

Market Timing Charts – The Bollinger Bands Letter

Each week we post a package of stock-market timing charts. The package was created to provide easy access to the most important stock-market timing tools. The charts use daily data, mostly from the US markets, and present a variety of technical analysis tools. Comments and suggestions are welcome: BBands@BollingerBands.com

There are currently 27 charts in the package with more in the wings. The charts are divided into several sections based on the indices:

- S&P 500 Index (7)
- NYSE Composite Index (9)
- Sentiment (2)
- Russell Indices (3)
- Sector Grid (1)
- Commodities (1)
- Dow Jones Industrial Average (2)
- Interest rates (1)
- International (1)

Short descriptions follow:

The first three charts feature the S&P 500 with Bollinger Bands and BB indicators. Chart one has %b in the indicator clip, chart two has BandWidth and chart three depicts BBTrend and its components. These charts are useful for diagnosing tops and bottoms as well as locating Squeezes, which mark the beginnings of trends, and Bulges, which mark the ends of trends. These three charts are the core of our work.

Chart four features the S&P 500 and the Volatility Index, VIX, which has become known as Wall Street's "Fear Gauge". The VIX and its related products have become prime drivers of stock-market action; high levels indicate panic, low levels complacency.

Chart five looks at the term structure of volatility and is really a sentiment indicator. The comparison is 30-day volatility estimates versus 3-month estimates. The higher the indicator, the more bullish sentiment is; the lower, the more bearish.

Chart six depicts the S&P 500 with three key moving averages, one month, a quarter, and a half year. The indicator clip displays the ratio between the S&P 500 and the Value Line Geometric Average, which is a measure of the strength of larger stocks versus smaller stocks. When the line is rising larger stocks are out-performing, when this line is falling the market's emphasis is on smaller stocks.

Chart seven presents a timing tool developed by Chartcraft's Abe Cohen, the percent of stocks above a moving average. Chartcraft calculated the percent of stocks over their 50-day simple moving averages on the NYSE. We take a more modern approach, eliminating the non-operating companies found on the exchanges (preferred stocks, bond funds, closed-end funds, etc.) by calculating this indicator for the S&P indices, the S&P 500 (large cap) and S&P 600 (small cap). The extremes are thought to mark over bought and over sold conditions.

Charts eight through fifteen feature the NYSE Composite Index and indicators derived by tabulating NYSE trading activity.

Chart eight has the advance-decline line in the indicator panel. The advance-decline line is a basic and valuable intermediate-term measure of the internal strength of the market. It is composed of the difference between the number of issues advancing on the day and those declining. Those differences are summed over time to create the indicator.

The indicator in chart nine is a histogram with the percent of advancing stocks plotted above zero and the percent of declining stocks plotted below. It is labeled Breadth Thrust after Martin Zweig's ideas about the forecasting value of days with large pluralities of advancing or declining stocks, especially when multiple occurrences occur in short time spans. Reference lines at + 90 and -90 are provided. There is a 10-day moving average of advances minus declines plotted in blue, which is a classic market timing tool that has gone by many names.

Chart ten presents a 21-day advance-decline oscillator. The advance-decline oscillator is a classic short-to intermediate-term indicator of the market's internal strength that is often compared to price action with trading bands to generate buy and sell alerts. Divergence analysis is key here.

Chart eleven is a variation on chart ten that uses the volume of NYSE stocks up and down each day to create the oscillator instead of numbers of advances and declines.

Chart twelve is a chart of Jim Miekka's version of the McClellan Summation index. Both the input and out equations and the overall levels differ from the original so it is named Miekka Summation here to avoid confusion. Details can be found in Greg Morris's "Market Breadth Indicators" on page 254. In addition to the traditional summation analysis, Jim's key reference level of 1500 is highlighted. In essence, all clear for stocks above that level.

Chart thirteen features a display of the numbers of NYSE stocks making new 52-week highs and lows each day. The green lines above zero are the number of stocks making new highs; the red lines below zero are the number of stocks making new lows. This is very valuable timing data from which a number of classic market-timing tools have been derived. For example, one of the most important warnings of a market top is an expansion of new lows while the market continues higher or consolidates at a high level. This chart also features Bill Ohama's naughtily named Titanic Syndrome signals. In our version the signals are separated into those occurring prior to a 52-week high, 'on board', and those occurring after, 'sinking'. For Titanic details please see Bill's article "Patterns that Detect Stock Market Reversals".

Chart fourteen presents Abe Cohen's High Low Index in the indicator clip. The blue line is the raw data, new highs / (new highs + new lows), and the red line is the indicator, a 10-day exponential smoothing of the raw data. The High Low Index was one of the first broad-market indicators regularly used in market timing and has remained popular with market timers to this day. Recently Harold Parker and Mike Moody found this indicator to be useful as an overlay in their relative-strength research. Crosses of 70 from above and 30 from below are the classic sell and buy signals.

Chart fifteen features Norm Fosback's High Low Logic Index, HLLI. This indicator may not be intuitively easy to grasp. It is a smoothing of the lessor of the number of issues making new highs or new lows each day. High readings in HLLI mean that large numbers of stocks are simultaneously making new highs and

new lows; in other words, the market is churning or 'out of gear', which is an indicator of a potential trend reversal. There are markers on the price chart highlighting Hindenburg Omen signals, a market-timing approach that includes HLLI.

Chart sixteen features a pair of classic overbought / oversold indicators for the broad market, the Arms Index, which is also known as the TRading INdex or TRIN, and the Open Arms Index. These indicators portray the balance between advancing and declining issues and up and down volume and are most telling at market extremes where all the volume has been concentrated in the advancers or decliners. We feature the 10-day 'open' calculation where each of the components are averaged before the indicator is calculated. Both the TRIN and the Open Arms Index have been rebased to zero from one and the scale inverted so that peaks and troughs in the indicators correspond with peaks and troughs in price. To aid comparability between the peaks and troughs we have used logs to plot the TRIN. There are reference lines at +0.3 and -0.3 which correspond to TRIN readings of 2.0 (oversold) and 0.5 (overbought).

Chart seventeen depicts the American Association of Individual Investors Sentiment Survey, a survey of short-term market sentiment. The green lines are the percent bullish and the red lines are the percent bearish. The black curve is Net Bulls, a formulation of my own, and the blue line is a ten-day exponential average of Net Bulls. AAI sentiment data reproduced with permission from the American Association of Individual Investors, 625 N. Michigan Ave, Suite 1900, Chicago, IL 60611; www.aaii.com.

Chart eighteen depicts the Investors Intelligence Survey of Investment Advisors. Like chart sixteen this is a sentiment series; we display the percent of advisors bullish in green and those bearish in red. Net Advisors Bullish is drawn as a black line with its 10-day ema smoothing in blue. The II survey is a longer-term indication than the AAI survey. Robert Colby's 32.7% reference level for bullish advisors is plotted as a dashed line, bullish sentiment below this level is long-term bullish.

Taken together charts seventeen and eighteen present a good picture of stock-market investor sentiment ranging from individual investors' short-term view, to the pros' intermediate-term outlook. You can couple charts sixteen and seventeen with charts four and five which present another aspect of sentiment, the desire to buy insurance.

Charts nineteen, twenty and twenty one feature the Russell indices and advance- decline lines derived from them. These charts allow an analysis of the relative performance and internal strength of stocks by size; all stocks (3000), large stocks (1000) and small stocks (2000). By using indices we eliminate the distortions caused by including non-operating company issues listed on the exchanges.

Chart twenty two displays a sector grid featuring 11 sector ETFs, along with commodity and gold ETFs and four broad-market ETFs to serve as benchmarks. This is a scatter plot. The x-axis is six-month momentum and the y-axis is one-month momentum. So, a very strong ETF will be in the upper right corner of the grid while a very weak ETF will be in the lower left corner. If those ETFs were to experience corrections, the strong ETF would move down towards the lower right while the weak ETF would move up toward the upper left. The labels are ranked by short-term momentum from the strongest (green) to the weakest (red).

Chart twenty three presents a view of the commodity markets via three commodity ETFs, DJP, GLD and USO; a commodity index, gold bullion and crude oil. Each of the series is indexed to 100 at the beginning of the chart which lets you see not only absolute performance, but relative performance.

Chart twenty four displays my favorite supply-demand indicator, David Bostian's Intraday Intensity. Here it is presented as a 21-day oscillator that has been normalized by dividing by total volume. This indicator was designed to track the actions of institutional investors as they accumulate or distribute stocks. The market average in the upper clip is the theoretical version of the Dow Jones Industrial Average*; it is this average that is used for the Intraday Intensity calculation. 21-day, 4% trading bands are plotted as in the classic market-timing approach from the 1970s.

*The theoretical Dow is calculated by taking the highs for all the stocks in the average to calculate the high of the average without regard to what time of the day the highs occurred; and the same process is repeated for the low of the average. This is the way averages were calculated prior to 1982, an abandoned method that still provides useful data.

Chart twenty five also presents the theoretical Dow, this time with a 21-day simple moving average and a pure momentum indicator that measures the deviation of the average from its 21-day simple moving average. Many regard this to be a primary timing tool.

Chart twenty six presents interest rates. These are constant maturity interest rates for six US Treasury maturities ranging from three months through 30 years. The series in the indicator clip is the spread between ten year and two year yields, an indication of the stance of monetary policy.

Chart twenty seven presents four important international indices, from the United Kingdom the FTSE 100, from Germany the DAX, from Japan the Nikkei 225 and from China the Shanghai Composite.

This chart package does not include commentary, which is presented in the Bollinger Bands Letter and in the Bollinger Bands Letter Weekly Updates. While re-distributing the newsletter or weekly commentary is not allowed, you are free to pass along the charts in the package.

The data used in this package and some of the indicators have been provided by Norgatedata.com. The programming language used to create this package is Python, the charts are created with matplotlib and the development environment is PyScripter.

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