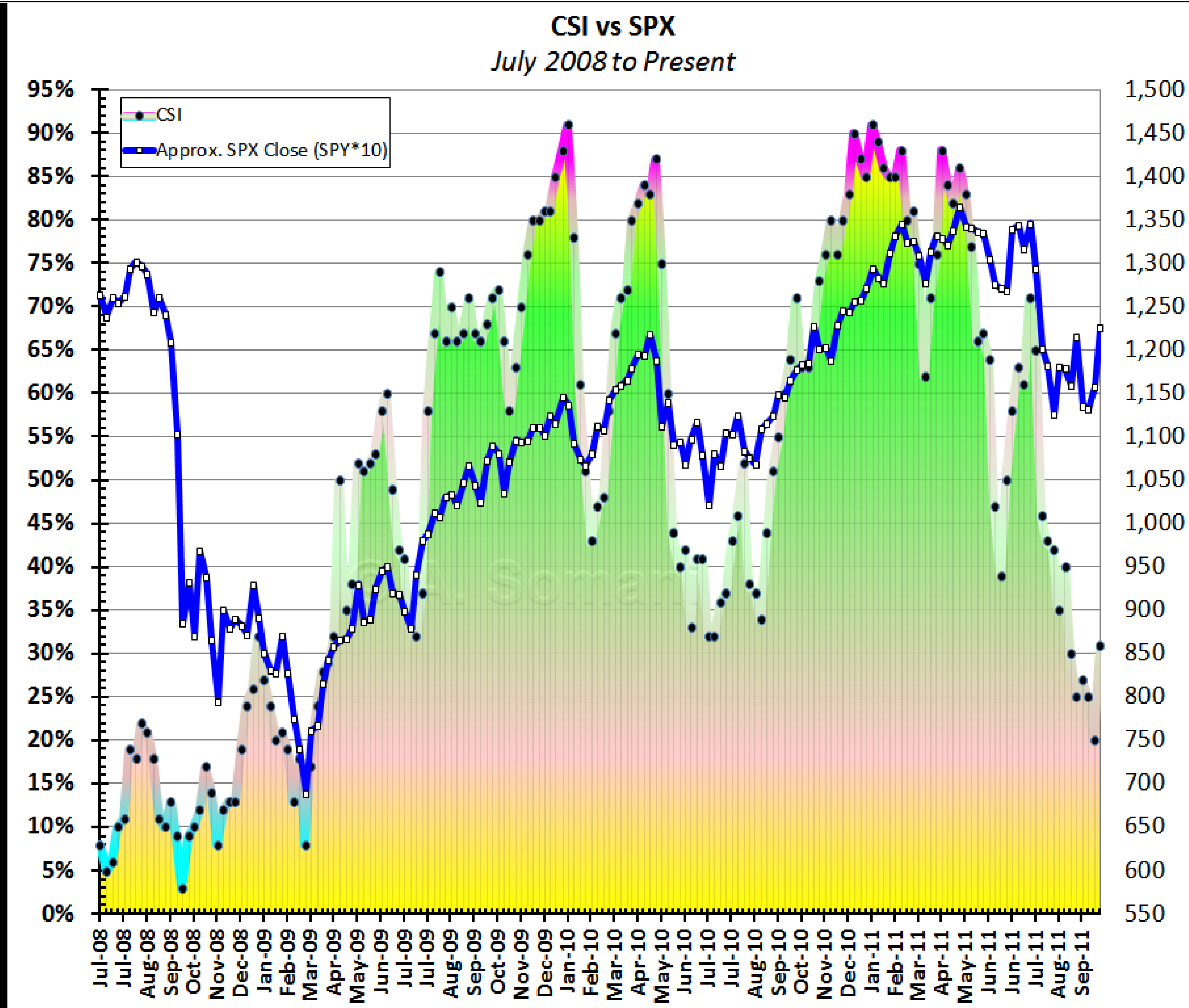
Crowd Sentiment Index (CSI) for US Equities

Imprecise CSI Interpretation Guidelines

	Bull Mkt.	Bear Mkt.
Extreme	86-100%	0-9%
Alarming	76-85%	10-24%
Neutral	51-75%	25-37%
Alarming	38-50%	38-50%
Extreme	25-37%	51-63%

The Crowd Sentiment Index (CSI) for US Equities is a smoothed and normalized composite of crowd sentiment (ranking from 0-100%) on the US stock market that is derived from various daily and weekly sentiment guages prepared externally by third parties.

Date	Approx. SPX Close (SPY*10)	%Ch.	CSI	Ch.
7/22/2011	1,346	2%	71%	10
7/29/2011	1,293	-4%	65%	-6
8/5/2011	1,201	**-7%**	46%	**-19**
8/12/2011	1,181	-2%	43%	-3
8/19/2011	1,126	**-5%**	42%	-1
8/26/2011	1,180	**5%**	35%	-7
9/2/2011	1,179	0%	40%	5
9/9/2011	1,159	-2%	30%	-10
9/16/2011	1,215	**5%**	25%	-5
9/23/2011	1,135	**-7%**	27%	2
9/30/2011	1,132	0%	25%	-2
10/7/2011	1,157	2%	20%	-5
10/14/2011	1,226	**6%**	31%	11



Comments and Opinions from the CSI Editor

Some Observations on Sentiment

- The CSI increased by 1100 basis points this past week to 31% – indicating that the price surge in the SPX since the Oct. 4th low is finally starting to impact crowd sentiment.

- In my opinion, the weight of the evidence continues to indicate that the SPX is most likely in a cyclical bear market that began on May 2nd, and so I continue to view the SPX as being in a cyclical bear market.

- Within the context of a cyclical bear market, the current level of the CSI may be interpreted as neutral. It thereby would not be a surprise to see the current multi-week rally off the Oct. 4th low continue for some more days or weeks before the next leg down in the cyclical bear market gets underway.

- I mentioned last week that, based on CSI readings that occurred during the 2007-09 cyclical bear market, it would be of no surprise if the CSI would get to 8% or below before a sizeable and multi-week cyclical bear market rally emerged (or the cyclical bear market concluded). However, it is clear, especially after the SPX definitively broke above its 50-day moving average on Monday, that a sizeable multi-week cyclical bear market rally (rather than just a simple multi-day retracement) began on Oct. 4th.

Some Observations on the Cyclical Price Trend

- According to Sam Stovall of S&P: *"In 80 percent of all the times since 1945 that the S&P has fallen by 15 percent or more, it has morphed into a new bear market."*
    - Further: *"Since 1945, when the S&P 500 has dropped at least 20% [from intraday high to intraday low] but less than 40%, the index has taken an average of 11 months to hit bottom and another 14 months [for a total of 25 months] to get back to its previous peak."* This suggests a cyclical bear market bottom sometime next year, very possibly in the second quarter.

- This week saw another decline in the Bloomberg Consumer Comfort Index, which has reliably negatively diverged from the SPX at recent cyclical bull market tops and seems to have done so again this time, having peaked in February, after bottoming in Nov. 2008.

- The ECRI made a recession call at the end of Sept., leaving no wiggling room in their announcement and putting their reputation on the line.

- This past week, the WLEI of the ECRI continued to decline, as it continues to drop unabated despite the recent advance in the stock market.
- As Chris Puplava indicates in his Friday article, when a WLEI bottom does not precede or coincide with an important multi-week bottom in the SPX, traders and investors should question whether that bottom in the SPX will really last.

- A sustainable increase in 10-year treasury yields and junk bonds and/or commodities, and/or the onset of significant new monetary easing (including QE3 or its equivalent), alongside a visible trough in the ECRI's Weekly Leading Index (or a new forecast of a recovery by the ECRI), can be at least some of what is expected to mark the bottom of the cyclical bear market or current decline in the SPX.
  - A positive sign for the bulls is that long-term Treasury yields seem to be breaking down and may have begun a major decline this month. Recall, that long-term bonds looked similarly extended in summer 2010 and late 2008 (a few months preceding the eventual SPX low of March 2009).
  - I find it hard to believe that the Fed will not significantly increase its monetary easing policies at some point before the middle of 2012 (at which time multiple quarters of negative GDP growth should be apparent), if the ECRI is indeed correct about the US heading into recession (or being in one now).

- I would advise caution (to myself firstly, and to readers, secondly) in comparing present market breadth statistics on the major US indices against seemingly comparable market breadth statistics collected prior to the last 2-3 years (if not prior to the last 12 months), in arriving at an opinion on the current market condition (relevant market breadth statistics in this regard include: advancers, decliners, up volume, down volume – and possibly even new highs and new lows). The reason I say this is that the amount of historical extremes we are seeing in market breadth statistics on the major US indices, currently, is unprecedented and appears surreal or unnatural (eg. see here). The cause for most of these extremes may stem from presently relatively high correlation and co-movement between individual issues, resulting from the rapidly increasing use of ETFs that has occurred over the past few years.

Some Other Market Observations

- The US Dollar Index and long-term Treasury bonds continue to be leading indicators of risk appetite, and every reader may want to keep a keen eye on them.

- One could argue that the recent strength in the stock market has much to do with the multi-week correction that the US Dollar Index needs (and appears to be taking – see *All Eyes on the USD* section of a recent Chris Puplava article), en route to what will likely be higher prices for it in the coming weeks and months (a cyclical rally that will likely end sometime next year), albeit within the context of a secular downtrend.

- The US Dollar Index appears ready to make at least a multi-day to multi-week low this week (at or slightly above its 200-day moving average), which may coincide with a corresponding top in US equities. However, on a multi-month to multi-quarter level, it is more likely that the US Dollar Index still has at least another low ahead of it (and US equities have at least another high ahead of them), before the cyclical bull market correction in the US Dollar Index and the cyclical bear market rally in US equities terminates.

- Gold and silver have yet to show noticeable strength concurrent with recent US Dollar Index weakness (unlike equities), and this may be yet another hint that the US Dollar Index is just taking a breather before further gains in the coming weeks and months. It will be interesting to see whether weakness in gold and silver continues despite the overwhelming bearishness that exists on these two markets. If yes, it would be a warning sign that liquidity may be evaporating from financial markets in much the same way it did in 2008.

- Last week, I mentioned that Q3 earnings estimates may not fully reflect the possibility of a recession. I was not sufficiently aware the extent to which earnings estimates for Q3 have been revised, however. As you can see, Q3 earnings estimates have been revised down significantly coming into Q3, and the question is really whether estimates have been lowered enough by the sell-side to ensure another quarter of a substantial beat rate. If companies are now still not able to beat estimates at a pace consistent with recent quarters (where close to 65% of companies have been beating estimates), it would be a definite sore spot for bulls, in my opinion.
  - The majority of earnings reports will be coming near the end of this month and early next month, and the 'success' of the earnings season or lack thereof is still too early to conclude upon right now. Some major market bellwethers do report this week, however, including Apple (on Tuesday). So far, negatives in financials have been offset by positives in tech companies.

- It is unusual, given the price thrust we've seen over the last several days, for the SPX not to continue higher, for the most part, for several more weeks. The SPX also has yet to make a significant retracement since its Oct. 4th low, and usually major bear market rallies appear as A-B-C rallies. It is likely that A is very near completion and B will begin sometime this week. Assuming a normal 5-12 week cyclical bear market rally, a rally as far as into early December would not be a surprise. However, based on the article from excellent technician Matthew Claassen this past week, the minimum price target for this rally (a 50% retracement of the prior leg down) has essentially been reached and the current rally could be much closer to five weeks in duration (suggesting a top in early Nov.).

- Growth stock investor extraordinaire Mike Scott, who seems to consistently have an excellent sense about the condition of the market, indicated this past week that no one should be surprised if SPX reaches the 200-day average (at ~1275) before terminating: *"I went back and looked at the following bear markets: 1969-1970, 1973-1974, 1981-1982, 2000-2003, 2007-2009...The one theme that is constant in all of these past markets is that there was an initial wave down followed by a bear market flag structure that rallied to the 200 day moving average before rolling over into wave 2 down. In one case the bear flag is more of a sideways consolidation (73-74)."*

Market Scenarios to Consider for the Coming Weeks

I'm not a market forecaster and don't believe one needs to even remotely accurately forecast the market to be successful in trading it or investing in it. However, I feel that it's useful to have some different market scenarios for the coming weeks on one's mind (sometimes to partly assist in trade planning and/or risk management), and then consider if market action is confirming or denying them.

#	Scenario	Guesstimated Probability	Notes
1	SPX reaches but fails to definitively break 1275-1295 before heading lower to re-test its Oct. 4th low.	40%	A re-test of the Oct. 4 intraday low will probably lead to a definitive break of said low – eventually, if not immediately.
2	SPX reaches but fails to definitively break 1250-1260 before heading lower to re-test its Oct. 4th low.	30%	A re-test of the Oct. 4 intraday low will probably lead to a definitive break of said low – eventually, if not immediately.
3	SPX reaches but fails to definitively break 1225-1235 before heading lower to re-test its Oct. 4th low.	20%	A re-test of the Oct. 4th low will probably lead to a definitive break of said low – eventually, if not immediately.
4	SPX definitively breaks 1295 before a re-test of its Oct. 4	10%	I am willing to leave the door open to the *possibility* of a

	intraday low.		continuing cyclical bull market at least until the SPX definitively breaks its Oct. 4 intraday low.

Cautionary Note on Interpretation: *The Crowd Sentiment Index (CSI) for US Equities is perhaps best used as a blunt and continuous (as opposed to discrete) indication as to the general market mood toward US equities, which can help a contrarian trader or investor to decide when to increase or hedge/decrease US equities exposure so as to help manage risk effectively and thereby maximize risk-adjusted returns. In a cyclical bull market, it is not unusual for the CSI to remain elevated for extended periods without the market declining in any significant way. Conversely, in cyclical bear markets, it is not unusual for the CSI to remain depressed for extended periods without the market rising in any significant way. Furthermore, the CSI is merely one tool a trader or investor can use to analyze markets, and should not be interpreted except in combination with the message being delivered by a suite of other tools the trader or investor feels confident in analyzing markets with.*