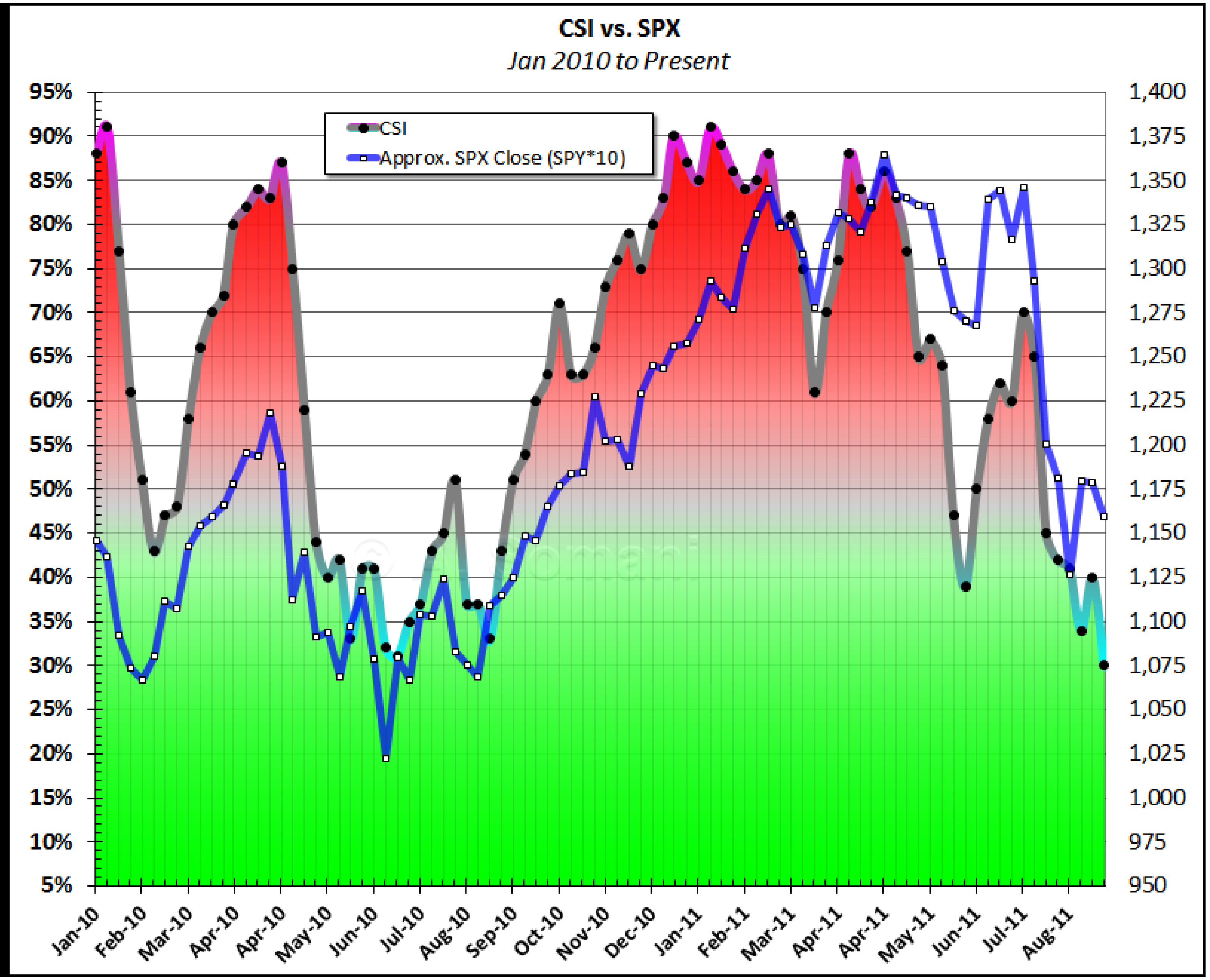
Crowd Sentiment Index (CSI) for US Equities

Imprecise CSI Interpretation Guidelines

	Bull Mkt.	Bear Mkt.
Extreme	86-100%	0-8%
Overweighted	71-85%	9-18%
Neutral	56-70%	19-29%
Overweighted	46-55%	30-38%
Extreme	27-45%	39-56%

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.
6/24/2011	1,268	0%	50%	11
7/1/2011	1,339	**6%**	58%	8
7/8/2011	1,344	0%	62%	4
7/15/2011	1,317	-2%	60%	-2
7/22/2011	1,346	2%	70%	10
7/29/2011	1,293	-4%	65%	-5
8/5/2011	1,201	**-7%**	45%	**-20**
8/12/2011	1,181	-2%	42%	-3
8/19/2011	1,126	**-5%**	41%	-1
8/26/2011	1,180	**5%**	34%	-7
9/2/2011	1,179	0%	40%	6
9/9/2011	1,159	-2%	30%	-10



Just My Humble Opinion

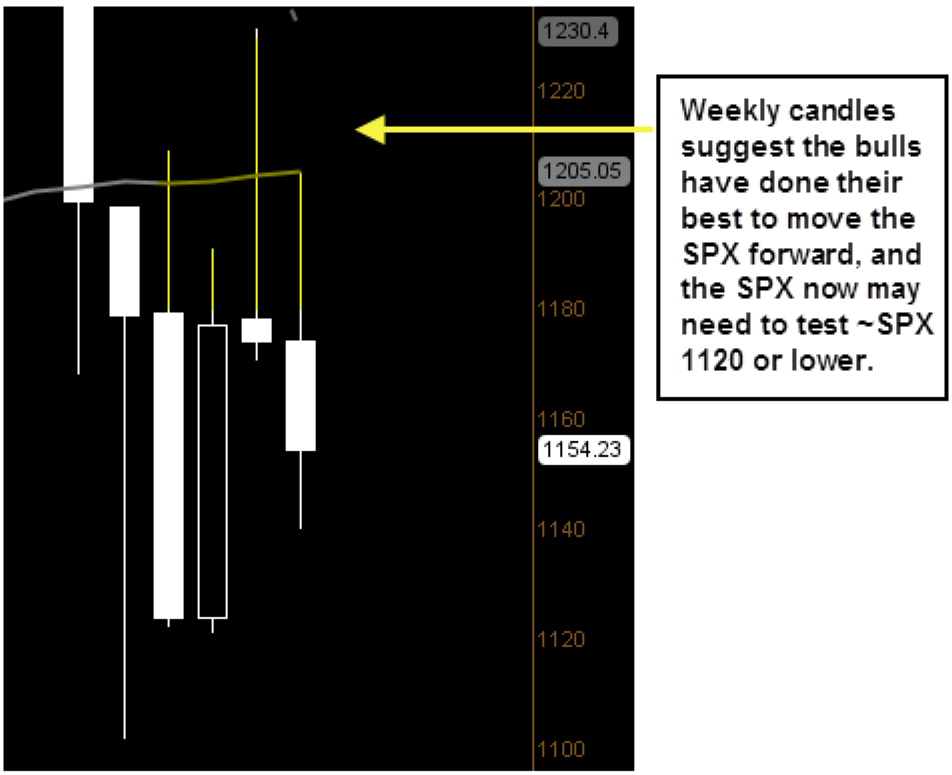
The CSI currently stands at 30%, after finishing this past week down a strong 1,000 basis points. It (just barely) sits at the lowest level in more than two years. Each of the past two weekly increases in the CSI have been met with more selling and pessimism. Will this trend continue? Interestingly, the CSI is making new lows for the year while the SPX is not. From a contrarian perspective, this could be viewed as a bullish development, especially if it continues. On the other hand, if the CSI falls much further, it risks hitting levels that should only be seen in cyclical bear markets. The cyclical trend of the SPX, ignoring the possibility of a significant / QE2-comparable new FOMC stimulus package this month (which seems increasingly unlikely, although it does appear that an at least small form of easing or stimulus will be introduced), strongly appears to be bearish (as I've alluded to in recent reports). But, admittedly, the possibility of the SPX being in a cyclical bull market correction cannot be dismissed, especially as long as the SPX does not definitively break its early Aug. lows.

This week, the SPX is entering its fifth week since the early Aug. capitulation low at SPX 1102-1120. It is rare, coming off such a capitulation low, for a rally in the SPX to top out in just three weeks and below the 50% retracement level of the previous leg down (the SPX rally high to this point occurred on Aug. 31 at SPX 1231). Most often, in my experience, a rally will continue off such a low for at least 5-10 weeks and retrace at least 50% of the previous leg down (equating to ~ SPX 1236), even if the SPX is within a cyclical bear market at the time. Based on this, I could argue that if the SPX re-tests the 1102-1120 level within the next 10 trading days (as it appears it will – more on that later), said level will hold and the SPX will rally to at least ~ SPX 1236 in subsequent weeks. Admittedly, this is my preferred scenario for the SPX (I would give this ~ 45% odds, currently), and I think it would be eventually followed by either a new 52-week high in the SPX (if the FOMC intervenes this with a significant new stimulus package, and not just any stimulus package) or a new 52-week low in the SPX.

The hair-raising possibility exists, of course, that the SPX will not just re-test the 1102-1120 level within the next 10 trading days, but definitively break said level (I would give this ~ 30% odds, currently). One possibility I would be on alert for in this scenario is a definitive break of the early Aug. SPX cash low (1102) but not the early Aug. SPX futures low (1077) - so as to create a bear trap and thereby a sharp bullish reversal. However, if the SPX futures low from early Aug. is also definitively broken, then, in this case, there is a high likelihood (say ~ 70%), based on my understanding of Fibonacci retracements and extensions, that the SPX will eventually reach ~1000-1020. It could take as much as several weeks for the SPX to reach this target or simply several hours, if the early Aug. lows in both the cash and futures market for the SPX are definitively broken.

There are at least a couple of other possibilities that I have not considered above, and they mostly involve the SPX not testing the 1102-1120 level within the next 10 trading days (I would give the possibility of no test within the next 10 trading days ~ 25% odds, currently). Here are a few of the reasons why I consider this possibility unlikely (ignoring the fact that the SPX closed on Friday within 3% of SPX 1120), currently:

1. The weekly candlestick chart of the SPX suggests that the bulls have tried their best to move the SPX higher without it needing to re-test the early Aug. low (note the long wicks on the candles below), and price now will be very difficult to push higher without first a test of SPX 1120.



2. Last week I drew attention to the idea that the first two trading days of September drew hard selling, probably driven by institutions. We saw this selling carry over to this past Tuesday, the third trading day of September, and the end of the month-end window dressing carryover from August. Unfortunately, the implications of such a strong selloff during the latter half of the month-end window dressing period are usually bad for the remainder of the month ahead, both in my experience and in recent reality. After all, we saw similar selling at the beginning of May, June, and August – and in each case further hard selling ensued during the course of each month, especially on an intra-month basis.

According to the Small Cap Investor Blog, which refers to a study completed by the always savvy Jason Goepfert at Sentimentrader:

> *The 2.6 percent loss during the first three trading days is actually the second worst start in September in the S&P 500's history…all previous 5 instances witnessed additional declines of over 9 percent during September and every one closed lower by the end of the month at least 5.8 percent.*

The number of occurrences of the above study are (not surprisingly) too few to draw valid statistical conclusions from. But, I find it interesting that in all previous cases Jason highlighted, the consequences for the SPX were quite nasty. Based on my calculations, an additional decline of 9% would translate to SPX 1060 and an additional decline of 5.8% would translate to SPX 1098. Currently, the SPX is still far from these levels, while the end of September is 15 trading days away.

3. Wayne Whaley at Witter Lester pointed out in his Friday missive that the third week of September, which the SPX enters following this coming week (which is an OPEX week – and sure to be even more volatile than usual), is seasonally the worst trading week of the year for the SPX. So, if the SPX does not test 1102-1120 this coming week, the following week may be the ideal time for such a test.