- *Price is not Truth in Today's market*
- *We seem to be transitioning from a STABLE AND CONSISTENTLY RISING market to a more volatile and challenging market without memory from day to day*
- *Use The market swings (up and down) to your advantage*

"For many, it will be increasingly difficult to navigate a market dominated by the overly popular ETFs and quant (volatility-trending and risk-parity) strategies that worship at the altar of price momentum. It is also because the "buy the dip" mentality remains indelibly etched on the forehead of most investors and traders that the Pavlovian reaction won't die easily. Favoring the bulls is the diminished number of publicly held companies outstanding (from more than 7,600 in 2000 to 3,800 in 2017), a 17% reduction in the float of the remaining companies via corporate buybacks, and still-abundant liquidity. And on top of this, as previously mentioned, is the market's participants confidence in buying the dips." - Kass Diary, *The Bull Wont Die Easily (November, 2017)*

In trying to understand the relentless Bull Market advance since the Trump Election I am reminded of what I wrote above in November, 2017. These words were underscored in Jim "El Capitan" Cramer's "Four Reasons Stocks Keep Going Up" written earlier this year -- in which he discusses the important structural changes that have led to the popularity of passive investing (ETFs) and in the share count drop caused by a near decade of aggressive corporate buybacks. Of course there are numerous other reasons (some Jim details further) like the employment of large liquidity infusions from central bankers around the world, optimism about the cut in corporate taxes, the reductions of business regulations (around the fringe), sustained lower interest rates, etc. As I have also written, investment vision is always 20/20 when viewed in the rear view mirror.

Price is Not Truth...In This Market

> *"In the short run the market is a voting machine, in the long run it is a weighing machine."* - Warren Buffett

Share price artificiality and limited price discovery have been the market mainstay, abetted by years of monetary easing (which produced generational lows in interest rates) and the broad move from active to passive investment strategies and products. But the weight of higher valuations, ever buoyant investor sentiment, the near end to short selling strategies (after large and cumulative market advances) and other factors (listed in today's opener) may have set us up with an unattractive risk/reward for investors with an intermediate term time frame. These past observations don't really help us project the future (or time a downturn in equities) -- though I did touch on some of my concerns in a January missive, *"Blinded By a Sense of History"* (with some updates in parentheses):

> *"It is a mania shared by philosophers of all ages to deny what exists and to explain what does not exist." - Jean-Jacques Rousseau*

I have no clue how long it will continue:

> ** What I am certain about is that liquidity, which has buoyed our markets for years, is starting to be reduced. (Central bankers are reversing course and beginning to contract their balance sheets.) * What I am fairly certain about is that we are at sentiment and valuation extremes -- at least based on history. (And every day these measures grow more stretched.) * Interest rates are likely headed higher, posing -- at some point -- a potential risk and alternative to stocks. (The ten year US note yield rose above 2.50% this morning.) * I expect no further major legislative initiatives coming out of Washington, D.C. -- specifically on the infrastructure front -- and a further deterioration in the relationship between the Republicans and Democrats as we move toward key midterm elections. (My expectation is that the House goes Democrat while the Senate stays Republican.) * As to the Administration, their belief appears to be that the benefit of world leadership is not worth the costs -- which runs the risk of a policy mistake in the year ahead. * As well, though markets have not been yet unnerved even with the White House having gotten bitten by a Wolff this past week, there exists the possibility that the Special Counsel's activities could be market unfriendly. * And I am of the view that the earnings and economic growth expectations will, once again, be disappointing in 2018-19. [Earnings revisions higher have been material (in large measure from tax cuts) but I see mid-year as a pivot point of slowing, not accelerating growth.]*

The markets seem to be moving back to being one with more concentrated leadership -- as technology and the FAANGs (a large percent of the S&P Index) have regained their strength. Small caps, supposed tax cut beneficiaries, are lagging. Again, historically these are not positive signposts but it can continue, I have learned, far longer than I anticipated. The speculation in *cryptocurrencies and blockchain and penny stocks is yet another thin reed indicator of a mature Bull. And so is the self confidence and hubris seen in the business media. Risk assets, like stocks, are called risk assets because they have risk -- though you wouldn't know it from the recent action in which fear and doubt has left the Exchanges. ... I see few longs that meet my standards of purchase.* My view through the windshield (and into the future) has been dramatically worse (over the last year) than my view through the rear view mirror (and the past) as stocks, up to the end of January, had marched ever higher without the sign of any meaningful pause. While Grandma Koufax used to say, *"Dougie, matzah doesn't grow to the sky,"* the investment trees were like redwoods until a month ago. From my perch, the major contributing factor to the relentless market climb was the unprecedented liquidity infusion by global central bankers which created an air of invulnerability and a period in which price discovery was lost in a flood of money and in which no adverse consequences were being considered to that monetary largesse. For a long while, price has not been truth -- stock prices continued their rise and, for most market participants, skepticism and doubt had left the room in one, long momentum trade.

February Made The Markets Shiver

> *"But February made me shiver With every paper I'd deliver Bad news on the doorstep I couldn't take one more step.."* - Don McLean, American Pie

Of course February delivered a shock to the markets as the cumulative beneficial market impact of the transition from active to passive markets and strategies that were formulated to follow price, short volatility and risk adjust based on asset classes unwound as too many market participants were on one side of the boat and the slightest of changes in correlation between those asset classes had an abrupt and adverse impact on global equities. Stocks quickly dropped by 10% in only a few trading sessions and, following the October, 1987 script (when Portfolio Insurance undermined socks), a 9% "V" rally ensued and the S&P Index rose by 250 handles in the matter of 10 days. A possible retest (much like in the November, 1987 period) may now be in the offering -- though visibility is low in a market dominated by machines and algos who are agnostic to fundamentals (See below) **Today's Quandary**

> *Several acquaintances I have that have consistently had bearish market outlooks acquiesced after Friday's market ramp and have taken off their short hedges. Since I am of the view that the machines and algos are working in overdrive (to the upside and to the downside) -- I believe a lot of these responses to the price action and technicals (my view remains that the dominance of ETFs and quant strategies are serving to ruin the ability of reading charts/technical analysis) may be misplaced and are simply interpretations of "flawed patterns" that can be easily reversed (witness the recent schmeissing). If, as I suspect, the early February dive was a tremor before the quake -- I want to move back into a short position (consistent with my intermediate term bearishness). But, frankly, the timing of this move has never been more difficult. Buyers live higher and sellers live lower in this world in which we are now often trying to interpret market, sector and individual price patterns that are "artificial." When bears grow bullish, in part, on possibly faulty data -- we should all take a pause and reflect upon the possible downside and begin to cull out long positions which no longer have an attractive reward vis a vis risk. -* Kass Diary, When Bears Grow Bullish

Yesterday I made the case that 2018 will be **The Year Of Volatility** -- a transition period away from the stability of the last 3-4 years. As mentioned, the markets may suffer from memory issues again as we might be returning to a market without memory from day to day -- a possible preamble to more difficult investment times in 2019 and beyond: **With leveraged ETFs, volatility trending/targeting, risk parity and other momentum and risk-based strategies ruling the day**

-- I see more volatility and less predictability ahead. Adjust your portfolio's "value at risk," maintain larger than normal cash reserves (in order to take advantage of growing opportunities) and fasten your seat belts as 2018 appears to be The Year of Volatility. Recognize that price, in today's market landscape, is not necessarily "truth" and capitalize on the volatility (if it occurs) by:

- *Being emotionless in your trading*
- *Being opportunistic in your trading*
- *Trade around your core holdings, buy adding on weakness and lightening up on strength*

Above all, do your own homework (be skeptical of talking heads who may not be rigorous in approach and trying to sell you a service) and maintain a diligent view towards risk appetite and profile.

Bottom Line

> *"Ch-ch-ch-ch-changes (Turn and face the strange) Ch-ch-changes Don't want to be a richer one Ch-ch-ch-ch-changes (Turn and face the strange) Ch-ch-changes Just gonna have to be a different one Time may change me But I can't trace time"* - David Bowie, Changes

The market's complexion is notably changing as central bankers reverse the easing policies of the last decade. At the same time rosy 2018-2020 economic and corporate profit expectations - may prove to be too optimistic - as tax reform may continue to "trickle up" and not "trickle down." (Note: The Atlanta Fed's 1Q2018 GDP forecast has been recently cut to +2.6%, it was projected to be over +4% about 1 1/2 months ago) Let the disruptive influences of leveraged ETFs, risk parity and volatility targeting/trending work to your advantage. Trading opportunities will abound as stock prices, at times, will provide buying and selling/shorting moments. Volatility is likely in the process of replacing stability - a possible preamble to a widening trading range in 2018 and a more difficult investment backdrop in 2019 and beyond.