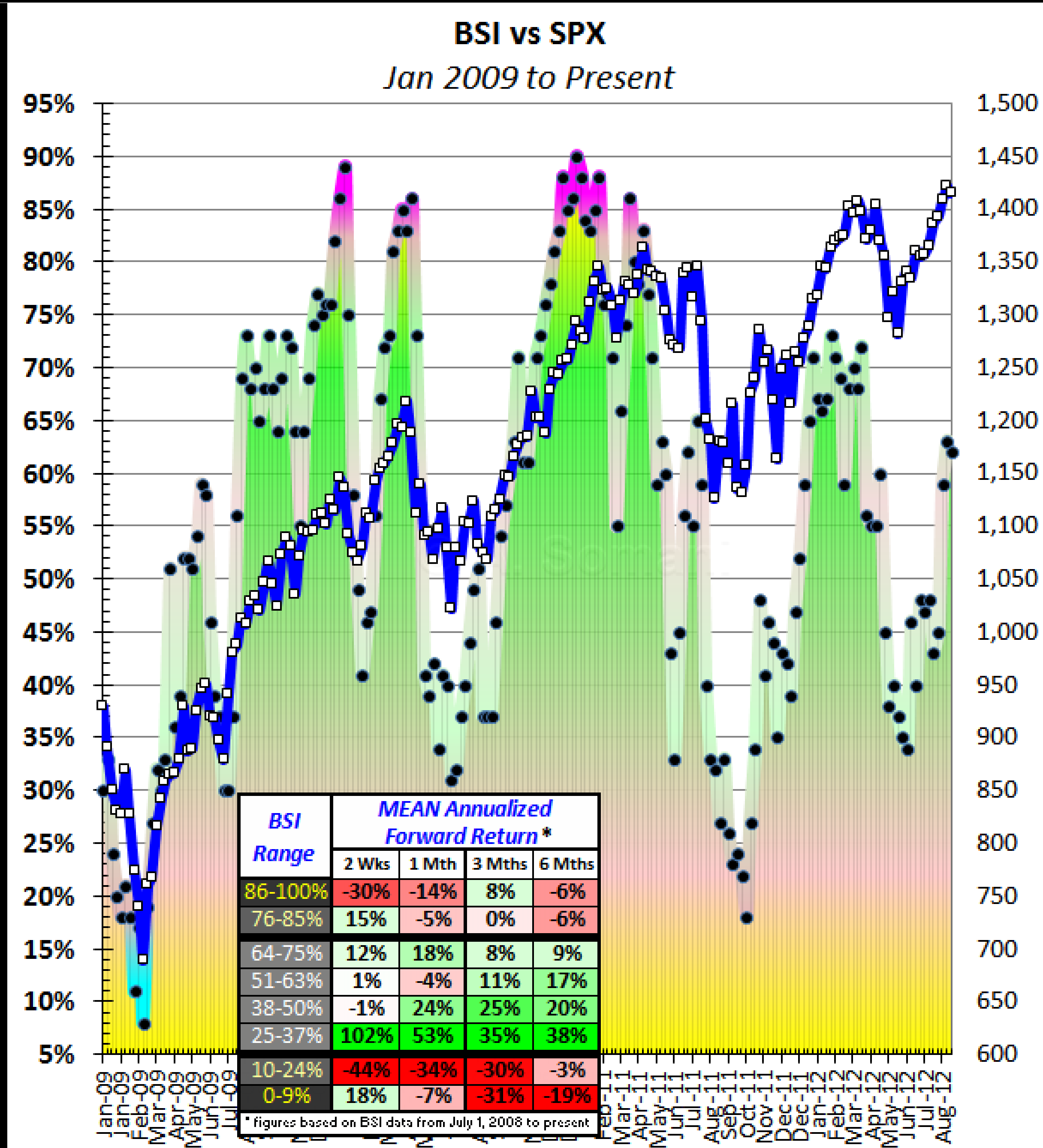
Bullish Sentiment Index (BSI) for US Equities

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)*
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



BSI Range	MEAN Annualized Forward Return*			
	2 Wks	1 Mth	3 Mths	6 Mths
86-100%	-30%	-14%	8%	-6%
76-85%	15%	-5%	0%	-6%
64-75%	12%	18%	8%	9%
51-63%	1%	-4%	11%	17%
38-50%	-1%	24%	25%	20%
25-37%	102%	53%	35%	38%
10-24%	-44%	-34%	-30%	-3%
0-9%	18%	-7%	-31%	-19%

* figures based on BSI data from July 1, 2008 to present

"Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria. The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell."

John Marks Templeton (d. 2008)

BSI Summary

The BSI fell 1 notch this past week to close at **62%**. Meanwhile the SPX closed slightly lower, but, basically stood flat.

The SPX currently sits 0.5% below its 52-week closing high and about 6% 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** – so, there is apparently an average amount of "gas in the tank" for a multi-week rally.

Understanding the BSI

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.

> ***"****I invest only when I hear the sound of cannon fire and see blood running in the streets. I sell when I hear the sound of violins.****"*** ***Nathan Mayer Rothschild (d. 1836)***

Additional Segment: Just the Humble Opinion of the BSI Editor

[The BSI Editor will only chime in occasionally each month, if at all, partly due to time constraints].

You may notice a few changes this week in some of the statistical data that is presented on the first page of the BSI Report.

The BSI uses a standard lookback period to determine high and low sentiment levels. I've been thinking about what lookback period to use for a long time and decided to increase it significantly this weekend based on further research I've done into the length of cyclical bull and cyclical bear markets. This has affected some of the data presented, albeit not drastically.

You may also have observed the table included with the BSI graph this weekend has more columns than in past reports and now includes forward returns based on BSI level for more than just 10 trading days (2 weeks). Unfortunately, due to data limitations, the table is based on data only going back to the beginning of Q3 2008. So, the table is not based on many periods of data and should be viewed / used with some caution and discretion (which I think goes without saying, but, I'm saying it anyway).

Moving on…

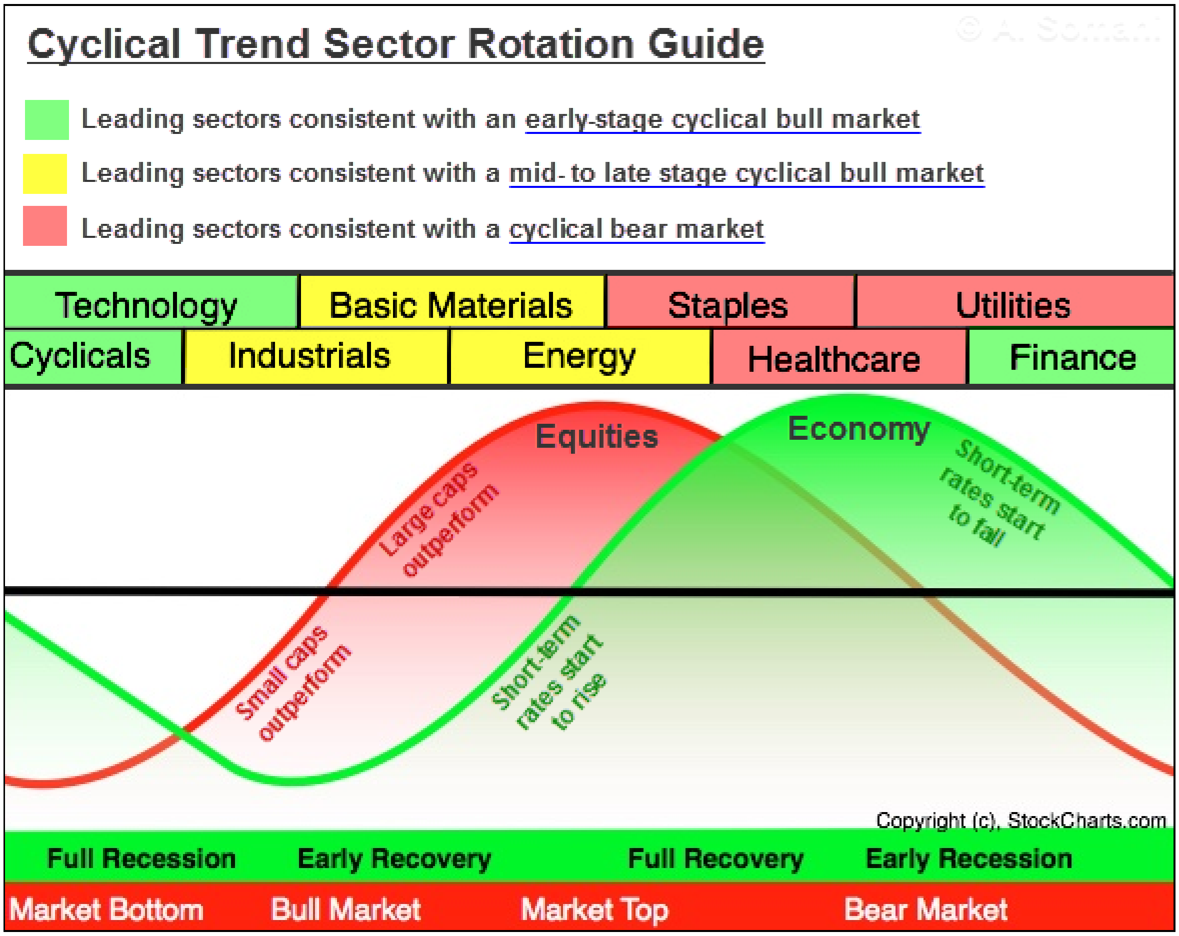
A fascinating data point I want to share: **since 1915, 90% (20 of 22) cyclical bear markets have ended in either Year 1 or Year 2 of the Presidential Cycle** (including the last five cyclical bear markets).

If we think about how Presidents have 4 years in office and seemingly like to do the 'dirty work' they need to do in the first two years of office, so as to make the last two years in office (which are the most memorable in the public's minds) relatively smooth sailing, I suppose this statistic may not be a huge surprise.

A couple other points (relevant if President Obama happens to get re-elected): the first year of a President's second term tends to be particularly weak (most such years have seen stocks fall) while the second year of a President's second term tends to be particularly strong (averaging a gain of over 20%).

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
Telecommunication Services 1 Industry	+5.26%	+10.08%	+17.07%
Energy 1 Industry	+6.41%	+9.28%	+2.63%
Information Technology 3 Industries	+8.66%	+8.43%	+17.99%
Financials 4 Industries	+5.61%	+6.82%	+15.02%
Health Care 2 Industries	+3.43%	+6.57%	+13.51%

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 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 [out of the ones linked to at the bottom of this segment or additional ones of intrigue that the author(s) of this segment has (have) come across] that may be of interest to the average market participant this weekend considering the above:

None.

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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"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***