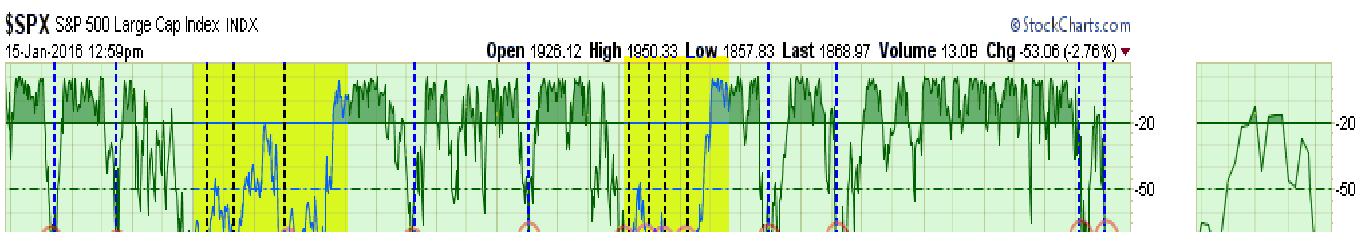
RIA Advice

EDITOR'S•NOTE:If you like the newsletter, please feel free to forward it to anyone you think might find it helpful. **Make sure you are following me** on social media for daily updates, announcements, and commentaries. (Twitter, Facebook, Linked-In)

Finally A Bounce

As discussed last weekend at length, the markets are currently exhibiting all the traits of a *"correction action."*•During these discussions, I have reiterated that you should not*"panic sell"* into the decline but instead take a disciplined approach to exiting the markets. To wit:

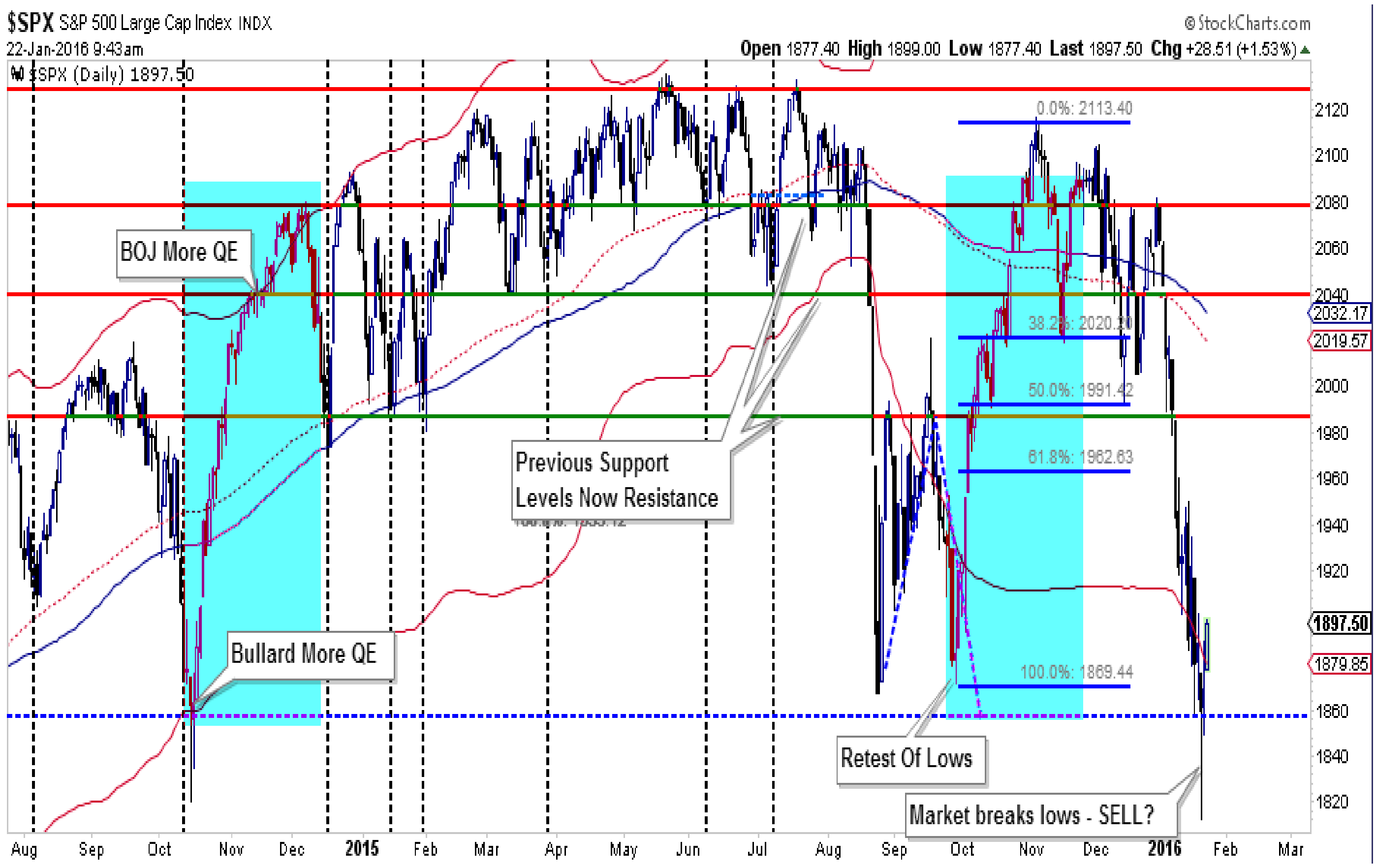
> "I know as I write this, that come Monday morning my inbox will be flooded with emails asking if it's time to go to '*all cash.'* **No.** I NEVER suggest being in '*all cash.'*•From a management standpoint, this is never a good idea. Trying to '*time the market'*•is impossible over the long-term and leads to very poor emotionally based decision making. However, as I regularly write, it is our job to reduce portfolio risk to manageable levels to preserve capital over time. We can do that by increasing and reducing our exposure to equity-related risk by paying attention to the price trends of the market. By the time the markets register important *"sell signals"*•denoting a change from the bullish to bearish trend, **the markets are generally oversold from the previous selling.** This is,•as shown in the chart below, always the case."



"The top section•of the chart is a basic ?overbought / oversold?indicator with extreme levels of *?oversold?* conditions circled. The shaded area on the main part of the chart represents 2-standard deviations of price movement above and below the short-term moving average. There a couple of very important things to take away from this chart. **When markets begin a *?bear market?* cycle *[which is identified by a moving average crossover (red circles) combined with a MACD sell-signal (lower part of chart)]*, the market remains in an oversold condition for extended periods *(yellow highlighted areas.)*** More importantly, during these corrective cycles, **market rallies fail to reach higher levels than the previous rally** as the negative trend is reinforced. **All of these conditions currently exist. Does this mean that the markets will go straight down 20% without a bounce? Anything is possible.** However, **history suggests that even during bear market cycles investors should be patient and allow rallies to occur before making adjustments to portfolio risk.** More often than not, it will keep you from panic selling a short-term market bottom.

Good News - Support Holds

While the markets were certainly volatile mid-week, with the Dow Jones Industrial Average plunging nearly 600 points on Wednesday, the recovery from those intra-day lows into the end of the week erased those losses. **This intra-week volatility is specifically why I focus on WEEKLY data when managing portfolios.** If you are a very short-term trader, using very short time-frames are useful for swing trading markets. However, if you are truly a longer-term investor, slowing price trends down by using weekly or monthly time frames•reduces the volatility that tends to lead to *"emotionally driven decisions."* Let me show you an example: Using DAILY price analysis would have clearly told you to sell last week when the markets broke their support going back to the 2014 October lows.



However, if we step back and look at WEEKLY price analysis, the reversal in the market shows that support has indeed held. **Furthermore, with the markets VERY oversold currently, the expected bounce is likely starting now.**

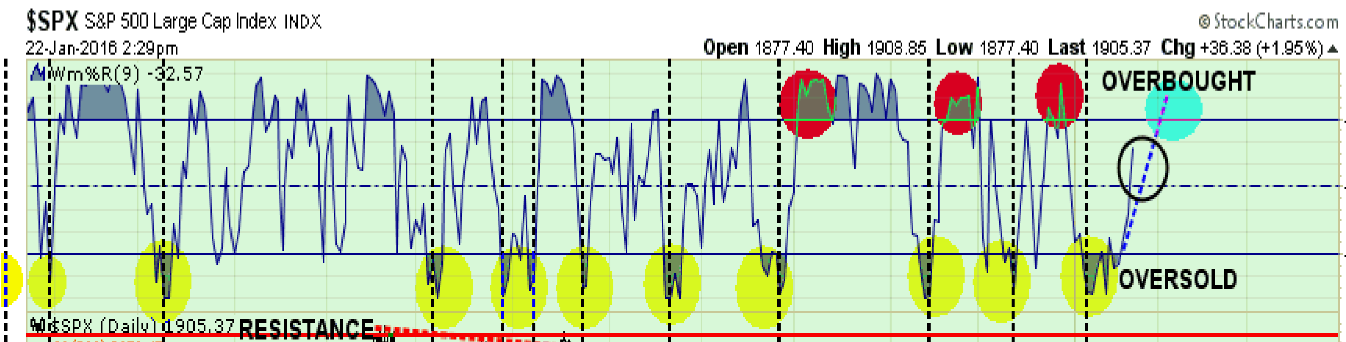
So, the next obvious question is:

> *"How big of a bounce should we expect to sell into?"*

Measuring Retracements

The chart below is the daily overbought/sold status of the market. I wrote last week:

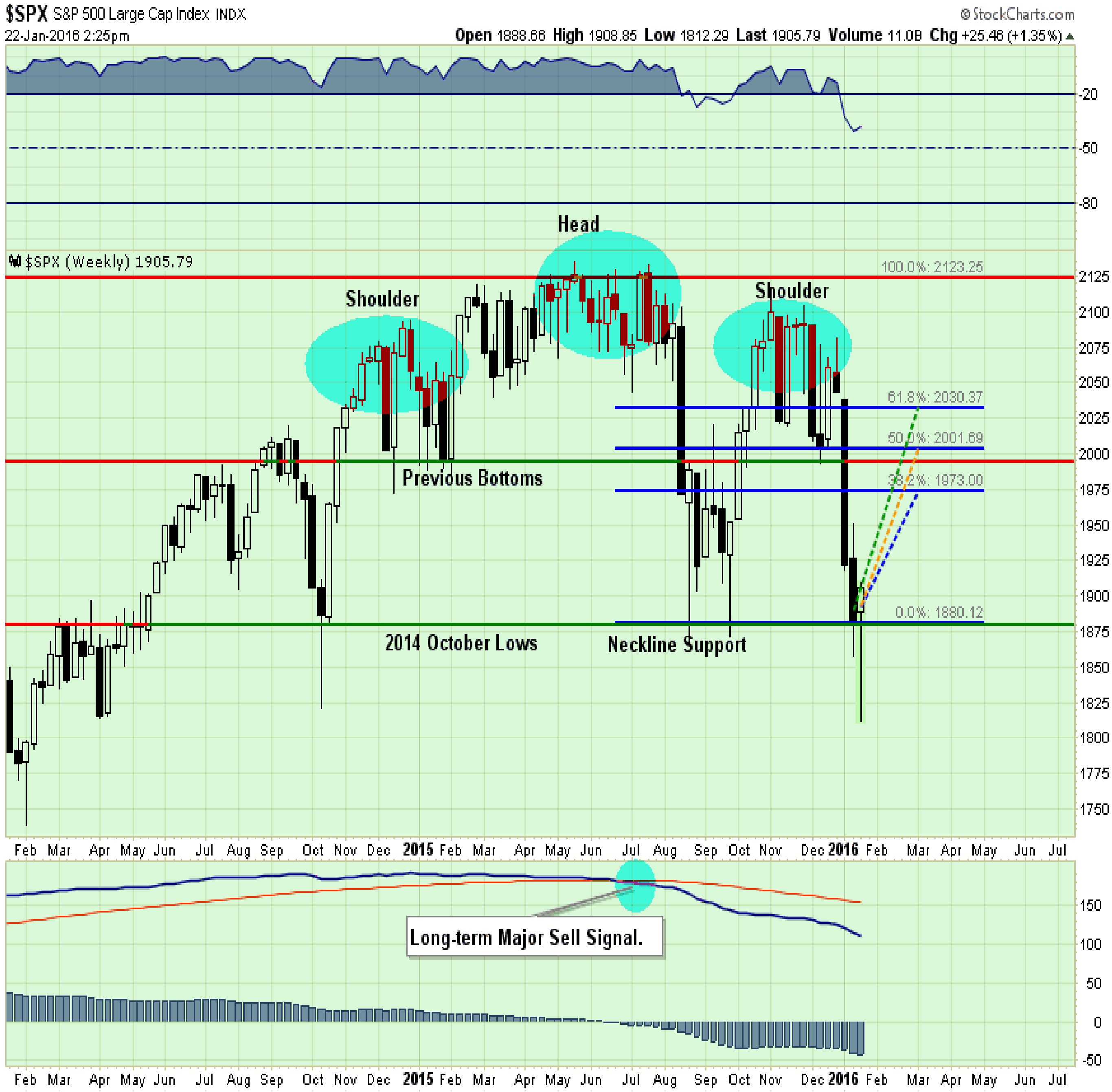
> "In particular note the top and bottom portions of the chart. These two indicators measure the '*over bought*'•and '*over sold*'•conditions of the market. You will notice that when these indicators get stretched to the downside, there is an effective•'*snap back*'•in fairly short order."



It is that very oversold condition that has continually suggested that something would happen to elicit a short-term retracement in the market. Not to be disappointed it was the promise of more liquidity by the ECB and Mario Draghi that elicited a massive short-covering rally on Friday. That is the good news. The bad news is, as shown by the hollow black circles, this small market recovery has already resolved more than half of the previous overbought condition. The chart below lays out three potential targets for the current reflexive rally. IMPORTANTLY, there is no guarantee that these mathematical retracement levels will be precise. Therefore, it is better to use these levels as a general AREA to begin reducing equity risk exposure accordingly. **1970ish** - Sell laggards and losers in portfolios.

(You know the one's, the one's you secretly keep hoping will come back.)

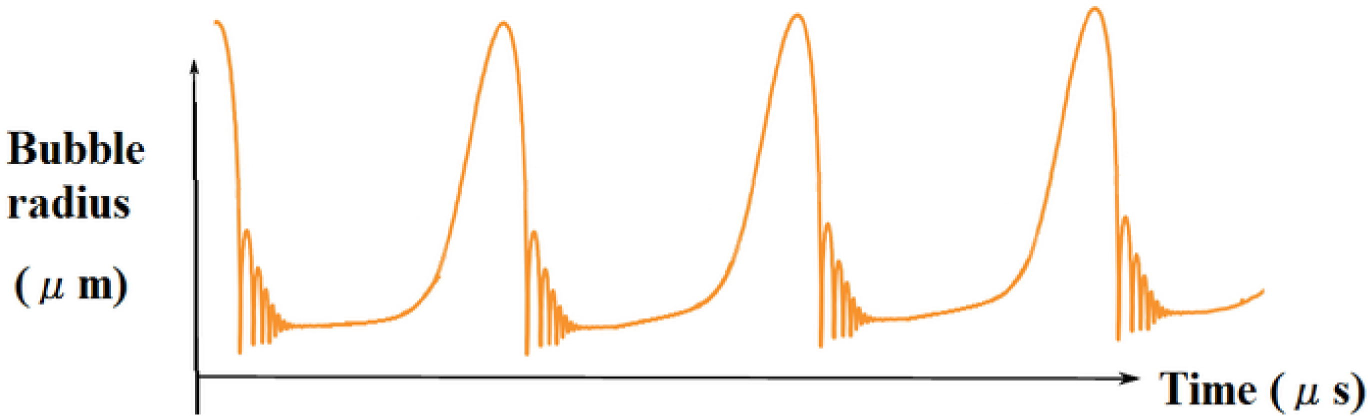
2000ish - Trim back winners to target levels **2030ish** - Final position cleanup.



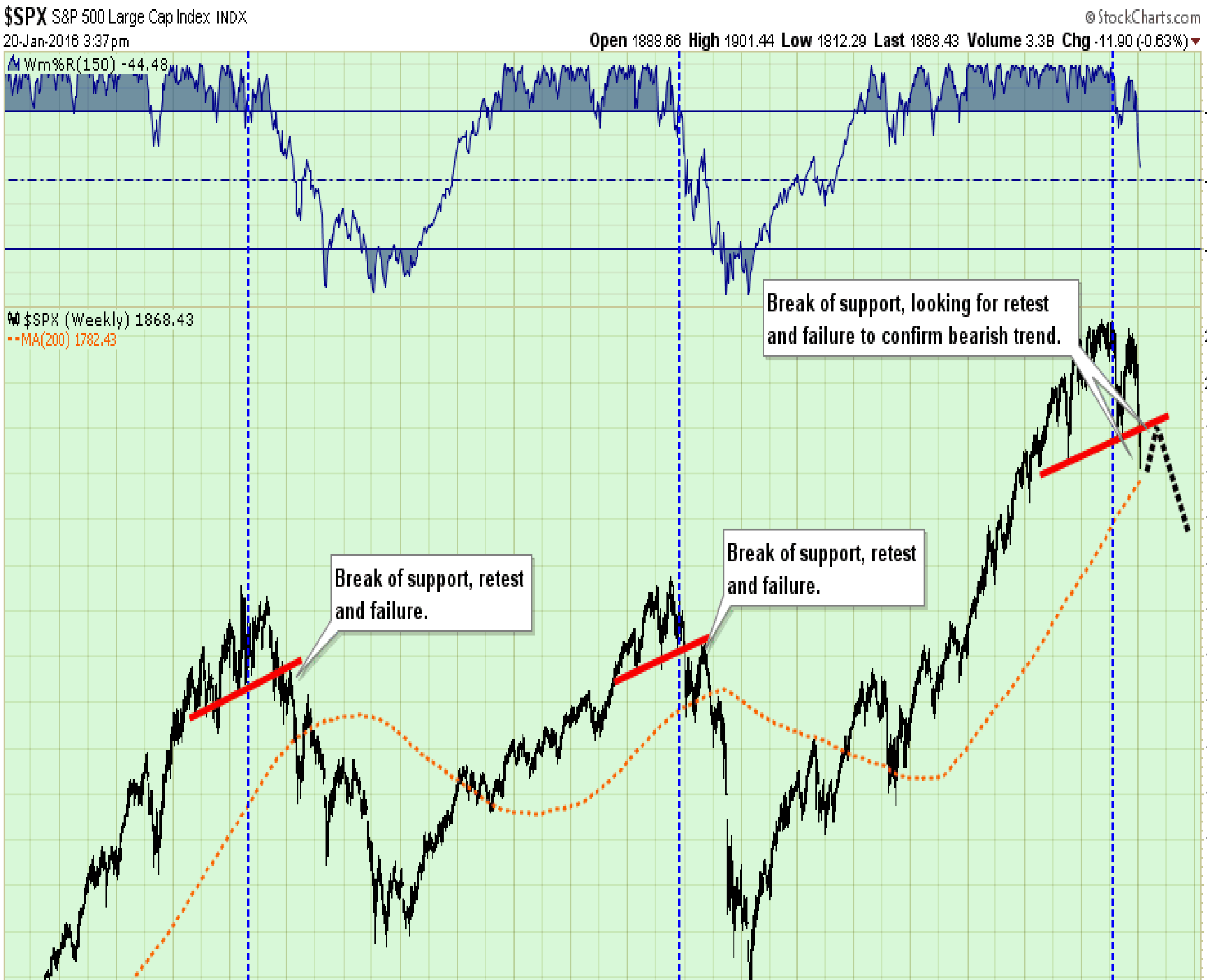
NOTE: For conservative investors it is currently unlikely the market will rise much more than between 1970-1990•during this•rally. I would do the majority of your portfolio rebalancing and risk reduction in this range.•Notice also, that the market has now traced out a fairly definitive "head and shoulder's" technical pattern similar to that seen in 2008. **If this rally fails, and breaks neckline support, the market will be in a confirmed bear market.**

This Looks A Whole Lot Like 2008

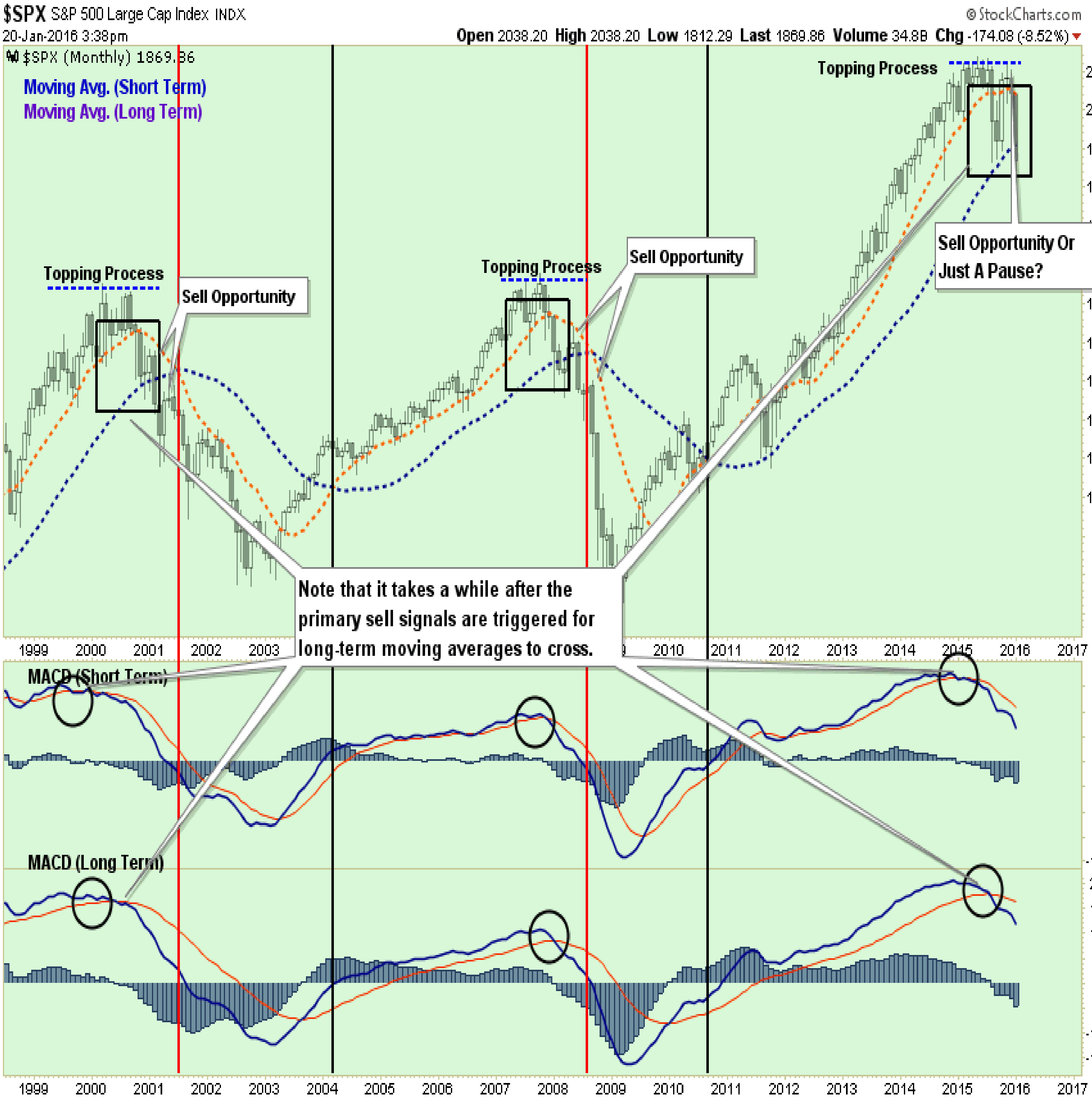
For the last several months I have repeatedly discussed the topping process in the markets and warned against dismissing the current market action lightly. [To wit:](#)

> ?Typically bubbles have an asymmetric shape. **The boom is long and slow to start. It accelerates gradually until it flattens out again during the twilight period. The bust is short and steep because it involves the forced liquidation of unsound positions.** The chart below is an example of asymmetric bubbles.
>
> 
>
>
> **The pattern of bubbles is interesting because it changes the argument from a fundamental view to a technical view.** Prices reflect the psychology of the market **which can create a feedback loop between the markets and fundamentals. This pattern of bubbles can be clearly seen at every bull market peak in history.**?

Take a look at the graphic•above, and the one below. See any similarities?



As you will notice, the previous two bull-market cycles ended when the topping process ended by breaking the rising support levels (red line). **The confirmation of the onset of the ?bear market?•was marked by a failed rally back to the previous rising support level.** Currently, that has not occurred as of yet. The next chart is another variation of the above showing the break-down of the rising bullish trend in the market. **In all cases, investors were given minor opportunities to reduce equity risk in portfolios well before the onset of the bear market decline.•**



Importantly, as I discussed above, the current *"relief rally"*•will most likely be short-lived and will likely fail to get investors *?back to where they were previously.?* •It is not advisable to try and *"game the rally."* The risk to the downside has risen markedly in recent weeks as the technical, fundamental and economic deterioration escalates. This is not a time to be complacent with your•investments. **How you personally manage your investments is up to you,** and I am only suggesting a few guidelines to rebalance portfolio risk accordingly. **However, the risk of being long a tremendous amount of equity risk is no longer as advantageous as it once was. This could all change, of course, if the Federal Reserve leaps into action with a rate cut, another liquidity program or direct market intervention.** If I am wrong and the market does revert back to a bullish trend, it is simply a matter of adding equity exposure back into portfolio allocations. However, the•more important concern for long-term investors is **what if I am right?**

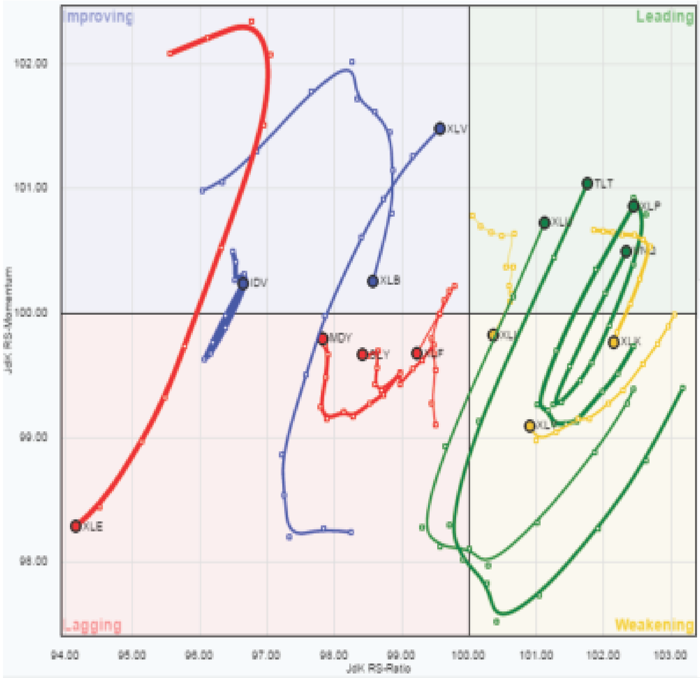
THE MONDAY MORNING CALL

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.**



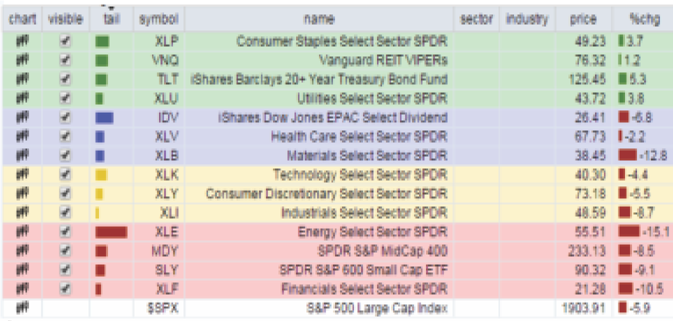
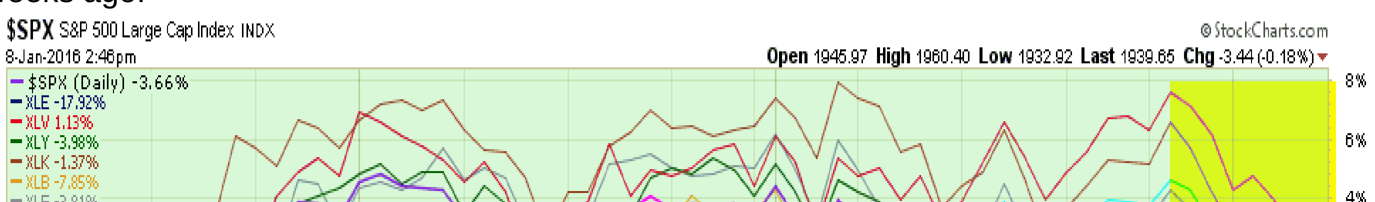
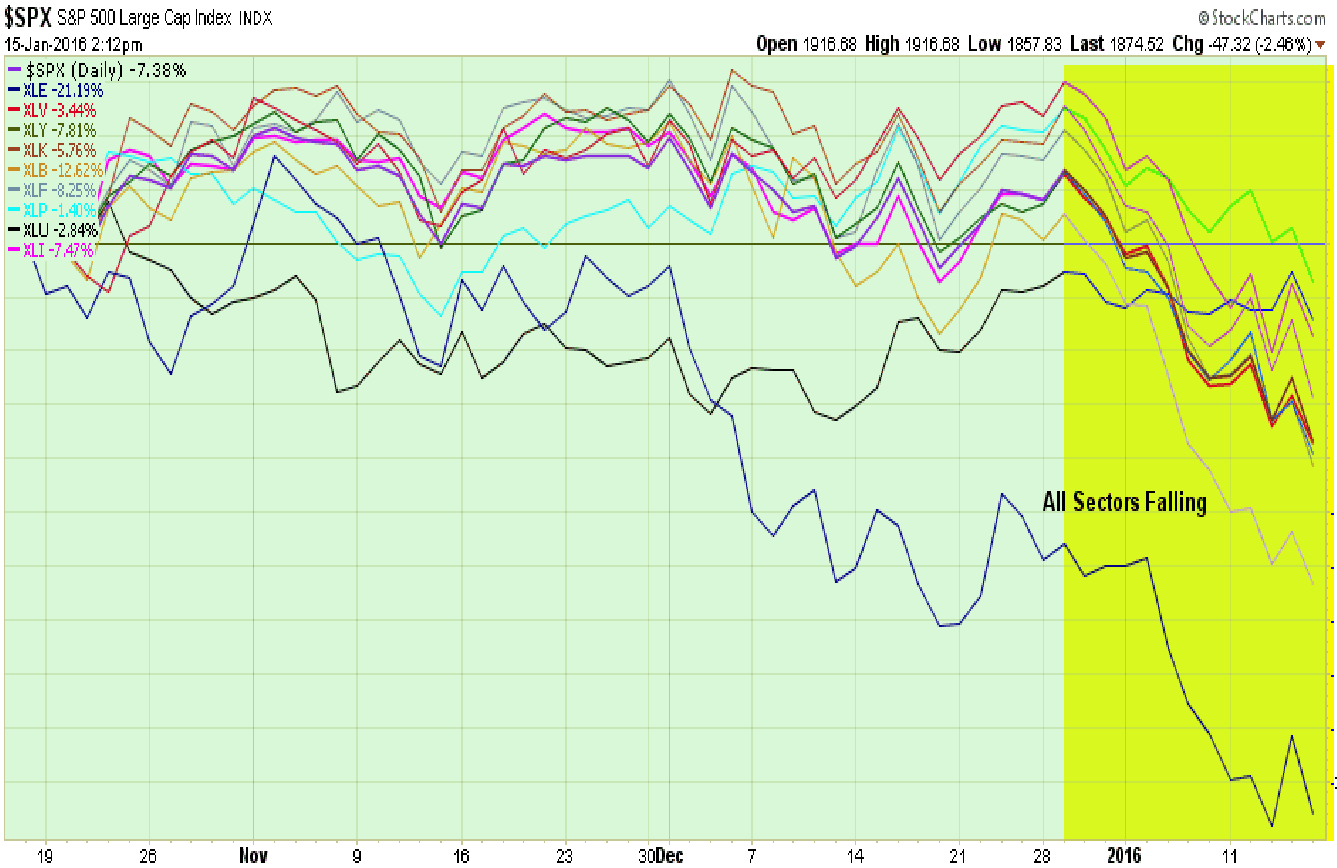


chart	visible	tail	symbol	name	sector	industry	price	%chg
	✓		XLP	Consumer Staples Select Sector SPDR			49.23	3.7
	✓		VNQ	Vanguard REIT VIPERs			76.32	1.2
	✓		TLT	iShares Barclays 20+ Year Treasury Bond Fund			125.45	5.3
	✓		XLU	Utilities Select Sector SPDR			43.72	3.8
	✓		IDV	iShares Dow Jones EPAC Select Dividend			26.41	-6.8
	✓		XLV	Health Care Select Sector SPDR			67.73	-2.2
	✓		XLB	Materials Select Sector SPDR			38.45	-12.8
	✓		XLK	Technology Select Sector SPDR			40.30	-4.4
	✓		XLY	Consumer Discretionary Select Sector SPDR			73.18	-5.5
	✓		XLI	Industrials Select Sector SPDR			48.59	-8.7
	✓		XLE	Energy Select Sector SPDR			55.51	-15.1
	✓		MDY	SPDR S&P MidCap 400			233.13	-8.5
	✓		SLY	SPDR S&P 600 Small Cap ETF			90.32	-9.1
	✓		XLF	Financials Select Sector SPDR			21.28	-10.5
			$SPX	S&P 500 Large Cap Index			1903.91	-5.9

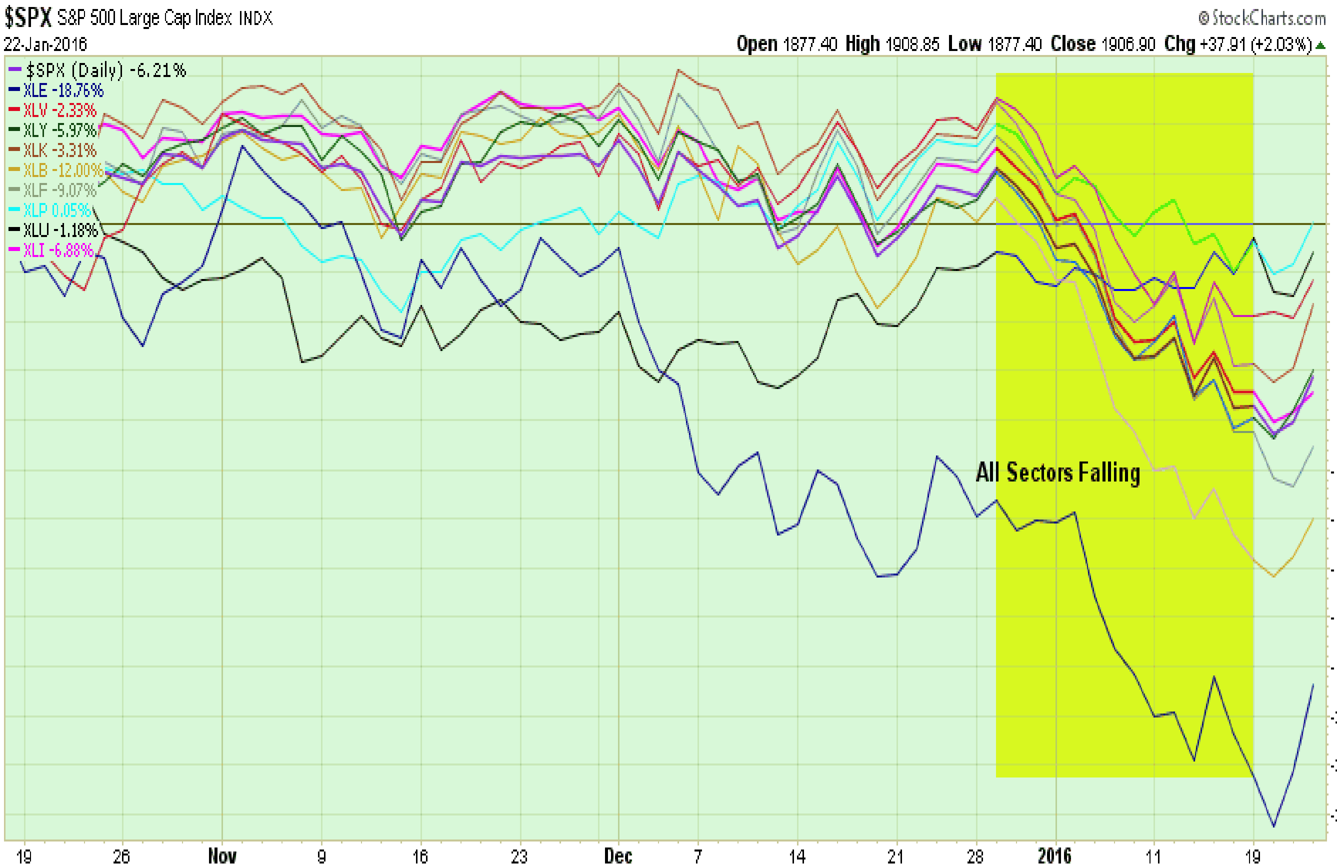
Not surprising interest rate sensitive sectors of the market surged last week as the 10-year Treasury plunged below 2%. The search for safe haven investments such as REIT's, Utilities, Bonds, and Staples has become a more crowded trade as capital leaves the previous leaders of Technology, Industrial and Discretionary sectors. Energy remains a disaster along with Mid and Small-Cap indices. Health care, Materials, and International•are only improving**by not losing** as much. **Portfolio equity models that rotate sectors (offense to defense) do not work in bear markets. Losing, by not losing as much, is NOT winning.** Below is sector performance from two weeks ago:



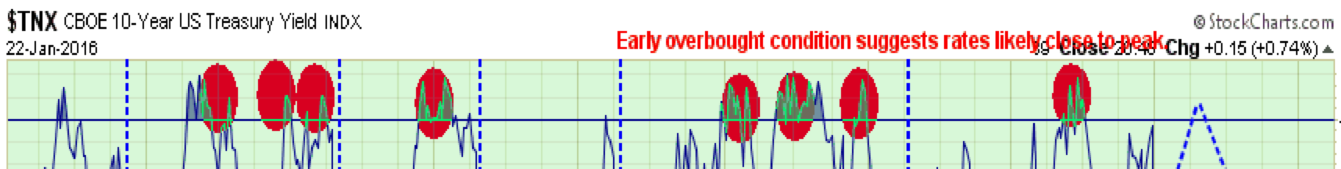
Last week:



This week:



The call for fixed income to go below 2% this year is rapidly coming to fruition. Unfortunately, it is happening much more rapidly than expected as economic weakness continues to take hold. **Do NOT add to fixed income for now.** Hold current allocations for now and add to positions as a bounce in the equity market will likely push rates back up to 2.15-2.2%



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

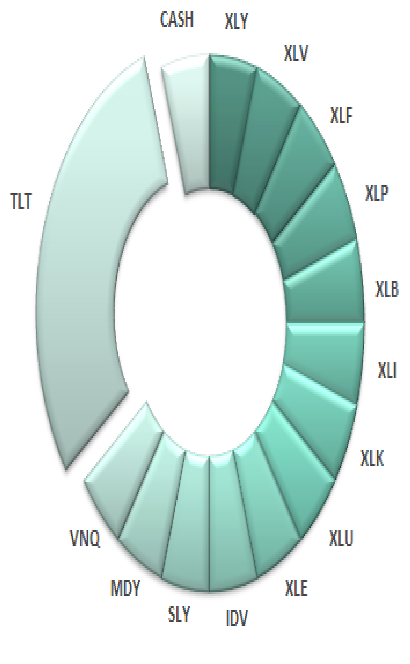
Hold current allocations for now. As I have suggested repeatedly throughout this missive, use a bounce in the market to reduce equity risk exposure. **I•have set the SARM Model to reflect the•allocation model following the expected short-term bounce.**

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

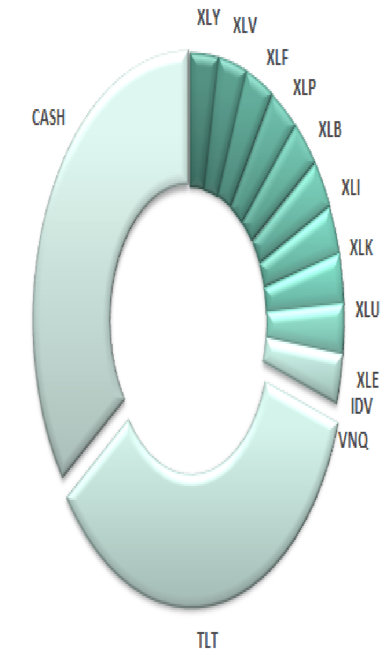
The example portfolio currently looks as follows:

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%
XLV	Healthcare	5.00%	Improving	3.00%
XLF	Financials	5.00%	Improving	3.00%
XLP	Staples	5.00%	Weakening	3.00%
XLB	Materials	5.00%	Improving	3.00%
XLI	Industrials	5.00%	Leading	3.00%
XLK	Technology	5.00%	Leading	3.00%
XLU	Utilities	5.00%	Lagging	3.00%
XLE	Energy	5.00%	Lagging	3.00%
IDV	International	5.00%	Lagging	0.00%
SLY	Small Cap	5.00%	Lagging	0.00%
MDY	Mid Cap	5.00%	Lagging	0.00%
VNQ	Real Estate	5.00%	Weakening	3.00%
TLT	Bonds	30.00%	Weakening	35.00%
CASH	Money Market	5.00%	--------	35.00%



Fully Allocated Model

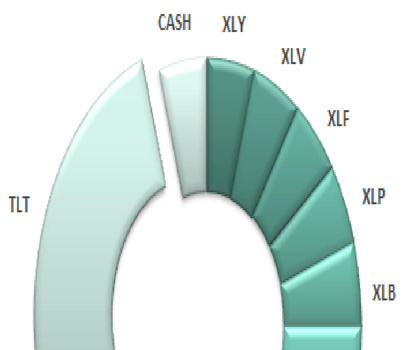


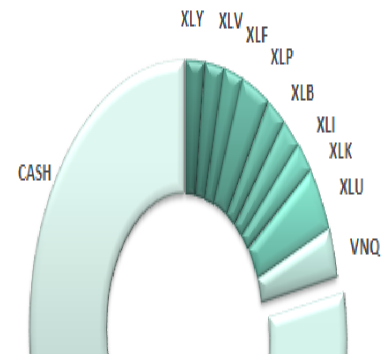
Risk Adjusted Model

During THIS•bouncein the market, adjust weightings 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	2.00%
XLV	Healthcare	5.00%	Improving	2.00%
XLF	Financials	5.00%	Lagging	2.00%
XLP	Staples	5.00%	Leading	3.00%
XLB	Materials	5.00%	Improving	2.00%
XLI	Industrials	5.00%	Weakening	2.00%
XLK	Technology	5.00%	Weakening	2.00%



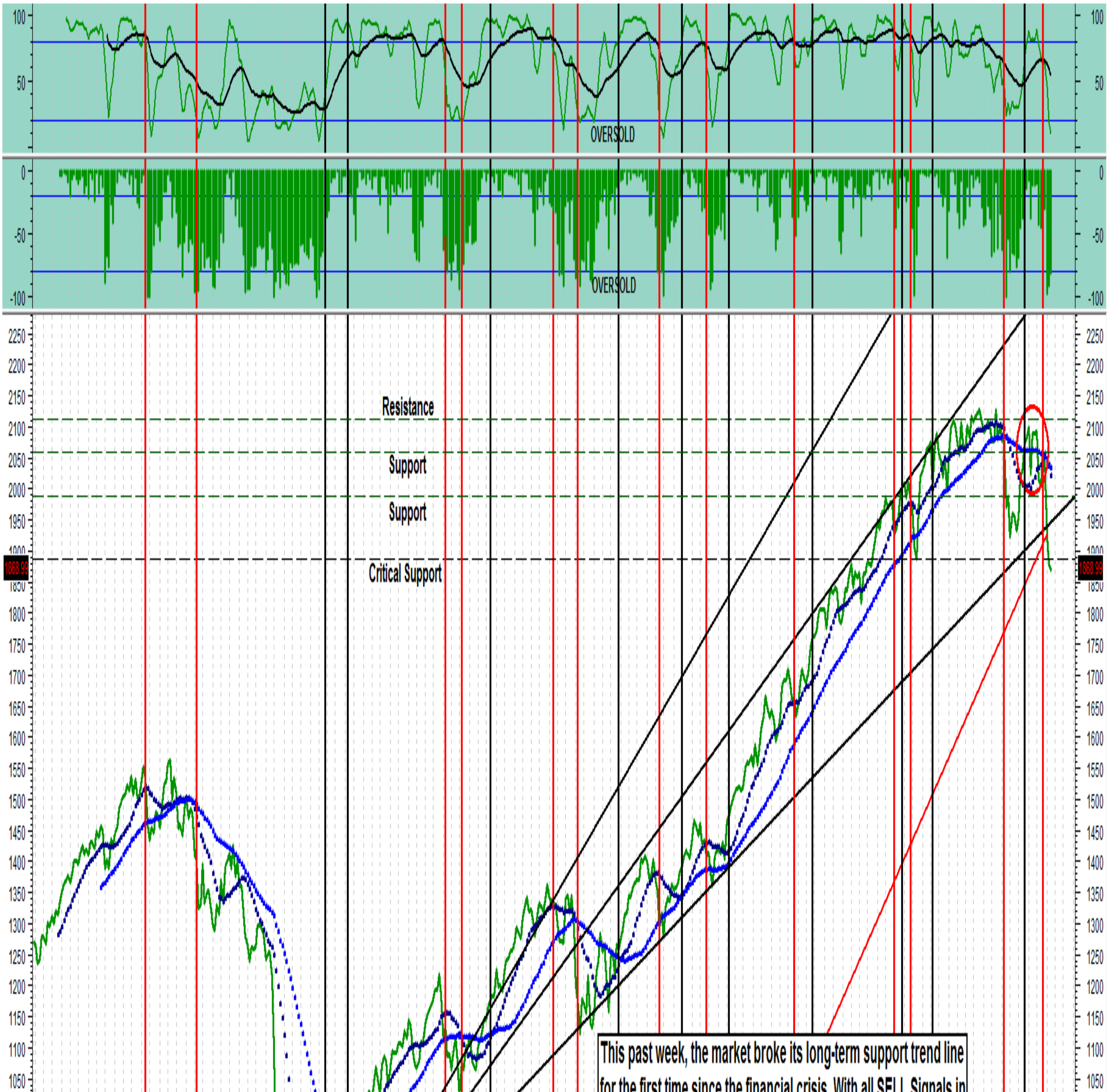


As I wrote last week:

> "Again, with this sell-off, the markets are oversold enough 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 increase•cash accordingly."

During this rally, cash will be increased to 43% of the portfolio, with 35% in bonds, and the rest in equity. **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•Fails -•Action Advised On This Bounce

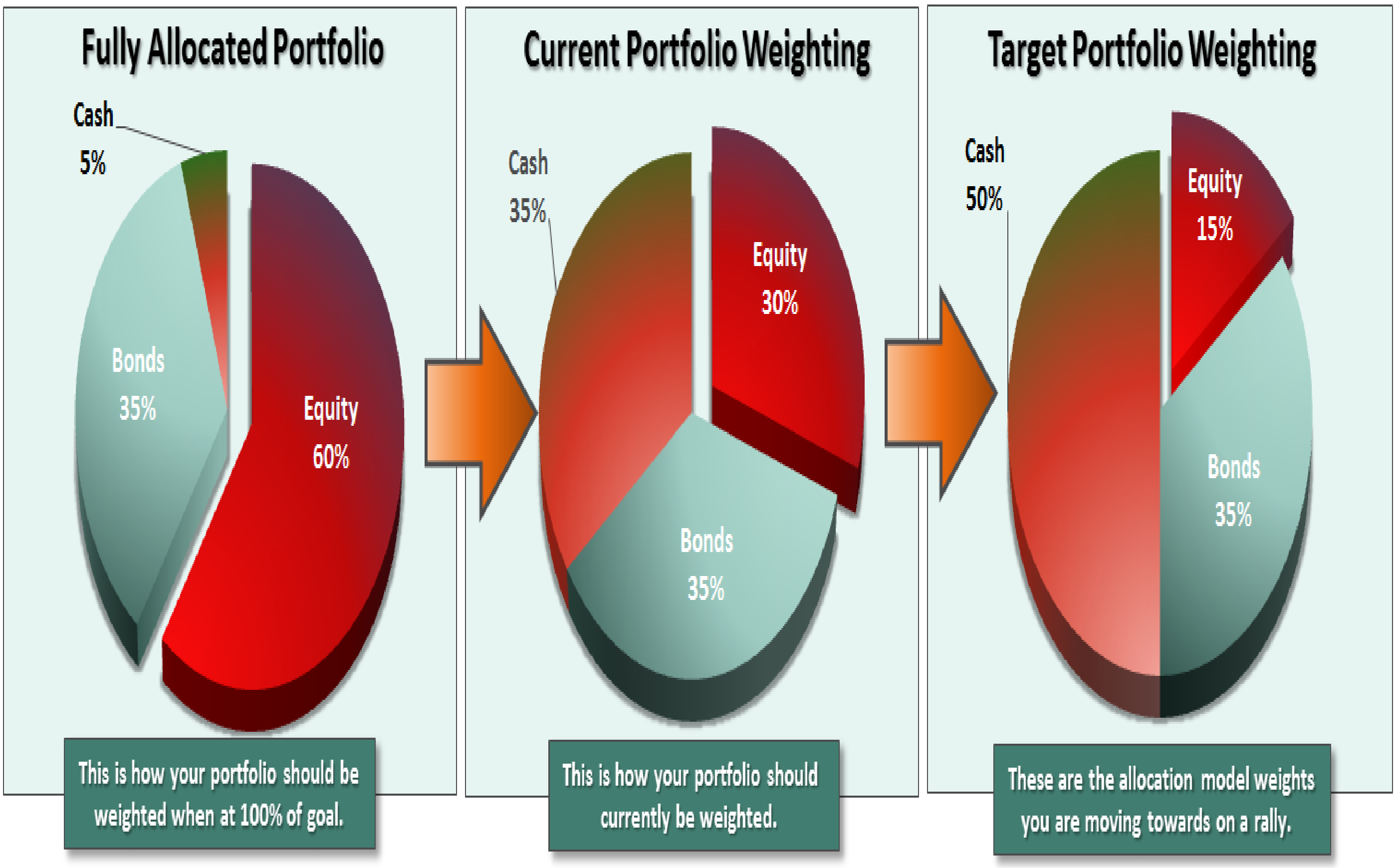
As discussed above, the market is has **NOW BROKEN•**the long-term trend support. **A change in TREND is critical** and suggests that the bull market advance that began in 2009 is over. •As shown in the chart above, the technical deterioration is significant. **I continue to advise caution. As I stated last week:**

> **"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 towards previous•resistance at 1990 on the S&P 500.**This level should be used to reduce portfolio equity risk to the current model levels. ON ANY RALLY NEXT WEEK• I will reduce the allocation model further to just 15% equity exposure.** ***(This is the lowest level the model goes.)"***

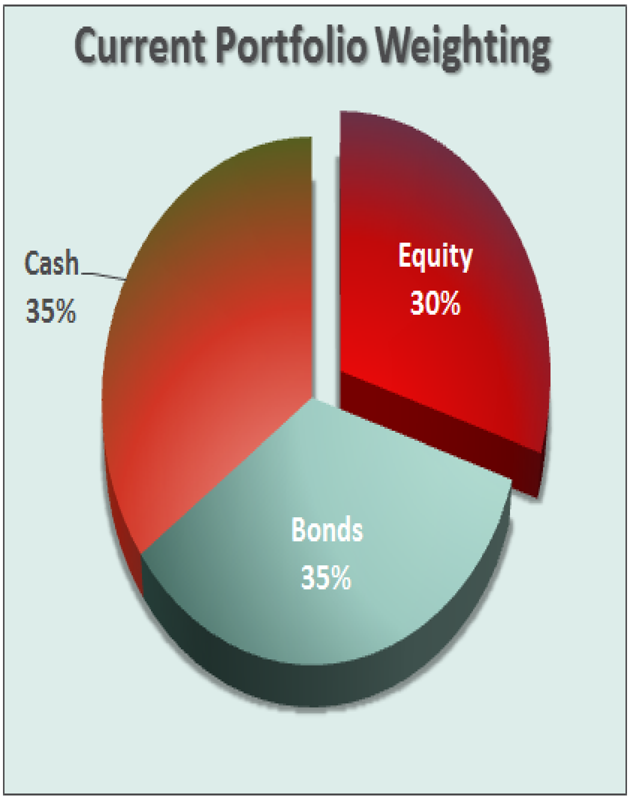
The market rallied on Friday, so I will hold the allocation into next week for now. As stated in the missive above, I expect this reflexive bounce could remain into next week. However, as always, there are no guarantees so act accordingly relative to your own risk tolerance. **The current market environment is NOT conducive for an overweight allocation to equity risk currently.**•If the recent market volatility has made your nervous as of late, you are probably carrying too much risk in your portfolio. Use this bounce in the markets to take some action in your portfolio to reduce risk for now. If you need help after reading the alert; don?t hesitate to contact me.

Current 401-k Allocation Model

I am adding the model allocation progression for clarity purposes. The chart below shows the transition from a fully allocated 401k plan, the current portfolio weighting, and the target allocation on the next reduction when, and "if", it occurs.



The 401k plan allocation plan below follows the K.I.S.S. principal. By keeping the allocation extremely simplified it allows for better control of the allocation and a closer tracking to the benchmark objective over time.



Current 401k Allocation Model

35.00% **Cash + All Future Contributions**

Primary concern is the protection of investment capital

Examples: *Stable Value, Money Market, Retirement Reserves*

35.00% **Fixed Income (Bonds)**

Bond Funds reflect the direction of interest rates

Examples: *Short Duration, Total Return and Real Return Funds*

30.00% **Equity (Stocks)**

The vast majority of stock funds track an index.
Therefore, select on ONE fund from each category.
Keep it Simple.

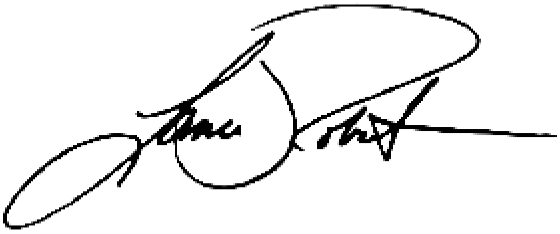
15% Equity Income, Balanced or Conservative Allocation
15% Large Cap Growth (S&P 500 Index)
0% International Large Cap Value
0% Mid Cap Growth

401k Choice Matching List

The list below shows sample 401k plan funds for each major category. In reality the majority of funds all track their indices fairly closely. Therefore, if you don't see your exact fund listed, look for a fund that is similar in nature.

Common 401K Plan Holdings By Class

Cash	*Stable Value*	**Equity**	
	Money Market	**Large Cap**	*Vanguard Total Stock Market*
	Retirement Savings Trust		*Vanguard S&P 500 Index*
	Fidelity MIP Fund		*Vanguard Capital Opportunities*
	G-Fund		*Vanguard PrimeCap*
	Short Term Bond		*Vanguard Growth Index*
			Fidelity Magellan
Fixed Income	*Pimco Total Return*		*Fidelity Large Cap Growth*
	Pimco Real Return		*Fidelity Blue Chip*
	Pimco Investment Grade Bond		*Fidelity Capital Appreciation*
	Vanguard Intermediate Bond		*Dodge & Cox Stock*
	Vanguard Total Bond Market		*Hartford Capital Appreciation*
	Babson Bond Fund		*American Funds AMCAP*
	Lord Abbett Income		*American Funds Growth Fund Of America*
	Fidelity Corporate Bond		*Oakmark Growth Fund*
	Western Asset Mortgage Backed Bond		*C-Fund (Common Assets)*
	Blackrock Total Return		*ALL TARGET DATE FUNDS 2020 or Later*
	Blackrock Intermediate Bond		
	American Funds Bond Fund Of America	**Balanced Funds**	*Vanguard Balanced Index*
	Dodge & Cox Income Fund		*Vanguard Wellington Fund*
	Doubleline Total Return		*Vanguard Windsor Fund*
	F-Fund		*Vanguard Asset Allocation*
			Fidelity Balanced Fund
International	*American Funds Capital World G&I*		*Fidelity Equity Income*
	Vanguard Total International Index		*Fidelity Growth & Income*
	Blackrock Global Allocation Fund		*American Funds Balanced*
	Fidelity International Growth Fund		*American Funds Income Fund*
	Dodge & Cox International		*ALL TARGET DATE FUNDS 2020 or Sooner*

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