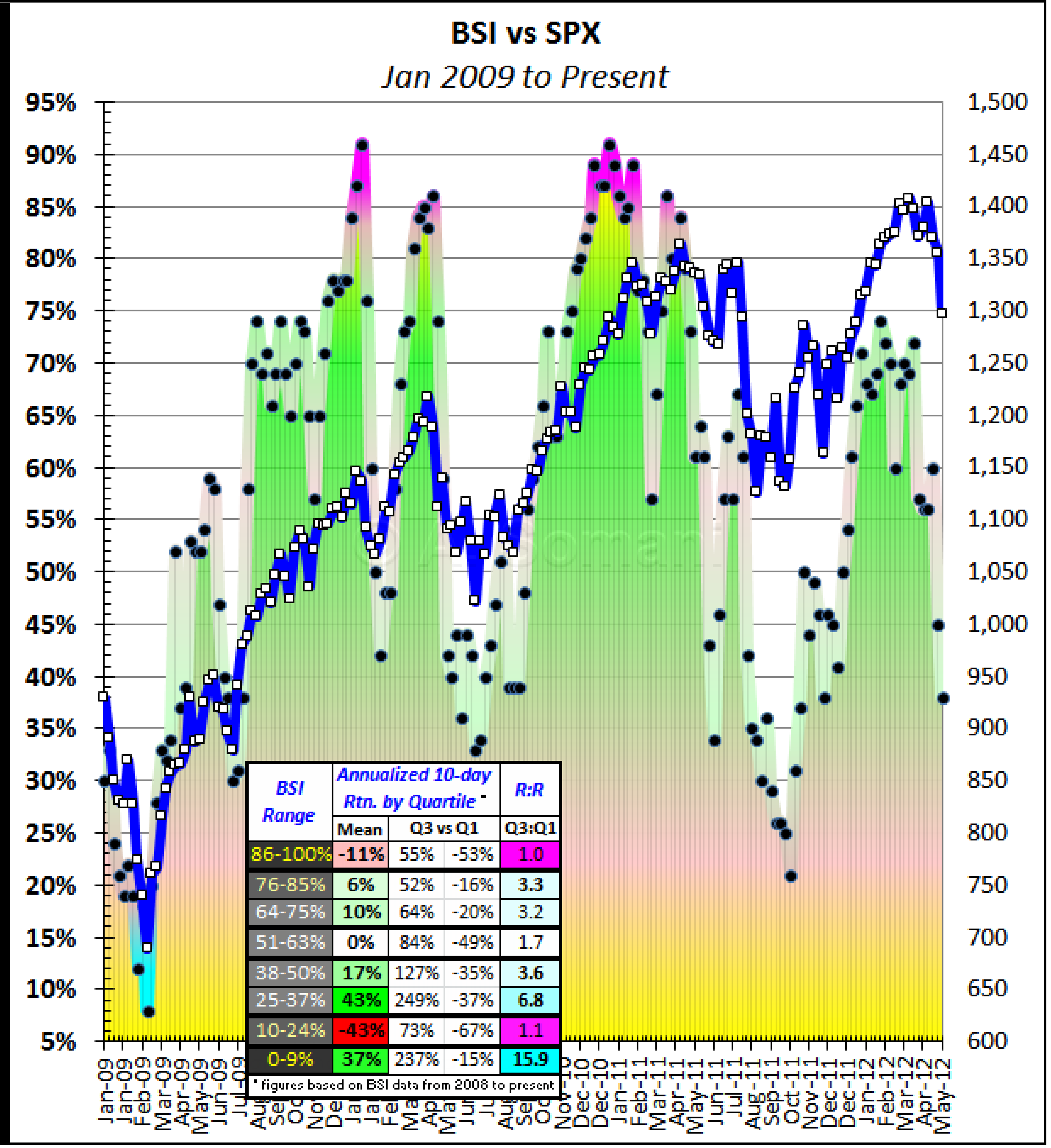
Bullish Sentiment Index (BSI) for US Equities

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)*
2/3/2012	1,345	2%	44	67%	-1	29
2/10/2012	1,344	0%	41	69%	2	27
2/17/2012	1,364	2%	42	74%	5	42
2/24/2012	1,369	0%	37	72%	-2	43
3/2/2012	1,373	0%	37	70%	-2	34
3/9/2012	1,376	0%	22	60%	-10	29
3/16/2012	1,403	2%	32	68%	8	24
3/23/2012	1,397	0%	34	70%	2	21
3/30/2012	1,408	1%	28	69%	-1	14
4/5/2012	1,398	-1%	24	72%	3	6
4/13/2012	1,371	-2%	-11	57%	-15	-15
4/20/2012	1,380	1%	-26	56%	-1	-29
4/27/2012	1,404	2%	-21	56%	0	-26
5/4/2012	1,370	-2%	-26	60%	4	-23
5/11/2012	1,356	-1%	-29	45%	-15	-33
5/18/2012	1,297	-4%	-41	38%	-7	-45



BSI Range	Annualized 10-day Rtn. by Quartile*			R:R
	Mean	Q3 vs Q1		Q3:Q1
86-100%	-11%	55%	-53%	1.0
76-85%	6%	52%	-16%	3.3
64-75%	10%	64%	-20%	3.2
51-63%	0%	84%	-49%	1.7
38-50%	17%	127%	-35%	3.6
25-37%	43%	249%	-37%	6.8
10-24%	-43%	73%	-67%	1.1
0-9%	37%	237%	-15%	15.9

* figures based on BSI data from 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

Summary

The BSI had a 7 notch drop this past week to close at **38%**. Meanwhile, the SPX closed lower by about 4%, for its largest weekly drop in about six months. The SPX currently sits about 8% below its 52-week closing high and about 1% 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 Shallow** – so, there is apparently an increasingly large amount of "gas in the tank" for a multi-week rally.

The BSI is perhaps best used as a blunt and continuous (as opposed to discrete) indication as to the general mood of trades and investors toward the US equity market. With regard to the BSI's associated indicators ("SPX Stretch from Mean" and "BSI Stretch from Mean"), specifically, 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 decide 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 appropriately. 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.

Just the Humble Opinion of the BSI Editor(s)

(Do not be surprised if this space is often empty, mainly due to time constraints.)

This weekend, the “SPX Stretch from Mean” and “BSI Stretch from Mean” columns are both flashing blue – indicating that the SPX is unusually stretched below its multi-week ‘mean’ and that investor sentiment has changed unusually swiftly to the negative. These are positive signs in that they indicate a multi-week bottom is at least getting nearer, but, they by no means warrant that the SPX can’t go lower (even lower by several percent, especially if the SPX has entered into a cyclical bear market – although I doubt that it has). Here’s a snapshot of how these columns looked in the summers of 2010 and 2011, respectively, for example (and no column was flashing blue on the trading week ended 5/14/2010, if you’re wondering):

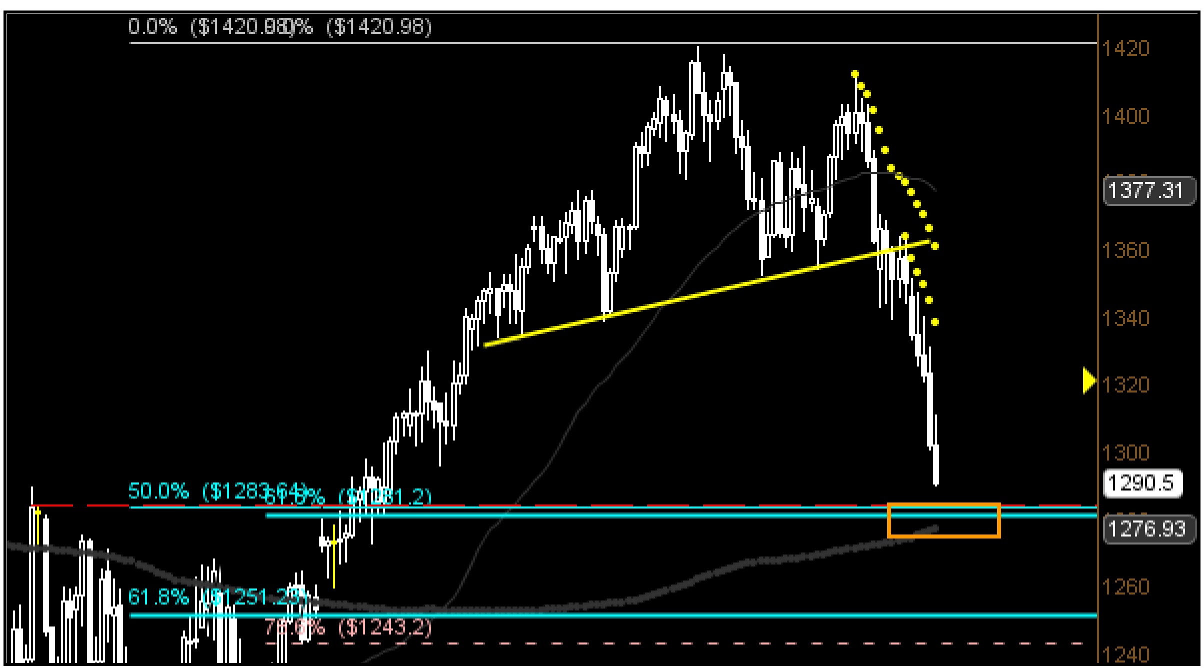
Date	Approx. SPX (SPY*10)	%Ch.	*SPX Stretch from Mean (-50 to 50)*		BSI	Ch.	*BSI Stretch from Mean (-50 to 50)*
5/21/2010	1,091	-4%	-41		42%	-17	-5
5/28/2010	1,094	0%	-43		40%	-2	-38
6/4/2010	1,068	-2%	-40		44%	4	-42
6/11/2010	1,097	3%	-33		36%	-8	**-50**
6/18/2010	1,117	2%	-11		44%	8	**-50**
6/25/2010	1,079	-3%	-10		42%	-2	**-50**
7/2/2010	1,022	-5%	-26		33%	-9	**-50**
7/9/2010	1,080	6%	-22		34%	1	**-50**
7/16/2010	1,067	-1%	-20		40%	6	**-49**
7/23/2010	1,104	4%	-7		43%	3	**-47**
7/30/2010	1,103	0%	5		47%	4	**-47**
8/6/2010	1,124	2%	22		51%	4	-35
8/13/2010	1,083	-4%	3		54%	3	-1
8/20/2010	1,075	-1%	-15		39%	-15	8
8/27/2010	1,069	-1%	-29		39%	0	-13

Date	Approx. SPX (SPY*10)	%Ch.	*SPX Stretch from Mean (-50 to 50)*		BSI	Ch.	*BSI Stretch from Mean (-50 to 50)*
7/15/2011	1,317	-2%	16		57%	-6	-36
7/22/2011	1,346	2%	20		67%	10	-35
7/29/2011	1,293	-4%	-1		61%	-6	-35
8/5/2011	1,201	-7%	-33		42%	-19	-40
8/12/2011	1,181	-2%	-41		35%	-7	-43
8/19/2011	1,126	-5%	-45		34%	-1	-42
8/26/2011	1,180	5%	-37		30%	-4	-45
9/2/2011	1,179	0%	-20		36%	6	-33
9/9/2011	1,159	-2%	-12		29%	-7	-15
9/16/2011	1,215	5%	2		26%	-3	-27
9/23/2011	1,135	-7%	-7		26%	0	-40
9/30/2011	1,132	0%	-21		25%	-1	**-47**
10/7/2011	1,157	2%	-23		21%	-4	**-48**
10/14/2011	1,226	6%	-7		31%	10	**-47**
10/21/2011	1,240	1%	7		37%	6	-43
10/28/2011	1,286	4%	21		50%	13	-18

The drop in the SPX since its early April high has now become large enough to be called a correction, certainly, and not a mere dip. Additionally, the SPY is currently down 11 out of the past 13 trading days as well as 6 trading days in a row. By comparison, at the Aug. 8, 2011 low, the SPY was down 10 of its past 13 trading days as well as 3 trading days in a row. Let me add that the 14-day RSI (one popular technical momentum indicator) is almost at the same level for the SPY and QQQ as back at the Aug. lows, notably.

If one looks back at when the SPY has fallen 6 trading days in a row, over the past several years, one typically finds that the SPY is either about midway or a little over midway through a steep decline – or – within 2% (occasionally 3%) of a multi-week bottom. I think it is likely that the same is true here; either the SPX is only, say, 40-65% of the way through a decline to a multi-week bottom, or, say, 85%+ of the way through a decline to a multi-week bottom. To me, it seems much more probable to be the latter than the former. Consider, for example, that – according to Bespoke Investments tweet – the current decline is the longest (of 5%+ declines in the SPX) since the cyclical bull market off the 2009 lows began, without an ensuing 5%+ rally, in terms of calendar days. In fact, it would not at all be a surprise to see a multi-week low develop in the SPX before the end of Wed. of this coming week, but, don't quote me on that.

If, however, the SPX really is closer to the midway part of a decline to a multi-week bottom rather than close to the end of a decline to a multi-week bottom, it should become readily apparent by a definitive break of the major support level in the SPX at about 1275-85 (pictured below using an S&P 500 continuous futures chart). This is the site of multiple Fibonacci retracement levels, the 200-day moving average, the approximate orthodox target of the head-and-shoulders pattern pictured, etc. It is a key level in a number of ways, in short, and if the SPX definitively breaks it, be prepared for potentially much more downside (just in case). I don't expect a definitive break (at least not without an intervening multi-week bottom), as I indicated above, but, anything is certainly possible.

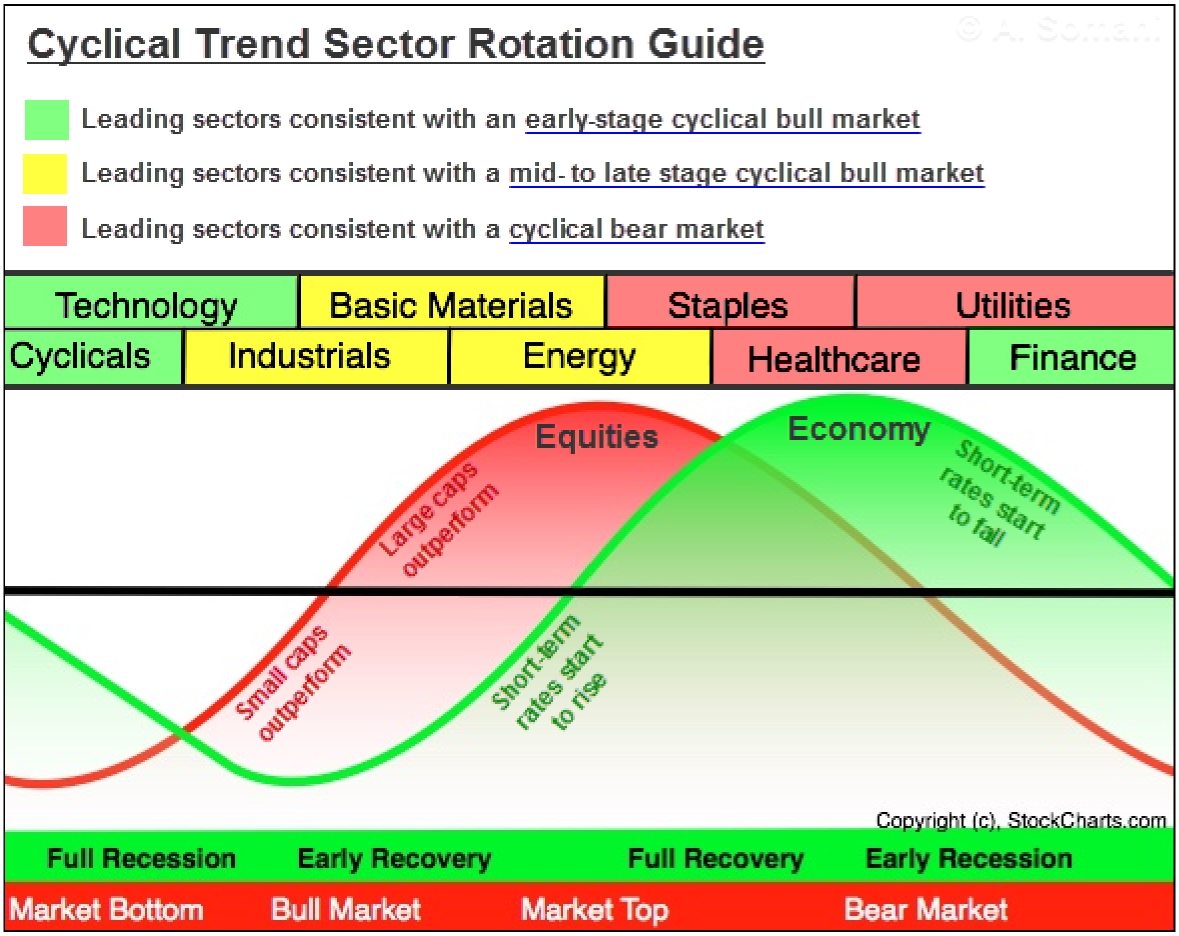


Very thankfully, my “backup plan” triggered about a week and a half ago, and has kept me mostly safe (hedged) from the decline in US equities since that time. I also have a plan to unwind my hedges, of course, because I know that following every large decline eventually comes a large rally, and – when it comes – it will be a rally I care about since I still strongly think that US equities are in a mid- to late stage cyclical bull market. I think it is highly improbable that the April high in the SPX will not be exceeded within the coming several months (and probably within the coming few months, in fact) – based on my studies of market breadth at historical cyclical bull market tops.

By the way, there was a slight error in the BSI level reported in last weekend's report, but, it hardly made any difference (46% reported versus 45% actual), fortunately.

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

Sector	Performance		
	1 Month	3 Month	YTD
Telecommunication Services 1 Industry	+5.79%	+5.90%	+6.11%
Consumer Staples 3 Industries	-2.26%	+1.09%	+2.79%
Utilities 1 Industry	+1.03%	+0.45%	-2.52%
Health Care 2 Industries	-2.58%	-0.84%	+5.04%
Consumer Discretionary 5 Industries	-7.18%	-3.67%	+7.49%

Sector rotation may be one tool for a person 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, <u>sector rotation currently appears to be consistent with US equities being in a mid- to late stage cyclical bull market</u>*.*

As detailed in earlier reports, I continue 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.”

This segment of the BSI Report is suspended for an indeterminate period of time due to time constraints. I hope to bring it back sometime in June, though.

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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