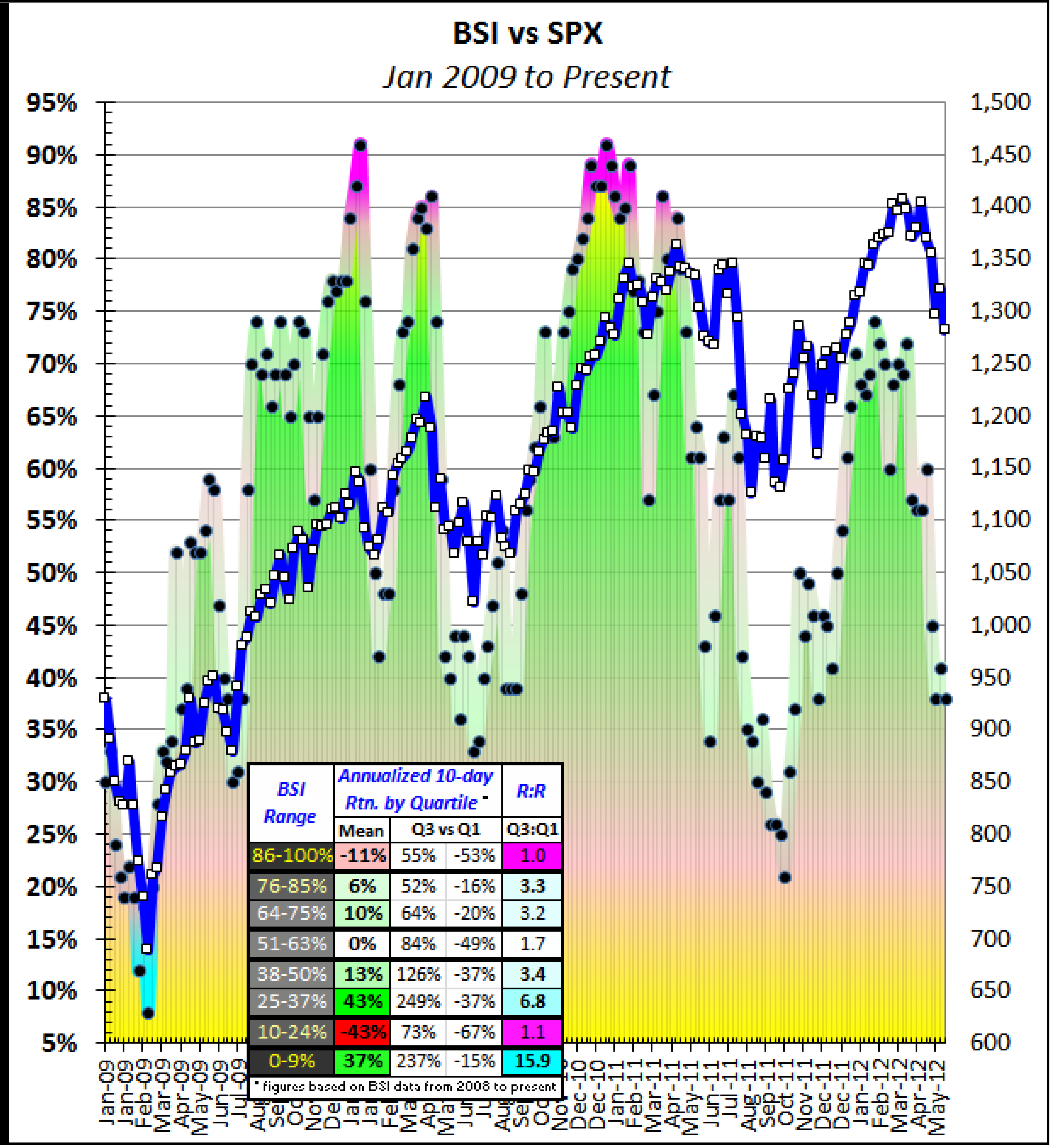
Bullish Sentiment Index (BSI) for US Equities

Rough BSI Interpretation Guidelines

Cyclical Bull Market		Cyclical Bear Market	
Extreme	86-100%	0-9%	Minimal
Extended	76-85%	10-24%	Shallow
Neutral	51-75%	25-37%	Neutral
Shallow	38-50%	38-50%	Extended
Minimal	25-37%	51-63%	Extreme

The Bullish Sentiment Index (BSI) for US Equities is designed to provide a single, numerical, and comprehensive measurement of bullish sentiment on the US stock market at any given time. It is normalized, oscillates in a range of 0-100% (where 0% indicates there is no bullish sentiment and 100% indicates bullish sentiment is at its zenith), and is constructed through the application of custom weighting and smoothing mechanisms to various third-party sentiment gauges.

Date	Approx. SPX (SPY*10)	%Ch.	*SPX Stretch from Mean (-50 to 50)*	BSI	Ch.	*BSI Stretch from Mean (-50 to 50)*
2/17/2012	1,364	2%	42	74%	5	42
2/24/2012	1,369	0%	37	72%	-2	43
3/2/2012	1,373	0%	37	70%	-2	34
3/9/2012	1,376	0%	22	60%	-10	29
3/16/2012	1,403	2%	32	68%	8	24
3/23/2012	1,397	0%	34	70%	2	21
3/30/2012	1,408	1%	28	69%	-1	14
4/5/2012	1,398	-1%	24	72%	3	6
4/13/2012	1,371	-2%	-11	57%	-15	-15
4/20/2012	1,380	1%	-26	56%	-1	-29
4/27/2012	1,404	2%	-21	56%	0	-26
5/4/2012	1,370	-2%	-26	60%	4	-23
5/11/2012	1,356	-1%	-29	45%	-15	-33
5/18/2012	1,297	-4%	-41	38%	-7	**-45**
5/25/2012	1,321	2%	-40	41%	3	**-45**
6/1/2012	1,282	-3%	-45	38%	-3	-39



BSI Range	Annualized 10-day Rtn. by Quartile*			R:R
	Mean	Q3 vs Q1		Q3:Q1
86-100%	-11%	55%	-53%	1.0
76-85%	6%	52%	-16%	3.3
64-75%	10%	64%	-20%	3.2
51-63%	0%	84%	-49%	1.7
38-50%	13%	126%	-37%	3.4
25-37%	43%	249%	-37%	6.8
10-24%	-43%	73%	-67%	1.1
0-9%	37%	237%	-15%	15.9

* figures based on BSI data from 2008 to present

Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria.
The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell.

John Marks Templeton

Summary

The BSI fell 3 notches this past week to close at **38%** – back to its May low. Meanwhile, the SPX closed lower by about 3%. The SPX currently sits about 10% below its 52-week closing high and about 0% above its 200-day moving average.

The current level of the BSI should be interpreted within the context of the current cyclical trend of US equities:

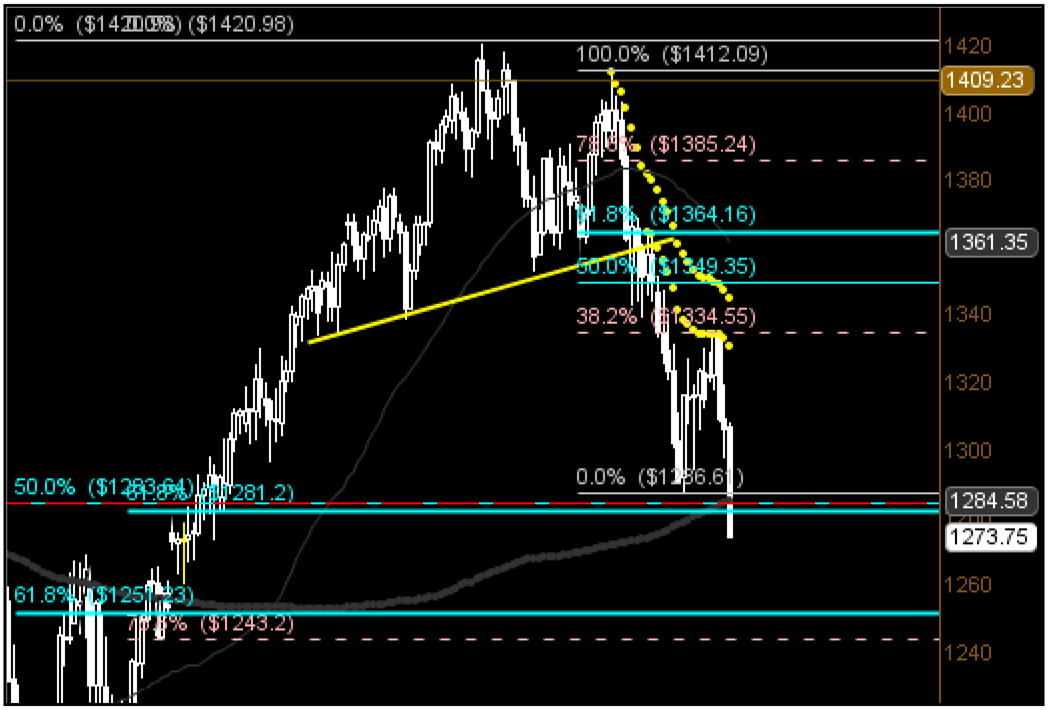
- Within the context of a ***cyclical bull market***, the current level of the BSI suggests **bullish sentiment is Shallow** – so, there is apparently an increasingly large amount of "gas in the tank" for a multi-week rally.

The BSI is perhaps best used as a blunt and continuous (as opposed to discrete) indication as to the general mood of traders and investors toward the US equity market. With regard to the BSI's associated indicators ("SPX Stretch from Mean" and "BSI Stretch from Mean", respectively), if their associated cells are colored blue (purple) this weekend, then it indicates an unusually oversold (overbought) market and/or unusually rapid drop (rise) in bullish sentiment. Overall, the BSI and its associated indicators are designed with the aim of helping a trader or investor to decide when to increase or hedge/decrease exposure to US equities so as to help manage risk effectively and thereby maximize risk-adjusted returns. However, the BSI and its associated indicators represent merely one suite of tools a trader or investor can use to analyze the US equity market with, and should not be interpreted except in combination with the interpretation of one or more other suites of tools that the trader or investor feels confident in comprehensively analyzing the US equity market with.

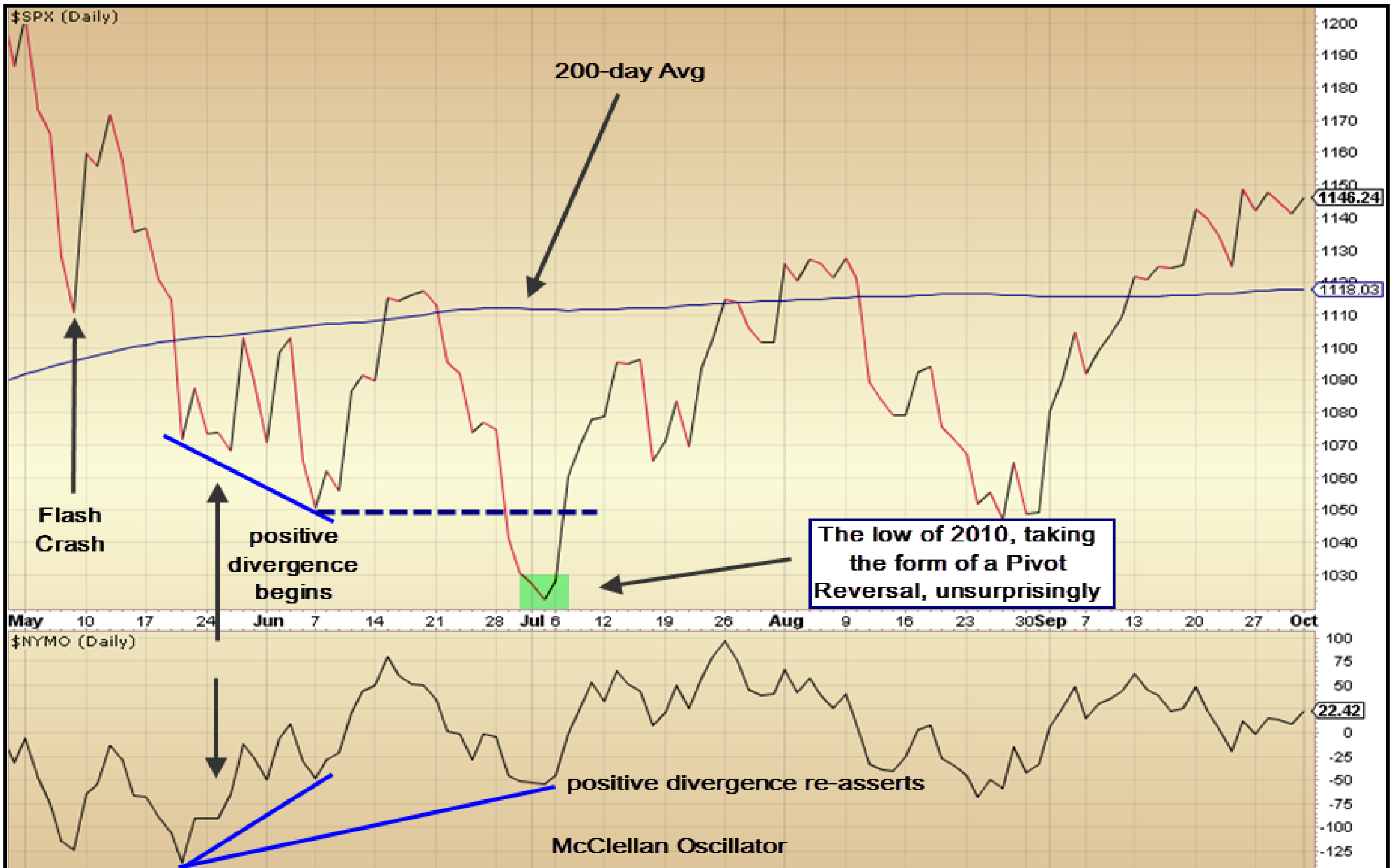
Knowledge of the cyclical trend of US equities is an important element of interpreting the BSI and its associated indicators accurately. For instance, in a cyclical bull (bear) market, it is not unusual for the BSI and its associated indicators to remain elevated (depressed) for extended periods without US equities declining (rising) in any significant way. At the end of each calendar month, it will be evaluated for the purpose of this report (based on reader feedback or anticipated reader feedback) whether it is fitting to comment on the BSI just within the context of a cyclical bull market, just within the context of a cyclical bear market, or within both the context of a cyclical bull market and the context of a cyclical bear market.

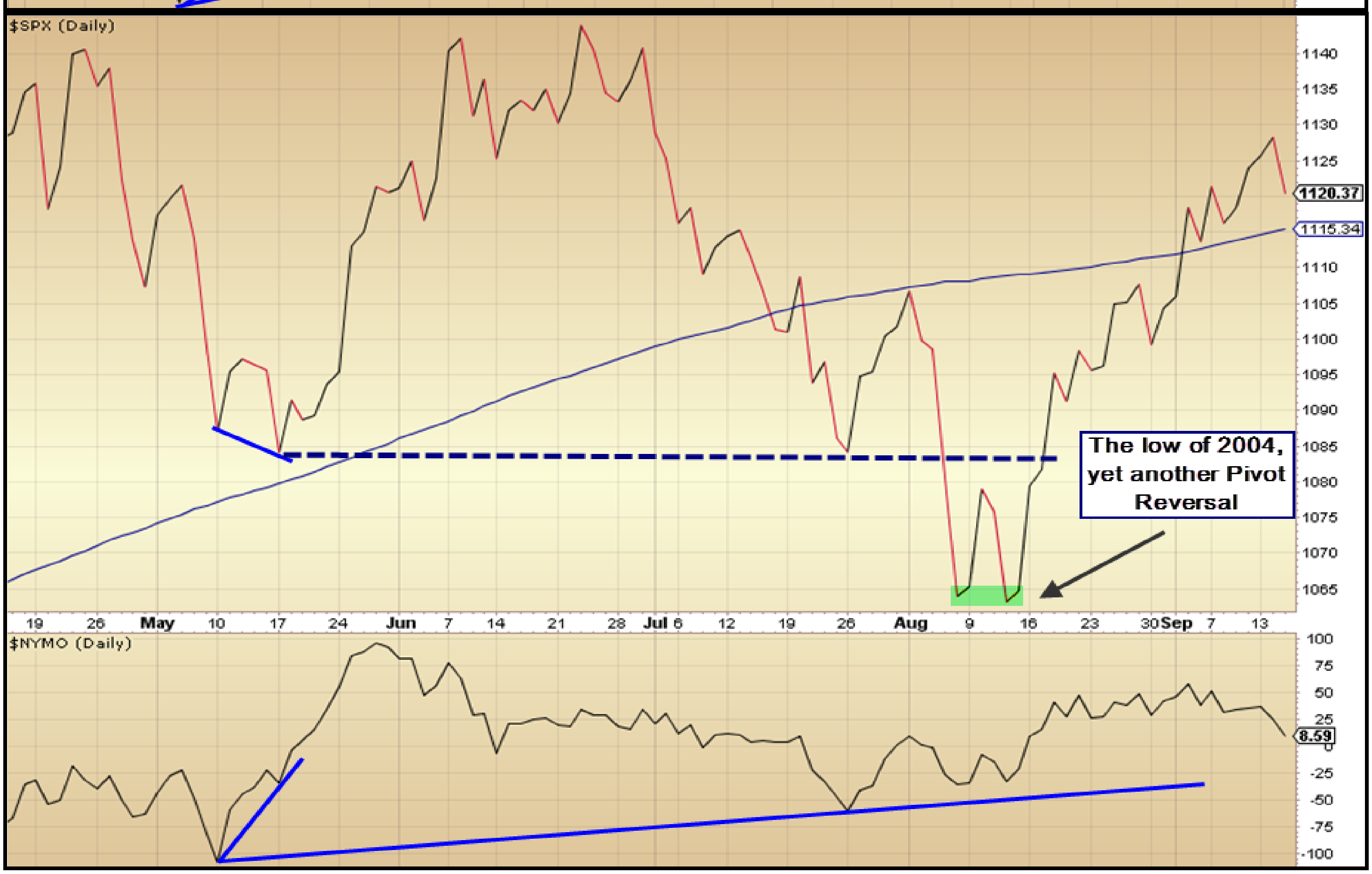
Just the Humble Opinion of the BSI Editor(s)
(Do not be surprised if this space is often empty, mainly due to time constraints.)

Most multi-month bottoms and tops in the SPX are *Pivot Reversals* – typically a false break of heavily watched resistance (at tops) or false break of heavily watched support (at bottoms). This is a good concept to remember (and one that I've mentioned before) as it continues to fool many market participants. The support area I mentioned (in S&P 500 Continuous Futures) a couple of weeks ago – a proxy of an area that many are watching on the SPX itself – was significantly closed below on Friday:



It is worth noting that the SPX is setup for a DeMark Sequential buy signal on its weekly chart at the end of this coming week – a signal that is very unusual to see in a cyclical bull market, and more often than not marks a multi-week exhaustion point. Importantly, although the SPX made a new multi-month low on Friday, a number of breadth-based metrics are showing positive divergence and making higher lows than they did back on May 18th, such as the McClellan Oscillator (an operating company only version). This is typically what one sees preceding a Pivot Reversal, although the first ensuing pop the SPX sees could be followed by one more additional low, as per the below examples from July 2010 and Aug. 2004:


$SPX (Daily)
200-day Avg
Flash Crash
positive divergence begins
The low of 2010, taking the form of a Pivot Reversal, unsurprisingly
1146.24
1118.03
$NYMO (Daily)
positive divergence re-asserts
McClellan Oscillator
22.42


$SPX (Daily)
The low of 2004, yet another Pivot Reversal
1120.37
1115.34
$NYMO (Daily)
8.59

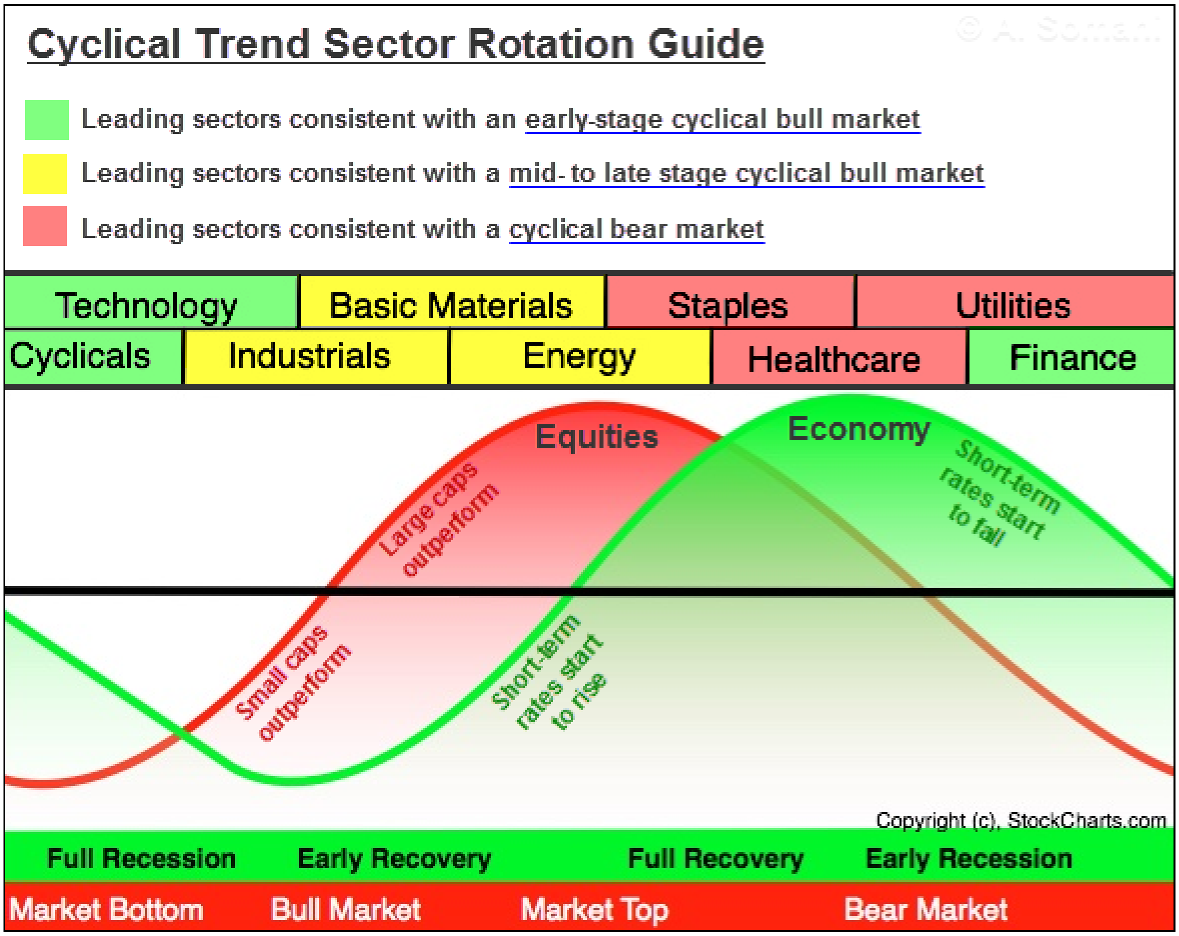
The above examples show how the same concepts can be expressed in somewhat different ways. Notice in the above images that the McClellan Oscillator is the indicator that marks the *Momentum Low* (on May 26th, 2010 and May 10th, 2004, respectively) – meaning the point in the bottom formation process where many market breadth based metrics see their low, but, price itself does not (yet). It is my thinking right now that in the current decline the SPX made its Momentum Low back on May 18th.

- If this is correct, then the SPX has already begun the process of forming a bottom and is very near to its ultimate *closing* low in the current correction (within say 2.5% – the main question being: does the currently completing leg of the correction include this closing low, or is there another leg coming that will include this closing low?).
- If this is incorrect, then a new low is coming in many market breadth based metrics (including the McClellan Oscillator), and the SPX could easily fall another 5%+ – which is certainly possible, especially with current headline risks, but, is also unlikely given that 15%+ corrections rarely occur within a year of each other, especially in cyclical bull markets. Consider, also, for example, that the Spanish 10-year government bond yield is already nearing 7% again. I don't believe European monetary authorities are going to let it go much above that before conducting major policy intervention (assuming credit markets don't calm down on their own in the meanwhile).

I want to add, once again, that I have little reason to think that the SPX currently is not in a cyclical bull market, as very few cyclical bull markets top with as much of a lack of weakness in individual components as was seen at the recent 52-week highs in the SPX and Nasdaq Composite, respectively. Lesser examples of this include the fact that the SPX Cumulative Advance-Decline line confirmed the latest SPX 52-week high – something that rarely occurs at the beginning of a cyclical bear market, based on data going back many decades. Also, consider that of the six cyclical bull market tops in the Nasdaq Composite since 1980, none have topped showing nearly the lack of weakness in component new highs and component new lows that the Nasdaq Composite showed at its latest 52-week high.

Additional Segment: Cyclical Trend Sector Rotation Monitoring

The following cyclical trend sector rotation guide is my personal adaptation of a chart made available by John Murphy of Stockcharts.com:



The top five performing sectors of the SPX over the past 3 months are highlighted below, color-coded according to the above guide:

Sector	Performance		
	1 Month	3 Month	YTD
Telecommunication Services 1 Industry	-0.07%	+4.69%	+5.89%
Utilities 1 Industry	-1.41%	+1.53%	-1.86%
Consumer Staples 3 Industries	-3.49%	-0.46%	+1.68%
Health Care 2 Industries	-5.88%	-2.62%	+3.49%
Consumer Discretionary 5 Industries	-9.43%	-5.55%	+6.52%

Sector rotation may be one tool for a person to consider use of (among a number of others) in helping to determine the cyclical trend of US equities. Based on the color-coded table shown above, sector rotation currently appears to be consistent with US equities being in a mid- to late stage cyclical bull market*.*

As detailed in earlier reports, I continue to view US equities as being in a mid- to late stage cyclical bull market.

Additional Segment: Magazine Cover Confirmation Indicator

Far more often than not, popular magazine covers will be meaningless for the average market participant. But, on occasion, one or more of these covers will **confirm** unsustainably bullish or bearish sentiment toward one or more publicly-traded asset classes or securities, and thereby mark a turning point or near turning point in one or more of these asset classes or securities, depending on the nature of the cover(s) in question. As financial commentator Barry Ritholtz has noted: “The magazine cover contrary indicator works when it reflects a fairly long lasting, well understood concept that is reaching a climax.”

This segment of the BSI Report is suspended for an indeterminate period of time due to time constraints. I hope to bring it back sometime in June, though.

Here are links that will allow one to (at least) view a thumbnail of the covers of (some of, if not most of) those weekly magazines that have enough readership and relevance for a market participant to consider monitoring each week, ordered in a descending fashion based on recent US public circulation numbers (Time Magazine is by far the most popular):

1. Time Magazine
2. Newsweek
3. Businessweek
4. The Economist

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