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Horizontal Banner for Term-vs-Whole Webinar May 18

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How to protect your retirement from Government overreach, taxes, and market debacles.

Another week of volatility, but with no real resolution to the burning question of "where do we go next?"•

Is this a continuation of the broadening topping process that began 15 months ago? Or, are the markets setting up the next bullish advance to all-time highs?

Unfortunately, while we can all speculate, the reality is that we will not know for certain until a decision has been made. As such, this is why I have kept long-term investment models conservatively allocated up to this point and still maintain a 50%+ exposure to cash.

The reasoning is simple. If the markets re-establish the bullish trend, I can rotate from the safety of "cash" back into equity-based risk. However, and unfortunately for those individuals that continually tout "buy and hold" investing, if the market breaks to the downside the next bull market rally will be primarily used making up previous losses.

This is an important concept to understand. **Historically speaking, when markets have a combination of high valuations and declining earnings, outcomes have been less than favorable.** Yes, eventually the markets, and subsequently investors, did get "back to even." However, as shown in the chart below, **the markets make new highs roughly about 5% of the time.** The other 95% of the time the markets are making up previous losses.

"Getting back to even is not a long-term investment strategy."

[SP500 Real Index Time To New Highs-051316-2](#)

While I am not predicting the market is about plunge tomorrow, **what I am suggesting is that the current market setup is much akin to previous major market topping processes as opposed to the beginning of new long-term secular bull market.**

[SP500 Chart 1-051316](#)

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The chart above shows three long-term (monthly) buy/sell indications. **Currently, two of the three long-term sell signals are in place. The third signal, which is a crossover of the intermediate and long-term moving averages, has not occurred as of yet, but the gap is closing.**

One other point of concern. As shown in below, equities are once again extended well above bonds. **Not surprisingly, the risk of reversion lies with the equity side of the ledger.** Furthermore, highlighted in red, **the markets are currently in the process of working off their extreme overbought condition**•which has tended not to be kind to longer-term investors either.

[SP500-Chart2-051316](#)

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Got It...But What About Now?

But that is soooo long-term.

I know...boring. More importantly, as Howard Marks once quipped:

***"Being right, but early, is the same as being wrong."*•**

While the long-term picture still clearly suggests a high level of risk aversion, short-term dynamics have improved which led to a small increase in equity exposure several weeks ago. As shown below, the market has continued to defend the 50-day moving average of the last week while in a corrective process, until Friday.

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While the market did violate the 50-dma on Friday, the market held support at recent bottoms. **Critically, there is a "*head and shoulders*" process being formed and the 2040 level is the neckline support of that pattern. A break of that neckline will lead to a more substantial correction process.**

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With the 50-dma trending positively above the 200-dma, we do want to give the markets the benefit of the doubt currently, but I am not dismissing my sense of cautionThis is also particularly the case given the recent strength in the advance-decline line and overall breadth of the rally.

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However, the breakout of the advance-decline line to new highs, may not be "*all that*." As noted by [Dana Lyons this past week](#).

"Believe it or not, however, that's not the strangest development, in our view. On Monday, May 9, NYSE New Highs recorded another 52-week high. What was unusual about it was that the stock averages were in the midst of a multi-week selloff. In fact, **of the 116 days since 1970 that the NYSE New Highs hit a 52-week high, this marked just the 4th time the NYSE was showing a negative 9-day rate of change ? and a record worst -2.20% at that.**

As far as the S&P 500 is concerned, it was just the 5th time the index had a negative 2-week rate of change on those days, as shown here."

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"As the chart above shows, the previous 4 occurrences regarding the S&P 500 all took place during the 2000-2002 bear market. Needless to say, stock performance following these events was atrocious."

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"Therefore, our most valuable takeaway is **simply the fact that what seemed like a development with bullish ramifications, is not necessarily so when looking at prior precedents.**"

Hmm...This Looks Familiar

One other thing. While the short-dynamics "LOOK" bullish, it potentially may not be so as Dana pointed above. **Furthermore, the technical setup is also playing out very similarly to that in**

November of last year as shown below.

[SP500-Chart3-051316-2](#)

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As shown, after the initial rally in October of last year, the market then began a process of rally and decline above the 50-dma until an eventual failure. That failure then led to a decline that set new lows.

Currently, we are seeing a very similar set of price actions. Following the low set in February of this year, the subsequent rally led to a fairly substantial deviation above the 50-dma as was the case in October of last year. The recent decline from that peak tested and held support at the 50-dma.

As shown above, the recent peak, as was the case before, was at a lower high. The lower part of the chart shows market "sell" signals. Currently, as in November, the market has triggered a sell signal at a very high level. This puts the market at a higher level of risk of a further decline in the short-term as well.

My conclusion is that the current market price action is extremely similar to what was seen late last year. **Will it turn out the same? We won't know until we know. But is betting "this time will be different" worth the risk?**

What Do Gundlach & Icahn Know?

While bullish sentiment about the markets has clearly risen in recent weeks, there are those that are suggesting *"something wicked this way comes."*•

Last week, Carl Icahn, the famed billionaire hedge fund activist investor, revealed a rather massive net short exposure to the S&P 500 of 150%. This is a massive increase relative to his modest short-hedge in December of last year.

IEP Gross

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"Putting this number in context, in the history of IEP, not only has Icahn never been anywhere near this short, but just one year ago when he first started

complaining about stocks, he was still 4% net long. Those days are gone, and starting in Q3 and Q4, Icahn proceeded to wage into net short territory, **with roughly - 25% exposure, a number that has increased a record six-fold in just the last quarter!**

What is just as notable is the dramatic leverage involved on both sides of the flatline, but nothing compares to the near **3x equity** leverage on the short side (this is not CDS). As a reminder, Icahn Enterprises used to be run as a hedge fund with outside investors, **but Icahn returned outside money in 2011, leaving IEP and Icahn as the two dominant investors.** According to Barron's, the entire fund appears to be about **\$5.8 billion, with \$4 billion coming from Icahn personally.** Which means that this is a very substantial bet in dollar terms.

When asked about this unprecedented bearish position, **Icahn Enterprises CEO Keith Cozza said during the May 5 earnings call that 'Carl has been very vocal in recent weeks in the media about his negative views.'** He certainly has been, although many thought he was merely **exaggerating.** He was **not.**

"We're much more concerned about the market going down 20% than we are it going up 20%. And so the significant weighting to the short side reflects that," Cozza added."

Jeff Gundlach, who heads Doubleline, recently concurred with Icahn's views saying:

*"It's tough to get much of a rally off of price-to-earnings this high with earnings falling and the Fed itching to tighten with GDP growth already projected to decline, **I'm sticking with my '2 percent upside and 20 downside' prediction on U.S. stocks.... it's working, I can see it going to 1,600.**"*

So, just how bullish do you feel?

"Bear markets usually end with a whimper, not with a bang." -Richard Band

THE MONDAY MORNING CALL

The Monday Morning Call- Analysis For Active Traders

The ongoing correction last week violated the 50-dma which raises short-term positioning alarm bells. However, as discussed above, the market held support and the recent neckline at 2040. Heading into next week, it will be critical for the market to hold support at 2040 and rally back above the 50-dma. A failure to do so will complete what currently appears to be another, in a series, of market topping processes.

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Why I Have No Exposure To International Stocks

If you wanted to beat the S&P 500 this year, **there has only been one real place to be - dividend stocks**. While there has been ongoing rhetoric about how "*cheap*" international stocks look, performance, despite massive interventions by the ECB, has been quite abysmal.

SP500-Comparison-YTD-051416

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However, it is not just this year, this has been the case since 2015. Having exposure to international and emerging market stocks has acted as a boat anchor to overall portfolio performance.

But it's not just the last 16-months either. International and emerging market equities have been a performance drag since 2009.

[SP500-Comparison-LT-051416](#)

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Lastly, while the short-term pop in emerging and international markets coincided with the ECB's "all-in" stimulus program, the realization of the lack of effectiveness of such programs in the Eurozone is already being realized.

Furthermore, it is worth noting that while the S&P 500 is currently holding up better than its international counterparts, **historical correlations (yellow highlights) suggests a much higher level of caution.**

Intermediate-Term Setup Still Cautionary

As stated above, while the short-term analysis still suggests a potentially bullish setup (*oversold condition*) heading into next week, I do want to restate my words of caution from last week:

1. *We still remain in a major trading range that has yet to be resolved.*
2. *Economic data remains weak both domestically and globally.*
3. *Earnings continue to remain poor.*
4. *We are moving into summer which historically tends to be weak.*
5. *This is a Presidential election year which has historically also been weak.*

Furthermore, as shown below, the current advance and topping process, remains in the confines currently of a "lower high and lower low" scenario. **While it may not "feel" that way, we are still within the broader confines of a downward trending market.**

As shown below, each of the last three peaks of market action has coincided with a downward trending topping process that eventually led to a fairly significant short-term correction. **The current setup is eerily similar to that of last November.**

As I have repeatedly stated over the last couple of weeks the current market setup feels like a "trap."

I remain cautious and already have an "inverse market" position loaded in our trading system to move portfolios quickly back to market neutral if markets break support.

I have not been, or am I currently, convinced about the potential of the market for a further advance from here. Again, this is why allocation models remain extremely underweight equity risk exposure currently.

Short-term portfolio management instructions currently remain:

1. *Tighten up stop-loss levels to current support levels for each position.*
 2. *Hedge portfolios against major market declines.*
 3. *Take profits in positions that have been big winners*
 4. *Sell laggards and losers*
 5. *Raise cash and rebalance portfolios to target weightings.*
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S.A.R.M. Model Allocation

The Sector Allocation Rotation Model (SARM) is an example of a **basic well-diversified portfolio**. The purpose of the model is to look *?under 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.**

Over the last several weeks, RISK based sectors outpaced performance relative to SAFETY. However, last week, the level of outperformance has begun to fade.

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The rotation from defensive to "*risk on*" sectors is now complete and potentially signals a further short-term correction in the market is possible. However, for now:

LEADING: Energy, Materials, Industrials, Mid-cap, Small-cap, Discretionary. (*REIT's are leading as investors chase risk and yield. Financials are rapidly improving playing catch-up*)

LAGGING: Utilities, Gold, Bonds, Staples, Technology, Healthcare

The sector comparison chart below shows the 9-major sectors of the S&P 500.

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The best sectors currently remain:

Discretionary, Industrials, Materials, Staples, Energy, Utilities and Financials.•

In other markets the best opportunities are:

Image not found or type unknown

Gold, Mid-Cap, Dividend Yield, Bonds, REIT's

However, as stated repeatedly, caution is highly advised.

S.A.R.M. • Sector Analysis & Weighting

As stated above, the SARM Model is an ***"equally weighted model"*** adjusted for risk. • **The current risk weighting remains at 50% this week.** It will require a move to new all-time highs in order to safely increase model allocations further at this juncture.

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Relative performance of each sector of the model as compared to the S&P 500 is shown below. **The table compares each position in the model relative to the benchmark over a 1, 4, 12, 24 and 52-week basis.**

Historically speaking, sectors that are leading the markets higher continue to do so in the short-term and vice-versa. **The relative improvement or weakness of each sector relative to index over time can show where money is flowing into and out of.** Normally, these performance changes signal a change that last several weeks.

Currently, as expected, the recent surge in "*risk*" is coming to an end as rotation into Utilities and Bonds, or "*safety*" begins. **This rotation suggests the current correction is likely not over as of yet which, again, suggests a more cautionary stance.**

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The last column is a sector specific "buy/sell" signal which is simply when the short-term weekly moving average has crossed above or below the long-term weekly average. The number of sectors on "*buy signals*" has improved from just two a few weeks ago to 15 this past week. **•Sectors that are on buy signals tend to outperform in the near term. •**

The risk-adjusted equally weighted model remains from last week. No changes this week.

SARM-ModelPortfolio-051416

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The portfolio model remains at 35% Cash, 35% Bonds, and 30% in Equities.

*As always, this is just a guide, not a recommendation. **It is completely OKAY if your current allocation to cash is different based on your personal risk tolerance, time frames, and goals.***

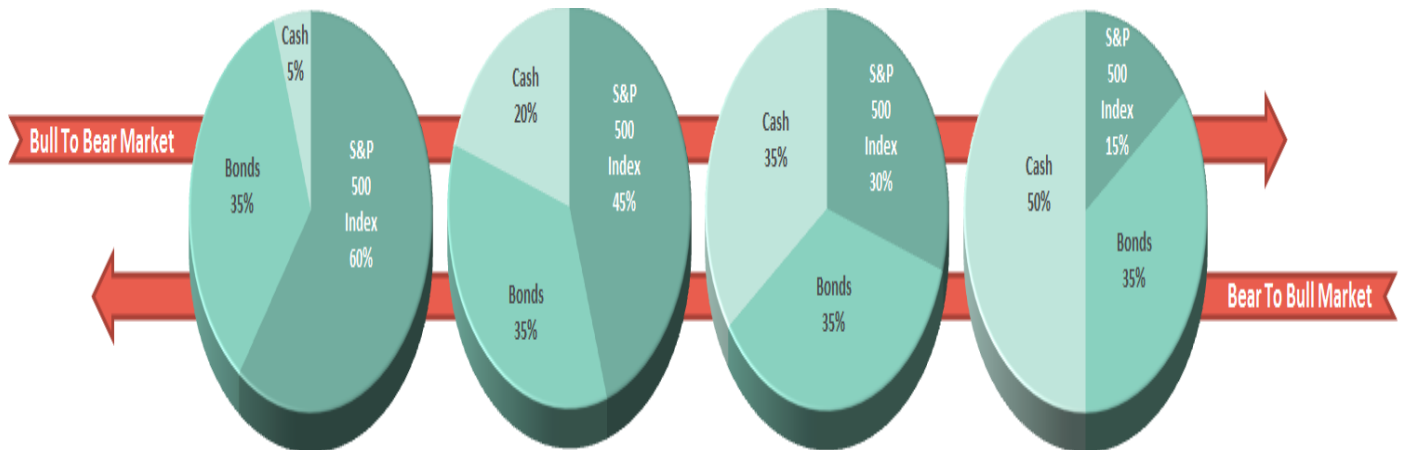
For longer-term investors, we need to see an improvement in the fundamental and economic backdrop to support a resumption of the bullish trend. Currently, there is no evidence of that occurring.

THE REAL 401k PLAN MANAGER

The Real 401k Plan Manager - A Conservative Strategy For Long-Term Investors

NOTE: I have redesigned the 401k plan manager to accurately reflect the changes in the allocation model over time. I have overlaid the actual model changes on top of the indicators to reflect the timing of the changes relative to the signals.

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. I never advocate being 100% out of the market as it is far too difficult to reverse course when the market changes from a negative to a positive trend. Emotions keep us from taking the correct action.



Yep...Still Waiting

As discussed in the main section of the newsletter, the short-term dynamics have begun to deteriorate. With the longer-term structures still negative, the potential of a bigger correction has risen in the last week.

While the market pushed back into oversold territory last week, the failure to hold the 50-dma raises some red flags. **While there is no need to make any changes to portfolios this week, as I have repeatedly stated, the markets are currently fraught with risk and should not be taken lightly.**

As I stated last week:

"While our intermediate-term buy signals are in place, we must wait for a breakout of the markets to new highs before increasing the allocation model further. **If such occurs, the model will quickly move in steps back to full equity allocations. Currently, however, the risk/reward ratio does not warrant a further increase at this time.**

Therefore, we continue to wait for either a breakout of the market to new all-time highs, or a breakdown below support reversing recent actions. **I will admit remaining trapped in 'limbo' is emotionally trying - but this is where investors typically make the biggest mistakes by trying to 'guess' at what the market will do next. We are better off to wait and let it 'tell' us."**

That advice remains this week. I try and remain very sensitive to making changes to the model since many 401k plans have limits to switching funds.

For longer-term investors, the markets have made virtually no progress since January of 2015. **Therefore, there is little evidence to suggest stepping away from a more cautionary allocation...for now.**

If you need help after reading the alert; don?t hesitate to [contact me](#).

Current 401-k Allocation Model

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. *(If you want to make it more complicated you can, however, statistics show that simply adding more funds does not increase performance to any great degree.)*

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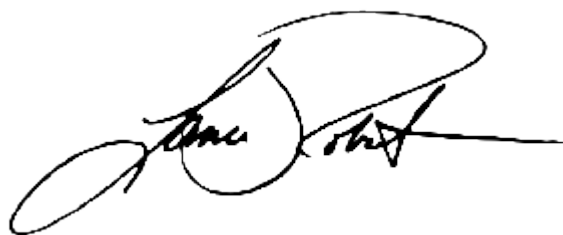
401k Choice Matching List

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 Vanguard S&P 500 Index Vanguard Capital Opportunities Vanguard PrimeCap Vanguard Growth Index Fidelity Magellan Fidelity Large Cap Growth Fidelity Blue Chip Fidelity Capital Appreciation Dodge & Cox Stock Hartford Capital Appreciation American Funds AMCAP American Funds Growth Fund Of America Oakmark Growth Fund C-Fund (Common Assets) ALL TARGET DATE FUNDS 2020 or Later
Fixed Income	Retirement Savings Trust		
	Fidelity MIP Fund		
	G-Fund		
	Short Term Bond		
	Pimco Total Return		
	Pimco Real Return		
	Pimco Investment Grade Bond		
	Vanguard Intermediate Bond		
	Vanguard Total Bond Market		
	Babson Bond Fund		
	Lord Abbett Income		
	Fidelity Corporate Bond		
	Western Asset Mortgage Backed Bond		
	Blackrock Total Return		
	Blackrock Intermediate Bond		
	American Funds Bond Fund Of America		
	Dodge & Cox Income Fund		
	Doubleline Total Return		
	F-Fund		
International	American Funds Capital World G&I		
	Vanguard Total International Index		
	Blackrock Global Allocation Fund		
	Fidelity International Growth Fund		
	Dodge & Cox International		
	Invesco International Core Equity		
	Goldman Sachs International Growth Opp.		
<p>The above represents a selection of some of the most common funds found in 401k plans. <u>If you do not see your SPECIFIC fund listed simply choose one that closely resembles the examples herein.</u> All funds perform relatively similarly within their respective fund classes.</p>		Balanced Funds	Vanguard Balanced Index Vanguard Wellington Fund Vanguard Windsor Fund Vanguard Asset Allocation Fidelity Balanced Fund Fidelity Equity Income Fidelity Growth & Income American Funds Balanced American Funds Income Fund ALL TARGET DATE FUNDS 2020 or Sooner
		Small/Mid Cap	Vanguard Mid Cap Growth Fidelity Mid Cap Growth Artisan Mid Cap Goldman Sachs Growth Opportunities Harbor Mid Cap Growth Goldman Sachs Small/Mid Cap Opp. Fidelity Low Price Stock Fund Columbia Acorn US Federated Kaufman Small Cap Invesco Small Cap

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](#)