



- ***Market Back To Overbought***
- ***It Wasn't All That***
- ***Seen This Before***
- ***Sector & Market Analysis - Returns Next Week***
- ***401k Plan Manager***

Follow Us On: [Twitter](#), [Facebook](#), [Linked-In](#), [Sound Cloud](#), [Seeking Alpha](#)

As I noted in last week's missive, I am traveling this week on our annual family vacation. Unfortunately, tomorrow we return back to reality and will have to leave the sun, the beach and the fun behind for another year. I hadn't planned to write a newsletter this week, but after I looked to see how the market ended the week, I felt I needed to make a few comments. The full

newsletter will return next week.

Market Is Back To Very Overbought

As I [noted last week](#):

*"What happens in the middle of the week is of little consequence to us. **We are only truly interested in where the week ends.**•In that regard, the bulls remained stuck at the 'Magenot Line'•which continues to keep the majority of our models on hold for now."*

Despite a rough week for Facebook (\$FB), which was an outcome which should have been a surprise to no one, the market did manage to clear the "Magenot Line" last week which brings January highs into focus.



In the intermediate-term, the market is moving back to rather extreme overbought conditions. The

market can most assuredly get even more overbought from current levels, but does suggest that upside is becoming more limited from current levels. **However, with the weekly "buy signal" triggered this past week, we must give the bulls some room to run. With our portfolios nearly fully allocated, there are not a lot of actions we need to take currently as the markets continue to trend higher for now.** We will continue to monitor our exposure and hedge risk accordingly, but with the weekly "buy signal" registered, we are keeping our hedges limited and are widening our stops just a bit. **As noted above, a short-term correction is needed before adding further equity exposure to portfolios.** That correction likely started on Friday, and I will not be surprised to see it continue into next week. A retest of 2800 is likely at this point, which would keep Pathway #1 intact. However, a violation of that level will likely trigger a short-term sell signal, which could push the market back towards previous support at 2740.



There is a lot of support forming at 2740, which should be supportive of the market over the next couple of months. A violation of that level suggests something has likely broken and more protective actions should be taken. **However, until that happens, we will give the markets the benefit of the doubt for now.** I have updated the current projected paths as we think they will play out over the next couple of weeks.

- **Pathway #1:** remains intact currently and a rally next week should push the markets to the January highs and the top of the current bullish trend channel from the April lows.
- **Pathway #2a:** a pullback next week that violates 2800, as stated above, will likely test the bottom of the bullish trend channel. This would likely be enough of a short-term correction to re-energize the bulls to make a run towards the January highs.
- **Pathway #2b:** A break of the bullish trend channel will quickly find a lot of support at 2740 as stated above. However, such a break will bring more concern in the short-term about the bullish trajectory and will raise the specter of a continued trading range through the end of the year.
- **Pathway #3:** has been removed for now as a more bearish outcome is not currently a high possibility.

Currently, all indications currently suggest a test of all-time highs remains likely by the end of the year.•For now.

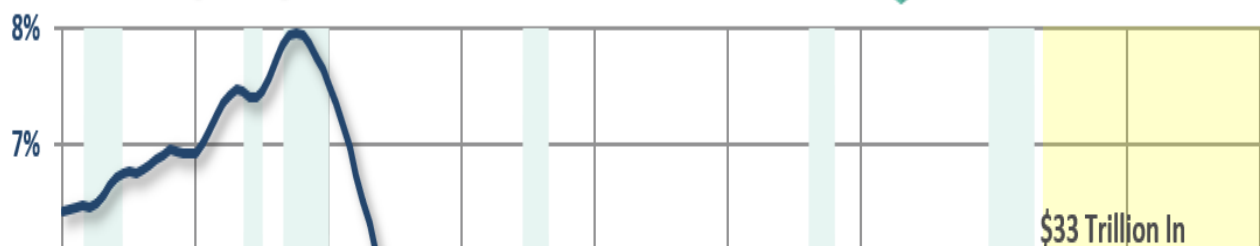
It Wasn't All That

I have a couple of thoughts on market drivers this past week:

1. **While the market popped on Thursday due to a perceived "trade deal" between Trump and Juncker, [there was no deal really](#).** There was a lot of hand shaking, back slapping and talk - but nothing of substance came from the meeting. **At best, the agreement set the tables with the EU back to where they were before Trump manufactured the whole trade/tariff issue to begin with.** So, I guess you can credit Trump for effectively solving the problem he created to start with, but not much more than that. Expect trade-related issues to return to the market sooner rather than later.
 - *We remain underweight industrials, materials, emerging and international markets.*•
2. **Amazon (\$AMZN) had a blow out quarter for earnings,** which was a good thing given the large contribution it has made to the markets advance this year. **However, while the earnings at the bottom line were fantastic it was due almost solely to a sub-3% tax rate** . Had it not been for the changes to the tax law last year, it is highly likely the shortfalls in revenue would have equated to a Facebook type plunge in the shares on Friday versus less than a 1% gain. There is no argument the behemoth has turned the corner profitability wise, however, the huge boost to bottom line earnings from a highly-reduced tax rate will fade in the coming quarters, and operating margins will again become an issue. At 286x trailing earnings and 90x projected earnings, which will likely prove to be to low, the risk of a deeper correction in the company outweighs the potential reward.
 - *We currently have no positions in \$AMZN*
3. **The 4.1% GDP number left MUCH to be desired.** While Trump was busy taking victory laps on Friday following the print, and making claims [we could see 8 or 9% in the future](#), the reality is very little actually changed economically speaking. As I [showed on Thursday](#), when I penciled in a 4% gain (*I was 0.1% short on my estimate*):

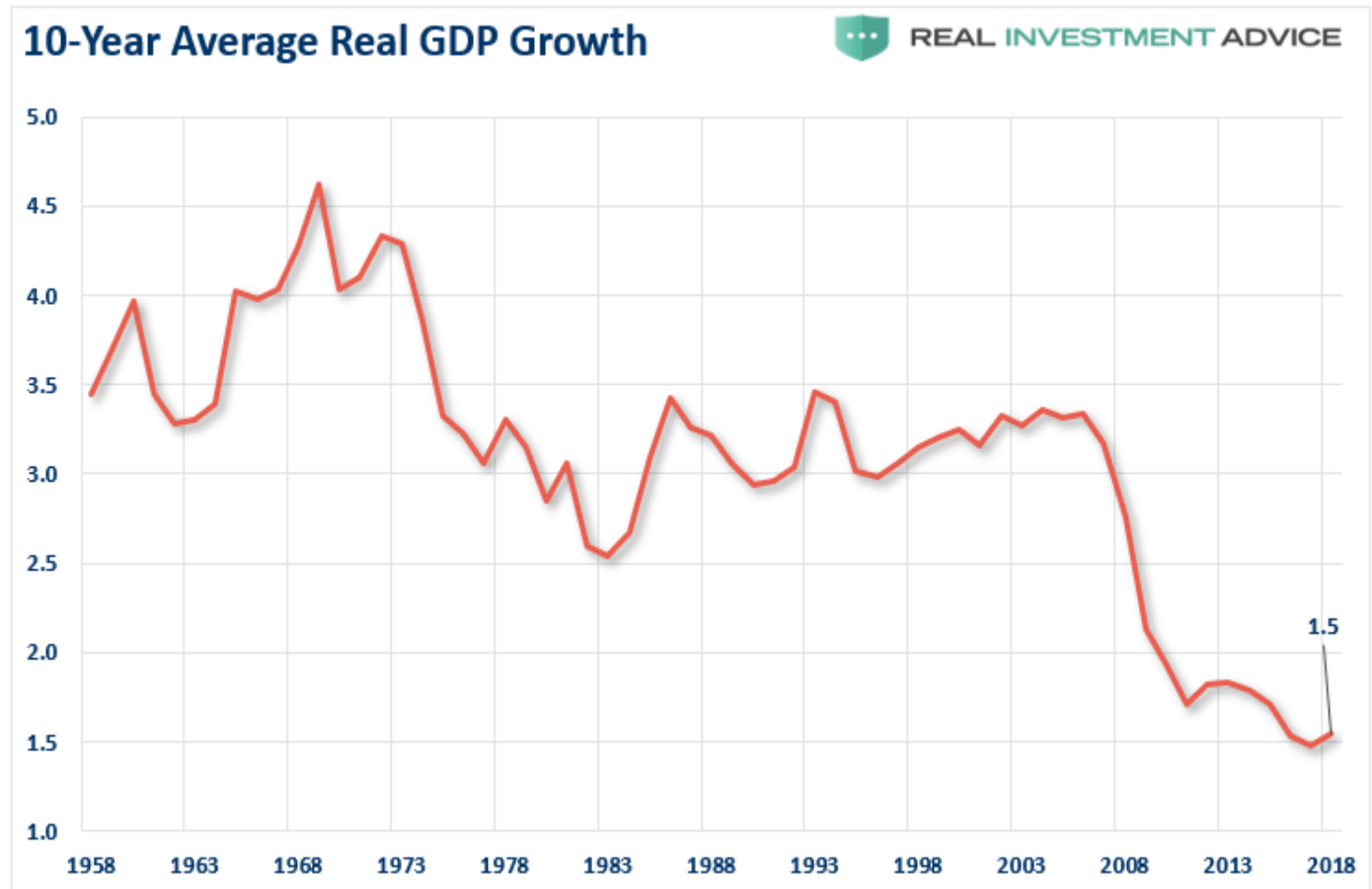
"Making similar adjustments for wages and productivity, we find the 5-year averages change very little. More importantly, current action is more typical of a late cycle expansion as opposed to the beginning of a new one."

Economic Prosperity Has Never Been So Poor



?An unusually large number of one-off factors appear to have boosted 2Q GDP, many of which are directly related to escalating trade concerns. As companies and countries race to secure supplies that may become expensive later on, exports have surged and inventories have swelled. If these trends are one-time adjustments (and our economists believe they are), the payback in 2H could be significant. Enjoy the 2Q GDP number, which may be the last best print for a while.?

But more importantly, despite the fact the BEA just revised the trailing GDP numbers **UP** by almost \$1 Trillion (going all the way back to 1967), Trump's hopes are just a bit more than outlandish when you consider the 10-year trailing average of real GDP just rang in at 1.5%.



While fighting trade wars, pushing tax cuts and increasing government spending may provide short-term boosts to the economy by pulling forward future consumption - they do not address the issues which are detracting from longer-term growth.

- Debt
- Spending Hikes
- Demographics
- Surging health care costs
- Structural employment shifts
- Technological innovations
- Globalization
- Financialization•

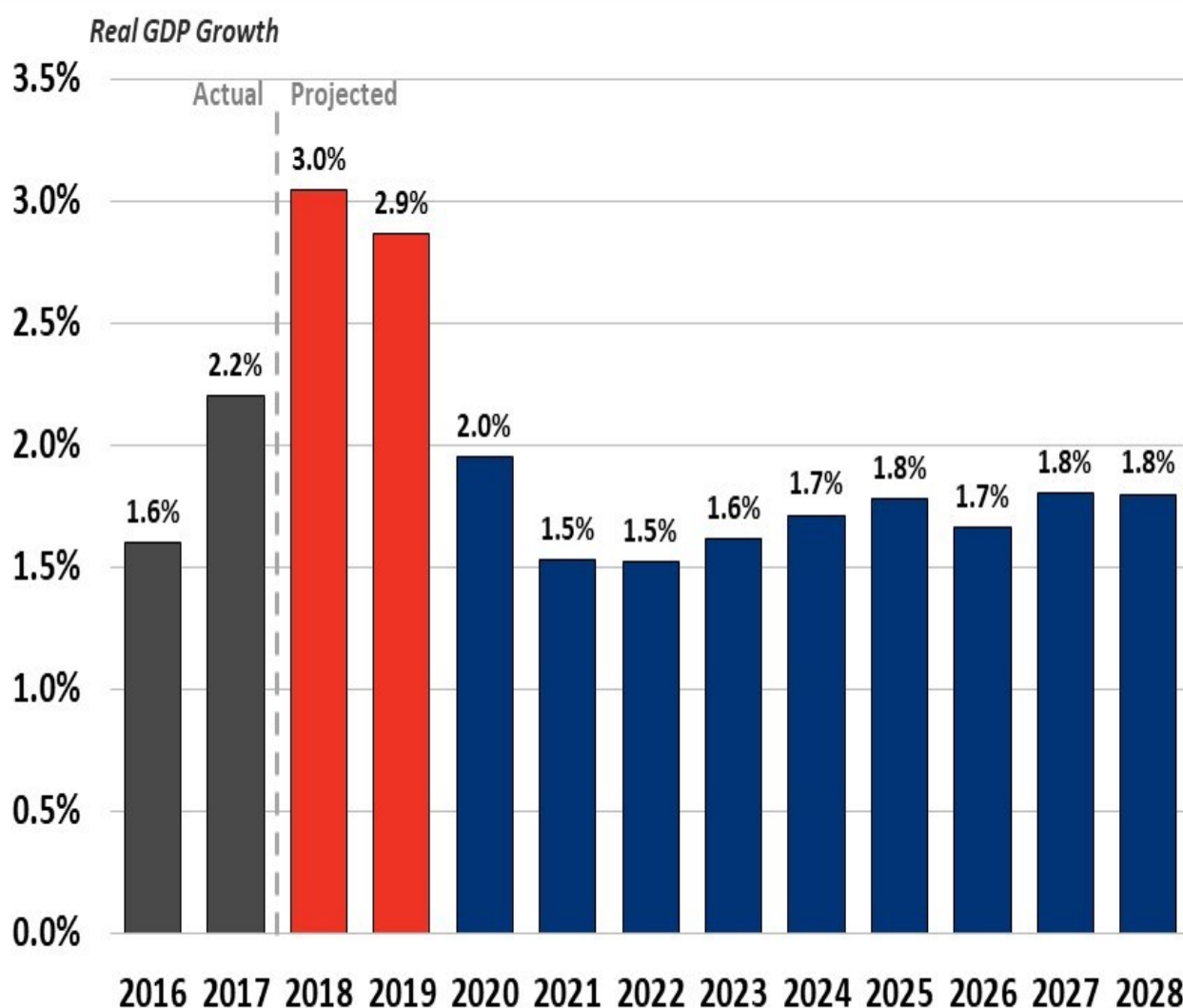
Our friends at the Committee for a Responsible Federal Budget concurred with our views on [Friday stating:](#)

*"Unfortunately, even 3 percent growth is unlikely to continue over the medium and long terms. An economy cannot operate above potential capacity indefinitely, as timing shifts and the sugar high fade. And potential GDP ? **which grows when people work more***

hours, new factories and machines and software are built, and society learns how to more efficiently produce goods and services ? is limited by an aging population. As we outlined in our paper *How Fast Can America Grow?*, population aging means lower labor force growth, less investment, and perhaps even less productivity. **As a result, nearly every forecaster projects a long-term growth rate of around 2 percent per year above inflation.** The Congressional Budget Office projects a rate of 1.8 percent.

(Note: there is no assumption by the CBO, or the BEA, for a recession in the next decade. This is highly unlikely to be the case and resultant GDP numbers will be disastrously worse than current projections.)

GDP Growth Projected to Slow



Sources: CBO, BEA



As I stated on Thursday:

"These factors (noted above) will continue to send the debt to GDP ratios to record levels. The debt, combined with these numerous challenges, will continue to weigh on

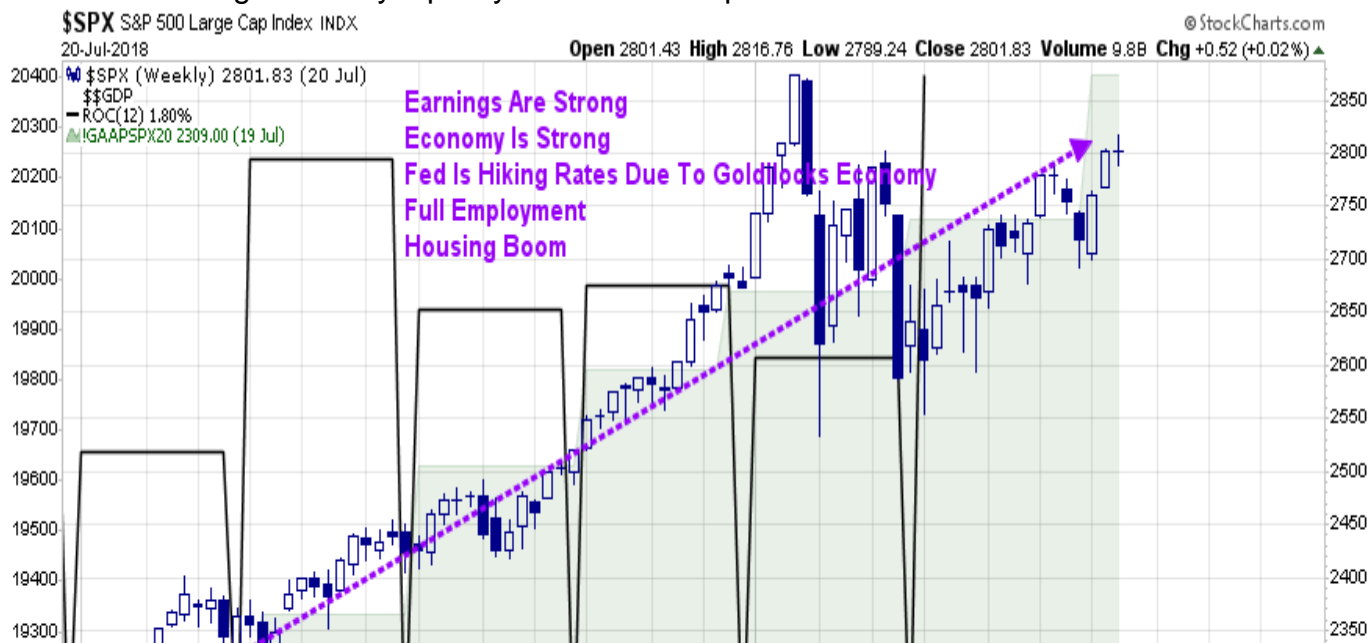
economic growth, wages and standards of living into the foreseeable future. So, while the economic report on Friday will be a "rosy" picture in the short-term, it is likely going to be the best print we see between now and the onset of the next recession."

Seen This Before

Last week, I compared charts from 2007-2008 to the 2017-present run-up. One of the biggest points being made currently for an uninterrupted bullish advance from current levels into the foreseeable future is that with earnings and economic growth strong, there is no reason for the party to end. I have added GDP and S&P 500 valuations to those charts from last week. In 2007, both economic growth and earnings were rising along with the market, which was not surprising given the bullish exuberance of market participants at the time along with a booming housing market, excess liquidity and rising oil prices. The Fed was hiking interest rates and the "Goldilocks economy" was set to continue indefinitely. **(There was no recession predicted at the time for the next decade according to the CBO/BEA)**



The current environment is much the same as it was in the first half of 2007. Rising earnings and GDP, no prediction of a recession anywhere (despite a falling yield curve) and the Fed is raising rates and reducing monetary liquidity without consequence.



As I noted last week:

"From an investment management standpoint, there is absolutely 'no doubt'•how this current evolutionary cycle in the market ends. We just don't know the "when," and becoming aggressively under-allocated to equity risk too soon not only impacts performance in the short-term but also subjects us, as portfolio managers, to career risk."

However, that is a game I must play as a portfolio manager...you don't. **This is particularly if you are within 3-5 years of retirement.**•Investing is not a game, or a competition, that YOU must win. **There is no prize for winning but a heavy toll that will be paid for losing.**•As Doug Kass noted last week:

"Investing is a complicated mosaic ? making decisions on only one or two factors often leads to a dangerous journey, particularly when valuations and stock prices are elevated, when a market's leadership seems to be narrowing and certainly with the recent emergence of a 'two-sided market' (from a formerly one-sided and bullish market) which often leads to a one -sided and bearish market. And, our investment world is more transparent and the transmission of news quicker and more universal than it has ever been. Communication is instantaneous and through a plethora of broadcasting and social media platforms, we are almost all armed with the same information about at the same time. It is how we interpret and analyze that information and our willingness to be open to changing data is what sets our opinion and investment performance apart. I worship not at the altar of price momentum but rather at the altar of security analysis and margin of safety. That process provides me with a relatively concise analysis of the relationship of reward and risk. At the core of my near-term concern are the deterioration (and worsening rate of change) in reward v. risk, the growing ambiguity of the trajectory of global economic growth, the pivot in monetary worldwide monetary policy, the likelihood of a steady move higher in short-term interest rates (and a higher risk free rate of return), evidence of a loss of any fiscal responsibility (on the part of Democrats and Republicans), expanding policy risks in part based on the behavior of our President, the possibility of a 'Blue Wave' in November and the evolution of a one-sided (long) market structure (and a rising role of FAANG stocks)."

While we remain long-biased in portfolios currently, Doug's view of the risk should not go unnoticed. **It is often thought that since we openly recognize and understand prevailing risks, which may or may not come to fruition, that such means we are bearish and sitting in cash. That is never the case.**•Without a thorough understanding of the prevalent risk, making an assumption of the possibilities and probabilities of a given market environment, and associated return and allocation assumptions, is impossible. **In other words, without understanding the risk, you are effectively "driving with a blindfold, hoping for a positive outcome."** Such is rarely the case over the longer-term. We prefer to drive with our eyes open, aware of our surroundings, and arrive safely at our destination. This is particularly the case when we have passengers (clients) riding along with us. While we are prudently aware of the risk, we are long equity and allowing the market to work for us. But we also have a strategy and investment discipline to deal with "accident" should one occur. Drive long enough, particularly blindfolded, and one will happen. **See you after next week.**

Market & Sector Analysis

S&P 500 Tear Sheet

Will Return Next Week

Performance Analysis

Will Return Next Week

ETF Model Relative Performance Analysis

Will Return Next Week

Sector & Market Analysis:

Will Return Next Week

Portfolio/Client Update:

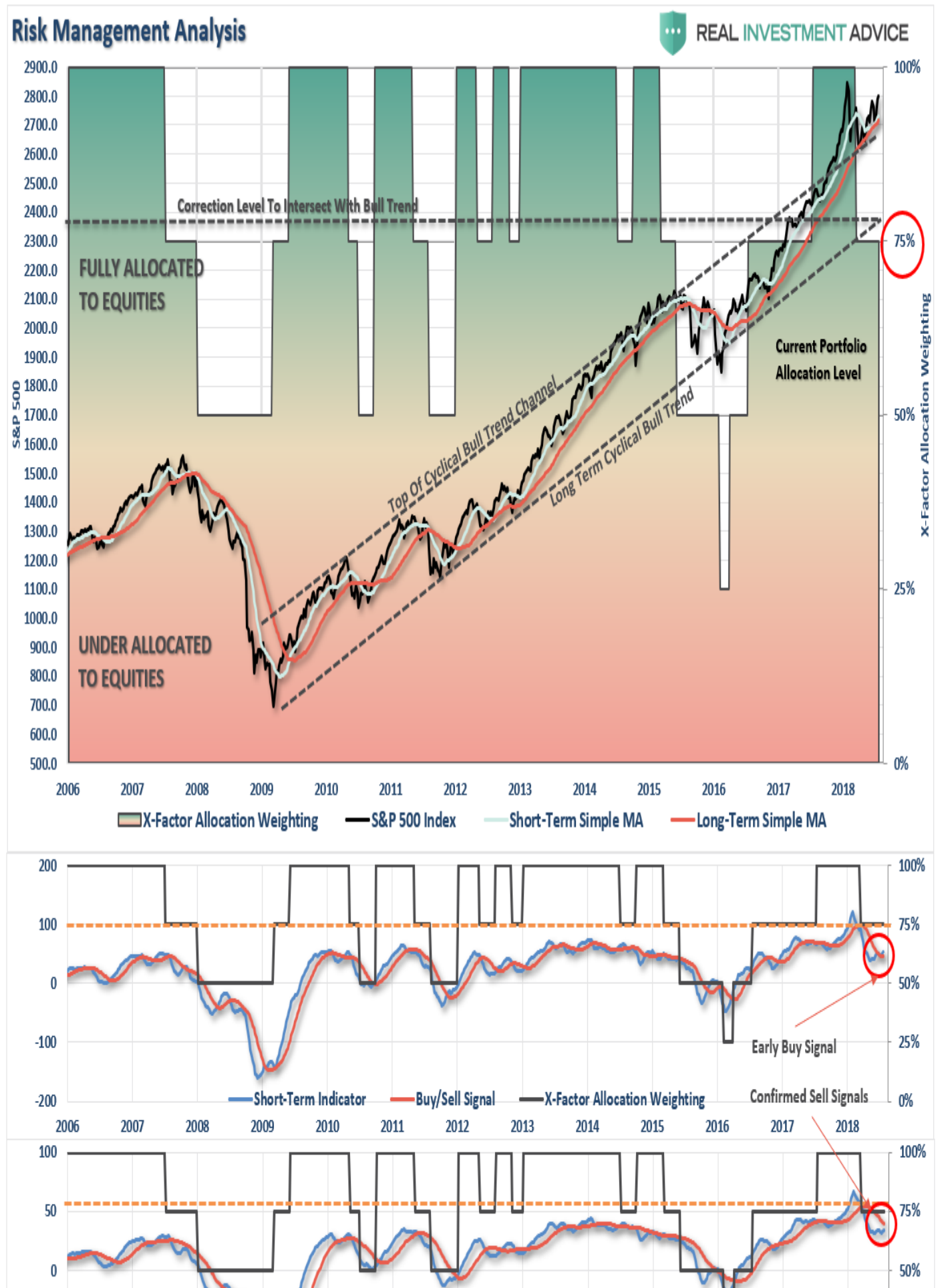
The improvement last week gave us the ability to add additional equity exposure to portfolios. With the break above the "Magenot Line"•this past week, we did increase equity exposure mildly. The cluster of support at the 50- and 100-dma remains in place, and we are currently evaluating market conditions for our next course of actions. While we are not raging long-term bulls, we do think that with earnings season in process the bias will be to the upside. There is a high probability of a substantive rally over the next couple of weeks, into which we could well find ourselves liquidating.

- **New clients:** We added 50% of target equity allocations for new clients.
- **Equity Model:** We previously added 50% of target allocations. We "dollar cost averaged" into those holdings opportunistically. •
- **Equity/ETF blended** models were brought closer to target allocations as we added to "core holdings."
- **Option-Wrapped Equity Model** were brought closer to target allocations and collars will be implemented.

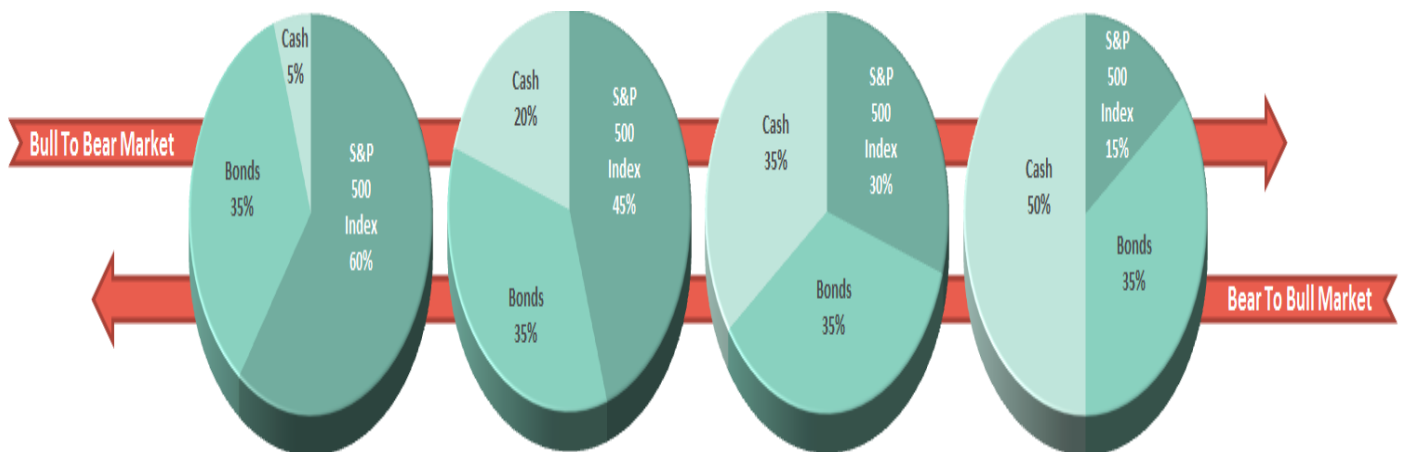
Again, we are moving cautiously, and opportunistically, as we continue to work toward minimizing risk as much as possible. While market action has improved on a short-term basis, we remain very aware of the long-term risks associated with rising rates, excessive valuations and extended cycles. **It is important to understand that when we add to our equity allocations, ALL purchases are initially "trades" that can, and will, be closed out quickly if they fail to work as anticipated.** This is why we "step" into positions initially. Once a "trade" begins to work as anticipated, it is then brought to the appropriate portfolio weight and becomes a long-term investment. **We will unwind these action either by reducing, selling, or hedging, if the market environment changes for the worse.**

THE REAL 401k PLAN MANAGER

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



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.



Wait For It

The market did trigger a weekly confirmed "buy" signal last week. However, by the times the signals occur the market has generally gotten either overbought or oversold in the short-term. As noted above, the market got extremely overbought last week and the correction on Friday will likely continue into next week. For now, remain cautious and continue to follow the rules below:

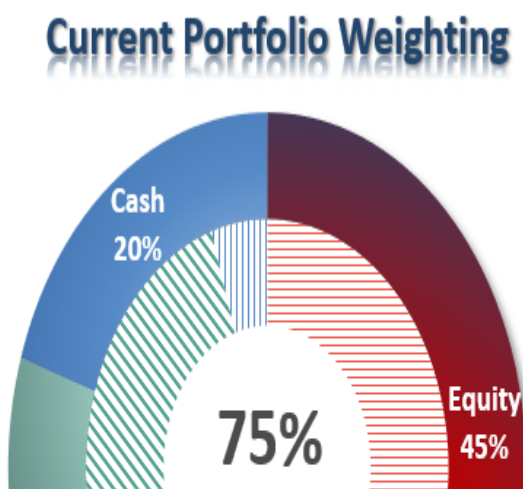
- If you are **overweight equities** - use any rally to reduce international and emerging market exposure.
- If you are **underweight equities** - look to rebalance to target allocations, as shown below, next week.
- If you are at **target equity allocations** currently, do nothing for now.

Next week, we will officially upgrade our allocation model back to 100% exposure given the market does not materially breakdown next week.

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. principle. 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 <i>Primary concern is the protection of investment capital</i> Examples: Stable Value, Money Market, Retirement Reserves
35.00%	Fixed Income (Bonds) <i>Bond Funds reflect the direction of interest rates</i> Examples: Short Duration, Total Return and Real Return Funds
45.00%	Equity (Stocks)

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
Fixed Income	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
	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
International			Fidelity Balanced Fund
	American Funds Capital World G&I		Fidelity Equity Income
	Vanguard Total International Index		Fidelity Growth & Income
	Blackrock Global Allocation Fund		American Funds Balanced
	Fidelity International Growth Fund		American Funds Income Fund
	Dodge & Cox International		ALL TARGET DATE FUNDS 2020 or Sooner
	Invesco International Core Equity		
	Goldman Sachs International Growth Opp.	Small/Mid Cap	Vanguard Mid Cap Growth
<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>			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