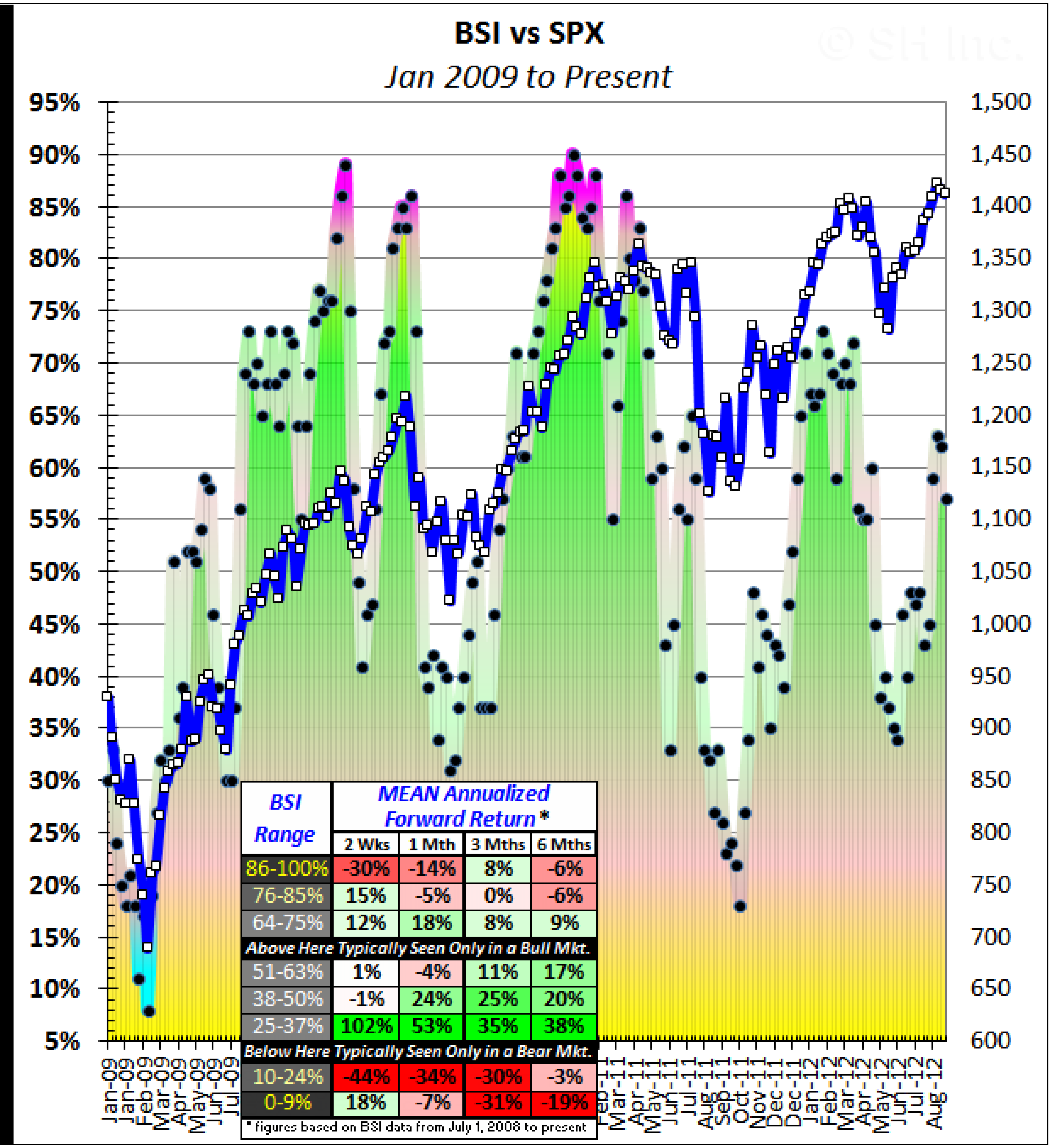
Bullish Sentiment Index (BSI) for US Equities

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)
5/11/2012	1,356	-1%	-29	45%	-15	-32
5/18/2012	1,297	-4%	-41	38%	-7	-43
5/25/2012	1,321	2%	-40	40%	2	-43
6/1/2012	1,282	-3%	-45	37%	-3	-38
6/8/2012	1,331	4%	-33	35%	-2	-39
6/15/2012	1,341	1%	-15	34%	-1	**-45**
6/22/2012	1,335	-1%	0	46%	12	-41
6/29/2012	1,361	2%	12	40%	-6	-38
7/6/2012	1,355	0%	19	48%	8	-30
7/13/2012	1,358	0%	15	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



"If you want to have a better performance than the crowd, you must do things differently from the crowd."
John Marks Templeton (d. 2008)

<u>BSI Summary</u>

The BSI fell 5 notches this past week to close at **57%**. Meanwhile the SPX closed slightly lower, but, was essentially flat.

The SPX currently sits <u>1%</u> below its 52-week closing high and about <u>5%</u> above its 200-day moving average.

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

- Within the context of a ***cyclical bull market***, the current level of the BSI suggests **bullish sentiment is Neutral** – indicating <u>there is an average amount of supply of investors eager to buy into US equities and that could fuel a multi-week to multi-month rally</u>.

<u>Understanding the BSI</u>

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

"**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].

Here's an excerpt from my comments in the Aug. 17th BSI Report:

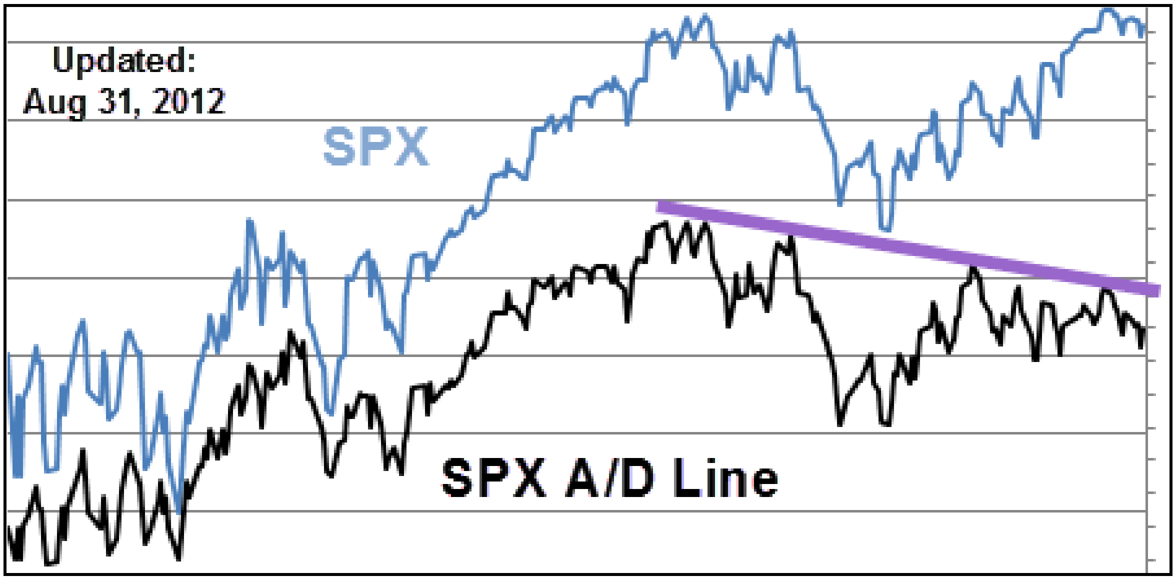
> Two major building blocks of the current cyclical bull market – a lack of excessive optimism as well as favorable monetary policy – continue to remain firmly in place. Their persistency means that this cyclical bull market will probably end up being one of the longest in US history. However, in early Sept., the current cyclical bull market will be hitting the 3.5 year mark. This is an important threshold because, when passed, it will indicate that this cyclical bull market is *significantly* closer to its end than its beginning, *in terms of duration*. I stress *duration* because, frequently, some of the biggest *price* gains in a bull market are seen near its end or in its very last stage.

In terms of the presence of favorable monetary policy and a lack of excessive optimism, the Fed re-affirmed its commitment to favorable policy for the foreseeable future at Jackson Hole on Friday, and the BSI – despite a 13-week rally in the SPX of about 10% since early June – sits in *Neutral* territory, suggesting that the SPX has a fairly positive 3- and 6-month outlook from its current level (about 1410). Nevertheless, the current cyclical bull market is now about 3.5 years old, and no cyclical bull market since 1900 has lasted more than a few weeks beyond 5 years. That makes the next 6 quarters very likely to contain the end of the current cyclical bull market and the start of a new cyclical bear market. **Worth remembering!**

Complementing fairly restrained bullish sentiment on US equities, with a tip of the hat to Rainsford Yang of MarketTells, is the 20-day average of Nasdaq Composite volume hitting a one-year low on Thursday – which has been a reliably bullish omen for the Nasdaq Composite looking 6 months forward over the last few decades (with only one exception back in the early '80s). This signal also nicely complements the UDT2 thrust on the SPX on July 27th when the SPX was at 1386 (thanks to friend Wayne Whaley for the concept of the UDT2 thrust). The UDT2 thrust has a perfect record of predicting gains for the S&P 500 6 months forward over the last few decades.

In the Aug. 17th BSI Report, I also commented on the status of market breadth (see next page for the comments made, including a freshly updated chart of the SPX versus its Cumulative A/D Line). There have been very few (countable on one hand, in fact) cyclical bear markets since 1929 (in the broad US equity market) that have not been preceded by one or more weeks of negative divergence in the Cumulative A/D Line, which makes it an important indicator to watch as the current cyclical bull market gets increasingly older. We may not yet know why the next cyclical bear market will begin – whether due to excessive inflation or no longer combatable deflationary threats – but, regardless, the seeds are being sown now and it is becoming increasingly important to keep an eye on leading indicators of cyclical downturns. As mentioned recently, statistically proven measures of absolute market valuation are already sitting at fairly high levels, indicating that the next cyclical bear market may lead to a greater-than-average cyclical bear market decline (i.e. a decline exceeding ~30%).

The SPX is normally led by its Cumulative A/D Line. The Line will usually negatively diverge from the SPX (for at least a week, and often for many weeks if not months) prior to a cyclical bull market top. In a recent report, I noted that, although the SPX was bound to make a new 52-week high soon, market breadth was showing deterioration. Unfortunately, the deterioration is still present, as you can see:



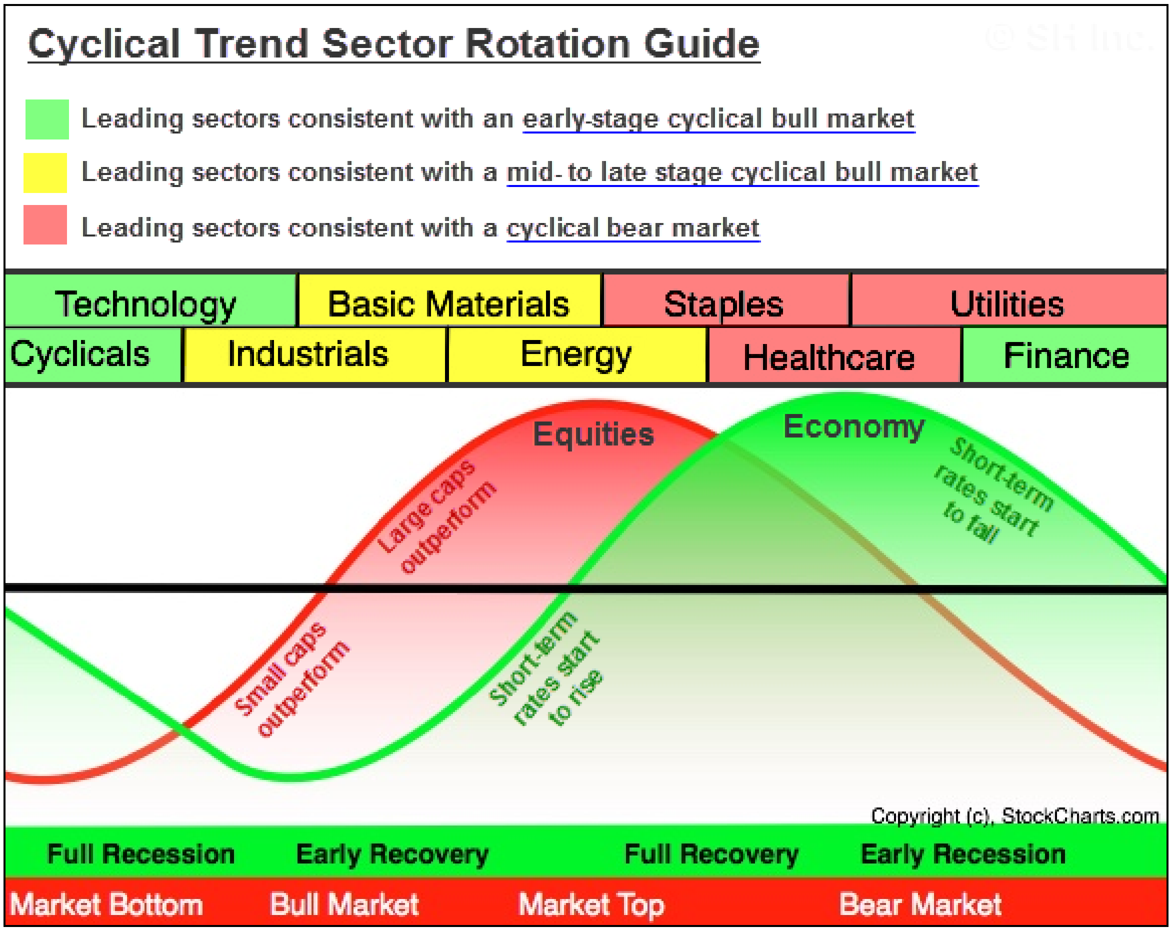
The deterioration seen above is not necessarily immediate cause for alarm (although it's uncommon to see in a cyclical bull market). This negative divergence is temporary and will disappear in the coming weeks or months (by either the SPX falling, its Cumulative A/D Line rising, or some combination thereof). However, this negative divergence is coalescing with a few other signs of an aging bull market – such as increasing amounts of Confusion in the Nasdaq Composite (in particular) as well as a relatively low percentage of component new highs in both the SPX and Nasdaq Composite (at least for now – this may soon change). In some ways, internally, the SPX looks like it did in the fall of 2006, in my opinion. So, now is the time to pay closer attention to indications of component weakness that are being temporarily masked by index price strength.

Just how high will the SPX go within the coming six quarters? A 10% rise from its recent 52-week high would take it to near its 2007 highs; a 20% rise, the low 1700s; and a 30% rise, the mid-1800s. One or more bottoms of corrections in the current cyclical bull market will eventually be re-visited in the next cyclical bear market (and thereby very likely before the end of 2014 or 2015). This is an important point to note as this cyclical bull market continues and as effective asset allocation becomes increasingly vital.

For instance, the bottom of this summer's decline (on a closing basis) came at 1278 on June 1st (when the BSI was at 37% and both the "SPX Stretch from Mean" and "BSI Stretch from Mean" cells were colored blue). Assuming (for demonstration only) the upcoming cyclical bear market decline is a mild one and sees the SPX fall just 25%, then unless the SPX rises above 1704 in the current cyclical bull market, the SPX will eventually revisit 1278 or lower.

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, CMT, of Stockcharts.com, who specializes in intermarket analysis:



The top five performing sectors of the SPX over the past 3 months are highlighted below, color-coded according to the above guide:

Sector	Performance		
	1 Month	3 Month	YTD
Energy 1 Industry	+1.89%	+11.50%	+1.75%
Information Technology 3 Industries	+4.86%	+8.48%	+17.73%
Telecommunication Services 1 Industry	-2.21%	+8.22%	+16.44%
Health Care 2 Industries	+1.28%	+7.80%	+13.76%
Financials 4 Industries	+2.81%	+7.59%	+15.18%

Sector rotation may be one tool for a trader or investor to consider use of (among a number of others) in helping to determine the 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 a mid- to late stage cyclical bull market.

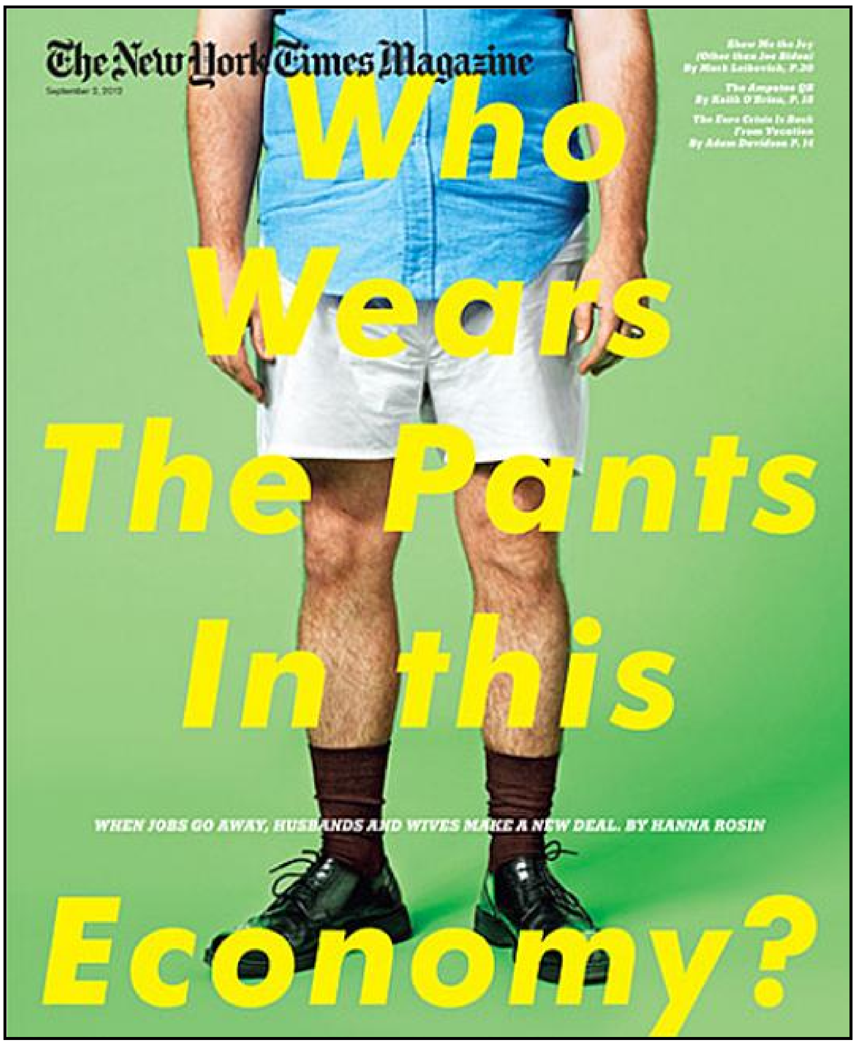
As (and largely for reasons) detailed in earlier reports, the BSI Report Editor continues to view US equities as being in a mid- to late stage cyclical bull market.

Additional Segment: Magazine Cover Confirmation Indicator

Far more often than not, popular magazine covers will be 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 of these asset classes or securities, depending on the nature of the cover(s) in question. As financial commentator Barry Ritholtz has noted: "The magazine cover contrary indicator works when it reflects a fairly long lasting, well understood concept that is reaching a climax."

Here are the magazine covers (from the heavily circulated magazines linked to at the bottom of this segment or that the staff of the *BSI Report* find intriguing) that may be of interest to the average market participant this weekend considering the above:

New York Times Magazine – Sept. 2, 2012



Caption: "When jobs go away, husbands and wives make a new deal."

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. New York Times Magazine
3. Newsweek
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***