EDITOR'S•NOTE:

- **Happy New Year,•**there are many changes on the horizon and I encourage you to send you comments and criticisms directly to me. I can't improve the site/newsletter without your suggestions.
- **I would appreciate it if you would send•**this newsletter to people who you think might enjoy it.
- **Make sure you are following me** on social media for daily updates, announcements, and commentaries. (Twitter, Facebook)

Breaking Markets - Sell Signals Flash

Over the last couple of months, I have repeatedly discussed the deterioration of market breadth, momentum and the fundamental backdrop of the markets. Read the following posts to catch up: >> Signs Of A Technical Top >> Signs Of A Fundamental Top Along with these warnings, I have continually suggested a health regimen of portfolio rebalancing, profit taking and risk controls in this weekly missive: To wit:

> "**As always, your portfolio, much like a garden, must be tended too in much the same way.** By doing so, it will ensure that it prospers and grows over time and yields a fruitful bounty.
>
> 1. ***HARVEST: Reduce ?winners? back to original portfolio weights.*** *This does NOT mean sell the whole position. You pluck the tomatoes off the vine, not yank the whole vine out of the ground.*

2. ***WEED: Sell losers and laggards and remove them garden.*** *If you do not sell losers and laggards, they reduce the performance of the portfolio over time by absorbing ?nutrients? that could be used for more productive plants. The first rule of thumb in investing ?sell losers short.? So, why are you still hanging onto the weeds?*
3. ***FERTILIZE AND WATER: Add savings on a regular basis.*** *A garden cannot grow if the soil is depleted of nutrients or lost to erosion. Likewise, a portfolio cannot grow if capital is not contributed regularly to replace capital lost due to erosion and loss. If you think you will NOT EVER LOSE money investing in the markets?then STOP investing immediately.*
4. ***WATCH THE WEATHER: Pay attention to markets.*** *A garden can quickly be destroyed by a winter freeze or a drought. Not paying attention to the major market trends can have devastating effects on your portfolio if you fail to see the turn for the worse. As with a garden, it has never been harmful to put protections in place for expected bad weather that didn?t occur. Likewise, a portfolio protected against ?risk? in the short-term, never harmed investors in the long-term.?*

> As I have discussed many times in the past, **the trend of the market is still positive and there is no reason to become extremely defensive as of yet.** However, this does not mean to become complacent in your portfolio management practices either."

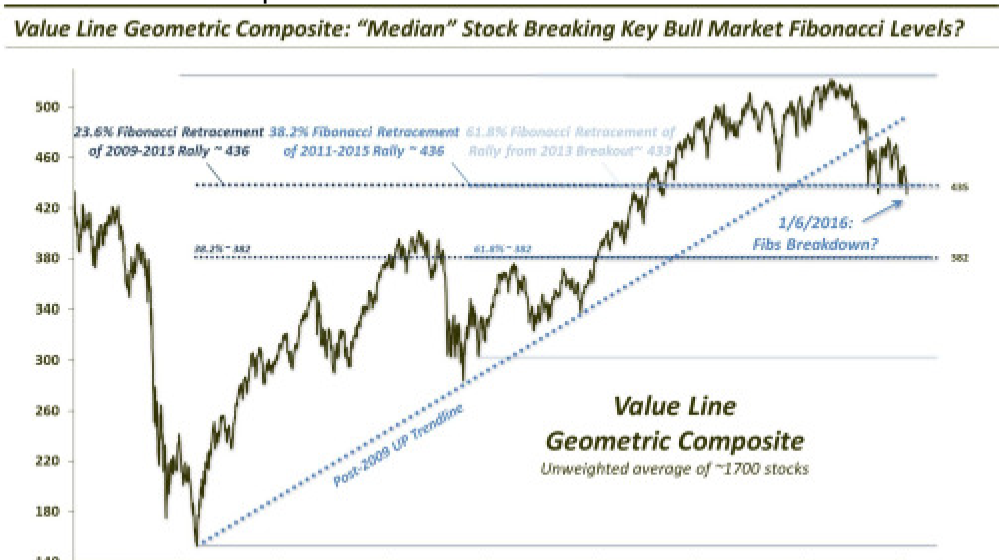
It is that last paragraph that I want to focus on with you today.

A Trend Change At Hand

My colleague Dana Lyons penned a very good piece earlier this week that dovetails with my own analysis.

> "In reality, there are only a relatively few number of really key days in the market. These days are easily identified in hindsight, though, at times, we can sense their possible importance in real time (e.g., July 20 and August 24.) We bring this up because *today* had the potential makings of a key day in the stock market, in our view. **Today?s potential price breakdowns among them threaten to undermine the sustainability of the post-2009 cyclical bull market."**

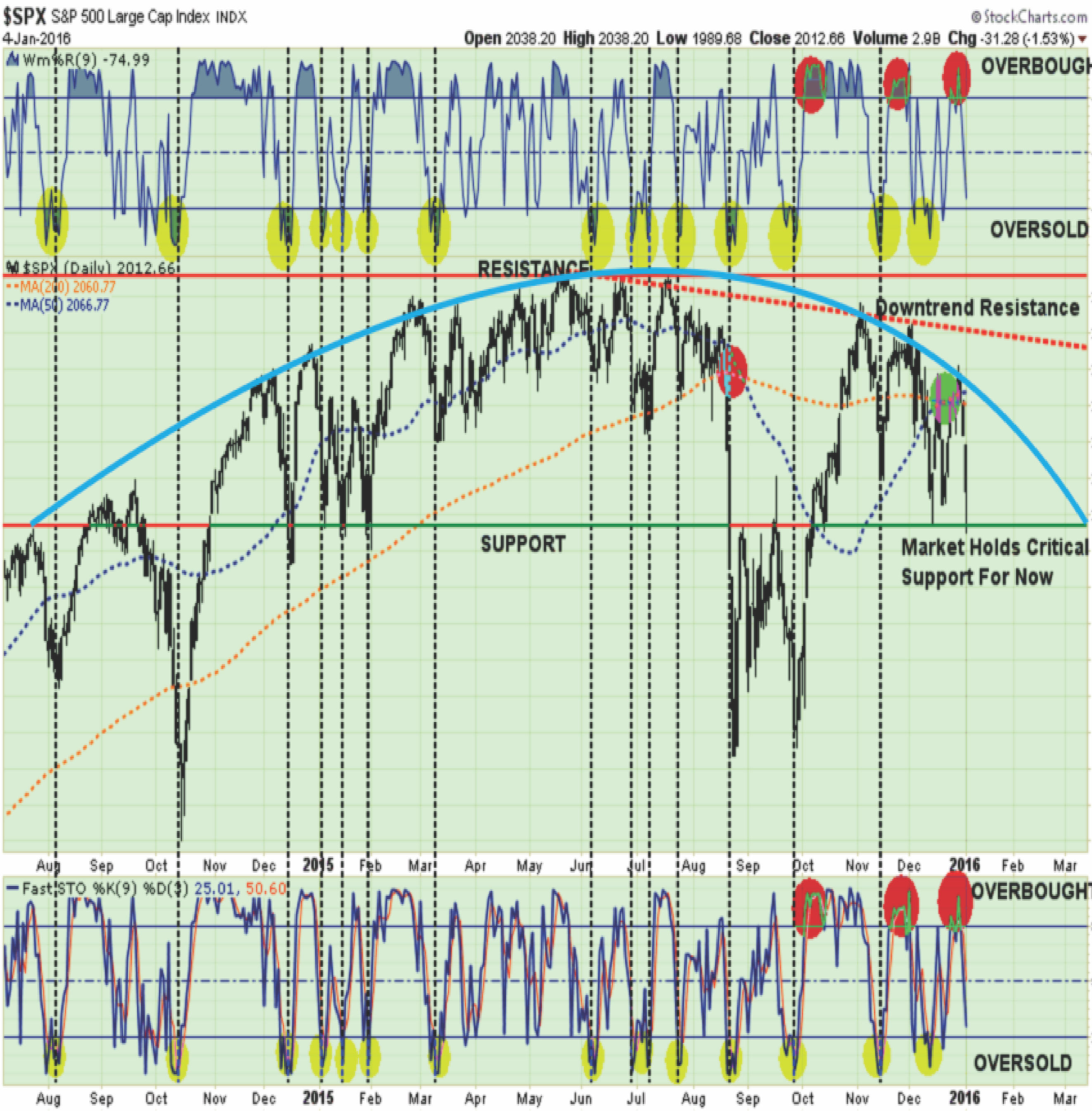
He is absolutely correct. While the media focuses on day-to-day news flow to try and assess a reasoning behind daily market gyrations, for long-term investors it is only the *"trend of prices"* that matter. Before I show you my analysis, take a look at Dana's. The two charts below are of the same Value Line index. The only difference is how the indices are measured. The first is the GEOMETRIC composite index and the second is the ARITHMETIC composite.



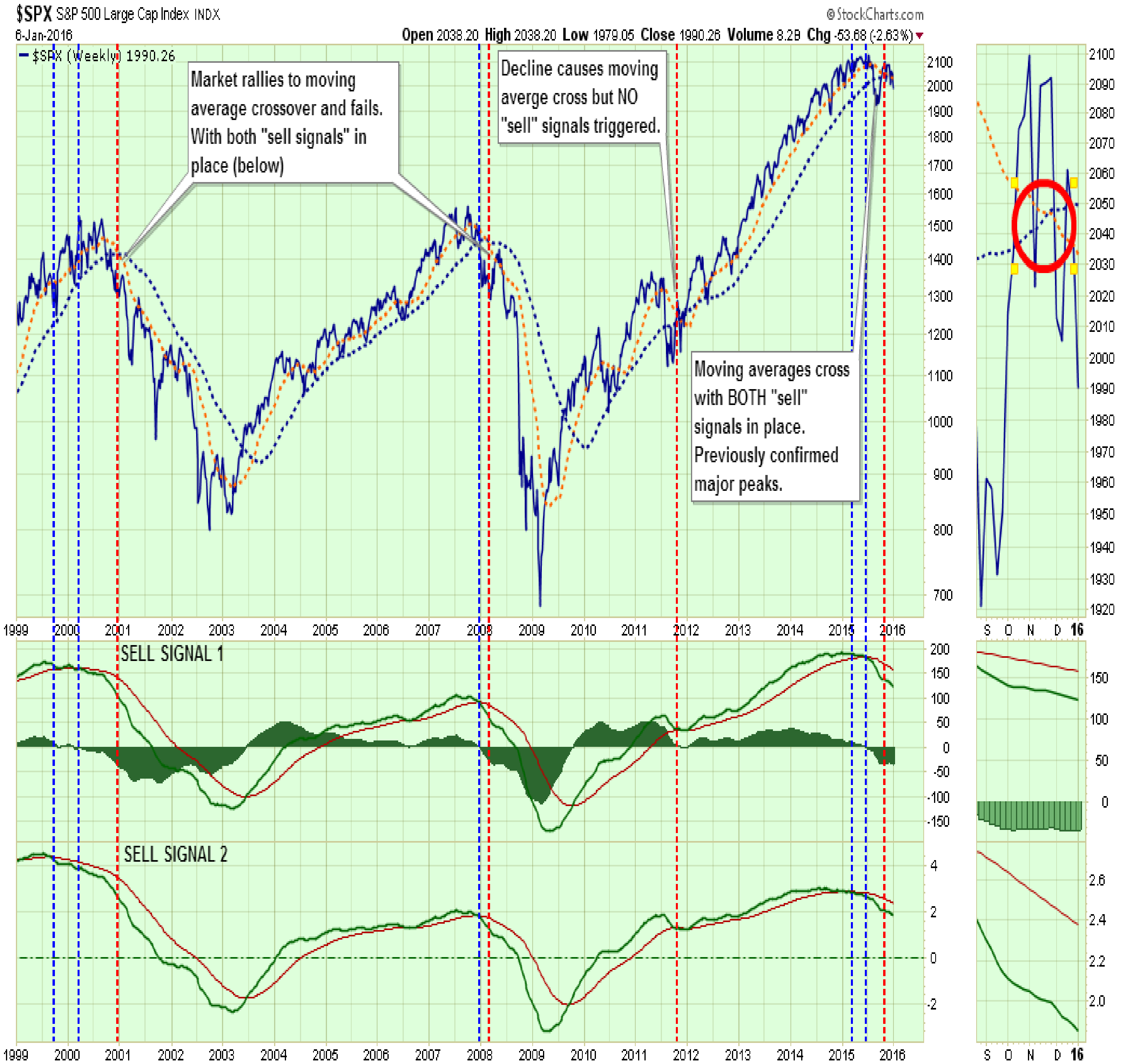
The index, as noted, is very broad by tracking more than 1700 stocks. What is important, is that for the first time since the lows of 2009, the index is breaking the bullish trend that has prevailed during that time. If we step back and look at this index going back to 1998, we can see what has happened previously when price trends changed direction.

Important Note: This is not a bullish or bearish call. It is simply an analysis of *"what is."*•Notice that when the *"trend"* of the market has changed from positively sloping to negatively sloping, it has not been a good time to be heavily allocated to *"equity risk"* exposure. Could this be a *"false flag"*, a *"head fake"*, or simply an *"overreaction"* that rights itself in short order with a resumption of the *"current bull market."* **Yes, it could be.**•However, there are other indications that suggest that the current correction may be different than previous *"buy the dip"* opportunities much like the decline in 2011 turned out to be. Earlier this week, I discussed the importance for the market to hold support at 1990 on the S&P 500. That level is under critical attack this morning as the market slides over concerns of China.

> ?Importantly, the ongoing topping process continues in earnest. As shown in the two charts below, **the current topping process is very akin to the processes witnessed at the previous two major market peaks in 2000 and 2007.** You can clearly see the topping process being made over the last 18 months in the market. Until, or unless, the market can break out of the current downward trend, the risk of lower asset prices remains elevated.?



More importantly, if we step back to a ?weekly? view of the markets we get a better picture of the level of deterioration currently in progress. As shown in the chart below, not only have both lower sell signals been triggered by deterioration in price momentum, the short and long-term moving averages have now crossed.



Since the turn of the century, the two primary moving averages have only crossed three other times ? **at the peak of the markets in 2001 and early 2008, and in 2011.** The difference in 2011 is that while the sharp decline in the prices due to the debt ceiling debate caused the moving averages to cross, the two lower sell signals were not triggered. This kept portfolios allocated more towards equities at that time. The current topping process, as discussed on Tuesday, is more akin to that seen in 2000 and early 2008. **With primary moving averages now crossed, sell signals in place and markets trading below supports, rallies in equities should be used to rebalance portfolios and reduce risk.•While the markets are not?*technically?* in a *?bear market?* currently, it is important to remember that they weren?t in 2001 and early 2008 either.** Waiting to make adjustments until after full recognition of the event doesn?t leave you many options.

Bob & George

A couple of notes from guys who are far smarter than I: Bob Janjuah, Nomura Securities

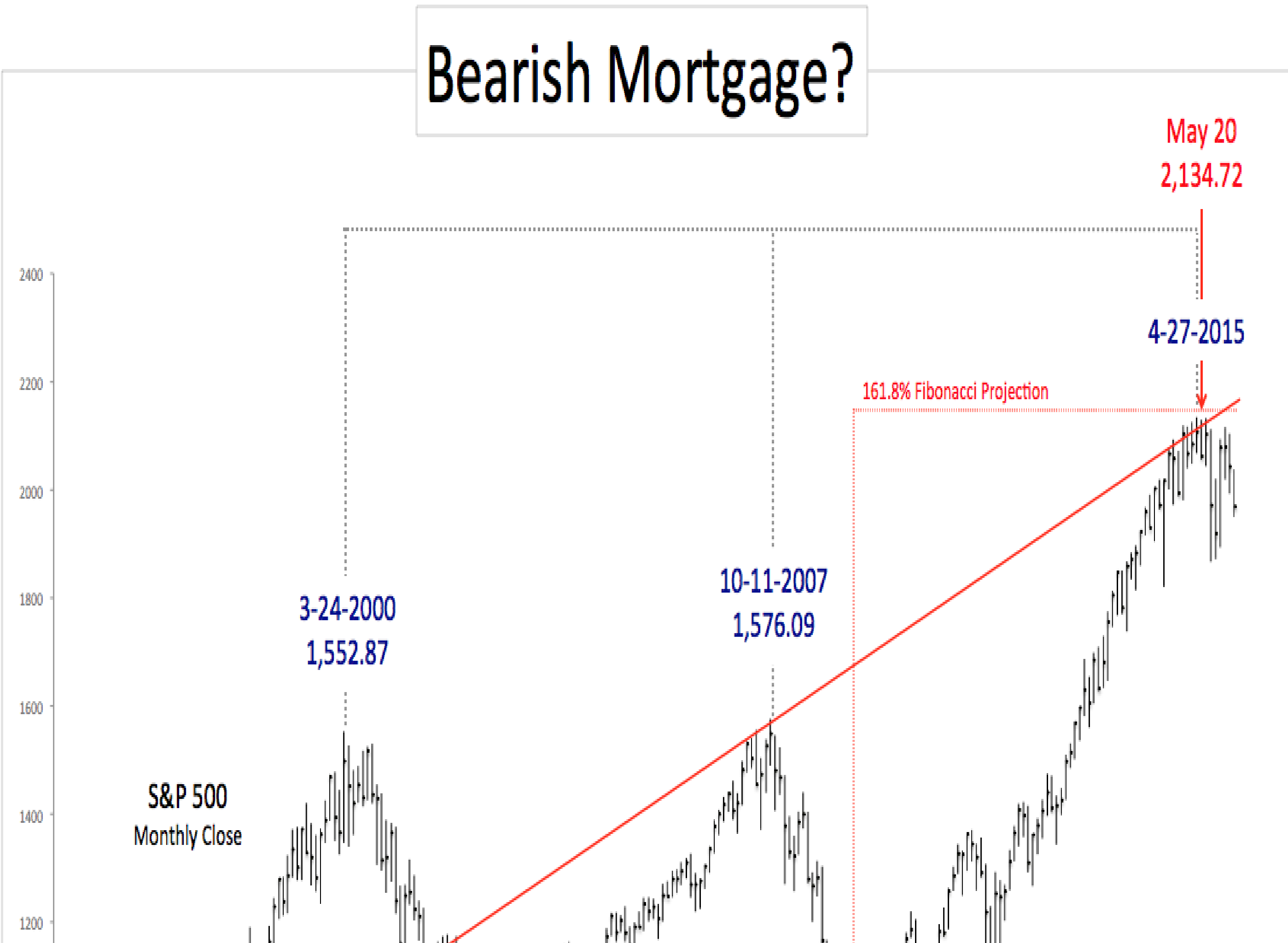
> "I now feel even more certain that debt-driven asset bubble implosions (such as the GFC) cannot merely be ?fixed? with even more debt and another round of central bank-driven asset bubbles. Policy since the GFC has resulted in a deeply unstable outcome in the global economy and across markets. Alan Greenspan and US legislators addressed the early 2000s debt-driven asset bubble collapse (primarily in corporate equities) by driving another round of debt-driven asset bubbles (primarily in housing and the financial sector). And we know how that ended! **I think the S&P 500 will trade down around 20% to 25% from current levels in H1, down to the 1500s level that I wrote about last year as a target for 2016** (we are already 7% off from the 2015 highs), before a recovery (once the Fed ?turns?). **I am looking for an earnings and jobs recession in the US this year, to become clear sooner rather than later in the year.** I do not want to be ?invested? in equities at least over H1, rather equities are a trading asset."

George Soros yesterday:

> ?China has a major adjustment problem,? Soros said. ?I would say it amounts to a crisis. When I look at the financial markets there is a serious challenge which reminds me of the crisis we had in 2008.? Soros has warned of a 2008-like catastrophe before. On a panel in Washington in September 2011, he said the Greece-born European debt crunch was 'more serious than the crisis of 2008.'"

And one last chart to close with:

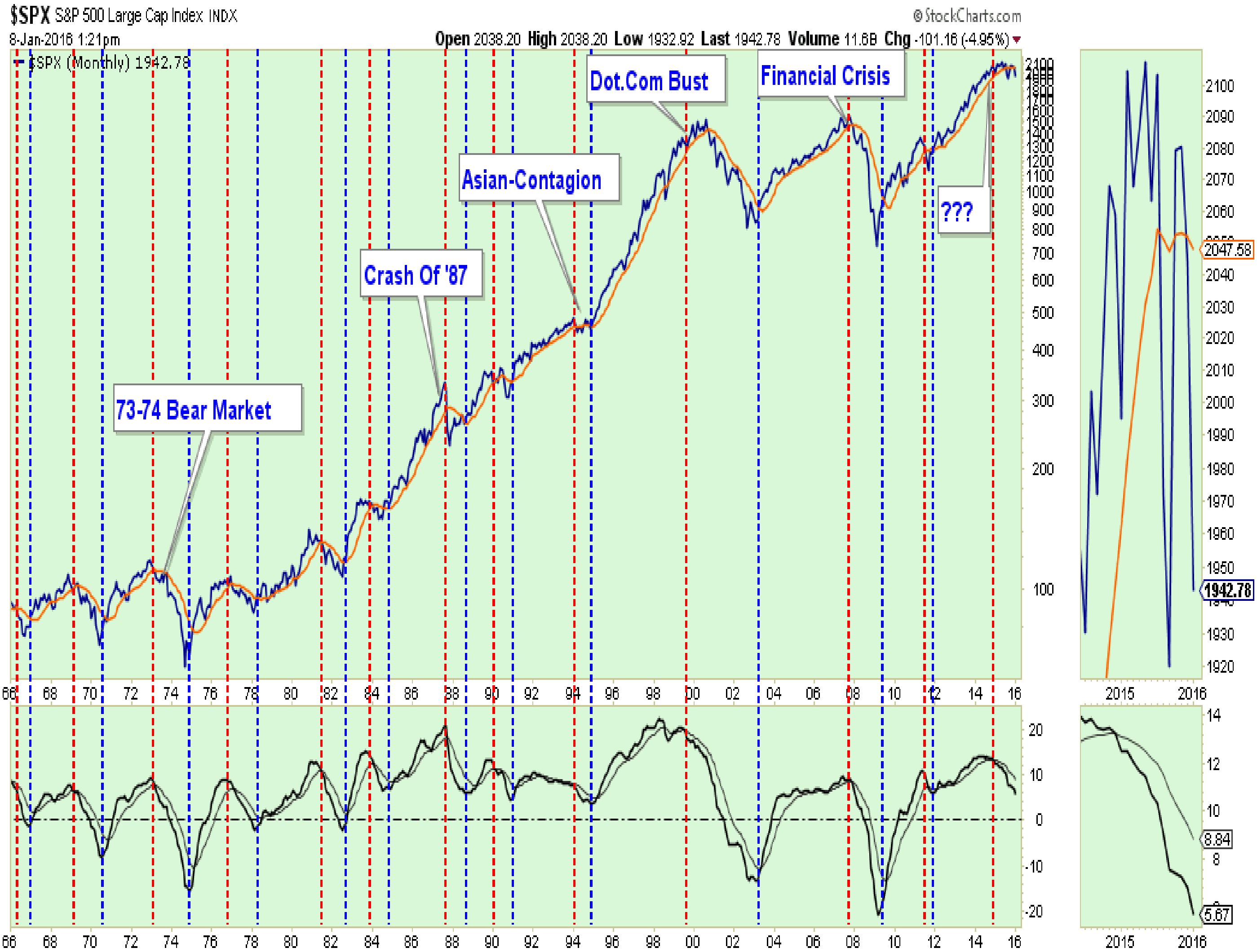
> "The bearish divergence between the S&P 500 and the major-market-top indicator meant that ? for the first time since the 2009 rally started ? new highs are no longer guaranteed, and the odds for a major market top increased."



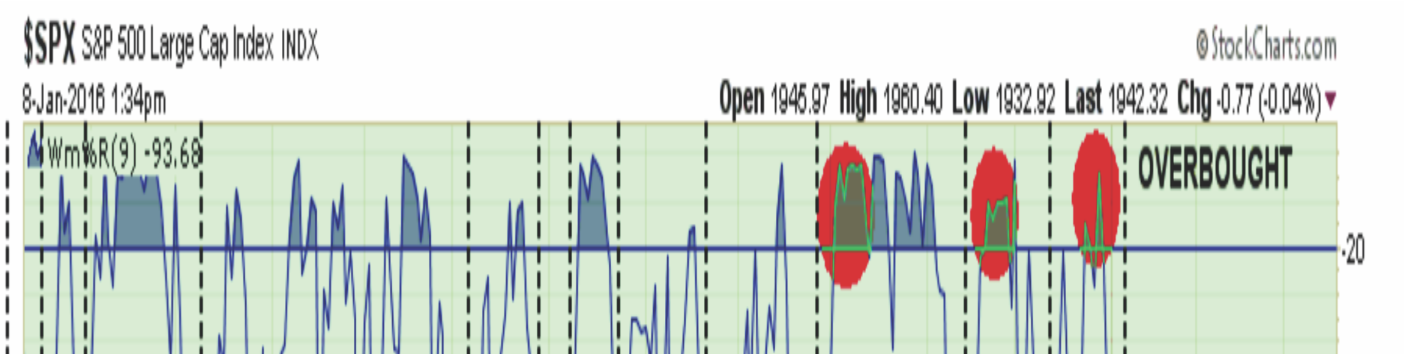
THE MONDAY MORNING CALL

Time To Reduce Risk

The chart below is a VERY long-term look at the S&P 500 going back to 1965. It is a monthly analysis of changes in price momentum and long-term moving average support.



The vertical **orange lines** are when **SELL signals** were issued as both momentum turned negative and prices violated the long-term moving average. Conversely, the **vertical blue** lines are**BUY signals** when market dynamics reversed to the positive. Currently, the markets are registering the first **confirmed set•**of monthly SELL signals since the peak of the market in late 2007.**Important Note: Don't Panic Sell** With all of the alarm bells currently triggering, the initial *"emotionally"* driven response is most likely an urge to go look at your portfolio statement and start pushing the *"sell"* button. **Don't Do It!** When working with technical analysis, particularly long-term views, by the time a *"signal"* is triggered, the short-term market move is already well advanced. On a short-term basis, prices oscillate back and forth like a rubber band be pulled and let loose. Physics state that a rubber band stretched in one direction, will initially travel an equal distance in the opposite direction when released. Take a look at the chart below.



In particular note the top and bottom portions of the chart. These two indicators measure the *"over bought"* and *"over sold"* conditions of the market. As with the rubber band example above, you will notice that when these indicators get stretched to the downside, there is an effective *"snap back"* in fairly short order. **With the markets having issued multiple sell signals, broken very important support and both technical and fundamental deterioration in progress, it is suggested that investors use these *"snap back"* rallies to reduce equity risk in portfolios.•**

Rebalancing Rules

Let me provide you again with the rebalancing rules that I reiterated through the majority of last years newsletters as markets deteriorated from the May-June highs. That period also marks the point where I reduced equity risk in portfolios by 50% *(which is where it remains currently.)*

> 1) **Trim positions that are big winners** in your portfolio back to their original portfolio weightings. (ie. Take profits) 2) **Positions that performed with the market should also be reduced** back to original portfolio weights. 3) **Move trailing stop losses up** to new levels. 4) **Review your portfolio allocation relative to your risk tolerance.** If you are aggressively weighted in equities at this point of the market cycle, you may want to try and recall how you felt during 2008. Raise cash levels and increase fixed income accordingly to reduce relative market exposure.

How you personally manage your investments is up to you. I am only suggesting a few guidelines to rebalance portfolio risk accordingly. Therefore, use this information at your own discretion.

Working With A Model Allocation

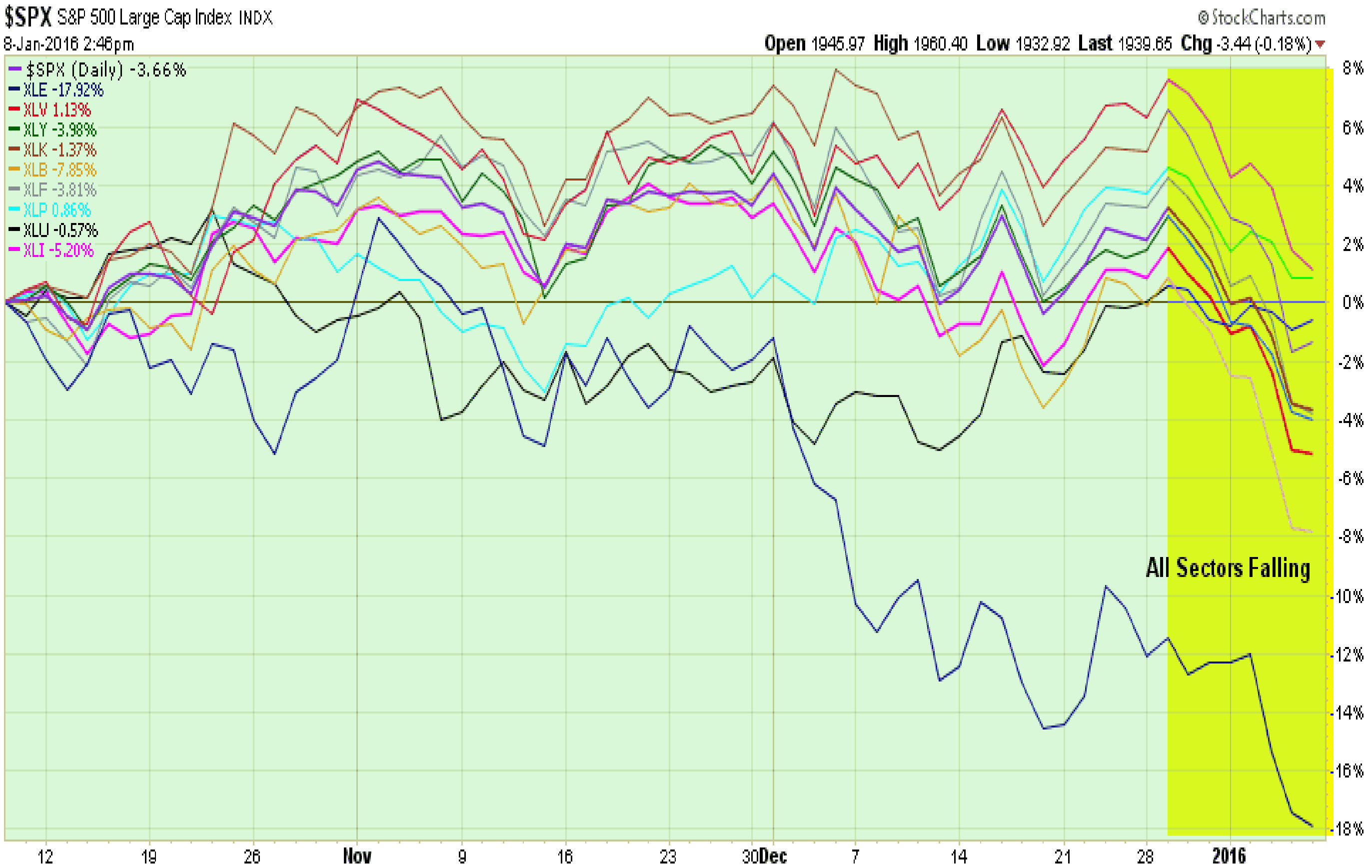
Let's review the model. *NOTE: The following is for example purposes ONLY. It is in no way a suggestion, recommendation, or implication as to any portfolio allocation model currently in use. It is simply an illustration of how to overweight or underweight a model allocation structure.* **Again, this is just for educational purposes, and I am not making any specific recommendations. This is simply a guide to assist you in thinking about your own personal position, how much risk you are willing to take and what your expectations are.** From that starting point design a base allocation model and weight it accordingly. The closer you want to track the S&P 500 Index, the less fixed income, real estate and cash your portfolio should have. For a more conservative allocation reduce allocations to equities. Got it? Okay.

S.A.R.M. Current

The **S**ector **A**llocation **R**otation **M**odel (SARM) is an example of **a basic well-diversified portfolio**. The purpose of the model is to look "beneath the hood" of a portfolio to see what parts of the engine are driving returns versus detracting from it. **From this analysis, we can then determine where to overweight sectors which are leading performance, reduce in areas lagging, and eliminate those areas that are dragging.** The Sector Allocation Rotation Model continues to deteriorate suggesting that markets are significantly weaker than they appear. **As suggested all through this missive, a reflexive bounce in the market•should be SOLD into currently.**

chart	visible	tail	symbol	name	sector	industry	price	%chg
			XLK	Technology Select Sector SPDR			40.62	-6.5
			XLI	Industrials Select Sector SPDR			50.30	-6.8
			XLB	Materials Select Sector SPDR			40.52	-9.8

While Technology, Industrials, Financials, Basic Materials, and HealthCare stocks have•shown better performance than the index as a whole, **these sectors are only winning by not losing** as much.



Small and Mid-capitalization stocks continue to struggle and should be avoided for now. Volatility risk is substantially higher in these areas and are better used during a firm growth cycle versus a weak one. **Adding to fixed income, not high-yield bonds,**•is advisable here as markets continue to see a flight to safety.•Hold current allocations•for now and add to positions when the equity market bounces. **The recommendations for *"pruning and trimming"* exposure over the past couple of months has already done much of the risk mitigation needed to navigate the current markets.** Therefore, there should be only relatively minor changes needed currently.

S.A.R.M. Model Allocation

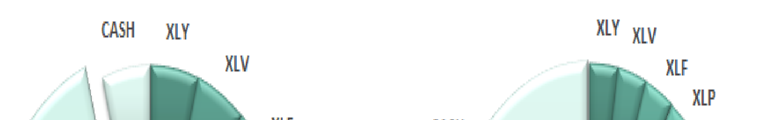
As we enter the New Year, I have set the SARM Model to reflect the•allocation model discussed above and below.

- **Hold**•Materials
- **Hold**•Industrials
- **Hold** Discretionary
- **Hold**•Energy
- **Hold**•Technology
- **Hold**•Utilities
- **Hold** Staples
- **Hold** Healthcare
- **Hold** Financials
- **Hold**•REITs
- **Hold**•Bonds

The example portfolio looks as follows:

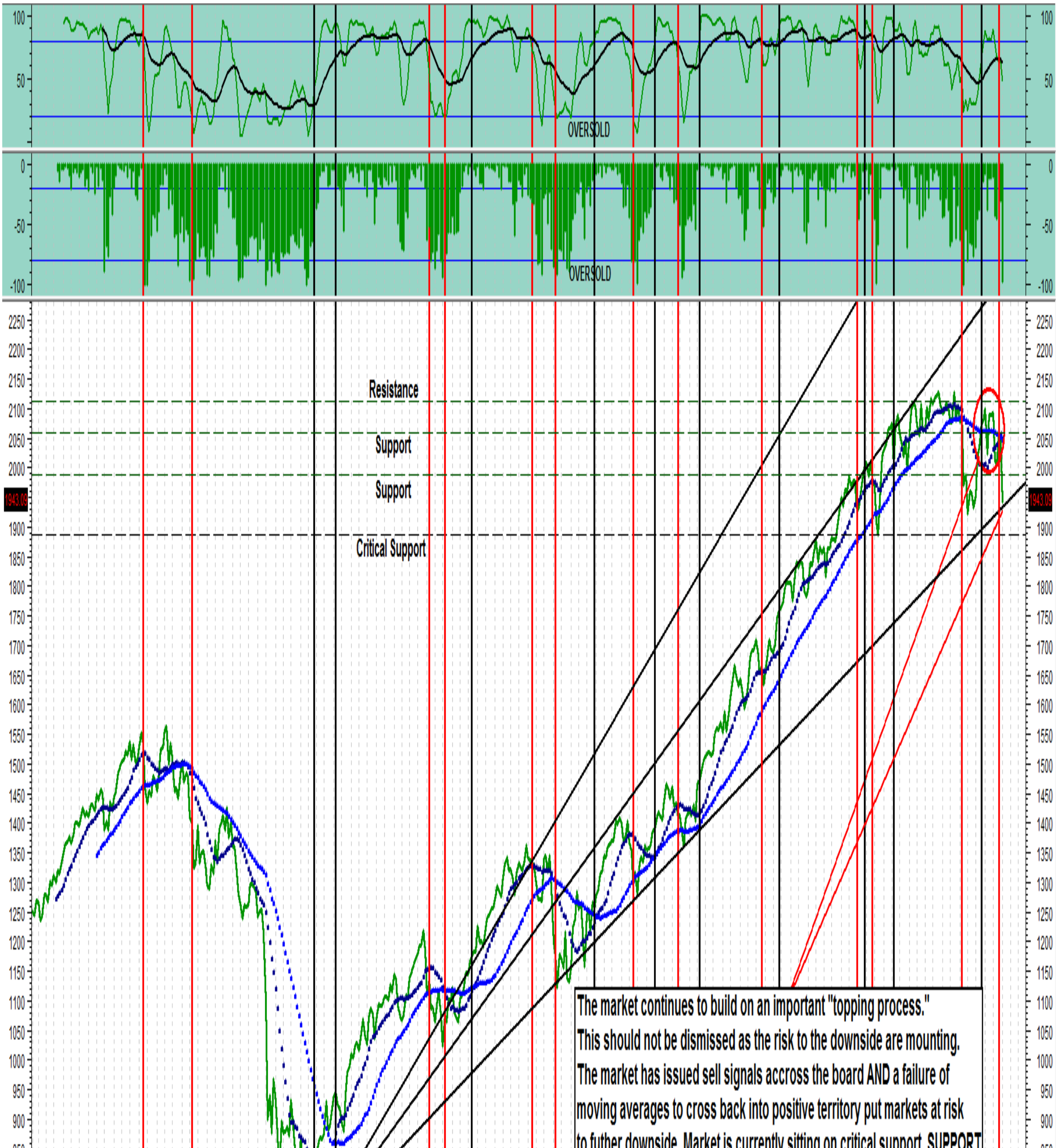
S.A.R.M. Model Allocation *(Assume 60/40 Allocation To Equal 401k Plan Manager)*

Symbol	Name	Model Weight	SARM Analysis	Adjusted Weight
XLY	Discretionary	5.00%	Weakening	3.00%



With the pullback this week, the markets are oversold enough once again to elicit a short-term rally over the next week or so. **As you will notice, the model is currently carrying 35% cash in the portfolio.** Any rally in the markets should be used to reduce cash and increase fixed holdings accordingly. **It is completely OKAY if your current allocation to cash is different based on your personal risk tolerance.** As you can see, **there are not DRASTIC movements being made.** Just incremental changes to reducing overall portfolio volatility risks. **However, if the expected bounce fails at resistance, then further reductions will be required in accordance with the risk reduction modeling.** Remember, as investors, our job is not to try and capture every single relative point gain of the market as it rises. While we certainly want to participate in the rise, **our JOB is to protect our capital against substantial losses in the future**. A methodology that regularly harvests gains, reduces risk and keeps the portfolio focused on longer-term goals will lead to a more successful outcome.

The Real•401K Plan Manager



Market•Failing - Caution Advised

As discussed above, the market has fallen to the long-term trend support and is threatening to violate that trend. **A change in TREND is critical** and suggests that the bull market advance that began in 2009 is over. •As shown in the chart above, the technical deterioration is significant.**I continue to advise caution. The 401k Model is NOT being tactically adjusted at this time because the markets are VERY OVERSOLD on a short-term basis.**•Over the next week or so the markets will likely rally to previous resistance at 1990 on the S&P 500. This level should be used to reduce portfolio equity risk to the current model levels. **IF THE MARKETS FAIL** - I will reduce the allocation model further to **just 15% equity exposure.** *(This is the lowest level the model goes.)* **The current market environment is NOT conducive for an overweight allocation to equity risk currently.**•Portfolio management rules still apply for now. If the recent market volatility has made your nervous as of late, you are probably carrying too much risk in your portfolio. As always, your portfolio, much like a garden, must be tended too in much the same way. By doing so, it will ensure that it prospers and grows over time and yields a fruitful bounty.

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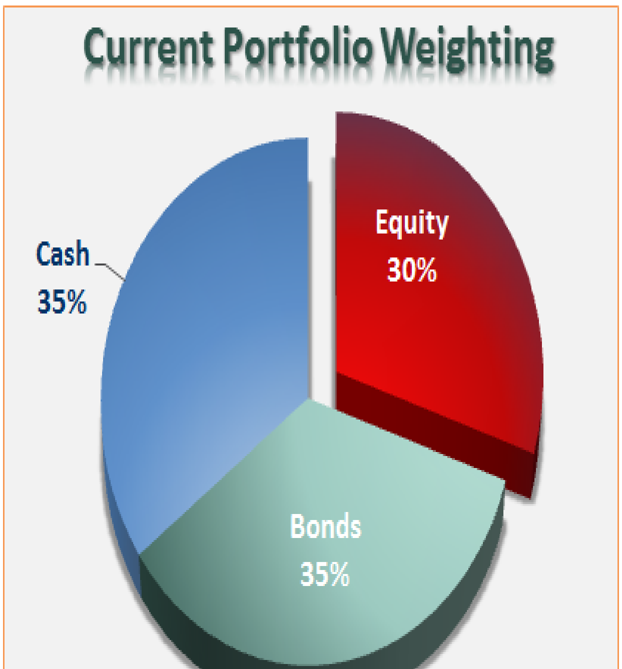
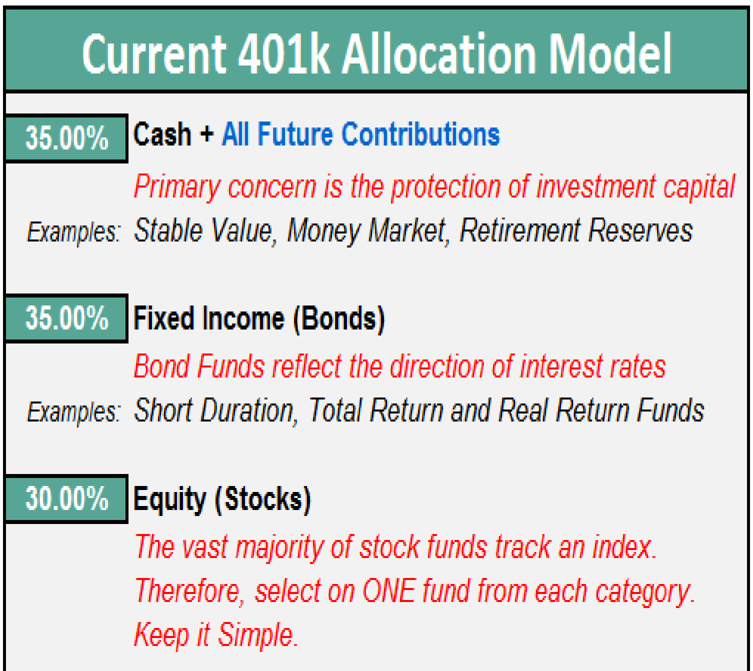
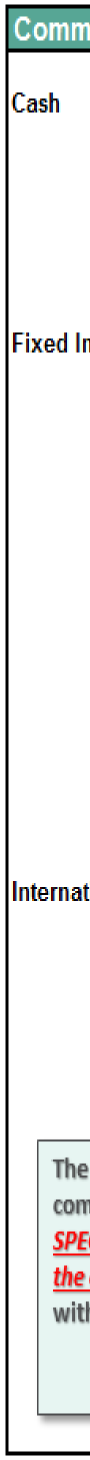
If you need help after reading the alert; don?t hesitate to contact me.

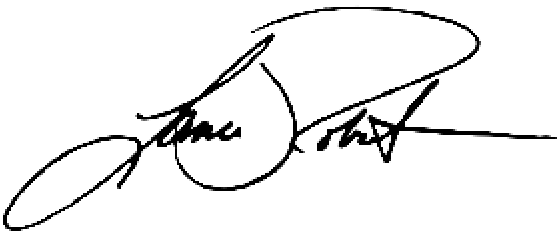
Current 401-k Allocation Model





401k Choice Matching List



Lance Roberts  Lance Roberts is a Chief Portfolio Strategist/Economist for Clarity Financial. He is also the host of ?The Lance Roberts Show? and Chief Editor of the ?Real Investment Advice? website and author of ?Real Investment Daily? blog and ?Real Investment Report?. Follow Lance on Facebook, Twitter and Linked-In