Strength + Weakness = Weakness?

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We like to think our models and indicators help us preserve a high degree of market objectivity. But sometimes we wonder: **the latest rally has progressed to the point where we see trouble afoot in both the strongest *and* weakest charts we can find**.

First, **the handful of sectors and themes now at new all-time highs are hardly those usually associated with a full-blown "risk-on" scenario** (Chart 1). As of early April, Staples, Utilities, and Telecom Services are all up 5-15% YTD in a flattish market. The S&P 500 Dividend Aristocrats (and high-yielding equity strategies in general) continue to live up to the considerable hype they've received in recent years, delivering market performance during the rebound after outperforming handily during the preceding decline. There's no free lunch in the stock market, however; Jun Zhu's work finds that stocks with high dividend yields remain expensive relative to the broad market—although that's been true for a very long time.

But it's not just the strong charts that suggest this rally is fragile… it's the weak charts, too (Chart 2).

U.S. Treasury bonds acted as they "should have" during the first month of the rally, with the yield on the 10-year Treasury backing up 35 basis points to 1.98% on March 11th (the one-month anniversary of the market low). But yields reversed to the downside in ensuing weeks, despite the grind higher in the DJIA and S&P 500. Considering the stock market's gains and signs of commodity market improvement (including a 13-point spike in the March ISM Price Index), **yield action is mysterious**.

The rollover in bond yields coincides with a loss in vitality among groups that we'd expect to be leaders if the rally has legs. The High Beta/Low Volatility Ratio has flat-lined in the last month, and the rebound in Small Caps has lost steam after a strong start. (The Russell 2000 is still down about 15% from its June 2015 peak.)

Finally, the bounce in Financials has proven weaker than the action of other battered sectors, and the RS trend has already rolled over on a short-term basis. While we're hesitant to use the last crisis as a template, we can't help but note that similar fades in Financials' relative strength occurred at the rally tops of May 2008, August 2008, November 2008, and January 2009.

Chart 1
Strong Charts That Worry Us

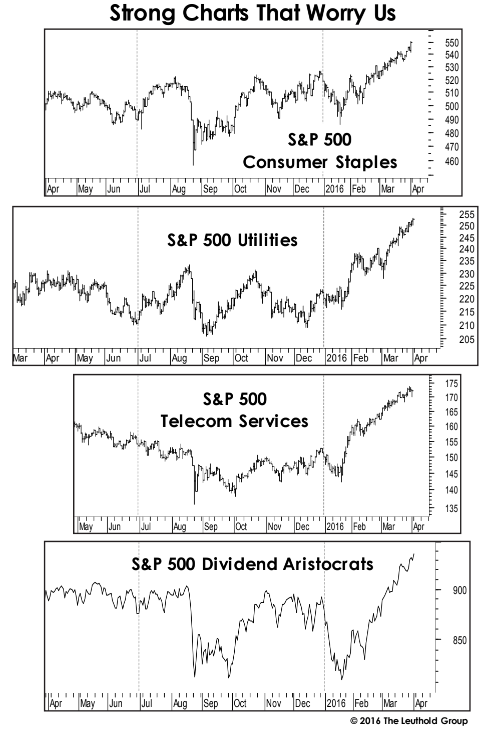

Chart 2
Weak Charts That Worry Us