

# PHASES & CYCLES®

**THE PERIOD OF DISBELIEF SHOULD  
GIVE WAY TO A CONSTRUCTIVE  
BUT SELECTIVE ADVANCE.**

In late January, the bulls got everything they could have wished for: the panic-driven sell-off, the media promoting the bear market and widespread fear and resignation – all accompanied by positive divergences and bottoming cycles. Indeed, it was a turnaround setup *par excellence*.

The bulls acted on this superb opportunity on January 22 and 23 with a powerful “reversal-day” action that most likely ended the bear market as measured by cyclical, sentiment and technical data.

Cyclically, the 39-week cycle has bottomed and now the upside portion of the cycle should provide much-needed support for this newborn bullish phase.

All sentiment indicators provided readings equal in magnitude to the October 2002 bottom. The insider data was the strongest since August 2002.

The number of stocks with selling climaxes reached an all-time record. The latest sentiment surveys (AAII and Investors Intelligence) displayed a bearishness that was last recorded in October 2002.

Technical Indicators confirmed the major turn in the markets when the January low was lower than the August low but a “positive” divergence occurred on many technical indicators (such as the declining number of new 52-week lows and MACD action).

Despite this overwhelming evidence, a number of “danger spots” exist on the otherwise increasingly bullish map. Two of them pose an imminent threat: (1) the markets are still trading below their falling 200-day moving averages, and (2) the multi-year trend lines dating from 2002, for the S&P/TSX Composite and the S&P 500, have both been violated.

We might, however, interpret this as just an indicator that the old bull/bear phase has ended and a new one has started. This should re-position the indices above their moving averages and establish new trend lines as it proceeds.

One of the desirable but not essential features of the bottom-building process is a successful retest of previous lows. Any further declines in the proximity of the January 23 low would get the bears really excited, especially in the face of the Fed's dramatic reductions in interest rates. Such a test would create the perfect setup for a multi-month rally.

*Following the impressive reversal action, the bulls should gradually continue disarming the last pockets of resistance. Once the remaining "stumbling blocks" are removed from the picture, we will be able to call for a total victory for the bullish forces.*

*During this period of disbelief (where a possible retest of the January 23 low may occur), investors' focus should remain on stock selection – choosing the stocks that best withstood the bear market/correction.*

**Phases & Cycles Inc.,**  
**2020 University, Suite 1903, Montreal, QC H3A 2A5**  
Tel.: (514) 393-3653 E-mail: [RonMeisels@phases-cycles.com](mailto:RonMeisels@phases-cycles.com) [www.phases-cycles.com](http://www.phases-cycles.com)  
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