

RIA PRO: Whistling Past The \$70 Trillion Debt Graveyard



- *Review & Market Update*
- *Whistling Past The \$70 Trillion Debt Graveyard*
- *The Real Crisis Is Coming*
- *Sector & Market Analysis*
- *401k Plan Manager*

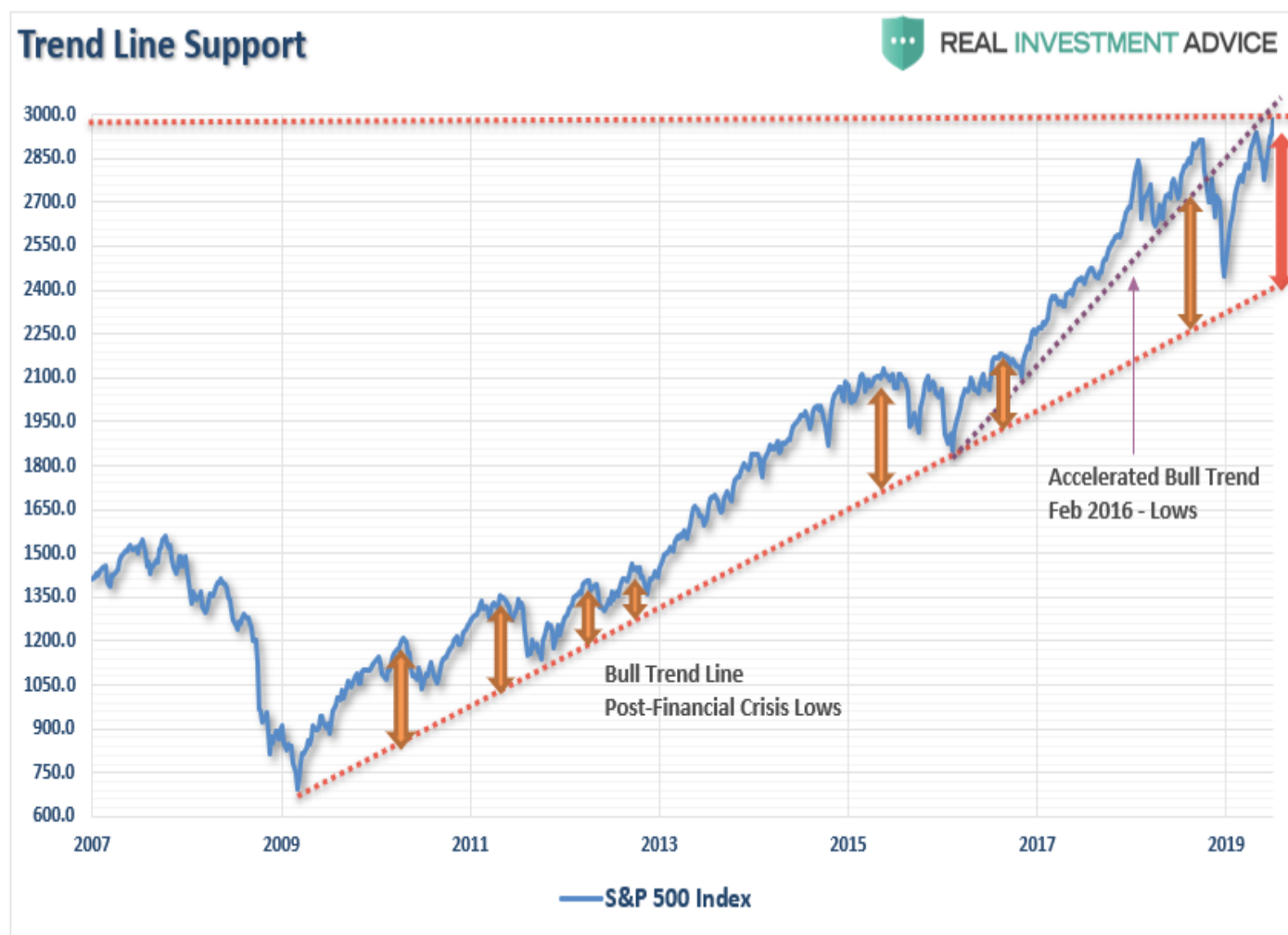
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Market Review & Update

[Last week](#), we discussed the setup for a near-term mean reversion because of the massive extension above the long-term mean. To wit:

"There is also just the simple issue that markets are very extended above their long-term trends, as shown in the chart below. A geopolitical event, a shift in expectations, or an acceleration in economic weakness in the U.S. could spark a mean-reverting event which would be quite the norm of what we have seen in recent years."



This analysis is what led us to take action for our [RIAPRO subscribers last week \(30-Day Free Trial\)](#), as we added a 2x-short S&P 500 index fund to **Equity Long-Short Account** to hedge our longs (GOOG, CRM, NVDA, EMN, IVV, RSP) against a potential mean reversion.

"This morning, we are adding a small 2x S&P 500 short position to the trading portfolio to hedge our core long positions against a retracement over the next few weeks. We will remove the short if the market can regain its footing and move higher, or the market sells off and reaches oversold conditions."

This is the purpose of hedging, as it reduces volatility over time, which inherently reduces the risk of emotionally based trading mistakes.

My friends at [Polar Futures Group](#) laid out the same concerns on Friday:

"The mean reversion trade: For the past few weeks I've been musing that the irresistible force? that has moved all markets has been the aggressive repricing of future interest rate expectations since last November. We've had a HUGE rally in the bond market, MASSIVE flows into bond funds, record levels (>\$13.7T) of negative yielding bonds, inverted yield curves, even Greek bonds trading through Treasuries...as markets anticipate a recession and much more Central Bank largess...which might just take us into MMT and/or never-never land where the Central Banks just buy all the bonds and that's that. I've thought that this irresistible force may have gone too far too fast and was due for a ?set-back? which would precipitate mean reversion trades across markets."

The core concepts of the mean reversion trades I'm considering are as simple as, 1) the public buys the most at the top (thank you, Bob Farrell,) and 2) when they're yelling you should be selling, and 3) positioning risk leaves some markets especially vulnerable."

They are exactly right.�

While the market is rallying in anticipation of more Central Bank easing, especially following the recent announcement by the ECB of lower rates and more QE, the markets are momentarily detached from weaker earnings growth, weaker economic growth, and a variety of other market-related risks.�

However, in the very short-term, the market is grossly extended and in need of some correction action to return the market to a more normal state. As shown below, while the market is on a near-term "buy signal" (lower panel) the overbought condition, and near 9% extension above the 200-dma, suggests a pullback is in order.�

\$SPX S&P 500 Large Cap Index INDX

26-Jul-2019

© StockCharts.com



As we have noted over the last few weeks, the very tight trading range combined with negative divergences also does not historically suggests continued bullish runs higher without some type of corrective action first.

\$SPX S&P 500 Large Cap Index INDEX
26-Jul-2019

© StockCharts.com

Open 3013.25 High 3027.98 Low 3012.59 Close 3025.86 Volume 1.7B Chg +22.19 (+0.74%)▲

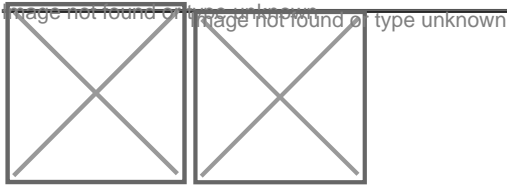


All of this supports why we trimmed our long positions slightly last week and increased our cash holdings for the time being.�

Our models still suggest a likely correction over the next two months as we move past the Fed. Such is particularly the case if the Fed signals their "rate cut" may be "one and done" for the time

being.�

But for now, we are going to opt to "wait and see" what happens.



The \$70 Trillion Dollar Graveyard

[On Thursday](#), Congress passed the spending bill we discussed last week:

"A divided House on Thursday passed a two-year budget deal that would raise spending by hundreds of billions of dollars over existing caps and allow the Government to keep borrowing to cover its debts, amid grumbling from fiscal conservatives over the measure's effect on the federal deficit.

65 Republicans joined the Democratic majority in the 284-149 vote, with 132 Republicans voting against the bill, despite President Trump's endorsement and pressure from key outside groups, [including the Chamber of Commerce](#), **to avoid a potentially catastrophic default on the Government's debt."�**

I highlighted the last sentence in red because it is **an outright "LIE" used to convince Americans that out of control spending must be done.**�

The reality is that *"interest payments on the debt"* are part of the MANDATORY spending in our budget along with social security, medicare, etc. **Currently, about \$0.75 of every dollar of tax revenue goes to mandatory spending.** For the last few months the Government has been at its statutory debt limit, and *"surprise"* we didn't default on our debt. Why? Because there is enough revenue currently coming in to cover the mandatory spending.�

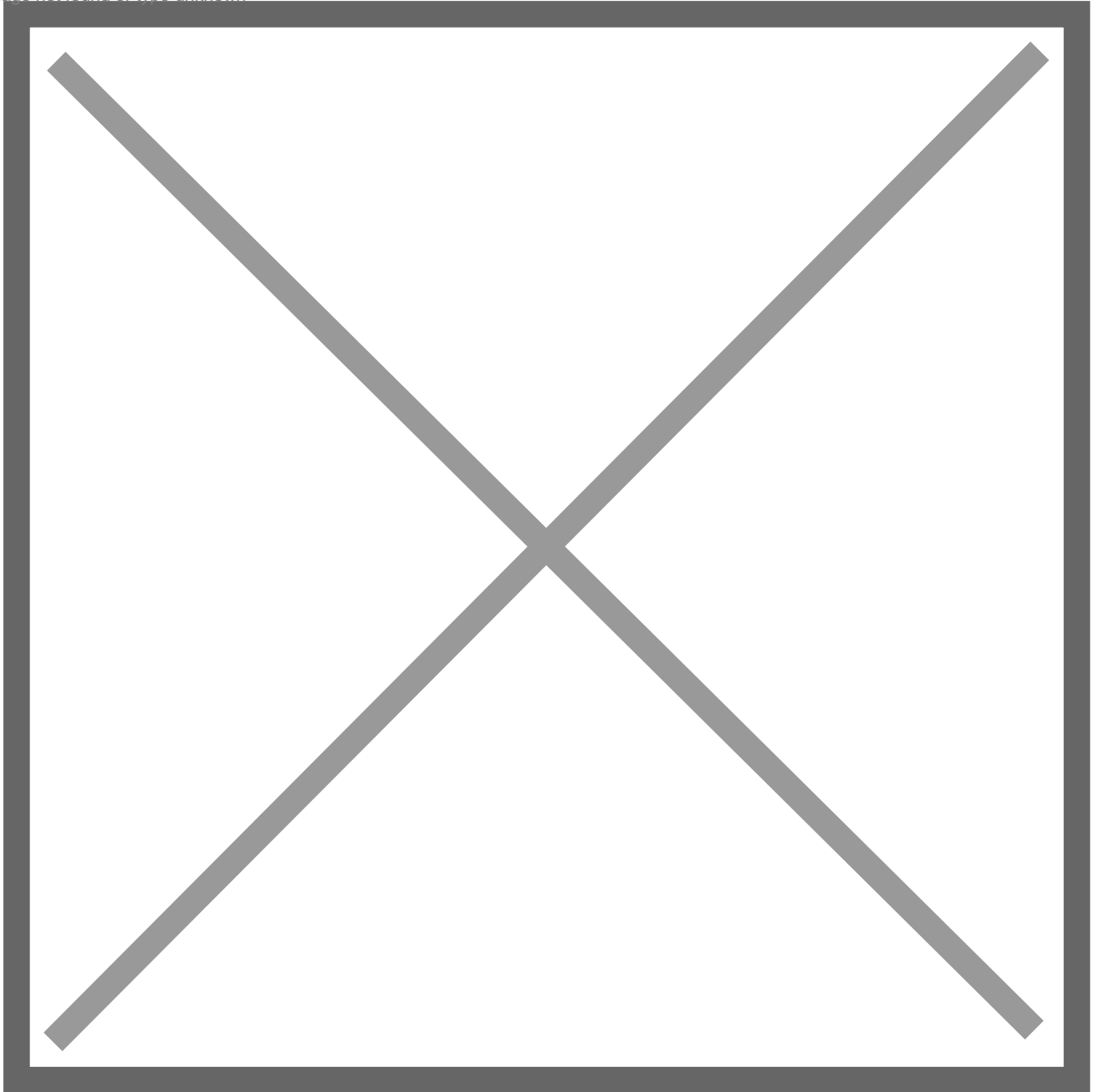
As I noted specifically [last week](#),

"In 2018, the Federal Government spent \$4.48 Trillion, which was equivalent to 22% of the nation's entire nominal GDP. Of that total spending, ONLY \$3.5 Trillion was financed by Federal revenues,�and \$986 billion was financed through debt.

In other words, if 75% of all expenditures is social welfare and interest on the debt, those payments required \$3.36 Trillion of the \$3.5 Trillion (or 96%) of revenue coming in.?

Do some math here.

*The U.S. spent \$986 billion more than it received in revenue in 2018, which is the overall 'deficit.'�If you just add the \$320 billion to that number **you are now running a \$1.3 Trillion deficit.***



The U.S. will not default on its debt.�

This is particularly the case since we no longer have any budgetary controls.�

Importantly, the spending increase of \$320 billion is on top of the annual 8% automated budget increase and the preexisting deficit. My original projection above is too conservative by \$500 billion, or more.�

But that's not the real story.

The crux of that article was focused on the roughly \$6 Trillion of unfunded liabilities of U.S. pension funds which Congress is now drafting a piece of legislation for entitled the **"*Rehabilitation For Multi-employer Pensions Act.*"**�

As noted in that article, while Congress is preparing a bailout for U.S. pension funds, there is a **\$70 Trillion pension problem globally which is not being addressed.�**

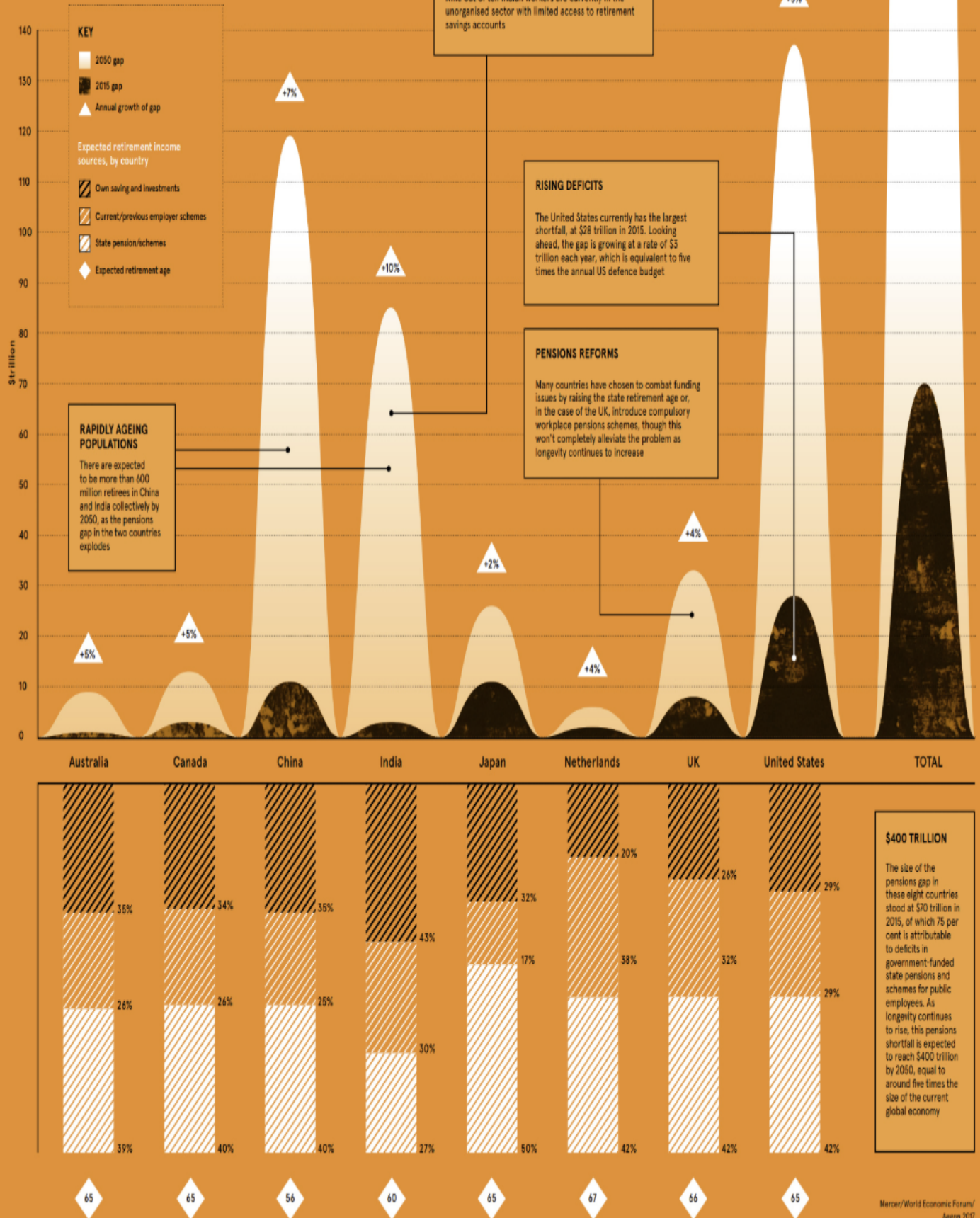
?According to an analysis by the World Economic Forum (WEF), there was a combined retirement savings gap in excess of \$70 trillion in 2015, spread between eight major economies?

\$400trn



SIZE OF THE GLOBAL RETIREMENT SAVINGS GAP

Shortfalls in pension savings in eight of the largest established pension systems*



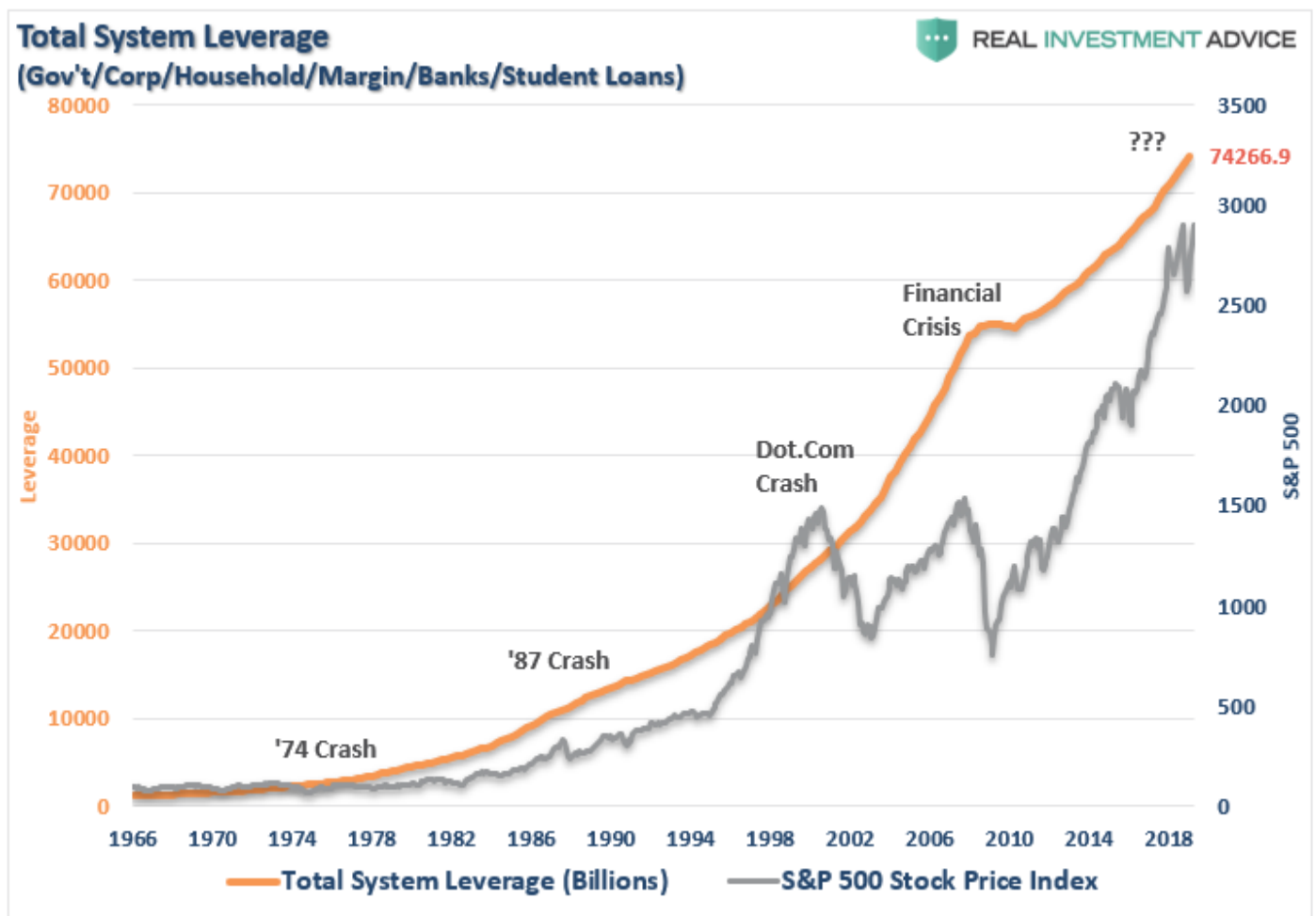
However, this isn't the \$70 Trillion graveyard we are addressing today.� From [CNN](#):

"America's debt load is about to hit a record. The combination of cheap money and soaring debt helped fuel the decade-long economic expansion and bull market, but America's gluttony of loans could work against it if its fragile economic balance shifts.

In the first quarter of 2019, the United States' total public- and private-sector debt amounted to nearly \$70 trillion, according to research by the Institute of International Finance. Federal government debt and liabilities of private corporations **excluding banks** both hit new highs."

Oh...you are talking about THAT \$70 Trillion.�

The chart below is Total U.S. Credit Market Debt (*including Student Loans*)�which is currently running just a smidgen over \$74 Trillion.The last time there was even a hint of deleveraging was during the "*Financial Crisis*."�

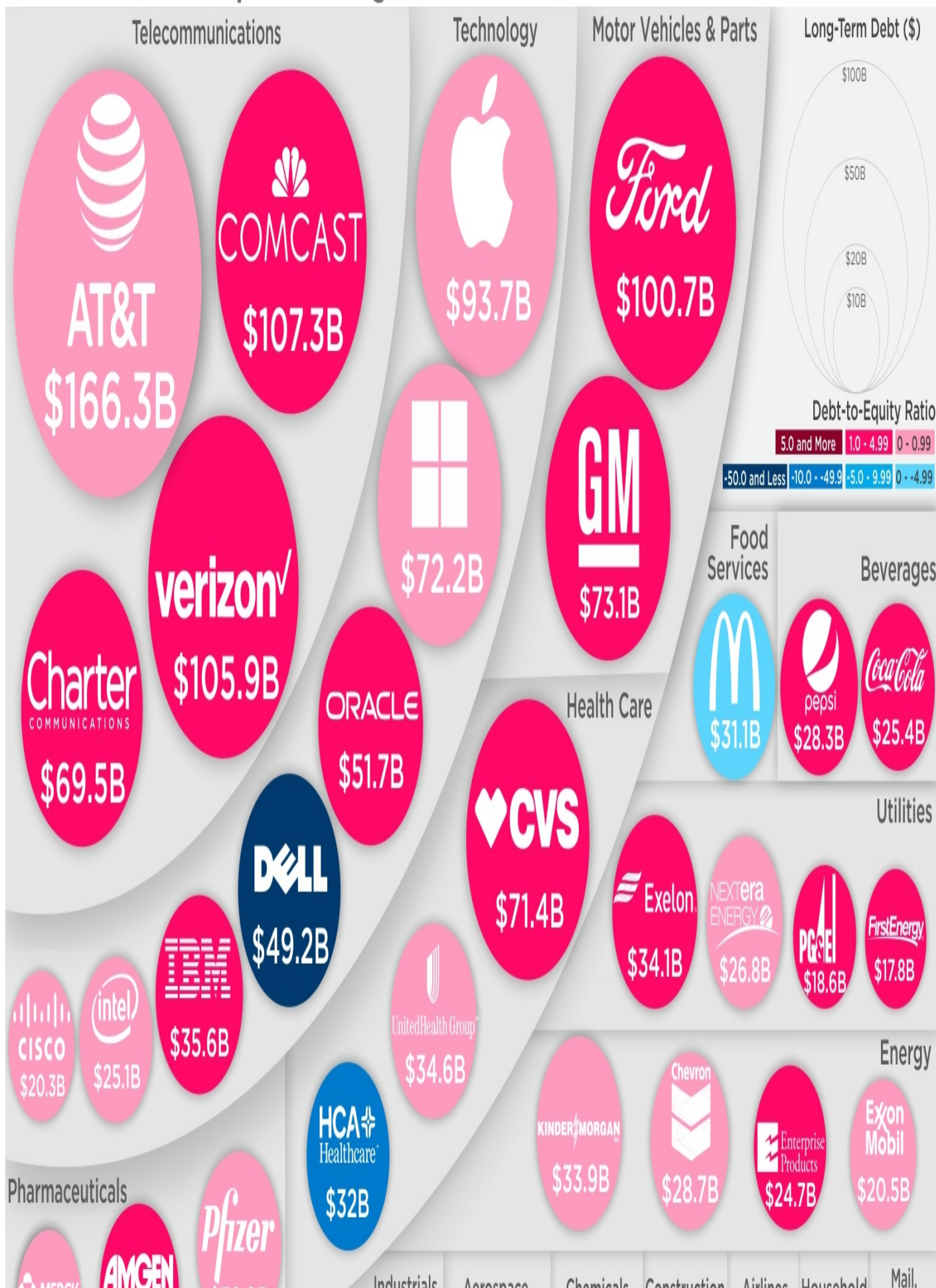


Corporate debt is a problem.�

The wonderful website "[HowMuch](#)" put the corporate debt bubble into a graphic to help us visualize the potential for widespread defaults during the next economic and market downturn.�

America's Biggest Corporate Debt

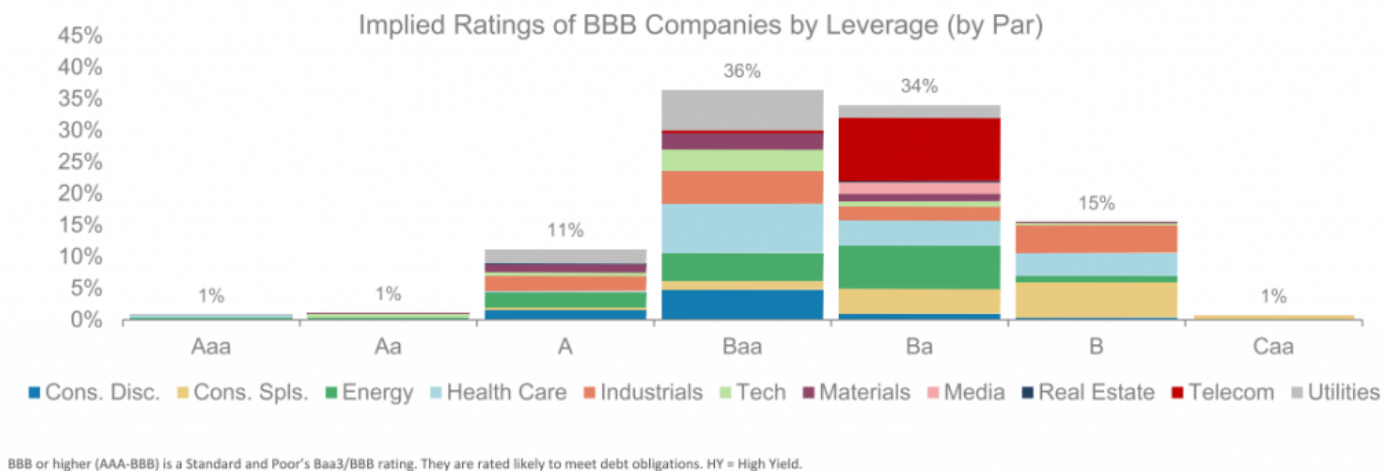
Non-Financial Companies' Long-Term Debt



The problem with corporate debt is the amount of debt which is at risk of default during the next economic recession. **(This isn't an "IF," it's a "WHEN" statement.)**

Let's start with a note from [Michael Lebowitz](#):

"The graph shows the implied ratings of all BBB companies based solely on the amount of leverage employed on their respective balance sheets. Bear in mind, the rating agencies use several metrics and not just leverage. The graph shows that 50% of BBB companies, based solely on leverage, are at levels typically associated with lower rated companies."

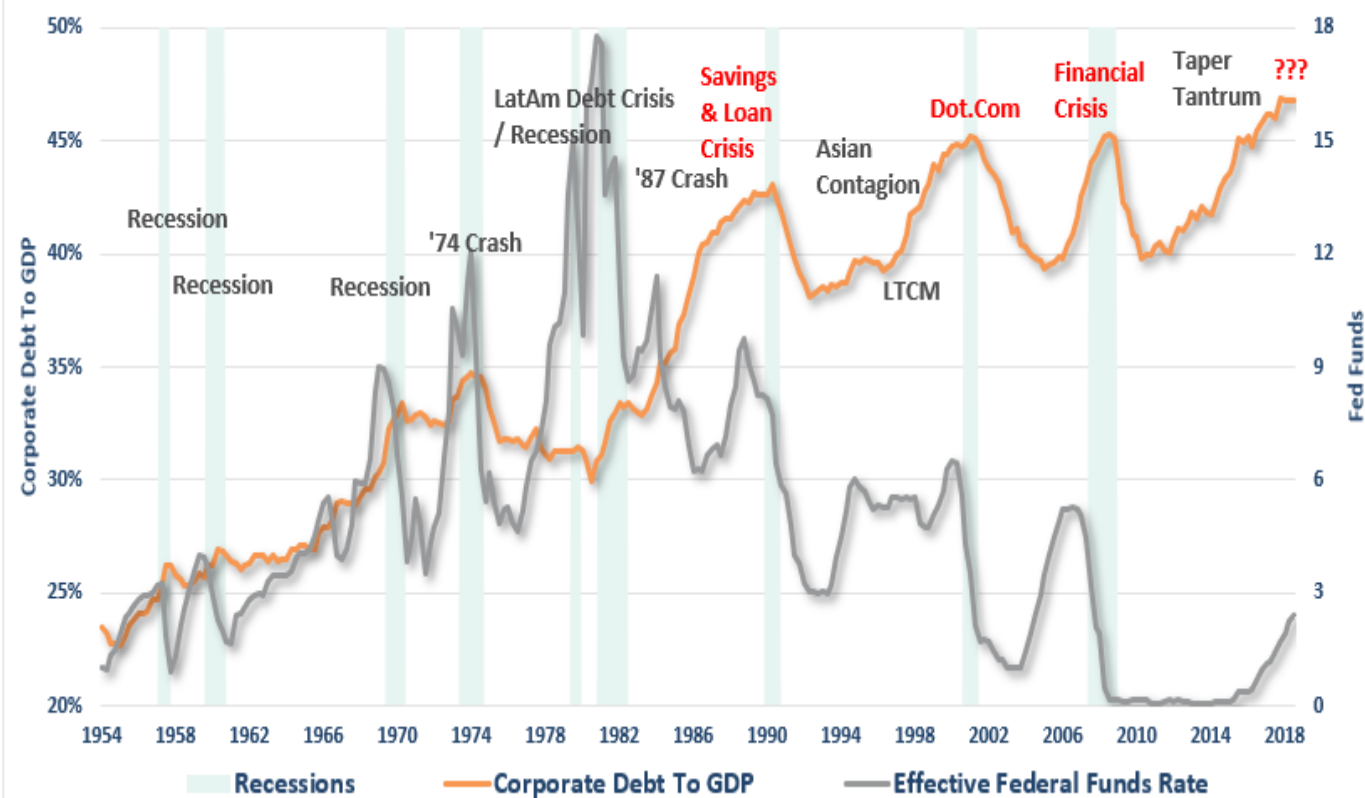


*"If 50% of BBB-rated bonds were to get downgraded, it would entail a shift of \$1.30 trillion bonds to junk status. **To put that into perspective, the entire junk market today is less than \$1.25 trillion, and the subprime mortgage market that caused so many problems in 2008 peaked at \$1.30 trillion.** Keep in mind, the subprime mortgage crisis and the ensuing financial crisis was sparked by investor concerns about defaults and resulting losses."*

The reason BBB-rated debt is so plentiful is due to the Fed's ultra-low interest rate policy over the last decade. Near zero rates, and easy credit terms, has seduced companies into taking on debt to fund operations, dividends, and stock buybacks. The consequence is we are now seeing corporate debt exceeding the levels of the global financial crisis.

Non-Financial Corporate Debt To GDP Ratio

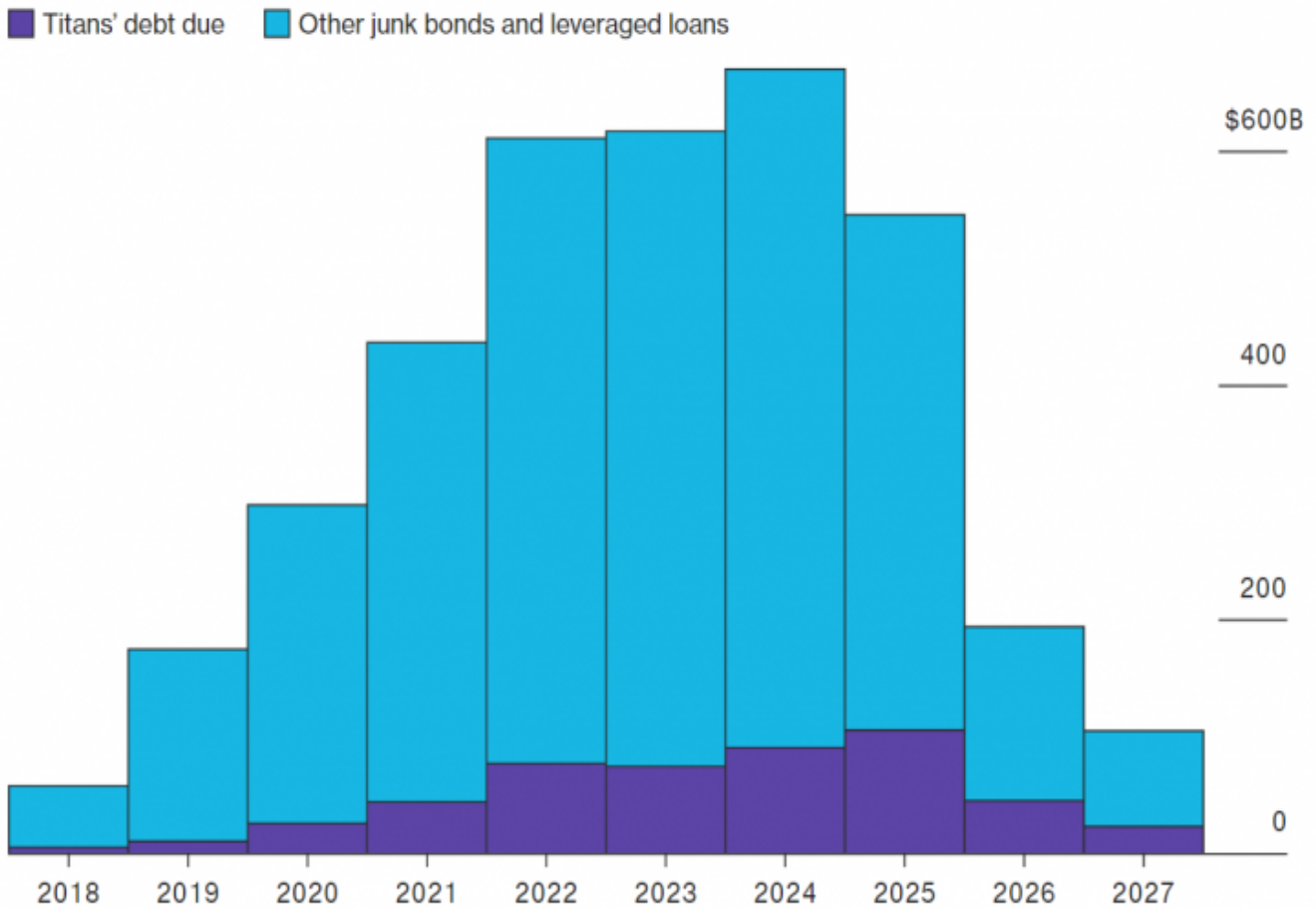
REAL INVESTMENT ADVICE



The real risk is that over the next 5-years more than 50% of the junk-bonds and leveraged-loans (which is sub-prime debt for corporations) is maturing and must be refinanced.

Debt Reckoning

More than \$4 trillion of junk bonds and leveraged loans will mature globally over the next decade, with the maturity wall peaking in 2024.




Source: Bloomberg

Let that sink in for a minute.

A weaker economy, recession risk, falling asset prices, or rising rates could well lock many corporations OUT of refinancing their share of this \$4.88 trillion debt. Defaults will move significantly higher, and much of this debt will be downgraded to junk.

But it isn't just corporate debt, that's a problem.

**REAL
INVESTMENT
ADVICE**

Are your investments prepared
for the next bear market?

**SCHEDULE YOUR
CONSULTATION
TODAY**

Whistling Past The \$246+ Trillion Graveyard

"According to the latest [IIF Global Debt Monitor](#) released today, debt around the globe hit **\$246 trillion in Q1 2019, rising by **\$3 trillion in the quarter**, and **outpacing the rate of growth of the global economy as total debt/GDP rose to 320%**.**

This was the second-highest dollar number on record after the first three months of 2018, though debt was higher in 2016 and 2017 as a share of world GDP. Total debt was broken down as follows:

- *Households: 60% of GDP*
- *Non-financial corporates: 91% of GDP*
- *Government 87% of GDP*
- *Financial Corporations: 81% of GDP*

And while the developed world has some more to go before regaining the prior all time leverage high, with borrowing led by the U.S. federal government and by global non-financial business, total debt in emerging markets hit a new all time high, thanks almost entirely to China."

This is why Central Banks, from the ECB to the Federal Reserve, are terrified of an economic recession or downturn. As I said previously, *"debt is the 'weapon of mass destruction'"*�

Given that global debt is 320% of global GDP, a deleveraging cycle will be too large for Central Banks to contain.

The deleveraging cycle WILL occur, all that Central Banks can do is hope to extend the current cycle long enough that "maybe" economic growth will catch up with the problem and lower the risk.

The irony is that it is the Central Banks on actions (lowering interest rates to zero and flooding the system with liquidity) which has inflated the debt bubble.

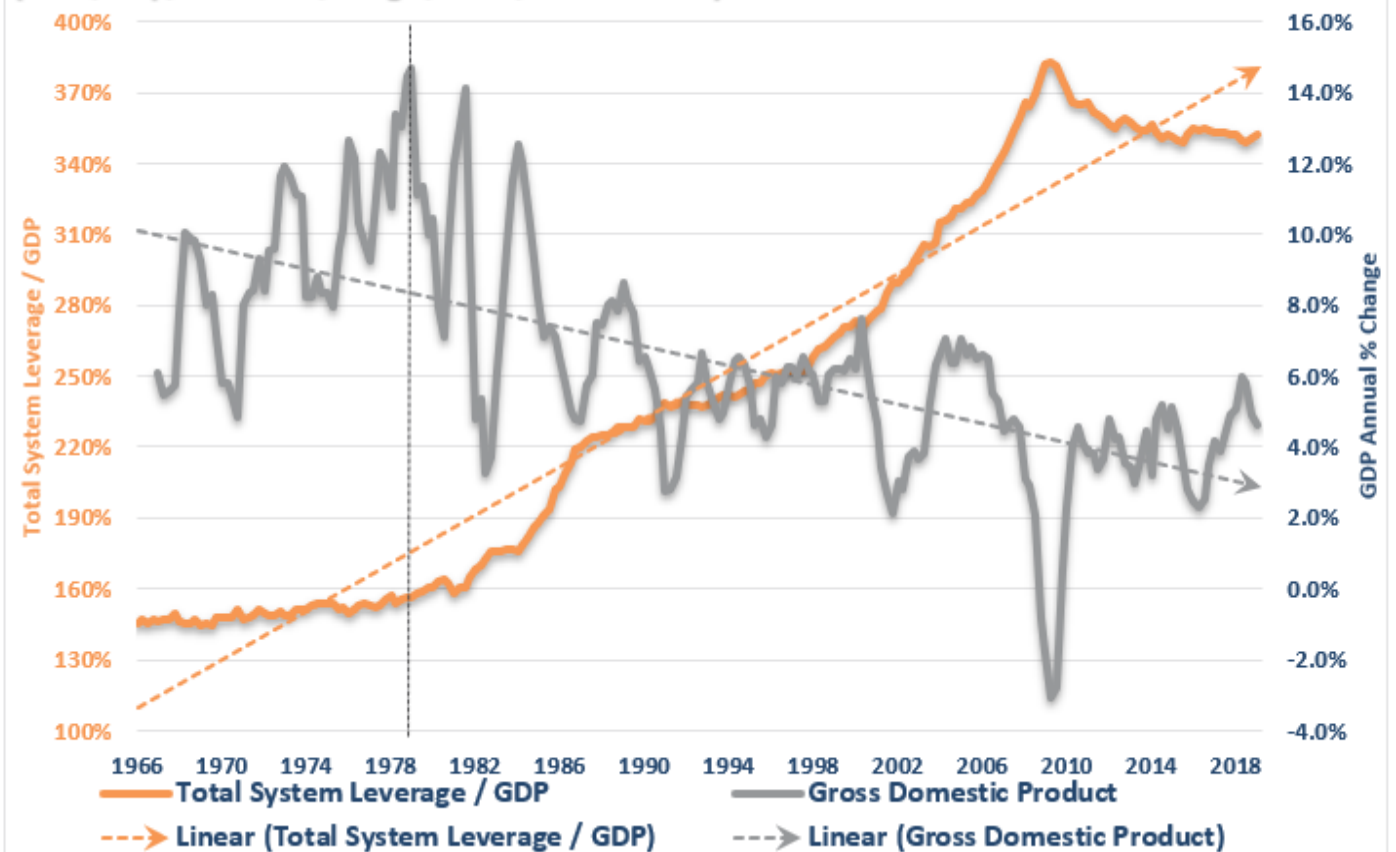
But that's everyone else's problem, right.

As noted above, the U.S. is currently running a debt-to-GDP ratio of roughly 350% so we are certainly not immune to the risk of a global *"debt contagion."*�

Total System Leverage / GDP

(Gov't/Corp/Household/Margin/Banks/Student Loans)

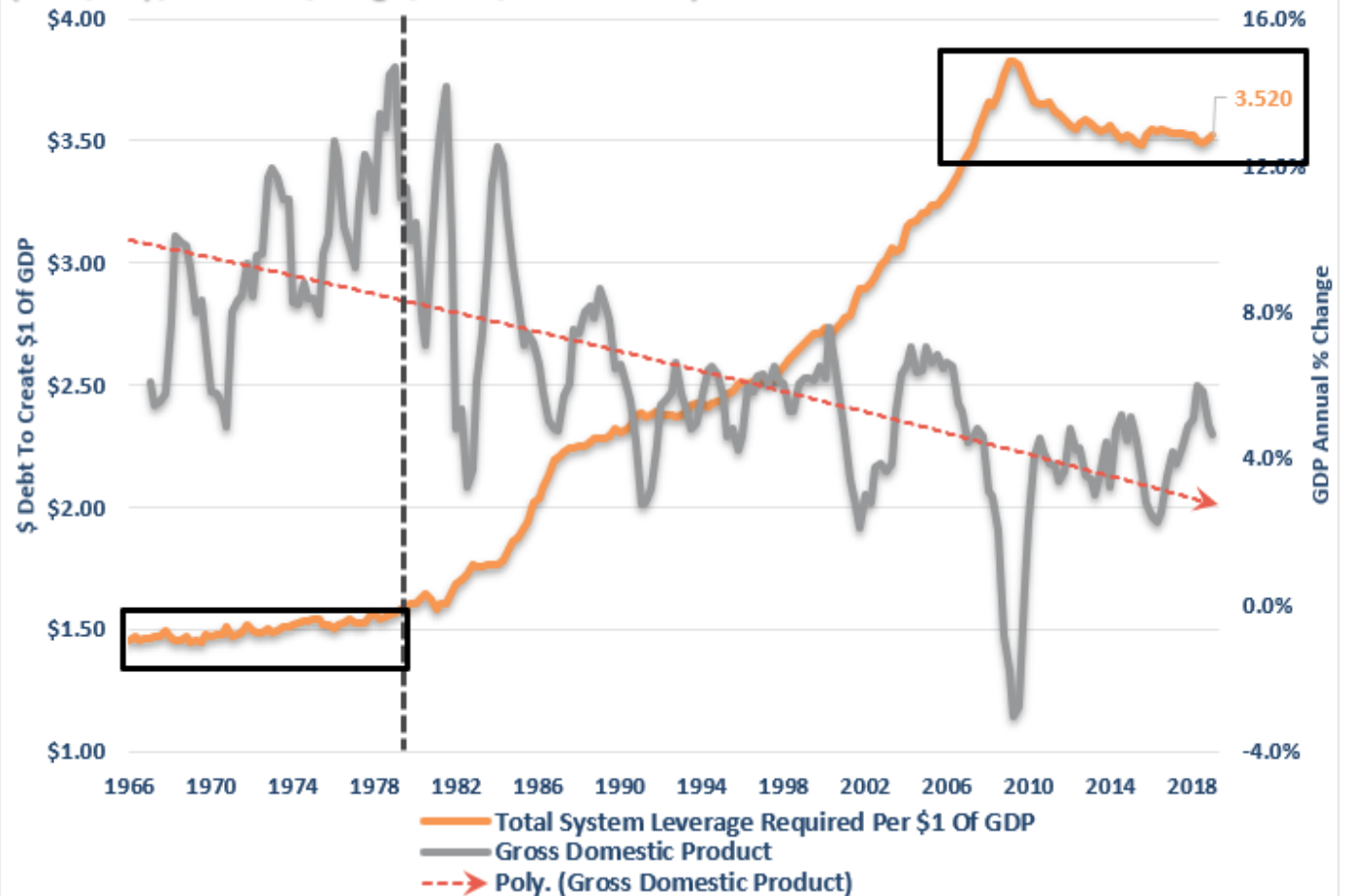
REAL INVESTMENT ADVICE



We can look at this a bit differently. The economy currently requires \$3.50 of NEW debt just to generate \$1 of new growth.��

Total System Leverage

(Gov't/Corp/Household/Margin/Banks/Student Loans)

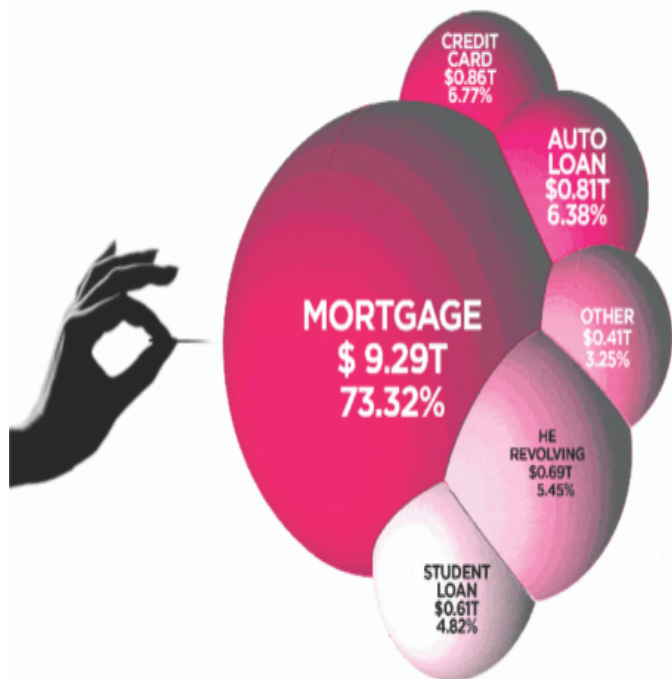


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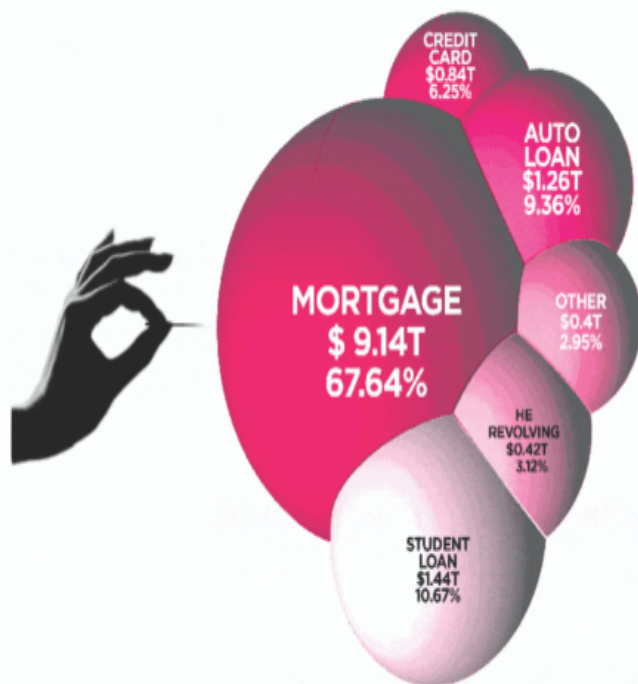
The problem with the exceedingly high debt levels is that since economic growth is a function of debt-supported spending, there is a finite limit to how much debt can be absorbed. As "HowMuch" showed, 10-years after the financial crisis, individuals are more levered today than they were then. (Notice the doubling of auto and student loan debt in particular.)

�

The Great American Debt Bubble Total Household Debt & Composition 2008



The Great American Debt Bubble Total Household Debt & Composition 2018



Article and Sources:

<https://howmuch.net/articles/the-great-american-debt-bubble>
FEDERAL RESERVE BANK OF NEW YORK - <https://www.newyorkfed.org/new-york-fed-consumer-credit-panel/tables>

howmuch.net

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The Real Crisis Is Coming

As I noted this past week, the real crisis comes when there is a [?run on pensions.? With a large number of pensioners already eligible for their pension, and a near \\$6 trillion dollar funding gap, the next decline in the markets will likely spur the ?fear?�that benefits will be lost entirely.�](#)

The combined run on the system, which is grossly underfunded, at a time when asset prices are dropping, credit is collapsing, and shadow-banking freezes,�the ensuing debacle will make 2008 look like mild recession.�

It is unlikely Central Banks are prepared for, or have the monetary capacity, to substantially deal with the fallout.

As David Rosenberg previously noted:

?There is no way you ever emerge from eight years of free money without a debt bubble. If it?s not a LatAm cycle, then it?s energy the next, commercial real estate after that, a tech mania years after, and then the mother of all of them, housing over a

decade ago. This time there is a huge bubble on corporate balance sheets and a price will be paid. It's just a matter of when, not if.

Never before in human history have we seen so much debt. Government debt, corporate debt, shadow-banking debt, and consumer debt are all at record levels. Not just in the U.S., but all over the world.

If you are thinking this is a Goldilocks economy, [*there is no recession in sight, Central Banks have this under control, and that I am just being bearish,*](#) you would be right.

But that is also what everyone thought in 2007.

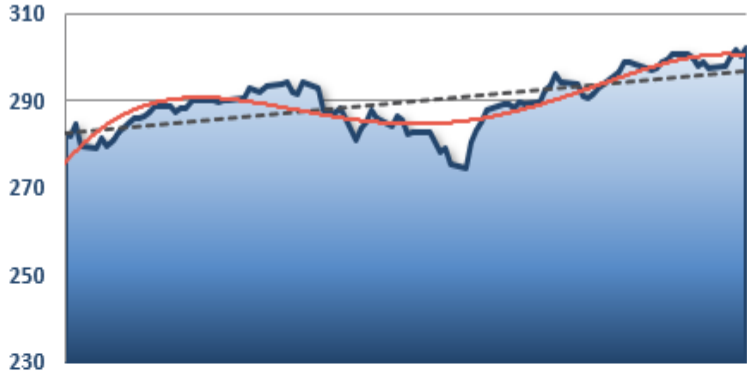
If you need help or have questions, we are always glad to help. [Just email me.](#)

See you next week.

Market & Sector Analysis

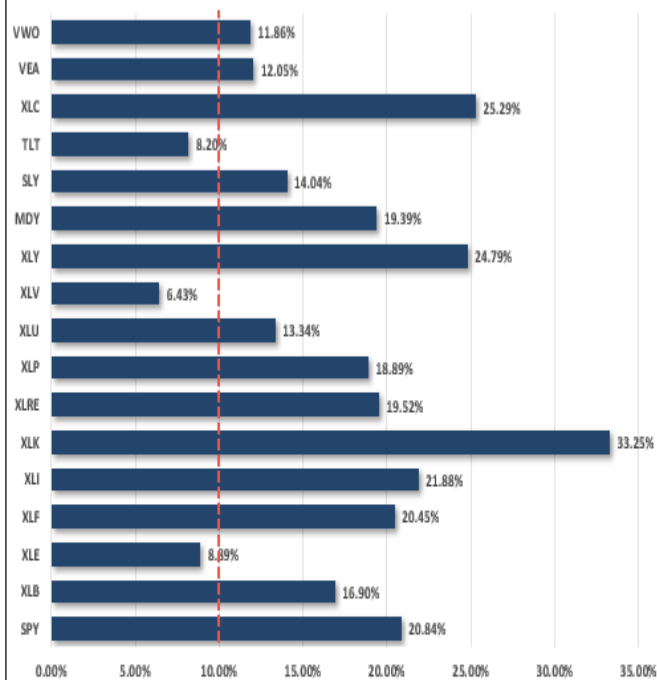
Data Analysis Of The Market & Sectors For Traders

S&P 500 Tear Sheet

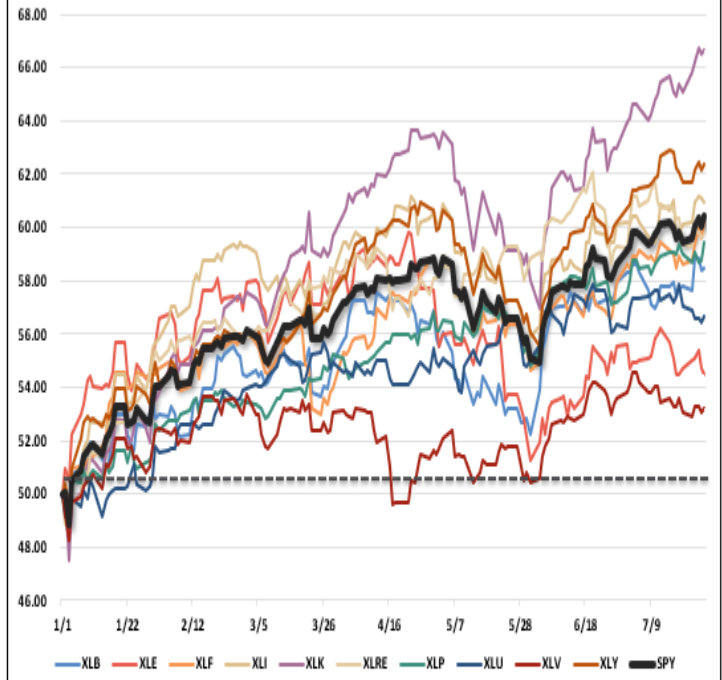
3 Month SPY Price									SPY RISK INFO		ZACKS		REAL INVESTMENT ADVICE	
									Item	T 2-Yr	T 1-Yr.	YTD	% Diff YTD/T1-YR	
									Price Return	22.06%	6.59%	20.84%	216.31%	
									Max Drawdown	-20.47%	-20.47%	-7.41%	-63.80%	
									Sharpe	0.81	0.44	3.28	6.50	
									Sortino	0.93	0.60	4.34	6.23	
									Volatility	13.99	15.31	12.10	(0.21)	
									Daily VaR-5%	(9.34)	(15.54)	22.22	(2.43)	
									Mnthly VaR-5%	(10.34)	(19.16)	12.52	(1.65)	
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	1.89%	1.85%	1.80%	(2.78%)	2.17%	1.67%	(17.16%)	7.83%	Shares	2,427.2	2,358.8	(2.82%)		
P/E Ratio	20.92	21.02	18.74	(12.16%)	21.65	16.38	(13.4%)	14.41%	Sales	59,712	63,919	7.05%		
P/S Ratio	3.17	3.26	3.36	2.96%	3.57	2.62	(5.96%)	28.04%	SPS	24.6	27.1	10.15%		
P/B Ratio	3.54	3.84	4.12	6.96%	4.14	3.01	(0.39%)	37.18%	Earnings	8,435	9,483	12.43%		
ROE	15.82%	17.27%	18.69%	7.60%	18.81%	14.98%	(0.63%)	24.75%	EPS TTM	4.1	4.9	17.97%		
ROA	2.94%	3.25%	3.53%	7.78%	3.53%	2.81%	(0.18%)	25.51%	Dividend	1.5	1.6	6.80%		
S&P 500 Asset Allocation														
Sector	1 Year Price Return	Weight	Beta	P/E	P/E High-5yr (Mo.)	P/E Low-5Yr (Mo.)	P/E % From Peak	ROE	DIV. YIELD	TTM Earnings Yield	Current Forward Earnings	Forward PE		
Energy	(19.88%)	4.89%	1.21	16.44	156.27	12.49	(89.5%)	9.4%	3.7%	6.06%	3.68	15.33		
Materials	(22.30%)	2.76%	1.22	13.20	22.97	13.86	(42.5%)	11.3%	1.9%	7.60%	4.12	15.62		
Industrials	2.59%	9.30%	1.14	15.35	22.20	14.76	(30.9%)	16.2%	1.9%	5.61%	5.23	15.87		
Discretionary	10.49%	10.31%	1.02	25.08	27.38	20.08	(8.4%)	28.9%	1.2%	3.99%	4.94	21.79		
Staples	13.08%	7.24%	0.61	20.79	22.83	17.62	(8.9%)	27.1%	2.7%	4.85%	3.90	19.34		
Health Care	4.31%	13.74%	0.87	16.91	20.62	15.93	(18.0%)	30.2%	1.8%	5.91%	6.59	15.49		
Financials	3.22%	13.19%	1.23	13.78	18.45	11.71	(25.3%)	11.6%	2.0%	7.29%	5.87	11.97		
Technology	16.77%	22.01%	1.25	22.02	21.75	14.42	1.2%	39.1%	1.4%	4.55%	5.29	19.83		
Telecom	(1.19%)	10.24%	0.86	20.50	27.57	17.47	(25.6%)	17.5%	0.9%	4.94%	6.30	17.75		
Utilities	16.81%	3.23%	0.33	20.26	20.31	15.58	(0.3%)	10.5%	3.3%	4.95%	3.64	18.64		
Real Estate	12.89%	3.00%	0.72	20.11	24.47	17.10	(17.8%)	10.0%	3.2%	4.98%	4.31	19.40		
Momentum Analysis														
Item	Price	ROC 50-Days	50-DMA	# Days Since Cross	% Dev 50-Day	200-DMA	# Days Since Cross	% Dev 200-Day	% Dev 50-200 DMA	% From 52-W High	% From 52-W Low	Buy/Sell		
Large Cap	302.01	5.66%	291.45	36	3.62%	277.86	39	8.69%	4.89%	(0.07%)	29.20%	Buy		
Mid Cap	361.37	4.92%	348.82	22	3.60%	339.90	38	6.32%	2.62%	(3.40%)	27.04%	Buy		
Small Cap	68.39	2.86%	66.35	21	3.07%	66.45	21	2.92%	(0.14%)	(12.60%)	21.47%	Sell		

Performance Analysis

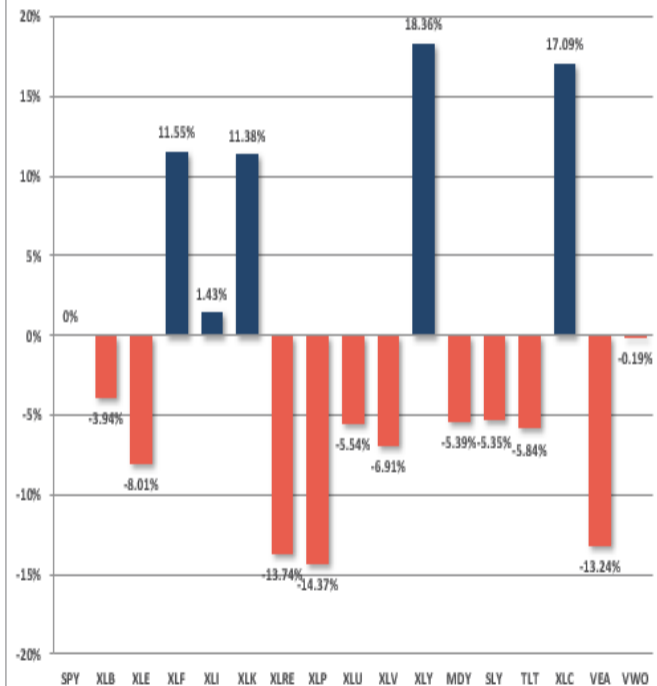
Year To Date Performance



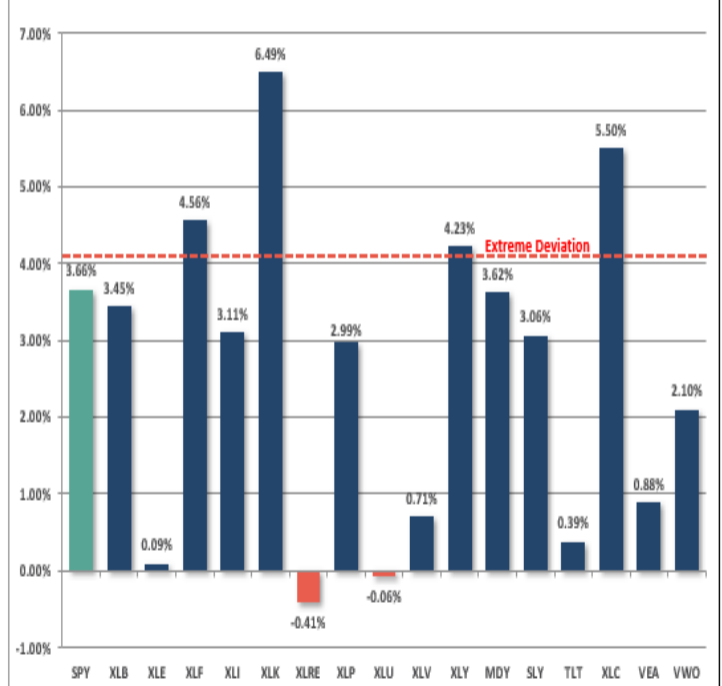
YTD Price - S&P Sectors Recalibrated To \$50/share



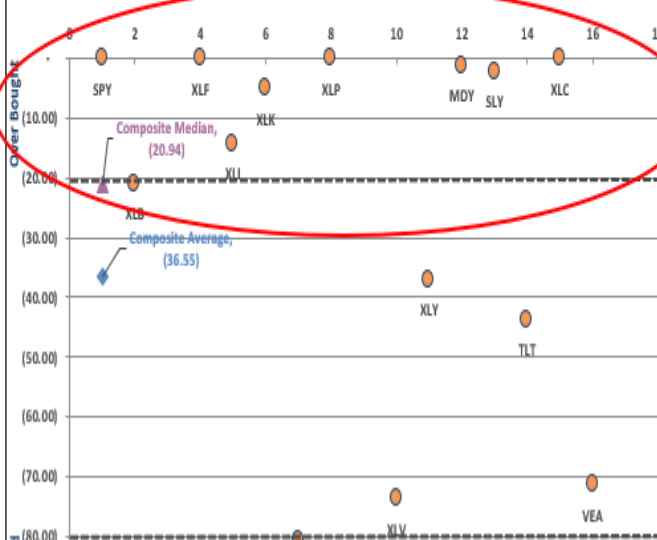
Year To Date Performance Relative To S&P 500



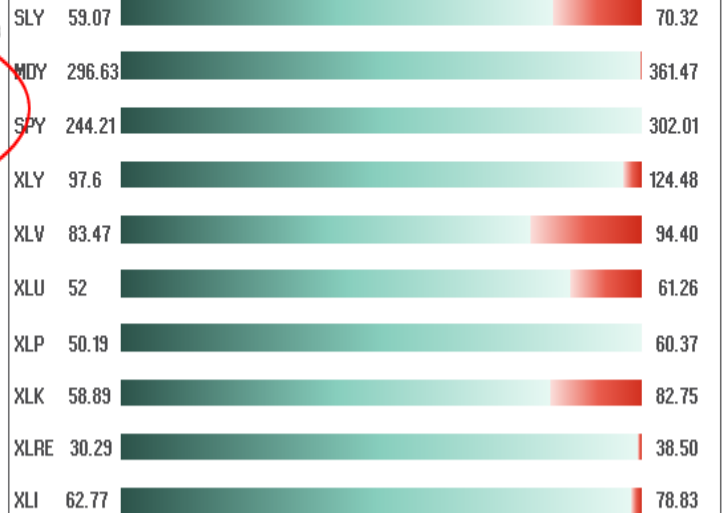
Price Deviation From 50-Day Moving Average



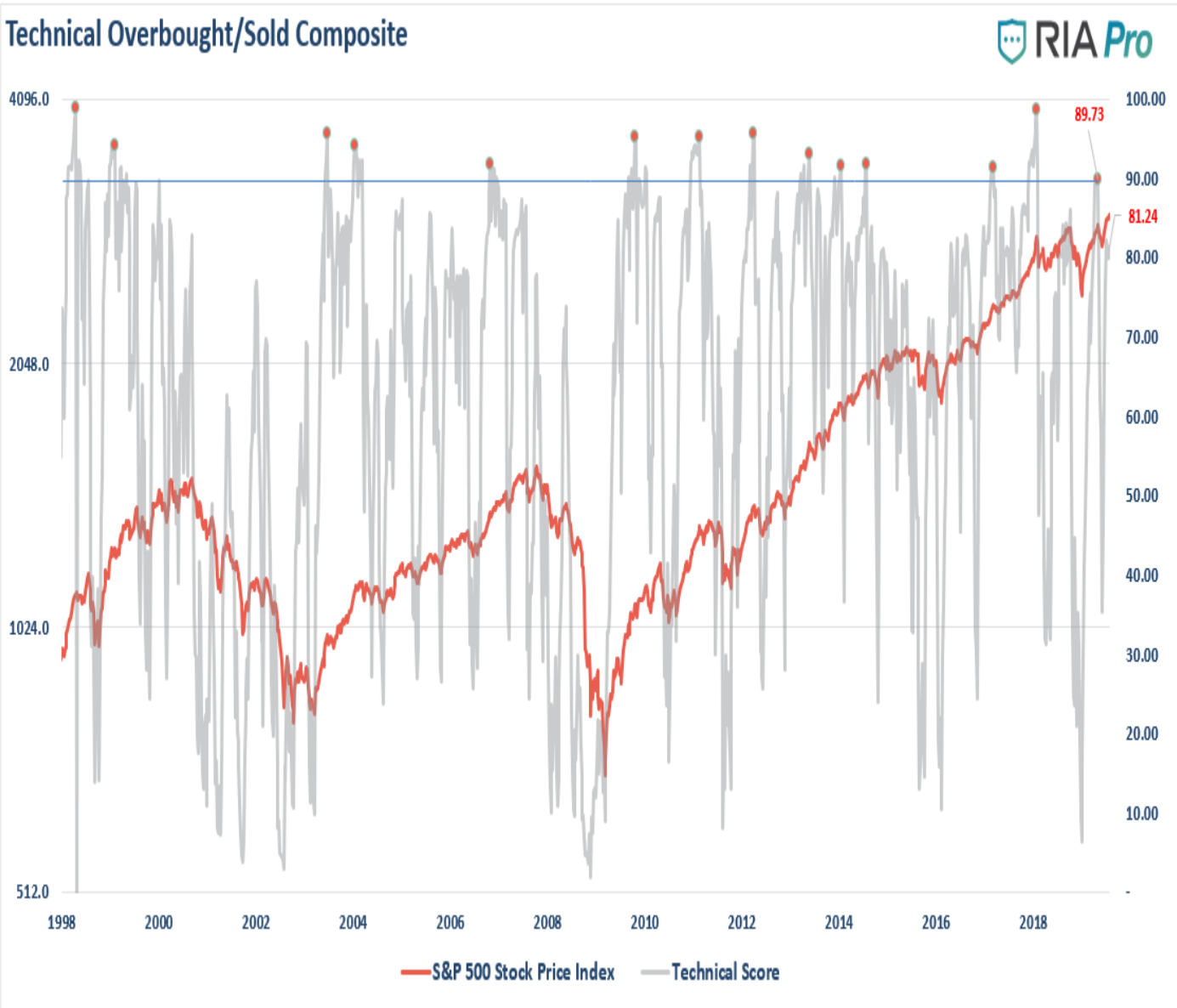
Overbought/Oversold 14-Periods



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	303.77	1.63	3.06	2.62	11.63	7.20	292.58	280.82	3.83%	8.17%	BUY
TACTICAL	SECTORS	XLB	SPDR-MATLS SELS	59.06	(0.52)	(2.10)	1.60	0.44	(7.61)	56.74	55.04	4.09%	7.30%	BUY
		XLE	SPDR-EGY SELS	62.45	(2.12)	(5.04)	(5.42)	(12.41)	(25.71)	62.80	63.56	-0.55%	-1.74%	SELL
		XLF	SPDR-FINL SELS	28.69	1.05	0.89	(0.41)	0.14	(5.21)	27.44	26.37	4.54%	8.80%	BUY
		XLI	SPDR-INDU SELS	78.50	(0.27)	(1.67)	(2.49)	(4.20)	(3.93)	76.21	73.60	3.01%	6.66%	BUY
		XLK	SPDR-TECH SELS	82.59	0.73	2.77	2.13	9.85	7.74	77.39	72.20	6.72%	14.39%	BUY
		XLP	SPDR-CONS STPL	60.37	(0.91)	0.90	2.53	0.61	5.89	58.30	55.56	3.55%	8.65%	BUY
		XLU	SPDR-UTIL SELS	59.98	(2.28)	(2.47)	0.26	(3.90)	6.74	59.58	57.25	0.67%	4.77%	BUY
		XLC	SPDR-COMM SV SS	51.72	2.67	2.02	0.63	1.47	(1.46)	49.10	46.90	5.35%	10.28%	BUY
		XLV	SPDR-HLTH CR	92.07	(1.29)	(3.68)	(0.50)	(9.26)	(2.53)	90.88	90.08	1.31%	2.21%	BUY
		XLY	SPDR-CONS DISCR	123.55	(0.49)	0.59	0.25	3.70	3.47	118.36	112.37	4.39%	9.95%	BUY
	SIZE	SLY	SPDR-SP SC 600	68.39	0.75	(1.94)	(5.37)	(8.65)	(14.78)	66.83	66.20	2.34%	3.30%	BUY
		MDY	SPDR-SP MC 400	361.37	0.81	(1.15)	(2.52)	(4.53)	(6.65)	349.66	340.52	3.35%	6.12%	BUY
CORE	Equal Weight Market	RSP	INVS-SP5 EQ ETF	110.02	(0.21)	(1.00)	(0.82)	(2.62)	(2.21)	106.53	102.87	3.28%	6.95%	BUY
	Dividend	SDY	SPDR-SP DIV ETF	102.73	(0.03)	(1.23)	(1.77)	(4.59)	0.51	100.32	97.68	2.41%	5.17%	BUY
	Real Estate	XLRE	SPDR-RE SELS	37.05	(0.95)	(2.30)	(0.70)	(4.45)	6.97	36.96	35.19	0.25%	5.28%	BUY
	International	EEM	ISHARS-EMG MKT	42.70	(2.00)	(3.55)	(6.06)	(10.35)	(11.66)	42.07	41.99	1.50%	1.68%	BUY
		EFA	ISHARS-EAFE	65.50	(1.64)	(3.41)	(4.85)	(6.02)	(12.00)	65.32	63.85	0.28%	2.58%	BUY
		IXUS	ISHARS-CR INT S	58.58	(1.75)	(3.16)	(4.69)	(6.85)	(12.01)	58.11	57.05	0.80%	2.68%	BUY
FI	Intermediate Duration	TLT	ISHARS-20+YTB	131.47	(1.80)	(4.07)	3.69	(4.17)	2.85	129.58	124.58	1.46%	5.53%	BUY
	International	BNDX	VANGD-TTL INT B	57.83	(1.37)	(2.14)	1.11	(6.27)	(1.50)	56.77	55.67	1.87%	3.88%	BUY
	High Yield	HYG	ISHARS-IBX HYCB	87.17	(0.96)	(3.07)	(1.93)	(8.82)	(5.74)	86.43	85.31	0.86%	2.18%	BUY
	Cash	BSV	VANGD-SHT TRM B	80.36										



RIA Pro

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, Materials

Over the last couple of weeks, we have seen a rotation from defense back to offense although not impressively as breadth remains weak. Nonetheless, we are continuing to maintain our exposure to Health Care for now. On Friday, Trump said there may be no trade deal with China until after the 2020 election. This is a ploy to try and get "trade" off of the headlines but leave optimism for the market a deal will eventually get done. The question is how long with the market continue to "buy it." Materials have improved recently, but are still lagging overall. We are maintaining our 1/2 weight position for now.

Current Positions: Overweight XLV, 1/2 XLB

Outperforming - Staples, Real Estate, Financials, Utilities

As noted above, the momentum has shifted from defense to offense currently. However, the defensive sectors continue to hold up and the recent correction will provide an opportunity to add to current holdings. Last week we took profits in Healthcare, Utilities, and Financials.

Current Positions: Overweight XLP, XLU, Target weight XLF, XLRE

Weakening - Technology, Discretionary, Communications

The previous "leaders" have been lagging in terms of relative performance but that has changed over the last two weeks. Discretionary, Communications, and Technology have broken out to new

highs but are extremely overbought currently. We will look to increase our exposure on short-term weakness.

Current Position: *1/2 weight XLY, Reduced from overweight XLK, Target weight.*

Lagging - Energy, Industrials

Energy began to improve this last week but failed at resistance and oil prices dropped. We are maintaining our half-weight in the sector but are close to being stopped out. Industrials have been testing previous highs and we will see if they can break above the multiple tops they are current challenging. There is no rush to increase exposure currently, but we are watching for a decisive breakout. For now, we are maintaining our "*underweight*" holdings in these two sectors until more evidence of improvement is available.

Current Position: *1/2 weight XLE & XLI*

OVERALL RECOMMENDATION

The entire market is back to an extreme "overbought." Take some action to rebalance portfolio risk if you have not done so previously.

That remains good advice heading into next week.

Market By Market



Small-Cap and Mid Cap - Small-caps got a pop with a short-covering rally this past week, but failed at resistance and turned lower. Small and Mid still continue to underperform the broader market which suggests leadership is becoming more narrow. With small and mid-caps back to extremely overbought conditions, this is likely a great opportunity to rebalance portfolio risk and reducing weighting to an underperforming asset class for now until things improve.

Current Position: 2013266080; No position

Emerging, International & Total International Markets

We are still watching these positions for a potential add to portfolios, but the extreme overbought condition keeps us sidelined for the movement. A pullback that reduces the overbought condition but does not violate support will provide the right entry point. Patience will be rewarded either by avoiding portfolio drag or gaining a more advantageous entry point.

Current Position: No Position

Dividends, Market, and Equal Weight - 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.

The rally over the last several weeks has fully reversed the previous oversold condition. Make sure and rebalance weightings in portfolios if you have not done so already. **#Hedge**

Current Position: RSP, VYM, IVV

Gold ? Gold spiked higher as the ECB confirmed more stimulus, and the Fed is expected to cut rates next week. This continues to be bullish set up for "gold bulls." We are holding out positions for now and continue to look for a better entry point on a pullback to add to holdings.

Current Position: GDX (Gold Miners), IAU (Gold)

Bonds?

Bonds took a hit last week as money rotated out of bonds and back into equities but found support at the 50-dma. You can add to your bond holdings if you need to as a Fed rate cut is going to be supporting for higher bond prices.

Stay long current positions for now, and look for an opportunity to add to holdings.

Current Positions: DBLTX, SHY, TFLO, GSY, IEF

High Yield Bonds, representative of the "risk-on" chase for the markets have been consolidating despite the rally in equities. This is not the time to add to holdings just yet, but a good time to like take profits and reduce risk short-term. **Given the deteriorating economic conditions, this would be a good opportunity to reduce "junk-rated" risk and improve credit quality in portfolios.**

OVERALL RECOMMENDATION


The entire market complex is back to an extreme "overbought." Take some action to rebalance portfolio risk if you have not done so previously.

That remains good advice heading into next week.

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	Notes
XLV	Discretionary	OB	Positive	Positive	Hold			X			Extreme Overbought
XLK	Technology	OB	Positive	Positive	Hold			X			Extreme Overbought
XLI	Industrials	OB	Positive	Neutral	Hold			X			Extreme Overbought
XLB	Materials	OB	Positive	Neutral	Hold			X			Extreme Overbought
XLE	Energy	Neutral	Negative	Negative	Warning			X			Failed At Resistance
XLP	Staples	OB	Positive	Positive	Hold			X			Extreme Overbought
XLV	Health Care	Neutral	Negative	Neutral	Hold			X			Reversing Overbought
XLU	Utilities	Neutral	Positive	Positive	Hold			X			Reversing Overbought
XLF	Financials	OB	Positive	Neutral	Hold			X			Testing Highs
XLC	Telecom	OB	Positive	Neutral	No Position					X	Extreme Overbought
XLRE	Real Estate	Neutral	Positive	Positive	Hold			X			Reversing Overbought
SLV	Small Caps	OB	Negative	Negative	No Position					X	Underperforming/Downtrend
MDY	Mid Caps	OB	Positive	Neutral	No Position					X	Testing Resistance
EEM	Emerging Mkt	OB	Positive	Negative	No Position					X	Testing Resistance
EFA	International	OB	Positive	Negative	No Position					X	Testing Resistance
IXUS	Total International	OB	Positive	Negative	No Position					X	Testing Resistance
GLD	Gold	OB	Positive	Neutral	Hold			X			Extreme Overbought
RSP	SP500 Equal Wgt	OB	Positive	Positive	Hold			X			Extreme Overbought
SDY	SP500 Dividend	OB	Positive	Positive	Hold			X			Extreme Overbought
IVV	SP500 Market Wgt	OB	Positive	Positive	Hold			X			Extreme Overbought
TLT	20+ Yr. Bond	Reversing	Positive	Positive	Hold			X			Correcting Overbought
HYG	Corporate High Yield	OB	Positive	Positive	No Position					X	Extreme Overbought
BNDX	Int'l Bond Aggregate	OB	Positive	Positive	No Position					X	Extreme Overbought
LEGEND: X = THIS WEEK => PREVIOUS DECLINING <= PREVIOUS IMPROVING						X	No Position				

Portfolio/Client Update:

As we have been discussing over the past couple of weeks, we needed to take profits and rebalance risks somewhat in portfolios. Despite the recent rally, there are plenty of warning signs which suggests a near-term correction is coming.

As noted previously, we have changed our focus to *risk control* and *capital preservation strategies* over *capital growth and risk-taking strategies*. While we do recognize the need to participate when markets are rallying, this is a dangerous environment to be heavily long in.

For newer clients, we are moving slowly in moving money into our portfolio models. Our thesis is suggesting a pullback in August/September which will allow us a better entry point to move money into our model portfolios.

We are also looking to make a long-term bet in the portfolio on the massive deviation between value and growth, which generally exists at the peaks of bull market cycles. We are actively searching for a "deep value" fund manager so we can add a fairly concentrated position into our portfolios. The reversion of value provides a significant risk hedge in the short-term and a long-term capital gain opportunity. We will discuss this more in detail in a future update when we locate the

right manager.

In the meantime, we continue to carry tight stop-loss levels, and any new positions will be "trading positions" initially until our thesis is proved out.

- **New clients:** *Our onboarding indicators have reverted to "risk-on" so new accounts will be onboarded selectively into their models where risk can be controlled. Positions that were transferred in are on our global review list and being monitored. We will use this rally to liquidate those positions to raise cash to transition into the specific portfolio models.*
- **Equity Model:** *Last Monday, we trimmed 10% of 11-holdings in the portfolio. This raised our cash levels about 1.3% overall. (We penned an article on these [actions here](#))*
- **ETF Model:** *We trimmed three of our defensive holdings last week to raise our cash levels a bit more than 1% and hedge risk against a downturn next month.*

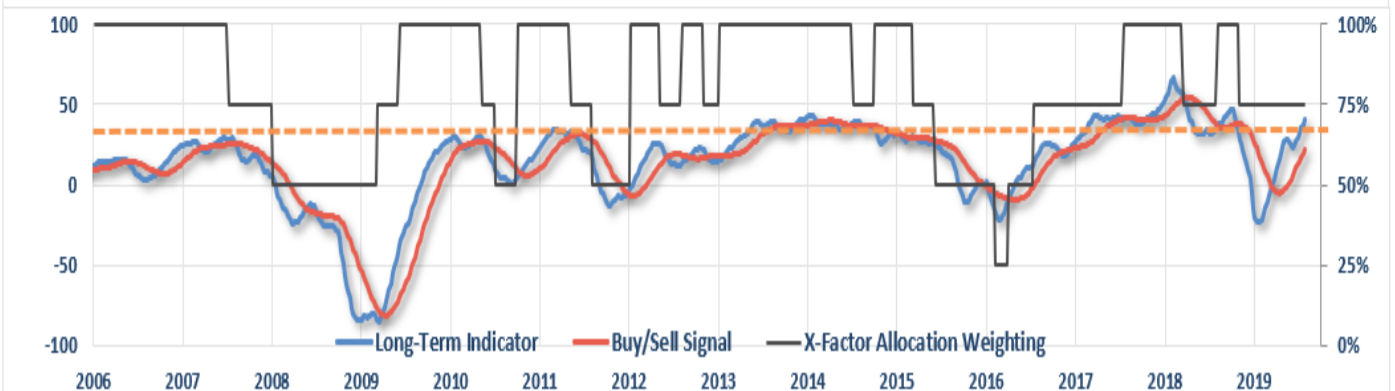
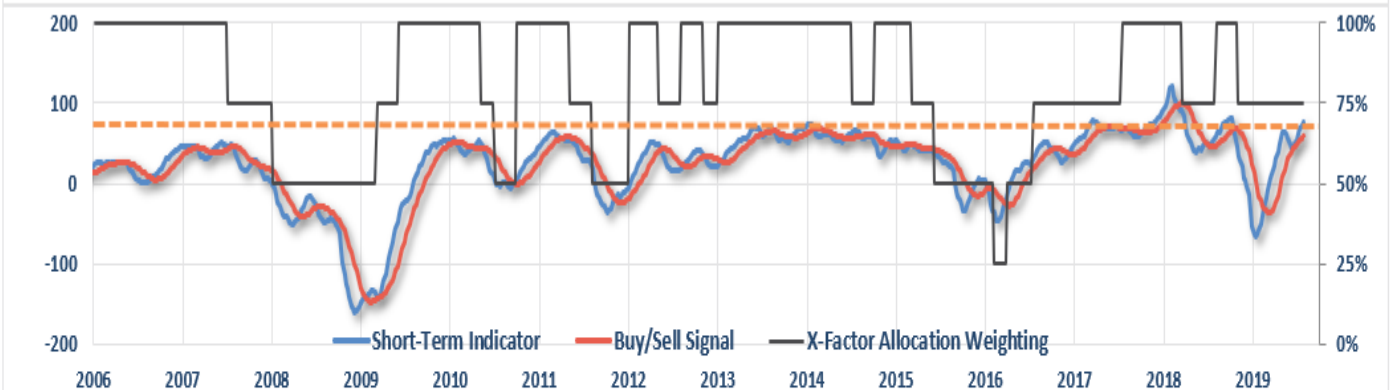
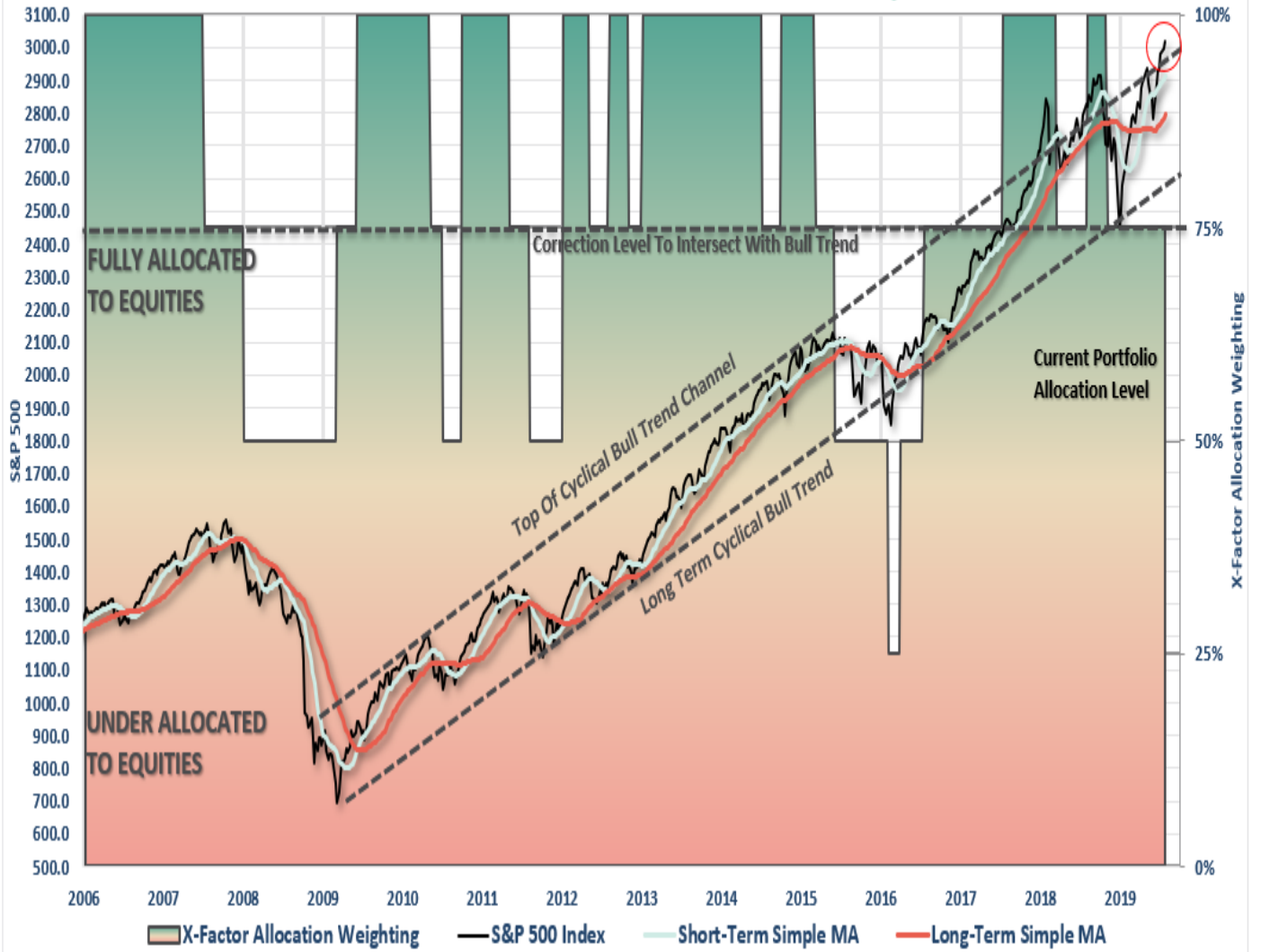
Note for new clients:

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](#)

Market Hits New Highs

As noted last week, the market breakout was straining the deviation from the long-term moving average. That continues to be the case this week.

Our conviction of a short-term correction to rebalance portfolios into continues to be high. We believe that correction will occur over the next two months to reverse the rather extreme overbought condition currently. **A 3 to 5% correction in August or September is likely.**

Currently, the hopes the Fed will cut rates next week, and earnings season, is keeping stocks elevated at the moment providing an excellent opportunity to take some actions to rebalance risk in portfolios. If you have not taken any actions in your plan, do the following on Monday.

- If you are **overweight equities** - Hold current positions but remain aware of the risk. Take some profits and rebalance risk to some degree if you have not already.
- If you are **underweight equities or at target** - rebalance risks, look to increase holdings in domestic equities opportunistically if the markets can hold support at the May highs next week.

With the markets back to extremely overbought conditions, patience will likely be rewarded.

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

401k Plan Manager Beta Is Live

We have rolled out a very early beta launch to our [RIA PRO subscribers](#)

Be part of our "**Break It Early Testing Associate**" group by using **CODE: 401**

The code will give you access to the entire site during the 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 have several things currently in development we will be adding to the manager, but we need to start finding the "bugs" in the plan so far.

We are currently covering more than 10,000 mutual funds and have now added all of our Equity and ETF coverage as well. You will be able to compare your portfolio to our live model, see changes live, receive live alerts to model changes, and much more.

We are building models specific to company plans. So, if you would like to see your company plan included specifically, [send me the following](#):

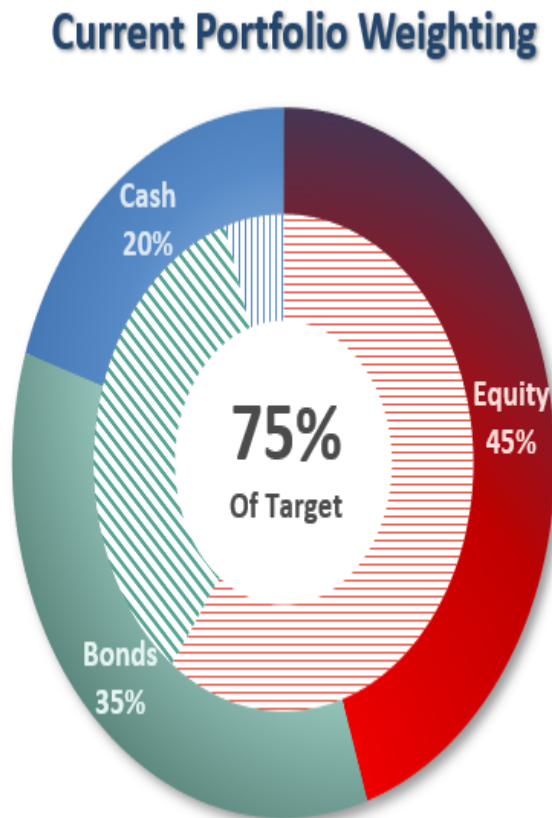
- *Name of the company*
- *Plan Sponsor*
- *A print out of your plan choices. (Fund Symbol and Fund Name)*

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. **(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 401k Allocation Model	
20.00%	Cash + All Future Contributions <i>Primary concern is the protection of investment capital</i> <i>Examples: Stable Value, Money Market, Retirement Reserves</i>
35.00%	Fixed Income (Bonds) <i>Bond Funds reflect the direction of interest rates</i> <i>Examples: Short Duration, Total Return and Real Return Funds</i>
45.00%	Equity (Stocks) <i>The vast majority of funds track an index.</i> <i>Therefore, select on ONE fund from each category.</i> <i>Keep it Simple.</i> 10% <i>Equity Income, Balanced or Conservative Allocation</i> 35% <i>Large Cap Growth (S&P 500 Index)</i> 0% <i>International Large Cap Dividend</i> 0% <i>Mid Cap Growth</i>

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.�

