December 11, 2018

8:51 AM EST

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Inside this issue

Winter is Here

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As you will see towards the end of this edition, I am scheduled to join my friends at Fox61 (Fox CT affiliate) tomorrow in the 9am hour offering key financial tips to consider before year-end.

I have started and stopped this edition at least 6 times over the past week so I am just going to send it out and get going on the next one which already has two articles done. I joined the good folks at Yahoo Finance's Midday Movers yesterday for their 90 minute show and didn't mince words as the Dow was down 400+ points below 24,000 when I forecast a bottom in stocks over the coming two days and new highs coming during the first three or four months of 2019. It looks like a may be off by a day. I will share the link when I have it.
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With seasonal winter already here in full force, lots of UCONN basketball and skiing are in my future if the past few weeks are any indication. It's been like a winter wonderland in Vermont. Cold temps, lots of natural snow and insane crowds. As I plan to ski as much as possible when it's this great this early, my wife always asks me when I am taking a break. "When the rains come", I always answer. She then usually asks me, "what if they don't come?"

Well, skiing in Vermont for 45 years, they always come, especially when early season has been this outstanding. It would be unprecedented for weather patterns to remain the same from October right to April. So while the gettin' is good, we will be skiing. That's one reason why this edition is late. I planned on finishing it up Saturday night, but after skiing from 8 am to 3:30 pm, something I just don't do anymore, I sat on my fat rear end and watched the UCONN men's game before falling asleep very early.

Speaking of UCONN, it's been a much better than expected early season for the women and men. While the women are always strong, I thought this was going to be the weakest team in many years and one that would lose a few regular season games, especially the one against #1 ranked Notre Dame on their court.

The blondes and I made the trip two Sundays ago and found the usual sea of green on campus. However, with only a handful of UCONN faithful on site, blue beat green in a game where the defending national champion played like schoolyard thugs, totally losing their composure to a UCONN team that only played 6 kids.

As many of you know, I have gone to a quasi online calendar so you can book an appointment when you want to and not just when we're in the office or respond to your email. For now, I do not include evening meetings nor early morning ones, but I will try and accommodate as best I can.

If you would like to schedule a meeting, Skype, FaceTime or call, please click on the link below and give it a try. My calendar is now open through December.

https://schedulewithpaul.as.me/

Don't forget about our blog, **www.investfortomorrowblog.com** for shorter-term analysis.

You can sign up to receive notifications when a new blog has been posted here.

http://www.investfortomorrow.com/BlogAlerts.asp

Lots of Sectors Resist Decline & Many Seasonal Stats Point Higher

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The correction in stocks technically continued through last week although I remain firm in my opinion that this is all part of the bottoming process that began in October. With each passing week, more and more bulls turn to bears and I feel like I am almost alone in my forecast that new, all-time highs will be seen in 2019. While higher prices will be accompanied by unusually high volatility, I do not believe that a rising tide is going to lift all ships this time around. The number of haves and have nots should increase significantly.

As four of the five major stock market indices are right around new lows, I think it's telling that the NASDAQ 100 is not and bucking the trend. Additionally, a whole host of sectors are following suit, lending more credibility to my position that stocks are bottoming not accelerating to the downside. They include semiconductors, software, telecom, internet, discretionary, homebuilders, materials, staples, utilities, REITs, healthcare and biotech.

Turning back to the correction and bottoming process, it has now gone from being a simple one based on price action to a more complex one, not unlike the decline we saw in Q1 of this year. By "simple", I mean that the decline unfolded in one or two legs to the downside and wrapped up in less than two month. "Complex" declines tend to bounce up and down, up and down several times over a period of more than two months. They also tend to suck in more and more investors who believe the decline is the beginning of a bear market which every decade or so does happen.

One of the differences between this decline and the Q1 one is that it is very unusual to have this kind of weakness this late in the year with this level of volatility. One day declines in December of 3%, like we saw last week, have only occurred in 1987, 2000 and 2008. The first instance led to the immediate re-launching of the great bull market. The second and third were during very ugly and nasty bear markets.

Let me throw another stat or two at you. When the first 11 months of the year are up, as 2018 has been, December has been up 20 of the last 22 years. I think most of us would gladly accept a breakeven month at this point, let alone finishing in the black. Furthermore, as markettells.com points out, buying the first down week in December, like we had last week, almost always leads to a rally one to two weeks later. There are tons of other positive seasonal stats this time of year because it's been one of the strongest seasonal tailwinds on record, especially in mid-term election years. So far, however, every single one of them is failing although there are still three weeks left in the year. Don't count Santa out just yet!
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Looking Under the Hood of a Midday Waterfall Decline

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This is going to be a little different kind of article that focuses on the minute to minute moves in the stock market. People often ask what happened or why something happened in the middle of the day which seemed rather large and out of the blue. Normally, I confine these topics to the blog, but last week's 800 point down Tuesday had two very obvious things occur so I am going to share.

Below is a chart that I found very interesting. Each little red or green bar represents 5 minutes in the trading day for Monday and Tuesday.

Monday's sharply higher open was due to a few relatively benign words from Presidents Trump and Xi regarding their tariff tantrum. Frankly, I was a little surprised at just how high stocks were set to open as I wrote about on **www.investfortomorrowblog.com** as well as on Twitter. I thought for the most nimble of traders, smart money would be selling into that news. In hindsight I certainly wished I was that smart money doing the selling after what has transpired since Monday's open.

As stocks traded towards the unchanged level on Monday, the S&P 500, which is the one index computerized traders use most, breached the average price of the last 200 days, also known as the 200 day moving average. I have long written about this widely followed gauge of the long-term trend for stocks. While we do not use it in our work, so many other people do that it warrants paying attention to its level.
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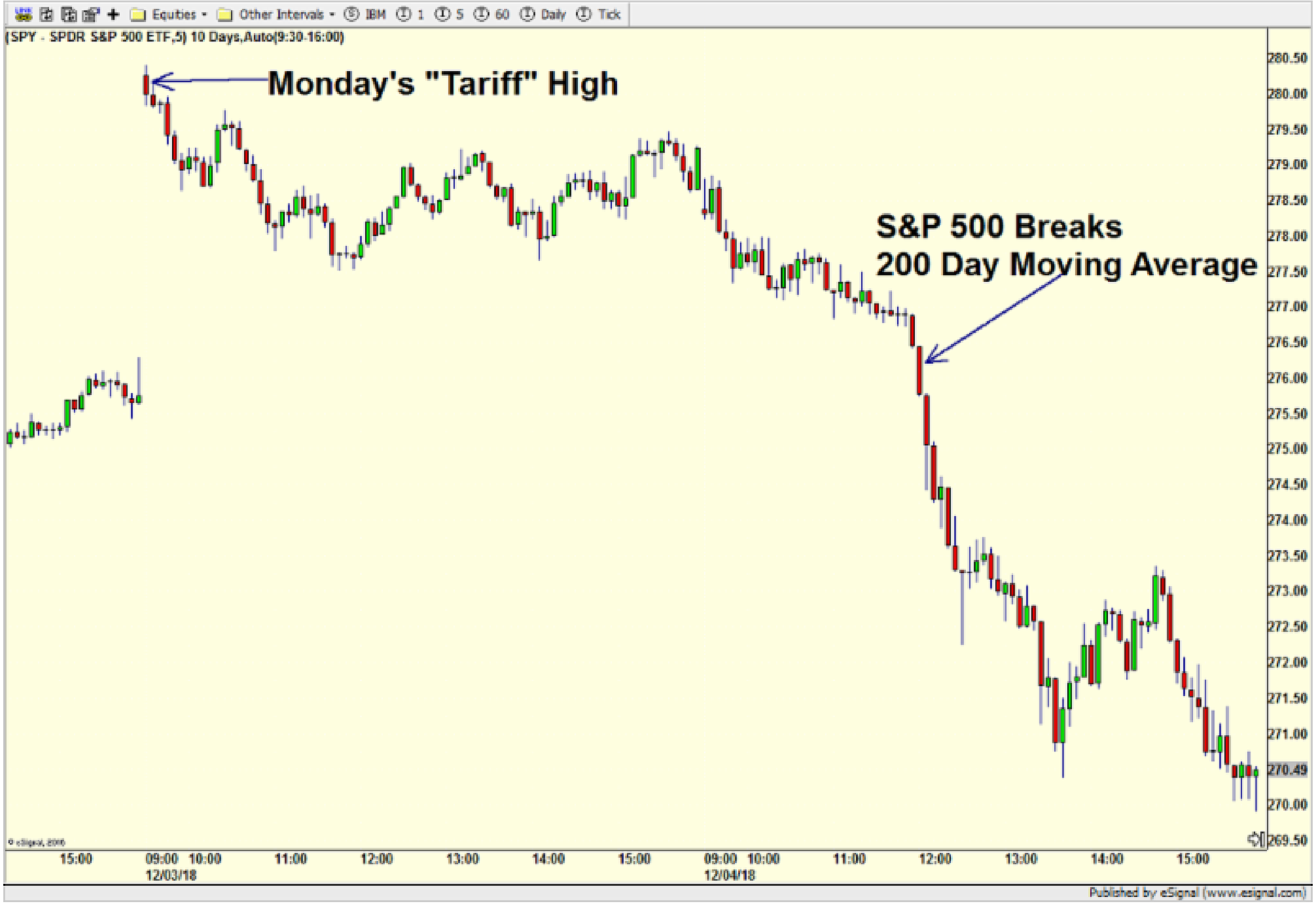
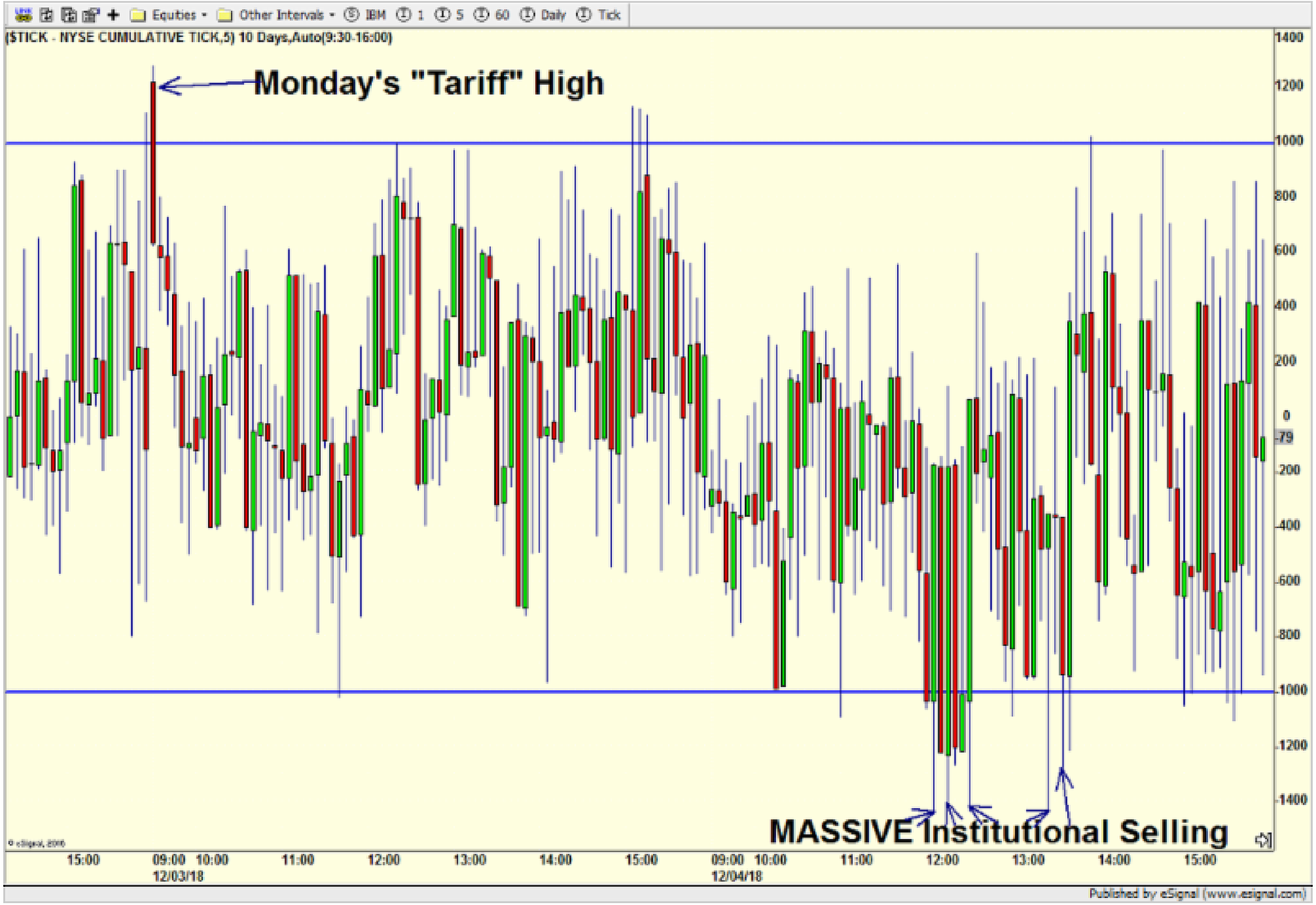


Above, you can see the arrow where where the S&P 500 breached the 200 day moving average. What happened next was fascinating if you are in to that sort of thing. You can see that the S&P 500 began to accelerate lower without any attempts to rally. In trading terms, that was very heavy, like trying to breathe with elephant sitting on your chest.

To gauge the intensity of that breach of the 200 day moving average, we turn to the chart below which is almost all noise. On the left side you can see Monday's high point right at the open. Without getting too technical and boring you even more, the levels that matter on the chart are those above 1000 or below -1000. That's where you can see intense buying (+1000) or selling (-1000). On Monday, the bulls got sucked in for a few minutes before having the rug pulled from beneath them.

Now look at the bottom of the chart for Tuesday where I show lots of little arrows. There, as the S&P 500 was breaking below the widely watched level of 2760, institutional investors using sophisticated computer programs hit the sell button to get out at any price. They didn't care where as long as it was right away. The selling was intense and broad-based. We do not know exactly why.



The first few programs around noon were accompanied by massive buying in the bond market, so we can reasonably conclude that at least one big player was selling stocks to buy bonds. Beyond that, there isn't a lot to offer.

I share this with you not because there is anything to glean from it regarding our strategies or your money, but rather just to give you a glimpse into what can happen during big market days.

Higher Rates Are to Blame. Lower Rates Are to Blame

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Everywhere I turn, there seems to be another reason for this correction. Slowing in Europe, China falling off a cliff, tariffs, soaring long-term interest rates, yield curve inversion, deceleration in the U.S. economy. I have heard it all. The problem is that none of these reasons can easily be tied to the decline directly, nor should they be. And every once in a while, declines occur and the reasons are not apparent until well after the fact.
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Let's look at interest rates which has probably been blamed more than anything else. You can see below on the 10 year treasury note from 2018 that yields had been moving much higher all year. And they actually went straight up in September as stocks were also rising sharply. During the sharpest leg of the stock market correction in October, rates were somewhat all over the place. Yet, since the beginning of November, rates have come way down, along with stocks. It's really hard to conclude that higher interest rates are responsible for this decline.

More recently, pundits and the media have been pounding the table about the yield curve boogeyman. The yield curve on the short end has inverted. Perhaps you are wondering, "what the heck is the yield curve and why on earth should I care?"

The yield curve is very simply the difference between two interest rates or yields. For example, if the 10 year note is yielding 3% and 2 year note is yielding 2%, the yield curve is positive by 1%. It's always the longer maturity minus the shorter one. Investors look at all different yield curve components ranging from the three month treasury bill to the two, three, five and ten year treasury notes and out to the 30 year treasury bond.

Almost all of the time, the various yield curves are "ordered" properly, meaning that the 30 year bond has the highest yield, followed by the 10 year, 5 year, 3 year, 2 year and three month. The bigger the difference in the yields, the more stimulative for the economy it is. That difference is also one way to gauge how incentivized banks are to lend as they borrow on the short side of the curve and lend on the long side. The bigger the difference, the more banks may be willing to lend which is good for their economy and their profits.

Anyway, last week, the yield curve for shorter-term maturities inverted, meaning that the yield on the three year was higher than the five year. Prior to that, the yield curve was flat. You would have thought that someone literally flipped a switch to recession as it seemed like the whole world woke up to a short-term inverted yield curve and the economy was now in a tailspin. That's beyond idiotic and nonsensical.

First, we only saw part of the yield curve invert. The 2/10 year yield curve which usually follows the 3/5 inverting hasn't done so yet. Inverted yield curves do lead to recessions and it is an accurate predictor, however, it's not like flipping a switch. There is usually several quarters to years of lag time before recession hits. And stocks typically perform well in the weeks and months after the 2/10 curve inverts which hasn't even happened yet.

With so many negative forces in the markets today, it certainly has the look and feel of a solid bottom forming with major rally coming amid continuing volatile conditions. Sticking my neck out as I usually do, I would be surprised to see stocks fall off a cliff from here. Just below 24,000 should provide a floor for now.

Upcoming Appearances

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Fox 61's Morning News - December 12th between 9:20 am & 9:40 am

Yahoo Finance Market Movers - December 18th at 9:00 am

Fox Business' Making Money - December 18th at 2:00 pm & 2:50 pm

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

Media Appearances

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

"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
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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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