

# Pay Attention

## The Yield Curve Is Sending A Message



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  - *No One Ever Says Sell*
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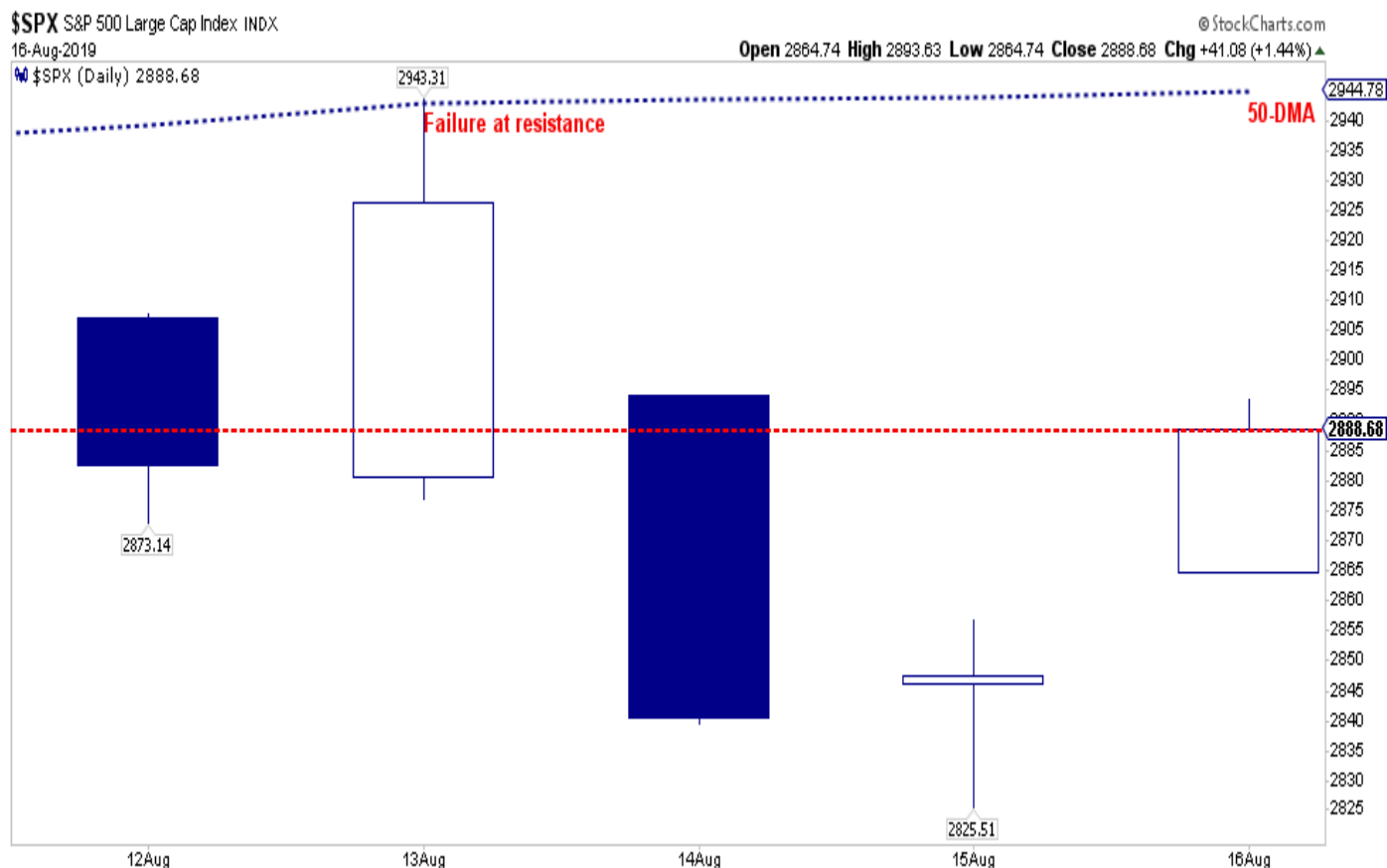
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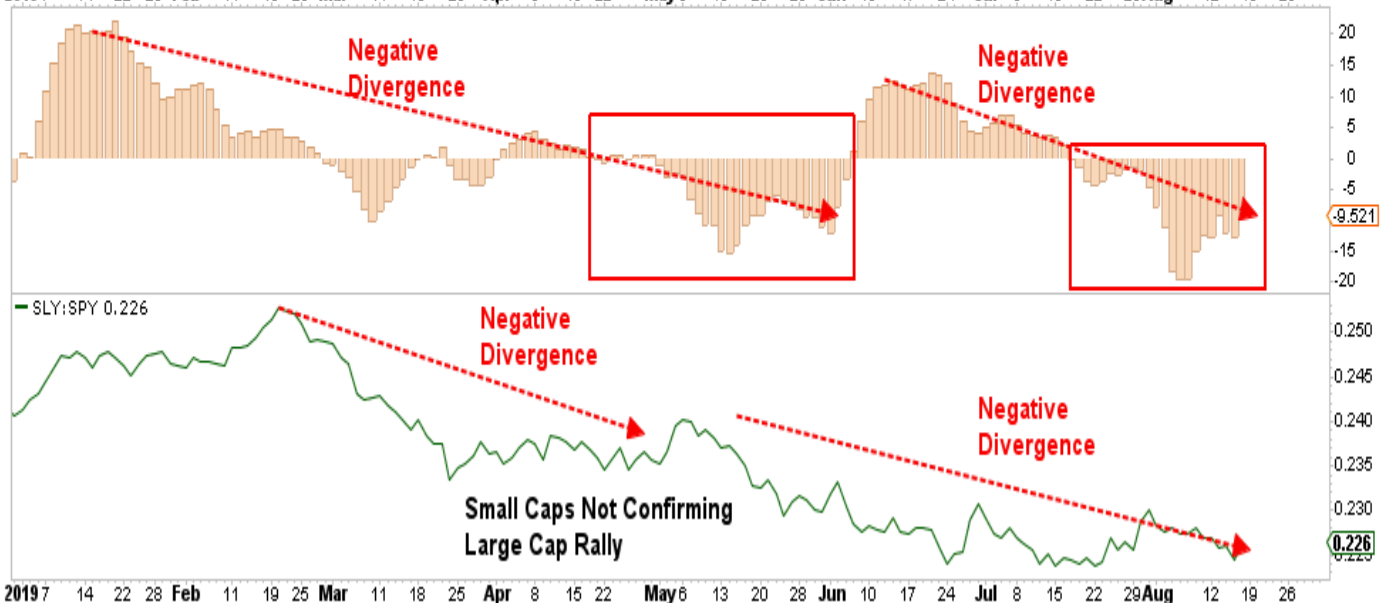
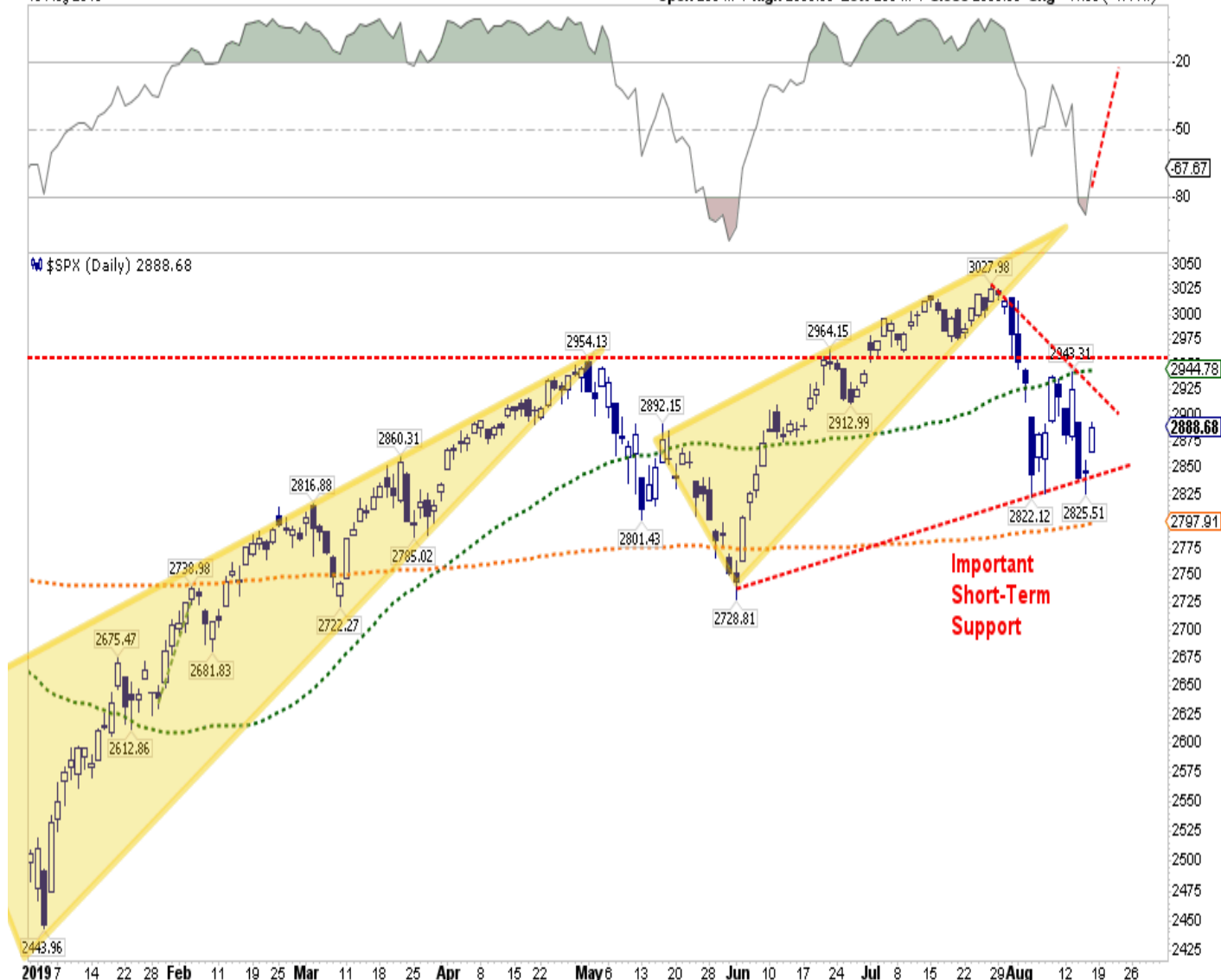
# Quick Review

Do you love #volatility yet?•

Last week the market swung wildly back on forth on "*trade talks*," "*tariff relief*," inverted yield curves, and recession fears to finish the week on "*hopes*" banks will rescue the markets once again.



The bounce on Friday, was not unexpected as the market had gotten very oversold on a short-term basis. As shown in the chart below, the bounce off support gives the market a little room to the upside before several levels of resistance kick in.•



This oversold condition is why we took on a leveraged long position on the S&P 500 which we discussed with our [RIAPRO subscribers on Thursday morning \(30-Day Free Trial\)](#)..

***"I added a 2x S&P 500 position to the Long-Short portfolio for an 'oversold trade' and a bounce into the end of the week. We will re-evaluate the holding tomorrow."***

We are holding the position over the weekend, as there is still room in the current advance for further gains. •Also, given the President is fearful of a market decline, we expect there will be some announcement over the weekend on "trade relief" to support the markets.

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However, **this does NOT** negate our commentary from last week suggesting this remains a "sellable rally." [To wit:](#)

***"The market is oversold on a short-term basis, and a rally from current support back to the 50-dma is quite likely."***

Again, **that rally should be used to reduce risk.** I wrote about this on Tuesday in [5-Reasons To Be Bullish \(Or Not\) On Stocks:](#)

*For longer-term investors, it is worth considering the historical outcomes of the dynamics behind the financial markets currently. **The is a huge difference between a short-term bullish prediction and longer-term bearish dynamics.** As Howard Ruff once stated:*

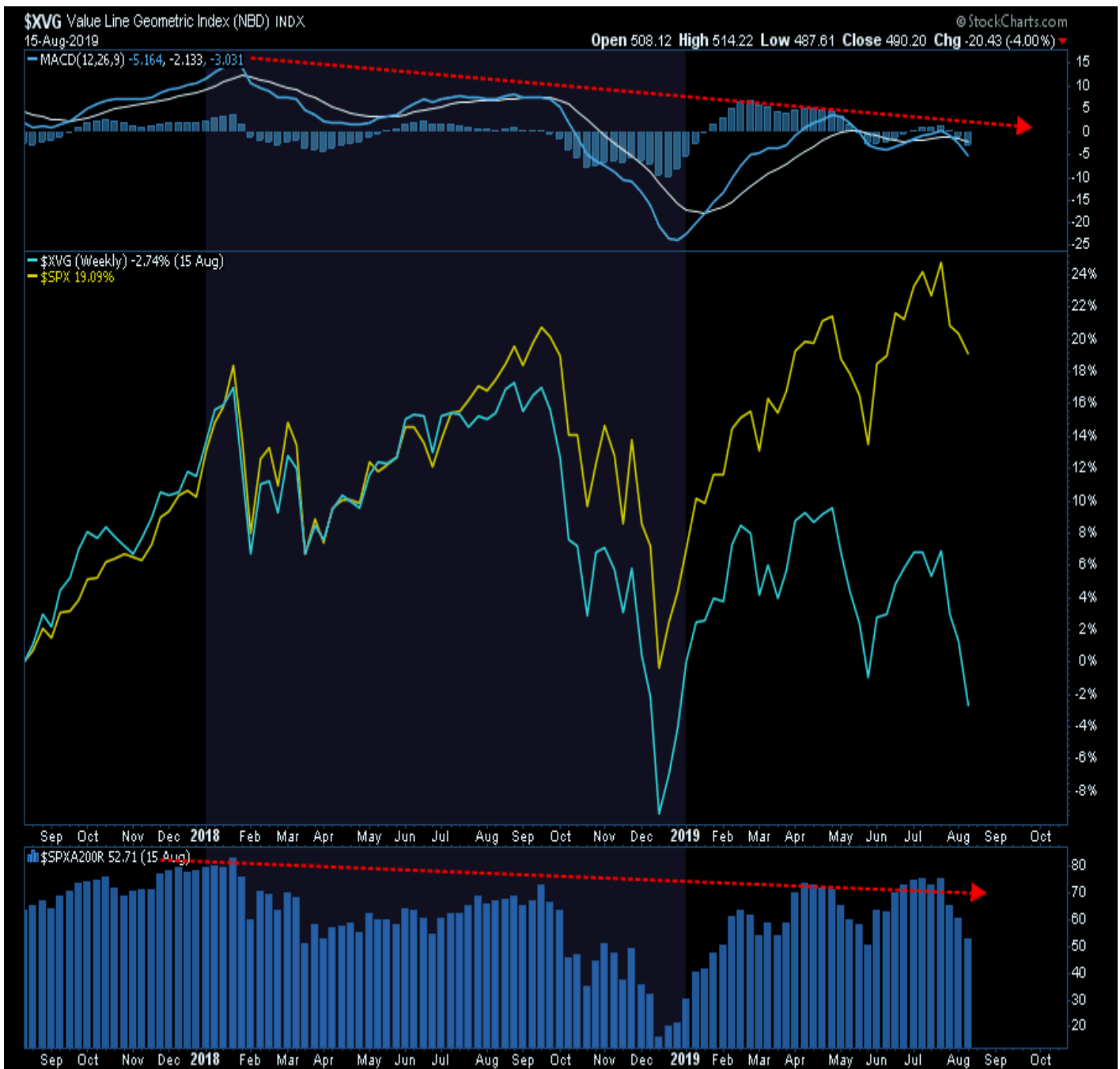
*?It wasn't raining when Noah built the ark.?*

*Notice that while the market has been rising since early 2018, the momentum indicators are negatively diverging. Historically, such divergences result in markedly lower asset prices. **In the short-term, the market remains confined to a rising trend which is running along the 200-dma.** •At this juncture, the market has not violated any major support points and does currently warrant a drastically lower exposure to risk. **However, the •?sell signals?•combined with negatively diverging indicators, suggest a •?reduction?•of risk, and hedging, is warranted on any rally."***



**With sell signals in place, maintaining higher levels of cash, hedging, and holding fixed income continues to provide benefits.●**

This is particularly the case given the narrowing participation in the broader market. While the S&P 500 is still holding up, that is due to crowding into the largest of market-capitalization-weighted stocks. If you look at the Valueline Geometric Index, there is substantially more damage being done beneath the surface which is supportive of falling yields as money seeks safety. **The negative divergences continue to suggest a higher level of caution.**



While the market did "bounce" on Friday, the media was quick to suggest it was something more than just a "bounce." Here is the WSJ:

*"The move came on top of gains on Thursday **and seemed to reflect a belief that, just maybe, the U.S. economy isn't in as much trouble as some investors had feared.**"*

Be careful falling into that trap.

Let's get into our analysis for this week.



REAL  
INVESTMENT  
ADVICE

Are your investments prepared  
for the next bear market?

SCHEDULE YOUR  
CONSULTATION  
TODAY

## Listen To The Yield Curve Message

On Wednesday, CNBC ran the following headline:



*?Stocks plunged on Wednesday, giving back Tuesday?s solid gains,after the U.S. bond market flashed a troubling signal about the U.S. economy.?? CNBC*

On Thursday, CNBC runs the following headline:

## Growth forecasts are rising and the economy looks nowhere near as bad as the bond market predicts

*"Economists ratchet up their GDP forecasts for the third quarter to a median 2.1% after a batch of better-than-expected data, according to the CNBC/Moody?s Analytics Rapid Update. The data paints a picture of an economy that looks nowhere near as bad as recent action in the bond market would suggest, and economists say it?s the strength of the U.S. consumer driving the economy. The manufacturing sector does show signs of strain, but the consumer is two-thirds of the economy and it*

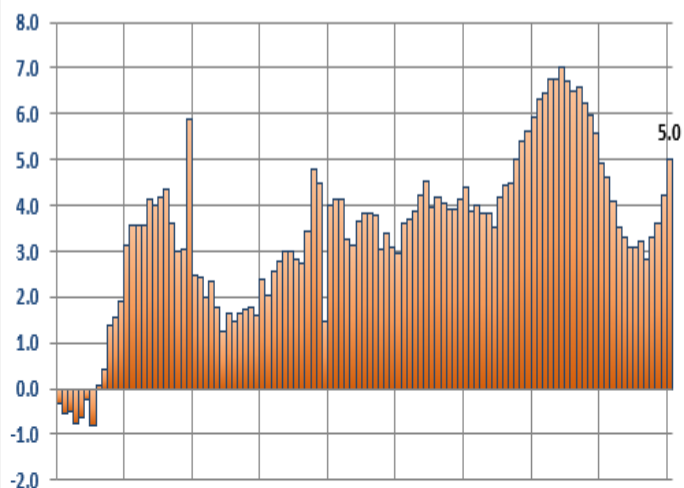
*is pulling its weight."*

**So, which message is correct?•**

Let's start with the economic data, which is showing a stronger than expected economy. The 6-charts below are the major measures of the economy most viewed by economists.

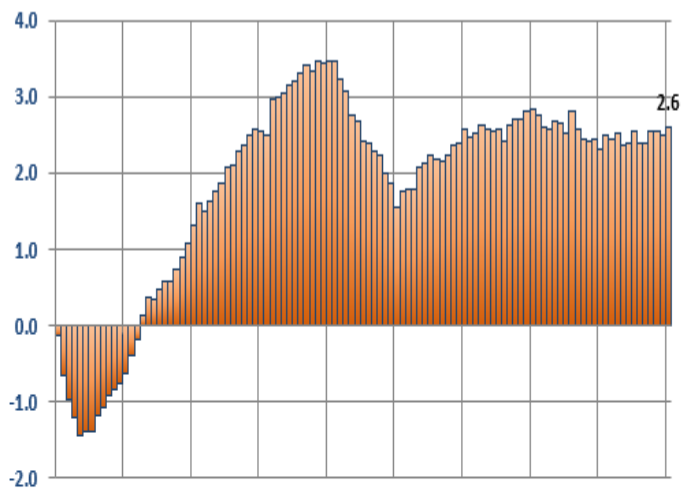


## Real Personal Income



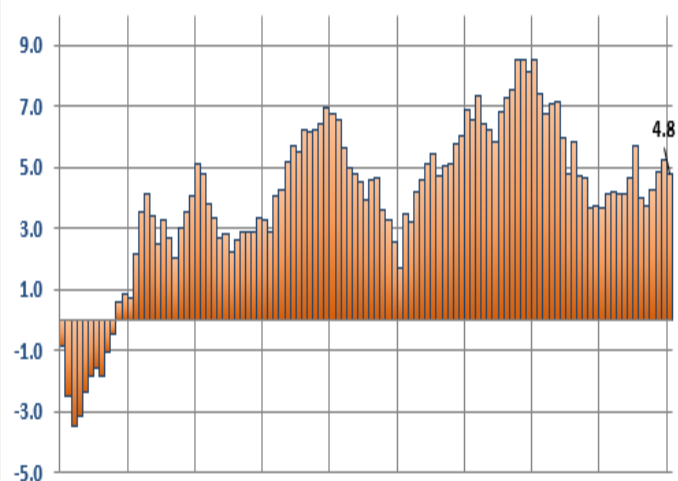
Real Personal Income

## Employment



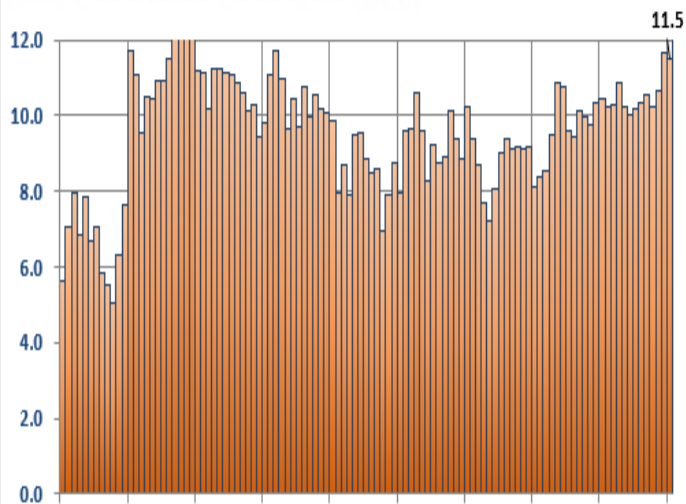
All Employees: Total Nonfarm Payrolls

## Industrial Production



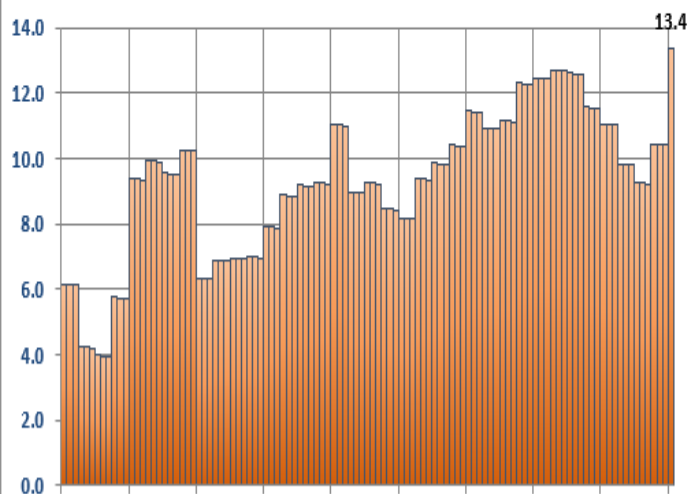
Industrial Production Index

## Real Consumer Spending (PCE)



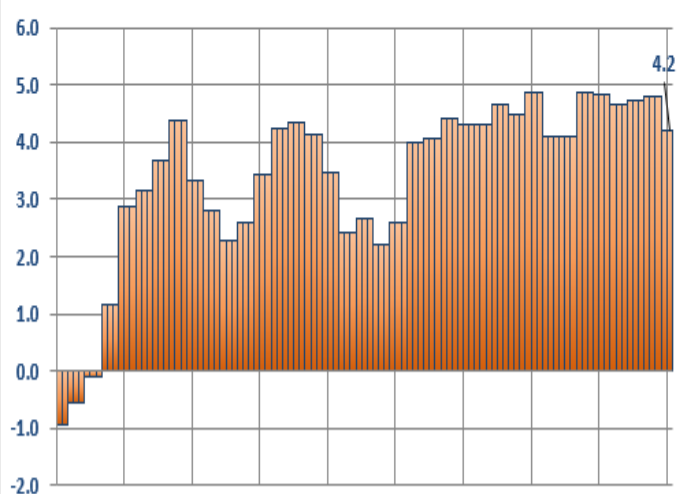
Real PCE

## Real Wages



Real Wages

## Real GDP

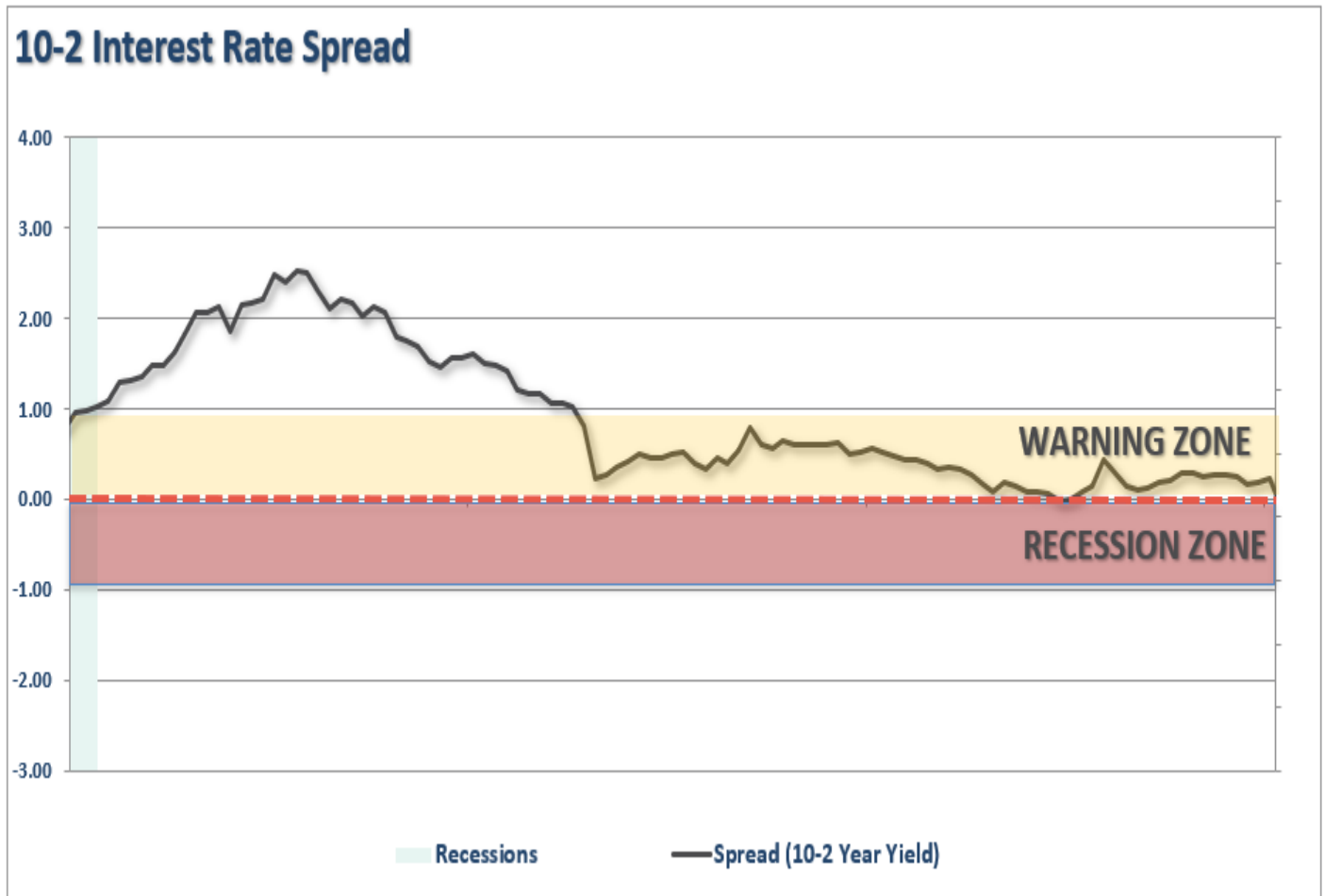


Real Gross Domestic Product

Clearly, there are **NO** signs of recession currently:

- 5% annualized real personal income growth
- 2.6% annualized employment growth
- 4.8% annualized industrial production growth
- 11.5% annualized real personal consumption expenditure growth
- 13.4% annualized growth in real wages
- 4.8% annualized real GDP.

Yet, the yield curve is close to inverting.



So, which indicator is right?

**As an investor, should you be betting on the economic data, or the "yield curve?"**

My apologies, I forgot to add the X-Axis to the charts above. (Not really, it was intentional)

**That time frame is 1991 though 1999.**

I don't need to remind you what happened next.

Now, which indicator would you follow?• The yield curve?

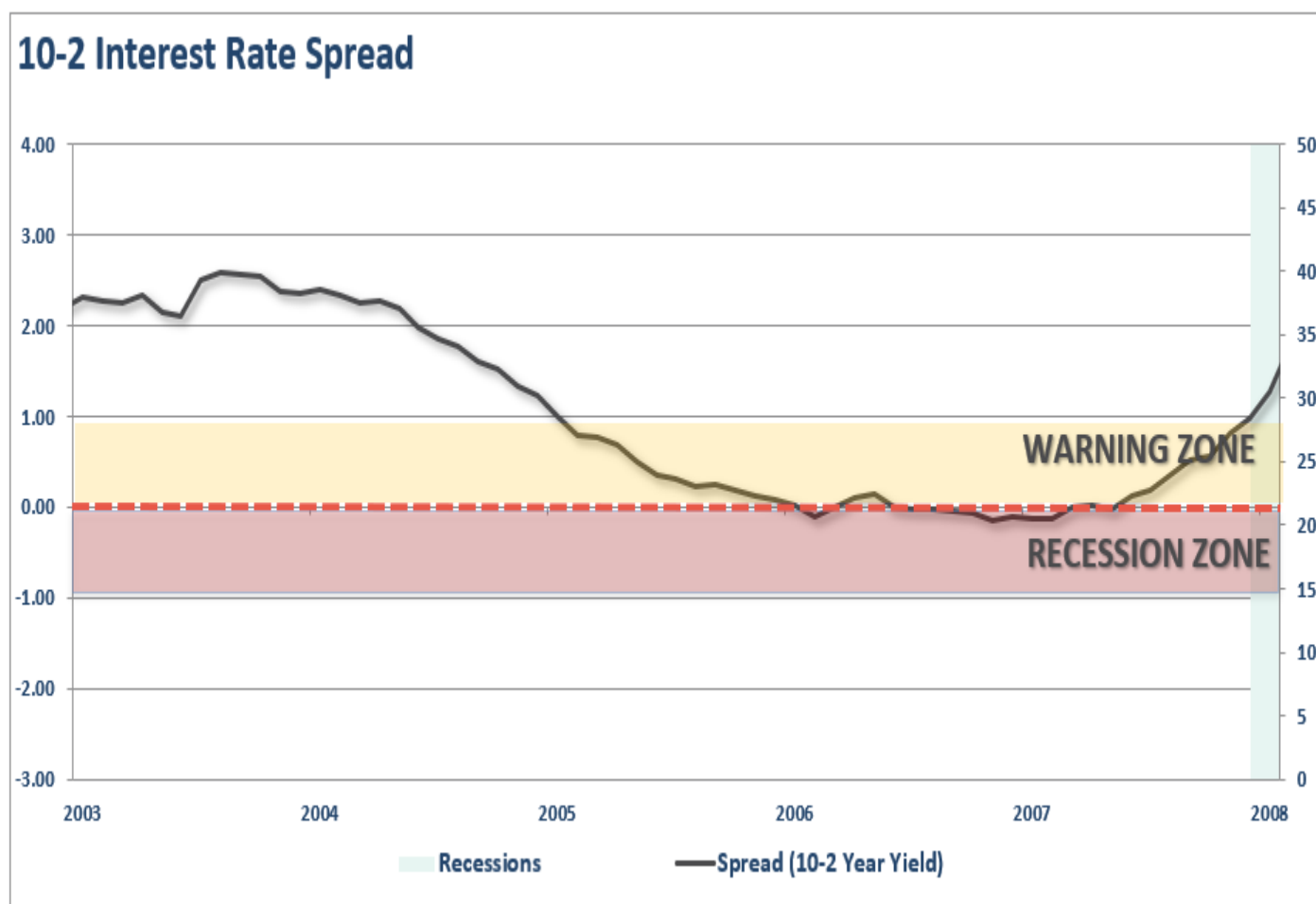
How about the stats in **December 2007?**

- 1.4% annualized real personal income growth
- 0.8% annualized employment growth
- 2.2% annualized industrial production growth

- 4.6% annualized real personal consumption expenditure growth
- 5.7% annualized growth in real wages
- 2.0% annualized real GDP.

Again, there is clearly no recession in sight, right?

**Here is the yield curve from 2003-2008**

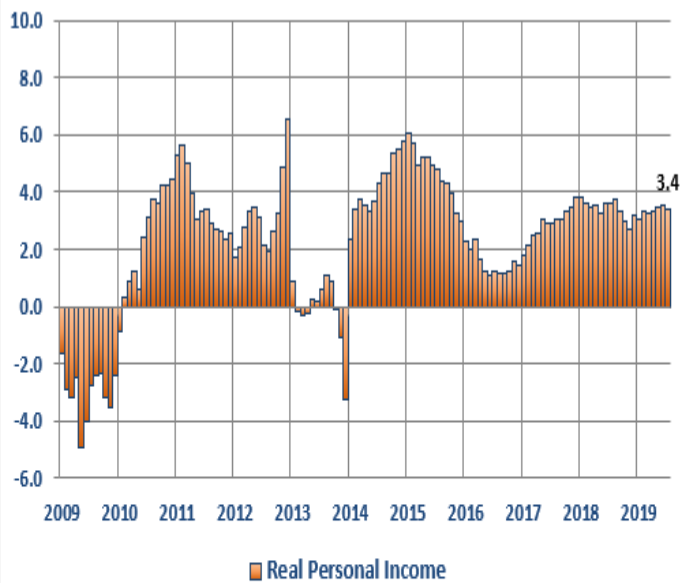


So, how about today.

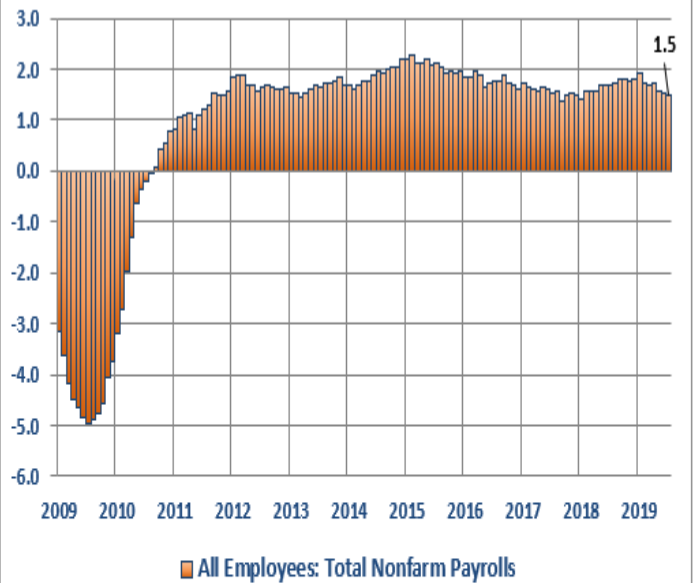
**CNBC says the consumer is strong, and the yield curve is wrong. •**

Here is the 6-panel chart of the current economic cycle to compare to the chart above.

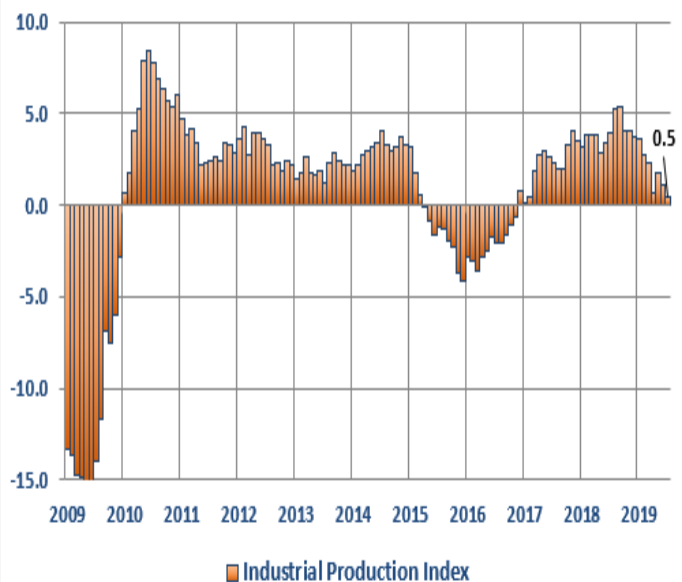
## Personal Income



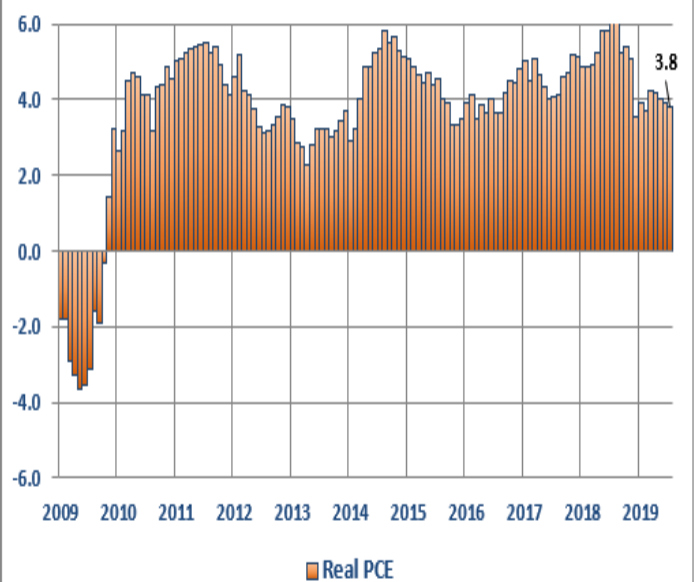
## Employment



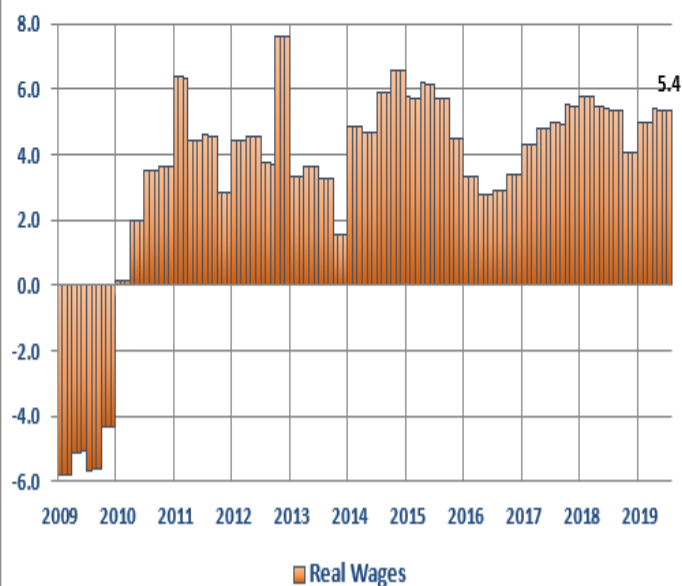
## Industrial Production



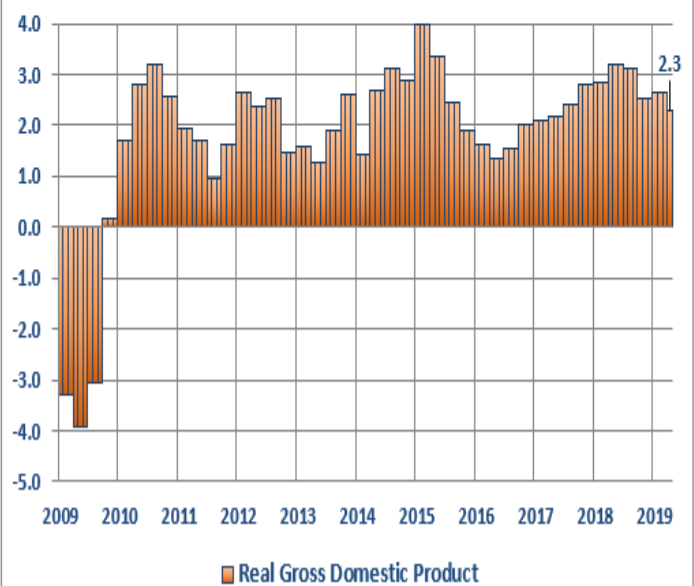
## Real Consumer Spending (PCE)



## Real Wages



## Real GDP



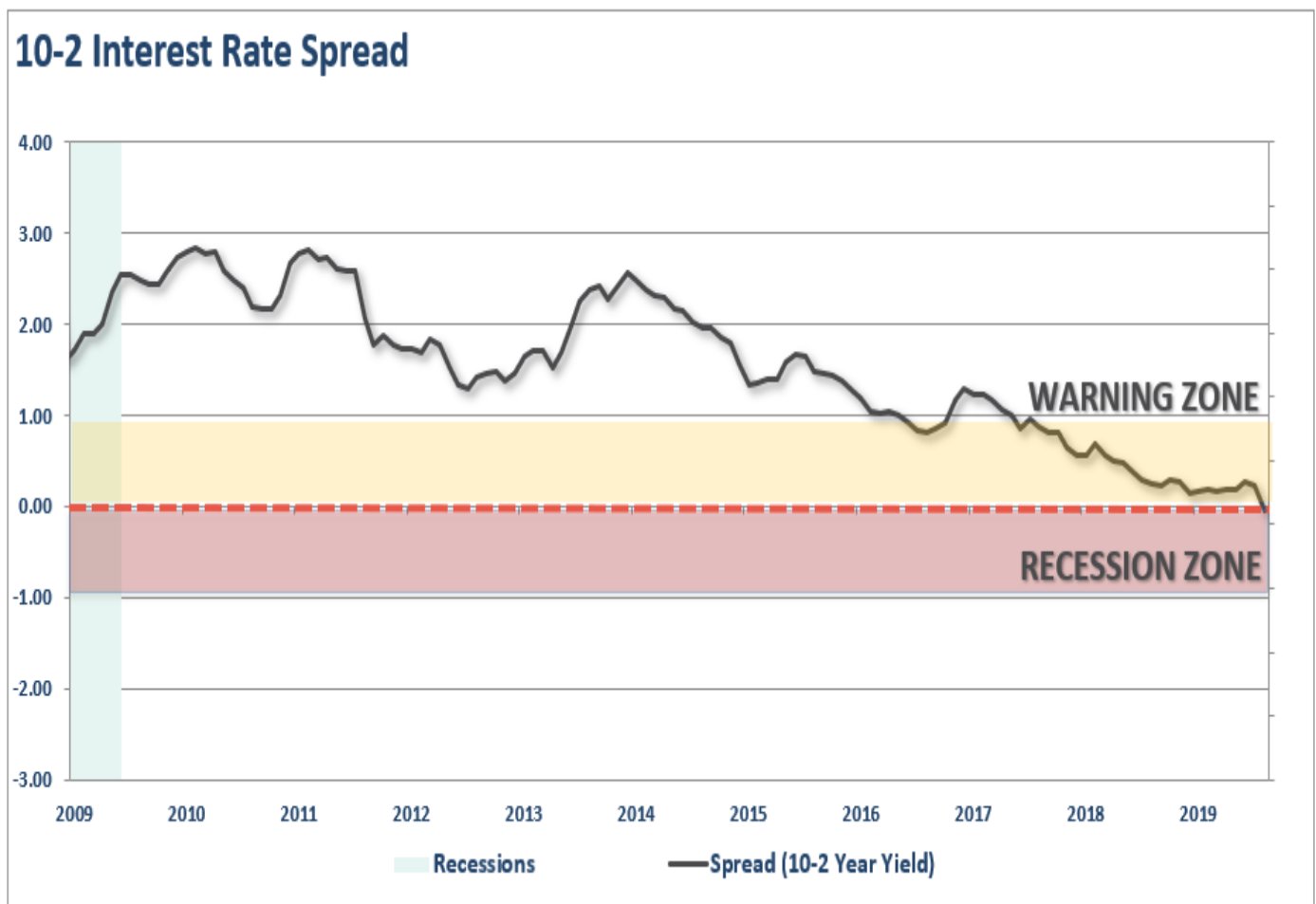
*(It is worth comparing the markedly weaker economic growth statistics between today and the late 90's. This goes a long way in explaining the disparity of wealth in the country today and surging debt levels.)*

Here are the final stats as of the latest reports:

- 3.4% annualized real personal income growth
- 1.5% annualized employment growth
- 0.5% annualized industrial production growth
- 3.8% annualized real personal consumption expenditure growth
- 5.4% annualized growth in real wages
- 2.3% annualized real GDP.

**To CNBC's point, based on this lagging, and currently unrevised, economic data, there is "NO recession in sight," so you should be long equities, right?**

Here is that pesky yield curve again. (2009-Present)

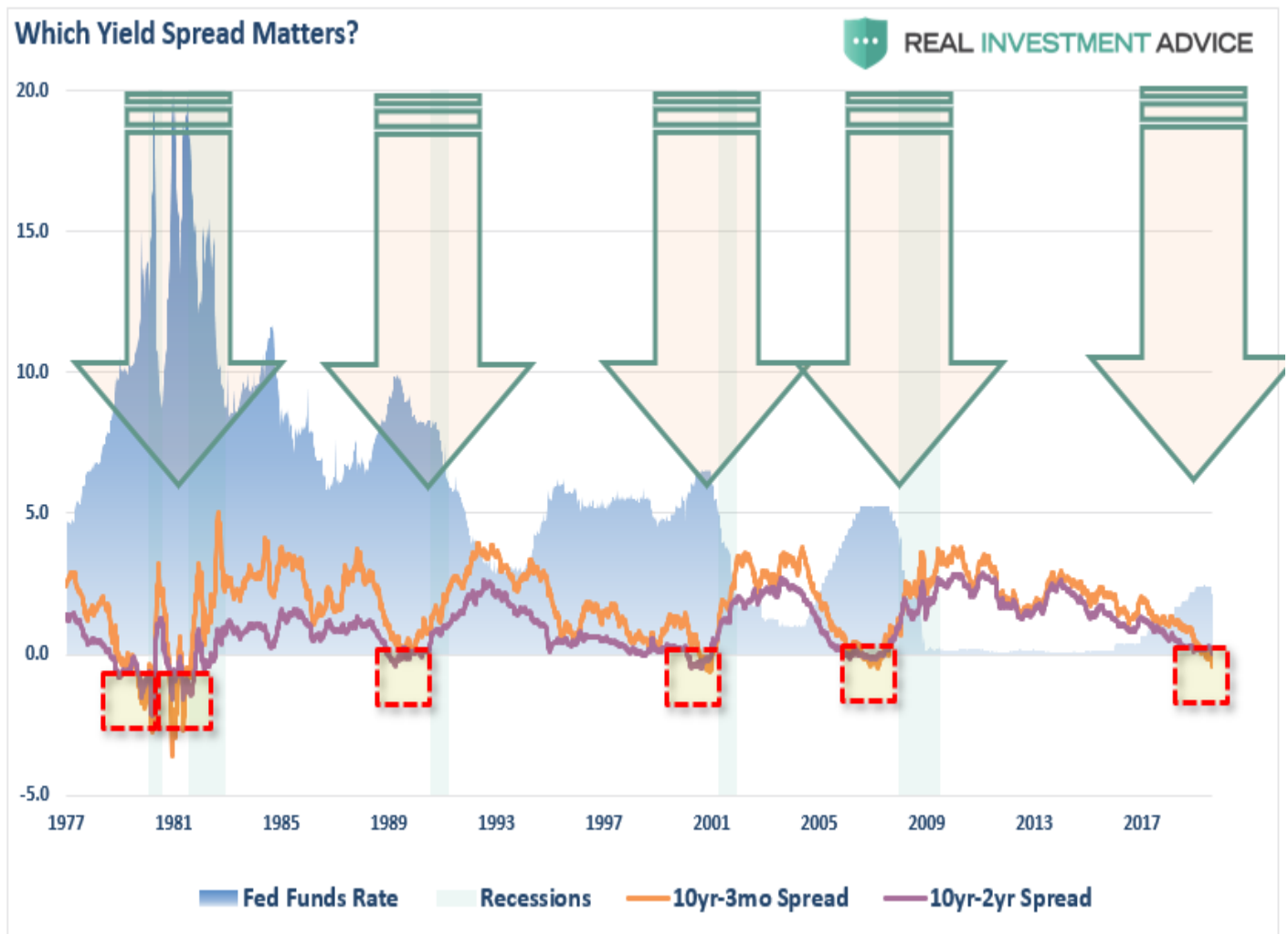


Which indicator should you follow?

**The yield curve is an easy answer.**

While everybody is "freaking out" over the "inversion," it is when the yield-curve "un-inverts" that is the most important.

The chart below, shows that when the Fed is aggressively cutting rates, the yield curve un-inverts as the short-end of the curve falls faster than the long-end. *(This is because money is leaving "risk" to seek the absolute "safety" of money markets, i.e. "market crash.")*

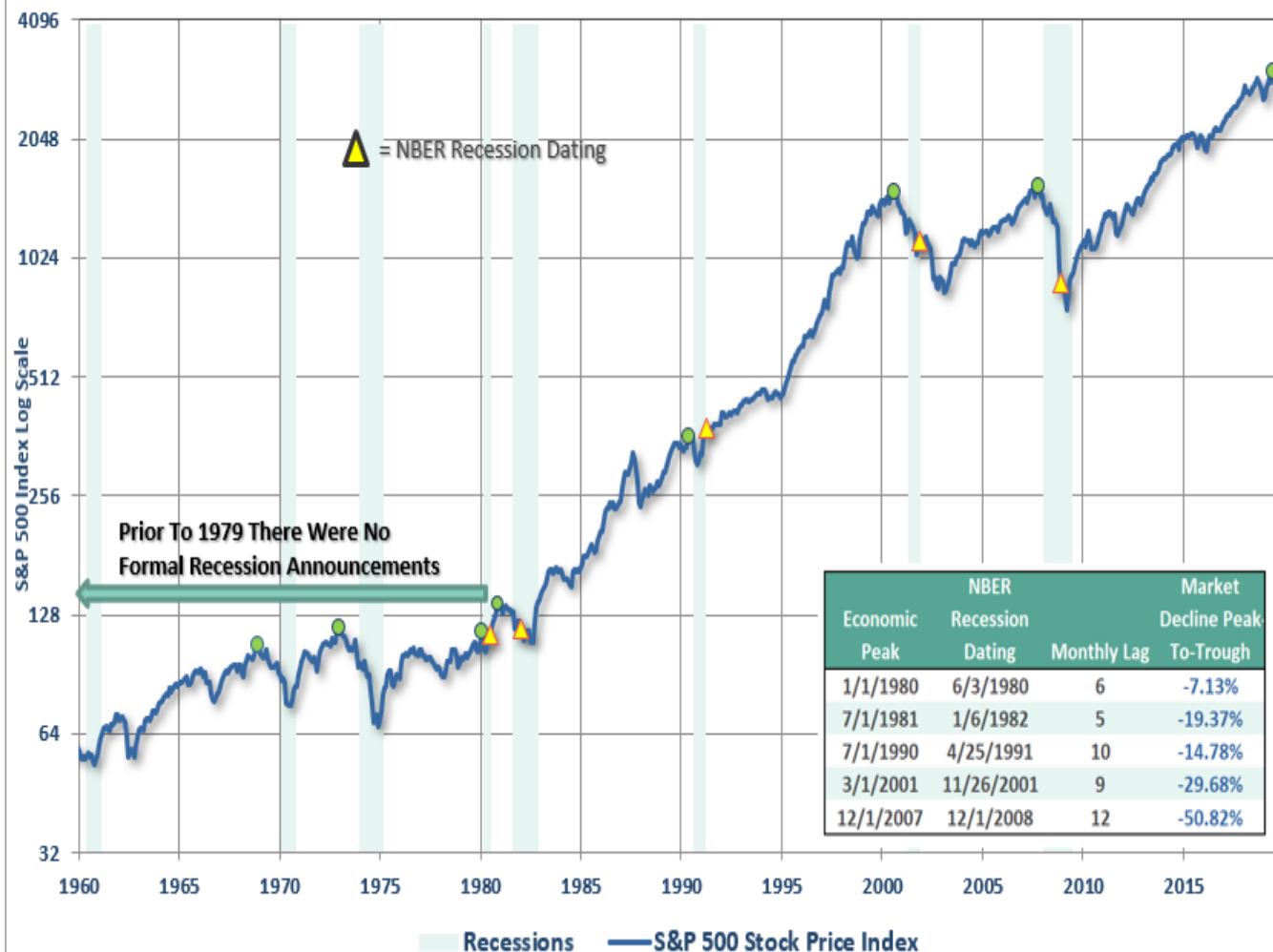


As noted above, the current economic data is only a "guess" about the current economy. In the next 12-months, we will see the "revised" data, but the yield curve is already telling you it will be weaker.

**Just as in December 2007, there was "no recession."** It wasn't until December 2008 that the data was revised, and the National Bureau of Economic Research (NBER) announced the recession had begun a full year earlier in December 2007. •

By the time the announcement was made, it did little to help investors avoid the damage. The chart below is the historical track record of recession dating and market turns. •

## NBER Recession Dating Vs. Market Realization



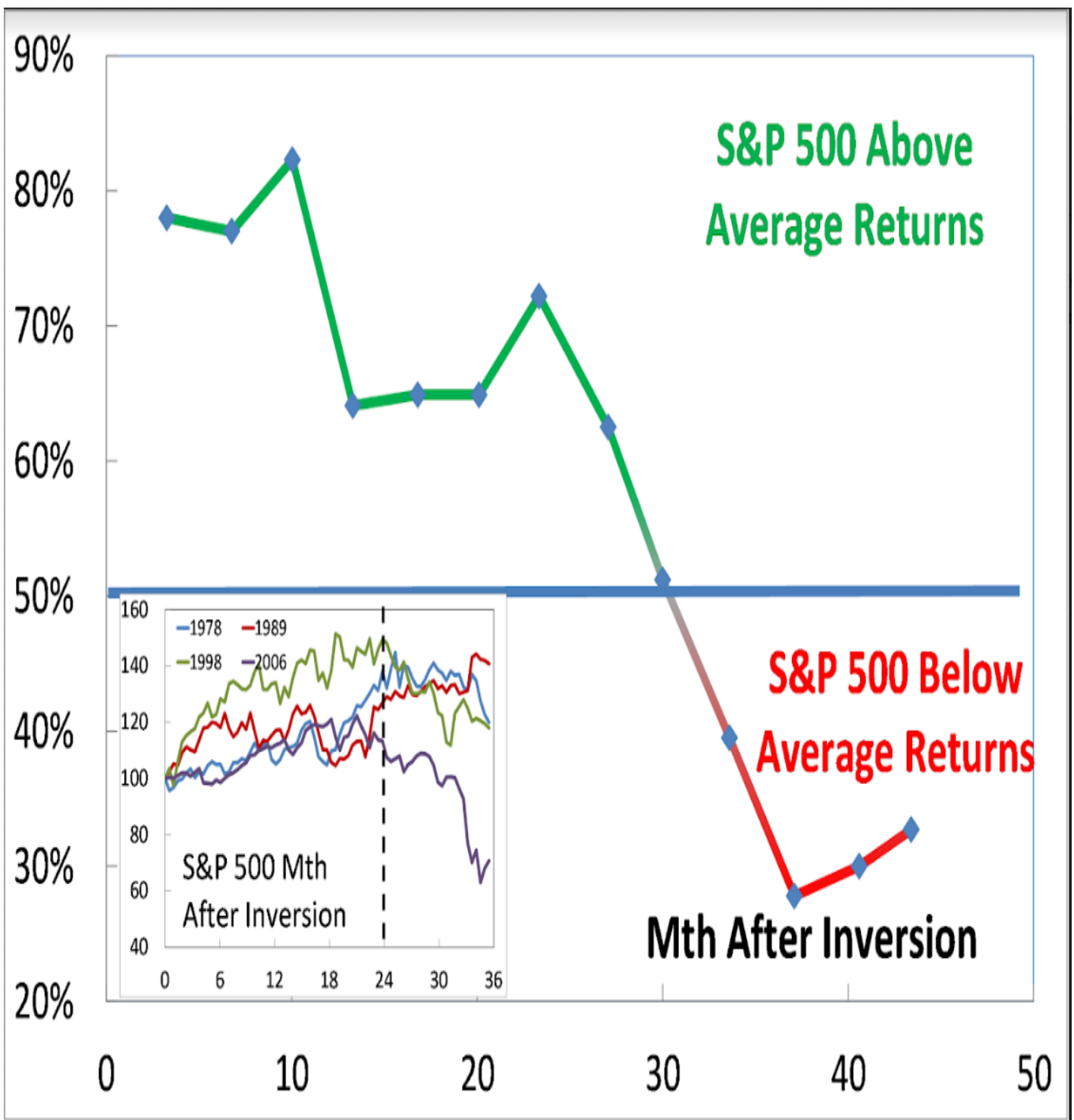
Despite commentary to the contrary, the yield curve is a *"leading indicator"* of what is happening in the economy currently, as opposed to economic data which is *"lagging"* and subject to massive revisions.

More importantly, while the consumer may be continuing to support growth currently, such can, and will, change dramatically when job losses begin to occur. Consumers are fickle beasts, and when a change in psychology occurs, it will happen very rapidly.

## No One Ever Says Sell

[Mark Kolanovic of J.P. Morgan](#) penned:

*?Historically, equity markets tended to produce some of the strongest returns in the months and quarters following an inversion. Only after [around] 30 months does the S&P 500• return drop below average,?*



**While the statement is not incorrect, it is advice that will ultimately lead to disappointment.●**

As discussed, in 1998 there was *no recession in sight* and investors were repeatedly advised to ignore the yield curve because *this time was different*.● Over the next two years, that advice held true as bullish optimism seemed well-founded. It was in early 2000 that Jim Cramer issued his *Top 10-Stock Picks* for the next decade.●

**The problem was that no one ever said *?sell.?*●**

While gains were made during the period between the initial yield curve inversion and the peak of the market, **all of those gains, plus much more, were wiped out in the ensuing decline**. By the time the selling was done, portfolio values had reverted to where they were roughly a decade earlier.



Since the majority of mainstream financial advice never suggest selling, investors had no clue that if they had gone to cash in 1998, they saved themselves both much grief, and years of losses to recover.

Following the *Dot.com* crash, the entire tragic event was considered an anomaly; **once-in-a-100-year event** which would not be replicated anytime again soon.

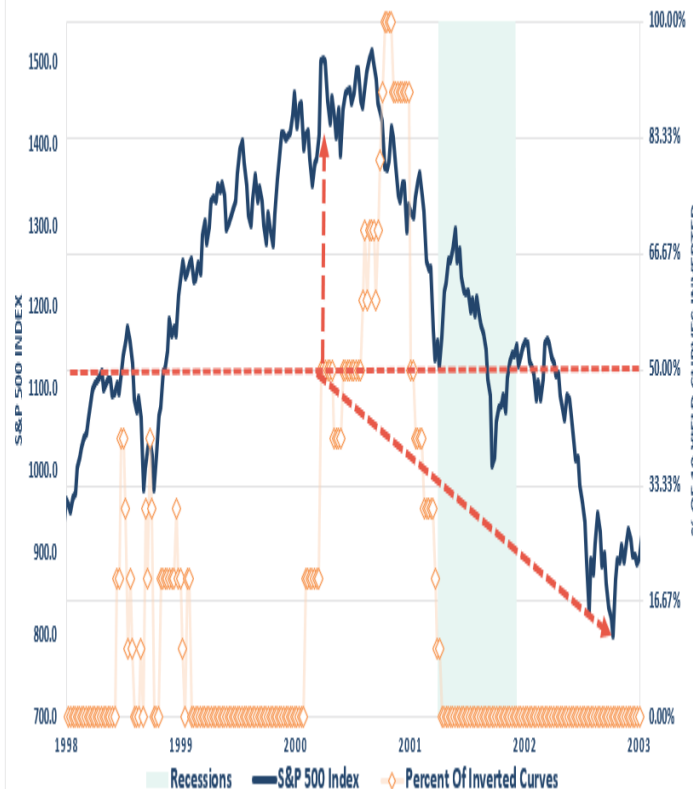
Unfortunately, just 4-years later, in 2006, investors were once again told to ignore the yield curve inversion as it was a *Goldilocks economy* and *sub-prime mortgages were contained*. While many of the individuals who had told you to stay invested leading up to 2000 peak were mostly gone from the industry, a whole new crop of media gurus, and advisors, once again told investors to *ignore the yield curve*.

For a second time, had investors just sold when the yield curve inverted, the amount of damage that would have avoided more than paid off for the small amount of gains missed as the market cycle peaked.

This quad-panel chart below shows the 4-previous periods where 50% of 10-different yield curves were inverted. I have drawn a horizontal red dashed line from the first point where 50% of the 10-yield curves we track inverted. I have also denoted the point where you should have sold and the subsequent low.

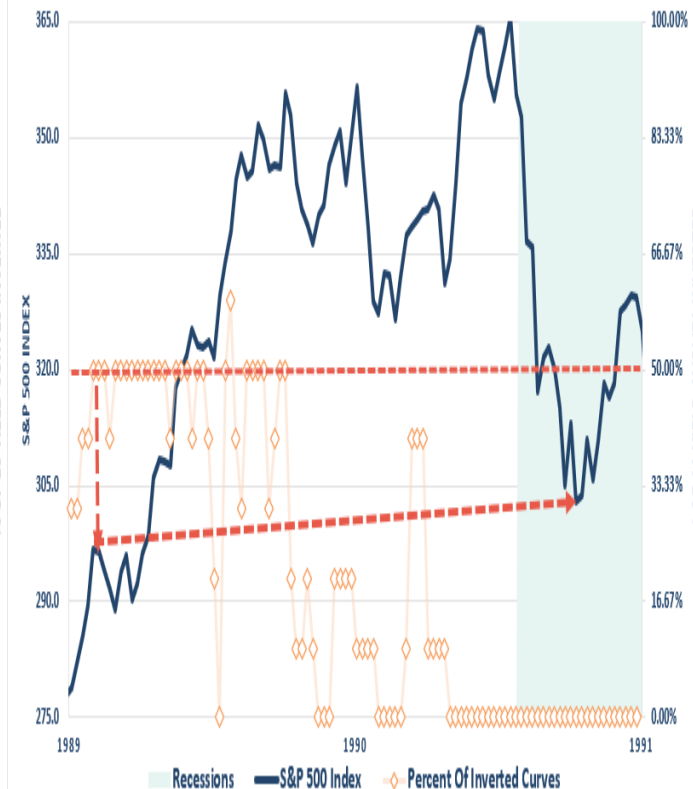
## PERCENT OF 10-YIELD CURVES INVERTED

REAL INVESTMENT ADVICE



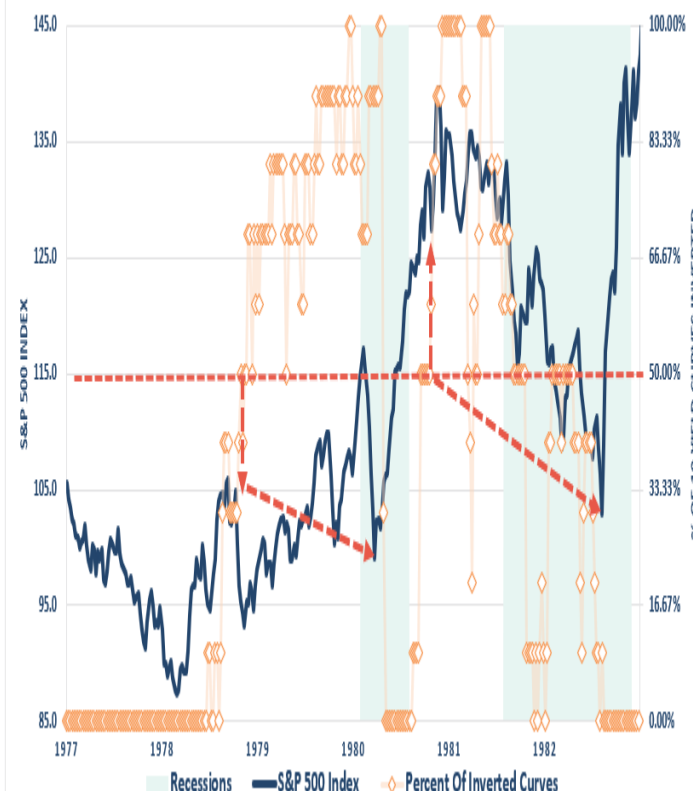
## PERCENT OF 10-YIELD CURVES INVERTED

REAL INVESTMENT ADVICE



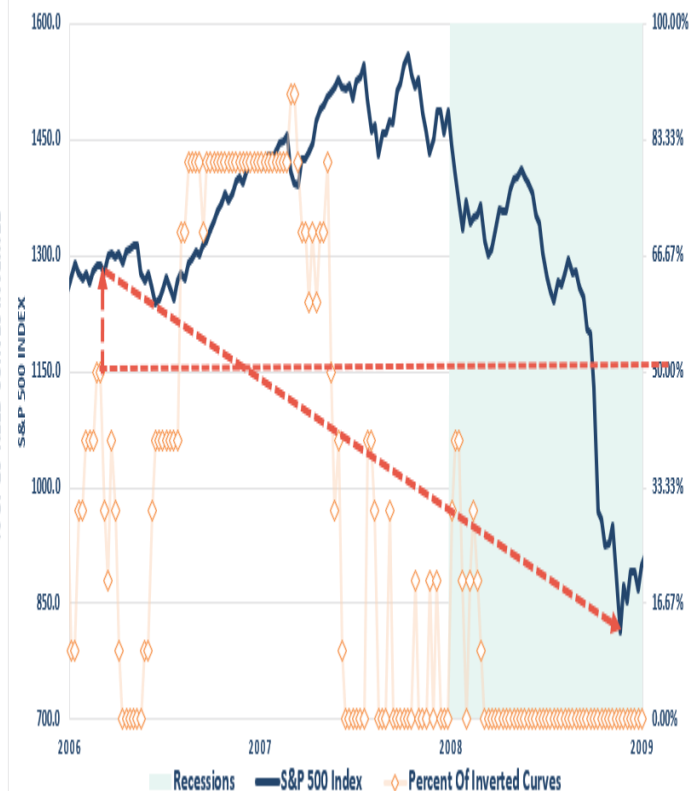
## PERCENT OF 10-YIELD CURVES INVERTED

REAL INVESTMENT ADVICE



## PERCENT OF 10-YIELD CURVES INVERTED

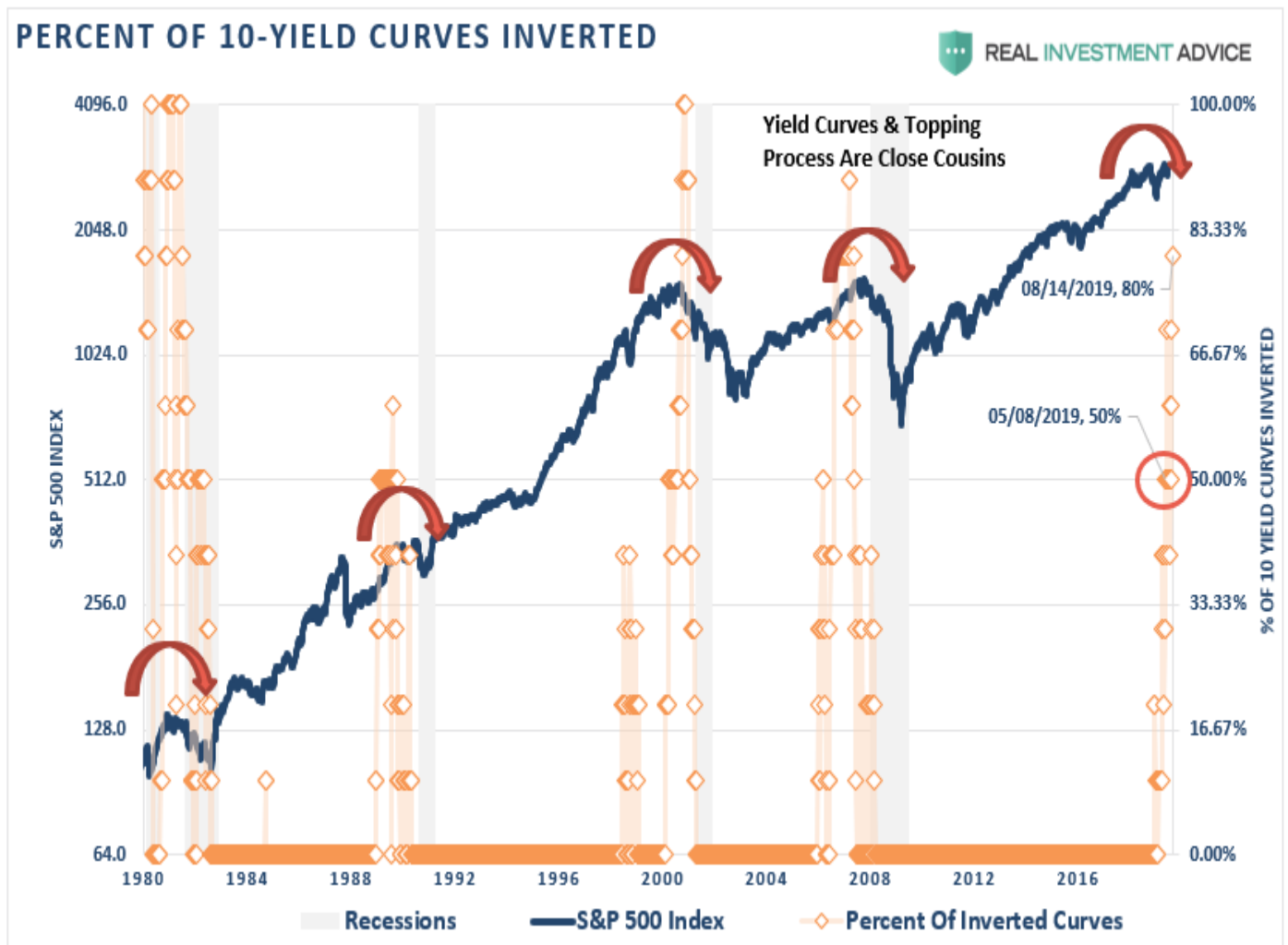
REAL INVESTMENT ADVICE



As you can see, in every case, the market did rally a bit after the initial reversion. However, had you reduced your equity-related risk, not only did you bypass a lot of market volatility (which would have led to investor mistakes) but ended up better off than those trying to "ride it out."

**That's just history**

Oh, as we noted last week, we just hit the 80% mark of inversions on the 10-spreads we track. *(Historically, there has never been a point where 80% of yield curves were inverted that a recession wasn't pending.)*



**This time is unlikely to be different.**

More importantly, with economic growth running at less than 1/2 the rate of the previous two periods, it will take less than half the amount of time for the economy to slip into recession. •

The yield curve is sending a message which shouldn't be ignored, and it is a good bet that *risk-based* investors will act sooner rather than later. Of course, it is simply the contraction in liquidity which causes the decline that will eventually exacerbate the economic contraction.

**While it is unwise to use the *yield curve* as a *market timing* tool, it is just as unwise to completely dismiss the message it is currently sending.**

Moreover, I am certainly **NOT** suggesting you sell everything and go to cash today. **However, history is pretty clear that you will likely not miss much if you did.**

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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IN 2019**

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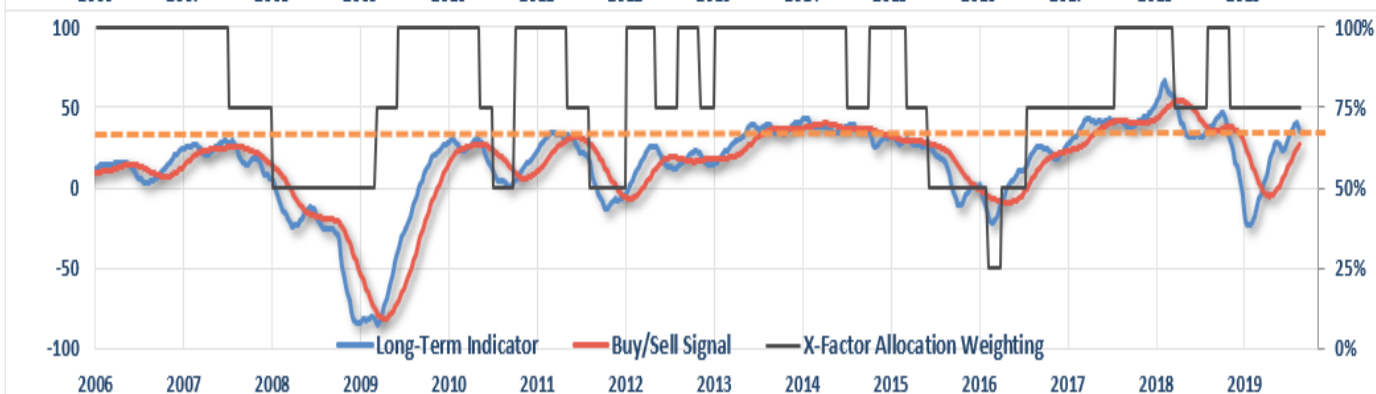
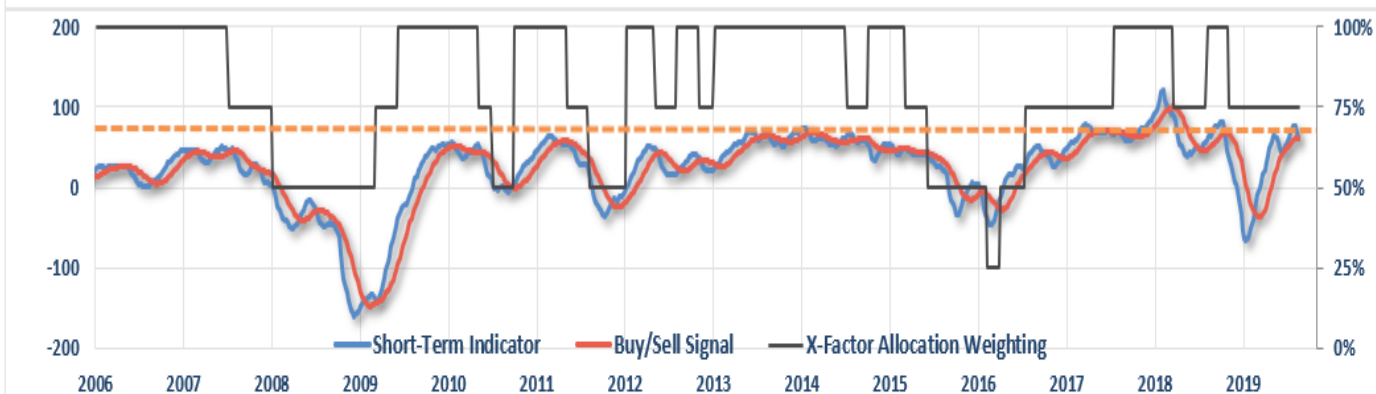
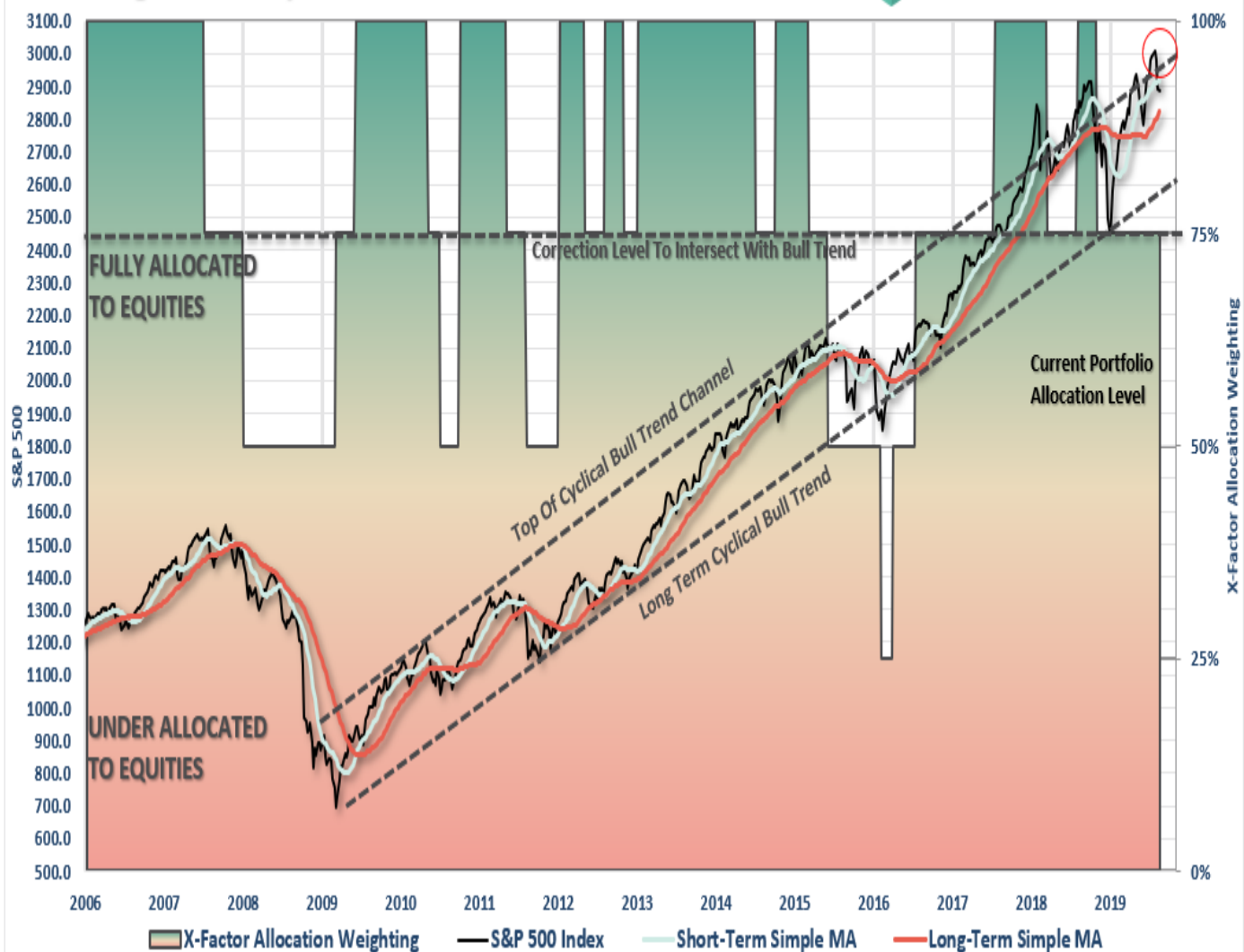
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## THE REAL 401k PLAN MANAGER

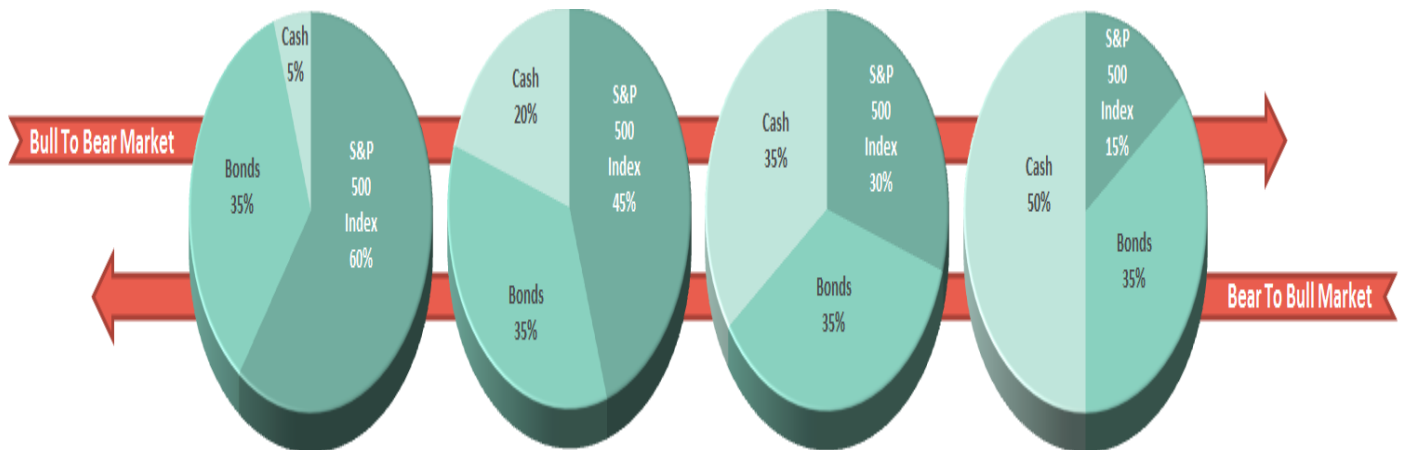
*A Conservative Strategy For Long-Term Investors*

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# Risk Management Analysis



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.**



## Trump Is Making This Really Tough - Part 2

As I wrote two weeks ago:

*"A less than anticipated rate cut, and outlook, by the Fed tripped up participants. Then Trump deciding to add additional tariffs on China, in order to force the Fed to cut rates, roiled stocks even more. **Stocks sold off for the entirety of last week, so expect a rally early next week to sell into. Take some actions if you have not already as the next two months could bumpy. The correction is likely not complete yet.***

More tweets and volatility this week, inverted yield curves, etc.

While volatility has risen markedly, the markets really haven't done anything "wrong" as of yet. This is one of those times we have to sit on our hands and wait. With markets moving from one tweet to the next, it is impossible to successfully trade these swings. •

Downside risk is elevated, so we are maintaining underweight holdings for now. However, if we begin to break supports, we will recommend reducing risks further. •

If you haven't taken any actions as of late, it is not a bad time to do so. •

- If you are **overweight equities**- Hold current positions but remain aware of the risk. Take some profits, and rebalance risk to some degree if you have not done so already. •
- If you are **underweight equities or at target** -rebalance risks and hold positioning for now.

If you need help after reading the alert; do not hesitate to [contact me](#).

## 401k Plan Manager Beta Is Live

We have rolled out a very early beta launch to our [RIA PRO subscribers](#)

Be part of our "**Break It Early Testing Associate**" group by using **CODE: 401**

**The code will give you access to the entire site during the BETA testing process**, so not only will you get to help us work out the bugs on the 401k plan manager, you can submit your comments about the rest of the site as well.

We have several things currently in development we will be adding to the manager, but we need to start finding the "bugs" in the plan so far.

**We are currently covering more than 10,000 mutual funds and have now added all of our Equity and ETF coverage as well.**•You will be able to compare your portfolio to our live model, see changes live, receive live alerts to model changes, and much more.

**We are building models specific to company plans. So, if you would like to see your company plan included specifically, [send me the following](#):**

- *Name of the company*
- *Plan Sponsor*
- *A print out of your plan choices. (Fund Symbol and Fund Name)*

I have gotten quite a few plans, so keep sending them and I will include as many as we can.

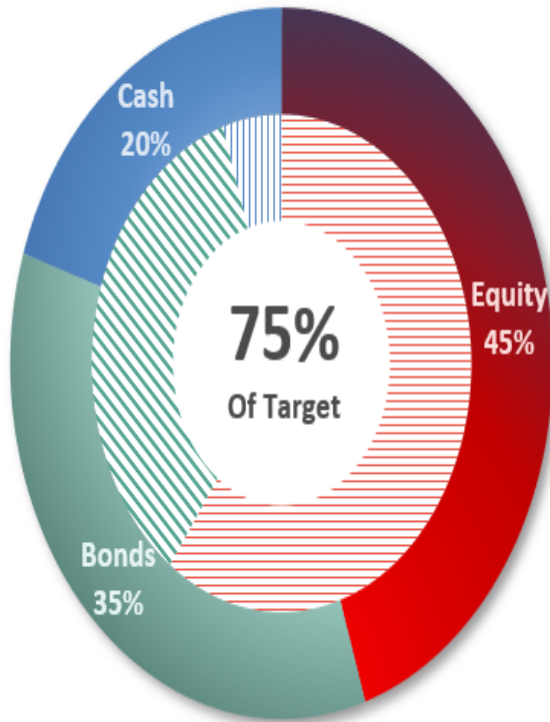
**If you would like to offer our service to your employees at a deeply discounted corporate rate, [please contact me](#).**

## **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 Portfolio Weighting



## 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*



Model performance is based on a two-asset model of stocks and bonds relative to the weighting changes made each week in the newsletter. This is strictly for informational and educational purposes only and should not be relied upon for any reason. Past performance is not a guarantee of future results. Use at your own risk and peril. •

