S&P500: From a Rising Trend Toward a Potential Sideways Range

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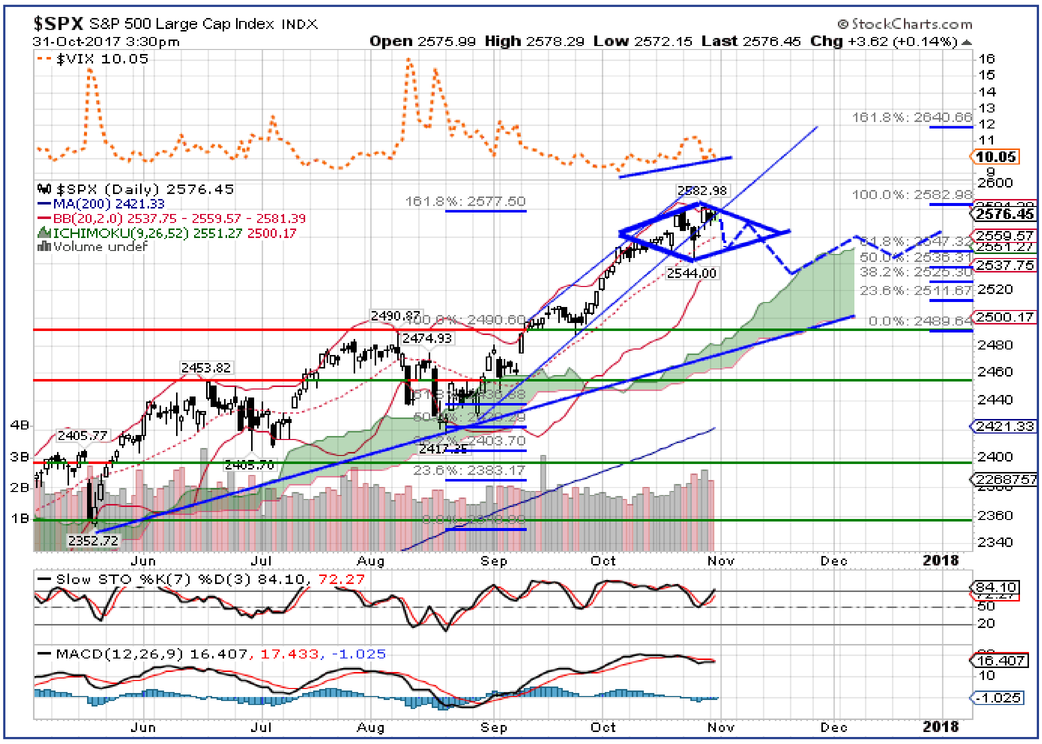
Last April, we noted the sudden outperformance of emerging markets versus S&P500 as an early signal to envision a new rise toward 2597, as an extension target of the rise from 2083 in November 2016 to 2400 in March 2017. Projecting a 162% extension from April's low at 2322 to July high at 2490 gives a 2592 target. The recent high has been seen last Friday, Oct. 27 at 2582, after a swing from 2578 to 2544. This is in sharp contrast to the linear rise, slowly and without pullbacks during the first 3 weeks of October, which started at 2520 to end at 2575 on October 31. Contrary to the usual bearish bias of the September-October period, the year 2017 has displayed great strength. This means that the weakness of the one-year cycle and the decennial cycle of the year ending in 7 has been overridden by a stronger cycle of wider amplitude. Possibly, one may think at an economic longer-term cycle displaying great strength, as the improving economic data seems to confirm. As the November to May period is seasonally bullish, one should expect that in 3 to 6 months the S&P should be much higher than current levels, possibly in the vicinity of 2767.

However, a review of the daily chart should also highlight a few risks in the coming weeks.

Indeed, the current rise started mid-August near 2417 and remained very well behaved within a rising channel until it was broken with a spike at 2544. There we have drawn a subjective diamond pattern, which suggests soon again a decline toward 2547 and smaller rebounds within that diamond between 2550 and 2570. Then, looking at the rising lows of the VIX in the last weeks, it is possible that the VIX will make a higher high above 11%, when and if the S&P500 breaks below the diamond in the next 10 days. In that case, a decline is likely toward 2525, which is a 62% retracement of the last rise 2485-2582. This level would also be the upper line of the daily cloud around mid-November and provide an expected rebound along the normal bullish seasonality into the month of December. The S&P500 should hold above the cloud, but it is unsure if it will close the year at a higher high.

In our view, given the recent rise powered only by a few large caps and given the recent poor performance of small stocks, our scenario of a sideways range until year end is more likely.

Of course, if the S&P500 breaks above the diamond pattern and rise above 2590, then the S&P500 has still a chance to rise toward 2640 to end the year 2017 at higher highs.



Graph:

S&P500 Daily Candles and VIX (orange dotted line) on the upper panel.

On the lower panel Daily STO & MACD display some bearish divergence calling for a transition from a trend to a sideways range..

Source: Stockcharts.com