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Intermarket Technical Analysis for September!

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To follow up on our "red path" view for a potential decline of the S&P500 in the September-October period, we review the recent daily inter-market relationship between the US currency, the yield spread of US 10-year Treasuries and German bunds, the relative strength of emerging equities (BRICS) versus the S&P500 itself. Is the recent run-up above the S&P500's January high (2872) sustainable? Does it erase the risk of a 10% correction?

In the chart below we focus on the visual correlation between the diverse curves. In inter-market technical analysis, the US$ Index and the Commodity Index usually move in opposite directions. A declining Commodity Index often means weaker relative strength of emerging equities versus the S&P500. Here we use the ETF EEM for emerging equities and the Bloomberg Commodity Index instead of the CRB *(too heavily weighted in oil)*.

During the first two weeks of August, the US$ Index rose from 94.25 to 96.85, while the relative strength of emerging markets versus S&P500 accelerated to lower lows along with a decline to a lower low of the Bloomberg Commodity Index. Near 96.85, comments in the media were about concerns that the rising US$ Index was accelerating the decline of Commodities Index leading in turn to weakness in emerging markets relative to the S&P500 would also drag down the S&P500. Thanks to a miracle, the yield spread of US the 10-year Treasuries and German bunds stopped rising and pulled back, dragging down the US$ Index from 96.85 back to 94.40. Given the inverse correlation with the US$, commodities rebounded a tad *(or stopped their decline)* and the relative strength of emerging equities versus S&P500 rebounded. As emerging markets stopped declining near 20 August, the fear to drag down the S&P500 disappeared and the S&P500 was able, also helped by a nice rebound of the technology sector, to display a break-up gap at 2876-2885 last week. This opened the door for a higher high above the one at 2872 in January 2018. Right now the yield spread of US 10-year treasuries and German bunds may have hit support and seems to rebound. This may push up the US$ Index, which has found support near 94.40 near the cloud. On the lower panel, the oversold daily STO is crossing up and would help such rebound. So, as the US$ Index is near its rising moving average *(55 days at 94.80)*, a rebound above it would allow a retest to 95.50. Above 95.70, a rise toward 97.00 is possible.

At the same time, we see on the chart that the relative strength of the EEM versus S&P500 may soon retest its recent mid-August low. Will the US$ rebound be strong enough to further drag down the relative strength of the EEM versus S&P500? Will a resumption of the emerging equity downtrend, in absolute or in relative terms, be enough to fill the famous 2876-2885 S&P500 gap and call for a temporary bull trap on US equities opening the door for a 4-year cycle 10% correction? Clearly, not only the "stabilisation" of the Chinese Yuan versus the US$, but also a stable or slightly lower US$ Index seems to be favouring the US equity bulls. On our chart below, the US$ Index has been in an uptrend since 2018 and is now oversold after a pullback holding above key support area, thus a rebound cannot be excluded.

Graph:

US$ Index in daily candles with Ichimoku cloud and Bollinger Bands and a 55-day Moving Average. The yield spread of US 10-year treasuries minus 10-year German bunds is represented with an orange line, correlating quite well with the US$ Index candles. On the upper panel are displayed the Relative Strength (RS) of Emerging Markets versus S&P500 in gold solid line and the Bloomberg Commodity Index in red dash line (both in percentage change on left scale). In addition, the green solid line is the S&P500 (right scale). On the lower panel the MACD is declining, just barely positive, while the daily "Slow STO" is well in the oversold area. The horizontal line at 92.50 represents a pivotal level longer term below which the market is said to be a very bearish US$. Currently, the US$ Index found support near the Ichimoku cloud.

Source: Stockcharts.com