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ZWEIG BREADTH THRUST: A RARE YOLO BUY SIGNAL

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EXECUTIVE SUMMARY

We would like to address the feedback from our recent publication, [*Nine Reasons Why This Rally Has Legs*](#). Some readers questioned our change in tone in the interpretation of the Zweig Breadth Thrust buy signal. The key differences between the two signals are a less hawkish monetary policy outlook and the presence of a market panic that sparked V-shaped rebound in the latest episode. That said, the key risk to our bullish scenario is a valuation headwind.

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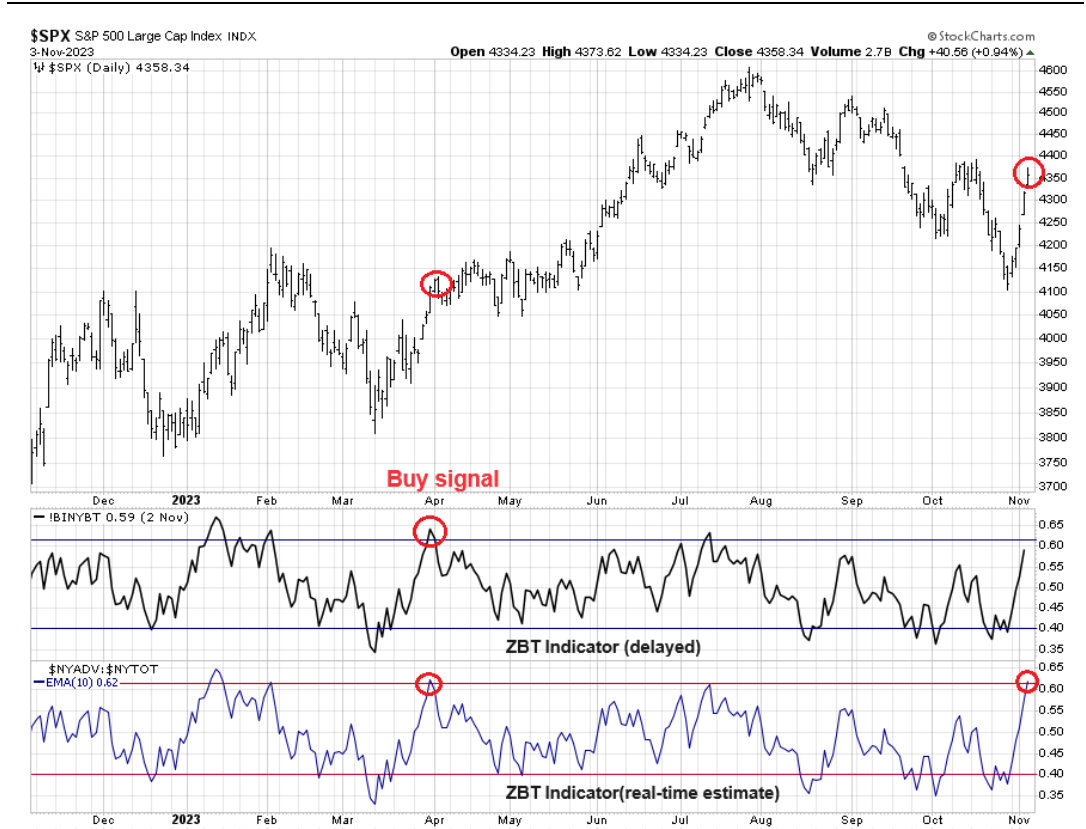
From Caution to YOLO

We would like to address the feedback from our recent publication, [Nine Reasons Why This Rally Has Legs](#). Some readers questioned our change in tone in the interpretation of the Zweig Breadth Thrust buy signal.

As a reminder, the ZBT is a price momentum signal. It is triggered when breadth indicators rise from oversold to overbought within 10 trading days. Breadth thrust price momentum signals usually resolve in a surge. The market triggered a ZBT buy signal on March 31, 2023 and our reaction was cautious (see [Why You Should Fade the Breadth Thrust](#)). This time, the tone is far more bullish and we are inclined to adopt a YOLO (You Only Live Once) to portfolio positioning.

We wrote in early April that we were cautious, but not outright bearish. We were mostly correct. Instead of a price surge, the S&P 500 traded sideways for two months after the buy signal, rallied and topped out in late July, and pulled back to the approximate level of the buy signal in late October.

Exhibit 1: Zweig Breadth Thrusts Compared



Source: StockCharts

Here's what's different about the latest signal compared to March.

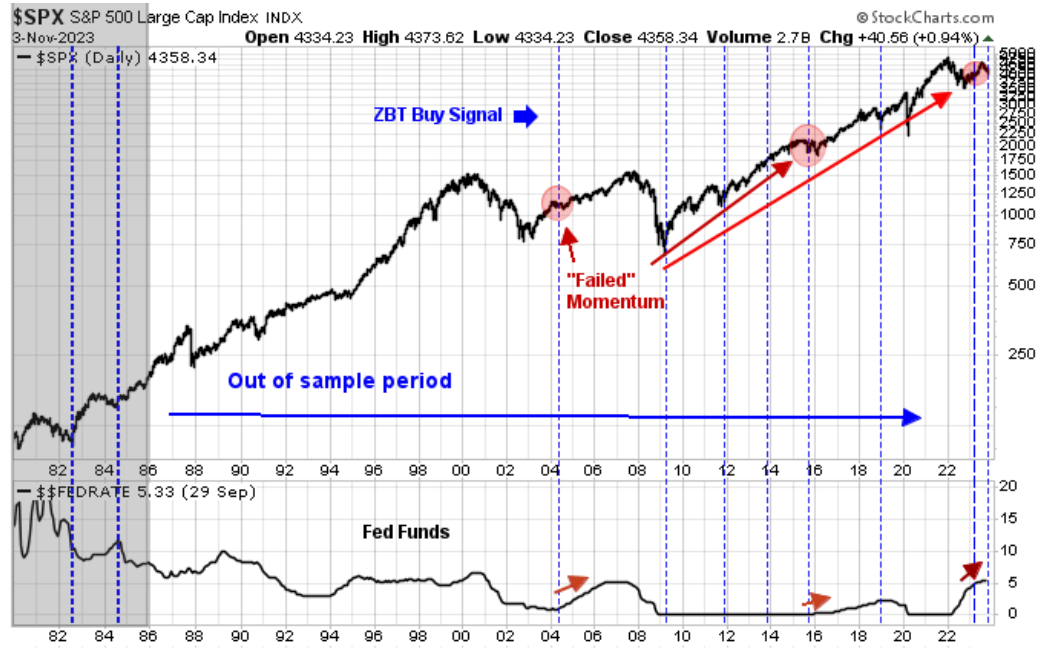


A History of ZBT Signals

The accompanying chart shows the out-of-sample history of ZBT signal when Marty Zweig outlined his breadth thrust signal methodology in 1986.

Excluding the latest buy signal, there have only been seven out-of-sample ZBT buy signals since 1986. The S&P 500 was higher a year later in all instances. Four of the buy signals were accompanied by runaway freight train-style price surges, but the market traded sideways and re-tested the buy signal entry points in three cases.

Exhibit 2: A History of ZBT Buy Signals



Source: StockCharts

Here's what made the "failures" different.

- The "failures" occurred against a backdrop of tightening monetary policy, as measured by a rising Fed Funds rate.
- Most of the "successful" signals came out of V-shaped panic bottoms, though the one in 2013 did not, and the 2015 "failure" was a V-shaped bottom that was later re-tested later.



What's Different This Time

It is against this framework that we can observe the Fed Funds rate continued to rise after the March ZBT signal. Today, investors can be more confident that the rate hike cycle is over. Fed Chair Powell signaled that the Fed is done raising rates at the last post-FOMC press conference, though he left the door open to more hikes should inflationary pressures persist.

Exhibit 3: A Comparison of ZBT Buy Signals



Source: StockCharts



In addition, successful ZBT buy signals generally occurred after a V-shaped panic bottom. An analysis of [SentimenTrader's Fear & Greed Index](#) shows that sentiment is far more extreme and panicked today compared to the March ZBT buy signal.

Exhibit 4: Investors Weren't Panicked in March



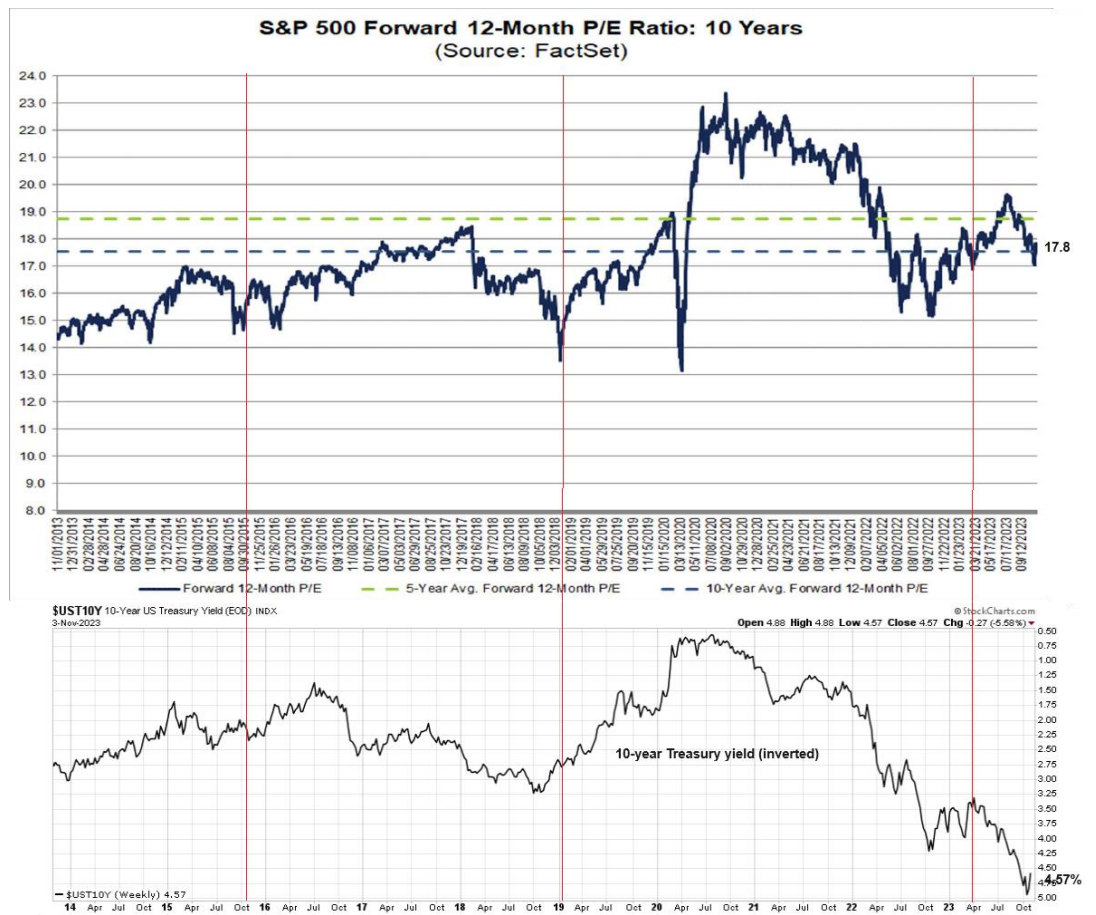
Source: SentimenTrader



Key Risk

While we are far more bullish on equities in the wake of the latest ZBT buy signal compared to the March signal, the one key risk to the bullish scenario is valuation. The accompanying chart shows past ZBT buy signals in the last 10 years as marked by red vertical lines. The current stock/bond valuation of an S&P 500 forward P/E of 17.8 compared to a 10-year Treasury yield of 4.57% is less attractive when compared to past buy signals. Arguably, it's difficult to envisage a new equity bull that starts at these lofty levels. In effect, the bulls are depending on the combination of price momentum and a less restrictive monetary policy and benign liquidity environment sparking the market's animal spirits to push stock prices higher.

Exhibit 5: A Valuation Headwind



Source: FactSet Information Systems, StockCharts

In conclusion, we are far more bullish on the equity outlook in the aftermath of the latest ZBT buy signal compared to the one in late March. The key differences between the two signals are a less hawkish monetary policy outlook and the presence of a market panic that sparked V-shaped rebound in the latest episode. However, investors face the risk of heightened valuation headwinds to this bullish forecast.



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