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Bull Market Strength Continues as Market Internals Improve

In our August commentary, *"Bull Market Strength Continues, but Signs of Near-Term Excess Emerge,"* we cautioned that markets were becoming vulnerable to a near-term correction. Since then, the major North American indices have retreated toward their respective 40-week moving averages (40wMAs), testing an important area of long-term support. In September, we noted that market weakness was deepening, although longer-term support remained intact. Last month, we suggested that the indices were testing this support and potentially preparing for their next advance.

The subsequent market action has been encouraging. Of the four major North American indices, the Dow Jones Industrials Average (DJI), NYSE Composite (NYA) and S&P/TSX Composite (TSX) have successfully tested their respective 40wMAs, recovered above their 10-week moving averages (10wMAs) and continue to trade above them.

The S&P 500 (SPX), however, has struggled to regain its 10wMA, largely reflecting weakness in NVIDIA and other mega-cap technology stocks. Nevertheless, it remains comfortably above its 40wMA, suggesting that its longer-term uptrend remains intact. Interestingly, the S&P 500 Equal Weight Index has exhibited a technical pattern remarkably similar to that of the NYA. This divergence from the capitalization-weighted SPX highlights the disproportionate influence that a handful of mega-cap technology stocks can exert on the broader index and suggests that underlying market participation is healthier than the headline SPX might indicate.

Although volatility remains elevated, the technical picture has improved considerably since early October. The longer-term uptrends remain intact, market participation is broadening, and investor sentiment has shifted toward greater caution. Together, these developments suggest that the recent consolidation may be establishing a firmer foundation for the next advance.

Momentum and Market Breadth

One encouraging development has been the improvement in market breadth. During August and September, the number of stocks reaching new 52-week lows consistently and substantially exceeded those reaching new highs, while declining volume regularly outpaced advancing volume. These conditions reflected widespread selling pressure and deteriorating market participation. Since October 1, however, the balance has begun to shift. We are now seeing more sessions in which new 52-week highs equal or exceed new lows, accompanied by stronger advancing volume relative to declining volume.

Nevertheless, the recovery has been uneven. After successfully testing the 40wMAs, the major indices have moved sideways, with sharp advances often followed by renewed selling pressure. Consequently, momentum and breadth indicators have fluctuated between positive and negative readings, sometimes from one session to the next. Such behavior is not unusual during a consolidation phase. Markets rarely transition directly from a correction into a sustained advance without periods of hesitation, profit-taking, and renewed volatility.

Charts courtesy of Workspace by LSEG

PAC-26-175; MKT-592, November 16, 2026

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The important consideration is the underlying trend rather than the day-to-day fluctuations. On that basis, the improvement in market internals since the beginning of October has been meaningful, suggesting that buying interest is becoming more broadly distributed across the market.

Investor Sentiment

Investor sentiment has also shifted notably, offering another potentially encouraging development from a contrarian perspective. Last month, the Investors Intelligence survey painted a less-than-encouraging picture, with bullish sentiment at 55.0% and bearish sentiment at just 16.7%. Such elevated optimism suggested investors remained relatively complacent despite the ongoing correction. This week's survey shows bullish sentiment declining to 37.0%, its lowest reading since early April 2026, when it stood at 33.0% and the SPX was trading just below its 40wMA. Meanwhile, bearish sentiment has increased to 24.1%, its highest level since late April. The American Association of Individual Investors (AAII) survey reinforces this shift. This week's readings show bullish sentiment at just 30.8%, while bearish sentiment has climbed to 51.4%, substantially above its historical average of 34.2%.

Ordinarily, a meaningful market correction is accompanied by a corresponding deterioration in investor confidence. Until recently, however, sentiment had remained surprisingly resilient despite the weakness in the major indices. We are now seeing the decline in optimism that was largely absent during the earlier stages of the correction. From a contrarian perspective, this is a constructive development. Excessive optimism can leave markets vulnerable to selling pressure, while a pronounced shift toward pessimism can indicate that much of the previous enthusiasm has been unwound. Although sentiment extremes do not guarantee an immediate advance, the recent deterioration in investor confidence suggests that an important source of market vulnerability has diminished. Particularly encouraging is that this shift has occurred alongside improving market breadth rather than a further deterioration in the underlying technical picture.

Market Outlook

As anticipated, markets remain volatile, with sharp advances frequently interrupted by equally sharp declines. Nevertheless, successful tests of long-term support and improved market internals suggest the correction may be giving way to a more constructive consolidation phase. These developments are particularly noteworthy as markets approach what has historically been one of the year's more favorable seasonal periods.

Our research on average monthly SPX returns from 1928 through 2026 (to date) shows that December and January rank as the third and fourth best-performing months, respectively, with average gains of 1.27% and 1.21%. Only July (1.69%) and April (1.37%) have historically produced stronger average monthly returns. The *Santa Claus rally*, which refers specifically to the final five trading sessions of December and the first two trading sessions of January, provides an additional historical end-of-year boost to markets. While seasonality alone is not a reliable predictor of future performance, this historical tendency adds another reason for cautious optimism as we approach year-end.

The combination of improving technical conditions, more cautious investor sentiment, and favorable seasonal tendencies suggests that markets may be positioning for a traditional year-end rally. However, the recovery remains incomplete. The major indices must still overcome important overhead resistance before a renewed upward leg can be confirmed. Until then, expect additional sideways movement and intermittent volatility.

Key Technical Levels to Watch

The charts on the following page highlight three important technical reference points that will help determine whether the current consolidation is nearing completion or whether additional corrective activity lies ahead.

Long-Term Support — 200-Day Moving Averages (200dMAs)

The major indices have successfully tested their respective long-term moving averages, reinforcing these levels as areas of underlying support. As long as the indices remain above their shaded support zones, the longer-term bull market structure remains intact. Only a sustained break below these areas would suggest that a more serious correction may be developing.

Short-Term Trend — 50-Day Moving Averages (50dMAs)

Three of the four major indices are currently trading above their respective 50dMAs, reflecting the improvement in their shorter-term technical profiles. The SPX remains the exception, continuing to struggle with resistance near its 50dMA as several influential mega-cap technology stocks lag the broader market. A sustained move below these averages would suggest that additional consolidation may be necessary before the next advance.

Overhead Resistance — Falling Trendlines and Previous Highs

Despite improved market internals, the indices have yet to decisively overcome the declining trendlines and previous highs that define the upper boundaries of their recent consolidation patterns.

For the DJI, a sustained move above 53,800 would be an encouraging first step, while a decisive advance above 54,750 would provide much stronger confirmation of a breakout. For the other major indices, the key resistance levels are 7,845 for the SPX, 24,870 for the NYA, and 37,070 for the TSX. Sustained advances above these respective levels, supported by continued improvement in momentum and market breadth, would provide stronger evidence that the consolidation phase has ended and a new upward leg is underway.

The technical evidence is becoming increasingly favorable, but confirmation remains essential. Until these resistance levels are decisively overcome, further consolidation cannot be ruled out. Nevertheless, with long-term support holding and market internals strengthening, the prospects for a renewed advance appear increasingly encouraging.

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