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Stocks Fall Sharply But Light at the End of the Tunnel

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By now, everyone knows that the Dow Jones Industrials fell by 1000 points last week, including a 531 point down day to close the week. More selling lies ahead in the short-term. It's getting ugly. There's blood in the streets. Sell what you can not what you want. Margin calls are coming. Maximum pain thresholds are being hit for the individual investor. Panic is here!

Before I opine on what it means, let's put it all in perspective. 531 points is a 3% decline and 1000 points is just under 6%. Since the Dow peaked on May 19, the popular index has corrected 10% so far. In a worst case scenario, it could grow to 15-20% if China unravels beginning Sunday night.

For several months I have written many times about my concerns with the market. The most timely blog post was right at the most recent top on July 20.

http://investfortomorrowblog.com/archives/1803

There were plenty of opportunities to take action, hedge, play some defense, sell, just do something proactive! I am sure that the vast majority of investors did absolutely nothing. In our portfolios, I am
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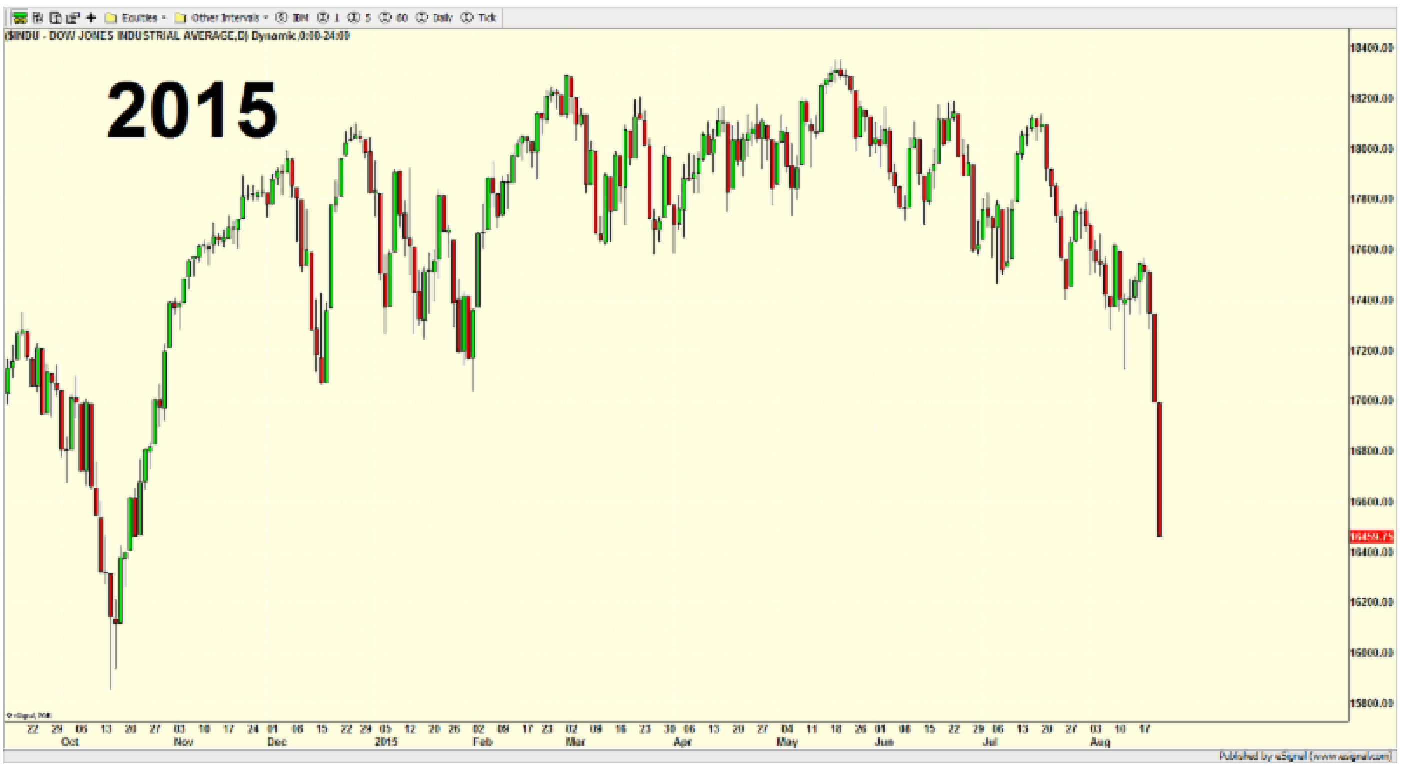
happy to report that we definitely took action several times by selling to raise cash as well as buying bonds which typically act as a flight to quality or "safe haven".

I am not arrogant enough or naive enough to believe that during a full-fledged stock market correction that we won't lose some money, but I am definitely pleased with our high levels of cash. This is a market time that separates the wheat from the chaff. The "pretenders" in the business get exposed. Investors don't plan to fail. They fail to plan.

I often speak about the investing risk/reward ratio, referencing 18,500 on the upside and 16,900 on the downside. That negative skew caused us to take various defensive measures in many of our 12 strategies over the past few months. With the Dow finally closing below 17,000 with more downside to follow, the risk/reward is in the process of swinging firmly back to the positive side. It's time to build a shopping list and prepare to deploy some of the beautiful cash that has built up.

Before I dive into the details of the stock market, I am going to start with my conclusion. While the evidence is certainly not as strong as it was a few months ago, I do not believe that the 6+ year bull market has ended; read, all-time highs lay ahead. The weakness looks like the first full-fledged correction since October 2011. The behavior we are currently seeing looks similar to what we actually saw in 2011, as you can see from the two charts below.



As I write this over the weekend and have not seen any stimulative action yet around the world, the preponderance of the evidence suggests that stocks are about to the enter the bottoming process, as soon as this week. While that doesn't mean an immediate return to Dow 18,300, it does suggest that the repair process starts sooner than later, although high volatility won't end soon.

From time to time as my great friend and colleague, Sam Jones, likes to say; Calling All Cars. It's time add cash to your accounts. Blood is in the streets. Panic is setting in. It's time to take on a little more risk or open a new strategy that's more aggressive. That will likely be my theme for the next few weeks. On a personal level, I will be making my entire 2015 retirement plan contribution over the next few weeks so you truly know I how view the current situation.

If you have any questions about the market's correction or your portfolio, please don't hesitate to contact me directly by replying to this email or calling the office.

Wave of Recognition

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I have already mentioned that the Dow is down 10% from its high with more on the way. The S&P 500 is off 7.5%, while the S&P 400, Russell 2000 and NASDAQ 100 have similar results to that of the Dow. This past week's selling is what I have often referred to as the wave of recognition.

It's the waterfall or elevator shaft decline that creates media headlines. Investors realize that this is no longer the mild bout of 3-5% weakness that bottoms quickly and returns to new highs. In October, amid the Ebola scare, the wave was just a few days before the final low.
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During this wave of selling, the market leaders are taken out and shot. It's ugly for them and it's not over yet. Biotech, consumer discretionary, home builders and healthcare all under siege. Amazon, Regeneron, Google, Netflix, Facebook, etc. were bludgeoned.

Dow Theory Sell and Death Cross

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Over the past week pundits have spoken about the "dreaded" Death Cross where the average price over the last 50 days on the Dow trades below the average price over the last 200 days. We have heard about a Dow Theory trend change, something I have written about several times before.

http://investfortomorrowblog.com/archives/1442
http://investfortomorrowblog.com/archives/1453

There is one again as both the industrials and transports closed below prior reaction lows (see blue lines on the charts below), signaling further downside.
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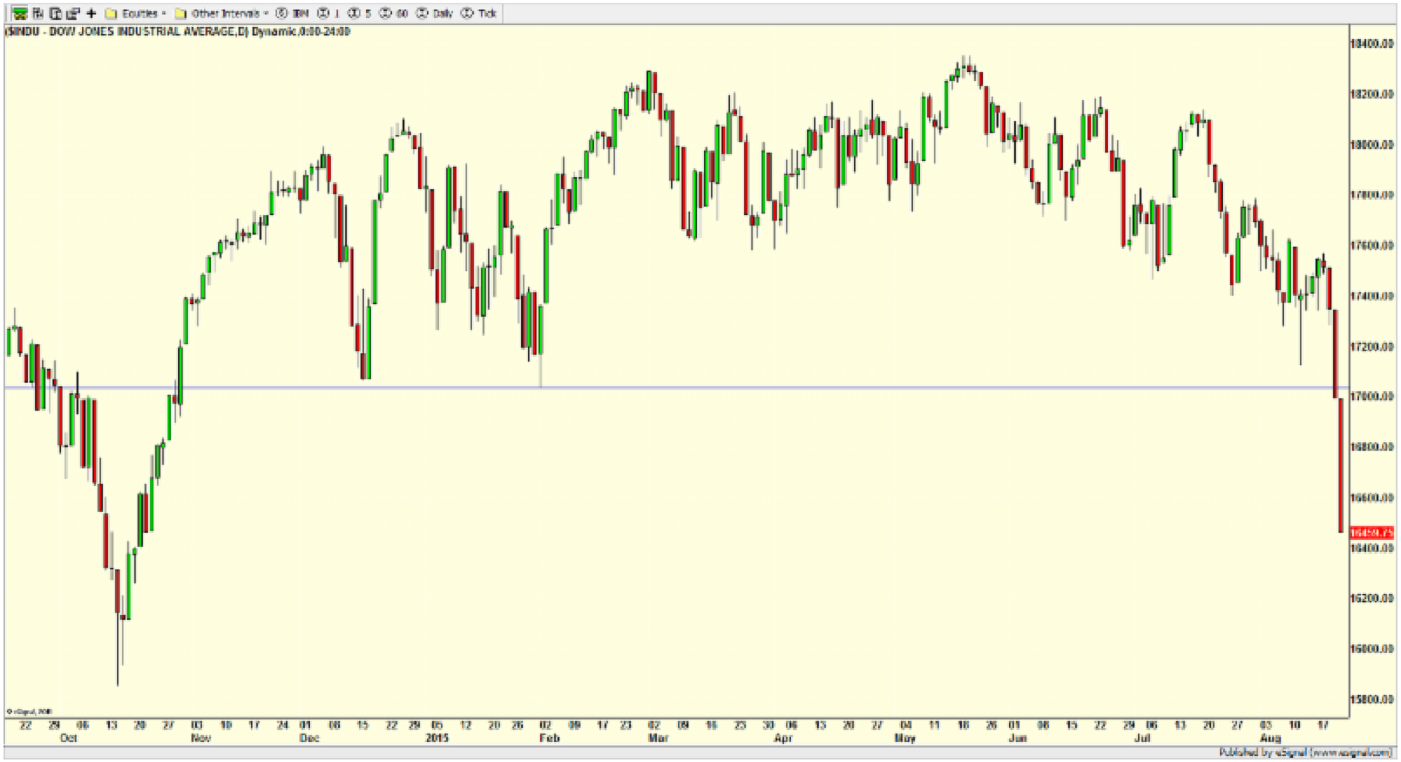

However, remember that the same condition occurred near the bottoms in October 2014, May 2012 and August 2011, right before stocks began another leg higher.

Are you getting the picture yet of all the negative sentiment popping up? This is exactly the opposite of what concerned me a few months ago when the headlines and masses were so positive.

3 Scenarios to Watch on Monday

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There are three scenarios I see for Monday and the short-term.

1 - Stocks open sharply lower and then spend the morning stabilizing and closing at least okay. From there, a sharp, snapback rally develops for 1-2 weeks before rolling over again to the downside. The final low is seen next month at lower levels.

2 - Stocks open sharply lower and see one or two feeble and failing rallies during the morning before a full-fledged crash in the afternoon. The Dow closes down at least 1000 points. Stocks remain volatile the rest of the week, but establish a low, just not the ultimate one.

3 - Stocks open higher and rally all the way to the close. The advance continues for a few days before rolling over again to the downside with another leg lower to come.

The bottoming process begins this week. The length of the process will be determined by how stocks act during the week.

If you have any questions about these scenarios, please reply to this email or call Renee in the office to schedule a meeting or call.

Upcoming Appearances

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Yahoo Finance - Live Show - September 16th Noon

Fox Business' Making Money with Charles Payne - September 16th 6:00 - 7:00 PM

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

"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
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