BILLS ASSET MANAGEMENT

BAM MARKET NOTE

OCTOBER 5, 2018

SAM BILLS (865) 525-1329
BO BILLS (615) 371-5928

The S&P has struggled a bit over the last couple of weeks. Earlier today, the much watched index moved back down to the support found at the January highs (2873). This is a very important level and to this point the S&P is holding above. The level is even more important as it also coincides with the current reading of the 50 day moving average. A failure for the S&P to hold above support, would likely lead to increased selling pressure. Next week should see some resolution. With earnings season starting in earnest it could turn out to be a volatile October.

The S&P is not the only index at a crucial level. We have been highlighting the relative weakness of the Russell 2000 and Nasdaq for a few weeks. The current weakness in the small cap space is very troubling and the Russell now sits tenuously close to the 200 day moving average. Many investors and advisors use the 200 day moving average as a barometer of whether we are in a bull or bear market. While we don't believe we are anywhere near a bear market, the weakness in small caps is cause for great concern. A decisive break below the moving average could lead to a rash of selling on the other major indices.

Our Point

We were hoping that weakness in the small-cap and technology space would be overcome by strength in the large-caps and multinationals. To this point, that has not happened and we began to see an acceleration in the divergence this week. Though the losses in the S&P have been modest over the last two weeks, there is no denying the increased weakness. Normally, the modest weakness in the S&P would be viewed as normal market action (and indeed it might be), however, the declines in the Russell and Nasdaq may be foreboding a scary October. There are a number of conflicting and confusing indicators currently. Interest rates are surging (up 13% over the last month) and are at their highest levels since 2011. As of now, there has not been a flight to the safety of treasury bonds (interest rates would be falling). However, the VIX (an indicator of market risk) spiked up to near 18 today before settling in at 15 – it is up nearly 30% this week. The advance/decline line of the NYSE along with high yield bonds have weakened decidedly. Yet, the long-term uptrend in the S&P remains firmly intact. The bulls are hoping that earnings season will provide the fuel for the market to turn back around. We should know soon as earnings season kicks into high gear over the next few weeks. The weakness in the markets has led us to take a few defensive measures this week. We were already holding a significant cash position but did sell one position and entered into another position that moves up as the market moves down. The increased cash and the inverse market position should damper portfolio volatility. We will be watching closely next week for additional clues for the near-term market direction and will make additional changes as warranted by the market environment.