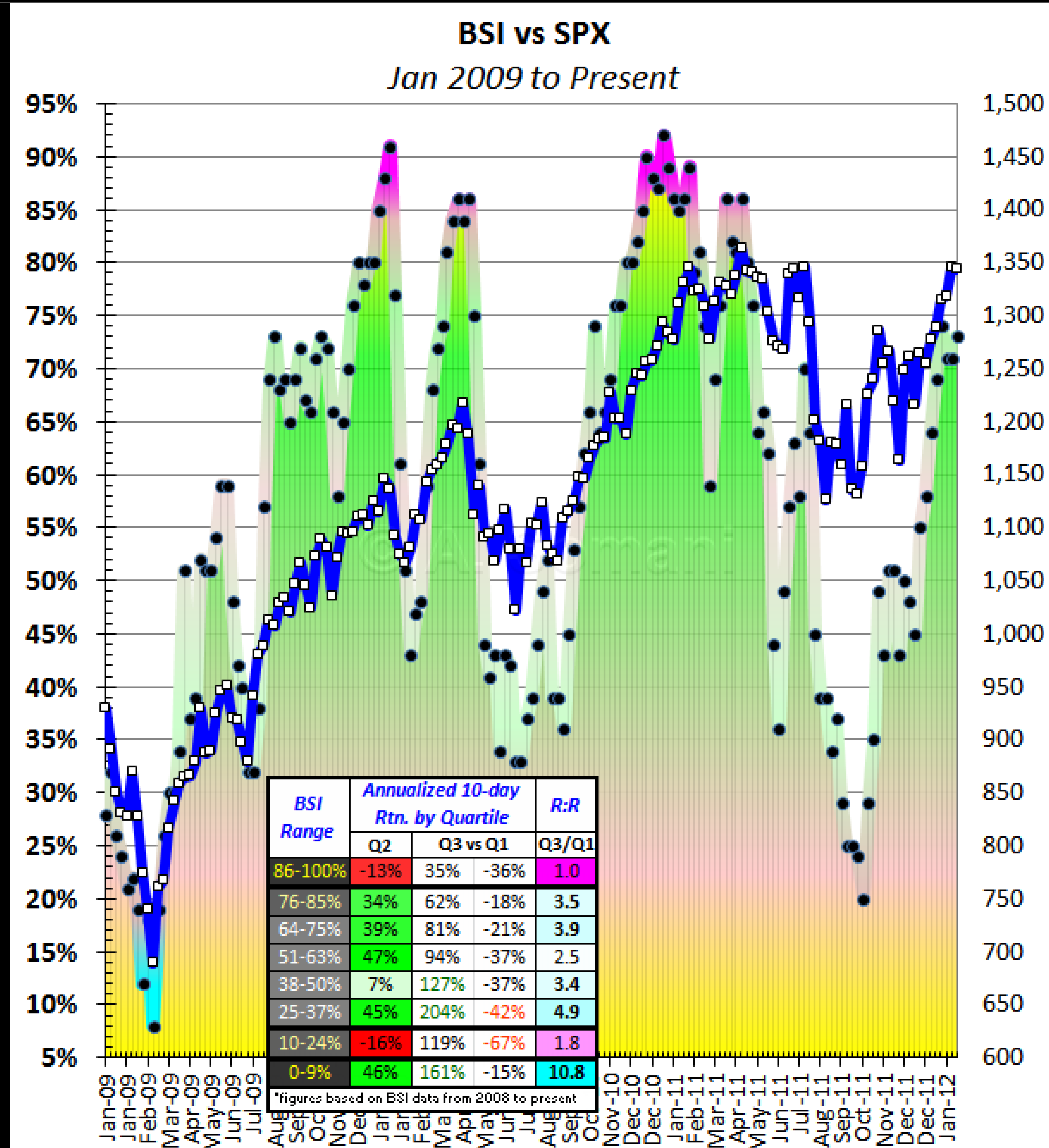
Bullish Sentiment Index (BSI) for US Equities

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)*
10/28/2011	1,286	4%	21	49%	14	-30
11/4/2011	1,255	-2%	23	43%	-6	5
11/11/2011	1,267	1%	14	51%	8	9
11/18/2011	1,220	-4%	-8	51%	0	21
11/25/2011	1,163	-5%	-28	43%	-8	19
12/2/2011	1,249	7%	-24	50%	7	17
12/9/2011	1,261	1%	-14	48%	-2	32
12/16/2011	1,216	-4%	-17	45%	-3	32
12/23/2011	1,264	4%	-4	55%	10	34
12/30/2011	1,255	-1%	-1	58%	3	44
1/6/2012	1,277	2%	12	64%	6	46
1/13/2012	1,288	1%	22	69%	5	44
1/20/2012	1,315	2%	36	74%	5	38
1/27/2012	1,318	0%	40	71%	-3	38
2/3/2012	1,345	2%	44	71%	0	30
2/10/2012	1,344	0%	41	73%	2	29



BSI Range	Annualized 10-day Rtn. by Quartile			R:R
	Q2	Q3 vs Q1		Q3/Q1
86-100%	-13%	35%	-36%	1.0
76-85%	34%	62%	-18%	3.5
64-75%	39%	81%	-21%	3.9
51-63%	47%	94%	-37%	2.5
38-50%	7%	127%	-37%	3.4
25-37%	45%	204%	-42%	4.9
10-24%	-16%	119%	-67%	1.8
0-9%	46%	161%	-15%	10.8

*figures based on BSI data from 2008 to present

BSI for US Equities – Summary

The BSI moved up 2 notches this week to close at 73%. On the other hand, the SPX ended the week about where it began, and now sits about 2% below its 52-week high and about 7% above its 200-day moving average.

This weekend, the "SPX Stretch from Mean" indicator is flashing purple once again. When it flashes purple, it indicates that the reward-to-risk of being long exactly the week following the flashing is historically poor. Here are some stats on how the SPX has fared the week following a purple flashing "SPX Stretch from Mean", only going back to the beginning of 2007 (16 occurrences) and excluding 2008 (as there were no occurrences in 2008):

Mean Return	-0.7%
Median Return	-0.1%
Quartile 3 (Q3) Return	0.5%
Quartile 1 (Q1) Return	-1.3%
Abs(Q3 / Q1)	0.42
Max Return	2.1%
Min Return	-4.6%
1% Moves	1 Up, 4 Down

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 Neutral** – so, there are apparently an average number of potential buyers of equities on the sidelines.

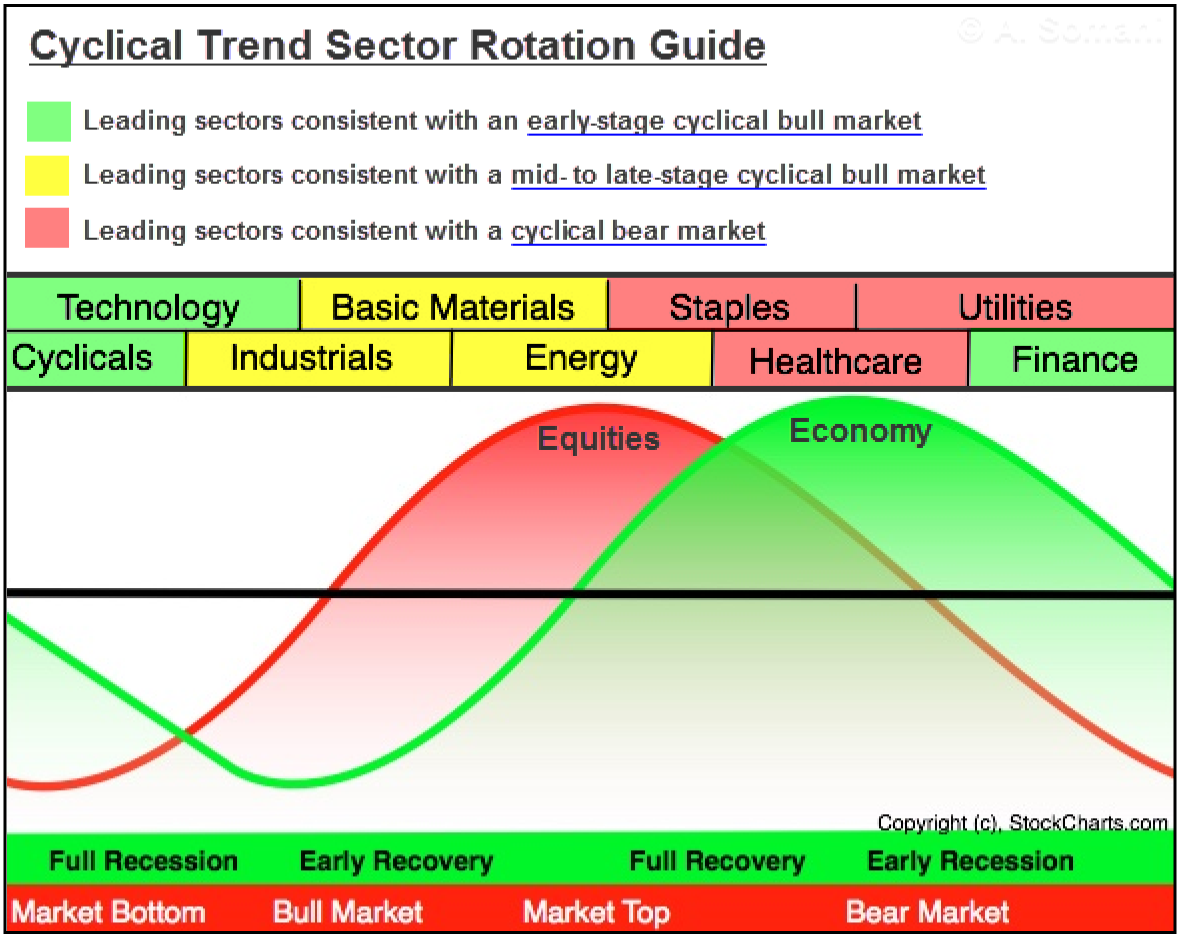
At the end of each calendar month, it will be evaluated for the purpose of this report (based on reader feedback or anticipated reader feedback) whether it is fitting to comment on the BSI just within the context of a cyclical bull market, just within the context of a cyclical bear market, or within both the context of a cyclical bull market and the context of a cyclical bear market.

I've seen a number of people suggest this weekend that US equities are about to enter a correction (a drop of typically 7%+). In fact, I've never seen so many people talking about buying the TVIX ETF. Perhaps they will all be right. So far, this rally since Oct. looks quite similar to the Sept. 2010 to Feb. 2011 rally, in my opinion, and I only see some signs of a correction coming. That suggests to me that a dip (a drop of perhaps 2-5% – which appears to have already begun on Friday) is significantly more probable than a correction, at this point. In any case, it is typically a fair bit more risky than usual to be long the week following a purple flash from the "SPX Stretch from Mean" indicator. But, if the SPX is really only in the *midst of a dip (or about to begin one), it will likely bottom and resume its upward trend quicker than many are expecting.*

Cautionary Note on BSI 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.

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 shown below, color-coded according to the above guide:

Sector	Performance 1 Month	Performance 3 Month
Industrials 3 Industries	+5.11%	+12.91%
Financials 4 Industries	+5.53%	+12.36%
Consumer Discretionary 5 Industries	+6.01%	+11.02%
Information Technology 3 Industries	+9.06%	+10.60%
Materials 1 Industry	+5.95%	+10.39%

This weekend's sector rotation pattern appears to be consistent with US equities being in an early stage cyclical bull market. Whether US equities actually are in an early stage cyclical bull market is another matter entirely *(they are in a mid- to late stage cyclical bull market in my own opinion)*. But, sector rotation may be a tool worth considering use of in one's determination of the cyclical trend of US equities.

<u>Additional Segment: Magazine Cover Confirmation Indicator</u>

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 publicly-traded 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>

I only see one magazine cover this weekend that is worth commenting on, based on the ones I review each weekend (see list near the end of this segment):

This cover is not going to be on the US edition of Time, but, will be on the other editions of Time around the world. It appears with Italian Prime Minister Mario Monti's face underscored by a few scary phrases like "Can this man save Europe?" and "Italy's Mario Monti: A Prime Minister for Desperate Times." Obviously, this is not the type of cover that accompanies positivity about economic prospects and a recovery in Europe. Why this is important is because doom and gloom over Europe has been a principle reason for many institutional investors (and some retail investors) staying out (or somewhat out) of the market in recent months. As long as there continues to be a feeling of doom and gloom on the future prospects of Europe, therefore, an important part of the Wall of Worry that stocks are climbing right now is still in place.

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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