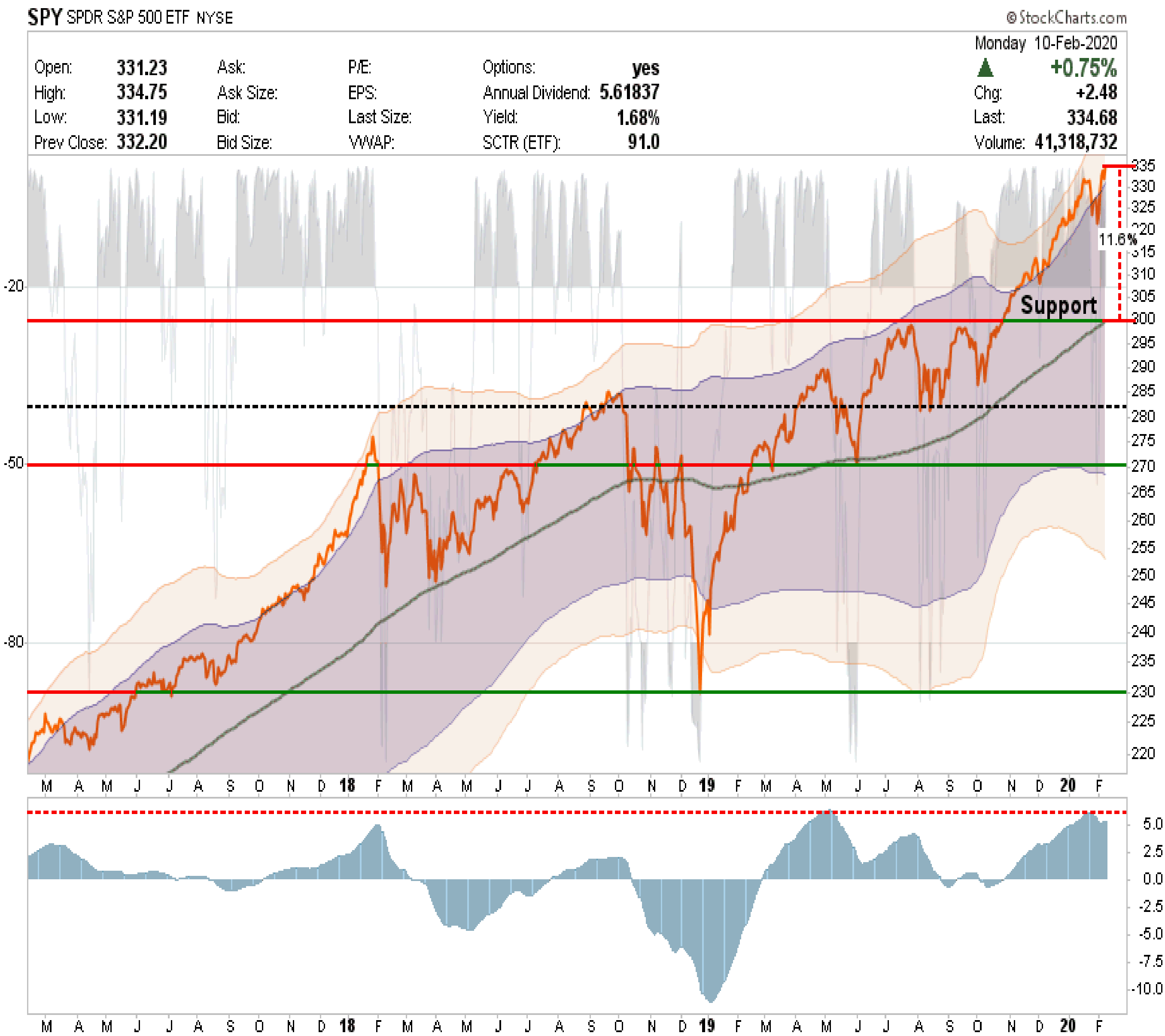
As discussed in this [past weekend's newsletter,](#) the market remains overly extended as the recent correction sharply reversed on expectations for more Fed liquidity. However, with the market extremely deviated from the long-term moving average, a correction is once again a high probability event.

> *"Previously, we discussed that we had taken profits out of portfolios as we were expecting between a 3-5% correction to allow for a better entry point to add equity exposure. While the ?virus correction? did encompass a correction of 3%, it was too shallow to reverse the rather extreme extension of the market. The rally this past week has reversed the corrective process, and returned the markets to 3-standard deviations above the 200-dma. Furthermore, all daily, weekly, and monthly conditions have returned to more extreme overbought levels as well."*



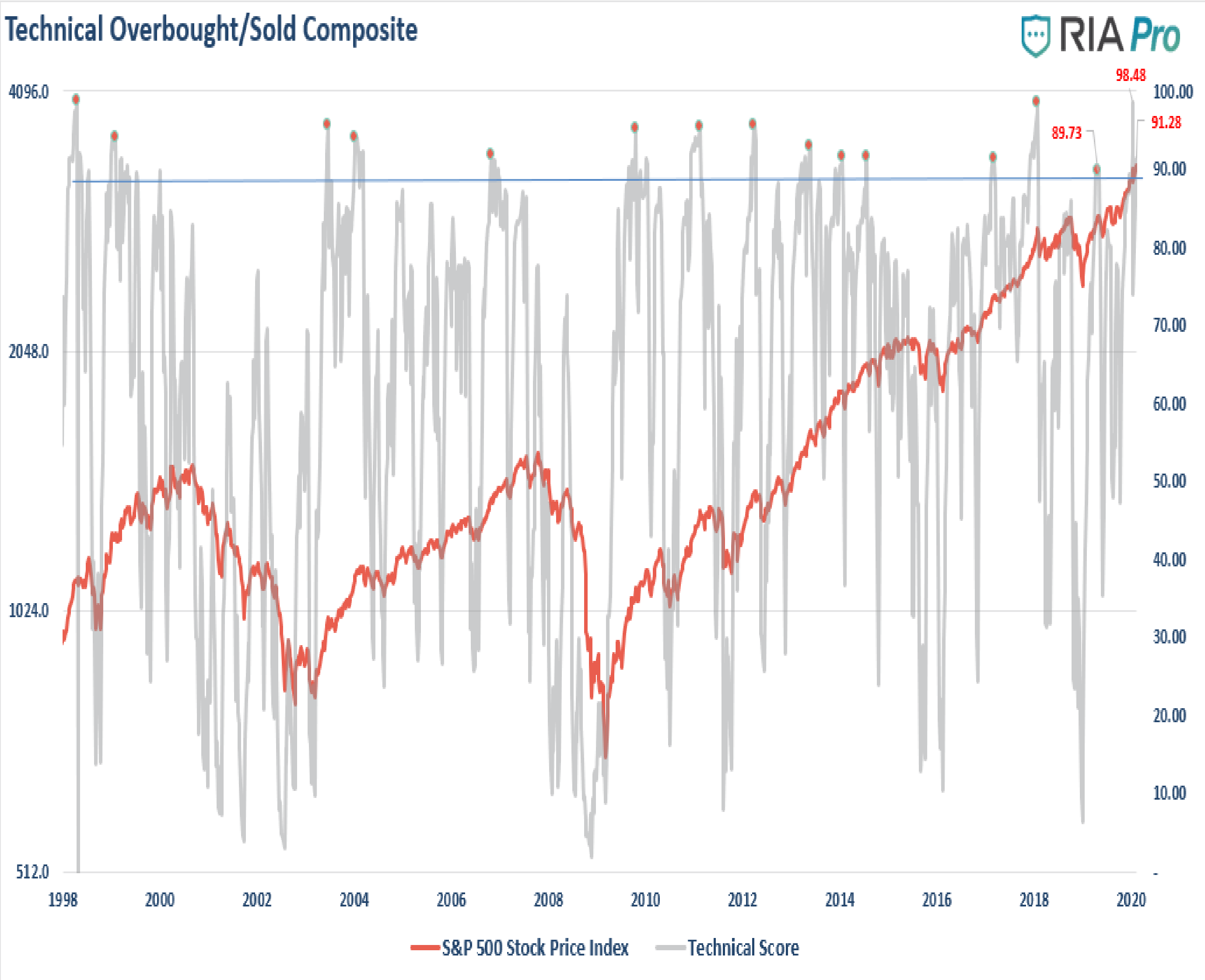
But it isn?t just the more extreme advance of the market over the past 5-weeks which has us a bit concerned in the short-term, **but a series of other indications which typically suggest short- to intermediate-terms corrections in the market.**

Furthermore, the markets are completely entirely the impact the *"coronavirus"* will have on the supply-chain globally. As David Rosenberg noted Monday:

> *"The impact of this virus is lasting longer and the effects, relative to SARS, are larger at a time when the Chinese economy is far softer. The follow-on effects on other markets has yet to be fully appreciated."*

Had the markets completed a correction that reduced the extreme overbought and extended conditions of the market, such would have offset the risk of the "viral impact" to the economy. However, without that correction, the eventual slowdown will likely have a great impact than is currently anticipated.

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)***



What we know is that markets move based on sentiment and positioning. This makes sense considering that prices are affected by the actions of both buyers and sellers at any given time. Most importantly, when prices, or positioning, becomes too *"one-sided,"* a reversion always occurs. **As Bob Farrell's Rule #9 states:**

> ***"When all experts agree, something else is bound to happen."***

So, how are traders positioning themselves currently?

Positioning Review

The COT *(Commitment Of Traders)* data, which is exceptionally important, is the **sole source of the actual holdings of the three key commodity-trading groups, namely:**

- ***Commercial Traders:*** *this group consists of traders that use futures contracts for hedging purposes and whose positions exceed the reporting levels of the CFTC. These traders are usually involved with the production and/or processing of the underlying commodity.*
- ***Non-Commercial Traders:*** *this group consists of traders that don?t use futures contracts for hedging and whose positions exceed the CFTC reporting levels. They are typically large traders such as clearinghouses, futures commission merchants, foreign brokers, etc.*
- ***Small Traders:*** *the positions of these traders do not exceed the CFTC reporting levels, and as the name implies, these are usually small traders.*

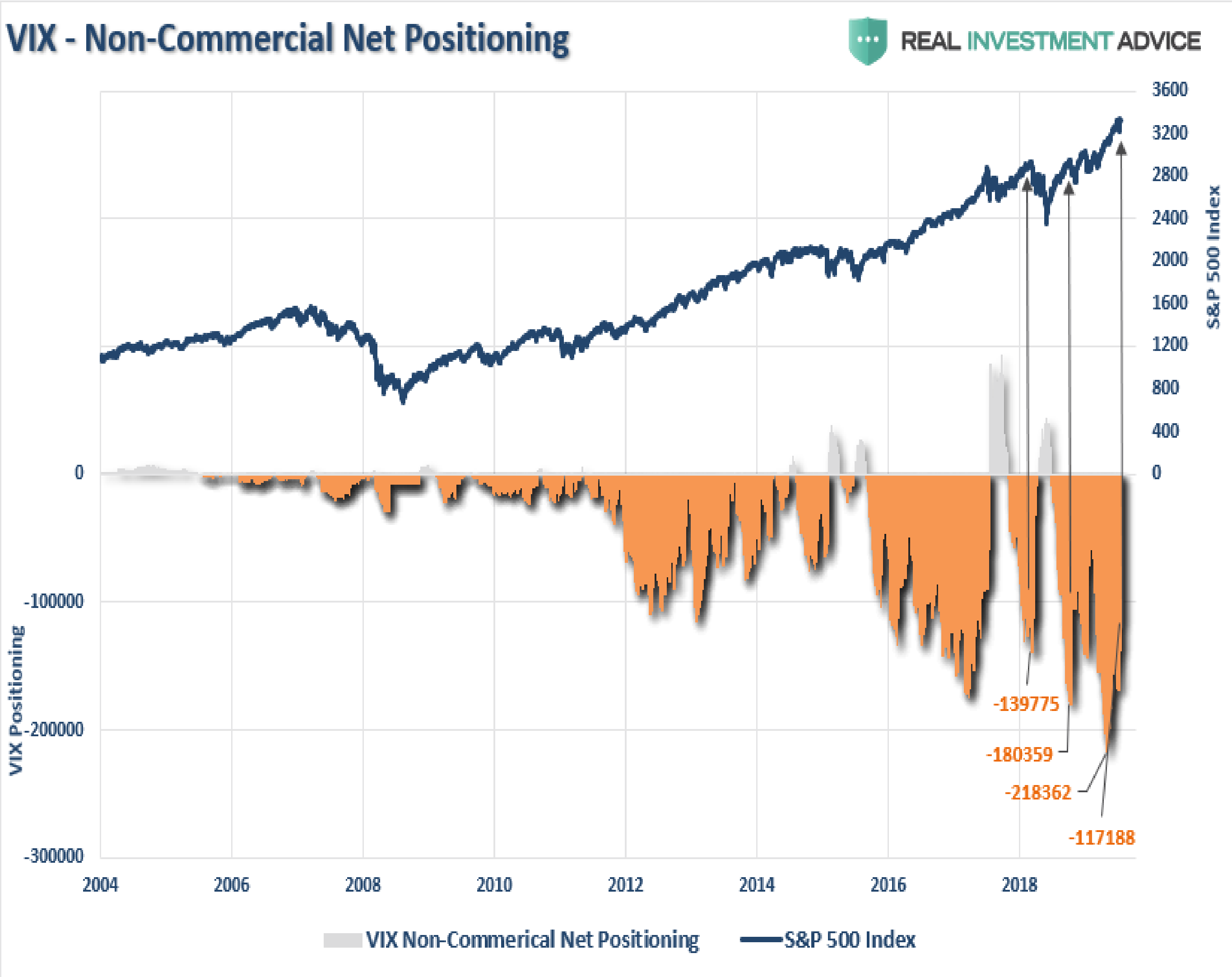
The data we are interested in is the second group of **Non-Commercial Traders.**

This is the group that speculates on where they believe the market is headed. **While you would expect these individuals to be *?smarter?* than retail investors, we find they are just as subject to *"human fallacy"* and *?herd mentality?* as everyone else.**

Therefore, as shown in the series of charts below, we can take a look at their current net positioning *(long contracts minus short contracts)* to gauge excessive bullishness or bearishness.

Volatility

The extreme net-short positioning on the volatility before to the correction last week, had suggested the correction was coming. However, while the correction reduced the net-short positioning somewhat, it remains at historical extremes. What the more extreme positioning tells us is there is plenty of *"fuel"* to drive a correction when one occurs.

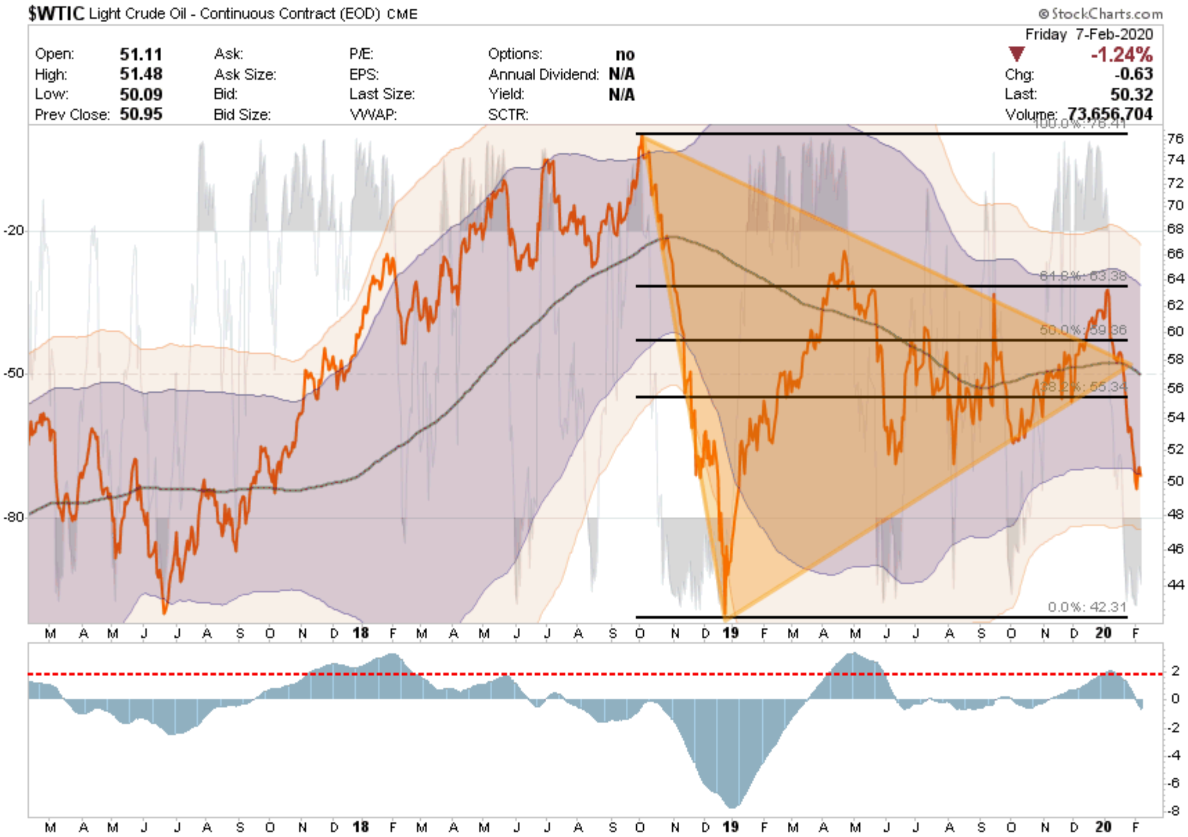


Investors have gotten used to extremely low levels of volatility, which is unique to this market cycle. This complacency, due to low volatility, has encouraged investors to take on greater levels of risk than they currently realize. When volatility eventually makes it return, the consequences to investors will not be kind.

Crude Oil Extreme

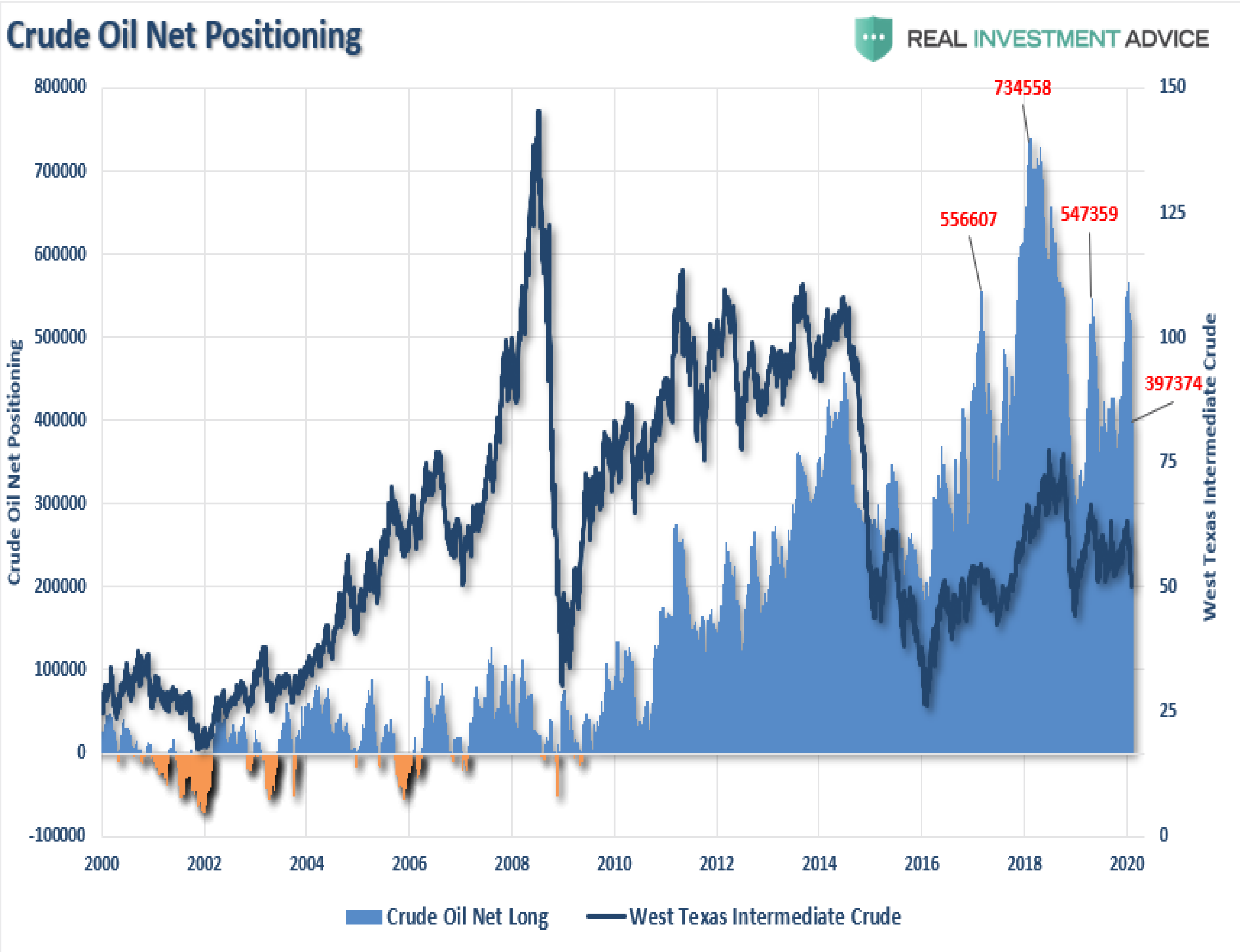
The recent attempt by crude oil to get back above the 200-dma coincided with the Fed's initiation of QE-4. Historically, these liquidity programs tend to benefit highly speculative positions like commodities, as liquidity seeks the highest rate of return.

However, beginning in December, that support for oil prices gave way, and prices have collapsed along with expectations for global economic recovery. We have been warning our ***RIAPro Subcribers (30-Day Risk Free Trial)*** for the last couple of months about the potential for this decline.



- *As noted previously, "Oil completely broke down last week, and collapsed below all of the important levels. Oil is now testing critical support at $51. A failure there and a break into the low $40?s is probable.?*
- *The support is barely holding and oil looks extremely weak. However, oil is extremely oversold so a counter-trend rally is highly likely and can be used to "sell" into.*
- *Stops Triggered for any direct crude oil positions.*
- *Long-Term Positioning: Bearish*

Despite the decline in oil prices over the last year, **it is worth noting that crude oil positioning is still on the bullish side with 397,000 net long contracts.**



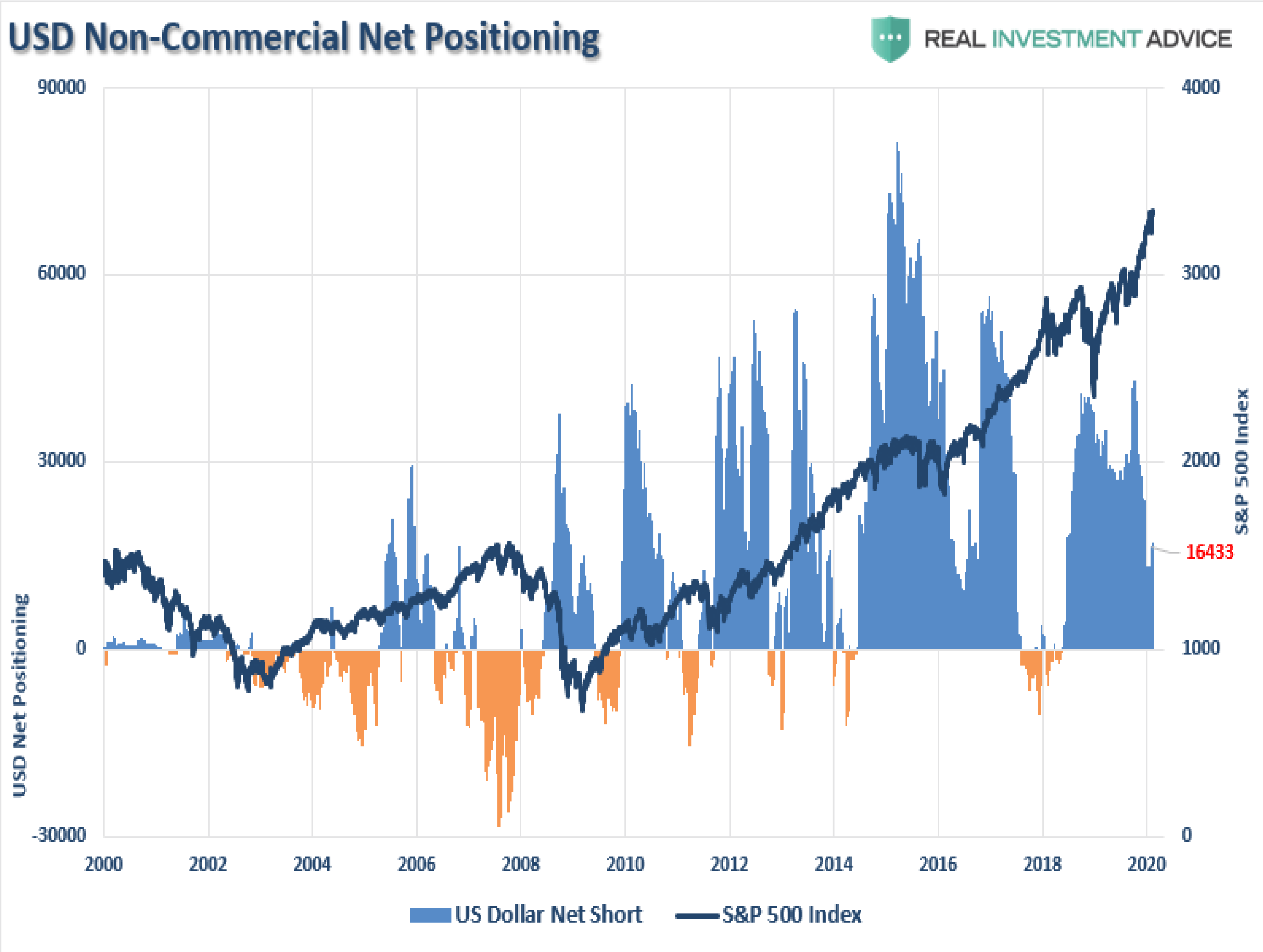
The inherent problem with this is that if crude oil breaks below $48/bbl, those long contracts will start to get liquidated which will likely push oil back into the low 40's very quickly. The decline in oil is both deflationary and increases the risk of an economic recession.

U.S. Dollar Extreme

Another index we track each week at ***RIAPRO.NET*** is the U.S. Dollar.

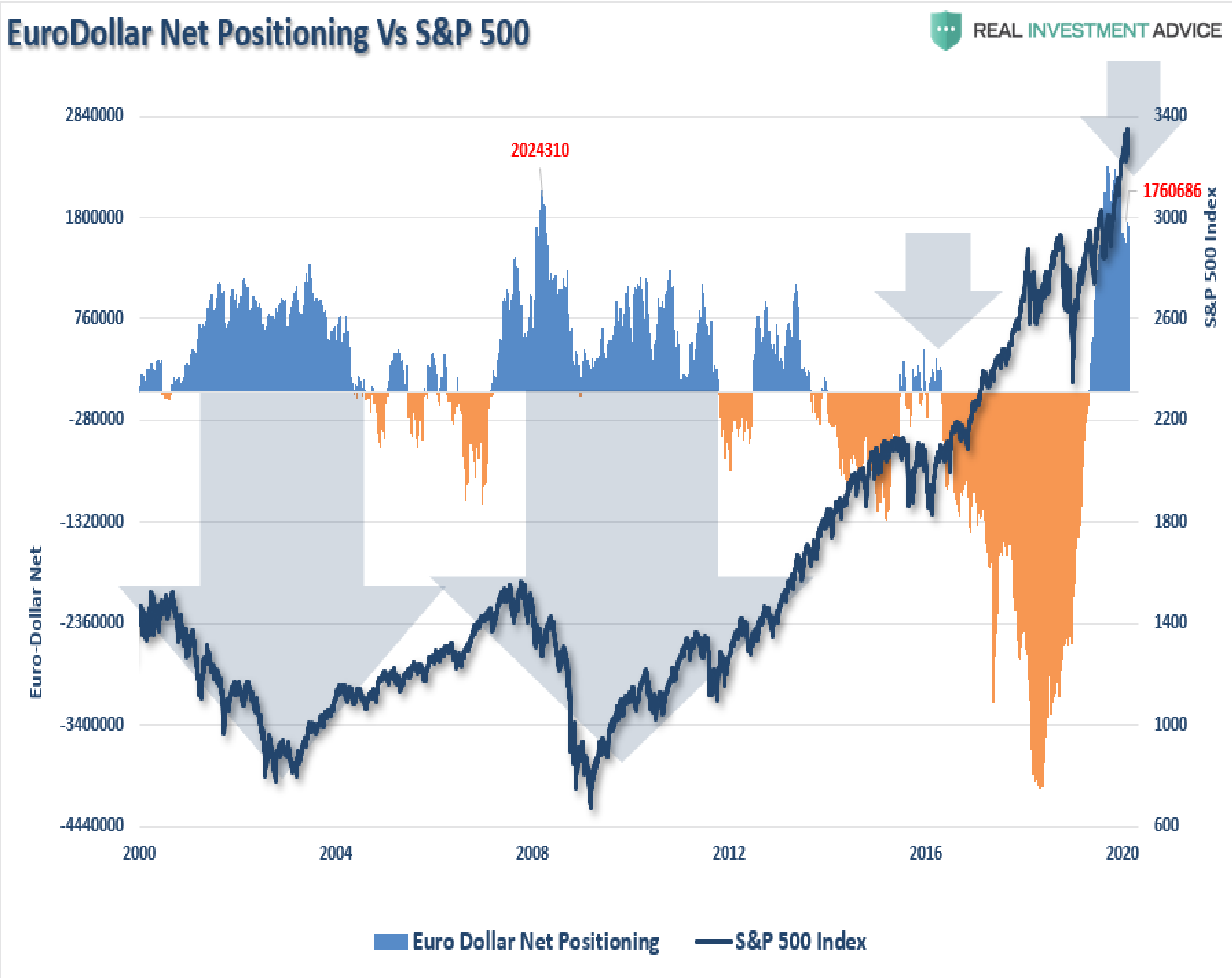
- *As noted previously: ?The dollar has rallied back to that all-important previous support line. IF the dollar can break back above that level, and hold,* ***then commodities, and oil, will likely struggle.***
- ***That is exactly what happened over the last two weeks. The dollar has strengthened that rally as concerns over the ?coronavirus? persist.*** *With the dollar close to testing previous highs, a break above that resistance could result in a sharp move higher for the dollar.*
- ***The rising dollar is not bullish for Oil, commodities or international exposures.***
- *The ?sell? signal has began to reverse. Pay attention.*

Much of the bulls rallying cry has been based on the dollar weakening with the onset of QE, but as shown above, that has yet to be the case. However, it is worth noting that positioning in the US Dollar has been weakening. **Historically, these reversals are markets of more important peaks in the market and subsequent corrections.**



It is also worth watching the net-short positioning the Euro-dollar as well. Historically, when positioning in the Eurodollar becomes **NET-LONG, as it is currently,** such has been associated with short- to intermediate corrections in the markets, **including outright bear markets**.

Net-long Eurodollar positioning has recently started to reverse from an all-time record. While the market hasn't corrected as of yet, if foreign banks begin to extract dollar-denominated assets to a large degree, the risk to the market rises sharply.

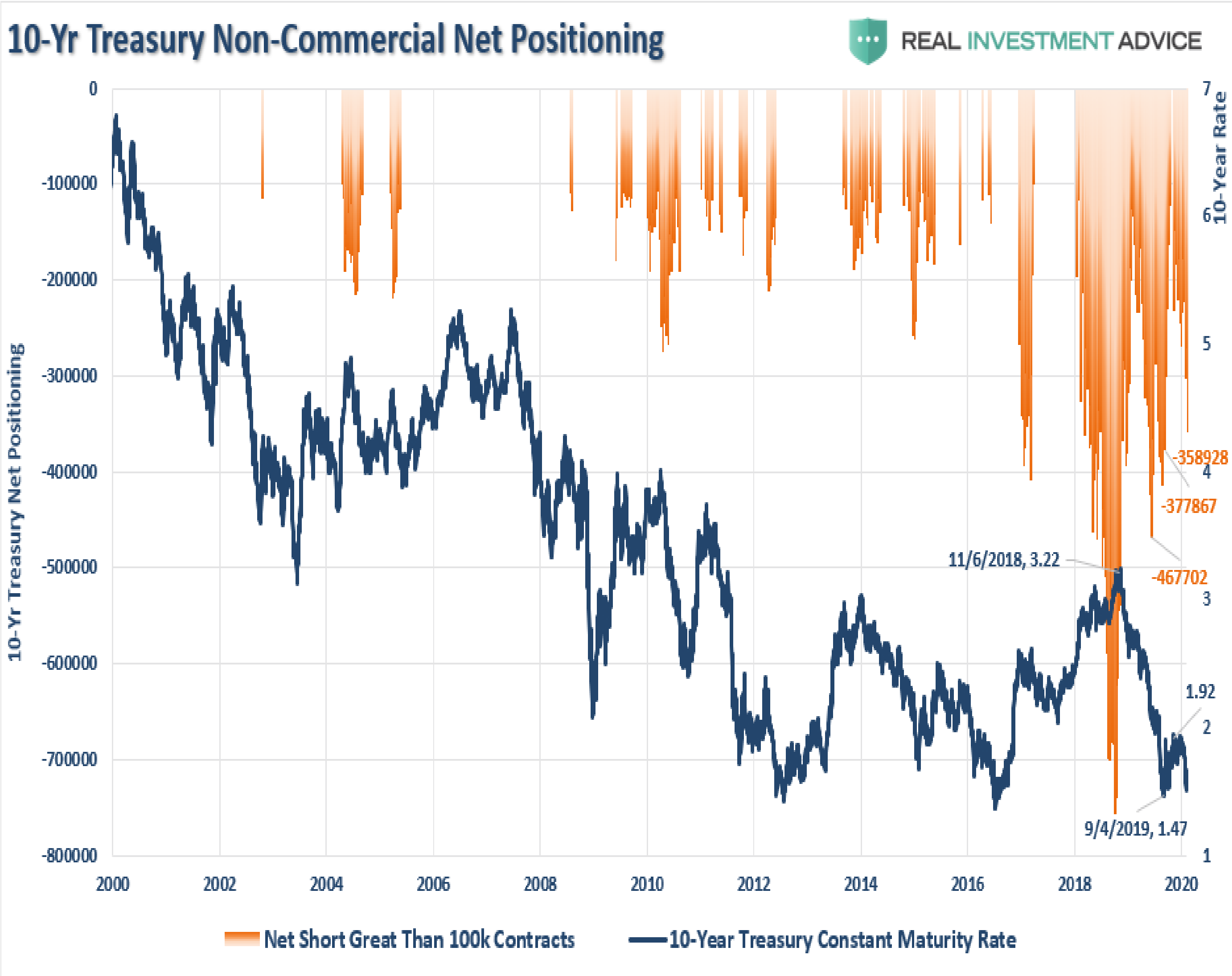


Interest Rate Extreme

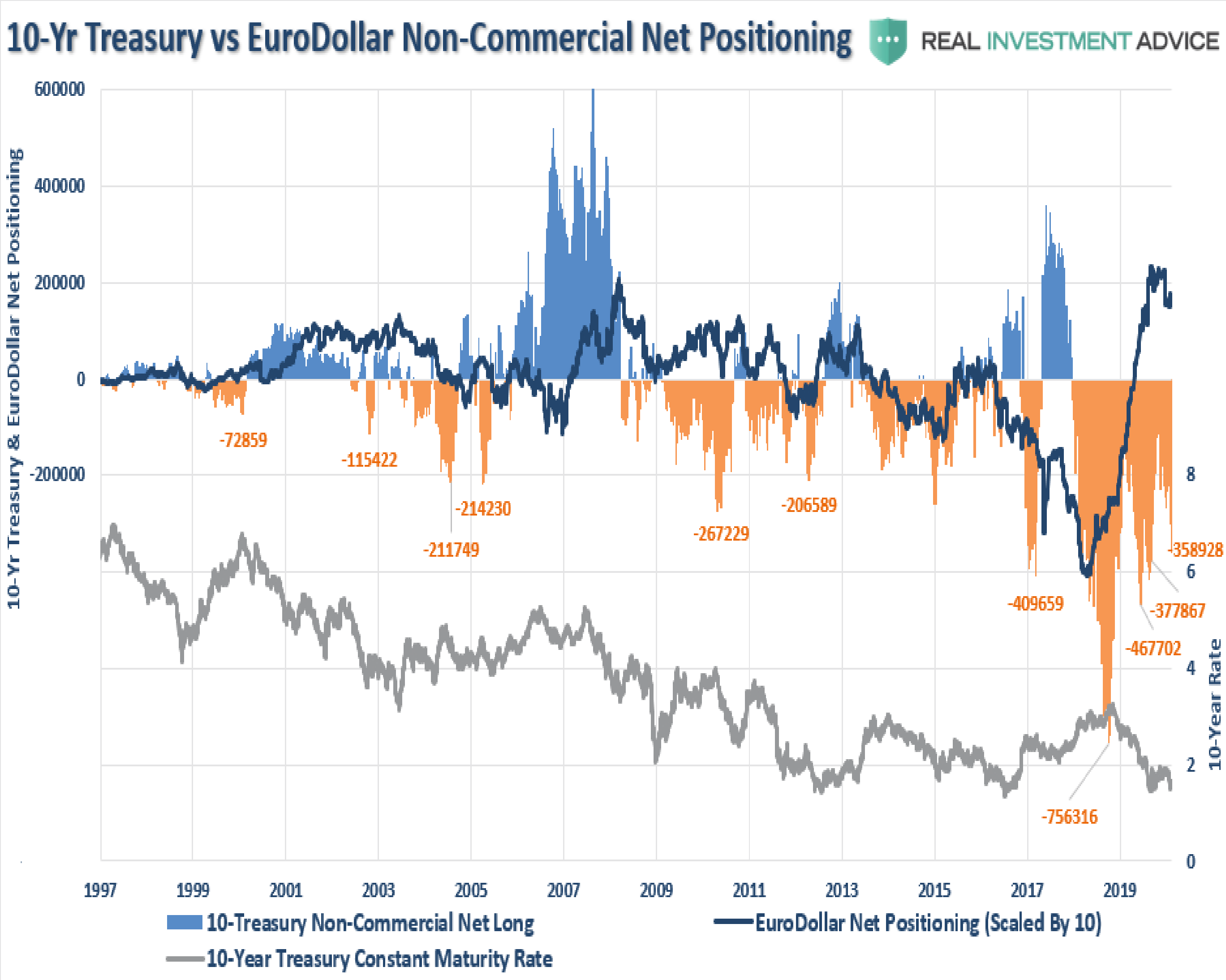
One of the biggest conundrums for the financial market *?experts?* is why interest rates fail to rise. In March of last year, I wrote [***"The Bond Bull Market"***] which was a follow up to our earlier call for a sharp drop in rates as the economy slowed. **That call was based on the extreme *"net-short positioning"* in bonds which suggested a counter-trend rally was likely.**

Since then, rates fell back to some of the lowest levels in 10-years as economic growth continues to slow, both domestically and globally. Importantly, while the Federal Reserve turned back on the "liquidity pumps" last October, juicing markets to all-time highs, bonds have continued to attract money for *"safety"* over *"risk."*

Not surprisingly, despite much commentary to the contrary, the number of contracts "net-short" the 10-year Treasury remains at some of the highest historical readings.



Importantly, even while the *"net-short*" positioning on bonds has been reversed, rates have failed to rise correspondingly. The reason for this is due to the near-record levels of **Eurodollar positioning, as noted above.**



This suggests a high probability rates will fall further in the months ahead. This will most likely occur in concert with further deterioration in economic growth as the impact of the *"coronavirus"* is realized.

Amazingly, investors seem to be residing in a world **without any perceived risks** and a **strong belief that financial markets can only rise further**. The arguments supporting those beliefs are based on comparisons to previous peak market cycles. Unfortunately, investors tend to be wrong at market peaks and bottoms.

The inherent problem with much of the mainstream analysis is that it assumes everything remains status quo. However, such never tends to be the case for long.

> *"Oil prices down 20% is not a good thing, even if it means lower gasoline prices. This is swamped by the negative implications for capital spending and employment in the key oil-producing regions of the U.S. Copper prices have dropped 11% in just the past two weeks and just above a three-year low, and this is a global macro barometer. Money flowing into bond funds, the lagging performance in the high-yield market, the slump in*

> *commodity markets and the weakness, both relative and absolute, in the Russell 2000 small-cap index, surely cannot be making the economic growth bulls feeling too comfortable right now.." - David Rosenberg*

We agree.

With retail positioning very long-biased, the implementation of QE4 has once again removed all *"fears"* of a correction, a recession, and a bear market, which existed just this past summer. Historically, such sentiment excesses form around short-term market peaks.

This is a excellent time to remind you of the other famous *"Bob Farrell Rule"* to remember:

> ***"#5 ? The public buys the most at the top and the least at the bottom."***

What investors miss is that while a warning doesn?t immediately translate into a negative consequence, such doesn't mean you should not pay attention to it.

It is akin to constantly running red lights and never getting into an accident. We begin to think we are skilled at running red lights, rather than just being lucky.

Eventually, your luck will run out.

Pay attention, have a plan, and act accordingly.