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Just Not a Good Season

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This newsletter is going to print on the long side because of all the charts included. For that reason, I am limiting it to two articles instead of three. I have another few articles lined up for next week when I will be on the road in Florida for meetings. I wish I could bring my golf clubs, but as with most of my travel, I jam pack my schedule to get the most out of being away. Four to five hours is a lot of time! However, if you're on the southeast coast of Florida and want to grab coffee or breakfast, let me know!

It's been a very challenging start to 2016 for the stock market bulls and I do not believe the extra large swings are over just yet. While the majority of the damage has already been done, I expect the uneasiness and volatility to continue through March before a better landscape sets in.

As with most corrections, really successful investors typically add to strategies with good long-term records during bouts of weakness. For those investors who realize that the volatility is greater than they want to experience, the best time to reduce risk is during the rally that occurs after the correction and not before. If you would like to discuss your own situation, please hit reply or call the office to schedule a meeting.

I could probably use the same market comments to describe the ski season in Vermont for '15-'16. It just hasn't been good overall! But that hasn't stopped some great times with two of the kids, the boys. My daughter has 3-5 basketball games every weekend so Teri volunteered to play chauffeur for the winter.
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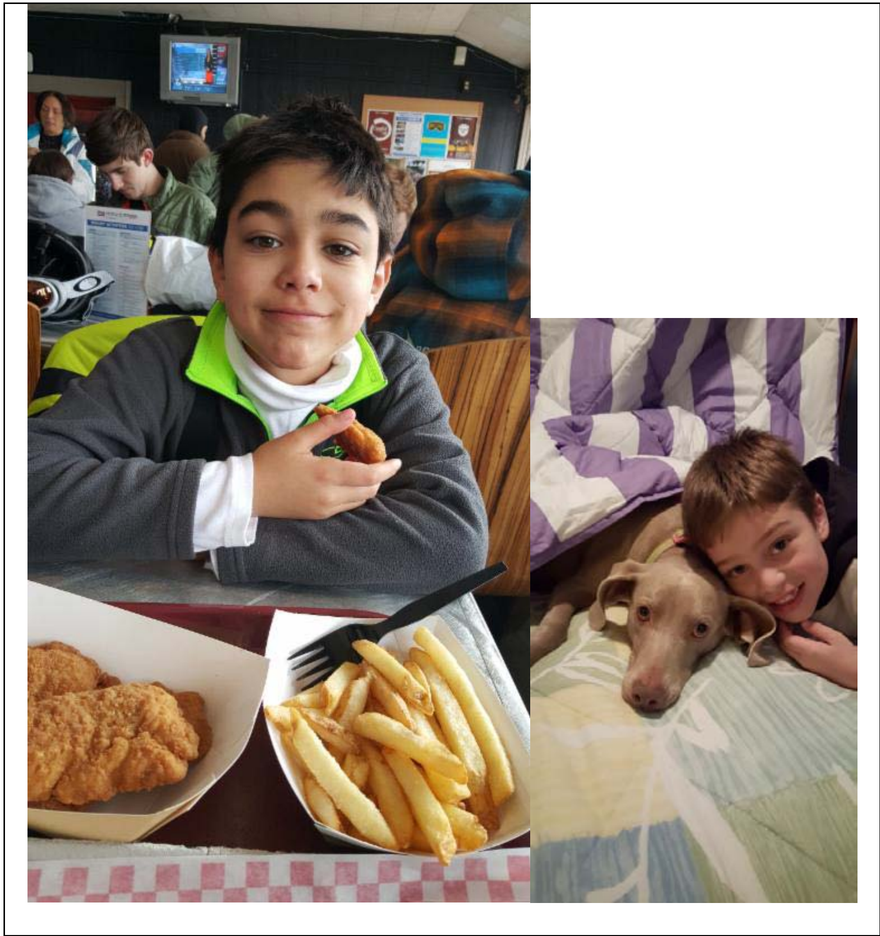
Below are the boys in Vermont. One at lunch eating less than healthy fare and the other hanging out with his favorite four-legged friend, Sydney.



As I mention from time to time, in between Street$marts issues I am often very active on**www.Investfortomorrowblog.com**, especially when market are volatile like now. If you would like to be notified when a new posting has been made, please see this link.**http://www.investfortomorrow.com/BlogAlerts.asp**

Panic Buying Seen Off January Low

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On January 22nd and January 29th, an extremely rare occurrence was seen in the stock market; something that had only happened 9 times since 1971. Over a span of five days, there were two days where 90% of the trading volume on the New York Stock Exchange took place in stocks that were up on the day.

90% volume days are nothing new to analysts. They have been watched since the days of Jesse Livermore in the 1920s. However, two so close together is a rare feat and something that should be watched very closely. Pre-2007, these events, most commonly known as breadth volume thrusts, were as rare as a pink rhino and always led to a new or refreshed bull market. Starting in 2007, however, these events have been seen roughly once every year and a half and their behavior has changed somewhat.
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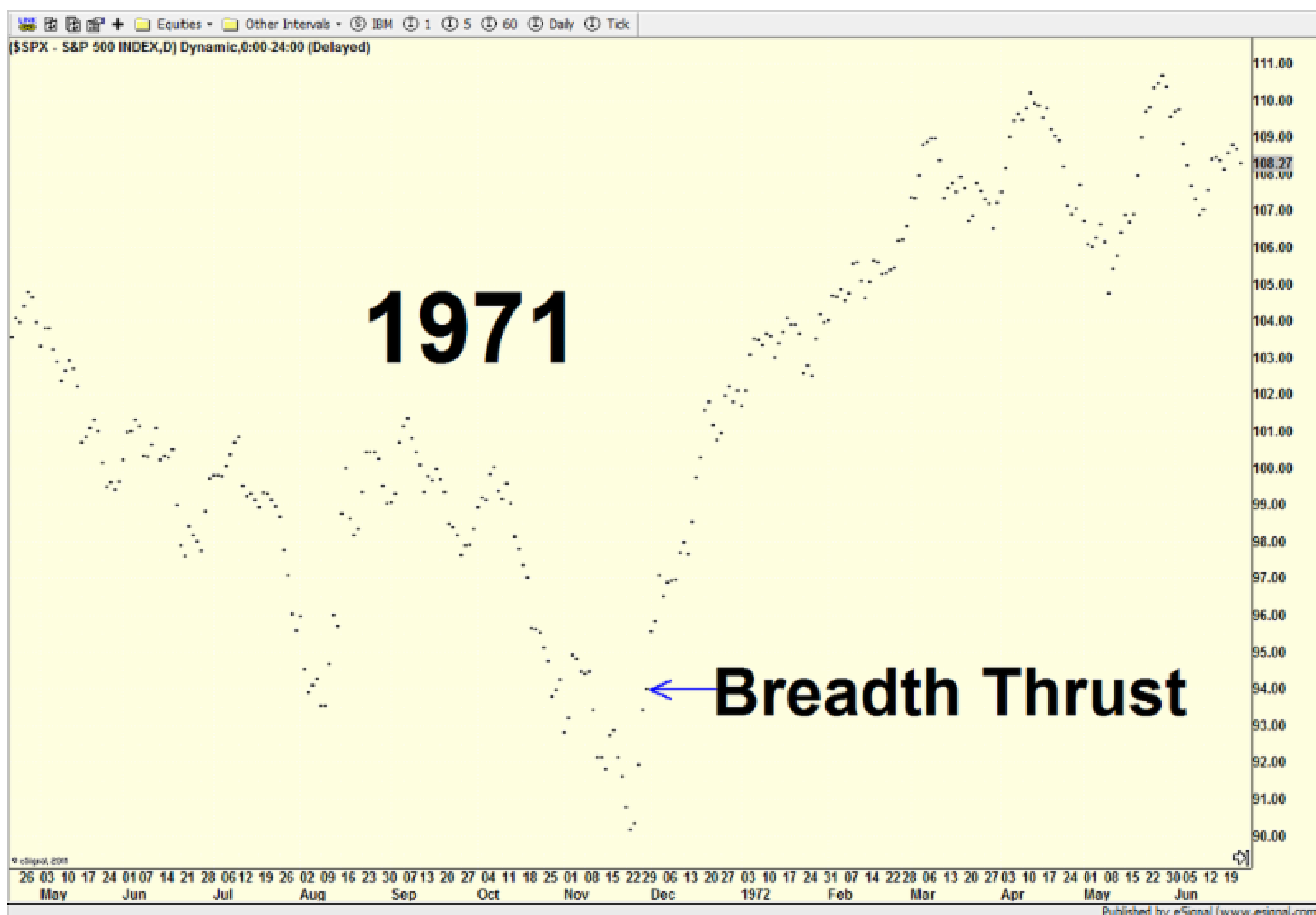
What changed?

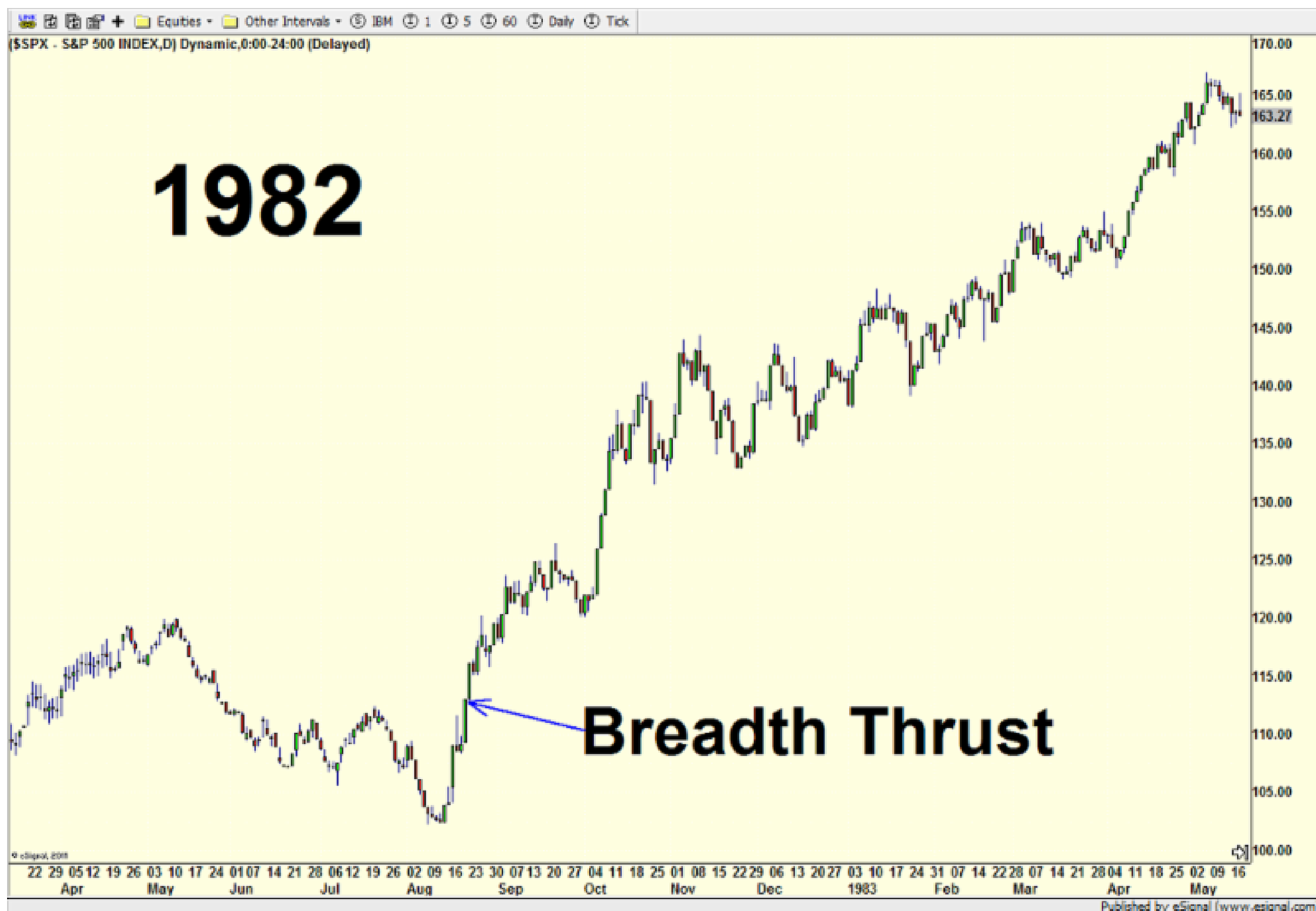
In July 2007, the SEC eliminated the uptick rule which had been in place since the 1930s to prevent short sellers from piling on a stock that was accelerating to the downside. (Short selling is the exact opposite of buying. One sells a stock they technically do not own in hopes of buying it back at lower prices.)

On the surface, I would have thought that these events would occur more frequently after the SEC eliminated trading stocks in fractions in 2001 and went to full decimalization. This change basically eliminated stocks closing unchanged on the day. Upon deeper analysis, the real culprit beginning in 2007 after the uptick rule was eliminated was the much maligned algorithmic or high frequency trading. This acutely hyper and ultra short-term computer driven trading exacerbates moves, especially on the most lopsided trading days which just happen to be on the days in question.

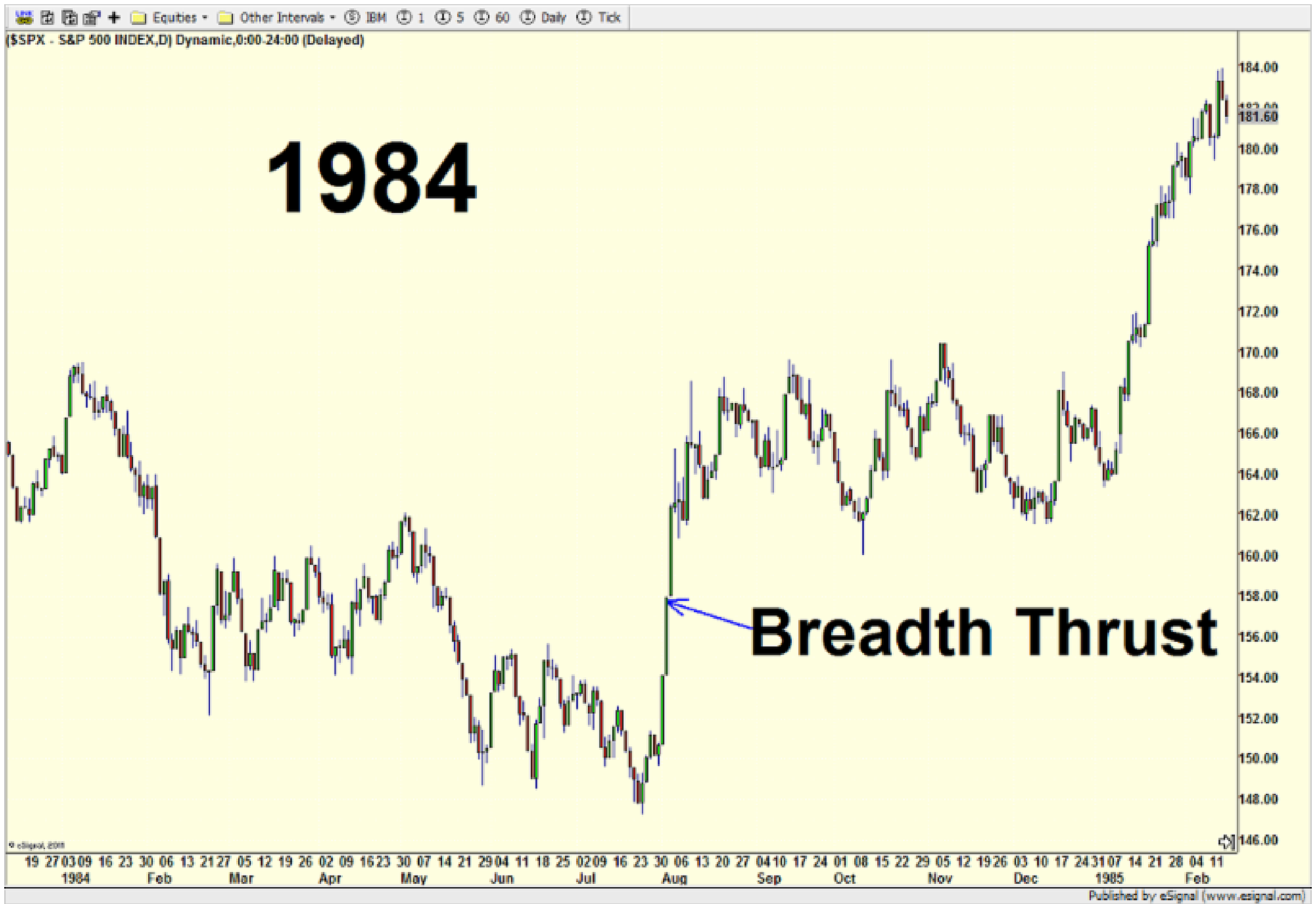
Getting back to the original topic at hand, the breadth volume thrust, let's dive in to the previous 9 occurrences to see similarities and differences. In 1971, it hit as stocks emerged from a bear market and never looked back over the ensuing few quarters. The drawdown or paper loss was 0.



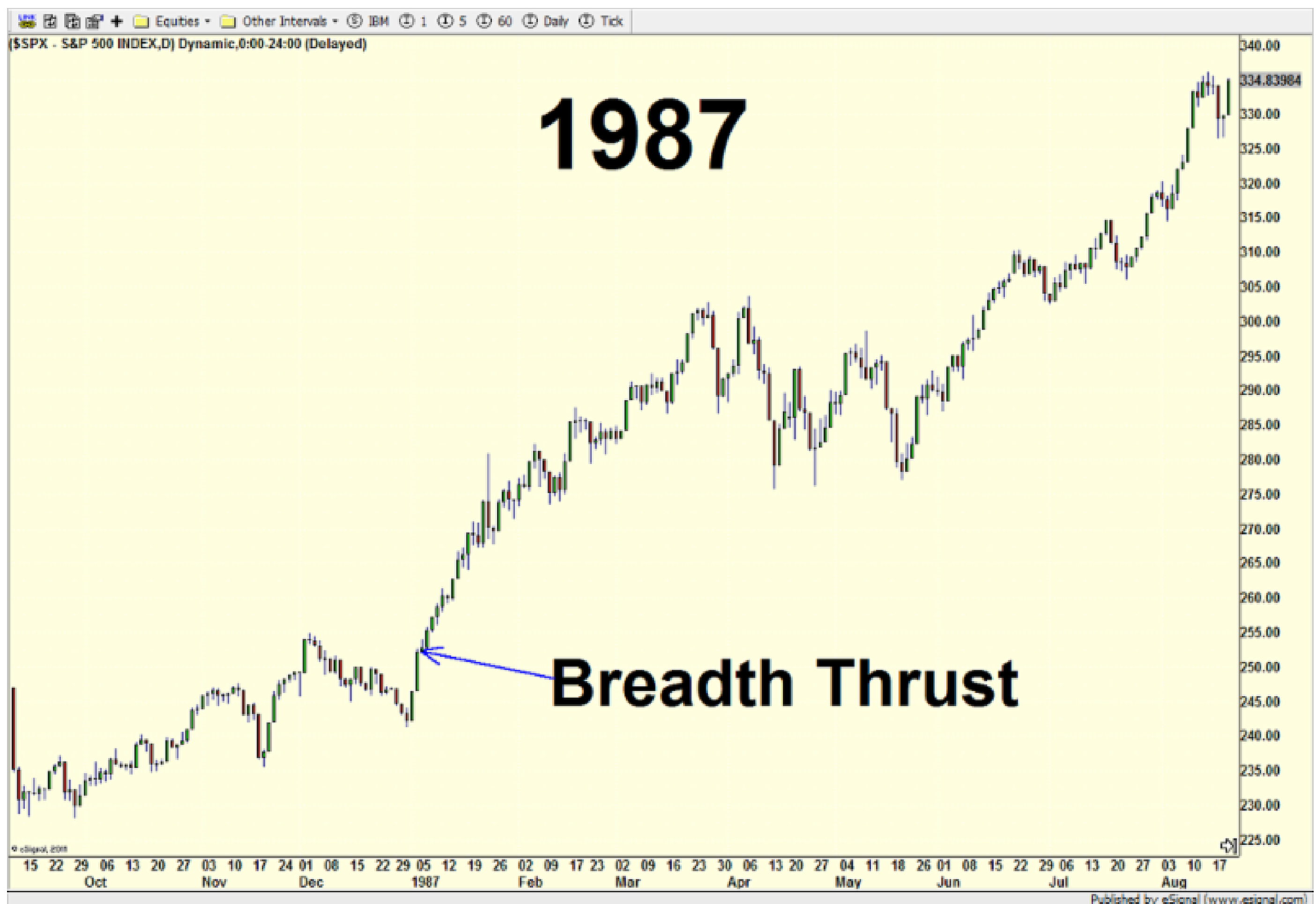
It took 11 years for the next thrust to appear in 1982, again as a new bull market was launching. As with 1971, the market never looked back and there was not any drawdown seen.



Two years later in 1984, there was another thrust as stocks were emerging from a bear market. As with the previous two occurrences, stocks just powered ahead without any paper loss at all.



January 1987 was next and that makes it four for four with stocks never looking back although this time, the market wasn't emerging from a bear market. A subtle change took place.



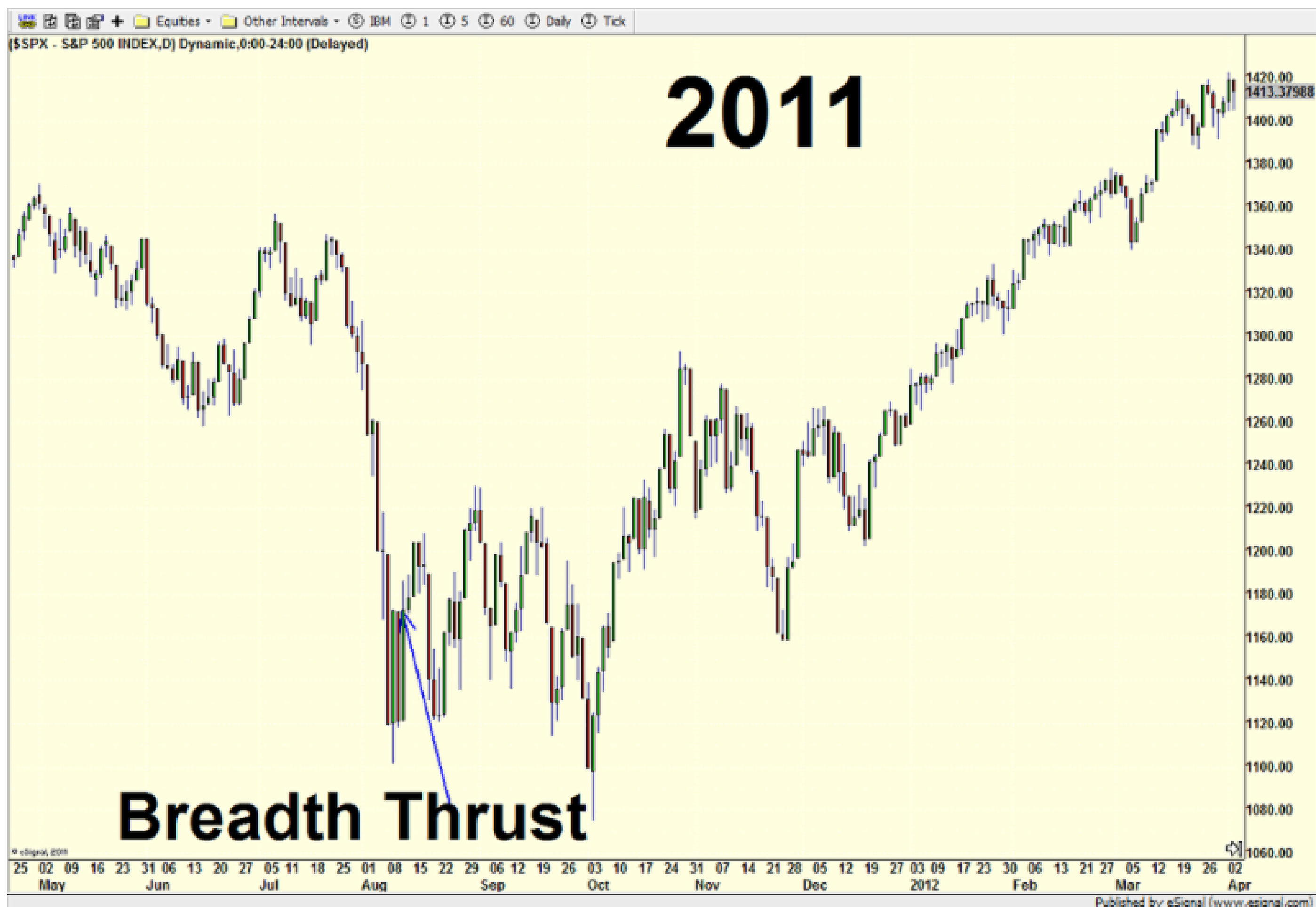
During the entire, historic bull market of the 1990s, there was not a single thrust. Not after the 1990 bottom nor the 1998 one. Even coming out of the 2000-2002 bear market, there were no thrusts. It wasn't until the uptick rule was eliminated in July 2007 did we see another thrust. This one occurred after a routine 10% correction in stocks.

Unlike all previous thrusts, stocks saw what I will call an immediate pullback or quick bout of weakness. Additionally, stocks did see a drawdown or paper loss over the following few quarters. In this case, it was 13.57% and the thrust turned out to be a failure in hindsight after stocks rolled over for good in May 2008.

A little more than year later in November 2008, another thrust took place. I vividly remember this one as it looked to me like stocks were finally bottoming. It was the perfect thrust like we saw in the 1980s, or so I thought. But as with 2007, stocks saw the immediate pullback before heading higher over the short-term. Additionally, the maximum paper loss was a painful 23% over the next quarter.

After the Flash Crash in early May 2010, the breadth volume thrust hit again. And as we saw with all thrusts since the SEC eliminated the uptick rule in 2007, there was an immediate pullback and stocks did not run away. There was also a 7.34% drawdown before the bulls were handsomely rewarded.

Following an almost 20% waterfall decline during the summer of 2011, the thrust was seen again in August. As with the previous three cases, there was an immediate pullback and stocks did not run away unfettered. Bulls also had to tolerate a modest 6.23% drawdown before being hugely rewarded.



Finally, in 2012 after a less than 10% decline, a thrust hit in very timely manner and stocks never looked back, nor was there an immediate pullback.

This brings us to 2016 and the current thrust, which occurred after an almost 15% correction in stocks. On the surface, this reminds me most of 2011 so far. With stocks declining on Tuesday, the immediate pullback scenario looks to be in play, but it's too early to tell what kind of drawdown may be seen. If 2011 continues to play out, there should be some modest upside shortly, followed by the drawdown and then a better rally.

What was an ironclad, close your eyes and back up the truck buy signal has morphed as the markets have evolved. Clearly, the elimination of the uptick rule and proliferation of computer driven, algorithmic trading has reduced the immediate effectiveness of the the breadth volume thrust. However, it should still be followed closely with the post 2006 behavior being the new norm.

As I was writing this article, an email came in from Rob Hanna who runs Quantifiable Edges newsletter with the same research thought. Thanks Rob, as always, for sharing!

2008 Price Analog Continues

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On January 21st, I put out this piece calling for the internal or momentum low. That was the bottom where stocks stopped going down in accelerated fashion and the majority of the damage was done. Typically, that's not the low where the strong rally begins. That's later. In this case, from a low in March and then into Q2.

http://www.investfortomorrow.com/newsletter/CurrentStreet$marts20160121.pdf

I know I have beaten the proverbial dead horse when I say that 2016 looks nothing like 2008 from an economic or fundamental point of view. I don't see any reasonable chance that the markets in general behave anywhere close to the way they in 2008.
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http://investfortomorrowblog.com/archives/2085

The only valid similarity has been a price analog that I began discussing in early January. Price analogs have been used for decades, across countries, asset classes, etc. Eventually, every single one of them breaks apart.

With that in mind, let's update the price chart for the S&P 500 from 2008 and 2016 through Wednesday.

In 2008, as I have mentioned before, stocks declined right out of the gate, but really just continued a correction that began in late 2007 as you can see below. Prices really accelerated lower into MLK weekend and bottomed when the markets reopened on Tuesday. From the low, there was an 8 day rally to relieve the very oversold nature of the market.

2016 has also seen selling right from the start, but really just continuing the correction that began in late 2015. Selling was strong into the MLK weekend and stocks bottomed on the Tuesday after. Just like with 2008, the initial rally lasted 8 days.

IF the price analog continues, stocks should see a secondary low later this week and embark on another rally towards Monday's peak. Remember, again, that eventually ALL analogs diverge and knowing when is the key!

In summary, while this comparison looks really nice on a chart, it's also something I have written about before from other analysis I have done. I keep referring to March as the time when the stock market should begin the real rally, where the January bottom was when the majority of the damage would end and stocks would stop going down. It's also a presidential election year and Q1 bottoms are also typically seen in March.

Investment Quotes/Adages To Live By

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"In God we trust, all others bring data."
- The Elements of Statistical Learning

"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."
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"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 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

"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

"A little bit at a time adds up to a lot in no time"

To Your Financial Success,

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