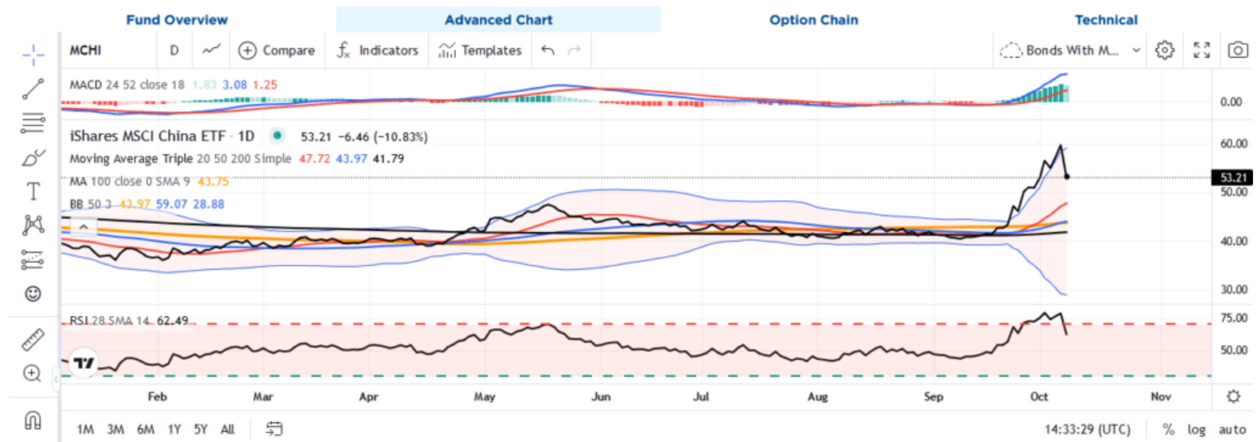
Chinese stocks (CSI 300) opened Tuesday morning following their week-long Golden Week holiday, with a massive 11% pop higher. However, shortly after opening, the index gave up half of the surge as China's economic planning agency did not offer additional economic, monetary, or financial stimulus. As shown below, Chinese stocks have been soaring since mid-September due to lower interest rates, new QE, economic stimulus, and measures allowing banks to buy equities more easily. Before Tuesday's trading, the CSI 300 was up nearly 50% on the stimulus measures in just a few weeks. But the index gave up a third of its recent gains without new stimulus. *(The ETF in the graph traded all week despite the holiday; therefore, its daily performance is slightly different than the CSI Index.)*

As we also see in the U.S. and other developed markets, volatility ensues when stimulus is repeatedly used to soothe markets and jump-start economic activity. Investors, like Paavolov's dogs, develop a taste for stimulus. Any shortfall versus their expectation, even if minimal, can rapidly erase gains on prior stimulus. Consequently, when used repeatedly and for non-crisis reasons, stimulus adds market volatility. As we have seen with Chinese equities, volatility can often accompany strong returns, but as we learned on Tuesday, failing to provide enough of what the market wants can push markets lower violently.

As the Fed embarks on a series of rate cuts, the U.S. and global market will build in expectations. Failure to meet said expectations can result in sharp downdrafts. Conversely, meeting or bettering expectations can cause markets to soar. Stimulus-driven markets detract investors from fundamentals and instead force their focus on government actions. While the government and investors benefit from the short-term effects, the long-term result is weaker economic growth, rich stock valuations, and unproductive low bond yields.



What To Watch Today

Earnings

- *No notable earnings releases today.*

Economy

Time	Event	Impact	Actual	Consensus	Previous
	WEDNESDAY, OCTOBER 9				
16:30	**USD** Fed's Jefferson speech			LOCKED	
18:00	**USD** FOMC Minutes			REPORT	
22:00	**USD** Fed's Daly speech			LOCKED	

Market Trading Update

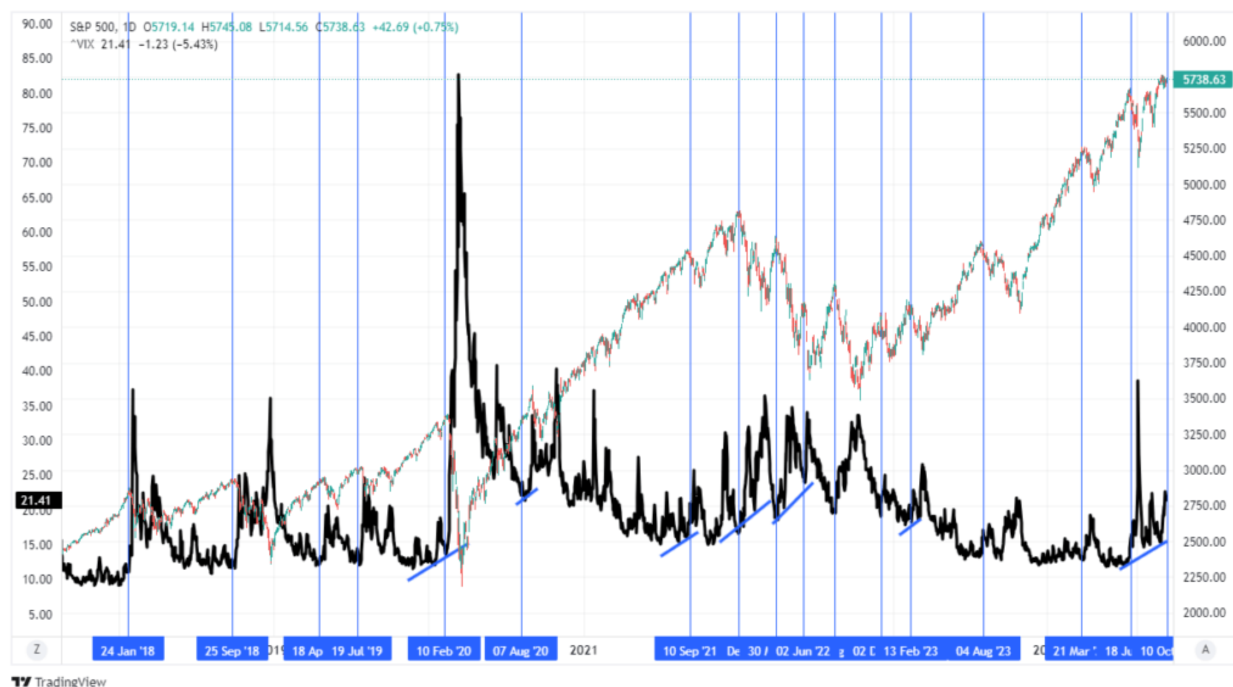
In ***yesterday's commentary***, we discussed how bonds are approaching a more deeply oversold basis as we head into the upcoming auctions. I have been getting a lot of emails on TLT in particular, so read that commentary if you have any questions.

Today, I want to return our focus to the market's ongoing consolidation. As discussed in ***"Technical Takes On The Market***," the market continues to act bullishly. To wit:

> *"An ascending triangle is forming on the daily charts, another bullish pattern that typically signals further upward movement. In this case, we?ve seen a series of higher lows in recent weeks, indicating buyers are stepping in earlier during each pullback. The flatter upper trendline from the previous to the recent all-time high indicates an ongoing increase in buying pressure."*

The market continues to trade off support, retesting the 20-DMA yesterday but failing to make any progress higher. The market's "*consolidation*" above support is bullish, as the previous overbought condition is reversed. However, the one concern that both Michael Lebowitz and I have discussed recently is the consolidation of the market, which is occurring with volatility rising. As shown, when such an environment has occurred, it has either been coincident with or a precursor to a correction. Could this time be different? Sure. However, history is an important guide to outcomes, and the current setup suggests there is a higher degree of risk than not.

Trade accordingly.



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Hurricane Milton And The Broken Window Theory

With hurricane Helene causing massive destruction and Milton likely to do the same, many pundits will declare these catastrophes as beneficial to the economy. Their simple logic is that significant spending is needed to rebuild. They are not wrong from a short-term point of view. Inevitably, both hurricanes will boost GDP. However, as nineteenth-century economist Frederic Bastiat pointed out, there is also an unseen negative effect. Consider Bastiat's logic when seeing inflated economic activity in the next few quarters. The following summary of his theory comes from our article, [Tales of Cobras, Windows, and Economic Promise].

> *Nineteenth-century French economist Frederic Bastiat has a well-known theory about unintended consequences. He uses a parable to explain that which is seen and what is not seen. His lesson starts with a stone that shatters a shopkeeper?s window. Most noticeable to the town?s people is the economic benefit of the broken window. In their minds, the shopkeeper must buy a window and employ a glazier to install it. As an aside, many economists peddle similar logic in the aftermath of natural disasters.*
>
> *Bastiat?s brilliance is pointing out the not so obvious opportunity cost of the broken window. In this case, after paying to fix the window, the shopkeeper has less money to spend elsewhere. The shopkeeper could have bought new equipment making his shop more productive and profitable. The benefits of which would have had a positive impact on the shopkeeper?s wealth but also the economy and the populace.*
>
> *Instead, replacing the window is at best a neutral economic event. There is undoubtedly no net economic gain, but there is an opportunity cost. Financial and material resources were used in a non-productive manner.*

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Hurricanes are Great for the Economy (but Terrible for People and Places)

Charles Marohn · September 3, 2019

How Howard Marks Thinks About Risk... And You Should Too

One of the biggest takeaways from Marks? series is the idea that risk and volatility aren?t the same thing. For years, many investors *(and academics*) have been taught that volatility?the ups and downs of stock prices?equals risk. However, Marks argues that this is a big misunderstanding.

Volatility is *one* part of the picture, **but risk is the probability of *losing* money.** Just because prices bounce around doesn?t mean you?re at risk of a big loss. Investors should focus on managing their downside, not just trying to avoid every little price swing.

[READ MORE...]

15-Risk Management Rules To Follow:

1. **Cut losers short and let the winner's run**. *(Be a scale-up buyer into strength.)*
2. **Set goals and be actionable.** *(Without specific goals, trades become arbitrary and increase overall portfolio risk.)*
3. **Emotionally driven decisions void the investment process.** *(Buy high/sell low)*
4. **Follow the trend.** *(80% of portfolio performance is determined by the long-term, monthly, trend. While a "rising tide lifts all boats," the opposite is also true.)*
5. **Never let a *"trading opportunity"* turn into a long-term investment.** *(Refer to rule #1. All initial purchases are "trades," until your investment thesis is proved correct.)*
6. **An investment discipline does not work if it is not followed.**
7. ***"Losing money"* is part of the investment process.** *(If you are not prepared to take losses when they occur, you should not be investing.)*
8. **The odds of success improve greatly when the fundamental analysis is confirmed by the technical price action.** *(This applies to both bull and bear markets)*
9. **Never, under any circumstances, add to a losing position.** *(As Paul Tudor Jones once quipped: "Only losers add to losers.")*
10. **Markets are either *"bullish"* or *"bearish."* During a *"bull market"* be only long or neutral. During a *"bear market"* be only neutral or short.** *(Bull and Bear markets are determined by their long-term trend as shown in the chart below.)*
11. **When markets are trading at, or near, extremes do the opposite of the *"herd."***
12. **Do more of what works and less of what doesn't.** *(Traditional rebalancing takes money from winners and adds it to losers. Rebalance by reducing losers and adding to winners.)*
13. ***"Buy"* and *"Sell"* signals are only useful if they are implemented.** *(Managing a portfolio without a "buy/sell" discipline is designed to fail.)*
14. **Strive to be a .700 *"at bat"* player.** *(No strategy works 100% of the time. However, being consistent, controlling errors, and capitalizing on opportunity is what wins games.)*
15. **Manage risk and volatility.** *(Controlling the variables that lead to investment mistakes is what generates returns as a byproduct.)*

Tweet of the Day

Mike Zaccardi, CFA, CMT
@MikeZaccardi

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$ASHR China ETF -13% premarket - potentially its worst session in its 11-year history

?Want to achieve better long-term success in managing your portfolio? Here are our [15-trading rules for managing market risks.](#)?

***Please [subscribe to the daily commentary](#)* to receive these updates every morning before the opening bell.**

> *If you found this blog useful, please send it to someone else, share it on social media, or contact us to set up a meeting.*