Getting Technical

The Bull Market Is Aging, but Hasn't Lost a Step

With the Dow notching a fresh all-time high, charts say the market is once again firing on all cylinders.

By Michael Kahn
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Last week, I wrote here that by watching how the market handled itself in the aftermath of the June 24 selloff we'd get an important insight into the strength of the bull market (see Getting Technical, "Bull Market Still Intact," June 25). We didn't have to wait long. Several major indexes rebounded to new highs within days.

The wake-up call, as I labeled it, that day served to knock back enthusiasm a bit, and while many sentiment gauges are still warning about excessive bullishness, we cannot argue with the market's trend. There seems to be more bull market to come.

Bearish pundits will argue that slowing earnings expectations, as well as the Federal Reserve's exit from its bond purchase program, even though it is widely known, will be major problems down the road. I do think that the lack of meaningful correction over the past few years and, yes, excessive bullishness, will cause that correction to be rather beefy when it does finally arrive.

That is not meant to scare anyone, and I am certainly not suggesting a market crash is on the way. Even in 1987, we had ample technical warning that the market was not healthy before things collapsed.

The hoopla surrounding the 17,000 level on the Dow Jones Industrial Average is a good way to boost cable-TV ratings, but these 1000-point milestones are not quite as meaningful as they once were. After all, 1000 Dow-points is less than a 6% move at current levels.

What I find more important is the resurgence of the Nasdaq and small company stocks. To be sure, the Russell 2000 is still lagging the Standard & Poor's 500 for the year, but it has finally ground its way back to its March highs (see Chart 1). It may not have closed at a record high during Tuesday's big market rally, but it did trade there intraday to complete the comeback.

Chart 1

Russell 2000
Even better, the Russell Microcap Index, where the average stock capitalization is roughly $500 million versus $1.9 billion for the Russell 2000, is showing some moxie again.

Although the micro-cap index has not recaptured its own March highs yet, it has outperformed the market since May and was the top percentage gainer in Tuesday's rally. To me, that suggests risk-taking is back to a proper bull market level but not so high as to suggest rampant speculation.

True, that conflicts a bit with other sentiment indicators that suggest excessive bullish opinion. However, I differentiate between opinion and actually putting money to work. As they say, talk is cheap.

The strategy that is working is simply following the trend, which remains to the upside. Of course, some day there will be reason to step aside. Perhaps Thursday's June nonfarm payrolls report will offer honey for the bears. Wednesday's ADP payrolls report did not.

I'd prefer to see technical deterioration before declaring the bull to be over. It could be a decline in market breadth according to the New York Stock Exchange advance-decline line. That indicator hit a record high Tuesday.

Perhaps the number of new 52-week highs will fall, indicating that fewer stocks are driving the market higher. For now, however, that indicator is also showing a healthy performance.

But there is one factor that does create a bit of a worry. The Treasury bond market had been in rally mode all year and while many, including me, thought it was a flight to safety, the rising stock market did not bear that out. So now, with the iShares 20+ Year Treasury Bond exchange-traded fund (ticker: TLT) making a preliminary breakdown below the rising December trendline I highlighted last week, I have to consider something different. Perhaps it will be rising interest rates that pose a problem as the summer progresses.
For now, the stock market is holding its own. It ignored the "Sell in May" mantra and seems not to be worried about rising energy prices. I don't know when this will end, but for now it is hard not to be part of the rally. Maybe the reaction to the Thursday jobs report will change my mind.

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