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]())

LAID OFF, RETIRED OR ABOUT TO BE - *Then this event is for specifically for you. Click the link below for full details.*

Brought to you by [KSEV RADIO am700]()•&[The Lance Roberts Show]()

RALLY FAILS, ALERTS RISE

Last week, I discussed the boost the market received as the BOJ made an unexpected move into negative interest rate territory combined with end of the month buying by portfolio managers. [To wit:]()

> "However, the announcement by the Bank of Japan (BOJ) to implement negative interest rates in a desperate last attempt to boost economic growth in Japan was only the catalyst that ignited the bulls. **The *"fuel"* for the buying came from the end of the month portfolio buying by fund managers."**

But more importantly, was the push higher by stocks that I have been discussing with you over the last couple of weeks. [To wit:]()

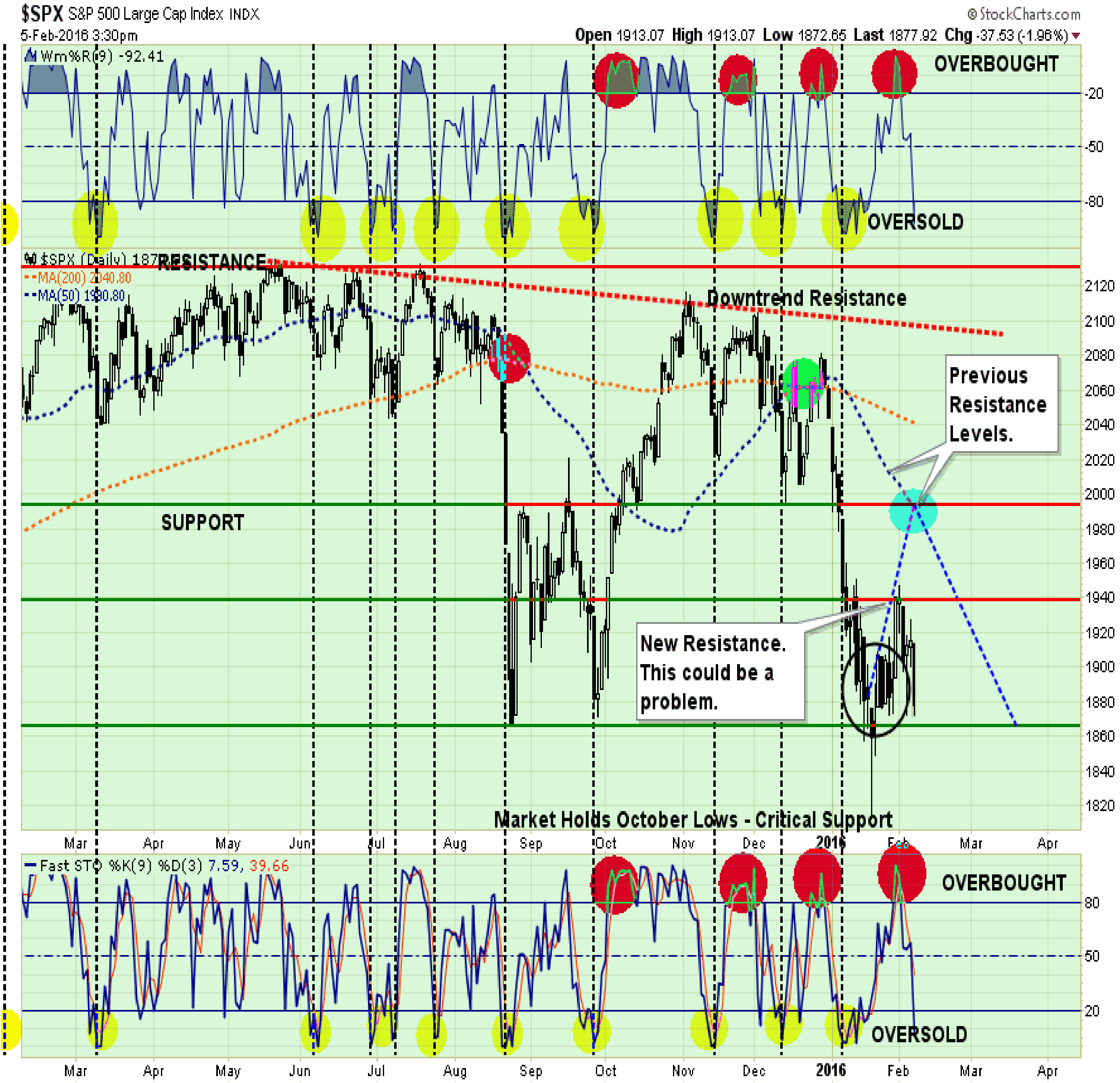
> "Over the last few weeks, I have suggested the markets would likely provide a reflexive rally to allow investors to reduce equity risk in portfolios. **This was due to the oversold condition that previously existed which would provide the *?fuel?* for a reflexive rally to sell into.** I traced out the potential for such a reflexive rally two weeks ago as shown in the chart below."

Previous•Chart

As I stated then, the most important parts of the chart above are the overbought / oversold indicators at the top and bottom. **The oversold condition that once existed has been completely exhausted due to the gyrations in the markets over the last couple of weeks.** This leaves little ability for a significant rally from this point which makes a push above overhead resistance unlikely.

> *"Just as an oversold condition provides the necessary ?fuel? for an advance, the opposite is also true."*

Here is the problem. •I have updated the chart above through Friday's close.



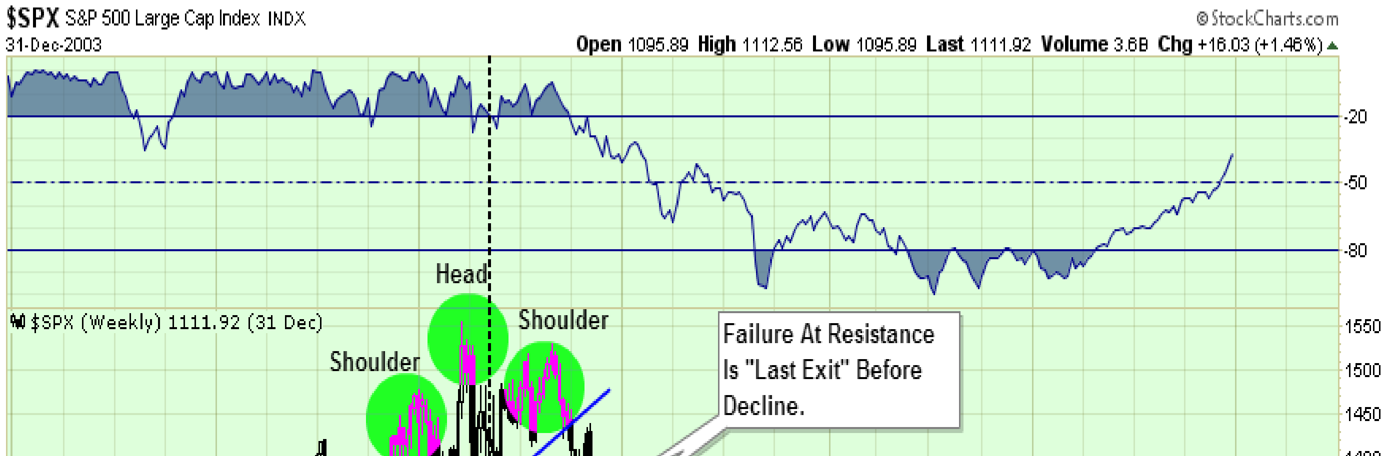
The rally failed at the previous reflex rally attempt during the late December/January plunge. This failure now cements that•high point as resistance.**Furthermore, the market continues to fail almost immediately when overbought conditions are met (red circles), which suggests that internals remain extraordinarily weak.•**

HEAD & SHOULDERS - NOT JUST DANDRUFF

The good news, if you want to call it that, is that the market is currently holding above the

recent lows as short-term oversold conditions once again approach. **It is critically important that the market holds above that support,** which is also the neckline of the current ***"head and shoulders" formation,*** as a break would lead to a more substantive decline.

However, this isn't the first time that we have seen a *"head and shoulders"* topping pattern form **COMBINED with a long-term major sell signal** as shown above. I emphasize this point because many short-term technicians point out *"head and shoulders"* formations that consistently do not lead to more important declines. However, when this topping process combines with enough deterioration in the markets to issue long-term "sell signals," it is something worth paying attention to. The first chart shows the same development in 2000.



And again in 2007.

These are the only two points since the turn of the century where a topping process was combined with a long-term sell signal. It is important to note that in both previous cases the markets did provide one last chance to exit before a more substantiative decline ensued. This is because by the time the market has declined enough to break the neckline, sellers have been temporarily exhausted. This allows the market to rise enough to test previous resistance where "sellers" once again emerge. It is very likely that if, or when, the market breaks current neckline support, individuals will be given one last chance to exit the markets for safer ground. A failure to do so has previously been the start of the *"trail of tears."*

PREDICTING OR PAYING ATTENTION?

Last night I gave a presentation to a group of doctors discussing the economy, the markets and what is most likely to come over the next few months. One of the questions I was asked during the Q&A section was:

> *"How can you be so sure that you are right? No one can time the market?"*

It is an interesting question, and one that I have been asked before. If you scroll down to the bottom of this report you will see a chart of the S&P 500 with the history of portfolio adjustments over time. You could call this timing, however, I prefer to call this risk management. **For me, *"timing the market"* is trying to be *"all in"* or *"all out."* If you try and do that playing poker you are eventually going to go broke.**•However, a good poker player understands the "risk of losing" given the particular hand that he is dealt. He will bet much heavier given a *"full house"* versus a *"pair of deuces."*• However, even given a great hand, a good poker player reads the other players at the table and adjusts his bets accordingly. The same is true when it comes to managing your portfolio. While you may have a *"great hand of stocks,"* you must read the rest of the players in the market. **If they are all buying or selling, what do they know that you possibly don't.**•So, that brings me to the question above. **I am NOT sure that I am right. However, since last May I have held exposure in portfolios to 50% of normal equity allocations because the price trends of the market have been deteriorating.** Furthermore, they continue to do so which is leading me to reduce allocations even more *(see next section.)* **Am I predicting a major market decline? NO.** However, I am suggesting that given the current weight of evidence that one may very likely already be in process. **The chart below is a MONTHLY chart of market indicators that measure a variety of market internals.** Currently, **every single measure is registering a "SELL" signal which has only occurred during the previous two bull market cycles.•**

Now, you can certainly make the case for why *"this time is different."*• However, if you are a good poker player, **should you really be betting heavily given the current hand?**•Even if correction only reverts back to the previous peaks of the past•two bull markets,**such would entail an additional decline of 18% from current levels, or 27% from the previous peak.**•Such a correction•would just about•meet•the average draw down of a bear market cycle throughout history as shown in the table below.

Recession Start	Recession Finish	Recession Length - No Of Months	Recovery Length - No Of Months	S&P Peak Prior To Recession		S&P Trough During Recession		S&P 500 Decline - Peak To Trough	
Oct-1873	Mar-1879	66	35	Aug-1871	91.38	Jun-1877	61.42	-32.79%	
Mar-1882	May-1885	39	21	Jun-1881	156.91	Jun-1884	114.36	-27.12%	
Mar-1887	Apr-1888	14	26	Nov-1886	170.46	Mar-1888	139.24	-18.31%	
Jul-1890	May-1891	11	19	Sep-1889	161.92	Dec-1890	132.16	-18.38%	
Jan-1893	Jun-1894	18	17	May-1892	179.49	Jul-1893	131.16	-26.93%	
Dec-1895	Jun-1897	19	23	Sep-1895	159.64	Aug-1896	137.66	-13.77%	
Jun-1899	Dec-1900	19	20	Mar-1899	209.07	Sep-1900	168.67	-19.32%	
Sep-1902	Aug-1904	24	32	Jun-1901	256.58	Oct-1903	173.58	-32.35%	
May-1907	Jun-1908	14	18	Jan-1906	264.46	Nov-1907	158.55	-40.05%	
Jan-1910	Jan-1912	25	11	Aug-1909	242.76	Jul-1910	198.11	-18.39%	
Jan-1913	Dec-1914	24	43	Aug-1912	229.35	Nov-1913	180.84	-21.15%	
Aug-1918	Mar-1919	8	9	Dec-1915	208.83	Jan-1919	107.94	-48.31%	
Jan-1920	Jul-1921	19	21	Jul-1919	124.01	Dec-1920	79.65	-35.77%	
May-1923	Jul-1924	15	26	Oct-1922	125.81	Oct-1923	105.31	-16.29%	
Oct-1926	Nov-1927	14	20	Sep-1926	172.69	Nov-1926	169.08	-2.09%	
Aug-1929	Mar-1933	44	49	Sep-1929	410.50	Jun-1932	79.58	-80.61%	
May-1937	Jun-1938	14	79	Nov-1936	281.34	Apr-1938	158.02	-43.83%	
Feb-1945	Oct-1945	9	36	Sep-1939	209.06	May-1942	110.38	-47.20%	Declined In Adv Of Recession
Nov-1948	Oct-1949	12	44	Jun-1948	158.35	Jun-1949	132.62	-16.25%	
Jul-1953	May-1954	11	38	Aug-1952	213.97	Sep-1953	196.27	-8.27%	
Aug-1957	Apr-1958	9	23	Apr-1956	405.28	Dec-1957	322.20	-20.50%	
Apr-1960	Oct-1960	11	105	Jul-1959	464.19	Oct-1960	409.09	-11.87%	
Dec-1969	Nov-1970	12	35	Jan-1966	665.83	Jul-1970	440.51	-33.84%	
Nov-1973	Mar-1975	17	57	Jan-1973	630.60	Sep-1974	305.45	-51.56%	
Jan-1980	Jul-1980	7	11	Sep-1976	415.57	Apr-1980	288.51	-30.57%	
Jul-1981	Nov-1982	17	91	Nov-1980	360.10	Mar-1982	266.02	-26.13%	
Jul-1990	Mar-1991	9	119	Aug-1987	653.30	Oct-1990	521.96	-20.10%	
Mar-2001	Sep-2001	9	72	Aug-2000	1,950.43	Sep-2001	1,329.32	-31.84%	
Dec-2007	Jun-2009	19	79	Jul-2007	1,656.43	Mar-2009	807.60	-51.24%	
Averages Since 1871									
Mean		18.24	40.66					-29.13%	
Median		14.00	32.00					-26.93%	
Mode		14.00	35.00						
Averages Since 1900		**15.74**	**45.13**					**-30.76%**	

Are you ready for that?

IS NOW A TIME TO WORRY?

Based on all the data above, not to mention deteriorating economic, fundamental and earnings as well, should you be worried about your investments? I found this note from United Capital rather interesting *(emphasis is mine)*:

> "For anxious investors who want a quick answer to the question, the simple answer is, ?No.? Now we?ll explain why. **First, corrections are natural, normal, and we?d even say, necessary.** I?ve gone through many of them, having started my career in investment management just two months before the 1987 crash. While different circumstances led to each one, **the fundamental aspect of a correction (or even a bear market) is that the market simply reprices securities to better match the underpinnings of an investment as they currently are.** Sometimes, this may happen because of a recession, which we do not think is the most likely scenario, but in many other cases, it?s simply because stocks got a little ahead of themselves. **Right now, stocks in the S&P 500 are more expensive relative to their earnings than they historically have tended to be, according to Ned Davis Research. That means that investors bid up share prices more than (or perhaps one might even venture to say ?earlier than?) they should have.** In that sense, a correction is just that: ?correcting? a stock?s value to what the earnings and net worth of the company in question should dictate."

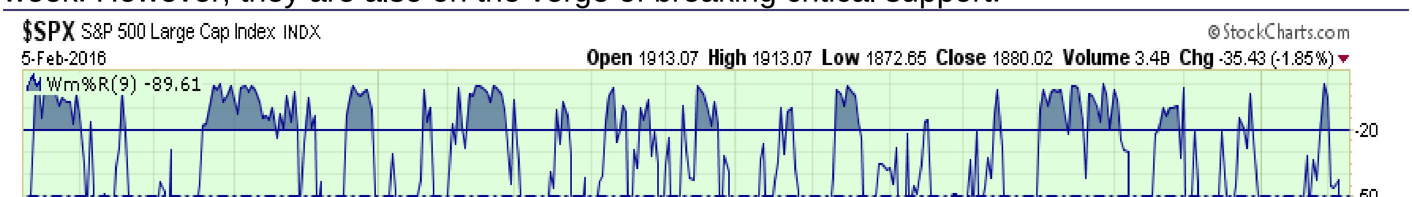
This really goes to the root of why I am so fed up with the financial advisory industry as a whole. **Let me translate the above for you.**

> "We don't really manage your money. **What we do is encourage you to buy some stuff and then sit on it so we can charge you a fee.** When prices decline, because we don't really pay attention to the markets, we have to send out an excuse letter to keep you from transferring your money to another advisor who actually pays attention to what is going on. **Even though we knew stocks were overvalued, and such overvaluation leads to corrective cycles in the market, we really didn't think about selling stocks to reduce the risk of loss.** We are too busy trying to get other people to invest money with us. The more the better. We hope you understand, but our revenue line is more important than yours. **Oh, and please deposit more money in your account because dollar cost averaging works better for us than you."**

I realize that is a bit harsh, but I want to make a point. I know some really great advisors that work extremely hard for the clients, manage risk and try to ensure their clients reach their goals. If you ever read a site like Seeking Alpha, you will see a lot of them. Then there are these guys which give the rest of the industry a bad name. **Let me be clear with you. YES, it is time to worry, and it may be time to worry a lot.•If I am wrong, and the markets turn around, we can ALWAYS buy stuff and sit on it again. But now is not that time.**•Apparently, if you don't take some action with respect to the risk in your portfolio, no one else is going to either.

THE MONDAY MORNING CALL

As stated above, the market•bounce failed much sooner than anticipated. This changes the tone of the market to substantially more bearish. As shown in the chart below, on a very short-term basis the market is oversold and once again suggests the markets could get some buying early next week. However, they are also on the verge of breaking critical support.

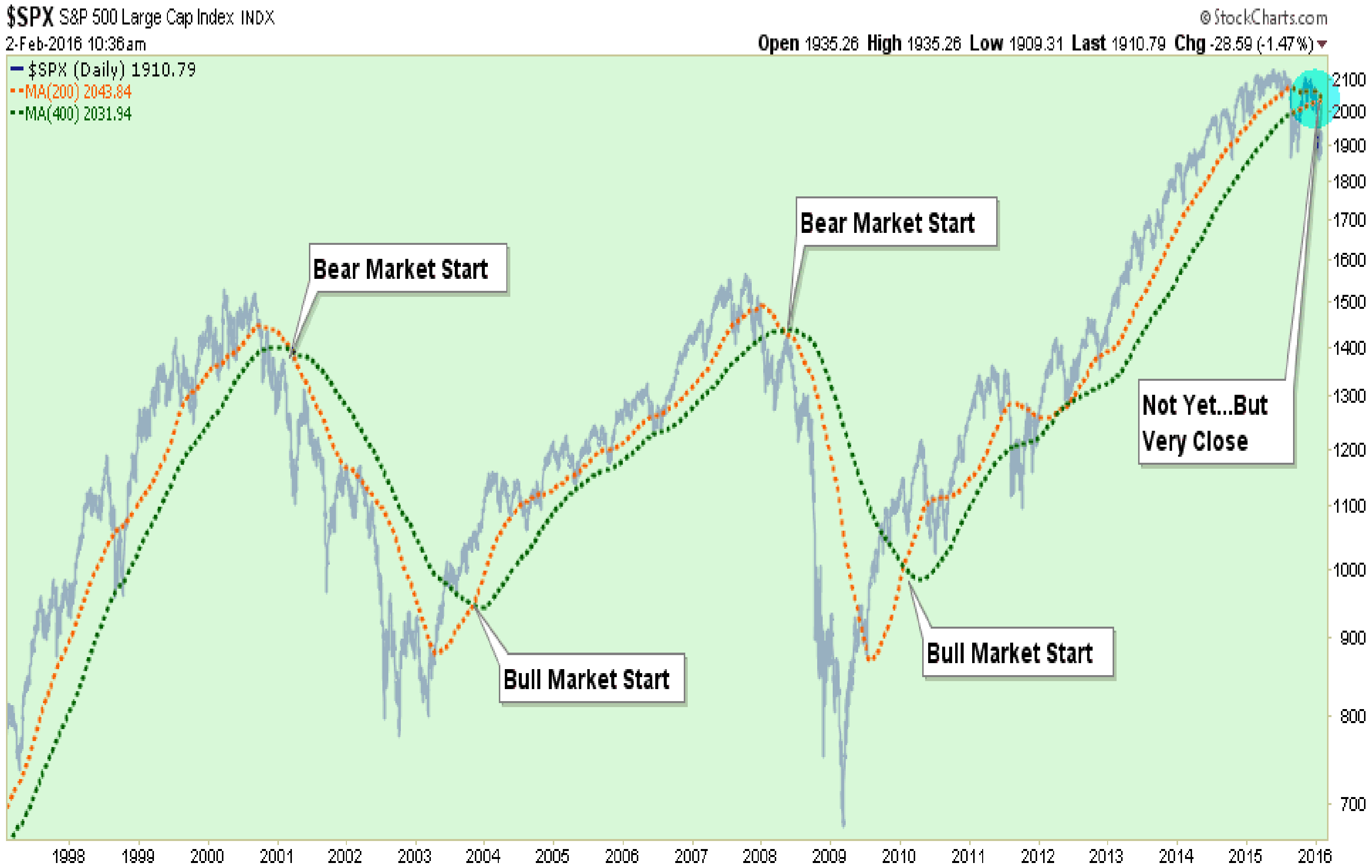


I continue to suggest taking actions to reduce risk in portfolios by taking the following actions on ANY RALLIES:

- *Trim back winning positions to original portfolio weights:* ***Investment Rule: Let Winners Run***
- *Sell positions that simply are not working (if the position was not working in a rising market, it likely won?t in a declining market.)* ***Investment Rule: Cut Losers Short***
- *Hold the cash raised from these activities until the next buying opportunity occurs.* ***Investment Rule: Buy Low***

One other point. The two moving averages in the chart above are the 200-day and 400-day. As you will notice they are about to cross. **Because these two moving averages are so long in nature, THEY WILL CROSS. It is now inevitable UNLESS the market immediately reverses to a runaway stampede higher.** This "real death cross" was brought to my attention earlier this week by a loyal reader:

> ?Most identify the death cross as when the 50-day moving average breaks below the 200-day moving average on the S&P 500. **However, the real death cross •takes place when the 200-day moving average crosses below the 400.** In 13 of the last 18 major correction episodes going back 1920- **72% •this crossover marked the onset of a major Bear market.** In the five exceptions, which were 1953,•1990, 1984, 1987, and 1996, the same crossover actually ended the correction at that time. **Importantly, these five episodes were during strongly trending SECULAR bull market cycles.** Given we are not currently in one of those periods, it is likely a cross-over now would be more related to each of the market failures since the turn of the century.?



As I stated above, I am not *"predicting"* anything. What I am doing is suggesting that current trends, based on historical precedents, suggests that *"something wicked this way comes."*•**Working With A Model Allocation** *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.•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 and add more to cash and fixed income.

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, any bounce, or a break of the lower support, should be SOLD into•immediately.**

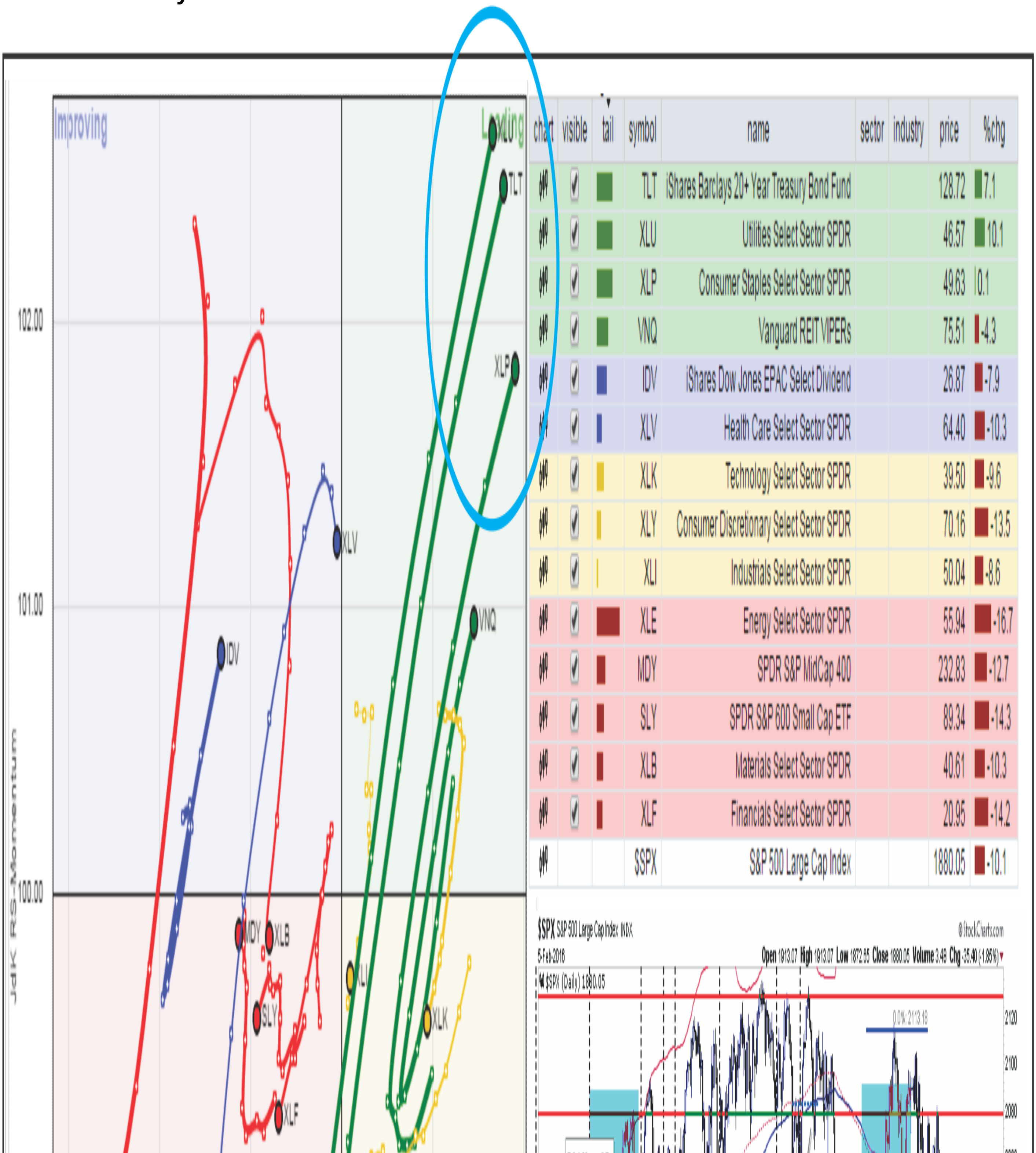
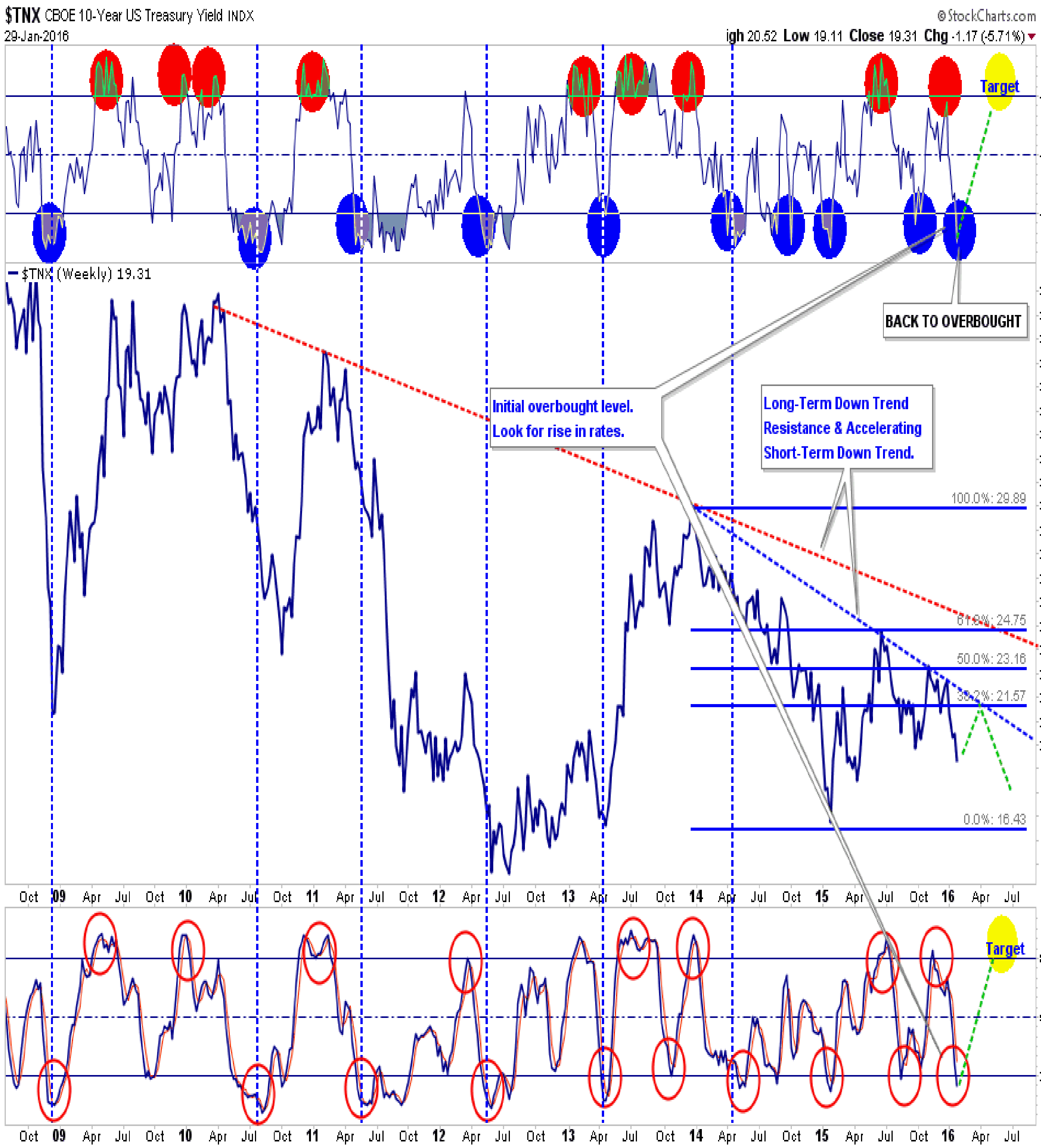


chart	visible	tail	symbol	name	sector	industry	price	%chg
	✓		TLT	iShares Barclays 20+ Year Treasury Bond Fund			128.72	7.1
	✓		XLU	Utilities Select Sector SPDR			46.57	10.1
	✓		XLP	Consumer Staples Select Sector SPDR			49.63	0.1
	✓		VNQ	Vanguard REIT VIPERs			75.51	-4.3
	✓		IDV	iShares Dow Jones EPAC Select Dividend			26.87	-7.9
	✓		XLV	Health Care Select Sector SPDR			64.40	-10.3
	✓		XLK	Technology Select Sector SPDR			39.50	-9.6
	✓		XLY	Consumer Discretionary Select Sector SPDR			70.16	-13.5
	✓		XLI	Industrials Select Sector SPDR			50.04	-8.6
	✓		XLE	Energy Select Sector SPDR			55.94	-16.7
	✓		MDY	SPDR S&P MidCap 400			232.83	-12.7
	✓		SLY	SPDR S&P 600 Small Cap ETF			89.34	-14.3
	✓		XLB	Materials Select Sector SPDR			40.61	-10.3
	✓		XLF	Financials Select Sector SPDR			20.95	-14.2
			$SPX	S&P 500 Large Cap Index			1880.05	-10.1

Not surprisingly interest rate sensitive sectors, along with the more defensive sector of the market, Staples, surged last week as the 10-year Treasury plunged below 2%...again. **The search for safe haven investments such as Utilities, Bonds, and Staples has become a more crowded trade as capital leaves the previous leaders of Technology, Industrial and Discretionary sectors. As noted by the BLUE circle above, the current level of•outperformance•by Utilities, Bonds &•Staples is unsustainable.**You should take profits in these sectors immediately and reduce overweighted positions back to normal levels. *(This is the essence of profit taking.)* **Energy remains a disaster along with Mid and Small-Cap indices. Financials have also weakened considerably along with Basic Materials as these economically sensitive sectors are continuing to be impacted by a slowing economy.** Healthcare and International•are only improving **by not losing** as much. **This also applies to REIT's which I will reduce exposure to on the next rally.•As I addressed last week:**

> **"The call for fixed income to go below 2%, the target is 1.8%, this year is rapidly coming to fruition.** Unfortunately, it is happening much more•rapidly than expected as economic weakness continues to take hold."



"With Interest Rates now very oversold, meaning bonds are overbought in price due to inverse relationship, **it is time to take some profits and rebalance the fixed income portion of portfolios back to model weights *(35% according to the model below.)*** We will look to add back to fixed income when rates push back up to the declining trend of 2.15% to a maximum of 2.4%."

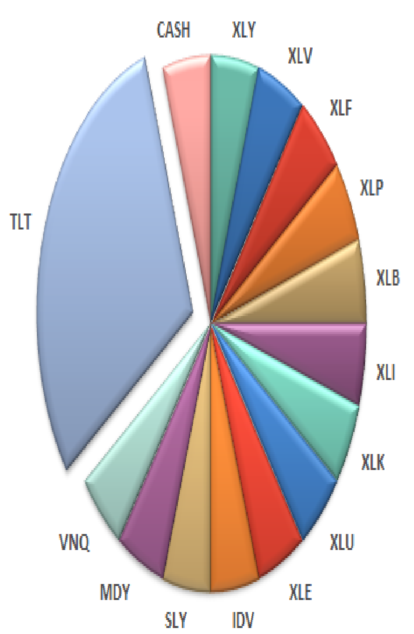
The recommendations for *"pruning and trimming"* exposure over the past couple of months has already done much of the risk mitigation needed to navigate the current markets. Therefore, there should be only relatively minor changes needed currently.

S.A.R.M. Model Allocation

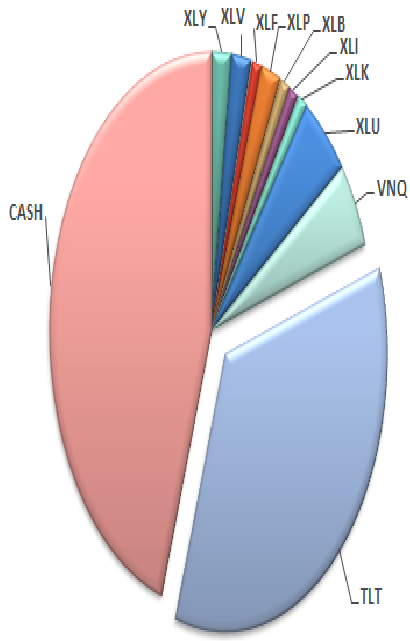
I have adjusted the model allocation to account for the rebalancing of bonds, REITS, and Utilities in portfolios. We will still want to use the current reflexive rally to take actions to rebalance portfolio models accordingly. **During THIS bounce** in the market, adjust weightings as follows:

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	1.00%
XLP	Staples	5.00%	Leading	2.00%
XLB	Materials	5.00%	Lagging	1.00%
XLI	Industrials	5.00%	Weakening	1.00%
XLK	Technology	5.00%	Weakening	1.00%
XLU	Utilities	5.00%	Leading	5.00%
XLE	Energy	5.00%	Lagging	0.00%
IDV	International	5.00%	Improving	0.00%
SLY	Small Cap	5.00%	Lagging	0.00%
MDY	Mid Cap	5.00%	Lagging	0.00%
VNQ	Real Estate	5.00%	Leading	5.00%
TLT	Bonds	30.00%	Leading	35.00%
CASH	Money Market	5.00%	--------	45.00%



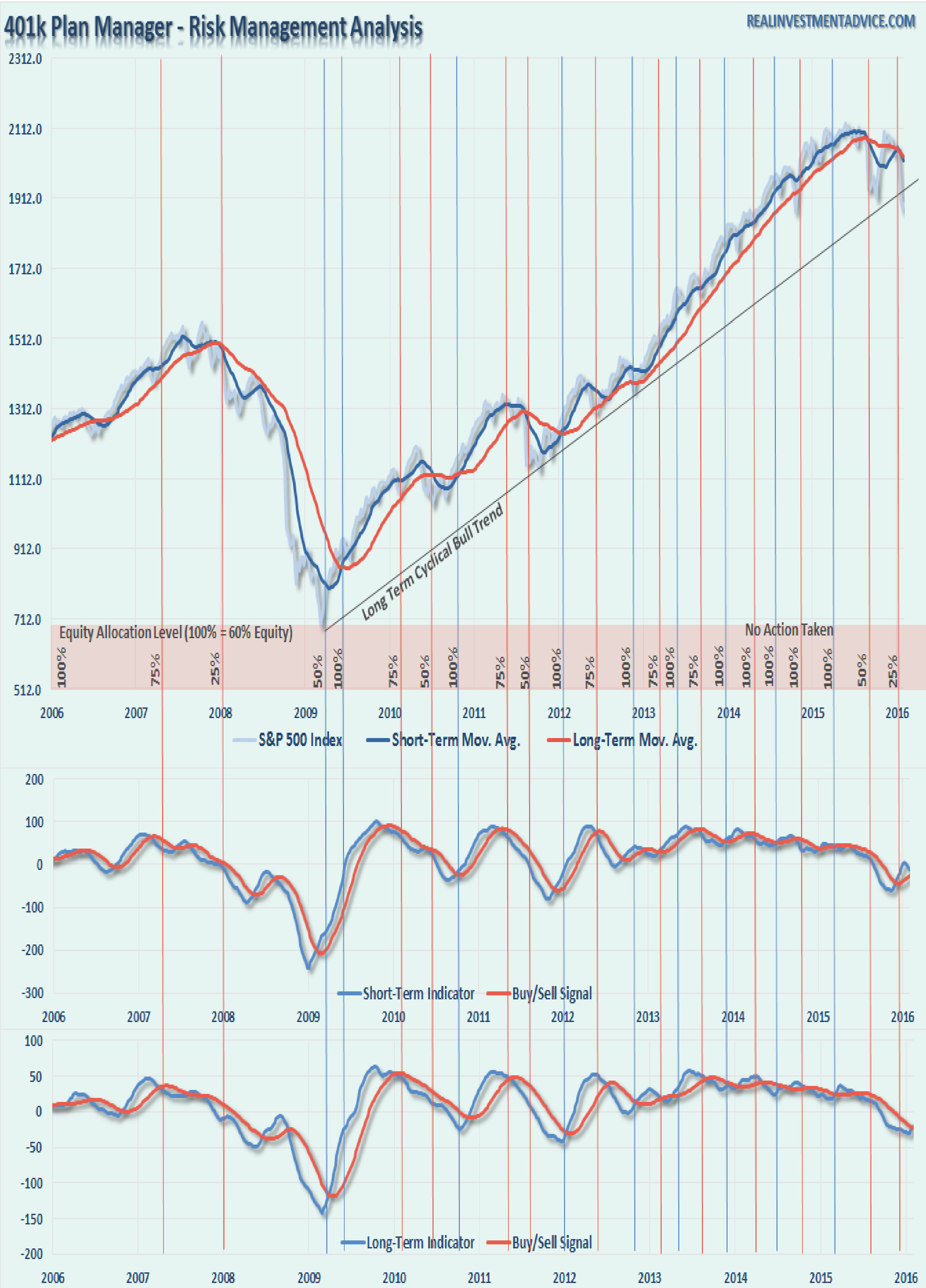
Fully Allocated Model



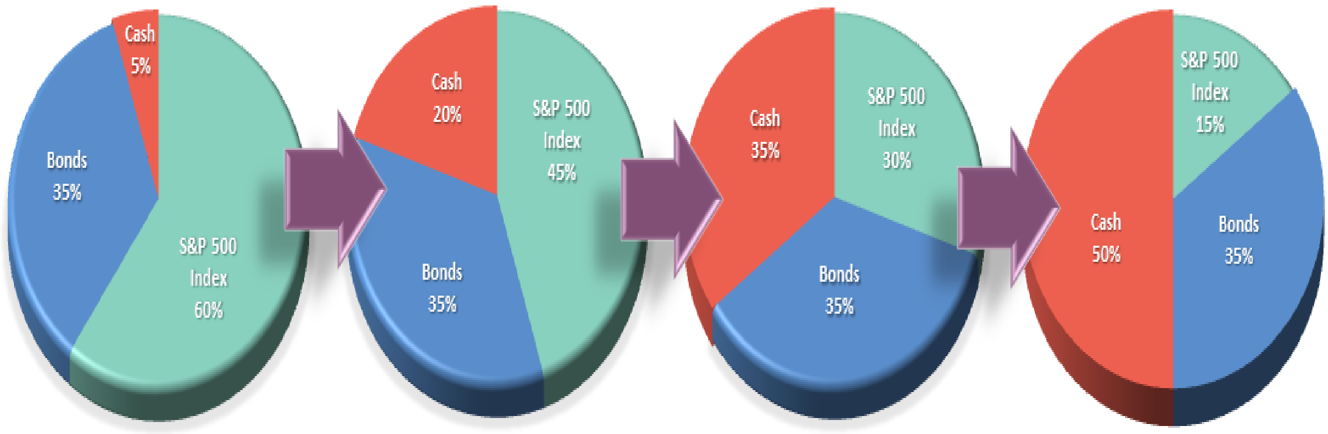
Risk Adjusted Model

During this rally, cash will be increased from 43% of the portfolio to 45%, with 35% in bonds, and the rest in equities. **It is completely OKAY if your current allocation to cash is different based on your personal risk tolerance. This is just a guide.** 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



I have added some new features to the 401k plan manager model following a recent discussion with my colleague Robert Seawright. This is to clear up the confusion between *"risk management"* and *"market timing."* Market timing denotes being *"all-in"* or *"all-out"* of the market. I am only suggesting small modifications to the *"risk"* side of your portfolio by minimizing losses during periods of market declines. As you will notice, I never advocate being 100% out of the market. As I have discussed many times in the past, it is far too difficult to reverse course when the market changes from a negative back to a positive trend. Emotions keep us from taking the correct action. There are 4-steps to allocation changes based on 25% reduction increments. As noted in the chart above a 100% allocation level is equal to 60% stocks.



Bounce Fails At Lower Resistance

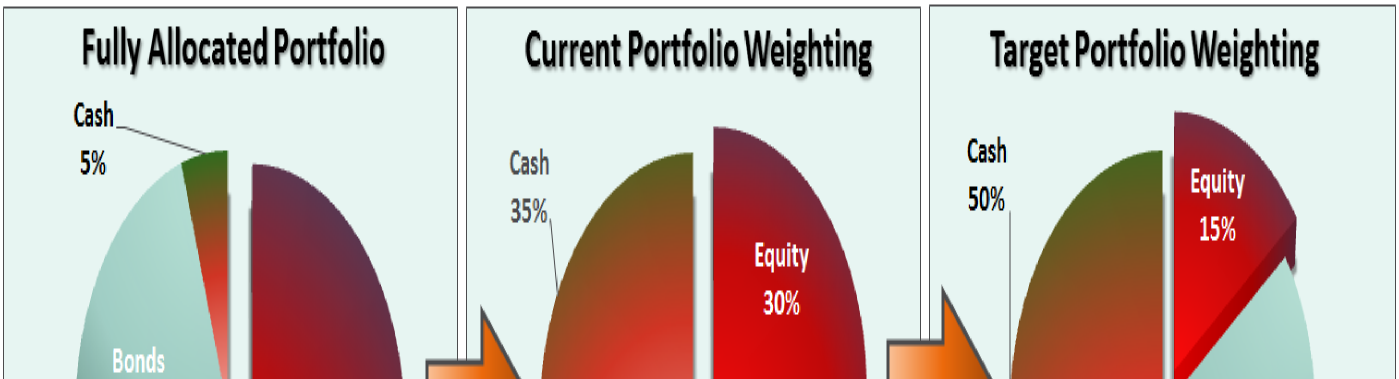
As discussed above, the market has **NOW BROKEN** the long-term trend support. **A change in TREND is critical** and suggests that the bull market advance that began in 2009 is over. •As shown in the chart above, the technical deterioration is significant. **I continue to advise caution. As I stated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

> **"The 401k Model is NOT being tactically adjusted at this time because the markets are VERY OVERSOLD on a short-term basis."**

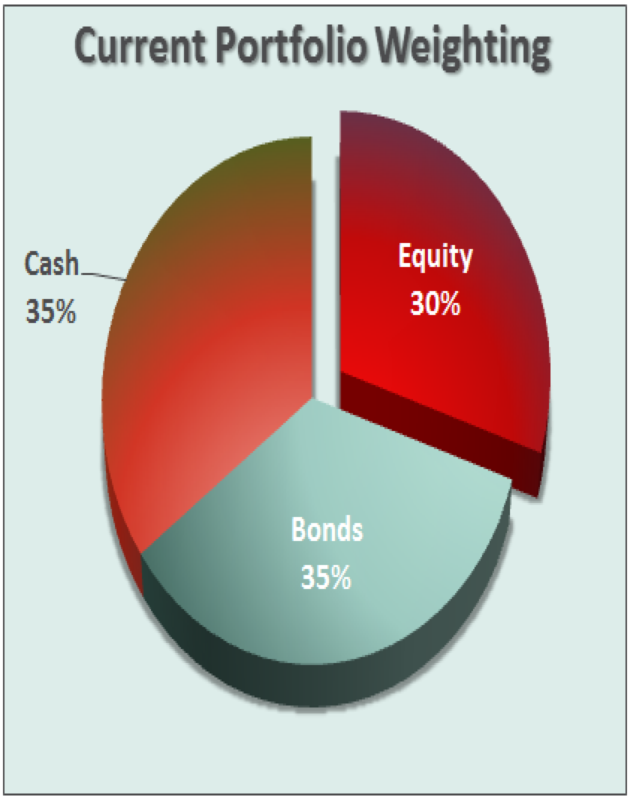
The problem is that the expected rally was much less than previously anticipated. **Therefore, ANY RALLY in the next week, OR A BREAK below the recent lows, requires that the allocation model moves to its final target levels of 25% exposure as shown below. The current market environment is NOT conducive to 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 for reduction over the next week.



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.

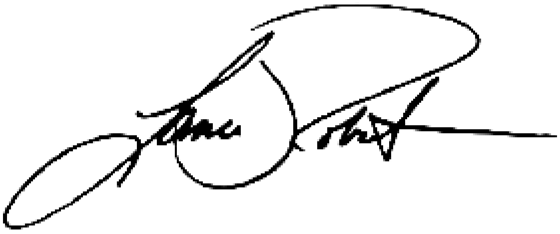
15% Equity Income, Balanced or Conservative Allocation
15% Large Cap Growth (S&P 500 Index)
0% International Large Cap Value
0% Mid Cap Growth

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*

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