In this issue of "Retail Investors Stage Riot Against Wall Street."

- ***Retail Investors Stage Riot***
- ***Market Takes A Hit***
- ***Greed Breaks Things***
- ***Portfolio Positioning***
- ***#MacroView: 2021 - A Disappointment Of Growth And Disinflation***
- ***Sector & Market Analysis***
- ***401k Plan Manager***

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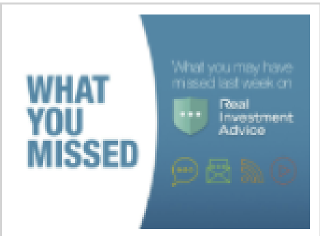
Catch Up On What You Missed Last Week



[#WhatYouMissed On RIA This Week: 1-29-21]

Written by Lance Roberts | Jan 29, 2021

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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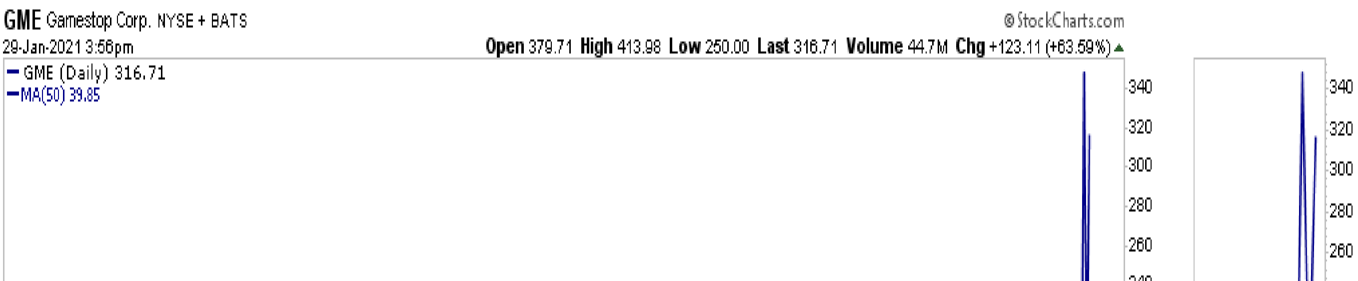
Retail Investors Stage A Riot On WallStreet

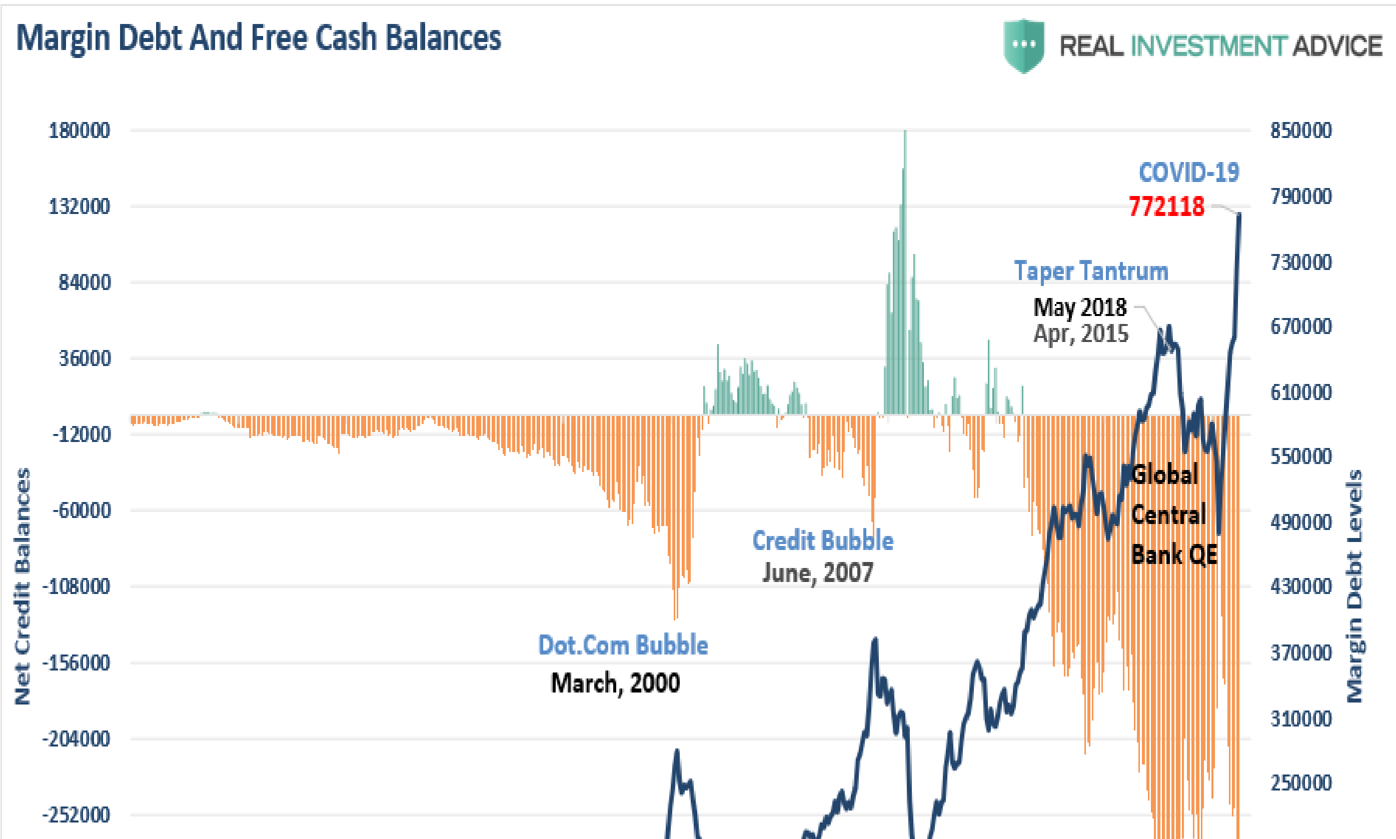
For years, Wall Street has taken advantage of retail investors. In 2000, they dumped companies with no earnings or revenue on unsuspecting individuals, eventually costing them their retirements. In 2008, it was outright mortgage fraud. From 2009 to the present, Wall Street has used algorithms, high-frequency trading, and user data purchases to front-run *"the little guy"* by scalping them for profits. Interestingly, this past week, retail investors hit back. Just as individuals used social media platforms to organize protests and riots across the country, traders used websites like *"Reddit"* to organize a successful short-squeeze on Wall Street hedge funds. That short-squeeze, which forces hedge funds who were short stocks to cover the positions, has sent a handful of stocks to the moon. Notably, Gamestop, a retail store that is on its way to bankruptcy, has been the movement's poster child. If you happened to be visiting Mars over the last few days, here is what I am talking about.



That chart is what a *"short-squeeze"* looks like when those short a stock have to "buy to cover" at the prevailing market price. It hasn't been pretty, and the *"Wall Street Bets"* Reddit group took credit earlier this week for forcing Melvin Capital, a hedge fund short Gamestop, to get a $2.7 billion bailout from its hedgefund friends. From that moment, it didn't take long for Wall Street to show its true colors by locking retail investors out of being able to buy Gamestop. Robinhood and others all restricted trading in the stock, which resulted in immediate class action lawsuits.

The Margin Problem

While Robinhood, and other brokers, took a lot of heat for restricting trading in shares of the most heavily shorted names, there was a reason - ***collateral requirements.*** Without getting into all of the minutiae of capital requirements and margin accounts, the simple fact is that the NSCC is required, by SEC rules tracing back to Dodd-Frank, to make sure there is always cash to settle. Depending on the net of buys and sells, the brokerage *(like Robinhood)* is on the hook to pay or receive the trading's net cash. That is simply credit risk. The NSCC takes on that credit risk. To mitigate the risk of a brokerage failure, they demand firms post a deposit of 10% of the collateral. Here is where the problem comes in. When firms are already heavily on margin *(currently at a record level of negative cash balances),* sharp changes in the underlying collateral value can lead to immediate demands for more deposits from the brokers.



On Thursday, Robinhood had to raise nearly $1 billion in capital to secure the ability to cover collateral requirements. We also saw margin requirements being adjusted by the DTCC. Of course, the risk to the markets is that with brokerage firms already running too lean, if a firm like Robinhood failed, the ripple effect through the financial industry would likely rival that seen during the Lehman bankruptcy in 2008. Such are likely reasons the markets sold off this past week.

Strange Bedfellows

As I stated at the beginning, it is about time Wall Street got a little bit of what they have been dishing out on Americans for years. It won't take long for Wall Street to *"circle their wagons"* and protect themselves, but maybe this is just the warning shot they needed to make some changes. ay just put ld have ever

Even Mark

The mania is

likely to get far worse before it ends. Such is particularly true if Citadel Securities, the hedge fund

efore making

Nonetheless,

bets."

At least

for now.

How Does This All End

The real question is what eventually happens. In Gamestop's case, the company is effectively a *"dead man"* walking retailer. So, the only reason anyone is buying the stock is simply due to the short-squeeze conditions that currently exist. As of this writing, the percentage of shares *"short"* is 122%. *(That isn't a typo.)* The problem comes when the "Wall Street Bets" traders eventually do want to sell. Those traders are *"paper rich,"* however, to convert their shares back into cash, they have to sell. The question will be WHO will they sell to? Such is where market dynamics come into play. As stated in ***"No Cash On The Sidelines:"***

> ***"Every transaction in the market requires both a buyer and a seller, with the only differentiating factor being at what PRICE the transaction occurs."***

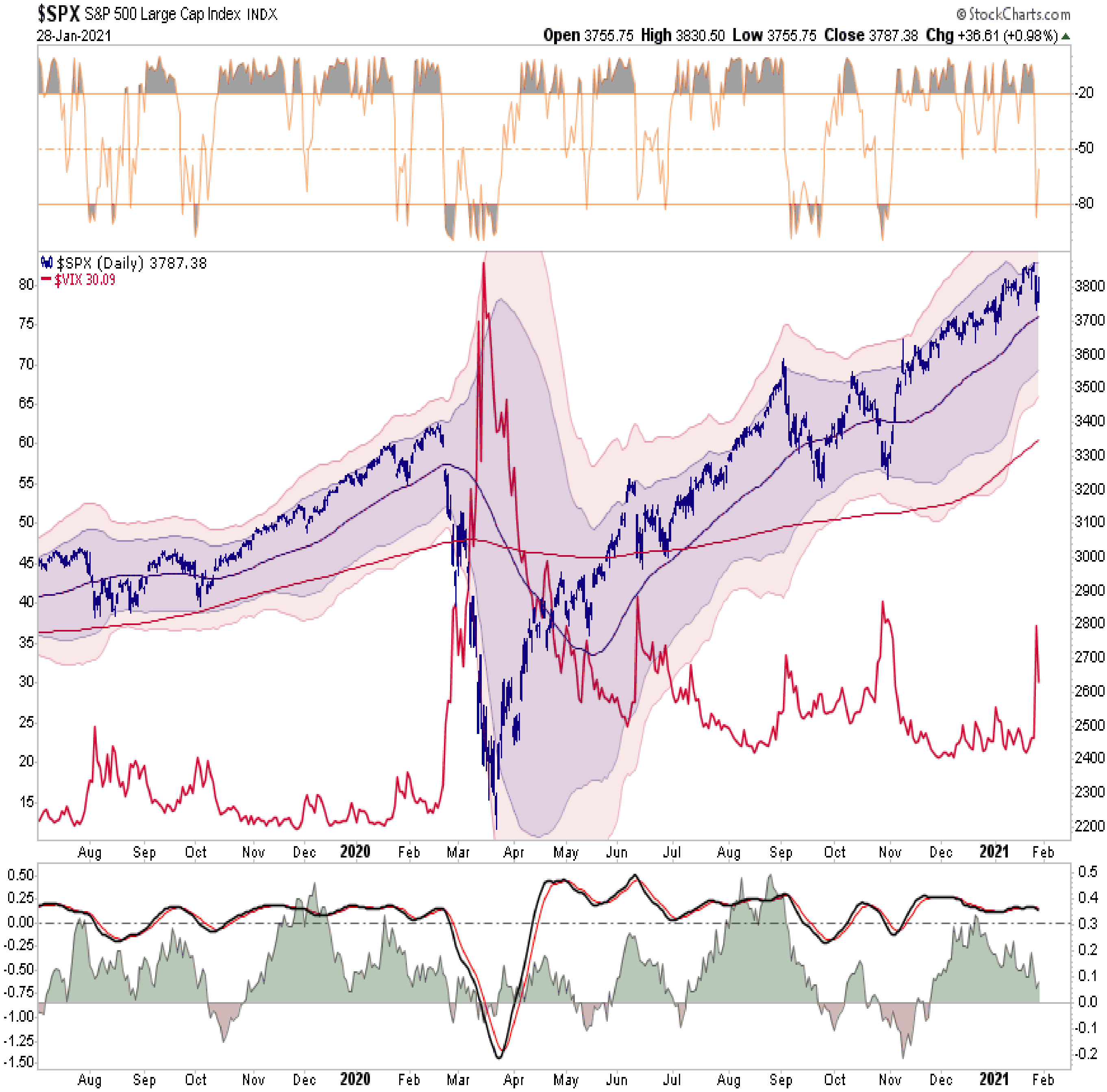
Think about a crowded theatre. At the moment, everyone is going into the theatre *(buying),* and no one is selling. However, when they begin to try and sell their positions, no one will be there to buy from them. Such is the equivalent of yelling *"fire."* The smart ones will get out early. The rest will find themselves scrambling towards a very narrow exit. Once the price starts falling, the sellers will swamp the buyers driving the price lower. In Gamestops case, given the company's value is around $10, where it was trading before the mania, the decline will be both brutal and fast. While Wall Street is the villain, this is one of those stories where the villain gets away with the crime in the end.

Markets Take A Hit

Last week, we discussed that our *"money flow"* signals were close to triggering, suggesting either a short-term correction of 3.-5% or an extended consolidation. ***(We publish a daily 3-minute video click here to subscribe)*** https://www.youtube.com/watch?v=DngAJ16A0YI Let me repeat that point from last week:

> "***Important Note:*** ***A correction can take on one of two forms.*** *The market either declines in price to alleviate the overbought condition, or it can consolidate sideways."*

Such remains the case currently, as on Wednesday, the market declined by almost 3% in one day. That swift sell-off did trigger our money flow "*sell signal,"* as the volatility index spiked higher.



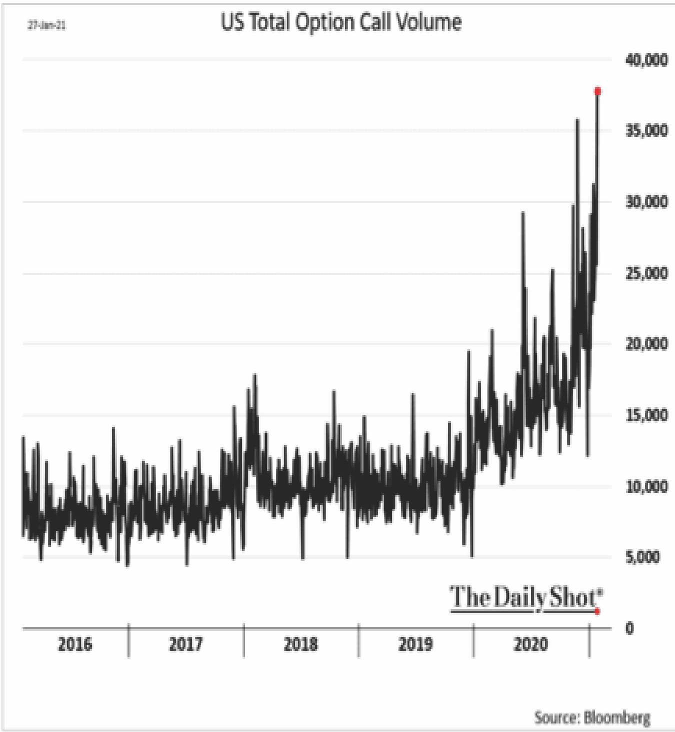
While the market did bounce on Thursday, it was a *"suckers rally."* That bounce led to a retest of the 50-dma on Friday. Money flows have continued to weaken, suggesting there remains underlying selling pressure in the market currently. **While I fully expect a reflexive rally next week, that will likely be an opportunity to reduce risk rather than chasing markets. Such will be the case until we see money flows start to turn positive again, suggesting some underlying buying pressure.** For now, we are maintaining our higher level of cash. ***After selling last Friday,*** we have the luxury to be patient and look for opportunities to add to our core equity holdings at cheaper prices.

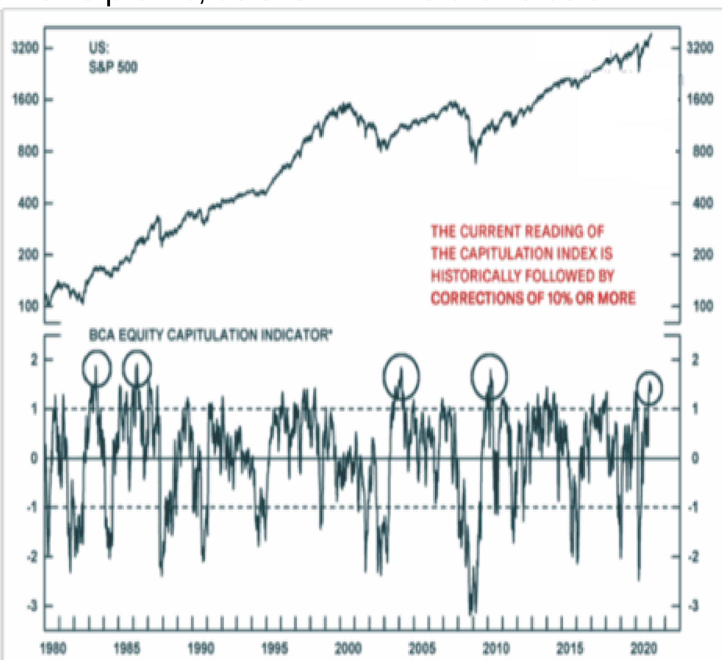
Greed Breaks Things

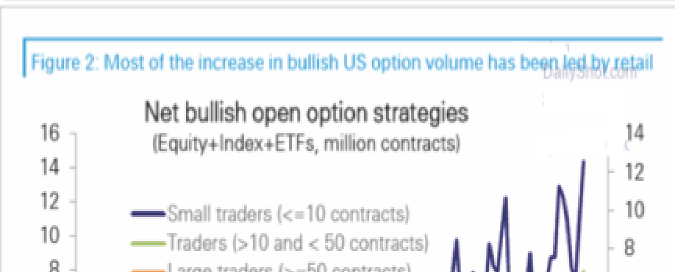
My colleague Doug Kass penned an excellent piece on Thursday discussing market conditions:

> ***"'If there is one common theme to the vast range of the world's financial crises, it is that excessive debt accumulation, whether by the government, banks, corporations, or consumers, often poses greater systemic risks than it seems during a boom.'*** *- Carmen Reinhart A grotesque level of speculation has taken us to where we are now. With a good perspective on history, we can have a better understanding of the past and present -- and thus a clear vision of the future. Like previous speculative cycles, this is about greed and trying to make money. Attempts to make trading seem like ideological notions and high minded intentions are fanciful to me.* ***Such makes my point that mishappened levels of speculation usually occur in the later stage of a Bull Market and, more often than not, presage a Bear Market. Speculation, as noted yesterday, is the outgrowth of undisciplined monetary policy."***

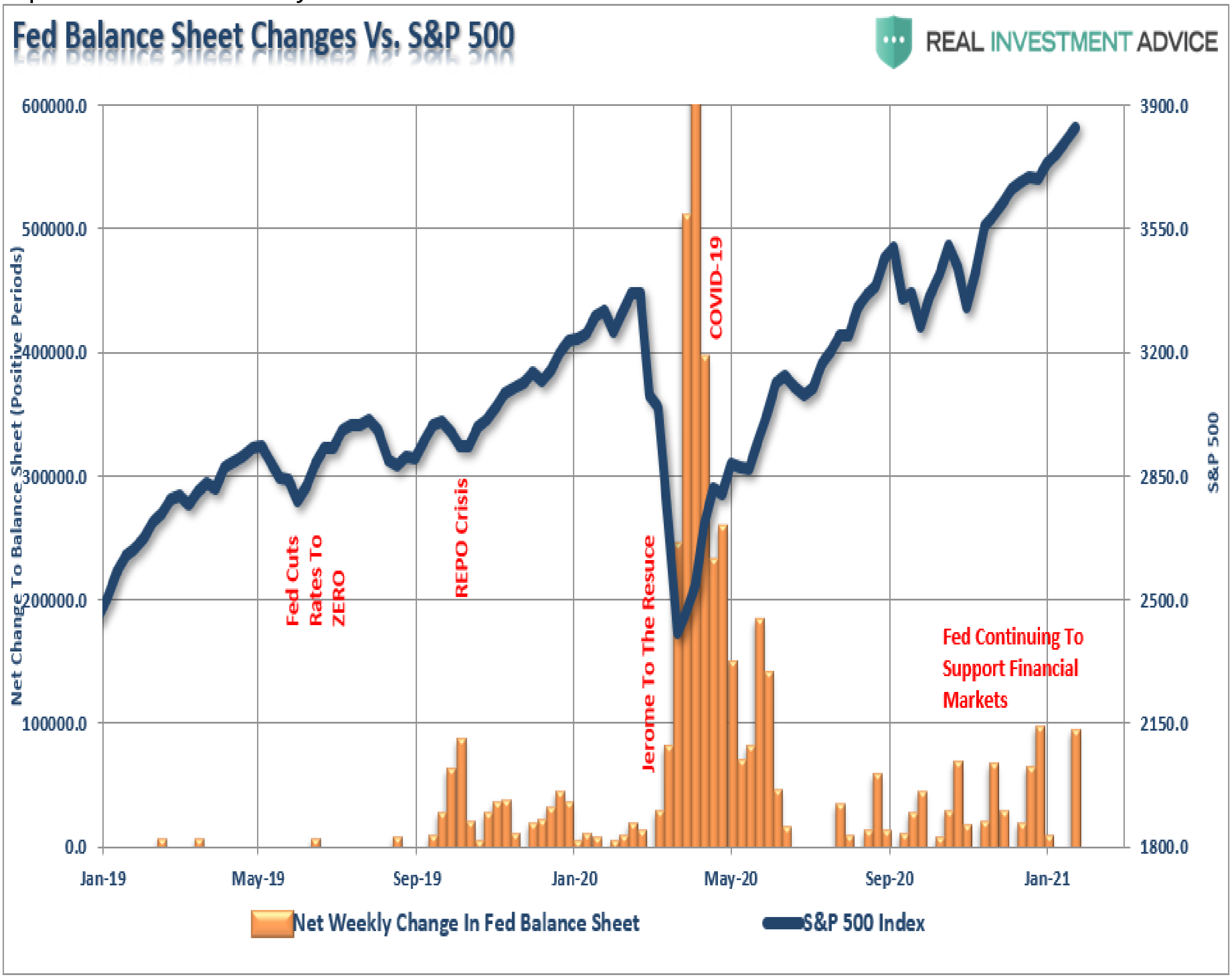
He is correct. The rampant speculation in the market is prolific, as shown in the charts below.







As Doug notes, speculation is the direct result of the ***"Moral Hazard"*** created by the Fed's ongoing monetary interventions. After a decade of injecting liquidity into the financial markets, it is no surprise that investors *"believe"* they have an *"insurance"* policy against loss. As noted in the linked article, such is the very definition of moral hazard. Every time the market *"wiggles,"* the Fed has expanded their monetary interventions.



However, at some point, the Fed may become trapped by the own policies. **If the direct stimulus does cause an inflationary surge, the Fed may get forced to cut QE and increase rates.** The last time they tried that was in 2018. It didn't go well.

Portfolio Positioning Update

As I discussed last week, we had positioned for a correction. Again, as noted above, **I am NOT saying the markets are about to crash.** Here is what we said last week:

> *"However, after the recent runup from November, **all of our indicators are beginning to align. Such suggests a 3-7% correction over the next month.** Could it be 10% or more? Absolutely. Once the correction begins, we can garner a better understanding of the downside risk."*

In our view, the management of risk will pay dividends over time, even at the expense of short-term gains. Therefore, while the correction from Wednesday was short-lived, at least for the moment, the risk is still present heading into February. Therefore, let me repeat the "rules" from last week:

1. ***Tighten up stop-loss levels*** *to current support levels for each position.*
2. ***Hedge portfolios*** *against major market declines.*
3. ***Take profits*** *in positions that have been big winners*
4. ***Sell laggards*** *and losers*
5. ***Raise cash*** *and rebalance portfolios to target weightings.*

Notice, nothing in there says, *?sell everything and go to cash.?*

The Problem Of Overpaying For Value

The current environment has become so richly priced there is little opportunity for investors to extract additional gains from risk-based investments. There is one true axiom of the market, which investors always tend to forget.

?Investors buy the most at the top, and the least at the bottom.?

If you feel you must chase the markets currently, then do it with a set of guidelines to follow if things turn against you. We printed these rules a couple of weeks ago but felt there are worth mentioning again.

15-Risk Management Rules To Follow:

1. **Cut losers short and let the winner's run.** *(Be a scale-up buyer into strength.)*
2. **Set goals and be actionable.** *(Without specific goals, trades become arbitrary and increase overall portfolio risk.)*
3. **Emotionally driven decisions void the investment process.** *(Buy high/sell low)*
4. **Follow the trend.** *(80% of portfolio performance is determined by the long-term, monthly, trend. While a "rising tide lifts all boats," the opposite is also true.)*
5. **Never let a *"trading opportunity"* turn into a long-term investment.** *(Refer to rule #1. All initial purchases are "trades," until your investment thesis is proved correct.)*

While we remain optimistic about the markets currently, we are also taking precautionary steps to tighten up stops, add non-correlated assets, raise some cash, and look to hedge risk opportunistically. Just because it isn?t raining right now doesn?t mean it won?t. Nobody has ever gotten hurt by keeping an umbrella handy.

The MacroView

#MacroView: 2021 – A Disappointment Of Growth And Disinflation

Written by Lance Roberts | Jan 29, 2021

There is a large consensus that the massive monetary interventions in 2020 will lead to an explosion of economic growth, inflation, and interest rates. We suspect that the outcome of more debt-driven spending will lead to a disappointment in growth and disinflation instead.

>> 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**

Market & Sector Analysis

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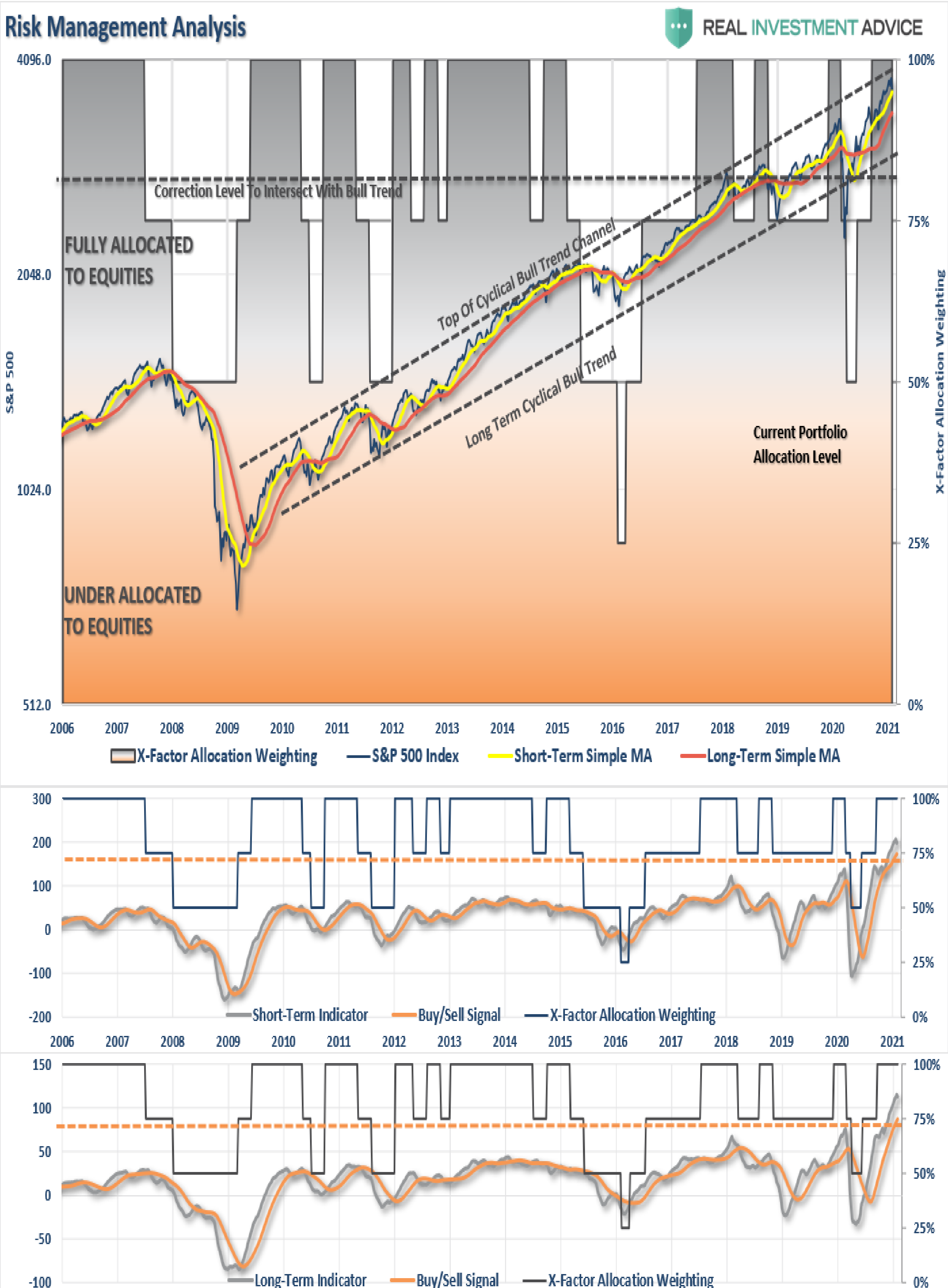
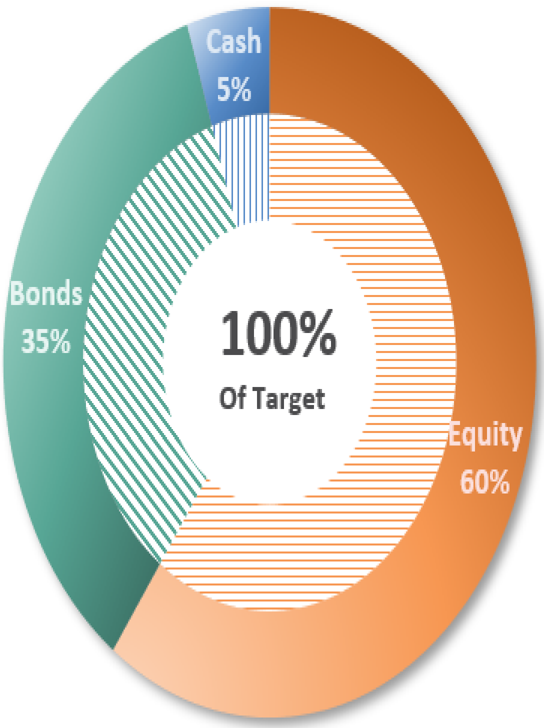
THE REAL 401k PLAN MANAGER

A Conservative Strategy For Long-Term Investors



Current Portfolio Weighting



Current 401k Allocation Model

5.00% **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*

60.00% **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
30% Large Cap Growth (S&P 500 Index)
5% International
5% Mid-Cap

Portfolio Instructions:

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

Commentary

Last week I stated: *"As we approach the end of January, the market is continuing to maintain new highs. However, on many levels the markets are extended, very overbought, and extremely bullishly biased. Such is often the makings of a short-term correction."*

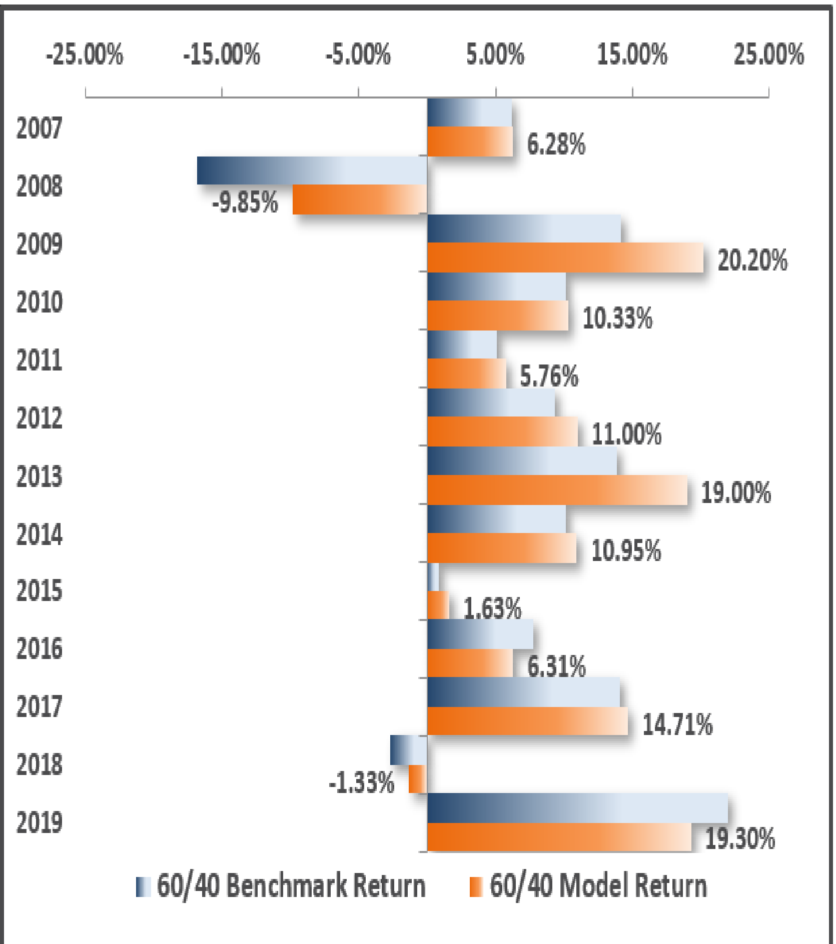
Well, that correction came this past week which was needed to reduce some of the those more overly bullish conditions. Heading into February, there is no reason to take any aggressive action with portfolios already fully allocated. Given that Februrary and March tend to be weak months, I would be reticent chasing more aggressive exposure in retirement plans currently. In fact, doing a bit of housecleaning by rebalancing weightings, reducing more aggressive positioning, etc., is likely a good practice currently.

Maintain exposures, but rebalance positions that have grown to outsize weightings in portfolio. Particularly in small/mid cap and international funds which are eggregiously overbought.

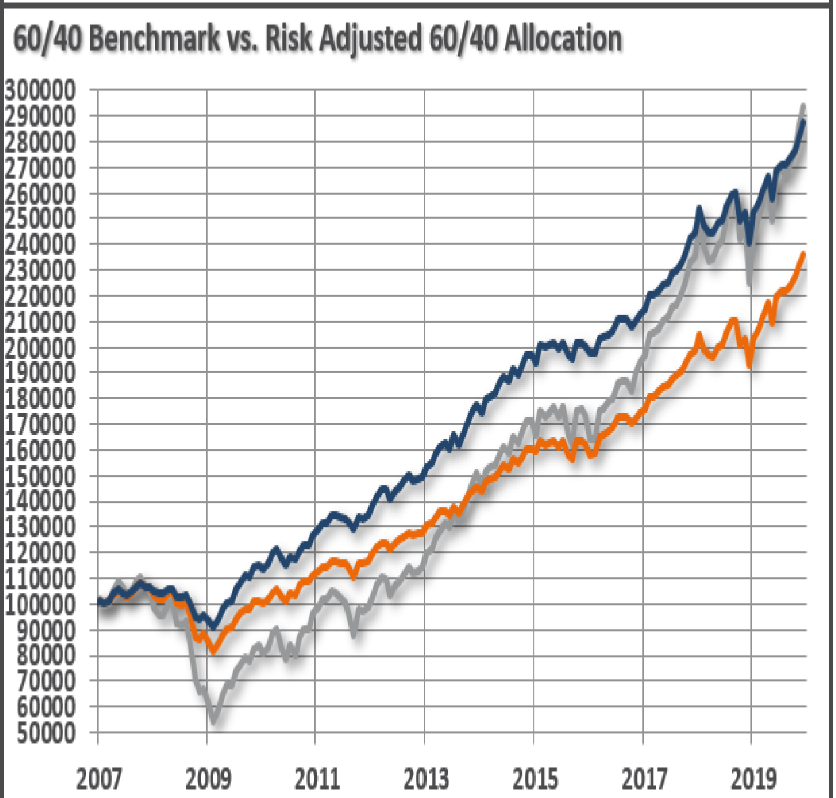
If you need help after reading the alert, do not hesitate to [contact me](#).

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 one should not rely on it 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	6.15%	6.28%
2008	-16.79%	-9.85%
2009	14.22%	20.20%
2010	10.17%	10.33%
2011	5.14%	5.76%
2012	9.33%	11.00%
2013	13.91%	19.00%
2014	10.08%	10.95%
2015	0.83%	1.63%
2016	7.79%	6.31%
2017	14.12%	14.71%
2018	-2.72%	-1.33%
2019	21.96%	19.30%



Portfolio vs Benchmark Statistics	
Number of Up Years	11
Number of Down Years	2
Best One Year Return Of Benchmark	21.96%
Best One Year Return Of Model	20.20%
Worst One Year Return Of Benchmark	-16.79%
Worst One Year Return Of Model	-9.85%
Benchmark Return 2007-Present	123.78%
Model Return 2007-Present	173.11%
Total Alpha Generated	49.33%
Mean Annual Return Of Benchmark	7.25%
Mean Annual Return Of Model	8.79%
Beta Of Model vs Benchmark	0.86



401k Plan Manager Live Model

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