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Commentary: Stocks are about to tumble by 7 to 10 percent

Matt Maley

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The S&P 500 has suffered a 7 to 10 percent decline in each year since 1995. I believe this year is no different — and that, in fact, such a decline is around the corner.

First of all, the market's strength appears to be flagging. Sure, the S&P is up 9.2 percent this year, but more than half of that advance came in the first two months of 2017. It is striking to note that right now the index stands almost exactly where it found itself at the beginning of June.

This is odd, because the fundamentals have proceeded quite well. The improvement in earnings we saw in the first and second quarters, and the recent better-than-expected economic data, have all become evident after most of this year's rally had already taken place. In other words, this is yet another example of when the market moves differently than the way fundamentals tell us it "should" move.

But this distinction isn't encouraging; quite the contrary.

Beyond the stalling in the level of the S&P 500 itself, it is interesting to note that the number of stocks above their 200-day moving average has declined markedly. This tells us that the market is becoming more "narrow" in leadership.

Even worse, we're also seeing a divergence in the breadth of the market on days in which the S&P sees a big move. Last Tuesday, when the S&P 500 enjoyed a 1 percent rise, 4.5 stocks in the index advanced for each that declined. Yet two Thursdays ago, when the market slid 1.5 percent, 20 stocks fell for each that rose.

And let's not forget about the macroeconomic backdrop.

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many years. As we have shown many times in the past, this liquidity has been the key fuel for the rally over the past eight to nine years — so the fact that it's going to be less plentiful going forward makes us quite cautious.

With monetary policy changing, we need to see fiscal policy pick up the slack. Although we do think we'll get some sort of tax package and other fiscal stimulus before next year's election, it's going to be a lot less than people were hoping for, and won't be enough to make up the difference.

In other words, the improvement in fundamentals is already behind us. Looking forward, several catalysts would seem to suggest that a drop is more likely than a rise. And for close watchers of the charts, the market's "internals" are telling us that already.

Matt Maley
Equity strategist at Miller Tabak

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S&P 500	2641.91 ▲	2.47	0.09%

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