M O M E N T U M   S T R U C T U R A L   A N A L Y S I S

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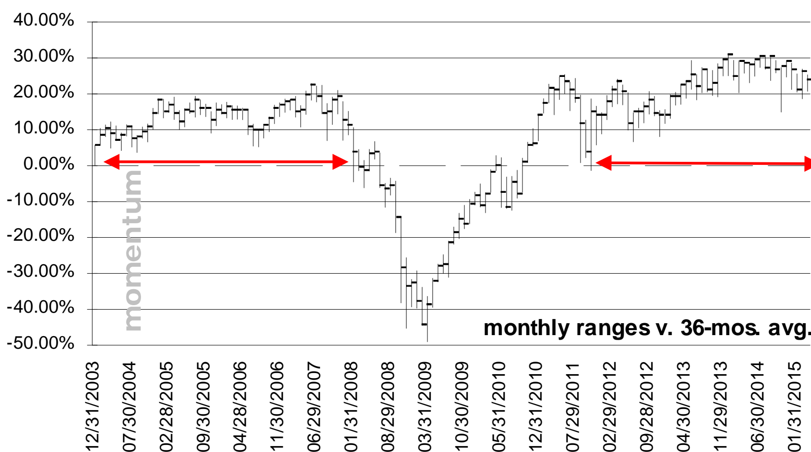
Momentum 102: Return to the Mean (revisited)



Charts in this report are annual momentum only. They show monthly price bars (of the Dow or S&P500) plotted relative to the 36-mos. avg. (in oscillator format) and go back to 1920.

Current annual momentum action of the S&P500 since 2003 is on the left.

What this report does is a bit different from prior ones that showed the same charts. In those reports MSA measured from the low monthly oscillator close of bear moves to the peak monthly oscillator close of bull moves to measure trend duration. In *this* report we are only measuring how long some of these moves were **suspended above the zero line** prior to returns to that mean. For example, in December 2003 the momentum action rose above the 36-mos. avg./zero line and did not touch back down to that mean until January 2008. A bit over four years above the mean, in other words. And historically that was a stretch - a long time without a pit stop. As is often typical with such long market rides, the return to the mean turned into a deep oscillation *below* the mean. Current action has been above the mean ever since its lows of October 2011, i.e. about three-and-a-half years, which is also a long time without a pit stop, archivally speaking.

What MSA has found is that moves above the mean which last a few years are in no manner “overdone” or excessive. Often those upside moves are refreshed by a touch down to the mean. Nothing more - no disasters. But when the time spent above the mean reaches the current duration or longer, then a simple return to the mean might not be all that occurs in the subsequent decline.

Let’s go back and look at the action in twenty-year clusters.

Current situation summary on page 4

M o m e n t u m   S t r u c t u r a l   A n a l y s i s
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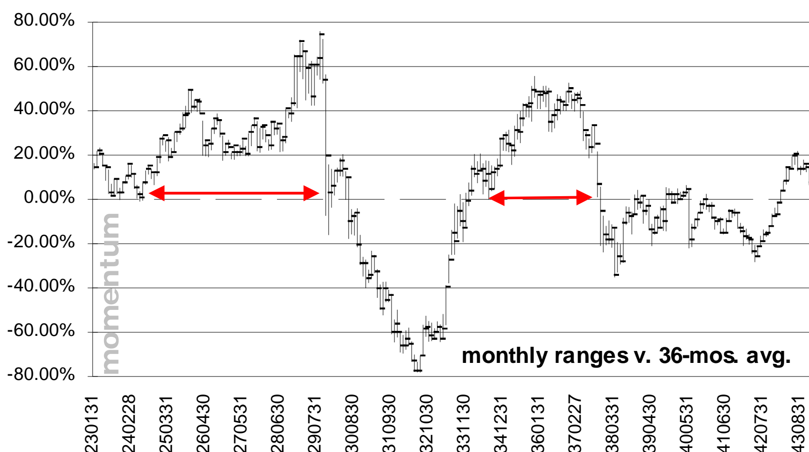
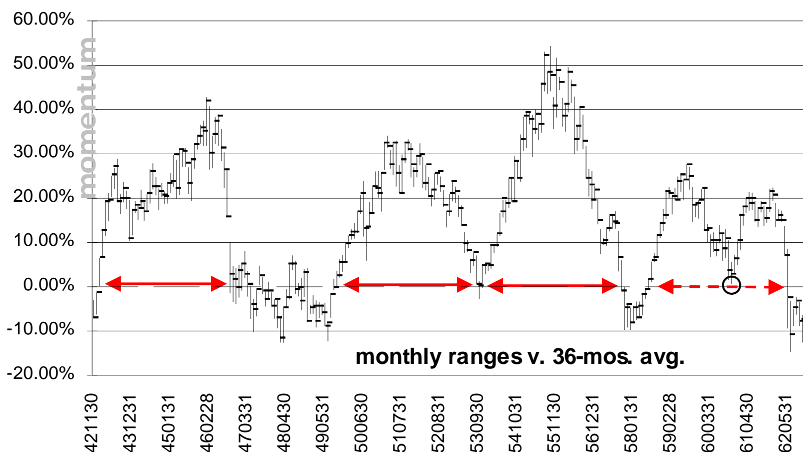


Returning to the Mean or ...
Oscillating the Mean - The Archives

Returns to or through the annual mean (36-mos. avg. or 3-year avg.) are regular market events - regardless of the perceived fundamentals at the time. Sometimes within a few quarters from a top, and after many points of decline, the fundamentals begin to explain the downturn. But sometimes it's just an issue of certain bull or bear fundamentals being overpriced - too high for too long. Take the 1987 crash, for example.

Clearly the **2004 to 2007** market (prior page) was excessive and paid for it with a deep oscillation below the mean. The current market is also in the aged category, so that feature needs to be recognized.

1929, above, was the end of a five-year upside exercise, perhaps among the oldest in American history. And we know how its excess was dealt with. Then in the post-bear recovery of **1933 to 1937** the momentum action remained above the zero line for three years and three months, and paid with a deep oscillation below the mean, which was also followed by much wallowing around below the zero line until 1942.

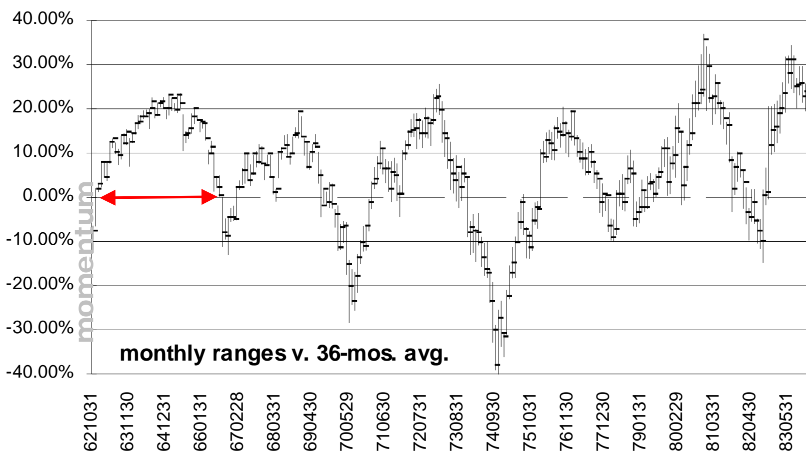


The **WWII bull market,** right, crossed above the zero line in January 1943 and only returned to the mean in September 1946 (more than three-and-a-half years). The subsequent downside oscillated the mean and remained depressed until 1949.

The next positive crossing of the zero line was in **September 1949**, and it did not see the zero line again until **September 1953**, which, as it turns out, is a rare occurrence in the archival record in that it halted mildly at the mean, despite qualifying as having been a "mature" stretch above the zero line. But it did return.

1953 to 1957 was a four-year trip above the zero line which resolved with a drop 10% below the mean, where it remained for six months before turning up.

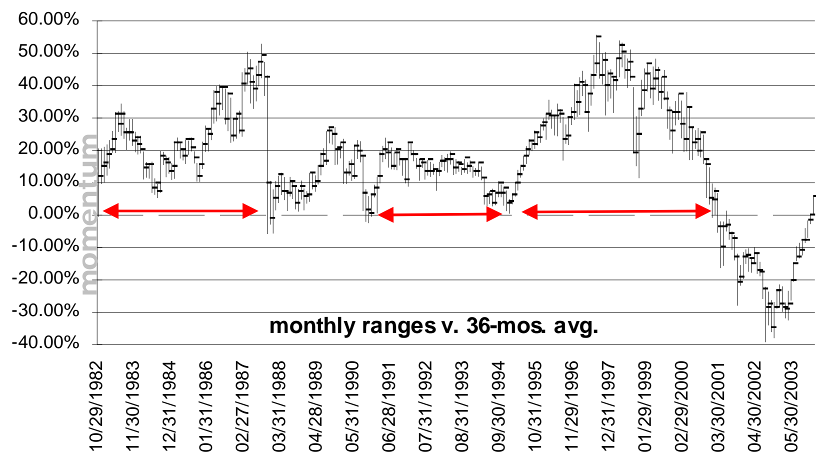
The period from **mid-1958 until 1962** actually had a decline to within 1/2% of the zero line in late 1960 (circled). I count that near miss as a return to the mean. I have noted the period on the chart with a dashed red arrow - so that four year period was in fact hyphenated by a pit stop and therefore does not count as an "aged" trend.



January 1963 to August 1966 was three-and-a-half years above the zero line, and it dropped to 12% below the mean.

No other period of time in the next few decades remained above the zero line by anything that could be defined as excessive. A regular breathing pattern is the best way to define the market action from the mid-1960s until the early 1980s. The mean was visited with regularity.

The period from **October 1982 until October 1987**, right, was equal to the excessive duration of the 1929 bull trend, and 1987 produced a crash as well. It halted shallow however, basically just below the mean. But it was a head-ripping, profit-filled event just getting there - if one viewed markets as oscillating realities, which they are.



January 1991 to December 1994, nearly four years, produced a decline to the mean.

Truly excessive duration was exhibited from **1995 to 2000**. It took five years before touching the mean, though the decline toward the zero line actually began in earnest several months before finally touching it in late 2000. Ultimately the action went well below the mean.

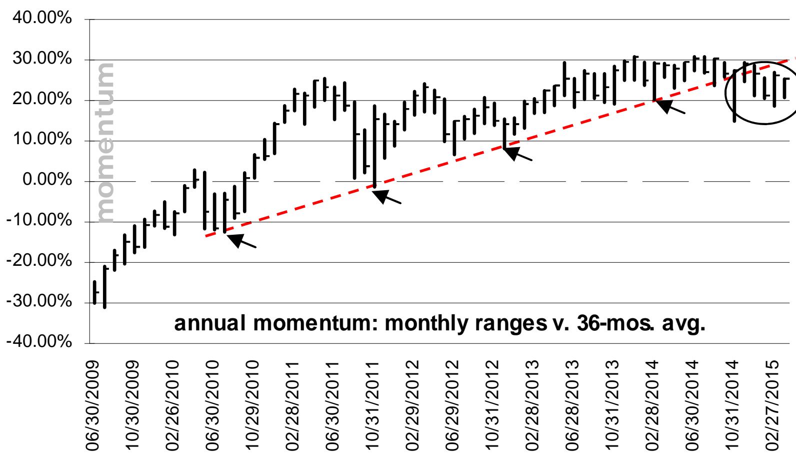
What to do with this historical information? See the next page.

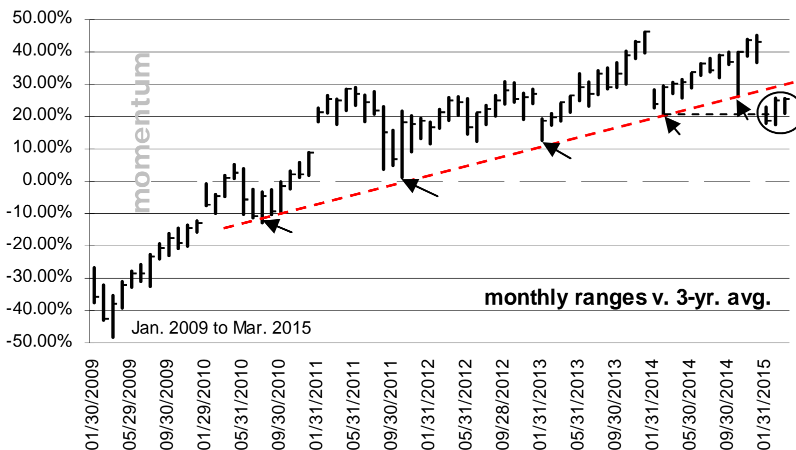
Unfortunately the term “excessive” when measuring duration is ball-park only. There is no magical number of months after which the clock says “Sell now!” But the archival history plainly shows that any trend that’s spent well over three years above the mean begins to qualify, and five years has been the rarity (twice only). Consider it a window.

The next step is the normal MSA process of measuring for structural momentum trend clarity and then defining a point of breakage. All of these downturns in momentum, whether from trends of excessive or normal duration, generated structural breakage. And sometimes it was abundantly clear even to the amateur. Such was the case in 1929, 1987, 2000, 2007, and countless other times. And MSA now includes the period from October 2014 to January 2015 as one of initial annual trend breakage. The breakage in October was registered on the 36-mos. momentum chart, shown on page one and again below. Also shown below is the 3-yr. avg. momentum oscillator. It registered breakage in January of this year (MSA prefers to see both annual studies shift trend before making assumptions).

The next step for MSA is to measure for intermediate trend breakage, because at present the intermediate trend is positive. For this past month, MSA defined a daily close below 2020 on the S&P500 as sufficient to signal downtrend in monthly momentum (price measured against the 3-month avg.). Next month that trend alert level will be adjusted upward sharply, possibly to 2050. More specifics on that adjusted number once this month closes.

But for now the current market has both excessive age above the mean and has produced initial annual momentum breakage. It’s only waiting for intermediate trend factors to join in. At that point MSA expects to see the market move down to the mean - *at a minimum*.





For the 36-mos. avg. it is now above 1700, but the 3-yr. avg. is at 1685 all this year.

36-mos. momentum action broke a four-point uptrend in October, reached back up, could not achieve prior highs, and is now below the up-trend structure, hovering and eroding.

3-yr. avg. momentum broke a five-point uptrend in January, taking out low readings of the prior year (horizontal), the first such violation of a prior year’s momentum low since the upturn in 2009. MSA said after the close of 2014 that likely resistance in 2015 should begin to show itself at the October 2014 low momentum level (the fifth point along the violated uptrend - last arrow). That low was 26.2% above the zero line then. 26.2% over the current 3-yr. avg. is 2126. Therefore, “around 2130” was MSA’s suggested overhead resistance for 2015. But downside structural breakage has already occurred as of January. MSA cannot overlook that action.