Weekly Trends

PRIVATE CLIENT SOLUTIONS

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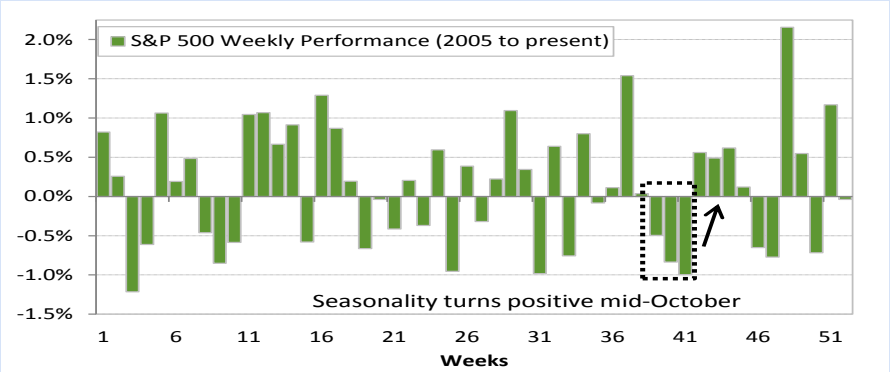
The "Three S's" For Strength Into Year End

- In our *2015 Market Outlook* report we highlighted the potential for equity market weakness in the summer/fall period. In the report we stated "we see a decent first half followed by potential weakness in H2/15 as the Fed begins to hike rates. The expected first rate hike is in mid-2015 which would coincide with the typically weak summer months. Stocks could come under pressure in the summer/fall period, but by end of year, we believe North American equities will be higher, in line roughly with corporate earnings growth." So far, this forecast has played out well with the S&P/TSX Composite Index (S&P/TSX) rallying to 15,450 in mid-April (+5.5% gain), before succumbing to selling pressure in the summer and fall. We'll see in the fourth quarter if we get the last part of our forecast correct (the most important part). This week we discuss the "Three S's" (seasonality, support and sentiment) which we believe supports our call for strength into year end.
- From a seasonal perspective, Q3 is notoriously weak for equities, with the S&P 500 Index (S&P 500) averaging -0.7% since 1990. But this is then followed by the strongest quarter of the year, with Q4 averaging +4.9%.
- Another factor that keeps us bullish is the fact that the S&P 500 has held technical support, and by definition, remains in a sideways range.
- Numerous investor sentiment surveys point to very bearish sentiment for equities, which from a contrarian perspective is bullish for the markets.
- Putting it all together, with the S&P 500 still above key technical support, seasonality turning bullish in mid-October, and sentiment at extreme bearish readings, we believe the equity markets are set to move higher into year end.

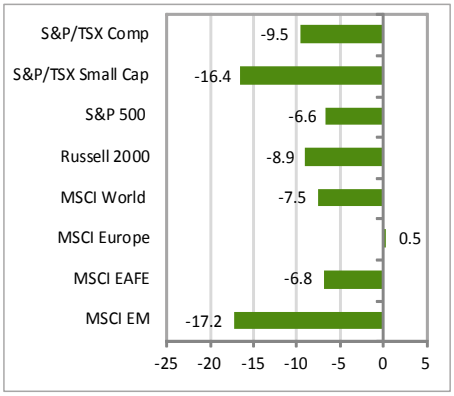
Chart of the Week

Historical Returns Suggest A Year-End Rally Beginning In Mid-October



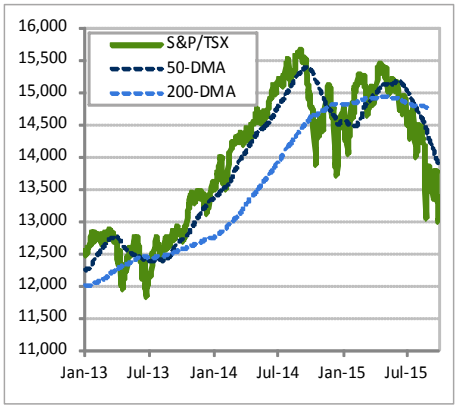
Source: Bloomberg, Raymond James Ltd.

Equity Market YTD Returns (%)



Canadian Sector	TSX Weight	Recommendation
Consumer Discretionary	7.2	Overweight
Consumer Staples	4.4	Market weight
Energy	18.5	Market weight
Financials	37.3	Market weight
Health Care	4.9	Market weight
Industrials	8.3	Overweight
Information Technology	2.9	Overweight
Materials	8.8	Underweight
Telecom	5.4	Market weight
Utilities	2.3	Underweight

Technical Considerations	Level	Reading
S&P/TSX Composite	13,241.9	
50-DMA	13,832.1	Downtrend
200-DMA	14,614.3	Downtrend
RSI (14-day)	43.7	Neutral



Source: Bloomberg, Raymond James Ltd.

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RAYMOND JAMES

The "Three S's" For Strength Into Year End

In our *2015 Market Outlook* report we highlighted the potential for equity market weakness in the summer/fall period. In the report we stated "we see a decent first half followed by potential weakness in H2/15 as the Fed begins to hike rates. The expected first rate hike is in mid-2015 which would coincide with the typically weak summer months. Stocks could come under pressure in the summer/fall period, but by end of year, we believe NA equities will be higher, in line roughly with corporate earnings growth." So far, this forecast has played out well with the S&P/TSX rallying to 15,450 in mid-April (+5.5% gain), before succumbing to selling pressure in the summer and fall. We'll see in the fourth quarter if we get the last part of our forecast correct (the most important part). In this week's publication we discuss the "Three S's" (seasonality, support and sentiment) which we believe supports our call for strength into year end.

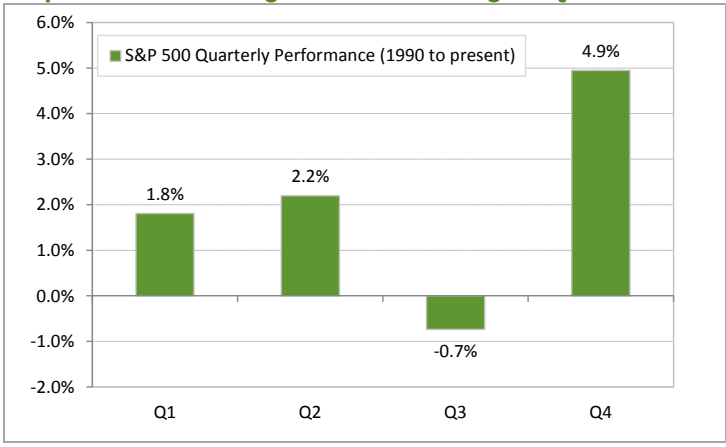
Seasonality

One factor weighing on stocks which is not receiving much attention is the weak seasonality for stocks. The third quarter is notoriously weak for equities, with the S&P 500 averaging -0.7% since 1990. But this is then followed by the strongest quarter of the year, with the fourth quarter averaging +4.9%. Looking at the S&P/TSX, the third quarter is even worse with Canadian stocks down 1.1% on average. While the slowdown in China and concerns of a US Federal Reserve rate hike have weighed on the equity markets over the last few months, weak seasonality has also been a contributing factor that many are overlooking.

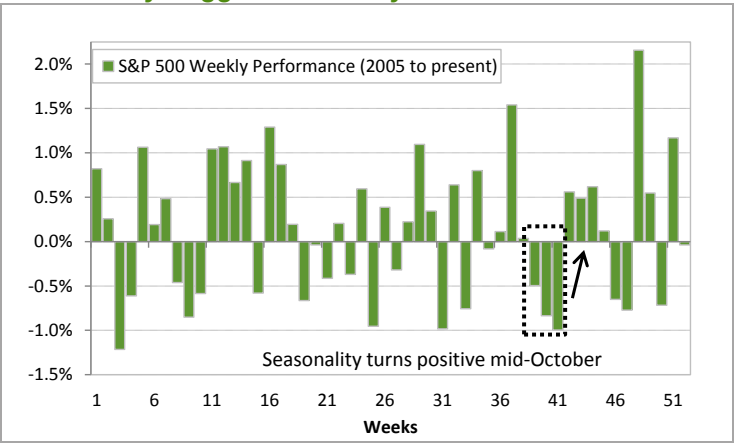
We took this one step further looking at weekly historical returns and found that we are currently in the weakest three-week period of the calendar year. Since 2005, the last week in September and first two weeks in October have been the worst three consecutive weeks for equity returns. Therefore, history suggests that we should expect further equity market volatility through mid-October, before the equity markets begin their year-end rally.

Finally, we examined the probabilities of a positive return in the fourth quarter and found that 80% of the time US stocks were positive in Q4, going back to 1990. Following a down Q3 the probability remains the same at 80% for a positive return in Q4, but gains historically have been higher in Q4, following a negative Q3, with the S&P 500 up 6% on average. Any way you slice the data, history suggests a bottom in the coming weeks, and solid returns into year end.

Equities Are Coming Into Their Strongest Quarter



But History Suggests Volatility Over Next Two Weeks



Source: Bloomberg, Raymond James Ltd.

Support and Sentiment

Another factor that keeps us bullish into year-end is the fact that the S&P 500 has held key technical support on the sell-off, and by definition, remains in a sideways trading range, rather than in a downtrend. Key technical support for the S&P 500 remains the 1,822 to 1,867 range which represents the October 2014 and August 2015 lows, respectively. Our base case view remains that the S&P 500 will consolidate in a trading range of roughly 1,865 to 1,990 over the next few weeks, before breaking out and rallying into year end. However, given the fact that the long-term uptrend has been violated we need to be monitoring price action closely, and should the S&P 500 fail to hold these important support levels, then we likely need to re-evaluate our bullish view.

Looking at sentiment, numerous investor surveys point to very bearish sentiment for the equity markets, which from a contrarian perspective is bullish. For example, the American Association of Individual Investors (AAII) survey, which measures the percentage of bullish/neutral/bearish investors over the next six months, declined to just 28% bullish this week. We prefer to smooth this indicator by taking a 4-week moving average (MA), and it is currently at 31%, which is at the bottom of its historical range. Since 2010 there have been four instances when the bullish reading fell below 30%, and in each instance the S&P 500 was up one month following the reading and up in three of the four instances three months after the reading. On average, the S&P 500 is up 3.6% and 3.8%, one and three months after the reading, respectively.

Putting it all together, with the S&P 500 still above key technical support, seasonality turning bullish in mid-October, and sentiment at extreme bearish readings, we believe the equity markets are set to move higher into year end.

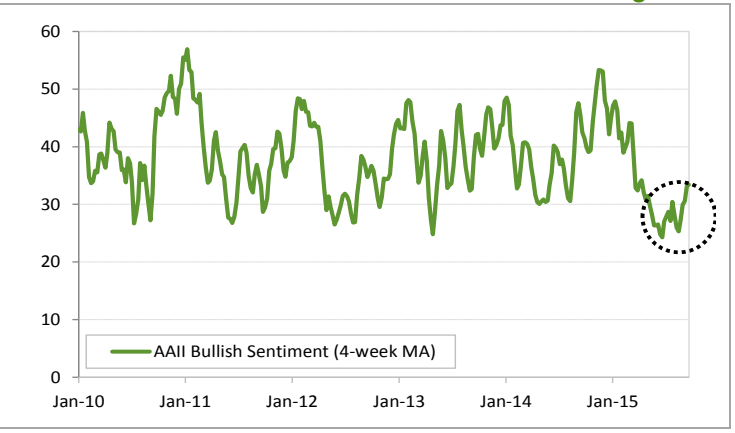
S&P 500 Returns After Bullish Sentiment Falls Below 30%

Date	1 Month	3 Months
8-Jul-10	4.8%	8.4%
9-Jun-11	4.3%	-7.0%
24-May-12	1.1%	7.6%
25-Apr-13	4.1%	6.3%
Average	**3.6%**	**3.8%**

Source: Bloomberg, Raymond James Ltd., AAII

S&P 500 Continues To Hold Key Technical Support

Investor Sentiment Is At Extreme Bearish Readings



Source: Bloomberg, Raymond James Ltd.

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