October 20, 2014

10:26 PM EST

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Inside this issue

Strawberry Band-Aids

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I am going to be on Fox Business' **Making Money with Charles Payne** for a full hour on Tuesday (October 21) from 6-7 PM. This is a relatively new show and I compare it to a modern day Wall Street Week with Louis Rukeyser. The hour flies by and it is really packed full of relevant topics.

A few weeks ago, I was on the show and I really enjoyed the banter and high paced content. The good folks at FBC chopped the show into bit sized links to view **here.**

Speaking of the media and a very nice segue, one of the non-formulaic inputs I use to figure out where the market is going has to do with media requests. Especially during declines, the number of media calls, emails and requests to appear usually spikes. That makes sense as declines are emotional and editors know that market stories and forecasts are likely to be watched, read and heard by the average person. When I am contacted by non-financial, mainstream local media, a major bottom is usually very close at hand.

Over the past two weeks, it felt like I did an awful lot of media although none on the local front with the decline being so small on a relative basis. Below you can click on a small sample to
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read what I said. Nothing will come as a surprise to long time readers. You can also go to **http://www.investfortomorrow.com/InMedia.asp** for a comprehensive list.

Advisers on sell off: Keep calm and diversified

Advisers tested by spike in market volatility

I also did two really interesting segments with my friend Jeff Macke at Yahoo Finance. In next week's issue, I will discuss and update those segments, one on bubbles in the financial markets and the other discussing the end of the bull market in 2015.

Finally, as long time readers know, there is never a dull moment in the Schatz house or lack of crazy or funny stories. Today, as I was running from dropping one son off at swim practice to an evening endowment meeting, Teri texted me the following comment from our 6 year old son who had just taken a nasty spill on the cement running from field to field. He cut up his arms and knee, but didn't cry because a bunch of other kids were there and "only little kids cry."

Teri took D to the bathroom to clean him up and cover the wounds. As she washed them off and put on a strawberry band-aid, yes strawberry, D turned to Teri and in his strong New York accent (from where it came, we have no idea) said, "Mom, strawberry band-aids are not just for babies. Real mean like me wear them too!"

Don't forget to check our blog for intra-issue updates.**www.Investfortomorrowblog.com**

Nailing the Bottom... For Now

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In the **last issue** I wrote about stocks being in a "murky" period for the next few weeks. I am going to pat myself on the back and say it has certainly looked "murky" since early October although I wish I had been more aggressive in taking action. The dark clouds have recently dissipated and the sun is starting to pop out. Once the decline began, it looked like the second half of October would see a low and that's been confirmed.

Also from the last issue, I shared research that indicated a 15% chance of a 8-11% decline during the Q4. This was based on the S&P 500 seeing a fresh high in September or October which usually insulates the market from much more than a 10% decline. So far, on a closing basis the Dow and S&P 500 have dropped almost 7% and 7.5% respectively, and 8.6% and 9.4% on an intra-day basis. The other major indices have seen more significant weakness.

Either by skill or luck, I am always happy to nail a low as it occurs, especially now, when so many others were calling for much more serious damage. With the world fixated on Ebola, Europe's economy, earnings and ISIS, fear was prevalent last week, the likes of which we haven't seen since mid June and in
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some cases, 2011.

So far, all we know for sure is that "A" bottom was achieved. Whether it was "THE" bottom remains to be determined. If prevailing sentiment becomes "sell the rally", the upside is likely to continue. However, if the masses believe that we just saw the final bottom of 2014 on the way to new highs, a more difficult path will be in store as I discuss below.

I continue to watch two scenarios as the most likely paths over the coming months. The green line in the chart below is obviously the more bullish of the two. It has last week's low as "THE" low from which the year-end rally has already launched and all time highs are to be seen within a few months. The orange line forecasts a lot more volatility with the currently rally petering out shortly and marginal new lows seen within a few weeks. From there, the real rally begins, similar to 2011, with higher prices down the road.

What is obviously missing from the scenarios above is a truly bearish one that has the bull market already over and this current rally representing a good selling opportunity leading to sharply lower prices right into the New Year and beyond. At this point, I just don't see it. We simply do not have enough dead canaries to warrant such a negative outcome. And speaking of dead canaries, I will update the Canaries in the Coal Mine next week.

For now, the takeaway is to watch for signs that the rally is hitting stumbling blocks. High yield (junk) bonds had a truly epic day on Friday, recovering five days worth of declines in one day. That nascent advance must live on. Good sector leadership needs to emerge and not from consumer staples, utilities and REITs. Although the banks are a bellwether sector, the bull market can live without them for a while longer, but that will likely lead to the eventual demise.

Before I finish this article, there are things that concern me. It's not all roses out there! After 67 months, the bull market is showing its age. Traditional Dow Theory just gave its first negative trend change in some time as both the industrials and transports closed below their August secondary lows. That's long-term problematic unless both make fresh all time highs in the coming months. What would bother me even more is if one index scores a new high, but the other one does not. Anyway, we have time to explore this further next week.

Short-Term It's Happening on the Blog

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For those of you interested in short-term comments, you should find the**www.investfortomorrowblog.com** very helpful. I publish several times during the week and you can sign up to be notified by email when something new has been posted. **http://www.investfortomorrow.com/BlogAlerts.asp**

Last Wednesday, after seeing the Dow down 370 in early trading, I posted the following on the blog.

If you woke up this morning, turned on the computer or TV and saw another Texas healthcare worker with Ebola, European markets under siege yet again and our own stock market futures in collapse, you probably did not feel so great. Anxiety? Panic?

As the morning progressed and our stock market opened, your saw an immediate mini panic with the Dow down 370. At the same time, the 10 year Treasury note's yield absolutely and totally collapsed under 2%. That is capitulation in stocks and flight to quality or safety in bonds. Heading to the exits en mass. Throwing the baby out with the bath water. Choose any cliché you want.

(Side note. Our Global Asset Allocation strategy has owned treasury bonds almost every day this year and today is the first time we are seeing a sell signal in that asset as its price has spiked to unsustainable levels.)

Is this "A" bottom or "THE" bottom or even a bottom. We should know more by the end of the day. If stocks rollover yet again during the afternoon and close below the lows of the morning, the panic is likely to follow through until we see another panic set up. If, however, stocks can hold the morning low and firm
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throughout the day, even to still close down, that would be a good sign that at least a bounce, if not full fledged rally is here.

[Post blog note: Stocks saw one more selling wave and then firmed the rest of the day, closing well off the lows.]

The Russell 2000 index of small cap stocks, which has been bludgeoned since July has performed very well this week on a relative basis. And so far today with stocks taking it on the chin early, small caps fought back to unchanged. This is bullish behavior and not typically what we see if stocks were on the verge of additional collapse or even crash. It will be VERY telling to see how the Russell 2000 ends the day.

[Post blog note: Russell 2000 held firm during the final selling wave and closed the day nicely in the green.]

Besides the small cap stocks, Apple and Netflix have been pillars of relative strength of late. When stocks finally bottom and bounce, I would closely watch these two large caps for leadership.

[Post blog note: While Apple held up very well and continues to do so as it reports earnings tonight, Netflix missed its earnings and sold off sharply. A longer-term concern I have is that one by one, the market is losing long-term leadership.]

On the sector front, none have been spared the carnage of the last month with energy being decimated the most, close to the point where they have performed so poorly, it's actually good going forward. I remain positive on REITs, biotech, transports and semiconductors for now, but that should change with the heightened volatility from day to day and week to week.

I fully expect wild swings today and probably the rest of the week.

On Wednesday and Thursday, most of our models returned to maximum equity exposure and I followed up with another short-term blog post on Friday, which you can read on the blog.

Upcoming Appearances

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Fox Business' Making Money with Charles Payne - October 21st 6:00pm - 7:00pm

Fox Business' Making Money with Charles Payne - November 4th 6:00pm - 7:00pm

Second Half class at U. of Mass. Dartmouth - October 29th 9:30am - 11:30am (email me for
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details)

You can view most of the past segments by clicking below.

Media Appearances

(http://www.investfortomorrow.com/InMedia.asp)

Investment Quotes/Adages To Live By

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"The only easy day was yesterday."
- The U.S. Marines

"When in doubt, get out!"

"If it's obvious, it's obviously wrong."
-Joe Granville

"It's ok to be wrong, but it's not ok to stay wrong."

"This time is different."

"The markets require the patience of a dozen men."
-Robert Rhea

"Luck is the residue of effort."

"The most bullish thing a market can do is go up in the face of bad news."

"The most bearish thing a market can do is go down in the face of good news."

"The market can stay irrational longer than you can stay solvent."
-John Maynard Keynes

"Government is best which governs least" - Thomas Jefferson

Inflation is the one form of taxation that can be imposed without legislation.
-Milton Friedman

"You cannot legislate the poor into freedom by legislating the wealthy out of freedom. What one person receives without working for, another person must work for without receiving. The
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government cannot give to anybody anything that the government does not first take from somebody else. When half of the people get the idea that they do not have to work because the other half is going to take care of them, and when the other half gets the idea that it does no good to work because somebody else is going to get what they work for,that my dear friend, is about the end of any nation. You cannot multiply wealth by dividing it." - Dr. Adrian Rogers, 1984

"Bear markets seem to be divided into three phases: the first being the abandonment of hopes upon which the final uprush of the preceding bull market was predicted; the second, the reflection of decreased earnings power and reduction of dividends, and the third representing distressed liquidation of securities which must be sold to meet living expenses. Each of these phases seems to be divided by a secondary reaction which is often erroneously assumed to be the beginning of a bull market."

- Robert Rhea via Tim Woods

"Free enterprise is a rough and competitive game. Nobody too big to fail. Nobody too small to succeed. It is a hell of a lot better than government control." - Ronald Reagan via Dan Kennedy

"A government big enough to give you everything you want is big enough to take everything you have." - Gerald Ford via Dan Kennedy

"The problem with socialism is that, sooner or later, you run out of other people's money." - Margaret Thatcher

"Diversification alone is no longer sufficient to temper risk... You need something more to manage risk well."

- Mohamed El-Erian

Friends And Family Plan

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Finally, as you know, our firm and this newsletter continues to grow mostly from your referrals. If you know anyone who is interested in securing their retirement, planning for it or just plain worried about it, please send them here. As always, thanks for thinking of us with your circle of family and friends.

Sign Up Here

You can also forward this email to family and friends by hitting the "forward email" hotlink at the bottom of this email.
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