

Commodities Weaken, Early Cycle Sectors Improve

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Marcus Aurelius

Jun 21

Executive Summary

Commodities are beginning to weaken which is in line with the next stage of the Business Cycle. We need to see a downtrend emerge of Lower Lows and Lower Highs before we enter into the next stage.

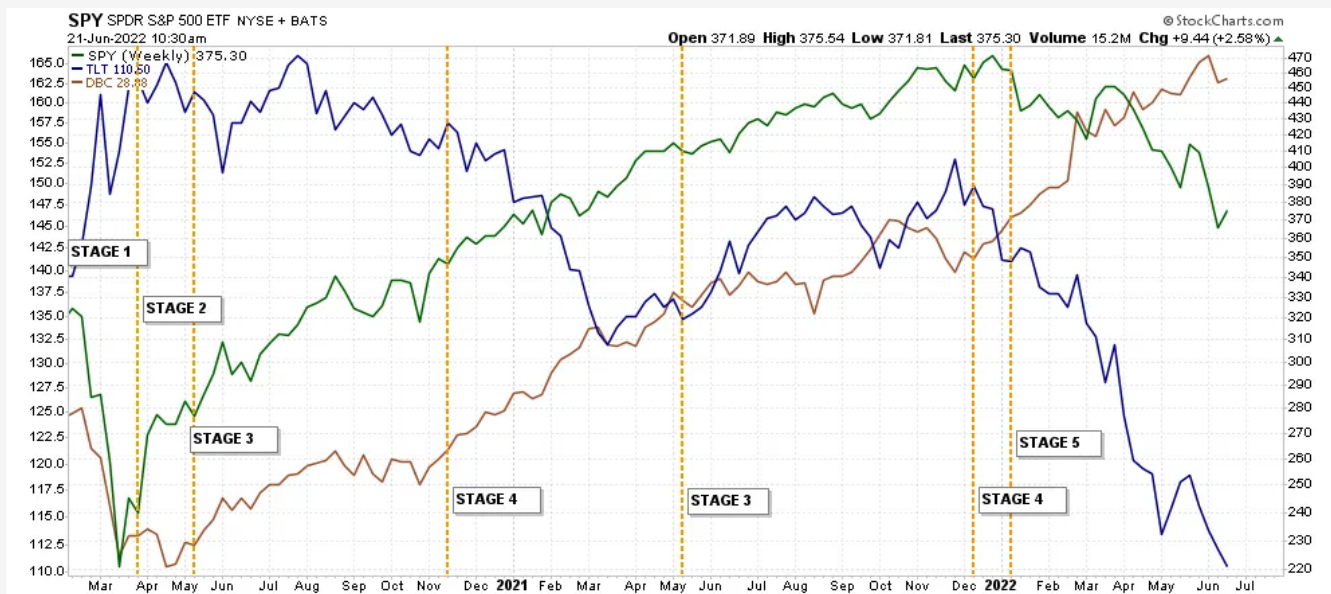
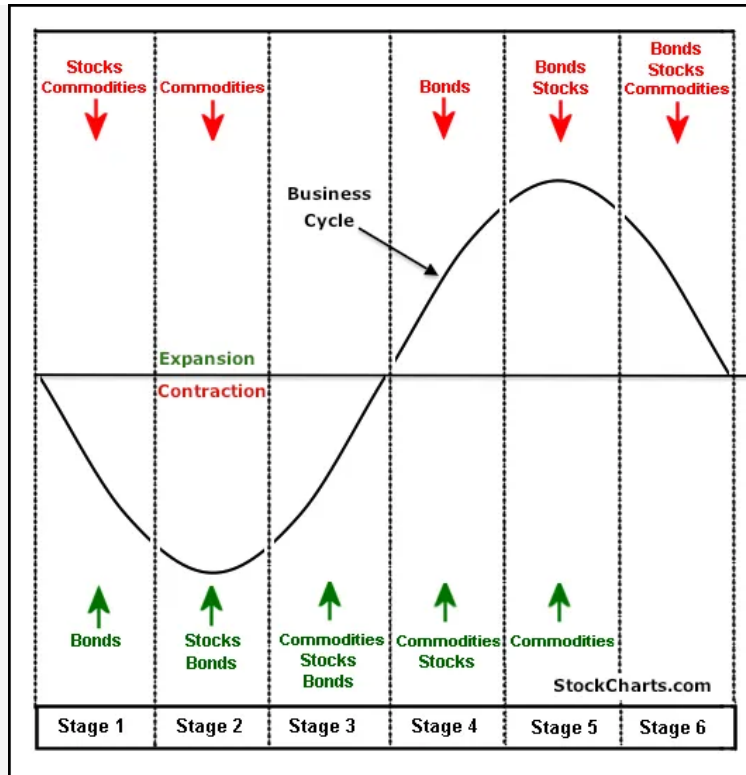
Top of cycle sectors Energy, Utilities, and Materials entered into the Weakening quadrant while early cycle sectors Discretionary, Technology, and Industrial continue to Improve. This suggests the market is searching for a bottom as valuations are returning to reasonable levels.

Stock indices are attempting to consolidate at current levels. We need to see a higher high and an attempt to push lower which is met with strong buying action before we can change our short term bias to the upside for a counter trend rally higher.

“Stop dithering around. In every confrontation, render what is just; from every impression, extract what is true.”

- Marcus Aurelius -

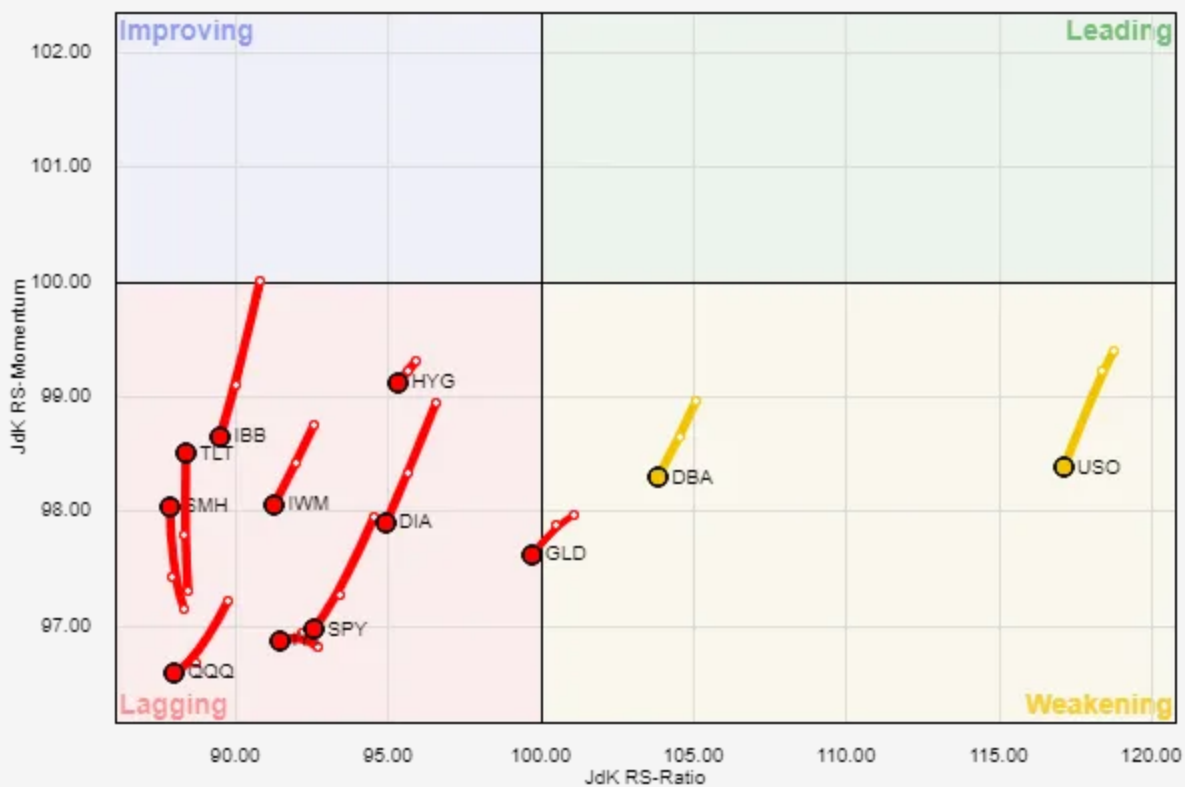
Business Cycle



Bonds (Blue). Stocks (Green). Commodities (Gold).

Stage 5 - We are in a late business cycle environment which corresponds with the rising concerns of a potential recession and economic downturn.

Asset Rotation

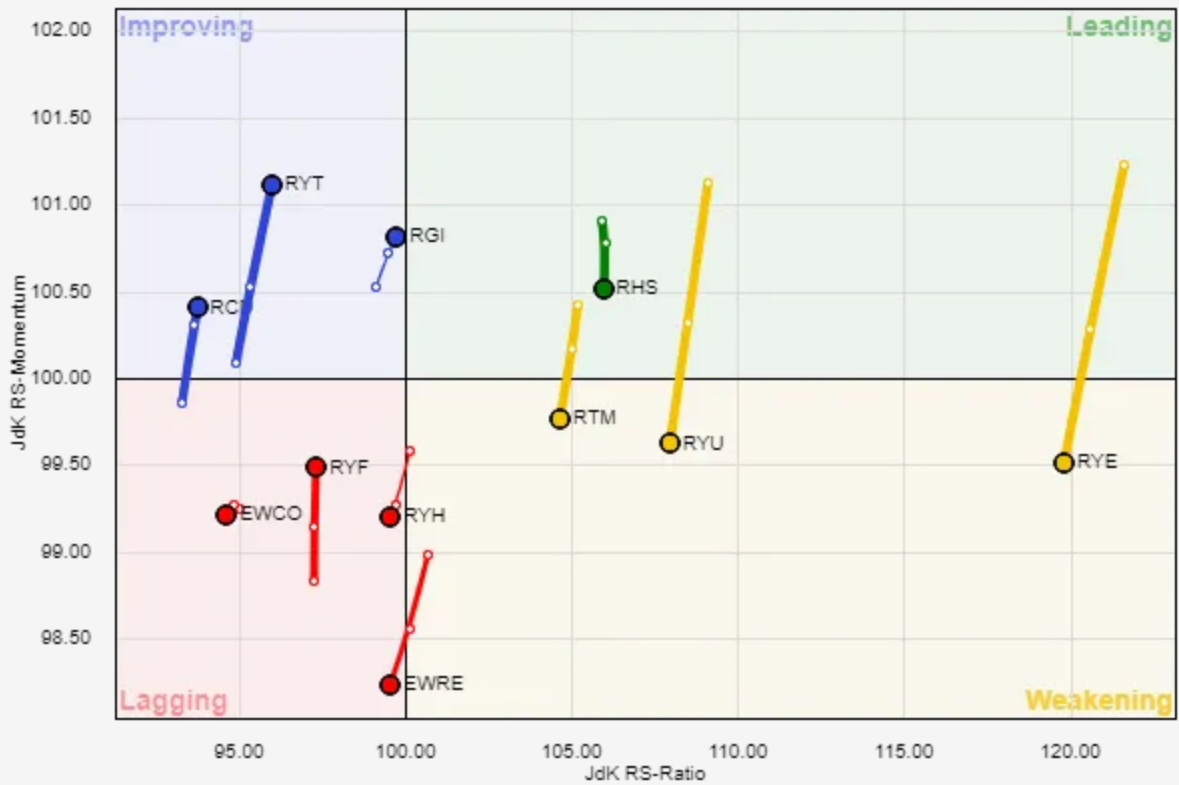
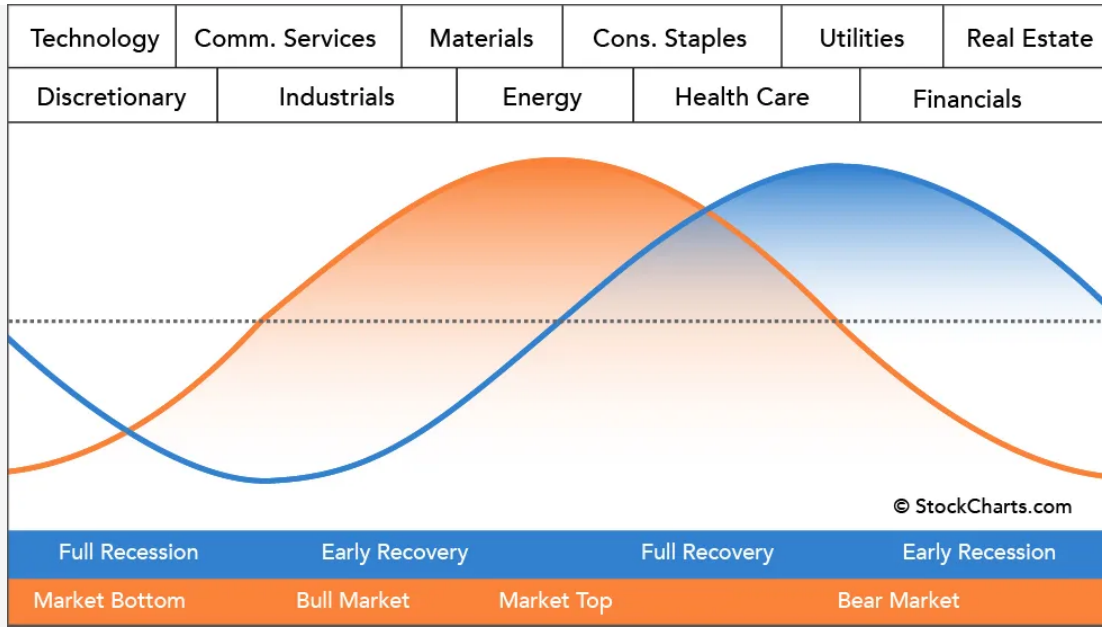


Bond ETFs - HYG, TLT. Stock ETFs - DIA, IBB, IWM, IYT, QQQ, SMH, SPY. Commodity ETFs - DBA, GLD, USO.

Asset Analysis

Commodities continued to weaken over the past week with Oil seeing a 10% drop and Gold moving into the Lagging quadrant. The potential change of character is in Bonds (TLT) and Semiconductors (SMH) which are moving towards the Improving quadrant. This rotation of weakening commodities and improving bonds suggests we could be heading into Stage 6 soon which will correspond with Commodities creating Lower Lows and Lower Highs.

Sector Rotation



Improving

Discretionary, Technology, Industrials.

Leading

Consumer Staples.

Weakening

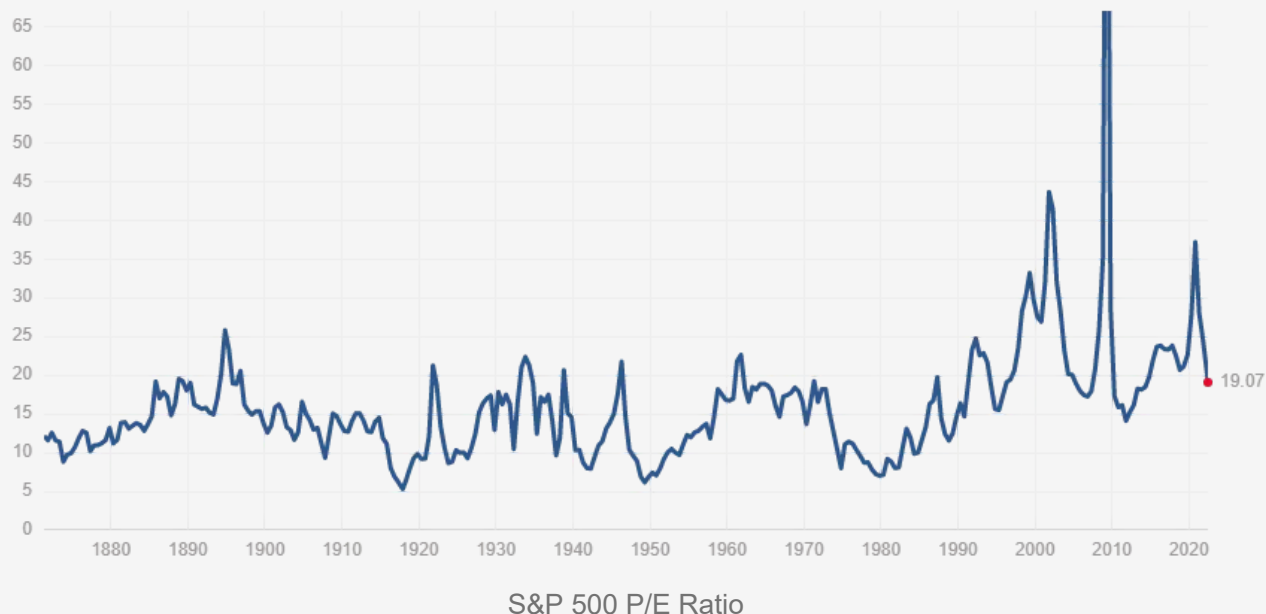
Energy, Utilities, Materials.

Lagging

Communication Services, Financials, Real Estate, Health Care.

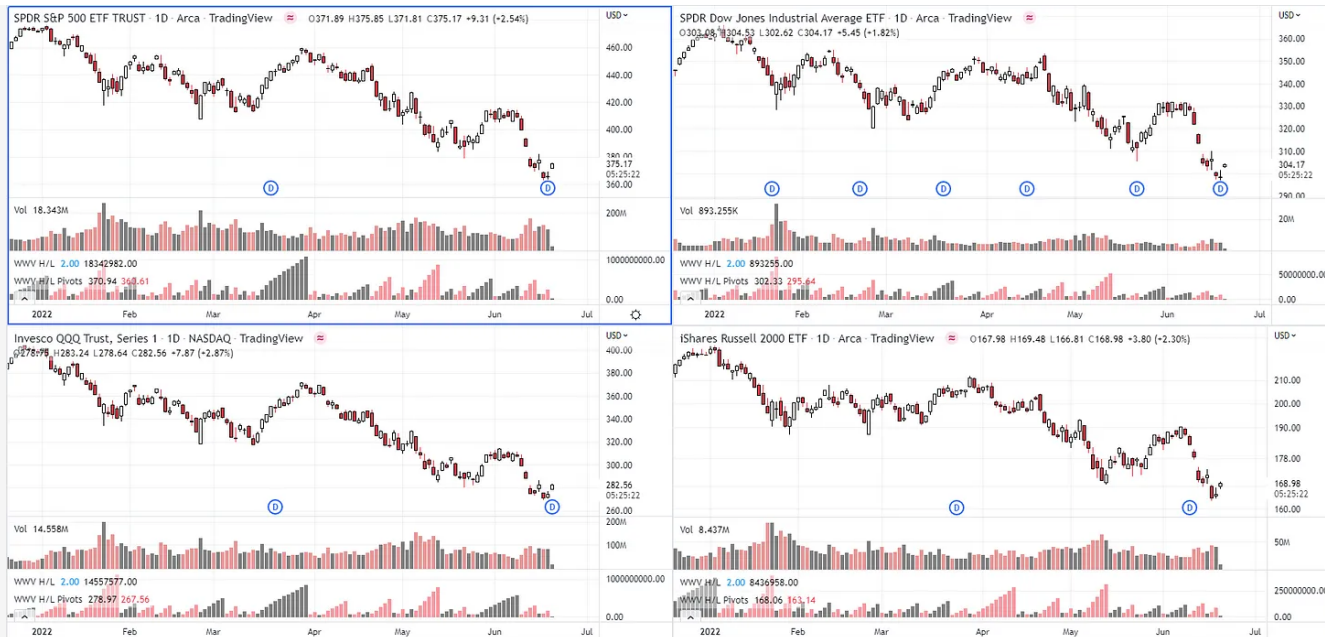
Sector Analysis

We are seeing Energy, Utilities, and Materials entering the Weakening quadrant this week which are all heavy commodity based businesses. Discretionary, Technology, and Industrials continued to improve from the prior week which suggests the markets overall are searching for a bottom.



The S&P 500 P/E Ratio has already worked off a lot of the froth being back down to 19 P/E from 35+ over the last 2 years. We could still see further downside in valuation especially if earnings reports and revisions start coming in much lower from a slowing economy, but the takeaway should be that stocks are nearing reasonable valuation for large institutions to be buying.

The Charts



Major Stock Index Daily Charts



Major Stock Index Intraday Charts

Technical Analysis

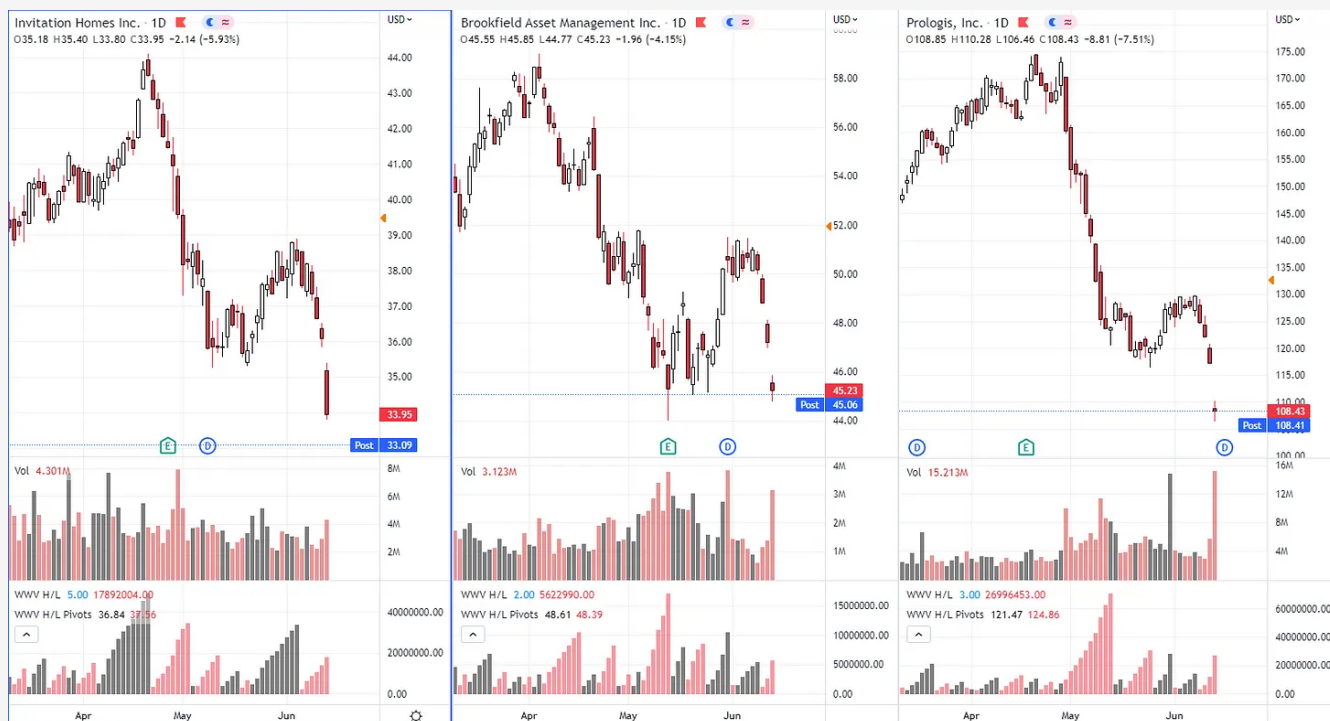
The stock indices remain in clear downtrends, but are attempting to create a horizontal trading range and consolidation at current levels. This could be a temporary break before continuation lower, or a valid attempt to lead a strong counter trend rally higher. As of right now, we see lower lows and lower highs which means our bias remains to lower prices.

We will want to watch this week closely to see if we make a higher high than last week's high as well as test lower that is met with strong buying action (imagine a long tail to the downside with price losing higher). We will want to be active in closing out our shorts, and seek out long opportunities in Discretionary, Technology, and Industrials if this bullish scenario plays out.

The Trades

Holds

Hold onto current short positions in Real Estate (INVH, BAM, PLD). This week could be a good time to close out these positions based on the type of action we see from the broad markets.



Closes

None at this time.

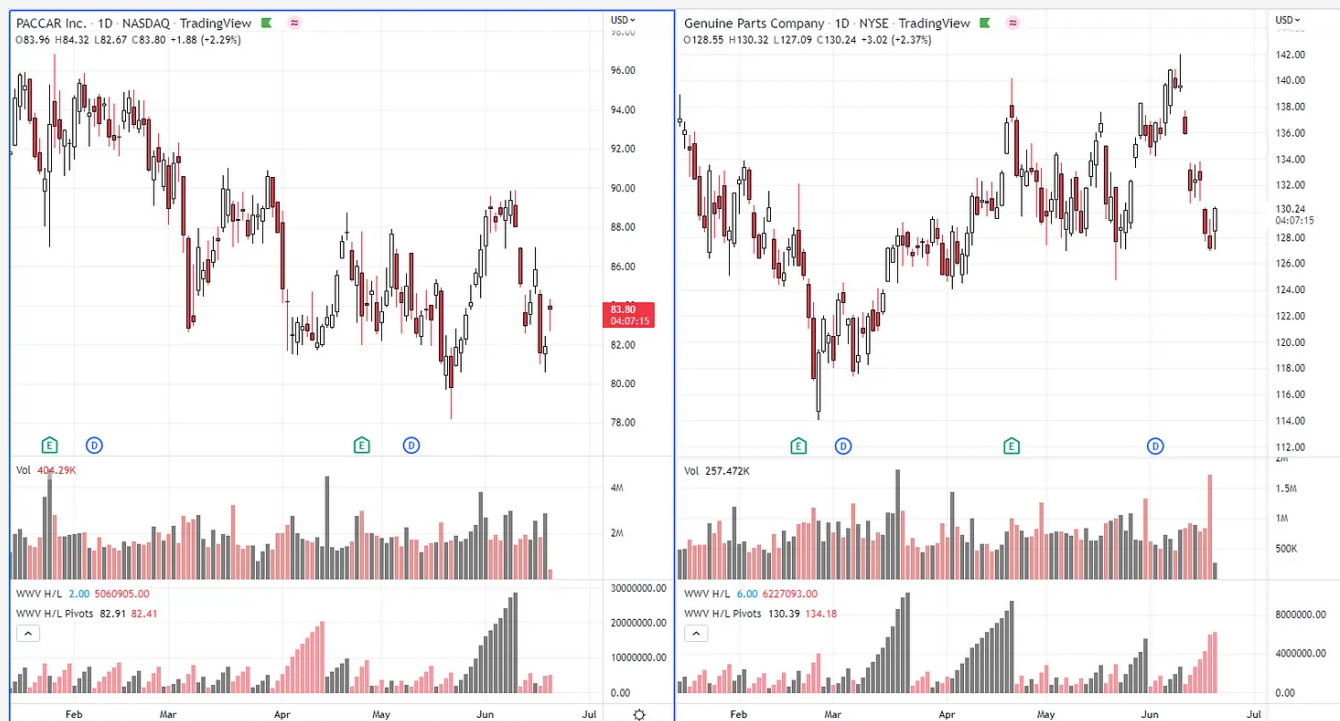
New Longs

There is no need to enter into these positions too soon. We need to see further convincing action on the broad indices that a real consolidation is taking place and counter trend rally is emerging. If this does play out, here are two semiconductors

(KLAC, ON), one industrial (PCAR), and one discretionary (GPC) which look encouraging from a valuation and technical perspective.



KLAC 15 P/E, +47% EBITDA | ON 16 P/E, +111% EBITDA



PCAR 14 P/E, +30% EBITDA | GPC 19 P/E, +21% EBITDA

New Shorts

None at this time.

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