

June 1st, 2016

Dow Theory for the 21st Century ●

Schannep Timing Indicator ●

COMPOSITE Indicator ●

Crazy, Isn't It?

OVERVIEW: One day the market's up 200 points, the next day down 200 points. One month (October 2015) up 1,000 points, another month (January 2016) down 1,000 points with March 2016 up 1,000 points again (see [Recent Letters](#) for examples). What next? Curiously, all the ups and downs have netted little change since December 2014.

Dow Jones: 17,787.13

S&P 500: 2,096.94

NYSE: 10,446.92



The market is in the midst of its 17th *secondary* reaction over the last 7 years. Whether it will turn out to be the first *primary* trend reversal since 2011 is still undetermined and unknowable. The Dow Theory has been similarly confused about what's next, and no wonder. Many economic indicators have gone from looking like tops and then changing, and from looking like bottoms and then changing. A few examples:

From last month's Letter:



This month's report:



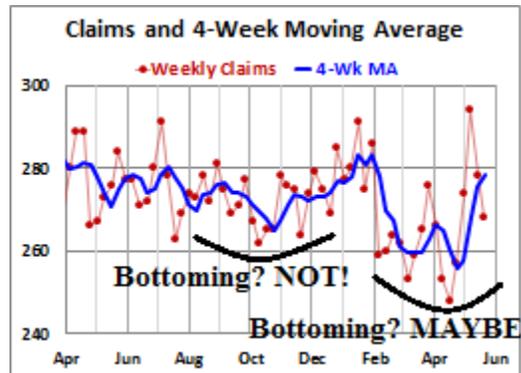
From last month's Letter:

This month's report:

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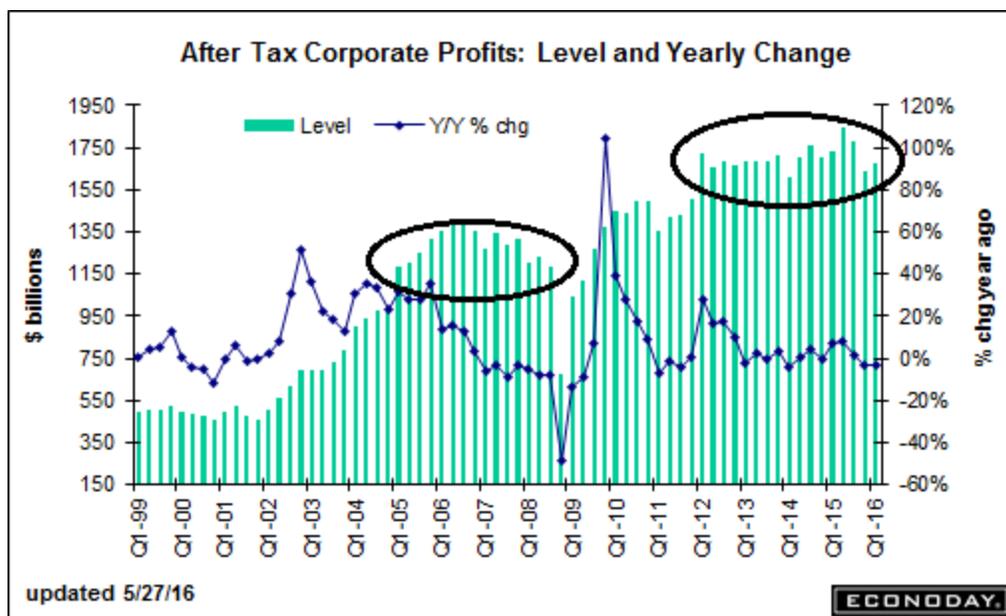
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At this point all indicators remain in BUY mode, yet questions continue over economic sustainability. Disappointing earnings and over-valuations rise to the top of concerns.

The earnings picture has been lackluster. The chart below demonstrates the stagnant ‘earnings recession’ which somewhat mirrors the stock market’s performance. In spite of the sideways market movement, we believe that we remain in a Secular Bull Market. As such, modest overvaluations do not historically lead to market declines.



Does this look like an earnings recession? UP 30% from pre-recession years

Adding to the malaise is the ongoing fear that a recession is ‘due by now’. According to the National Bureau of Economic Research, we have had 18 recessions in the last 100 years, an average of 1 recession every 67 months. The most recent recession ended on 6/30/09, or 84 months ago. Understanding that recession beginnings are frequently recognized in hindsight, to date we don’t believe one is upon us; and with the yield curve steepening, evidently neither does the bond market. <<6/10 Editor's correction. The yield curve is NOT steepening as is evident in the chart below. As today's Wall Street Journal notes:

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"...this latest drop in the 10-year has caused a *flattening* of the yield curve - the difference between short-term and long-term interest rates -- that is disconcerting".



Of course we look for what we think we will see, as in these immortal words:

Everything we hear is an opinion, not a fact. Everything we see is a perspective, not the truth.

-Marcus Aurelius

Now, back to what we think we see:

The DOW THEORY for the 21st Century This indicator returned to GREEN on April 13th at the 17,908.28 level when the S&P closed above 2,072.78 and the Dow above the 17,792.75 levels. Since that time, all three indexes established highs on April 20th and have since set back. Thus, we are once again in a set-up for a potential signal change. Dow Theory for the 21st Century and **The Original DOW THEORY** are shown below with the recent setback qualifying for each as a secondary reaction. After that, what we look for is at least a 3% bounce on one of the indexes. We got that on May 25th with the Dow Transports up 3.1% at 7743.71. The next thing we watch for is all three indexes closing above their April highs shown on the top row, which would be a reconfirmation of our existing BUY signal OR a lower low than the setback lows by the S&P500 plus one other index which would be a SELL signal.

Step		Dow Industrials		S&P500 Index		Dow Transports	
	Market Highs	4/20/2016	18096.27	4/20/2016	2102.4	4/20/2016	8109.19
#1	> 3% Setback on two indexes	19-May	17435.40< -3.7%	19-May	2040.04 -2.9%	13-May	7507.31< -7.4%
#2	Bounce >3% on one index					5/31	7798.35< 3.9%
#3	Break up on all three, or down on S&P plus one						

We continue to update the progress on the [Subscriber's Homepage](#).

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We realize that not all Theorists are with us in our current interpretation. We love this quote from Robert Rhea's 1932 book *The Dow Theory* (p.28): "Any thinking man will readily realize that if the Dow theory were infallible, or if even one or two men could always interpret its implications correctly, there would probably soon be no speculation in stocks". An unlikely scenario, and thus the reason there are multiple Dow Theory newsletters to choose from. Thank you for choosing ours!

Schannep ↑TIMING ↓INDICATOR: The Schannep Timing Indicator has remained steadfastly GREEN with an average entry level of 11,746 from the August-October of 2011 Buy signals. As such, this indicator has kept us at least 50% in the market at all times since 2011 and has served to smooth out the effects of the Dow Theory's multiple SELL and BUY signals.

The COMPOSITE Timing Indicator: Now that this indicator has returned to a 100% investment position as of April 13th, 2016, it stands with one-half in from April 13th at 17,908 with the other half already in from 2011 at 11,748 for an average level of 14,828. Not a bad average entrance in this topsy-turvy market.

The BOTTOM LINE: Is the market rising 12% a crazy idea? Well, if the Dow Industrials break above the April highs (18,096.27), the next goal is the all-time highs of 18,312.39. After that...? The last time we looked to the [Rule of Seven](#) was in our [October 30th Letter](#), where we pointed out the next target at that time was 18,171. It reached 17,918 before setting back to 15,660. From this February's low to the April high was a total increase of 2,436 points. When 7/4^{ths} of those points (4263) is added to the starting point, a Target 'A' of 19,923 is indicated (12% above today's level):



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As we write this Letter on Memorial Day, we honor all deceased veterans. Among them: my father Col. Dwight B. Schannep, U.S. Army Air Corp, West Point Class of 1929; and my brother Col. Robert N. Schannep, U.S. Air Force, West Point Class of 1960. We will never forget their service and sacrifice.

With our Indicators unanimously in BUY mode, we obviously look for higher market levels while keeping an eye out for any reversal. That said, we look forward to a profitable summer, and beyond.

Jack & Bart Schannep
Editor and Contributing Editor
for The Schannep team

Historically we have tracked the performance of Jack's ACTUAL ROTH IRA portfolio, fully following the *Composite Timing Indicator's signals* which is currently 100% invested in approximately equal amounts into each of the following Exchange Traded Funds:

<u>Value</u>	<u>Shares</u>	<u>Price</u>	<u>Holdings</u>
\$267,492	3320	\$80.57	RSP (equal-weighted S&P500)
\$262,789	1480	\$177.56	DIA (tracks the Dow Industrials)
\$266,529	1271	\$209.70	SPY (tracks the S&P500)
\$3,168	3,168	\$1.00	Money Market
\$799,978	= Total Value 5/31/16		

For the last 12 months this portfolio with dividends reinvested is -2.1% vs. the Dow Jones UP +1.3% and the S&P500 UP +1.4% *including dividends*. The problem with such reporting is that it represents only what I am doing, which could be very different from others. Subscribers use this letter for Market Timing, which could include shorting, going long, even utilizing leveraged investments that could double or triple – in either direction. These results have been monitored by several independent sources that track our performance such as [Hulbert Financial Digest](#), [DowTheoryInvestments.com](#), [CXO Advisory Group](#) and [TimerTrac.com](#)

This Letter concentrates on the big picture, the trend of the major stock market indices which usually influences the price direction of most individual stocks.

Bart Schannep is the President of Southwest Investment Advisors, Inc. This article is co-written as an outside business activity by Bart Schannep as Contributing Editor in conjunction with Jack Schannep. As such, Southwest Investment Advisors, Inc. does not review or approve materials presented herein. The opinions and any recommendations expressed in this Letter are those of the authors and do not reflect the opinions or recommendations of Southwest Investment Advisors, Inc. nor its broker/dealer and separate and unrelated company, National Planning Corporation (NPC).

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