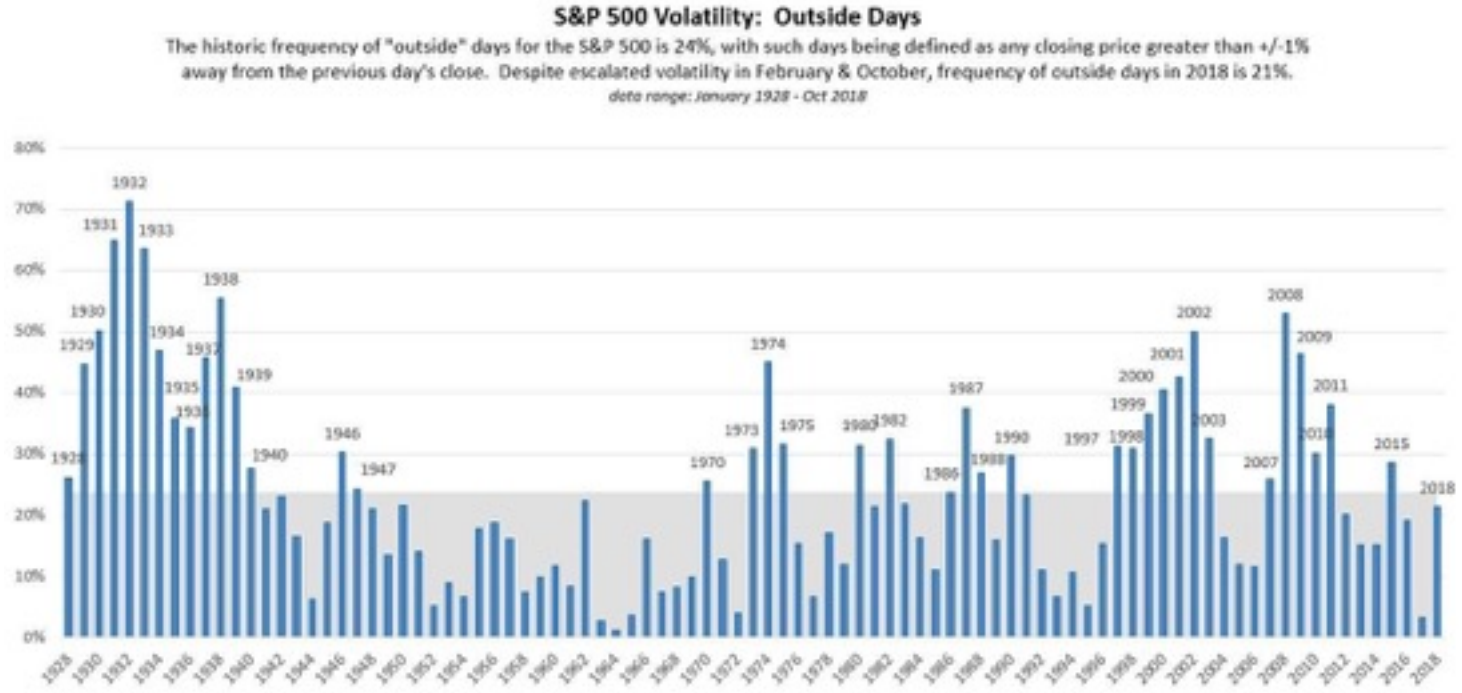
November 12, 2018

DESPITE OCTOBER VOLATILITY, US EQUITIES HOLD TOP SPOT

October 2018 did not disappoint with regard to market volatility. The S&P 500 Index (SPX) was down 7% and the Nasdaq 100 was down 8.7% in the month of October, but underneath the surface, we saw many individual stocks correct more than that. For instance, IBM, Caterpillar, and Amazon were all down more than 20% in the month of October. As a result of the recent market volatility, many of our equity indicators, like the NYSE Bullish Percent (BPNYSE) and the NYSE High Low Index (NYSEHILO) fell into oversold territory, to their lowest levels since early 2016. This has all come within the context of US Equities continuing to hold onto the number one spot within our Dynamic Asset Level Investing (DALI) tool, which has been the case every day since August 2016. There is no doubt that we are operating in an interesting time that presents a positive long-term relative strength picture for equities, with an oversold to washed out condition for many of the equity risk indicators, and volatility is at the forefront of investors' minds these days. One way to look at volatility is through the CBOE Market Volatility Index (VIX), which has spiked up to a recent high of 28 after spending most of the year below 20. Another way to look at volatility is through the simple idea of how many days has the market moved by 1% or more?

In 2018 there have been 45 days in which the S&P 500 Index has closed with a return of +/- 1% out of 210 trading days so far in the year. In other words, about 21% of the days in 2018 would be considered "volatile days," and despite the recent spike in volatility, that number is still below the long term average of 24%. In case you're wondering, nine out of the 45 "volatile days" in 2018 have come in the month of the October, while February of this year actually saw 12. Interestingly enough, the only year (so far) in the past seven years that saw an above average number of "volatile days" was 2015, which saw nearly 29% of the days move +/- 1%. There have only been two years in modern history that saw 50% of the trading days as "volatile days" – 2002 and 2008. On the other end that spectrum, the return of the volatility in 2018 comes off a year that witnessed the lowest amount of volatility in more than 50 years, as just over 3% of the days in 2017 were +/- 1% days.



Click the image for larger view. Source: Nasdaq Dorsey Wright

The turn of the calendar to November has many investors cheering the end of October with all eyes on the midterm election results and reaction to that. Further, the month of November also starts what is known as the “seasonally strong” six month period in the market, which lasts from the start of November through the end of April. We are all familiar with the saying "Sell in May and go away," which estimates that we would do just as well to sell all of our holdings as we would be invested in the market during the months of May through October. Typically, conjecture doesn’t mature into adage without basis in reality and “Market Seasonality” is just such an example, as it has shown an impressive trend in terms of magnitude, consistency, and longevity. We’ve discussed seasonality many times over the years as we switch between seasonally biased periods.

The end of the October trading brought with it the end of the seasonally weak period, which began with the close of the market on April 30th. Over this period, the Dow Jones Industrial Average (DJIA) returned 3.94%, which is well above the average return for the seasonally weak period.

The premise of "Market Seasonality" is essentially that, historically speaking, the market performs far better during the November through April time period than it does from May through October. On its own, that isn't a particularly profound statement, however, when we examine the magnitude of this effect over the years, its significance becomes clear. Consider this: If you had invested $10,000 in the Dow Jones on May 1st and sold it on October 31st each year since 1950, your cumulative return would be only about $1,500. Meanwhile, the same $10,000, invested only during the seasonally strong six months of the year, would now be worth over $1 million! Put another way, almost all of the growth of the Dow Jones Index since 1950 has effectively been during the "good" six months of the year.

As we mentioned above we are coming off a seasonally weak period in the market, which saw the DJIA produce a gain of 3.94%. Despite the recent volatility, US equities remain the number one ranked asset class in DALI, and we have seen some encouraging signs in recent days including the bullish percent for the Nasdaq-100 (BPNDX) and several sector BP charts reversing into Xs. Additionally, we have just seen the NYSE High Low Index (NYSEHILO) reverse up from below 10% and the NYSE Bullish Percent (BPNYSE) has reversed back in X’s after falling to 30%. Furthermore, we are now entering what has been the traditionally strong period for the market. While this does not guarantee that we will see a strong equity market over the next few months, the reversals up from some of these indicators has provided some evidence of new demand coming back into the market as we enter a seasonally strong period.

Editorial Note: DALI stands for Dynamic Asset Level Investing and is a tool available on the Dorsey Wright Research platform. The DALI tool was designed as a tactical tool to provide guidance for asset allocation decisions among asset classes, as well as within asset classes, steering an investor toward those areas of the market that are exhibiting superior relative strength. DALI is used to evaluate the supply and demand forces of asset classes, and rank them from strongest to weakest based on a relative strength score. Relative strength is a ranking system used to measure a security’s price momentum relative to its peers.

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