Prospero Institute

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sub advised portfolios **strategy development** **customized research** **consulting**

Long Term Trend

Last week I reviewed the host of breadth signals that indicated the probability of at least a short term advance in U.S. equities…. and also suggested the short term positives be tempered somewhat as a result of the negative trend condition in U.S. equities (i.e. position of 10 and 40 week or 9 and 39 week sma and ema on the S&P 500). Additionally we looked at how the S&P 500 tends to stall around long term moving averages (52 week in last report) on it's first push higher out of a correction.

Breadth indicators provide an equal weighted measure of the constant battle between the forces of supply and demand. Here is a review of some of the buy signals over the past 4 weeks:

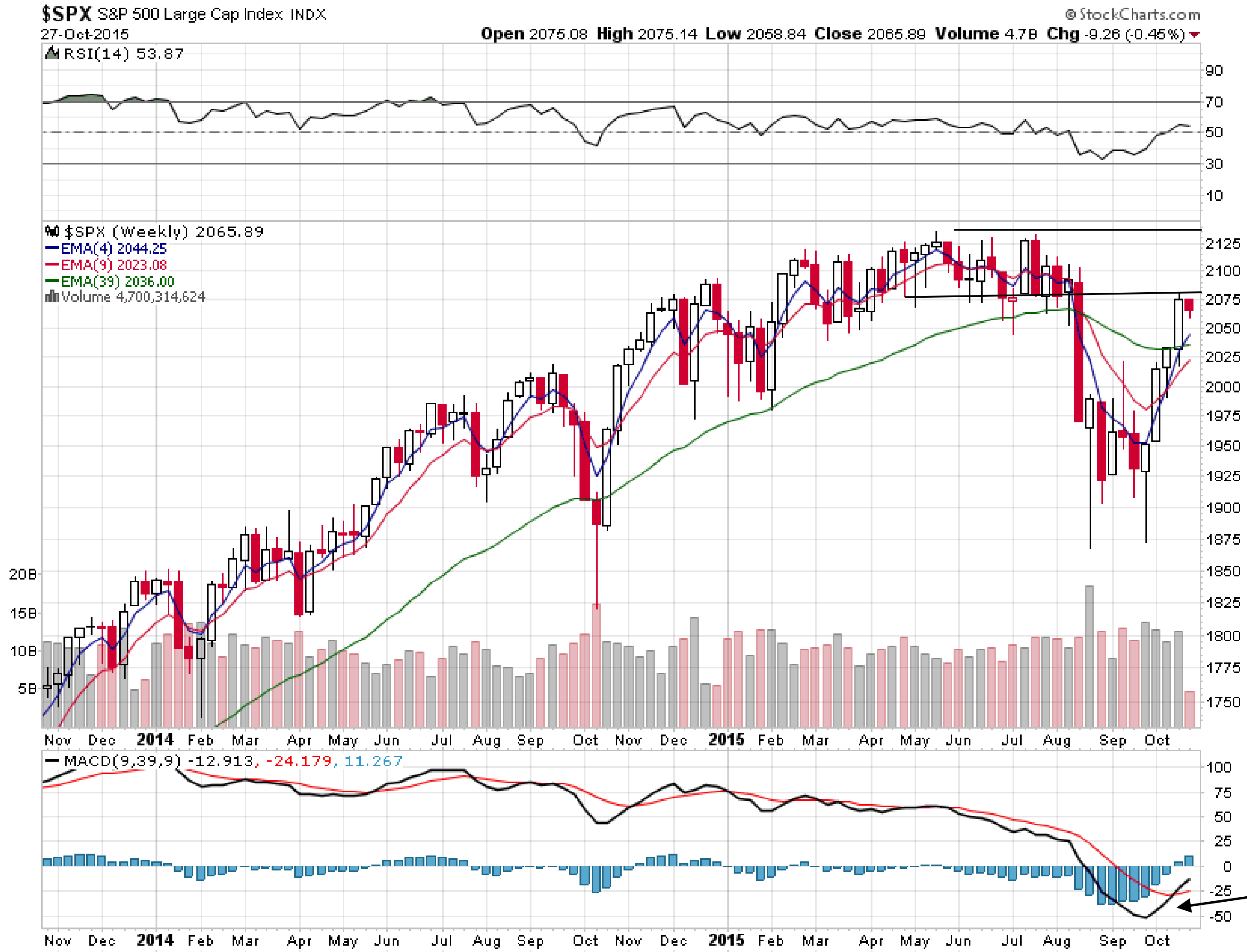
10.12.2015: NYSE advance decline Zweig Breadth thrust

10.19.2015: Nasdaq advance decline Zweig Breadth thrust

9.14.2015: Absolute Breadth Index Nasdaq (advance decline)

10.12.2015 NYSE Volume Summation Index

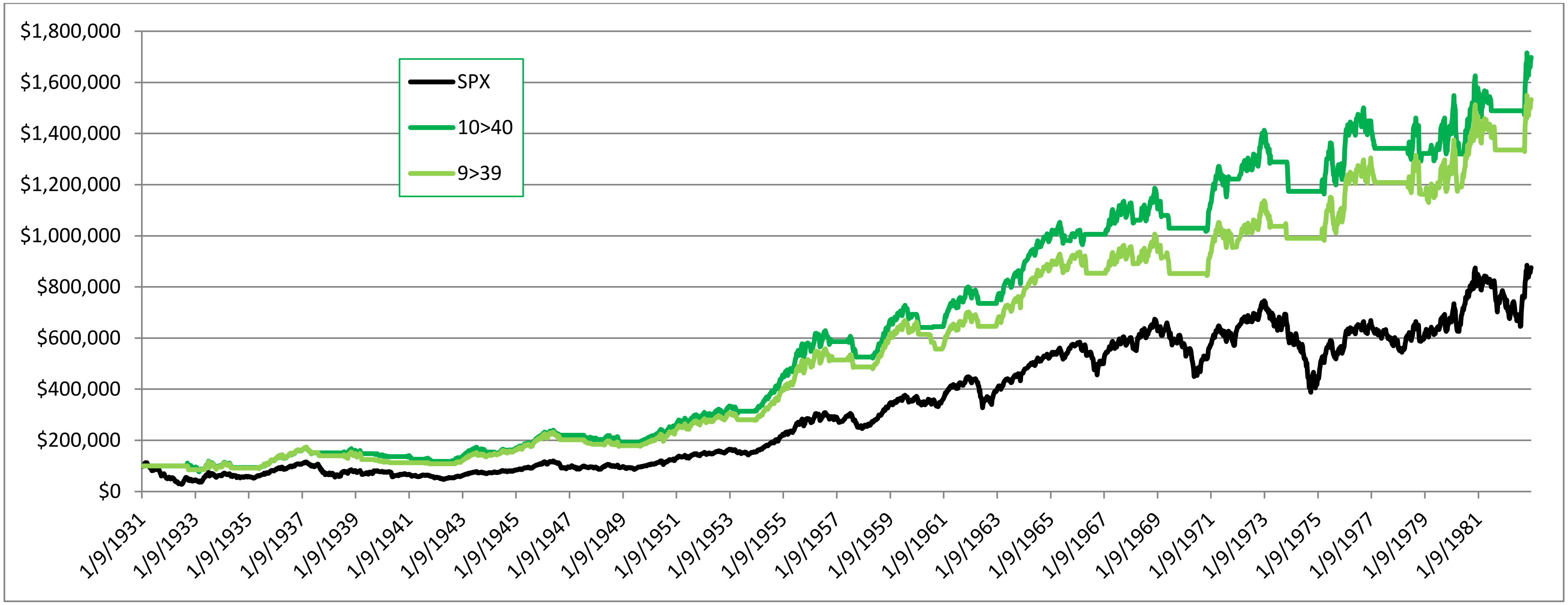
In previous reports I outlined the probability of a stock market advance over the near term as a result of the signals outlined here. Why do we test performance of these signals over short periods of time like 4 or 8 or 10 weeks? Does this mean we are only interested in stock market performance over the short term? Of course not. The reality is that the markets have an upward bias over time and as we move out in time horizon other factors undoubtedly come into play. Sometimes short term buy signals turn in to positive or bullish intermediate and/or long term trend momentum or trend signals. Sometimes they do not. Yet the reality is that these signals tend to speak at opportune times and are designed to help you become more confident and certain about the risks and opportunities of increasing equity exposure in the equity markets.



As a result of improving breadth outlined over the past few weeks the S&P is now trading above it’s 4, 9 and 39 week exponential moving averages. Additionally the 4 week ema has crossed above the 9 week and 39 ema while the 9 week is close to crossing above the 39 week ema.

Trend momentum turned higher 2 weeks ago indicating acceleration in trend.

Now that market breadth has spoken perhaps it is a good time to look at a trend. The chart above provides an opportunity to assess or interpret the trend condition of the S&P 500 from a traditional perspective. In that vein a common measure of long term trend is the 50 and 200 day cross. i.e. a cross up of the 50 day above the 200 day is bullish and often referred to as the “golden cross” whereas a cross below of the 50 and 200 day is referred to as a “death cross”. (The weekly equivalent is the 10 and 40 week moving averages while the 9 and 39 week exponential moving averages provide a similar measure). The death cross has received its name because of the fact that all prolonged bear markets have been preceded by a “death cross”…. And reducing your equity exposure when a death cross occurs would help you avoid a good portion of the bear market declines throughout history. The problem however is that not all death crosses have led to a prolonged decline in stock prices. Additionally when a market selloff “only” results in a correction the death cross tends to signal a sell a little late…. and as the market advances out of a correction low the buy signal seemingly occurs a little later than perhaps one would like to see. Like now…. i.e. the S&P 500 has rallied out of it’s lows yet the golden cross has not yet signaled a buy. This is precisely why Prospero utilizes a combination of breadth (advance decline, up vs. down volume and 52 week high vs. lows) and also a combination of varying trend measure lengths to determine (signal) when it is time to reduce or increase equity exposure. Nevertheless the 10 and 40 week as well as the 9 and 39 week ema measures have produced a decent track record over time… yielding results that exceed a passive buy and hold approach over longer periods of time.



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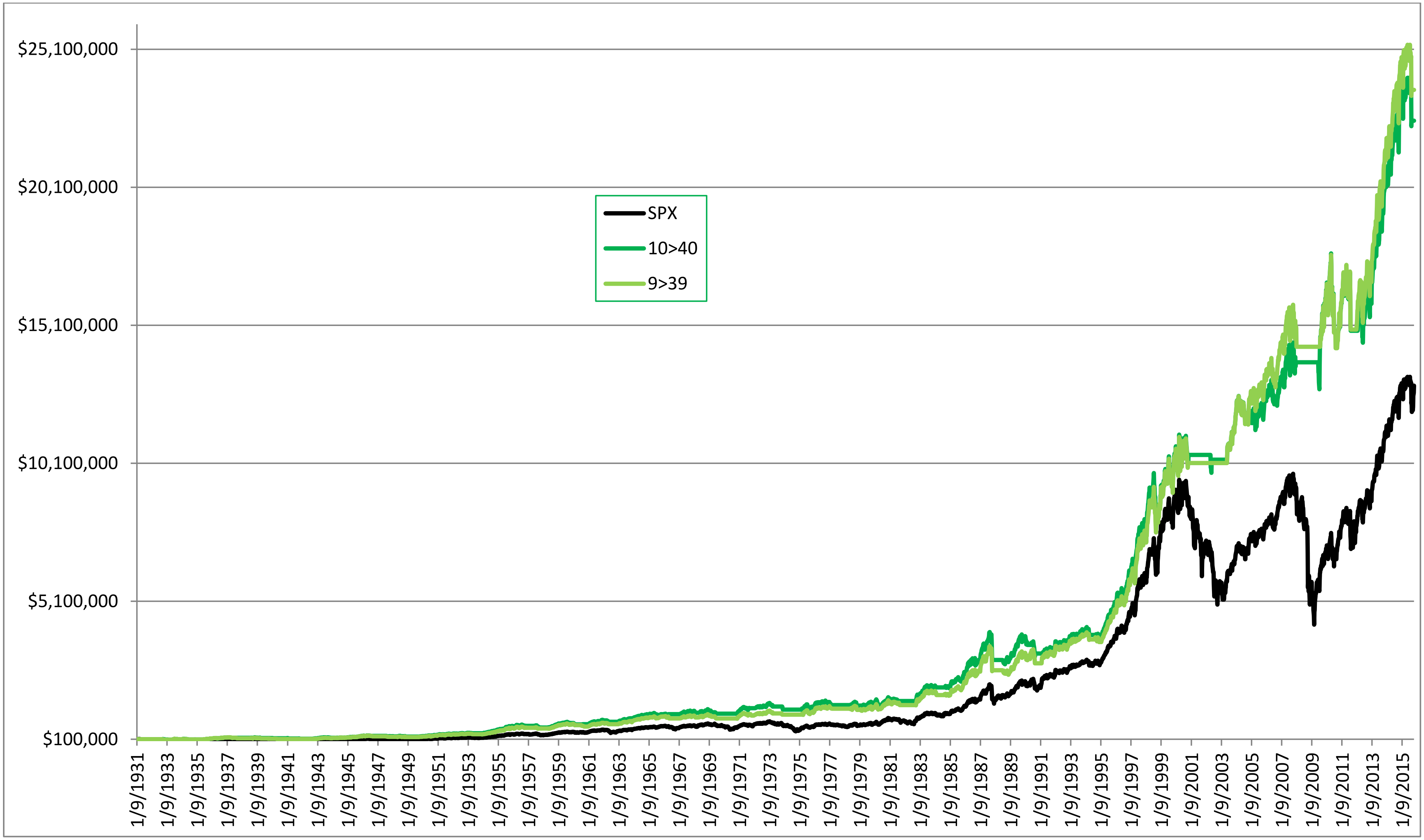
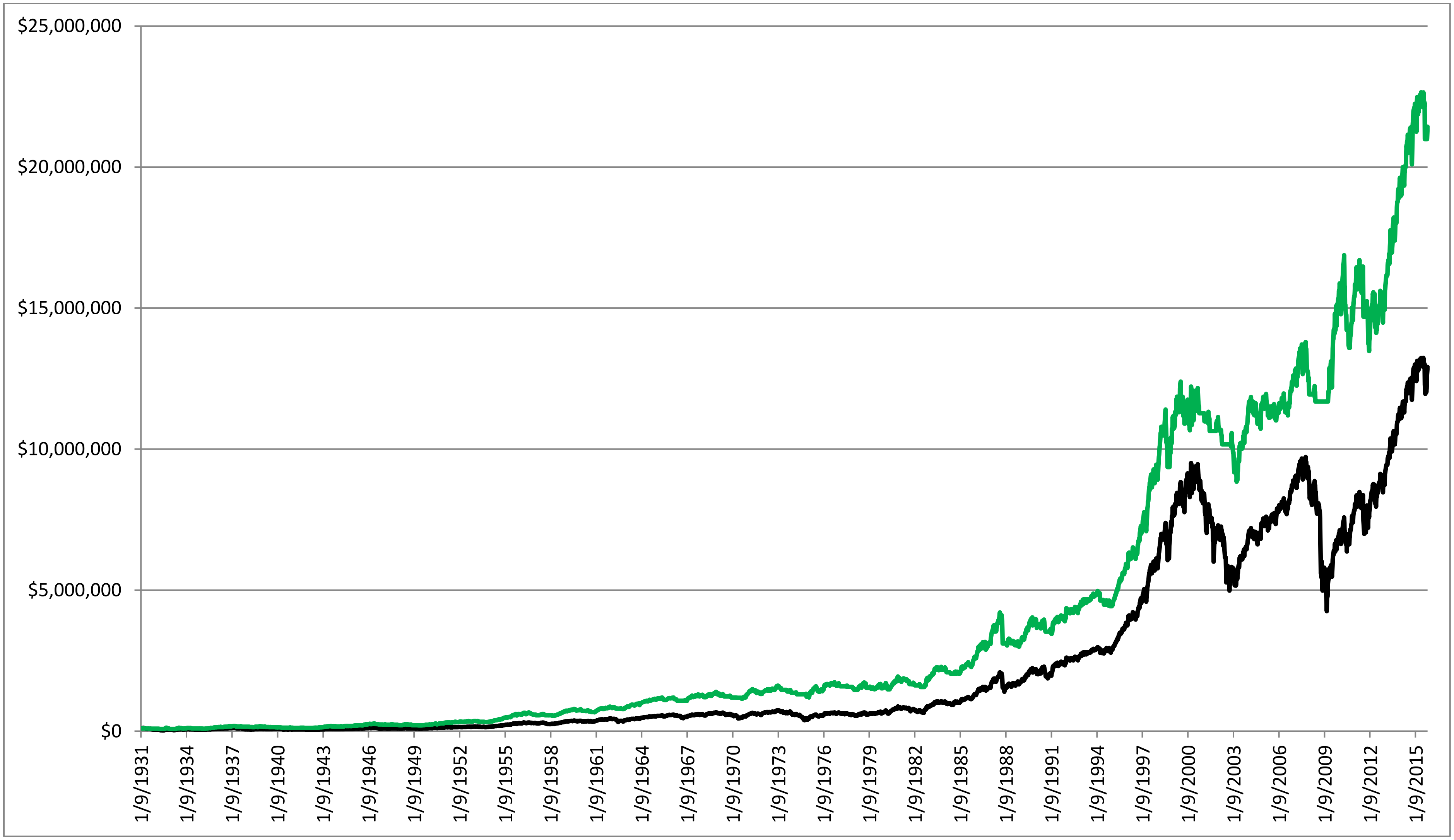


Combination of multiple moving average signal vs. passive approach

Combining a short, intermediate and long term trend signal into one trend indicator provides seemingly the “best of both worlds”. Buy signals occur earlier and the equity allocation tied to this signal is held until the long term trend indicator signals a sell. While this indicator is susceptible to bear markets the back tested returns deliver similar total returns than the 10 and 40 week or 9 and 39 week long term trend indicators yet exits a little earlier than these longer term measures.

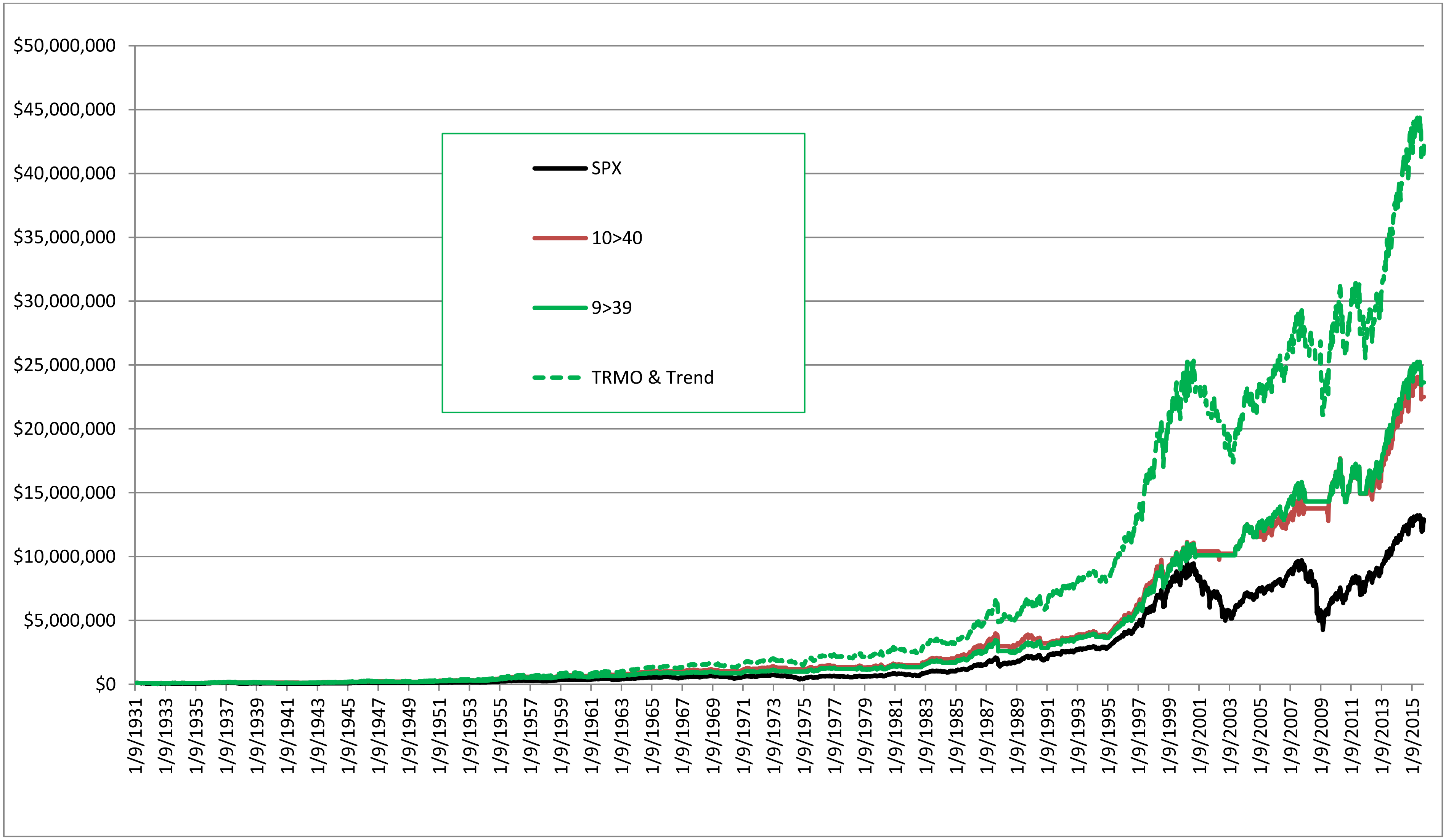


Combination of trend and momentum: (TRMO)

Trend momentum is simply the result of dividing a short term moving average by a long term moving average. Essentially this is a MACD indicator that standardizes the distance between the two moving averages and allows for comparative analysis between securities. The indicator signals a buy when the red line crosses above the green line **(2 weeks ago)**, a sell if/when the red line crosses below the green line IF the red indicator line is below 1.00, and a hold when the red indicator is above the 1.00 level.

Back test of TRMO vs. 10 & 40 week, 9 & 39 week and passive (buy and hold)

While the TRMO indicator is susceptible to failed signals and substantial draw downs during a prolonged equity market decline the back tested results indicate that **this tool set is worthy of determining some portion of your equity allocation**…. as the equity curve back test shows a total return substantially greater than either of the long term measures of trend. (**all corrections tend to make us feel that the equity markets are on the cusp of entering a prolonged equity market decline yet the reality is that this does not happen very often).**



Rather than interpret or subjectively assess the trend condition of the financial markets Prospero quantitatively tests and develops a multitude of single indicator, multiple indicator and systematic ETF portfolios on a sub advisory and consulting basis. The idea is to reduce or eliminate the biases and subjectivity associated with making investment decisions. Indicators combine breadth and trend while portfolios consist of several (often 5) sub strategies within each portfolio model. Each of the sub strategies are designed two objectives:

1. manage stock market risk (utilizing varying combinations of breadth and varying lengths of trend measures)
2. provide dynamic asset allocation exposure based on specific asset allocation objectives. (Large vs. Mid or Small, Value or Growth, U.S vs. International).

The idea is to reduce or eliminate subjectivity and emotion thereby helping you become more confident about the future of client portfolios.

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