US STOCKS: SHADOWS AND SIGNALS

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Rita remarks in the film "Groundhog Day": "I like to see a man of advancing years throwing caution to the wind. It's inspiring in a way." She asks Phil: Don't you worry about cholesterol?" Phil responds: "I don't worry about anything." (Harold Ramis, director).

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CONCLUSION

The United States Federal Reserve Board has been a glorious contributor to the worldwide and American economic recovery which embarked in mid-2009. This marketplace general has not been the only central bank fighting to spark and sustain economic recovery. The European Central Bank, Bank of England, and Bank of Japan have performed notable roles in this international effort. So has China's. Political players in America and beyond also have generated economic growth via massive deficit spending. And of course numerous other intertwined variables influence the economic growth theater.

Economic recovery and highly accommodative monetary policies, whether in the US or elsewhere, may tend to encourage equity marketplace rallies or particular levels in stock price benchmarks such as the S+P 500. However, they do not guarantee them. Anyway, many prophets forecast further climbs in the S+P 500 over its recent 1/15/14 high around 1851. Corporate profits perhaps will continue to grow. Share buybacks may remain significant. Moreover, the Fed is not ending this round of quantitative easing all at once. Even as the Fed continues to taper its debt purchases, it still prints money via QE's avenue. Plus its highly accommodative interest rate repression scheme remains entrenched. Consequently, due to ongoing low US Treasury yields, "investors" and others may continue to seek "good" (or at least satisfactory) yields (returns) in US stocks (and other equity territories) as well as in higher-yielding debt instruments (such as junk bonds or emerging marketplace debt). The worthy Fed sentinel probably will continue its quest to achieve sufficient inflation of around two percent; it remains determined to slash unemployment further. Other central banks likewise remain married to lax monetary policies.

Yet during the darkest days of the worldwide economic crisis of late 2008/early 2009 as well as during the subsequent recovery, Federal Reserve Board easy money policies have played key roles in encouraging bull moves in the S+P 500 (and many other equity playgrounds). Likewise, the elimination of some of these schemes, particularly previous rounds of quantitative easing (money printing), has occurred alongside highs in American stock benchmarks.

What does tapering foreshadow? The Fed's recent decision to reduce (taper) and eventually eliminate the current gigantic round of money printing warns that a notable top is or relatively soon will be in place. Thus the mid-January 2014 high point in the S+P 500 arguably represents an important top. If a stock marketplace peak is not currently in place, one probably will be by around the end of first quarter 2014. Several other indicators likewise portend a plateau in the S+P 500. Fed tapering, to the extent it coincides with at least a modest decline in the S+P 500 and related indices, will hint that economic growth in America, other advanced nations, and developing and emerging countries will be less than predicted by guardians such as the International Monetary Fund.

FED POLICIES AND S=P 500 PRICE TURNS

In their famed traveling song "Truckin'", The Grateful Dead underscore:
"Sometimes the lights all shining on me
Other times I can barely see
Lately it occurs to me
What a long strange trip it's been".

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The following table highlights the S+P 500's interim bear moves within its major bull advance that commenced on 3/6/09 at 667. Underline the connection between bull and bear trends in the S+P 500 and Federal Reserve policies in recent years.

Since the Fed is not the only actor on the central bank stage, the summary also points out several other important central bank actions from the gloomy times of the global financial crisis up to the present day (which though it has sunshine, also has clouds and headwinds).

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Particularly note the S+P 500 declines in spring 2010 and spring 2011 that followed roughly around the time QE1 and QE2 money printing extravaganzas ended. Will the S+P 500 similarly slump alongside the Fed tapering announced in mid-December 2013? How much of an actual reduction in Fed money printing must occur before stock price deterioration becomes fairly substantial?

High	Low	Percentage Decline	Duration
1220 (4/26/10)	1011 (7/1/10)	17.1pc	Two months, one week

[QE1 ended in March 2010. QE1's introduction in November2008/March 2009 fit with the S+P 500's major low at 667 on 3/6/09. Note also that the Federal Funds rate (monthly average has been under .25 percent since December 2008, thus thereafter bolstering the economic recovery and stocks. Of course America (and others) also engaged in huge deficit spending to combat the global economic crisis. Remember China's big economic rescue plan/easing of 4Q08 and thereafter. Recall the major bottom in China's Shanghai Composite stock index on 10/28/08 at 1665.

The Fed unveiled QE 2 end August/November 2010. The S+P 500's final trough in the interim downturn from the April 2010 elevation occurred 8/27/10 at 1040.]

High	Low	Percentage Decline	Duration
1371 (5/2/11)	1075 (10/4/11)	21.6	Five months

[QE2 ceased in June 2011. Note the similar timing of important tops in emerging stock marketplaces ("MSCI Emerging Stock Markets Index" from Morgan Stanley; MXEF on Bloomberg) and commodities "in general" (broad S+P Goldman Sachs Commodity Index) around that time. The MXEF high was 4/27/11 at 1212. The broad GSCI pinnacle occurred at 762 on 4/11/11 and 5/2/11.

The Fed announced Operation Twist on 9/21/11. Note that this policy, like the revelation of QE2, occurred roughly as a twenty percent S+P decline became increasingly likely (imminent). Since the traditional definition of a bear trend is a twenty percent or greater drop from a significant top, the Fed designed these easing actions to promote overall stock marketplace and economic confidence and thereby support GDP growth and a stock bull move. The Fed has allies. The European Central Bank unveiled its Long Term Refinancing Operation (LTRO) on 12/8/11.]

High	Low	Percentage Decline	Duration
1422 (4/2/12)	1267 (6/4/12)	10.9pc	Two months
1475 (9/14/12)	1343 (11/16/12)	9.0	Two months

[Focus on these two 2012 dives in the S+P 500 together. First, focus on the June and November 2012 lows while keeping in mind the S+P 500's 2008 collapse from around 1313 on 8/11/08 and 1265 on 9/19/08. On 9/13/12, the Fed declared QE3; it offered forward-looking policy guidance (and QE4) on 12/12/13. The ECB head unleashed his "whatever it takes speech" to protect the Eurozone on 7/26/12. The ECB proclaimed its Outright Monetary Transaction (OMT) policy 8/2/12.]

1687 (5/22/13)	1560 (6/24/13)	7.5	One month

[Recall that the Fed began to murmur about exit strategies around the time of this spring 2013 peak (for example, the 6/19/13 FOMC Meeting's Press Conference). Tapering fears encouraged selling of American equities. However, nervous Fed officials offered soothing statements and pulled back from tapering warnings. However, this 2013 slump while tapering remained a definite near term possibility was an omen for a bearish S+P 500 price trend when the Fed launched actual tapering.

Compare the 1560 depth with the peaks of 2000 (3/24/00 at 1553) and 2007 (10/11/07's 1576). Was the Fed trying to insure the S+P 500 stayed above the 2000 and 2007 pinnacles?

Japan's introduction of even more quantitative easing and further fiscal deficit spending ("Abenomics") in the wake of its December 2012 election probably encouraged the subsequent stock marketplace rallies in Japan and the United States (and Europe).]

1710 (8/2/13)	1627 (8/28/13)	4.9	Almost four weeks
1851 (1/15/14)	??	??	Two weeks so far

[On 12/18/13, the Federal Reserve announced the first round of tapering. It unveiled a second cut in its debt securities purchases 1/29/14. All else equal, this tapering, though rather slow, portends a downturn in the S+P 500 given the experiences of ending QE1 and QE2. Of course tapering and other US (and overseas) central bank policies are not the only factors influencing stock (and interest rate, currency, and commodity) levels and trends.]

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A five percent fall in the S+P 500 from 1/15/14's 1851 gives about 1758, a 10pc shrinkage 1666. A 15pc decline reaches 1573, with a worrisome 20pc tumble 1481. If the S+P 500 withers 33pc, that gives 1233. Suppose the S+P 500 keeps moving lower. At what point might the Fed slow down or halt its tapering process (or engage in other easing actions, including renewed forward guidance rhetoric)? All else equal, a ten percent drop in the S+P 500 would make the Fed watchful, but it probably would not induce it to substantially change its current policy. However, a S+P 500 slump around 20 percent or so (especially if that slide was "fast" and if "volatility" existed in other important financial marketplaces) probably would motivate the Fed to delay or halt its tapering program.

A one pc advance over 1851 gives 1870, a five pc climb equals 1944. Keep in mind that the S+P 500 and Dow Jones Industrial Averages are quoted in nominal terms. All else equal, sustained nominal GDP growth (perhaps assisted by money printing), tends to raise nominal prices.

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Here's a very brief marketplace timing footnote relevant to the current US stock marketplace situation.

Regardless of marketplace history, key highs for US stock benchmarks such as the S+P 500 are not destined to be made in (or very near to) calendar January (or during calendar March). However, although the S+P 500 established its 2000 pinnacle in March (3/24/00 at 1553), the Dow Jones Industrial Average peaked in January, at just over 11,900 on 1/14/00. Not only was the S+P 500's recent high in mid-January; the Dow Jones reached its recent height almost in January 2014 (at 12/31/13 at 16,588).

A US stock marketplace peak in March 2014 would be a diagonal time move of about five years from the S+P 500's 3/6/09 major bottom at 667 (and the Dow Jones one that day at 6470).

OTHER BEARISH SIGNALS FOR US STOCKS (WARNINGS FOR US AND WORLDWIDE ECONOMIC GROWTH)

In the 1980 movie "Caddyshack" (Harold Ramis, director), Judge Smails chirps: "It's easy to grin When your ship comes in And you've got the stock market beat."

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Even though the S+P 500 decisively broke above its 2011 ceiling, the continued downtrend since spring 2011 in emerging stock marketplaces in general (MXEF) has been a longstanding warning trend for the S+P 500. Not only did the MXEF's 1212 high on 4/27/11 not climb to its Goldilocks Era peak at 1345 (11/1/07) or even its final top during the financial crisis (5/19/08's 1253). MXEF highs since spring 2011 have edged lower; note 2/29/12's 1085, 1/3/13's 1083, 5/9/13's 1065, and 10/23/13's 1048.

China's Shanghai Composite peaked on 8/4/09 around 3478, rather soon after its major bottom in October 2008. See its 4/18/11 top at 3067 (around the times of the MXEF's) and its further erosion thereafter.

Suppose the S+P 500 starts to tumble further from its recent height alongside those in emerging stock marketplaces. Are current widespread worries about emerging/developing countries such as the "fragile five" (Brazil, India, Indonesia, Turkey, and South Africa) and Argentina (and others) starting to increase concerns regarding prospects for advanced nations? What if marketplace watchers, despite current generally optimistic forecasts regarding Chinese economic growth, become increasingly uneasy regarding China's economic situation and outlook?

What about European stocks in this perspective? The SXXP (Stoxx Europe index of 600 European stocks) established its recent high at 337.7 on 1/21/14, shortly after the S+P 500's. Its major low occurred at almost the same day as the S+P 500's, at 155.4 on 3/9/09. It attained its major peak in the Goldilocks Era not long before that in the S+P 500, on 7/13/07 at 401.0, with its final summits of 391.3 on 10/11/07 (compare the MXEF's 11/1/07 one at 1345) and 5/19/08 (MXEF at 1253 that day) established around the time of crucial S+P 500 ones (10/11/07 at 1576, 5/19/08 at 1440). Suppose the SXXP fails to exceed its 1/21/14 high and retreats more and more beneath its comparable 5/19/08 interim top at 332.9, achieved before the acceleration of the worldwide economic disaster. What would this hint regarding the future pattern of the S+P 500?

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In recent years, key highs in the broad GSCI often have occurred around the time of those in the S+P 500. Since spring 2011, even though the broad GSCI has fallen lower (diverged from) the S+P 500, many key turns in the two domains nevertheless have occurred at roughly the same time. The bearish trend in commodities in general intertwined with the substantial decline in emerging marketplace stocks. The slump since 2011 in commodities (and emerging marketplace stocks), arguably has presaged (although admittedly over a long warning period) the decline in American equity benchmarks. In any event, marketplace players should watch the MXEF and GSCI trends alongside the S+P 500's move after the recent Fed tapering. The 595 to 605 range in the broad GSCI represents important support, as does 550 to 575 (556 was the 6/22/12 low and the 5/3/10 high; 573 was the 10/4/11 low).

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For the first 11 months of 2013, foreigners were net sellers of US stocks, with net liquidation averaging about $2.3 billion per month. Although this is not a huge sum, it contrasts with net buying in other recent calendar years. Compare monthly average net buying of $9.1bb in 2012, $2.1bb in 2011, $9.1bb in 2010, $12.7bb in 2009, $3.7bb in 2008, and $16.3bb in 2007 (US Treasury, TIC data).

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The heated desire of central bankers and politicians (and debtors/borrowers) for sufficient inflation (think of the Fed, ECB, and Bank of Japan's two percent target) signals that the leverage, debt, and credit problems created during the Goldilocks Era (and arguably even earlier) probably have not been adequately fixed. So does ongoing talk of currency wars and competitive devaluation.

In addition, recent nervous talk by many leading central bankers and regulators about deflation (despite their relatively optimistic growth predictions) hints at looming trouble for US and other stocks. See "Inflation Hopes, Deflation Fears, Marketplace Signs" (1/20/14). Unemployment remains stubbornly high in many places, particularly Europe. US household incomes remain relatively weak despite the recovery. American consumer confidence at 80.7 in January 2014 (Conference Board) stands far under its January 2000 (144.7) and June 2007 (111.9) heights (compare the timing of the 2000 and 2007 US stock marketplace peaks).

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In marketplaces, greater risk orientation frequently intertwines with growing leverage. Over the past couple of years, and arguably especially so in recent months, many marketplace players (including investors) have ventured into an assortment of marketplaces (often deemed as relatively risky; picture junk bonds) in searches for decent (good) yields/returns. Recall past periods where this has occurred.

What about leverage in the US stock marketplace? According to the NYSE, margin debt in December 2013 established an all-time record at $445 billion. Of course only future information will unveil whether this remains the top. However, past peaks and subsequent substantial declines in this borrowing yardstick have been associated in time with S+P 500 bear moves. For example margin debt peaked in July 2007 at $381bb, not long before the S+P 500's summit in October 2007 (that month coincided with a drop off from $345bb). NYSE margin debt peaked in March 2000 at $279bb, the same month as the S+P 500's 3/24/00 top at 1553.

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The United States still retains its dangerous long run fiscal deficit problems. Despite some recent calmness in Washington following the government shutdown and financing fights, the nation's political divisions remain severe. Neither the long run deficit situation nor the political divisions are likely to be resolved in US election year 2014.

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Two perspectives on the relationship between US Treasury notes and the S+P 500 hint that the S+P 500 arguably has reached an important top, or may soon do so.

The US government 10 year note established a major low bottom on 7/25/12 at 1.38 percent. It gradually ventured up to about 3.01pc on 9/6/13 and 3.05pc just after New Year 2014. The Fed and other key central banks are determined to create sufficient inflation. Might they have done too much easing? Hasn't the Fed (and others) engaged in so much money printing (and yield repression) that excessive inflation eventually may appear? In any event, history reveals that sustained substantial UST interest rate increases often lead to downturns in US equities. Might this be the case in regard to the potential for a top in US stocks at or around the time of the Fed's finally engaging in its tapering program?

Alternatively, many see the US (and German) government debt marketplaces as "flight to quality" (safe haven) marketplaces. Imagine times of severe financial stress and when economic downturns (or at least a weaker recovery) and a S+P 500 slump seem likely or are underway. In the context of the Fed's ending of money printing, this "flight to safety" opinion (rather than the UST yield rises lead to US stock declines vision) probably is the majority viewpoint. Why?

Scan the long run downtrend in the UST 10 year from its 6/13/07 peak at 5.32pc. The UST established interim yield highs at 3.91pc on 12/31/09 and 4.01pc on 4/5/10; QE1 ended in March 2010. The UST yield dipped to 2.33pc on 10/8/10. The Fed terminated QE2 in June 2011; yield highs occurred before and not long after that time (3.77pc on 2/9/11, 3.61pc on 4/8/11, and 3.22pc on 7/1/11. The UST plummeted to 1.67pc on 9/23/11.

History may not repeat itself in the US quantitative easing context. And other central banks continue to ease significantly. In any case, the UST 10 year yield has marched lower since its recent high over three percent, recently resting around 2.65pc (about half the June 2007 peak). In regard to the timing of the recent yield high around 3.05pc for the UST, compare the timing of the S+P 500's high (1/15/14 at 1851) as well as that in the Dow Jones Industrial Average (12/31/13 at 16,588).

From this flight to quality/Fed reduction in money printing vantage point, a sustained fall decisively underneath 10/23/13's 2.47pc interim low would signal lower prices for the S+P 500. Such a UST yield fall, if accompanied by a bear move in the S+P 500, would tend to confirm opinions of those who perceive flight to quality buying of UST as connected (at least occasionally) to notable declines in the S+P 500 and "related" stock marketplaces. Recall that the final low in the UST 10 year yield after its 12/18/08 bottom at 2.04pc was right after the March 2009 low in the S+P 500, on 3/18/09 at 2.47pc. In the current situation, watch too the 2.33pc low on 10/8/10 and the 3/20/12 top at 2.40pc and the 10/28/11 one at 2.42pc.

The lead/lag and flight to quality perspectives in regard to UST and S+P 500 movements (relationships) are not necessarily contradictory, though they sometimes are in tension.

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Besides, one can have yield jumps in debt marketplaces outside of America that are bearish for US (and other stocks). The crisis on the European periphery in the past few years is merely one example. In the current context, see the increase in the Chinese government 10 year note rates since 1/9/09's 2.70pc bottom, and especially since the 5/10/13 low at 3.41pc.

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