

SENTIMENT UPDATE

S&P 500 = 1548.34

REFERENCED CHART LINKS

Do Sentiment Indicators Lead at Stock Market Peaks?

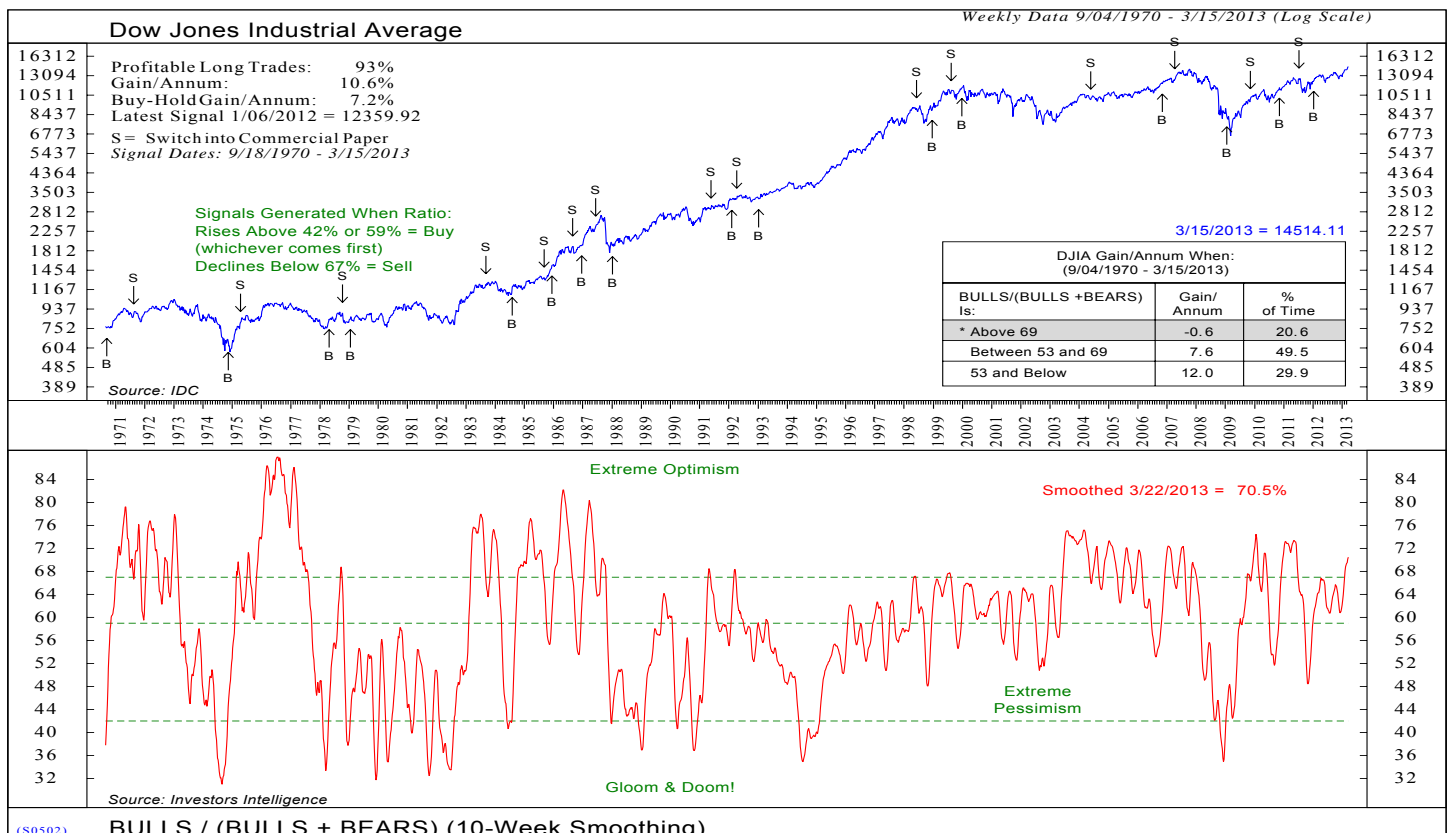
I generally think of peaks and troughs in sentiment as fairly coincident to highs and lows in the stock market. Thus, generally at extremes, sentiment is not a leading indicator. But of course, before we get to true extremes, sentiment does get into zones that warn us to "get ready to sell" or "get ready to buy." As I have tried to prove over the years, sentiment works well in most market environments. The times it does not work well are during bubbles on the upside or systemic panic on the downside. In these cases, I use Keynes' note that "markets can remain irrational longer than one can stay solvent."

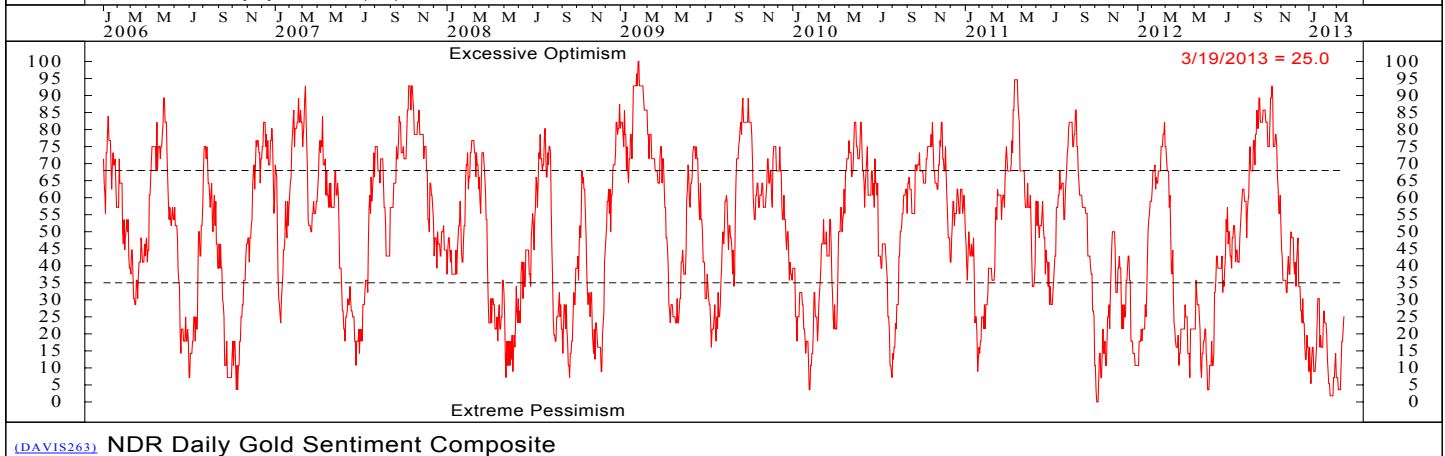
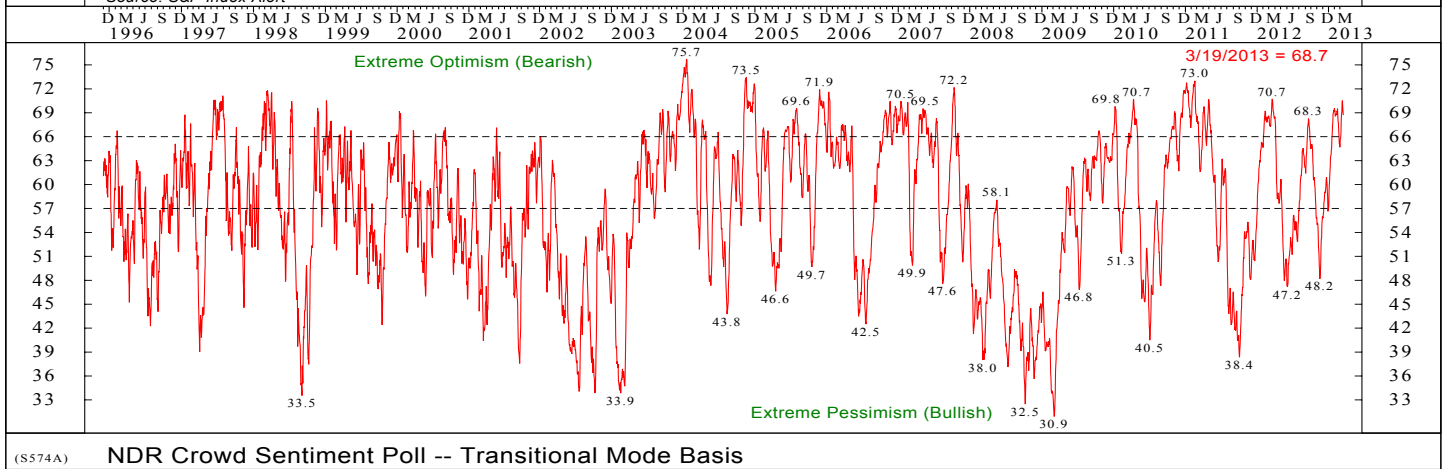
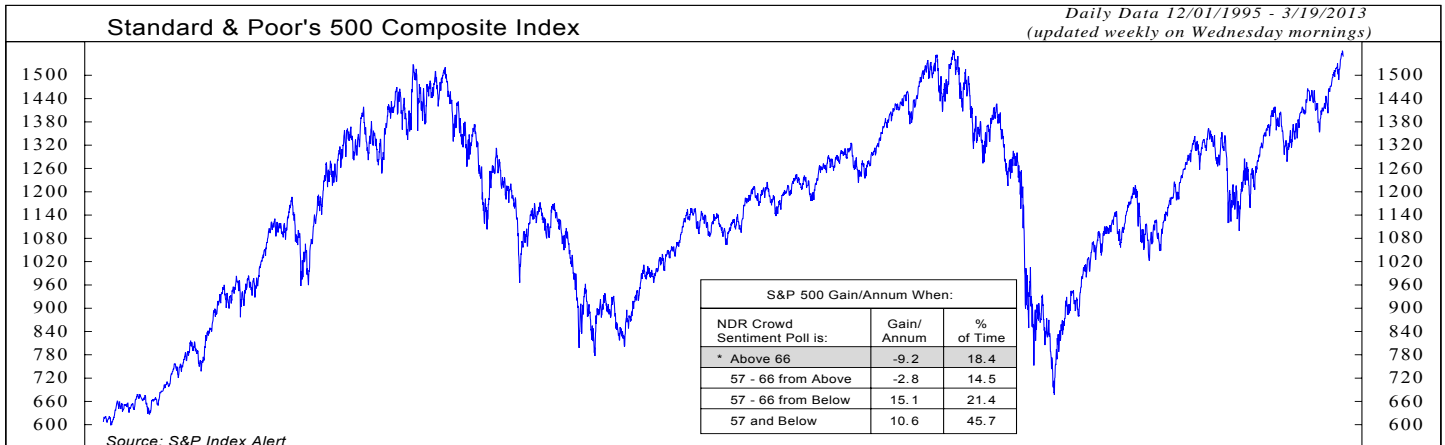
So no indicators work in all kinds of markets. The way I try to get around this is to tell clients that if the market has great momentum up or down, then less emphasis should be put on sentiment. For example, early this year I noted we had many "breadth thrusts" on the upside, saying in that case, momentum generally trumps sentiment. In late 2008, during a systemic panic after Lehman Brothers, momentum turned down sharply, and sentiment got way too pessimistic too early.

All of this explains why NDR, instead of using sentiment as a leading indicator, generally likes to say "go **with** the flow until it reaches an extreme and then begins to reverse; that is the time to go contrary."

Given the background of strong upside momentum (and a friendly Fed), I have stated that my favorite sentiment indicator right now is S0502 (below). There are two types of analysis on this chart. One is bracket or mode analysis that generally tries to be a leading indicator of tops or bottoms. The other type of analysis is a signal analysis that is more of a trigger for when to act. It is true that we are at excessive optimism, which is a sentiment warning, but on a signal basis, we are still on a timely buy signal. The [Fab Five Sentiment Component](#) uses S0502 on a signal basis.

In conclusion, John Templeton says that stocks go from pessimism at a bottom to skepticism during the rise, to optimism as it matures, and euphoria at a peak. I think we are in the optimism phase. Updates on S574A for stocks and DAVIS263 for gold are shown on page 2.





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