Bullish Sentiment Index (BSI) for US Equities

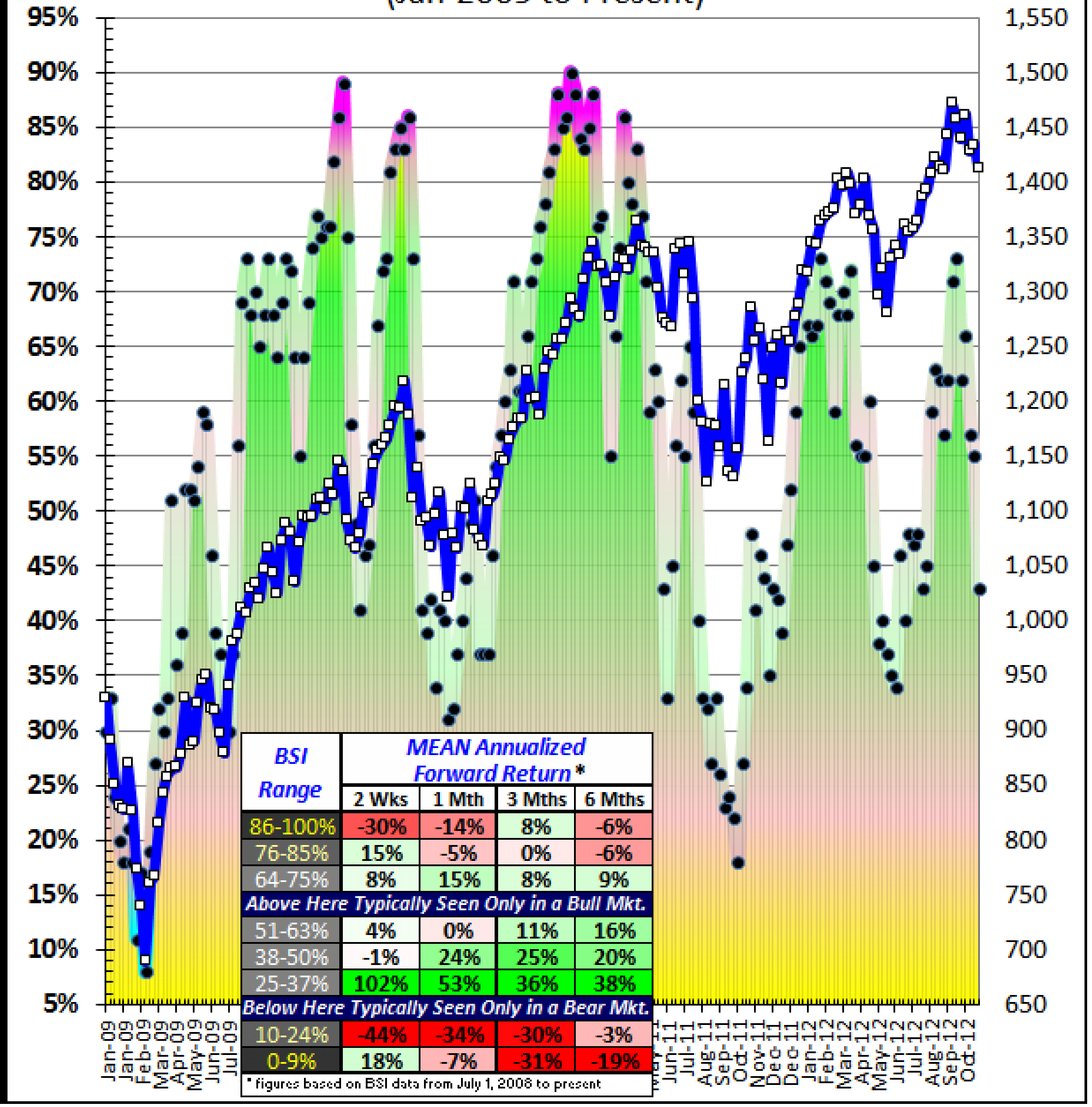
The Bullish Sentiment Index (BSI) for US Equities is designed to provide a single, numerical, and comprehensive measurement of bullish sentiment on the US stock market at any given time. It is normalized, oscillates in a range of 0-100% (where 0% indicates there is no bullish sentiment and 100% indicates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

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

Date	Approx. SPX (SPY*10)	%Ch.	SPX Stretch from Mean (-50 to 50)	BSI	Ch.	BSI Stretch from Mean (-50 to 50)
7/6/2012	1,355	0%	19	48%	8	-30
7/13/2012	1,358	0%	14	47%	-1	-18
7/20/2012	1,365	1%	8	48%	1	-16
7/27/2012	1,387	2%	10	43%	-5	-24
8/3/2012	1,394	0%	7	45%	2	-19
8/10/2012	1,408	1%	24	59%	14	14
8/17/2012	1,422	1%	29	63%	4	30
8/24/2012	1,415	0%	30	62%	-1	33
8/31/2012	1,412	0%	21	57%	-5	32
9/7/2012	1,443	2%	28	62%	5	35
9/14/2012	1,472	2%	38	71%	9	37
9/21/2012	1,459	-1%	37	73%	2	41
9/28/2012	1,440	-1%	18	62%	-11	31
10/5/2012	1,461	2%	7	66%	4	20
10/12/2012	1,429	-2%	-20	57%	-9	17
10/19/2012	1,434	0%	-29	55%	-2	12
10/26/2012	1,414	-1%	-37	43%	-12	5

BSI vs SPX
(Jan 2009 to Present)



"If you want to have better performance than the crowd, you must do things differently from the crowd."

John Marks Templeton (d. 2008)

BSI Summary

The BSI fell a dramatic 12 notches this past week to close at 43%. Meanwhile the SPX closed lower by about 1.5%.

The **SPX** currently sits approximately **4% below its 52-week closing high** and approximately **2.5% above its 200-day moving average**.

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

Within the context of a cyclical bull market, the current level of the BSI suggests:

- **bullish sentiment is at a Shallow level**; or
- **there is presently a large amount of underinvested market participants** available to fuel a multi-week to multi-month rally in US equities.

Understanding the BSI

The BSI may be best used as a blunt and continuous (as opposed to discrete) indication as to the general mood of global market participants toward the US equities market. With regard to the BSI's associated indicators ("SPX Stretch from Mean" and "BSI Stretch from Mean"), if their associated cells are colored blue (purple) this weekend, then they are indicating an unusually oversold (overbought) US equities market and an unusually rapid drop (rapid rise) in bullish sentiment, respectively. Overall, the BSI and its associated indicators are designed with the aim of helping market participants to gauge when to tactically 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 that a market participant can use to analyze the US equities market with, and should not be interpreted except in combination with the interpretation of one or more other suites of tools that the market participant feels confident in comprehensively analyzing the US equities 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 may not be 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 the BSI 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.

> ***"**Success in investing doesn't correlate with I.Q. once you're above the level of 25. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing.**"*** **Warren Edward Buffett**

Just the Humble Opinion of the BSI Report Editor

[The BSI Report Editor will only chime in occasionally each month, if at all, partly due to time constraints].

One of the things I like to do is count how many days the SPX has been above or below its 200-day average (since last touching the average) and then compare the count to historical norms. So far, the SPX has spent a bit more than an average amount of time above its 200-day moving average. That said, I think the SPX will at least touch its 200-day moving average again before the end of January. When it may happen between now and then is a more difficult question.

I have two main scenarios that I think are the most likely right now for how the SPX will next touch its 200-day moving average. One scenario is that the SPX will touch its 200-day moving average in Nov. if the SPX continues lower from here (the SPX is currently about 2.5% above its 200-day moving average). Another scenario is that the SPX has made or is about to make a multi-week bottom (probably above 1405) that will be followed by an attempt by the SPX to make a new 52-week high. If this latter scenario occurs (which I know is one that well-regarded technician Tom DeMark is expecting), I think you will see a correction occur shortly after the attempt that will take the SPX back down to (at least) its 200-day moving average before the end of Jan.

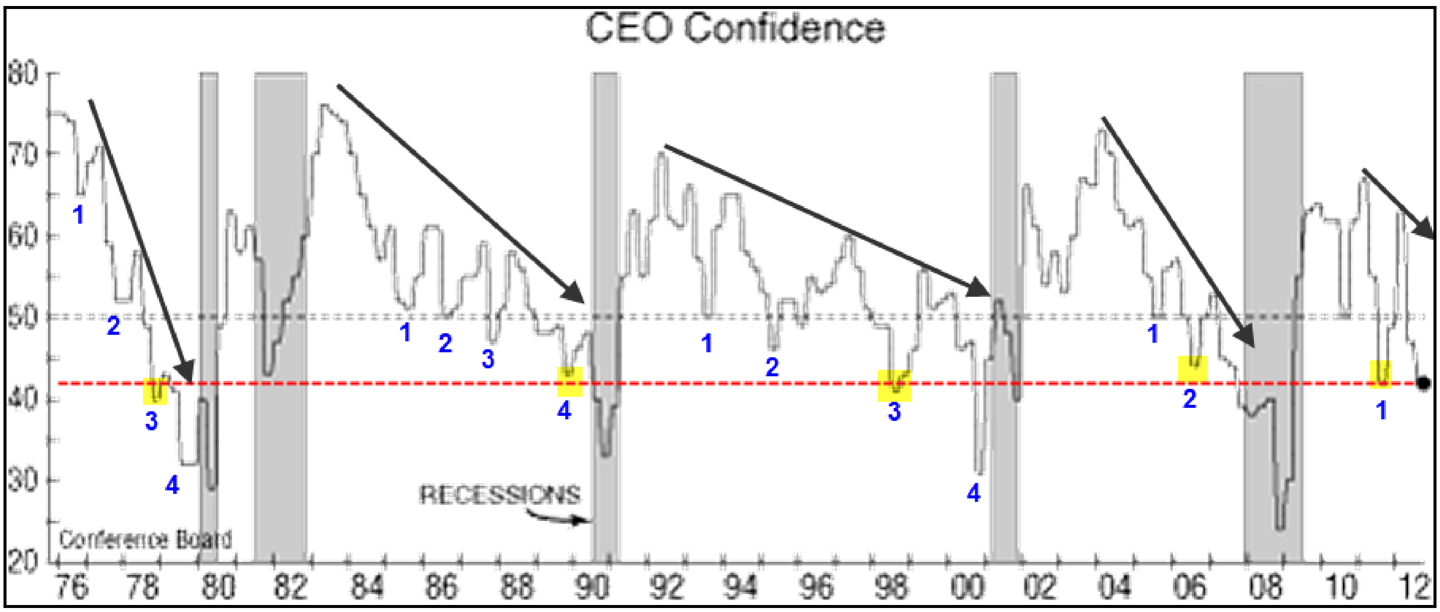
So far, the SPX has not yet produced the type of oversold conditions that often occur as part of the first correction (and thereafter sustained bottom) following a 3+ month rally. This is another factor leading me to believe that either a multi-week bottom is being presently formed that will probably be re-tested in a later correction (in Dec. or Jan.) or the SPX will continue falling from here (probably to its 200-day moving average later this month) as part of completing a correction.

Moving on, this is a pretty interesting chart from Barry Ritholtz – indicating that the broad US equity market historically has typically peaked a number of months (on average about four months) before the beginning of NBER-designated recessions (lending support to the idea of the equity cycle leading the economic cycle by a number of months – many textbooks from academia often say six months, I believe). I think the broad equity market is not a great leading economic indicator, personally, unless the drivers of cyclical bull and cyclical bear markets (and the conditions typically or almost always preceding each) from a market breadth perspective are uncovered and well understood (in which case the broad equity market – as represented by the SPX for the US – is a truly awesome leading economic indicator).

You may have heard of Ray Dalio at Bridgewater (one of the world's largest and most successful hedge funds) suggesting that investors take into account which element of the economic cycle the economy is in (he suggests there are four elements to the cycle) as part of determining asset allocation. I think the chart on the next page should be helpful in this regard, for those who are interested. The chart is based on Dalio's four elements as well as the idea that there are really maybe only four key asset classes investors need to consider in performing asset allocation today: equities (stocks), bonds, gold and cash.

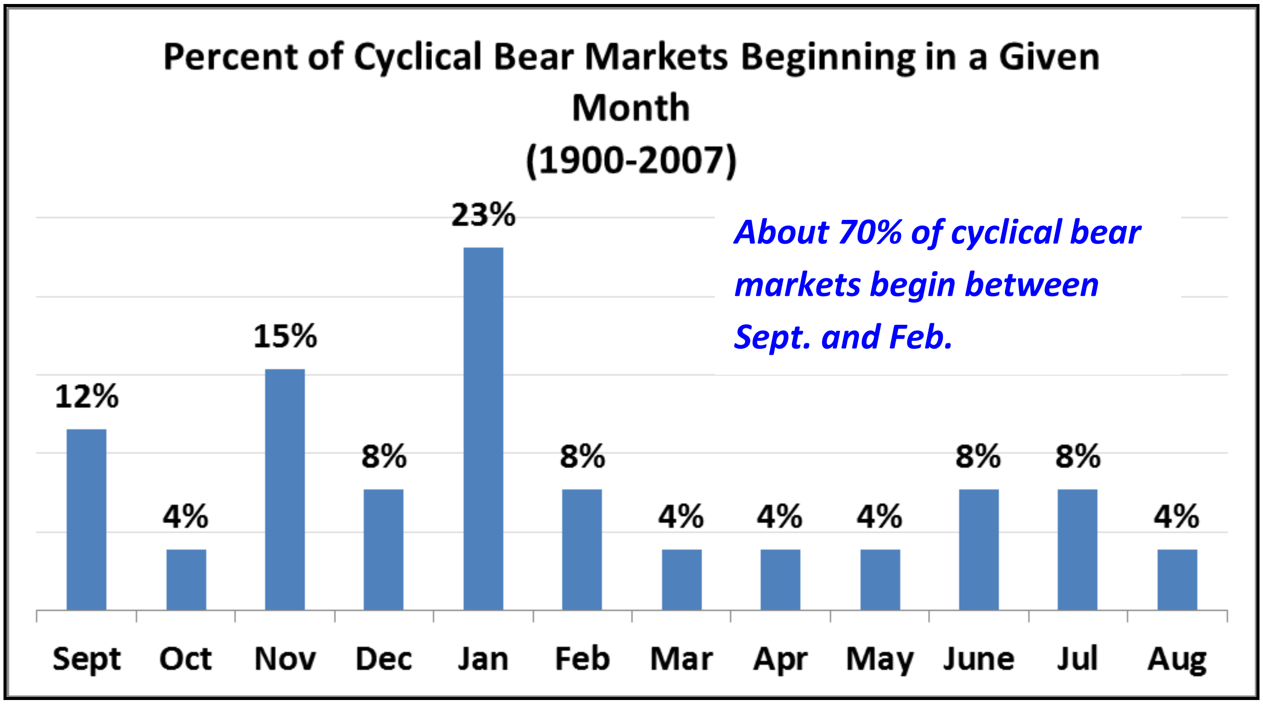
Inflationary Growth (Stocks and Gold)	Disinflationary Growth (Stocks and Bonds)
Inflationary Stagnation (Gold and Cash)	Deflationary Stagnation (Cash and Bonds)

Another chart I want to share is this "Chart of the Week" (annotations are mine) from Jim Stack's InvesTech Research (I am a fan of some of his work and think he knows more about how cyclical bull and cyclical bear markets start and end than all but a relatively very small number of investors):



The CEO Confidence Survey tends to be a leading economic indicator. It is getting near levels which would suggest a recession may be a lot closer than we would hope. My guess is there is a rebound coming from the current level (or very near it) that will then be followed by a new lower low in 2013 or early 2014 (at which point the economy should have either rolled over or be much closer to rolling over). As many of you know, I think there is a very strong chance that a cyclical bear market (and then economic recession) begins in 2013 or early 2014 (with the odds of a cyclical bear market increasing as we get later and later into this period – particularly after Aug. 2013). At the same time, I think the SPX could easily see the 1600-1800 zone before it weakens enough to roll over into a cyclical bear market.

On the next page is a chart I created regarding the months in which cyclical bear markets tend to historically begin.



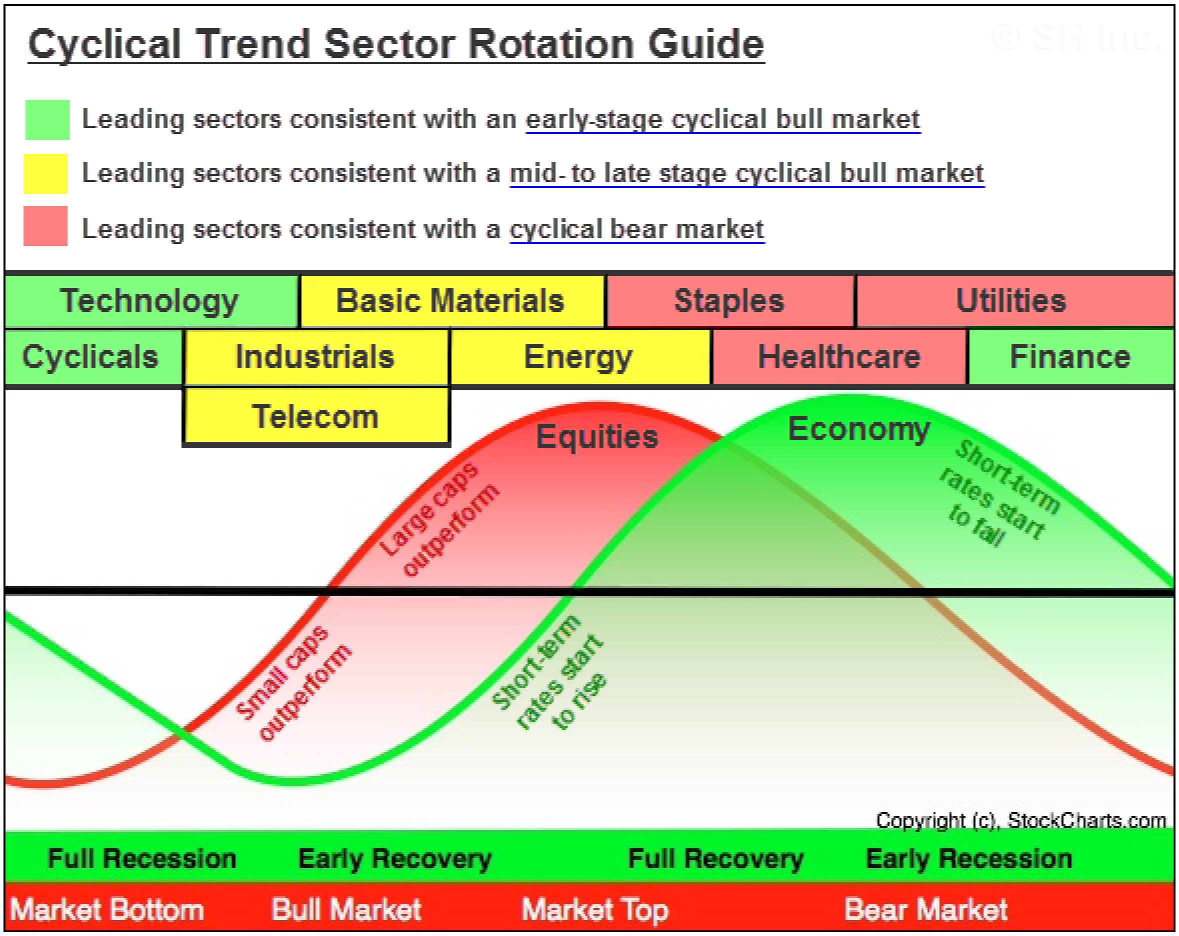
Since 1900, 50% of cyclical bear markets have begun in one of Sept., Nov. or Jan., and about 70% of cyclical bear markets have begun in the six month period between Sept. and Feb. This data is based on 26 cyclical bear markets that occurred between 1900 and 2007.

An additional point worth noting is that about 80% of bear market damage in the SPX, since 1950, has occurred between May and Oct., according to Alpha Investment Management.

On that note, the seasonally strong period of late Oct. to late Apr. has begun. Those who went away in late Apr. to early May should have re-entered the market late last week or be in the process of re-entering the market. Perhaps partly for this reason, the window dressing period for late Oct. to early Nov. tends to be particularly strong. Over 90% of the market's gains since 1950 have occurred between late Oct. and late Apr.

Additional Segment: Cyclical Trend Sector Rotation Monitoring

The following "Cyclical Trend Sector Rotation Guide" is the BSI Report's staff's adaptation of a chart made available by John Murphy, CMT, the 'father of intermarket analysis':



The top five performing sectors of the SPX over the trailing quarter are highlighted below and color-coded according to the above guide:

Sector	Performance		
	1 Month	3 Month	YTD
Financials 4 Industries	+1.28%	+7.66%	+19.19%
Consumer Discretionary 5 Industries	-0.97%	+6.73%	+18.17%
Materials 1 Industry	-0.97%	+6.71%	+9.85%
Health Care 2 Industries	-0.46%	+5.50%	+17.35%
Industrials 3 Industries	-0.03%	+4.16%	+8.68%

Sector rotation may be one tool for a market participant to consider use of (among a number of others) in helping to determine the current 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 an early to mid-stage cyclical bull market*.*

Largely for reasons detailed in earlier reports, the BSI Report Editor continues to view US equities as being in a mid- to late stage cyclical bull market.

Additional Segment: Magazine Cover Confirmation Indicator

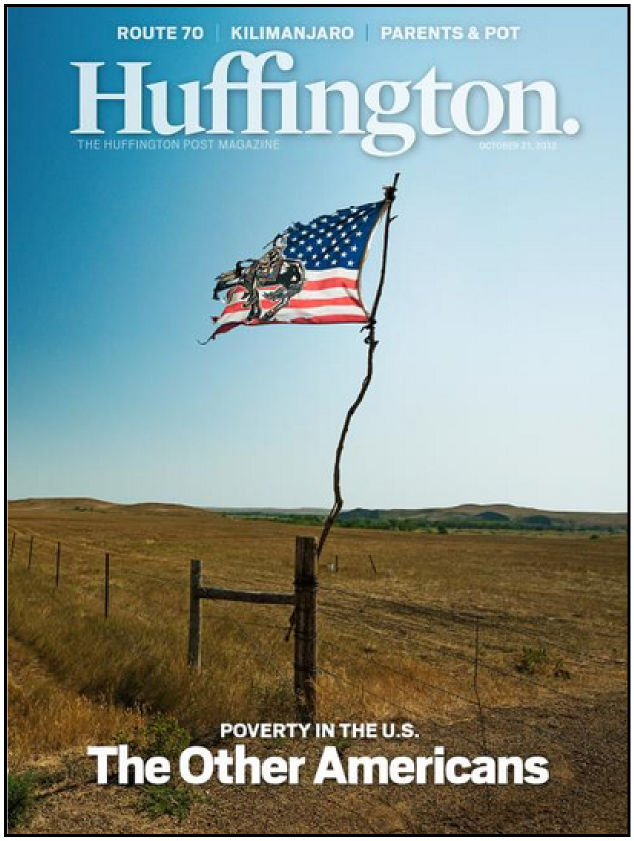
Far more often than not, popular magazine covers will be of little or no use to market participants. But, on occasion, one or more of these covers will **confirm** unsustainably bullish or bearish sentiment toward one or more publicly-traded asset classes or securities, and thereby mark a turning point 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: *"*<u>The magazine cover contrary indicator works when it reflects a fairly long lasting, well understood concept that is reaching a climax.</u>"

In light of Ritholtz's comment, here are the magazine covers this weekend (from the widely read magazines linked to at the bottom of this segment or that the BSI Report's staff find intriguing) that may be of interest to market participants:

A bullish omen? This week's Barron's cover complements the data from the BSI:

Caption reads: "Money managers turned surprisingly bearish in our latest BIG MONEY POLL. Skeptics predict stocks will drop 8% by June. They blame Washington."

To I suppose some degree complementing the above cover from Barrons is this cover on poverty in America from Huffington Post Magazine:



And yet another magazine cover that doesn't look too rosy on China:

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 widely read):

1. Time Magazine
2. Newsweek
3. New York Times Magazine
4. Businessweek
5. The Economist

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“Start keeping a diary. Write down every time you are convinced that the market is going up or down. After a few years, you will realize that your insights are worth nothing. Once you realize that, it becomes much easier to float on that ocean we call the market.” ***Meir Statman***