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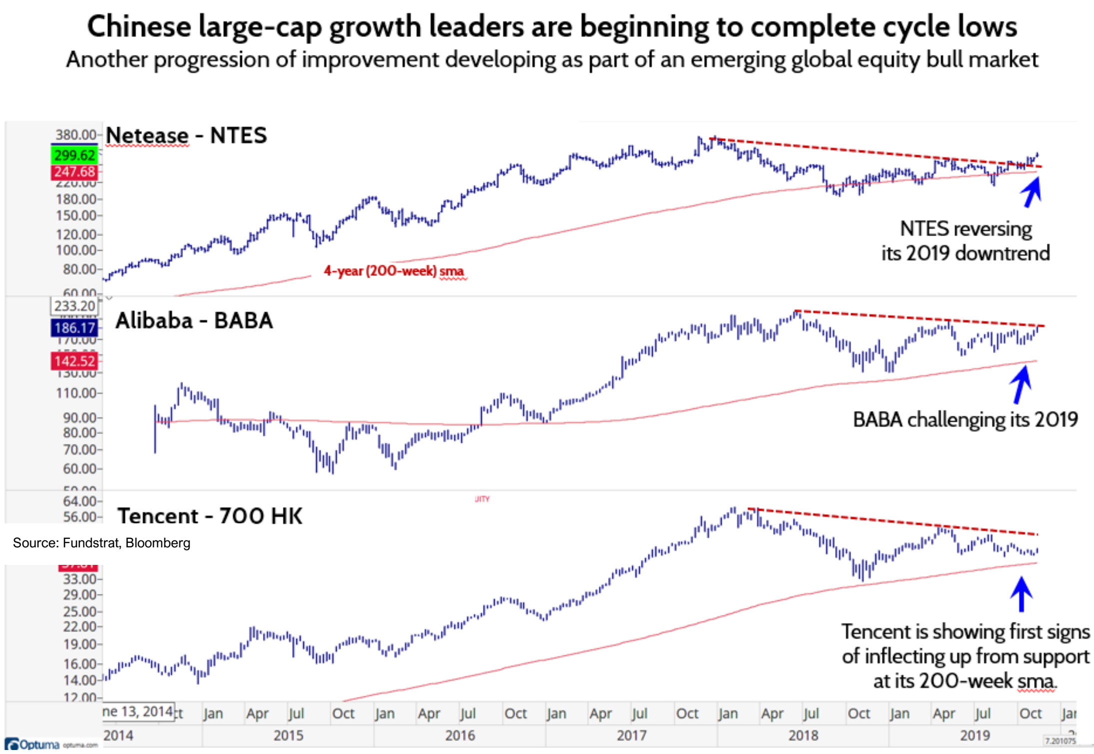
Cyclical rotation in-tact heading into final weeks of 2019

The long-term equity cycle backdrop continues to improve as major US equity indices extend their October rallies to all time highs. Within equity markets cyclicals, notably financials and industrials, have broadly reaccelerated with their relative performance trends versus the S&P 500 finally reversing 2-year downtrends. This action continues to confirm the bullish view I have outlined here through the summer and fall.

This week saw a number of key technical hurdles breached. Financials and industrials continued to outperform, making increased relative performance highs that are now above their 200-day moving averages. In contrast, as noted below in the sector section, utilities and staples are beginning to break down right on track.

In addition, as I'm writing this note on Thursday afternoon, the largest bond ETF, the TLT (135.48), has just moved to a new low, gapping below the key 136 support level I focused on in our October 24th note. The TLT's 2019 uptrend is now broken and serves as one more technical data point confirming a rotation away from safety toward risk-on assets.



One near-term risk I see is a temporary pause/pullback taking hold shortly given almost all risk assets are overbought short-term. As an example, the Russell 2000 Small-cap index is showing early signs of stalling at resistance at the upper end of its March-October trading range. I expect pullbacks to be short lived, so don't get shaken out of long positions attempting to micro-manage selling only to have to buy back. This market cycle appears to have legs to run for many quarters. We suggest to stay long and strong using pullbacks to increase exposure.

So what is there to buy other than the cyclicals we've been recommending here for months? Well, Chinese growth stocks, such as Netease (NTES), Alibaba (BABA) and

Tencent (700 in HK) are showing a classic progression of a major cycle lows developing following 12-18 month bear markets.

Leading the rally is NTES pushing above its summer highs, with BABA close behind as both begin to reverse their 2019 downtrends. Tencent is particularly interesting this week as it begins to bottom almost exactly at its rising long-term uptrend defined by its rising 200-week sma.

Bottom line: My outlook remains unchanged - expect further upside in equities well into Q1 driven by broadening participation across cyclicals with the off-side positioning by most money managers being overweight safety stocks and underweight cyclicals, as fuel for further rotation

Figure: Rob's Weekly Sector Review

Source: FS Insight, Factset

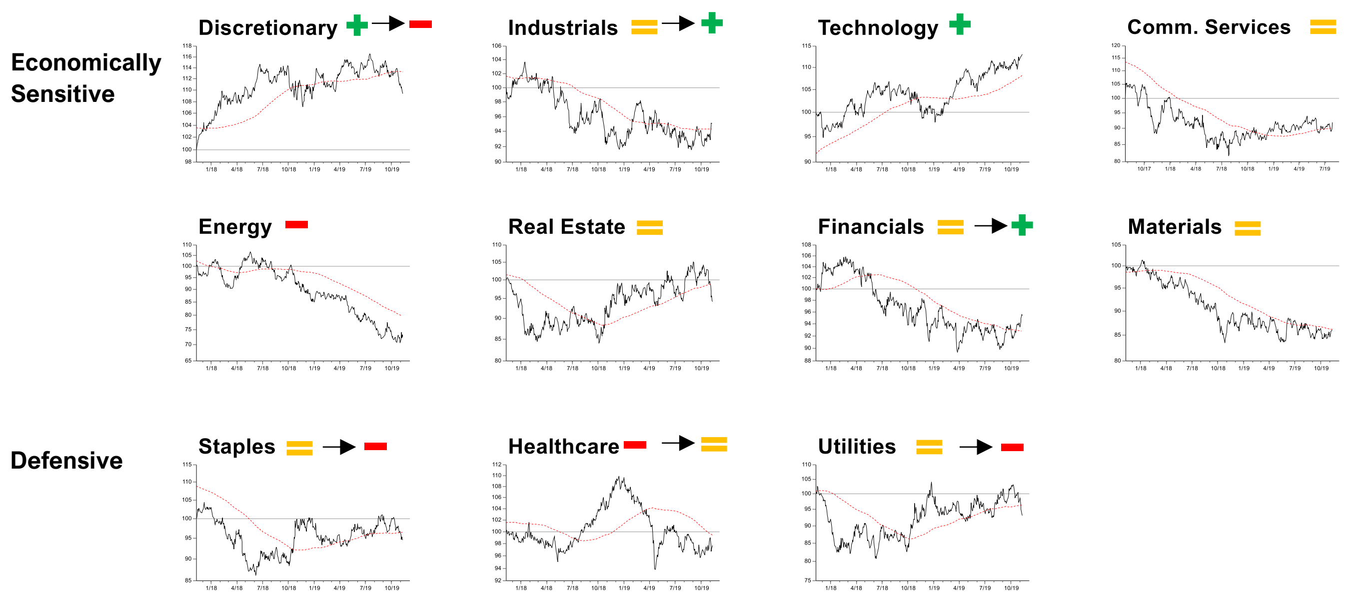
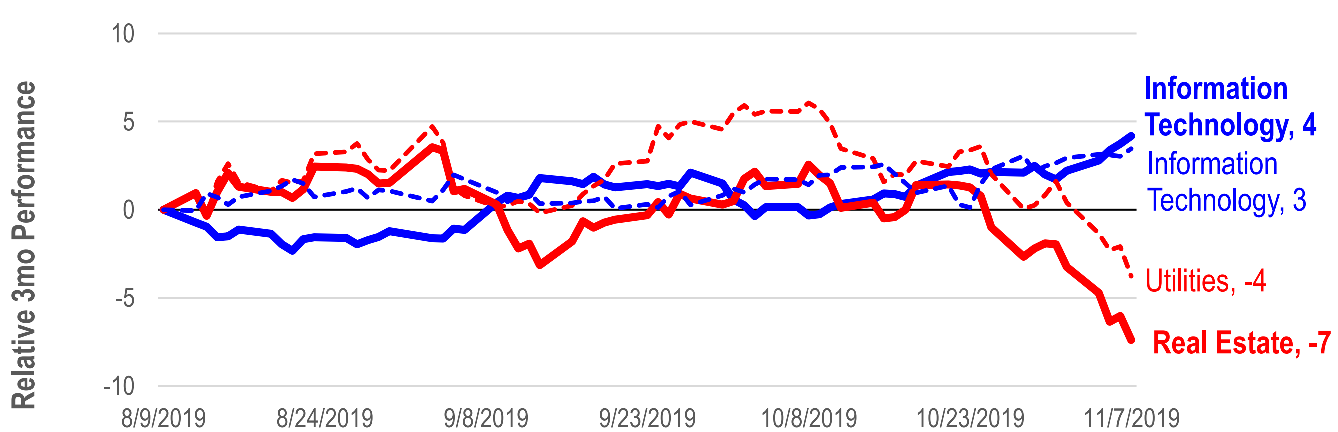


Figure: Best and worst performance sectors over past 3 months



Source: FS Insight, Bloomberg

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