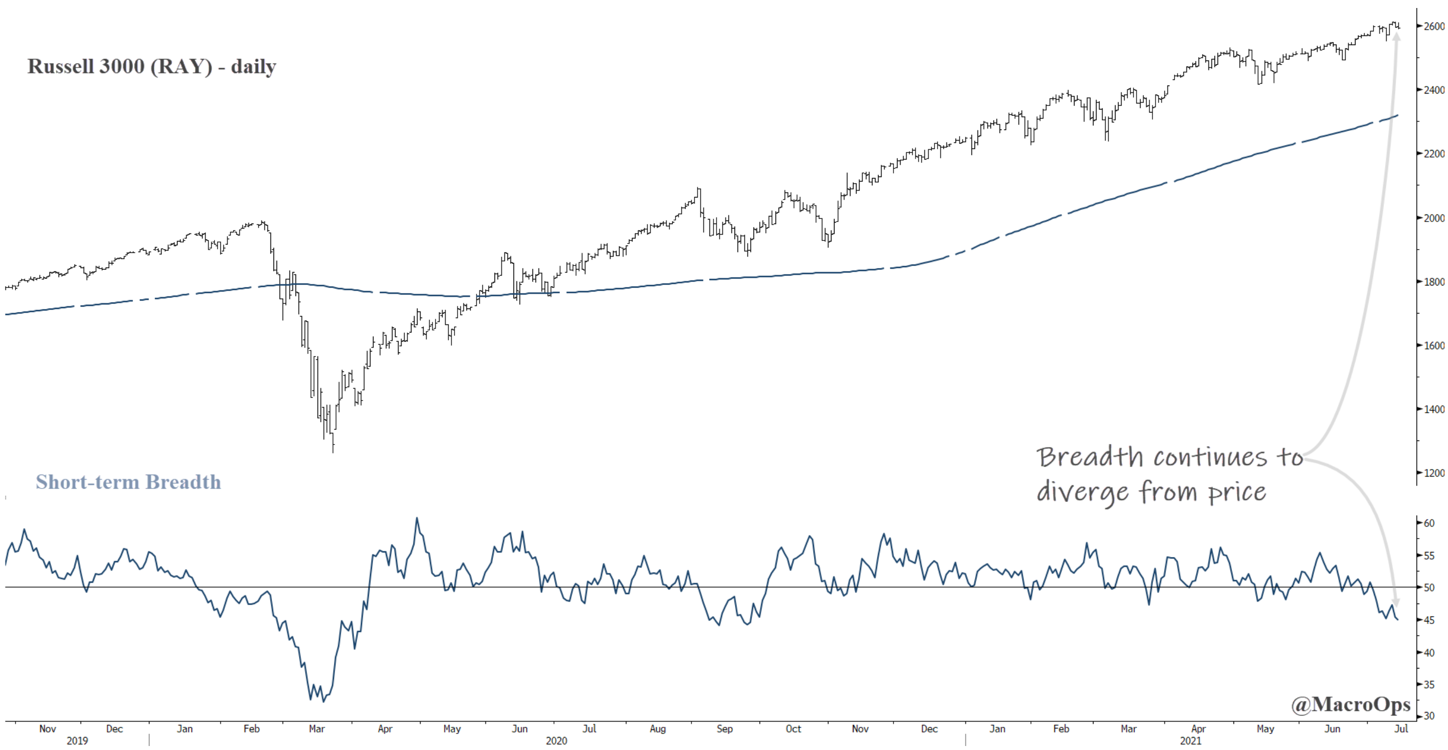
07/14/2021: A “No Sense” Signal

Operators,

The divergence in breadth continues. Our short-term breadth indicator for the Russell 3k has trended down to its lowest reading since September which was after a 10% correction in the index.



This is an interesting contrast with large caps and Qs that are at or within spitting distance of all-time highs. The reflation trade looks at risk of further unwind, while money continues to get parked in the big FAMG stocks for the summer.

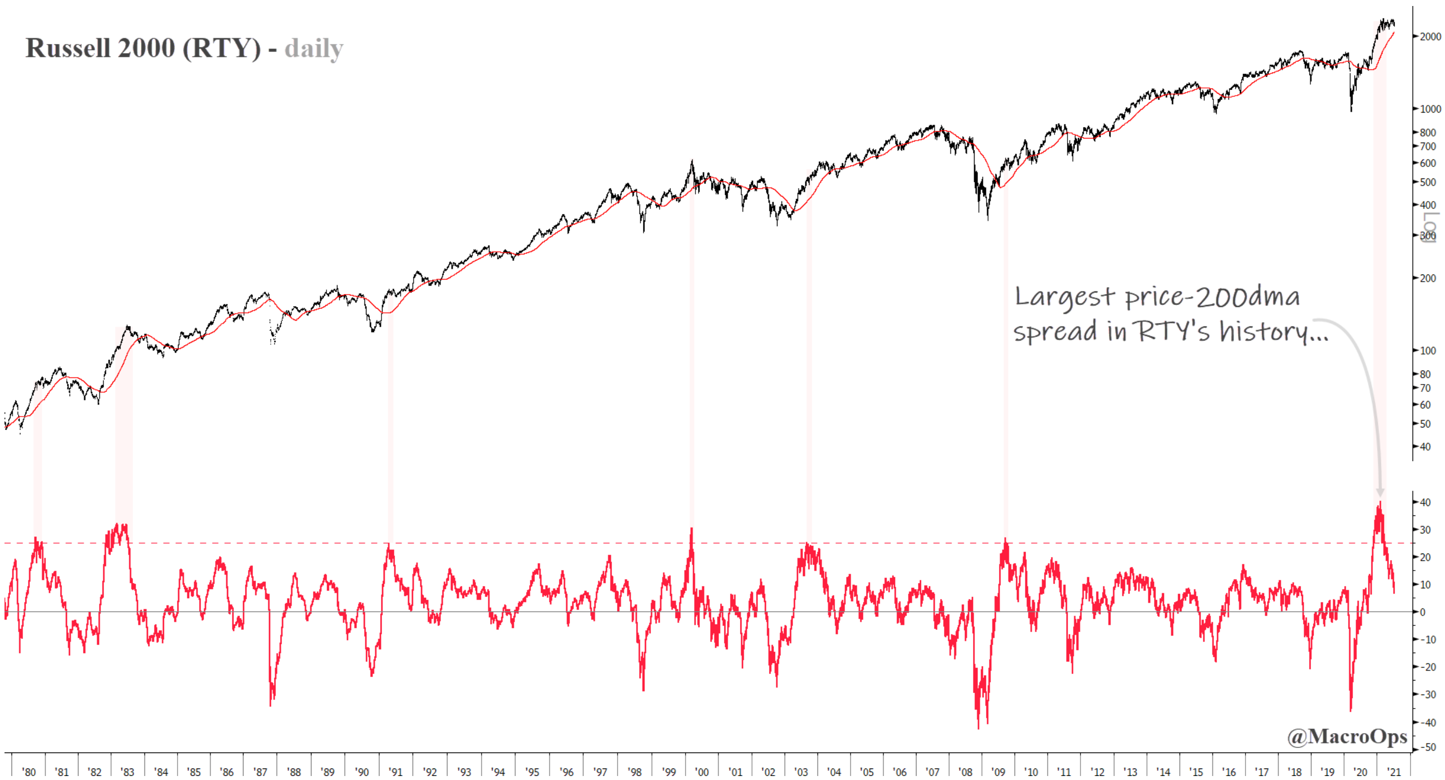
I’m not sure how long the upward trend in the main indices can last if this broader weakness continues. Especially as our TL Score has been stuck at -3 this past week… All of this is more confirmatory evidence that our *Summer Doldrums* thesis is still very much in play.

Because of this, we’re going to continue to take swings at opportunistic hedges. Today we’re getting back into long bonds and will be putting in a sell stop order on Russell 2k (RTY). Let’s first take a look at what’s going on in small caps.

There are three technical forces that are always at work on the tape (1) trend (2) momentum and (3) mean reversion. These forces work off feedback from one another in a kind of yin and yang fashion. Momentum drives the trend to overextension, which kicks in the force of mean reversion and tips momentum in reverse.

Back at the turn of the year I wrote about the extreme extension in small-caps and argued that while it was a great sign of longer-term strength, an extension like that historically led to reversion over the short to intermediate-term.

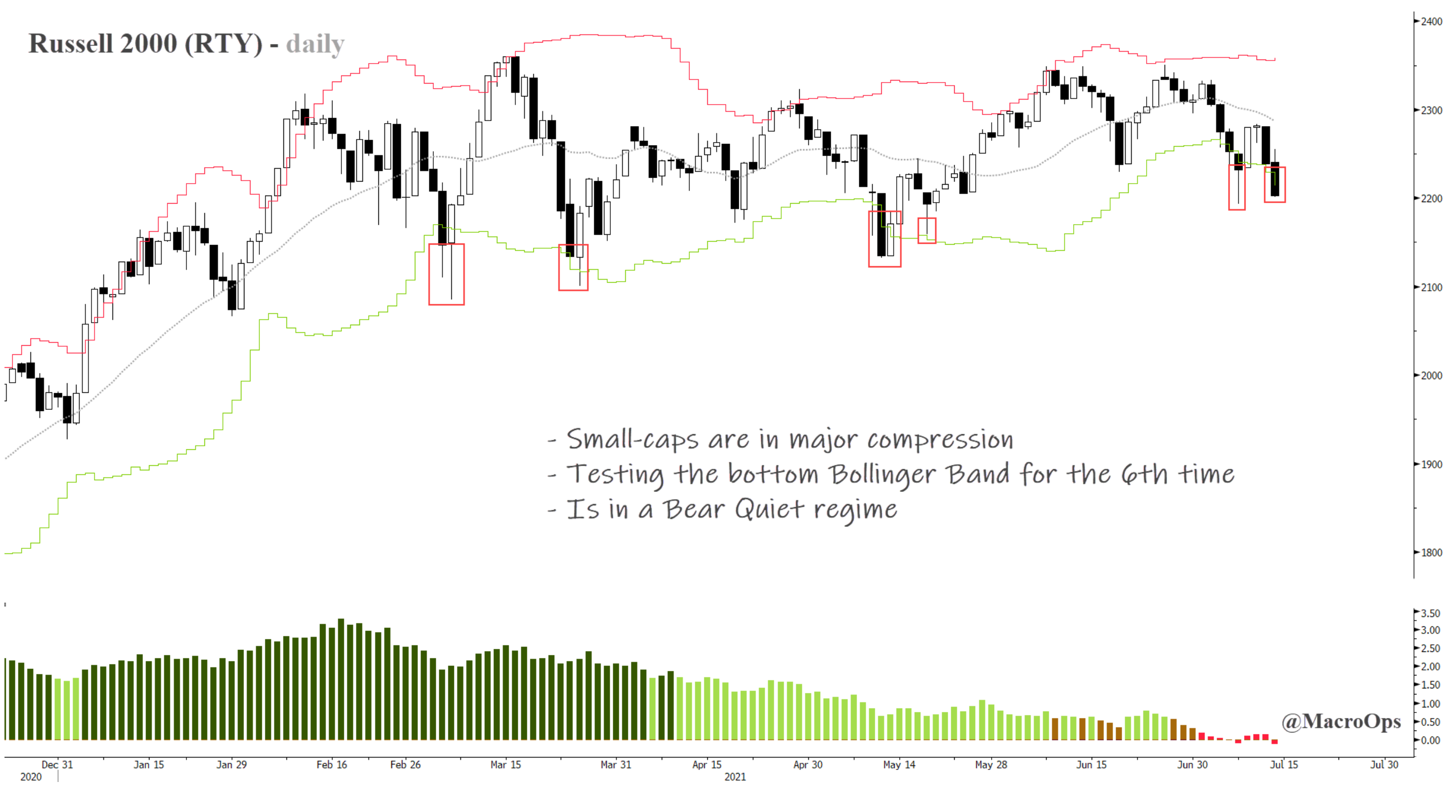
Small-caps have been trading in a tight sideways regime for the last five months after hitting their **largest spread from the 200-day moving average in history**. Trend to momentum to mean reversion...



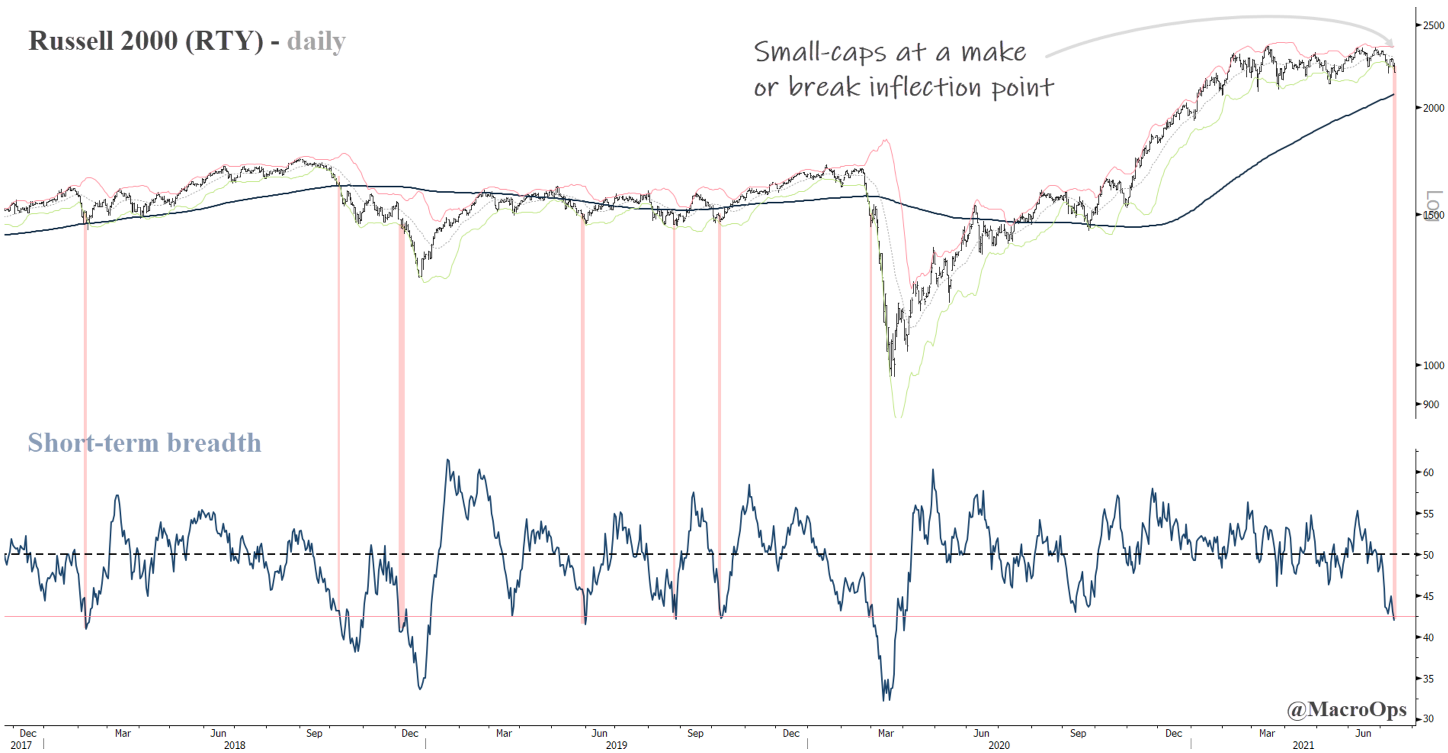
Another interesting point is the major compression we're seeing in the Russell. Weekly Bollinger Band width has **only been this narrow three other times over the last decade-plus**. Like a wound-up rubber band with stored energy, compression regimes like these lead to expansionary regimes (ie, big trends).

We can see that the prior three instances (vertical red zones) preceded major trend changes or reacceleration of an existing trend.

Currently, RTY is testing its bottom BB for the 6th time over the last five months. There are two ways to look at this (1) 80% of breakouts from trading ranges fail and reverse so we should expect this one to fail too or (2) RTY is retesting its lower BB just two days after the last failed volatility breakout, a sign of budding weakness.



We can turn to RTY breadth to give us more context. And here, our short-term breadth indicator shows that this test of the lower BB is not like the past 5 since the start of the year. RTY's breadth is at its <u>weakest levels</u> since the COVID bear market.

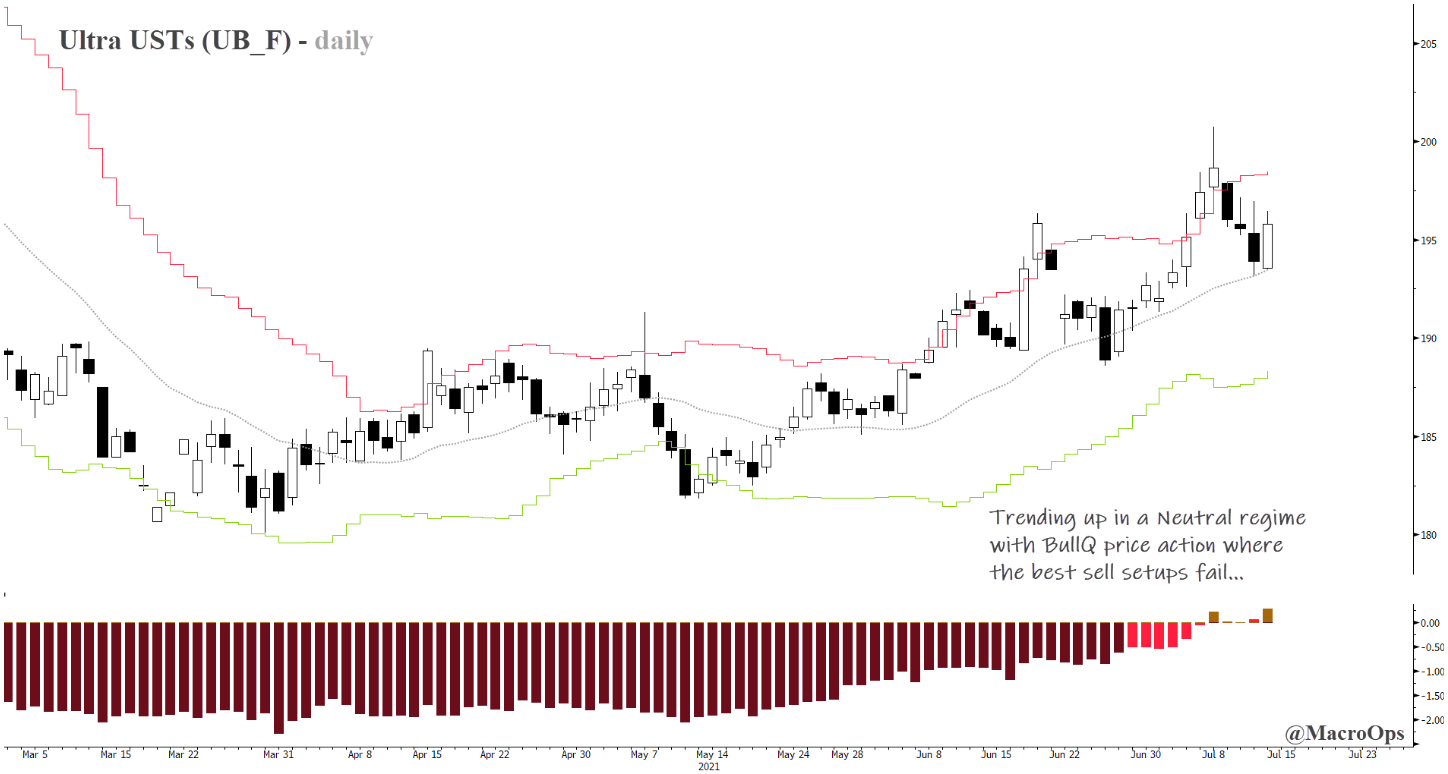


This is a +EV setup and since it'll provide us an additional hedge to our long book, we'll take a swing by place a sell stop order that will <u>only trigger</u> should this price confirm the breakdown (details for the trade are below).

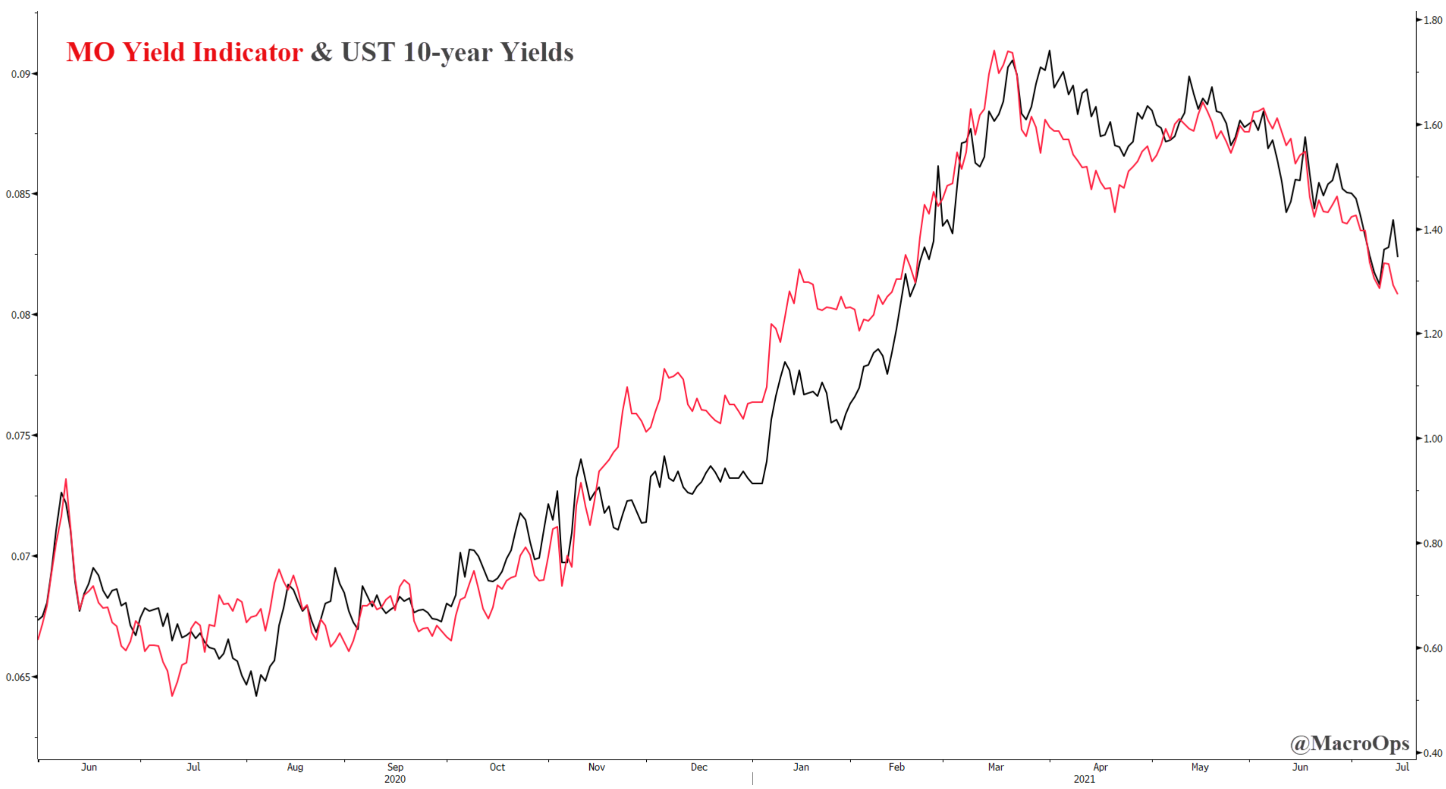
Next up, bonds.

Bonds saw the recent 13-year high print in CPI, shrugged, and moved higher. Seeing a lot of people scratch their head over this one as it makes "No Sense"... which we at MO know to be a powerful signal in and of itself (read more about our *No Sense algorithm* here).

Bonds are stair-stepping higher in a Neutral regime.

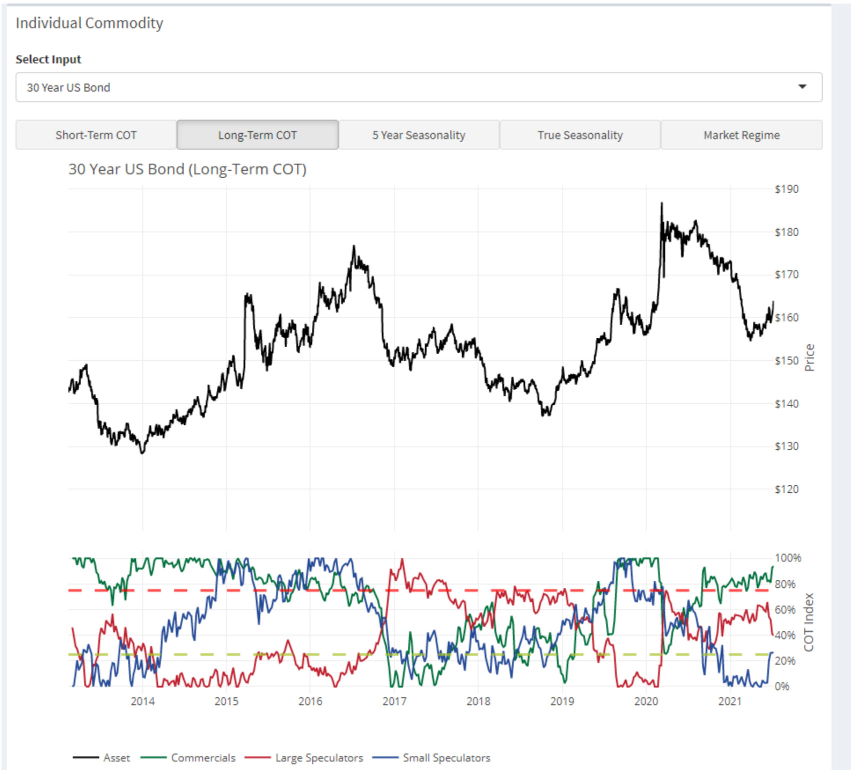


Our Yield Indicator continues to lead the way lower.



And the crowded short positioning we pointed out [last month](#) has proven to be stubbornly bearish. Meaning, there's still plenty of fuel for the trend to continue higher.

Commercial net long positioning is in the 94th percentile which historically has proven to provide quite a bullish tailwind to the trend. And seasonality remains very favorable until mid-September.



We remain bullish on the SPX and Qs, for now at least. But with [Trend Fragility](#) as high as it is and our TL Score as low as it is, our process demands we turn more defensive. Putting in a sell stop on RTY and buying some bonds here are two hedges that we may be able to make money on regardless of what FAMG does.

We're sizing both small and will only add to if we get further technical confirmation.

Details for both trades below:

Buy Ultra Long Bond Futures (UBU2021)

- **Entry:** 196’10
- **Stop:** 193’00
- **At-Risk:**100bps

Sell Stop Order on Russell 2000 (RYU2021 or TNA as ETF alternative)

- **Entry:** 2190.00 (trade only triggers if price hits this level)
- **Stop:** 2258.00
- **At-Risk:** 50bps

Hit me up in the CC if you have any questions or comments.

Your Macro Operator,

Alex