



Expect Volatility To Shrink In November—Mike Swanson (11/01/2015)



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This monthly newsletter goes out to people on my free email list. Most of these people are extremely bullish now on the stock market as they reflect the mass psychology in the market now. You can see this in the surge back up in the Investors Intelligence Survey in the number of people calling themselves bulls on the market and the drop in those calling themselves stock market bears. I see it personally in emails I get from people, and most of the emails I have been receiving are from people almost crazed about the stock market and angry at me for telling people that the stock market is now risky and dangerous.

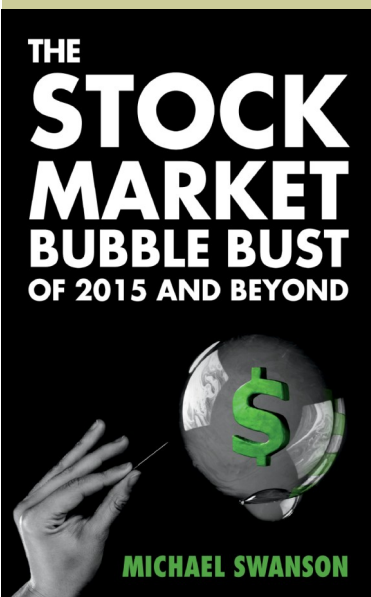
If you are new to this monthly newsletter then you need to know that back in July I warned people that the bull market that began in March of 2009 was coming to an end. You can read this issue here:

<http://wallstreetwindow.com/wswmonthly/wswmonthly07082015.pdf>

And in August I once again pleaded with people to protect themselves ahead of what would be a violent stock market drop:

<http://wallstreetwindow.com/wswmonthly/wswmonthly07302015.pdf>

One of the things that happened with the market going into the August drop was that volatility in the stock market shrank as the DOW went into a trading range for most of the year. I pointed this out at the start of August and warned that this meant that a big move was going to come in the markets and that it

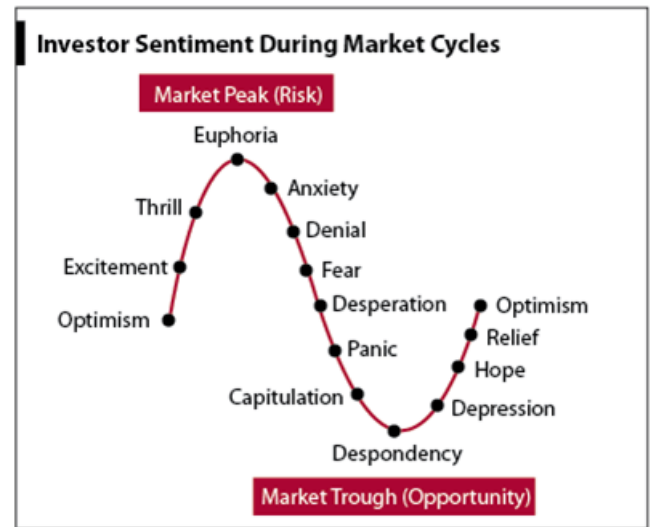


would likely end up being a down move to begin a new bear market. And then at the end of August we saw the market dump in four days at such a rapid rate that it took everyone by surprise.

It surprised me too. I was not looking for the DOW to open down 1,000 one points one morning, but it did. Then in September the market continued to trade in a wild manner with big swings up and down. I told people that the bear market was still one, but then in October we got a rally that took me by surprise. I thought the S&P 500 would rally back up to the 2000 area, but it managed to get back above the 2090 level for a brief moment of time last week.

I still view this as a bear market rally, because of what is happening in the internals of the stock market when it comes to the behavior of the sectors in the market and individual stocks when compared to the market averages. Most stocks simply are not rallying up with the market and many now are starting to decline again. Members of my Power Investor private group know what is happening, but most people on my free email list really have no idea what is going on and many of these people are totally bullish on the stock market now, because they have seen it rally in the past few weeks and everyone is telling them it is going to go up forever. And they want to believe that.

Last week I picked out some great stocks to bet against for the Power Investor group and have more to come. In my view we are getting a simple bear market rally that marks the denial phase of this bear market. That comes when you get the first initial bear market drop and then a bear market rally that everyone thinks is just a correction and new bull run. But in the past the corrections led to runs through the 200-day moving average and beyond, but in bear market rallies all you get are moves back up to the 200-day moving averages that then peter out. The market hits them, sometimes even goes through them, and then drifts for a few weeks before rolling over and going down again. How many times did gold and mining stocks do this in their last bear market and how many times did the US stock market do this in it's 2007-2008 bear market and it's 2000-2003 bear market? The answer is many. Take a look at the chart on the right for just one example.



But the masses love to buy after the market goes up and so cannot help themselves. They must buy into bear market rallies and believe and few of them learn anything from the past.

You may disagree with this analysis, and I am not going to spend time today trying to convince you of it. Right now I want to bring something very simple to your attention that can help you this month. The US stock market is lined up to do something simple and very obvious.

I do not care if you believe this is a bear market or a bull market there is one thing that is crystal clear and that is that we have seen some giant swings both up and down in the market since the end of August. Whatever you think of the ultimate market direction you can agree that this is true.

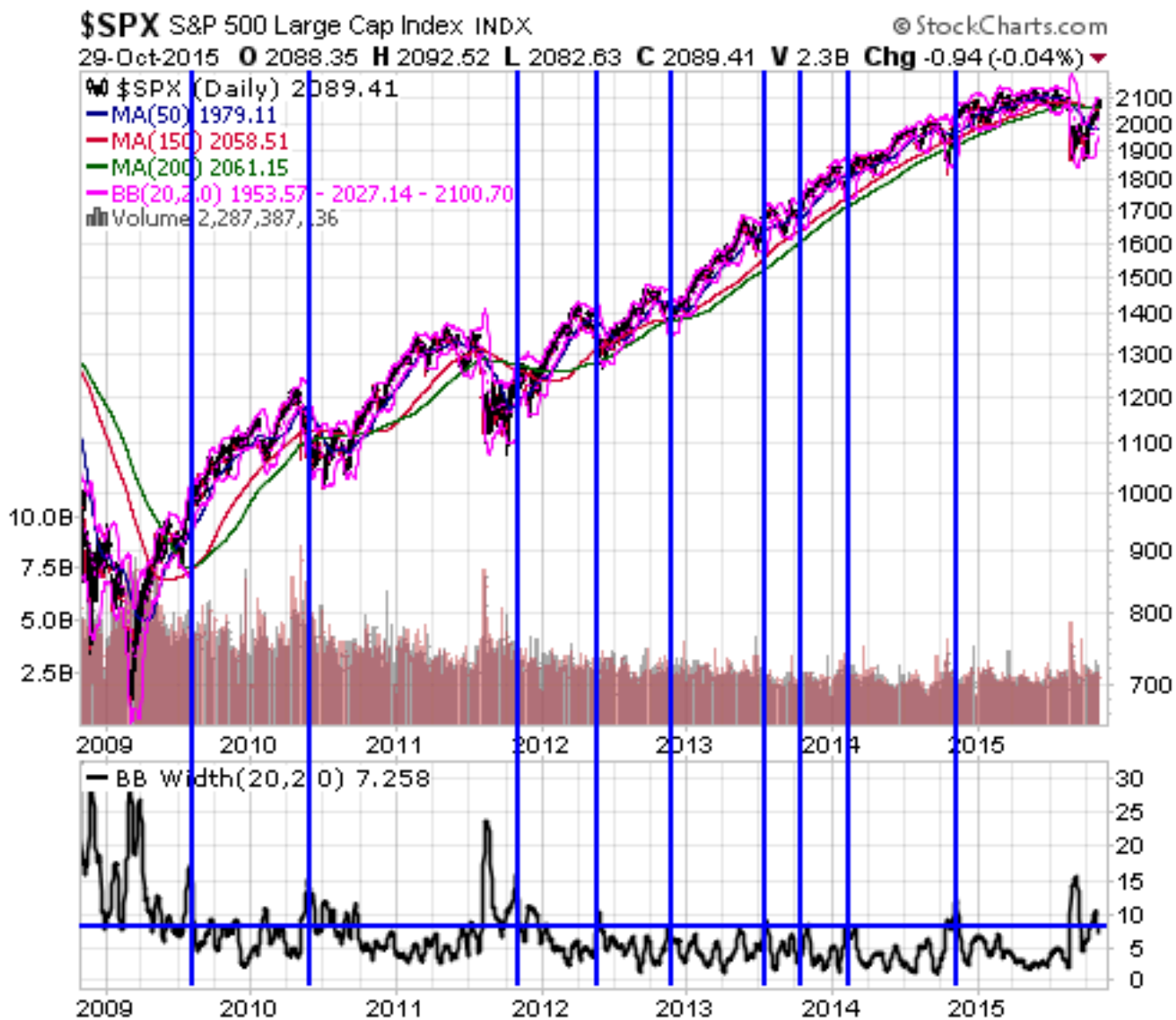
Now people like to think market "volatility" comes when the stock market drops a lot, but volatility also happens when the market makes a big move to the upside in a short period of time. When the market drops a lot in a fast amount of time the VIX spikes up and you often get either a bottom, if it is a bull market, or some sort of bounce or bear market rally if it is a bear market. We saw that happen after the August drop. I wasn't surprised when the market rallied into the September Fed meeting and then dropped, but was surprised when it made a "double bottom" by holding its August lows, but it did for now and that sparked a big market rally in October. It was one of the biggest gains in the market in a short space of time seen in years even if it wasn't big enough to take the market up to new highs.

Now people make almost make notice of market volatility when it happens to the upside. But when the market surges up at an extreme rate something almost always follows and that is a period of sideways action for several weeks. No matter whether it is a bear market or bull market this is almost always what happens.

And this is what has happened in all of the rallies since the last bear market ended that have resulted in as big of an expansion in market volatility as this one has.

I measure this by looking at the daily 20-day Bollinger Bands. They go wide apart from each other when volatility expands in a market and narrow when it contracts. When it expands it represents an extreme drop or rally that is about to run out of steam and then lead to a period of sideways action.

On the chart on the next page I have the Bollinger Band width indicator using the 20-day Bollinger Bands at the bottom of the chart. It is now above 10. I have drawn lines on all of the past times it has been above 10 since the bear market bottom of March of 2009. After all of these times there were a period of sideways action in the market for at least a few weeks and often a dip back down to previous support levels.



What this means is that we can expect the market to go sideways for most if not all of November. In bear markets after bear market rallies of this size you typically see a sideways period of a month or so too and then the start of a new leg down. So whether this is still a bull market like so many say it is or a I bear market as I have been telling you either way we can expect the market to do very little in November and mainly go sideways. So if you are bullish on the market then you must look for the market to consolidate its recent gains in November before it will be able to have a sustainable rally back up to its highs and beyond. So be patient before you do any buying. There is no need to buy now. Wait. Now if we get a period of sideways movement in the US stock market in November we will be able to look beyond the averages to determine whether it represents a pause before another big bull market rally or a topping pattern that will be a prelude to another big drop.

We will be able to figure out which is the case by seeing if many stocks are trading with the market averages or if most stocks are trading

weaker than the averages are and are trading down in November. If the latter is the case then we will know that the markets averages will turn down again. That type of action is what tipped us off to the July top.

Right now there are several weak sectors that are in a position to drop in November no matter what. I am already focusing on them for short-sell and put options ideas for Power Investor members. Last year casino stocks topped out in October and have been going down ever since even though the market rallied into this past Spring and July. There are some sectors that are likely to do what the casino stocks did and just fall into oblivion no matter what the stock market does. A market rally like this creates a great moment and opportunity to bet against the worst stocks and sectors in the market. You do not want to do such bets AFTER the market has already fallen, but instead after it has rallied. That is how short selling and betting against the stock market works.

At the same time you do not want to buy AFTER the market has already rallied quickly in a short space of time, but buy on dips and after periods of sideways consolidation that prove themselves to be a buying opportunity. So if you are bullish be patient about buying and wait to see if this is going to be a real pause or a horrible bear market trick. I will be monitoring this situation very closely for you in November. I expect the sideways pattern will play out for a few weeks and once it does I will update you on what is happening inside the stock market. You will not make decisions based on simply looking at the market averages, but by knowing the total picture of the market.



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