



Initial “Sell” Signal Is In

After eight straight months of advance in the markets what the media absolutely believed could not happen finally has - the market quit going up. However, you can't really blame the media for believing in an “unstoppable” rally, after all, like a “Bigfoot” sighting, they clearly saw evidence of an urban legend.

However, as we have been discussing for many weeks, such market advances that push prices to extreme divergences from their historic norms are ultimately due for a correction. Without such corrections the markets become distorted, unhealthy and subject to severe crashes.

This week we will review our analysis from last week, set targets for the current correction and discuss recommended actions for portfolios currently.

However, before we jump into the analysis I want to give you a few updates to the coming changes to the newsletter and website.

- *“Streetworklive.com” is merging into “STAWealth.com.” Only the look is changing – all the great features will remain the same.*
- *This weekly newsletter will actually become three different HTML documents that you will be able to print, read on your tablet and phone, share with friends post to your social network. The three pieces will be:*
 - **Portfolio Management:** Market analysis & Investing Strategy
 - **Market/Sector Analysis:** Analysis of 15 major sectors /markets
 - **401k Plan Manager:** Expanded and improved model/analysis
- *Also, more frequent postings to the daily blog that are short reads, quick analysis or video/audio analysis of investing ideas, economics, strategies or tips.*

As we get closer to the rollout of the new site I will keep you informed of all of the changes. I hope you will find the new website to be more useful and informative in the management of your financial future.

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401k Plan Manager

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- [Click Here For Current Model Allocation.](#)

Disclaimer & Contact Info.

No Long Term Gains Without Short Term Volatility

Before we get into the crux of the market analysis this week I just want to address a couple of emails that I received this past week. The emails were all generally the same – *“I have been following your advice in the newsletter and my portfolio is down \$X recently.”*

Yes, if you have been following our advice exactly – your portfolio would have been **down** over the past couple of weeks. That is because interest rates surged thereby suppressing bond prices AND stock prices corrected. It is important to remember that investing is not a “science” but rather an art form of reading statistical evidence and then applying a “best guess” as to what “may” happen in the future.

As hard as I have tried in my 30 some odd years of playing with money – I have yet to master the art of “prescience.” If I had – I would be sitting on the beach and buying lottery tickets.

Our objective, as money managers, is to capitalize on market movements as much as possible with the least amount of risk. It requires a lot of “educated guessing” which means that sometimes – we are going to be wrong. However, what I am confident of is that when we are “wrong” it WILL NOT cost our clients 30-50% of their net worth. Chasing markets when they are rising is not the objective of investing.

The objective of investing is twofold:

- 1) *Grow your SAVINGS, those dollars you have sacrificed your time and effort for, at the rate of inflation over time to keep the purchasing power of those savings; and*
- 2) *Protect those savings from catastrophic losses.*

That’s it. No more or less. Just grow your money at the projected rate of inflation and protect it from catastrophic losses. No one, and I do mean no one, ever got rich investing in the markets. Why? Because taking on speculative investment risks will eventually leads to catastrophic losses.

However, in order to grow your money at the rate of inflation over the “long term” means that some assets need to be allocated toward investments that will grow in the value over time. While, fixed income provides cash flows to portfolios; it does not contribute to the growth of capital during the holding period to maturity.

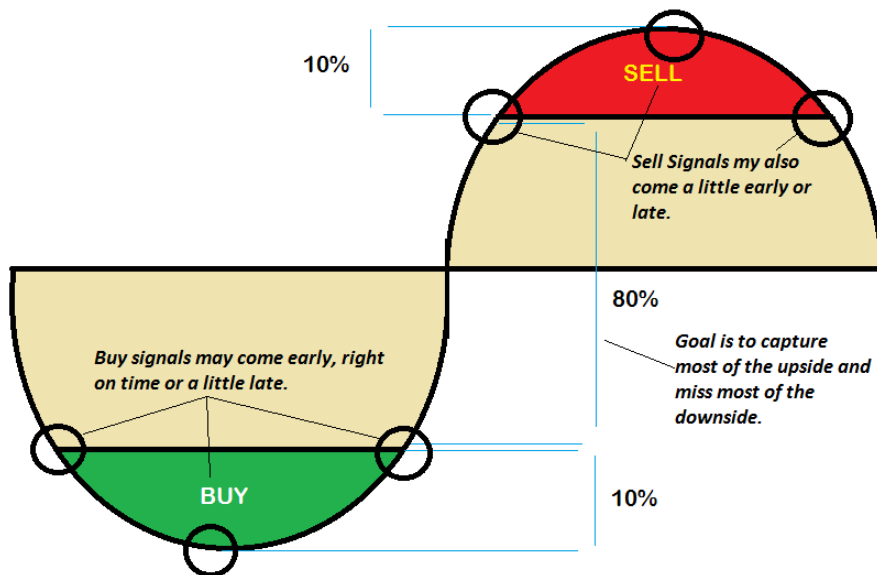
Therefore, this is why all portfolios must have some exposure to “risk” over time to capitalize on market movements over the long term horizon. However, we must judge when the “risk” is greater than the reward of being invested and adjust exposures accordingly. Our goal is, as shown in the chart on the next page, moderate exposure to risk assets when markets are bottoming and reduce that exposure near market tops. As stated, this is not an exact “science” and therefore we may be early, or late, in taking action.

JOIN THE CONVERSATION



FEEDBACK

CLICK TO SEND COMMENTS



We are **NOT** “market timers” trying to ping the tops and bottoms of markets. It is an impossible task that cannot be successfully replicated over time. However, if we are successful at navigating the tops and bottoms of markets we can successfully capture the 80% of the rise in the market that has the least amount of “risk” to portfolios. The same goes with declines.

However, let’s take my advice from the [May 18th](#) – 401k Plan Manager Section of the weekly newsletter:

“The markets are getting extremely overbought, as discussed above, and the risk of being “long” the market is rapidly rising.

*However, no technical trends or supports have been violated currently so we remain fully allocated to the market until something changes. However, as we continue to recommend, **if you are overweight in your equity exposure it is recommended that you reduce to target weights and rebalance the proceeds into cash and fixed income.***

If you are underweight equities – do nothing and remain patient until the market gives us a better opportunity to increase equity related risk”

That week the S&P 500 ended at 1667.47. The follow are the weekly closes with the percentage changes to current. I have compared this to a rebalanced portfolio using two funds that we use in client portfolios: OAKMX which tracks the S&P 500 and DBLTX which is a fixed income fund.

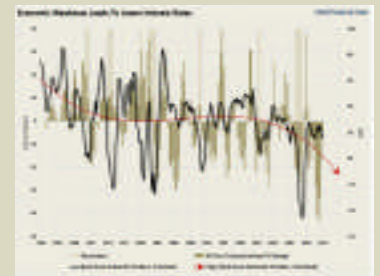
Date	S&P 500 Close	Cumulative % Chg.
5/18/2013	1667.47	
5/25/2013	1649.6	-1.07%
6/1/2013	1630.74	-2.20%
6/8/2013	1643.38	-1.44%
6/15/2013	1626.73	-2.44%
6/22/2013	1592.43	-4.50%

OAKMX (60%)	DBLTX (40%)	Total % Chg.	Rel. To S&P 500
-0.49%	-0.04%	-0.53%	0.54%
-0.58%	-0.21%	-0.79%	1.41%
0.02%	-0.11%	-0.09%	1.36%
-0.49%	0.07%	-0.42%	2.02%
-1.78%	-0.57%	-2.35%	2.15%

RECOMMENDED READING

[5 Reasons Why Now Is The Time To Buy Bonds](#)

The recent surge in interest rates has bond owners scurrying for cover. However, this may be a good buying opportunity.



[Deflation: The Fed's Real Worry](#)

It isn't inflation that the Fed is worried about. The recent drop in inflation is cause for concern of further economic weakness.

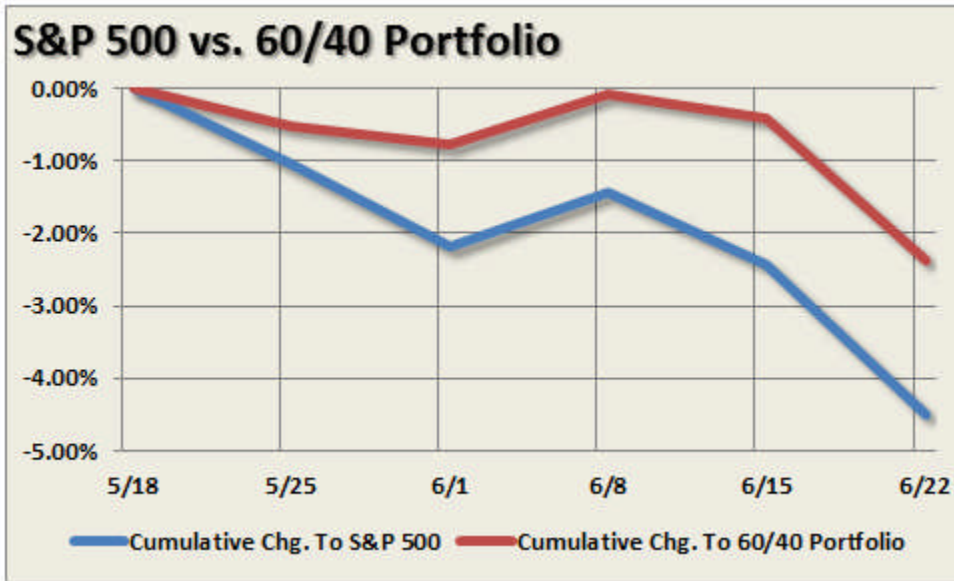


[Fed's Economic Projections](#)

The Fed's economic projection history is abysmal. While they say the economy is better they downgrade their forecasts.



Yes, both portfolios declined in value over the past several weeks but the balanced portfolio declined only half as much suffering a 2.35% loss versus 4.5% for the market.



However, one thing to note, is that the 60/40 portfolio was negatively affected by the very sharp increase in interest rates in this past week which is seen in the sharp drop between 6/15 and 6/22.

The point here is that even with a conservatively allocated portfolio there is simply no way to avoid market volatility in the short term while still expecting to achieve long term performance. It is a highly unrealistic expectation.

When we discuss **“conservation of principal”** this DOES NOT mean that we will tell you to “sell” at the exact top and “buy” at the exact bottom. We might get lucky from time to time – but generally, as I stated above, we are going to be generally early or late.

This does NOT mean that our signals are broken or that the long term strategy doesn’t work. What it means is that we are waiting for the markets to TELL us what it is doing rather than trying to guess at the future. Conservation of principal simply means we seek to limit losses when they occur, as much as possible, within the context of the current environment. This is particularly the case when you have so many artificial influences impacting the markets from the Federal Reserve interventions.

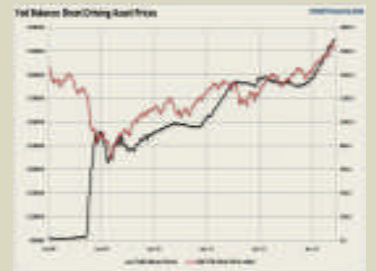
One of the biggest mistakes that investors consistently make is having **“unrealistic expectations”** about their portfolio. If your expectations are that you will be able to capture all of the upside when the market is rising and not capture the bulk of the declines – then you are mistaken. This is an unrealistic expectation that will leave you poorer in the long run. Any advisor that tells you they can achieve such a goal is lying to you.

Your investment return target should be the expected rate of annual inflation plus dividends after taxes. **Currently, that is about 4.5%.**

RECOMMENDED READING

3 Reasons Stocks May Stumble Despite Fed.

Prior the Fed meeting I wrote this piece on why stocks could stumble despite the Fed’s actions. I was right.



What Inflation Says About Bonds & The Fed

Declining rates of inflation impact the bond market and the Fed’s future actions.



Empire Index: Don’t Look

While the N.Y. regional index ticked up in May the internals were a disaster.



For every percentage point that you target above that rate requires an exponential increase in the amount of “risk” you take to achieve it. **Risk is a function of the amount of money you will lose when you are wrong.**

Reviewing The “Sell” Signal

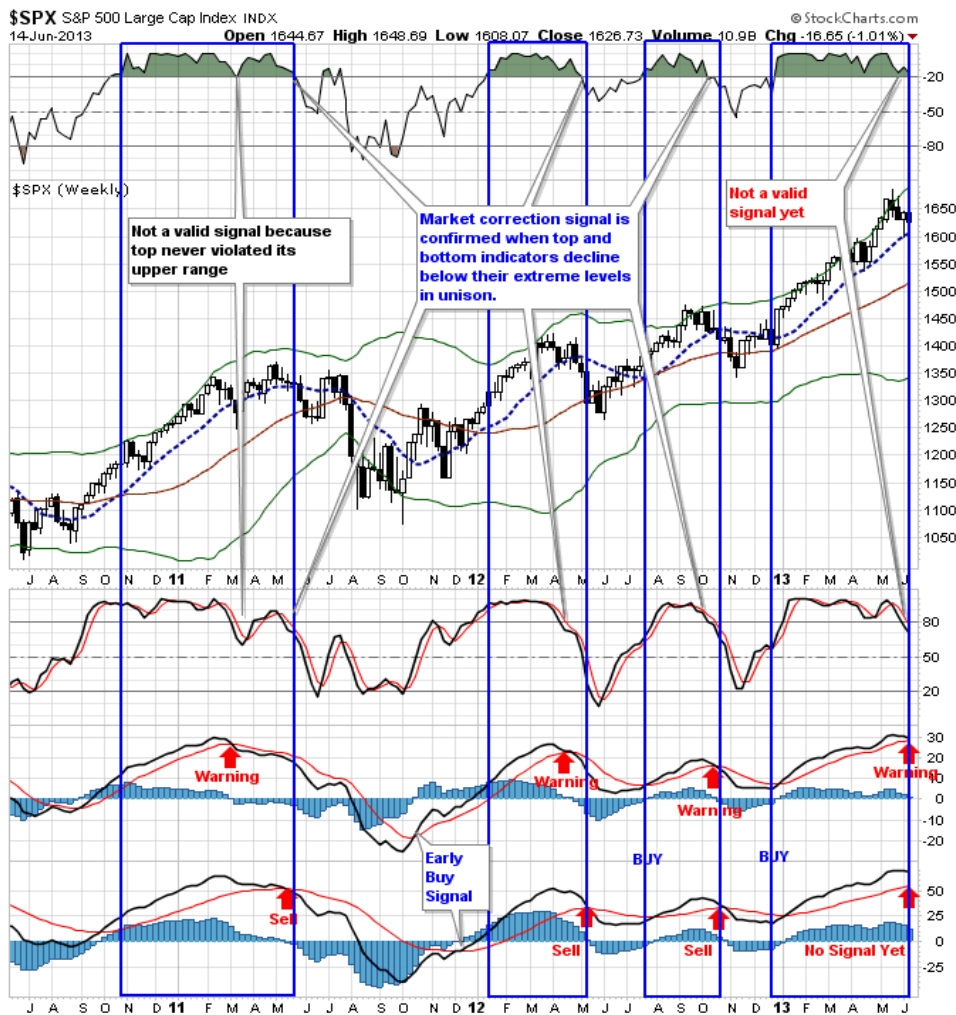
I stated in last week’s missive that:

“Currently, we have a March of 2011 scenario on our hands as the price momentum indicator is registering a sell signal but our proprietary indicator is NOT...at least not yet.

So far, none of our signals are indicating that the current selloff in the markets over the last three weeks is anything other than a normal garden variety pullback.

The last transformation below will be the addition of two indicators which can provide a “warning” and a “confirmation” of an impending correction.

As I have notated below the two blue indicators are called moving average convergence/divergence indicators (MACD) which measures the strength, direction, momentum and duration of prices. The problem for fundamentally based investors is that things such as valuation, earnings, etc. are fine for telling you “WHAT” to buy – however, they are horrible indicators for telling you “WHEN” to buy or sell.”



(Note: I am not advocating market *TIMING* – which is trying to be either “all in” or “all out” of the market. This is not a winning strategy. However, I am advocating using price analysis to determine optimal times to manage portfolio risk by increasing or decreasing exposure to equities. Furthermore, as opposed to the mainstream media that tells you that you should “buy and hold,” the whole premise of investing is to “buy low” and “sell high.” **How can you do that if you don’t know where “high” and “low” exist?”**)

As you can see in the chart above the top of the two MACD indicators tends to give ‘early warning’ signals. These warning signals are just that – a ‘warning’ that you should start to pay very close attention to your portfolio.

Notice that in the chart above the SELL Signals in the bottom most MACD indicator ALWAYS align with the signals of the other indicators. When all of these signals align it is always in conjunction with a market correction.

Currently, the top of the two MACD indicators is very close to issuing a ‘warning.’ It will take a VERY strong rally next week to keep that from happening.”

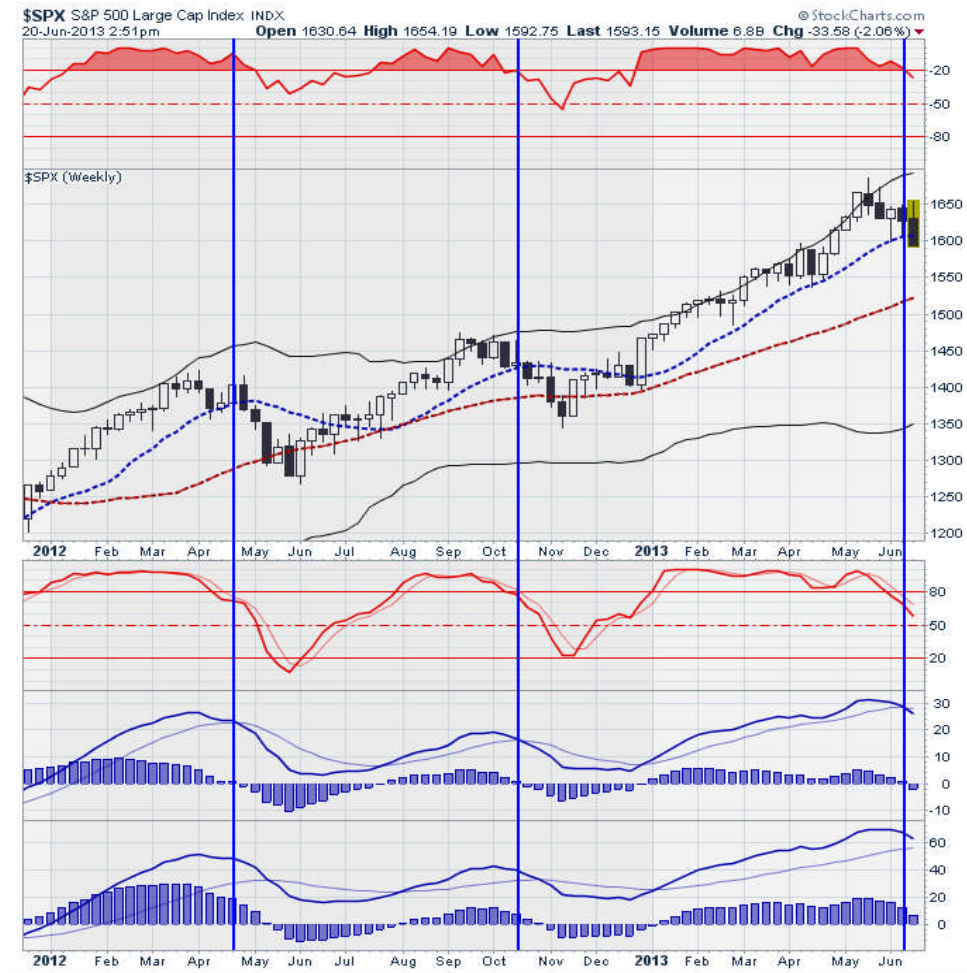
During this past week a “strong rally” failed to occur and an INITIAL SELL SIGNAL was triggered on Thursday. I updated the analysis that day in our [Daily X-Change Blog](#) stating:

“With the selloff in the markets today the market has not only thrown off a weekly sell signal (denoted by the vertical blue lines) but also violated support at 1600 as shown in the chart below.

(For a complete explanation of the charts above, and below, please review [last weekend's newsletter](#) which details all the different indicators in detail.

While much of the selloff has been attributed to the Federal Reserve’s statement yesterday I fear that the real culprit is likely a potential resurgence in the [Euro-zone crisis](#) as witnessed by spiking yields across the region and an announcement today that the IMF is likely to cease funding aid to Greece. From [Zero Hedge](#):

“As [we warned earlier in the week](#), Greece is notably missing its Troika goals and the issue just became a lot more critical. As [The FT reports](#), the **IMF is preparing to suspend aid payments to Greece over what it claims is a EUR 3-4 billion shortfall that has opened up**. Between health care budget shortfalls, central banks refusing to roll-over Greek bonds, and amid signs that even the scaled-back privatization plans that Athens had agreed to being behind schedule, the IMF - [following its own admissions of mistakes in the Greek bailout](#), has warned EU officials the shortfall will require it to stop aid payments by the end of July. The **equity market is already reacting** (as is EURJPY - EUR weakness against the big carry pair) to this re-awakening of EU event risk (and the awkward timing with Merkel's election so close) - with the Fed's comfort blanket somewhat removed.”



As I stated [in last weekend's newsletter](#) this initial **'Sell Signal'** is a warning that a further correction is likely to come. This is a **'wake up'** call to pay attention to your portfolio. However, this is not a signal to **'panic sell'** and make emotional based investment mistakes. In this regard here are the actions that should be taken within portfolios.

- 1) Review all holdings in the portfolio fundamentally to determine if anything has changed within the fundamental storyline.
- 2) Review each positions weight relative to the portfolio. Assume that each position in a portfolio was 5%. Trim back positions that are now greater than 5% back to portfolio weight. (It is not uncommon that when a warning is issued that the market will continue to rise – therefore, we only want to trim profits currently and sell positions on bounces if trends become broken.)
- 3) Positions that are **fundamentally broken**, lagging or otherwise not performing should be sold in their entirety UNLESS they are a hedge against a correction. Positions that are lagging during a market rally tend to lead on a market decline. (This includes gold, gold miners, precious metals, etc.)

4) **Do not sell winners to buy losers.** Hold cash as a hedge against the coming correction. Notice that all warnings above are eventually followed by a sell signal and a market correction.

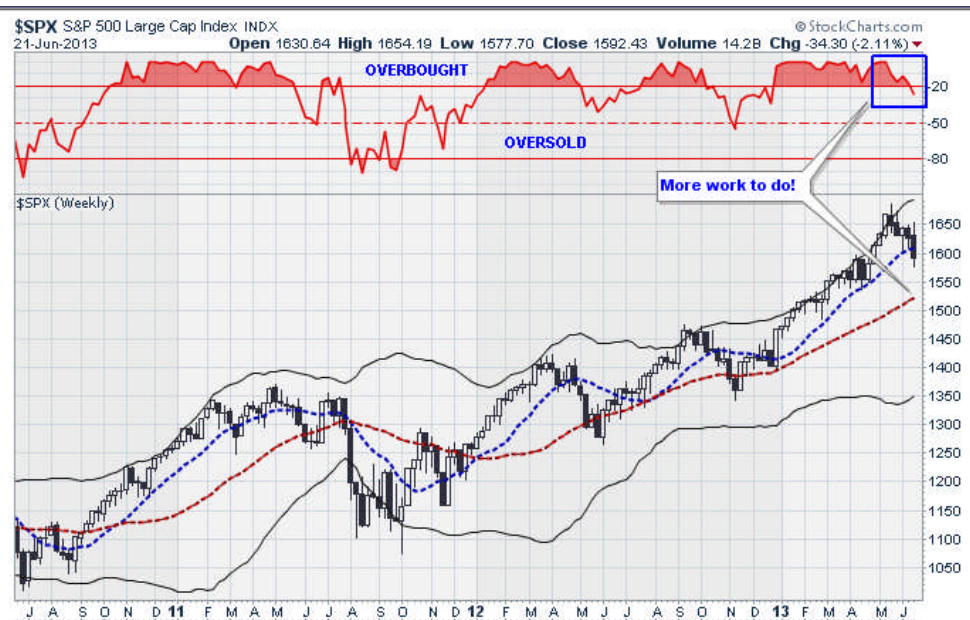
Notice that in the chart above the **SELL Signals in the bottom most MACD indicator ALWAYS align with the signals of the other indicators.** When all of these signals align it is always in conjunction with a more significant market correction. Currently, the indicators are issuing a very strong '**warning**' and it is likely that within the next couple of weeks we will see a deeper correction occur.

With support at 1600 now removed it is likely that we could see a retracement to the longer term moving average (red dashed line) above which is currently at 1525. A violation of that level and we have a whole new ball game to deal with."

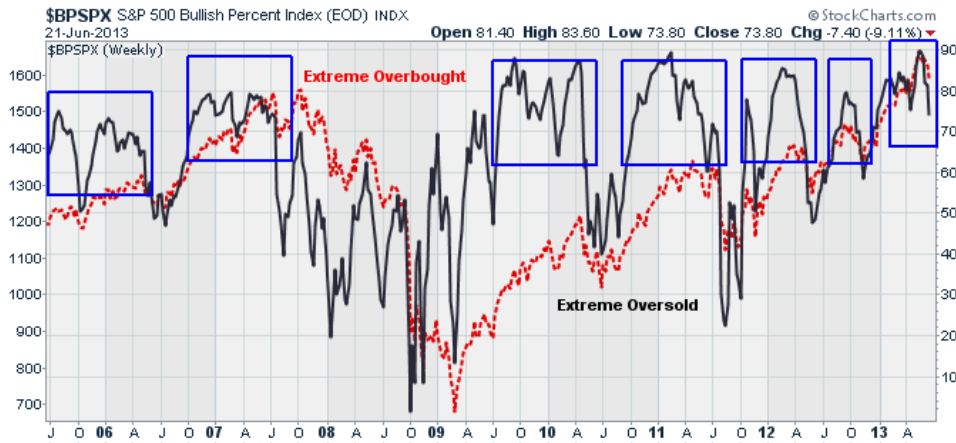
Still Over Bought, Bullish & Extended

Even with the correction that has occurred to date the market remains extremely overbought, overly bullish and extended. In order to provide for a more palatable entry into the markets to increase exposure to risk assets there is still considerably more work to be done.

The first chart below shows the overbought/oversold indicator is still in the overbought stage. It is likely that it will take a decline in the market back to the longer term moving average (1525) to correct the overbought condition for a better market entry point.

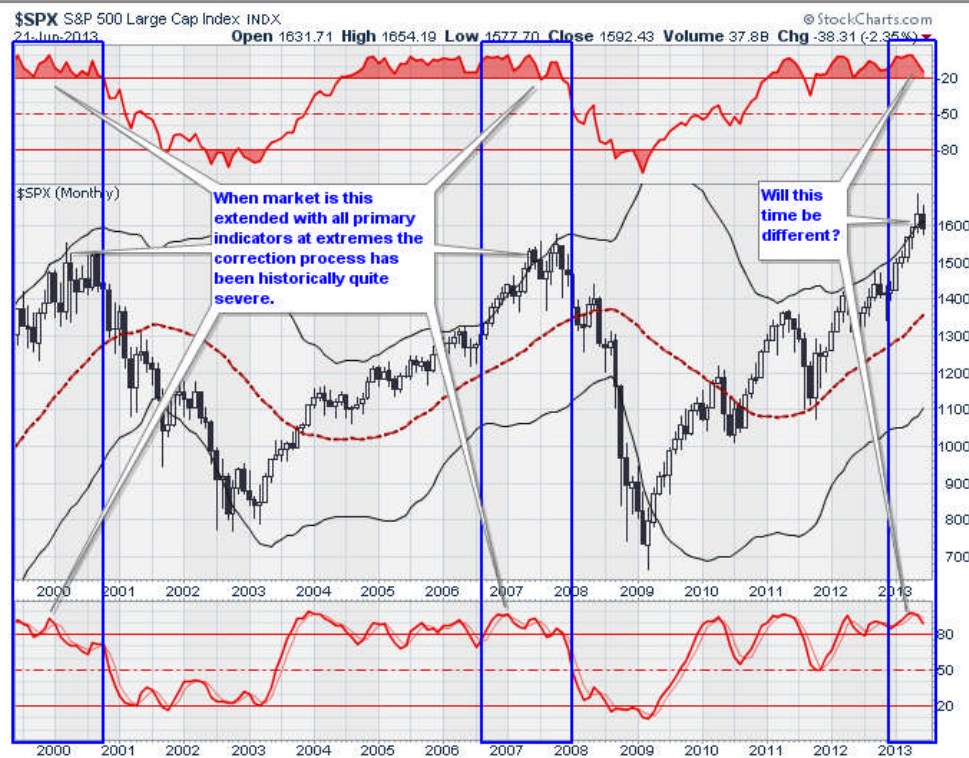


The next chart is the number of stocks on "bullish" signals as measured by the "bullish percent index." While the bullish percent index has declined a bit in recent weeks – it remains at extremely elevated levels. Furthermore, the downturn in the index indicates a generally deeper correction, than what we have seen currently, is underway.



Lastly, our standard deviation analysis, as we discussed last week, still shows that we are now beginning to work off some of the overextended nature of the recent advance. The chart below is a MONTHLY chart of the market which shows the extreme nature of the recent market action as compared to past market extremes.

If the current correction is the beginning of a more significant long term reversion process then there is still a lot more work to do before a friendlier risk/reward entry point is given. Even if the current correction is within the context of the 2011 correction we should expect a decline to somewhere between 1400 and 1500 on the S&P 500 index.



Summer, Debt and Eurozone

From all the analysis it appears that the current correction still has more room to go before it is done. There are also three factors weighing on the markets currently:

1) **Summer:** summer months tend to be the weakest months of the year for the financial markets historically speaking. Going back in history the returns in the summer months have averaged close to zero. The support for the markets to drive higher is waning; this leaves the path of least resistance for prices currently to the downside.

2) **Debt Ceiling Debate:** The showdown between Congress and the Senate over the debt ceiling and budget is rapidly approaching. Another massive brawl as we saw in 2011 could weigh on the markets.

3) **Eurozone:** More and more evidence is beginning to show that cracks are forming once again in the Eurozone. The question this time is whether the “jaw boning” of Mario Draghi will be able to stem the tide of a potential credit crisis and negative market impact.

Fundamentally, the economy is showing signs of weakening and earnings growth appears to be hitting more than just a “soft patch.” While there is no evidence of a recession currently there is little wiggle room to absorb any significant economic impact in the months ahead.

This is why the most important thing we can do is to continue monitoring our portfolio’s closely and making the necessary adjustments when our markets give us clear direction.

As I stated last week: *“It is important to remember that if you think that every position you buy is going to be a winner, or you expect your advisor to only buy winners, then you should **NOT BE INVESTING**.”*

It is an unrealistic expectation that will lead to larger losses than you can imagine. Having a loser in your portfolio is just a reality of investing – it does not mean you, or your advisor, is loser for making a mistake. There is NO PROFESSIONAL INVESTOR on the planet that doesn't have losers more often than not. It is how you deal with them that matters. Limit the loss, correct the problem and move on.

This is why the greatest investors in history all have the same investing rule in one form or another: ‘Cut your losers short and let your winners run.’

It seems simple – but it is an extremely tough rule to follow.”

Have a great week and I hope you are enjoying your summer.

Lance Roberts

STREETTALK ADVISORS

What makes us different?

It's really pretty simple. We believe that managing risk is the key to long term success. Conserve the principal and the rest will take care of itself.

Risk = Loss

Seems like a simple concept – yet most people take way too much risk in their portfolio which is fine as long as the market goes up. The problem comes when it doesn't.

Managed Risk = Returns

By applying varying levels of risk management to a portfolio of assets the potential for large drawdowns of capital is reduced thereby allowing the portfolio to accumulate returns over time.

Total Return Investing

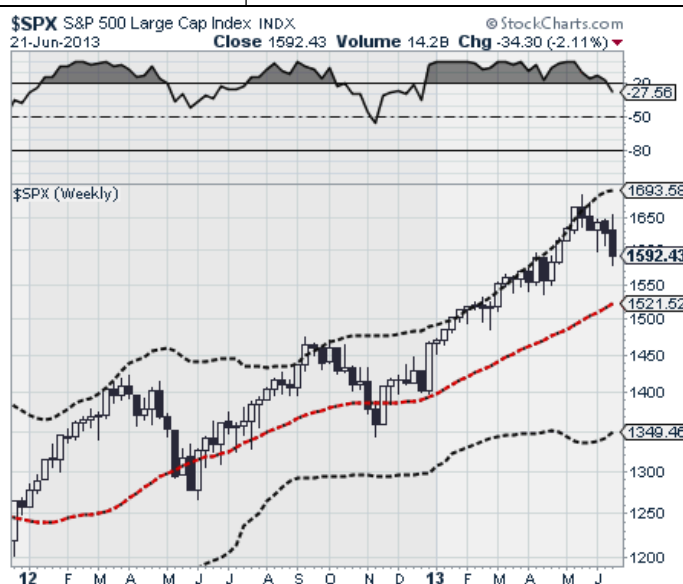
We believe that portfolio should be designed for more than just capital appreciation. There are times when markets do not rise. During those periods we want income from dividends and interest to be supporting the portfolio.

If you are ready for something different then you are ready for common sense approach to investing.

[Get Started Today!](#)

S&P 500 – Reduce On Rallies

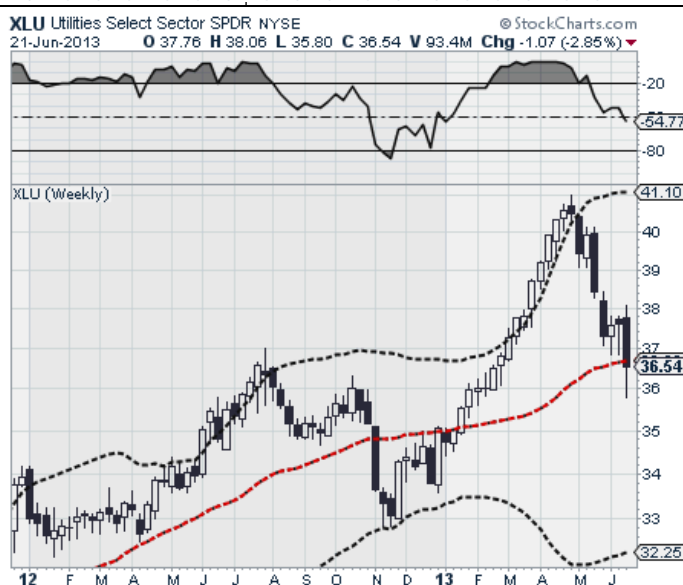
Current trend suggests that a further correction is coming. Reduce on rallies until current negative trend is reversed.



Utilities – Reversion To Mean Complete

While it is too early yet, given the recent spike in interest rates, to make a “buy” recommendation on this sector – the current correction has completed a reversion back to the long term mean.

It will be important for Utilities to find support at current levels otherwise a bigger correction to 2012 lows could be in the cards.



Technology – Lagging & Correcting

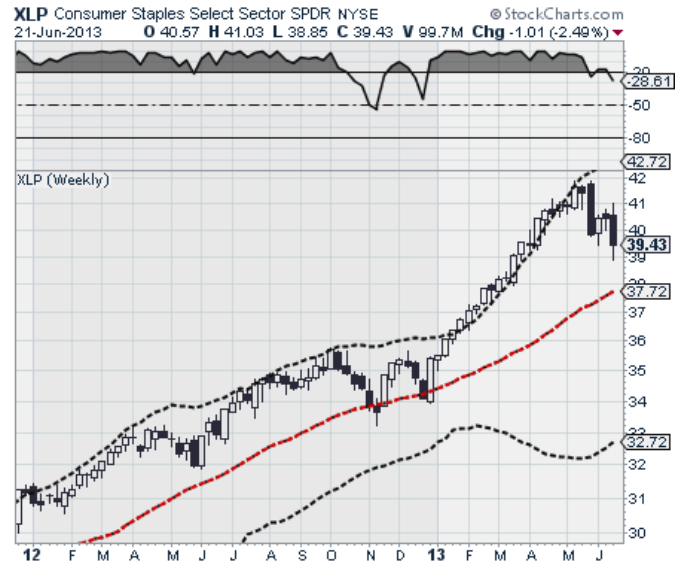
While technology did show some signs of life very late in the 2013 rally it appears that the correction in technology will pace the overall market.

Look for a reversion to the long term mean (red dashed line) before adding technology to the “watch list” for a buying opportunity.



Staples – Reduce On Bounces

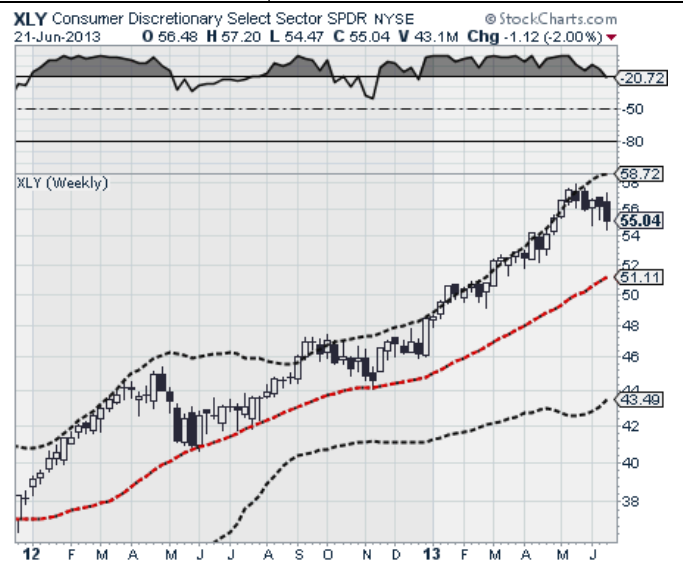
Besides the fact that most staple related stocks have gotten expensive valuation wise – the sector is in the process of a mean reversion. Currently still extremely overbought – staples should be reduced on rallies to underweight holdings until the correction process is completed.



Discretionary – Same As Staples - Reduce

The only difference between discretionary stocks and staples is that discretionary stocks have only begun its correction process.

Positions should be reduced to underweight until the correction process is completed.



Energy – Oil Failed On It's Breakout - Reduce

We stated last week that energy stocks had deviated from its long term correlation to oil prices. Last week the break out in oil prices from its "pennant pattern" failed as oil prices tumbled this past week.

Energy prices are now correcting back toward their long term mean but I would suspect that if oil prices continue their decline we could see a deeper correction in oil related stocks.

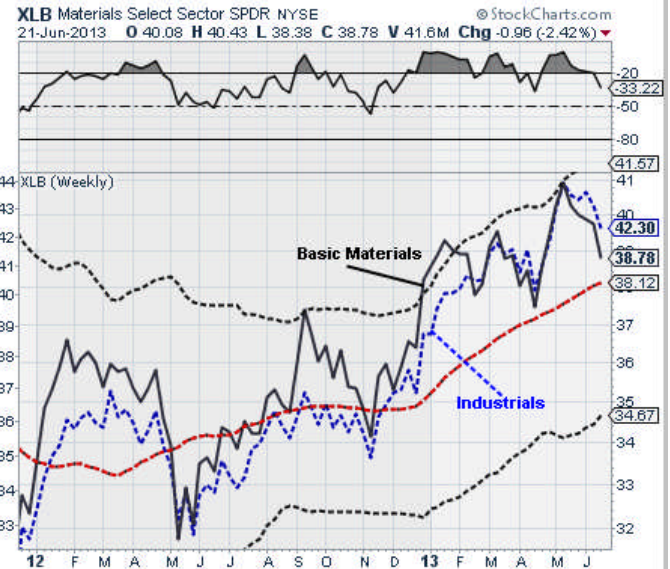
Reduce energy related holdings in portfolios on rallies for the time being until we see prices begin to firm.



Basic Materials / Industrials - Reduce

Materials and Industrials have always tended to move in lockstep with one another. Both sectors well within their current corrections and the reversion to their respective long term mean is almost complete.

However, with the breakdown in commodities and global economic weakness increasing (see CAT and FDX latest reports) I would remain underweight these sectors for now and cut back weightings on rallies. Look for a change in trend before adding back to holdings.

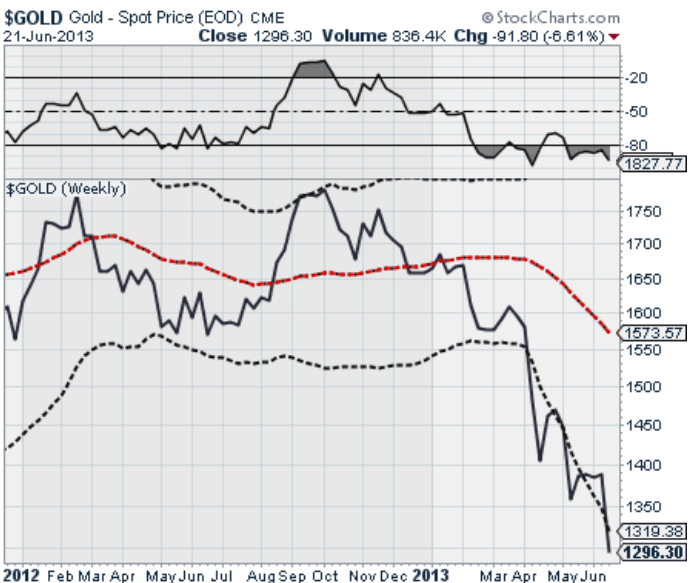


GOLD - Sell

The Gold trade is broken. The same for Silver, Gold Miners and other precious metals.

Last week gold violated its critical support levels which caused us to close out all holdings. This is a trade that has gone wrong and must be eliminated.

This does not mean that we will never own gold again – it simply means that until the price trends improve it is not worth exposing money to.



Interest Rates - Buy

For a complete explanation on interest rates and why we are recommending a technical buy on bonds please read the following:

[5 Reasons Why Now Is The Time To Buy Bonds](#)

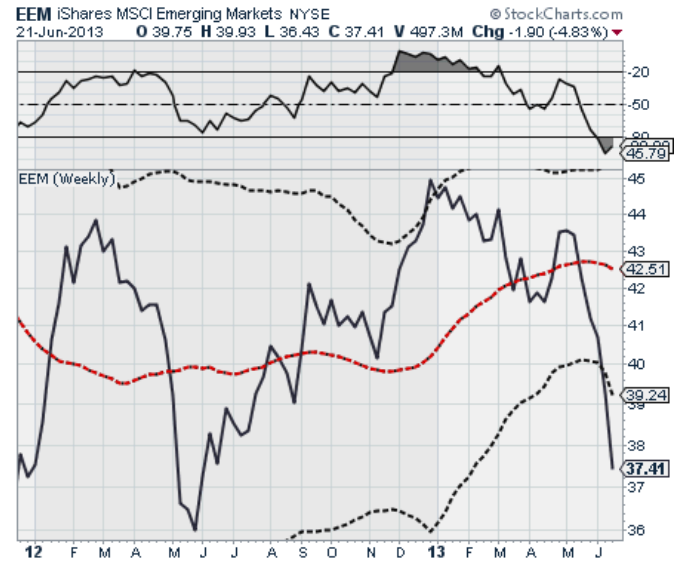


Emerging Markets – Very Oversold

There was a time, all the way back at the beginning of this year, that the media was touting that the strength of Emerging Markets would keep them chugging ahead of the U.S. Economy. I said then that this would not be the case. It turned out that I was right.

Emerging markets are being crushed by the depression in Europe. However, they are extremely oversold and due for a tradable bounce.

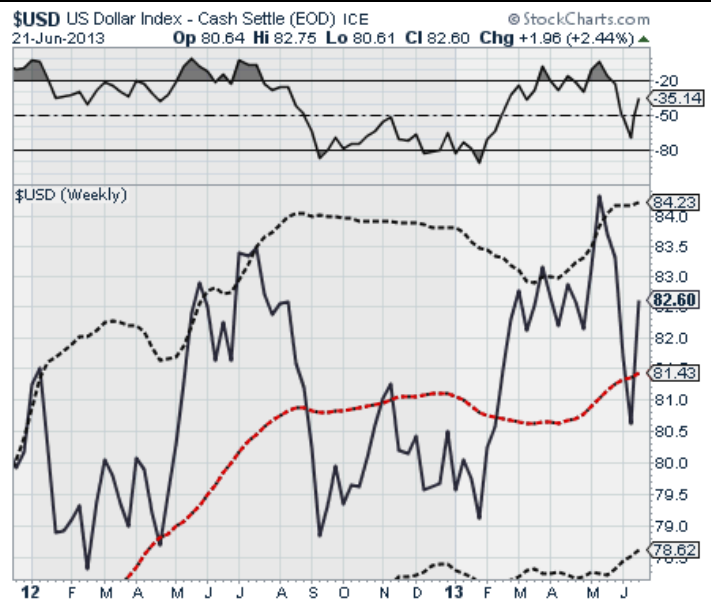
Long term investors should eliminate holdings from portfolios for now.



US Dollar – Oversold Bounce

I stated several weeks ago that the dollar breakout would not last. Since then the dollar has plummeted against foreign currencies until the market rout last week which saw short covering in the dollar and liquidation in all other asset classes.

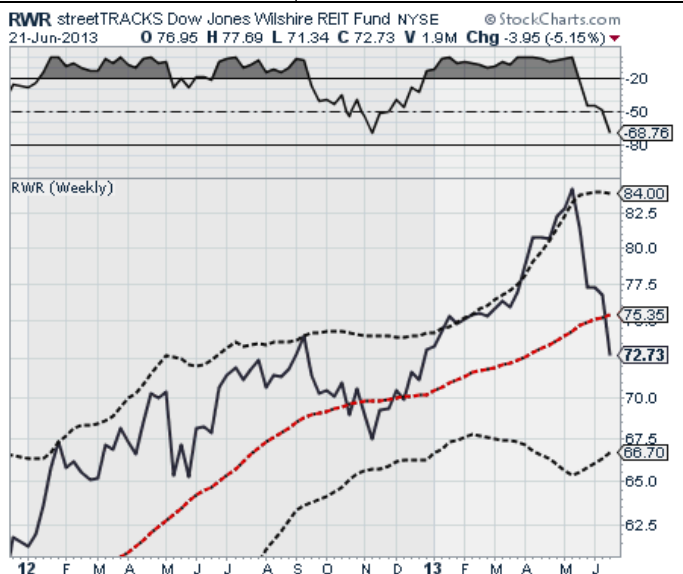
The dollar is likely to bounce back to 84 during the markets correction, however, longer term I think, for now, the trend will be to the downside as the U.S. Economy shows more signs of weakness.

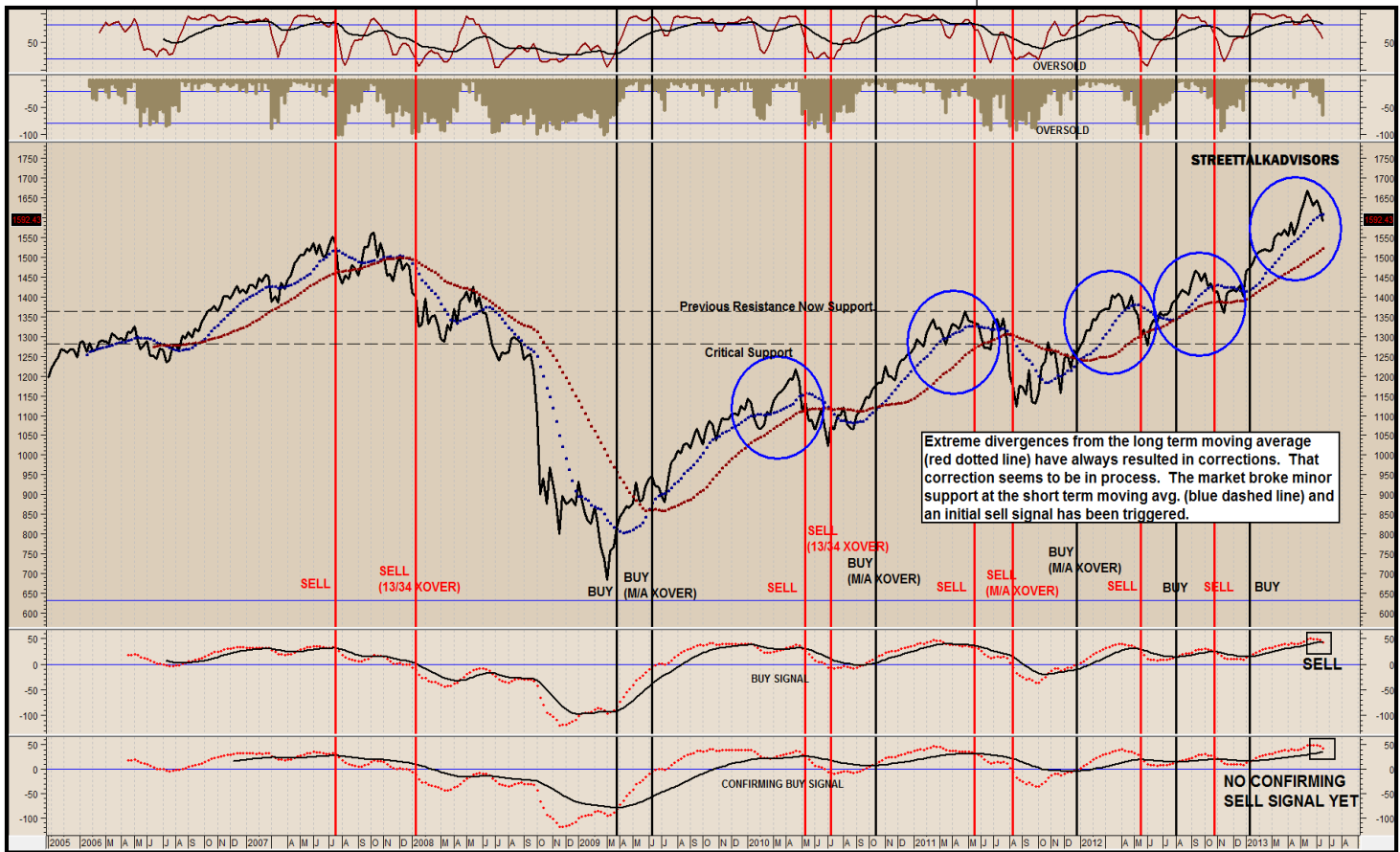


Real Estate – Sell

The sharp rise in interest rates as of late has driven a spike into the heart of the overbought, overextended and overvalued real estate sector.

Reduce weightings in these assets on any bounces to the long term moving average. Correction likely has further to go.





The rally that began in December of 2012 came to an end this past week as the correction triggered an initial sell signal and broke support at the short term moving average (blue dashed line in the chart above.) However, currently the bullish trend is still in place and critical support lies at the longer term moving average (red line) currently around 1525.

With earnings season gearing up, combined with still lofty expectations for corporate earnings, the path of least resistance for stock prices currently is to the downside. However, there is no indication, as of yet, that this is anything other than just a dip within the context of the current uptrend.

Therefore, there is no reason, as of yet, to reduce the portfolio allocation model from the current 100% allocation level.

However, as stated in this week's missive above, it is time to take some actions within your portfolio. We continue to highly recommend that you rebalance this week to the current allocation levels if you have not done so already if you are overweight equities and/or underweight fixed income.

If you need help after reading the alert; don't hesitate to [contact me](#).

[Suggestions Wanted]

I am in the process of revamping the newsletter and the 401k plan manager for the new website. If there is anything that you would like to see added to the 401k plan manager [please email me](#).

Common 401K Plan Holdings By Class

Cash	Stable Value Money Market Retirement Savings Trust Fidelity MIP Fund	Equity Large Cap	Vanguard Total Stock Market Vanguard S&P 500 Index Vanguard Capital Opportunities Vanguard PrimeCap Vanguard Growth Index Fidelity Magellan Fidelity Large Cap Growth Fidelity Blue Chip Fidelity Capital Appreciation Dodge & Cox Stock Hartford Capital Appreciation American Funds AMCAP American Funds Growth Fund Of America Oakmark Growth Fund ALL TARGET DATE FUNDS 2020 or Later Vanguard Balanced Index Vanguard Wellington Fund Vanguard Windsor Fund Vanguard Asset Allocation Fidelity Balanced Fund Fidelity Equity Income Fidelity Growth & Income American Funds Balanced American Funds Income Fund ALL TARGET DATE FUNDS 2020 or Sooner
	Fixed Income	Balanced Funds	
	Pimco Total Return Pimco Real Return Pimco Investment Grade Bond Vanguard Intermediate Bond Vanguard Total Bond Market Babson Bond Fund Lord Abbett Income Fidelity Corporate Bond Western Asset Mortgage Backed Bond Blackrock Total Return Blackrock Intermediate Bond American Funds Bond Fund Of America Dodge & Cox Income Fund	Small/Mid Cap	Vanguard Mid Cap Growth Fidelity Mid Cap Growth Artisan Mid Cap Goldman Sachs Growth Opportunities Harbor Mid Cap Growth Goldman Sachs Small/Mid Cap Opp. Fidelity Low Price Stock Fund Columbia Acorn US Federated Kaufman Small Cap Invesco Small Cap

The above represents a selection of some of the most common funds found in 401k plans. This is not meant to be a list of "suggested funds" but rather a guide to match up the selections in your existing 401k plans to the allocation model asset class weightings in the chart below.

I will modify this list over time as the asset allocation model changes to reflect international holdings, emerging markets, commodities, etc. as the model changes to reflect the addition of those holdings.

[Email me](#) if you need further assistance.

Current 401k Allocation Model

5.00% 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

60.00% Equity (Stocks)

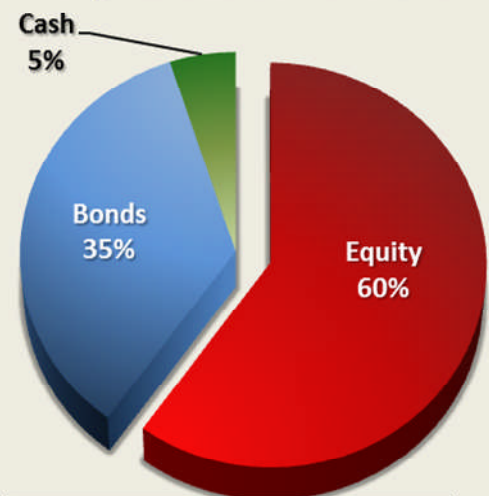
*The vast majority of stock funds track an index.
Therefore, select on ONE fund from each category.
Keep it Simple.*

30% Equity Income, Balanced or Conservative Allocation

20% Large Cap Growth (S&P 500 Index)

10% Mid Cap Growth

Fully Allocated Portfolio



This is how your portfolio should be weighted when at 100% of goal.

Disclaimer & Contact Information

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