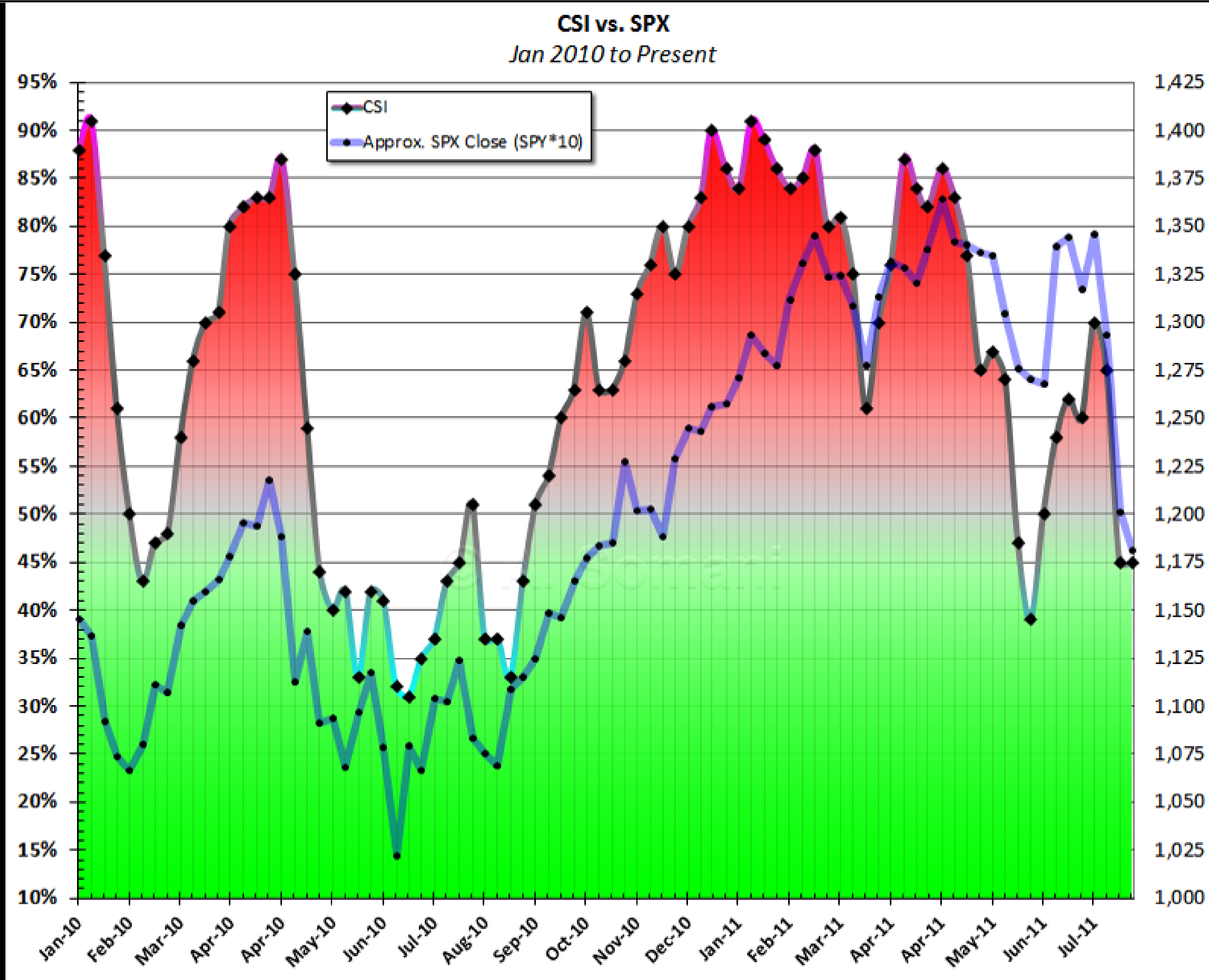
Crowd Sentiment Index (CSI) for US Equities

The Crowd Sentiment Index (CSI) for US Equities is a normalized and smoothed composite of investor sentiment on the US stock market derived from various daily and weekly sentiment guages produced by third-parties.

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%

Date	Approx. SPX Close (SPY*10)	%Ch.	CSI	Ch.
5/27/2011	1,335	0%	67%	2
6/3/2011	1,304	-2%	64%	-3
6/10/2011	1,276	-2%	47%	**-17**
6/17/2011	1,271	0%	39%	-8
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%	45%	0



Opinionated CSI-related Commentary from an Always-learning Market Student
Despite an ~2% decline in the SPX this past week, the CSI remains where it stood last week – just barely in what is overall an extremely bullish territory within the context of a cyclical bull market (and I will later discuss if such a context is still relevant). One caveat to the CSI reading this week that I should note is that I'm missing a small portion of the data that should help construct this week's reading. This temporary problem should be resolved well before this time next week but, thankfully, it is very unlikely it would have a material impact on the level of this week's CSI reading (so don't be surprised if this week's CSI reading of 45% changes somewhat when viewed in next week's CSI Report, although any change will most likely be insignificant).

The current level of the CSI suggests that the multi-week rally attempt the SPX has been making since Monday's low will more than likely continue into this week, and very possibly well beyond it. On Monday, extreme price change and heavy volume, combined with a number of other factors (such as the position of the CSI on Friday, bullish extremes in put/call ratios, and the VIX and VXO making trailing two year highs near 50), indicated that a capitulation bottom had formed. Capitulation bottoms have, in the past, led to multi-week rallies where typically at least 50% of the preceding multi-week decline is retraced. Thus, my expectation going forward is for a continued SPX retracement to at least ~1215 in the coming weeks. Based on my experience and understanding of Fibonacci retracement levels, a retracement to higher than ~1215 (and especially to higher than ~1250) in the coming weeks would suggest the future re-test of Monday's low, if/when it comes (most declines into a low like that formed on Monday will normally see a re-test as much as several weeks later), will more likely than not be successful – and eventual new highs in the SPX will be in order, thereafter. That is not to say that it is impossible that Monday will emerge as a long-term V-bottom, or that Monday did not mark a multi-week low (meaning that a multi-week low is still yet to come and will come from below Monday's low – which is a scenario I'm sure many bears would back right now), but the chance of either of these scenarios being correct is currently quite low, in my humble opinion.

With the SPX having closed this past week more than two standard deviations below its 200-day moving average as well as below its 20-month moving average (two events that rarely happen together except in a cyclical bear market), I think it is important that traders and investors position themselves for the very real possibility of a cyclical bear market being underway (from the May 2011 high) once the current multi-week rally attempt runs out of energy. The CSI, having reached much lower levels last summer than it has at any time this summer, externally suggests that many traders and investors are not seeing a cyclical bear market on the horizon as yet. It is difficult to blame them when the 10-year govt. bond is essentially providing the same yield as dividends on the SPY ETF (which is a rare occurrence and one that we have not seen since Oct. 2008). It should not come as a surprise that I'm (also) very skeptical that May marked the top of the cyclical bull market off the March 2009 lows, especially as none of the classical breadth-based markers of a cyclical bull market top (*a negatively diverging cumulative advance/decline line, a daily or weekly close with a significant number of issues making new lows as well as some issues still making new highs, and only a small portion of issues making new highs as price peaks*) occurred coming into or at the May top. And, as I think back to the famous words on sentiment from the admirable and legendary value investor John Templeton (*"Bull markets are born from pessimism, grow on skepticism, mature on optimism, and die on euphoria"*), I do not feel that the euphoria or excessive optimism one would see at a cyclical bull market top was present in May (or in the months prior to May). With the above in mind, it may be wise to wait for further lagging signals of a cyclical bear market, such as the SPX making a monthly close below its 20-month moving average (as monthly closes above and below the 20-month moving average have proven to be excellent long-term signals on the SPX since at least 1950), before getting too worried about the likelihood of a new cyclical bear market having started in May. After all, the VIX has still not materially breached the 50 level that it would need to in order to point to an impending crisis or meltdown of some kind.

Truly, my concern about the possibility of a new cyclical bear market having started in May stems not from any of the classical breadth-based markers of a cyclical bull market top having been present coming into or at the May top (since they were not – just as they were not coming into or at the April top last year), or even the price declines we have seen in the SPX in recent weeks. Rather, as Chris Puplava eloquently and subtly hints at this weekend, there is a case to be made that the SPX – without QE being present – has had a tendency to fall apart (at least in recent years), perhaps in an attempt to hastily return to the equilibrium level that a more free market (one not so influenced by trillions of dollars' worth of Fed easing) would have it trading at (maybe somewhere at or below 950, for example, as knowledgeable value investors like Jeremy Grantham *might* suggest). The new apparent need for QE to fuel any market rise of economic significance has led to a stock market that is more highly correlated with (other) leading economic indicators than any I can remember. It has perhaps also led to a stock market that can top more quickly and suddenly than any we have seen in the past once Fed-provided liquidity for it is removed, and without leaving behind one or more of the classical breadth-based markers of a cyclical bull market top (markers that, together, have in fact helped pinpoint every cyclical bull market top since at least 1929, based on research results that I have been informed about from a well-known Wall Street advisory firm). Thus, unless current leading economic indicators get a boost from a new easing program of some kind from the Fed, and soon, then perhaps the May top will indeed go down in history as a (unique and one-of-a-kind) cyclical bull market top (as incredible as that should seem). Personally, I'm not holding my breath that this will be the case (as 'this time is different' is rarely a bet that I like to take), but I still must (unfortunately) keep such a possibility in mind. Of course, the announcement of a new easing program from the Fed within the next few months would probably render consideration of said possibility a moot point, anyway.

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.*

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