Any reference to specific stocks, ETFs, or groups of stocks are provided for educational purposes only and should not be construed as advice to buy or sell those instruments. Chart illustrations are from TC2000® (version 7).

MARKET UPDATE

Listed in Table 1.1 is the weekly (Column 1) and yearly (Column 2) performance of the indices representing the broad market. **Column 3 has been changed this week.** It currently reflects each index's performance since its bull market high, with the date of that high shown in parenthesis. Column 4 shows the performance corresponding to the start of the current bull market from the March 9, 2009 low. *Note:* The percent changes indicated in Tables 1.1 and 1.2 are calculated using closing prices during the designated period.

TABLE 1.1: THE BROAD MARKET

Index	*Performance Week of 1/4/2016*	*Performance Year-to-Date 2016*	*Performance from Bull Market High*	*Performance to Date Bull Market*
Dow Jones Industrial Avg	**-6.19%**	**-6.19%**	**-10.74% (5/19/15)**	**+149.68%**
S&P 500 Index	**-5.96%**	**-5.96%**	**-9.80% (5/21/15)**	**+184.10%**
Nasdaq Composite Index	**-7.26%**	**-7.26%**	**-11.02% (7/20/15)**	**+266.03%**
S&P 400 Midcap Index	**-6.44%**	**-6.44%**	**-15.55% (6/23/15)**	**+223.38%**
Russell 2000 Index	**-7.90%**	**-7.90%**	**-19.26% (6/23/15)**	**+204.78%**
Dow Jones Transport Avg	**-7.49%**	**-7.49%**	**-24.64% (12/29/14)**	**+223.55%**

The new year got off to a rough start. Last week's sharp selloff pushed the major market averages—the Dow, S&P 500, and Nasdaq—back into correction territory. It was also a historic week, with the Dow experiencing its *worst ever* first week start to a new year. The mid cap and small cap indices are deeply into correction territory now, approaching bear market levels. The Transportation Average has officially crossed over into a bear market decline, having fallen more than 20% from its bull market closing high.

The CBOE Market Volatility Index (VIX) rose to 27 on Friday, but is still well below the level it reached during the August correction (an intraday reading over 50 on August 24). The decliners versus advancers hit an extreme level last week. The broad market is very oversold now on a short-term basis, and oversold on an intermediate-term basis as well, so it is due to have at least a relief rally soon.

Figure 1.1 shows a daily chart of the Dow Jones Industrial Average. The Dow accelerated to the downside through the lower boundary (C2) of the descending channel, closing below its 100- and 500-period SMAs, horizontal lines H5 and H6, and the up trendline (T1). The action was similar on the daily chart of the S&P 500 Index shown in Figure 1.2. It was the worst week for the large cap indices since the 2011 market correction. Both indices are within striking distance of their September lows. The S&P is getting close to the 1900 level.

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Figure 1.1
Daily Chart of the Dow Jones Industrial Average – March 2015 to January 2016

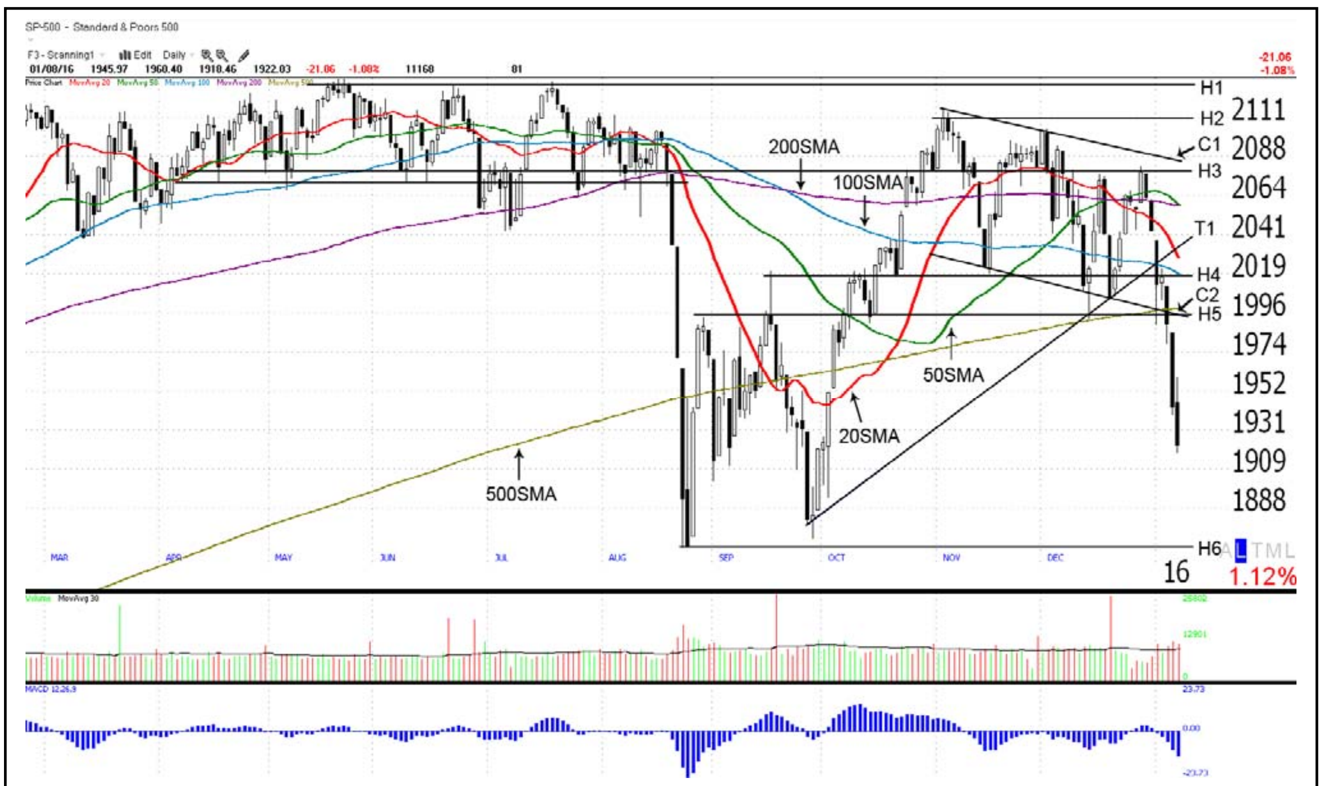

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Figure 1.2
Daily Chart of the S&P 500 Index – March 2015 to January 2016

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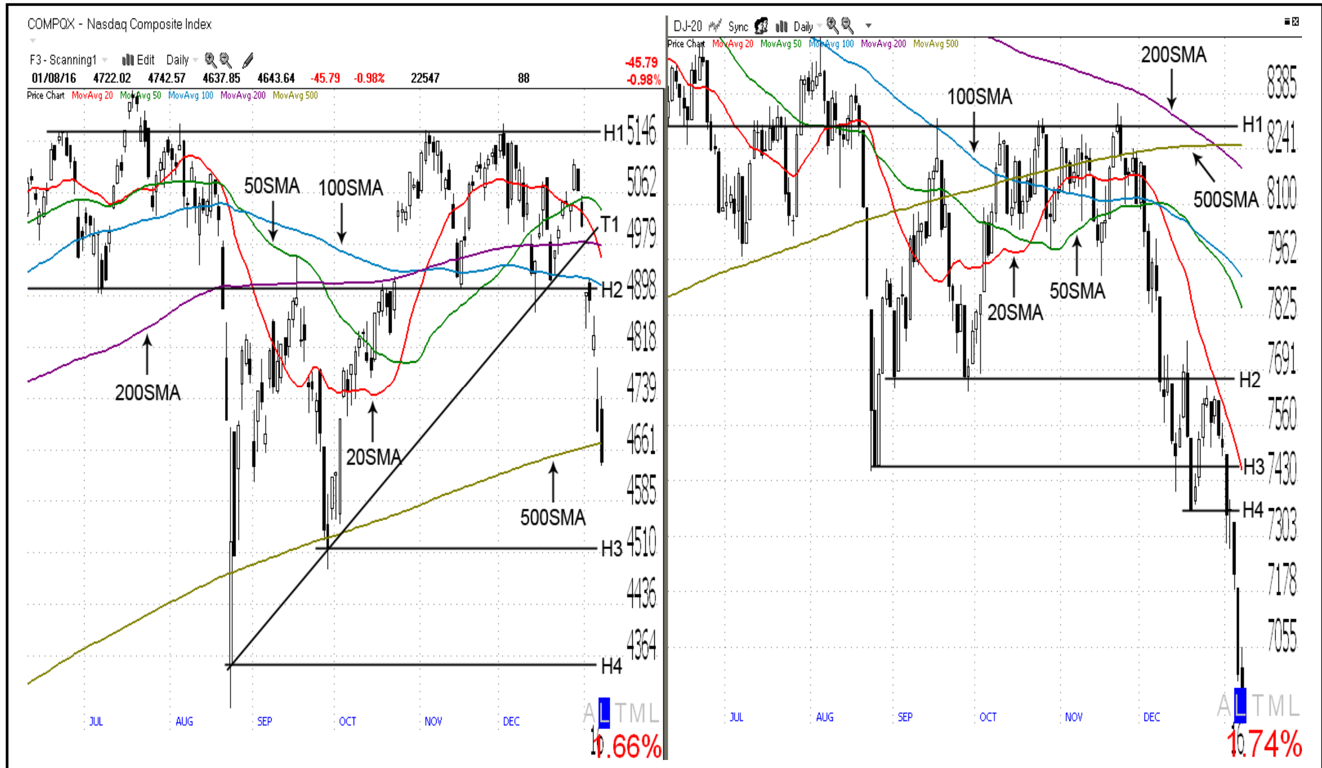

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Figure 1.3
Daily Chart of the Nasdaq Composite Index (Left) and Dow Jones Transportation Average (Right)

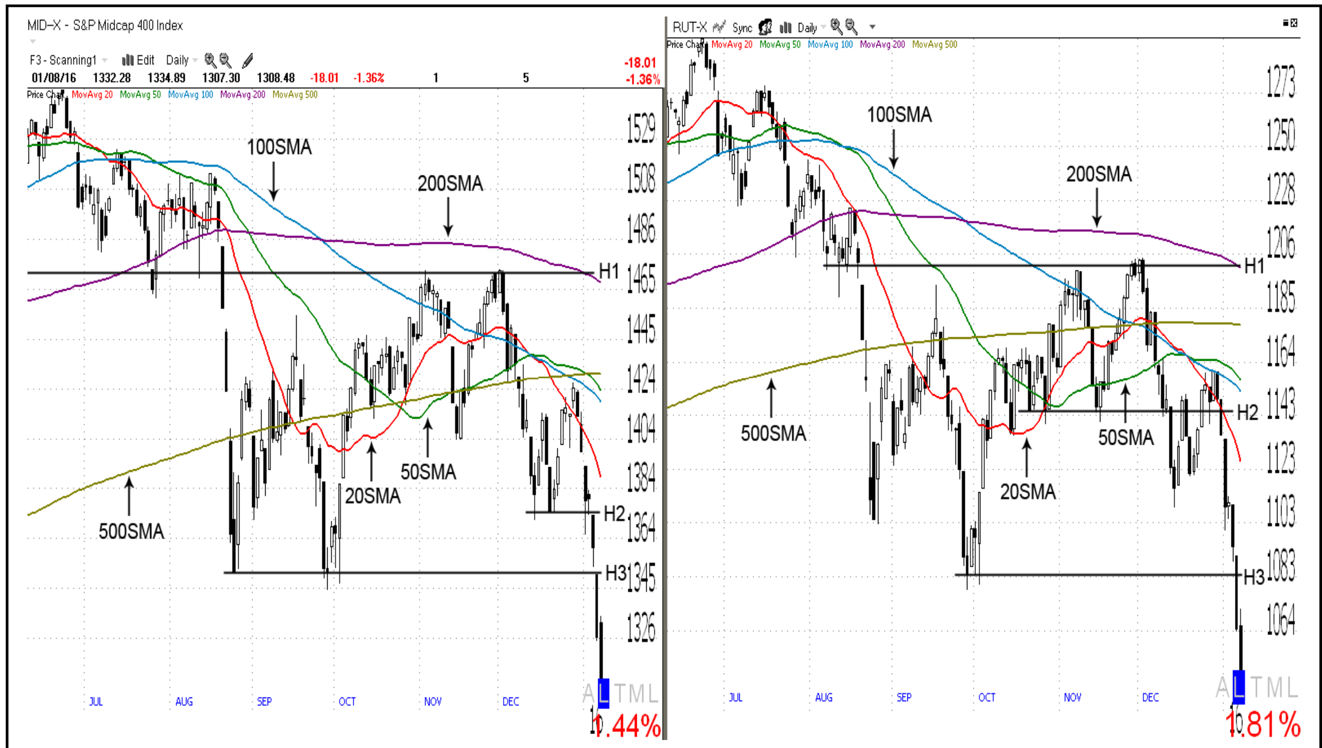

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Figure 1.4
Daily Chart of the S&P Midcap 400 Index (Left) and Russell 2000 Index (Right)

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Figure 1.3 shows a two-chart layout with the daily chart of the Nasdaq Composite Index on the left and the Dow Jones Transportation Average on the right. The Nasdaq was the best performer last year, but led the major market averages to the downside last week. On Monday, it gapped below the 100- and 200-period SMAs, the bottom of the multi-week trading range (H2), and the up trendline (T1); and closed below the 500-period SMA on Friday. The Transportation Average easily took out the December low, officially falling into bear market territory, though several of its component stocks were already there prior to last week's selloff.

Figure 1.4 shows a two-chart layout with the daily chart of the S&P Midcap 400 Index on the left and the Russell 2000 small cap index on the right. The Midcaps fell through the December low (H2) and broke the double bottom support at the August-September lows (H3). The Russell was the worst performer last week losing almost 8%. It melted through the September low (H3), and is now down nearly 25% off its December 2014 bull market high.

WHAT'S DRIVING THE MARKET

Monday's global selloff emerged from the rout in the Chinese stock market coming on the heels of another weak manufacturing report for the world's second largest economy. Chinese manufacturing contracted for the tenth consecutive month. The Shanghai Index fell 7%, triggering circuit breakers for the first time ever and halting trading on the Shanghai market. Asian markets got hit, as did the European markets. The German DAX fell hard losing more than 4%. According to CNBC, about 9% of German company sales, and about 15% of their earnings, can be contributed to China.

It was just the start of the troubles in China, which persisted throughout the week. The conflict between Saudi Arabia and Iran also had some impact on world markets. Once again, oil was a factor. WTI and Brent crude both opened higher on Monday revealing concerns about the Mideast conflict. However, later in the session, news came out about an inventory glut in the U.S. (Cushing, Oklahoma had its highest level of supply seen in the area). Oil lost its gains closing the session negative and declined for the rest of the week. Although the Mideast tensions may be unsettling, for now it does not suggest any disruptions in supply.

Some of the recent U.S. economic data has not been very good. Remember, the PMI fell below 50 in December showing contraction. On Monday, the ISM report was released, showing manufacturing declined again. Recall from last week the Director of the IMF lowering their forecast for world growth this year. On Wednesday, news came out that the World Bank was also cutting its global growth forecast for 2016.

On Wednesday, the yuan plunged to a five-year low. China's service activity slipped again in December, showing their transition to a consumer-led economy still needs work. On Thursday, the Dow fell another 392 points as the China selloff continued to spill over into global markets. According to WSJ.com, "The People's Bank of China made its largest downward adjustment to the yuan since August."

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On Friday, the Chinese market stabilized some. The Chinese stock market is only 25 years old, and clearly they are experiencing some growing pains. China ended the week down 9.9%, Germany fell 8.3%, and Japan lost 7%. On Friday morning, a good employment report came out for the U.S. The Dow opened up about 150 points, but it was downhill from there. The imbalance going into the close on Friday was $1.7 billion to the sell side, which is significant. The session ended down almost 168 points. The Dow lost more than 1,000 points in one week. Now we'll look for an oversold bounce, and then see whether a solid bottom sets up or the market takes another leg down.

The volatility will likely continue for the Chinese market. In fact, as of Sunday evening while I was still working on this weekend's rather lengthy report, I saw news of the Shanghai Composite dropping another 2.5% during China's Monday trading session.

ECONOMIC NEWS AND REPORTS

Institute of Supply Management (ISM) Report – The ISM report for December came in weaker than expected, falling to 48.2 from 48.6, compared to consensus expectations for an increase to 49.0. That was back-to-back numbers under 50. December's reading was the lowest since 2009, and was the sixth consecutive month of declines matching the last longest losing streak for the report in 2004.

Auto Sales – December was another good month for auto sales, though not as strong as some economists had expected. However, according to AutoData, annual sales for 2015 hit a new all-time high of 17.47 million making last year the best ever for vehicle sales, compared to the prior high of 17.4 million in 2000. 2015 saw an increase of about 5% over 2014. Auto dealers and auto parts companies sold on the news.

Federal Open Market Committee (FOMC) – On Wednesday, the Fed released the minutes from the December FOMC meeting. Following is the link for your reading pleasure:
http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20151216.pdf

Wholesale Inventories declined by 0.3% in November, falling more than expected as inventories of both durable and nondurable goods fell. The report is another indication that growth slowed during Q4 2015.

Gross Domestic Product (GDP) – CNBC lowered its forecast for Q4 GDP to just 1.2%, a full percentage point below prior estimates. Morgan Stanley is even more pessimistic, looking for GDP of just above zero. President Obama will give his final State of the Union address for the new year on Tuesday.

Monthly Employment Report – The December jobs report was released on Friday:

- U.S. employers added 292,000 jobs, exceeding economist expectations of 210,000. The October and November jobs were revised upward by 50,000.

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- The Unemployment Rate held at 5.0%; economists had expected it to fall to 4.9%. The U6 unemployment rate was 9.8%.
- Hourly Earnings were unchanged versus estimates for an increase of .2%, and up about 2.5% year over year.
- The Labor Force Participation Rate ticked up a bit in December, but remains at 40-year low of 62.6%. Participation by men is at an all-time low.

It was a good report, and the last two years (2014-2015) brought the best job growth overall since 1999. However, there continue to be challenges with the participation rate, stagnant wages, underemployment, and the quality of jobs being created. Those problems have contributed to sluggish economic growth.

Robert Reich, the former Labor Secretary, was on CNBC on Friday and said about wages: "It's unusual where you have this degree of job growth and employers don't feel the necessity of bidding up wages. But what's happening actually is that most of the job growth, according to the Bureau of Labor Statistics (BLS), is occurring in low wage occupations. Leading the way in today's job report was temp jobs, healthcare jobs, drivers (service transportation jobs), and jobs that don't pay very much. And that's been the story of much of this recovery."

Regarding the U6 number, Reich said: "If you look at the underemployment rate that the BLS put out today, it's very close to 10%. These are people who are too discouraged to look for work, or are working part-time but would rather be working full-time. When you've got an underemployment rate that is that high, you know that there's a lot of slack. The number of hours, typical work week is still very low (34.5). That also is an indication of a lot of slack in the labor market."

Earnings Season Starts Next Week

On Wednesday, Bob Keiser of S&P Capital IQ gave their earnings expectations for Q4 2015:

- 5.2% decline factoring in energy drag (-67.7%)
- Earnings growth for S&P 500 is expected to be +0.6%

Keiser elaborated on Q4 earnings expectations: "It's going to be a continued story. Headline S&P earnings are not going to look so good. If you exclude the Energy sector, just the Energy sector not Materials and Industrials, you're looking closer to 6%. So it is the same story we've dealt with really all of 2015, now it's carrying over into 2016 with crude oil at $34/barrel."

Keiser commented on forward earnings: "At 2000, the S&P is trading 16 times forward earnings. If you get down closer to 1900, that's 15 times forward earnings. That's a lot more attractive than where you were a year ago at 18 times forward earnings. So we're kind of starting to like the market here."

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GLOBAL NEWS AND EVENTS

Saudi Arabia severed diplomatic ties with Iran following attacks on its embassy in Tehran during protests over the execution of a Shiite cleric. Three of Saudi Arabia's allies (Sudan, Bahrain, and UAE) backed them by either severing or reducing diplomatic ties with Iran. Meanwhile, North Korea claims to have successfully tested a hydrogen bomb.

There were more acts of terrorism around the globe. Disturbingly, this seems to be the new normal. Another potential terrorist attack in Paris was thwarted. The suspect was shot as he rushed a police station armed with a knife and wearing a fake explosive belt. More than 100 women reported being harassed or sexually assaulted by Arab or African men on New Year's Eve in cities across Germany. Assaults were also reported in Finland, Austria, and Switzerland. In the U.S., two Iraqi refugees were arrested in California and Texas, alleged to have provided support to ISIS. Additionally, a man inspired by ISIS attempted to execute a police officer in Philadelphia.

SECTOR SYNOPSIS

Table 1.2 shows the weekly (Column 1) and yearly (Column 2) performance of the ten main economic sectors. **Column 3 has been changed this week.** It currently reflects each index's performance since its bull market high, with the date of that high in parenthesis. Column 4 shows the sector performance corresponding to the start of the current bull market from the March 9, 2009 low.

TABLE 1.2: SECTOR SUMMARY

SPDR Sector ETF	*Performance Week of 1/4/2016*	*Performance Year-to-Date 2016*	*Performance from Bull Market High*	*Performance to Date Bull Market*
Cons Discretion (XLY)	**-5.82%**	**-5.82%**	**-9.98% (11/25/15)**	**+356.92%**
Cons Staples (XLP)	**-2.91%**	**-2.91%**	**-4.37% (12/16/15)**	**+152.55%**
Energy (XLE)	**-7.08%**	**-7.08%**	**-44.66% (6/23/14)**	**+44.24%**
Financials (XLF)	**-7.26%**	**-7.26%**	**-13.60% (7/22/15)**	**+253.04%**
Healthcare (XLV)	**-5.57%**	**-5.57%**	**-11.91% (7/20/05)**	**+210.88%**
Industrials (XLI)	**-6.21%**	**-6.21%**	**-14.51% (2/20/15)**	**+223.70%**
Materials ETF (XLB)	**-7.74%**	**-7.74%**	**-23.09% (2/24/15)**	**+120.35%**
Retail (XRT)	**-5.23%**	**-5.23%**	**-19.49% (7/16/15)**	**+348.36%**
Technology (XLK)	**-6.40%**	**-6.40%**	**-10.05% (12/4/15)**	**+203.25%**
Telecom (IYZ)	**-5.56%**	**-5.56%**	**-14.25% (4/23/15)**	**+102.16%**
Transports (IYT)	**-7.53%**	**-7.53%**	**-24.69% (12/29/14)**	**+222.58%**
Utilities (XLU)	**-0.39%**	**-0.39%**	**-12.75% (1/29/15)**	**+89.58%**

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All of the sectors were negative last week, but the least negative were two defensive groups—defensive meaning they have less exposure to an economic downturn than more cyclical groups. Utilities closed the week down less than one-half percent. This group also does not have overseas exposure like multinationals do. Consumer Staples fell less than 3%.

ENERGY UPDATE

As illustrated on the daily chart of the Light Sweet Crude Oil Index on the left in Figure 1.5, it was another wild week for oil as crude fell for five straight days losing 10.5%. Oil tested the 2009 low, which can be seen on the monthly chart shown on the right. CNBC's Jackie Deangelis identified the following major factors putting pressure on oil prices:

- Large build, low demand
- U.S. and Mideast continue to produce
- Strength in the U.S. dollar
- Chinese growth concerns

I regularly monitor the price action of some key oil stocks and ETFs. For now, I continue to avoid putting on *core* long positions in this market segment until there are new signs of a potential bottoming process. I have no problem taking short-term trades in the group to the long and short side as good opportunities to do so arise.

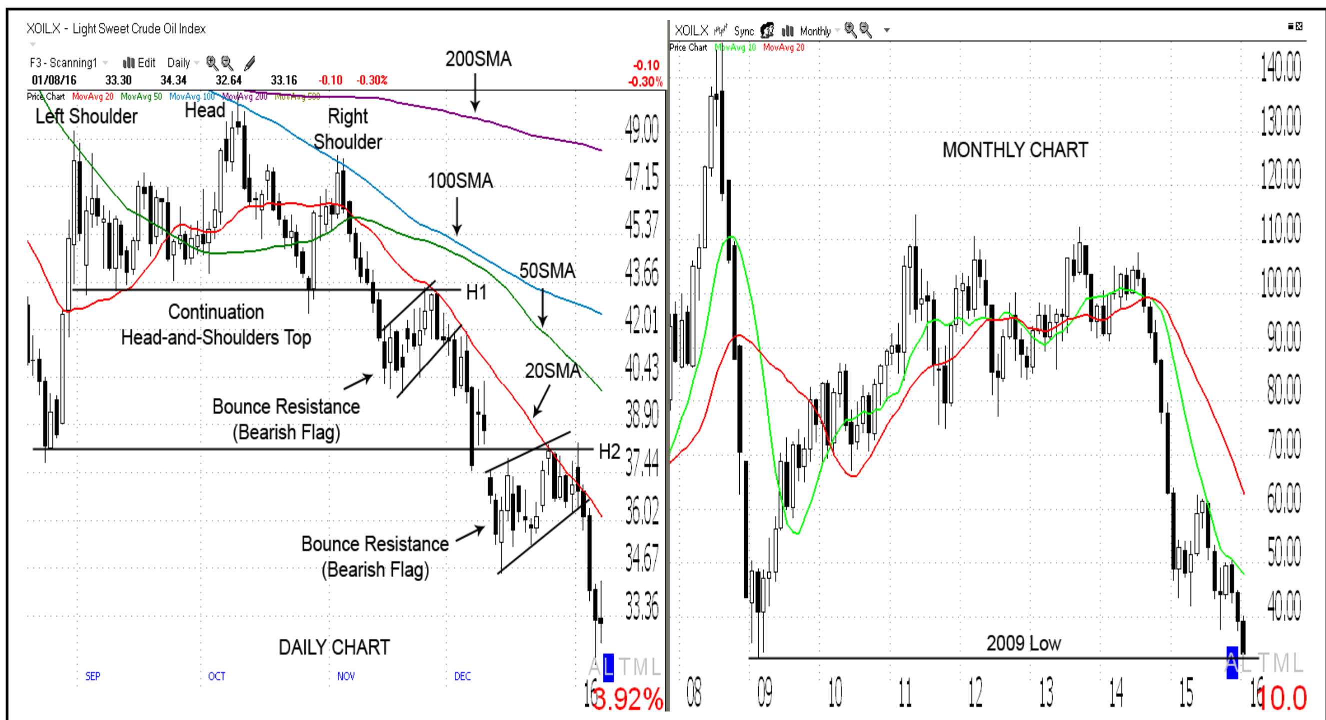

Figure 1.5
Light Sweet Crude Oil Index – Daily Chart (Left) and Monthly Chart (Right)

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MARKET EDUCATION

IS THIS A BULL MARKET OR A BEAR MARKET?

In light of last week's market decline, it is a good time for another one of my in-depth discussions on corrections, bull markets, and bear markets. Listed in Table 1.3 are some key technical concepts that can help determine if a bull market remains in force. In addition to the technical signs, the fifth row indicates certain depths of decline that many analysts and market commentators adhere to when identifying bull market corrections and bear markets.

The concepts outlined in Table 1.3 provide some guidelines that can be used to analyze a long-term (major) uptrend, and a shift from a bull market to a bear market. However, there are challenges for each one as discussed in the following pages, and identified in the illustrations where applicable.

TABLE 1.3: BULL MARKETS		
1	Peaks and Bottoms	The prominent peaks and bottoms are rising. Watch for the following: 1. Changes in the rate of ascent of the peaks. 2. Change in the direction of the peaks and bottoms. 3. A divergence between the rising peaks in price and the peaks of an indicator that measures the momentum of the trend.
2	New Bull Market High	After a correction, price must break out above resistance created by the prior bull market high and hold above it. Failure to do so shows a loss of momentum for the major uptrend.
3	Correction Low	After moving to a new bull market high, the prior bull market correction low should provide support below the market. It should not be violated during a subsequent correction.
4	Support Lines	Price remains above one or more important long-term moving averages and/or a long-term up trendline.
5	Percentage Decline	It is generally accepted that a bull market correction is a decline in excess of 10%, and a bear market is under way when price has declined 20% or more.

Let's begin the discussion by looking at the bull market that started from the March 2009 low, analyzing the uptrend from a standpoint of whether it is still a bull market, or has shifted to a bear market. It is difficult to analyze a nearly seven year bull market as one long trend. Thus, although the daily chart may be used for some of the analysis, for a bull market that lasts a few years or longer, it is easier to examine some of the concepts in Table 1.3 using the weekly chart to gain a long-term perspective. Pay close attention to the illustrations included with the discussion, noting when the daily chart is used versus the weekly.

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Figure 1.6 shows a weekly chart of the Dow Jones Industrial Average from 2010 through the close on Friday, January 8. The three significant market corrections (in excess of 10%) that occurred during that time are identified. As this chart clearly shows, the bull market closing high prior to a significant decline is very important. It marks the resistance level that must be broken in order for a bull market to continue its advance (Row 2 in Table 1.3). Those high points also create the most prominent rising peaks on the chart (Row 1 in Table 1.3).

The correction lows are also very important, because they mark the levels that must provide support, and they create the most prominent rising bottoms on the chart. Those prominent peaks and bottoms (price pivots) guide your eye to the upward direction of the major trend, and help identify changes in the trend direction.

Looking at the left side of the chart in Figure 1.6, note the 2010 correction. As the market recovered from that decline, it eventually surpassed the bull market high (line H1) setting a new high and continuing the bull market. The 2011 correction was deeper, but not deep enough to enter bear market territory, and it did not breach the 2010 correction low. As the market recovered from that correction, once again it surpassed the prior bull market high (H2). Although the Dow dipped back below that line on a subsequent pullback, it ultimately moved above that level extending the bull market.

Figure 1.6
Weekly Chart of the Dow Jones Industrial Average – Market Corrections

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There was not another decline in excess of 10% until the summer of 2015. Here's where the nearly seven year bull market has run into some trouble. Unlike the 2010 and 2011 corrections, so far the Dow has failed to break out above the prior bull market high, so it is now setting up a potential double top on the weekly chart. That shows a loss of momentum of the bull market, and the risk of a bear market taking hold. However, the index is still above its prior correction low (the August 2015 low), so there is still the possibility that the bull market is trapped in a relatively wide trading range.

I've drawn a long-term up trendline (T1) on the weekly chart. However, there are some challenges with a long-term trendline. Recall from my past discussions of an intermediate-term up trendline being broken, and redrawn, one or more times during the evolution of the trend. The same may occur with a long-term up trendline. It may be violated during a deep correction, or during a period of prolonged consolidation, and redrawn if the major uptrend resumes. Thus, a break of a long-term trendline, by itself, it not a signal that a bear market is under way (Row 4 in Table 1.3).

Another challenge with a long-term trendline is that it may remain untested for several years. It may even have only two price pivots along the line, which some analysts would argue is not a valid trendline (a third test is needed to validate the line). This particular line (T1) does not go all the way back to the 2009 low, because that would generate a line that had been untested during almost the entire bull market.

When drawing a long-term trendline on a weekly chart, consider whether the charting service you utilize provides a true weekly chart, or a rolling 5-day chart. If it is a rolling 5-day chart, the trendline you see one week may need to be adjusted during a subsequent week(s) because of the way the data is plotted on the chart. Additionally, your line may not be at the same slope as another trader's line who utilizes a different platform. *Note:* TC2000 (Version 7) plots the weekly chart as a rolling five-day chart.

Figure 1.7 shows the weekly chart of the S&P 500 Index during the same period of time as the Dow in Figure 1.6. The charts look quite similar, but note that the 2010 and 2011 corrections were deeper on the S&P than the Dow, and the 2015 correction was shallower. The 2011 correction on the S&P was so deep that it nearly entered bear market territory. In fact, if you study the daily chart of that correction, it exhibited a bear market configuration. It could be argued that it was a "baby bear" market, a term I've heard used by Sam Stovall, a well-known analyst. However, since it did not officially pass the 20% level, it is considered by many analysts to be a deep correction within the bull market that started from the March 2009 low.

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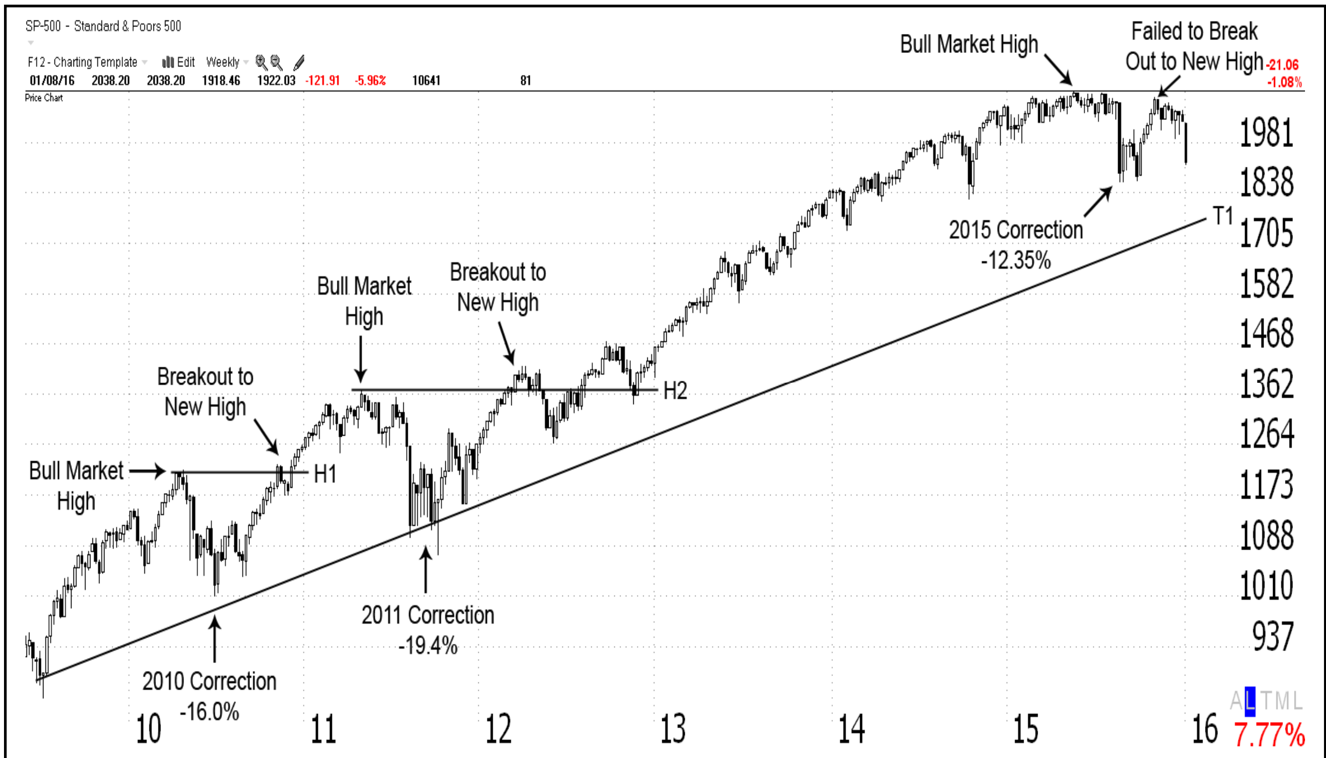

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Figure 1.7
Weekly Chart of the S&P 500 Index – Market Corrections

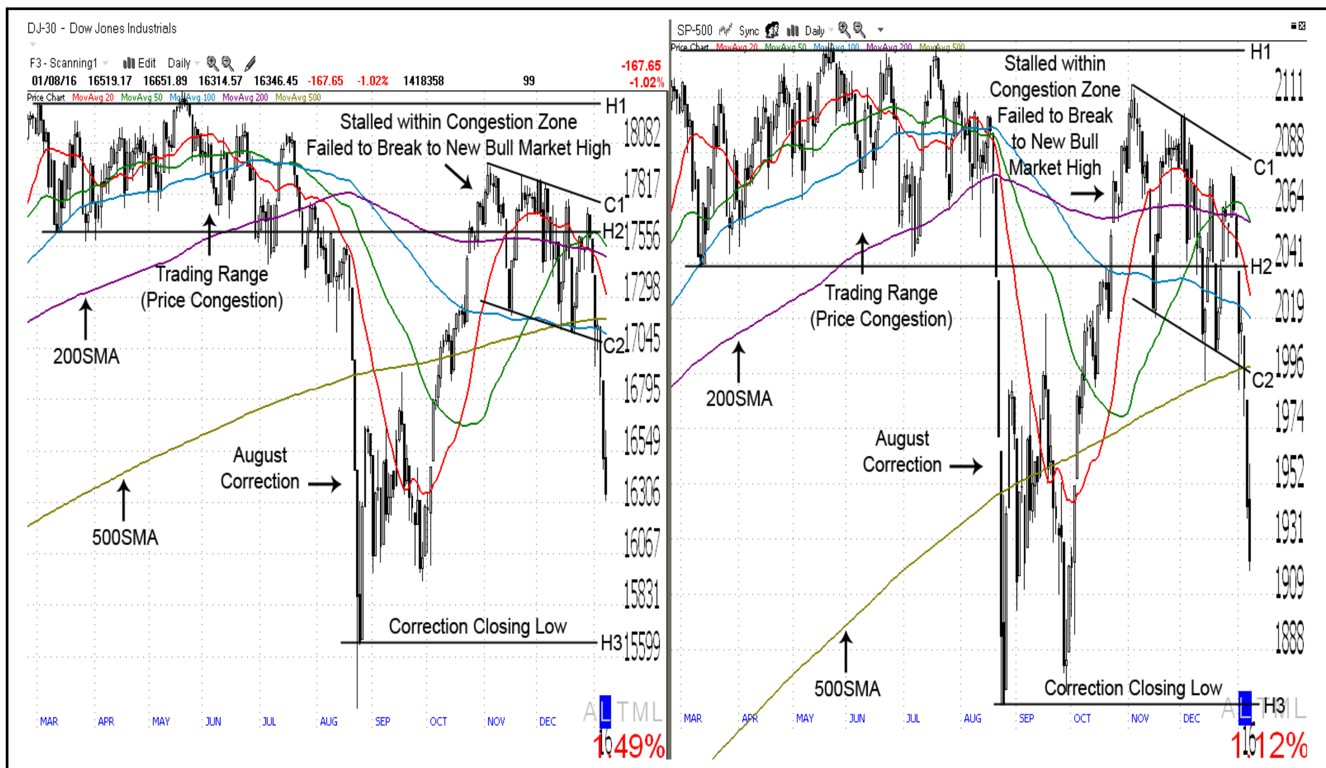

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Figure 1.8
Dow Jones Industrial Average (Left) and S&P 500 Index (Right) – Failure to Extend the Bull Market

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Figure 1.8 shows a two-chart layout with the daily chart of the Dow on the left and the daily chart of the S&P 500 on the right. These charts show the price action during the last several months. You may recall in several of my weekly reports during the second half of 2015 that I mentioned the following at various points, all of which are identified in Figure 1.8:

- The inability of the Dow and S&P 500 to break out to new bull market highs (line H1).
- Price had stalled within the multi-month trading range that was formed during the first half of 2015 (between lines H1 and H2).
- As price was stalled within that congestion zone, the peaks were declining. The path of least resistance was to the downside.
- Price was declining in a shallow descending channel—slightly declining peaks and bottoms (between lines C1 and C2). Last week's sharp selloff was a significant acceleration of the decline.

I've heard analysts mention the 200-day simple moving average (SMA) as a dividing line between a bull and a bear market (Row 4 in Table 1.3). However, I've seen instances where that moving average is broken during a market correction, but price moves back above it as it recovers from the decline, and continues on to higher highs. Thus, although it is certainly worth noting when a correction against the major uptrend is deep enough to break that moving average, by itself, it does not signal a bear market is under way.

Even the very long-term 500-period SMA may be violated during a correction. Both the Dow and the S&P moved under and back over the 500-day SMA during the 2015 correction. They also did so during the 2011 correction without entering a bear market. *Note:* The 500-day SMA is approximately equal to the 100-week SMA, representing about two years of data.

One thing bull markets tend to have in common near their end is that they typically lose momentum. Major uptrends rarely reverse to the downside from a single top in a sharp inverted V-pattern. Rather, the end of a bull market usually occurs as more of a prolonged topping process (Row 1 in Table 1.3), and it can be seen on the chart. There is often a notable change in the rate of ascent of the rising peaks, and/or a shift from up to sideways, before a new bear market begins. Additionally, there may be a negative divergence between the prominent peaks in price, and the corresponding peaks of an indicator that measures the momentum of the uptrend.

Figure 1.9 shows a two-chart layout with the weekly chart of the Dow Jones Industrial Average on both sides. The end of the 2002-2007 bull market is shown on the left, and the last several months of the current bull market (2009 to present) is shown on the right. Just looking at the weekly price peaks reveals the loss of momentum on both charts. During both bull markets, the peaks were rising, but the ascent of their rise slowed. That was followed by a lower peak when the market failed to move to a new bull market high.

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The chart on the left has a head-and-shoulders shape, which was confirmed with a break of the neckline as the bear market gained ground. On the right, it looks more like a double top setting up. The first top was a slow, rounding over action. The second top was sharper, and slightly lower than the first. The combination of the two creates an Eve-Adam variation of a double top. The double top is not yet confirmed—it needs to close below the August low. By the time it is confirmed, if that occurs, the bull market will be well off its high.

The Relative Strength Index (Wilder's RSI) is plotted in the middle panel with a 14-period setting. This is an oscillator, which is typically used to determine short- to intermediate-term overbought and oversold conditions, depending on the setting. However, it can also be utilized to gauge the momentum of a longer trend if looking at the direction of the indicator's peaks compared to the peaks in price, rather than whether the indicator is flashing an overbought reading. On both charts, there was a negative divergence accompanying the slowing ascent of the price peaks.

The RSI is also plotted in the bottom panel, but this time with a much longer 21-period setting. The MACD has also been added in this window, but the plot line has been made invisible. The point of doing that is to leave the MACD's midline behind so it can be used as a midline for the RSI. That makes it east to identify when the 21-period RSI has crossed above or below its midline of 50 on the weekly time frame.

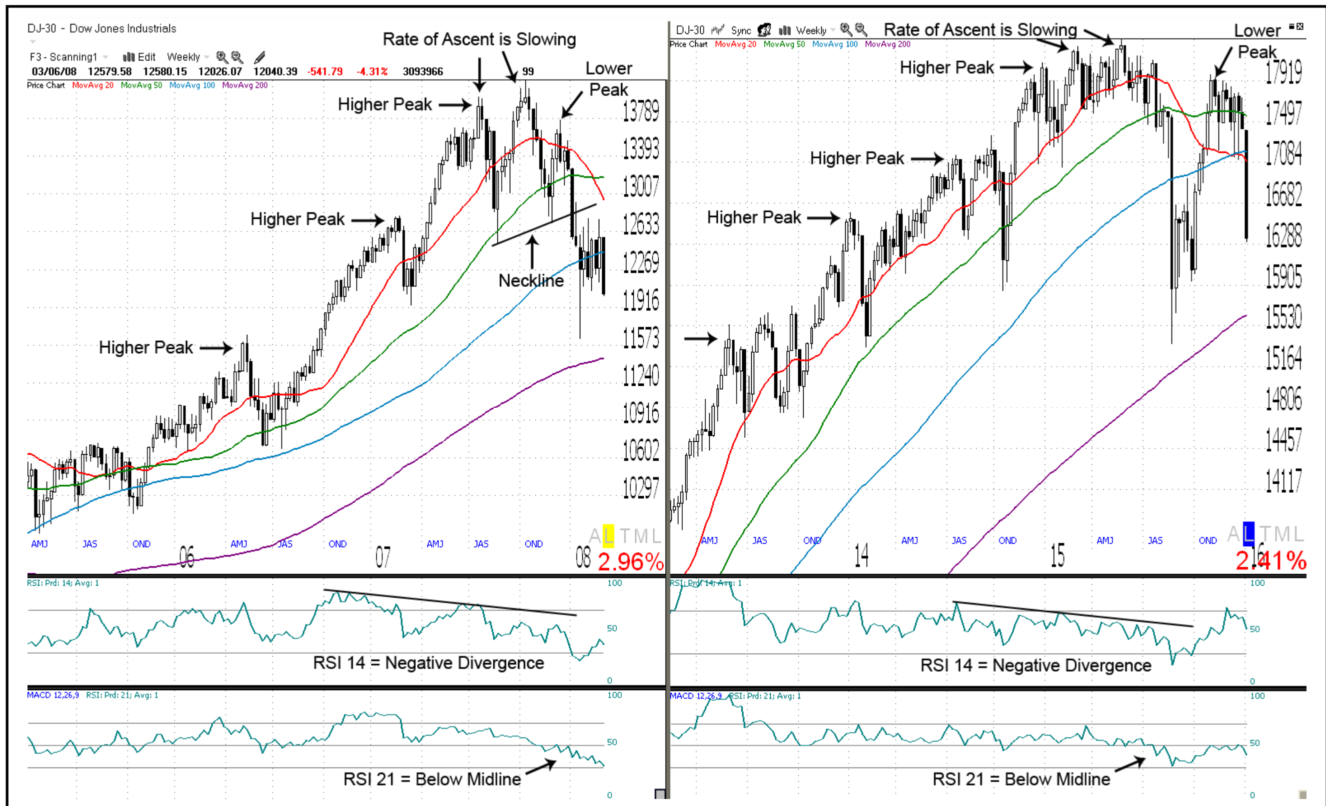

Figure 1.9
Dow Jones Industrial Average – 2002-2007 Bull Market (Left) and Current Bull Market (Right)

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When using the longer setting of 21, the RSI remains above its midline during most of a long-term uptrend, and below it during most of a major downtrend. The 21-period RSI lost momentum going into the final top of the 2002-2007 bull market, and eventually dropped below the midline. It also did so going into the rounding top that formed during 2015.

When you hear comments on the financial shows about the “market” being in a bull or a bear, it is typically the Dow and/or the S&P 500 they are referring to. That is, it is generally the large cap indices that are used to represent the broad market. The Nasdaq Composite Index is also a broad average in that it includes thousands of stocks, so it is frequently referenced as well. Those three indices are considered to be the major market averages. As of last week, all three are technically still in a bull market given that they have not yet fallen 20% off their bull market highs. However, they are exhibiting signs that a shift from bull market to bear market may be occurring. In 2015, the market lost momentum. It went sideways for much of the year, and then the correction during the summer broke the back of momentum. And as I’ve stated several times in past weekly Logan Reports, there are segments of the market that were in a bear market (e.g., energy and other commodities).

Let’s look at the Dow Jones Transportation Average using the concepts in Table 1.3 to analyze the chart. Figure 1.10 shows a two-chart layout with the daily chart on the left and the weekly chart on the right. On the weekly chart, the horizontal line labeled R1 represents the approximate bull market high prior to the 2010 correction. Line CL1 represents the approximate 2010 correction low. It was a very deep correction, nearly entering bear market territory. The index rallied off line CL1, and broke through resistance at line R1 to a new bull market high.

Line R2 represents the approximate bull market high on the Transports prior to the 2011 correction. Line CL2 represents the approximate 2011 correction low. That correction was 28%, so technically it was a bear market decline. However, the 2011 correction low (CL2) did not breach the prior correction low (CL1). If we were to use only the 20% decline concept (Row 5 in Table 1.3) as a definition of a bear market, the Transports experienced a bear market during 2011.

During 2011-2012, the Transports rallied off line CL2 but failed to break above the prior bull market high (R2). The index drifted back to line R1 by about mid-2012 where it bumped along that new support line for several months. The index then rallied up through line R2 and climbed for several months with relatively minor interruptions. The next decline in excess of 10% came in October 2014, when the index fell 11% from the closing high (at approximately R3) to the closing low (at approximately CL3). The Transports then pushed up through resistance at R3 and formed a new top (R4). Price bumped along near that high for a few months.

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On the daily chart (Figure 1.10, left), had you viewed the action that created the R4 top on the weekly chart, as it was occurring at the right edge of the daily chart, you'd see a trading range had formed. At the time, the question was, "Is this consolidation, which will be followed by a breakout to a new bull market high? Or is this a topping process, which will resolve to the downside?" With the benefit of hindsight, we now know the answer.

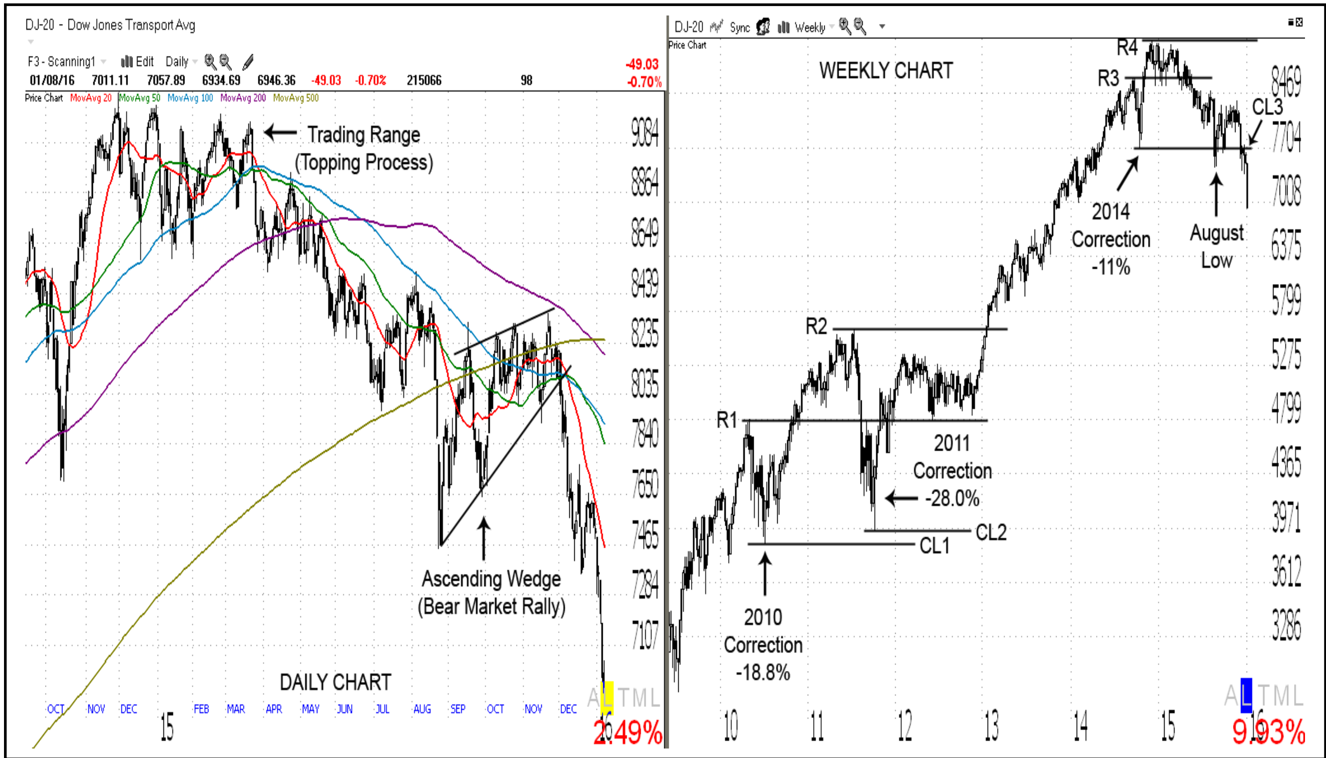

Figure 1.10
Dow Jones Transportation Average – Daily Chart (Left) and Weekly Chart (Right)

Back to the weekly chart on the right in Figure 1.10, the Transportation Average rolled over, broke down through the prior peak (R3), and then broke down through the prior correction low (CL3). The index declined for fell for several months from the R4 peak to the August low. The August-November advance was in the form of a bearish ascending wedge as shown on the daily chart. It was resolved to the downside, and now we can see that it was a bear market rally which was followed by an acceleration of the downtrend in the following weeks.

Although the Transportation Average just officially entered bear market territory last week (per Row 5 of Table 1.3), this index only includes 20 component stocks. If you were to drill down into the industries that comprise the larger transportation segment, you'd find that many of the stocks in those industries (e.g., shippers, truckers, and railroads) were already in a bear market.

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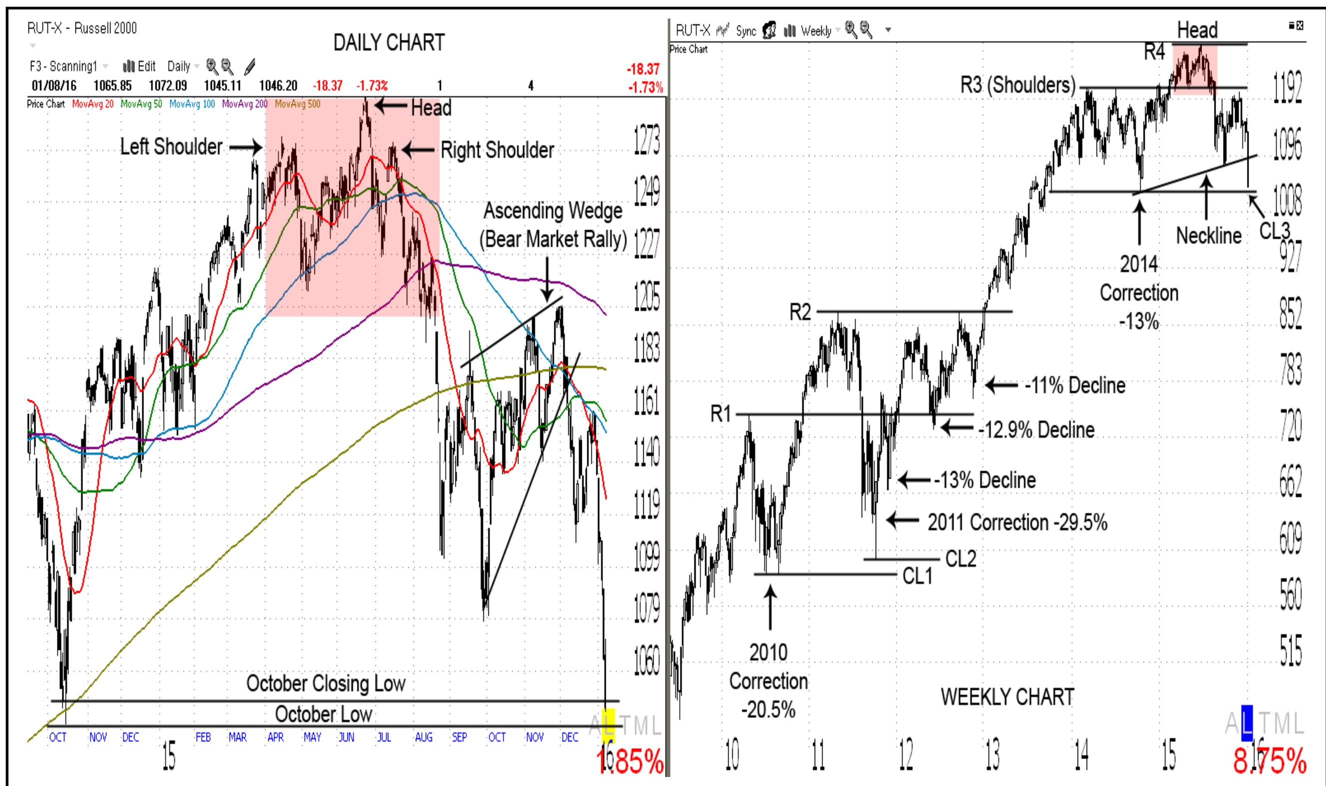
Regarding the percentage decline (Row 5 in Table 1.3), during the last two bull markets on the charts of the Dow and the S&P 500, there have been few corrections in excess of 10%. However, there have been several declines that have averaged between 7-9%. The 10% requirement is arbitrary, but it is frequently touted as the dividing line for a decline to be classified as a correction. In my own analysis, based on the actual declines during the most recent bull markets, I consider a decline between 5% and 10% to be a minor to standard correction on the major market averages, and a decline in excess of 10% to be a relatively deep correction.

The fact that 10% is arbitrary also begs the question of whether the same standard should apply to a very narrow index, such as the Transportation Average; and especially since all of its components are in one market segment. You could argue that the Dow Jones Industrial Average is also narrow, and it is in that it only includes 30 components. However, even though it is still called the "Industrial" average, only a minority of its components are from the Industrials sector. Over the decades, the mix of Dow components has changed significantly to include other sectors, such as Technology and Financials.



TC2000

Figure 1.11
Russell 2000 Small Cap Index – Daily Chart (Left) and Weekly Chart (Right)

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Figure 1.11 shows a two-chart layout of the Russell 2000 Index with the daily chart on the left and the weekly chart on the right. On the weekly chart, note that the 2010 correction technically crossed into bear market territory, though only by one-half percent. The decline ended with a double bottom (CL1). The index rallied above resistance at the prior high (R1). The index topped out again in 2011 (R2), followed by a decline of nearly 30%. Here again, that decline was technically a bear market based on the 20% guideline discussed previously. However, the decline only lasted five months, and did not breach the 2010 correction low (CL1). If you look at the daily chart back then, though, the detail shows the chart exhibited bear market-type behavior (downward legs separated by bear market rallies or consolidation).

The Russell rallied again off the 2011 low (CL2), but it was not a smooth move up. There were three more declines in excess of 11% as the index zigged and zagged its way upward. Those would actually be corrections against a new bull market if we look at the 2011 correction as a bear market. The trend finally smoothed out for a multi-month run up to R3, after which price consolidated for several months. At its lowest point, price declined 13% off the R3 top in 2014. From there, the Russell rallied again through resistance at line R3, eventually forming another top (R4).

If you look at the daily chart (left) for more detail, you'll see that the price action that created the peak at R4 on the weekly chart was a head-and-shoulders top on the daily chart. The price action is highlighted in pink on both charts. The whole pattern on the left formed between lines R3 and R4 on the weekly chart. That daily head-and-shoulders top has already followed through to the downside, exceeding the target for the pattern by a significant amount by the time it formed the August low.

As shown in Table 1.1, the Russell is down more than 19% off its bull market high, so it is nearly into bear market territory. With the benefit of hindsight, it looks like the advance from the September low to the November high on the daily chart in the shape of a bullish ascending wedge may have been a bear market rally. And that formed the right shoulder of the head-and-shoulders pattern setting up on the weekly chart. That lower peak shows the loss of momentum of the major uptrend. Last week's decline broke the upward sloping neckline, but has not yet violated the 2014 correction low (CL3).

In Conclusion

Now back to the question, "Is this still a bull market, or is it a new bear market?" Segments of the market are in a bear, and other segments are still technically in a bull. I can't guarantee that the major averages won't stabilize and charge upward resuming the bull market. However, I look at the charts and see the loss of momentum of the major trend, and later we may look back and see that it was a bear market developing.

I've discussed in past Logan Reports the difficulty of identifying a bull market top. Following are a few reasons why it is difficult:

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1. Nobody rings a bell at the end of a bull market. A bull market usually tops out with more of a prolonged topping process rather than declining from a single price point.

2. The price formations can cause confusion. What appears to be a negative reversal pattern (e.g., a double top), may continue sideways and ultimately break out to the upside proving to be a continuation pattern. Conversely, a period of prolonged sideways movement may break to the downside and prove to be a topping process (e.g., a rectangular-type top).

3. The first leg down of a bear market usually looks like just another bull market correction.

4. The rally following the first leg down of a bear market usually looks like a resumption of the bull market. When looking in the rear-view mirror, after the downtrend has resumed, it will be clear that it was actually a bear market rally.

5. Bull and bear markets are driven by fundamental forces. Economic changes occur over a period of time, so it is difficult to identify a turning point based on economic reports and indicators.

There's no single indicator that I am aware of which identifies the precise turning point of a major trend. It is only certain with the passage of time. By the time it can be stated that a market has definitely shifted from a bull to a bear, the market is typically well off its bull market high. Therefore, I tend to put most of my energy into analyzing the intermediate-term movements within the longer trend, and the periods of prolonged sideways movement, in order to take advantage of the trading opportunities those movements offer. I can't trade a seven year bull market as a whole, but I can benefit from the directional movements within it, to the upside and downside.

When a bear market does take hold, keep in mind this concept: "The bull walks up the stairway, but the bear jumps out the window." The average bear market for the major averages is significantly shorter than the average bull market. In my book *Profiting from Market Trends* (Wiley & Sons, 2014), I included chapters on bull markets and bear markets. In my research, I identified the bull markets on the Dow Jones Industrial Average over the past 50 years (excluding the one that began in March 2009 because it was still in force), and found the average bull market lasted approximately 3.9 years. In contrast, the average bear market of the past 50 years lasted approximately 1.2 years.

Look again at the concepts in Table 1.3. By the time price takes out the prior correction low, or a long-term moving average or up trendline, or declines 20%, it is well off the bull market closing high. Thus, those concepts do not identify the turning point of a major trend. Rather, they serve to help determine whether a bull market is still in force, or has shifted to a bear. In fact, of the ten bear markets I identified in my book, five of them were declines of 21% to 27%. Hence, by the time price had fallen the requisite 20% touted as the dividing line for a bear market, the decline was nearly over.

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Given the difficulty of identifying, with certainty, the end of a major trend (a bull or bear market), I focus on the intermediate-term movements within the long-term trend. Since I began publishing my weekly Logan Report in August 2013, I've continually shared my analysis of the intermediate-term up legs within the bull market, and how I monitor the corrections for signs of bottoming action in order to participate in another potential leg up. During a bear market, I monitor the down legs, and the bear market rallies, for opportunities those trends provide for selling short and going long.

If a bear market is now in progress for the large cap indices, it doesn't necessarily mean the averages will fall as far as they did during the 2007-2009 bear market. That was a very severe bear market, the worst since the 1973-1974 bear. The Nasdaq is another story—it has experienced back-to-back severe declines. It lost nearly 80% of its value during the 2000-2002 bear market, and fell more than 55% during the 2007-2009 bear. It took 15 years for the Nasdaq to recover back to its 2000 high.

If the bearishness continues, I'd be surprised to see the Fed hike the short-term interest rate again at the next FOMC meeting. The employment report was good, but some other economic reports have suggested slowing, and the lowered GDP estimates make the U.S. more susceptible to a recession (though that is not generally seen as a high probability at this time). The Chinese market woes spilling over into global markets has significantly increased the volatility. These are things the Fed is undoubtedly noticing.

Ironically, the Fed started raising rates into a potential economic downturn (slowing growth), a profit recession, and no real threat of inflation. Job creation has been chugging along, but the wages are not up much and participation rate still historically high. On Friday, Mohamed El-Erian, Chief Economic Advisor at Allianz, suggested that the market is in the process of re-pricing investor confidence in the infallibility of central banks.

Coming Next Week…

First, let me thank you for your patience in receiving this weekend's report. As you can see, it entailed a lot of thought and time spent on the illustrations. I had planned to provide a new Stock Talk segment in this report, but because of last week's sharp selloff, I felt it was timely, and more important, to provide in-depth analysis of the market averages. Barring any market catastrophes next week, the Market Education segment will be replaced with a Stock Talk piece in next weekend's Logan Report.

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