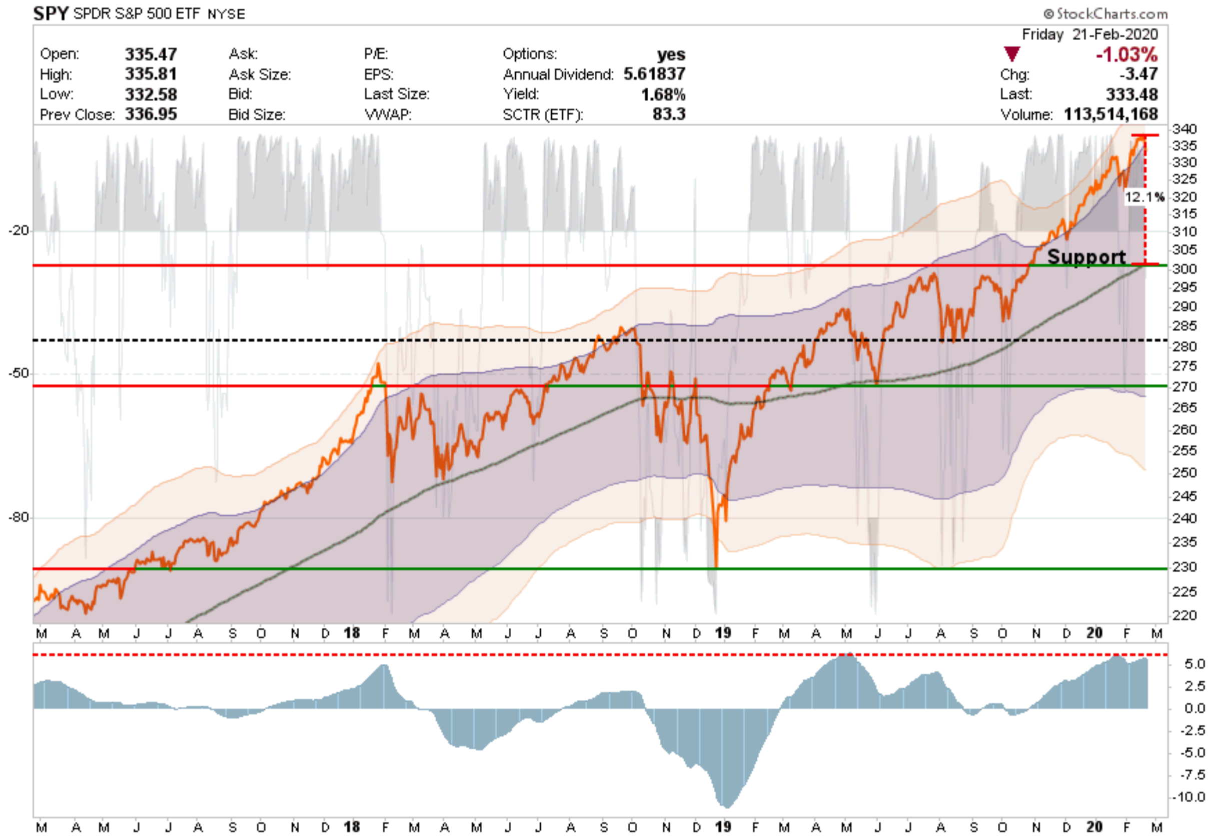
Special Report: S&P 500 Plunges On Coronavirus Impact

Dow plunges 1,000 points on coronavirus fears, 3.5% drop is worst in two years

> "Stocks fell sharply on Monday as the number of coronavirus cases outside China surged, stoking fears of a prolonged global economic slowdown from the virus spreading." - *CNBC*

According to CNBC's logic, the economy was perfectly fine on Friday, even though the market sold off then as well. **However, over the weekend, stocks are plunging because the virus is now important?**

No, this has been a correction in the making for the past several weeks that we have been discussing in our weekly market updates. Here was what **we posted yesterday morning:**



- *As noted last week:* ***?With the market now trading 12% above its 200-dma, and well into 3-standard deviations of the mean, a correction is coming.? That correction started last Friday.***
- *Currently, there is a strong bias to ?buy the dip? of every corrective action. We recognize this and given the S&P 500 hit initial support on Friday we did add 1/2 position of VOOG to the Dynamic Model. The model is underallocated to equities and has a short hedge so we are taking this opportunity to add slowly.* ***However, we suspect there is more to this corrective action to come this week.***
- ***As noted previously, extensions to this degree rarely last long without a correction.*** *There is more work to be done before the overbought and extended condition is corrected. We will look to add to our holdings during that process.*

While the correction occurred all in one day, which wasn't our preference, it nonetheless set the markets up for a short-term bounce. We highly suggest using that bounce to rebalance portfolio risks accordingly.

Daily

On a daily basis, the market is back to oversold. Historically, this condition has been sufficient for a bounce. The difference, however, is the current oversold condition (top panel) is combined with a *"sell signal"* in the bottom panel. **This suggests that any rally in the markets over the next few days should be used to reduce equity risk, raise cash, and add hedges.**

If we rework the analysis a bit, the 3-standard deviation discussed previously is in the correction process. However, with the break of the 50-dma, uptrend channel, and triggering a short-term sell signal, the 200-dma comes into focus as important support.

As with the chart above, **the market is oversold on a short-term basis, and a rally from current support back to the 50-dma is quite likely.**

Again, that rally should be used to reduce risk.

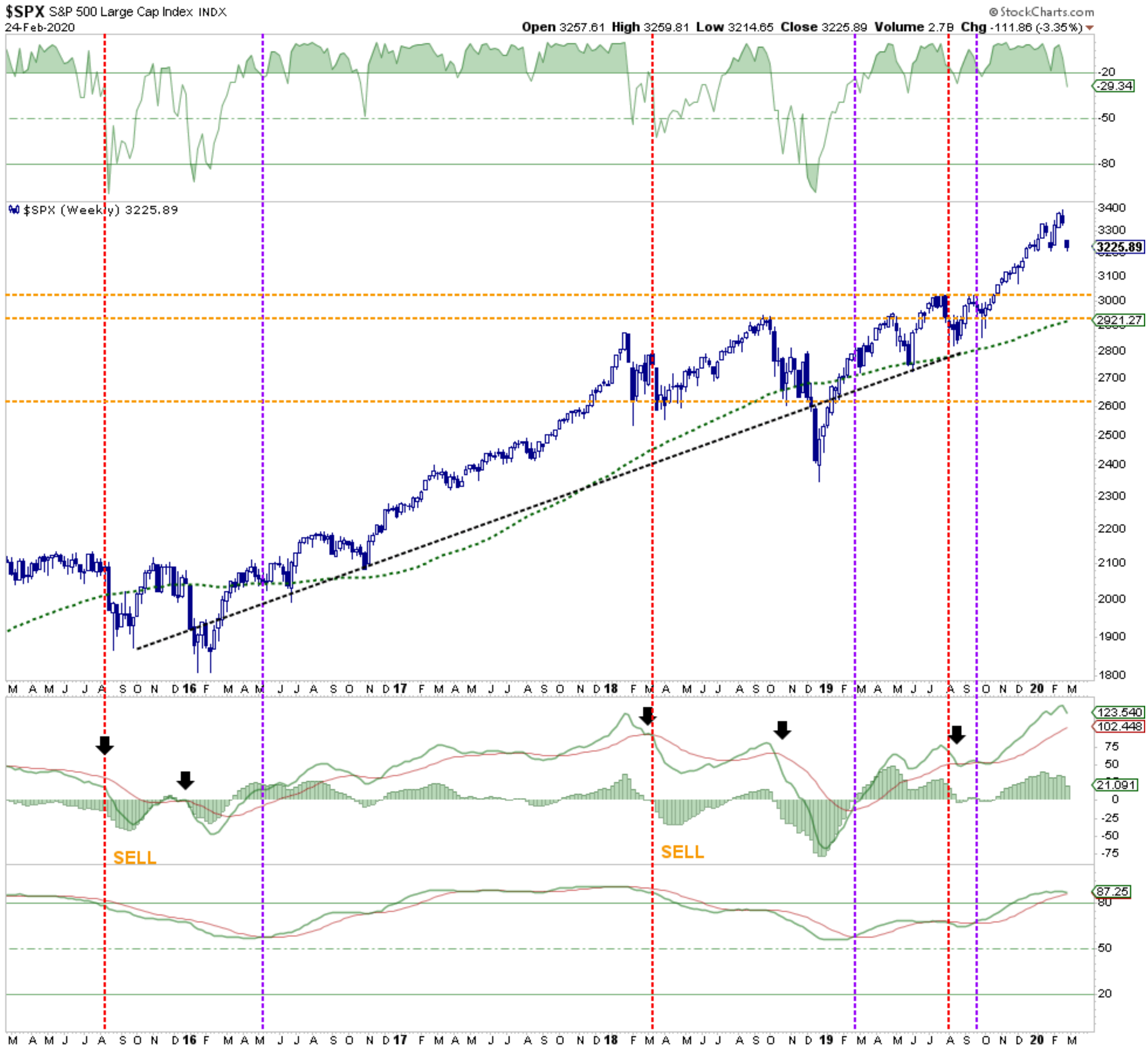
The following chart is a longer-term analysis of the market and is the format we use for *"onboarding"* our clients into their allocation models. *(Vertical black lines are buy periods)*

Notice that while the market has been rising since early 2016, the momentum indicators are extremely stretched. Historically, such divergences result in markedly lower asset prices. **In the short-term, as noted above, the market remains confined to a rising trend which is denoted by the trend channel.** At this juncture, the market has not violated any major support points and does not currently warrant a drastically lower exposure to risk. **However, if the *"sell signals"* are triggered, it will suggest a larger *"reduction"* of risk.**

The analysis becomes more concerning as view other time frames.

Weekly

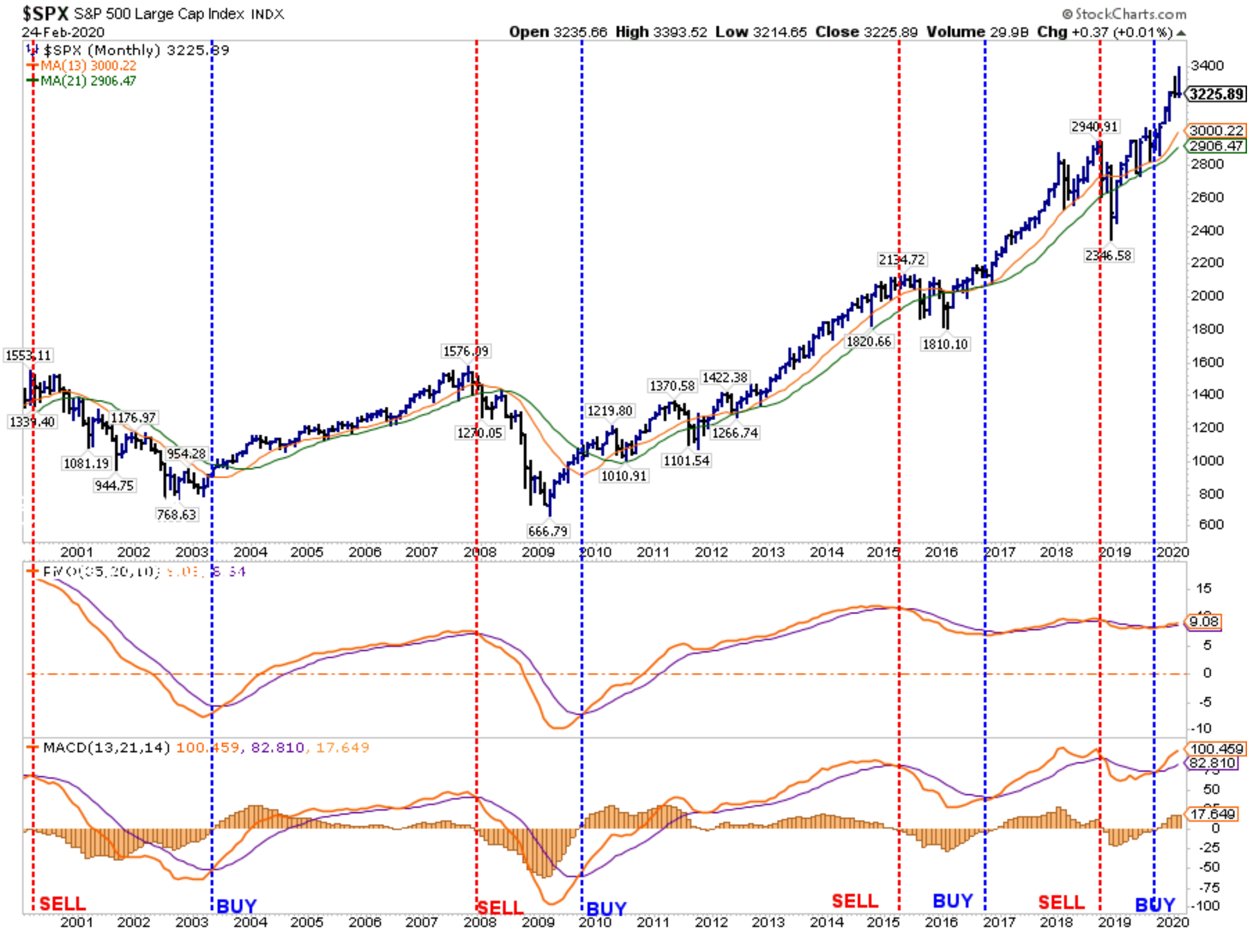
On a weekly basis, the rising trend from the 2016 lows is clear. The market has not violated that trend currently, which suggests maintaining some allocation to equity risk in portfolios currently. **However, the two longer-term sell signals, bottom panels, are closing. If they both confirm, it will suggest a more significant correction process is forming.**



The market is still very overbought on a weekly basis which confirms the analysis above that short-term rallies should likely be sold into, and portfolios hedged, until the correction process is complete.

Monthly

On a monthly basis, the bulls remain in control currently, which keeps our portfolios primarily allocated to equity risk. As we have noted previously, the market had triggered a *"buy"* signal in October of last year as the Fed *"repo"* operations went into overdrive. These monthly signals are *"important,"* but it won't take a tremendous decline to reverse those signals. It's okay to remain optimistic short-term, just don't be complacent.



Don't Panic Sell

The purpose of the analysis above is to provide you with the information to make educated guesses about the *"probabilities*" versus the *"possibilities"* of what could occur in the markets over the months ahead.

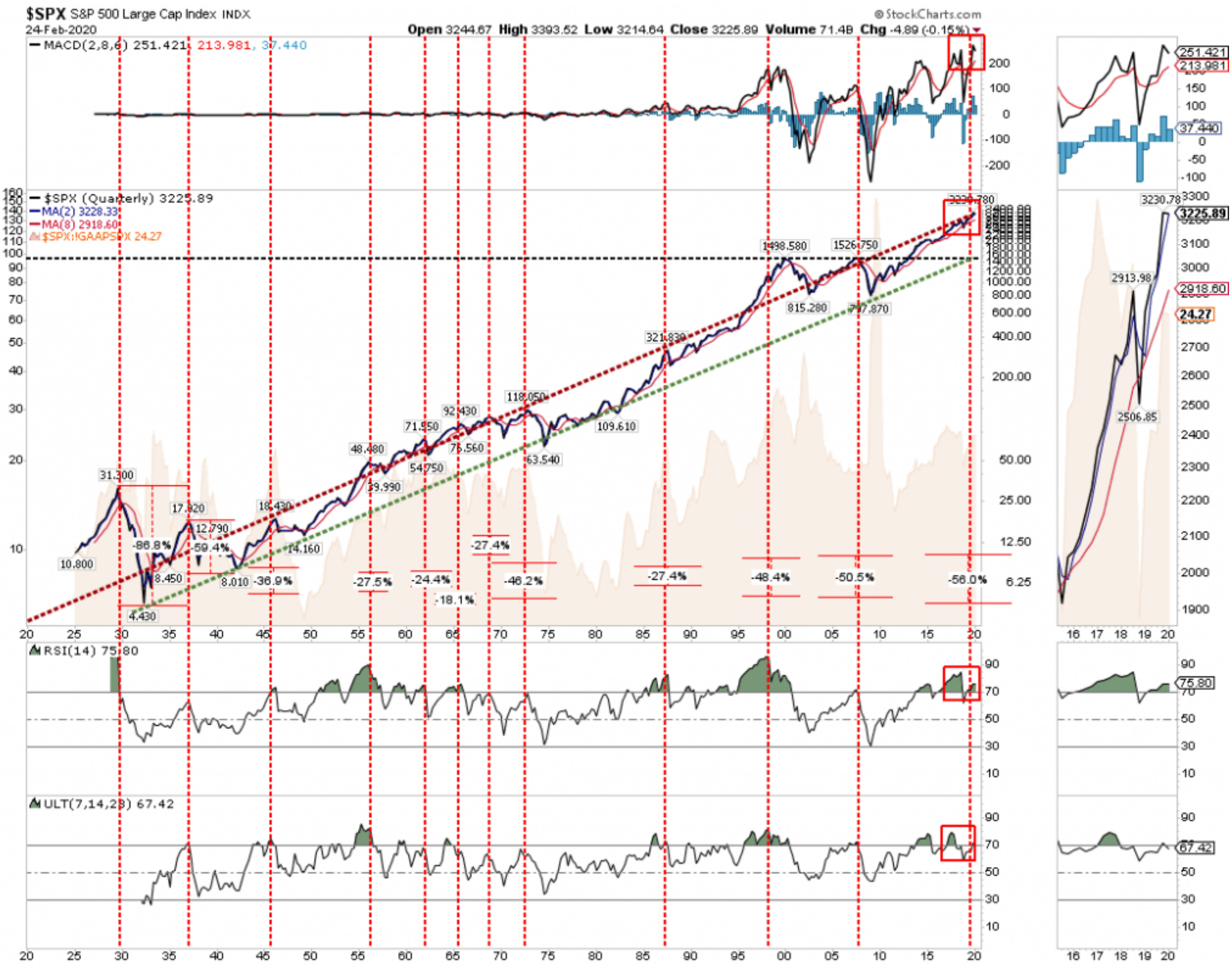
It is absolutely *"possible"* the markets could find a reason to rally back to all-time highs and continue the bullish trend. *(For us, such would be the easiest and best outcome.)*

However, the analysis currently suggests the risks currently outweigh potential reward and a deeper correction is the most *"probable"* at this juncture.

Don't take that statement lightly.

I am suggesting reducing risk opportunistically, and being pragmatic about your portfolio, and your money. [Another 50% correction](#) is absolutely possible, as shown in the chart below.

(The chart shows ever previous major correction from similar overbought conditions on a quarterly basis. A similar correction would currently entail a 58.2% decline.)



So, what should you be doing now. Here are our rules that we will be following on the next rally.

1. ***Move slowly.*** *There is no rush in adding equity exposure to your portfolio. Use pullbacks to previous support levels to make adjustments.*
2. ***If you are heavily UNDER-weight equities, DO NOT try and fully adjust your portfolio to your target allocation in one move.*** *This could be disastrous if the market reverses sharply in the short term. Again, move slowly.*
3. ***Begin by selling laggards and losers.*** *These positions are dragging on performance as the market rises and tends to lead when markets fall. Like ?weeds choking a garden,? pull them.*
4. ***Add to sectors, or positions, that are performing with, or outperforming*** *the broader market.*
5. ***Move ?stop-loss? levels up to current breakout levels for each position.*** *Managing a portfolio without ?stop-loss? levels is like driving with your eyes closed.*
6. ***While the technical trends are intact, risk considerably outweighs the reward.*** *If you are not comfortable with potentially having to sell at a LOSS what you just bought, then wait for a larger correction to add exposure more safely. There is no harm in waiting for the ?fat pitch? as the current market setup is not one.*
7. ***If none of this makes any sense to you ? please consider hiring someone*** *to manage your portfolio for you. It will be worth the additional expense over the long term.*

While we remain optimistic about the markets currently, we are also taking precautionary steps of tightening up stops, adding non-correlated assets, raising some cash, and looking to hedge risk opportunistically.

Everyone approaches money management differently. This is just our approach to the process of controlling risk.

We hope you find something useful in it.