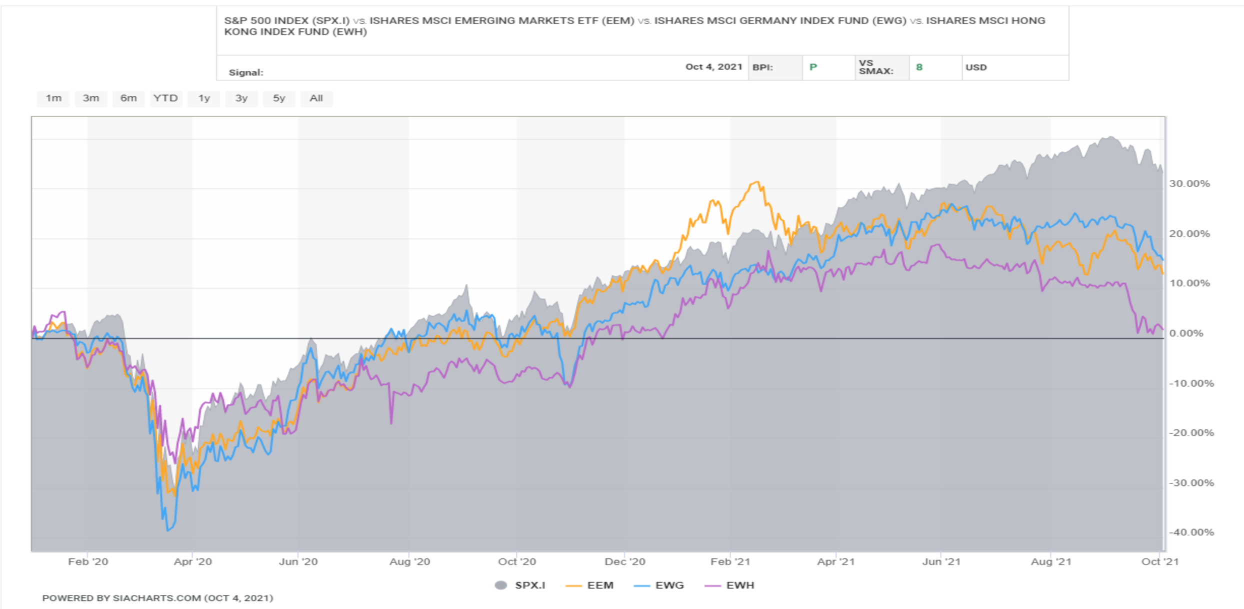
SIACharts Quarterly Chartbook & Outlook – Autumn 2021

Global Market Review and Outlook: Key Themes to Prepare for the Coming Quarter

Summer of Sideways Slips into a Potentially Choppy Autumn

It has become increasingly clear over the summer that the initial stimulus fuelled stock market recovery that roared up off the bottom in early 2020, followed by the post-US election rally at the end of last year has ended and a common mid-cycle pause has been underway for the last six months.

The mid-cycle pause is a time when central banks start to take their feet off the gas, reducing access to easy money and capping equity market upside for a while. At the same time, the reason that central banks ease back is that underlying economic conditions are improving, limiting the downside for stocks. In the past, this type of situation has lasted 6-12 months, currently we are about six months in.



The above chart compares the US S&P 500, with ETFs for Germany, Hong Kong, and Emerging Markets. It shows that while the US market led the recovery out of the March 2020 bottom, international markets stopped following the US higher back in February. Over the last seven months, international markets have been trending flat to downward while the US kept climbing into August. In the last six weeks, the US has started to follow international markets back downward.

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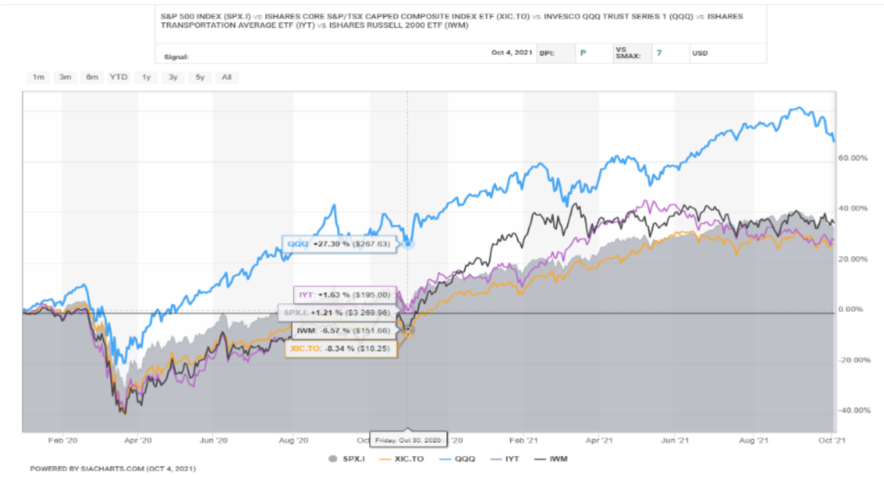
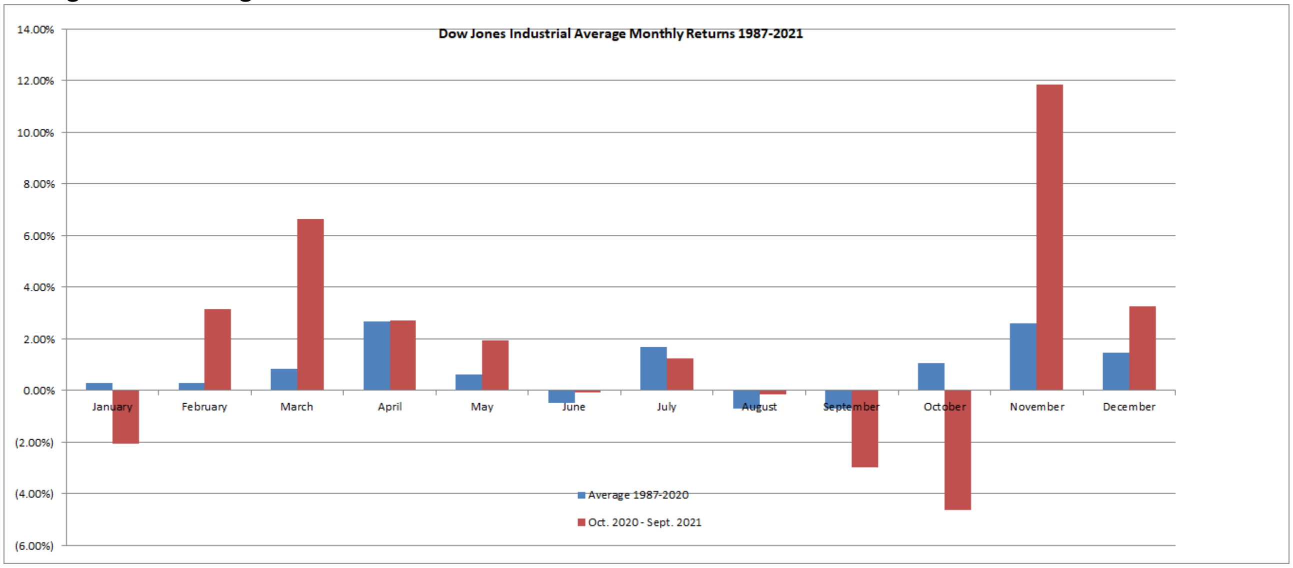


This chart shows that even within North America, upward momentum has been slowing for some time and what gains there were have been concentrated in fewer and fewer stocks. The small cap Russell 2000 peaked in March and has been trending sideways for six months. The S&P/TSX Composite peaked in June, while the Dow Tranoports peaked in May. The NASDAQ Composite continued to climb into August but recently has come under pressure with its divergence from other indices being resolved through a downward correction.

So far the sideways ranges have held, particularly 2,100 for the Russell 2000 Index. Should these levels continue to hold, it would suggest continuing underlying support and the potential for markets to eventually bounce back. Should key support levels like that fail, however, it could suggest the potential for a deeper market decline.

Seasonally, the autumn has tended to be a mixed quarter. The weakest time of the year for stocks runs from mid-August to late October, and so far, this year has been no exception with the S&P 500 falling nearly 5.0% in September and posting its worst month since March of 2020. Last year, the US election weighed on stocks in October, but then after the US election, the Dow took off and posted even stronger than average returns for November and December.



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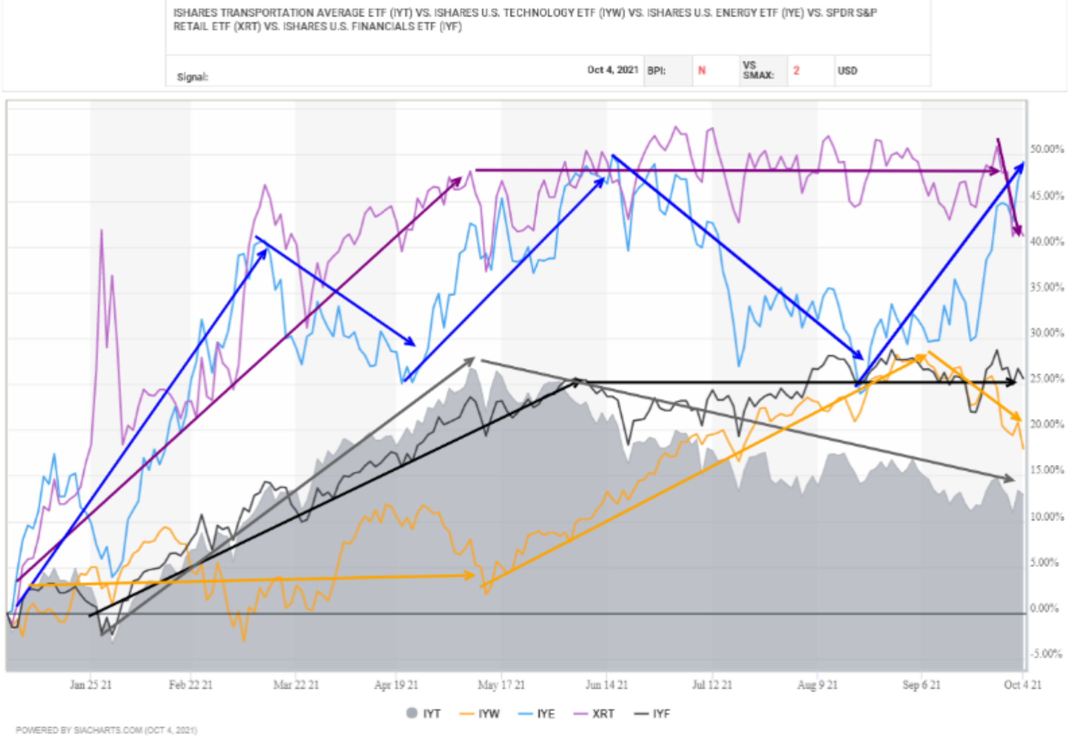
Another feature of this mid-cycle pause that continued through the summer is a series of rolling takedowns and rebounds. It's hard for a broad index to make headway when underlying sectors are so out-of-sync, with different groups going in opposite directions at any given time.

This chart highlights varying performance across a number of industry groups over the course of this year. For equity markets to pick a direction and break out of the current range, more sectors are going to need to get in gear with each other instead of offsetting each other.



Technology, in orange, struggled through the first half of the year, recovered in the summer but has been dropping off again recently.

Energy, in blue, has mirrored tech through much of this year, climbing in the first half, correcting though the summer and rallying again recently.

Transports, in grey, had a strong first half but have been trending steadily downward since peaking in the spring.

Retailers, in purple, were strong for much of the year but have turned downward recently. Financials in black, spent the summer flat, consolidating the gains made in the first half of the year.

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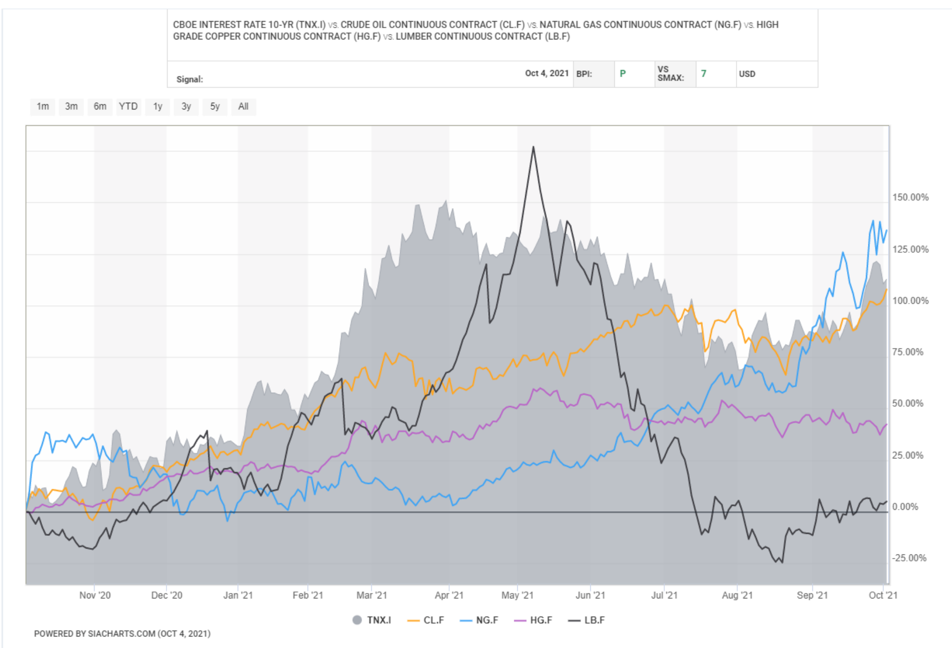
Key Investing and Trading Themes for the Coming Quarter

Energy Prices and Increasing Inflation Pressures

Through 2020 and the first half of 2021, investors attitudes toward the energy market were mainly shaped by the demand side and fears over whether/how much impact pandemic economic disruptions including lockdowns and rebounds could have on demand.

Over the summer, and particularly in September, fears about a demand shortfall faded and were replaced by concerns about a supply shortfall. Two Gulf of Mexico hurricanes in rapid succession, Ida and Nicholas, caused significant production disruptions. Overseas, the inability of some of the smaller OPEC+ members to meet higher quotas as previous cutbacks continue to be unwound have raised more questions about how much excess capacity there actually is in the world.



The combined impact of these disruptions has sent energy contracts soaring, with US crude oil rallying to its highest level since 2014 and natural gas soaring to its highest level since 2008. Soaring gasoline prices in the UK due to transportation problems has also added to the case for higher energy prices.

Investors may also note that while copper, in purple, has been steady, lumber, in black, looks like its roller coaster ride has hit bottom and started to climb once again.

The impact of rising, falling and rising commodity prices can be seen in the grey line, the US 10-year treasury note yield, which has started to climb once again with commodity inflation pressures building again.

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Inflation, Supply Chains, and Earnings Season

Earnings season for the quarter that ended in September runs from Mid-October through late November. Based on recent results from companies with August quarter ends, there are many themes which could play out this time around.

1) *Year over year distortions ease and year over year comparisons may get harder going forward*

   Q1 and Q2 of 2020 were heavily distorted by the initial waves of COVID and lockdowns. Q3 of last year saw economies reopen so the comparisons may get more difficult. This also means that moving forward, we may see initial recovery momentum for many companies slow naturally.

2) *Guidance may be more important than results*

   US stock markets rallying to record highs earlier this summer has built high valuations and high growth expectations in the share prices of many companies. The market reaction to recent results from companies like FedEx, Nike, Micron, and Pepsico, showed that investors are less willing to pay up for positive past quarter results, and appear more focused on guidance and future growth potential. In several cases, we saw companies beat the street on earnings but see their stocks decline because of soft or murky guidance.

3) *Rising Costs and Supply Chain Disruptions*

   While a chip shortage impacting the semiconductor and auto sectors has been known for some time, comments from several of the companies mentioned above, along with Bed, Bath and Beyond, suggest that supply chain disruptions and their potential impact on corporate earnings may be broader and deeper than previously thought.

   In addition to companies having trouble accessing materials and inventory in general, the cost of doing so also appears to be in the rise, including freight rates and fuel costs and materials costs. In addition, many sectors are having a hard time finding employees which has started to push up wages as well.

   Combined this means that corporate costs are rising and it's unclear how much power companies have to push higher costs on to consumers, and how much their profit margins could be cut.

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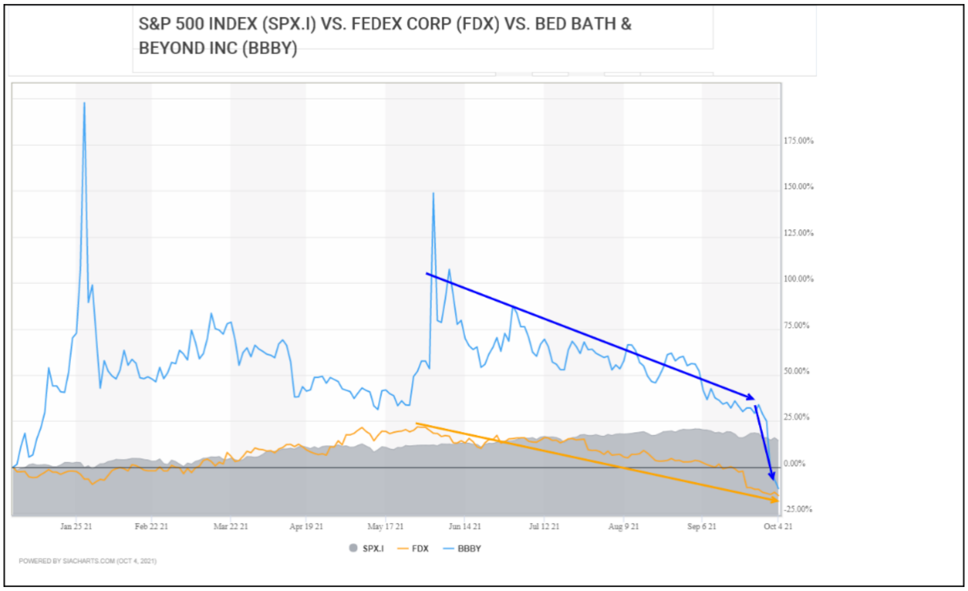

This chart shows that both Bed, Bath and Beyond, in blue, and FedEx, in orange, saw declines accelerate after they reported earnings last month as investors say cloudy outlooks as a reason to head for the door.

Not-So-Transitory Inflation, Rising Interest Rates, and The End of the Easy Money Party

One consistent mantra that has been coming out from central bankers has been that “inflation is transitory” and that they are prepared to let inflation run above target for a short period of time. One thing that has become clear over the summer between rising wages, other rising costs, and the recent resurgence is that inflation is not transitory. This realization has pushed the US 10-year treasury note yield back up above 1.50% and the US 30-year treasury note yield back up above 2.00%, which has increased pressure on central bankers to take action to rein in stimulus.

Following summer and September meetings, last year’s coordinated stimulus drive by central banks appears to have fractured into three camps.

- **Hawkish (cutting back on stimulus is underway)**

  Bank of Canada, Reserve Bank of New Zealand

- **Neutral (tapering stimulus has not started but they have talked about it, perhaps starting before the end of this year)**

  US Federal Reserve Board, European Central Bank, Bank of England

- **Dovish (no plans to cut back on stimulus)**

Bank of Japan, People's Bank of China

Based on recent member projections and comments from officials, the US central bank is likely to start tapering stimulus by the end of this year, finish tapering by mid-2022 and start raising interest rates in late 2022. The Bank of Canada appears to be on track to finish tapering by the end of this year and then maintain its balance sheet while it starts to raise rates in 2022. The People's Bank of China may need to increase stimulus it Evergrande's debt problems cause stress in its financial system. The RBNZ raised interest rates 0.25% on October 6th.

The COVID Effect: Vaccines, Treatments, and Re-Openings

The COVID pandemic continues to impact certain sectors of the market and fast-moving developments may continue to impact certain stocks in the coming quarter.

The chart at right shows that vaccine producers Moderna, in orange, and Pfizer, in grey, have been coming back down as the need for third (and beyond) doses for the general population has come into question. It remains unclear where the boosters conversation will land as winter approaches. Meanwhile both companies appear to be moving toward completing clinical trials and looking for approvals for children in the 5-12 range. Merck's positive clinical trial results for a COVID treatment drug has sparked a rally in its shares, shown in blue, while helping to depress its vaccine competitors.

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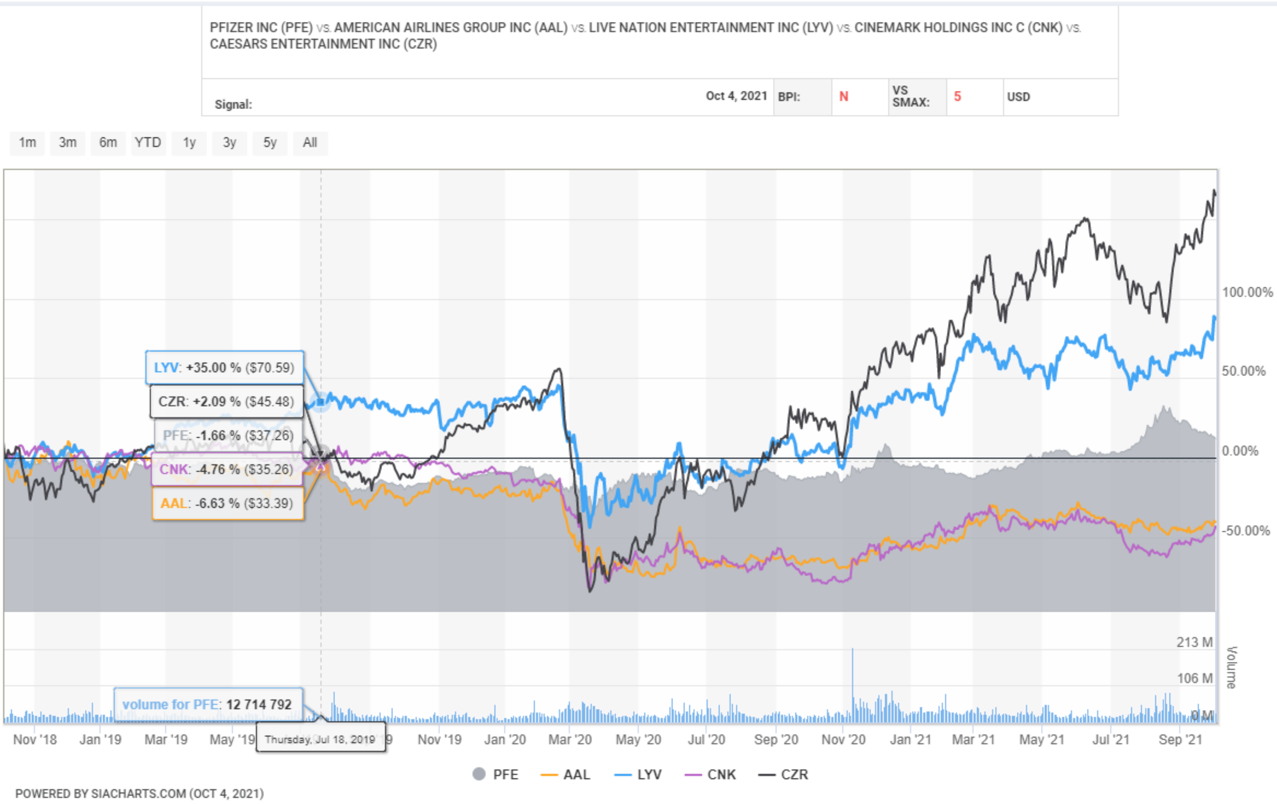

Meanwhile, other sectors impacted by lockdowns have had a mixed performance lately. The chart above shows that concert promoter Live Nation, and casino/hotel operator Caesars Entertainment have done well, but airlines like American Airlines and movie theatre chains like Cinemark continue to struggle.

External Noise

It seems like there is always something else going on. At the time of writing, Chinese real estate giant Evergrande continues to have financial problems and difficulties meeting its interest obligations. It remains to be seen if or how this mess will get cleaned up and if the damage is going to be contained to China or if it could have wider implications or not.

US politicians kicked the can down the road for now and averted starting the quarter off with a government shutdown, but the debt ceiling needs to be raised by mid-October and the government is only funded to the beginning of December. While these shenanigans have gone on many times before, there remains an underlying risk that someone could miscalculate and cause short-term turmoil until the country's spending issues get resolved.

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Summary: Coming out of a summer of sideways, equity markets are nearing the end of their seasonally weakest time of the year, but we aren't out of the woods yet as there are several shoes potentially yet to fall. Near-term risks include the market reaction to earnings, the potential for guidance to show slowing growth momentum, supply chain disruptions, or rising costs.

It's possible that markets may be choppy through to the Nov 2-3 FOMC meeting when the timetable for US tapering may become clearer, but after that, historical seasonality turns positive through the end of the year. Strap in, this quarter could be another roller coaster ride.

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Asset Class and Sector Ranking Analysis

SIA Charts Asset Class Ranking		
As of Sept 30, 2021		
Asset Class	Change*	
Commodities	none	
CAD Equity	none	
US Equity	none	
International Equity	none	
Cash	none	
Currency	none	
Bond	none	
*Change in Ranking Since June 30, 2021		
Source: SIA Charts		

Even though there were some changes in market sentiment in September, there were no changes to the SIA Charts Asset Class Rankings during Q3.

With commodities still in top spot, followed by the three equity asset classes then the non-equity Cash, Currency, and Bond asset classes still stuck at the bottom of the rankings, the current Asset Class rankings continue to support a Green - Favored SIACharts Equity Action Call™.

There were only a few minor changes at the highest industry group level over the whole quarter. In particular, Materials fell by two spots as the falling lumber price dragged on forest products companies and struggling metal prices (copper, silver, gold, platinum) weighed on both base and precious metal miners.

A deeper dive into the 31 sectors on a monthly basis, highlighted on the next page, shows that there was a lot more happening that a high-level view would suggest.

SIA Charts Sectors Ranking		
As of Sept 30, 2021		
Sector	Group	Change*
Consumer Discretionary	Cyclical	none
Industrials	Cyclical	none
Energy	Resource	none
Communications Serivces	Cyclical	none
Financials	Interest Sensitive	+1
Consumer Staples	Defensive	-1
Information Technology	Cyclical	none
Real Estate	Interest Sensitive	+1
Health Care	Defensive	+1
Materials	Resource	-2
Utlities	Interest Sensitive	none
*Change in Ranking Since June 30, 2021		
Source: SIA Charts		

For example, Energy started and finished the quarter in the green zone of the sectors report but dipped into the yellow zone mid quarter. The three groups within Financials were particularly mixed with financial services in the green zone, banking in the yellow zone and insurance in the red zone. Similarly, Consumer Discretionary had significant differences in relative strength with the two retail groups in the green zone, leisure and consumer durables in the yellow zone, and autos in the red zone.

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Market Sector / Industry	Symbol	June	July	August	September
Energy	EWI345				
Materials	EWI330				
Metals & Mining	EWI352				
Chemicals	EWI340				
Industrials	EWI335				
Aerospace & Defense	EWI454				
Transportation	EWI524				
Manufacturing	EWI466				
Construction	EWI457				
Conglomerates	EWI360				
Diversified Services	EWI476				
Consumer Discretionary	EWI310				
Leisure	EWI487				
Retail	EWI506				
Specialty Retail	EWI517				
Consumer Durables	EWI367				
Automotive	EWI362				
Consumer Staples	EWI332				
Consumer Non-Durables	EWI377				
Wholesale	EWI532				
Food & Beverages	EWI386				
Tobacco	EWI396				
Health Care	EWI334				
Drugs	EWI436				
Health Services	EWI444				
Financials	EWI333				
Banking	EWI399				
Insurance	EWI419				
Financial Services	EWI410				
Real Estate	EWI425				
Technology	EWI337				
Computer Software	EWI550				
Computer Hardware	EWI543				
Electronics & Semiconductors	EWI559				
Communications New	EWI573				
Internet	EWI568				
Media	EWI495				
Telecommuncations Services	EWI572				
Utilities	EWI338				
Source: SIA Charts					

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Dow Jones Industrial Average (DJI.I)

Trading action in the Dow Jones Industrial Average and the Dow Jones Transportation Average this quarter indicates that after over a century, their Dow Theory Relationship still holds.

Dating back to the writings of Charles Dow in the late 1800s and early 1900s, Dow Theory indicates that the Dow Industrials and Dow Transports need to confirm each other for a trend change or a breakout to be sustainable.

In the third quarter, the Dow Industrials completed a bullish Triple Top breakout to a new high but this was not confirmed by the Dow Transports which instead continued to decline. The Dow Industrials have since reversed back into a column of Os indicating that their sideways trend has resumed.

33,000 initial support continues to hold for now, but if that fails, the Triple Top would be called off and a new downtrend would start with next potential support near 31,090. A breakout over 35,740 to a new high, would confirm the Triple Top and signal the start of a new advance with next potential resistance near 38,700 based on a horizontal count.

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Dow Jones Transportation Average (DTX.I)

Since peaking back in June, the Dow Jones Transportation Average has been under distribution, completing two bearish Double Bottom patterns which both remain active.

Through the quarter, fundamentals for the sector continued to deteriorate with airlines and freight companies having trouble finding enough staff, leading to the supply chain disruptions that an increasing number of companies have started to complain about.

In addition to having to pay higher wages to attract staff, the transportation sector is also facing increased costs form rising oil and gasoline prices which may also be weighing on the group.

Currently in a downleg, next potential support for the Dow Transports appears near 1,329 based on a horizontal count then 1,303 based on a previous column high. Initial rebound resistance appears near 1,468 based on a 3-box reversal.

Russell 2000 Index (RLS.I)

Over the last six months, the North American Index which has best exemplified the overall sideways market trend has been the Russell 2000.

Sideways action continued through the summer with the Russell 2000 remaining in the 2100 to 2350 range.

Whichever way the index breaks out of this range could set the tone for the broader market. Next potential upside resistance on a breakout appears near 2575 based on a horizontal count. Next potential downside support on a breakdown appears between a previous column high near 2010 and the 2000 round number.

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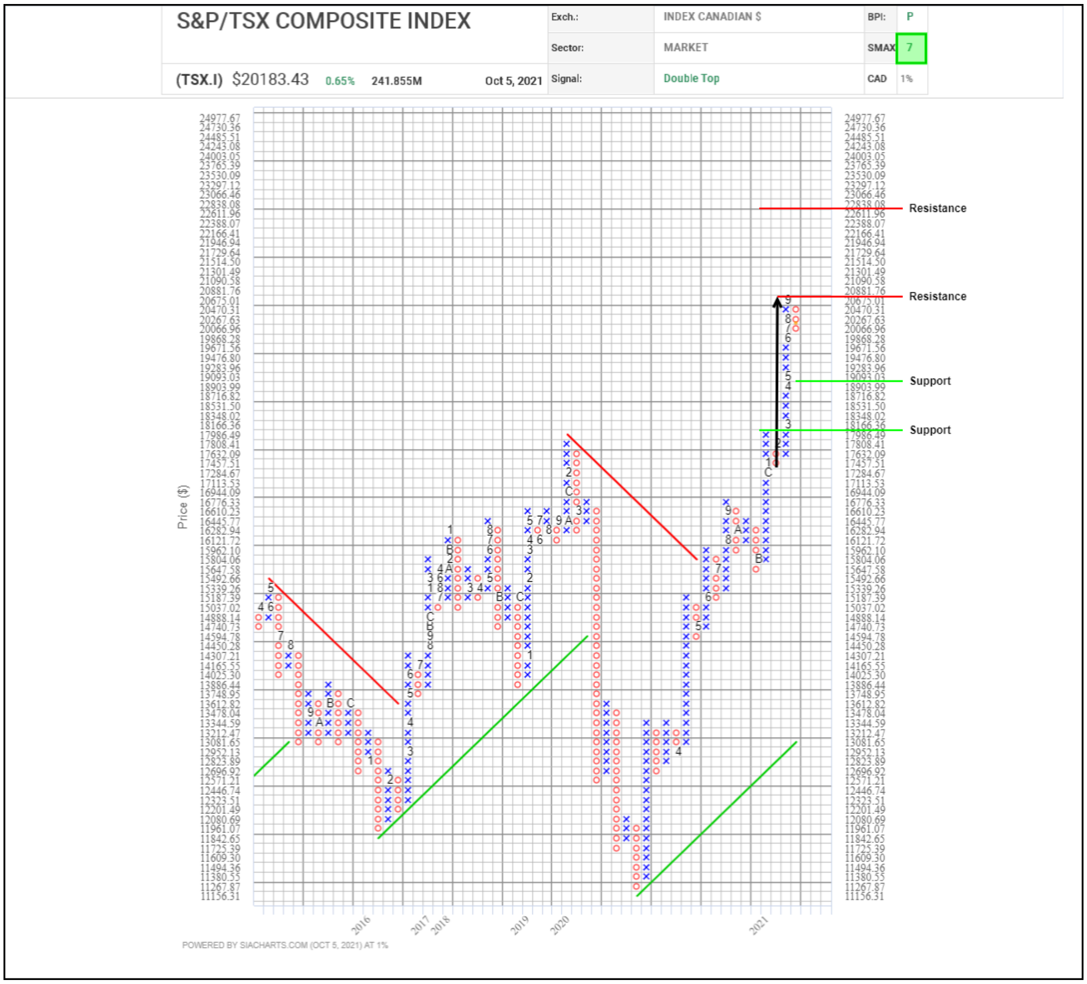
S&P/TSX Composite Index (TSX.I)



Earlier this year, the S&P/TSX Composite broke out to a new all-time high and since then, it has continued to climb, in a steady high pole advance, supported by its sensitivity to rising oil & gas prices and energy stocks. Only recently has there been as much as a 3-box correction.

So far, the index has managed to hold the 20,000 level indicating its uptrend remains intact with next potential resistance at the previous high near 20,880, then 22,390 based on a horizontal count. A break of 20,000 would suggest a deeper correction has started. Next potential downside support appear near 18.900 which would have to be breached to trigger a bearish high pole warning.

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Crude Oil Continuous Contract (CL.F)

Crude oil has been quite the roller coaster ride for the last 18 months, after plunging off a cliff in early 2020 on concerns about a shortfall in demand from COVID lockdowns the price has been recovering lost ground as demand has bounced back.

Recently, thinking around oil has shifted from a demand story to a supply story. With US production disrupted by hurricanes in the Gulf of Mexico and some OPEC+ producers struggling to bring production back on stream, concern has shifted to the potential for supply shortfalls, boosting the price of oil back up past its 2018 peak near $77.50/bbl to is highest level since 2014.

Based on previous column highs, next potential resistance appears near $88.90 then the $100.00 round number. Initial support appears near the $75.00 and $70.00 round numbers.

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CBOE Interest Rate 30-Year Continuous Contract (TYX.I)

One of the factors which appears to have rattled investors recently is a resumption in the upward trend of US traded interest rates.

The US 30-year treasury yield for example, had peaked back in March and decllined through the spring. In July, the rate bottomed out at a higher low near 1.80% and had stabilized through September.

This month, responding to increasing inflation pressures from rising wages and enegy prices, TYX.I regained 2.00% and then broke out over 2.05% completing a bullish Spread Double Top pattern and signaling the start of a new advance. This move renewed speculation that the Fed may have to start tapering soon, and helped to ignite a rally in the US Dollar while dragging on stocks, commodities and other currencies.

Based on previous highs, next potential upside resistance for the 30-year rage may appear near 2.12% then 2.25% and 2.31%. Initial support moves up to 2.00% a 3-box reversal and a significant psychological round number.

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Fear Indicators: Gold Continuous Contract (GC.F)

We have received a lot of questions lately over whether the recent downturn in equity markets is a common downswing, a correction, or the start of a deeper downturn. So far stocks appear to be in a normal downswing considering not only that key support levels for indices like the Russell 2000 have held, but we have not seen a resurgence in some of the key fear indicators like gold and the VIX, or a flight to defensive havens.

Back in early 2020 when the pandemic started and equity markets crashed, fear of financial stress sparked a stampede into gold that sent it up above $2,000/oz by the summer of 2020.

As financial stresses eased and markets got back up on their feet, capital moved out from havens like gold back into risk markets.

In recent weeks, gold has settled into a trading range between $1,725/oz and $1,830/oz. While it has bounced up off the bottom of this zone, it really hasn't moved up very much through the current equity market selloff suggesting that while investor enthusiasm for stocks has faded a bit, fear has not increased yet and it would take a move up above $1,830 to signal a significant change in sentiment.

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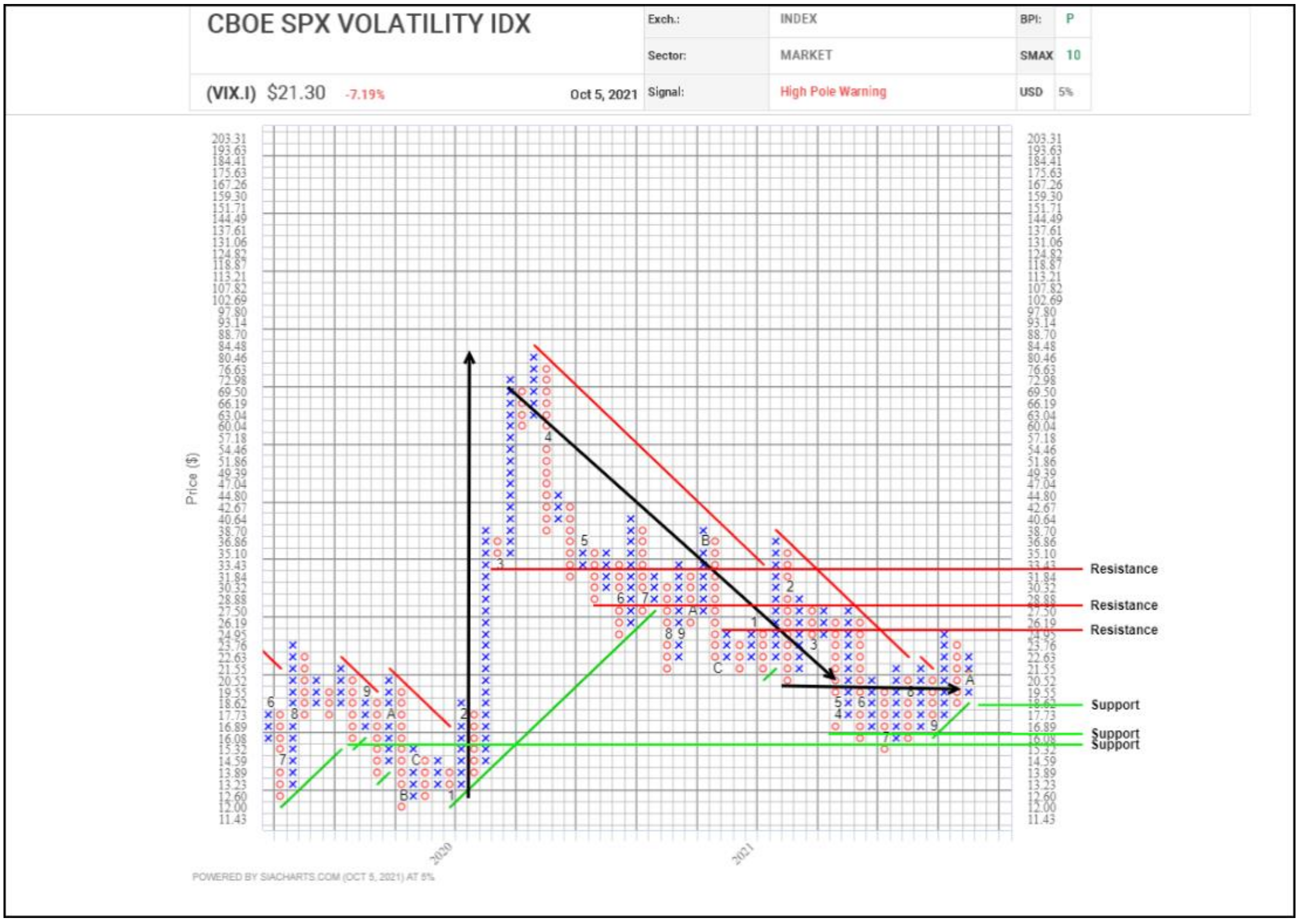
Fear Indicators: CBOE SPX Volatility Index (VIX.I)



Similarly, the VIX Volatility Index, commonly known as the fear gauge, soared in early 2020 as stock markets crashed, then fell back as stock markets recovered and confidence improved.

Since bottoming out in July, the VIX has been creeping back upward but within a 14.5 to 26.5 sideways range.

At this point, it would take a breakout back up above 26.5 in the VIX to indicate that a significant increase in fear has occurred. Until then, while not at extreme levels of complacency, investor confidence remains intact and fear relatively subdued.

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