



*In this 09-10-21 issue of "Investors Hold Record Allocations Despite Rising Warnings."*

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- **Sector & Market Analysis**
- **401k Plan Manager**

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## **Market Starts A Correction Right On Cue**

As [noted last week:](#)

*"However, in the meantime, the "stairstep" advance continues with fundamentally weak companies making substantial gains as speculation displaces investment in the market. **Thus, while prices remain elevated, money flows weaken, suggesting the next downturn is roughly one to two weeks away.** So far, those corrections remain limited to the 50-dma, which is approximately 3% lower than Friday's close, but a 10% correction to the 200-dma remains a possibility."*

**That correction started on Monday with the week ending in 5-straight down days which is the worse slide since February.**

However, while that sounds terrible, the total decline for the week was just **-1.69%**. Yes, that's it, less than 2%. **While CNBC probably ran their "Markets In Turmoil" segment, traders huddled over candles and incense chanting incantations at the Fed for more accommodation.**



**With sell signals in place, volume rising, and breadth weak, a retest of the 50-dma early next week will not be a surprise.** The question will be whether traders show up again, as they have done every other time over the last 6-months to *"buy the dip."*

As shown, the market remains well confined to its rising trend with support sitting at the 50-dma. Volatility did pick up late last week as volume spiked suggesting more selling pressure on Monday.



The question is *"this time different."* Will the market hold the 50-dma again, or has the risk of a more substantial correction finally caught up with investors.

As noted previously, 5-10% corrections are absolutely normal in any given market year. **However, if you didn't like the 1.69% correction this week, a 10% correction will feel like an all-out "crash."**

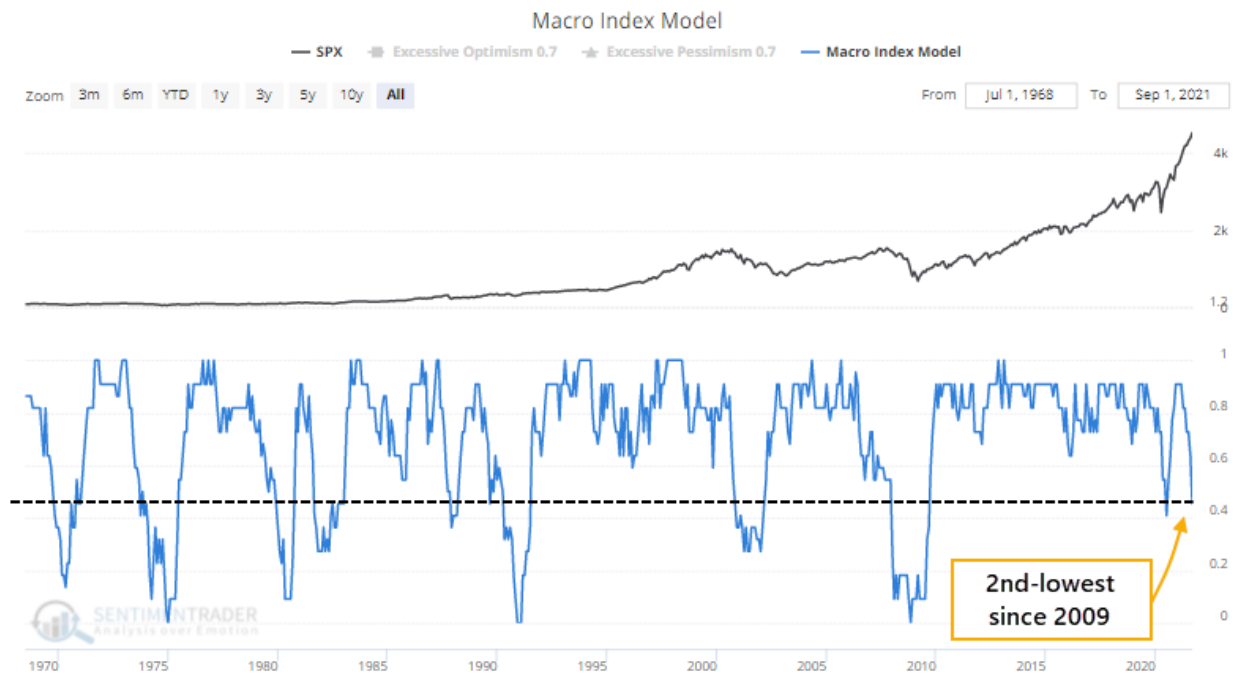
Such is why we have repeatedly suggested taking some actions in advance.

## Macro Conditions Continue To Deteriorate

Over the last couple of weeks, I noted the deterioration of underlying market conditions. Weakening breadth, lower participation, and negative divergences all suggest risks of a correction. On Thursday, [Sentiment Trader](#) provided some additional commentary supporting our concern.

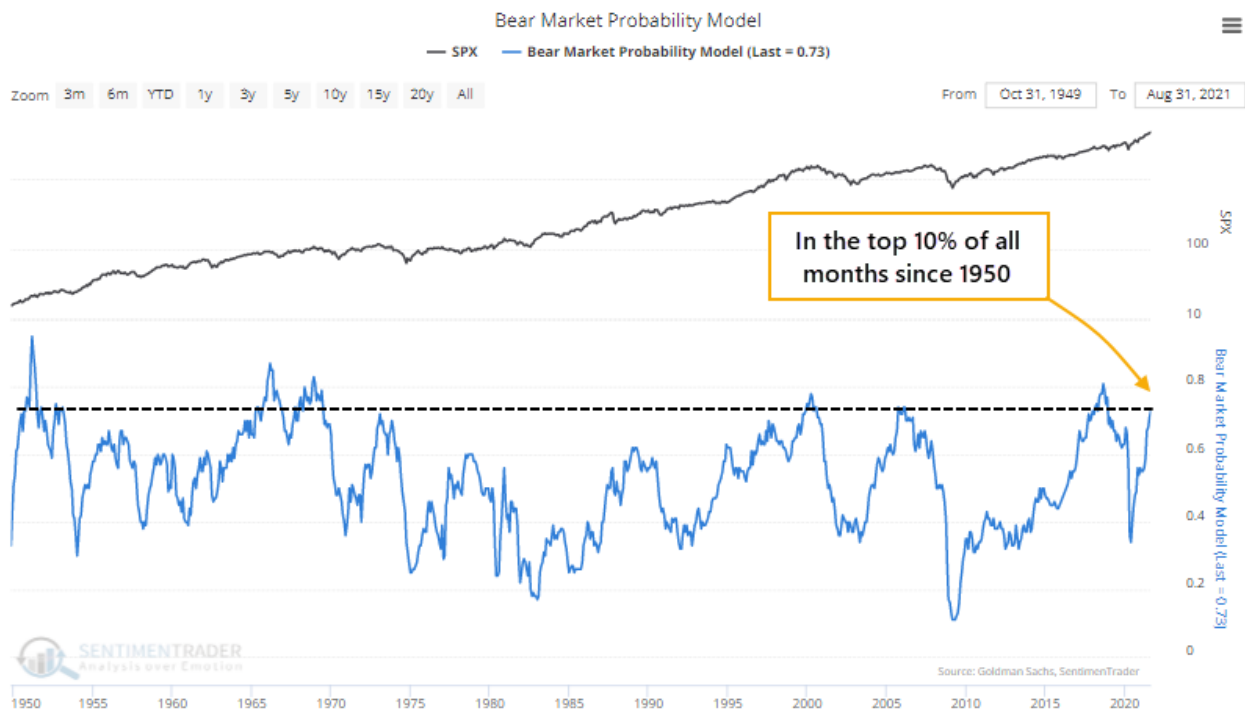
***"To differentiate temporary slowdowns from real problems, we look for significant macro deterioration. The Macro Index Model combines 11-diverse indicators to determine the state of the U.S. economy. Stock market investors should be bullish when the Macro Index is above 0.7 and bearish when below or equal to 0.7.***

***Once the final reports were in for August, the model plunged below 46%, the 2nd-lowest reading of the past decade."***



At the same time, Sentiment Trader noted their Bear Market Probability Indicator also jumped. This model has 5-inputs, namely the unemployment rate, ISM Manufacturing index, yield curve, inflation, and valuations.

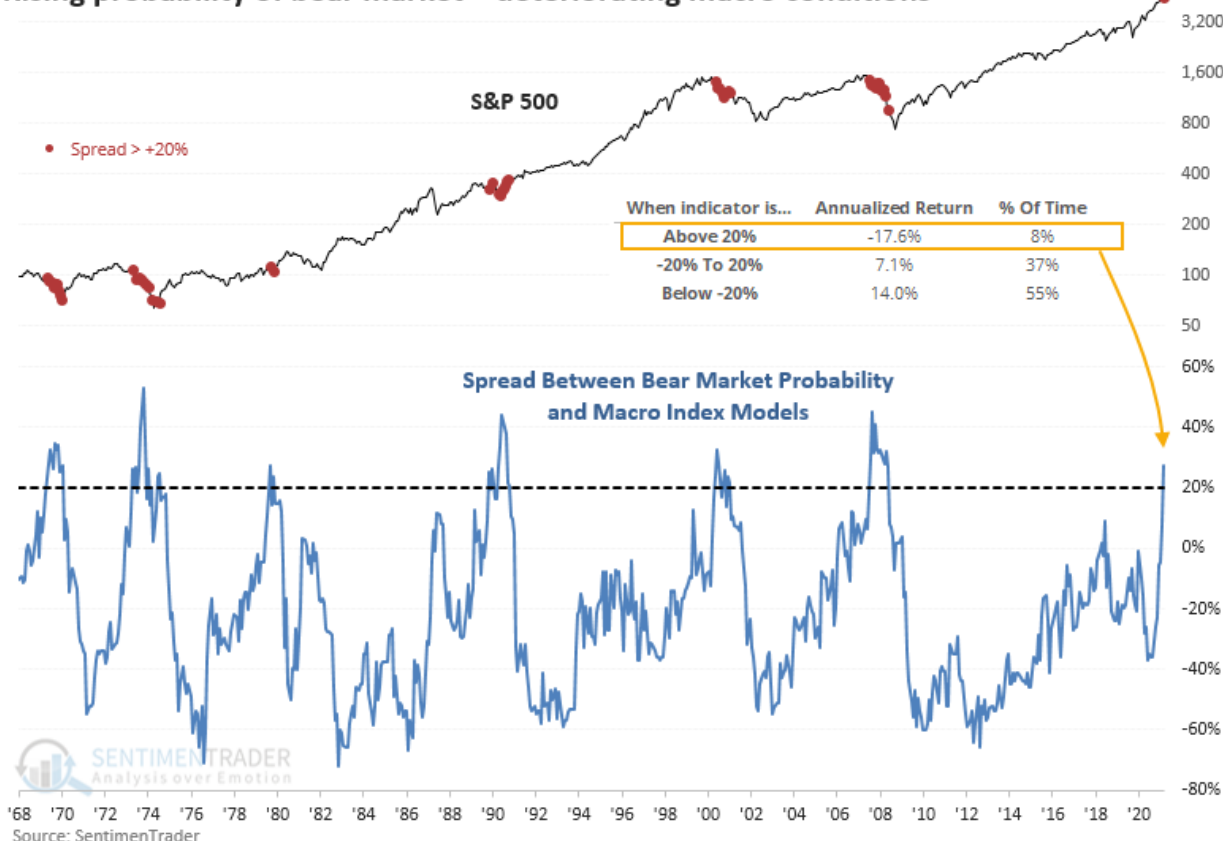
*"The higher the score, the higher the probability of a bear market in the months ahead. Last May, the model was in the bottom 10% of all months since 1950. This month, it jumped into the top 10% of all months."*



So, what does all of this mean? According to Sentiment Trader, the combination of these two measures should not be overlooked. To wit:

"The chart below shows the spread between the Bear Market Probability and Macro Index models. The higher the spread, the higher the probability of a bear market. **The chart shows that the S&P 500's annualized return is a horrid -17.6% when the spread is above 20% like it is now.**"

### Rising probability of bear market + deteriorating macro conditions



The point here is that while the market remains exceedingly bullish, there are signs of trouble brewing beneath the surface. Such is why we suggested raising cash levels, adding non-correlated assets, and reducing overall risk.

**But as Paul Harvey used to say: "There is more to this story."**



**Real Investment Show**  
with Lance Roberts

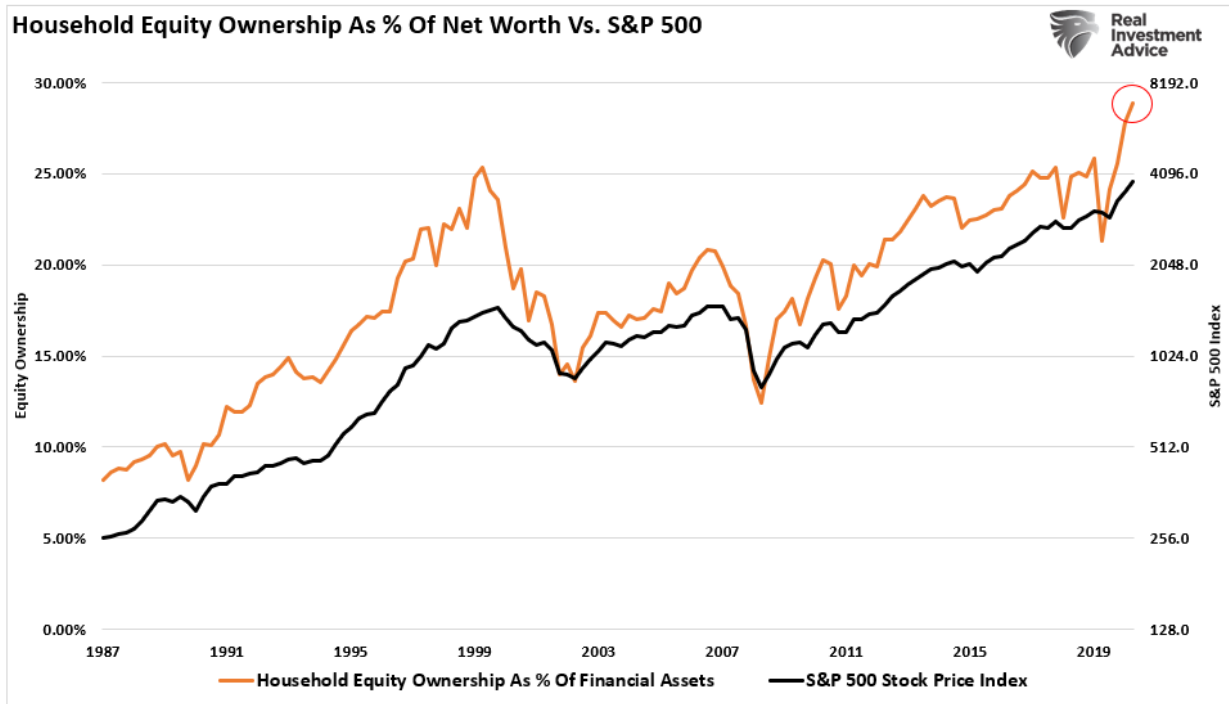
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## Investor Record Allocations

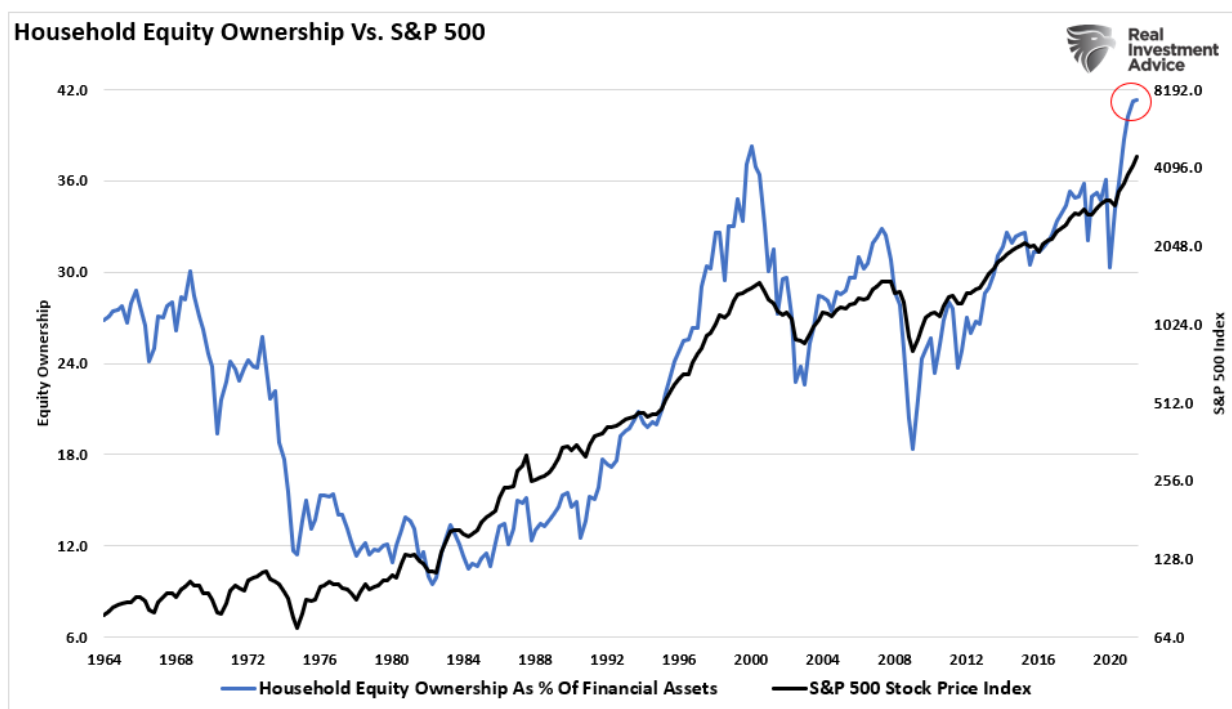
As noted, there is certainly cause for concern. However, investors aren't.

Such should be of no surprise after an extended bull market advance with very low volatility.

**Without any concern for corrections, individuals have increased equity risk levels relative to their overall net worth.**



Or, we see the same when we analyze their equity allocations as a percentage of their overall financial assets.



Regardless of the calculations, the message is the same. As we noted in Thursday's [Daily Market Commentary](#):

***"Bob Farrell's rule #5 states: ?The public buys the most at the top and least at the bottom.?"***

The two charts above speak volumes as to the wisdom of Bob Farrell's rules. Previous peaks in equity ownership have corresponded with peaks in financial markets.

As the old Wall Street axiom states: ***"If everyone has already bought, who is left to buy?"***

At the moment, however, investors are incredibly confident that markets can only go higher as long as the "Fed" remains accommodative. While there is undoubtedly **a substantial argument as to the ability of the Fed to keep markets inflated, there are other "risks" present that could lead to a short-term correction.**

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[dmc]

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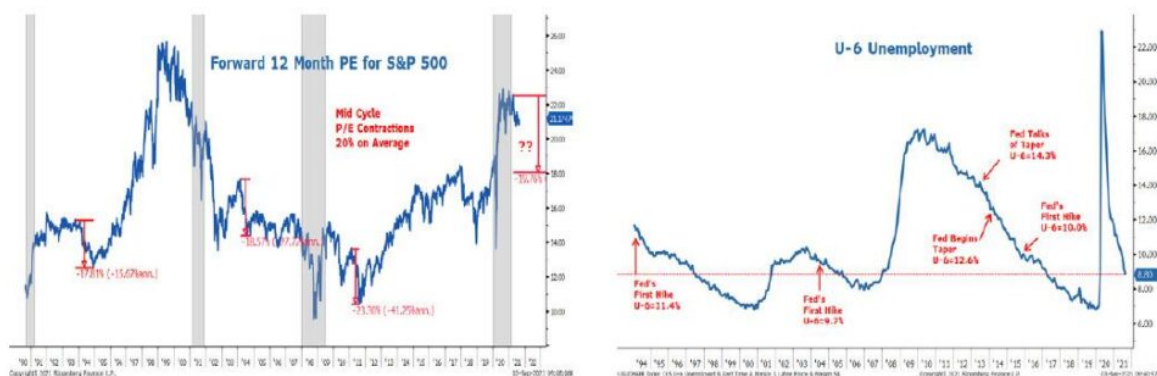
## An Increasing Number Of Correction Warnings

While investors are carrying record allocations, some of the largest Wall Street banks are worrying. A recent article on [Zero Hedge](#) compiled their outlooks. To wit:

*"Andrew Sheets warns that equity market internals has continued to follow a "midcycle transition." That process usually ends with quality stocks, like the FAAMGs, getting hit and **poses an outsized risk to the S&P 500** through October." - Morgan Stanley*

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### End of Mid-Cycle Transition Ends with SPX Correction of 10-20% by Fire...



Source: FactSet, company data, Morgan Stanley Research

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*"Suvita Subramanian, warned that '**downside risks remain**' and asking '**what good news is left?**' Sentiment is all but euphoric with our Sell Side Indicator (see SSI) closer to a sell signal than at any point since 2007." - Bank of America*



## #2 Sell Side Indicator (SSI)

Neutral: +10% price return over next 12 months

Wall Street's consensus equity allocation has been a reliable contrarian indicator over time. At 59.5%, Wall St. is neutral on US stocks, but remains closest to a "Sell" signal since 2007, indicating tepid 12m returns on the S&P 500 (+6.7% price returns).

### Exhibit 9: Pause in bullishness but still near extreme levels

Sell Side Consensus Indicator (SSI), as of August 31 2021



Source: BofA US Equity & Quant Strategy Note: Buy and Sell signals are based on rolling 15-year +/- 1 standard deviation from the rolling 15-year mean. A reading above the red line indicates a Sell signal and a reading below the green line indicates a Buy signal.

BofA GLOBAL RESEARCH

Deutsche Bank's strategists '**expect an imminent correction**' even though they see the S&P 500 rising back around current levels by year-end. Some more details on the coming pullback in markets **which DB believes will see the S&P drop 6%-10%:**

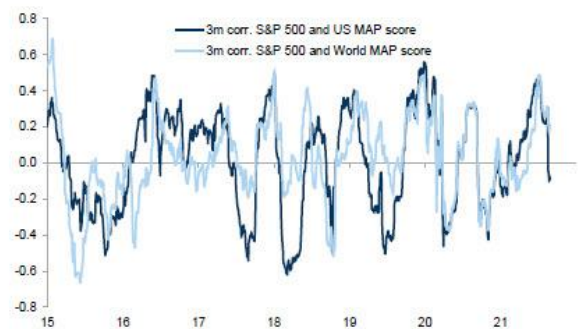
*Christian Mueller-Glissmann stated that high valuations have increased market fragility. If there is a new negative development, it could generate growth shocks that lead to rapid de-risking. As such, there is very little buffer left if you get large negative surprises." - Goldman Sachs*

### Exhibit 1: Growth expectations have de-rated across assets Risk Appetite Indicator PC1 'Global Growth' factor



Source: Datastream, Haver Analytics, Goldman Sachs Global Investment Research

### Exhibit 2: Bad news has not been bad news for the S&P 500 MAP score: macro surprises relative to consensus



Source: Bloomberg, Goldman Sachs Global Investment Research

You get the idea. **Between the leverage in the market, economic growth slowing, and rising inflationary pressures, numerous issues could disrupt the high levels of market complacency.**

The bullish argument is that such a correction will force the Fed's hand. As Zerohedge aptly concluded:



*"Even the smallest market hiccup will prompt a furious response at the Marriner Eccles building, because we are now well beyond the point of no return and Jerome Powell and company simply can not afford even the smallest drop in stocks without risking a full-blown market meltdown, much to the chagrin of the banks above who are predicting just that."*

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## In Case You Missed It



### #MacroView: The Insecurity Of Social Security

Written by Lance Roberts | Sep 10, 2021

The latest report from the Social Security Board of Trustees revealed the vast insecurity of the welfare programs and the problem facing retirees.

[> Read More](#)

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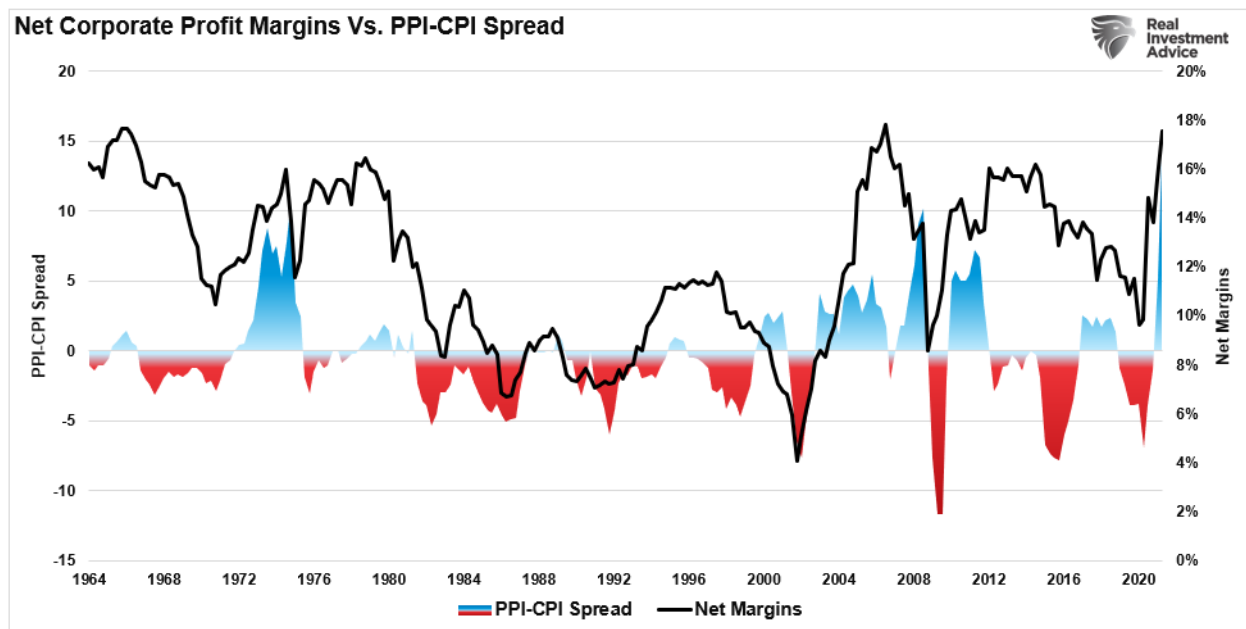
## Beige Book Reveals The Fed's Biggest Problem

The most significant risk for the market is a change in investor psychology. As long as nothing disrupts that bullish bias, investors will continue to aggressively "buy dips." However, that psychology is directly linked to the Fed's ongoing balance sheet expansion. Thus, the potential problem for investors is inflation.

The [Fed's Beige Book](#) is a summary of economic conditions in the 12 Federal Reserve Districts.

- **Boston:** "Inability to get supplies and to hire workers."
- **New York:** "Businesses reporting widespread labor shortages."
- **Philadelphia:** "Labor shortages and supply chain disruptions continued apace."
- **Cleveland:** "Staff levels increased modestly amid intense labor shortages."
- **Richmond:** "Many firms faced shortages and higher costs for labor and non-labor inputs."
- **Atlanta:** "Wage pressures more widespread."
- **Chicago:** "Wages and prices increased strongly"
- **St. Louis:** "Contacts continued to report labor and material shortages."
- **Minneapolis:** "Hiring demand outstripped labor response by a wide margin."
- **Kansas City:** "Wages grew at a robust pace."
- **Dallas:** "Wage and price growth remained elevated amid widespread labor and supply chain shortages."
- **San Francisco:** "Hiring activity intensified further, as did upward pressures on wages and inflation."

**Inflation is becoming problematic for the Fed mainly if these pressures are not as "transient" as hoped.** Higher wages are corrosive to both earnings and margins. As shown below, strongly rising producer prices are initially good for profit margins until inflation can not get passed along to consumers. Such is the case currently, with the most significant historical spread between PPI and CPI.



With supply chain disruptions looking to last longer than expected, the Fed is trapped between supporting a slowing economy and fighting inflation.

It's a battle they are likely going to lose, no matter what they choose.

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## Portfolio Update

As noted above, market action became sloppier this week.

**Over the last few weeks, we discussed that stock selection was essential to portfolio performance as breadth continues to narrow in the market.** This past week was not much different. The question is now whether the previous leaders will become laggards? Such could suggest more trouble overall for markets.

In the meantime, equity allocations remain underweight. We have increased the bond portfolio duration closer in alignment with our benchmark as we continue to look for lower rates as economic growth slows. Cash remains roughly 10% of our equity allocations as a risk hedge for now.



As noted above, there is a reasonable possibility the market stalls at current levels and works off some of the overbought conditions. **There is also a more than a possible risk of a correction between 5% and 10%.**

However, I don't know which it will be until we start seeing definite signs of the market breaking down. At that point, it will be too late to make adjustments. Such is why, as we have stated previously, this is an opportune time to get in front of risk by taking some simplistic actions.

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

These actions will not protect you from a decline. **They will, however, lessen the blow and allow you to rebalance risk accordingly where they become present.**

Or, you can do nothing and hope for the best.

It's your choice.

Have a great weekend.

By Lance Roberts, CIO

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## Market & Sector Analysis


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## THE REAL 401k PLAN MANAGER



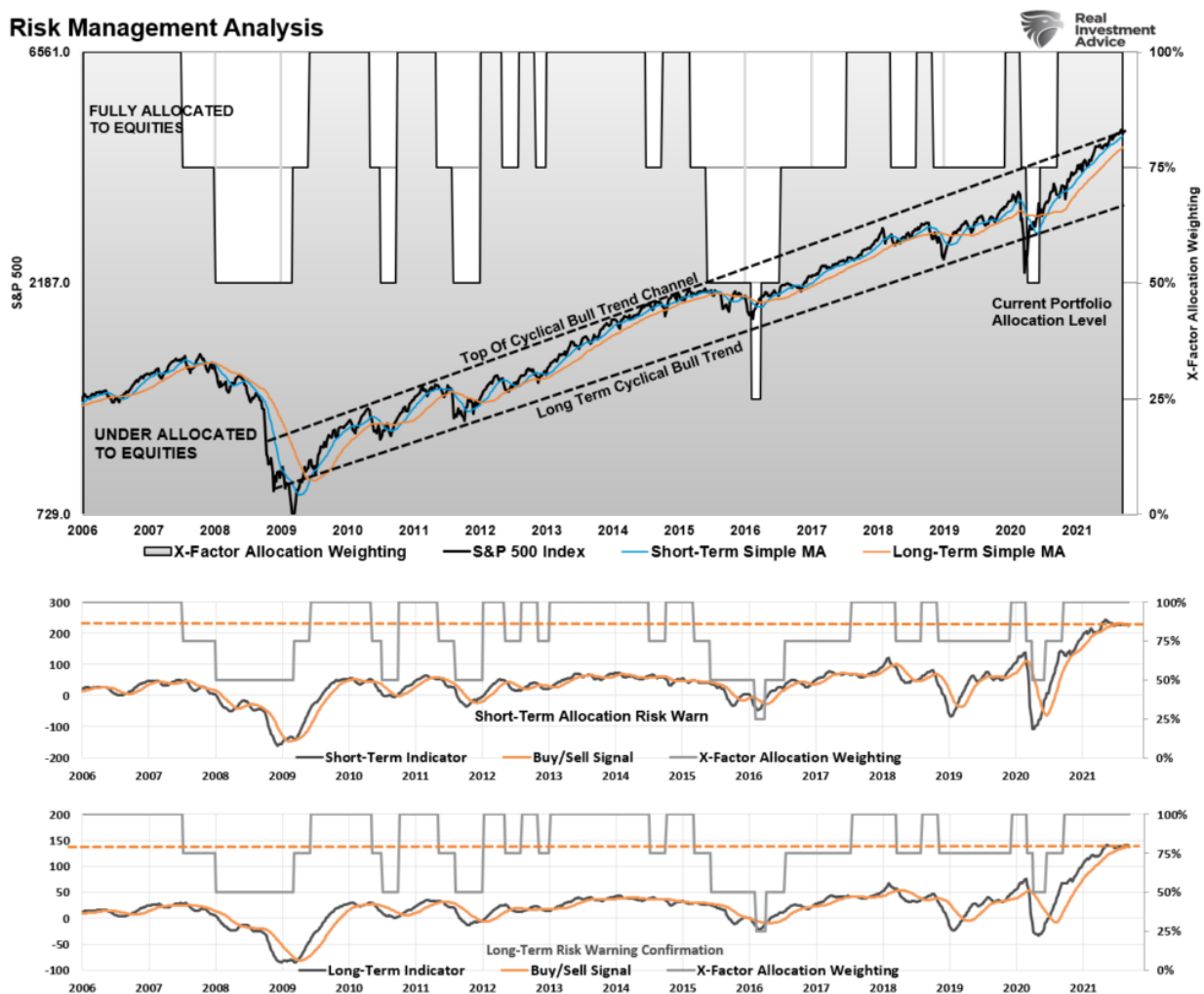
### Looking for the 401k Plan Manager?

Find it in the Retirement section of our website.

[Find It Here](#)

Attention: In the next couple of weeks, the 401k plan manager will no longer appear in the newsletter. However, the [link to the website](#) will remain for your convenience. Be sure to bookmark it in your browser.

#### Risk Management Analysis



### Commentary

This past week was a bit rougher for markets than usual. However, while the market did violate its 20-dma, it remains well-entrenched above the 50-dma. Moreover, with the market having sold off every day last week, a rally next week will not be surprising heading into options expiration.

The one thing to watch for is a violation of the 50-dma, which will most likely indicate we are starting a bit larger correction between 5-10%. Given the Fed looks to be aggressively moving towards tapering their balance sheet purchases, we may have seen the peak in the market for now. However, the bullish bias remains very strong, so it is still too early to get overly defensive.

In the meantime, we can take some actions to reduce portfolio risk accordingly. First, continue to move all new contributions to either money market or stable value funds for now. Also, rebalance your equities and bonds back to weightings as equities are likely now out of tolerance.

International and small-cap stocks continue to underperform as of late as the momentum chase has turned back to the growth trade. Remain underweight these sectors.

There is no need to be aggressive here.

## Model Descriptions

1. Understand your allocation options:

### CORE STRATEGY

The core strategy consists of holdings that are based on market fundamentals, valuations, and long-term market trends. These are holdings that should be considered "long-term" investments and should primarily track the benchmark index over time. The turnover of the portfolio should be extremely low with the exception of rebalancing periods due to market gyrations.

### TACTICAL STRATEGY

The tactical strategy consists of holdings which based on the short- to intermediate-term trends of the market. As macro-economic, monetary and fiscal policy, and investor psychology impacts markets, the holdings in the tactical strategy will shift to take advantage of market rotations. Importantly, this portion of the portfolio can move to all cash if needed to reduce risk in the event of a market downturn.

### FIXED INCOME

The fixed income strategy is designed to both take advantage of changes in interest rate and inflation expectations, but also deliver a lower degree of volatility to the overall portfolio. The primary focus of the fixed-income portfolio is to protect capital, generate income, and lower overall portfolio volatility.

## Choose The Model That Fits Your Goals

2. Choose the financial strategy that best fits your retirement goals and let RIA do all the work for you:

Current Target

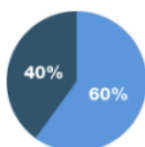


Risky

Conservative

#### Aggressive Growth

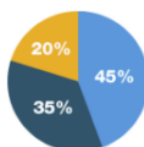
100% Stocks  
0% Bonds



A portfolio that is 100% exposed to stocks for investors seeking to obtain "benchmark". This portfolio is most suitable for younger investors with a long-term time horizon to retirement.

#### Growth

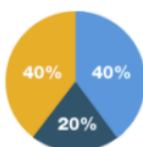
80% Stocks  
20% Bonds



For investors still wanting more growth from their portfolio, but with a slightly lower risk profile the addition of fixed income lowers overall volatility. This portfolio is suitable for investors with a 10-20 year time horizon to retirement.

#### Balanced

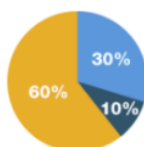
60% Stocks  
40% Bonds



Investors seeking a more conservative approach that will track a balanced index may find the balanced. With lower volatility, but with a growth component, the portfolio is suitable for investors 10-15 years to retirement.

#### Conservative

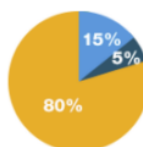
40% Stocks  
60% Bonds



For those approaching retirement and are more (<10 years) concerned about capital preservation over growth the conservative model may be useful. With a lower exposure to stocks, volatility is reduced and should protect portfolios against potential market drawdowns.

#### Ultra Conservative

20% Stocks  
80% Bonds



For investors rapidly approaching retirement, where funds will be rolled out of company retirement plans, an ultra-conservative model may be useful in ensuring capital protection. Useful for individuals within 24-months of retirement.

#### Fixed Income Only

0% Stocks  
100% Bonds



For individuals within 12-months of retirement, an all fixed income portfolio may be appropriate to protect capital before the roll-over process. If your window to retirement is longer than 12-months, the Ultra-Conservative model may be more appropriate.

## Model Allocations

## Asset Class

CORE STRATEGY						
Large Cap Blend (Ex. S&P 500 Index)	25	20	20	15	5	
Large Cap Growth	10	5				
Large Cap Value			5			
Large Cap Dividend			5	10	10	
Mid Cap Growth	10	5				
Mid Cap Value			5	5		
Small Cap Blend	15	15	5			
TACTICAL STRATEGY						
International Growth	5	5	5			
International Value			5	5		
International Blend	5	5				
Emerging Markets	10	5				
Real Estate	10	10	10	5	5	
Commodities	10	10				
FIXED INCOME						
Short Term Core			5	10	20	35
Intermedia Core		10	15	30	30	30
Global Fixed			10	10	15	10
High Yield Bond		10	5			
Inflation Protected			5	10	15	25
CASH						
Retirement Reserves/Stable Value						
5 Year Standard Deviation	15.8	13.1	9.8	6	4.4	3
5 Year Annual Return	16.7	13.8	10.7	7.9	5.8	3.4
5 Year Maximun Drawdown	-34.3	-30.2	-24.5	-16.7	-11.2	-8.2

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

**Or, let us manage it for you automatically.**



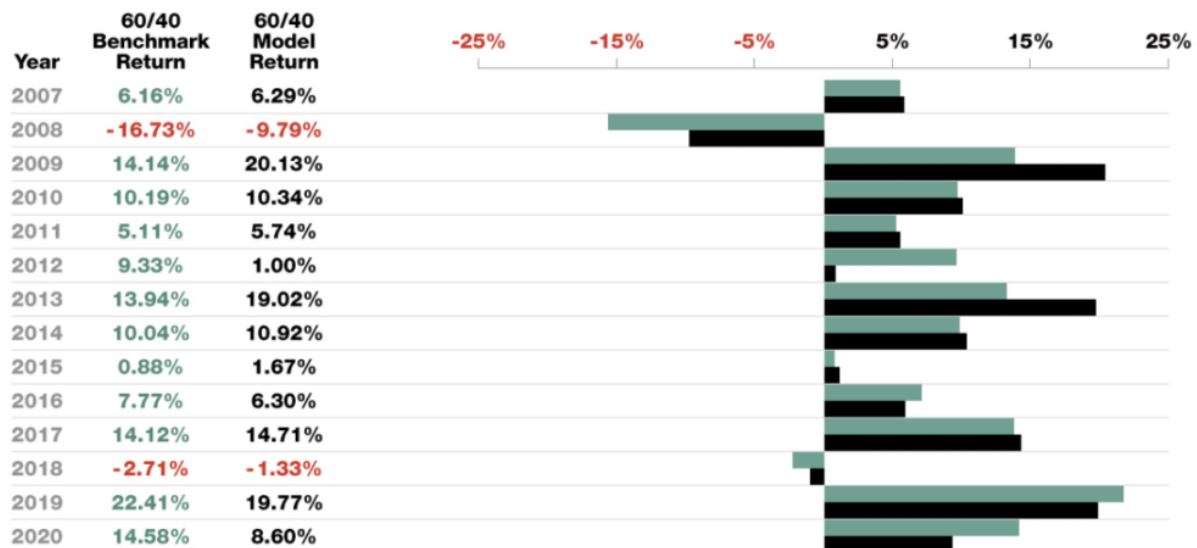
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## 401k Model Performance Analysis

*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.*

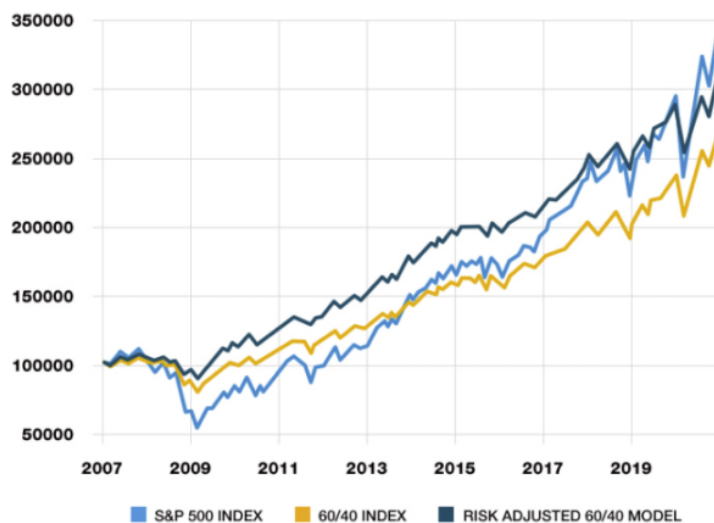




#### Portfolio vs Benchmark Statistics

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%
Beta of Model vs Benchmark	0.87
Jensens Alpha	1.91%
Sharpe Ratio	0.29

#### 60/40 Benchmark vs Risk Adjusted 60/40 Allocation



Have a great week!