

Capitulation in US Equities – Generally a ‘Buy’ Signal

The most recent ‘Capitulation’ event in US equity markets occurred on Monday, 9th March 2020. Capitulation is a relatively rare event – and generally a ‘Buy’ signal – and has occurred only 17 times since S&P 500 records began in 1953.

Capitulation is that event in markets where sellers are overwhelming buyers as investors give up in reaction to consistent bad news and share prices decline in rapid succession. As we have signalled many times before, history teaches us that when markets capitulate it is either the bottom of that particular correction, close to it or it is the beginning of a bottoming process.

The indicator we are using here is Jack Schanep's proprietary capitulation indicator (a fuller definition is overleaf). As long-standing subscribers know, Jack Schanep is the editor of [The Dow Theory newsletter](#) (and also author of the book *Dow Theory for the 21st Century*).

In GillenMarkets, we have tended to use the percentage deviation in an index from its underlying 30-week moving average to highlight potential capitulation events. Indeed, we successfully used this technique in early October 2016 to flag a potential bottom in the sterling exchange rate, and that subsequently proved to be the bottom of the sterling sell-off following the Brexit vote at end June 2016.

Jack Schanep's capitulation indicator is a little more complex, but also more useful, we feel, for two reasons:

- It uses a time-weighted moving average so that it gives greater weight to more recent data compared to earlier data (similar to how our Coppock Indicator works); and,
- It has a history of good calls dating back to the start of the S&P 500 Index in 1953.

Since 1953, using the Schanep Capitulation Indicator, US equity markets have capitulated on only 17 occasions, including the latest signal on 9th March 2020.

This website/newsletter service has been in operation since November 2009, and in that time we have witnessed three capitulation events in US equity markets – on 8th August 2011, 24th December 2018 and 9th March 2020.

Capitulation in US Equities					
Date	S&P500 Level	Days from Actual Bottom	% From Actual Bottom	Returns - 6 Mths Later	Returns - 1 Year Later
22-Jun-62	53	2	1%	19%	33%
25-May-70	70	1	1%	21%	42%
23-Aug-74	72	28	13%	16%	18%
30-Sep-74	64	3	2%	32%	32%
19-Oct-87	225	0	0%	15%	23%
03-Dec-87	225	1	1%	18%	21%
23-Aug-90	307	34	4%	19%	28%
31-Aug-98	957	0	0%	29%	38%
20-Sep-01	985	1	2%	17%	-7%
19-Jul-02	848	57	8%	6%	17%
09-Oct-02	777	0	0%	12%	34%
07-Oct-08	996	32	20%	-18%	12%
12-Nov-08	852	6	9%	6.6%	30%
23-Feb-09	743	10	8%	31%	47%
08-Aug-11	1,119	39	1%	14%	25%
24-Dec-18	2,417	0	0%	22%	26%
09-Mar-20	2,747	10	19%		
Averages		13	5%	17%	26%

Source: thedowtheory.com

As the table highlights, following a Schanep capitulation signal, the average return over the following six months from the S&P 500 Index has been 17% with only one period where a loss was recorded over the subsequent six-month period (-18% following the signal on 8th October 2008).

The average 1-year return following a capitulation signal has been 26%, again with only one period where a loss was subsequently recorded (-7% following the signal on 20th September 2001). In our view, these are excellent odds and are the reason why capitulation is a 'Buy' signal, on average.

In deep bear markets, markets can capitulate more than once. So, it's safer to describe capitulation as signalling either the bottom (which it did on four occasions since 1953), close to the bottom or the start of a bottoming process.

In late 2008, for example, during the Global Financial Crisis, US equity markets capitulated three times in succession – in October 2008, again in December 2008 and then for the last time in February 2009. So, on the first capitulation signal in October 2008, it was to prove subsequently that it was the start of a bottoming process on that occasion.

It is also worth noting that Jack Schanep's Capitulation Indicator gave its 'Buy' signals on average 13 days from the actual market bottom and on average within 5% of the actual bottom (see the table).

At the very least this might assist investors to avoid selling when a capitulation signal has been given or to make additional purchases if you have the capacity to do so at such times.

GillenMarkets

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Schanep Capitulation Indicator Definition: From his book *Dow Theory for the 21st Century* the actual definition of the Schanep Capitulation Indicator is:

'A short-term oscillator is utilised which measures the percent of divergence between the three (US) major stock market indices (Dow Jones Industrial Average, S&P 500 and the New York Stock Exchange Composite) and their 10-week, time-weighted moving averages. Market bottoms are identified when the divergence between the three major (US) stock market indices is 10% below their respective ten-week, exponentially time-weighted moving averages'.

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