Groundhog Day

If you've ever seen the movie *Groundhog Day,* starring Bill Murray, you will completely understand where I'm about to go. In the movie, Bill Murray is stuck in a time loop. He wakes up the exact same time every day to the same song. No matter what he does throughout the day, he fails to alter the universe enough to shake him out of the time loop. It didn't matter if he stole money, went to jail or killed himself along with Punxsutawney Phil, he still woke up every day at 6:00 AM to the tune of "I've Got You Babe".

Well, some days I feel as if we are all reliving *Groundhog Day*. Over the past 6 months, the S&P 500 has traded roughly in a 90 point range from 2,040 to 2,130. By all accounts, we have essentially gone nowhere. During this time, we've had a few minor shocks here and there, but at the end of the day, we still ended up in the same place. Not even the following has been able to derail this anti-climatic market and push us out of the current trading range.

- The fear of Greece leaving the Euro.
- Commodities making another run to lower levels.
- A short term spike in U.S. interest rates.
- The Chinese stock market declining nearly 30% over a two week time period.
- A high probability we see a third quarter in a row of declining S&P 500 corporate earnings.

Since I first started writing this column in December 2014, the S&P 500 is up 1.4%. In that monthly piece, I highlighted a few indicators foreshadowing slower growth in the future. The flattening U.S. Treasury yield curve (10 year minus 2 year), declining commodity prices (CRB Index) and the relative underperformance of U.S. small cap stocks (Russell 2000).

Guess what?

It's 6 AM and your alarm clock is playing... "I've Got You Babe".

That's right. The same conditions that were present at the beginning of December are with us today. The U.S. Treasury yield curve continues to flatten and now stands at 152 basis points, which is 18 basis points flatter than back in December. The CRB Index just declined another 9.2% in July and is now over 20% lower than where it stood 8 months ago. Lastly, in July the Russell 2000 underperformed the S&P 500 by 2.7%, as the Russell 2000 declined 1.4%, while the S&P 500 was up 1.3%. All of these indicators point to slower growth ahead; however, the overall market surely doesn't seem to care. And, so we go to sleep and wake up to find ourselves still smack in the middle of the trading range.

Even though the stock market has gone nowhere, the majority of the underlying components have acted quite differently. According to Investopedia, market breadth is defined as the following:

"A technique used in technical analysis that attempts to gauge the direction of the overall market by analyzing the number of companies advancing relative to the number declining. Positive market breadth occurs when more companies are moving higher than are moving lower, and it is used to suggest that the bulls are in control of momentum. Conversely, a disproportional number of declining securities is used to confirm bearish momentum."

On the surface, the S&P 500 looks just fine. At the end of July, the S&P 500 closed up 2.18% since the start of the year and is only down 1.27% from the record closing high set on May 21 of this year. For all intents and purposes, the S&P 500 is basically trading at an all time record high. Again, the headline number and performance look great. However, when reviewing the individual companies that make up the index and the associated breadth, one may come away utterly confused. Let's take a look at where the S&P 500 and the average stock within the S&P 500 trade relative to its 52 week high.

% Below 52 Week High	
S&P 500	-1.27%
Average stock within the S&P 500	-14.00%

You might be wondering how this is even possible. How can the index practically be at a record high, while the underlying companies making up the index are much worse off? Therein lies the rub. As long as a few of the largest companies in the index do very well, the overall index can power higher or at the very least maintain its level. In fact, six out of the largest sixteen companies in the S&P 500 have made up nearly all of the positive performance since the start of the year. This list includes Apple, JP Morgan, Pfizer, Amazon, Google and Walt Disney. Basically, a few stocks are propping up the entire S&P 500. As you see from the table above, the average price performance for all 500 stocks in the index is down 14% from its 52 week high. It is unbelievable the overall market has hung in there with all of the underlying weakness.

Another popular way to measure breadth is by analyzing the total number of advancing vs. declining issues and the number of new 52 week highs vs. 52 week lows traded on the New York Stock Exchange (NYSE). In theory, as the market goes up, you want to see advancing issues exceed declining issues. In addition, you want to see a greater number of issues trading at a 52 week high vs. trading at a 52 week low. A greater number of highs being set in relation to lows is confirmation of a likely sustainable broad market rally. Recently, there were two trading days that stood out like a sore thumb - July 17th and 18th. Both of these days saw the S&P 500 close higher than the previous day. Also, both of these days closed within a whisker of the all-time record high close, 0.20% and 0.12%, respectively. However, the positive broad market performance masked the underlying weakness among all stocks traded on the NYSE. On July 17th, we saw 1.8 times more declining issues relative to advancing. There were 2.1 times more declining issues to advancing on July 18th. In addition, both days saw 2.6 times more issues trade at a 52 week low over those that traded at a 52 week high.

Now, let those stats sink in for a little. Not only is the market trading near an all-time high, but more issues are also trading at a 52 week low than a 52 week high. Any rational person would think it should be the complete opposite, and they would be correct! But it's not, and this is the hand we've been dealt. How long will it take before the underlying weakness overwhelms the broader market? That's anybody's guess. Maybe it never happens and the underlying weakness reverses itself setting the stage for record highs in the S&P 500. Who knows? For now, the market continues to shrug off any bad news, while we remain stuck in a time loop of the current trading range. If the most recent history is any guide, no matter what happens today, you'll wake up tomorrow at 6AM with your alarm clock playing... "I've Got You Babe".

--Billy Little, CFA

"It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have it, it requires ten times as much skill to keep it." ~ Ralph Waldo Emerson