PHASES & CYCLES®

NEW YORK SHOULD HOLD UP REASONABLY WELL UNTIL AT LEAST YEAR END.

TORONTO IS ALREADY WEAKENING.

JANUARY MAY BRING A PERIOD OF GREATER VULNERABILITY FOR THE S&P 500.

As 2017 enters its last month, the year appears to be a repeat of 2016 – a seemingly relentless rise punctuated by minor pullbacks. To date the S&P 500 is up over 17% for the year. The longest losing streak has been four trading days. No correction has exceeded 3%. The post-Thanksgiving period continued the process. The S&P 500, Dow Industrials, NASDAQ, NYSE Composite, Russell 2000 and the NYSE daily advance/decline line all made new all-time highs.

November was positive but it may also be looked back upon as a month that began a transition. While new all-time highs were posted yet again, New York's internal structure started to show some minor cracks. Our most recent Market Comments have documented how the market picture is becoming cloudier even as the advance continues. The latest concern is the significant decline in the daily equity put/call ratio, indicating growing bullishness (a contrary indicator). But to date anything more than a minor pullback has been difficult to forecast. New York's incredibly strong underlying bullish impulse continues to run roughshod over potential opposition to higher prices.

We have repeatedly commented on the importance of the upward sloping trend channel's influence on the S&P 500's behaviour. The larger of these trend channels dates from the major low in February 2016 and is still in force. The S&P 500 is currently approaching the top of this trend channel, with a major overhead resistance point looming at about 2,670. A smaller trend channel started in March of this year. The S&P 500 broke above the resistance offered by this smaller channel in early October and has corrected twice back to this broken trend line – examples of broken resistance becoming new support – in the last few weeks. These trend channels give us some clear near-term parameters: 2,670 to the upside and about 2,545 to the downside.

If there is a more significant pullback in the cards, it is likely to wait until early 2018. The small pullback into mid-November probably coincided with the early maturation of the 39-week cycle. There are still further cyclical pressures closer to Christmas but this may just express itself as a modest downward drift or shallow pullback. While some portfolio managers may want to lock in profits in December after such a strong year, this selling impulse will likely be offset by those who want to retain holdings to show a fully invested position and strong performance for the year. We do not expect any major liquidation of New York stocks in December.

Toronto's S&P/TSX Composite Index had a strong three month run to new all-time highs but is now starting to look a little tired in the short term. The action since mid-November has been noticeably weaker. We noted two weeks ago that Toronto was overbought and that some sectors and stocks were already pulling back. The percentage of S&P/TSX Composite Index stocks trading above their respective 50-day Moving Averages has declined from over 80% in early October to a recent low near 52%. The big Banks, which were leaders in the rally, are now either in pullback mode or showing negative divergences in internal momentum. The S&P/TSX Composite Index's immediate challenge is to hold on to most of its autumnal gains and stay above its 200-day Moving Average. A successful outcome will signal significantly further upsides.

New York and Toronto are understandably a little stretched after several months of strong gains. Toronto is already showing signs of fatigue. New York's upside momentum should allow it to hold up a little longer, probably into January. But both markets are in need of a healthy rest to digest and consolidate a very positive 2017.

We continue to believe that profit-taking and some pruning of short-term market exposure is prudent. The bull market has another major upside chapter to write in 2018 but first it is likely to face some selling pressure.

PAC-17-231; MKT-428; December 4, 2017

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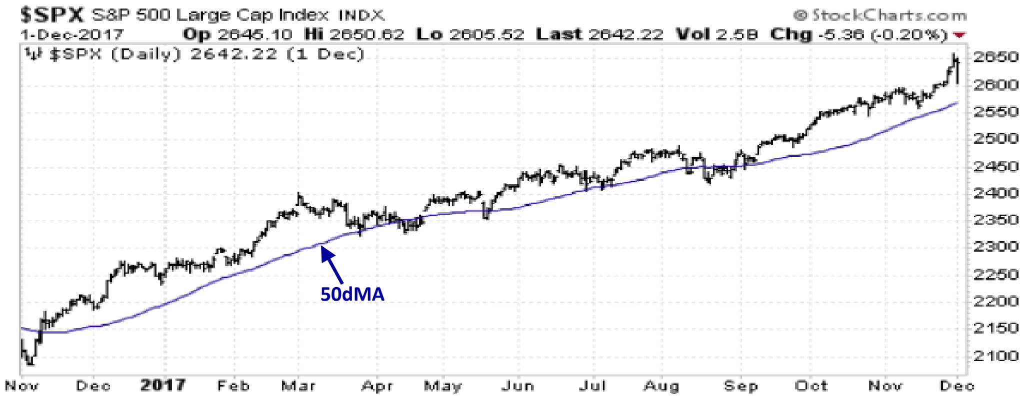
S&P 500



Two weeks ago we said that "a rally above the recent all-time high at 2,597 will keep the advance going, but a <u>sustained</u> move below 2,566 would lead to further downside". The S&P 500 declined for a day below 2,566, quickly reversed (catching the short sellers) and has since moved smartly above 2,600 in a series of new all-time highs.

The S&P 500's dominant price pattern of the last few months remains unchallenged. The pattern is "*higher highs and higher lows*", all taking place well above the rising 50-day Moving Average. Until this price pattern changes, and until the S&P 500 moves below its 50-day Moving Average and that Moving Average turns downwards, all remains well for the bulls. Remarkably, the 50-day Moving Average has not had a negative slope – an indicator of an intermediate-term downtrend – <u>for over one year</u>.

The internal momentum picture has improved with the S&P 500's most recent rally. Should a pullback occur, good initial support should appear at the recent 2,600 breakout point, and then in the 2,545 to 2,565 zone. Below that, the next area of support is 2,500 and there is a band of strong support all the way down to 2,450, the location of the rising 200-day Moving Average and a two-year old uptrend line.

The S&P 500's recent rally extends the bullish move that began in August. With overhead resistance likely to appear in the higher 2,600s, this three-month advance may be nearing its end. But only a pullback below 2,450 (a more than 7% correction) would damage the S&P 500's very bullish chart. We <u>do not</u> expect this to occur.

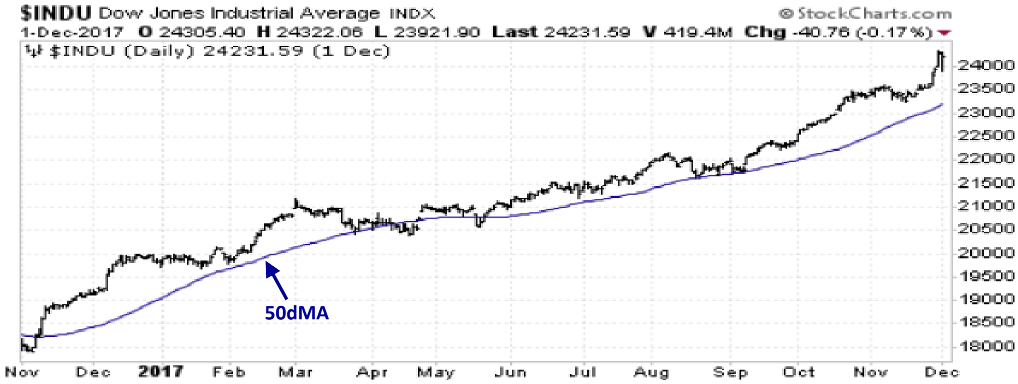
S&P/TSX Composite Index

The S&P/TSX Composite Index has moved horizontally in November on either side of the 16,000 level. This has helped close the large gap that existed between the Index and its rising 50-day Moving Average. The S&P/TSX Composite Index made a small "double-top" near the level of its recent all-time high. The second peak last week saw internal momentum indicators at lower levels than earlier in November.

Toronto looks a little fatigued from its 1,200 point rally. If there is a pullback, initial support should appear near the 50-day Moving Average, in the 15,830 to 15,850 area. A move below 15,830 would end the recent pattern of "*higher highs and higher lows*". Below this zone the rising 200-day Moving Average and the trend line extending from early 2016 will offer further support if needed in the 15,500 area. Any sustained move above the recent all-time high at 16,131 will indicate that November was just a brief resting period before a renewal of the bullish advance.

Toronto's maximum downside risk is about a one-half retracement of the autumn rally, towards the 200-day Moving Average. This "healthy renewal" would be less than a 4% correction. The S&P/TSX Composite Index's <u>upside potential remains considerably greater</u>, with our <u>minimum target</u> being 17,000.

Dow Industrials



The Dow Industrials continues to "reach for the stars." A minor pullback in mid-November was followed by a burst to new all-time highs. The Dow Industrials is in acceleration mode. The Index has moved above the overhead resistance offered by its major up trending channel that began in early 2016. But it is also comfortably near the mid-point of a more recent one-year rising trend channel, which projects an upside target near 25,000.

There are a few clouds in this very bullish picture. A negative divergence in internal momentum is developing. The gap between the Index and its 50-day Moving Average was closed a little in mid-November but the Industrials is now racing away once again. But one cloud has been removed. With a rapid leap upwards, the Dow Transports made a new all-time closing high earlier this week. It is now back in synch with the Industrials, reconfirming the primary up trend.

There is good initial support in the 23,200 to 23,500 zone. The rapidly rising 50-day Moving Average offers further support around 23,100 and there is trend channel support at 22,800. The short-term pattern of "*higher highs and higher lows*" remains intact as long as the mid-November low at 23,242 holds.

A month ago we forecast that "upside potential remains massive" for the Dow Industrials. This is still the case. But with the Industrials increasingly in "stretch mode", a healthy 3-4% pullback remains possible.

FTSE

The FTSE has not made a new all-time high for six months. Instead, it has moved horizontally within a 400-point (5%) range, on either side of its 50-day Moving Average. The important 7,200 and 7,100 support levels have not been threatened. In early November, as we expected, the FTSE briefly approached its all-time high but was quickly turned back.

Until there is a breakdown below the 7,200 and 7,100 levels, we suggest that the last six months is a consolidation period within a larger bullish advance. There is good support in the 7,350 to 7,400 area and below that at 7,200. The pattern of *"higher highs and higher lows*" remains intact as long as the 7,200 level is defended.

The FTSE still shows considerable upside potential. It is clear that breaking out above the last all-time high at 7,599 is proving to be a major challenge. More backing and filling and base-building may be needed in the short-term. But if the FTSE is successful in getting and staying above 7,599, then it is blue skies above, underpinned by a multi-month base.

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