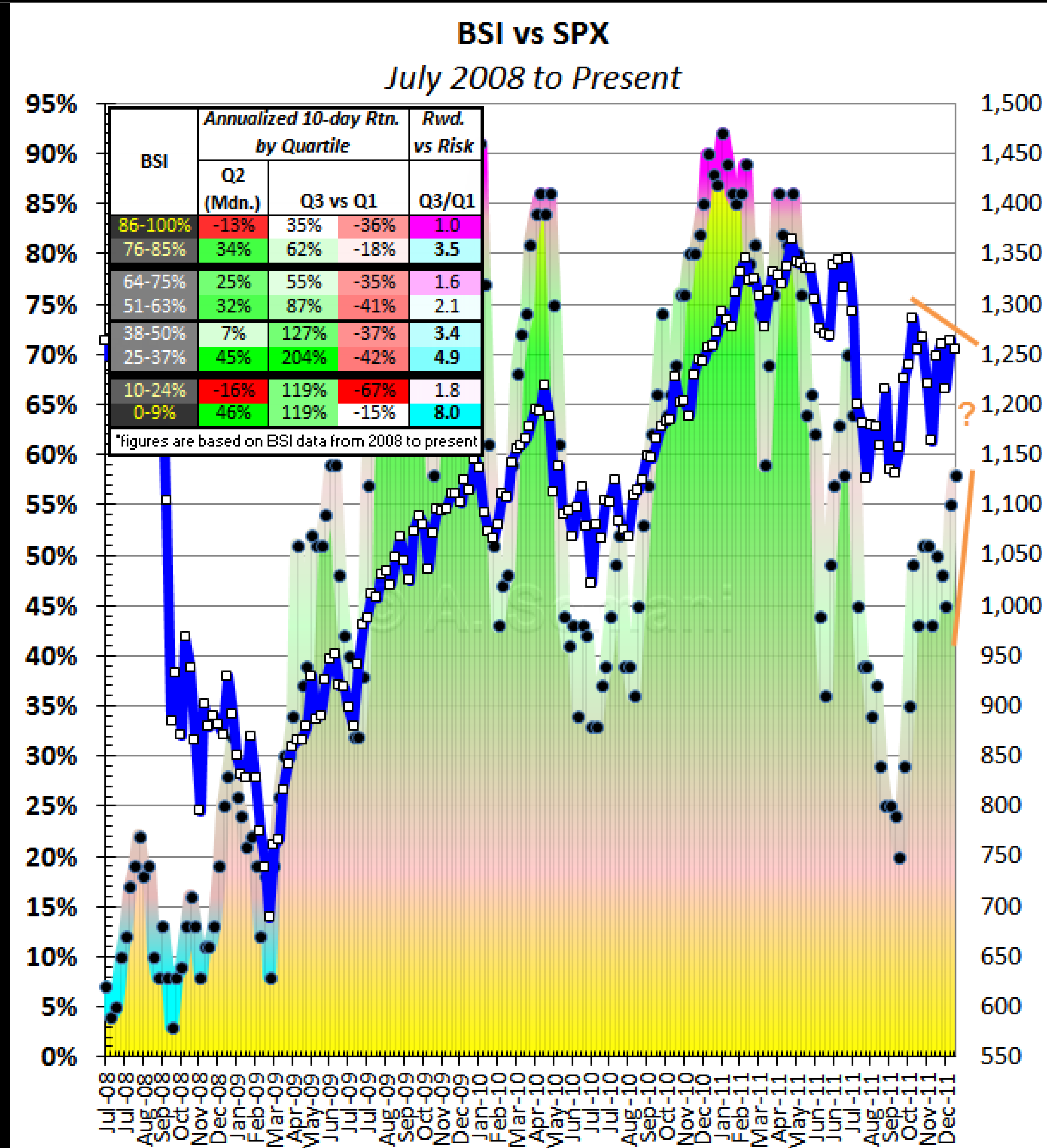
Bullish Sentiment Index (BSI) for US Equities

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 maximum), 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)*
9/16/2011	1,215	5%	-4	25%	-4	-33
9/23/2011	1,135	-7%	0	25%	0	-43
9/30/2011	1,132	0%	-14	24%	-1	**-47**
10/7/2011	1,157	2%	-22	20%	-4	**-48**
10/14/2011	1,226	6%	-19	29%	9	**-48**
10/21/2011	1,240	1%	-6	35%	6	**-45**
10/28/2011	1,286	4%	14	49%	14	-16
11/4/2011	1,255	-2%	29	43%	-6	0
11/11/2011	1,267	1%	21	51%	8	13
11/18/2011	1,220	-4%	4	51%	0	22
11/25/2011	1,163	-5%	-19	43%	-8	14
12/2/2011	1,249	7%	-26	50%	7	26
12/9/2011	1,261	1%	-24	48%	-2	32
12/16/2011	1,216	-4%	-23	45%	-3	32
12/23/2011	1,264	4%	-5	55%	10	39
12/30/2011	1,255	-1%	0	58%	3	**45**



BSI	*Annualized 10-day Rtn. by Quartile* Q2 (Mdn.)	Q3 vs Q1		*Rwd. vs Risk* Q3/Q1
86-100%	-13%	35%	-36%	1.0
76-85%	34%	62%	-18%	3.5
64-75%	25%	55%	-35%	1.6
51-63%	32%	87%	-41%	2.1
38-50%	7%	127%	-37%	3.4
25-37%	45%	204%	-42%	4.9
10-24%	-16%	119%	-67%	1.8
0-9%	46%	119%	-15%	8.0

*figures are based on BSI data from 2008 to present

BSI for US Equities – Summary

The BSI rose 3 notches this past week to close at 58%, continuing to break out of the range it formed between early November and mid-December and indicating a new shift in investor sentiment. Meanwhile, the SPX fell about 1% this past week, despite the strong bullish seasonality of the last 4-5 trading days of the year, and now sits about 8% below its 52-week high and right on its 200-day moving average.

There is a noticeable multi-week positive divergence taking place between the SPX and BSI. Typically, I have found the BSI to be a coincident indicator and sometimes a leading indicator to the SPX, on a multi-week basis. On rare occasions it will function as a lagging indicator to the SPX, on a multi-week basis. So, the current multi-week positive divergence could be a good or bad omen, but is a bit more likely to be the former based on historical tendencies.

This weekend, the "BSI Stretch from Mean" is flashing purple, which suggests that bullish sentiment may be rising too quickly and that a one or more week pullback would be healthy. However, I wouldn't put much stock in this signal when the SPX is not at all stretched above its mean (note that "SPX Stretch from Mean" is currently at 0).

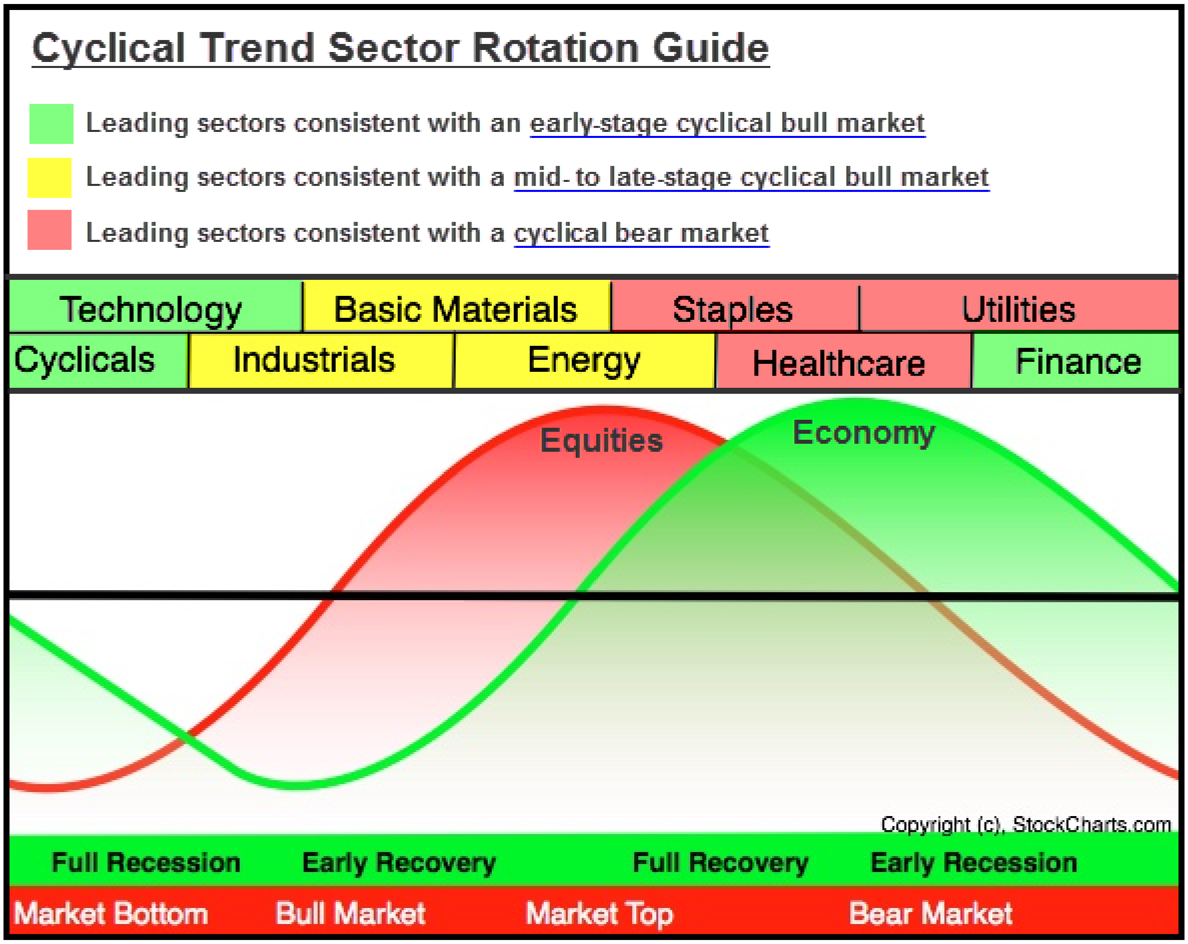
The current level of the BSI should be interpreted within the context of the current cyclical trend:

- Within the context of a ***cyclical bull market***, the current level of the BSI suggests **bullish sentiment is at the Neutral level** – so, there are apparently an average number of potential buyers of equities on the sidelines.

- Within the context of a ***cyclical bear market***, the current level of the BSI suggests **bullish sentiment is at the Extreme level** – so, there are apparently extremely few potential buyers of equities on the sidelines.

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 shown below:

Sector	Performance 1 Month	Performance 3 Month
Energy 1 Industry	-1.44%	+17.70%
Industrials 3 Industries	+0.60%	+16.49%
Materials 1 Industry	-2.51%	+15.52%
Consumer Discretionary 5 Industries	+0.76%	+12.25%
Financials 4 Industries	+1.90%	+11.20%

Sector rotation patterns currently indicate that US equities are in a mid- to late-stage cyclical bull market. Whether they actually are is another matter entirely, but sector rotation patterns may be worth considering in one's determination of the cyclical trend.

I don't mind noting again, as I did back in Oct., that I believe the summer / fall downturn was really just a large cyclical bull market correction rather than the start of a cyclical bear market. All prior cyclical bull market tops going back to at least 1929 have left behind one or more of a trio of breadth-based market topping signatures, based on my research. None of these signatures appeared prior to or coincident with the April 2011 or April 2010 market tops. This, among other factors that time does not permit me to go into right now, suggests to me that US equities are indeed in a mid- to late-stage cyclical bull market.

I view the difference between a cyclical bull market correction and a cyclical bear market as important, partly because I keep statistics on the length and rise of cyclical bull markets as well as cyclical bear markets to get a sense of the reward-to-risk of the current cyclical trend. Most cyclical bull markets last about 2.5 years and the current one is nearing 3 years in age. The current cyclical bull market has also risen the mean rise of a cyclical bull market of about 100%.

I view the current cyclical bull market as somewhere between the 5th and 9th inning in terms of completion.

Cautionary Note on Interpretation: *The Bullish Sentiment Index (BSI) for US Equities and its associated indicators ("SPX Stretch from Mean" and "BSI Stretch from Mean") are 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 BSI and its associated indicators 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 BSI and its associated indicators to remain depressed for extended periods without the market rising in any significant way. Furthermore, the BSI and its associated indicators represent merely one suite of tools a trader or investor can use to analyze markets, and should not be interpreted except in combination with the message being delivered by one or more other suites of tools that the trader or investor feels confident in comprehensively analyzing markets with.*