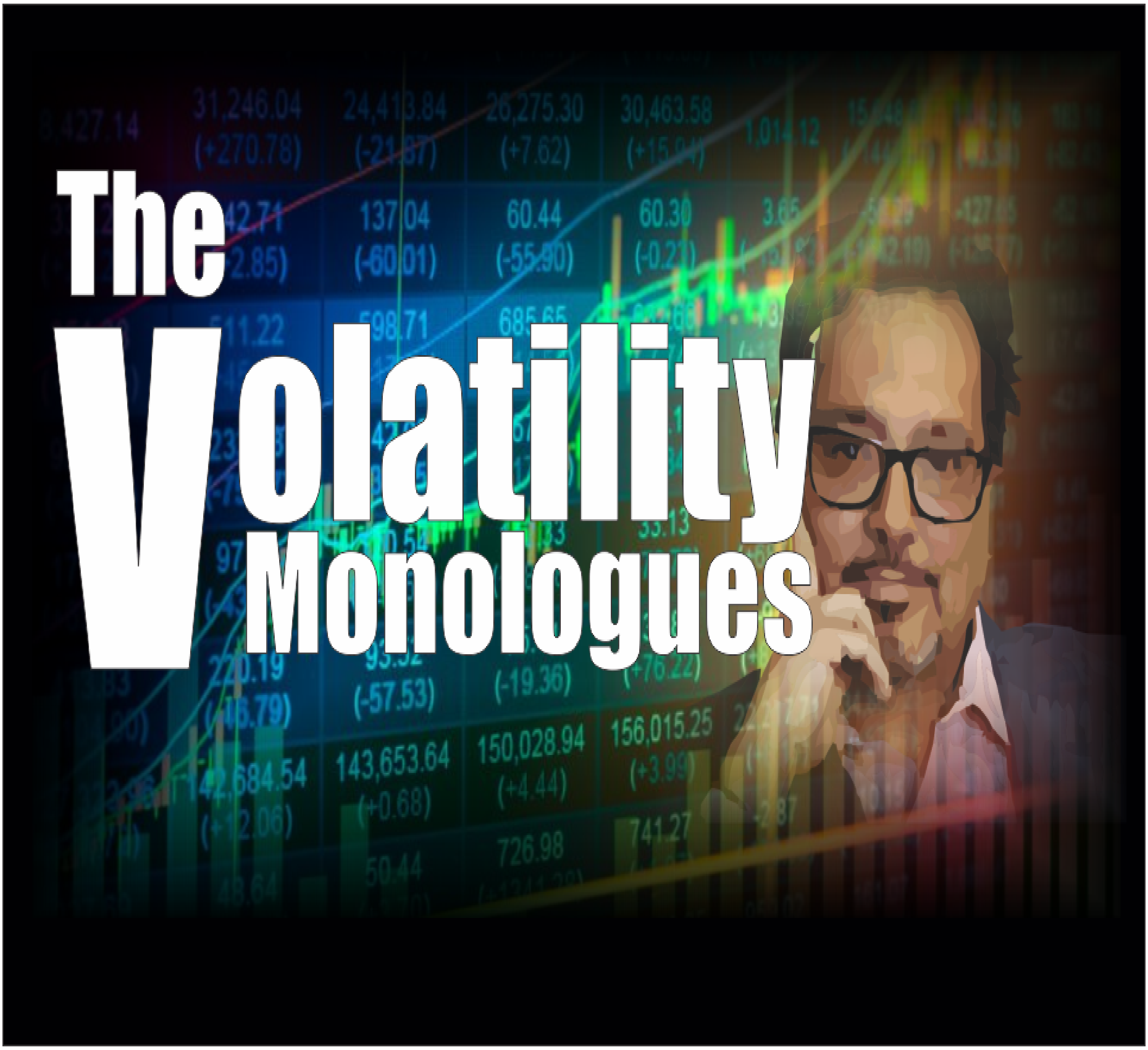


Let?s have a chat about a topic that feels foreign to us. Since the election it?s been off the radar. It?s ok to keep the lights on when discussing this subject. Come closer. Let me whisper:

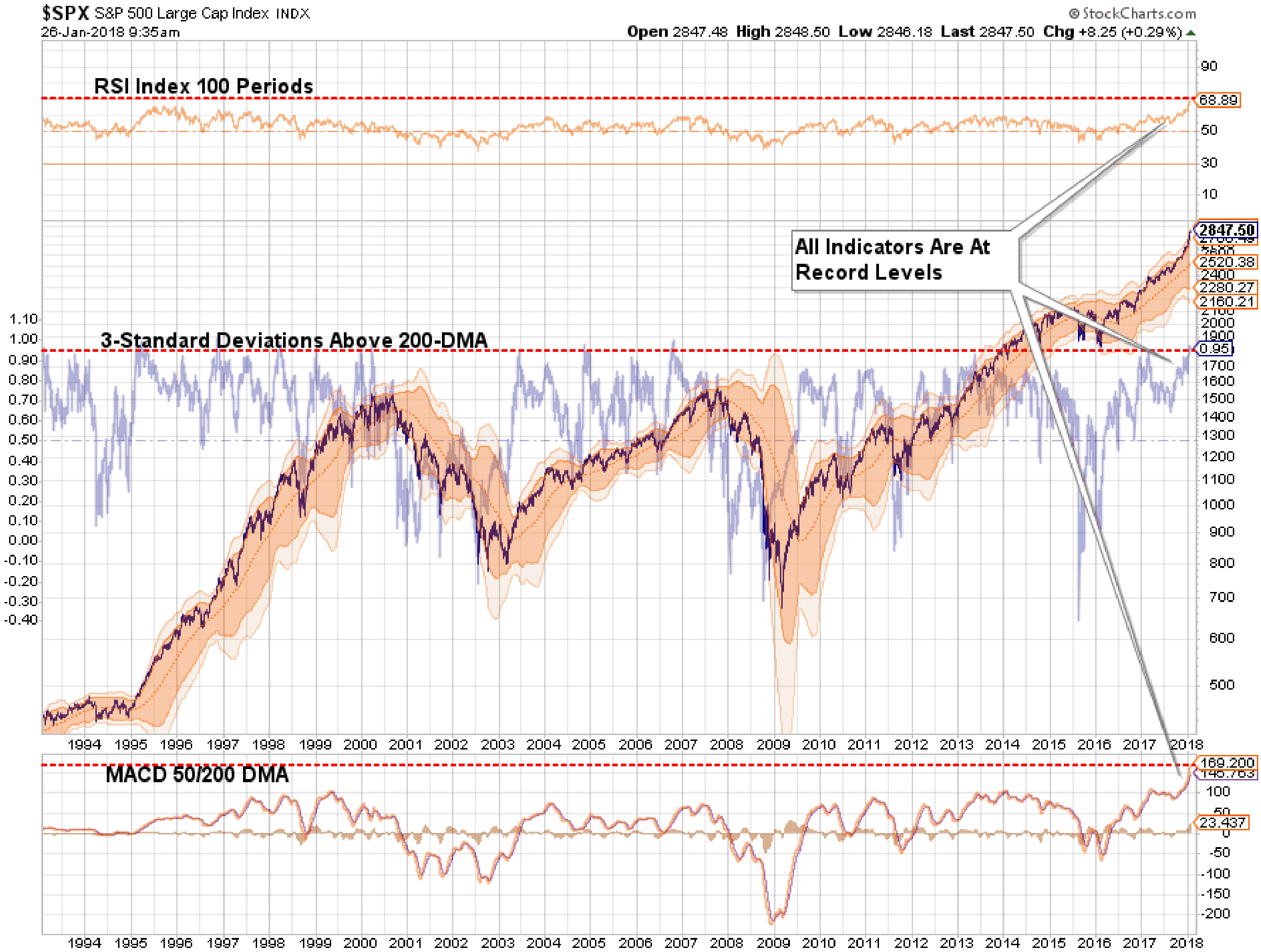
> ***?Markets can be volatile.?***

I know. It?s been a while. Take a deep breath. There are rules to buy and disciplines to sell. We write of them ad nauseam at Real Investment Advice. We stressed in 2017 that investors should have been taking profits, To help readers understand I thought it would be helpful to add perspective (tagging on to the context already provided on our blog and in the recent [Real Investment Report](#)):

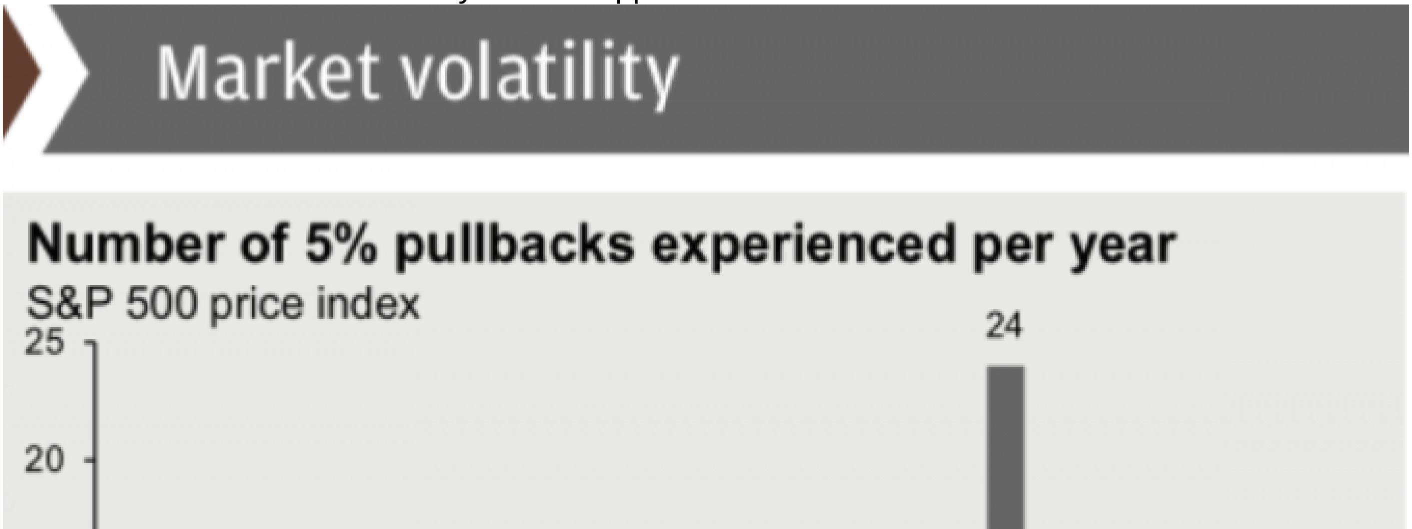
> ***"If the initial hint of a pullback in prices from an unprecedented market extension has you anxious to flee for an exit, then candidly, stocks are not a suitable long-***

term investment. You should seek to meet with a financial professional and restructure your portfolio conservatively on a reflexive bounce."

In other words, if you can?t handle the first sign of heat, get out of the kitchen. Volatility, pullbacks and corrections are par for the course. Unfortunately, it?s been so long since markets have experienced a hiccup or retracement; whether deep or shallow (too early to call), it?s going to feel extremely uncomfortable. Five-percent is going to feel like 10 percent, 10 like 20. You get the picture.



I mean, this market has rocketed above its 50-day moving average. A correction back to the average (as of this writing), would be 6 percent. I?m sorry*. Five to six percent pullbacks were considered market noise in the past; in the present, this noise is gonna hurt, emotionally.* Novice investors may be surprised or grow disappointed if markets return to how they have historically behaved. Per J.P Morgan?s Guide to the Markets•, it?s unusual for stocks*not* to suffer multiple 5% pullbacks in a year. I know it sounds clich•, but corrections and pullbacks are healthy, allows for weak hands to exit and ultimately creates opportunities to add to stock allocations.



Per Lance Roberts, Clarity Financial?s Chief Investment Strategist:

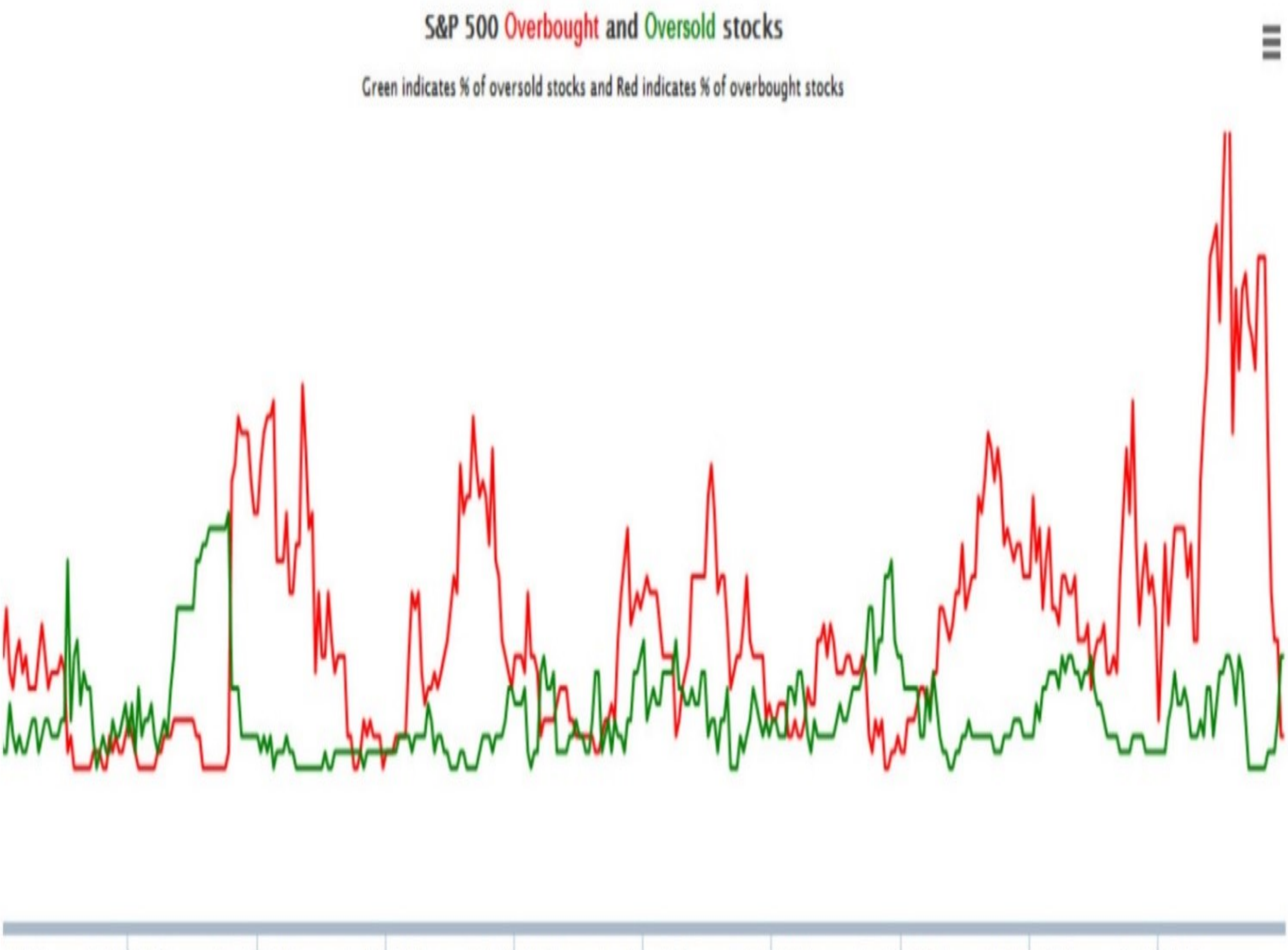
This is what we are looking for to drive our next set of portfolio actions:

- *If the market rallies back* ***and sets a new closing high,*** *•the bullish trend will be confirmed and equity allocations will remain at target levels and hedges removed.*
- *If the market rallies back* ***BUT FAILS to set a new high,*** *•a series of actions will take place.*
  - *At the point of rally failure, portfolio hedges will be modestly increased.*
  - *If the subsequent decline breaks the previous low, the hedges will be further increased and tactical trading long positions will be reduced."*

Currently, as a *rules-based investor*, you should be in observation mode, not blow-up-your-asset-allocation mode. **You don?t want to get emotional over your money, especially as volatility returns. But...** All through December we discussed on the Real Investment Hour, that volatility would return in 2018.

Boy, has it.

It?s smart to be concerned. Yellow lights are flashing. If the market is too volatile for your emotional makeup even in the face of a market that?s doing what markets usually do (you just may not be in long enough to understand), then you may require a new game plan. If you believe you must sell because your gut requires Pepto, please don?t use a machete and slaughter your portfolio allocation. Be surgical. Calm. Cool. Liquidate the weakest and most volatile positions first then adjust for the long term when conditions are attractive to do so. Come up with a mutually agreed-upon strategy with your financial professional. I encourage you to call or meet with your adviser. Ask questions. Seek input first. **If you?re advised to do nothing right now, do nothing...for now.**•That doesn't mean *"do nothing...ever."*•

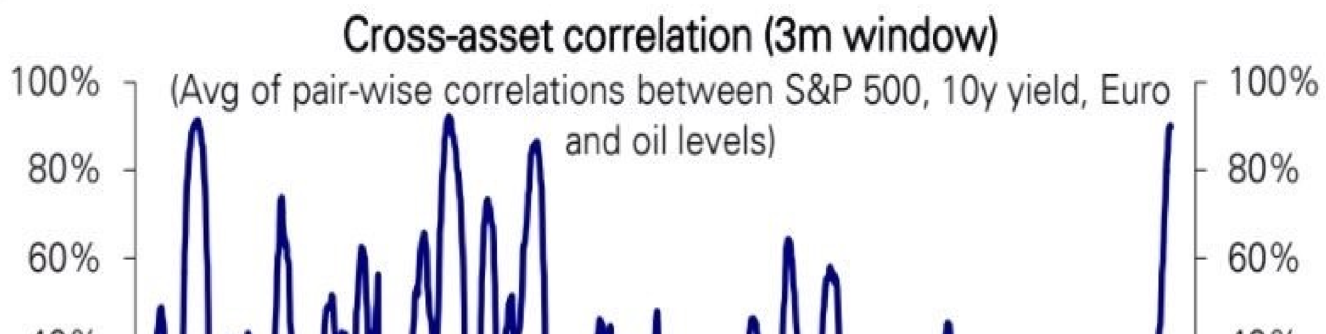


Here is an overview from ChartLab. Notice how extremely overbought markets were since the beginning of the year (red line). For the *?Blindexers,?* or those who recently purchased into their full stock allocation without regard to euphoria or heady valuations, well, this is a formidable test of your commitment to buy and hold. Investors who have been through turbulent market periods, especially since 2000, know that ?trees don?t grow to the sky.? They?ve exercised caution to enter markets (partial positions), taken profits consistently, and managed losses on weak positions (as suggested in the blog, newsletter, on the radio show). If conditions deteriorate per Lance Roberts? commentary above, then you may grow weary of ?doing nothing right now.? The input to your financial professional shouldn?t fall on deaf ears. The more your input is politely ignored, the greater the frequency of phone calls and meetings that result in similar words communicated by your adviser, the stronger the eventual impact, possibly negative it is going to have on your portfolio. All talk no action is not going to help keep your emotions in check. Sometimes, it takes compromise to avoid costly financial decisions. If markets continue to falter, the longer you are dismissed as being ?emotional,? the greater the ultimate explosion of a building mental powder keg is going to be. The result will be an all-or-none decision where you?ll demand all stocks liquidated, most likely at or close to the bottom of a negative cycle. In other words, if your financial professional listens, I mean actively listens, and initiates with alacrity some disciplined form of risk protection, even if it?s surgically trimming away the investments which are experiencing the most negative impact (possibly cyclical, emerging market stocks), thus raising cash, the greater the odds you?ll stick with an allocation to stocks through the downturn and ostensibly experience the upswing. I call it selling down to your personal emotional-neutral zone. It may take several surgical strikes depending on the cycle, but hey, that?s better than taking a machete to portfolio positions, selling everything and then ostensibly, never returning to the market. Be prepared to eventually be on the other side of the desk, listening to the same old advice that cost you to lose a decade of wealth creation. For now? If you?re in the game for long-term, you shouldn?t make any major portfolio changes. However, it?s perfect while markets are volatile and traders are not yet willing to scoop up shares on the dip, to shake off the complacency witnessed since the election and have a face-to-face with your financial partner.

Why does it feel so bad??

First, remember when I outlined how diversification isn?t risk management? Now you?re witnessing in real time exactly what I was writing about. The following chart outlines one reason why it feels so bad. Correlations, or the connections among asset classes approached 90% this year. I call it the ?maximum feel good.? Currently, asset classes are correlated tightly on the downside leaving few places to hide, thus the ?max feel rotten.? Bond prices moved up along with stocks in 2017 (albeit not at the same pace, but higher just the same), connected and headed lower (prices down, yields rising), with stocks this year. Unless holding cash, a hedge (or short fund), floating-rate bonds, select overseas fixed income funds and Amazon, diversification is not doing a typical stock & bond portfolio any favors, currently.

Figure 1: Very strong momentum across asset classes has seen oil up, the dollar down, equities and bond yields up, with the average correlation between them rising to 90%



Mentally, you are not ready for volatility or markets behaving like, well, markets. Second, please understand that last year?s and January?s market moves were unusual. Investors haven?t experienced a 5% pullback in stocks in **TWO YEARS**. Now, as intermediate and long-term bond yields move higher at a hastened pace, stocks are finally taking notice. Perhaps, there?s a point where stock dollars begin to rotate into bonds; especially inviting for a global society that?s aging and requires safety and income. If the ten-year Treasury heads north of 3.25%, I think you?ll see it. Last, that darn recency bias, a very-human pitfall where we fool ourselves into believing that the trend of recent history (good or bad), will continue, has convinced many that this period of smooth sailing will lead to more of the same. Recency bias has sucked in investors since late 2017 and January 2018. The absence of volatility has made it easy to forget market cycles, assuage fears. Heck, it?s been a fun ride no doubt about it. We?ve been writing at RIA of lofty valuations and the strange extended lack of volatility to help readers remain grounded. To battle recency bias, try to focus on long-term personal financial benchmarks so short-term volatility doesn?t compel you to act indiscriminately out of fear. *Fight your prehistoric lizard fight-or-flight brain and think it through.* As fiscal policy commandeers the driver?s seat and monetary policy begins to pull the liquidity pillar out from under the market?s foundation, stocks are going to be shaky at times. Inevitably, cracks are going to form. Volatility has returned and that?s not necessarily a bad thing, especially if as an investor, you?re seeking to place capital to work at lower prices. Remember, what?s good for Main Street or the economy can be anathema for Wall Street. Low interest rates and cheap money are going to be tough addictions to break. Unfortunately, the central bank detox though necessary, is going to return stock investing to those who are most suited to handle the gyrations. Fundamentals will again, matter for something. Consider the latest market moves a wake-up call.