



In this 07-02-21 issue of "As Good As It Gets Will Q2 Mark Peak Reporting?"

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- **401k Plan Manager**

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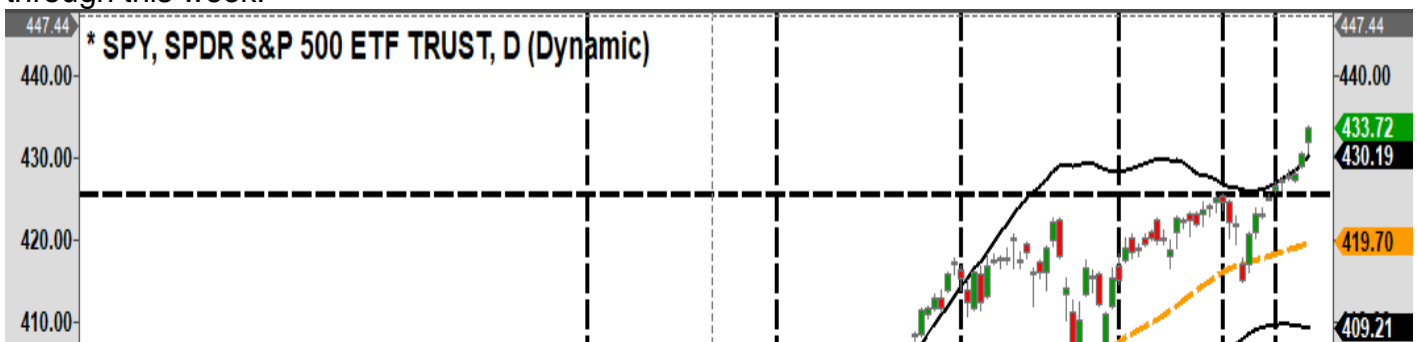
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Market Rallies To All-Time Highs

With the 4th of July weekend upon us, this week's newsletter will be slightly shorter than usual. Such will ensure you "pitmasters" can get to work doing what you do best. As we [discussed last week](#), the market not only got off the mat and rallied back to new highs. That action continued through this week.

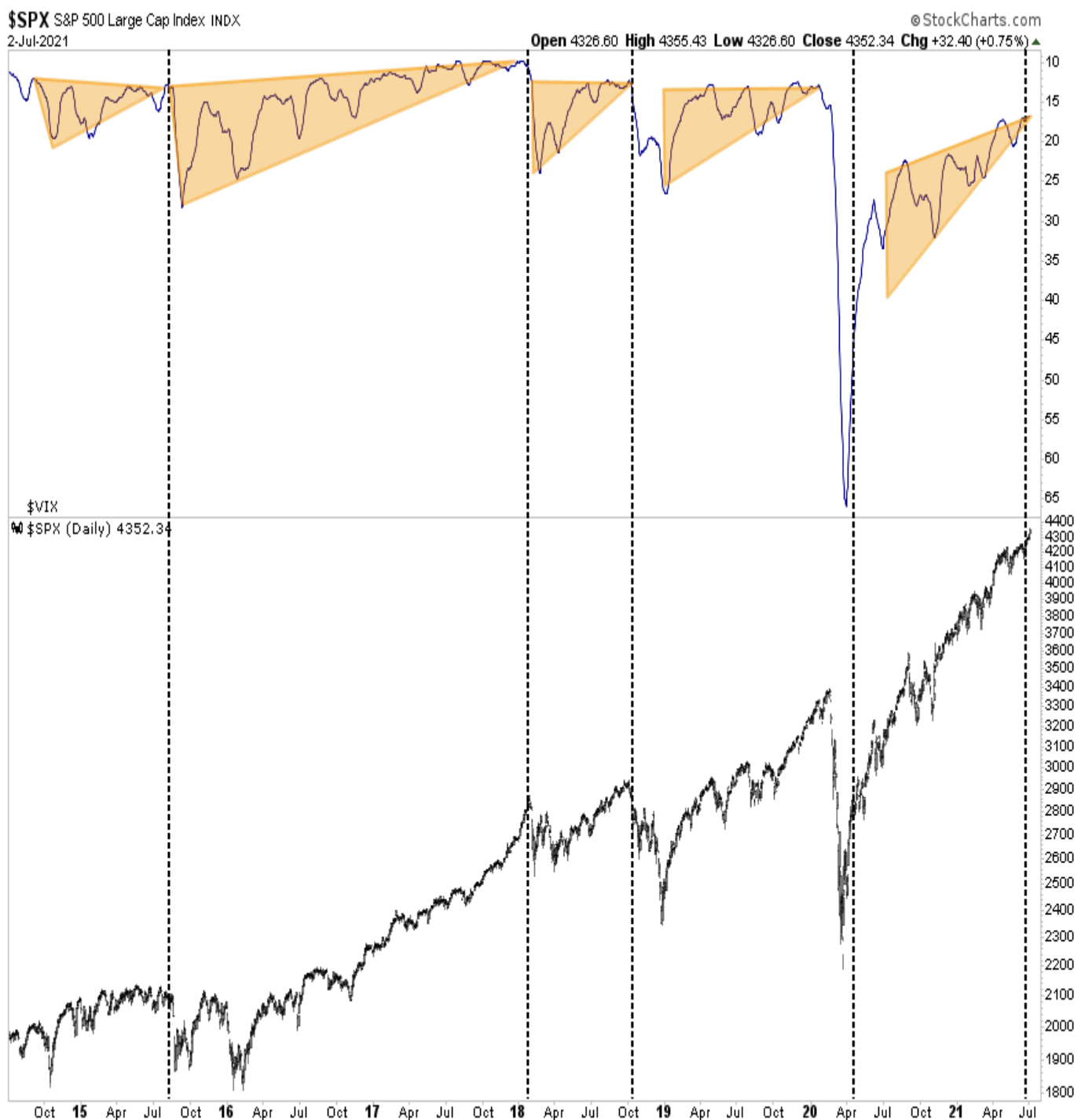


The technical backdrop is not great. **With the market back to 2-standard deviations above the 50-dma, conviction weak, and investors extremely bullish, the market remains set up for additional weakness. However, we are in the first two weeks of July which tends to be bullishly biased. After increasing our equity exposure previously, we will give the market the benefit of seasonality for now.**

Complacency Concerns

With the "money flow buy signal" not yet back to a typical peak, such suggests another week or so of upside is likely. However, as noted, we suspect there is not much upside in the market for current levels. Lastly, we discussed the high level of complacency in the markets previously. [To wit:](#)

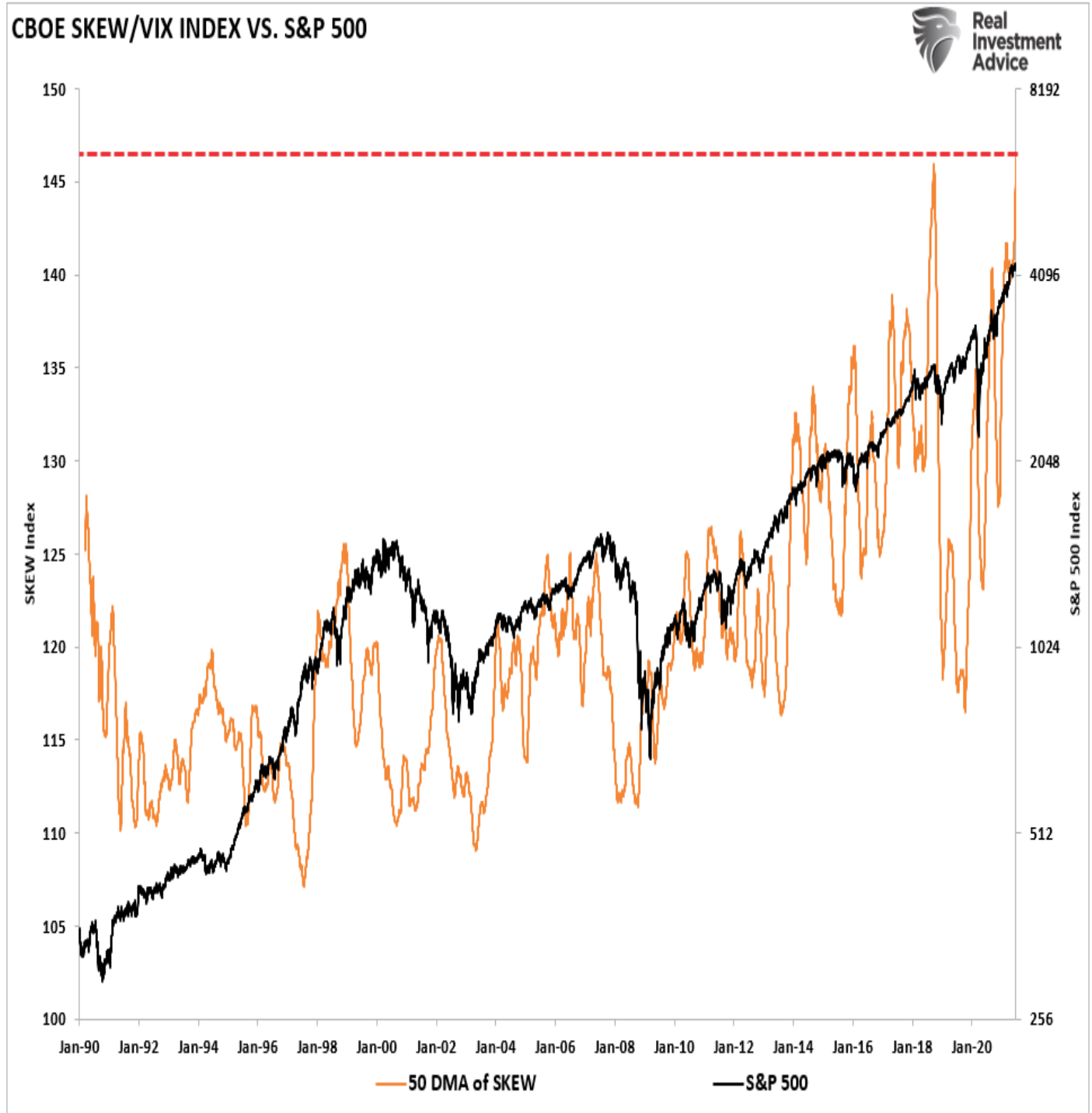
"Currently, complacency has reached more extreme levels. As noted last week, the 15-day moving average of VIX, on an inverted scale, suggests a correction is likely. By this measure, the correction should begin somewhere around July 21st ? August 10th."



The same gets confirmed by the exceptionally [high reading of the SKEW index](#).

*"One such indicator is the CBOE SKEW index. The index measures the perceived tail risk of the distribution of S&P 500 investment returns over a 30-day horizon. It is similar to the VIX index, but instead of measuring implied volatility based on a normal distribution, it measures the implied risk of future returns realizing outlier behavior. A SKEW value of 100 indicates the options market perceives a low risk of outlier returns. **Conversely, values above 100 reflect an increased perception of risk for future outlier events.**"*

We are clearly above 100 currently.



The bulls are indeed in charge of the markets currently, but the clock is ticking.



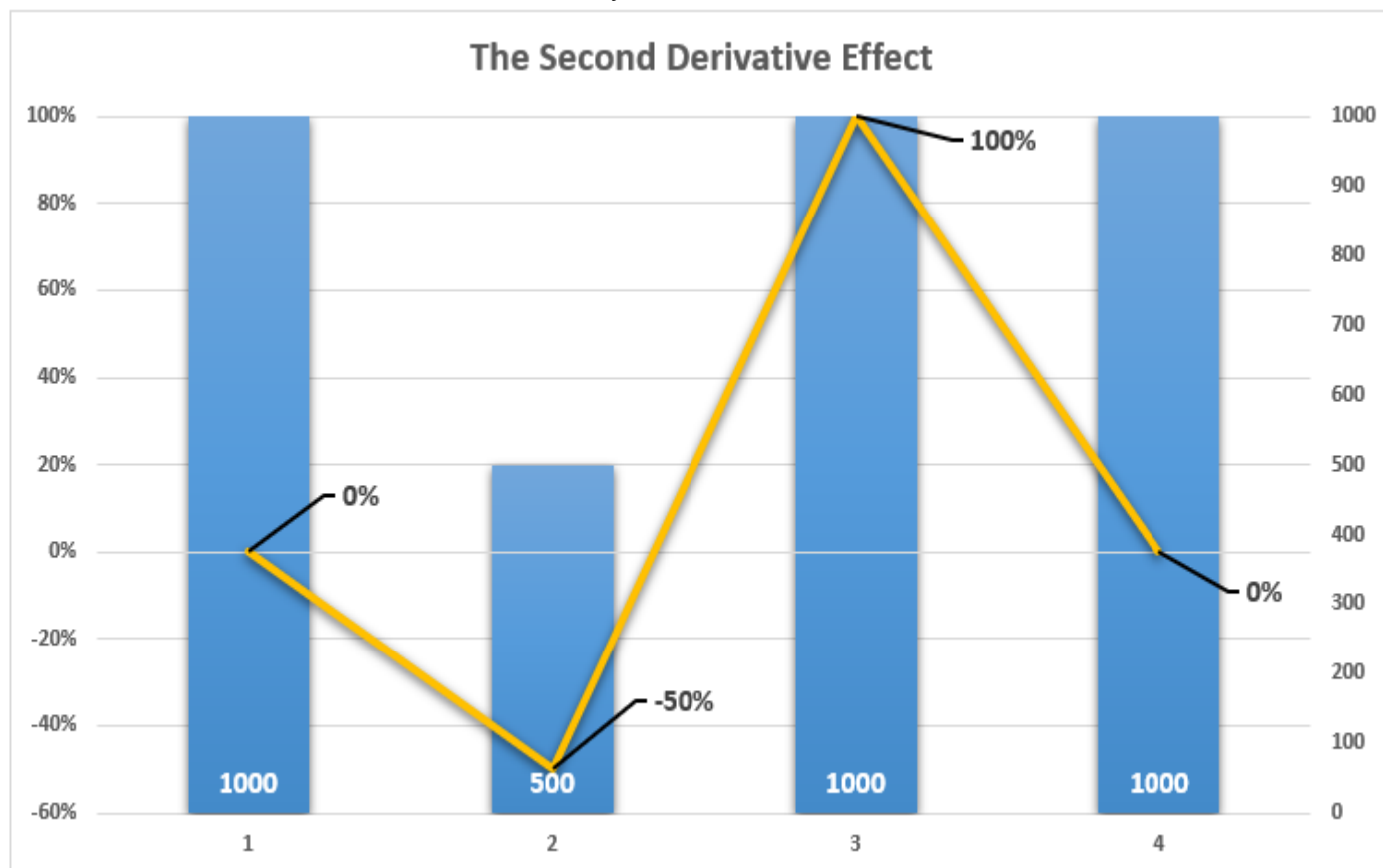
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As Good As It Gets

There is much at risk in the market as we head into the 3rd quarter and begin Q2-reporting for the S&P 500 index. For clarity, we need to review the "second-derivative" effect.

*?In calculus, the **second derivative**, or the **second-order derivative**, of a function f is the derivative of the derivative of f .? ? Wikipedia*

In English, the "second derivative" measures how the rate of change of a quantity is itself changing. I know, still confusing. Here is a simplistic example. Assume the economy is \$1000 in value in Year 1. Then, in Year 2, there is a 50% recession. However, in Year 3, the economy grows back to \$1000. And, in Year 4, the economy remains at \$1000.

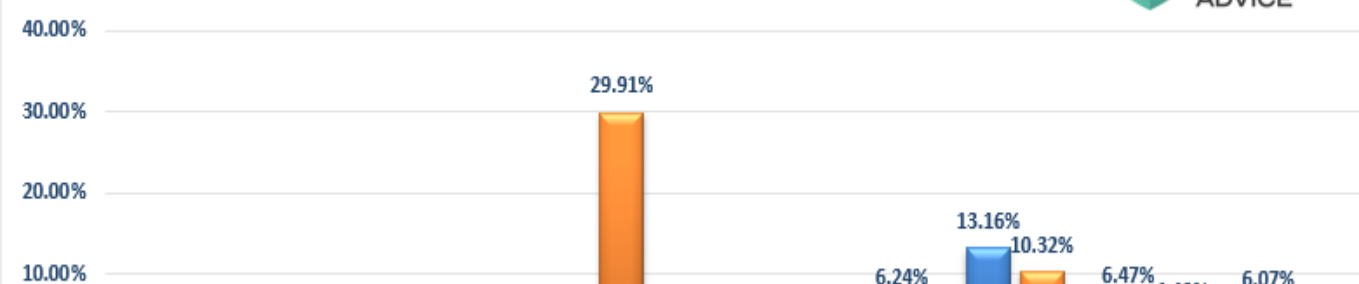


The "second derivative" effect is evident in years 3 and 4. In year 3, the economy recovers by \$500, a 100% increase from Year 2's level of \$500. However, in Year 4, the growth rate falls to zero as the economy remains at \$1000.

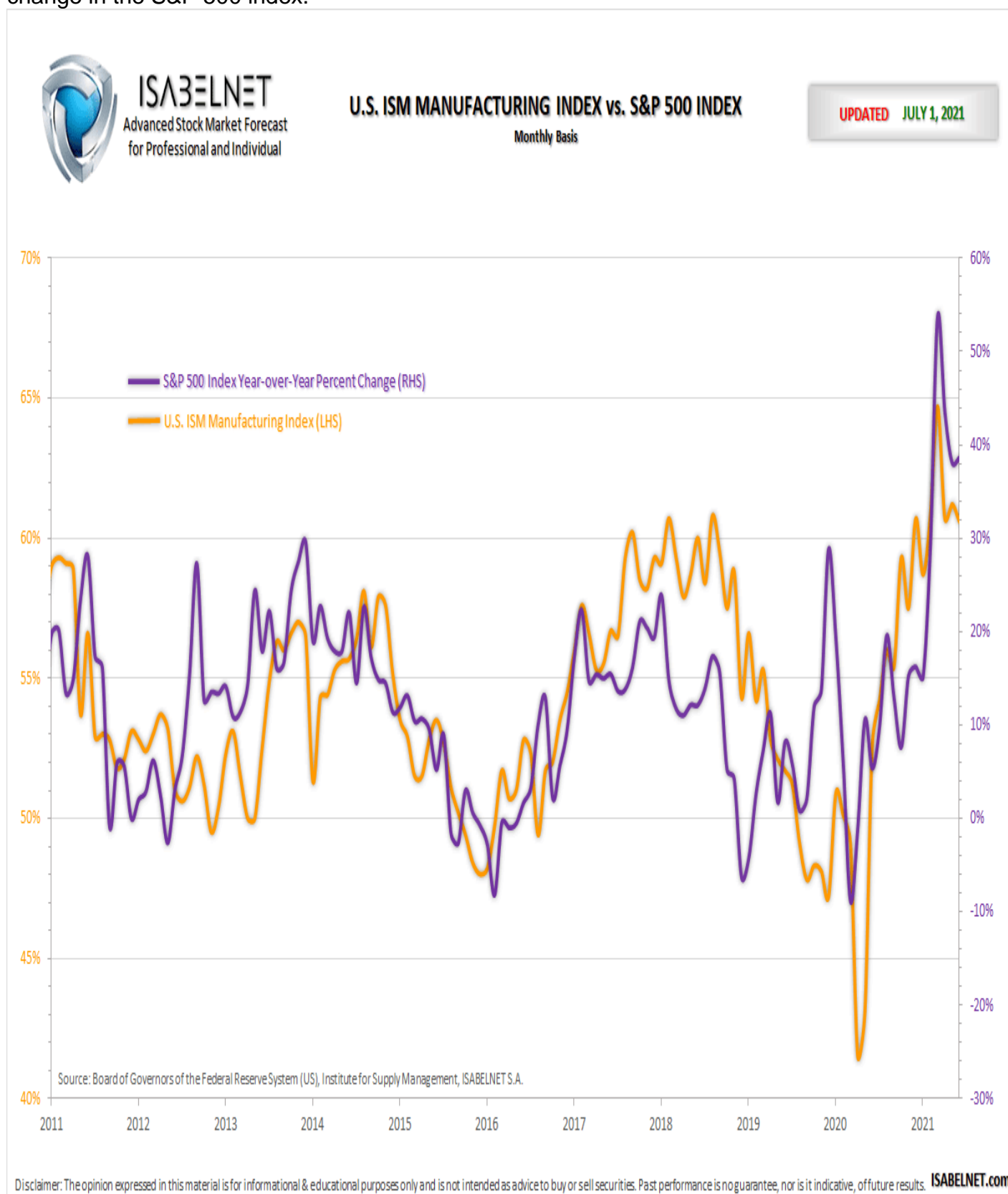
A Coming Change

Why am I telling you this? Because we are at that point in the recovery cycle. **Over the next couple of months, we will see the most significant numbers of the recovery cycle as we compare Q2-2021 to Q2-2020, which was the depth of the economic shutdown.** As shown in the chart below, we will see a robust GDP report, but such will be the cycle's peak.

GDP Quarterly (Real) Annual Rate Of Change

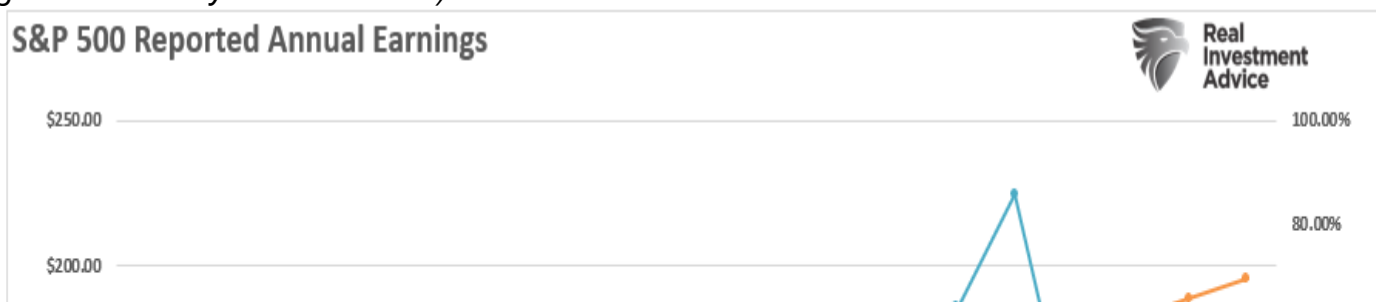


The manufacturing activity indices have already peaked, which has a high correlation to the annual change in the S&P 500 index.

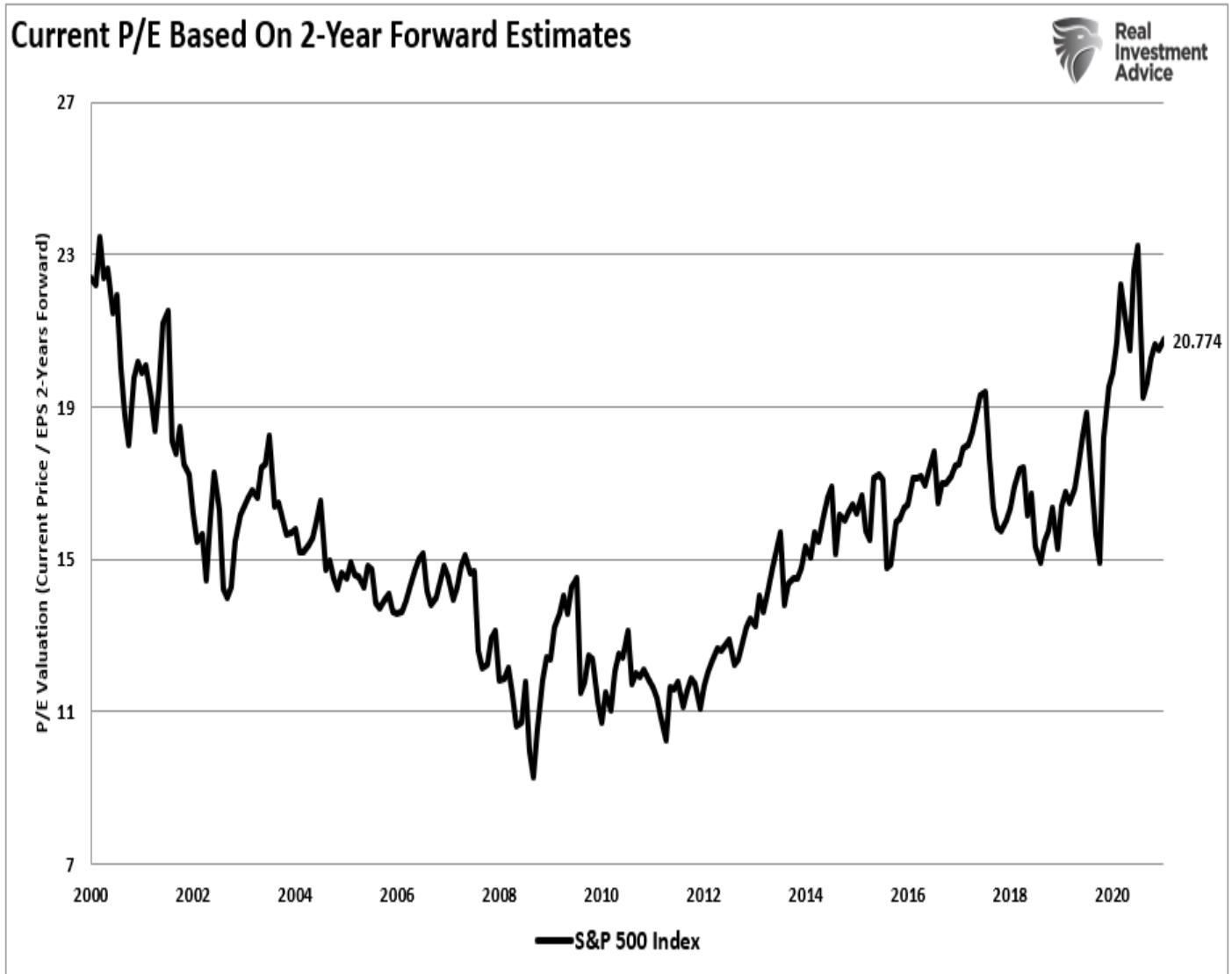


We will also see a peak in the annual rate of change in earnings as the economy slows. (Note: Current earnings estimates are exceptionally optimistic. By the end of 2021, the peak in earnings growth will likely move forward.)

S&P 500 Reported Annual Earnings



With valuations highly elevated on a two-year forward basis, when earnings are eventually revised lower with slower economic growth, valuations will rise. ***(You will often see media types compare forward P/E's to current reported P/E's, suggesting markets are cheap. However, that is not apples to apples as you are comparing forward to trailing P/E's. As shown, two-year forward P/E's are at the highest level since the "Dot.com" peak.)***



The point here is that much of the growth in the economy is currently *"priced in"* to expectations. When things are as *"good as they can get,"* that is usually the point where things inevitably start to go wrong. With no more stimulus coming from the Government and 9-million people coming off of unemployment benefits by September, a *"fiscal cliff"* is fast approaching. Such could well lead to a disappointment in expectations in a market currently priced for perfection.

In Case You Missed It



#MacroView: Capitalism Does Not Equal Corporatism – Pt. 2

Written by Lance Roberts | Jul 2, 2021

The problem is continuous interventions to halt the "Darwinian" function of "capitalism." That brutal process must function; otherwise, it leads to "corporatism."

[>> Read More](#)

Fully Invested Bears

The problem in discussing *?investment risk?* is that such commentary is summarily dismissed as being *?bearish,* **? By extension, such means I am either sitting in cash or short the market. In either event, I have ?missed out? on the last advance.** However, now, the discussion of *?risk?* is even more futile due to the Fed's massive interventions. Such reminds me of something famed Morgan Stanley strategist Gerard Minack said once:

?The funny thing is there is a disconnect between what investors are saying and what they are doing. No one thinks all the problems the global financial crisis revealed have been healed. But, when you have an equity rally as you've seen for the past four or five years, everybody has had to participate. What you've had are fully invested bears.?

The idea of *?fully invested bears?* defines the reality of the markets we live with today.

Despite the understanding that the markets are overly bullish, extended, and valued, **portfolio managers must stay invested or suffer potential *?career risk?* for underperformance.** The reason I bring this up is because of this comment from the legendary Leon Cooperman.

<https://twitter.com/SquawkCNBC/status/1410201672765300738?s=20> The clip is fascinating because Becky Quick refers to Leon as a *"fully-invested bear"* as he states:

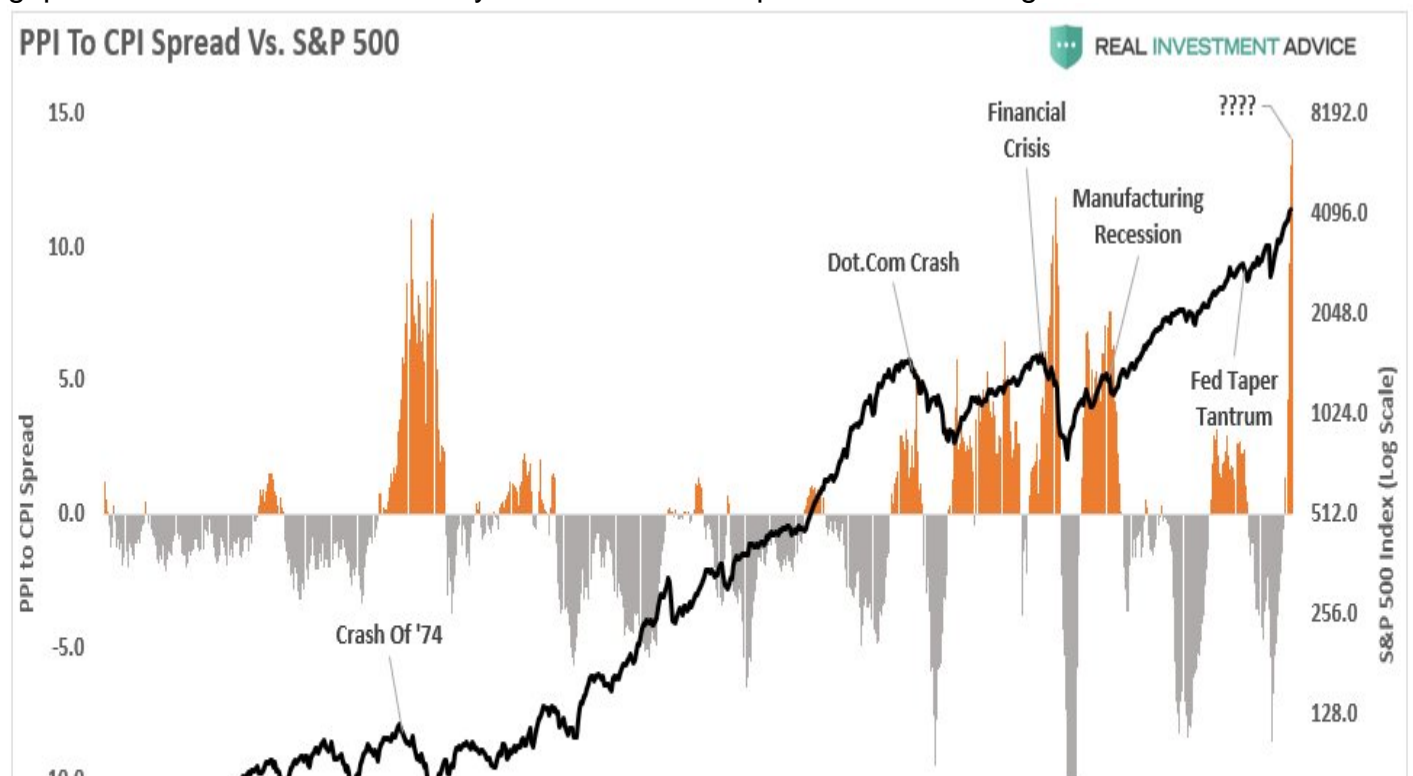
"You have to be in the market right now."

The Two Big Risks

There are two inter-related risks to the market currently. The Fed and *"inflation."* As Leon correctly notes, companies should be able to pass on inflated materials costs to their consumers:

?Everybody is worried about inflation. Inflation is a positive for common stocks because inflation in companies' costs works its way into selling prices, which lift the nominal level of revenues and earnings.

In theory, that is true, but as noted above, with the *"fiscal cliff"* approaching, there is a risk that consumers can't absorb as much *"inflation"* as he hopes. Moreover, as I showed previously, the gap between CPI and PPI already indicates that companies are retaining inflation.



The other problem is the Fed. The markets will not react kindly to the Fed moving to curb inflationary pressures. In either case, the risk to markets remains elevated. While I certainly agree you *"have to be invested in the markets currently,"* we are also fully aware of the risks. Yes, that makes us *"fully invested bears."*

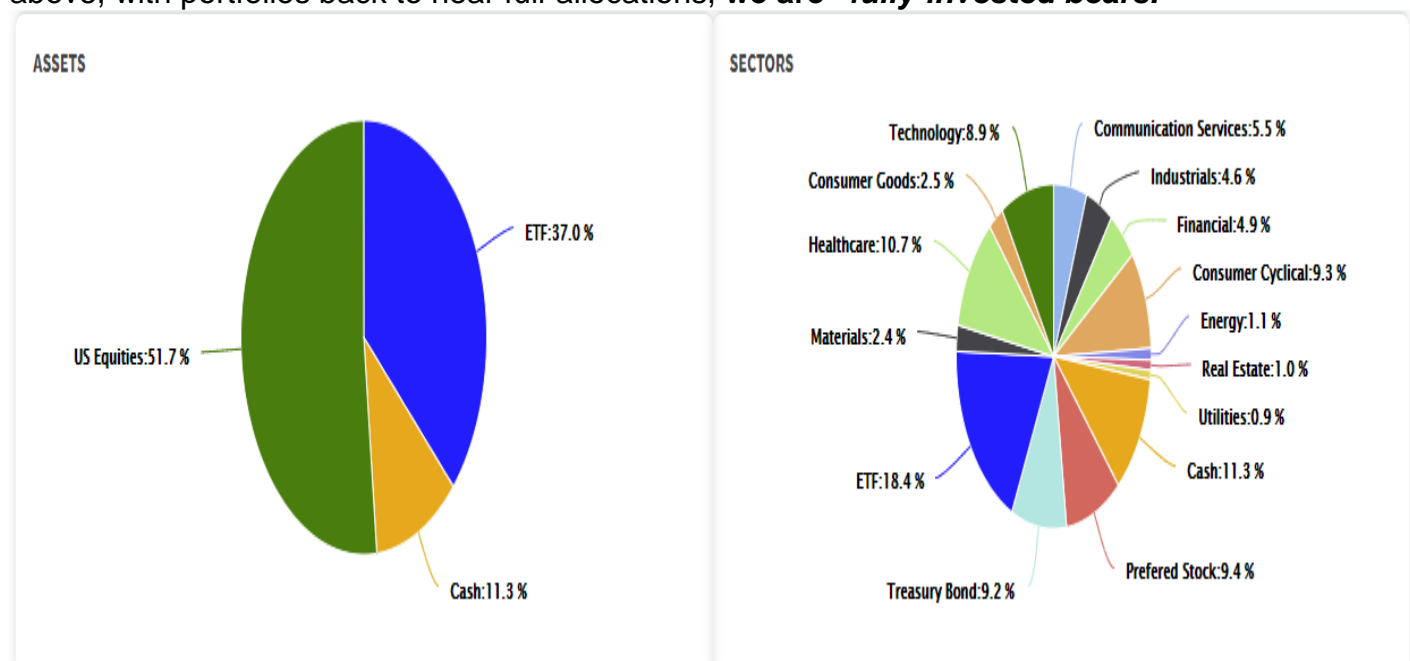
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Portfolio Update

As noted above, the *"buy signal"* is back in play. With the markets bullishly biased, the seasonally strong first two weeks of July should lift asset prices. **However, with the markets back to overbought, bullish, and deviated conditions, the upside is limited near term.** As noted above, with portfolios back to near full-allocations, **we are *"fully-invested bears."***



The biggest problem for investors is the *herding effect* and *loss aversion*. As markets are rising, individuals believe that the current price trend will continue to last for an indefinite period. **The longer the rising trend lasts, the more ingrained the belief becomes until the last of holdouts finally buy-in as the financial markets evolve into a euphoric state.** Once the market begins to decline, there is a slow realization it is more than a *buy the dip* opportunity. **As losses mount, the anxiety of loss begins to climb until individuals seek to avert further loss by selling.** Such is the basis of the *Buy High / Sell Low* syndrome. **However, by understanding what drives market returns over the long term, you can mitigate the risk of making psychological errors.** It is likely, given there is *no fear* of a market correction, an overwhelming sense of *urgency* to get invested, and a continual drone of *bullish chatter*, the markets are poised for an unexpected, unanticipated, and inevitable event. What will that be? No one knows until after the fact. Such is why applying *"risk management"* before the event is critical to the eventual outcome. **After all, you don't carry an "umbrella" after it rains, do you?** I hope you have a terrific 4th of July weekend, and I will see you again next week. **By Lance Roberts, CIO**

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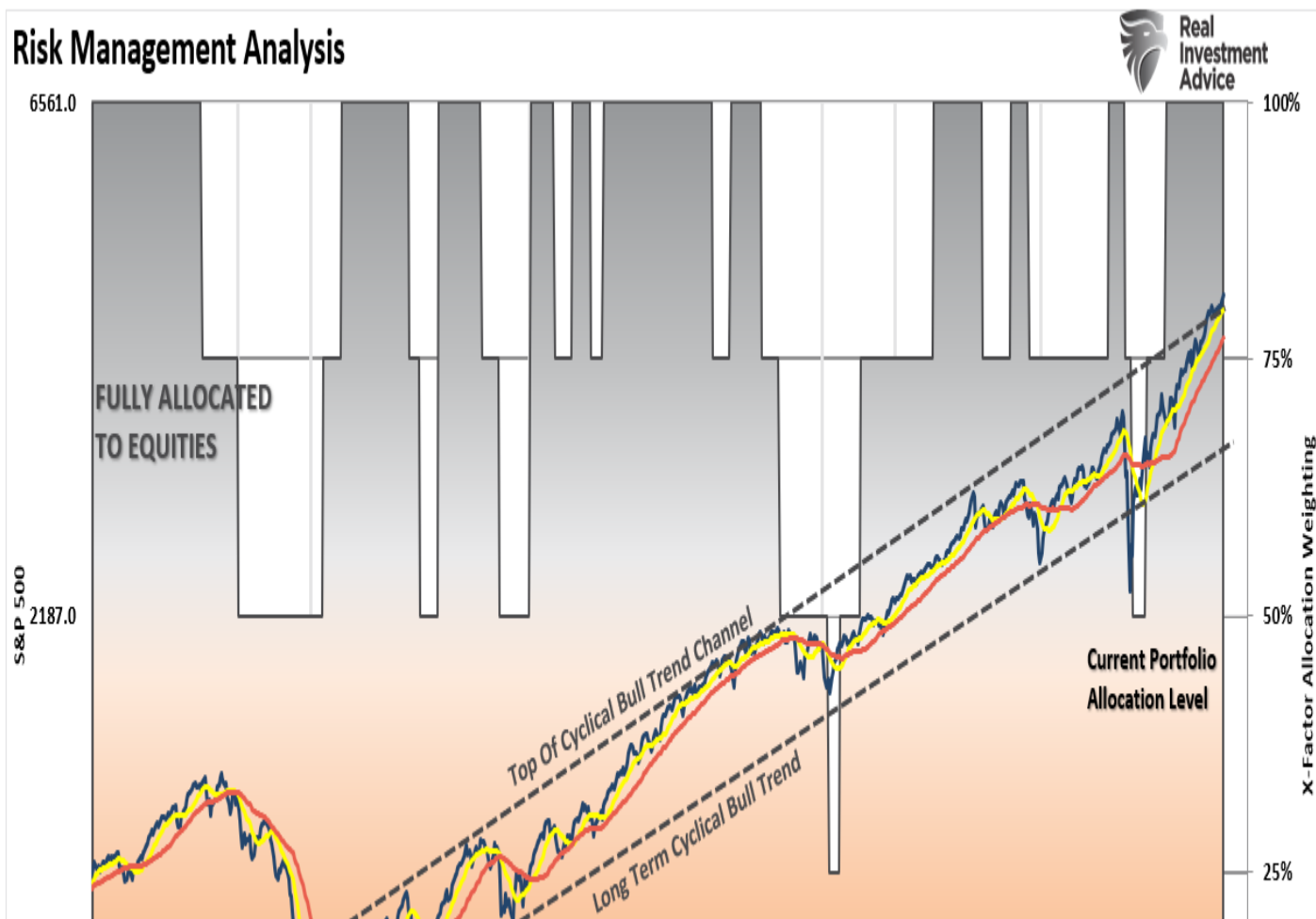
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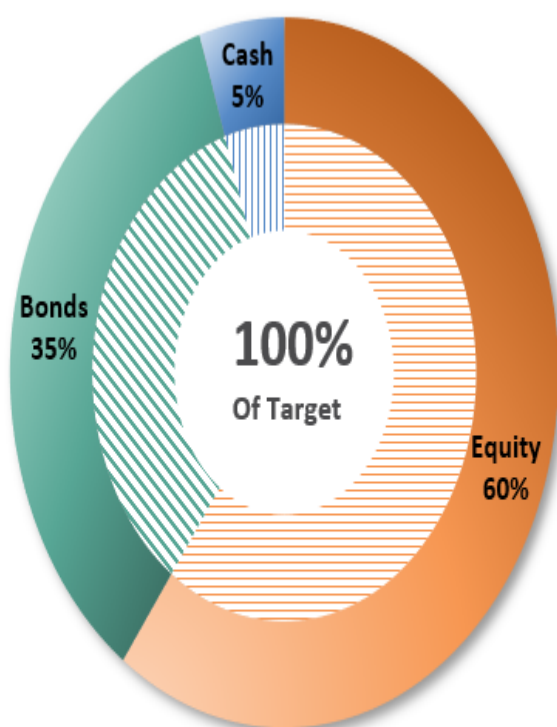
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Current Portfolio Weighting



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

The recent rally off of the 50-dma triggered our "buy signal" previously from a mid-cycle point. Such suggests that while the market will get a respite from selling temporarily it will likely return by mid-July.

As noted last week, the first two-weeks of July tend to be bullishly biased so continue to maintain exposure to market s for now.

If you are underweight equity exposure you can bring to targets, but move slowly. We are still liekly to see more volatility over the next week or so. **Again, there is no need to be aggressive here. There isn't likely a lot of upside to the market as we head into summer, so we would recommend not being overly aggressive.**

401k Plan Portfolio Allocation Model[caption] If you need help after reading the alert, do not hesitate to [contact me](#).

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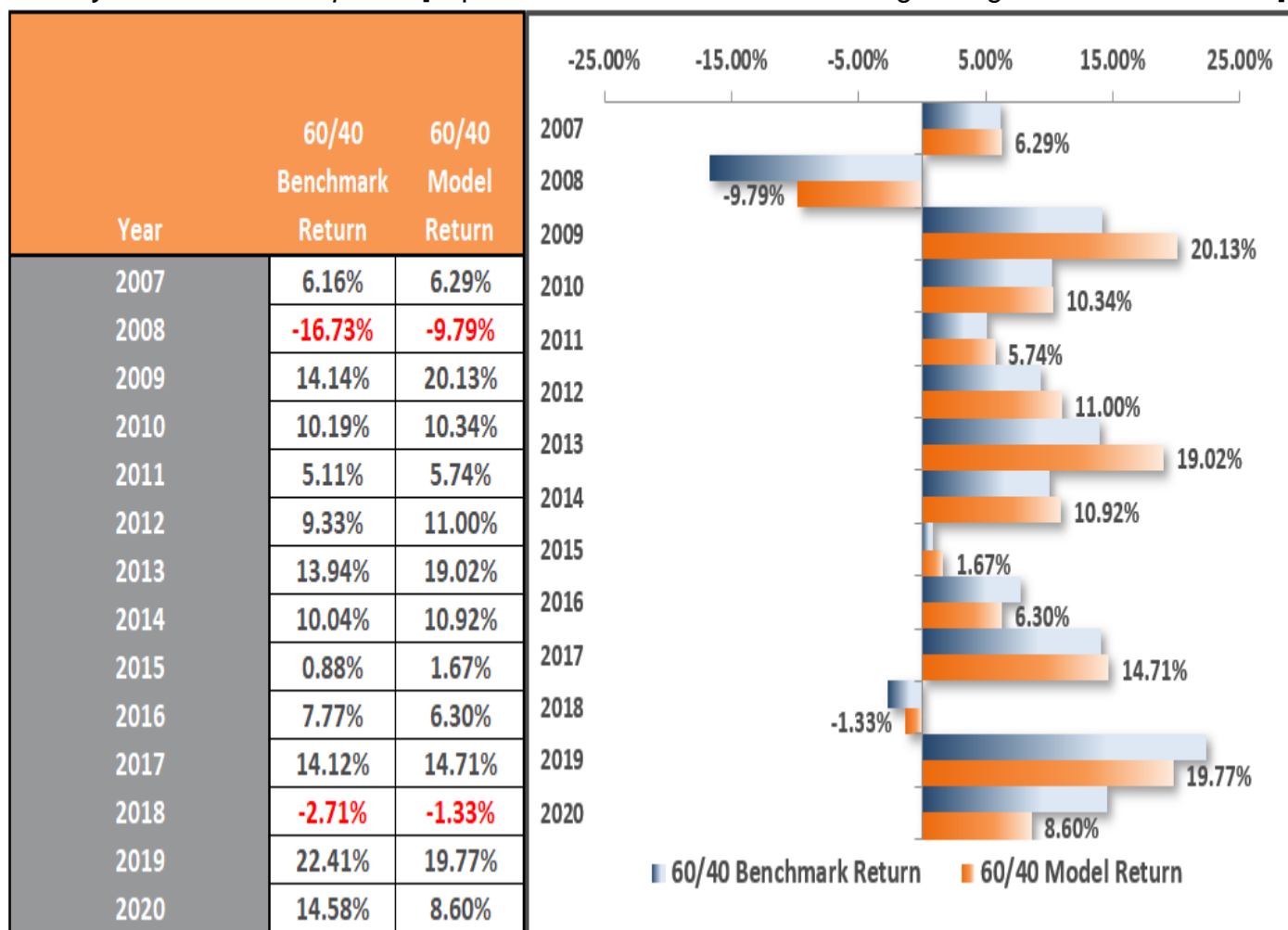
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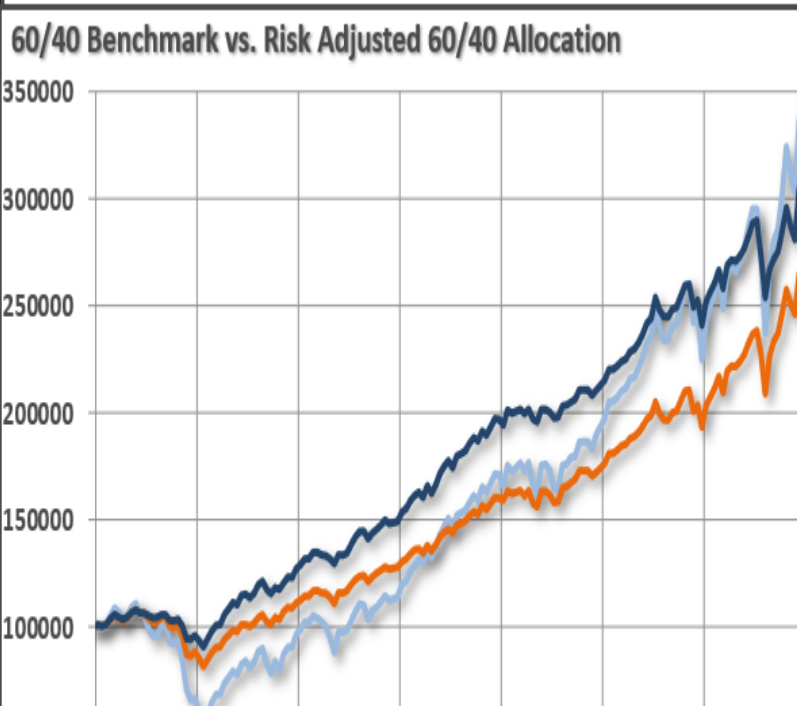
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Model performance is a two-asset model of stocks and bonds relative to the weighting changes made each week in the newsletter. Such is strictly for informational and educational purposes only, and one should not rely on it for any reason. Past performance is not a guarantee of future results. Use at your own risk and peril. [caption id="attachment_444741" align="alignnone" width="1041"]



Portfolio vs Benchmark Statistics	
Number of Up Years	12
Number of Down Years	2
Best One Year Return Of Benchmark	22.41%
Best One Year Return Of Model	20.13%
Worst One Year Return Of Benchmark	-16.73%
Worst One Year Return Of Model	-9.79%
Benchmark Return 2007-Present	171.16%
Model Return 2007-Present	213.32%
Total Alpha Generated	42.17%
Mean Annual Return Of Benchmark	7.80%
Mean Annual Return Of Model	8.81%



401k Model Performance Analysis[/caption] Have a great week!