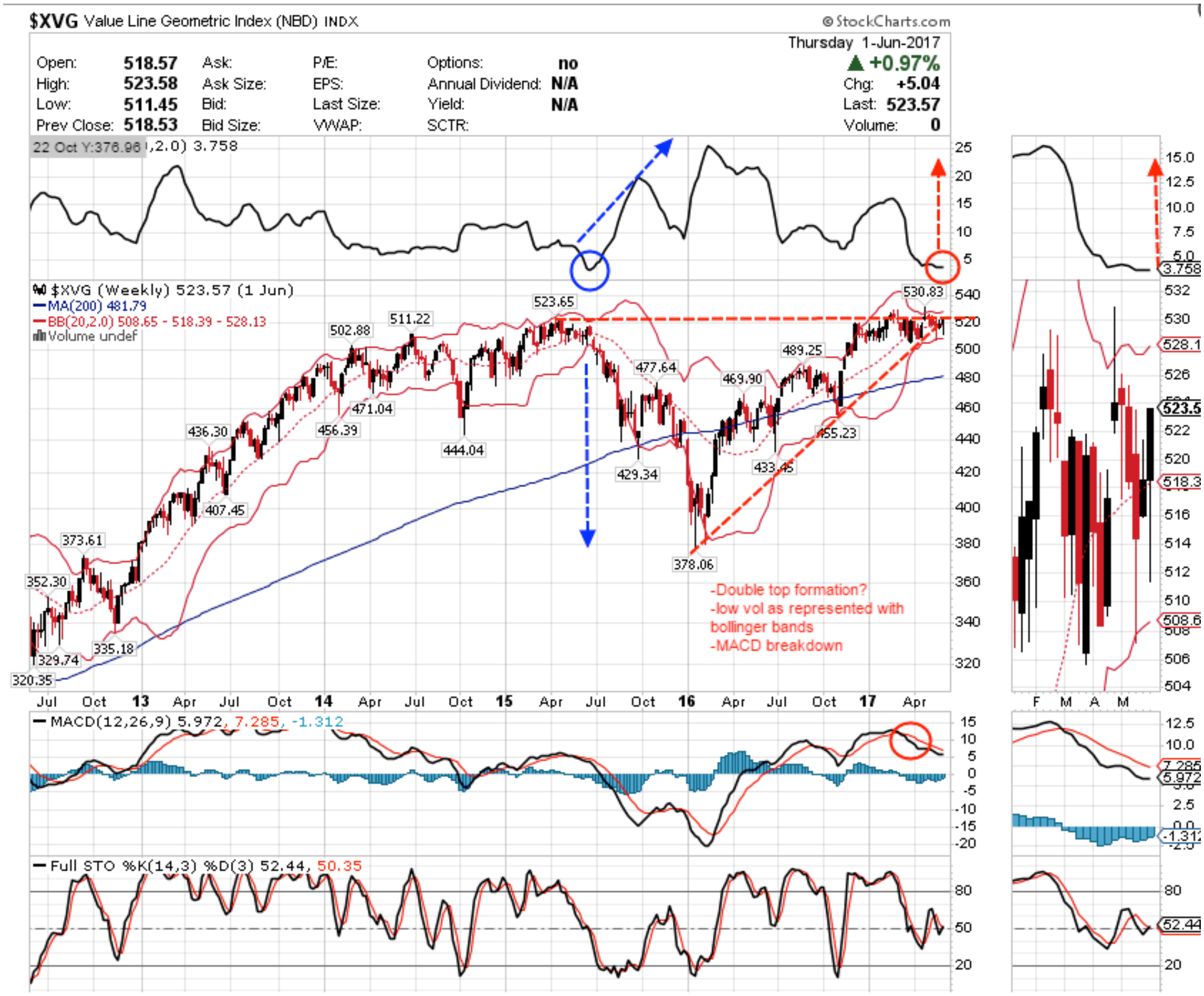
Stock Market or Market of Stocks?

When investors and market participants seek to understand the market they generally look to the major indices as their authority to tell them. This would include the Dow Jones Industrial average, Nasdaq 100, and the S&P 500 along with other variations and derivates of those indices. These collections of indices are usually regarded as the stock market and as a result are used to implicate and describe every other listed stock. Although this method is pervasive throughout the industry it is most likely not the purest way to look at the overall market. For instance the Dow Jones is only a collection of 30 listed large cap stocks which really could never effectively represent the over 5k listed stocks. The Nasdaq is a index which is heavily weighted towards technology and biotechnology. Apple makes up nearly 15% of the Nasdaq with Amazon, Google, Microsoft, and Facebook totally just over another 15%. This is to say as the technology sector goes the Nasdaq goes. Likewise, the S&P 500 is weighted by market cap. This means that again the mega cap tech stocks and Dow Jones listed large cap stocks will represent a disproportionate amount of sway within the index. For these reasons it may be better to look for an alternative index when trying to evaluate the market.

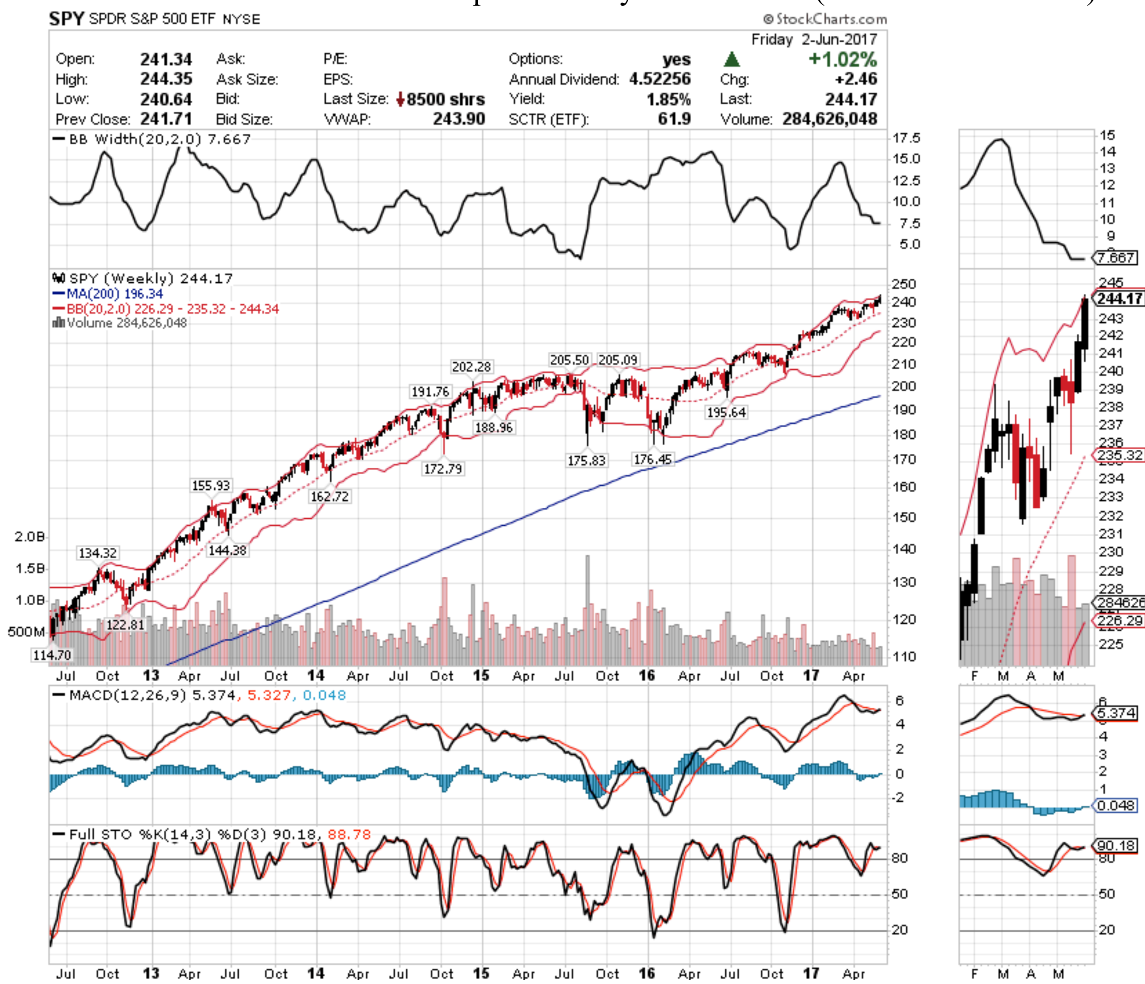
In my Opinion the index that represents the market in the purest sense is the Value Line Geometric Index (XVG). The Geometric index takes the perspective of having a market of stocks and not a stock market. This is because this particular index has an equally weighted distribution of stocks and derives its price from the mean or average daily move of all stocks. With so many distractions in the market place it is important to be able to find ways to minimize the amount of "noise" in valuations of the market. The Geometric index removes the "noise" and allows you to adsorb the true moment, breadth, health, and trend of the equity market. With that being said it may be useful to look at the current state of this index to create a more accurate macro picture.

Below is the current Chart of The Value line Geometric Index:



For reference the indicators being used are the MACD, Stochastic Oscillator, Bollinger Bands, and a measurement of the Bollinger Band relative width. The first thing you may notice is the possible double top formation that could be maturing. This pattern started of the February 2016 correction lows and now appears to be losing momentum (and volatility) near the previous index high in the summer of 2015. Double top formations are a bearish formation and generally signal a reversal in both price and trend. Something else to pay close attention to is the breakdown of the MACD. Although it is normal for stocks and markets to catch their breath before moving higher we should caution that further breakdown and widening of the MACD does not bode well for the current uptrend. Perhaps most alarming is the lack of volatility. This can be seen in the tightness in spreads between each Bollinger band. Each band represents 2 SD above and below a 20 period MA. When spreads are tight volatility is low and is expected to revert back to the mean with an increase in vol. When spreads are wide volatility is high and is expected to revert back to the mean with a decrease in vol. currently, the Bollinger Bands are extremely tight and are at a spread width last seen at the highs of July 2015. This may be seen as further evidence that a return to vol is imminent. Although this does not indicate direction of vol the double top formation with a weakening MACD and Stochastic would imply a pick up in a downside move. Further weakness in price and momentum are needed to make a definitive call as to the validity of the chart pattern.

When you compare the chart of the Geometric index vs. that of the S&P 500, the difference is staggering.
Below is a chart of the S&P500 as represented by the ETF SPY(SPDR S&P500 ETF):



The patterns are completely different as the above chart misrepresents itself as a true indicator of stocks. I am not implying that no information, knowledge, or profits can be made from the major indices but rather you handicapping yourself. It be like driving with one eye covered. Yes you could probably make it to your destination just fine, but maybe you won’t. It’s not ideal to drive partially blind and it’s also not ideal to invest partially blind either. Use both eyes. Use the Geometric index.