RIA Advice

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- **The 2017 Economic & Investment Summit•**
- **April 1st, 2017** at the Royal Sonesta Hotel,•Houston, Texas
- ***Featuring:****•Danielle DiMartino-Booth, Greg Morris, Dave Collum, Michael Lebowitz•& Lance Roberts*

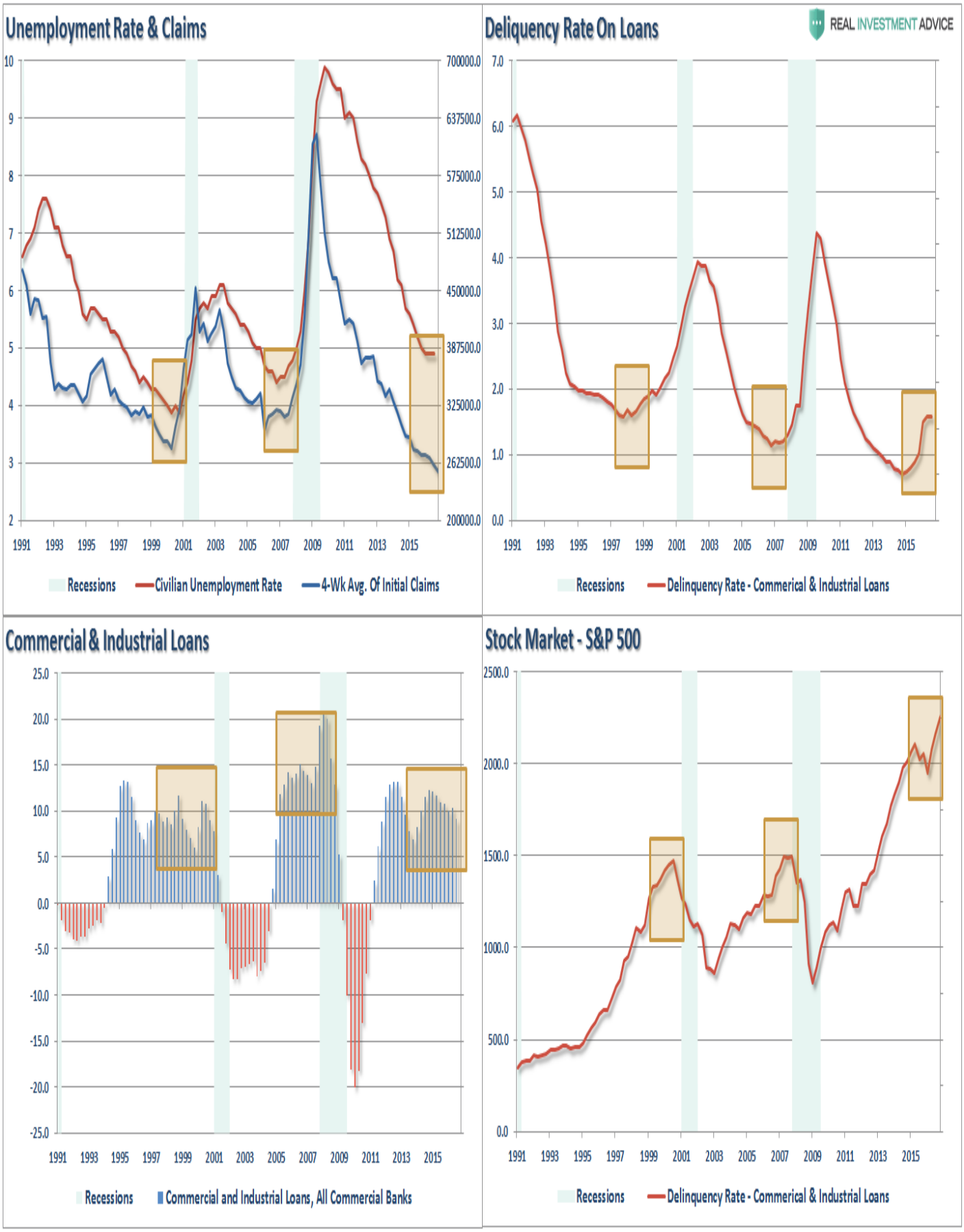
(Seating Is Very Limited)

- ***Visualizing 10-Reasons For Caution***
- ***Market & Sector Analysis***
- ***401k Plan Manager***

Visualizing 10-Reasons For Caution

Just recently, David Rosenberg in a recent research note, laid out 10-reasons to be cautious in the market. I thought it would be useful to look at each of these in a visual form to get a better idea of what he is addressing. The obvious reason to look at these indicators is that market records are records for a reason. As I wrote previously:

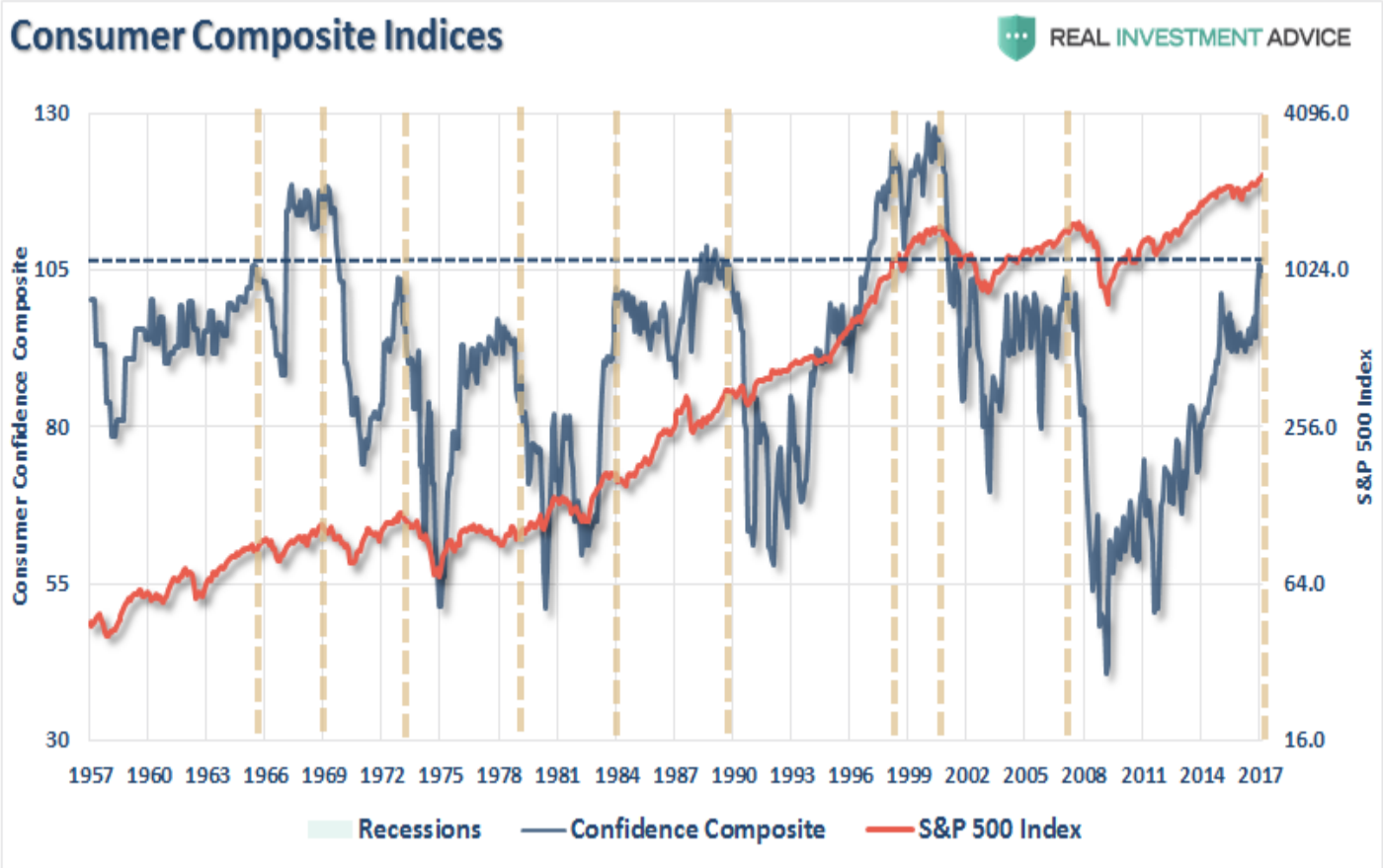
> ***?****First, ?record levels? of anything are records for a reason.* ***It is where the point where previous limits were reached. Therefore, when a ?record level? is reached,•it is NOT THE BEGINNING, but rather an indication of the MATURITY of a cycle.*** *While the media has focused on employment, record stock market levels, etc. as a sign of an ongoing economic recovery, history suggests caution. •The 4-panel chart below suggests that current levels should be a sign of caution rather than exuberance.?*



However, while economic data suggests we may closer to the end of the current economic cycle than the beginning, data related specifically to the stock market is also suggesting the same. Let's take a look:

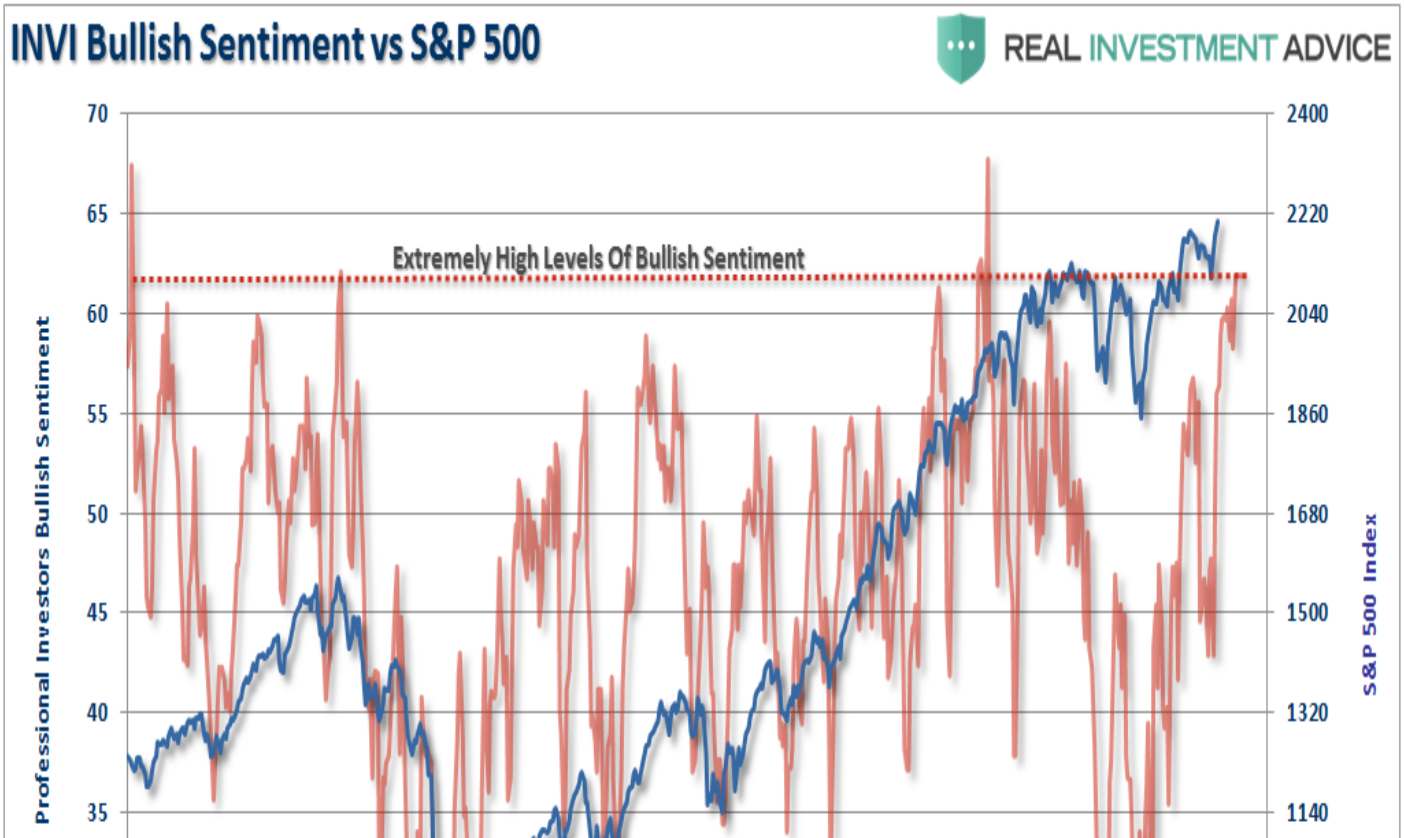
1 - Confidence Levels at 105

The chart below a COMPOSITE confidence index consisting of both the University of Michigan and Conference Board indices. At 105, the index is currently at levels that have historically denoted the end of an economic cycle. *(This should be expected as it is the point in the economic cycle where everything is now "as good as it gets.")*



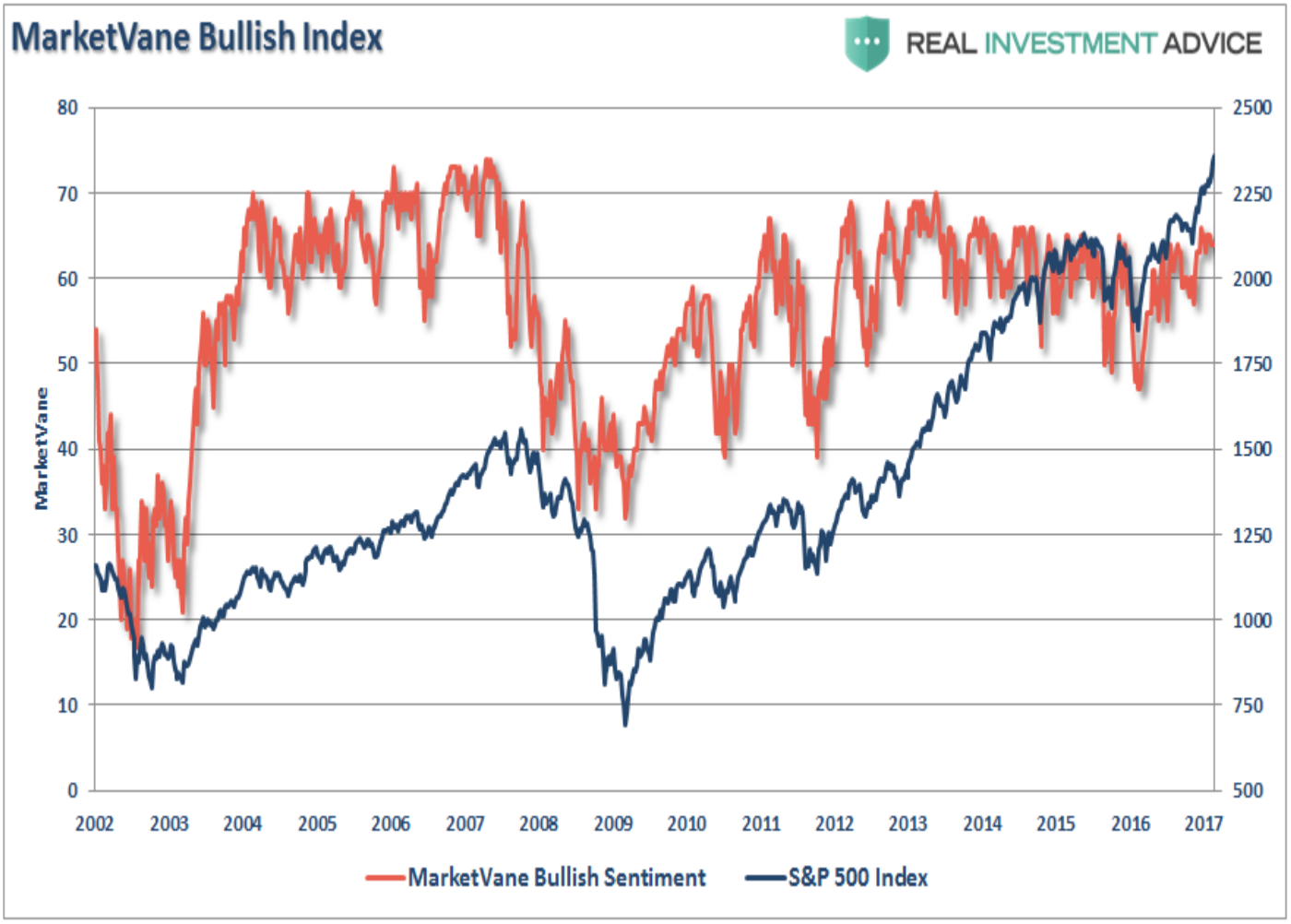
2 - Investor's Intelligence Sentiment at 61.8%

The Investor's Intelligence survey is a survey of professional newsletter writers and professional investors. It has a long record and has been widely adopted as a contrarian market indicator for good reason. At 61.8%, the index is currently at levels normally associated with market peaks both short and longer-term.



3 - Market Vane Bullish Sentiment:•64%

The Market Vane bullish sentiment index is a yardstick for traders as it measures the number of traders that are long a certain commodity. In this case the S&P 500 index. Currently, at 64%, as with the other indicators above, it is currently reflecting levels of bullishness that have historically been associated with corrective actions.

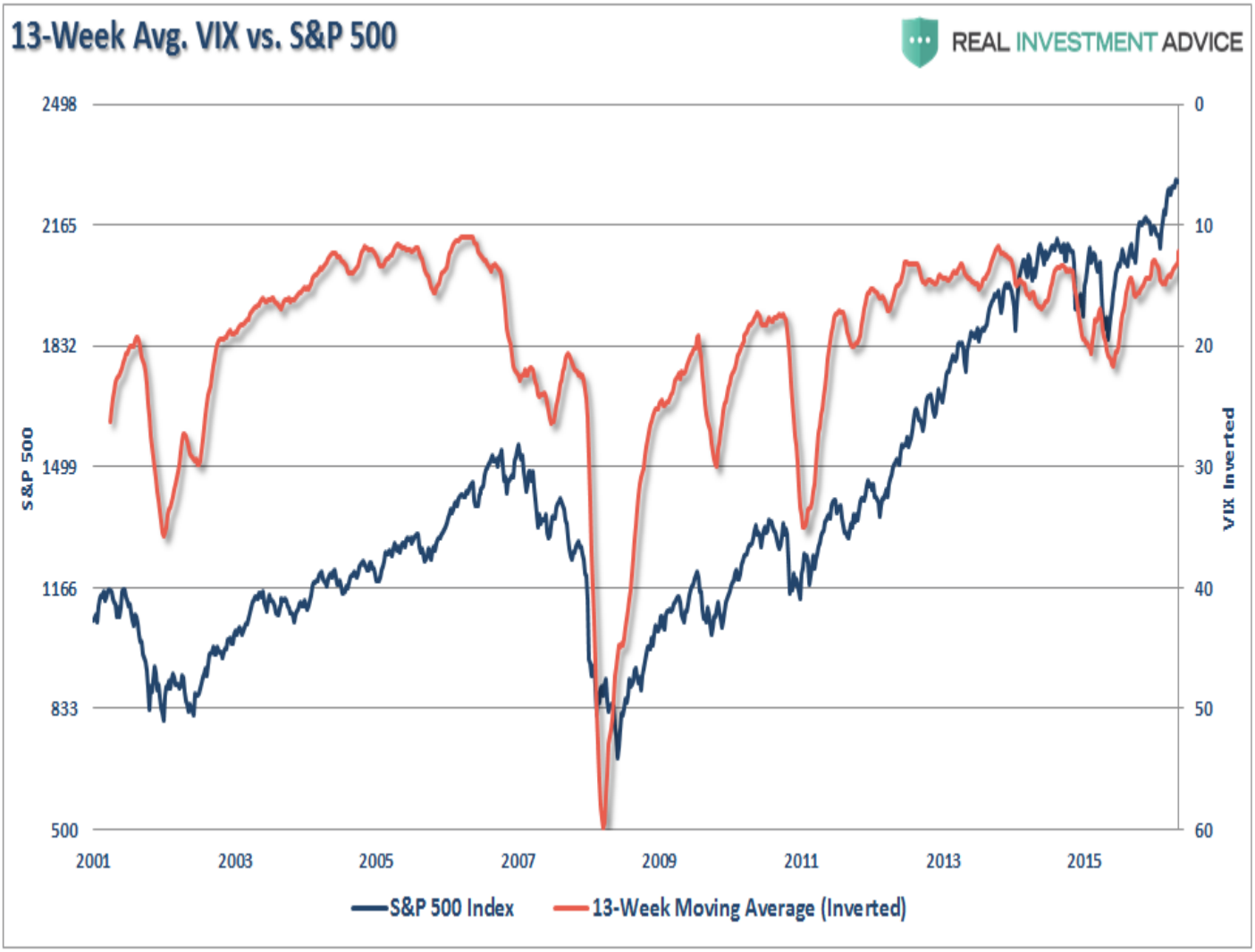


4 - CBOE?s equity volatility index (VIX) @ 12.2•? The S&P?s 65-day rolling volatility (inverted scale) is at levels which typically occur ahead of a corrective phase.

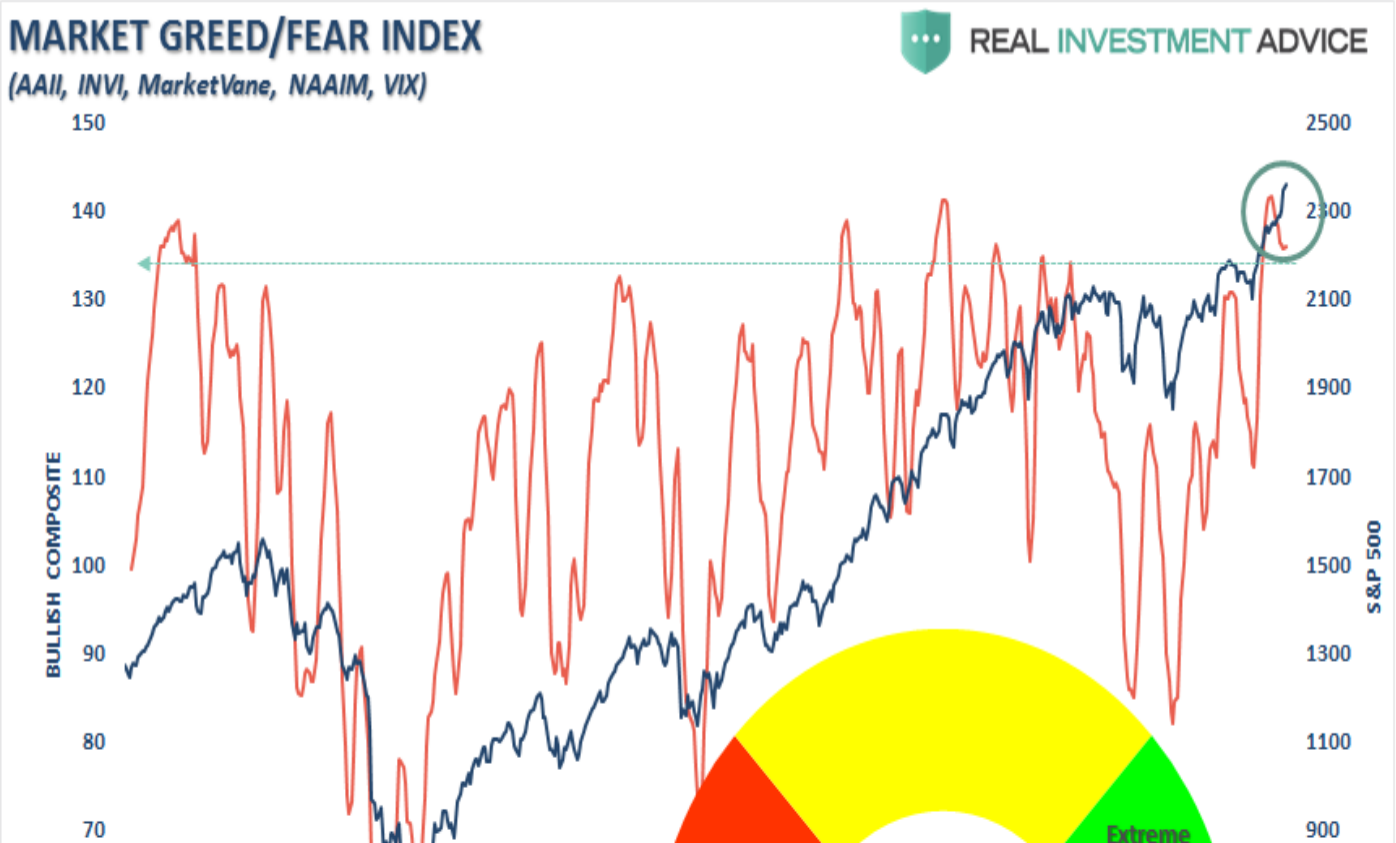
The volatility index shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. This volatility is meant to be forward-looking, is calculated from both calls and puts, and is a widely used measure of market risk, often referred to as the *"investor fear gauge."* When the gauge is at extremely low levels it suggests that investors have little fear of a market reversion. From a contrarian standpoint, this is when corrections have tended to occur. I noted last week the record levels of short positions currently outstanding on the Volatility Index.

> *"The extreme net-short positioning on the volatility index suggests there will be a rapid unwinding of positions given the right catalyst.* ***As you will note, reversals of net-short VIX positioning has previously resulted in short to intermediate term declines."***

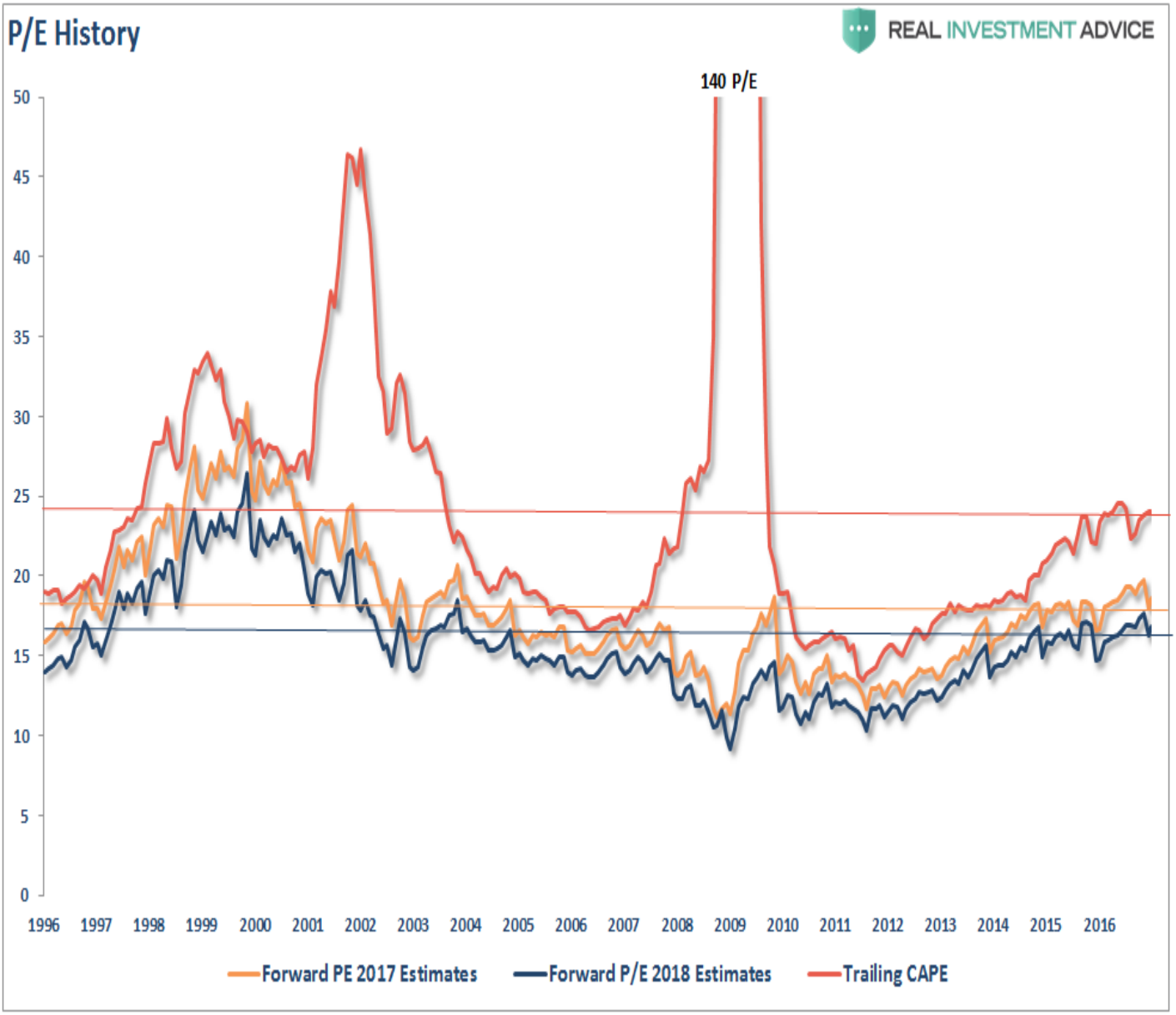
The chart below shows the 13-week moving average (65-day) of the volatility index versus the S&P 500. I have inverted the index to provide a clearer relationship between the two indices. From a contrarian viewpoint, the index currently suggests the risk of a correction outweighs the potential for a further advance.



The next chart compiles all the indices above into a single composite for analysis purposes. Given the combined composite is pushing extreme levels, a bit more caution is likely well advised.

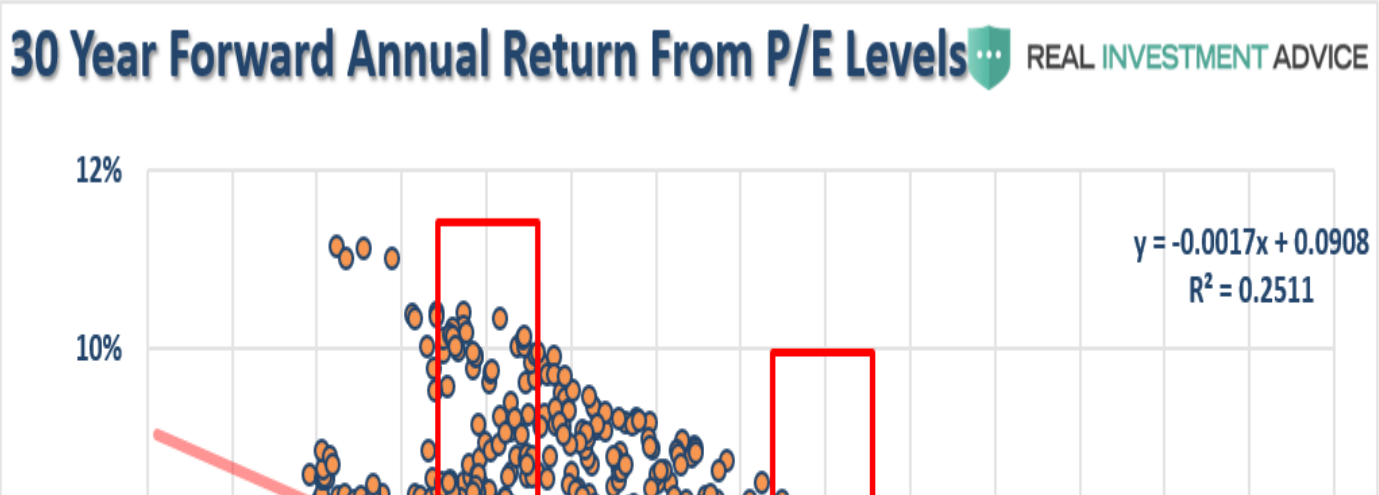


5 - Forward P/E multiples: 18.75x 2017 estimates, 16.75x 2018 estimates and 24x trailing CAPE. All are above long-term means and forward estimates are subject to large downward revisions.•



Of course, as I showed in my article earlier this week on valuations:

> *"**Over any 30-year period the beginning valuation levels, the price your pay for your investments has a spectacular impact on future returns.** I have highlighted return levels at 7-12x earnings and 18-22x earnings. We will use the average of 10x and 20x earnings for our savings analysis."*

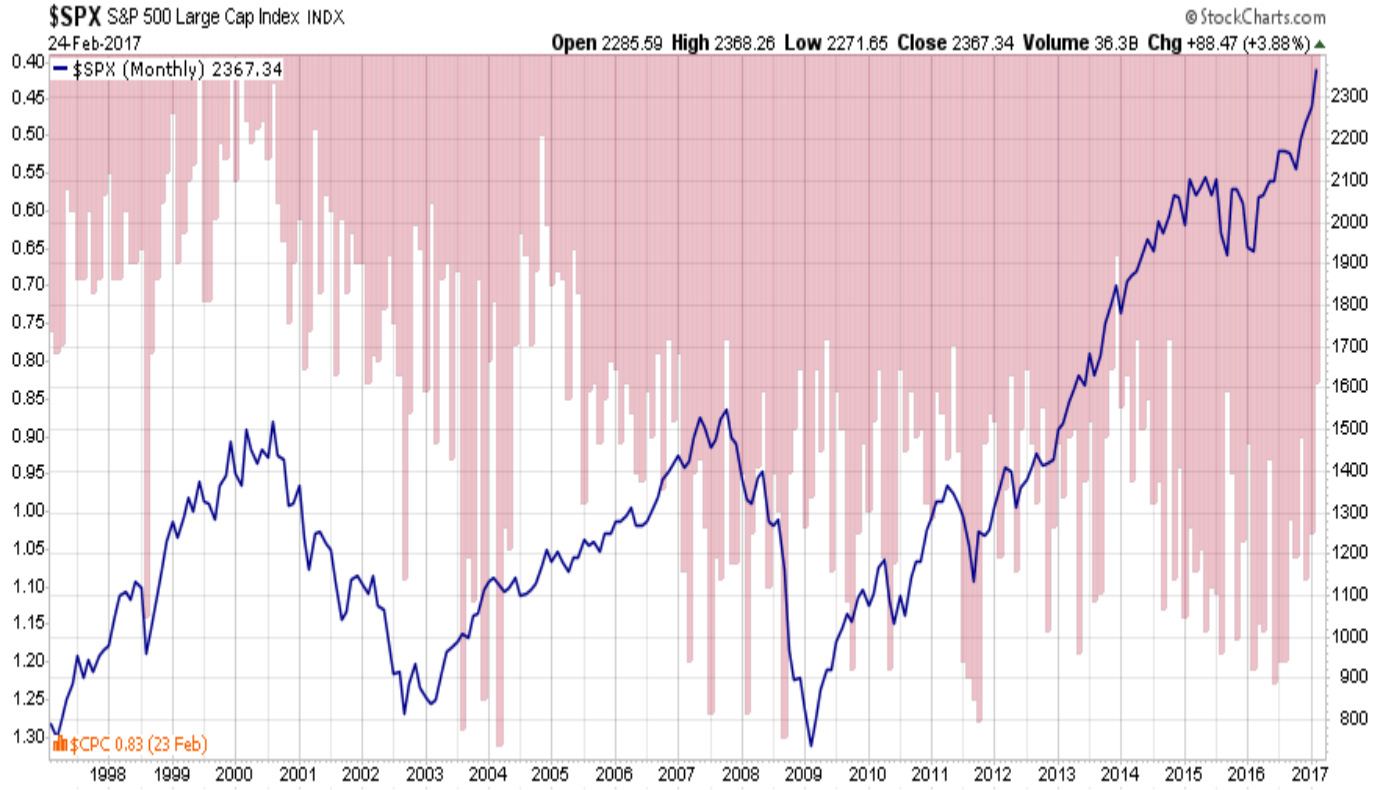


"As you will notice, 30-year forward returns are significantly higher on average when investing at 10x earnings as opposed to 20x earnings or where we are currently near 25x. The point to be made here is simple and was precisely summed up by Warren Buffett:

'Price is what you pay. Value is what you get.'?•

6 - NYSE Put/Call Ratio: 0.80x

One way to interpret the put-call ratio is to say that a higher ratio means it's time to sell and a lower ratio means it's time to buy. When the ratio is above 1.00 it suggests the market is out of balance to the sell side and equity exposure can be increased. **When the ratio is below 1.00 it suggests the market is out of balance to the buy side and investors should be more cautious.•**



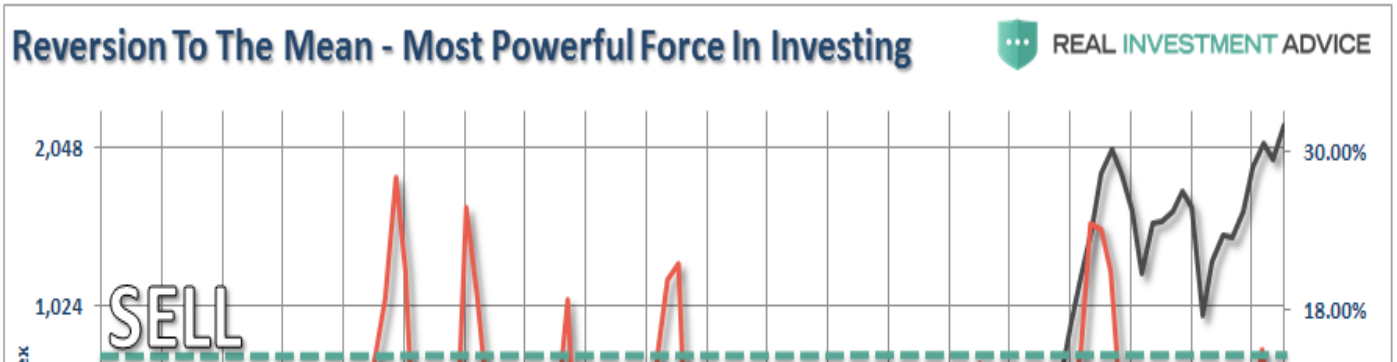
7 - The 14-week•RSI (Relative Strength Index) has moved to 74.26, above the 70•level widely viewed as being an ?overbought? threshold.•

As shown, on a weekly basis there are only a few points where the markets have been this overbought on a weekly basis. **With the exception of the 2013-2014, during the $85-billion per month QE program, each previous occasion has triggered a short-term correction or worse.•**

8 - The S&P 500 has now gapped up nearly 8% above its 200-day moving average, another sign of an overextended stock market.

As I have explained numerous times in the past, moving averages are like *"gravity."* Prices can only move so far above the longer-term average before the gravitational force exerted causes prices to *"revert to the mean."*•

The problem, is these cyclical bull markets are quickly believed to be the beginning of the next secular multi-decade bull market. **However, as discussed previously, this is currently unlikely the case given the lack of economic dynamics required to foster such a secular period.** The chart below brings this idea of reversion into a bit clearer focus. **I have overlaid•the 3-year average annual real return of the S&P 500 against the•inflation-adjusted price index itself.•**



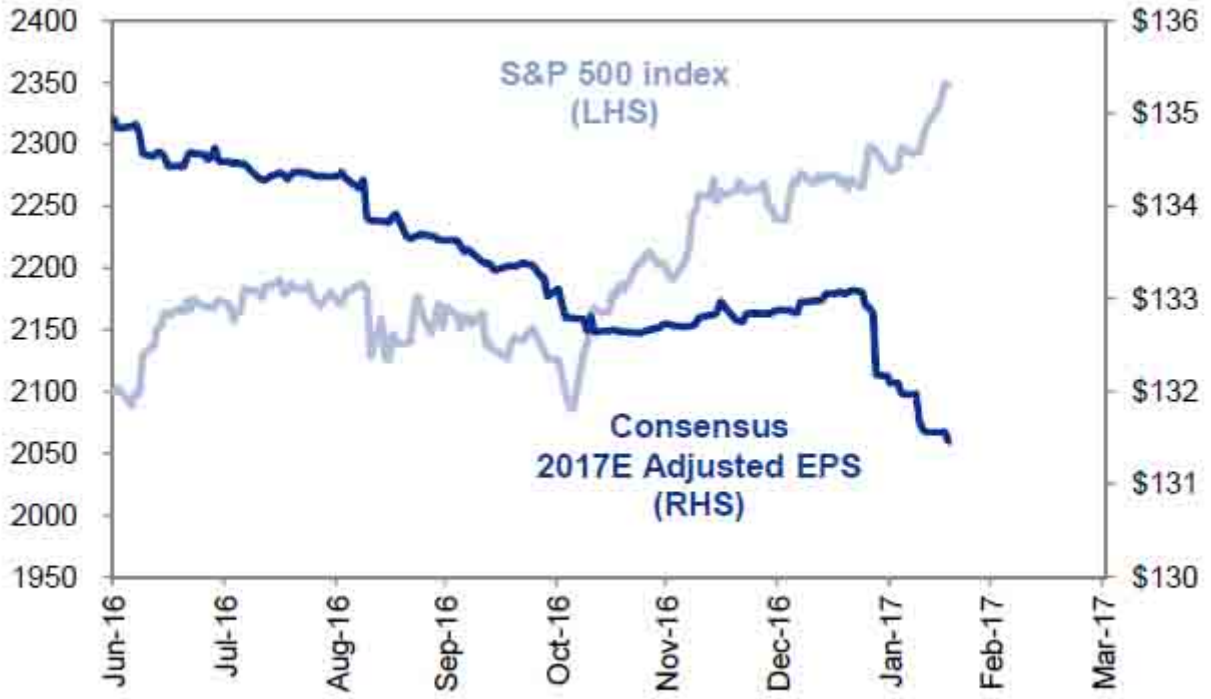
Historically, we find that when price extensions have exceeded a 12% deviation from the 3-year average return of the index, the majority of the market cycle•had been completed**While this analysis does NOT mean the market is set to crash, it does suggest that a reversion in returns is likely.** Unfortunately, the historical reversion in returns has often coincided at some juncture with a rather sharp decline in prices.

9 - Earnings expectations have significantly lagged market price action ? in fact, according to S&P Capital IQ data, analyst EPS projections for 2017 have actually dipped a little to $130.31 from $131.02 three months ago.

As ZeroHedge recently noted from Goldman Sachs:

> *"**Cognitive dissonance exists in the US stock market.** S&P 500 is up 10% since the election despite negative EPS revisions from sell-side analysts (see Exhibit 1). Investors, S&P 500 management teams, and sell-side analysts do not agree on the most likely path forward. On the one hand, investors, corporate managers, and macroeconomic survey data suggest an increase in optimism about future economic growth**. In contrast, sell-side analysts have cut consensus 2017E adjusted EPS forecasts by 1% since the election and ?hard? macroeconomic data show only modest improvement."***

Exhibit 1: S&P 500 rallied as consensus adjusted EPS was revised down
as of February 16, 2017



Source: FactSet and Goldman Sachs Global Investment Research.

10 - The S&P 500 has already climbed above year-end targets for well over half of the Wall Street strategists out there.

As I laid out at the beginning of this year in *"The Problem With Forecasts"*, even the most bullish analysts weren't as optimistic as the market is now.

"Since optimism is what sells products, it is not surprising, ***as we head into 2017, to see Wall Street?s average expectation ratcheted up another 4.7% this•year.****Of course, comparing your portfolio to the market is a major mistake, to begin with."*

WALL STREET YEAR-END 2017 TARGETS FOR S&P 500			
Strategist	Firm	S&P 500 Target	% Above 2016 Close
David Kostin	Goldman Sachs	2300	2.73%
Andrew Garthwaite	Credit Suisse	2300	2.73%
Savita Subramanian	BofA Merrill Lynch	2300	2.73%
Julian Emanuel	UBS	2300	2.73%
Tobia Levkovic	Citi	2325	3.85%
Sean Darby	Jefferies	2325	3.85%
Brian Belski	BMO Capital Markets	2350	4.97%
David Bianco	Deutsche Bank	2350	4.97%
Dubravko Lakos-Bujas	JP Morgan	2400	7.20%
Jonathan Golub	RBC Capital Markets	2400	7.20%
John Stoltzfus	Oppenheimer	2450	9.43%

as of 12/19/2016

The problem is that since there is never an expectation the markets can go down, it is just that belief which eventually ensures an investor error. This point was clearly made this past week as I was asked to pen an article for Millennials about saving and *"passive indexing."***•I did a very thorough study showing that even dollar cost averaging from current valuation levels is likely to be disappointing over the next few years.** To wit:

"So, with this understanding let me return once again to the young, Millennial saver, who is going to endeavor at saving their annual tax refund of $3000. The chart below shows•$3000 invested annually into the S&P 500 inflation-adjusted, total return index at 10% compounded annually and both 10x and 20x valuation starting levels. ***I have also shown $3000 saved annually in a mattress."***

> *"I want you to take note of the point made that when investing your money when markets are above 20x earnings,* ***it was 22-years before it grew more than money stuffed in a mattress."***

When I returned the study and my findings back to the media outlet, I immediately received a message back stating:

> ***"This is not a message that we want to project."•***

In other words, they wanted an article suggesting that Millennials should just ***"buy everything."•*** **Maybe that is an indicator within itself.**

#PortfolioHedgesMatter

Market & Sector Analysis

Data Analysis Of The Market & Sectors For Traders

S&P 500 Tear Sheet

The *"Tear Sheet"* below is a *"reference sheet"* provide some historical context to markets, sectors, etc. and looking for deviations from historical extremes. If you have any suggestions or additions you would like to see, send me an email.

SPY RISK INFO

Item	T 2-Yr	T 1-Yr.	YTD	% Diff YTD/T1-YR
Price Return	11.77%	22.54%	5.91%	(73.78%)
Max Drawdown	-15.32%	-6.53%	-1.48%	-77.39%
Sharpe	0.59	1.20	1.20	0.00
Sortino	1.10	1.42	1.42	0.00
Volatility	11.93	10.21	10.21	0.00
Daily VaR-5%	(18.44)	6.45	1.65	(0.74)
Mnthly VaR-5%	(12.47)	(4.33)	(4.33)	0.00

S&P 500 Fundamental Analysis

Item	2 years ago	1 year ago	Current	1 Yr % Change	5 Year High	5 year Low	% From High	% From Low
Dividend Yield	1.93%	2.17%	1.90%	(13.87%)	2.20%	1.83%	(13.29%)	4.16%
P/E Ratio	18.61	16.64	20.29	17.98%	41.89	18.44	(51.6%)	10.04%
P/S Ratio	2.63	2.62	3.18	17.66%	3.08	1.79	3.40%	77.83%
P/B Ratio	3.13	2.99	3.72	19.50%	3.53	2.30	5.37%	61.96%
ROE	15.24%	15.59%	15.56%	(0.15%)	16.12%	15.01%	(3.46%)	3.70%
ROA	2.89%	2.92%	2.80%	(4.36%)	2.99%	2.80%	(6.54%)	0.00%

S&P 500 Market Cap Analysis

Item	12-M Ago	Current	% Chg
Shares	2,505.3	2,517.1	0.47%
Sales	56,046	55,794	(0.45%)
SPS	22.4	22.2	(0.92%)
Earnings	7,482	7,317	(2.20%)
EPS TTM	3.5	3.5	1.02%
Dividend	1.3	1.3	4.87%

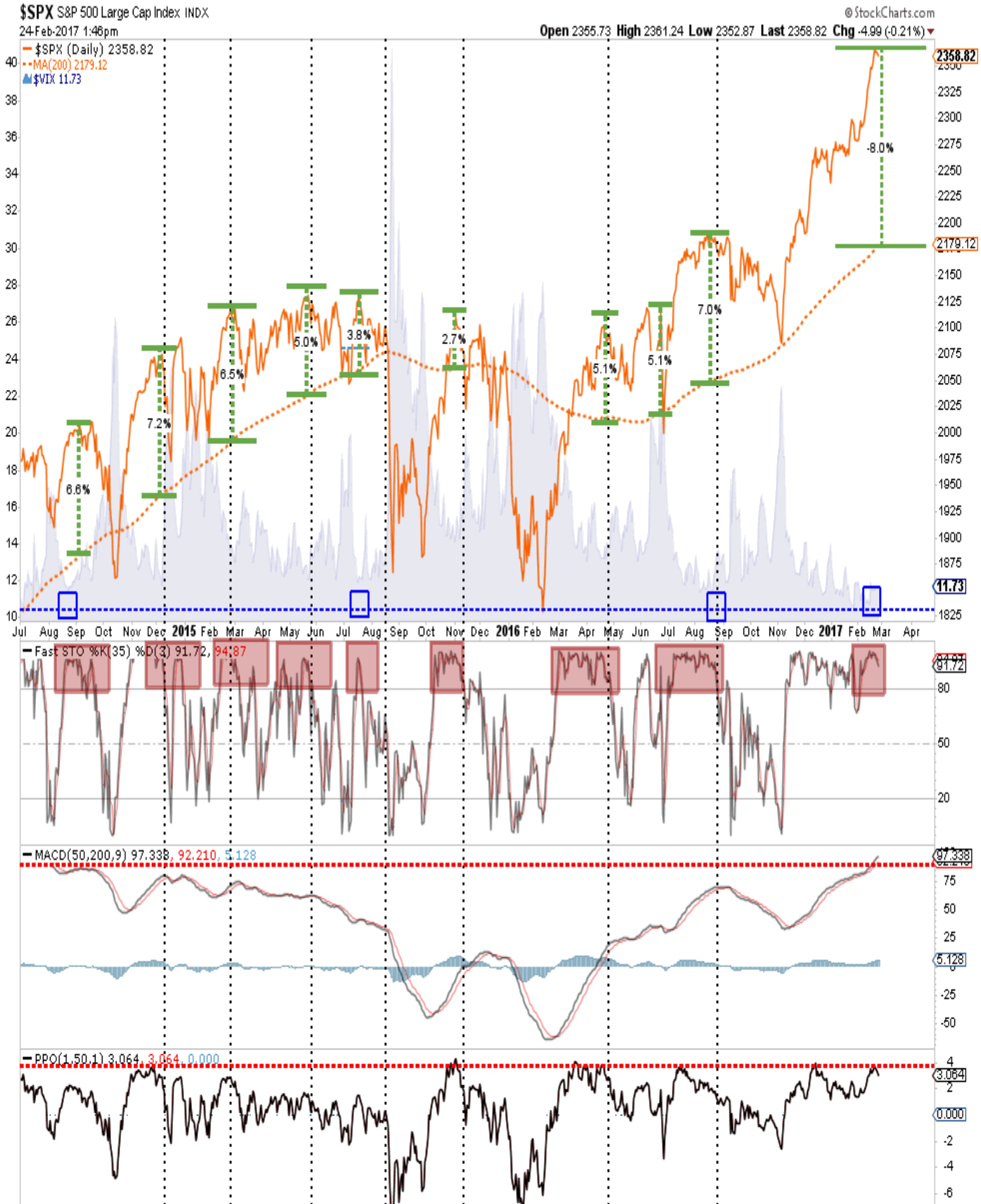
S&P 500 Asset Allocation

Sector	1 Year Price Return	Weight	Beta	P/E	P/E High-5yr (Mo.)	P/E Low - 5Yr (Mo.)	P/E % From Peak	ROE	DIV. YIELD	TTM Earnings Yield	Current Forward Earnings	Forward PE
Energy	18.36%	6.74%	1.19	123.57	152.97	11.47	(19.2%)	3.6%	2.7%	0.75%	2.06	28.70
Materials	25.47%	2.85%	1.40	20.15	54.34	11.91	(62.9%)	17.5%	2.1%	4.96%	3.87	17.61

Review & Sector Analysis

Positioning Review & Update Let's start with a quick update from last week.

> ***"While the 'bullish backdrop'•clearly remains, there is ample evidence to reduce overweight equity positions and refrain from making new purchases currently.*** *As shown in the chart below, the deviation in the price of the S&P 500 from its underlying 50 & 200 day moving averages, bottom two indicators, are currently at extreme levels.* ***At these levels, a pull back or correction has been a common occurrence."***

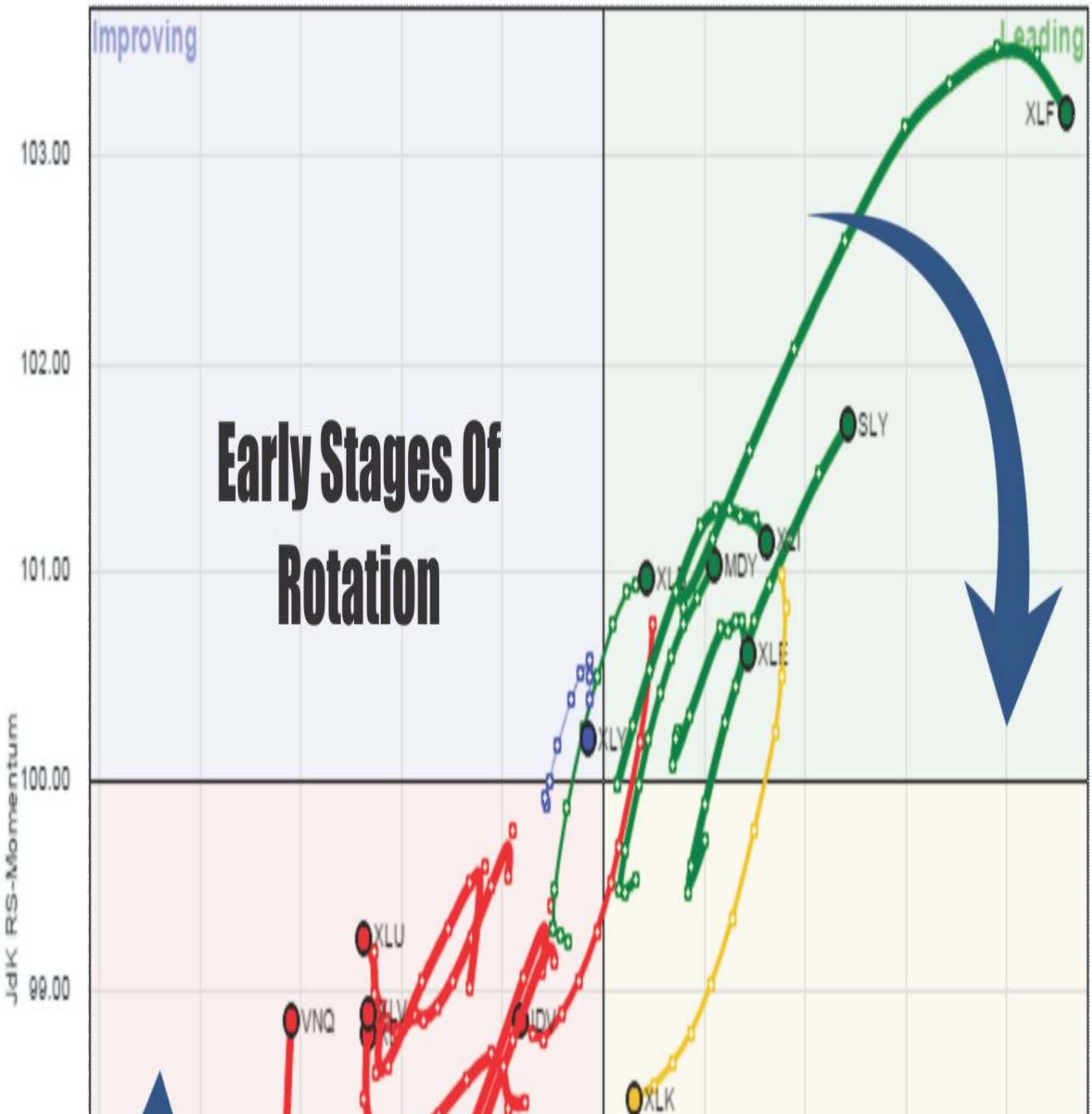


"A correction can happen in one of two forms:

1. *The price of the index begins to trade in a sideways pattern for a couple of weeks which allows the underlying moving average to catch up with the price, OR;*
2. *The price corrects to, or beyond, the underlying average.•*

While a sideways correction is entirely possible, it generally rarely happens. *Most likely, a•correction would entail a price reversion towards 2175 to 2200. Given the market finds support at these levels, investors should be afforded a better entry point to add exposure.* ***However, a violation of those levels would suggest a deeper correction is in the making."***

IMPORTANTLY, I also stated that I was temporarily holding off adding new equity positions to portfolios currently until the risk/reward opportunity becomes a bit more favorable.With portfolios nearly fully allocated at this juncture, my bigger concern is focused on the numerator of the risk/reward equation.•That remains the case this week as the hedges that were added to portfolios in December continue to operate by adding support to portfolios **as the *"Trump Trade"* fades as hopes of infrastructure spending, tax reform and repatriation get pushed off into the future.•As I noted (with a video) at the beginning of the year,** these **rotations usually are early indicators of a *"risk off"* transition and provide opportunities for investors.** Here is the rotation chart from January 5th.



As you can see, that rotation has continued to accelerate since then as expected.

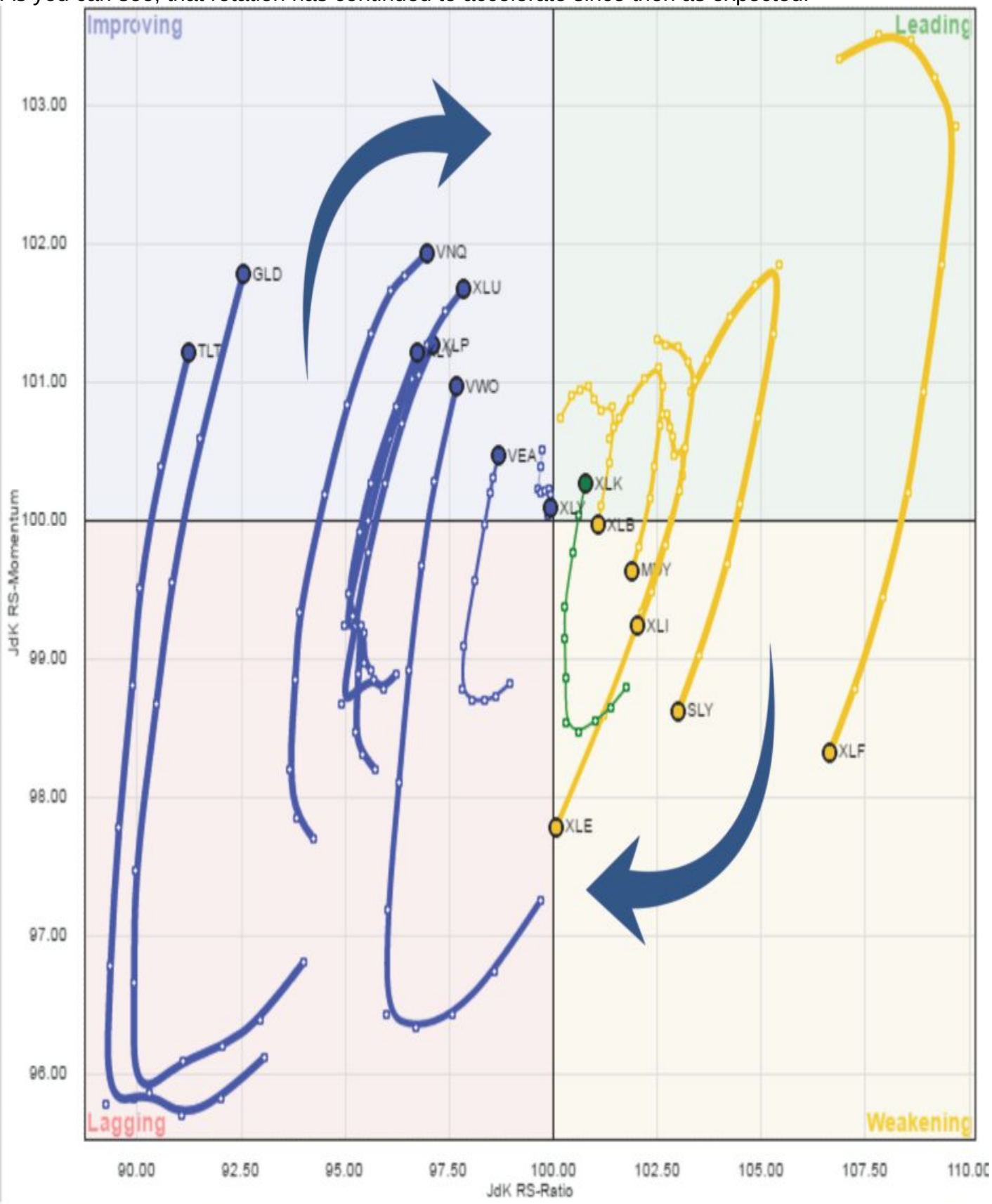
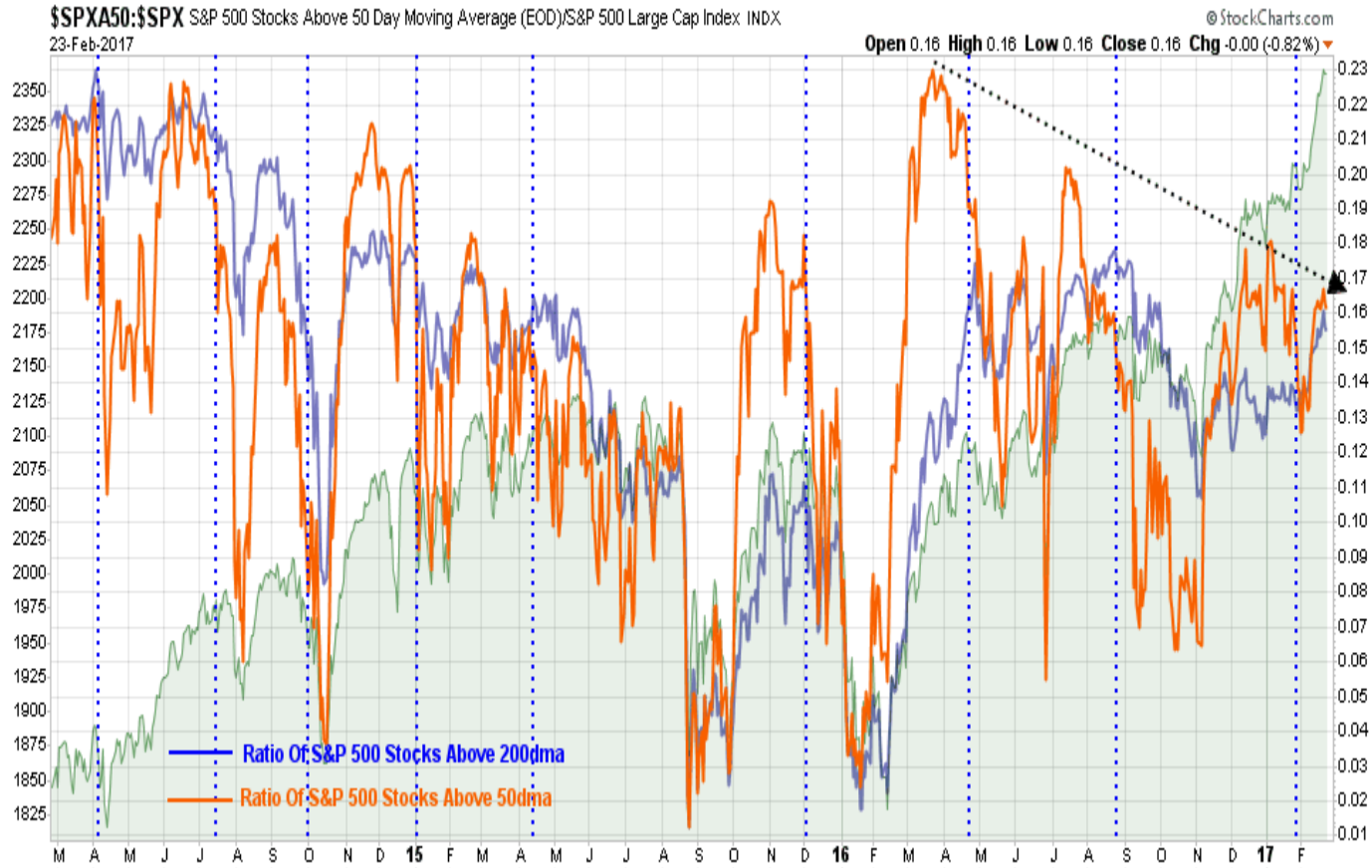


chart	visible	tail	symbol	name	sector	industry	price	%chg
	✔		XLK	Technology Select Sector SPDR Fund			52.44	7.9
	✔		TLT	iShares 20+ Year Treasury Bond ETF			121.78	4.5
	✔		GLD	SPDR Gold Shares			119.76	10.8
	✔		VNQ	Vanguard REIT ETF			85.03	5.1
	✔		XLV	Health Care Select Sector SPDR Fund			74.55	7.1
	✔		XLP	Consumer Staples Select Sector SPDR Fund			55.11	5.9

Of course, if you are simply watching the broad market indices, these internal rotations of the market have been masked. **So while the media has hyped the markets making new highs every day of the week, this has not been the case for the stocks that make up the index itself as noted by the number of stocks currently trading above their respective 50 and 200-day moving averages.**



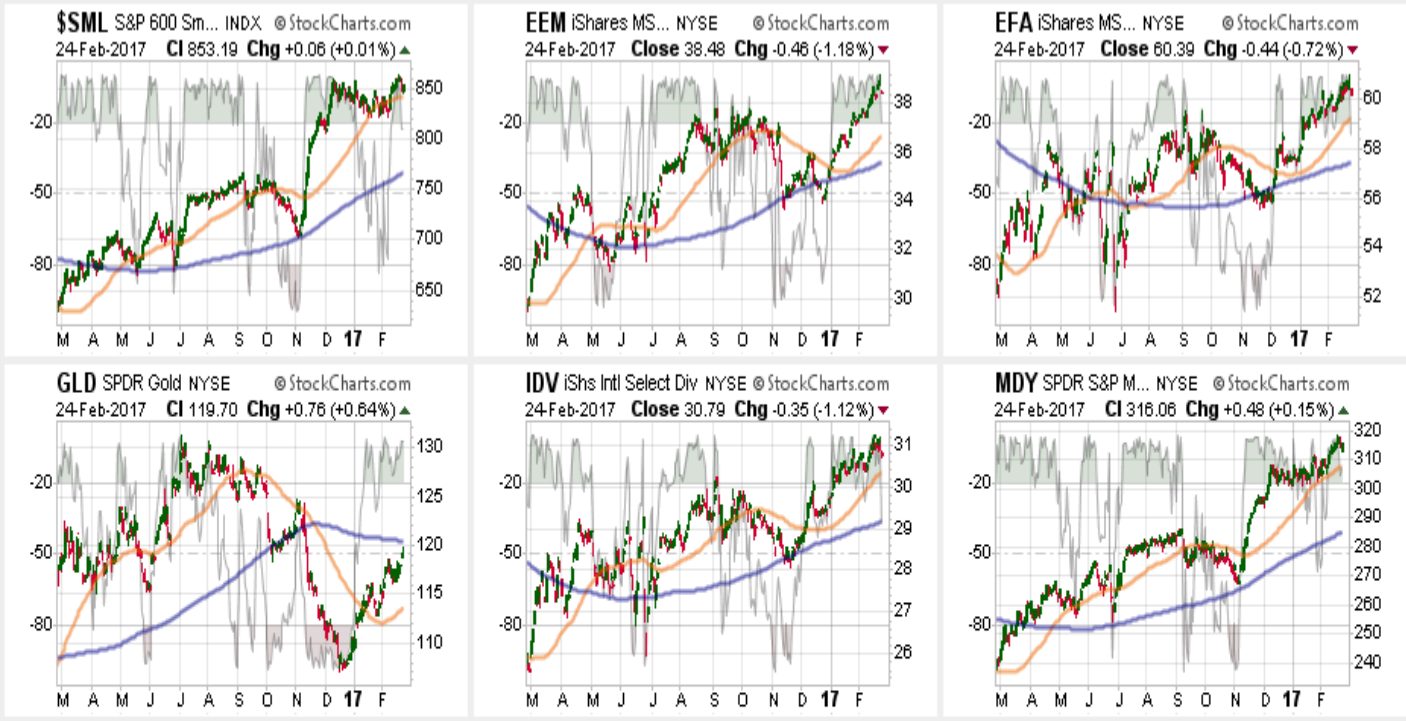
But this is today's discussion in a nutshell, with markets making daily new highs there is absolutely nothing to worry about, right? **After all, who can argue with the advice pushed out by CNBC?**

Technology, Discretionary, Industrials, Staples, Utilities, Health Care and Financials continue to push highs. Energy continued to struggle after breaking its 50-dma. Basic

Materials•continues to lag but is holding its ground.

Notably, watch Staples, Utilities, and Healthcare as the 50-dma is crossing 200-dma.

From the broader index positioning: **Like Utilities above, REIT's are also pushing a 50-200 dma crossover.** This all corresponds to the *"safety trade"* that is currently underway. Small Caps, Mid Caps, and Dividend Stocks bounced off their respective 50-dmas **BUT are all extremely extended above their longer-term moving averages suggesting a higher degree of risk. Emerging and International markets got a lift from the weakening dollar which prompted an increase in International weightings in portfolios three•weeks ago from a trading perspective.** These areas are also extremely overbought currently as well. **Caution is advised.**



The table below **shows thoughts on specific actions related to the current market environment.•**

(These are not recommendations or solicitations to take any action. This is for informational purposes only related to market extremes and contrarian positioning within portfolios. Use at your own risk and peril.)

	Over Bought / Sold	50/200 DMA	Trend	Action	Notes
XLY	OB	Positive	Positive	Take Profits	Extreme Overbought/Weakening
XLK	OB	Positive	Positive	Take Profits	Extreme Overbought/Weakening
XLI	OB	Positive	Positive	Take Profits	Extreme Overbought/Weakening
XLB	OB	Positive	Positive	Take Profits	Overbought/Weakening
XLE	OS	Positive	Positive	Warning	Broke 50-dma
XLP	OB	Positive	Positive	Take Profits	Overbought/Improving
XLV	OB	Improving	Positive	Take Profits	Overbought/Improving
XLU	OB	Positive	Improving	Take Profits	Overbought/Improving
XLF	OB	Positive	Positive	Take Profits	Overbought/Weakening
$SML	OB	Positive	Positive	Take Profits	Overbought/Weakening
EEM	OB	Positive	Positive	Take Proits	Dollar / Rate Risks
EFA	OB	Positive	Positive	Take Proits	Overbought
GLD	OB	Negative	Negative	Sell	Overbought/Target $120 Reached
IDV	OB	Positive	Positive	Reduce	Dollar/Rate Risks
MDY	OB	Positive	Positive	Hold	Take Profits/Rebalance
SDY	OB	Positive	Positive	Hold	Take Profits/Rebalance
TLT	Declining	Negative	Negative	Hold	Added To Portfolio - Hedge
VNQ	OB	Improving	Improving	Hold	Overbought/Improving

Portfolio Update: Eleven•weeks ago, as suggested, we hedged our long-equity positions with deeply out-of-favor sectors of the market *(Bonds, REIT?s, Staples, Utilities, Health Care and Staples)* which have continued to perform well in reducing overall portfolio volatility risk. This next week we will take some profits in these areas be rebalancing them to•original target levels. The market is now egregiously overbought but "exuberance" continues to push asset prices higher. Importantly, **all positions•maintain very tight trailing stops as the mid to longer-term dynamics of the market continue to remain very unfavorable.•**No new additions to equity are currently recommended as risk/reward remains unfavorably balanced going into next week. **Rebalancing remains•strongly advised.**

THE REAL 401k PLAN MANAGER

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

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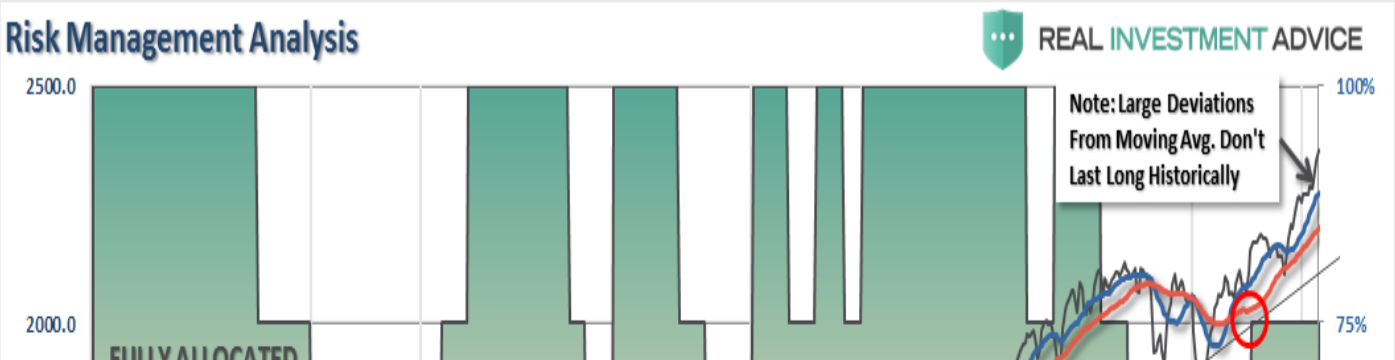
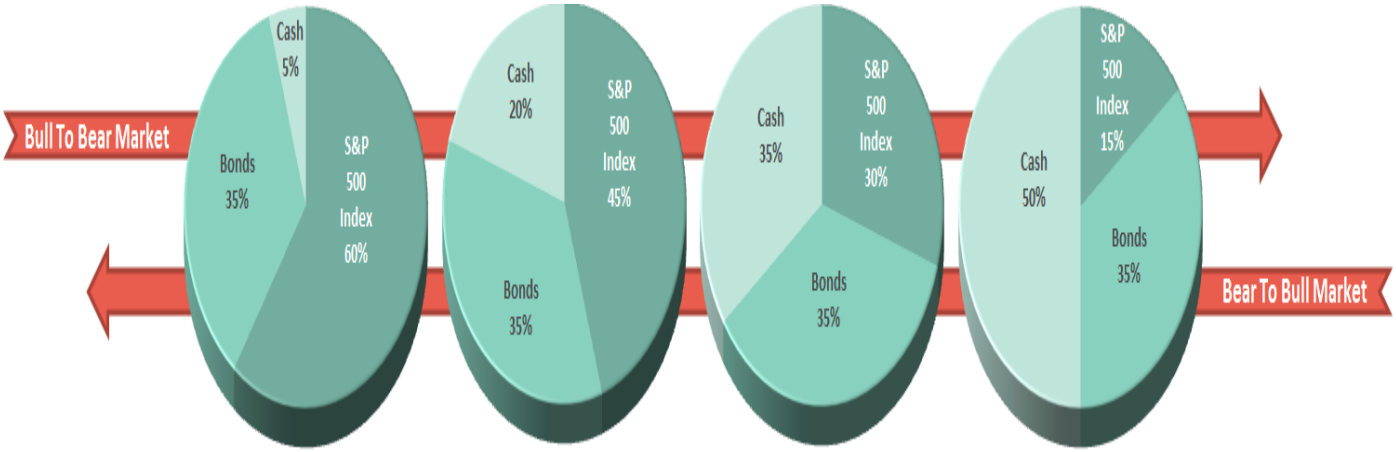


There are 4-steps to allocation changes based on 25% reduction increments. As noted in the chart above a 100% allocation level is equal to 60% stocks. I never advocate being 100% out of the market as it is far too difficult to reverse course when the market changes from a negative to a positive trend. Emotions keep us from taking the correct action.



Risk/Reward Not Favorable

As I noted two•weeks ago:

> ***"****While, in retrospect, I should have increased the 401k model allocation to 100% at the beginning of the year,* ***the risk/reward setup for an incremental increase in exposure simply has not been justifiable given the limitations that exist in 401k plans as it relates to trading limitations."***

And last week:

> *"A correction back to short-term supports around •2200-2250 on the S&P 500 would likely be a "buyable" trading level.* ***As noted in the chart above, the current extension above the moving average will likely be corrected sooner rather than later.****Such a correction will relieve some of the extreme overbought conditions that currently exist and allow for additional risk exposure in portfolios if needed."*

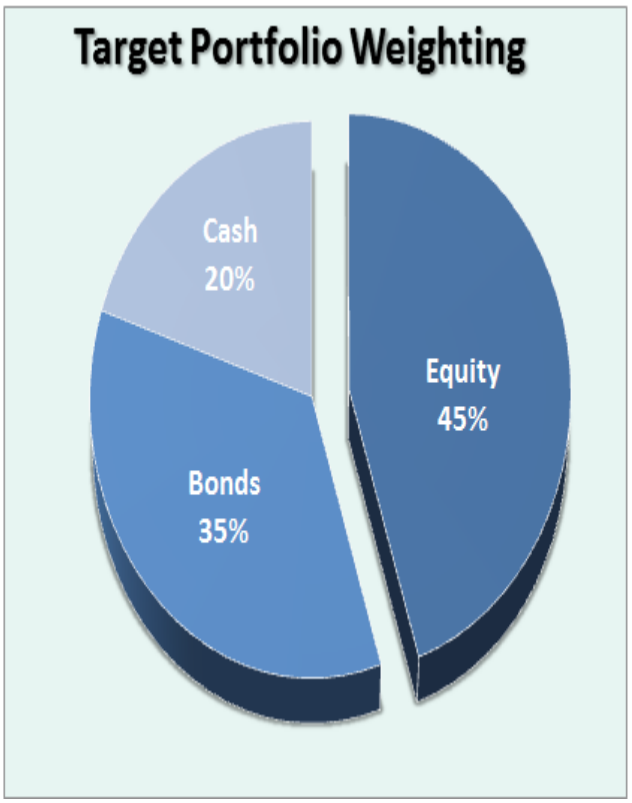
I continue to suggest using this current extension•to as an opportunity to clean up portfolios.*(Use guidelines noted previously.)*

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.*

If we can get a correction that resolves the overbought, extended and excessively bullish backdrop to the markets currently, I WILL increase the allocation model to 100%. •For now, we will wait and let the markets tell us what it wants to do next. 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.)*



Current 401k Allocation Model

20.00% **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

25% Intermediate Duration Bonds

10% International Bonds

0% High Yield

45.00% **Equity (Stocks)**

Select ONE fund from each category - Keep It Simple.

15% Equity Income/Balanced/Conservative Growth

25% Large Cap Growth (S&P 500 Index)

5% Mid-Cap Growth

0% International Large Cap Value

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*
	Money Market
	Retirement Savings Trust
	Fidelity MIP Fund
	G-Fund
	Short Term Bond
Fixed Income	*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.

The above represents a selection of some of the most common funds found in 401k plans. ***If you do not see your SPECIFIC fund listed simply choose one that closely resembles the examples herein.*** All funds perform relatively similarly within their respective fund classes.

Equity	
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
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