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The "QE, Not QE" Rally Is On

Last week, we discussed the "QE, Not QE" rally:

> *"Just recently, we released a study for our **[RIAPro Subscribers (30-Day Free Trial)](#)** on historical QE programs and what sectors,• markets, and commodities perform best.(If you subscribe for a 30-day Free Trial you can read the entire report **'An Investor's Guide To QE-4.'**)" 'On October 9, 2019, the Federal Reserve announced a resumption of quantitative easing (QE). **Fed Chairman Jerome Powell went to great lengths to make sure he characterized the new operation as something different than QE.** Like QE 1, 2, and 3, this new action involves a series of large asset purchases of Treasury securities conducted by the Fed. The action is designed to pump liquidity and reserves into the banking system. **Regardless of the nomenclature, what matters to investors is whether this new action will have an effect on asset prices similar to prior rounds of QE.** For the remainder of this article, we refer to the latest action as QE*

Equity Index Returns	Large Cap Dow Jones	Large Cap S&P 500	Large Cap NASDAQ	Large Cap S&P 100	Mid Cap S&P 400	Small Cap S&P 600	Small Cap Russell 2k	All Equity	Equity Factors: Growth	Equity Factors: Value
QE3	18.3%	23.6%	19.6%	19.7%	30.1%	35.6%	31.5%	25.5%	21.4%	26.3%
QE3 Max	18.3%	23.6%	19.6%	19.7%	30.4%	35.6%	31.5%	25.5%	21.4%	26.3%
QE3 Min	-7.3%	-6.9%	-11.4%	-7.9%	-5.3%	-8.5%	-9.3%	-8.1%	-7.6%	-6.0%
QE2	7.3%	6.0%	2.6%	5.0%	10.5%	9.9%	8.7%	7.1%	5.4%	6.7%
QE2 Max	14.5%	13.7%	12.4%	12.6%	20.3%	19.5%	20.3%	16.2%	12.5%	15.0%
QE2 Min	-0.9%	-0.8%	-0.1%	-1.2%	0.0%	0.0%	0.0%	-0.4%	-0.1%	-1.6%
QE1	25.6%	33.2%	65.8%	26.0%	58.0%	45.9%	47.3%	43.1%	38.9%	26.9%
QE1 Max	25.6%	33.2%	65.8%	26.0%	58.0%	45.9%	47.3%	43.1%	38.9%	26.9%
QE1 Min	-23.3%	-22.0%	-9.6%	-23.4%	-18.1%	-25.0%	-23.9%	-20.7%	-14.4%	-29.8%
QE Avg.	17.1%	20.9%	29.3%	16.9%	32.9%	30.5%	29.1%	25.2%	21.9%	20.0%
QE Avg. Max	19.5%	23.5%	32.6%	19.4%	36.2%	33.7%	33.0%	28.3%	24.3%	22.7%
QE Avg. Min	-10.5%	-9.9%	-7.1%	-10.9%	-7.8%	-11.2%	-11.0%	-9.8%	-7.3%	-12.5%
Average vs. S&P 500	-3.9%	0.0%	8.4%	-4.0%	11.9%	9.5%	8.2%	4.3%	1.0%	-1.0%

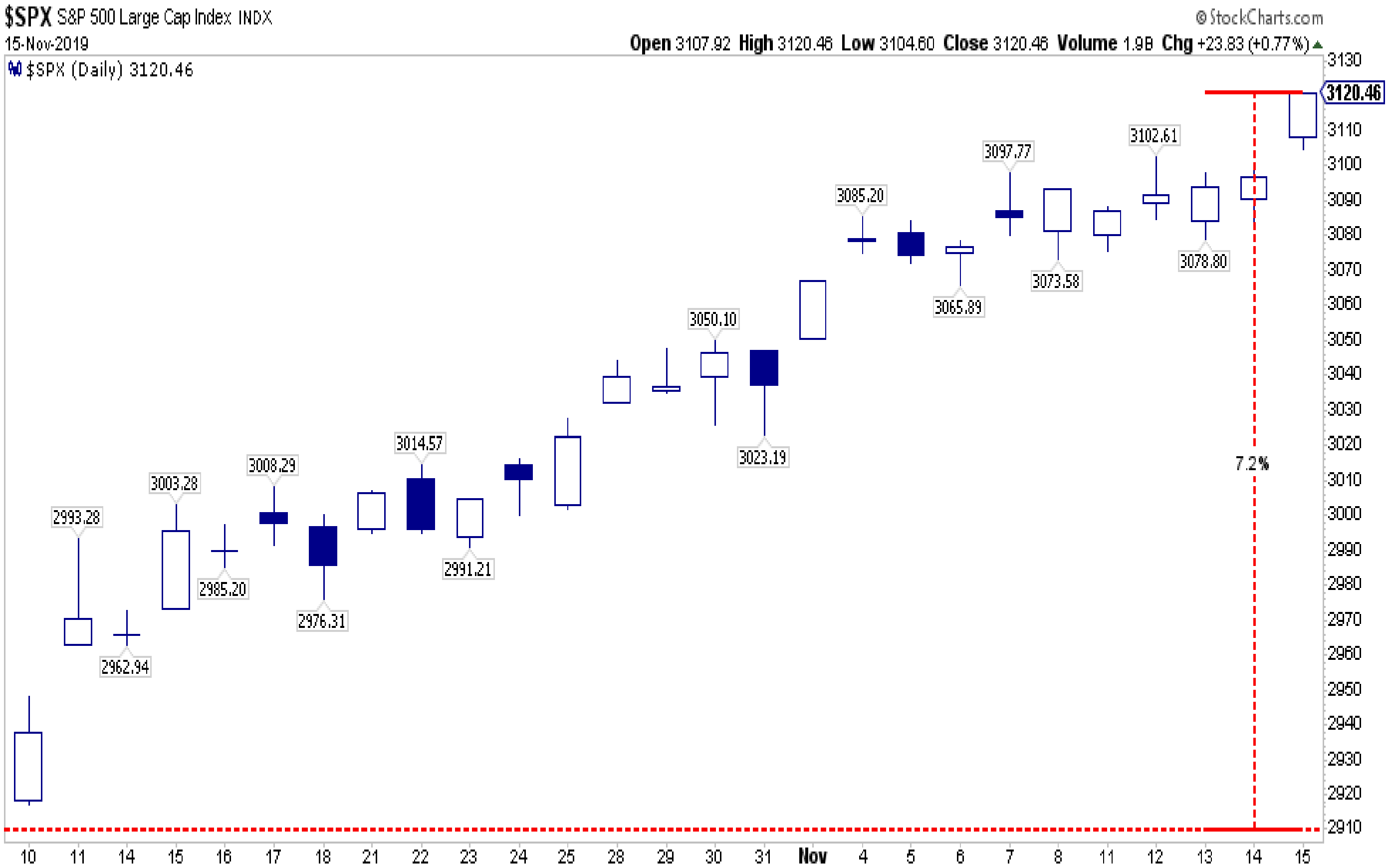
Equity Indexes - Annualized and Normalized Returns per $100bn of QE	Large Cap Dow Jones	Large Cap S&P 500	Large Cap NASDAQ	Large Cap S&P 100	Mid Cap S&P 400	Small Cap S&P 600	Small Cap Russell 2k	All Equity	Equity Factors: Growth	Equity Factors: Value
QE3	1.34%	1.72%	1.43%	1.44%	2.18%	2.56%	2.28%	1.85%	1.56%	1.91%
QE2	1.83%	1.51%	0.64%	1.24%	2.67%	2.52%	2.20%	1.80%	1.35%	1.69%
QE1	1.42%	1.82%	3.45%	1.44%	3.07%	2.47%	2.54%	2.33%	2.12%	1.49%
QE Avg.	1.53%	1.68%	1.84%	1.38%	2.64%	2.52%	2.34%	1.99%	1.68%	1.70%

As you will notice, all major markets increased in value during QE-1, 2, and 3.

Regardless, whether you believe the Fed's actions are *"QE," "QE-Lite," of "Not QE at all"* is largely irrelevant. What is relevant is that•each time the Fed has engaged in monetary programs, the markets have risen. Therefore, it should **not be surprising investors now have a *["Pavlovian"](#)* response to the Fed's *"ringing of the bell."***•During the past few weeks, we have discussed the probability of a year-end rally, which would be supported by both the Fed, and a *"trade deal."*•The following links will catch you up on our premise.

- *[The QE Rally Is On - How To Play It & What Happens Next 11-08-19](#)*
- *[The Fed's "Not QE" And How We Are Playing It 10-25-19](#)*
- *[For The Bulls, It's Now Or Never 10-18-19](#)*
- *[Trade Deal Done? Is 3300 The Next Stop For The Market? 10-11-19](#)*

With the Fed cutting rates, Trump touting *"trade deals,"* and now *"tax cuts for the middle class,"*•not to mention the Federal Reserve increasing their balance sheet, it should not surprising markets have rallied over the last 5-weeks as shown below.



Think about it this way, in just 5-weeks the market has almost advanced as much as the long-term historical average annual return. This should suggest two things.

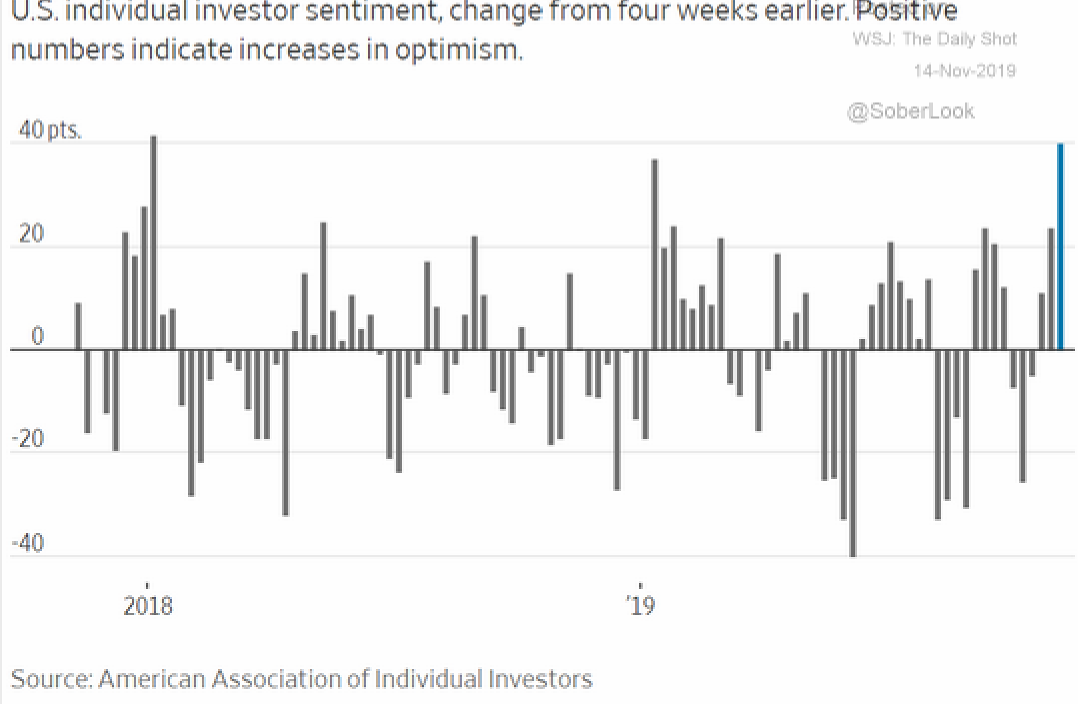
1. *The market has already priced in a bulk of the benefit from the additional liquidity; and,•*
2. *The market has advanced too quickly.*

Too Fast, Too Furious

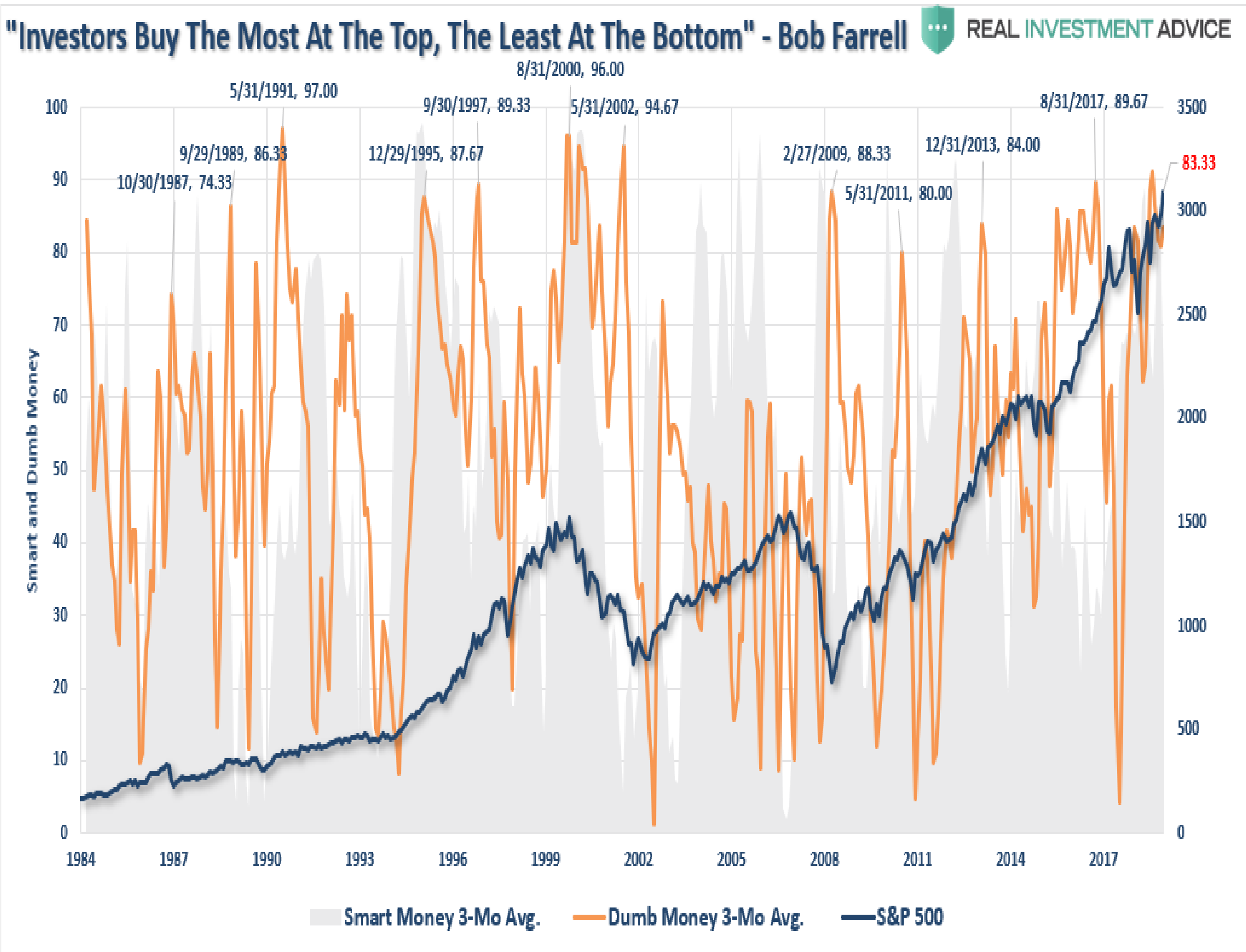
On Tuesday, [I posted a series of charts]() which showed the rather rapid reversion from more extreme bearishness mid-summer to more extreme bullishness now. As I noted:

> *"But it isn?t just the more extreme advance of the market over the past 5-weeks which has us a bit concerned in the short-term,* ***but a series of other indications which typically suggest short- to intermediate-terms corrections in the market. Historically, when all of the indicators are suggesting the market has likely encompassed the majority of its price advance, a correction to reverse those conditions is often not far away. Regardless of the timing of that correction, it is unlikely there is much upside remaining in the current advance, and taking on additional equity exposure at these levels will likely yield a poor result."***

What is quite amazing is that this reversal from *"bearish"* to *"bullish"* occurred precisely as the Fed began pumping liquidity into the markets. The last time investor sentiment was this bullish was at the beginning of 2018, which eventually led to a near 20% correction.

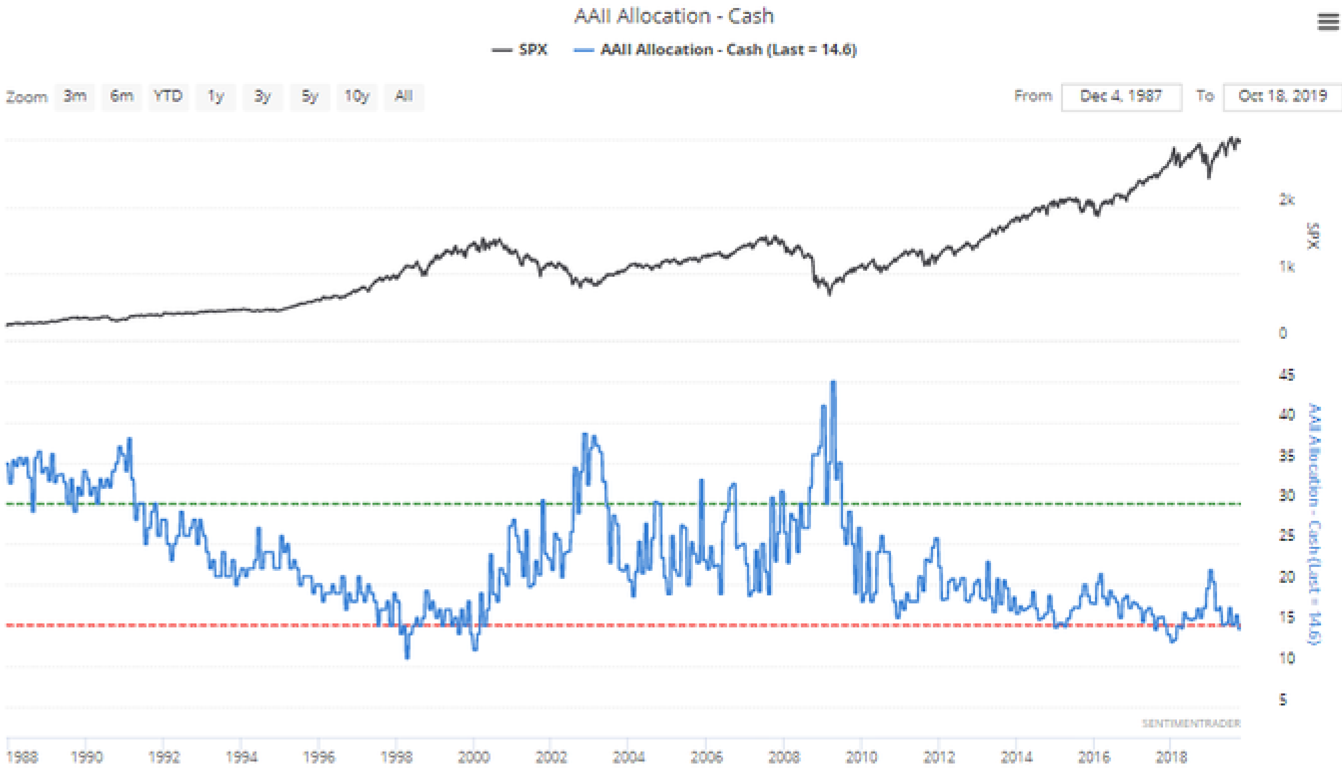


As with above, retail investors are "all in" once again with the smart/dumb money indicator noting an extreme bullish bias of retail investors.



Of course, this coincides with [extremely low individual cash levels]() of individuals.

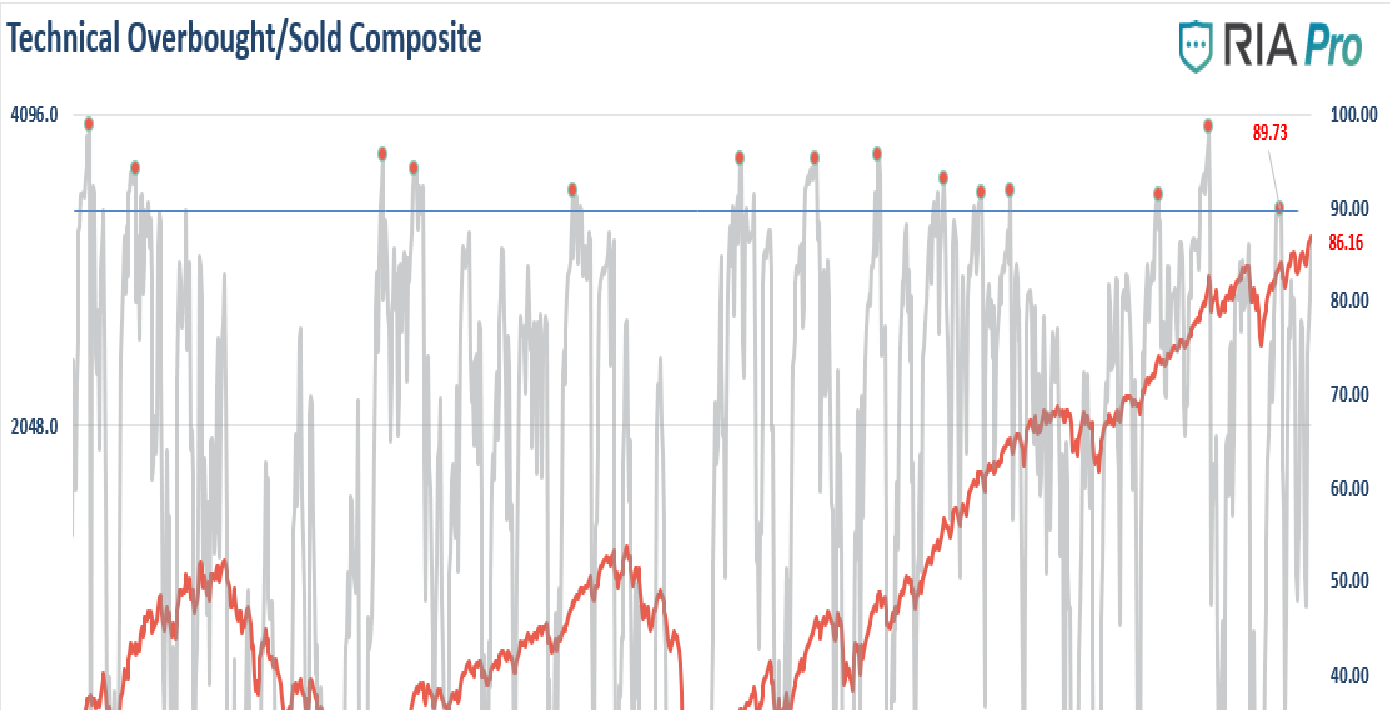
"With cash levels at the lowest level since 1997, and equity allocations near the highest levels since 1999 and 2007, it suggests investors are now functionally 'all in.'?•



With net exposure to equity risk by individuals at historically high levels, it suggests two things:

1. ***There is little buying left from individuals to push markets marginally higher, and;***
2. ***The stock/cash ratio, shown below, is at levels normally coincident with more important market peaks.***

Lastly, for a *"bullish sentiment"* perspective, investment newsletters are now exceedingly bullish. https://twitter.com/LanceRoberts/status/1194220089572245504?s=20 These are all *"contrarian"* indicators, which suggest that if everyone is *"all in,"* there is currently no one left to *"buy."* Such conditions typically are associated with short-term market corrections. However, even if we set aside investor sentiment and positioning for a moment, the rapid reversion is price has sent our technical composite overbought/oversold gauge back towards more extreme levels of overbought conditions. ***(Get this chart every week at RIAPRO.NET)***



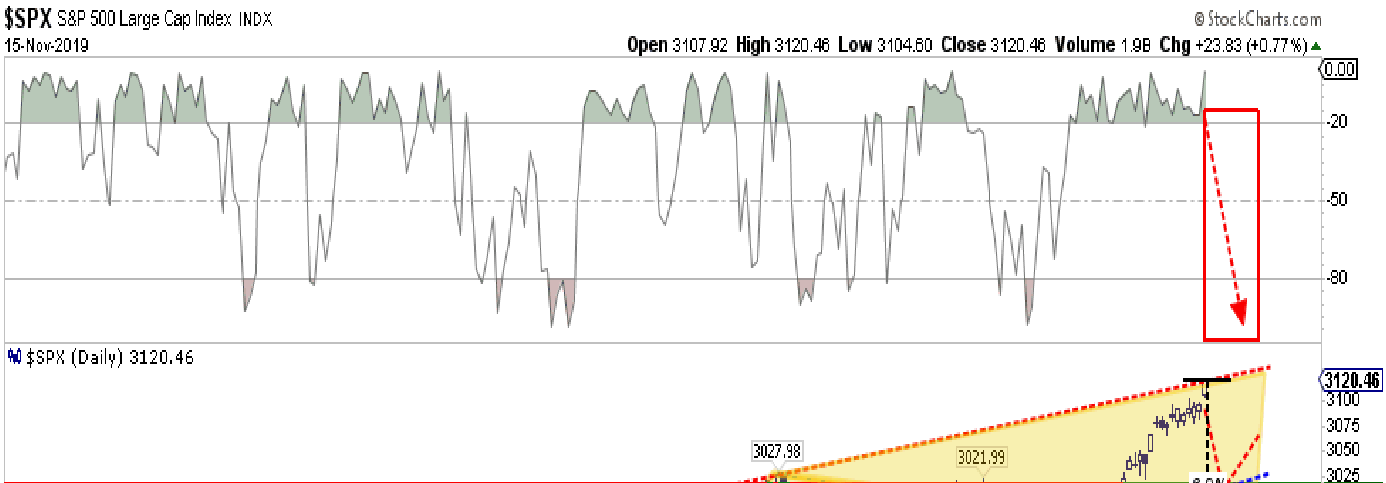
As noted previously, virtually every measure of volatility has been suppressed as the "*fear of a correction"* has evaporated. https://twitter.com/sentimentrader/status/1194668465182924801?s=20 Low volatility measures are a representation of more extreme levels of investor complacency. Such complacency provides *"fuel"* for a reversion as investors sentiment transitions from complacency to fear. As we noted just recently for our RIAPRO.NET subscribers, the divergence of breadth is also indicative of short-term tops in markets. https://twitter.com/Not_Jim_Cramer/status/1195065667680161792?s=20 What all of this data suggests is that markets have risen *"too fast, too furious"* which raises the probability of a price correction in the short-term. **This is why•we have hedged our portfolios last week.**Does that mean we are bearish and betting on the market to crash. Not at all.

Why We Hedge

Currently, our portfolios are long-biased meaning we have more equity-risk in our allocation than fixed income and cash. Given the market's advance, and the data points set out above, and [this past Tuesday,](#) we have three choices in how we manage our client portfolios at this juncture:

1. **Do Nothing** - if the markets correct, we lose some of our gains and just have to wait for the portfolio to recover.
2. **Take Profits** - as we have done with extremely overvalued assets in the past, we can take profits, raise cash, and reduce our equity exposure in advance of a correction. Such actions mitigate the damage of the decline, but positions have to be repurchased, or new ones added, to resize the portfolio in the future.
3. **Hedge** - adding a position to the portfolio that is the *"inverse"* of the market. *(the position goes up in value as the market declines.)*This action allows us to keep our existing positions intact, and by *"shorting against the portfolio"* allows us to effectively reduce our equity risk (and related capital destruction) during a market correction.

Why did we choose *"Option 3"* at this juncture? Option 1 - is never really a good option. Riding the market up and down, and spending time *"getting back to even,"* doesn't make a whole lot of sense. Option 2 - is something that we took advantage of twice this year already. We took profits at the peak of the market in May and July before both of the subsequent swoons. We also added new exposures in early October. So, taking profits again in some positions would lead to a gross underweight in certain areas of the portfolio allocation. **This makes Option 3 the most optimal at this stage of the rally.** With the Fed engaged in pumping liquidity into the markets, and any day may also include a random market manipulation from a *"Trump tweet,"* the most opportunistic method to hedge risk is to add a *"short S&P 500"* index position to the portfolio. The chart below shows the range of options which we expect could occur.



1. ***Market breaks ABOVE the current upward trending range.*** *We are currently carrying a stop at 3150 for our short position, where we will close it out. Yes, we will have a minimal loss in the position but the rest of our equity holdings will advance more than making up for the differential.* ***(Example: On Friday, the S&P 500 increased .77%, our 60/40 Equity Portfolio with the Short Position rose by .46%)***
2. ***Market corrects to the currently rising 50-dma*** *and in that process reverses the current overbought condition of the market (top panel, red box) back to oversold. Note: the 50-dma also currently coincides with the previous resistance of this year's market highs. A retest of this level that holds, and removes the overbought condition as noted, would be very bullish. We will close out the hedge and increase our long-exposure.*
3. ***If the market breaks below the 50-dma, and is NOT oversold,*** *the next level of support is the lower rising trendline. This is also important support, and a successful test that reverses the overbought condition would require a removal of hedges.•*
4. ***The last support is the rising 200-dma.*** *If the market test and holds the 200-dma, is oversold, and sentiment has returned to a more bearish position, we will close out our hedges.*
5. ***IF the market breaks below the 200-dma,*** *we will likely be discussing the process of reducing long positions and increasing short-hedges.•*

Importantly, the range of corrections discussed only runs 3-6%, which is well within the normal confines of a bullish correction. When we discuss hedging against risk, it is invariably taken that we have sold everything and are now betting on a market *"crash."*•Such is hardly the case. We are simply taking prudent actions in the portfolio management process to reduce capital risk, and potentially add some incremental *"alpha"* to portfolios if a correction occurs. This is just how we manage risk. You have a choice to either manage risk, or ignore it. The only problem is that ignoring risk has a long history of not working out very well. If you need help or have questions, we are always glad to help. Just email me. See you next week.

"NEW" - Financial Planning Corner

by Danny Ratliff, CFP Welcome to the planning corner. I?m Danny Ratliff a Certified Financial Planner with RIA Advisors. **Starting next week, we will provide an unadulterated look at financial planning norms and myths. We will inform you on financial planning trends, changes in laws and regulations.** •The intent is to be a resource of sound financial advice that you, or someone you know, can put to practical use. We will be covering such topics as:

- ***Social Security*** *- take it now or later.*
- ***Long Term Care*** *- do you really need it?*
- ***Medicare*** *- the best strategies to maximize your benefits.*
- ***Workplace Benefits*** *- are you getting the most from them? You may be missing out on "free money."•*
- ***Risk Management -*** *what you need to know to mitigate the things that can hurt you.•*
- ***Estate Planning*** *- now that you've got money, tips on how to pay less taxes and not lose it.•*
- ***Savings Rates*** *- what is important, and what's not.*
- ***Accumulation and distribution of assets*** *- taxes, legal issues, and considerations you probably haven't thought of.*

Don't hesitate to ***send me an email*** if you have any questions or topics you'd like us to cover.• We encourage your feedback and look forward to hearing from you.

Market & Sector Analysis

Data Analysis Of The Market & Sectors For Traders

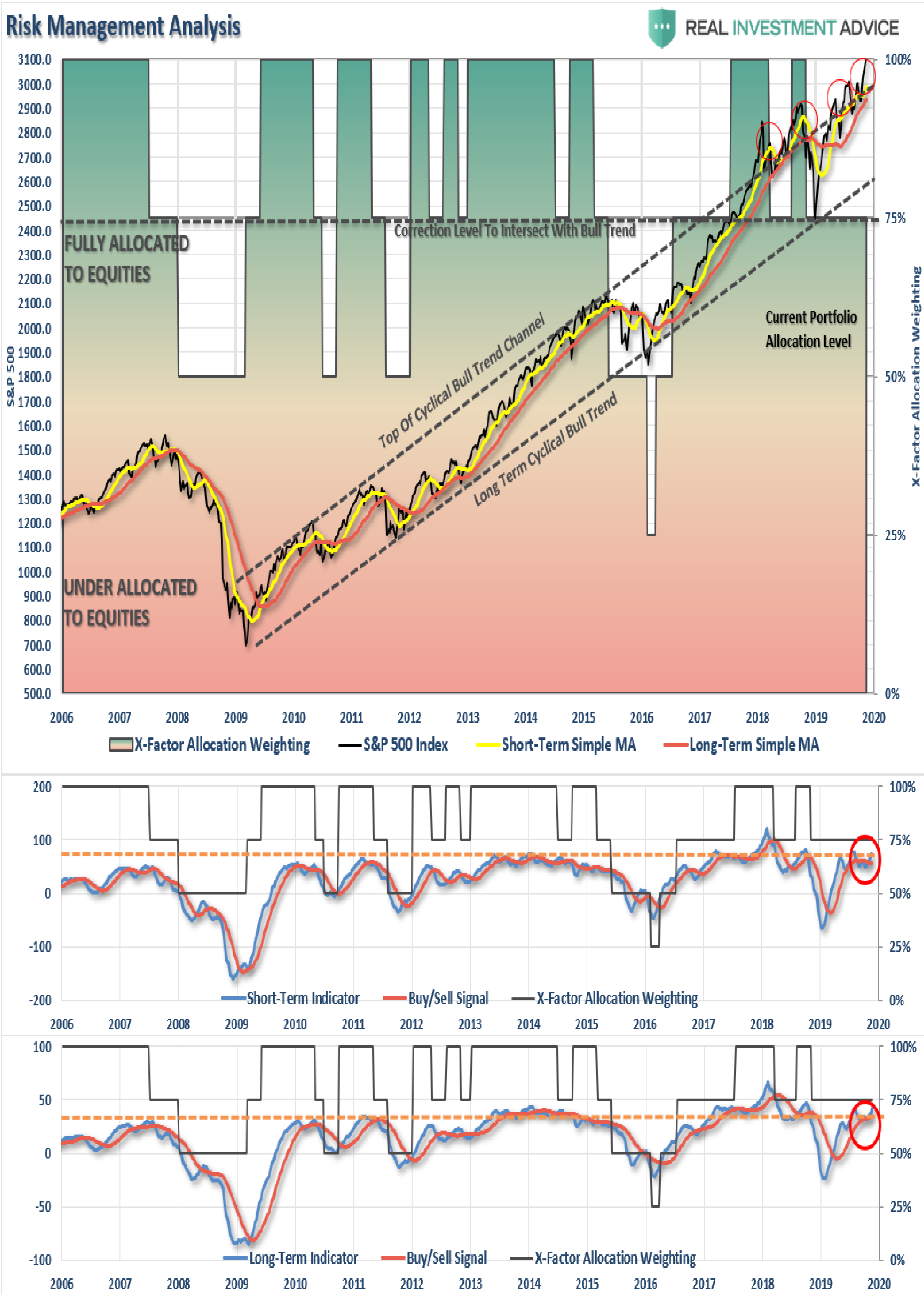
MISSING THE REST OF THE NEWSLETTER?

This is what our *RIAPRO.NET* subscribers are reading right now!

- *Sector & Market Analysis*
- *Technical Gauges*
- *Sector Rotation Analysis*
- *Portfolio Positioning*
- *Sector & Market Recommendations*
- *Client Portfolio Updates*
- *Live 401k Plan Manager*

THE REAL 401k PLAN MANAGER

A Conservative Strategy For Long-Term Investors



Click To Enlarge

Portfolio Instructions:		
Allocation Level To Equities	Reommendation	When To Take Action
Less Than Target Allocation	Increase To Target	On Correction In Market
Equal To Target Allocation	No Change	N/A
Over Target Allocation	Rebalance Holdings	Immediately

Commentary

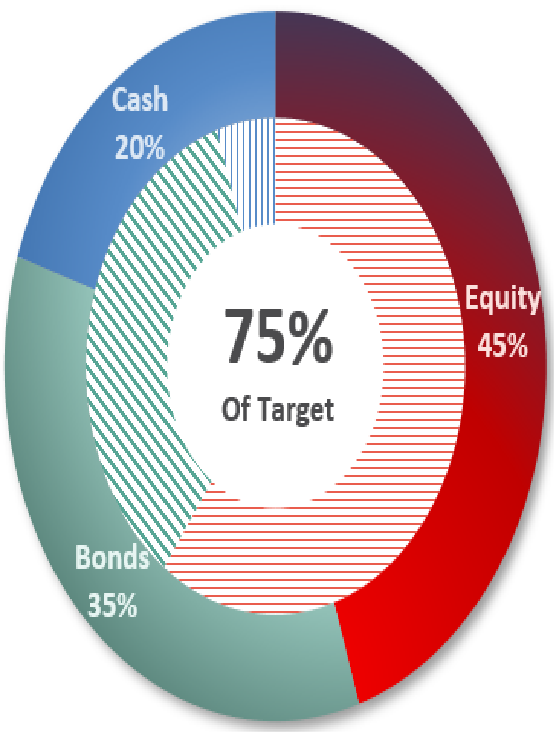
Currently, the market is very overbought and deviated well above long-term trends. This has historically been unsustainable, so remaining patient for a modest correction will provide for a better opportunity to add addtional risk. Market trend is positive, but risk/reward is temporarily out of favor.

If you need help after reading the alert; do not 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 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)**

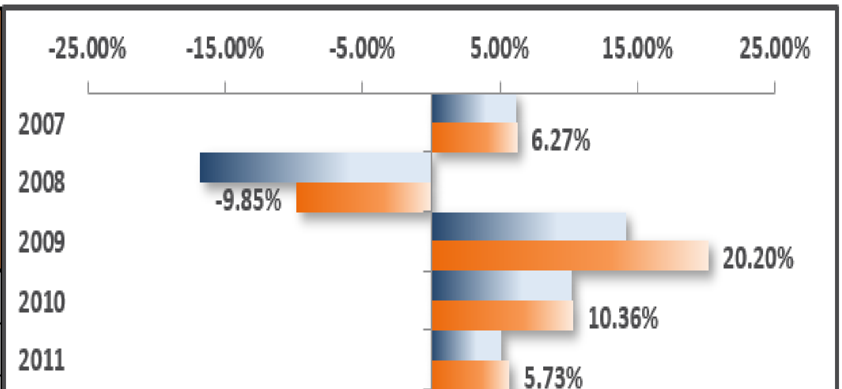
The vast majority of funds track an index.
Therefore, select on ONE fund from each category.
Keep it Simple.

10% Equity Income, Balanced or Conservative Allocation
35% Large Cap Growth (S&P 500 Index)
0% International Large Cap Dividend
0% Mid Cap Growth

Click Here For The "LIVE" Version Of The 401k Plan Manager *See below for more details.*

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.•

Year	60/40 Benchmark Return	60/40 Model Return
2007	6.14%	6.27%
2008	-16.78%	-9.85%



401k Plan Manager Live Model

As an [RIA PRO subscriber](#) *(You get your first 30-days free) you have access to our live 401k p* **•The code will give you access to the entire site during the 401k-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 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)*

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