Portfolio Model Review: 10-07-19

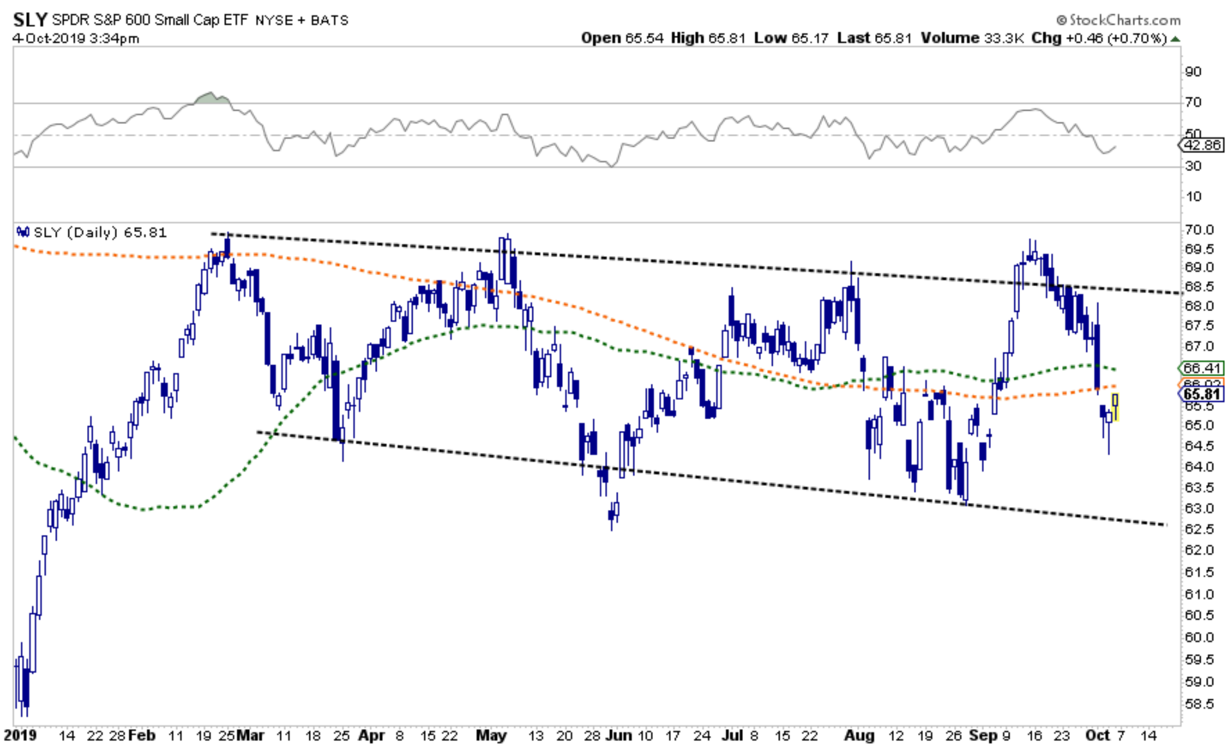
On Friday, I went through the sector analysis of the market and our portfolio positioning. If you missed it, I am providing that analysis today. The regular market and sector reports will return starting tomorrow.

Feel free to email with any questions or comments.

Let's start with the UGLY

The ugliest of sectors remains Energy (XLE). The trend remains sorely negative and even the recent spike due to the Saudi oil refinery explosions failed at the downtrend resistance line. With the economy slowing, particularly in the manufacturing sector, the pressure on oil prices, and the energy sector, remains to the downside for now.

Current Positioning In Portfolios: No Sector Holdings, 1/4th weight XOM

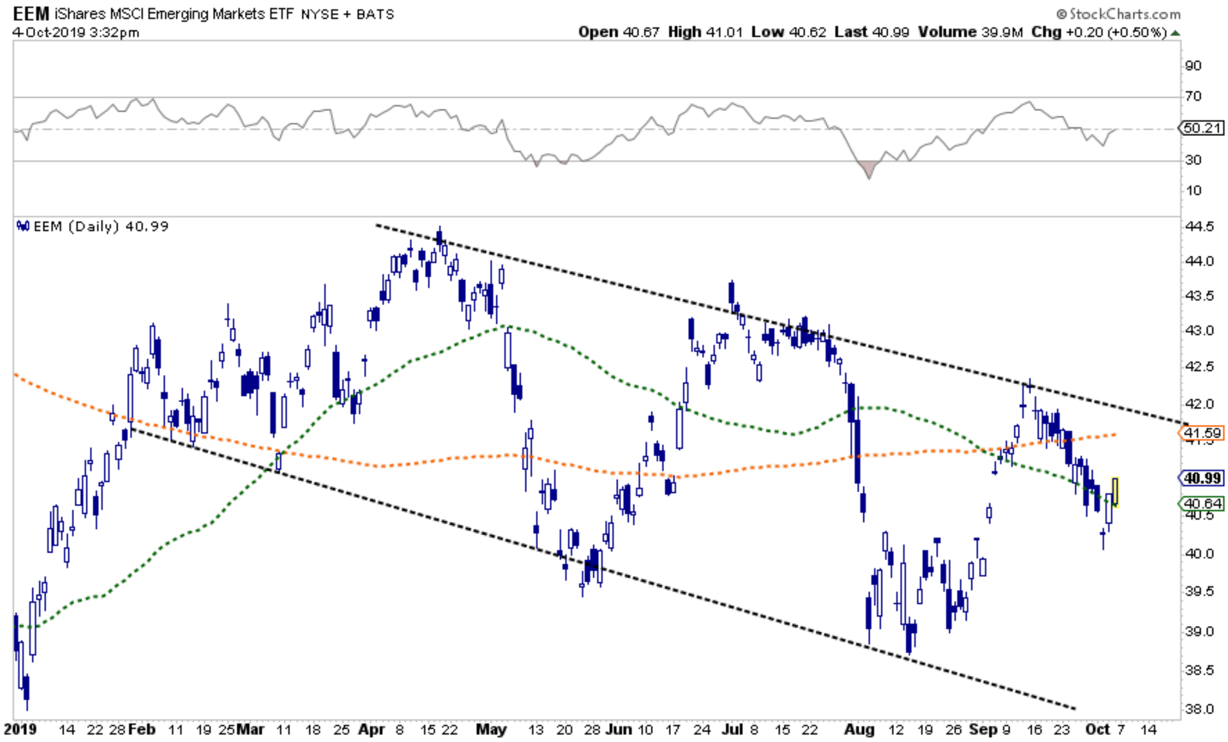


Small stocks remain in a declining trend overall, however, volatility in this market has provided some decent trading opportunities for nimble investors. Small Cap stocks are the most sensitive to changes in the economic environment and don't benefit from share repurchase activity to the degree major large cap companies do. With the small-caps trading below both their 50- and 200-dma, there is more risk to the downside currently.

There is no reason to be invested in small-caps currently as they have increased portfolio volatility and provided additional drag on performance. **Buy and hold asset allocation models are not a**

suitable fit for late-stage bull market cycles.

Current Positioning In Portfolios: No Holdings



Emerging markets, like small-caps, are very subject to changes in global-trade, and in this case, *"trade wars" and "tariffs."*

Also, like small-caps, emerging markets have been in a long-term downtrend and have added additional drag, and increased volatility, to traditional asset-allocation models. With the 50-dma crossed below the 200-dma, the risk to emerging markets remains to the downside currently.

Current Positioning In Portfolios: No Holdings

Transportation is literally the "heartbeat" of the American economy. If you eat it, consume it, wear it, watch it, or listen to it, it was transported to you by truck, train, plane or ship at some point on its way to you. The importance of this statement is that transportation tells you a lot about the economy, and currently it is suggesting things aren't all that great.

With transportation trading below the 50- and 200-dma, the risk is to the downside. Importantly, the 50-dma is close to crossing below the 200-dma as well. A break of lows is an important signal for the sector and the economy, so pay attention.

Current Positioning In Portfolios: No Sector Holdings, 1/2 weight NSC

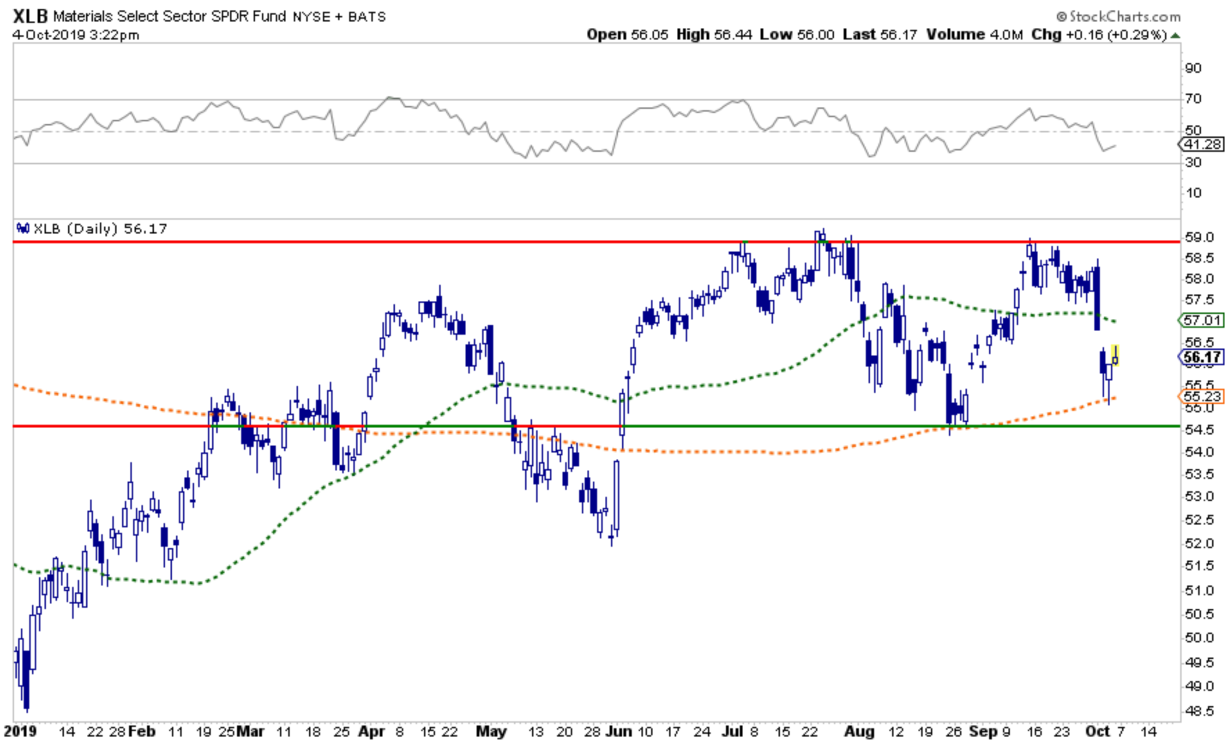
Not Really BAD, More OKAY-ish

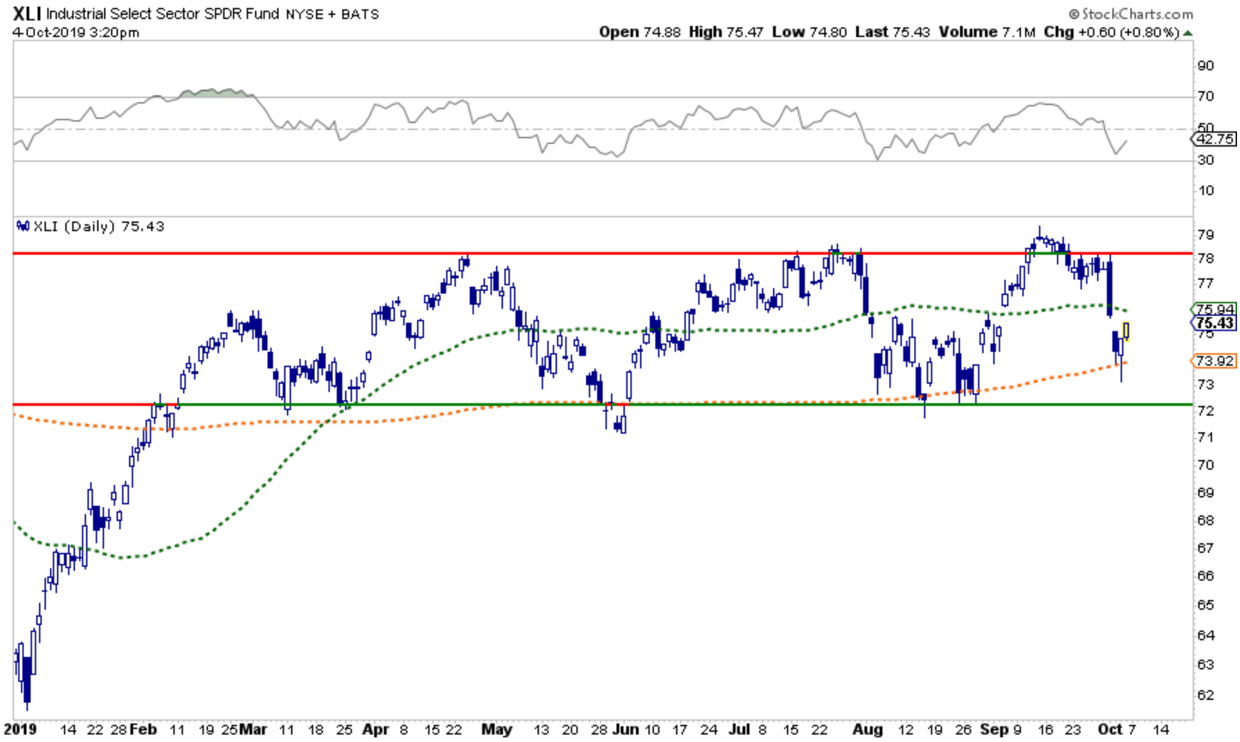
Financial's have been trading sideways since May and have continued to consolidate. While the chart pattern doesn't look so bad, the risk to the sector is rising as credit risk in the sector is high. There is a tremendous amount of debt sitting on the borderline between investment grade (BBB) and junk. There is also a good amount of junk debt related to the energy sector as well, and declining oil prices is accelerating that risk. If you are long the sector, that has been "okay" for now, but watch lower support. A break of that level will signal a substantial risk increase to the overall market given the weighting of the sector to the overall market.

Current Positioning In Portfolios: No Sector Holdings. underweight V

Like financials, the healthcare sector hasn't really provided much lift to portfolios this year, but has added a good amount of volatility. Support continues to hold, but the sector continues to trade below the 50-dma. Healthcare tends to be a "risk off" sector, so we are maintaining some weighting as a defensive position, but are maintaining a tight stop at recent lows.

Current Positioning In Portfolios: Target Weight XLV, JNJ, HCA, UNH, ABT, CVS





Basic Materials and Industrials have been in a long sideways consolidation waiting for a resolution to the ongoing *"trade war*" which has plagued the sectors for the last 18 months. The good news is that both sectors continue to defend support at the 200-dma, However, there is now significant overhead resistance at recent highs which also trace back to early 2018.

As we noted in [last weekend's newsletter](), we expect a trade deal to be announced, or at least the beginning process of a deal, next week. This should theoretically lift the sectors out of their slump. The risk, of course, is a disappointment which sends the sectors lower quickly, particularly if tariffs are increased further.

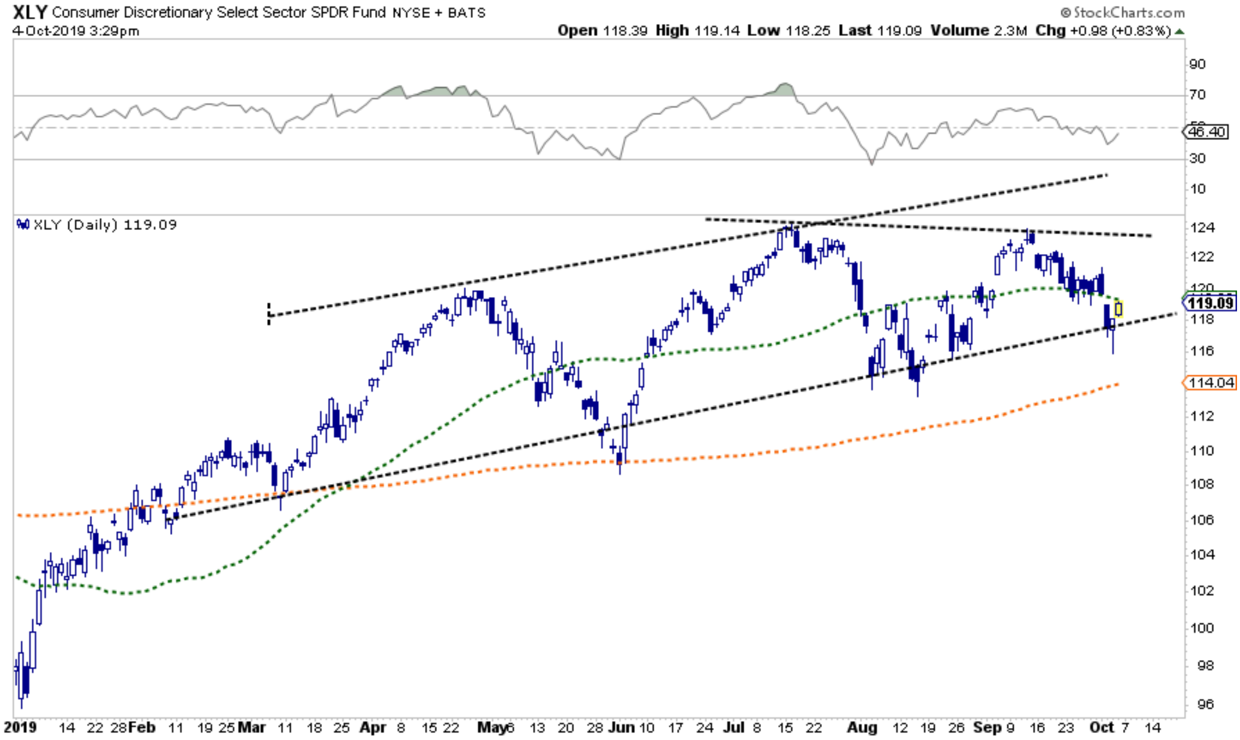
Current Positioning In Portfolios: 1/2 Weight XLB & XLI, Underweight VMC, DOV, UTX, BA

Mid-Cap stocks look a whole like Industrial and Basic Materials. Like Small-caps, mid-capitalization stocks do not benefit as much from share buybacks, and are more economic sensitive. If a "trade deal" is completed, I would expect to the see the sector move higher, however, a failure, or more tariffs, will likely see a break of important support.

Mid-cap stocks have provided no appreciable benefit to traditional asset-allocation models and have increased overall volatility. While mid-caps are holding support at the 200-dma, they are underperforming their large-cap brethren and remain below the 50-dma which has now turned lower. Some caution is advised.

Current Positioning In Portfolios: No Holdings

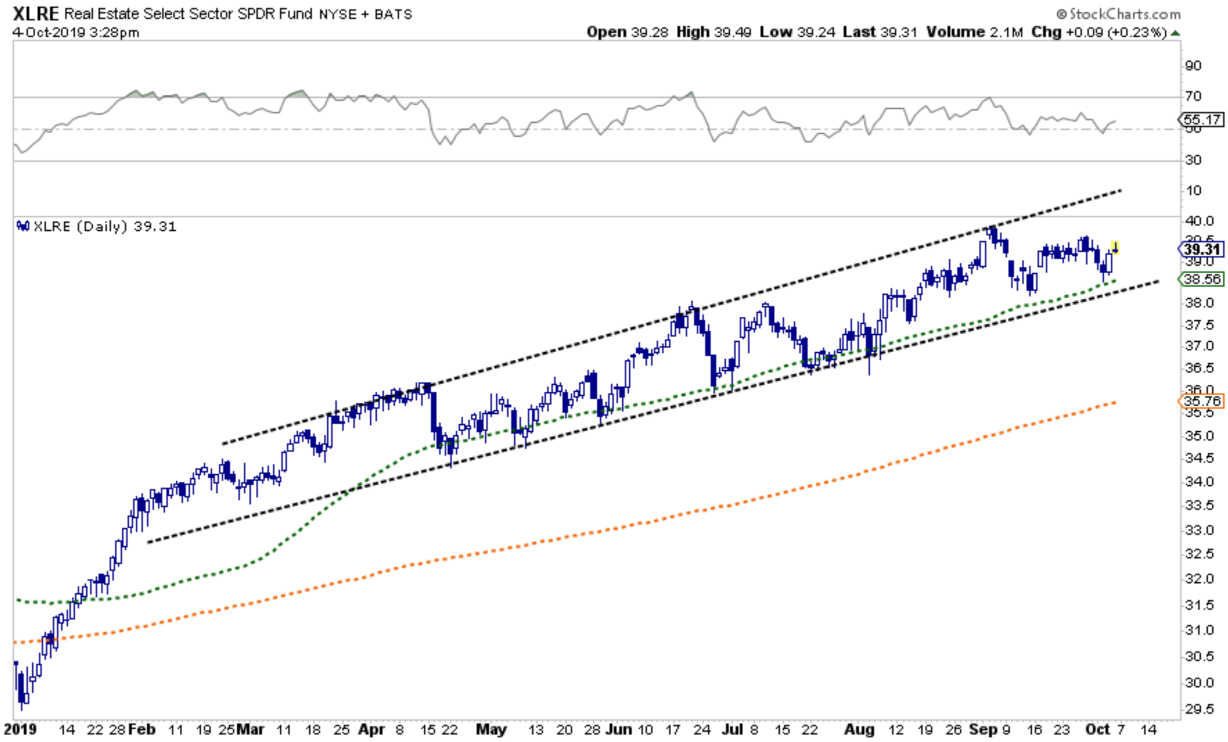
The Good



Market participants have continued to chase momentum in the market. This chase continues to confine money flows into a few sectors which show relative strength and have high liquidity. Discretionary continues to be one of those sectors which remains in a very defined uptrend. The recent double top is a concern and we are watching that closely, particularly since we are seeing early warning signs coming out in falling retail sector employment and weaker core durable goods.

It is important the sector holds its current uptrend line and climbs above the 50-dma next week. The consolidation between the lower uptrend line and the declining tops is critically important. A failure to break out of the upside of this consolidation will likely coincide with a weaker overall market.

Current Positioning In Portfolios: XLY, AAPL, MDLZ, YUM, COST



Real estate has continued to be a strong performer and remains in a strong uptrend particularly as interest rates continue to fall. The sector is very overbought, and a traditional *"defensive"* sector has become a *"momentum"* trade and is now very crowded.

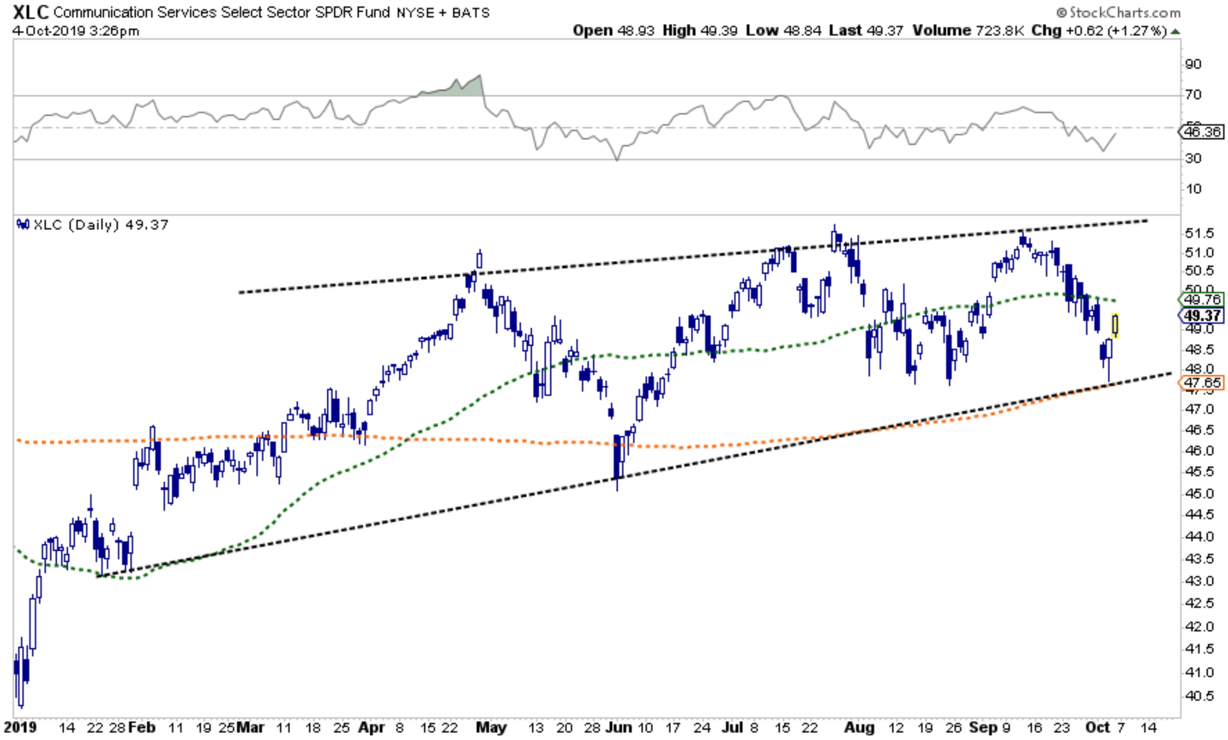
However, for now, the trend is positive and pullbacks to the 50-dma continue to provide *"buyable"* entry points. However, that moving average, and subsequent trendline, are now an important *"sell signal"* if violated. Continue to take profits on rallies to the top of the trend channel.

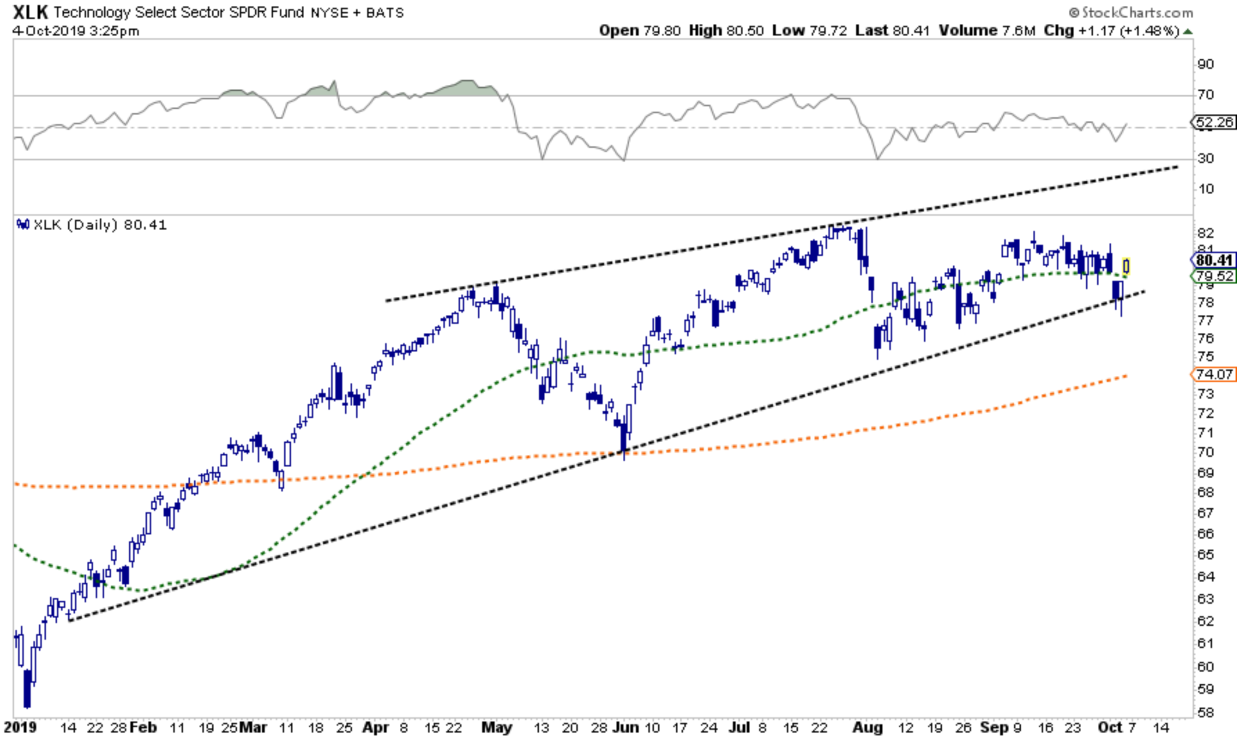
Current Positioning In Portfolios: XLRE, CHCT, WELL

Staples and Utilities, like Real Estate, and Utilities, have continued to be the *"safe haven"* trade amidst the *"sea of volatility"* in other sectors of the market. However, all three of these sectors share the same traits of a very defined uptrend, extreme overbought long-term conditions, are historically extremely over-valued, and have become a very *"crowded"* momentum trade.

As with Real Estate above, a violation of the lower bullish trendline, which coincides with the 50-dma is now a *"hard stop"* for the sector which will suggest that something in the markets have changed, and likely for the worse.

Current Positioning In Portfolios: XLP, XLU, PG, PEP, AEP, DUK





While the Technology and Communications sectors remain in positive uptrends, the performance to the S&P 500 has started to deteriorate. Both sectors are testing the lower bounds of their current uptrend, with communications remaining below the 50-dma. Technology is in a better position above the 50-dma but remains in a downtrend from the July highs.

Given that technology is a major weight of the S&P 500, if the leadership continues to falter here, this is going to have a more important impact to the overall trend of the S&P 500. Stops for both sectors remain at their current uptrend lines.

Current Positioning In Portfolios: XLC, XLK, CMCSA, VZ, MSFT

Overall portfolio positioning remains slightly overweight cash, underweight equities with a bias to defensive positioning, and fixed income, where we have shortened duration a bit and improved credit quality.

Once we see the outcome of the "trade negotiations" next week, we will look to make other portfolio allocation adjustments accordingly.