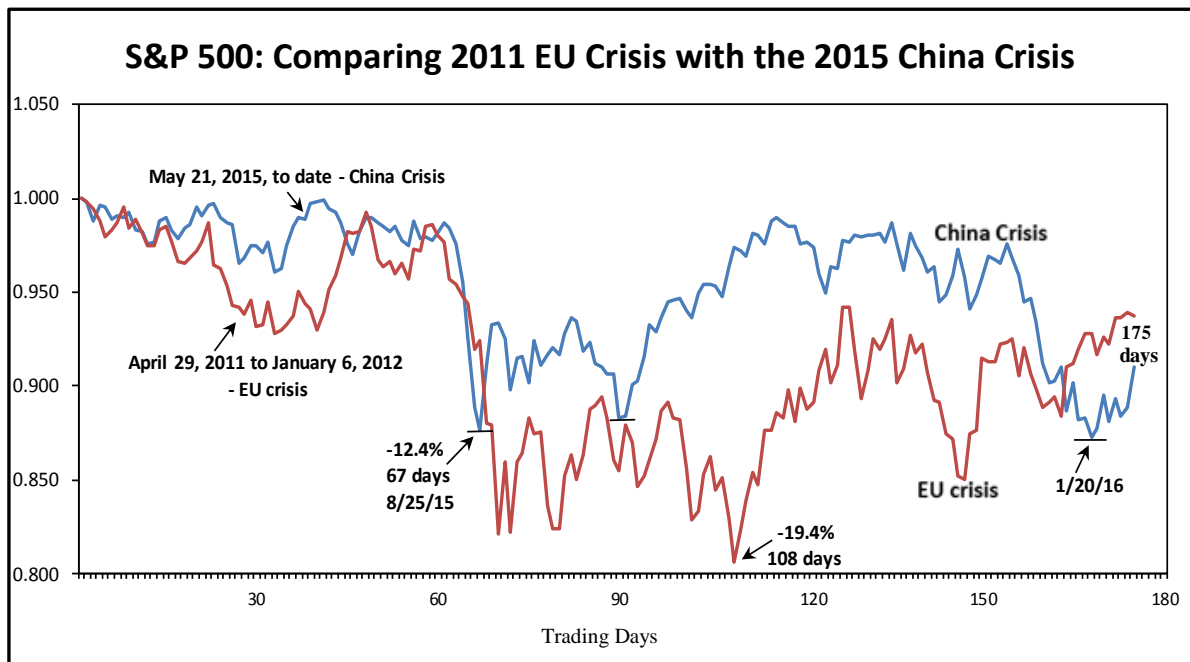


BUSINESS CYCLE DEVELOPMENTS

Another **Market Trough Indicator** has signaled, which totals two of six **MTI's**. Two **MTI's** have been sufficient enough to reenter the equity market on weakness when dealing with external shocks or equity markets that are only discounting economic slowdowns. We've been discounting the former – an external shock pertaining to China's degree of slowing and two devaluations since May 2015 (see highlighted portion of the [1/20/16 report](#) for discussion on outlook). Two of six **MTI's** implies investors can re-enter the market on weakness; however, there's still six of 10 **Market Peak Indicators** pointing toward a spring to early summer major top in the S&P ahead – see [December 2nd report](#). The only way to reconcile the **MPI's** pointing toward a major peak in the equity market and the **MTI's** speaking of higher near term levels, is to view the decline from May 2015 thru January 2016 as an external shock. That shock has probably been fully discounted, given the two **MTI's**, but markets likely face a rougher period ahead given the number of **MPI's**. This very same pattern occurred in 2011 with the Euro Crisis. Then, the S&P peaked in April 2011 and fell thru October by -19%, only to rebound to new highs, but only by a few percentage points.

The first **MTI** to signal was the *S&P 500 Diffusion Index*. Every intermediate S&P decline – discounting shocks or slowdowns and followed by a rebound – has been characterized by a specific number of S&P industries significantly underperforming an average S&P industry. This signal appeared the second week



of January. The second **MTI**, and the most recent, is the *S&P 500 Percentage Trend*, which also signaled in December, but can't be assessed until a month later. These two **MTI's** are both dependent variables – obviously not the best tools when attempting to measure an outcome (i.e. market recovery) – but they have worked well and guided the market rebound due to the 2011 exogenous shock related to the Euro Crisis. Since 2000, when two **MTI's** are showing, the market recovery occurred two months later (+/- 2 mo.) – i.e. March (January to May).

Notice in the chart that the S&P dipped three times (blue line) in response to the slowing and two devaluations in China totaling 6% – in August 2015 and January 2016. It's believed that the two declines and rebounds from the 1860 level of the S&P 500 will be sufficient to fully discount the Chinese shock, even though the Euro Crisis triggered a -19% decline for six months in 2011. Draghi's “whatever it takes” cauterized that 2011 decline and China's cash injections will likely hold off further serious declines – as that is what the two **MTI's** are predicting. Since equities are a claim on a real asset, any artificial fiscal or monetary pumping will revive stocks once comprehension of an unexpected devaluation is discounted and there's an easing policy response.