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October 17, 2014

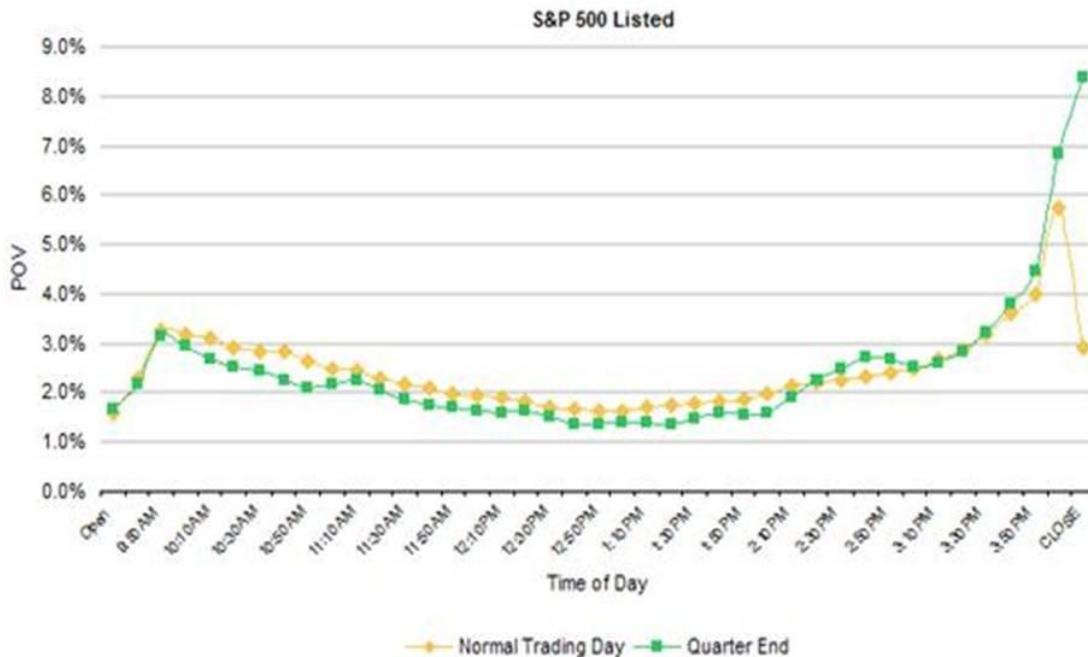
## **Always October**

Financial markets are becoming increasingly complex and fast moving. Securities pricing this week was turbulent and filled with cross currents. Stocks, bonds, currencies and commodities are moving in big chunks and at first glance some of the moves do not make sense. For example, oil fell below \$80 a barrel this week (the first time since 2012) with economic sanctions on Russia, the world's largest oil producer, and ISIS running amok through the Middle East. Normally when there are concerns about supply disruptions in the oil market, prices soar. Trumping geo-political turmoil is the highest oil output in the U.S. since 1985 and softer global demand.

In the U.S., initial earnings reports have been better than expected on average (average EPS growth of 8.5%), mortgage delinquencies fell to an 8-year low, jobless claims reached a 14-year low on a workforce of 10 million larger than what it was in 2000, industrial production was stronger than expected and Christmas spending is projected to be up 5% year-over-year. The stock market decline that began in mid-September reached a crescendo on Wednesday with the Dow collapsing 460 points high to low and the VIX spiking to 31. What are they thinking?

Institutional traders often want to keep their trading activities as private as possible, especially during market hours. One way to prevent other traders from front-running your trading activity is to wait until late in the trading day to execute trades. This leaves little warning to other active traders on how positions are being moved until the final minutes of the day.

Shown below are charts of trading volume during a typical day and during a final day of the quarter. The charts measure time in 20 minute increments. POV on the Y axis represents "percent of value." Starting at about 2 hours before market close, you can see the POV lines rising and reaching peaks at or near the close.



Source: Morgan Stanley Electronic Trading

The point of this is to say that late day stock action can often give us some insight into what institutions are thinking. Let's review the past week of trading activity with particular attention to pricing trends late in the trading day.

### S&P 500 Market Action Summary:

**Friday 10/10:** Previous day close 1928.21. Up +8.6 to high of 1936.80. At 2:40pm ET, S&P 500 turns negative and closes down -19.50 points to 1906.13.

**Monday 10/13:** Previous day close 1906.13. Up +6 to a high of 1912.09. At 2:30pm ET, S&P 500 turns negative and closes down -31.4 points to 1874.74.

**Tuesday 10/14:** Previous day close 1874.74. Up +24 to a high of 1898.71. At about 12:12pm ET, S&P begins to give back almost all of the morning's gains to close at 1877.70.

**Wednesday 10/15:** Previous day close 1877.70. After a gap down open, the S&P 500 declines roughly 57 points to a low at about 1:30 pm ET. In the final two and a half hours of trading, the index rallies nearly 42 points to close at 1862.49.

**Thursday 10/16:** Previous day close 1862.49. Within the first hour of trading, The S&P 500 falls 27 points to a low of 1835.02. From 10:20 am ET, stocks recover losses and close roughly flat at 1862.76.

**What are they thinking?**

1. It is always tricky this time of year (no pun intended). Historically, the last week of September and first few weeks of October are the weakest period for stocks. Why? Much has to do with corporate third quarter earnings and fourth quarter outlooks. Companies and analysts historically start the year with bold, optimistic forecasts - sometimes even aggressive. Americans set the bar high. This is the American way. With few exceptions, estimates are reduced throughout the year. In the third quarter with three months left and time running out, it is throw in the towel time and time to get realistic.
2. Adding to market volatility and increased volume is mutual fund fiscal year ends in October. Harvesting gains, selling losers and rebalancing are dialed up by institutions and professional money managers in October.
3. Coupling the earnings' confession time and mutual fund rebalancing with the October options expiration made this week particularly volatile. Uneven global economic data fueled growth concerns - Ebola is a wildcard creating uncertainty. In February 2003, an American businessman returning from China died of SARS. In March 2003, the CDC issued a global alert which placed a damper on air travel and related economic activity. Because of the severity of the disease, Ebola could have a stronger dampening effect.
4. On Wednesday, there was panic/forced selling that caused the market to become extremely oversold. The S&P 500 traded almost 5 standard deviations below its 50-day moving average at the low. The 10-year U.S. treasury rate whipsawed from about 2.2% on Tuesday down to 1.86% on Wednesday to 2.15% on Thursday indicating an incredibly rapid flight-to-safety trade reversed within 24 hours.
5. Small capitalization stocks measured by the Russell 2000 ETF (IWM) which have lagged the S&P 500 all year were up over 4% from the Wednesday low to the Thursday close versus the S&P 500 advance of 2.3%. Some of the gain is likely the result of short covering. Relative strength in small cap stocks could also be a signal that institutions are re-risking their portfolios which is a bullish indicator for the overall market, even if for just a short-term trade.
6. Institutions appear to be showing us that the sell-off that began on September 22 for the S&P 500 set an important low on Wednesday. The current rally may be a short-term reflex action to an extreme oversold condition. It is often the case that lows have to be retested before the market moves higher on a sustained basis.

### **What are we thinking?**

1. In an increasingly complex, volatile and fast paced trading environment, the Delta MSI provides a simple way to make investment decisions while keeping your emotions out of the equation.
2. The market became extremely oversold at the Wednesday low. The Delta MSI touched 14.8% intra-day. As we mentioned last week, a sub-20% reading has occurred only 11 times in 24 years and a sub-10% only 6 times. To have a high confidence in buying into an oversold condition, we would like to see the Delta MSI below 10%.
3. Concurrent indicators showed a panic, selling climax: VIX spiked to 31, the 34 basis point collapse in 10-year treasury rates was the largest single day move since the \$1 trillion QE program was announced in March 2009 and the number of stocks hitting new highs was 1 versus 838 stocks reaching new lows.

4. The extraordinarily lopsided ratio of new highs to new lows shows how correlations migrate towards one when selling is extreme. Stock selection is not as good a defense in extreme conditions as not owning stocks at all.
5. While stocks are currently trading up from an extreme oversold condition, all of the major indexes are trading below their 200-day moving averages. Given the longer dated moving averages have been penetrated to the downside and some are showing daily declining values, caution is still warranted.

We end the week with the Delta MSI at 18.1%. This is the 7th consecutive week the indicator has declined -- turning definitively bearish in the week ending September 26.

### Special Note: Jackie Ann Patterson Joins Delta

Delta is now working with Jackie Ann Patterson. Jackie has over 8 years of investment industry experience including consulting to Fidelity Investments, plus 20 years of experience in the computer, software, and technology industries. Ms. Patterson is the founder of Own Mountain Trading Company dba BackTesting Report, a publisher of investment newsletters and educational material. Ms. Patterson is also the author of three books: *Truth About ETF Rotation*, *Fund Your Retirement by Investing in Top Exchange Traded Funds in One Hour Per Week*, *Truth About MACD and Administering Wills and Trusts: A layperson's Guide for Executors and Trustees of Mid-Sized Estates*. Jackie will be applying her years of computer based back-testing experience and study of tactical investment methodologies to assist Delta with offering clients robust risk-mitigated investment strategies.

### Delta Market Sentiment Indicator

MARKET SENTIMENT IS

**BEARISH**

THIS WEEK'S NUMBER IS

**18.1**

Our technical number decreased this week from 23.8 to 18.1

#### INDICATOR STATISTICS

Consecutive Bearish Weeks:	4
Cycle Inception Date:	9/25/2014
Range:	18.1-39.1
Mean:	26.3
Bullish Weeks YTD:	28
Bearish Weeks YTD:	14
*S&P 500	-3.8%
*DJIA	-3.5%
*NASDAQ	-4.2%

\*Percentage change during current cycle

#### Delta Market Sentiment Indicator Over the Past Year



The *Delta Wealth Accelerator* website is [www.deltawealthaccelerator.com](http://www.deltawealthaccelerator.com).

As always, if you have any questions or any interest in our tactical strategies and our wealth management solutions, please give us a call at (415) 249-6337 or email us at [info@deltaim.com](mailto:info@deltaim.com).

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