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wealthgram@gscgi.ch • www.gscgi.ch
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S&P500: how far and how long may the current correction last?

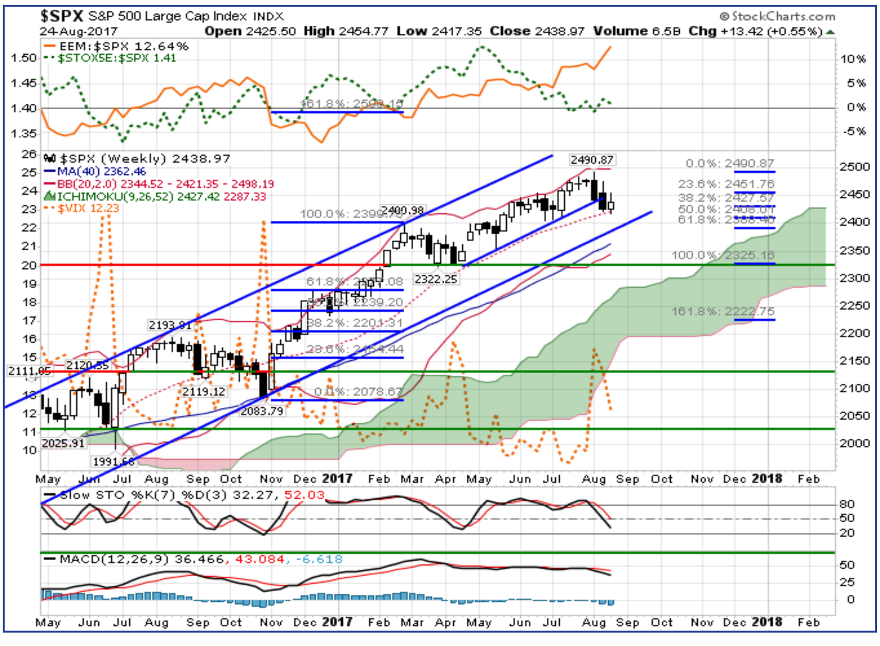
...article de Bruno Estier Strategic Technicals - http://bruno.estier.net/ - bruno.estier@bluewin.ch

In August, as usual, there are warnings in the equity markets about the risk of a seasonal correction in the fall. Looking at the weekly chart of the S&P500, one can see that the VIX index of implied volatility was just below 10% during July. Such a low level is followed, in the coming months, by a significant rise as the seasonal equity correction develops into the fall. That was the pattern during the summer-fall 2016. Sure enough, a rise of VIX to 16%, from mid-August 2017 forward, is presently visible. Moreover, a correction has started to develop for the S&P500, from 2490 to 2420, crossing down the weekly Stochastic and MACD, which represent a declining price momentum.

How long and how deep can this equity correction develop? The timing appears easier to define as the seasonality is really helping us. The time frame of this correction should last two months – into mid-October 2017. Last year, it lasted a little longer until the end of October, but perhaps it was tied to the presidential election process? Historically, the chance for an uptrend to resume for US equities increases a lot after mid-October. The issue of the depth of the correction is a little more difficult to define. From a pure technical analysis view point, the target of such correction is near the previous medium-term consolidation, which occurred during March-April 2017 near 2322, as seen on the chart. With two down weeks to 2420 and one week of rebound so far, it is likely that the first down leg of the correction has been done.

As the 2016 correction is hinting, the rebound following that initial down leg can last several weeks. Lasting more than a month can separate the low of the first down leg from the low of the second down leg. Furthermore, the price pattern of the rebound between the two down legs is notoriously difficult to forecast. Of course, the weekly momentum indicators may display close to the end of the second down leg, some bullish divergences that will help to pinpoint the end of the correction. But, we should also monitor the upper panel of the chart, where the relative strength of emerging markets versus S&P500 *(orange line)* and of the Eurostoxx50 versus S&P500 *(green dashed line)* are represented. Currently, we note that the rising orange line is displaying outperformance of emerging markets, and the almost flat dashed green line represents Europe. A year ago, both relative strength lines started to fall in the last two weeks of the US equity correction, and suddenly the market was panicking and believing in a global equity correction! Let's hope that we will get a similar signal in 2017, which will help assess when the VIX will make its top, thus calling the end of the equity correction. Given the last high near 16% of VIX, we can guess that the next top will be between 16% and 23%, which was its high last year.

Of course, we don't know what news will trigger the price action of the ongoing correction, but we have identified a few parameters, which can help monitor the situation during the fall!



Graph:

S&P500 Weekly Candles and VIX line (orange dotted line). On upper panel relative strength (RS) line of ETF Emerging versus S&P500 (orange line) is rising and RS of Eurostoxx50 (green dotted line) versus le S&P500 is flat. On lower panel weekly STO could decline to oversold area or rebound near the 50% line.

Source: Stockcharts.com