- ***Market Review & Update***
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Market Review & Update

As we discussed last Saturday it was important for the markets to hold within to consolidation band, or break out to the upside, if the bulls were going to maintain control of prices in the short-term. The return of *"Tariff Man"* put the markets back on edge.•

As I noted then:

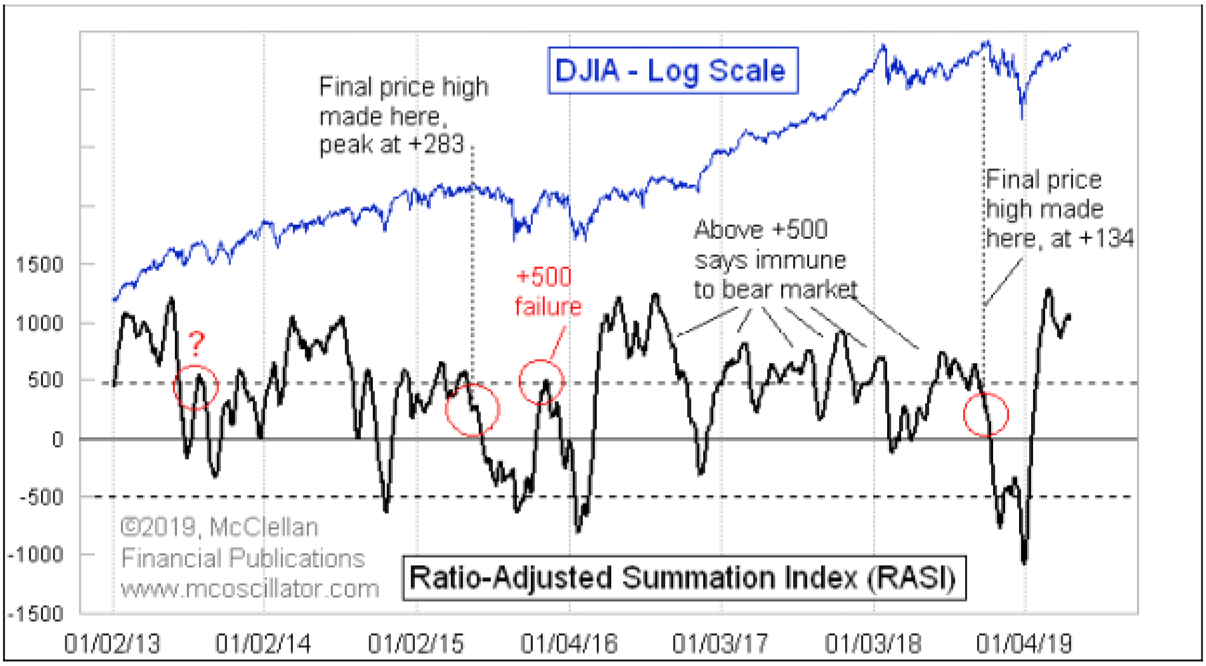
> ***"The market's stellar run is set for a breather over the next couple of months. Specifically, as we approach the end of the seasonally strong period, the odds of a 'reset' rise markedly."***

I also discussed our portfolio actions with respect to our clients:

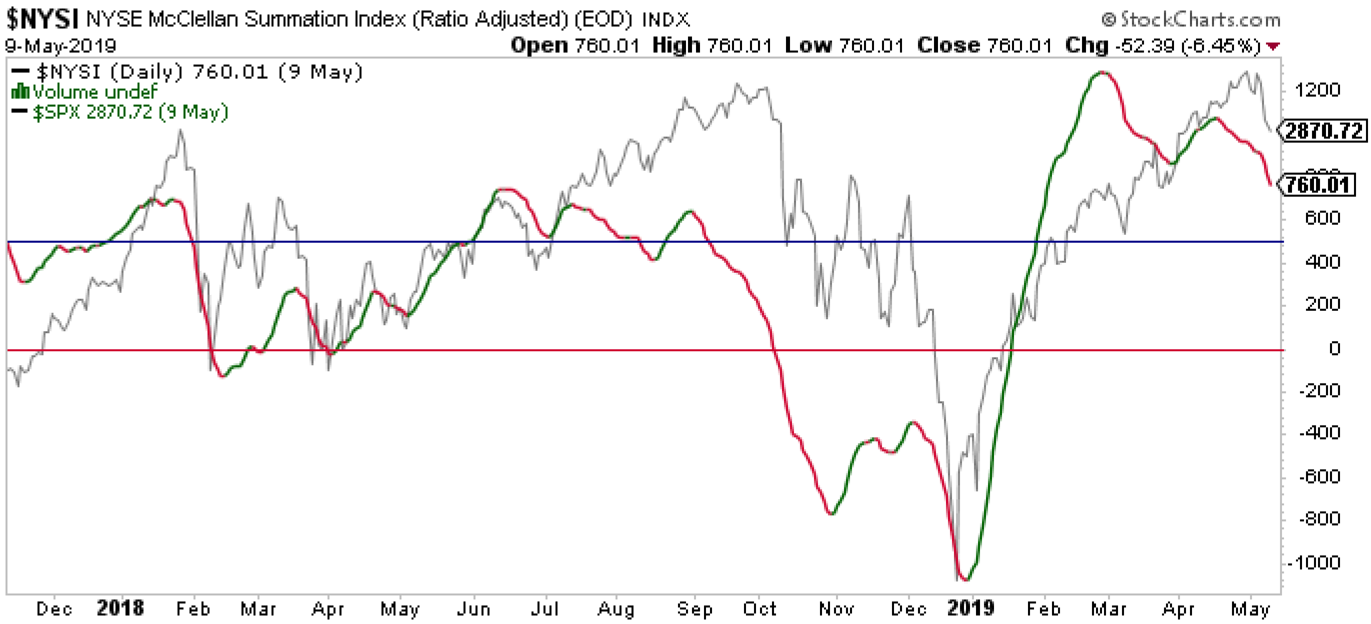
> *"This brings me to what we did with our equity portfolios last Tuesday and subsequently reported to our RIA PRO subscribers on Wednesday morning.* ***(Try NOW and get 30-days FREE)***
>
> ***"A common theme through today?s report is 'Profit Taking.'*** *Over the last couple of weeks, we have continued to discuss taking profits and rebalancing risks. Yesterday we sold 10% of our many of holdings prior to earnings to capture some profits. We also added to some of our Healthcare holdings which have been under undue pressure and represent value in a market that has little value currently."*
>
> ***Yes, markets are hovering near all-time highs, and everything certainly seems to be firing on all cylinders. However, such is ALWAYS the case before a correction begins. Such is the nature of markets."***

Currently, the bulls do remain in charge, and as investors, we must *"pay homage at the alter of momentum"* for now. This aligns with a note my Canadian research department sent me from Tom McClellan last week:

> *"We are now 4-months into the rebound off of the Dec. 24, 2018 low, so it is a natural question to wonder if the uptrend is going to continue, or whether, instead the major averages are going to stop here at the level of the prior highs.• This week?s chart offers us some useful clues about which answer applies this time.*
>
> *Here is the shortcut version:* ***Gobs of breadth is a good thing****." - Tom McClellan, April 25th.*



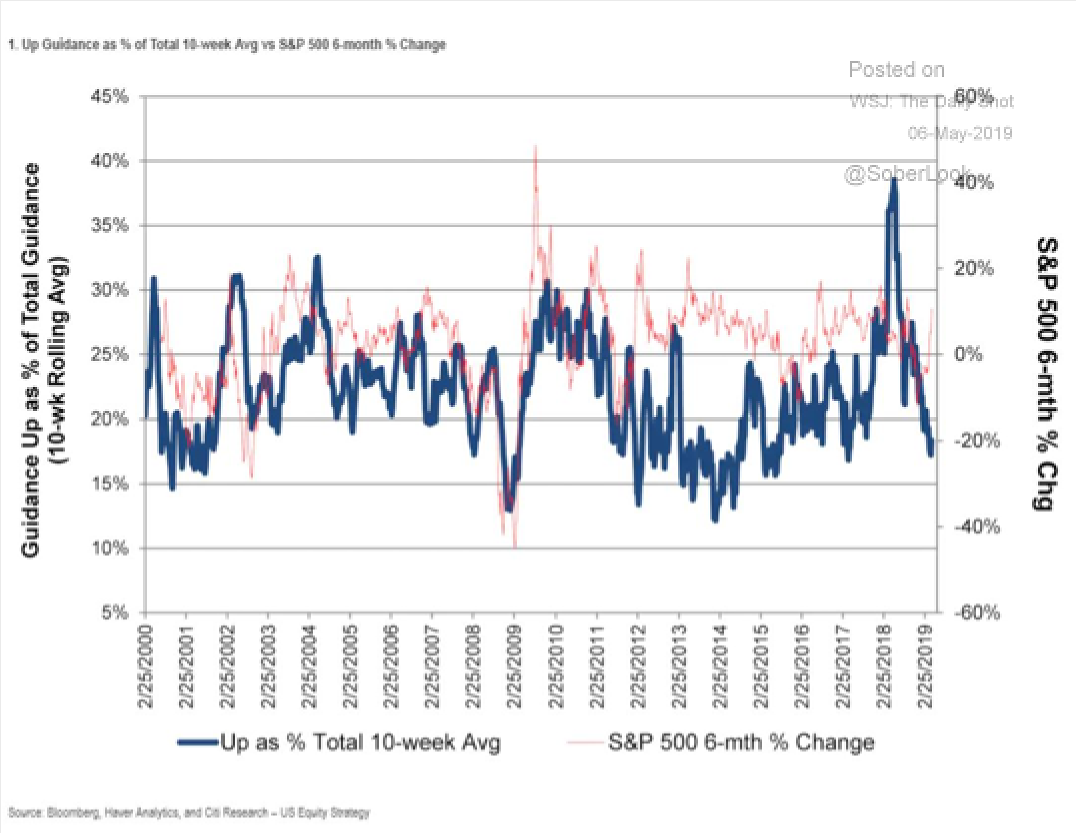
We agree, which is why we still maintain a long-bias towards equity risk. But, that exposure is hedged with cash and bonds which remain at elevated levels. As shown below, The summation index has turned lower which typically precedes correction periods in the market. **This doesn't mean the markets will "crash," but does suggest downward pressure on asset prices in the near term. *(It also doesn't mean stocks won't bounce while working their way lower either.)***



***"Momentum"* driven markets are *"fickle beasts"* and will turn on you when you least expect it.•**

In Tuesday's technical update, I noted the fundamental underpinnings continue to erode which is consistently reducing the support for asset prices at current levels. [To wit:]

> *"Not only are earnings on the decline, but so is forward guidance by corporations."*

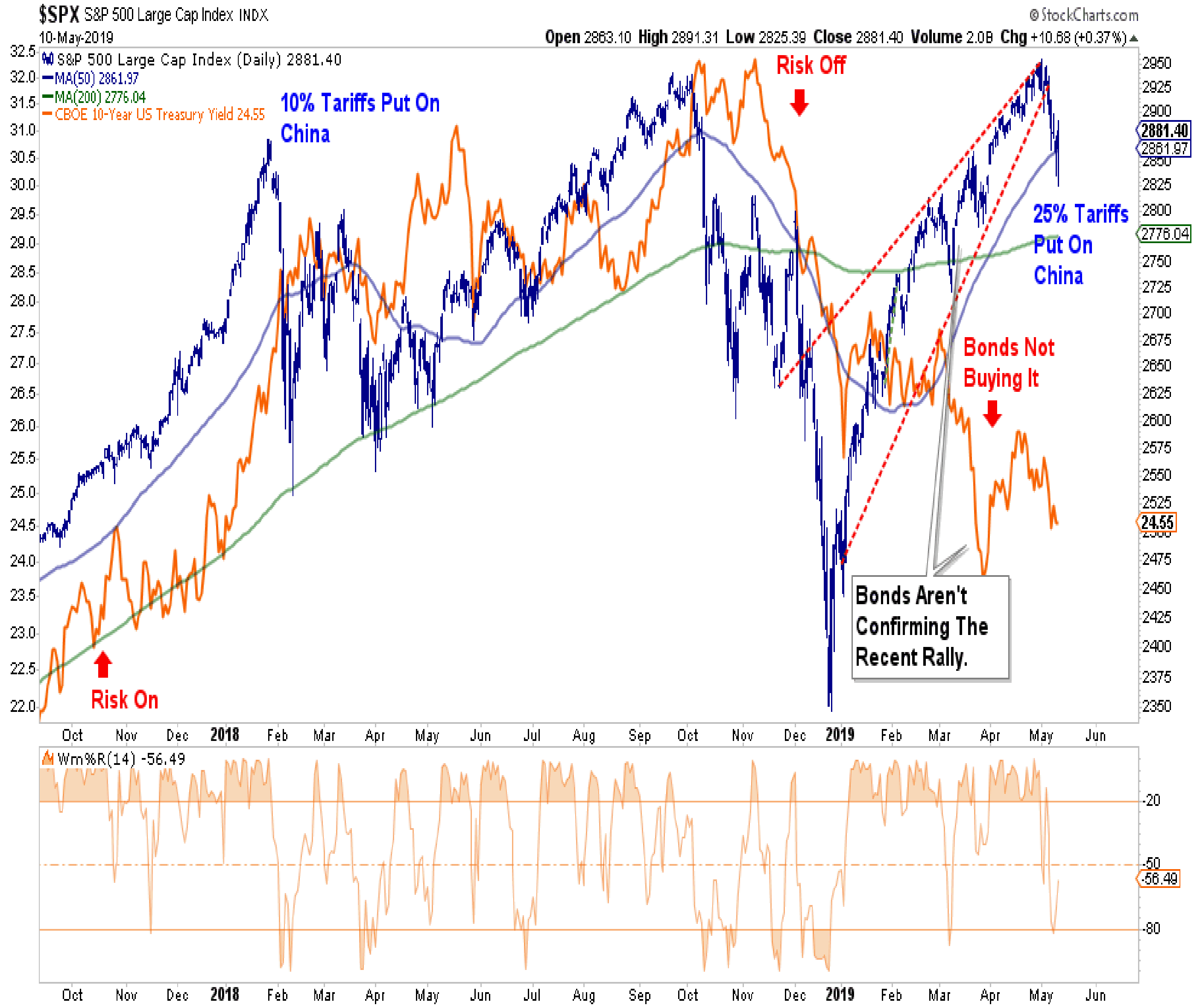


As we will discuss momentarily in more depth, the *"Trade War"* is not a good thing for markets or the economy as recently suggested by the President.•David Rosenberg had an interesting point on this as well on Friday:

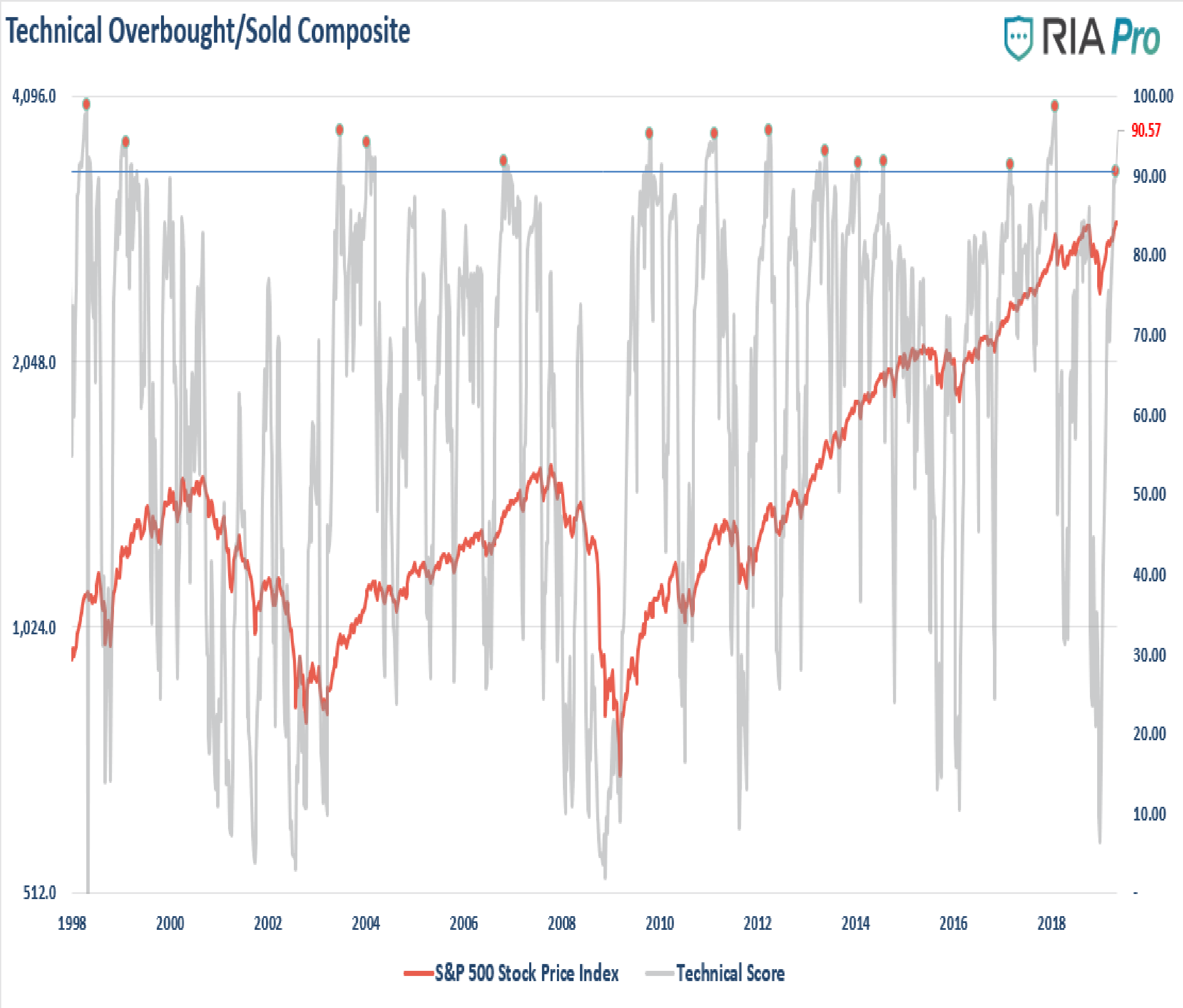
> *"Tracing through the GDP hit from a tariff war on EPS growth and P/E multiple compressions from heightened uncertainty, the downside impact on the S&P 500 would come to 10%. I chuckle when I hear economists say that the impact is small-meanwhile, global trade volumes have contracted 1.1% over the year to February...how is that bullish news exactly?"*•

Remember, at the beginning of 2018, with *"tax cuts"* just passed, and earnings growing, the market was set back by 5% as an initial tariff of 10% was put into place. **Fast forward to today, you have tariffs going to 25%, with no supportive legislation in place, earnings growth and revenue weakening along with slower economic growth.•**

In the meantime, the bond market is screaming *"deflation,"* and yields have clearly not been buying the 3-point multiple expansion from the December 24th lows.•



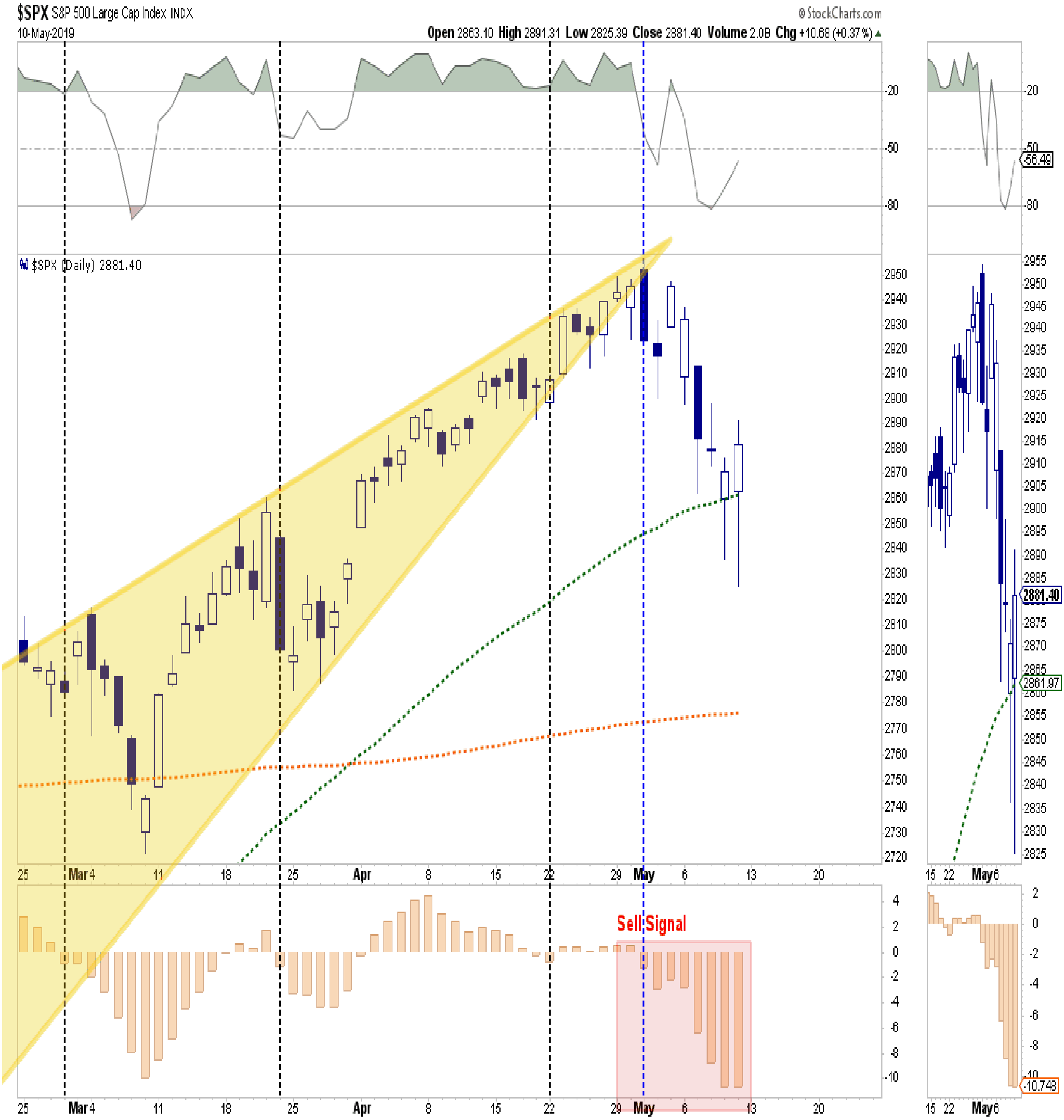
Lastly, stock market positioning was excessively bullish with record long stock exposure combined with record shorts on the volatility index and our technical composite index back near record levels *(shown below).*•



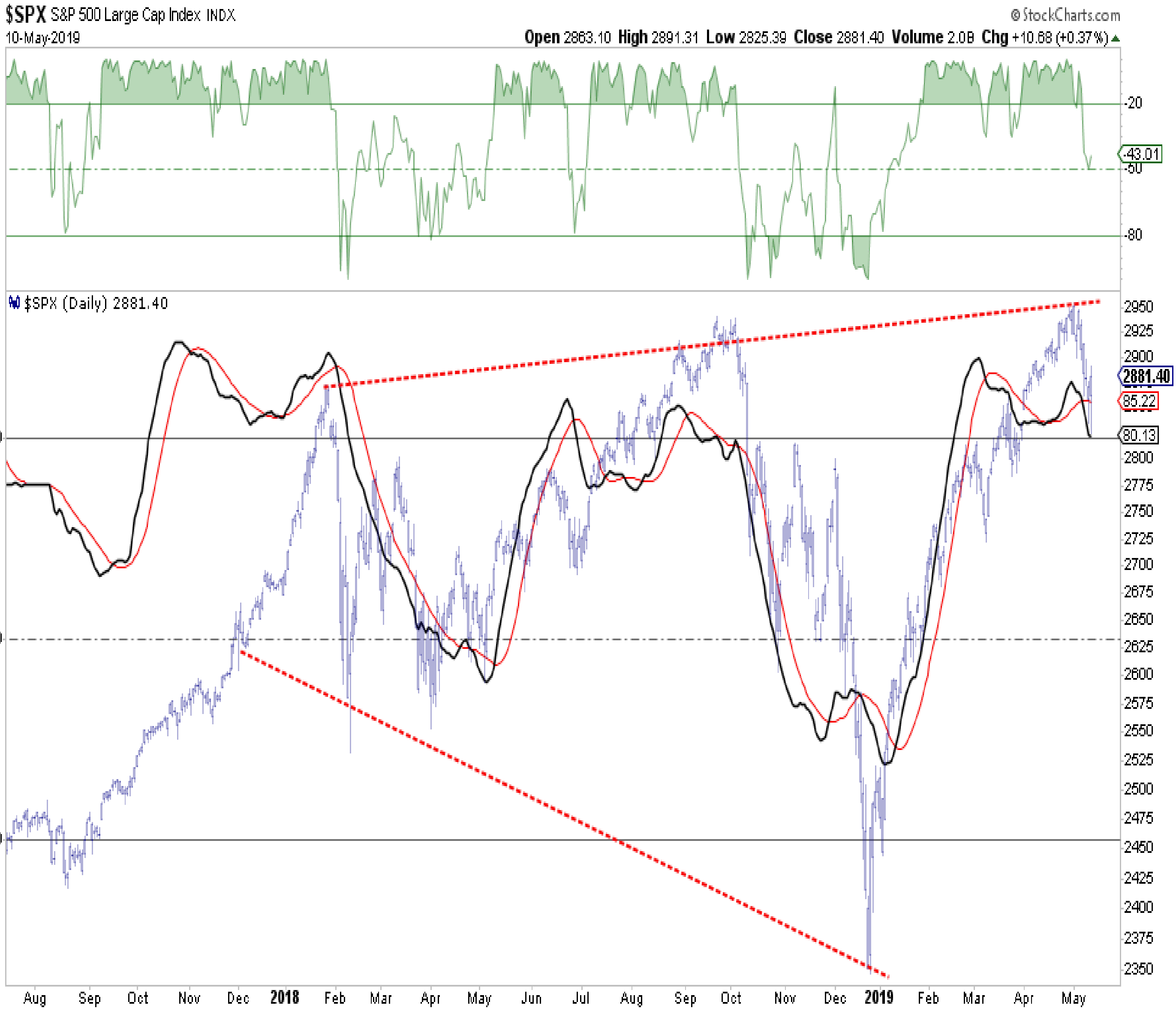
The table was set for a decent correction; all that was needed was the right catalyst.

> *"Since it is ALWAYS and unexpected event which causes sharp declines in asset prices, this is why advisors typically tell their clients***?since you can?t predict it, all you can do is just ride it out.?**•
>
> *This is not only lazy, but ultimately leads to the unnecessary destruction of capital and the investors time horizon."*
>
> ***(If you missed that article, it contained our [Portfolio Management Guidelines](#))***

On a short-term basis, as shown below, the market is very oversold, so the bounce on Friday was expected *(which is why we* ***took on a trading position in 2x S&P 500 in our equity trading account****.)* However, we plan to use any rally next week to rebalance risk into as we head into summer.•



Most importantly, the failure of the market to confirm new highs now puts adds additional resistance and confirms the current topping process continues.•



The *"megaphone"* pattern which has continued to build over the last 18-months suggests a deeper correction is likely during the coming months. As I addressed on Tuesday:

> *With the market pushing overbought, extended, and bullish extremes, a correction to resolve this condition is quite likely. The only question is the cause, depth, and duration of that corrective process. Again, this is why we discussed taking profits and rebalancing risk in our portfolios last week.*
>
> *I am not suggesting you do anything, it is just something to consider when the media tells you to ignore history and suggests 'this time may be different.'*
>
> ***That is usually just about the time when it isn?t.***

Game Of Thrones

Just as Jon Snow faced the *"White Walkers'"* in the battle to save civilization, Trump has squared off with China again over trade.•

Most of the comments I have read about the ongoing *"trade deal"* negotiations are, in my opinion, wrong. The general belief is that China *"wants*" a deal with the U.S. and Trump has the upper hand in this matter. To wit a recent comment by Kevin Giddis via Raymond James:

> *"It doesn?t help when the Chinese reportedly backed away from issues important to the U.S. just days before they are set to meet to negotiate a deal. Could this be as simple as a 'clash of culture,'* ***or the way each side has postured themselves to get a deal done?"***

I believe this to be incorrect and I laid out my reasoning Tuesday in *"Trade War In May, Go Away:"*

> *"The problem, is that China knows time is short for the President and subsequently there is 'no rush' to conclude a 'trade deal' for several reasons:*
>
> 1. ***China is playing a very long game****. Short-term economic pain can be met with ever-increasing levels of government stimulus. The U.S. has no such mechanism currently, but explains why both Trump and Vice-President Pence have been suggesting the Fed restarts QE and cuts rates by 1%.*
> 2. ***The pressure is on the Trump Administration to conclude a ?deal,? not on China.*** *Trump needs a deal done before the 2020 election cycle AND he needs the markets and economy to be strong. If the markets and economy weaken because of tariffs, which are a tax on domestic consumers and corporate profits, as they did in 2018, the risk off electoral losses rise. China knows this and are willing to ?wait it out? to get a better deal.*
> 3. ***As I have stated before, China is not going to jeopardize its 50 to 100-year economic growth plan on a current President who will be out of office within the next 5-years at most.*** *It is unlikely, the next President will take the same hard-line approach on China that President Trump has, so agreeing to something that is unlikely to be supported in the future is unlikely. It is also why many parts of the trade deal already negotiated don?t take effect until after Trump is out of office when those agreements are unlikely to be enforced.•*
>
> *Even with that said, the markets rallied from the opening lows on Monday in 'hopes' that this is just part of Trump?s 'Art of the Deal' and China will quickly acquiesce to demands.* ***I wouldn?t be so sure that is case."***

Doug Kass agreed with my views yesterday:

> *"I****t was never likely that tariff pressures were ever going to force China to succumb and altar deep rooted policy and the country's 'evolution' and planned economic growth strategies.***

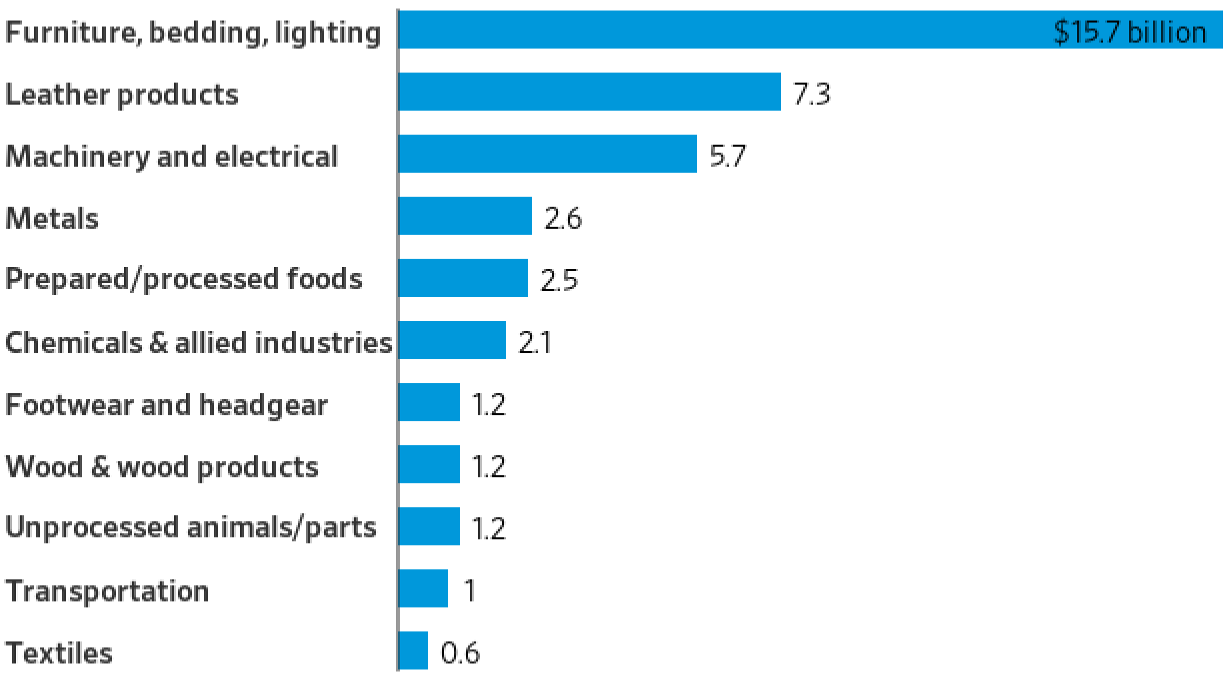
> *Trump's approach failed to comprehend the magnitude of the tough structural issues (that were never going to be resolved with China) and, instead, leaned on a focus of the bilateral trade deficit.* ***Technology transfer, state-sponsored industrial policy, cyber issues and intellectual property theft were likely never on the table of serious negotiation from China's standpoint and despite Trump's protestations that discussions were going well.***
>
> *As I have suggested for months, the unilateral imposition of tariffs will cause more economic disruption than the Administration recognizes (in our flat and interconnected economic world):*
>
> - *China's role in world trade is important - the country is the third largest exporter in the world.*
> - *Specifically, China is a prime source of cheap, imported goods for American consumers.*
> - *China is the largest owner of U.S. debt.*
>
> *Last night at a political rally in the Panhandle of Florida the president said that* ***"we don't have to do business" with China. That statement is short-sighted.***

I agree particularly with the last point. **There is little evidence that U.S. consumers have the *"willpower"* to either forgo purchases or be willing to pay substantially higher prices.•**

Pocketbook Issue

Many Chinese-made consumer goods are among the imports targeted for tariff increases on Friday. In 2017, the U.S. imported $42 billion of those products.

Consumer goods imported from China, 2017



Note: Figures may not add up to total due to rounding.
Source: Peterson Institute for International Economics

Trump was also misguided on Friday when he tweeted:

> *The process has begun to place additional Tariffs at 25% on the remaining 325 Billion Dollars. The U.S. only sells China approximately 100 Billion Dollars of goods & products, a very big imbalance. With the over 100 Billion Dollars in Tariffs that we take in,* ***we will buy agricultural products from our Great Farmers, in larger amounts than China ever did, and ship it to poor & starving countries in the form of humanitarian assistance.*** *In the meantime, we will continue to negotiate with China in the hopes that they do not again try to redo deal!*
>
> ***Tariffs will bring in FAR MORE wealth to our country than even a phenomenal deal of the traditional kind.*** *Also, much easier & quicker to do. Our Farmers will do better, faster, and starving nations can now be helped. Waivers on some products will be granted, or go to new source! If we bought 15 Billion Dollars of Agriculture from our Farmers, far more than China buys now, we would have more than 85 Billion Dollars left over for new Infrastructure, Healthcare, or anything else. China would greatly slow down, and we would automatically speed up! ? Donald J. Trump,* [May 10, 2019]

The economy is not built on *"goodwill."* •Let's examine his comment.

- ***We tax China more,*** *which means their consumption of U.S. products will decline as they seek cheaper sources elsewhere and in turn U.S. exports fall which comprises more than 40% of U.S. profits.*
- ***U.S. buys products from farmers and gives it poor countries.*** *While a great idea from a humanitarian standpoint, and does stabilize farmers short-term, it again has a negative impact on exports and corporate profits from other sectors of the economy.*
- ***Trade is a zero-sum game.*** *There is only a finite amount of supply of products and services in the world. If the cost of U.S. products and services is too high, China sources demand out to other countries which drain the supply available for U.S. consumers. As imbalances shift, prices rise, increasing costs to U.S. consumers.•*

As noted, tariffs impact domestic consumers more than then impact to China. If tariffs impact China they stimulate their economy with massive credit injections just as we have seen them do recently. **The U.S. doesn't have that luxury currently which is why both President Trump and Vice-President Mike Pence have discussed the need to drop rates by 1% now while the economy is still expanding.** To wit:

Donald J. Trump @realDonaldTrump

China is adding great stimulus to its economy while at the same time keeping interest rates low. Our Federal Reserve has incessantly lifted interest rates, even though inflation is very low, and instituted a very big dose of quantitative tightening. We have the potential to go...

54.8K 12:56 PM - Apr 30, 2019

18.2K people are talking about this

Donald J. Trump @realDonaldTrump

....up like a rocket if we did some lowering of rates, like one point, and some quantitative easing. Yes, we are doing very well at 3.2% GDP, but with our wonderfully low inflation, we could be setting major records &, at the same time, make our National Debt start to look small!

61.2K 1:05 PM - Apr 30, 2019

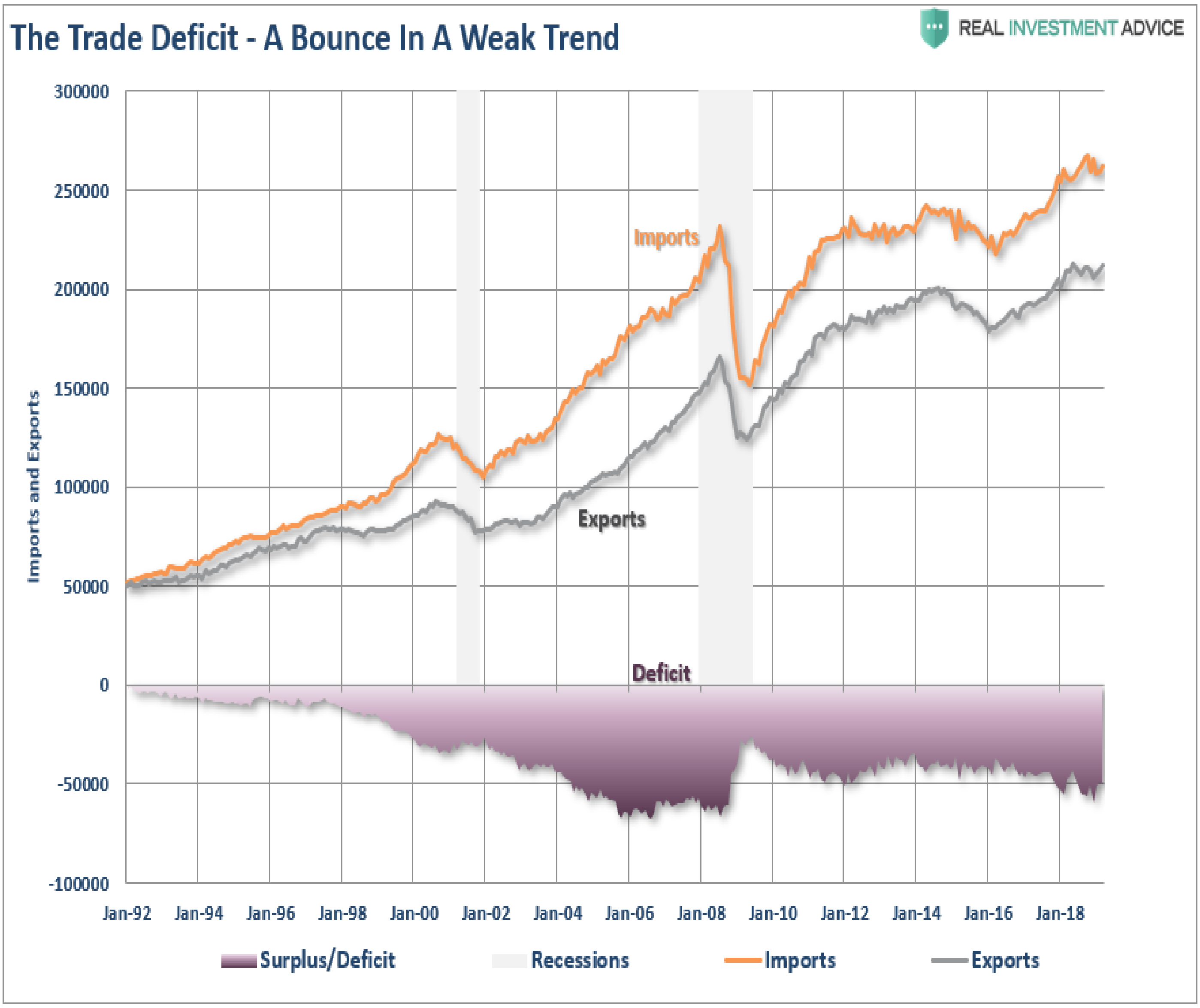
21.8K people are talking about this

This is also extremely short-sighted and dangerous.•

Yes, it would have the effect of lifting markets higher temporarily, but would only ensure that the next recession and coinciding market crash would be larger with no *"policy tools"* available to offset the slide.•

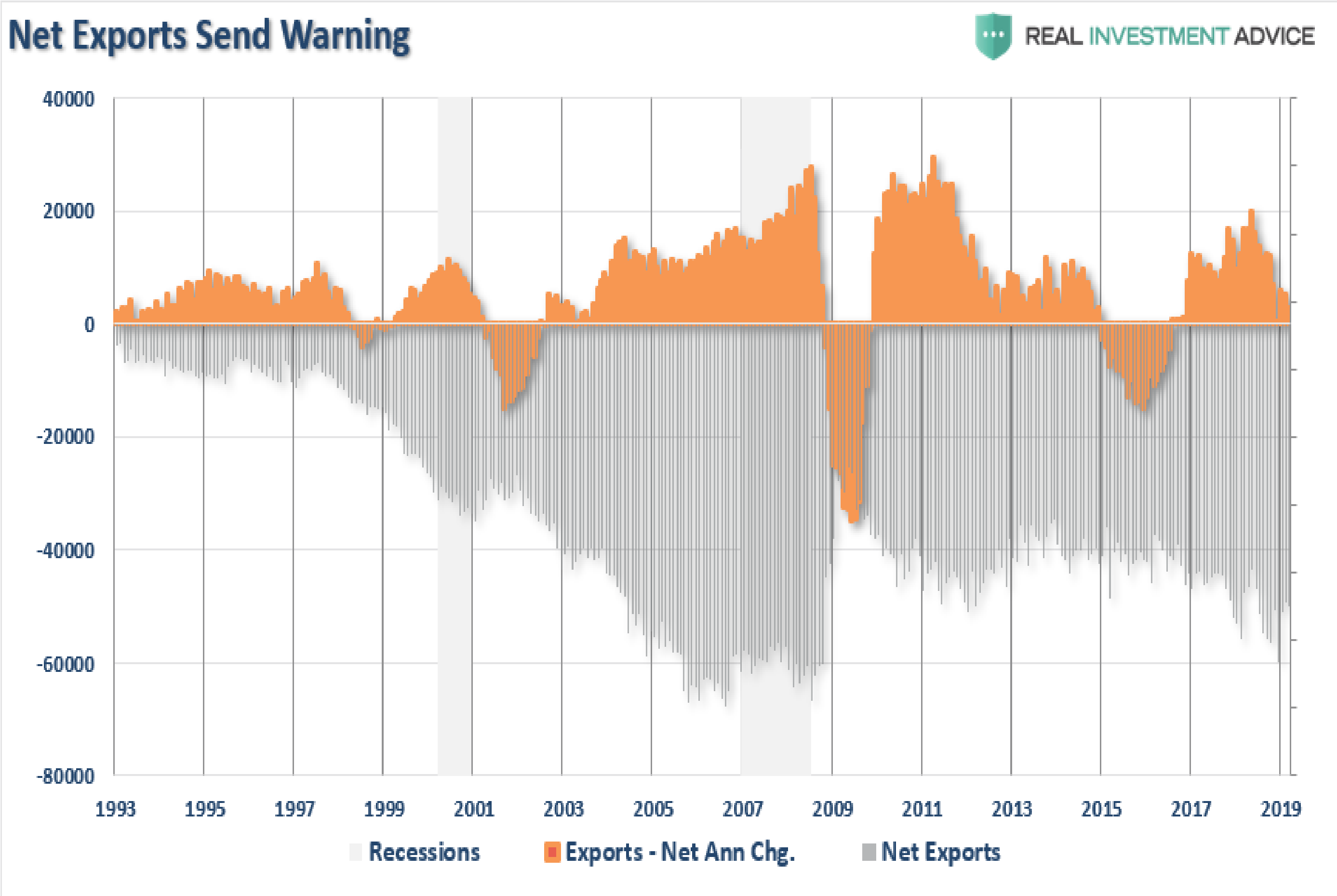
Secondly, Trump attacking China on the trade deficit is equally short-sighted.•

We have run a trade deficit since Reagan came into office as American's went on a *"credit-driven"* consumption spending spree. That deficit has continued to grow over the years as credit-based consumption in the U.S. has outstripped the rest of the world's ability to keep pace. **As a function, we import more than we export.•**

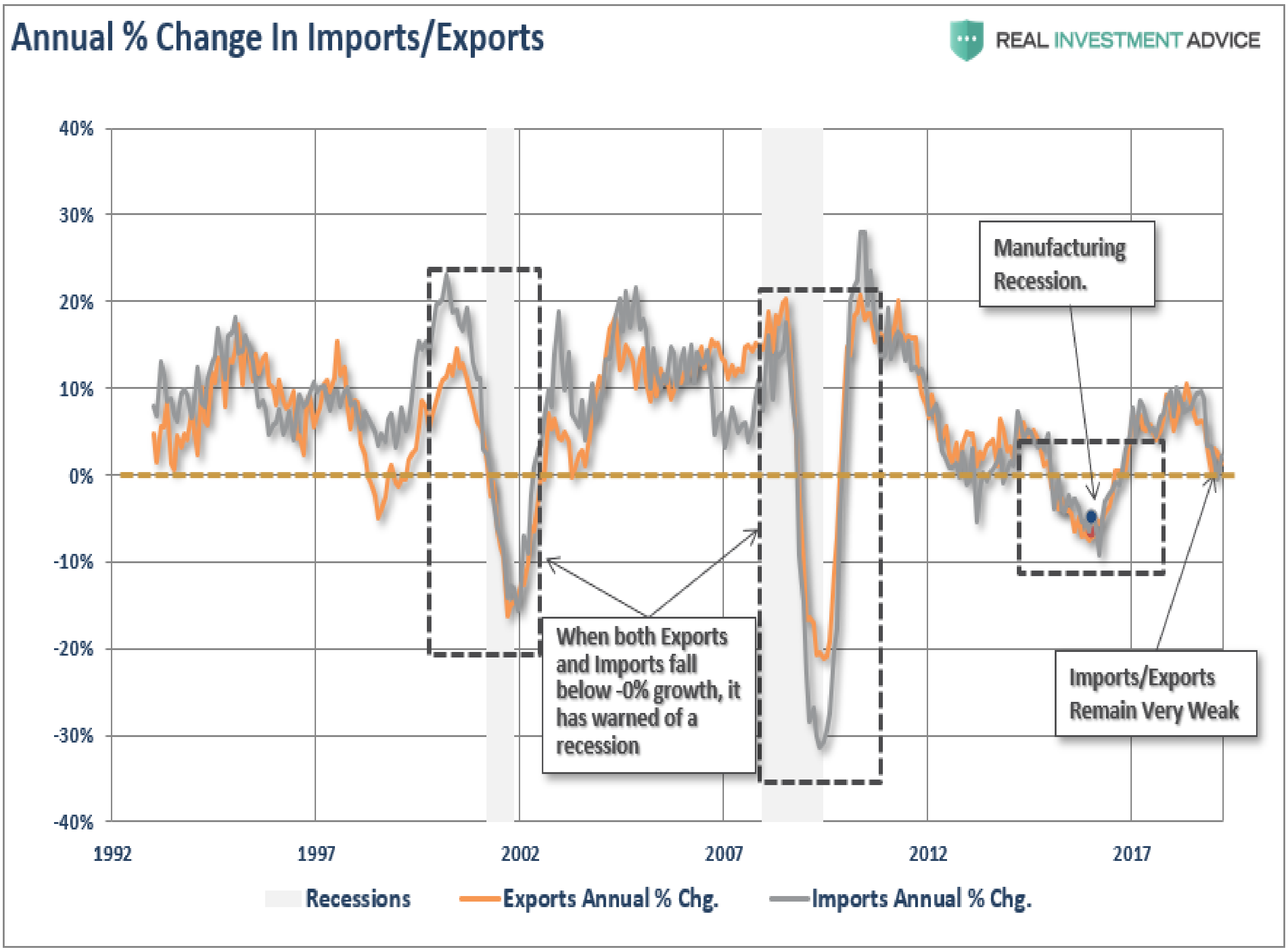


Again, exports account for roughly 40-50% of corporate profitability and we are a very *"flat and interconnected world."*•

The attack on the trade is having a knock-off effect of pushing the dollar higher which is a direct negative to exporting companies. Furthermore, global economic weakness is gaining steam and the demand for exports is declining. Note in the chart below, that it is not *"negative"* net exports that signal recessions, **but it is when net exports peak and decline toward zero. *(While 2012 was not an official recession, it was for all intents and purposes a manufacturing recession.)***



The chart below deconstructs net exports *(exports less imports, a direct input into the GDP calculation)* where you can see that both the demand for exports and imports is declining. **This is indicative of a weakening economic environment which will translate into weaker earnings for U.S. multi-national corporations.**•



Trump is picking the wrong time in the cycle to add additional costs to both consumers and exporters. **While imposing *"tariffs"* may sound like a good idea in theory, the reality is that it is the consumer that pays the price, literally.**

For Trump...time is short.•**A recession is coming and the Federal Reserve is already preparing for it.** Via Mish Shedlock on Friday:

> *"Two Fed governors now propose targeting the long end of the yield curve if there is another recession.*
>
> *Targeting yields on longer-term rates gets renewed attention from a second Fed governor. The proposed QE Replacement Mechanism was Last Used in WWII.*
>
>> *"Federal Reserve Governor Lael Brainard on Wednesday became the second U.S. central banker to talk about the possibility of **targeting longer-term interest rates as a 'new' tool to combat the next recession.***
>>
>> *Fed Vice Chairman Richard Clarida floated the idea in a speech earlier this year, and **has done research on its use in Japan**.*
>>
>> *'Once the short-term interest rates we traditionally target have hit zero, we might turn to targeting slightly longer-term interest rates?initially one-year interest rates,*

for example, and if more stimulus is needed, perhaps moving out the curve to two-year rates,' Brainard said.

'Under this policy, the Fed would stand ready to use its balance sheet to hit the targeted interest rate, but unlike the asset purchases that were undertaken in the recent recession, there would be no specific commitments with regard to purchases of Treasury securities,' she added."

Think Japan.

Brainard and Clarida are worried about the short end of the curve. ***Negative interest rates did not help the ECB nor Japan.*** *•Then again,* ***pinning the 10-year yield at 0% did not help Japan either.***

The result is easy to spot: bubbles and busts of increasing amplitude over time.

By the way, this talk is indicative of a Fed that is far more concerned about a recession than they want you to believe.

In 2007, the banks were preparing for a credit crisis. No one paid attention until it was too late.•

For the last 6-months, the Fed has consistently been leaking messages about rising risk in the credit markets and has been quietly prepping for a recession.

Once again, no one is paying attention.•

The problem for Trump has always been *"time."*•He entered office at the tail-end of an economic cycle, and while his policy prescriptions have certainly helped extend the current cycle, they haven't, and won't, repeal it.•

"Winter IS Coming."•

The only question is whether investors are prepared for it?

If you need help, or have questions, we are always glad to help. Just email me.

See you next week.

Market & Sector Analysis

Data Analysis Of The Market & Sectors For Traders

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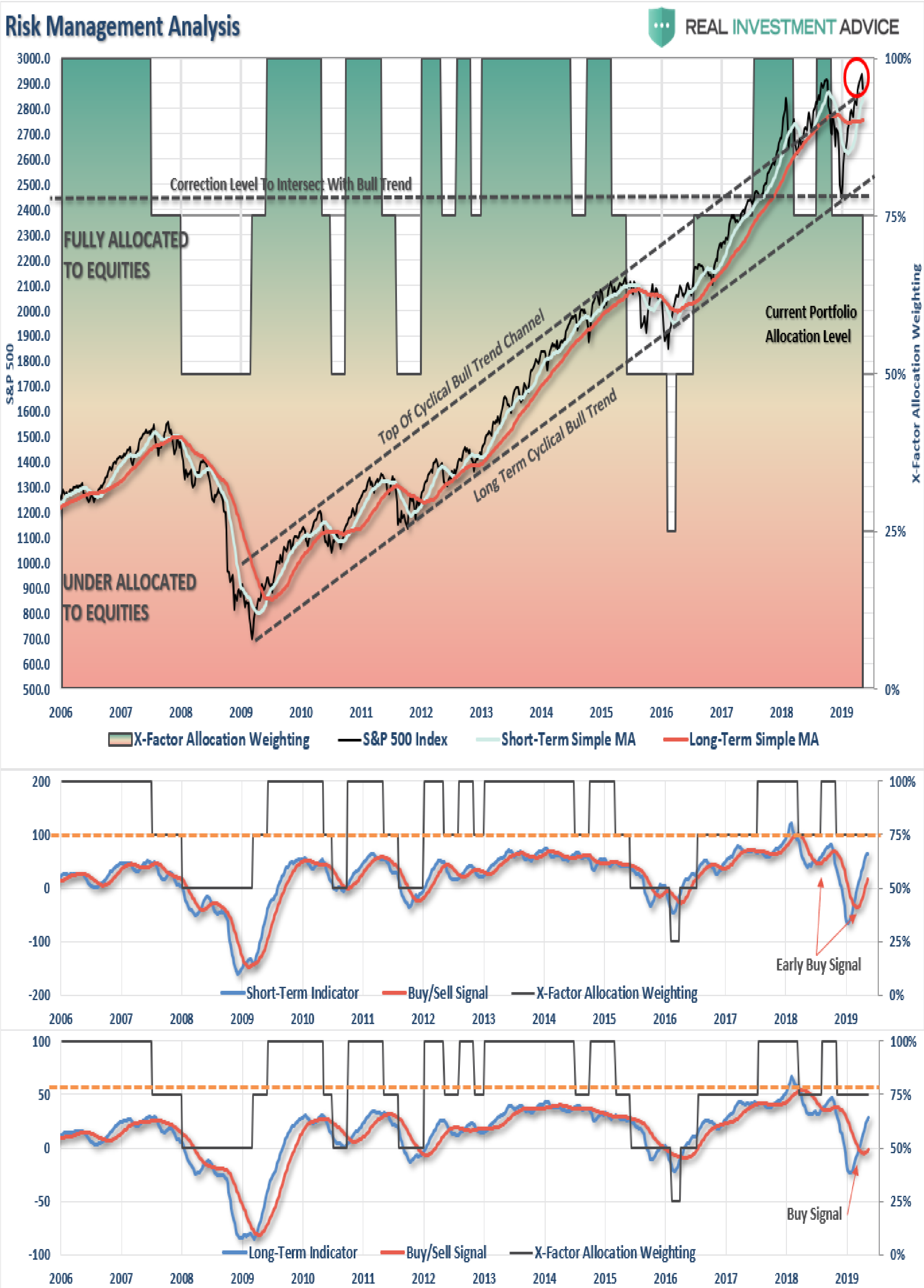
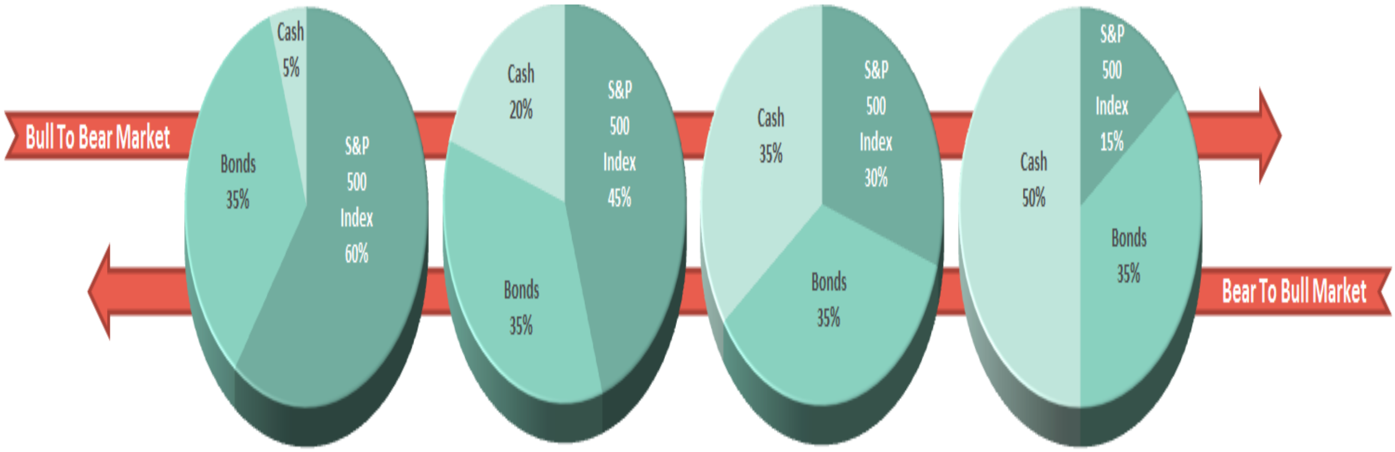
A Conservative Strategy For Long-Term Investors



Risk Management Analysis
REAL INVESTMENT ADVICE
Correction Level To Intersect With Bull Trend
FULLY ALLOCATED TO EQUITIES
UNDER ALLOCATED TO EQUITIES
Top Of Cyclical Bull Trend Channel
Long Term Cyclical Bull Trend
Current Portfolio Allocation Level
S&P 500
X-Factor Allocation Weighting
X-Factor Allocation Weighting
S&P 500 Index
Short-Term Simple MA
Long-Term Simple MA
Early Buy Signal
Short-Term Indicator
Buy/Sell Signal
X-Factor Allocation Weighting
Buy Signal
Long-Term Indicator
Buy/Sell Signal
X-Factor Allocation Weighting

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.*



Trade War Returns

The market sold off last week as the "trade war" returned.•

As we have discussed over the last several weeks, the market was very overbought and in need of a rest.•

> "As stated above, given the run higher this year, a retracement this summer is highly likely which will provide the best opportunity to tactically take portfolios to 100% of target.•
>
> As is always the case, by the time these more 'bullish" actions occur, the risk/reward opportunity in the short-term is not generally favorable. In this case, in particular, the angle of ascent of the markets from the December lows has been more abnormal than not.
>
> *That opportunity is coming soon, and is why 'patience'* is required when investing."

With that opportunity to add exposure to portfolios forming, we are now on alert next week for some resolution to *"trade negotiations"* that pulls the pressure off the market. With the markets holding support on Friday, this is good news and once we see how Monday opens we may be able to increase exposures to equities next week.•

Again, as noted last week,

> *"With both 'buy'•signals now in place, we****WILL move target allocations to 100% equity exposure on any corrective actions which reduces the extreme overbought short-term condition without violating important support."****•

In the meantime, we can prepare for this opportunity by continuing our actions we have recommended over the last several weeks.•

- *If you are **overweightequities** - take some profits and reduce portfolio risk on the equity side of the allocation. However, hold the bulk of your positions for now and let them run with the market.*
- *If you are **underweight equities or at target -** remain where you are until the market gives us a better opportunity to increase exposure to target levels.*

If you need help after reading the alert; don?t hesitate to **contact me**.

Exciting News - the 401k Plan Manager is "Going Live"

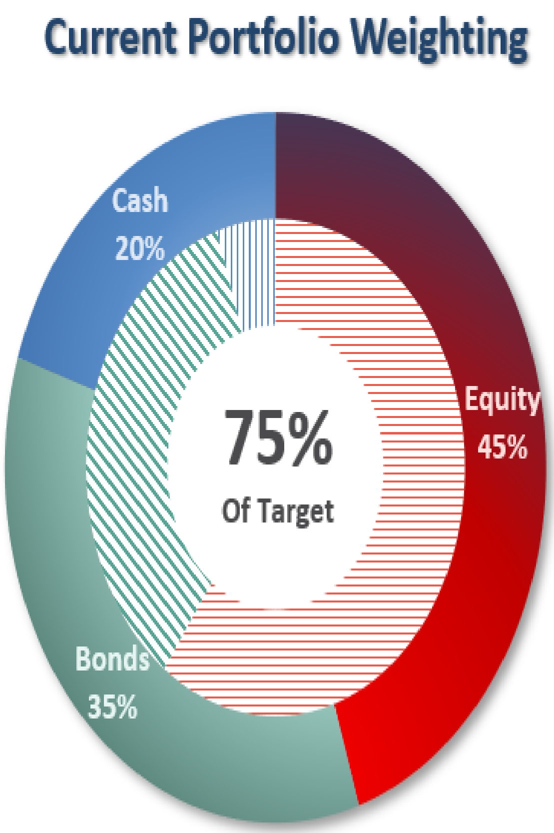
We are making a *"LIVE"* version of the 401-k allocation model which will soon be available to **RIA PRO subscribers.** You will be able to compare your portfolio to our live model, see changes live, receive live alerts to model changes, and much more.•

This service will also be made available to companies for employees. If would like to offer our service to your employees at a deeply discounted corporate rate please contact me.

Stay tuned for more details over the next couple of weeks.

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**
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
Examples: Short Duration, Total Return and Real Return Funds

45.00% **Equity (Stocks)**
The vast majority of funds track an index.
Therefore, select on ONE fund from each category.
Keep it Simple.
10% Equity Income, Balanced or Conservative Allocation
35% Large Cap Growth (S&P 500 Index)
0% International Large Cap Dividend
0% Mid Cap Growth

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.*
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*

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.