

Stocking Stuffer

(Short Market Update)

Real Investment Report

- ***The Santa Rally Left Much To Be Desired***

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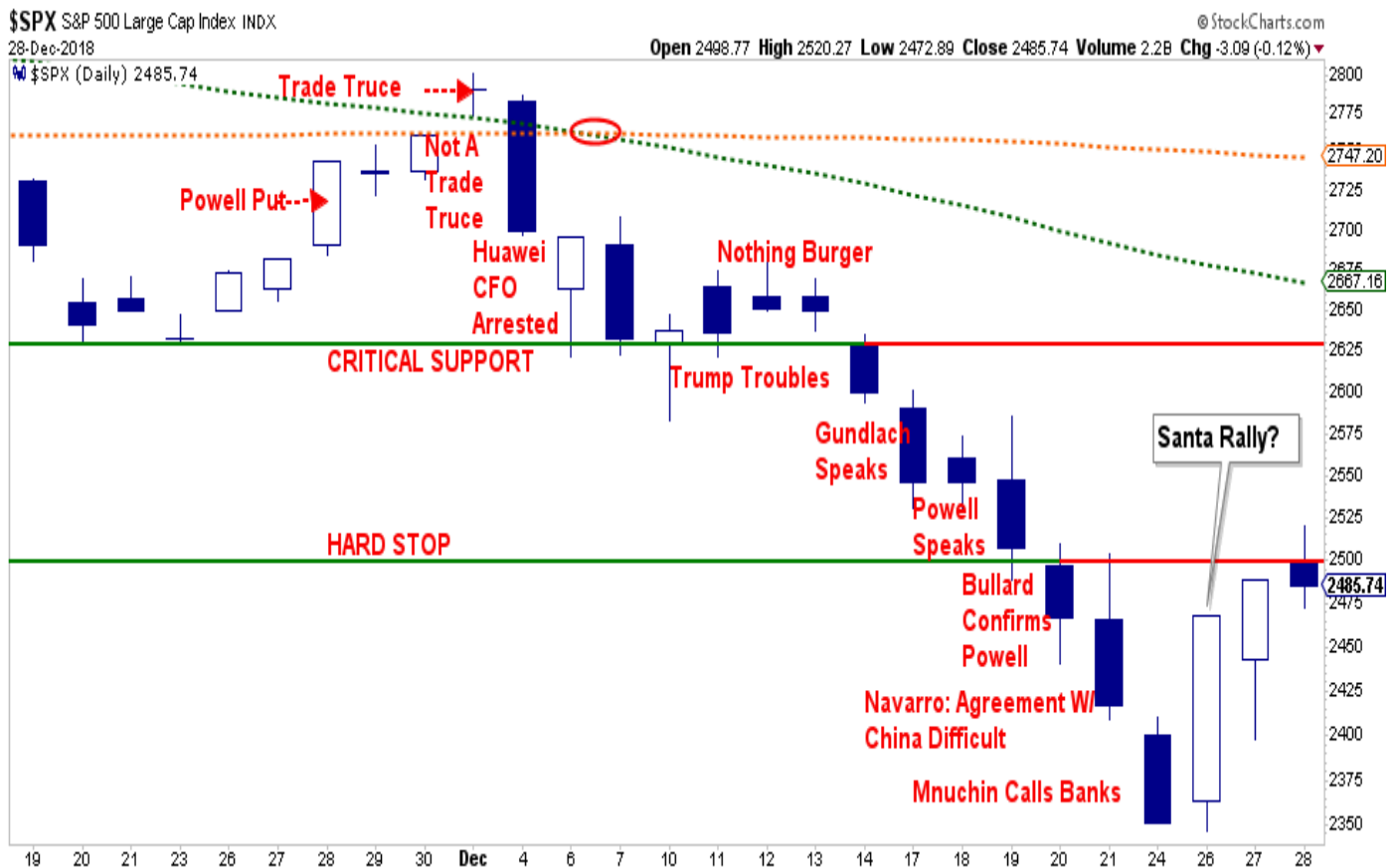
This is going to be just a short market update as I am traveling this week to Taos, New Mexico for a quick end of the year ski trip with my family. It is also a bit bittersweet, as this is the last year that all four of my kids will be together as my oldest leaves for Germany next summer. However, after such

a rough last couple of months, not to mention the worst December performance for the markets since 1939, I simply could not leave you "hanging" particularly as we head into the New Year. The full letter will return in the New Year. So, let's get to it.

The Santa Rally Left Much To Be Desired

Over the [last couple of weeks](#), I have been discussing the potential for an oversold bounce heading into the end of the year. (*Better known as a Santa Claus rally.*) As I wrote:

"Well, I was clearly wrong. After being good all year, all investors got last week was a 'big lump of coal.' The relief that was needed to allow the 'bulls' to take charge, at least temporarily, failed to materialize. This past week was one of the worst December performances on record."



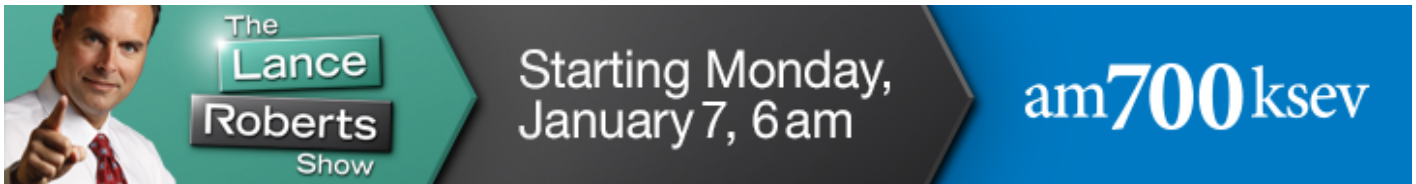
But as noted, the market did finally muster a bit of a rally last week. That's the good news. The not so good news is that it did little to reverse any of the real technical damage done to the market over the course of the month. **The rally this past week was simply an oversold, short-covering, bounce that left much to be desired in terms of commitment.** As I noted on Thursday:

*"Following the breakdown of the market from its consolidation pattern in October and November, the market plunged 20% from its previous all-time highs. Despite the massive surge in stocks yesterday, **all the market managed todo was recoup 2-days of losses.**"*



"From the previous peak in early December, the market has yet to even achieve a 38.2% retracement of that decline. It would not be surprising to see this rally try and recoup a full 61.8% of the decline over the next several weeks."

Interestingly, the market retraced exactly 38.2% of the previous decline and failed at important overhead support. With just one trading day of the month left, it is critically important the markets muster a rally, otherwise, **we are most likely looking at a retest of recent lows at a minimum, or new lows at the worst.** While I still expect a rally which could potentially reach 2650-2700, **the overall market environment remains negative which, for longer-term investors, continues to favor higher levels of cash and fixed income.**

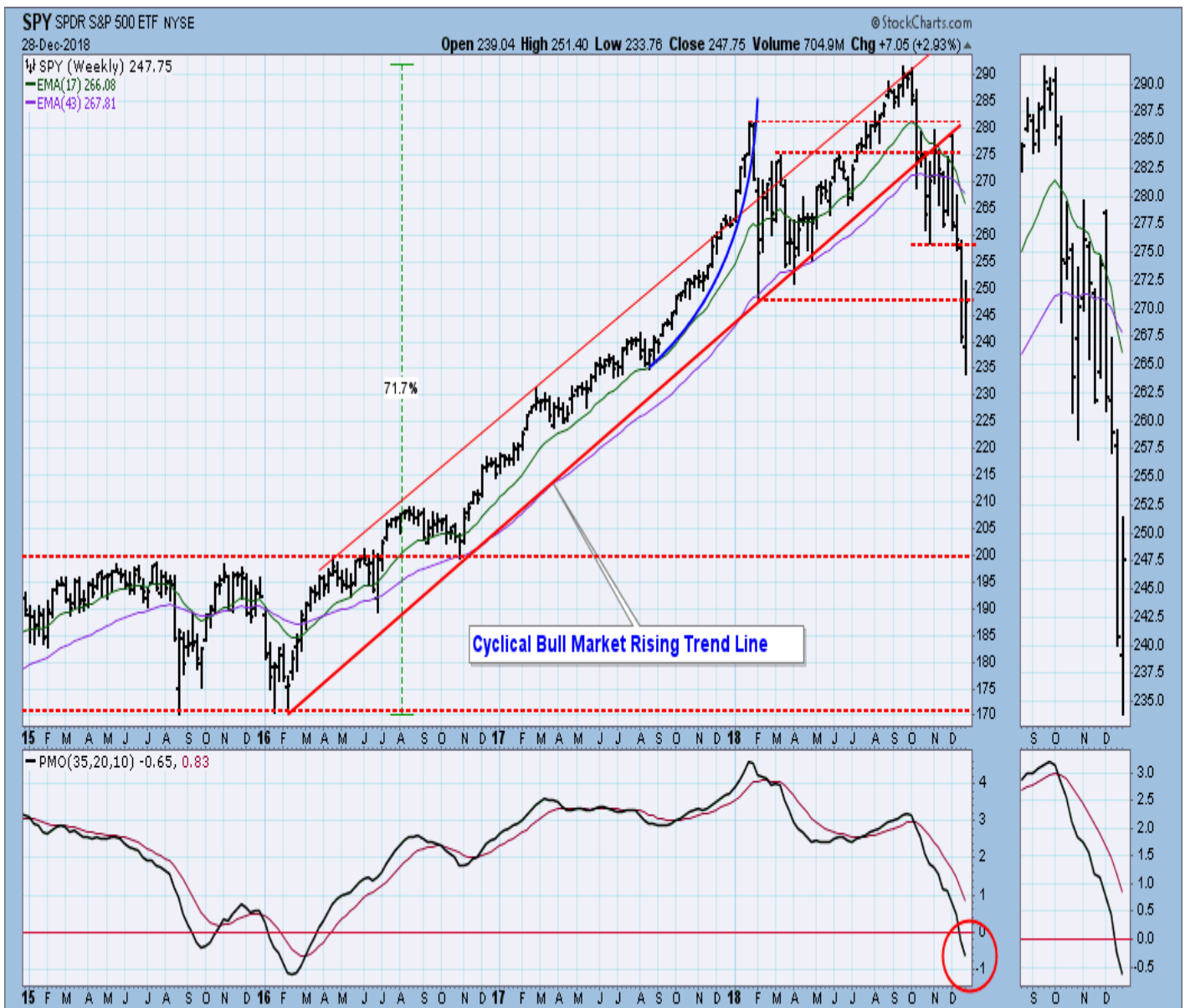


[Carl Swenlin of Decision Point](#) had a note out on Friday confirming much the same.

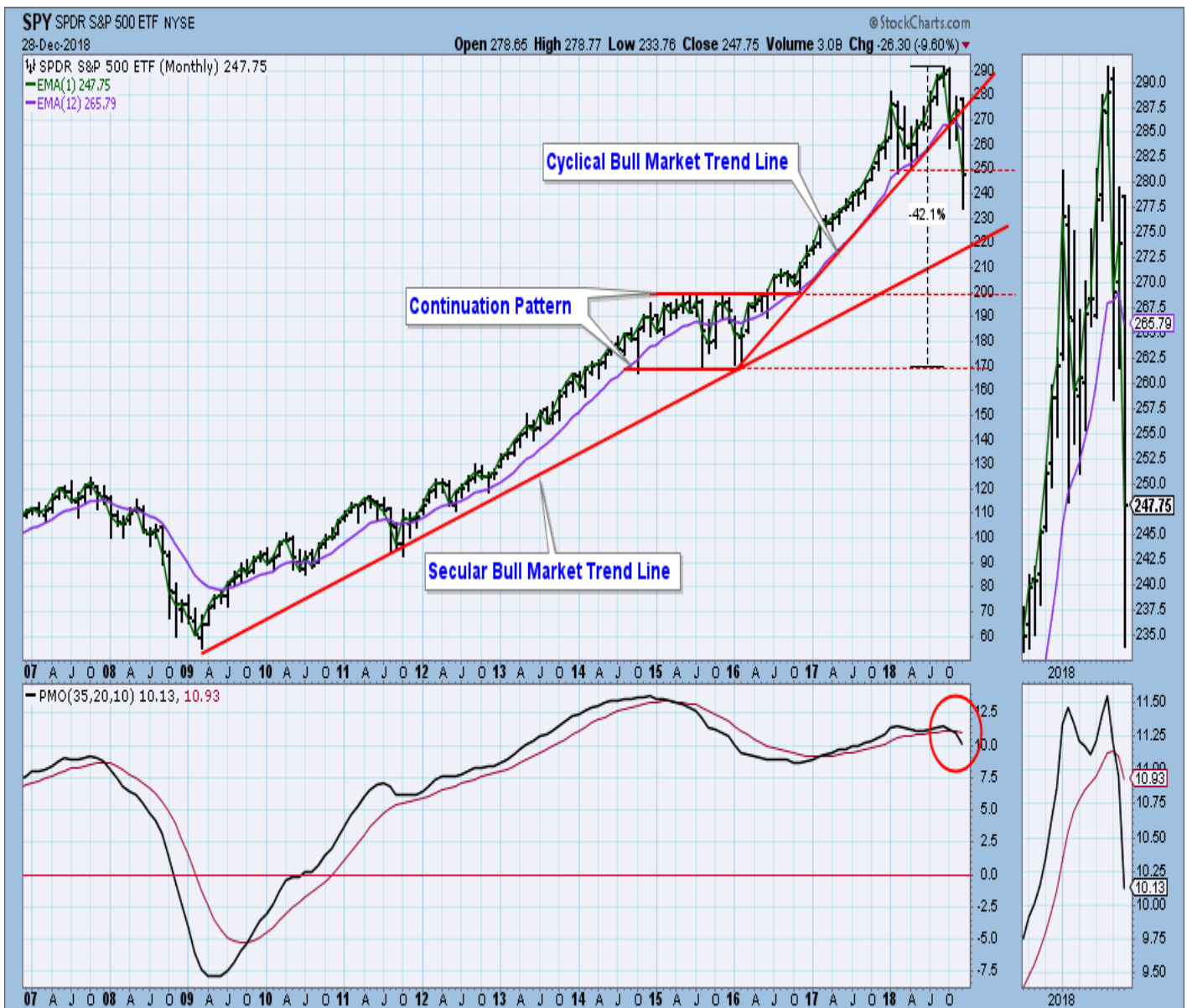
*"**SPY Daily Chart:** This week's advance was basically a short-covering rally. Things were really black on Monday, probably sucking in the last of the shorts. **While Wednesday's huge rally caught our attention, volume on that day wasn't as exciting.** Yes, it was above the 250-EMA of volume, it should have been a lot higher if the move truly was a turning point. The daily PMO has turned up, but just barely."*



"SPY Weekly Chart: The net gain for the week was just under +3%, and the weekly PMO was barely affected."



"SPY Monthly Chart: The line drawn across the February low represents the most immediate overhead resistance. The next important support is on the secular bull market rising trend line; however, I favor the top and bottom of the 2015 consolidation pattern as a more credible zone of support. **The monthly PMO is below the signal line and falling. This is very bearish."**



As I noted above, the markets are indeed very oversold on a short-term basis, and as Carl noted in his missive, we must be wary of oversold readings in a bear market as markets tend to remain oversold during protracted declines. **However, deeply oversold readings have a high probability of sparking a rally and currently, the S&P is currently displaying some of the lowest readings seen in almost three years.**



I agree with Carl's conclusion that we are most likely in a bear market. But that does not mean that you should sell everything you own. There is a simple reality about markets which is continually misunderstood by those of the *"persistently bullish"* persuasion. During bull markets, given the prices are *"trending"* higher over time, investors **should** have a general tendency to *"buy value"* on opportunity and hold those investments over the longer-term. However, in bear markets, where prices are *"trending"* lower over time, **investors need to adopt an attitude of selling into rallies, holding cash, and searching for truly undervalued opportunities.** Also, shorting becomes a much more viable strategy. During running bull markets, it is best to run a primarily long-biased portfolio. **However, as we move into 2019, we will look to start adding a "short book" to our "long-biased" portfolio strategies.** While we have been holding significantly higher levels of cash since earlier this year, and have been consistently buying bonds on moves above 3% on the 10-year Treasury, we are now looking for the next set of opportunities. Last Thursday, we did add 1/2 positions of a few equities we like (*MSFT*, *V*, *PFE*, *ABBV*) but have hedged that with a position in Gold Miners using *GDX* as a proxy. On a rally, back to our target zone, we will sell positions that have not been performing as well as expected, **and look to add additional hedges**

to portfolios as needed to protect long-term holdings.•While we have a long-term view of the market, and our holdings of high-quality enterprises, there are a couple of things investors must remember.

1. **Companies change.** *What was a great company 5-years ago, may not be so today. (GE)*
2. **Markets change.** *Bull markets are only one-half of the market cycle.•*
3. **Life changes.** *In 2000, you had 30-years to retirement. Today, you have eleven, which means riding out a bear market is not as feasible as it once was.•*
4. **Needs change.** *In 2000, the goal of your portfolio was accumulation. Today, kids are heading to college, the house note has to be met, and retirement needs are clearly in focus.••*

The point is that things are vastly different today than they were 5, 10, or 15 years ago **and both WHAT you need from your portfolio, and HOW you achieve those needs, have also changed.** Your portfolio strategy must change also over time. Yes, it is absolutely feasible to buy good quality companies, hold them, and ride the markets out over time. You will make money. You just won't meet your financial goals due to the destruction of both capital and time during the second half of every market cycle. ([Read this](#)) **The market cycle does appear to have changed.** Therefore, portfolio strategies also need to adjust for a different environment until this part of the cycle completes. However, that is a conversation for next year. In the mean time, we wish you a happy, safe, and prosperous New Year.