

RIA PRO: The QE Rally Is On - How To Play It & What Happens Next



- *The "QE, Not QE" Rally Is ON*
- *How To Play It*
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The "QE, Not QE" Rally Is On

Just recently, we released a study for our [RIAPro Subscribers \(30-Day Free Trial\)](#) on historical QE programs and what sectors, markets, and commodities perform best. *(If you subscribe for a 30-day Free Trail you can read the entire report "An Investor's Guide To QE-4.")*

"On October 9, 2019, the Federal Reserve announced a resumption of quantitative easing (QE). **Fed Chairman Jerome Powell went to great lengths to make sure he characterized the new operation as something different than QE.** Like QE 1, 2, and 3, this new action involves a series of large asset purchases of Treasury securities conducted by the Fed. The action is designed to pump liquidity and reserves into the banking system. **Regardless of the nomenclature, what matters to investors is whether this new action will have an effect on asset prices similar to prior rounds of QE.** For the remainder of this article, we refer to the latest action as QE 4. To quantify what a similar effect may mean, we start by examining the performance of various equity indexes, equity sectors, commodities, and yields during the three prior QE operations. **After normalizing the data for the duration and amount of QE,**

Equity Index Returns								
	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
QE3	18.3%	23.6%	19.6%	19.7%	30.1%	35.6%	31.5%	25.5%
QE3 Max	18.3%	23.6%	19.6%	19.7%	30.4%	35.6%	31.5%	25.5%
QE3 Min	-7.3%	-6.9%	-11.4%	-7.9%	-5.3%	-8.5%	-9.3%	-8.1%
QE2	7.3%	6.0%	2.6%	5.0%	10.5%	9.9%	8.7%	7.1%
QE2 Max	14.5%	13.7%	12.4%	12.6%	20.3%	19.5%	20.3%	16.2%
QE2 Min	-0.9%	-0.8%	-0.1%	-1.2%	0.0%	0.0%	0.0%	-0.4%
QE1	25.6%	33.2%	65.8%	26.0%	58.0%	45.9%	47.3%	43.1%
QE1 Max	25.6%	33.2%	65.8%	26.0%	58.0%	45.9%	47.3%	43.1%
QE1 Min	-23.3%	-22.0%	-9.6%	-23.4%	-18.1%	-25.0%	-23.9%	-20.7%
QE Avg.	17.1%	20.9%	29.3%	16.9%	32.9%	30.5%	29.1%	25.2%
QE Avg. Max	19.5%	23.5%	32.6%	19.4%	36.2%	33.7%	33.0%	28.3%
QE Avg. Min	-10.5%	-9.9%	-7.1%	-10.9%	-7.8%	-11.2%	-11.0%	-9.8%
Average vs. S&P 500	-3.9%	0.0%	8.4%	-4.0%	11.9%	9.5%	8.2%	4.3%

Equity Factors	
Growth	Value
21.4%	26.3%
21.4%	26.3%
-7.6%	-6.0%
5.4%	6.7%
12.5%	15.0%
-0.1%	-1.6%
38.9%	26.9%
38.9%	26.9%
-14.4%	-29.8%
21.9%	20.0%
24.3%	22.7%
-7.3%	-12.5%
1.0%	-1.0%

Equity Indexes - Annualized and Normalized Returns per \$100bn of 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
QE3	1.34%	1.72%	1.43%	1.44%	2.18%	2.56%	2.28%	1.85%
QE2	1.83%	1.51%	0.64%	1.24%	2.67%	2.52%	2.20%	1.80%
QE1	1.42%	1.82%	3.45%	1.44%	3.07%	2.47%	2.54%	2.33%
QE Avg.	1.53%	1.68%	1.84%	1.38%	2.64%	2.52%	2.34%	1.99%

Equity Factors	
Growth	Value
1.56%	1.91%
1.35%	1.69%
2.12%	1.49%
1.68%	1.70%

As you

will notice, all major markets increased in value during QE-1, 2, and 3. Since the market increased each time the Fed engaged in monetary programs, it should **not be surprising investors now have a "Pavlovian" response to the Fed "ringing the bell."** Over the last month, we have been discussing the end of the year rally which would be supported by both the Fed, and a "trade deal." This past week, as expected, headlines were floated which suggested that tariffs would be reduced in exchange for essentially nothing, This is precisely the case we [laid out in September](#):

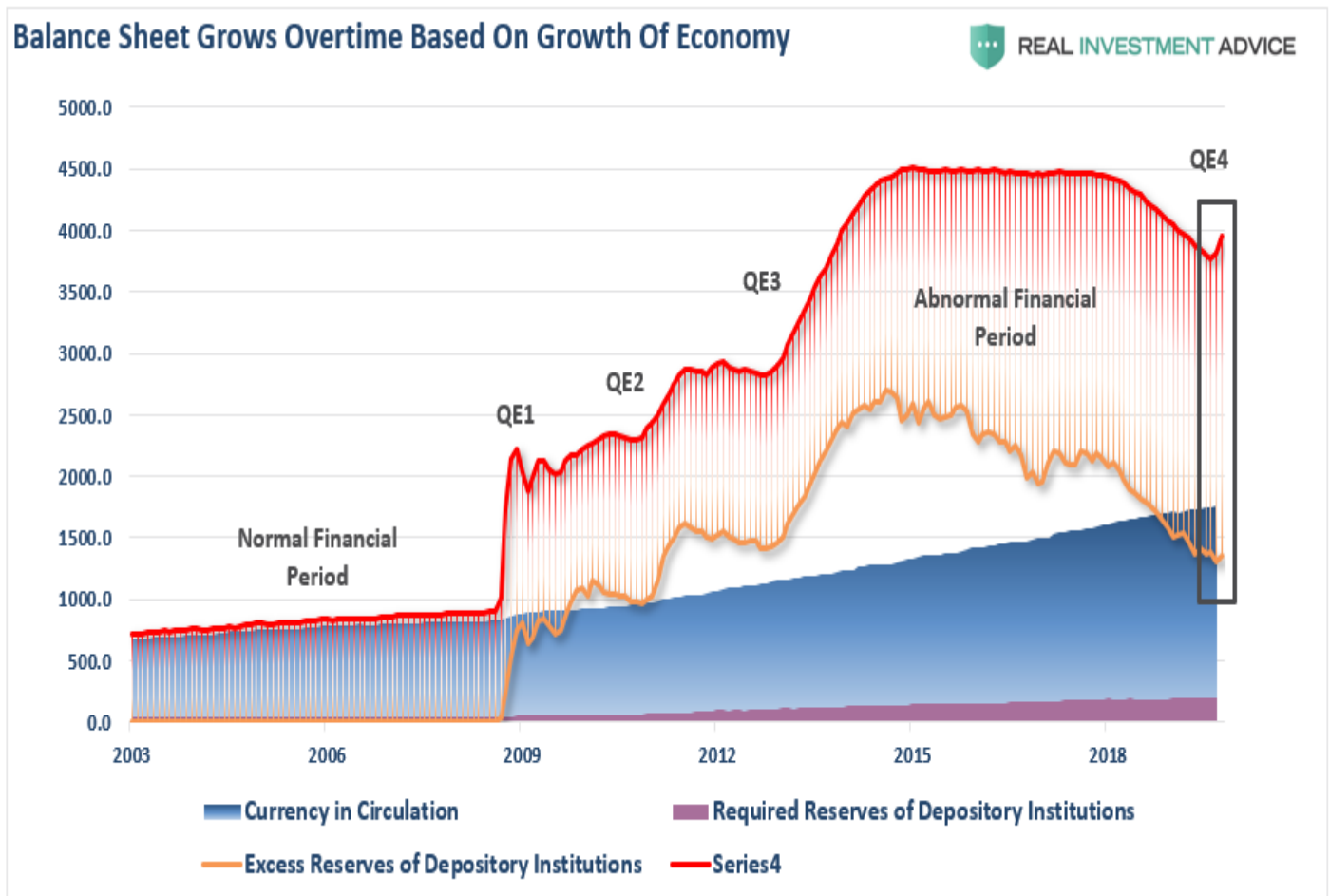
"Trump can set aside the last 20%, drop tariffs, and keep market access open, in exchange for China signing off on the 80% of the deal they already agreed to. For Trump, he can spin a limited deal as a ?win? saying ?China is caving to his tariffs? and that he ?will continue working to get the rest of the deal done.? **He will then quietly move on to another fight, which is the upcoming election, and never mention China again.** His base will quickly forget the ?trade war? ever existed. **Kind of like that ?Denuclearization deal? with North Korea.?**

We followed that in early October by laying out the case for the "trade deal" to push the [markets to 3300](#):

"Assuming we are correct, and Trump does indeed cave into China in mid-October to get a small deal done, what does this mean for the market? The most obvious impact, assuming all tariffs are removed, would be a psychological pop to the markets which, given that markets are already hovering near all-time highs, would suggest a rally into the end of the year."


Then, just [two week's ago, as the Fed went into action](#):

*"Clearly, the Fed is concerned about something other than the impact of 'Trump's Trade War' on the economy. 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 to more liquidity.**"*



That is where we are today. **The questions now are:**

1. How do you play it; and,
2. What happens next?

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for the next bear market?

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How To Play It

As we have been noting over the last month, with the Fed's more accommodative positioning, we continue to maintain a long-equity bias in our portfolios currently. **We have reduced our hedges, along with some of our more defensive positioning. We are also adding opportunistically,** to our equity allocations, even as we carry a slightly higher than normal level of cash along with our fixed income positioning. Currently, it will likely pay to remain patient as we head into the end of the year. With a big chunk of earnings season now behind us, and economic data looking weak heading into Q4, the market has gotten a bit ahead of itself over the last two weeks. On a short-term basis, the market is now more than 6% above its 200-dma. **These more extreme price extensions tend to denote short-term tops to the market, and waiting for a pull-back to add exposures has been prudent.**



Also, the majority of our indicators are back to more extreme overbought readings, which have typically denoted short-term tops at a minimum. As I noted last week:

"Given the markets tend to pullback just before Thanksgiving, and during the second week of December, we will have a better opportunity increase allocations if we are patient."

Once we see that pullback, or even a slight consolidation of the recent advance, we can increase

allocations in portfolios towards more equity related exposure. ***This begs the question of "what to buy,"*** which brings us back to our recent [RIAPRO.NET article](#):

"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. The expected top five performers during QE4 on a normalized basis from highest to lowest are: Silver, S&P 400, Discretionary stocks, S&P 600, and Crude Oil."


Equity Indexes - Forecasted Annualized Returns Based on PRIOR QE								Equity Factors		
	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	Growth	Value
Forecasted QE 4	5.35%	5.89%	6.44%	4.81%	9.25%	8.82%	8.18%	6.98%	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%

QE4					QE4					QE4				
Equity Index	Expected Return	vs. S&P 500	Index Rank	Total Rank	Equity Sector	Expected Return	vs. S&P 500	Sector Rank	Total Rank	Treasury & Commodities	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					

I would highly suggest reading the whole article.



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What Happens Next?

Michael Lebowitz, CFA recently penned:

*"A Honus Wagner baseball card from 1909 was recently auctioned for over \$3 million. While that may seem like a lot of money, it is not necessarily expensive. A baseball card is nothing more than paper and ink with no real value. Its street value, or price, is based on the whims of collectors. **"Whim" is impossible to value. Stocks are not baseball cards.** Stocks represent ownership in a corporation, and therefore, their share prices are based on a future series of expected earnings and cash flows. Further, there are*

many other types of investments that serve not only as alternatives, but provide a means to assess relative value. **Today, investors are trading stocks on a "whim," with scant attention to their value.** Unlike a baseball card, when a stock's street value rises much more than its real value, an inevitable correction will occur. The only question is not if but when will investors realize what they are truly buying."

There is an important distinction to be made here between "investing" vs. "speculating." Benjamin Graham, in his seminal work *Security Analysis* (1934) defined investing as:

*"An operation in which, upon thorough analysis, **promises safety of principal and a satisfactory return.** Operations not meeting these requirements are speculative."*

The problem is that today, the term *investor* is now being applied ubiquitously to anyone who participates in the stock market. As Graham noted later in *"The Intelligent Investor:"*

*"The newspaper employed the word *investor* in these instances because, in the easy language of Wall Street, everyone who buys or sells a security has become an investor, regardless of what he buys, or for what purpose, or at what price, or whether for cash or on margin."*

To understand "what happens next," one must understand the difference between "investment" and "speculation." While QE-4 may be driving stocks higher today based on a "whim," there are two very important difference between QE-4 and QE-1 or 2; **1) stocks are no longer undervalued or 2) under-owned.**

S&P 500 Valuations		
Factors	Most Recent Value	Historical Percentile
Margin-Adjusted P/E (MAPE)	46.0	99%
Median EV to Sales (Ex-Financials)	3.1	99%
US Total Market Cap to GDP	144%	99%
EV to Free Cash Flow Margin-Adjusted (Ex-Financials)	41.1	98%
Median Price to Sales	2.6	97%
Cyclically Adjusted P/E (CAPE)	33.2	96%
Median Price to Book	3.4	96%
Median EV to EBITDA (Ex-Financials)	12.6	94%

Source: Bloomberg, Yale/Robert Shiller, John Hussman *Numbers as of July of 2019 ©2019 Crescat Capital LLC

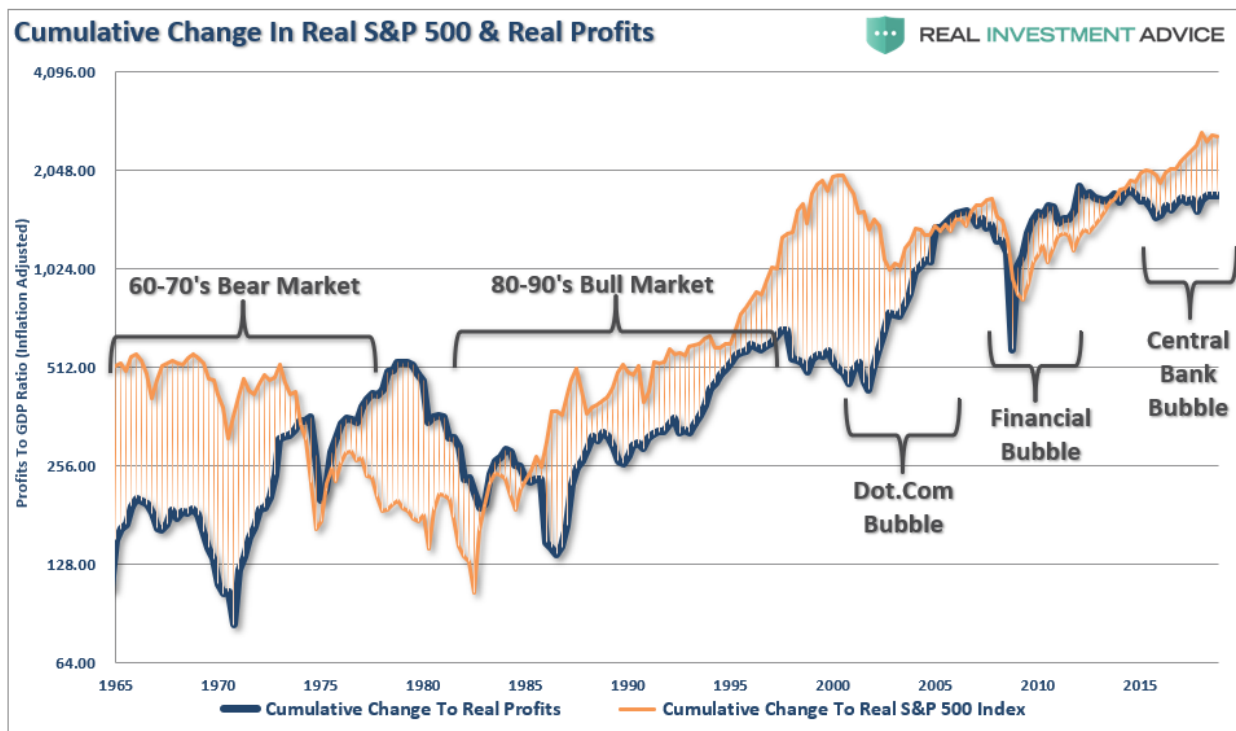
"With cash levels at the lowest level since 1997, and equity allocations near the highest levels since 1999 and 2007, it suggests investors are now functionally 'all in.'"



With investors paying exceptionally high prices for equity ownership, expected forward returns becomes much more problematic. [As we addressed on Thursday:](#)

"The detachment of the stock market from underlying profitability guarantees poor future outcomes for investors. But, as has always been the case, the markets can certainly seem to 'remain irrational longer than logic would predict,' but it never lasts indefinitely. 'Profit margins are probably the most mean-reverting series in finance, and if profit margins do not mean-revert, then something has gone badly wrong with capitalism. If high profits do not attract competition, there is something wrong with the system, and it is not functioning properly.'? ? Jeremy Grantham

Another way to look at the issue of profits as it relates to the market is shown below. When we measure the cumulative change in the S&P 500 index as compared to the level of profits, we find again that when investors pay more than \$1 for a \$1 worth of profits there is an eventual mean reversion.



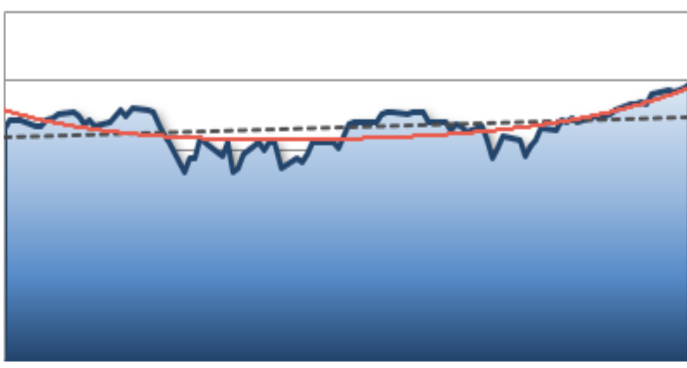
With investors paying more today than at any point in history for each \$1 of profit, the next mean reversion will be a humbling event.

That is just math. However, in the meantime, individuals are "*speculating*" within the markets based solely on the premise that a "*greater fool*" will be there when the time comes to sell. Unfortunately, that is rarely the case. There are virtually no measures of valuation which suggest making investments today, and holding them for the next 20-30 years, will work to any great degree. **This is the difference between "*investing*" and "*speculation*."** When you think about QE-4, as it relates to your portfolio, you have to consider the premise of valuations, margin of safety, and risk. Yes, the markets are indeed bullish by all measures, and holding risk will likely pay off in the short-term. (*speculation*)�However, over the long-term, the ?*house will always win*.? (*investing*)

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

Market & Sector Analysis

S&P 500 Tear Sheet� ��

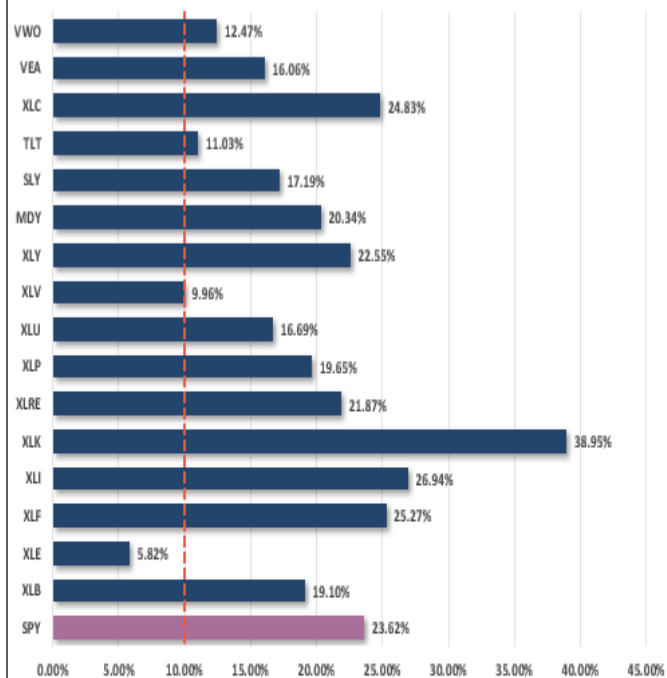
3 Month SPY Price									SPY RISK INFO		ZACKS		REAL INVESTMENT ADVICE	
									Item	T 2-Yr	T 1-Yr.	YTD	% Diff YTD/T1-YR	
									Price Return	19.23%	10.14%	23.62%	132.92%	
									Max Drawdown	-20.47%	-16.88%	-7.41%	-56.08%	
									Sharpe	0.71	0.71	2.12	1.99	
									Sortino	0.84	0.90	2.60	1.89	
									Volatility	14.95	15.56	13.29	(0.15)	
									Daily VaR-5%	(12.01)	(12.17)	8.50	(1.70)	
									Mnthly VaR-5%	(12.02)	(12.01)	6.06	(1.50)	
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	1.83%	1.91%	1.80%	(6.07%)	2.18%	1.68%	(17.51%)	7.22%	Shares	2,404.9	2,561.2	6.50%		
P/E Ratio	20.97	18.30	19.22	4.79%	20.84	15.81	(7.8%)	21.54%	Sales	62,346	65,471	5.01%		
P/S Ratio	3.34	3.18	3.66	13.14%	3.58	2.61	2.17%	40.15%	SPS	25.9	25.6	(1.40%)		
P/B Ratio	3.69	3.85	4.39	12.13%	4.21	3.01	4.29%	45.62%	Earnings	9,253	9,693	4.76%		
ROE	15.94%	18.26%	19.25%	5.11%	19.25%	15.00%	0.00%	28.32%	EPS TTM	4.7	4.9	4.91%		
ROA	2.97%	3.43%	3.50%	2.01%	3.53%	2.81%	(0.87%)	24.47%	Dividend	1.6	1.7	6.18%		
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	(13.69%)	4.43%	1.22	18.05	127.61	12.35	(85.9%)	8.0%	3.9%	5.62%	2.94	17.25		
Materials	(15.79%)	2.70%	1.23	16.71	22.97	13.86	(27.3%)	9.8%	1.8%	6.78%	4.24	15.09		
Industrials	11.86%	9.45%	1.17	18.36	22.23	14.78	(17.4%)	17.7%	1.9%	5.51%	5.22	16.27		
Discretionary	8.15%	9.97%	1.04	24.10	27.17	20.19	(11.3%)	28.9%	1.3%	4.10%	4.88	21.94		
Staples	7.06%	7.26%	0.59	20.92	22.83	17.62	(8.4%)	27.7%	2.7%	4.82%	3.96	20.00		
Health Care	2.53%	13.77%	0.85	16.46	20.60	15.70	(20.1%)	33.0%	1.7%	6.09%	6.84	15.29		
Financials	10.06%	13.20%	1.26	13.91	18.45	11.70	(24.6%)	11.5%	2.1%	7.05%	5.86	12.54		
Technology	23.79%	22.36%	1.27	23.48	22.54	14.41	4.2%	40.0%	1.3%	4.31%	5.43	20.77		
Telecom	10.10%	10.39%	0.88	21.33	26.73	17.47	(20.2%)	17.1%	0.9%	4.80%	6.58	18.18		
Utilities	16.72%	3.37%	0.26	20.38	21.00	15.58	(2.9%)	10.4%	3.2%	4.79%	3.69	19.79		
Real Estate	17.79%	3.03%	0.69	20.84	24.47	17.10	(14.8%)	9.5%	3.2%	4.86%	4.39	20.29		
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	308.94	5.64%	298.66	21	3.44%	290.06	114	6.51%	2.97%	(0.23%)	32.16%	Buy		
Mid Cap	364.22	6.14%	352.72	21	3.26%	349.30	21	4.27%	0.98%	(0.58%)	28.04%	Buy		
Small Cap	70.28	7.69%	67.73	19	3.76%	67.26	19	4.49%	0.71%	(0.71%)	24.83%	Buy		

Performance Analysis

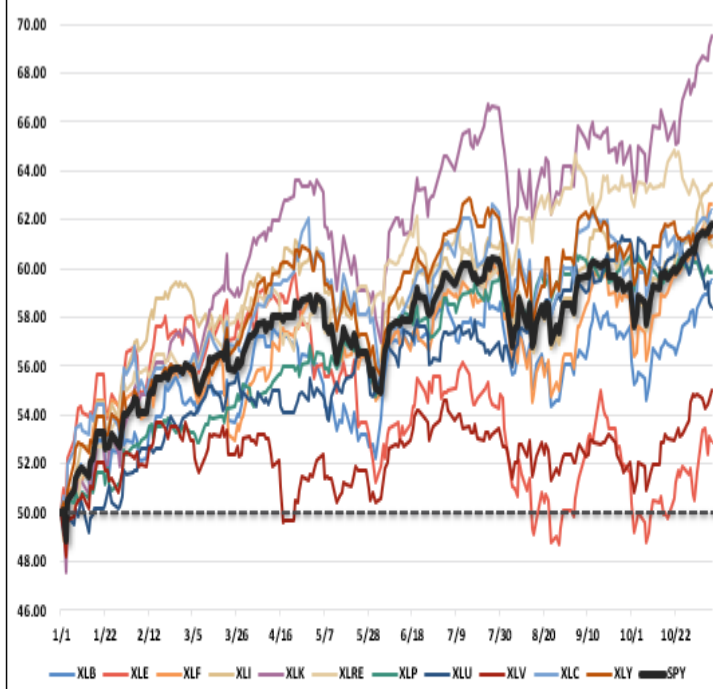
Year To Date Performance



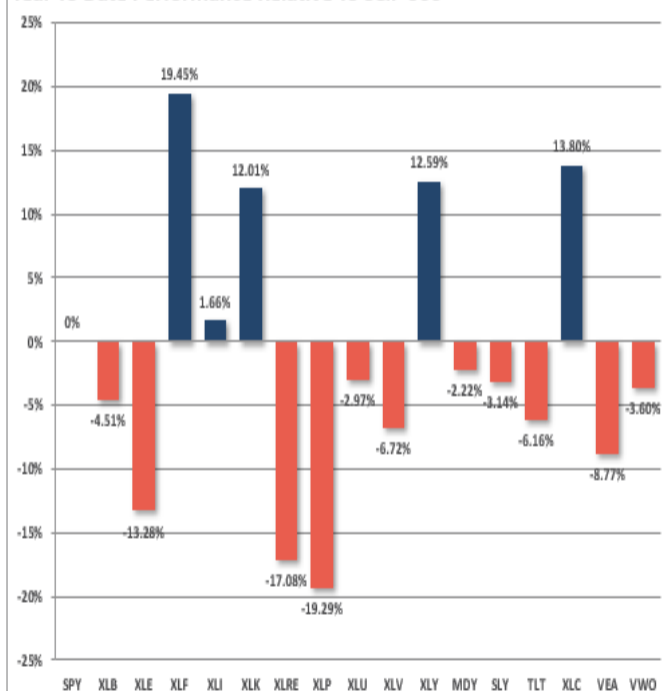
REAL INVESTMENT ADVICE



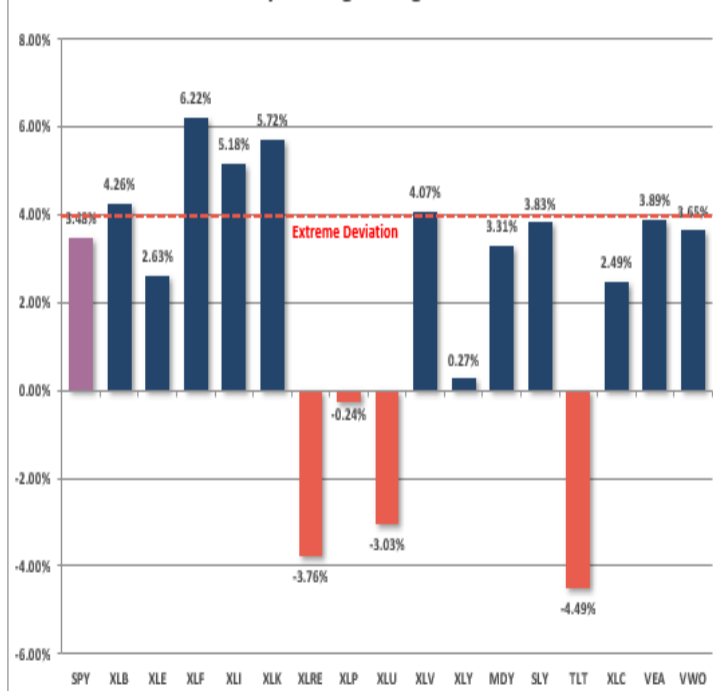
YTD Price - S&P Sectors Recalibrated To \$50/share



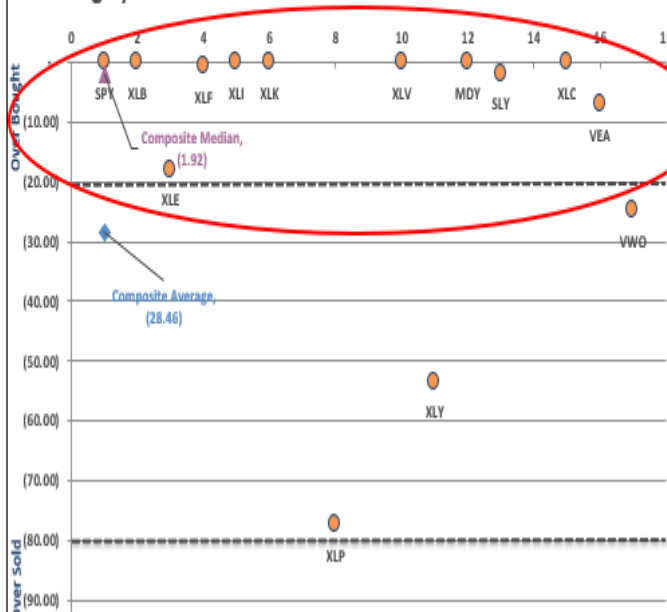
Year To Date Performance Relative To S&P 500



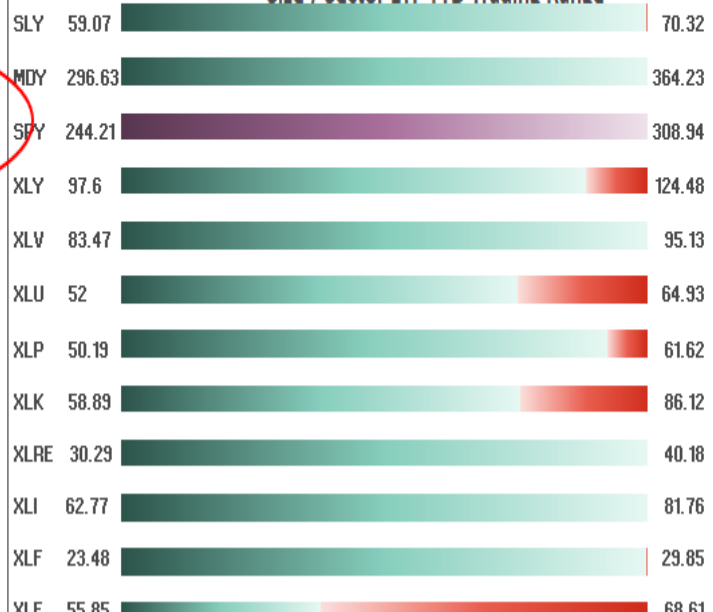
Price Deviation From 50-Day Moving Average



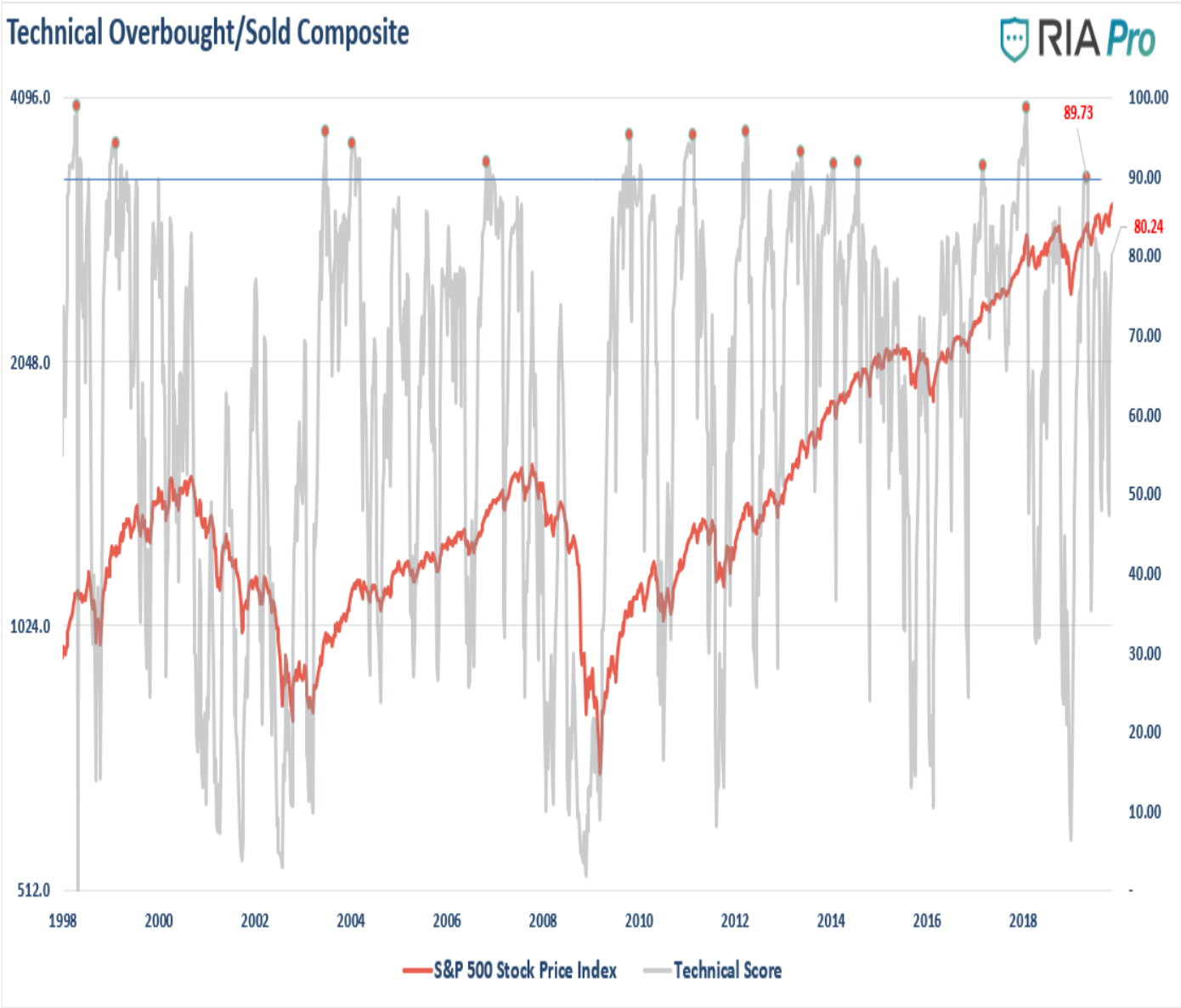
Overbought/Oversold 14-Periods



Size / Sector ETF YTD Trading Range



Technical Composite



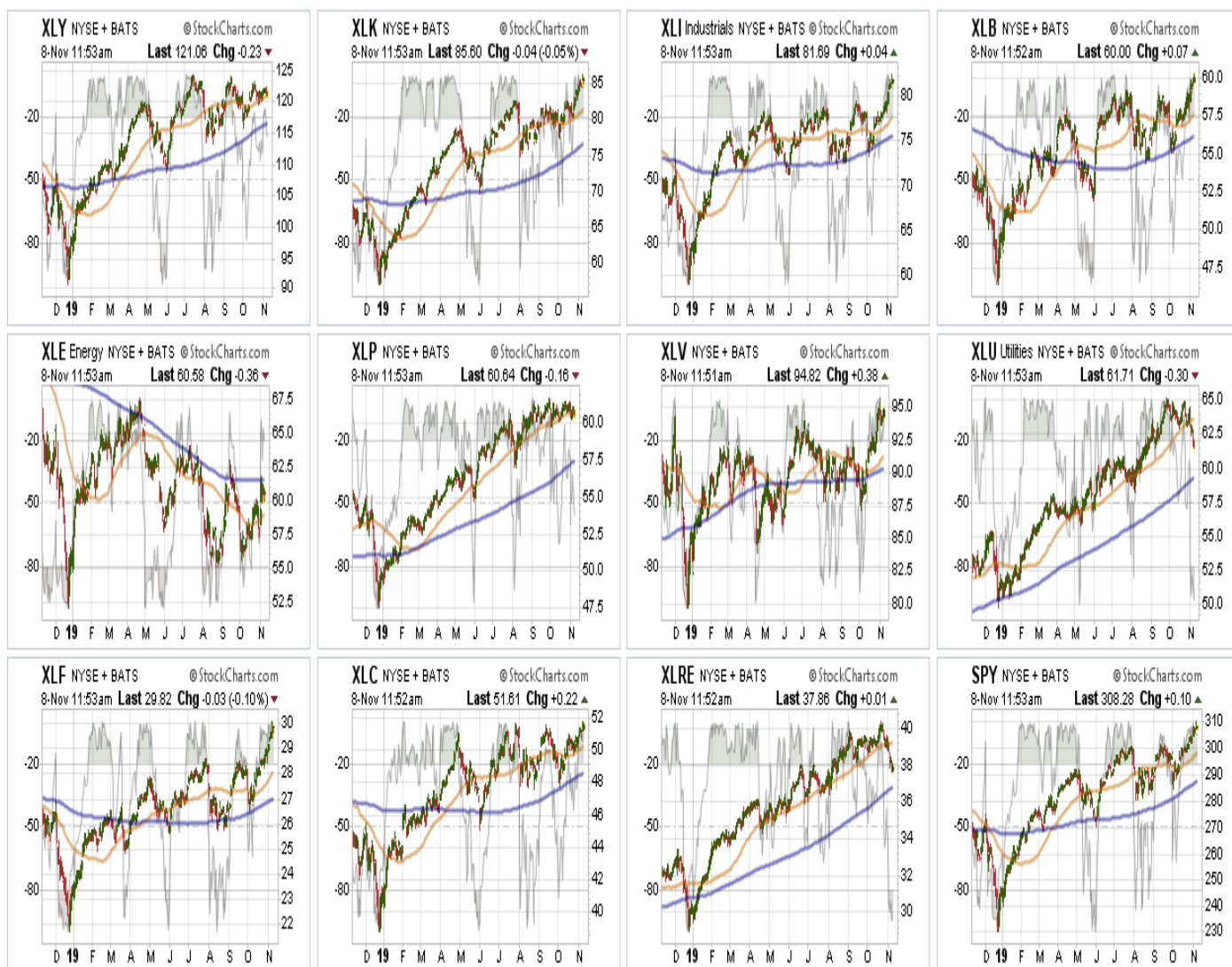
ETF Model Relative Performance Analysis

RIA Pro		RELATIVE PERFORMANCE		Current	Model Position Price Changes Relative to Index					SHORT	LONG	% DEV -	% DEV -	Buy / Sell
		Ticker	ETF NAME	Price	1 Week	4 Week	12 Weeks	24 Weeks	52 Weeks	WMA	WMA	Short M/A	Long M/A	Signal
BENCHMARK		IVV	ISHARS-SP500	310.67	0.88	4.29	6.91	9.10	10.97	298.24	294.20	4.17%	5.60%	BUY
TACTICAL	SECTORS	XLB	SPDR-MATLS SELS	60.17	1.08	0.63	(0.64)	2.76	(1.53)	57.37	57.03	4.88%	5.51%	BUY
		XLE	SPDR-EGY SELS	60.69	1.50	0.55	(0.48)	(10.61)	(22.37)	58.73	61.83	3.34%	-1.84%	SELL
		XLF	SPDR-FINL SELS	29.84	1.59	3.63	5.39	2.00	(0.94)	27.75	27.42	7.54%	8.84%	BUY
		XLI	SPDR-INDU SELS	81.76	1.04	2.17	3.13	1.72	1.93	76.98	76.48	6.21%	6.90%	BUY
		XLK	SPDR-TECH SELS	86.12	0.83	1.29	3.10	8.39	12.34	80.82	78.54	6.56%	9.66%	BUY
		XLP	SPDR-CONS STPL	60.76	(1.52)	(4.42)	(6.00)	(3.47)	(4.04)	60.72	58.86	0.06%	3.23%	BUY
		XLU	SPDR-UTIL SELS	61.75	(4.53)	(7.69)	(6.31)	(5.89)	1.57	63.23	60.71	-2.35%	1.72%	BUY
		XLC	SPDR-COMM SV SS	51.53	0.26	(0.73)	(1.19)	(1.70)	2.61	49.98	49.34	3.10%	4.43%	BUY
		XLV	SPDR-HLTH CR	95.13	(0.61)	1.48	(1.86)	(2.88)	(8.62)	91.16	90.85	4.36%	4.71%	BUY
		XLY	SPDR-CONS DISCR	121.34	(1.14)	(3.67)	(2.21)	(2.13)	(0.68)	120.24	118.76	0.91%	2.17%	BUY
	SIZE	SLY	SPDR-SP SC 600	70.28	0.04	1.47	0.65	(1.41)	(9.42)	67.10	67.09	4.74%	4.75%	BUY
		MDY	SPDR-SP MC 400	364.22	(0.09)	0.06	(0.32)	(1.96)	(4.74)	349.84	350.02	4.11%	4.06%	SELL
CORE	Equal Weight Market	RSP	INVS-SP5 EQ ETF	111.81	0.06	0.14	0.50	(1.09)	(1.53)	107.28	106.71	4.22%	4.78%	BUY
	Dividend	SDY	SPDR-SP DIV ETF	106.13	0.10	(0.19)	1.05	(1.57)	(1.51)	101.63	100.74	4.43%	5.35%	BUY
	Real Estate	XLRE	SPDR-RE SELS	37.78	(4.58)	(7.99)	(9.19)	(6.30)	3.10	39.14	37.66	-3.47%	0.33%	BUY
	International	EEM	ISHARS-EMG MKT	43.68	0.18	0.38	3.56	0.24	(1.22)	41.27	41.98	5.84%	4.04%	SELL
		EFA	ISHARS-EAFE	68.38	(0.35)	0.03	2.93	(3.54)	(3.13)	64.94	65.17	5.30%	4.93%	SELL
		IXUS	ISHARS-CR INT S	60.66	(0.12)	(0.10)	2.54	(2.60)	(2.92)	57.69	58.03	5.15%	4.54%	SELL
FI	Intermediate Duration	TLT	ISHARS-20+YTB	134.91	(4.90)	(8.23)	(14.59)	(3.52)	8.05	142.16	133.77	-5.10%	0.85%	BUY
	International	BNDX	VANGD-TTL INT B	57.82	(1.74)	(5.15)	(9.05)	(6.22)	(4.90)	58.62	57.36	-1.36%	0.81%	BUY
	High Yield	HYG	ISHARS-IBX HYCB	86.85	(0.85)	(4.20)	(6.04)	(7.70)	(8.02)	86.89	86.60	-0.05%	0.29%	BUY
	Cash	BSV	VANGD-SHT TRM B	80.50										

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 ? Energy (XLE), Healthcare (XLV) The relative performance improvement of Healthcare relative to the S&P 500 lagged a bit this past week after breaking out to new highs. Energy also improved as the rotation to "value" continues but faltered at resistance on Friday at the 200-dma. Energy needs to break above the downtrend to become an attractive candidate for portfolios. **Current Positions: 1/2 weight XLE**

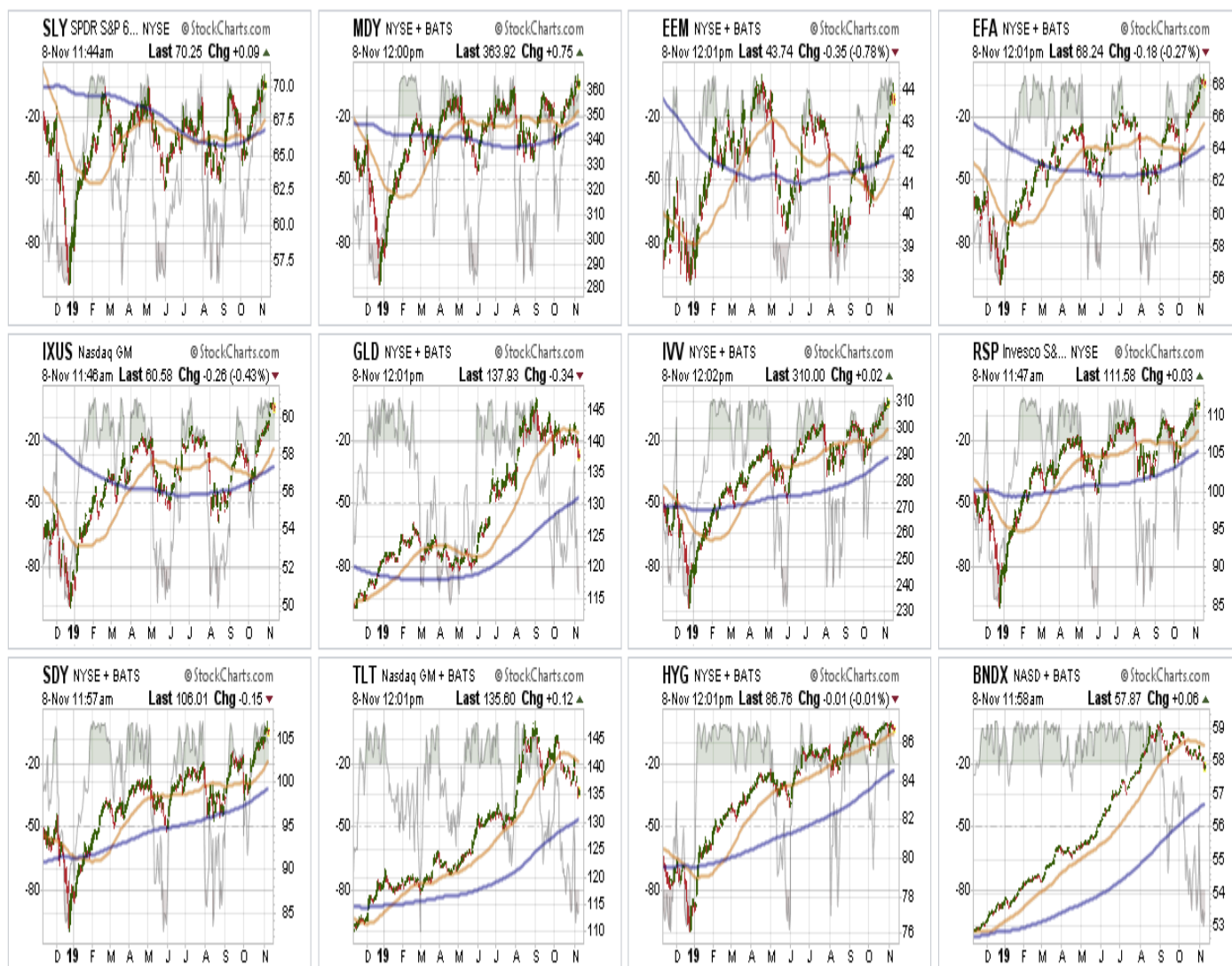
Outperforming ? Industrials (XLI), Financials (XLF) Financials have been running hard on Fed rate cuts and more QE, but rate cuts are, longer-term, not great for net-interest income margins on banks. Combined with the high level of corporate debt on their books, we remain cautious on the sector. But, with the breakout to new highs, we will be looking for some consolidation to add exposure to the sector which is extremely overbought currently. Industrials, which perform better when the Fed is active with QE, also broke out to new highs, and like Financials are extremely overbought. We are looking to add back to our position but need a bit of a correction or consolidation first. **Current Positions: 1/2 weight XLI**

Weakening ? Real Estate (XLRE), Staples (XLP), Technology (XLK), Utilities (XLU) After having taken profits in our defensive sectors, the rotation from defense to offense has picked up some steam. Utilities, Real Estates and Staples have all broken their 50-dmas and are FINALLY working off the extreme overbought condition that existed. This is good news and will allow us to buy additional exposure to the sectors at cheaper prices. Technology broke out to all-time highs, which is bullish for now, but, as with most running sectors of the market, is back to extremely overbought. Hold positions for now but be patient on adding new positions as we will likely get a better opportunity soon. **Current Position: 1/2 weight XLK, XLRE, XLU, XLP**

Lagging ? Basic Materials (XLB), Discretionary (XLY), Communications (XLC) Basic Materials broke out to new highs as well, following Industrials, and we expect to see better performance as money rotates into the sector. Be patient as, just like the other offensive sectors, the market is VERY overbought. Communications

has lagged, but also finally broke out to new highs. We are looking to add to our holdings of Materials and Communications, but these sectors are also currently extremely overbought so be patient for now. **Current Position:** 1/2 weight XLB, Target weight XLC

Market By Market



Small-Cap (SLY) and Mid Cap (MDY) ? Small- and Mid-caps have finally broken out of the previous ranges which suggests higher highs to come. This aligns with our commentary above about the sectors which perform the best under QE programs. However, both markets are EXTREMELY overbought currently. Be patient for the right entry point. **Current Position:** No 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," and finally broke above important resistance. However, these markets are sensitive to the US Dollar which is showing some strength. With both markets EXTREMELY overbought currently, be patient for the right entry point. **Current Position:** No 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. Be aware that all of our core positions are VERY overbought. A short-term correction or consolidation is likely before a further advance can be made. **Current Position:** RSP, VYM, IVV

Gold (GLD) ? With QE-4 in play, the most defensive of sectors got hit last week. Gold is one of

those sectors, and after taking profits, Gold broke support at the \$140 level. Next support is \$135 and stops should be placed on all positions at \$130. Gold is very oversold so a tradeable opportunity is approaching. **Current Position:** GDX (Gold Miners), IAU (Gold) Bonds (TLT) ? Bonds are now back to extremely oversold. This rise in yields was expected, which is why we added a "steepner 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.)

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

LEGEND: X = THIS WEEK => PREVIOUS DECLINING <=< PREVIOUS IMPROVING

X No Position

Portfolio/Client Update:

Over the last couple of weeks we have been discussing the need to cautiously, and opportunistically add exposure to portfolios. The reason for the increase is simply a function of current market momentum and the fact the Fed is back into the "QE game." We have been constantly reviewing portfolios and markets looking for right opportunities. Currently, the market is

extremely overbought which limits our ability to add "*broad market*" exposures. We are waiting for a brief market pullback or consolidation to add exposure to ETF Models in 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. **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. In the Equity model, as noted below we were able to pick off some very beaten up stocks we have been watching for a while, and we trimmed off some issues which were under pressure from the markets rotation to offense from defense. We are actively looking **to slowly increase our equity exposure modestly** to "*rent whatever rally*" we may get from the "QE-4."

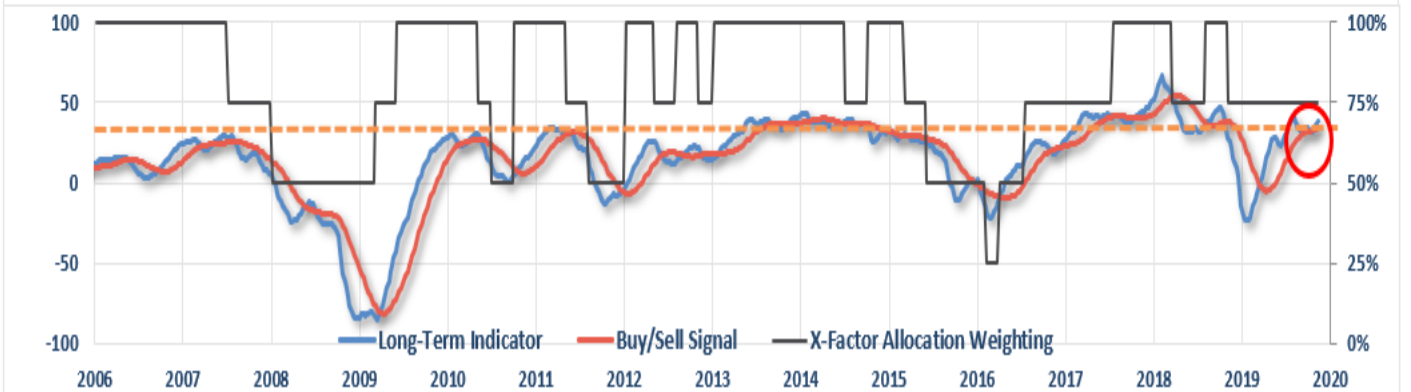
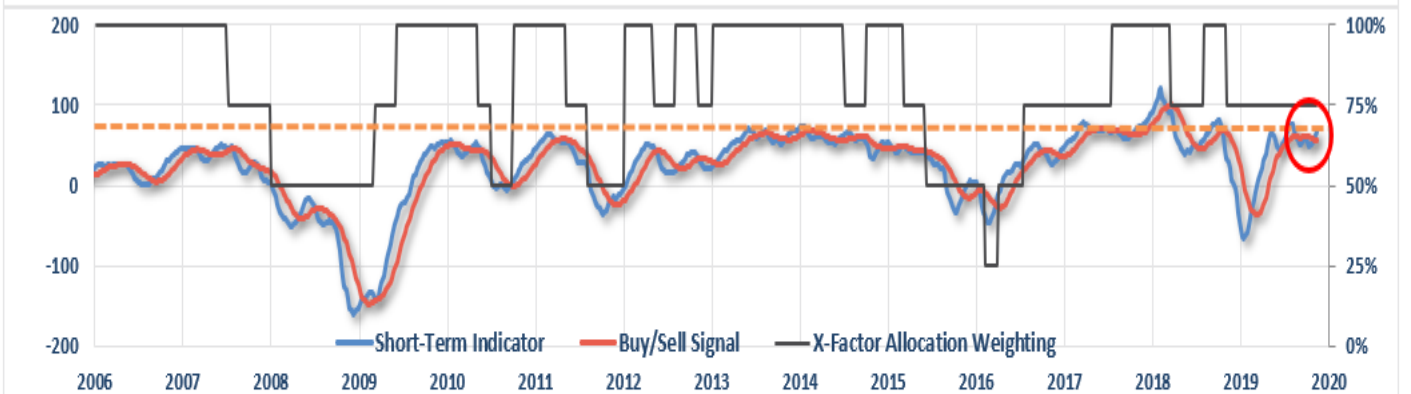
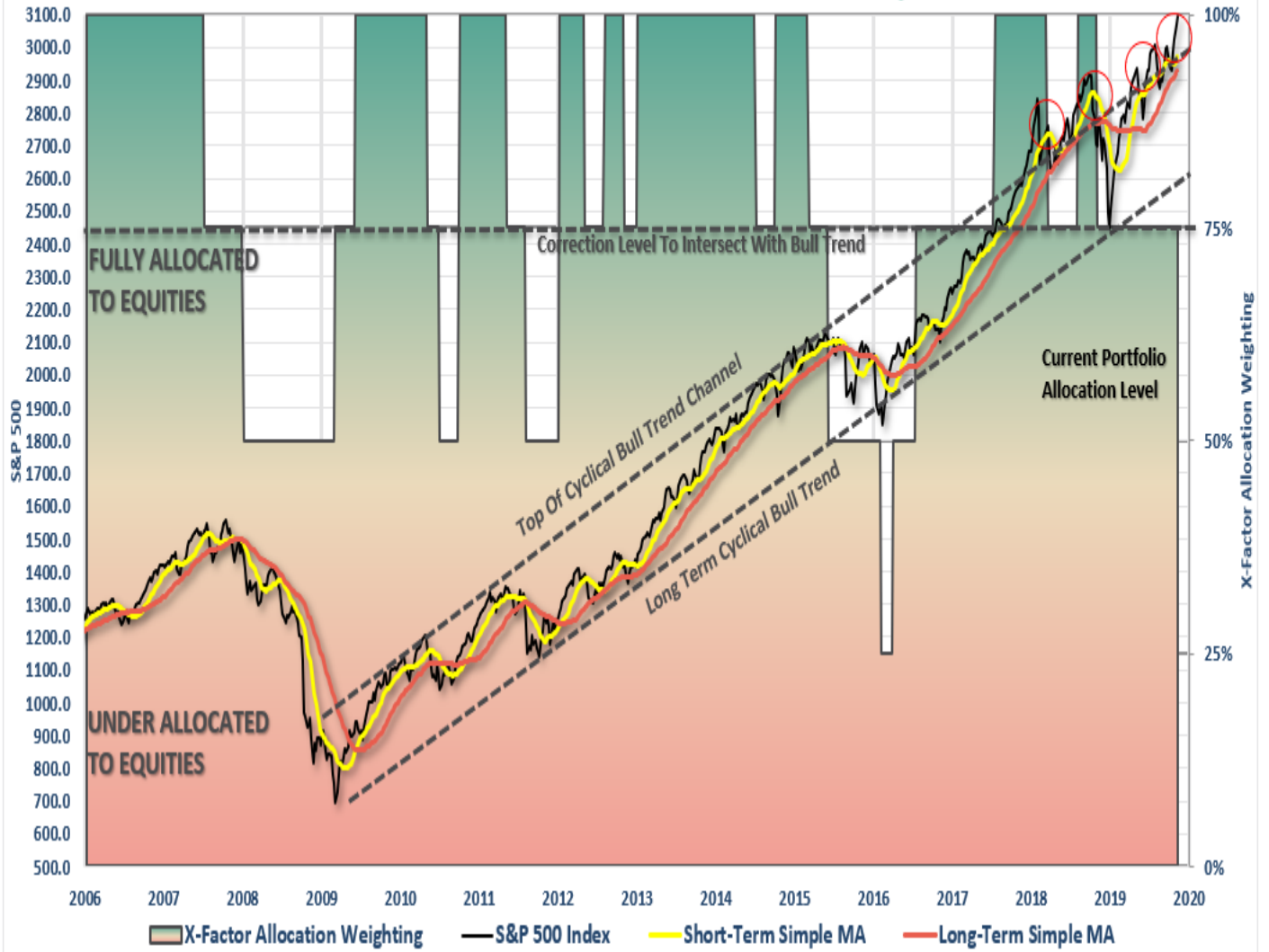
- **New clients:** *Please contact your adviser with any questions.*
- **Equity Model:** Sold YUM, MDLZ. Bought KHC, ABBV, XOM, MU, IEF
- **ETF Model:** Bought IEF

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](#)

Watch Your Step Getting On The Bull

Last week we noted:

"Given the 'bulls' upper-hand heading into the end of the year, we looking to increase our equity exposure slowly. Given the markets tend to pullback just before Thanksgiving, and during the second week of December, we will have a better opportunity to increase allocations if we are patient. We need to see a bit of a pullback to reduce the rather excessive extension of the market above the 200-dma, but a pullback that doesn't break back below the previous highs. Such action will confirm the breakout and suggest our target of 3300 is attainable."

Please review the chart above. While we are indeed looking to increase equity allocations, there are reasons to remain cautious. With the market once again pushing above its cyclical bullish trend line, and testing the cycle trend highs from 2007, the risk of a short-term correction action is elevated. Such a correction will provide a much better entry point to add risk to portfolios accordingly. This week, continue making adjustments to prepare to opportunistically increase equity exposure on a pullback which doesn't fail at support levels.

- If you are **overweight equities** - Hold current positions.
- If you are **underweight equities** - rebalance portfolios to target weights
- If at **target weight equities**, hold positioning and look for a pullback to increase exposure.

Understand this increase could well be short-lived. The markets have been in a very long consolidation process and the breakout to the upside is indeed bullish. However, we must counter-balance that view with the simple reality we are VERY long in the current economic and market cycle which is where "unexpected" events have destroyed capital in the past. 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](#):**

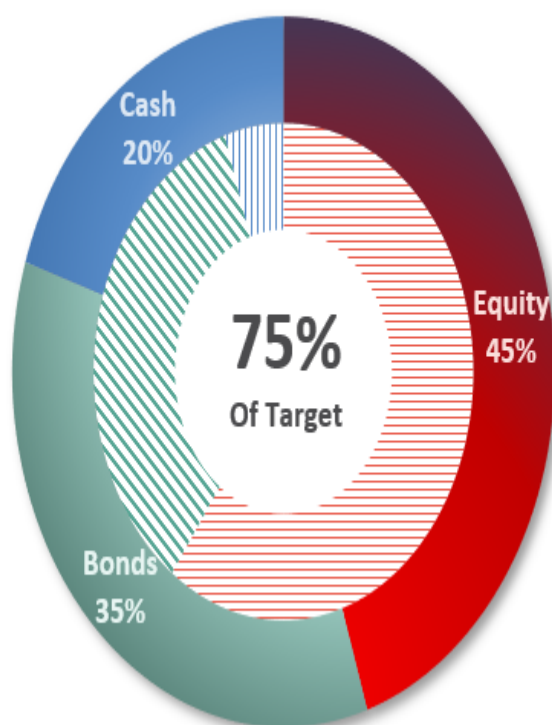
- Name of the company
- Plan Sponsor
- A print out of your plan choices. (Fund Symbol and Fund Name)

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.�(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

35.00% Fixed Income (Bonds)

Bond Funds reflect the direction of interest rates

Examples: Short Duration, Total Return and Real Return Funds

45.00% Equity (Stocks)

The vast majority of funds track an index.

Therefore, select on ONE fund from each category.

Keep it Simple.

10% Equity Income, Balanced or Conservative Allocation

35% Large Cap Growth (S&P 500 Index)

0% International Large Cap Dividend

0% Mid Cap Growth

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.�

