

RIA PRO: The Fed's "Not QE" And How We Are Playing It



- *Market Review & Update*
- *Playing The Fed's QE*
- *Sector & Market Analysis*
- *401k Plan Manager*

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Market Review & Update

"If you are a bull, what is there not to love?"

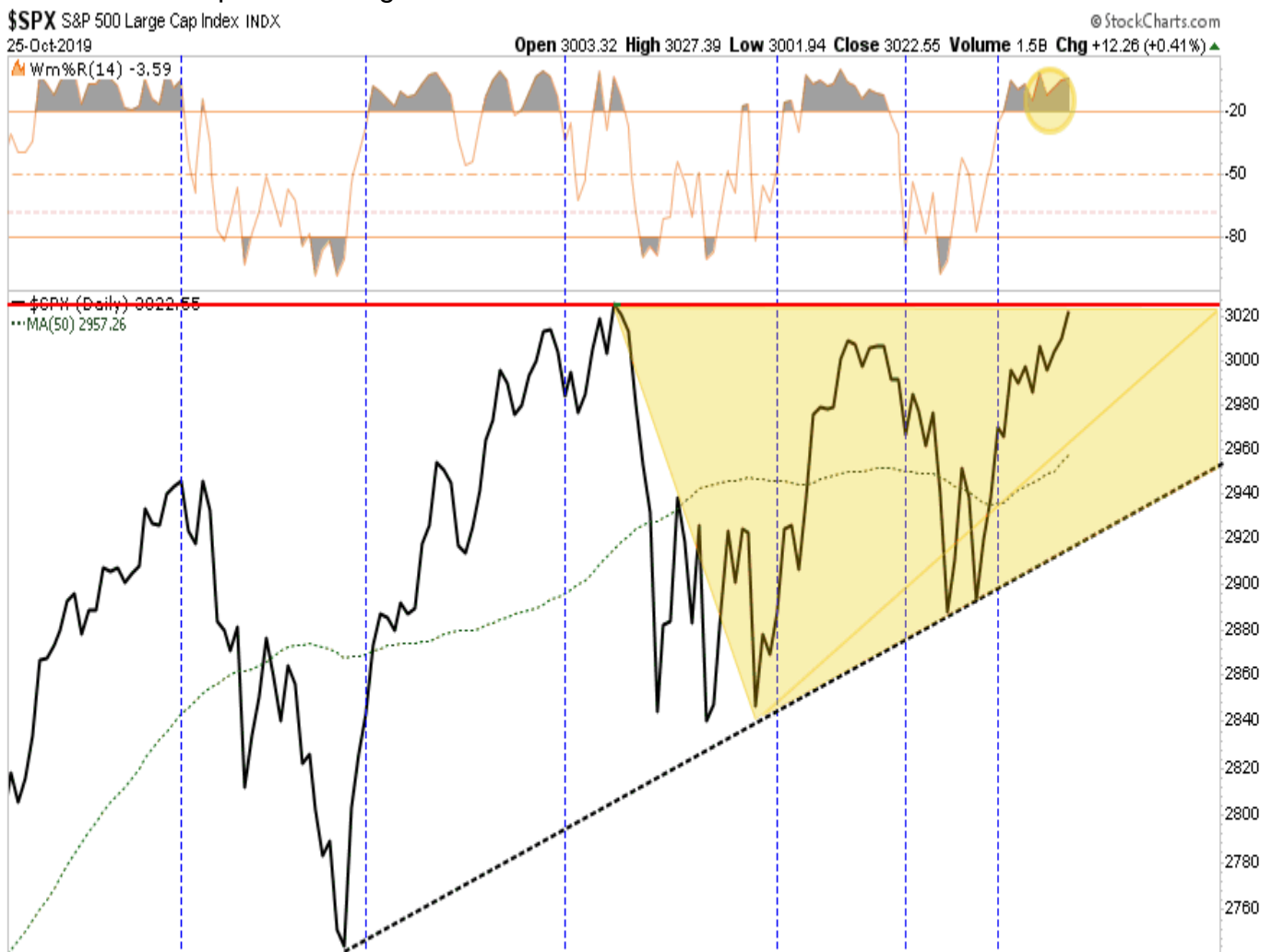
That was the [message from last week](#), as we discussed the reasoning for our increase of equity exposure in portfolios on an opportunistic basis. Of course, besides the fact we are moving into the seasonally strong period of the year, the primary reasons for the increase in equity really came down to two simple factors:

- *Trump moving the put the "trade war" to rest (as we previously anticipated.)*
- *The Fed moving to increase bond purchases and effectively launch QE4 (more on this in a moment.)*

[As noted in Tuesday's discussion](#):

*"Readers are often confused by our more bearish macro views on debt, demographics, and deflation, not to mention valuations, which will impair portfolio returns over the next decade versus our more bullish bias toward equities short-term. That is understandable since the media wants to label everyone either a 'bull' or a 'bear.' **However, markets are not binary.** Being a bear on a macro-basis doesn't mean you are only allowed to hold cash, gold, and stock in 'beanie-weenies.' Conversely, being 'bullish' on equities doesn't necessarily mean an exclusion of all other assets other than equities."*


This is an important point. **Our job as investors is to capture gains when the reward outweighs the risk and protect our capital when risk is prevalent.** After a sloppy summer, the markets had gotten oversold to a more extreme level which provided the support, and the "fuel," required for an advance with the right catalyst. The Fed's "QE" was the "match that lit the fuse." While the bulls were able to string together a decent rally last week, they were unable to capture new highs for the market.



While the markets are "risk-on" at the moment, the oversold condition has now reverted to a more extreme "overbought" condition which limits a further advance from current levels. A correction back to the 50-dma within the next week or so would not be surprising. However, between now and the end of the year, there is still room for an advance. This is why we are suggesting adding exposure "selectively" and "opportunistically" on pullbacks. As shown below, the market is now trading below its previous bullish trendline advance which provides resistance to a further advance to about **3100-3300 currently**.



Given the market is not grossly overbought on an intermediate-term basis, (*yellow highlight box*), there remains potential upside into the end of the year. This technical backdrop, combined with the Fed's QE program (*I know, it's not QE*), is why we continue to maintain a long-equity bias in our portfolios currently. We have slightly reduced our hedges, along with some of our more defensive positioning, but remain well aware of the risk currently, which is why we are also maintaining a slightly higher than normal level of cash.



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for the next bear market?

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Playing The Fed's QE (Not QE)

On Thursday, the Fed announced that they will nearly double the daily repo liquidity operations to \$120 billion, as well they said the sizing of the 14-day term repo programs would rise from \$30 billion to \$45 billion. For the most part these daily and term repo operations have been oversubscribed, meaning there is more demand than liquidity being offered by the Fed. This growing problem is a reason for the recent announcement of QE (*not QE*). (**For more on "[Repo](#)" [read this.](#)**) As noted by Zerohedge on Thursday morning:

*"In a statement published at 1515ET, precisely when the S&P ramp started (on Wednesday), the New York Fed confirmed it would dramatically increase both its overnight and term liquidity provisions beginning tomorrow **through November 14th.** 'The Desk has released an update to the schedule of repurchase agreement (repo) operations for the current monthly period. Consistent with the most recent FOMC directive, **to ensure that the supply of reserves remains ample even during periods of sharp increases in non-reserve liabilities, and to mitigate the risk of money market pressures that could adversely affect policy implementation'**"*

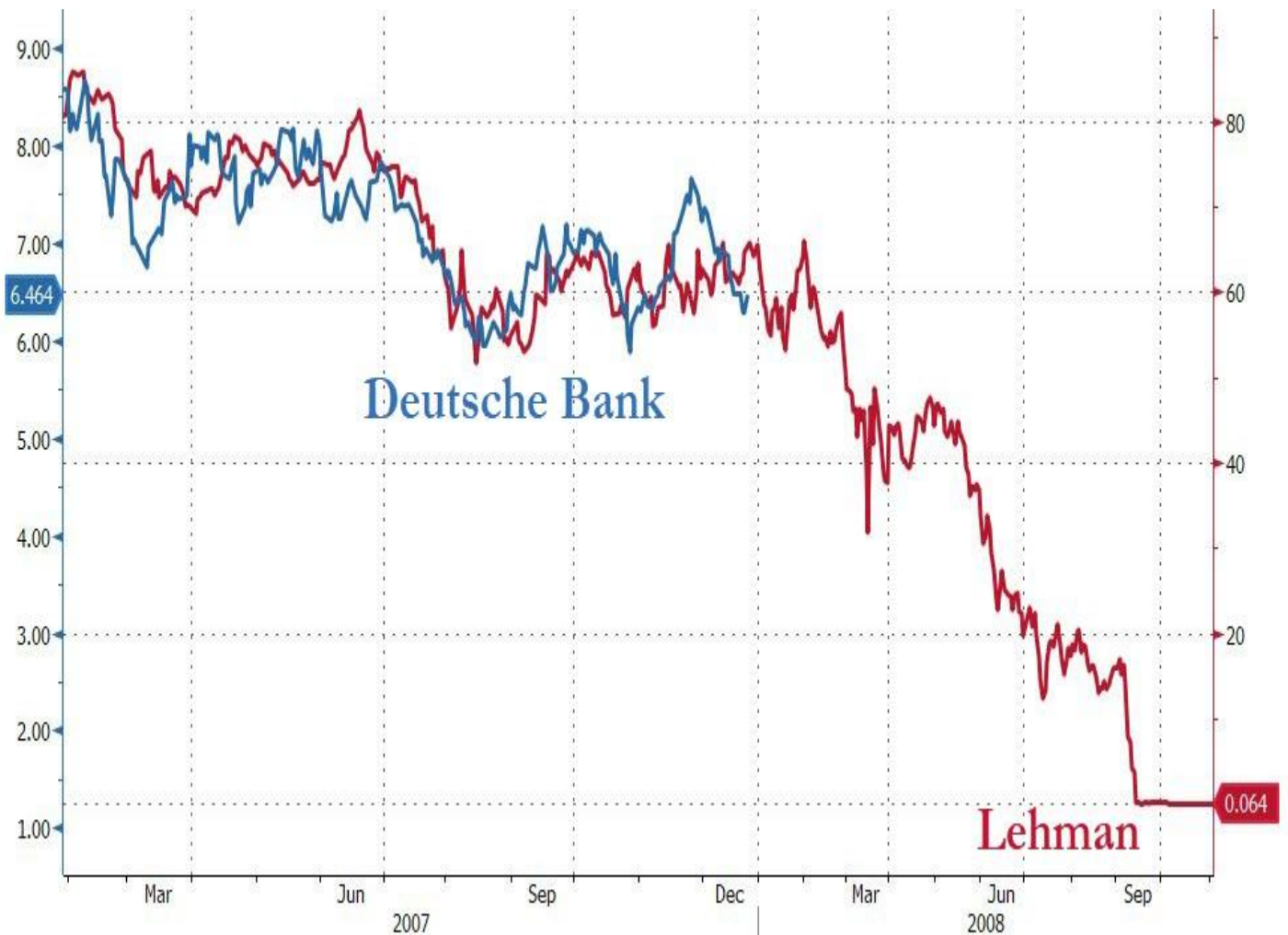
| OVERNIGHT OPERATIONS DATES | | | AGGREGATE OPERATION LIMIT |
|---|----------------------|---------|---------------------------|
| Tuesday, 10/15/2019 - Wednesday, 10/23/2019 | | | At least \$75 billion |
| Thursday, 10/24/2019 - Thursday, 11/14/2019 | | | At least \$120 billion |
| TERM OPERATION DATE | MATURITY DATE | TERM | AGGREGATE OPERATION LIMIT |
| Tuesday, 10/15/2019 | Tuesday, 10/29/2019 | 14-days | At least \$35 billion |
| Thursday, 10/17/2019 | Friday, 11/1/2019 | 15-days | At least \$35 billion |
| Tuesday, 10/22/2019 | Tuesday, 11/5/2019 | 14-days | At least \$35 billion |
| Thursday, 10/24/2019 | Thursday, 11/7/2019 | 14-days | At least \$45 billion |
| Tuesday, 10/29/2019 | Tuesday, 11/12/2019 | 14-days | At least \$45 billion |
| Friday, 11/1/2019 | Thursday, 11/14/2019 | 13-days | At least \$35 billion |
| Tuesday, 11/5/2019 | Tuesday, 11/19/2019 | 14-days | At least \$35 billion |
| Thursday, 11/7/2019 | Thursday, 11/21/2019 | 14-days | At least \$35 billion |
| Tuesday, 11/12/2019 | Tuesday, 11/26/2019 | 14-days | At least \$35 billion |

This is a massive 60% increase in the overnight repo liquidity availability (from \$75 billion to \$120 billion) and a 28% jump in the term repo provision (from \$35 billion to \$45 billion). The Fed continues to insist this is not "Quantitative Easing," and this is simply short-term funding for short-term cash needs (the original excuse were corporate tax payments which have long since passed.) However, [as we addressed just recently](#), we suspect it is something significantly different when you consider the most recent Term Repo operation was 1.38x oversubscribed;

"This was not about covering unexpected cash draws to pay quarterly taxes, which was one of the initial excuses for the funding shortfalls."

<https://twitter.com/LanceRoberts/status/1183001339766476800> Nope. **This was bailing out a bank that is in serious financial trouble. It started with the ECB a month ago loosening requirements on banks, then proceeded to the Fed reducing capital reserve requirements and flooding the system with reserves.**

Who was the biggest beneficiary of all of these actions? **Deutsche Bank**. Deutsche is about 4x as large as Lehman was in 2008 and is currently following the same price path as well. Let me repeat, **the Fed is terrified of another Lehman Crisis; as they do not have the tools to deal with it this time.**



(Courtesy of [ZeroHedge](#)) Clearly, the Fed is concerned about something other than the impact of "Trump's Trade War" on the economy.



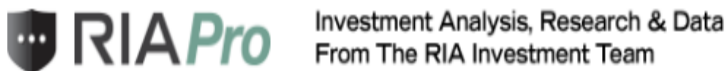
As noted by Zerohedge:

"Needless to say, if the funding shortage was getting better, none of this would be happening; instead it appears that with every passing day the liquidity shortage is getting worse, even as the Fed's balance sheet is surging. The only possible explanation, is someone really needed to lock in cash for month end (the maturity of the operation is on Nov 7) which is when a 'No Deal' Brexit may go live, and as a result one or more banks are bracing for the worst. The question, as before, remains why? Just what is the source of this unprecedented spike in liquidity needs in a system which already has \$1.5 trillion in excess reserves?"

That is the correct question. But in the meantime, the injection of liquidity continues to support asset prices as the litany of "algo's" which drive -80% of the trading on Wall Street, respond in "[Pavlovian](#)" fashion to more liquidity.

Funding The Deficit

Every morning, at [RIAPro.net](#), we post commentary as to what is moving the markets. On Thursday we pointed out a dynamic in the funding of the U.S. Treasury that few are following despite the implications it has on monetary policy.



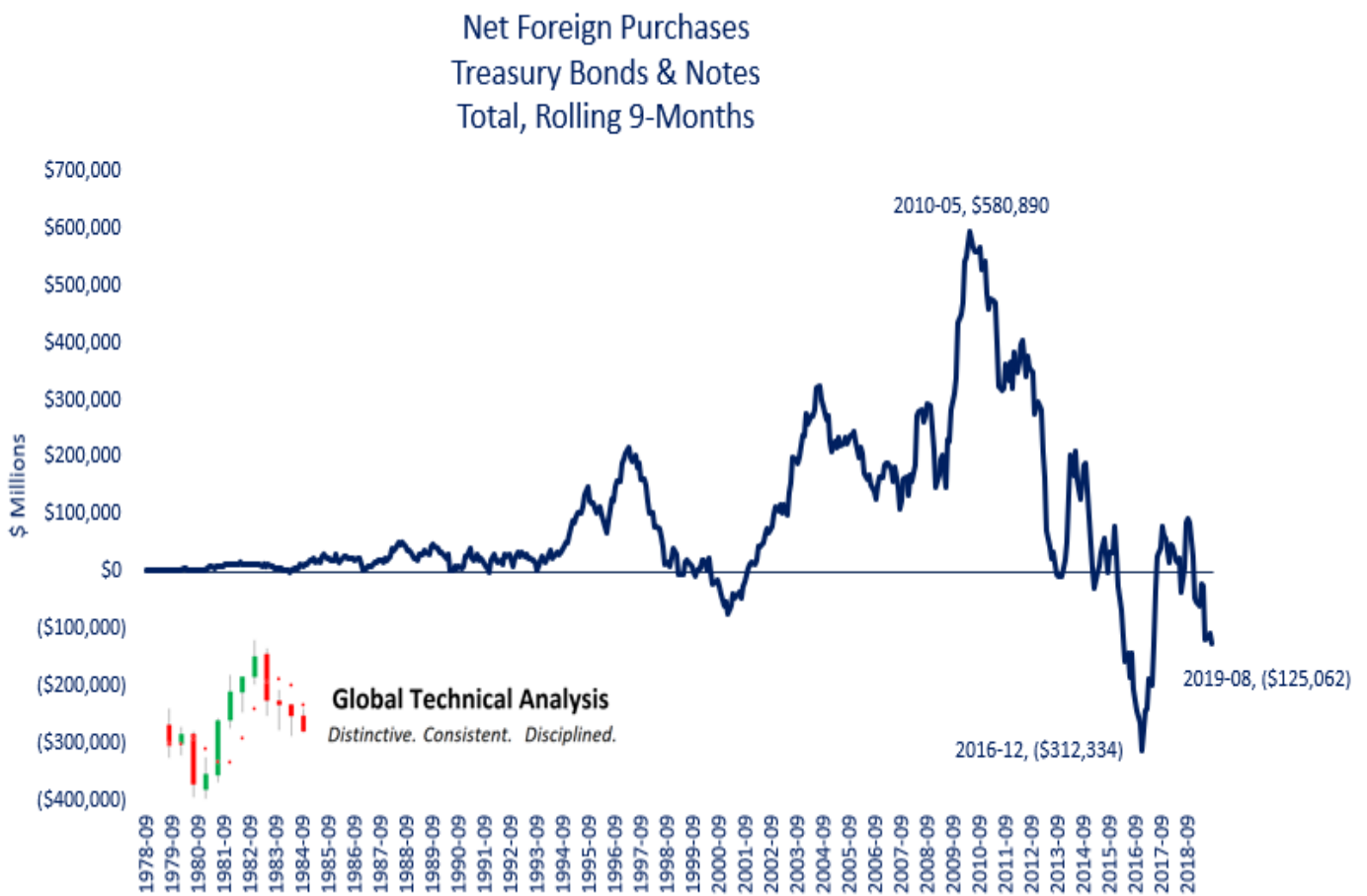
Dashboard Macro ▾ Ideas ▾ Research ▾ Portfolio ▾ 401K - Beta

| Commentary | Portfolio Alerts |
|--|--|
| <p>October 24, 2019</p> <p>Today's Chart of the Day is probably one of the most important macro charts to understand, yet is so underappreciated. The chart highlights that net purchases of U.S. Treasury debt by foreign investors (central banks, governments, corporations, and citizens) have been negative over the last two years. This is occurring as deficits top the \$1 trillion mark. In other words, not only are trillion dollar deficits being entirely funded with domestic funds, but domestic funds must also absorb the foreign net selling. To better understand the implications of this new dynamic, we suggest reading an article we wrote in June titled Who is Funding Uncle Sam?</p> <p>We believe the funding situation is one causes of the overnight funding issues and the sudden introduction of QE.</p> <p>Speaking of which, the Fed announced that they will double the size of their overnight repo facility to \$120 billion and two week term repos will increase from \$30 to \$45 billion.</p> <p>There is a good amount of economic data coming out this morning. Of note is Durable Goods (expectation - 7%) Inhless Claims (+214k) and PMI</p> | <p>Portfolio Action Update</p> <p>Equity Portfolio</p> <p>As noted in the last update we took profits from positions that were grossly extended and showing signs of correction. The second was to add to, or add new, positions in the portfolio to keep current allocations levels.</p> <p>Today, we took some initial actions in the Equity Portfolio and added:</p> <ul style="list-style-type: none">• 1/2 position of XOM which brings our position up to a full weight.• A full position of MU <p>We have 3-other positions slated to add over the coming days and will do so opportunistically.</p> <p>We are also looking to rebalance and add exposure to the ETF model as well.</p> <hr/> <p>October 15, 2019</p> <p>Portfolio Action Update</p> |

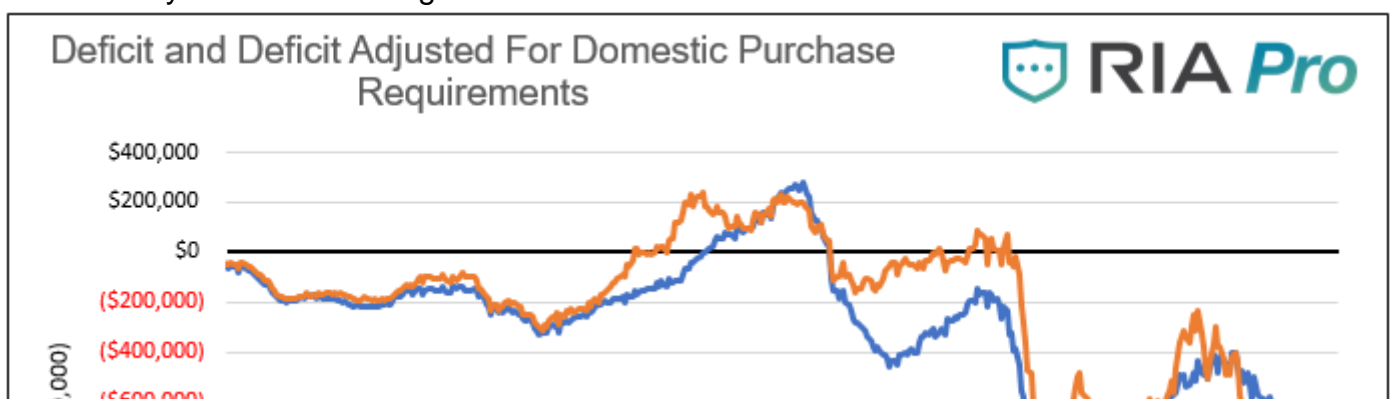
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On Thursday, we posted the following:

"Today's Chart of the Day is probably one of the most important macro charts to understand, yet is so underappreciated. The chart highlights that net purchases of U.S. Treasury debt by foreign investors (central banks, governments, corporations, and citizens) have been negative over the last two years. This is occurring as deficits topple the \$1 trillion mark. In other words, not only are trillion dollar deficits being entirely funded with domestic funds, but domestic funds must also absorb the foreign net selling. To better understand the implications of this new dynamic, we suggest reading an article we wrote in June titled [Who is Funding Uncle Sam?](#)"



The problem is something we have discussed previously, which is a "dollar funding shortage." In other words, the Treasury needs to sell bonds to cover deficit spending. If there is a "shortage" of buyers, then the Treasury can't "raise the money" it needs to meet spending demands. Hence the need for the Fed to step into to monetize existing debt so domestic issuers can take up new issues. We believe the funding situation is one causes of the overnight funding issues, and the sudden introduction of QE. As shown, despite deficits not being as large as in the last recession, the amount of domestic funds required to fund the Treasury deficit is now larger.



Regardless of the reason, the Fed is injecting liquidity into the market at the highest pace since the Financial Crisis. This certainly doesn't suggest that "All is well in Denmark." So, how do we "play it?"

Playing QE4

Tuesday's article, ["It's Crazy, But We Are Adding Equity Risk,"](#) was based on research we did for our portfolio allocation models.

"While it may seem 'crazy,' it is for these reasons, despite the longer-term bearish backdrop, that we need to 'gradually' and 'incrementally' increase exposure for the next couple of months. Importantly, I did not say leverage up and buy speculative investments. I am suggesting a slight increase in exposure toward equity risk, as opportunity presents itself, until we have an allocation model that both hedges longer-term risks, but can take advantage of shorter-term bullish cycles."

That research was just published for our [RIAPro subscribers \(Click here for a 30-day FREE Trial to read the entire report\)](#) which revealed the performance of equities, commodities, and bonds during periods of QE. **Here is an excerpt:**

"If we assume that assets will perform similarly under QE 4, we can easily forecast returns using the normalized data from above. The following three tables show these forecasts. Below the tables are rankings by asset class as well as in aggregate. For purposes of this exercise, we assume, based on the Fed's guidance, that they will purchase \$60 billion a month for six months (\$360 billion) of U.S. Treasury Bills."

| Equity Indexes - Forecasted Annualized Returns Based on PRIOR QE | | | | | | | | |
|--|------------------------|----------------------|---------------------|----------------------|--------------------|----------------------|-------------------------|------------|
| | Large Cap Dow Jones | Large Cap S&P 500 | Large Cap NASDAQ | Large Cap S&P 100 | Mid Cap S&P 400 | Small Cap S&P 600 | Small Cap Russell 2k | All Equity |
| Forecasted QE 4 | 5.35% | 5.89% | 6.44% | 4.81% | 9.25% | 8.82% | 8.18% | 6.98% |

| Equity Factors | |
|----------------|-------|
| Growth | Value |
| 5.87% | 5.94% |

| S&P Equity Sector Returns - Forecasted Annualized Returns Based on PRIOR QE | | | | | | | | | | | |
|---|---------|-----------|------------|-------------|--------|-------------|-------|----------|------------|-------------|-----------|
| | Staples | Utilities | Financials | Industrials | Energy | Health Care | Comm. | Discret. | Technology | Real Estate | Materials |
| Forecasted QE 4 | 4.84% | 2.43% | 5.24% | 8.24% | 6.60% | 8.52% | 1.96% | 8.89% | 4.84% | 6.72% | 6.97% |

| Trsy Bonds & Commodities Returns - Forecasted Ann. Returns Based on PRIOR QE | | | | | | | |
|--|--------|-------|-------|--------|-----------|-------|--------|
| | 2yr* | 10yr* | 30yr* | Copper | Crude Oil | Gold | Silver |
| Forecasted QE 4 | (0.03) | 0.19 | 0.14 | 8.61% | 8.68% | 4.04% | 12.78% |

| Equity Index | QE4 | | | | Equity Sector | QE4 | | | | Treasury & Commodities | QE4 | | | |
|-----------------|-----------------|-------------|------------|------------|---------------|-----------------|-------------|-------------|------------|------------------------|-----------------|-------------|----------------|------------|
| | Expected Return | vs. S&P 500 | Index Rank | Total Rank | | Expected Return | vs. S&P 500 | Sector Rank | Total Rank | | Expected Return | vs. S&P 500 | Commodity Rank | Total Rank |
| S&P 400 | 9.25% | 3.35% | 1 | 2 | Discret. | 8.89% | 3.00% | 1 | 3 | 2yr* | (0.03) | n/a | n/a | n/a |
| S&P 600 | 8.82% | 2.92% | 2 | 4 | Health Care | 8.52% | 2.63% | 2 | 7 | 10yr* | 0.19 | n/a | n/a | n/a |
| Russell 2k | 8.18% | 2.29% | 3 | 9 | Industrials | 8.24% | 2.35% | 3 | 8 | 30yr* | 0.14 | n/a | n/a | n/a |
| All Equity Avg. | 6.98% | 1.08% | 4 | 10 | Materials | 6.97% | 1.08% | 4 | 11 | Silver | 12.78% | 6.88% | 1 | 1 |
| NASDAQ | 6.44% | 0.55% | 5 | 14 | Real Estate | 6.72% | 0.83% | 5 | 12 | Crude Oil | 8.68% | 2.79% | 2 | 5 |
| Value | 5.94% | 0.04% | 6 | 15 | Energy | 6.60% | 0.70% | 6 | 13 | Copper | 8.61% | 2.72% | 3 | 6 |
| S&P 500 | 5.89% | - | 7 | 16 | Financials | 5.24% | -0.66% | 7 | 19 | Gold | 4.04% | -1.85% | 4 | 23 |
| Growth | 5.87% | -0.03% | 8 | 17 | Staples | 4.84% | -1.05% | 8 | 20 | | | | | |
| Dow Jones | 5.35% | -0.54% | 9 | 18 | Technology | 4.84% | -1.06% | 9 | 21 | | | | | |
| S&P 100 | 4.81% | -1.08% | 10 | 22 | Utilities | 2.43% | -3.46% | 10 | 24 | | | | | |
| | | | | | Comm. | 1.96% | -3.94% | 11 | 25 | | | | | |

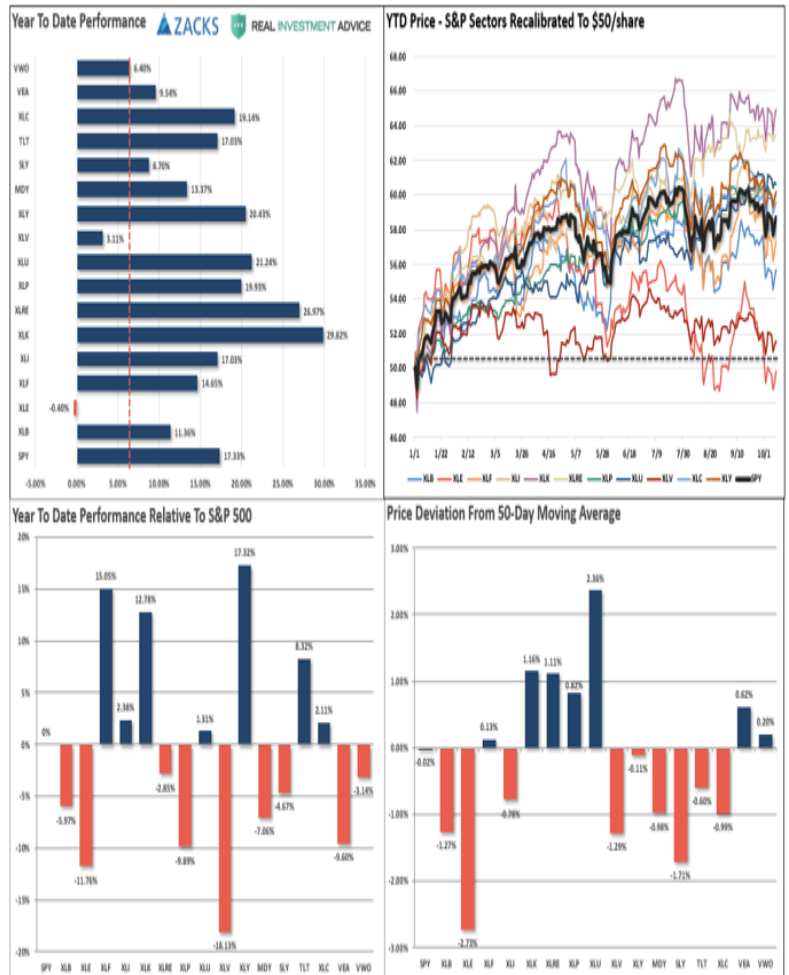
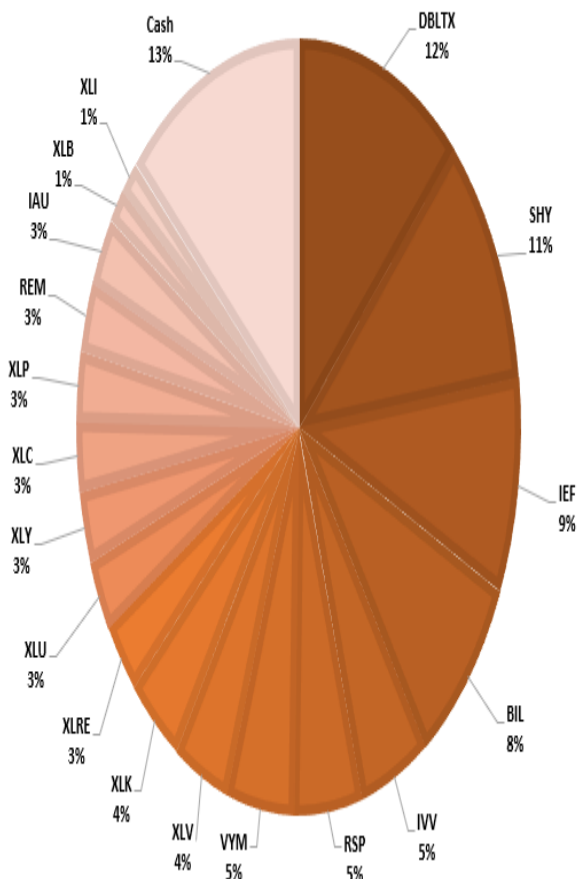
Not surprisingly, during periods of QE we find that:

- Markets exhibit higher volatility.
- Defensive positioning underperforms relative to the S&P 500.
- Growth stocks outperform (on a relative basis.)
- Longer-term bond yields rise while shorter-term yields were flat, resulting in steeper yield curves in all three instances. #2013266080;
- Copper, crude oil, and silver outperformed the S&P 500.

This data supports our recent changes in positioning where we have taken profits in our defensive positions like utilities and staples, and are increasing exposure to cyclical and growth sectors.

"This is why we continue to maintain a long-equity bias in our portfolios currently. We also recently slightly reduced our hedges, along with some of our more defensive positioning. We are still maintaining slightly higher than normal levels of cash."

60/40 ALLOCATION MODEL



In our equity portfolio we have also added positions to take advantage of the steeper yield curve, while shortening duration and increasing credit quality in our bond portfolios to hedge against higher rates.

(Our portfolios are displayed "real time" at RIAPro.)

While we believe that QE4 will likely provide some upside bias ([Our target expectation is 3300](#)) there are significant differences between QE4 and QE1, namely the entire economic and financial backdrop are [entirely reversed.�](#);

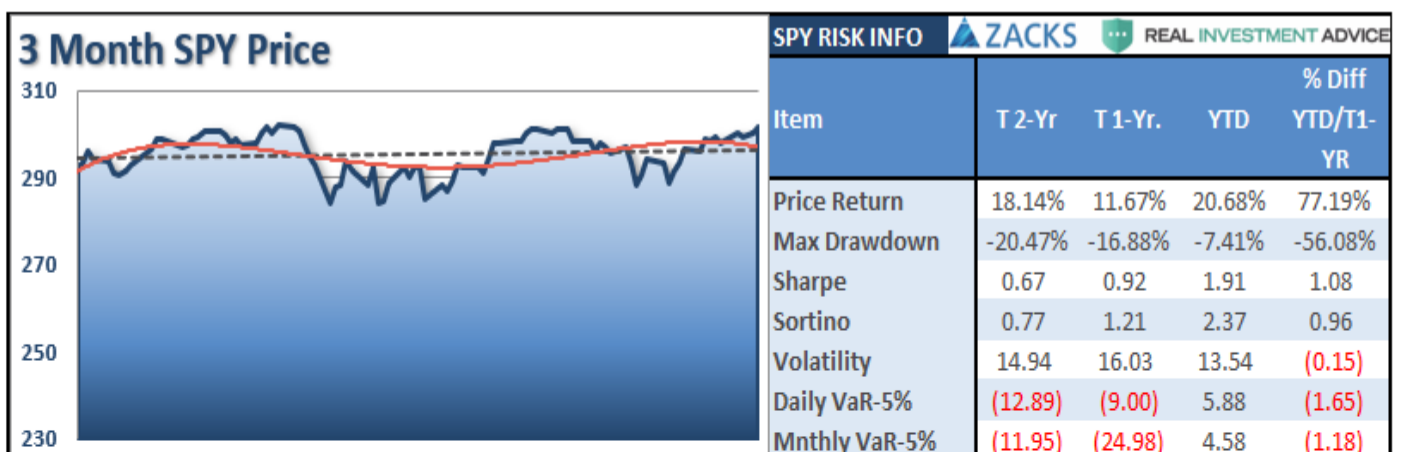
"The critical point is that QE and rate reductions have the MOST effect when the economy, markets, and investors have been 'blown out,' deviations from the 'norm' are negatively extended, confidence is hugely negative.�In other words, there is nowhere to go but up. The extremely negative environment that existed in 2009, particularly in the asset markets, provided a fertile starting point for monetary interventions. Today, the economic and fundamental backdrop could not be more diametrically opposed."

While another \$2-4 Trillion in QE might indeed be successful in further inflating the third bubble in asset prices since the turn of the century,�there is a finite ability to continue to pull forward future consumption to stimulate economic activity.�In other words, there are only so many autos, houses, etc., which can be purchased within a given cycle.�There is evidence the cycle peak has been reached. If we are correct, and the effectiveness of rate reductions and QE are more diminished than many expect. There is a limit to just how many bonds the Federal Reserve can buy, and a deep recession will likely find the Fed powerless to offset much of the negative effects.� If more ?QE? works, great. We are positioning for it. But, as portfolio managers taking care of our clients retirement savings, we are maintaining hedges and plenty of "risk controls" just in case things don't work out as planned. What are you doing with your money? If you need help or have questions, we are always glad to help. [Just email me.](#) See you next week.

Market & Sector Analysis

Data Analysis Of The Market & Sectors For Traders

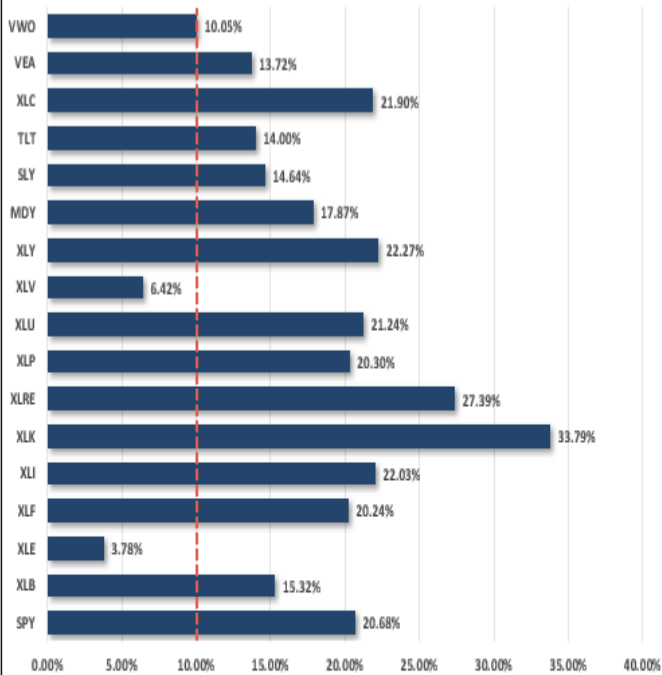
S&P 500 Tear Sheet



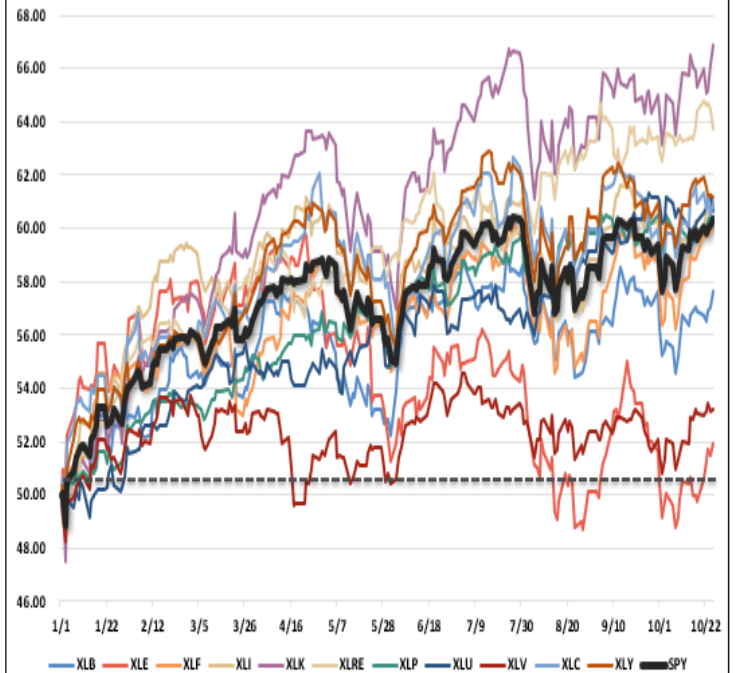
| S&P 500 Fundamental Analysis | | | | | | | | | S&P 500 Market Cap Analysis | | | |
|------------------------------|-------------|------------|---------|---------------|-------------|------------|-------------|------------|-----------------------------|----------|---------|---------|
| Item | 2 years ago | 1 year ago | Current | 1 Yr % Change | 5 Year High | 5 year Low | % From High | % From Low | Item | 12-M Ago | Current | % Chg |
| Dividend Yield | 1.87% | 1.77% | 1.84% | 3.59% | 2.18% | 1.68% | (15.62%) | 9.68% | Shares | 2,408.3 | 2,328.4 | (3.32%) |
| P/E Ratio | 21.04 | 18.76 | 18.65 | (0.56%) | 21.60 | 16.39 | (13.6%) | 13.82% | Sales | 60,973 | 64,564 | 5.89% |
| P/S Ratio | 3.27 | 3.42 | 3.29 | (4.14%) | 3.57 | 2.62 | (7.90%) | 25.33% | SPS | 25.3 | 27.7 | 9.53% |
| P/B Ratio | 3.60 | 4.14 | 4.09 | (1.37%) | 4.14 | 3.01 | (1.36%) | 35.75% | Earnings | 8,816 | 9,501 | 7.77% |
| ROE | 15.94% | 18.26% | 18.71% | 2.40% | 18.82% | 15.00% | (0.59%) | 24.76% | EPS TTM | 4.4 | 4.9 | 11.37% |
| ROA | 2.97% | 3.43% | 3.53% | 2.81% | 3.53% | 2.81% | (0.05%) | 25.53% | Dividend | 1.6 | 1.7 | 6.16% |

Performance Analysis

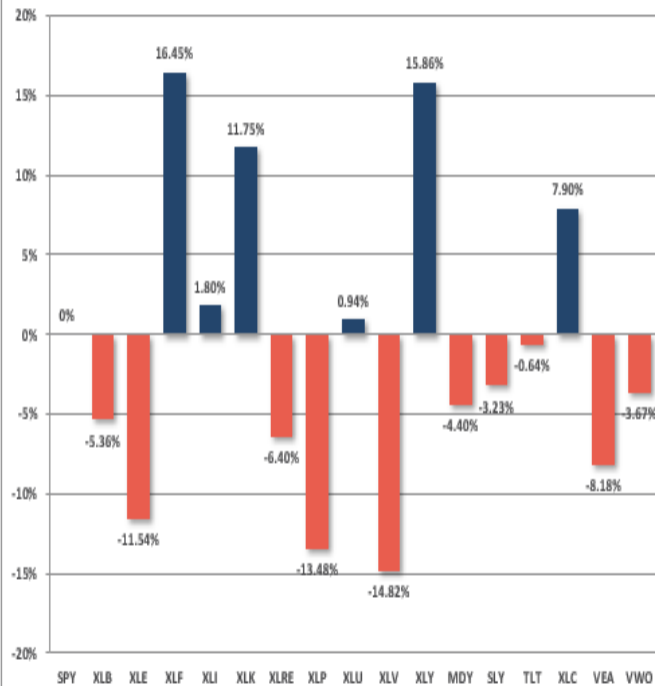
Year To Date Performance



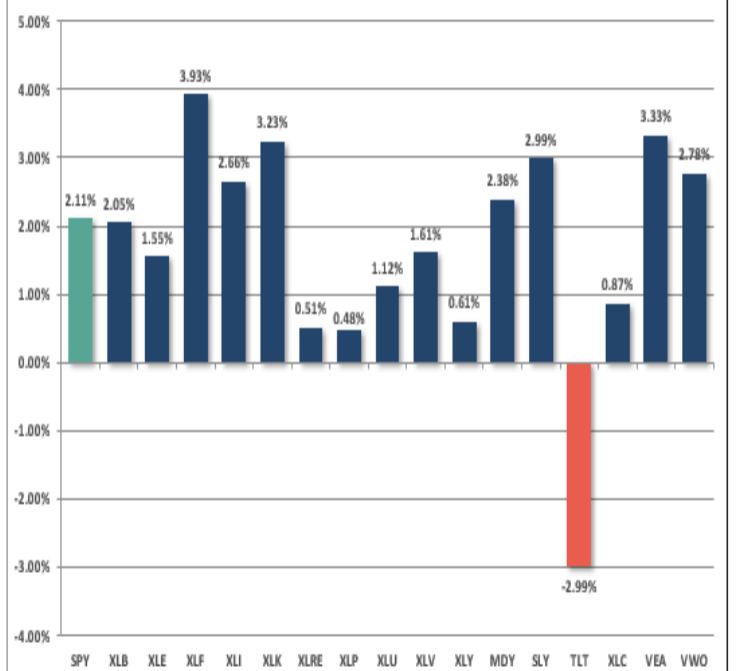
YTD Price - S&P Sectors Recalibrated To \$50/share



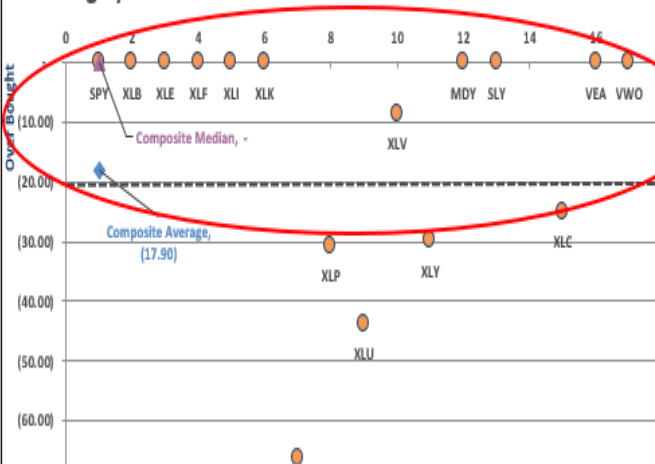
Year To Date Performance Relative To S&P 500



Price Deviation From 50-Day Moving Average



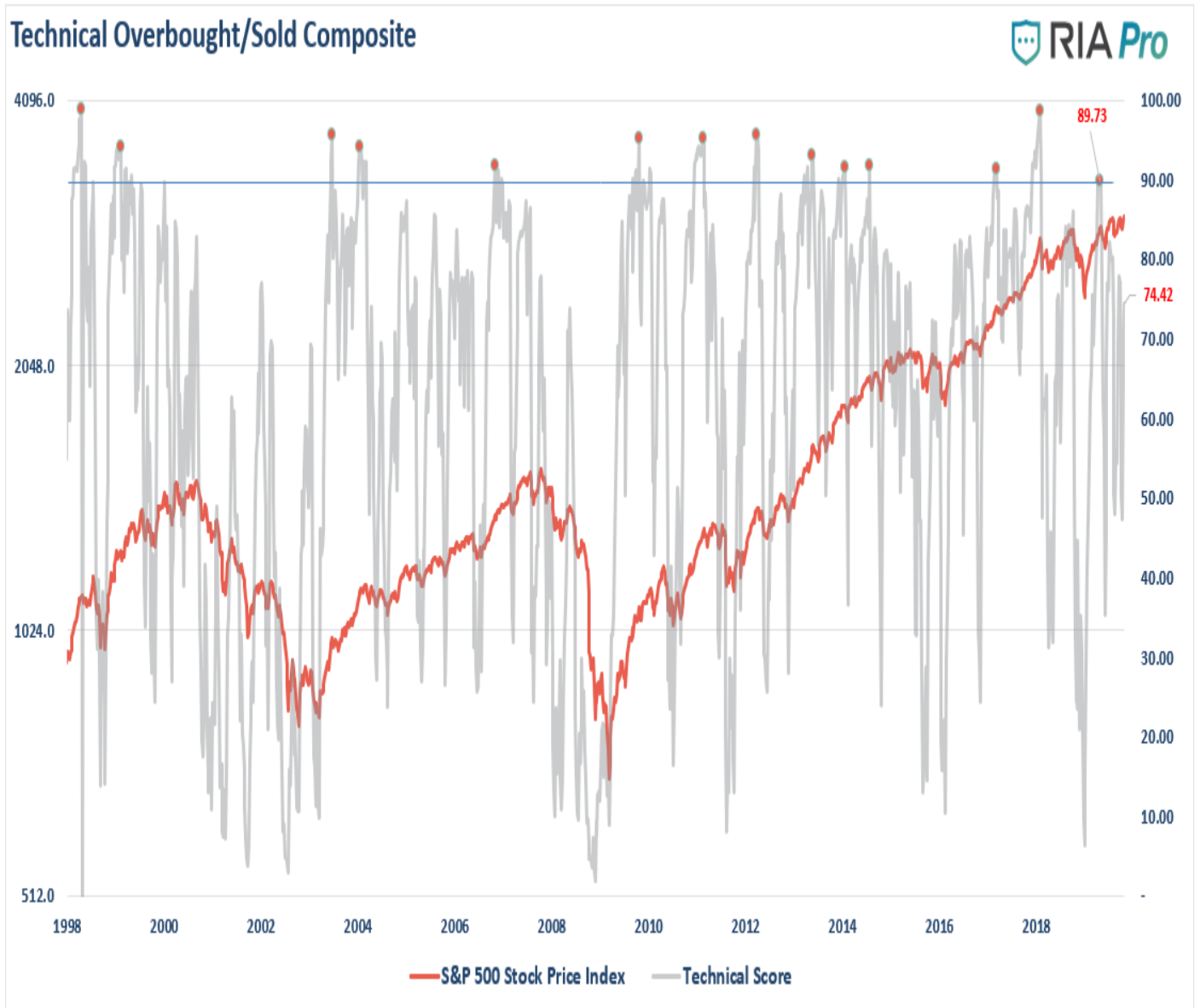
Overbought/Oversold 14-Periods



Size / Sector ETF YTD Trading Range



Technical Composite



ETF Model Relative Performance Analysis

| RELATIVE PERFORMANCE | | Ticker | ETF NAME | Current Price | Model Position Price Changes Relative to Index | | | | | SHORT WMA | LONG WMA | % DEV - Short M/A | % DEV - Long M/A | Buy / Sell Signal |
|----------------------|---------------------|--------|-----------------|---------------|--|--------|----------|----------|----------|-----------|----------|-------------------|------------------|-------------------|
| | | | | | 1 Week | 4 Week | 12 Weeks | 24 Weeks | 52 Weeks | | | | | |
| BENCHMARK | | IVV | ISHARS-SP500 | 303.31 | 1.24 | 2.12 | 3.02 | 4.59 | 13.56 | 296.29 | 292.61 | 2.37% | 3.66% | BUY |
| TACTICAL | SECTORS | XLB | SPDR-MATLS SELS | 58.26 | 0.07 | (1.17) | (1.40) | 1.07 | 0.99 | 57.15 | 56.80 | 1.95% | 2.58% | BUY |
| | | XLE | SPDR-EGY SELS | 59.52 | 3.13 | (2.31) | (4.48) | (11.66) | (24.03) | 58.81 | 62.16 | 1.20% | -4.25% | SELL |
| | | XLF | SPDR-FINL SELS | 28.64 | 0.65 | (0.09) | 0.75 | (0.37) | (0.18) | 27.48 | 27.24 | 4.21% | 5.12% | BUY |
| | | XLI | SPDR-INDU SELS | 78.60 | 0.92 | (0.73) | 0.65 | (1.53) | 0.19 | 76.34 | 76.16 | 2.96% | 3.21% | BUY |
| | | XLK | SPDR-TECH SELS | 82.92 | 1.25 | 1.93 | 1.88 | 4.26 | 8.22 | 80.00 | 77.75 | 3.65% | 6.65% | BUY |
| | | XLP | SPDR-CONS STPL | 61.09 | (0.66) | (2.17) | 0.12 | 2.01 | (0.07) | 60.47 | 58.47 | 1.03% | 4.48% | BUY |
| | | XLU | SPDR-UTIL SELS | 64.16 | (0.71) | (2.96) | 3.65 | 6.11 | 6.66 | 62.77 | 60.39 | 2.22% | 6.24% | BUY |
| | | XLC | SPDR-COMM SV SS | 50.32 | (1.20) | 0.01 | (2.48) | (2.13) | (0.73) | 49.84 | 49.10 | 0.96% | 2.49% | BUY |
| | | XLV | SPDR-HLTH CR | 92.06 | (0.91) | 0.93 | (1.91) | (1.05) | (8.25) | 90.63 | 90.65 | 1.58% | 1.56% | SELL |
| | | XLY | SPDR-CONS DISCR | 121.06 | (2.15) | (0.96) | (0.51) | (1.38) | 3.51 | 119.86 | 118.09 | 1.00% | 2.51% | BUY |
| E | SIZE | SLY | SPDR-SP SC 600 | 68.75 | 0.60 | 0.21 | 0.19 | (4.24) | (9.81) | 66.64 | 66.96 | 3.16% | 2.67% | SELL |
| | | MDY | SPDR-SP MC 400 | 356.75 | (0.07) | (0.17) | (0.72) | (3.37) | (4.34) | 348.17 | 349.02 | 2.46% | 2.21% | SELL |
| E | Equal Weight Market | RSP | INVS-SP5 EQ ETF | 109.43 | 0.24 | (0.40) | (0.23) | (1.34) | (0.26) | 106.66 | 106.29 | 2.60% | 2.96% | BUY |

Sector & Market Analysis:

Be sure and catch our updates on Major Markets (Monday) and Major Sectors (Tuesday) with updated buy/stop/sell levels

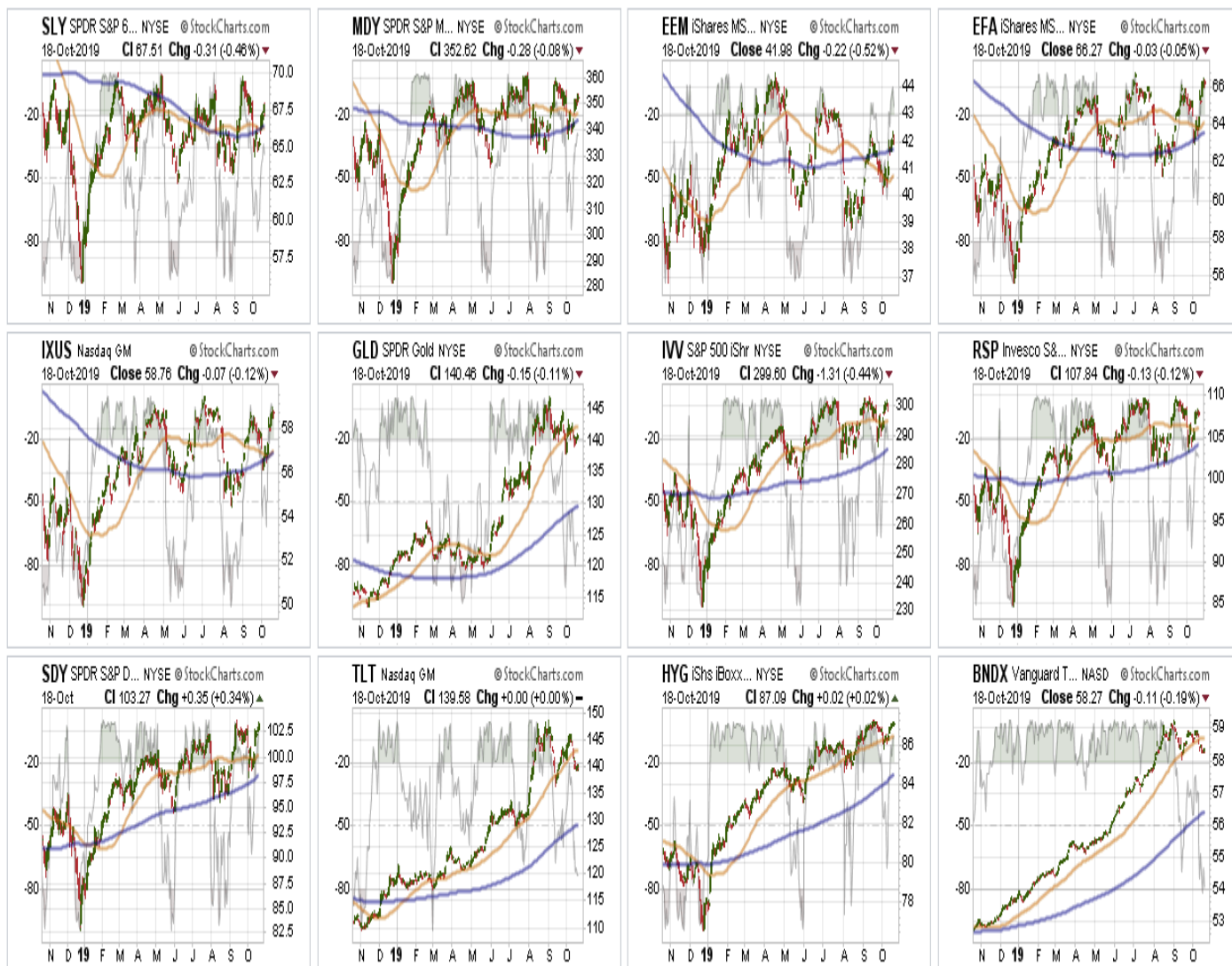
Sector-by-Sector



Improving ? Healthcare (XLV), Industrials (XLI), Energy (XLE) The relative performance improvement of HealthCare relative to the S&P 500 continued to improve this past week as money has rotated into underperforming sectors. Energy has also shown some signs of life in the rotation to some "value" continues. However, it is too early to get aggressive in the sector, but the improvement in relative performance puts it on our radar. Industrials, which perform better when the Fed is active with QE, has also picked up steam. **Current Positions: 2013266080; Target weight XLV, 1/2 weight XLI** **Outperforming ? 2013266080; Staples (XLP), Utilities (XLU), Real Estate (XLRE)** Defensive and "value" positioning continues to outperform relative to the broader market. After taking some profits, we trimmed profits out of XLP previously and re-positioned the portfolio. We are remaining patient to see how the market responds to the trade announcement next week. Real Estate, Staples, and Utilities all continue to flirt with highs but remain GROSSLY extended. We took profits in these two areas last week but remain fully exposed as the 2013266080; trend remains positive. **Current Positions: 2013266080; Target weight XLP, XLU, XLRE** **Weakening ? Technology (XLK), Discretionary (XLY), Communications (XLC)** As noted last week, Discretionary and Communications have turned higher and continue to

consolidate in a broadening pennant pattern. Relative performance continues to lag the S&P 500 currently. AMZN's disappointing earnings dragged on discretionary holdings along with NFLX impacting communications. Technology broke out to all-time highs on Friday which needs to hold. If the "bulls" are going to make an advance, the time is now. **Current Position:** **Target weight XLY, XLK, XLC Lagging ? Basic Materials (XLB), and Financials (XLF)** We previously got stopped out of XLF, but will likely look to re-enter the position shortly with the Fed now engaged in increasing bank reserves. XLF is testing resistance and is overbought, so we need a bit of a pullback to add some exposure. We are looking to add to our materials holdings but need a bit of a correction that holds support. **Current Position: 1/2 weight XLB**

Market By Market



Small-Cap (SLY) and Mid Cap (MDY) ? Small- and Mid-caps popped up last week, and have cleared 200-dma's. Unfortunately, they continue to drag overall performance and remain trapped below fairly significant resistance. However, we are watching for technical improvement as when the Fed is engaged in QE, small and mid-cap stocks tend to outperform. If we see a better entry point, we will look to add exposure accordingly. Both markets are EXTREMELY overbought currently. Be patient for the right entry point. **Current Position:** **Emerging, International (EEM) & Total International Markets (EFA)** The same advice goes for Emerging and International Markets, which we have been out of portfolios for several weeks due to lack of performance. These markets rallied recently on news of "more QE." However, the overall technical trend is not great, so we need to see if this is sustainable or just another "head fake." Both markets are EXTREMELY overbought currently. Be patient for the right entry point. **Current Position:** **Dividends (VYM), Market (IVV), and**

Equal Weight (RSP) These positions are our long-term core positions for the portfolio given that over the long-term markets do rise with economic growth and inflation. Currently, the short-term bullish trend is positive, and our core positions are providing the base around which we overweight/underweight our allocations based on our outlook. **Current Position:** RSP, VYM, IVV **Gold (GLD)** Despite the rally in the broader market, Gold turned higher last week after basing along the \$140 level. Gold also broke above its 200-dma. If you need to add some weight this is a decent trading opportunity. **Current Position:** GDX (Gold Miners), IAU (Gold) **Bonds (TLT)** Bonds continue to work off its massive overbought condition from the previous run down in rates. This rise in yields was expected, which is why we added a "steeper trade" to our portfolios. Given that we improved our credit quality and shortened duration previously, we are holding our positions for now. We have tightened up our stops. Stay long current positions for now, and look for an opportunity to add to holdings. **Current Positions:** DBLTX, SHY, IEF

Sector / Market Recommendations

The table below shows thoughts on specific actions related to the current market environment. (These are not recommendations or solicitations to take any action. This is for informational purposes only related to market extremes and contrarian positioning within portfolios. Use at your own risk and peril.)

| | | Over Bought / Sold | 50/200 DMA | Trend | Action | OVERWEIGHT | BUY | HOLD | REDUCE | SELL | RIA Pro | Notes |
|------|----------------------|--------------------|------------|----------|-------------|------------|-----|------|--------|------|---------|----------------------------------|
| XLY | Discretionary | OB | Positive | Positive | Hold | | | X | | | | Testing Resistance |
| XLK | Technology | OB | Positive | Positive | Hold | | | X | | | | New Highs |
| XLI | Industrials | OB | Positive | Neutral | Hold | | | X | | | | Testing Resistance |
| XLB | Materials | OB | Positive | Neutral | Hold | | | X | | | | Testing Resistance |
| XLE | Energy | OS | Negative | Negative | No Position | | | | | X | | Testing Resistance |
| XLP | Staples | Declining | Positive | Positive | Hold | | | X | | | | Holding Support/Near Highs |
| XLV | Health Care | OB | Positive | Neutral | Hold | | | X | | | | Testing Highs |
| XLU | Utilities | Declining | Positive | Positive | Hold | | | X | | | | Holding Support/Near Highs |
| XLF | Financials | OB | Positive | Neutral | Hold | | | | | X | | Testing Highs |
| XLC | Communications | OB | Positive | Neutral | No Position | | | X | | | | Testing Resistance |
| XLRE | Real Estate | OB | Positive | Positive | Hold | | | X | | | | Testing Highs |
| SLY | Small Caps | OB | Negative | Negative | No Position | | | | | X | | Extreme Overbought/At Resistance |
| MDY | Mid Caps | OB | Positive | Neutral | No Position | | | | | X | | Extreme Overbought/At Resistance |
| EEM | Emerging Mkt | OB | Positive | Negative | No Position | | | | | X | | Extreme Overbought/At Resistance |
| EFA | International | OB | Positive | Negative | No Position | | | | | X | | Extreme Overbought/At Resistance |
| IXUS | Total International | OB | Positive | Negative | No Position | | | | | X | | Extreme Overbought/At Resistance |
| GLD | Gold | OS | Positive | Positive | Add | | | X | | | | Holding Support/Add |
| RSP | SP500 Equal Wgt | OB | Positive | Positive | Hold | | | X | | | | Testing Highs |
| SDY | SP500 Dividend | OB | Positive | Positive | Hold | | | X | | | | Testing Highs |
| IVV | SP500 Market Wgt | OB | Positive | Positive | Hold | | | X | | | | Testing Highs |
| TLT | 20+ Yr. Bond | OS | Positive | Positive | Add | | | X | | | | Testing Support |
| HYG | Corporate High Yield | OB | Positive | Positive | No Position | | | | | X | | Testing Highs |
| BNDX | Int'l Bond Aggregate | OS | Positive | Positive | No Position | | | | | X | | Broke 50-DMA |

LEGEND: X = THIS WEEK => PREVIOUS DECLINING <= PREVIOUS IMPROVING X No Position

Portfolio/Client Update:

In [last week's missive](#), we addressed the reasons (seasonality, trade, buybacks) for increasing our equity exposures in portfolios. To wit:

*"Given the fact the Federal Reserve is back to providing liquidity into the markets, we have to remain cognizant of the market's "perception" of what will happen with QE, versus what we expect to the outcome to be. **In the short-term, the catalyst is likely a net positive to stocks so we need to adjust equity exposure slightly to take advantage of the potential upside bias as we head into the end of the year.**"*

We have begun adding exposure this week to the Equity portfolio with a few purchases, and given the short-term overbought status of the market we are waiting for a small correction to step into more exposure in the ETF portfolios. As stated last week, we are looking to add exposure to small and mid-capitalization markets, basic materials, industrials, financials and energy. These additions will increase our overall allocation towards equity risk as we head into the end of the year. However, these are NOT permanent additions, but rather opportunistic positions to potentially add some "alpha generation" to portfolios over the next couple of months. We will be carrying tight stops and re-evaluating the holdings regularly for adjustments. As we move into next week, depending on how markets are acting, we will look to slowly increase our equity exposure modestly to "rent whatever rally" we may get from the "QE-4."

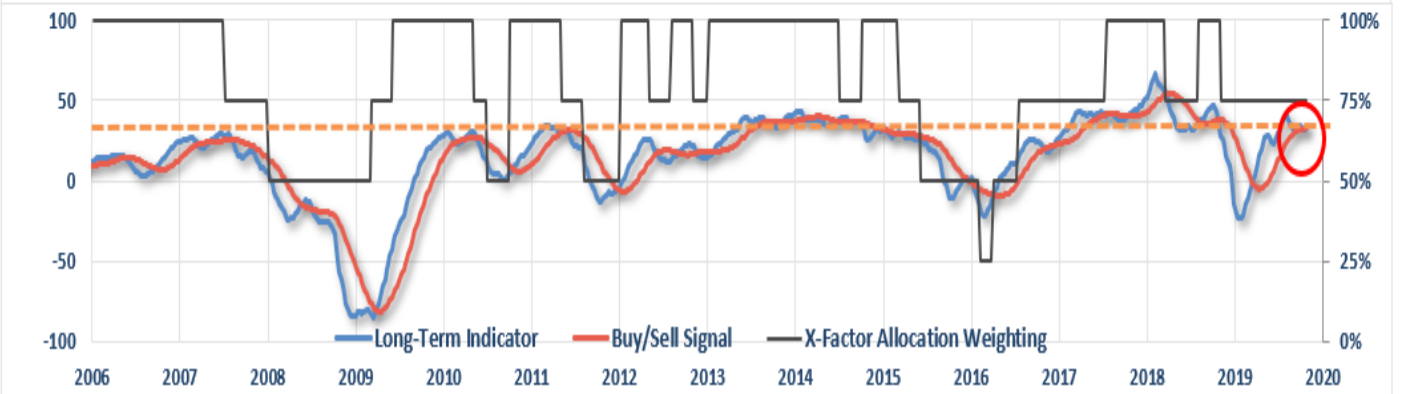
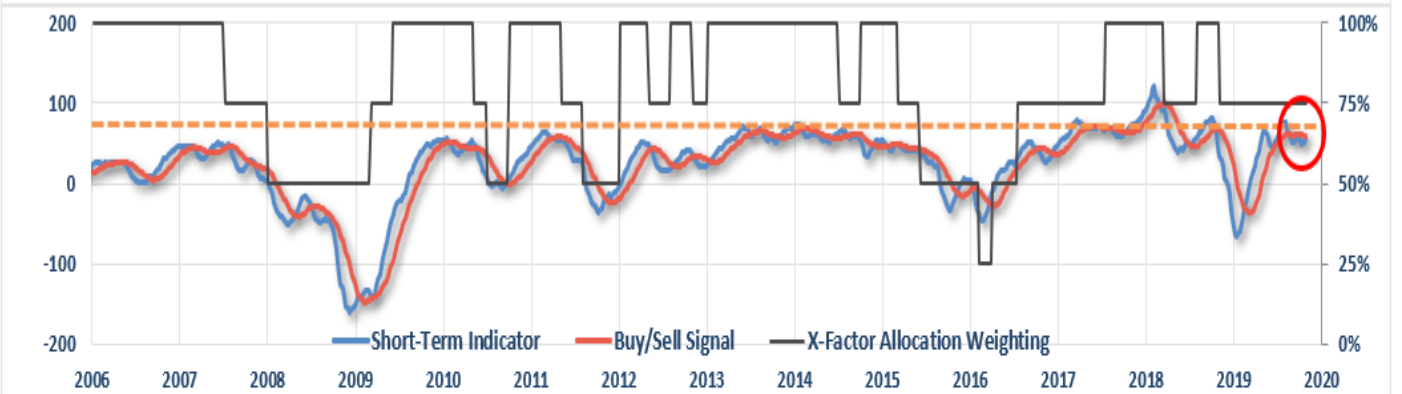
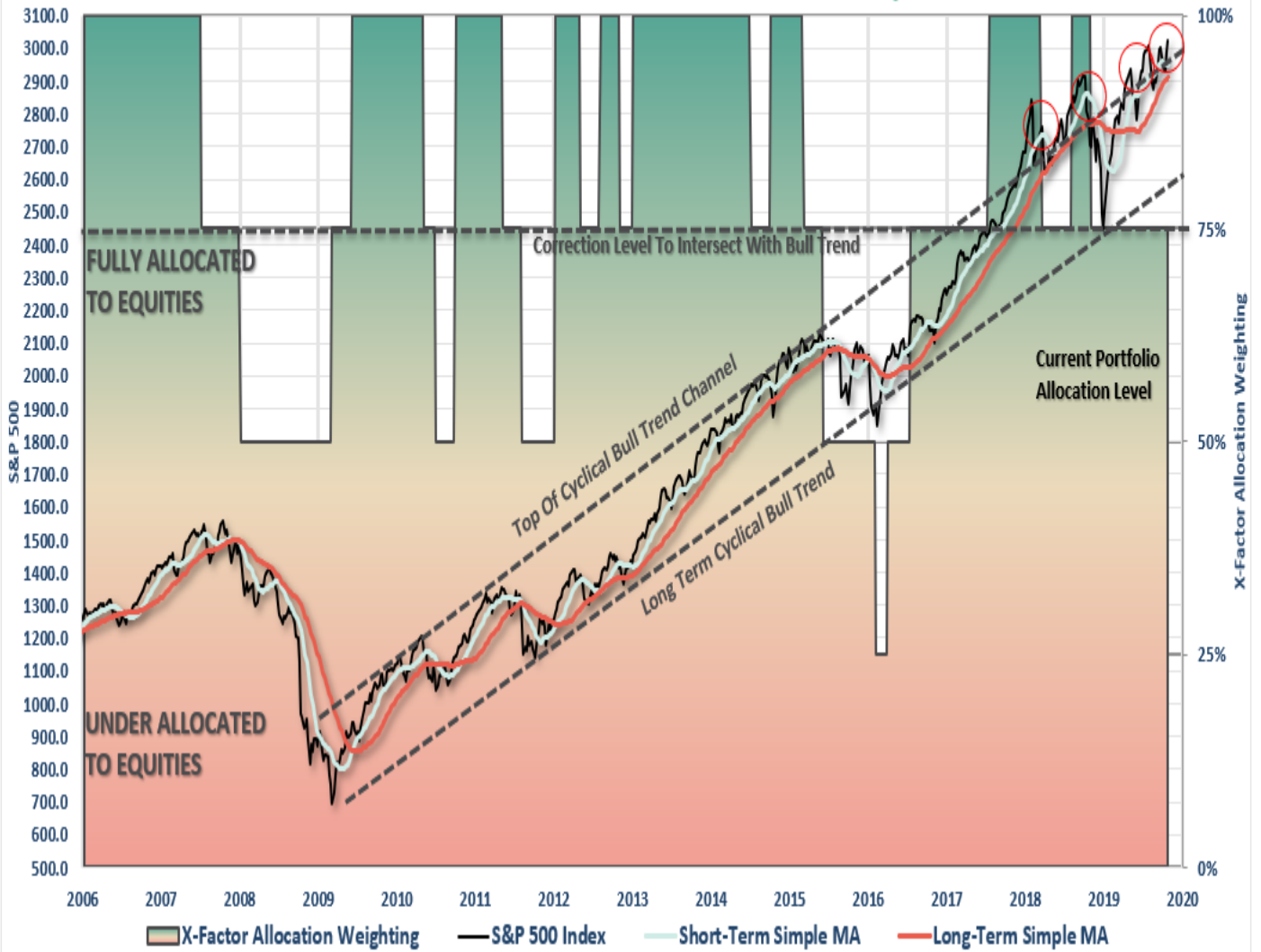
- **New clients:** Please contact your adviser with any questions.
- **Equity Model:** Added positions in XOM, ABBV, AMZN, and MU
- **ETF Model:** No changes yet.

Note for new clients: It is important to understand that when we add to our equity allocations, ALL purchases are initially *trades*; that can, and will, be closed out quickly if they fail to work as anticipated. This is why we *step* into positions initially. Once a *trade* begins to work as anticipated, it is then brought to the appropriate portfolio weight and becomes a long-term investment. **We will unwind these actions either by reducing, selling, or hedging if the market environment changes for the worse.**

THE REAL 401k PLAN MANAGER

A Conservative Strategy For Long-Term Investors

Risk Management Analysis



There are 4-steps to allocation changes based on 25% reduction increments. As noted in the chart above a 100% allocation level is equal to 60% stocks. **I never advocate being 100% out of the market as it is far too difficult to reverse course when the market changes from a negative to a positive trend.** Emotions keep us from taking the correct action.

[401k Plan Manager Allocation Shift](#)

Testing Highs But Can't Make Them

Please read the main body of the newsletter this week. **2013266080**; Given the "bulls" have the upper-hand heading into the end of the year, we will likely increase our portfolio exposures over the next couple of weeks once we get a handle on how the markets are going to react to all of the news. However, despite all of the news on earnings, trade, and the Fed's QE-4 program, the markets were unable to make and sustain new highs last week. While we are waiting for a breakout to add exposure, you can continue to make changes to align portfolios with the current model and prepare for the increase in exposure if the opportunity presents itself.

- If you are **overweight 2013266080; equities** - Hold current positions but remain aware of the risk. Take some profits, and rebalance risk to some degree if you have not done so already. 2013266080;
- If you are **underweight equities** - rebalance portfolios to target weights, **or if at target, hold positioning for now.**

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

401k Plan Manager Beta Is Live

Become a [RIA PRO subscriber](#) and be part of our "**Break It Early Testing Associate**" group by using **CODE: 401 (You get your first 30-days free)** The code will give you access to the entire site during the 401k-BETA testing process, so not only will you get to help us work out the bugs on the 401k plan manager, you can submit your comments about the rest of the site as well. **We are building models specific to company plans. So, if you would like to see your company plan included specifically, [send me the following](#):**

- Name of the company
- Plan Sponsor
- A print out of your plan choices. (Fund Symbol and Fund Name)

I have gotten quite a few plans, so keep sending them and I will include as many as we can. **If you would like to offer our service to your employees at a deeply discounted corporate rate, [please contact me](#).**

Current 401-k Allocation Model

The 401k plan allocation plan below follows the K.I.S.S. principle. By keeping the allocation extremely simplified it allows for better control of the allocation and a closer tracking to the benchmark objective over time. 2013266080; **(If you want to make it more complicated you can, however, statistics show that simply adding more funds does not increase performance to any great degree.)**

Current Portfolio Weighting



Current 401k Allocation Model

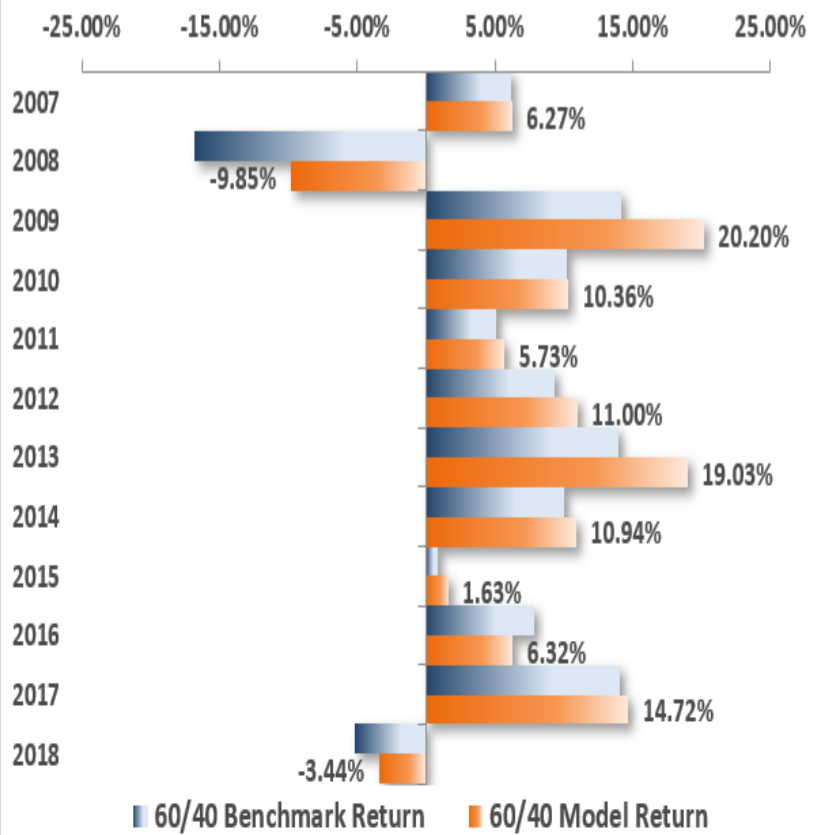
20.00% Cash + All Future Contributions

Primary concern is the protection of investment capital

Examples: Stable Value Money Market Retirement Reserves

Model performance is based on a two-asset model of stocks and bonds relative to the weighting changes made each week in the newsletter. This is strictly for informational and educational purposes only and should not be relied upon for any reason. Past performance is not a guarantee of future results. Use at your own risk and peril. #2013266080;

| Year | 60/40 Benchmark Return | 60/40 Model Return |
|------|------------------------|--------------------|
| 2007 | 6.14% | 6.27% |
| 2008 | -16.78% | -9.85% |
| 2009 | 14.20% | 20.20% |
| 2010 | 10.22% | 10.36% |
| 2011 | 5.09% | 5.73% |
| 2012 | 9.33% | 11.00% |
| 2013 | 13.93% | 19.03% |
| 2014 | 10.06% | 10.94% |
| 2015 | 0.82% | 1.63% |
| 2016 | 7.81% | 6.32% |
| 2017 | 14.12% | 14.72% |
| 2018 | -5.13% | -3.44% |



| Portfolio vs Benchmark Statistics | |
|------------------------------------|---------|
| Number of Up Years | 10 |
| Number of Down Years | 2 |
| Best One Year Return Of Benchmark | 14.20% |
| Best One Year Return Of Model | 20.20% |
| Worst One Year Return Of Benchmark | -16.78% |
| Worst One Year Return Of Model | -9.85% |
| Benchmark Return 2007-Present | 88.49% |
| Model Return 2007-Present | 135.70% |
| Total Alpha Generated | 47.22% |
| Mean Annual Return Of Benchmark | 6.08% |
| Mean Annual Return Of Model | 8.16% |
| Beta Of Model vs Benchmark | 0.86 |
| Jensens Alpha | 2.53% |
| Sharpe Ratio | 0.20 |

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

