

# **This Is Nuts...Again**

## **Reducing Risk As Tech Goes 1999**



*In this issue of, "This Is Nuts...Again. Reducing Risk As Tech Goes 1999."*

- *Twice In One Year*
- *Fundamentally Detached*
- *A Very Narrow Market*
- *Portfolio Positioning*
- *MacroView: The Fed Has Inflated Another Asset Bubble*
- *Sector & Market Analysis*
- *401k Plan Manager*



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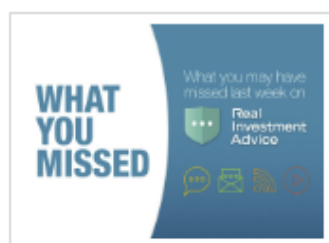
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## Catch Up On What You Missed Last Week



### **#WhatYouMissed On RIA This Week: 07-10-20**

Written by Lance Roberts | Jul 10, 2020

Here is what you might have missed from the RIA Crew last week. A compilation of our best blogs, newsletter, podcasts, the daily radio show and commentary from RIAPRO.NET.

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## Twice In One Year

It is a bit hard to comprehend that twice, in the same year, I would be writing primarily the same article. In early January, I penned the following:

***"When you sit down with your portfolio management team, and the first comment made is 'this is nuts,' it's probably time to think about your overall portfolio risk. On Friday, that was how the investment committee both started and ended ? 'this is nuts.'"***

At that time, I tweeted the following chart, which compared the Nasdaq to the S&P 500 index. The bands on both charts are 2-standard deviations of the 200-WEEK moving average. there are a couple of things which should jump out immediately:

1. ***The near-vertical price acceleration in the markets has been a historical hallmark of late-stage cycle advances, also known as a ?melt-up? phase.***
2. ***When markets get more than 2-standard deviations above their long-term moving average, reversions to the mean have tended to follow shortly after that.***

**\$SPX** S&P 500 Large Cap Index: INDX  
9-Jan-2020

Open 3217.55 High 3275.58 Low 3214.64 Close 3274.70 Volume 7.5B Chg +39.85 (+1.23%) ▲

© StockCharts.com

— S&P 500 Large Cap Index (Weekly) 602.77%  
— BB(200,2.0) 320.27% - 455.86% - 591.44%  
— Nasdaq Composite 1107.55%  
— BB(200,2.0) 485.65% - 789.30% - 1092.96%



That was so 6-months ago. Here is where we are today.



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## Fundamentally Detached

The divergence is particularly notable when you consider the economic and fundamental differences between now and then. *(While we are discussing the Nasdaq, to maintain consistency with previous reports, I am using earnings estimates for the S&P 500 to show the relative change.)*

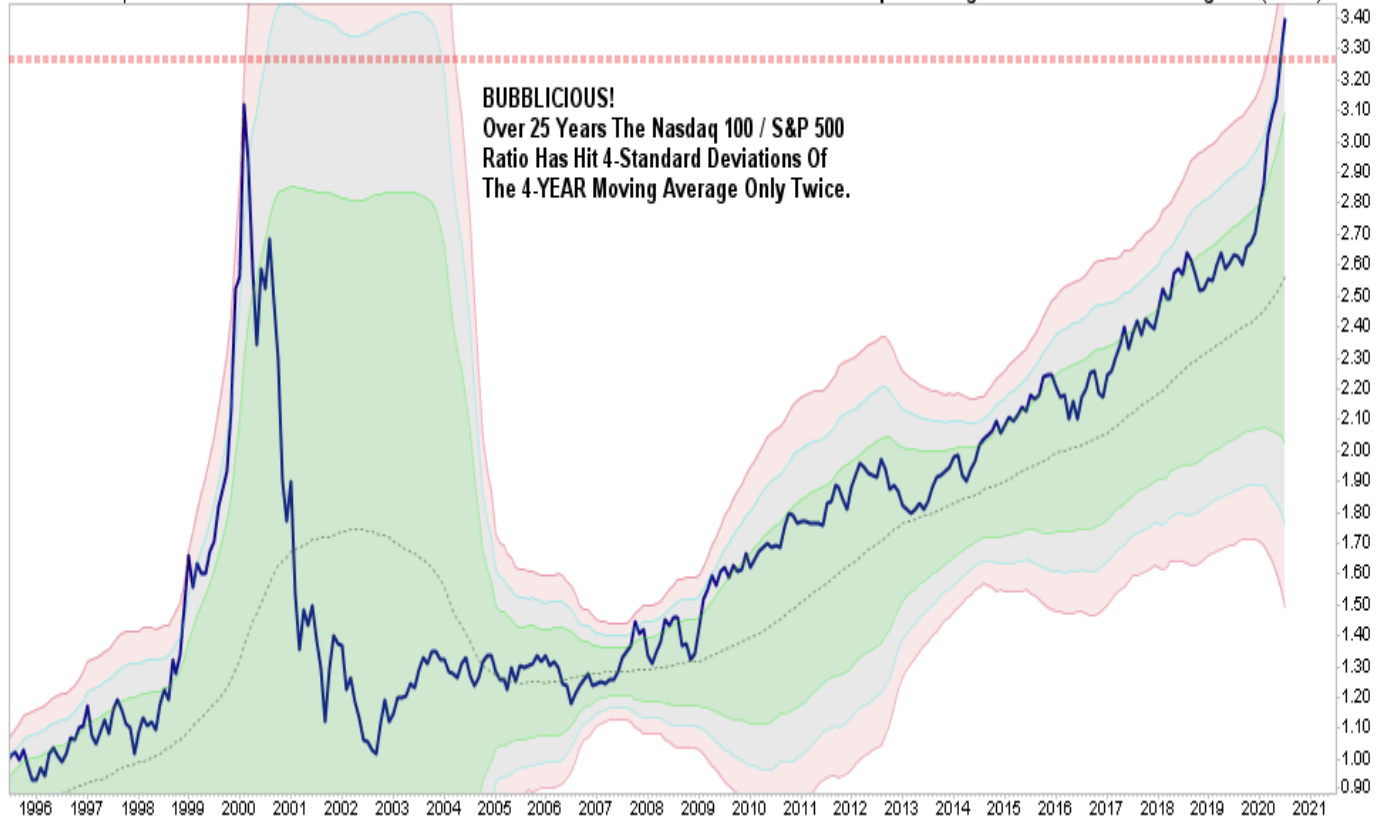
	Jan-20	Jul-20	Difference
<b>Nasdaq Price</b>	9,178.86	10,559.54	<b>15.04% Increase</b>
<b>GDP YoY Growth Rate</b>	3.97%	-7% (est)	<b>-10.97% Decrease</b>
<b>Unemployment Rate</b>	3.60	11.10	<b>7.50% Increase</b>
<b>Continuing Claims (Mil)</b>	1.76	18.06	<b>16.30 Million Increase</b>
<b>Debt To GDP Ratio</b>	106.75%	123% (est)	<b>16.25% Increase</b>
<b>Fed Funds</b>	1.54%	0.00%	<b>-1.54% Decrease</b>
<b>10-Year Rate</b>	1.87%	0.67%	<b>-1.20% Decrease</b>
<b>2020 Earnings Est.</b>	160.92	91.79	<b>-42.96% Decrease</b>
<b>2021 Earnings Est</b>	171.23	145.66	<b>-14.93% Decrease</b>

When looking at the acceleration in the price of the Nasdaq, and particularly within the small group of stocks driving that advance, you can begin to fathom our concerns. Furthermore, the divergence

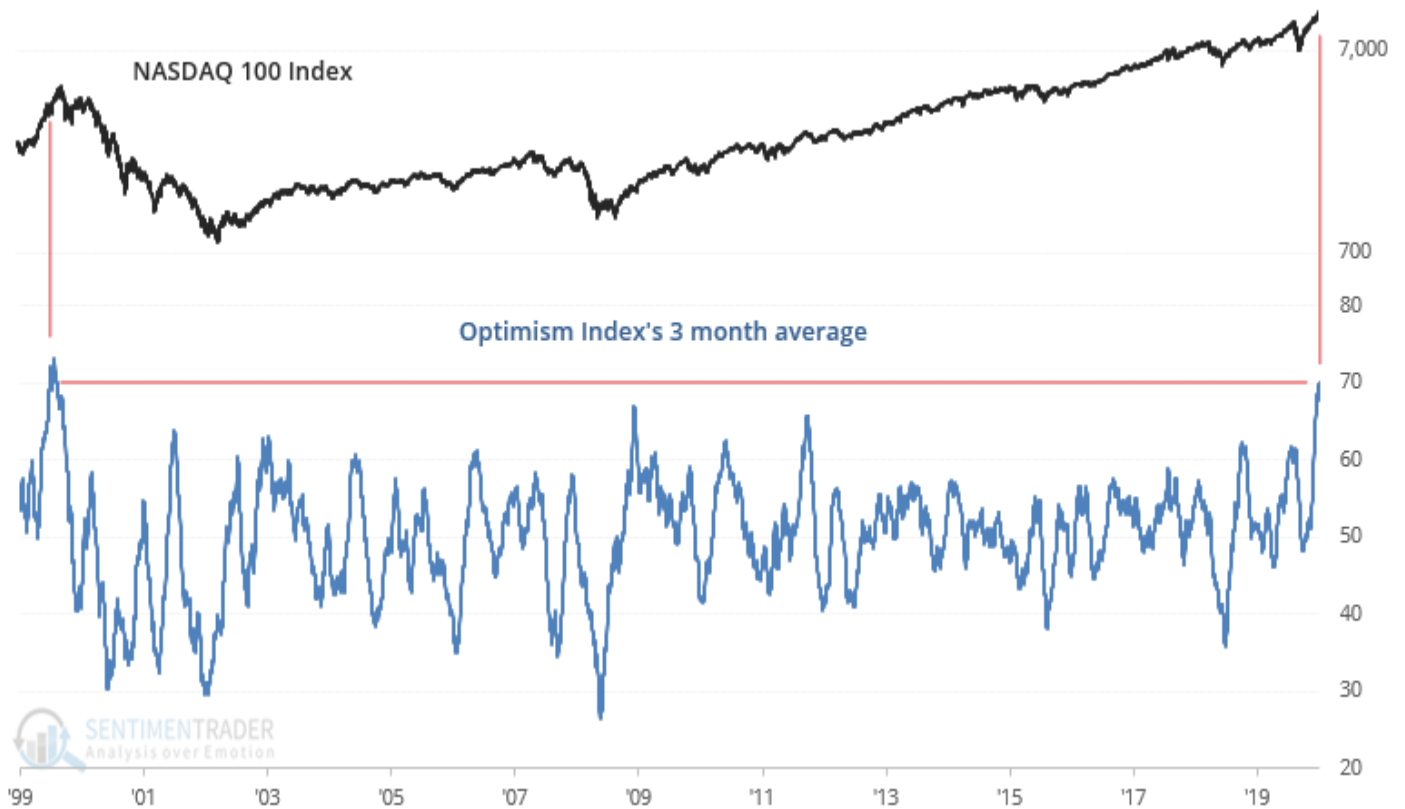
between the Nasdaq and the S&P 500 index is emulating the late 90's. (The horizontal red line is where the ratio was last Friday just for perspective.)

\$NDX:\$SPX Nasdaq 100 Index/S&P 500 Large Cap Index: INDXX  
10-Jul-2020 2:53pm

© StockCharts.com  
Open 3.20 High 3.40 Low 3.19 Last 3.40 Chg +0.12 (+3.69%) ▲



Optimism in the Nasdaq 100 has also reached levels of exuberance seen only once previously in the last 25 years. Yep...the late 90's.



**Yes, "This Is Nuts."**

For the second time in a single year, we have begun the profit-taking process within our most profitable names. *Apple, Microsoft, Netflix, Amazon, Costco, PG, and in Communications and*

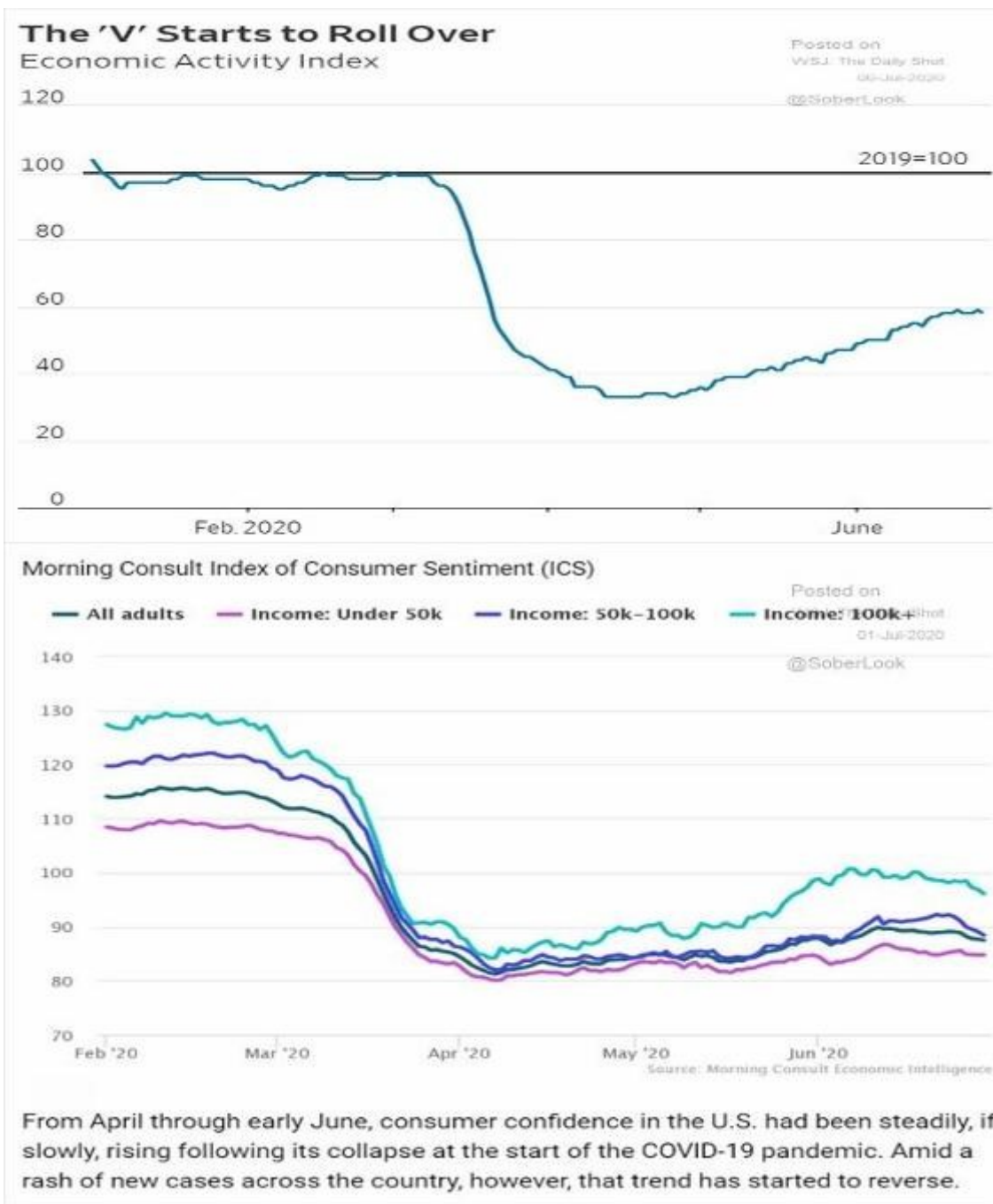


## Technology ETF's.

*(Note: Taking profits does not mean we sold the entire position. It means we reduced the amount of our holdings to protect our gains.)*

As discussed in this week's [#MacroView \(below\)](#), the "bearish case" does have "teeth" and should not be summarily dismissed. As Doug Kass noted this past Monday:

*"Several key labor-intensive industries - education, lodging, entertainment (Broadway events, concerts, movie theaters, sporting events), restaurant, travel, retail, non-residential real estate, etc. - face an existential threat to their core. For these industries, they simply cannot survive the conditions they face. For these gutted industries, we face, at best, **an 80% to 85% recovery in the years to come**. It should be emphasized that Covid-19 just sped up what was already a secular decline."*



When the market

historically becomes this detached from the underlying fundamentals, reversions tend to happen fairly quickly.

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### A Very Narrow Market

In our subscriber service ([RIAPro - 30-Day Free Trial](#)) we recently added a new service with institutional money manager **Jeffrey Marcus of Turning Point Analytics (TPA)**. One of his latest notes to subscribers drove home the point we are discussing now. To wit:

***"It seems like we have dodged a bullet, yet a look under the surface reveals a much sicker market. The relative performance chart below shows that while the S&P 500 is still down 1.88%, but TPA's BIGTECH Index (the top 8 stock in the NASDAQ 100 by market cap) is up an astonishing 48.99% year to date (YTD).***



***The table below shows that these 8-stocks represent \$8 trillion in market cap, which is 29% of the market cap of the S&P 500 (\$27.3 trillion). TPA ran the numbers***

to see just what effect these 8 stocks have had on an index of 500 stocks. **The BIGTECH effect has been to add 8.71% of performance to the S&P 500 YTD.**

## TPA BIGTECH EFFECT ON MARKET PERFORMANCE

TPA BIGTECH	CUR MKT CAP				
AAPL	\$1,652,985,338,950				
MSFT	\$1,613,983,587,769				
AMZN	\$1,536,783,819,956				
GOOGL	\$1,023,656,570,488				
GOOG	\$1,023,656,570,488				
FB	\$694,528,378,548				
TSLA	\$253,385,685,459				
NVDA	\$251,313,600,000				
<b>TOTAL</b>	<b>\$8,050,293,551,658</b>				
<b>BIGTECH MARKET CAP</b>				<b>\$8,050,293,551,658</b>	
RUSSELL 3000 MARKET CAP =				\$33,286,079,406,367	
<b>BIGTECH MARKET CAP PERCENT OF ALL U.S. STOCKS</b>				<b>24.19%</b>	
S&P500 MARKET CAP =				\$27,393,429,708,668	
<b>BIGTECH MARKET CAP PERCENT OF S&amp;P500 STOCKS</b>				<b>29.39%</b>	
<u>TICKER</u>	<u>SHORT NAME</u>	<u>PX LAST</u>	<u>CHG PCT YTD</u>		
SPX	S&P 500 INDEX	\$3,170	-1.88		<b>2020 YTD EFFECT</b>
.BIGTECH	BIGTECH	\$8,693	48.99	<u>S&amp;P500 WEIGHT (%)</u>	<u>ON S&amp;P500 (%)</u>
AAPL	APPLE INC	\$381	29.87	6.14	1.83
MSFT	MICROSOFT CORP	\$213	34.96	5.91	2.07
AMZN	AMAZON.COM INC	\$3,081	66.74	4.91	3.28
GOOGL	ALPHABET INC-A	\$1,504	12.26	1.72	0.21
GOOG	ALPHABET INC-C	\$1,496	11.89	1.66	0.20
FB	FACEBOOK INC-A	\$244	18.67	2.23	0.42
TSLA	TESLA INC	\$1,366	226.51	0.00	0.00
NVDA	NVIDIA CORP	\$409	73.67	0.96	0.71
		<b>BIGTECH EFFECT ON S&amp;P500 2020 YTD</b>			<b>8.71</b>
		<b>S&amp;P500 WITHOUT BIGTECH 2020 YTD</b>			<b>-10.59</b>

**Just A Handful Of Stocks**

At the time of the analysis, the S&P 500 is down 1.88% for the year. Without the BIGTECH stocks, **the benchmark would be down 10.5% in 2020**. We have mentioned this before, but a healthy rally is one with broad participation. The current rally is very narrow, historically dependent on less than 2% of the S&P 500 member stocks. **Such means the overall performance of the S&P 500 is not representative of the market as a whole. It also means the index performance hinges on a very small group of stocks.** In addition, TPA Canaries in the Coalmine (table below) shows that the 14-day RSI of the ratio of BIGTECH/S&P 500 is also at 70.87. That RSI level denotes that BIGTECH is overbought relative to the S&P 500. **At this juncture, one of two things can happen to make the BIGTECH/S&P 500 ratio less overbought:**

1. **Stocks other than BIGTECH can rise faster than BIGTECH; or,**
2. **BIGTECH can fall.**

**Given how much BIGTECH has meant to S&P 500 performance, investors should pray for the former."**

Here is a visual of what Jeff is talking about.

**Chart 7: S&P500 more concentrated in the 5 largest stocks than ever**



Source: BofA Global Investment Strategy, Bloomberg



Throughout history, whenever there seems to be a "Can't Lose Bet" in the financial markets, you are essentially guaranteed to "Lose Money."

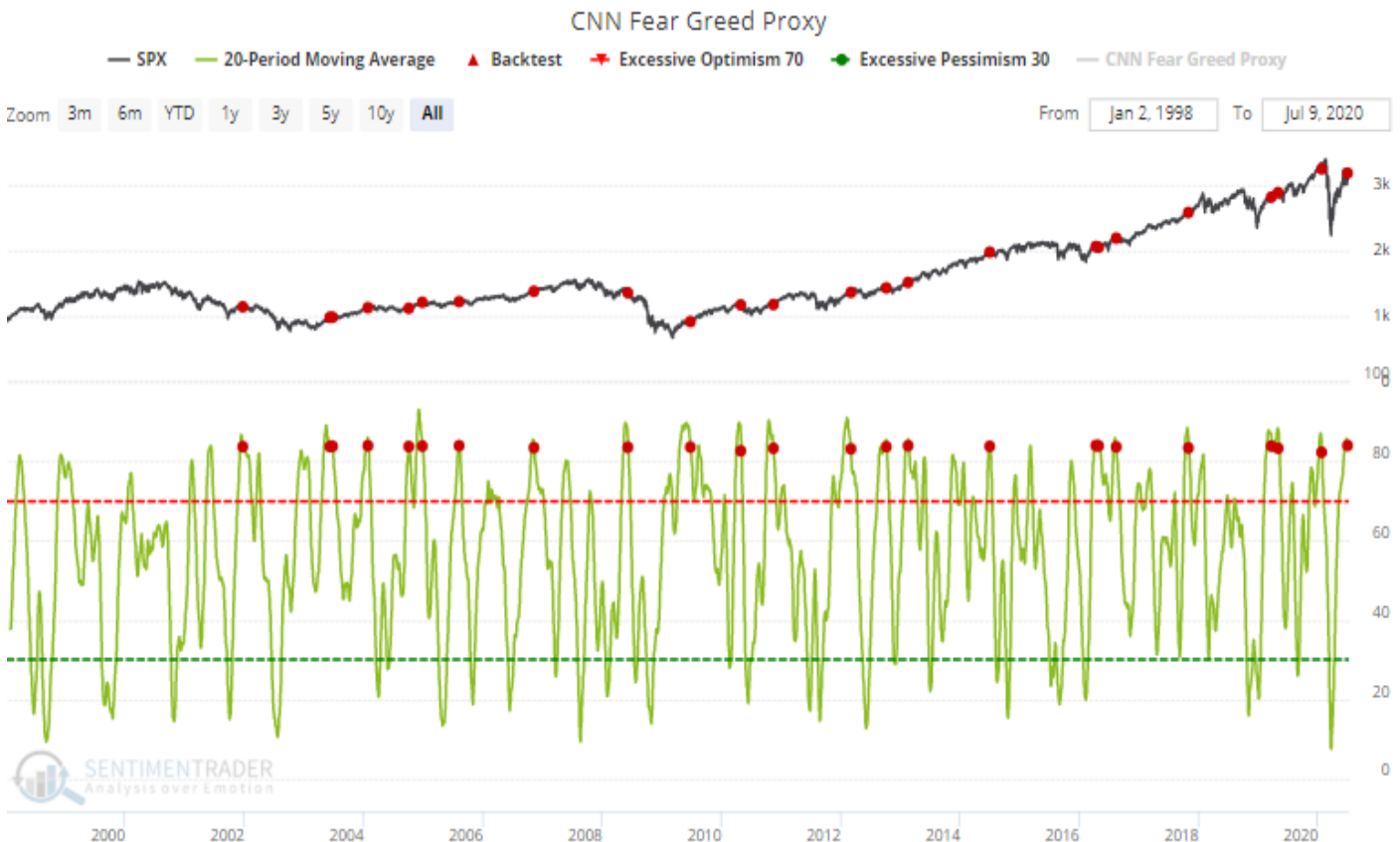
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## Updating Risk/Reward Ranges

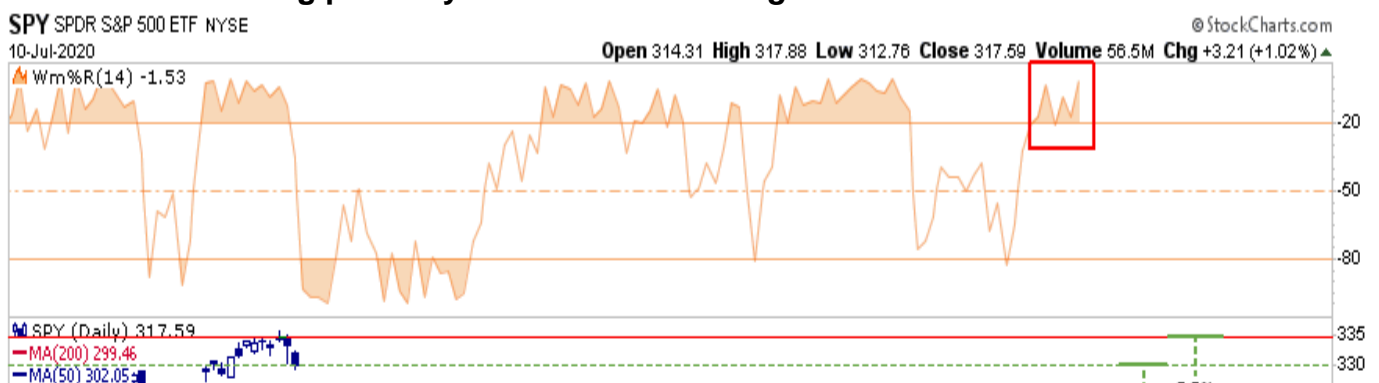
As noted by Sentiment Trader this past week, the CNN Fear/Greed Proxy has turned down recently from very high readings. While this does NOT suggest stocks will crash, it does indicate over the next few weeks returns will likely be more muted with increased volatility.



With this in mind we can update our risk/reward ranges for next week. As [noted last week](#):

*"The rally reversed much of the short-term oversold condition. While the bulls are in control of the market currently, the upside is somewhat limited. However, the downside risks are reduced with the improvement in the technical underpinnings. **Such puts the risk/reward dynamics to a more equally balanced, than opportunistic, positioning. As such, risk controls and hedges should remain for now.**"*

That advice played out well this past week, given daily swings in the market. While the market was up for the week, it has not reclaimed the June highs. **As such, the consolidation continues with risk/reward remaining primarily "neutral" with a "negative" bias.**



- **-2.6% to breakout level vs. +1.1% previous rally peak. (Neutral)**
- **-4.5 to 5.4% to 50 & 200 dma support vs. +4.0% to January peak (Neutral)**
- **-7.9% to previous consolidation peak vs. +5.5% to all-time highs. (Negative)**
- **-14.2% to previous consolidation lows vs. +5.5% to all-time highs. (Negative)**

## Reason To Focus On Risk

It seems appropriate to restate something I wrote the last time we saw these types of divergences.

***"Our job as investors is to navigate the waters within which we currently sail, not the waters we think we will sail in later. Higher returns come from the management of 'risks' rather than the attempt to create returns by chasing markets. Robert Rubin, former Secretary of the Treasury, defined this philosophy when he stated;***

***'As I think back over the years, I have been guided by four principles for decision making. The only certainty is that there is no certainty. Second, every decision, as a consequence, is a matter of weighing probabilities. Third, despite uncertainty, we must decide and we must act. And lastly, we need to judge decisions not only on the results but also on how we made them.***

***Most people are in denial about uncertainty. They assume they're lucky, and that the unpredictable can be reliably forecasted. Such keeps business brisk for palm readers, psychics, and stockbrokers, but it's a terrible way to deal with uncertainty. If there are no absolutes, all decisions become matters of judging the probability of different outcomes, and the costs and benefits of each. Then, on that basis, you can make a good decision."***

## An Honest Assessment

It should be evident that an honest assessment of uncertainty leads to better decisions. Still, the benefits of Rubin's approach, and mine, goes beyond that. **For starters, although it may seem contradictory, embracing uncertainty reduces risk, while denial increases it.** Another benefit of acknowledged uncertainty is **it keeps you honest.**

***"A healthy respect for uncertainty and focus on probability drives you never to be satisfied with your conclusions. It keeps you moving forward to seek out more information, to question conventional thinking and to continually refine your judgments and understanding that difference between certainty and likelihood can make all the difference." - Robert Rubin***

We must be able to recognize and be responsive to changes in underlying market dynamics. If they change for the worse, we must be aware of the inherent risks in portfolio allocation models. **The reality is that we can't control outcomes. The most we can do is influence the probability of specific outcomes. Such is why we manage risk by investing on probabilities rather than possibilities.** Such is essential not only to capital preservation but to investment success over time.



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# The MacroView



## #MacroView: The Threats To The Bullish Thesis Have Grown

Written by Lance Roberts | Jul 10, 2020

Since the March lows, the markets have rallied on optimism of a “V-shaped” economic recovery and constant stimulus from the Fed. In recent weeks, the threats to the bullish thesis have grown.

[>> Read More](#)

If you need help or have questions, we are always glad to help. [Just email me.](#) See You Next Week **By Lance Roberts, CIO**

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## Market & Sector Analysis

*Data Analysis Of The Market & Sectors For Traders*

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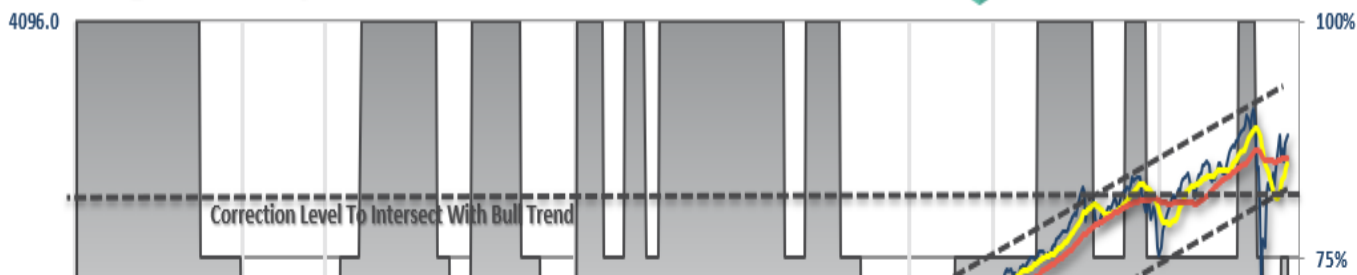
## THE REAL 401k PLAN MANAGER

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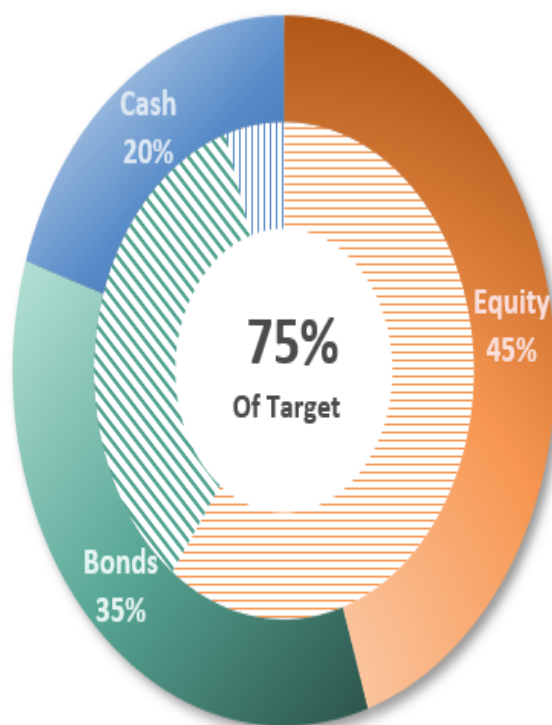
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### Risk Management Analysis

 **REAL INVESTMENT ADVICE**



## 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.*

20% Equity Income, Balanced or Conservative Allocation

25% Large Cap Growth (S&P 500 Index)

0% International Large Cap Dividend

0% Mid Cap Growth

## Portfolio Instructions:

Allocation Level To Equities	Recommendation	When To Take Action
Less Than Target Allocation	Hold Exposure At 75%	Hold Exposure
Equal To Target Allocation	Hold Exposure At 75%	Hold Exposure
Over Target Allocation	Hold Current Exposure	Hold Exposure

## Commentary

As discussed previously, the market bounced off support keeping allocations intact for now. Hold positions at current target weights for now. We are still running below our target of 100% equity, but if the market continues to firm up, we will gradually move back to full exposure.

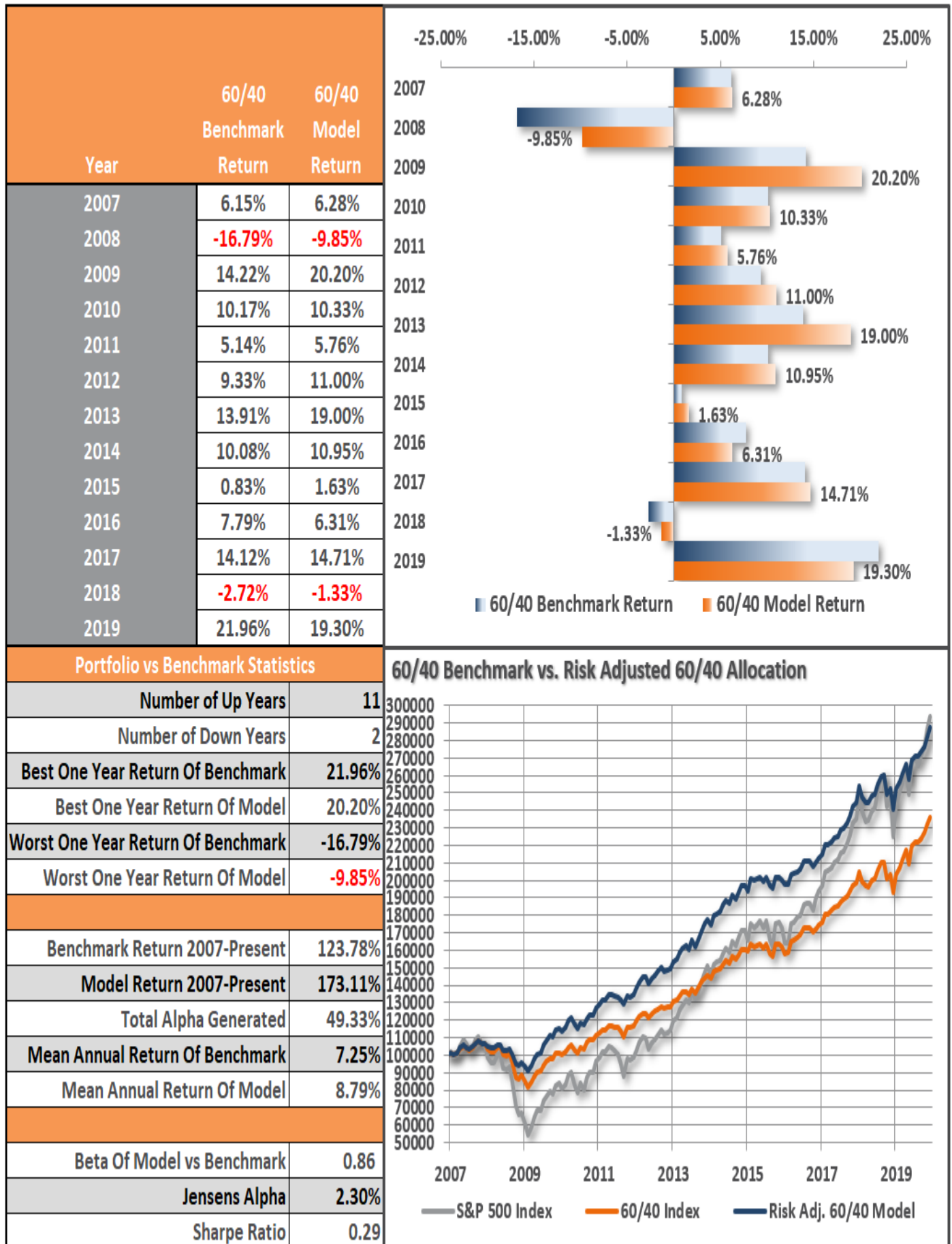
In the short-term the market is extremely overbought, so we need a pullback before we can raise the target to 100% exposure.

No changes this week to models or holdings.



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

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



# 401k Plan Manager Live Model

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Macro

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Symbol

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Enter Portfolio Name

Add Portfolio

Delete Portfolio

Rename Portfolio

My Info

Fund Selection

Comparison

Summary

Commentary

My Portfolio

RIAPro Portfolio

RIA PRO MODEL PL

Retirement Income (My Portfolio Annual ROR 9.44 %)

Current account balance	10,000
Estimated Retirement Balance	632,861
Estimated Retirement Balance (Inflation Adj)	620,204
Monthly Income	2,768
Monthly Income (Inflation Adj)	2,713
My Cumulative Contribution	172,934
Employer Cumulative Contribution	103,760

Retirement Income (RiaPro Annual ROR 9.02 %)

Current account balance	10,000
Estimated Retirement Balance	609,786
Estimated Retirement Balance (Inflation Adj)	597,590
Monthly Income	2,667
Monthly Income (Inflation Adj)	2,614
My Cumulative Contribution	172,934
Employer Cumulative Contribution	103,760

My Fund Composition

RIAPro Fund Composition

My Asset Composition

RIAPro Asset Composition