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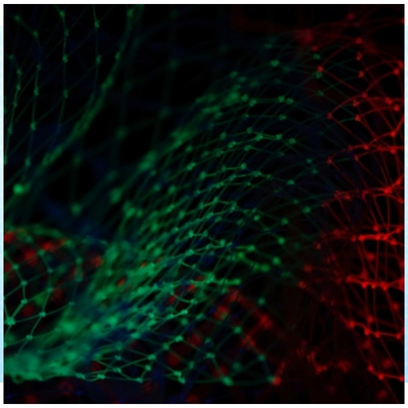

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Technical Note

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Technical market analysis uses patterns in market data to attempt to understand market dynamics, trends, and turning points. The goal of this short note is not to predict the future, but instead make sense of the market volatility, in both directions, that has occurred thus far in 2022. This note will discuss ratio analysis and moving averages.

In the discipline of technical analysis, Fibonacci ratios are commonly used to help identify how far a correction could be expected to go and where support (or resistance) might occur. The theory suggests that a countertrend move generally completes when it retraces 38.2% to 61.8% of the prior dominant trend. If the pullback does not reach these levels, then it is not even considered an interruption of the trend. If the countertrend move exceeds these levels, then something larger or different is afoot. Based on Fibonacci ratio analysis, the corrective zone for the entire post-Covid rally in the S&P 500 is shown in the red box, between 3815 and 3195. In late July, the index fell to 3637, satisfying the correction when entering the zone where support would be expected. Indeed, the market found support and experienced a strong corrective rally over the summer.

Taking a closer look at the decline this year into June, and applying the Fibonacci ratio analysis, we could have reasonably expected the markets to potentially rally to the 4088 to 4367 zone, depicted in purple. Indeed, the markets wasted no time and rallied deep into those levels in July and August.

Technical analysts commonly look to the 200-day moving average as a common indicator of market direction and a source of support and resistance. The S&P 500 broke below the moving average (blue line) in the first quarter, sending a warning signal that a more serious decline could be coming. On August 15, the S&P 500 touched this moving average, which proved to be a strong, short-term resistance. It is no surprise that the powerful summer rally had found a good spot to take a breather.

What next? Who knows? I find that this analysis works great with the benefit of hindsight, but that making a prediction of the future to generally be a fruitless endeavor. It may be reasonable to expect the market to churn between the July lows and August highs for some time. A rally that sustains above the 200-day moving average, and higher than the 4367-resistance level, could be considered by some to indicate that the current correction is over and that a new, potentially bullish, formation has begun. On the other side of the coin, if current June lows do not hold during any future weakness, then there is plenty of room until the bottom of the red corrective zone. While it would be very surprising to see the index move lower than the 3195 level, a fresh market low would not be a fun experience. One thing is for sure – this market has been very volatile in both directions, and that may be something we all need to get accustomed to for some time to come.

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