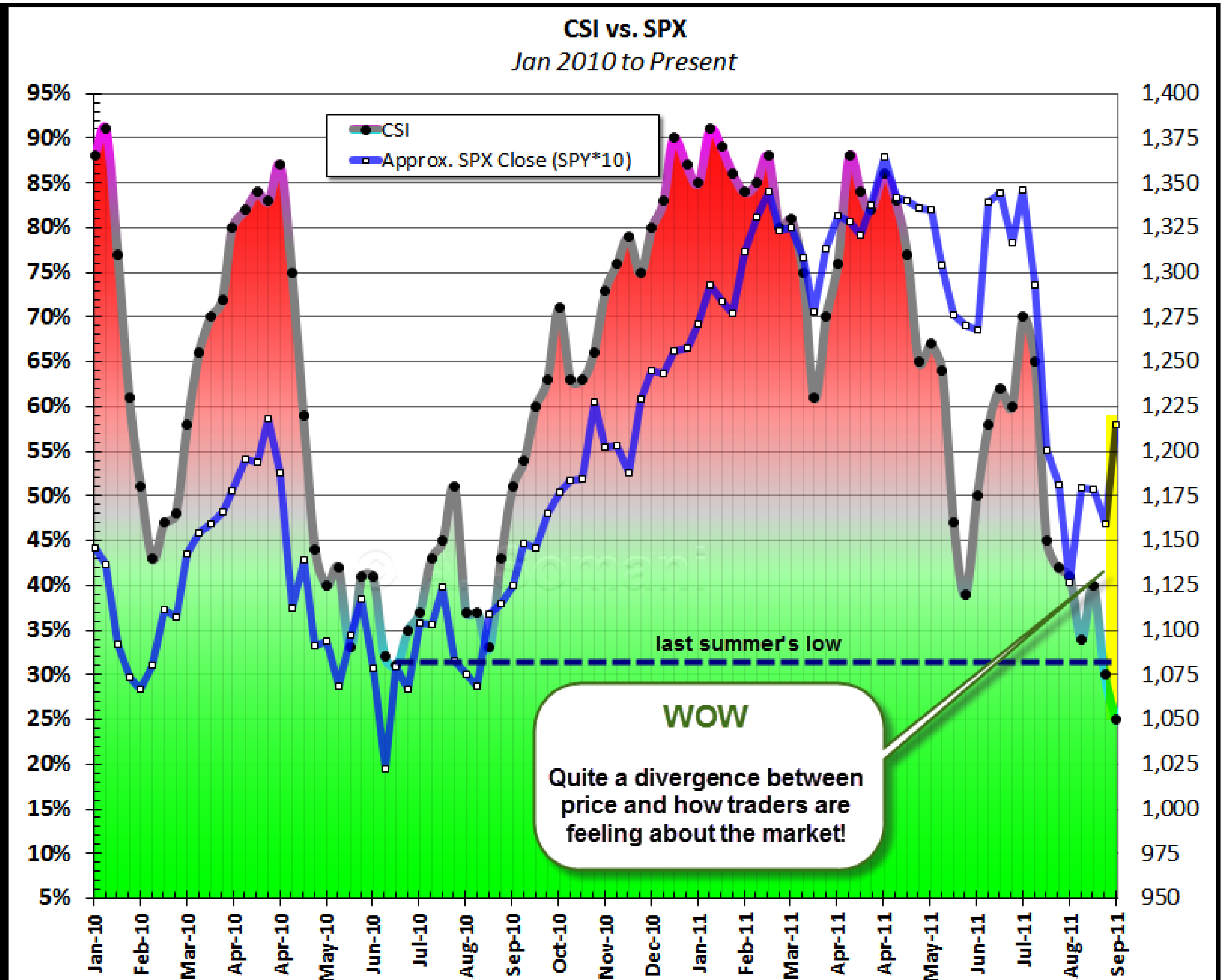
Crowd Sentiment Index (CSI) for US Equities

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.
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
9/16/2011	1,215	**5%**	25%	-5



Just My Humble Opinion

Due to time constraints and professional obligations, this week's report was intended to be very short – but it did not turn out that way as I was able to create some "extra time" for it. Next week, I will also be constrained (probably more so), and unfortunately do not expect to have time to say much (if anything).

The CSI currently stands at a multi-year low of 25%, and is bordering levels that should usually only be seen in a cyclical bear market. There is currently a fairly large spread between the CSI and price, which I've pointed out above. There was a similar albeit smaller spread last week, which I suggested had bullish connotations if it continued – with a caveat. On the surface, yes, the current spread appears bullish, and likely means the current multi-week rally has not seen its highs yet and potentially has much further to go. On the other hand (and here's the caveat), a lower CSI concurrent with higher price will not always be a good sign: the CSI tends not to sink below the mid- to high 20s after being above said level for a long time, unless a cyclical trend change (and thereby cyclical shift in trader and investor sentiment) is underway, such as when the SPX is transitioning from a cyclical bull market to cyclical bear market. Such a shift occurred between Oct. 2007 and Mar. 2008, for example, after which a large cyclical bear market rally began that topped out several weeks later. Thus, a bull should want to see the CSI turn up soon and from as close to this week's level as possible.

I have indicated in my reports for the past several weeks that, though SPX price action has been reminiscent of a cyclical bear market, and that it can be argued that a cyclical bear market began off the late April high for a multitude of reasons, bulls should certainly still be respected. Why? Firstly, if the Fed comes out with a significant positive surprise this week (for example, a monetary easing package similar in magnitude to QE1 or QE2) or at any point in the near future, especially before a test of the Aug. low (if it does get tested), then it will represent another game changer. In such a situation, the drop into the Aug. low (or any marginal new low produced) will probably be looked back on as nothing more than a larger-than-usual cyclical bull market correction. Secondly, it is possible the SPX can hold its own at or above current price levels for a significant number of months without a monetary easing package similar in scale to QE1 or QE2 (though, I do not currently believe this to be likely), especially given the current spread between the SPX earnings yield and the 10-year treasury yield – so, until the Aug. lows are definitively broken (if they do break), one has to be careful in not 'jumping the gun' and prematurely calling what we are witnessing a *cyclical bear market*.

Last week, I asserted that I thought the rally off the early Aug. low was unlikely to be over, but that a re-test of the Aug. low appeared to be both near and needed to support further rallying:

Most often, in my experience, a rally will continue off such a low [as the early Aug. 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 SPX did not get down to 1102-1120 this past week and does not look like it will this coming week. It did get down to 1136 this past week (a re-test of the Sept. 6 low), however, and then rallied hard and very quickly. While I favor the essence of my favored scenario from last week (that the multi-week rally off the early Aug. low is not quite complete and has at least an intraday high in it closer to SPX 1236 than it achieved last month), the nearer term picture suggests this week could easily represent another post-OPEX turning point in the market. It is worth noting that since its YTD high (late April on a closing basis but early May on an intraday high basis), the SPX has failed to manage two 1%+ consecutive weekly rises. To complement this idea, the current day-to-day picture suggests that at least some backing and filling is likely required before the SPX can rally much further (especially past SPX 1225-1230). Given the bearish seasonality of this coming post-OPEX week, the extent to which the SPX is stretched from its 5-day mean currently, and the likelihood that the SPX may have difficulty getting above its 50-day moving average and assorted other resistances (at least on its first try), I would not bet strongly on an up week. A bullish consolidation or a dip to the high 1100s seems more likely.

Of course, what the Fed announcement on Wednesday (and the reaction that follows) will consist of is a complete wildcard – and could potentially bode exceptionally well for either bulls or bears (not only through to the end of the week, but also at least until the next meeting in early Nov.). While I would be surprised if Mr. Bernanke announced a monetary easing program of similar magnitude to QE1 or QE2, especially given the current level of consumer inflation, I would not put it past him to do something like this, especially as the ECRI's WLI continues to weaken and suggests a trough to the current economic slowdown may still be months away.

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.*