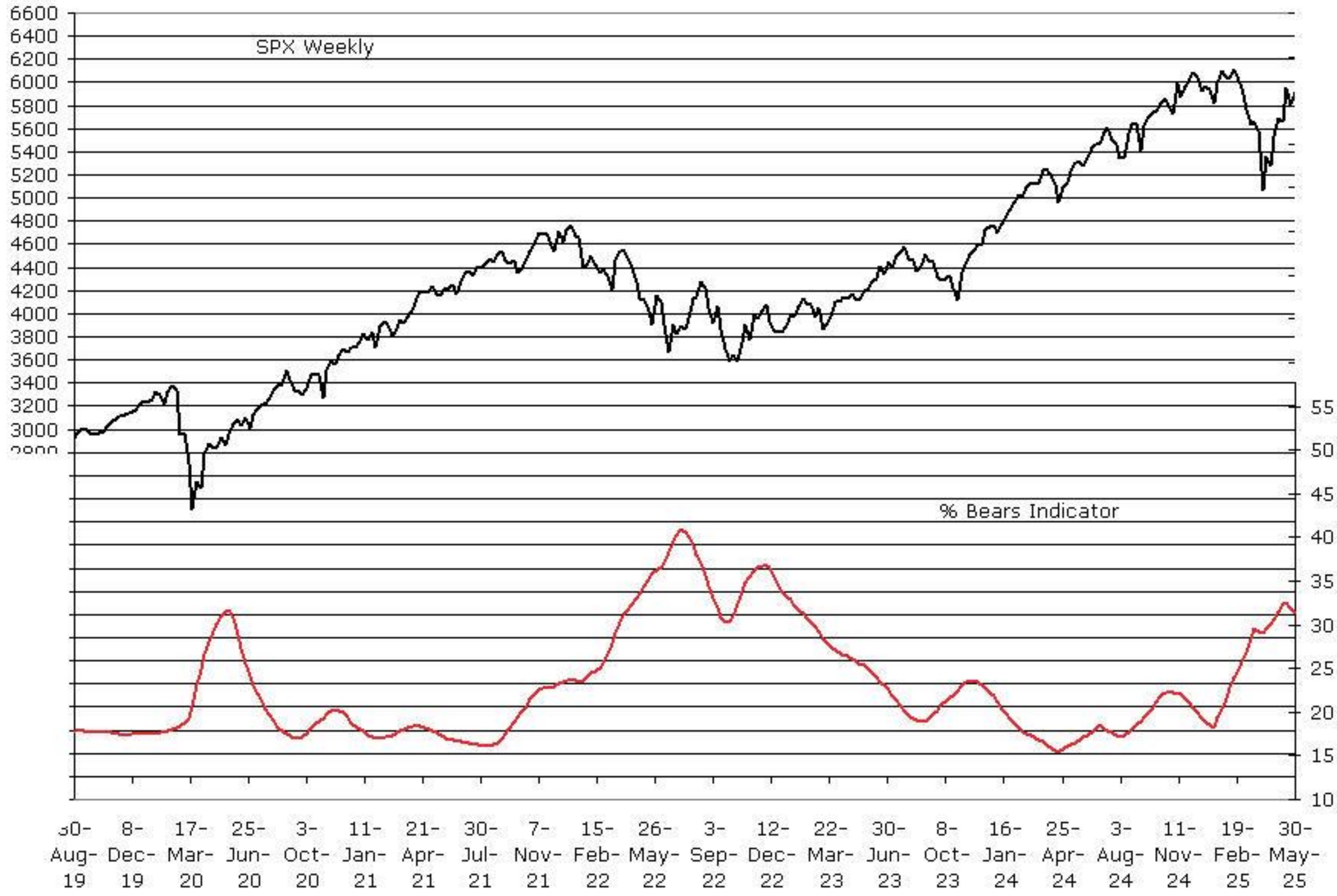
<u>The McClellan Oscillator has pulled back</u>: This pulled back from a high level and is in buy mode. The indicator suggested some upside last month this pullback is bullish. The McClellan is around -60, which means it is set for a summer rally. Overall, breadth is improving short-term. However, the intermediate-term picture is still weaker than we would like to see. The McClellan is our most sensitive breadth indicator so it looks stronger than our FBO's.

Market Review: Sentiment – Put/Call Ratio



<u>Put/Call is showing lots of short-term bullishness</u>: Sentiment indicators are “condition” indicators for us, and not timing tools. Put/Call is more of a short-term indicator. We have been looking for a spike in this indicator and finally got it, before this rally occurred. This indicator is the only one we have that suggested the decline could occur. The surprise of the tariff news finally gave the spike. I believe that Put/Call is the most important indicator we have to evaluate expectations of a news event. Now, it has pulled back due to the April rally –the indicator is neutral.

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



Investor's Intelligence %Bears is a strong and improving pattern: This moved above the 40-area in 2022, the highest reading in years. Since October 2022, this has remained elevated. The last move below 20 and then back above it is quite positive, suggesting investors were quick to turn bearish on any decline. Now above 30 is a plus, as the indicator is where it was during the depths of the Pandemic in 2020. Overall, this suggests the sentiment backdrop is positive intermediate term. This suggests the next market buy signal may be greeted with skepticism. When you look at Put/Call (previous page) and combine it with this, it suggests short-term problems that have improved, and long-term positives.

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

TLT still looks like a bottom: TLT is holding support. The daily stochastic is in buy mode, and the weekly is oversold and should buy a recycle. This is a base, and we continue to look for 95 or higher by the end of July. Look at the other Bond ETFs in this report – TLT looks worse. We remain neutral intermediate-term, but within that context, this should move higher into the summer. We would try to sell this around 95 if we see this sooner than summer. Per the last monthly, we bought the last daily recycle as it held 84.

Other Markets: Bonds – MUB – iShares National Muni Bond

MUB broke support at 105: This broke below, and above, the 2022 low. We have been using MUB above 105 to suggest rate rises should slow or reverse. Now, this is below 105. This is stronger than TLT. The daily stochastic is a new buy recycle, and the weekly is a buy pattern with waning momentum. This pattern has weakened and back below 105 is a concern, suggesting higher rates are possible. This has been our favorite Bond ETF. The intermediate pattern is a base. This should be up over the summer, ideally above 107.

<u>Other Markets</u>: Bonds – LQD – iShares iBoxx $ Invest Grade Corp Bond

<u>LQD is also stronger than TLT:</u> Corporates were where the Federal Reserve (FED) was buying the most bonds in 2020. The FED supported this during the pandemic, and afterward this market went to where it should have been. LQD had a double bottom in the 100-area. The daily stochastic is overbought, and the weekly is a slight sell signal. This should be able to exceed 111 by the end of July, even if it fails in here. We would sell a move to 111 to 115. It may be that high grade Corporates are safer than Treasury.

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

<u>The High Yield Bond ETF failed at 80-area resistance</u>: The daily and weekly stochastics are overbought again. Confirmation of a new uptrend will be a move above 80, which has failed so far but is being tested again. Back below 75 would suggest a test of 72, lower than this would be a concern and a surprise. So far, this is stronger than most Bond ETFs.

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

EEM moved below, and above 43-area support: This moved through the 44-area resistance and then broke down through that area. The daily stochastic is in sell mode and the weekly stochastic is overbought. EEM is still an intermediate term range. This is not a favorite Emerging Market play. We continue to recommend an active manager or mutual fund solution for Emerging Markets. Look at EELV to avoid China exposure when that country becomes too volatile. We note that this HAS improved.

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

EFA gapped above 85-area resistance, as drawn: EFA has held the breakout. It is significant that EWG has improved, suggesting Europe should do well. We also like Japan – it may have ended a secular bear market. The daily stochastic is in sell mode, and the weekly is overbought. We have felt that, by summer, the US should be outperforming international markets. The key 75-area mentioned in the last Monthly, was fully tested and held. Back below 84 would suggest this rally is ending.

Other Markets: Currencies – FXE – CurrencyShares Euro Trust

FXE is fully testing 105-area resistance: Accumulation models still suggest that FXE is vulnerable. The Euro broke above, but is now below, resistance in the 104 to 105-area. This held the 95-area support. We will watch what happens on this weekly sell recycle. However, the trading thus far suggests FXE will remain in a trading range, exactly as we expect the dollar to do.

Other Markets: Currencies – FXY – CurrencyShares Japanese Yen Trust

<u>The Japanese Yen has bottomed, per the last two Monthlies</u>: When FXY broke the 80-area and fell off sharply, it started a completely new downtrend. FXY recently made a higher low. The weekly recycled as well. FXY remains intermediate-term weak. Longer-term, it looks as if FXY could move into a trading range, which should be positive for the Japanese equity markets. The daily recycled and this made higher lows. Above 66-area resistance would target 68 to 72.

Other Markets: Currencies – DXY – US Dollar Index

<u>The dollar is holding the 100-area:</u> The dollar broke out of the long-term trading range. This rallied through much of 2021 and hit trading targets as mentioned here in 2022. Look at FXE on p.22 as well, to get a handle on the dollar. The dollar moved out of the 2023 to 2024 range. The intermediate picture is still strong. Look at a long-term chart of the dollar. The dollar is a multiyear uptrend (since 2008) and this has resumed. Look at DXY on Bigcharts.com. This should stay in a trading range for 2025. The daily stochastic has recycled. It should rally.

Other Markets: Commodities – DBC – PowerShares DB Commodity Index

DBC is still building a base in the 20 to 26-area: DBC is testing the low end of the trading range. The daily stochastic is oversold and close to recycle. The weekly is indecisive. This still is a bottoming pattern, and seasonal tendencies on oil is turning up in June. DBC should turn up. Agriculture has positive seasonality now. This is not a bad chart, but it is a downtrend that should start to turn up. We bought the last recycles. Buy the next daily recycle. If this breaks 19 we would have some concerns.

Other Markets: Commodities – GLD – SPDR Gold Shares

GLD has entered a consolidation: GLD Accumulation has improved, but given the move it has had, it is still a bit weak. The daily stochastic is in buy mode, and the weekly is in sell mode. Gold rallied on seasonal strength, but this has ended and it may be starting to break down. Much below 290 targets 270. Several indicators are now giving some selling indications. There is the strong possibility of an intermediate term peak this month. GLD is a hold for investors but be sure you have a stop loss point. Traders should sell this.

Other Markets: Commodities – USO – United States Oil

USO is a double bottom: The daily stochastic is in sell mode, and the weekly is in buy mode. USO has a positive intermediate chart and seasonal strength starts in June. There is strong support in the 65 to 60-area, and this is being tested. Oil still looks to be a range, but it is ready to rally if the daily turns up. Some of this price action is due to the equity market turbulence. We have to see how this holds up this month. This is a new weekly buy recycle so it could rally from here.

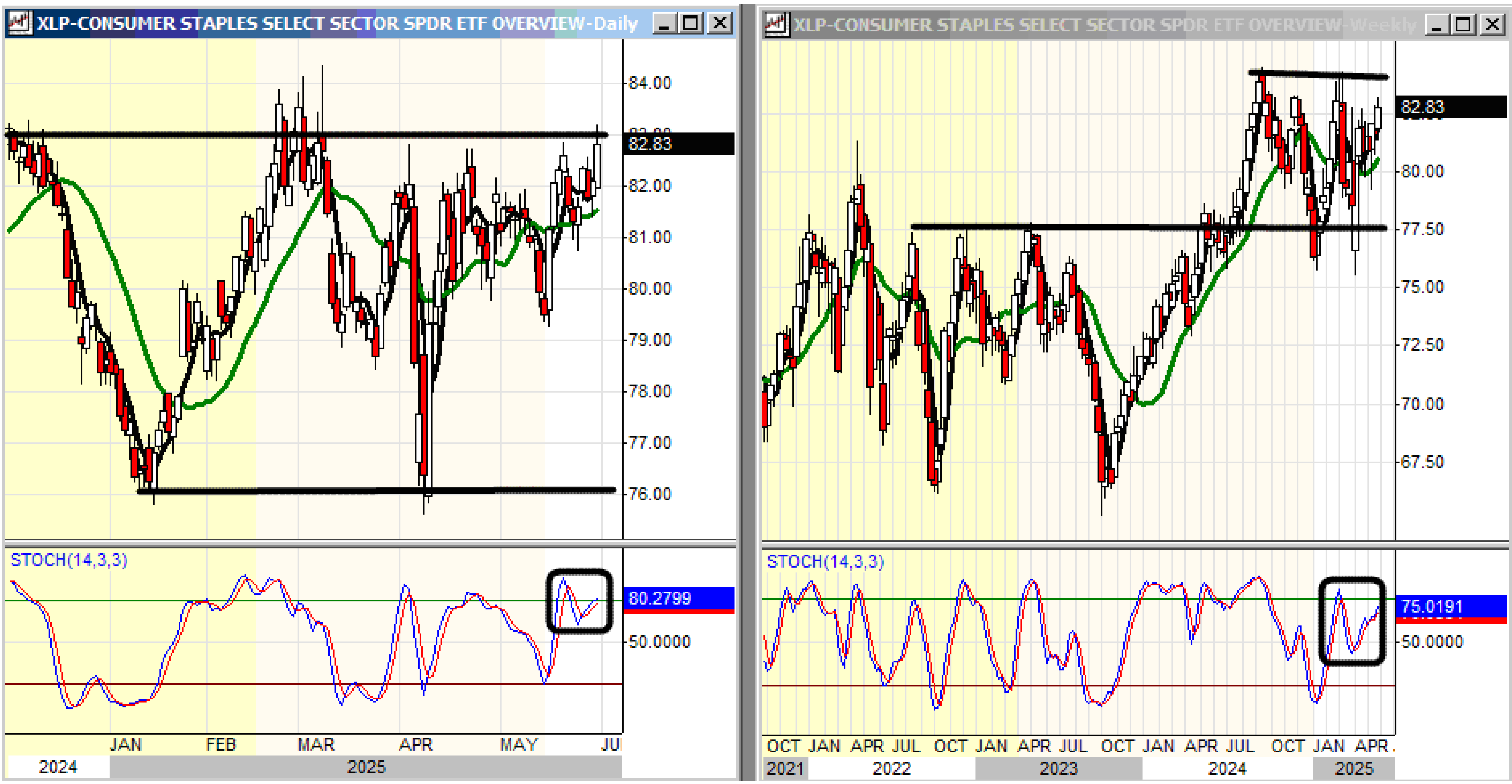
Other Markets: Commodities – UGA – United States Gasoline Fund

UGA is still a base: The daily stochastic is oversold. The weekly is a buy pattern. This is a strong chart as long as the 55 to 50 - area can hold intermediate-term. Gas prices are falling. A move above 65 again would be our cue to look for higher oil prices and above that again targets 75 by summer. A move above the 75 resistance could target new highs, but would be unlikely, in our view. Traders can buy the next recycle; investors can hold for now. This should have a summer rally but remember gas prices were generally lower in the first Trump Administration.

ETF Sector Charts: Consumer Discretionary (XLY)

Consumer Discretionary has rallied to resistance: XLY held the 170-area intermediate support, although it did test it as we thought it might. Note that AMZN, a major component, looks very similar to XLY. This is a neutral chart longer-term although it looks worse short-term. We now have a daily stochastic that is in slight sell mode, and an overbought weekly. The Accumulation Model is still weaker than we would like, suggesting a bit more turbulence is possible in this sector in 2025 – this is what we have seen. We think our stock ideas are solid names even if the sector is showing less accumulation. We bought the last weekly recycle. Some consolidation, and this should rally. EQUAL WEIGHT

ETF Sector Charts: Consumer Staples (XLP)



XLP is defensive and holding up well: The intermediate-term chart broke out above 77.50 then moved below, is now above it once again. We recommended buying the last daily and weekly recycles. XLP is defensive and trading well. Since it moved above 77.50, it hit new highs, per our comments in the August Monthly. The daily stochastic is in sell mode and the weekly is a sell pattern, although somewhat inconclusive. This is short-term up as long as above 77. It looks like some money is flowing in here. Keep adding on recycles. EQUAL WEIGHT

ETF Sector Charts: Energy (XLE)

XLE is an intermediate-term consolidation: Seasonal weakness ends in May/June. The daily stochastic is oversold and close to a buy recycle, and the weekly is a buy recycle. XLE has strong accumulation. Compare this to USO – it is weaker but on support and seasonality is turning up. XLE does have some capitalization issues, but weakness in CVX is balanced by some strength in XOM. The move above 90 targeted 93 on a trading basis, which hit, and suggests 110 is possible for investors in 2025. This rallied into the end of March. We need to be careful but seasonals are turning up, and the support at 75 has held so far. Buy the next daily recycle. EQUAL WEIGHT

ETF Sector Charts: Financials (XLF)

XLF tested and held support: XLF hit new highs but sold off with the market. The daily Stochastic is in sell mode. The weekly is overbought Banks are a bit weak, but other subgroups are trying to hold up. We added on the last daily recycle. Credit cards are also a strong subgroup intermediate-term. XLF should still outperform in 2025, and the chart is one of the strongest in this report. However, this has turned into a crowded trade and we will watch this at the end of a summer rally. Watch banks carefully as if they don't rally there could be problems. There has been some improvement with the April rally. OVERWEIGHT

ETF Sector Charts: Real Estate (XLRE)

<u>XLRE is holding up:</u> This has probably made an intermediate-term bottom. Please see the long-term charts of IYR as it is similar to XLRE, but with more data. Interest rates have affected the real estate markets and XLRE is reflecting the rate situation, which the markets think is improving, but we are not sure it is – watch TNX, and TYX, which have failed at 5% so far, but could go through that number. This has held but it is not doing well. Below 42 is a concern, but this may trade back and forth around this area. The latest trading has held support, and the intermediate chart is a base. However, this is still weak relative to the other sectors. Careful when the daily stochastic moves into a sell recycle. This could weaken again. UNDERWEIGHT

<u>ETF Sector Charts</u>: Health Care (XLV)

<u>XLV broke below, and above support:</u> XLV broke down, below the 135-area. This has been weak since the election but has a weekly recycle after the decline. Accumulation on XLV remains strong. The daily stochastic is in buy mode, and the weekly is oversold. XLV is holding support on a closing basis, but back above 135 would be ideal. This is not a great looking chart given the recent market action, but you can try to buy it here. Below 130 would be a concern. This is a weak equal weight. EQUAL WEIGHT

ETF Sector Charts: Industrial (XLI)

<u>XLI broke below, and above the 120-area support:</u> The accumulation model on XLI remains very strong. The daily stochastic is in slight sell mode, and the weekly is overbought. XLI's strength was not widely acknowledged, so it should have more to run. This remains a strong formation as long as XLI is above 115 and holding 135 to 130 is important here. XLI performed well in 2024 yet the markets are ignoring the performance of XLI. This is performing well and should do even better in the summer. OVERWEIGHT

ETF Sector Charts: Materials (XLB)

XLB broke and revalidated 82-area support: XLB is weaker than we thought it would be. Short-term support from 82 broke on a gap. The Accumulation was weak, suggesting this could have problems and this is why we have been an equal weight. The weekly stochastic is up and not an overbought pattern, the daily is in sell mode. Back above 85 has improved this chart, however. The intermediate-term trend is now sideways rather than up, and the weak Accumulation and price action keep it from being a favorite.   EQUAL WEIGHT

ETF Sector Charts: Utilities (XLU)

XLU held the 79-area support: This broke out above 79 and is above there once again. The daily stochastic is in sell mode. The weekly is overbought. Income Investors were buying this on pullbacks, as we have recommended over the last six years. This is also an AI play, as the power grid should be attracting more money. These can do well in 2025, even in a summer rally. So far, this is outperforming and is functioning as a defensive sector. We remain an equal weight. Back below 77 would suggest the rally is over, but this is still an income play for now, and dividend stocks look a bit better. This short-term consolidation is attractive. EQUAL WEIGHT

ETF Sector Charts: Technology (IYW)

<u>IYW Broke and revalidate the key 130-area:</u> Tech has been everyone's favorite overweight for a while, and because of this Tech has been overvalued. To some extent the last correction masked an unwind of many tech over weights. The daily stochastic is in sell mode, and the weekly is overbought. We have consistently said not to sell the ultra high relative strength tech names, and they are trading better than the rest of the sector, but there are less of them. Buy the very best companies on recycles for your Tech allocation. We thought Tech should have problems later in 2025, so weakness after a summer rally would not be a surprise. Accumulation has started to improve on IYW and QQQ on the last decline. It has improved on this rally as well. This is setting up for a summer rally. EQUAL WEIGHT

ETF Sector Charts: Telecom (IYZ)

<u>This fully tested 25-area support:</u> This broke out above 25 and retested that area, now support. IYZ is defensive and holding. We moved to an Underweight in February 2021. We have seen some advance in T, which is the probably the biggest reason this improved. The daily stochastic is in sell mode, and the weekly is overbought. This is still one of the weaker sectors intermediate-term, but it is improving and part of the rotation out of Tech we are seeing. For now, we will maintain our underweight. We want to see how this trades after a summer rally.
UNDERWEIGHT

Research Piece: Bullish Exhaustion = Pullback or Consolidation

By Cam Hui – Humble Student of the Markets

Bullish Exhaustion

You can tell a lot about market psychology by the way it responds to news.

The accompanying chart shows how the S&P 500 responded in the extended trading hours and during the trading day to important news. Why did the S&P 500 rally 2.1% after Trump announced he was pausing the 50% tariffs on the EU for a month? Why did the index initially rally but ended the trading day with just a 0.4% gain last Thursday when the U.S. Court of International Trade ruled that Trump exceeded his authority when he imposed “Liberation Day” tariffs and the tariffs on Canada, Mexico and China for fentanyl smuggling?

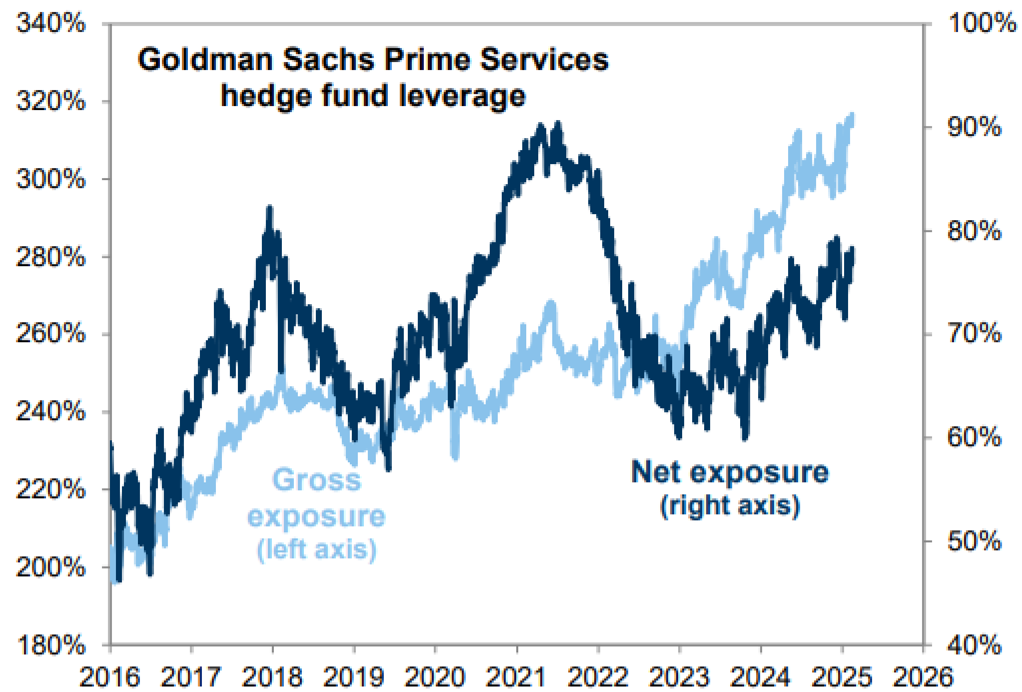
Stock prices weakened Friday in reaction to an angry social media declaration by President Trump that China had violated its trade agreement. I interpret the market’s inability to react to good news as a sign of bullish exhaustion.

Poised to Rally

Hedge fund positioning is supportive of a beta chase on good news. Although gross exposure, which reflects the use of capital, is high, net exposure, which reflects directional exposure, is roughly neutral by historical standards.

Exhibit 4: Hedge fund gross and net leverage

Aggregated data from Goldman Sachs Prime Services as of 13-Feb-25; should not be relied upon as a comprehensive view of the market



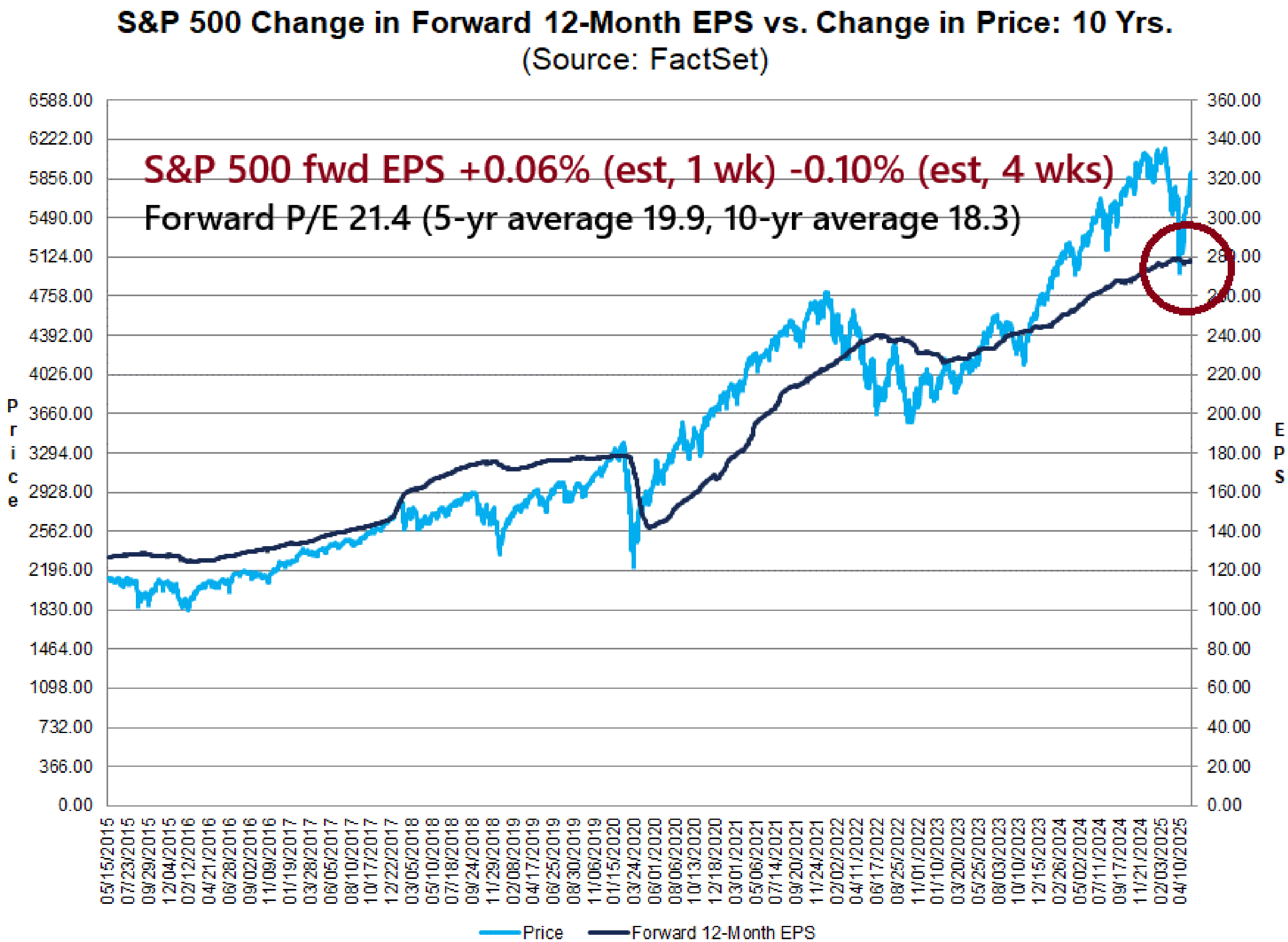
Source: Goldman Sachs Prime Services, Goldman Sachs Global Investment Research

Similarly, CTA trend followers have recovered from an extreme short position to neutral.

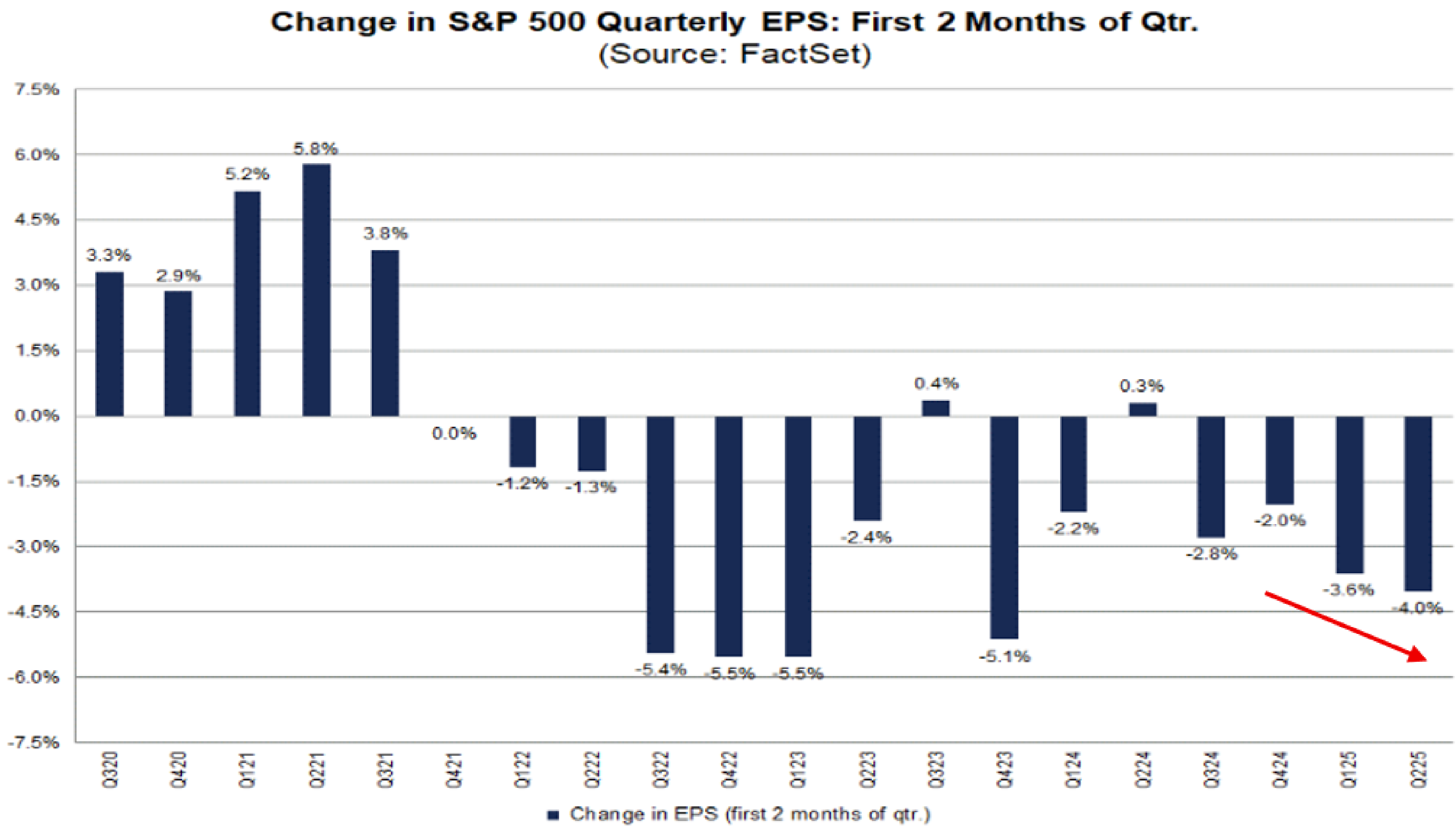
Key Risks

Why didn't stock prices rally on the news?

You can always point out the risks in hindsight. The S&P 500 is trading at a historically elevated forward P/E of 21.3, which limits upside potential as trade war uncertainty hangs over the market.



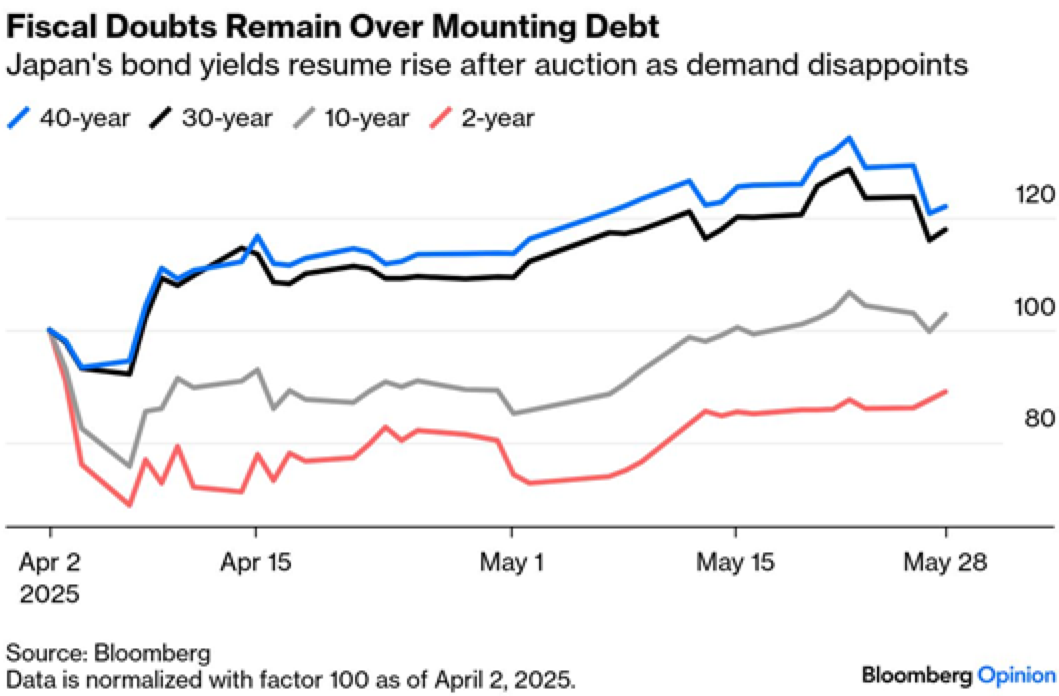
The combination of an elevated forward P/E with an above average and decelerating rate of quarterly EPS revisions poses headwinds for equity prices.



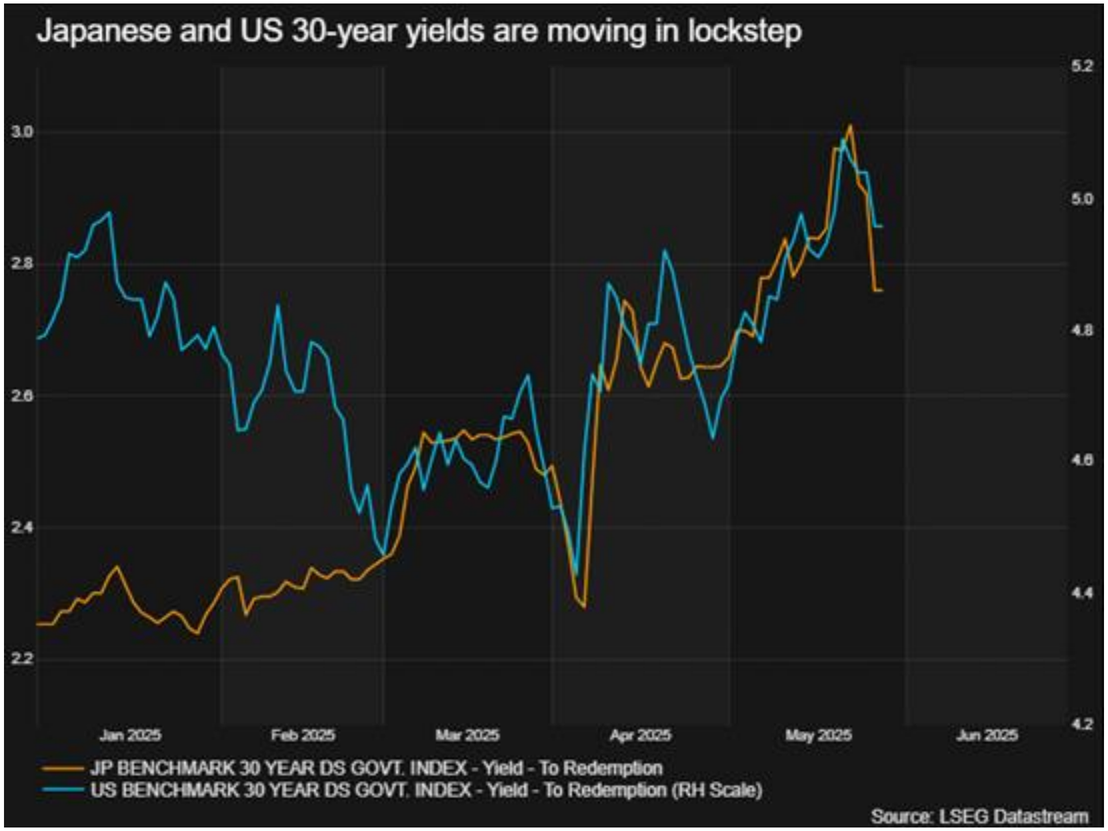
One other key risk to asset prices is posed by the bond vigilantes, who recently flexed their muscles by throwing a minor tantrum.

If tariffs are rolled back by the courts, it would expose a big hole in the government's budgeting process. The Budget Lab estimates the court decision represents a $2 trillion revenue loss over 10 years, which makes the new budget a tough sell for the fiscal hawks in the Republican Party. Treasury Secretary Bessent would be faced with the risk of another bond market tantrum if nothing is done.

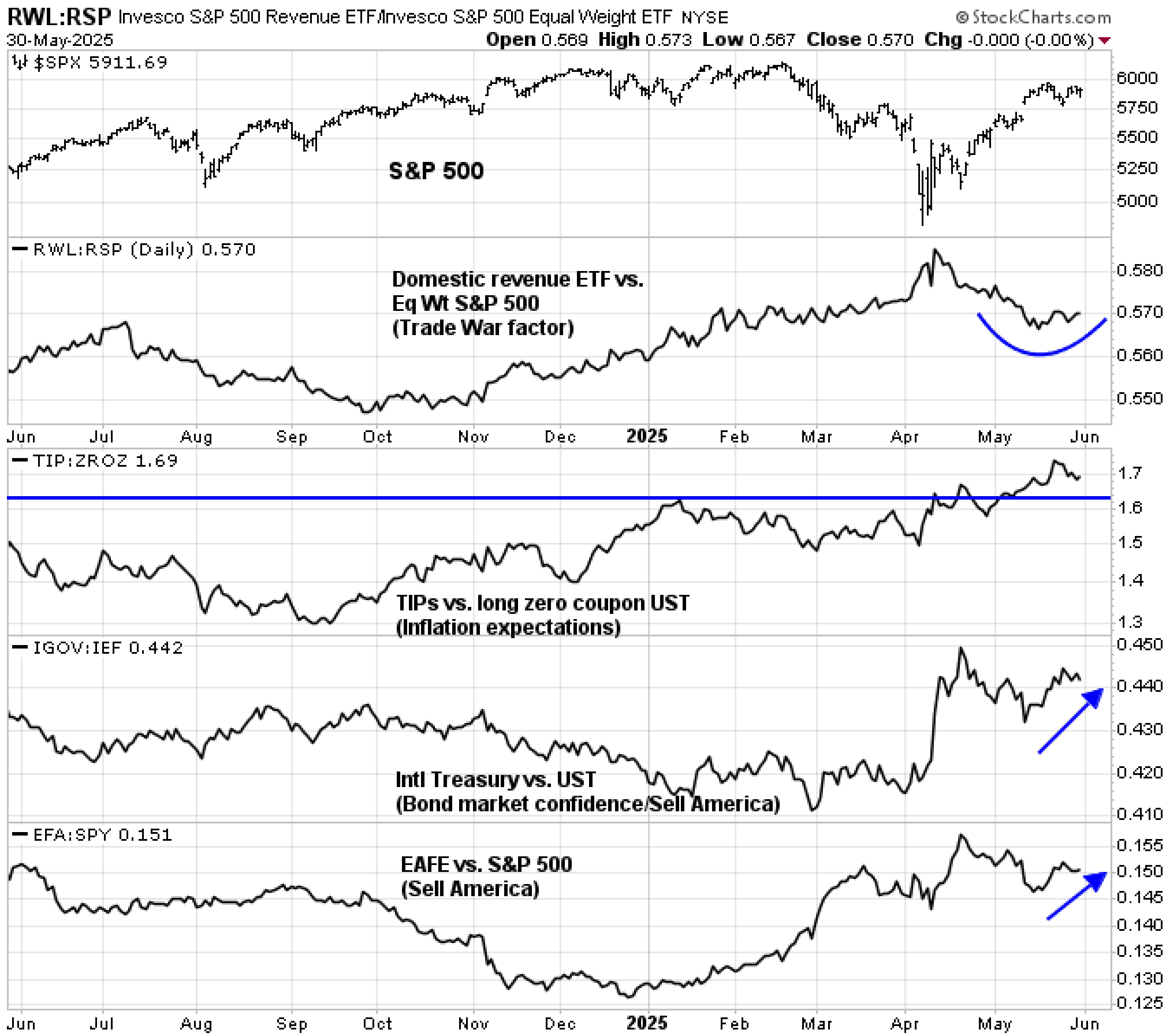
Fortunately, the bond market was calm and Treasury yields fell in the wake of the court decision, but risks remain. In particular, bond yield risk is emerging in Japan after a series of disappointing JGB auctions.



Japan's debt to GDP is over 250%, and the BoJ already owns over half of the country's debt. As JGB yields rise, the risk of Japanese investors repatriating funds from abroad to take advantage of rising Japanese yields is increasing. Already, Japanese and U.S. 30 years are highly correlated. Further upward rate pressure in Japan could resolve in a disorderly unwind of the Yen carry trade and a global risk-off stampede.



An analysis of the Trump policy equity factors shows the bearish backdrop is continuing. The trade war factor unexpectedly edged up on the news of the court decision, indicating greater tariff anxiety. Inflation expectations and Sell America factors edged up. The court decision and subsequent Trump Administration appeal are elongating the period of trade war uncertainty.



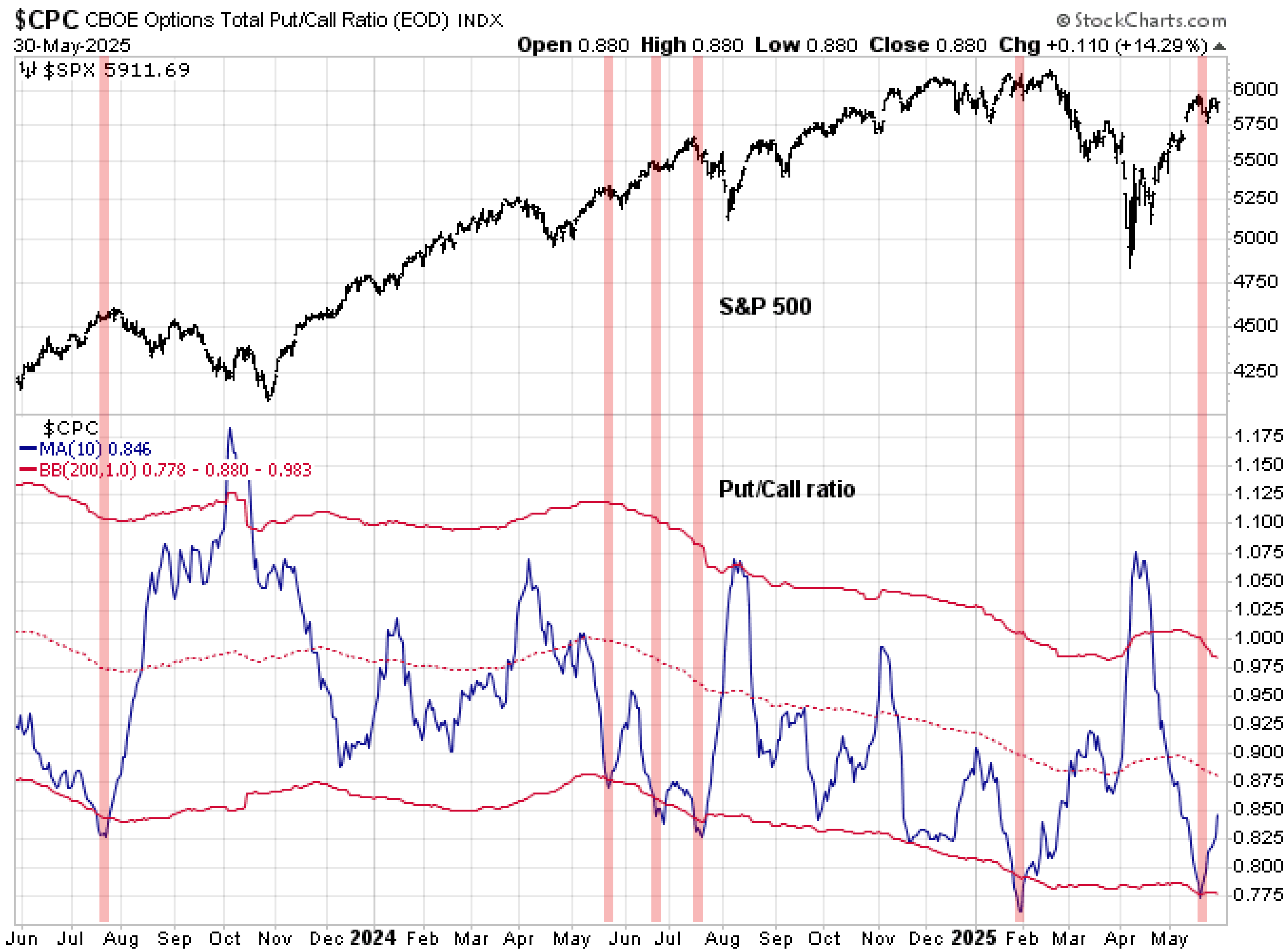
In particular, further strength in the Sell America trade would exacerbate a Yen carry trade unwind.

A Range-Bound Market

The market's inability to rally on good news was a sign of bullish exhaustion. The recent violation of an upward sloping trend line in the face of positive news reinforces my view that the U.S. equity market is in a wide trading range. Technical conditions point to either a pullback or consolidation in the short-term.

Elevated valuation and continued uncertainty over trade policy, fiscal policy and the growth outlook all serve to create a roof over stock prices and the S&P 500 is unlikely to exceed its all-time highs in the near future. On the other hand, market panics will activate a Trump Put at levels defined by the April lows.

As well, option market sentiment has become a little overly frothy. The 10 dma of the CBOE put/call ratio recycled after falling below its one-standard deviation Bollinger Band. While this isn't necessarily outright bearish, similar episodes in the last two years has seen the S&P 500 struggle to advance under such conditions.



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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