February's Correction: Buyable Weakness?

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We believe the decline from the broadly-inclusive market highs of late January is a yet another late-cycle correction and not the first installment of something more sinister. But we are flexible in that view and remain open to evidence tilting toward the latter possibility.

- A major argument against an imminent lapse into a bear is simply the recent behavior of the stock market itself. While every market top unfolds in its own unique way, there are some common threads that (to our eyes) have yet to reveal themselves—including a transition away from cyclical leadership and an overall thinning in participation in which breadth measures, like advance/decline lines and equal-weighted indexes, not only underperform but fail to confirm ongoing highs in the DJIA and S&P 500. In fact, evidence of such a distribution process has failed to appear at any point in the upswing off the 2015-2016 correction lows.

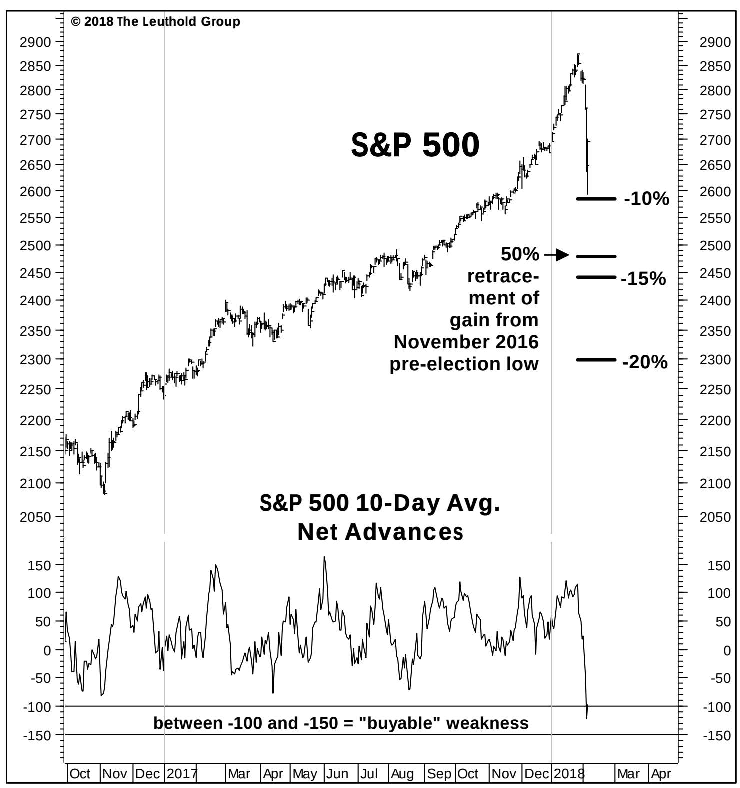
- While the above observations are technical in nature, we infer from them that the Fed's timid tightening gestures have so far failed to register on the most cyclically sensitive groups.

- We should distinguish between the "underperformance" and "divergence" of these bellwether groups. Small Caps, Value, and Transportation stocks, for example, have all been underperformers since their one-month rocket ride in the wake of Trump's election. But these laggards were still celebrating new highs until a few days before the late January S&P 500 high. Maybe it's just semantics, but we view these groups as relatively weak, and not yet "divergently" weak.

- While today's valuations render it dangerous to hold out for "too much" evidence of an impending top (or, worse yet, a top that's **already** in place), our work hasn't eroded enough for us to make a full-blown bearish call.

- The S&P 500 flirted with the 10% correction threshold at the morning lows on February 6th. The remaining targets are presented in the chart as references, not forecasts.

- Distinguishing between a late-cycle correction and a new cyclical bear is difficult, and we are banking heavily on the absence of the traditional distribution signs cited above. Action during the correction can also be helpful, and we're encouraged that an excellent measure of the market's downside thrust (10-Day S&P 500 Net Advances) remains within the zone (as of February 6th) that's historically shown to be "buyable" weakness. So far, so good.



Data through February 6th