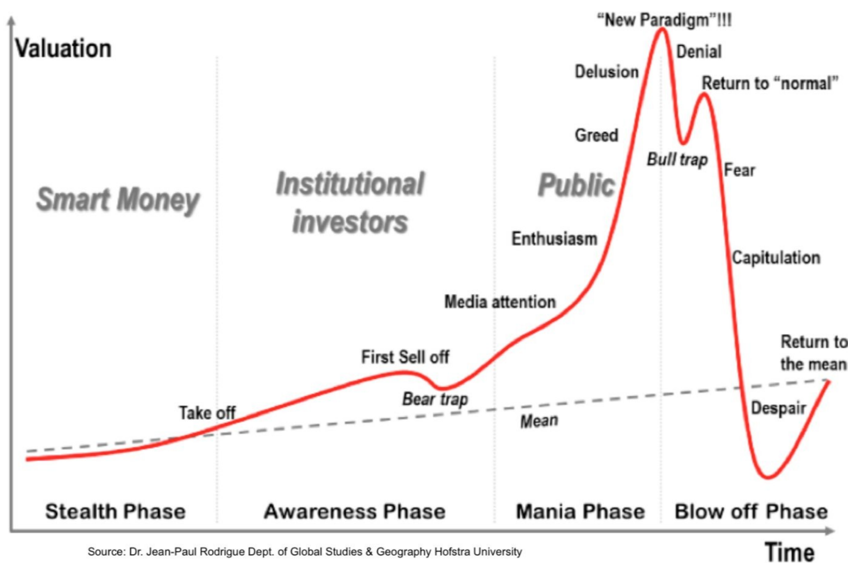
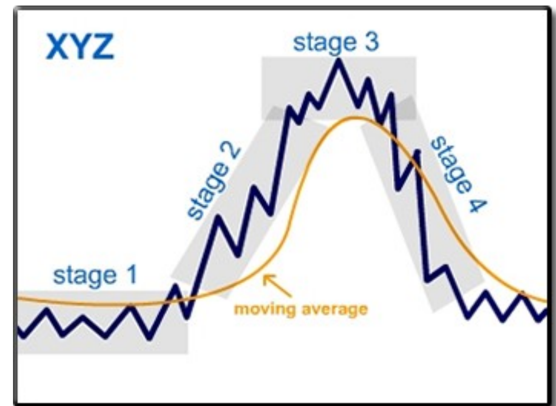
WallStreetWindow PowerInvestor

How A Bear Market Happens Here —Mike Swanson (03/12/2017)





In the next 6-8 weeks the stock market is likely to hit a turning point. By the end of this report you will know what to watch for at that moment. If it happens few will know it until it is too late, but you will.

Now bull markets end when everyone is bullish and has bought into the market and bear markets end when everyone gives up in despair and sells. We have seen two manic bull market peaks in the last 17 years. The first was in 2000 and the second was in 2007. At both peaks people told themselves that a "new paradigm" had formed that justified stock market valuations and a belief that the stock market could go up forever. In 2000 that "new paradigm" was the notion that the internet was a new thing that created a "new economy" and with the help of Alan Greenspan

Contents

INVESTORS THROW RECORD MONEY INTO STOCKS...P.2

What the start of a bear market looks like...p.10.

The most important thing to watch for now..p.8.

any stock market drops could be contained. Of course that didn't work out too well.

But as the market dropped 9/11 happened and so many people convinced themselves that terrorist attacks caused themselves to lose their money and then when the market went into a new bull market in 2003 they saw real estate price go up and up.

In 2006 Ben Bernanke promised that real estate prices do not have bear markets and many people believed him. He raised rates in order to prevent any new bulls and said that the stock market could be guided in a policy of "great moderation." That was the big buzzword of 2006 and 2007 that a lot of stock market investors believed in. They bought their stocks with no plan of how they would get out so as a result they got out after the 2008 stock market crash when the stock market FORCED them to sell.

When you have no plan of when you will sell then you will one day become a forced seller. And that is where we are today. People have been diving into the market over the past few months with zero plan of how they will get out and justify their decision based on the "new paradigm" that Donald Trump is going to create a massive economic boom by passing tax cuts and increasing government spending without increasing the budget deficit.

In reality the news doesn't matter when it comes to stock market cycles. What matters is the cycle itself! In bull markets all news is bought whether it is good news or bad news. That's why after BREXIT the market just went up and why it went up after Trump too. It's also why when you have a bear market and people keep seeing good earnings reports it doesn't help stocks at all. So no matter who well Trump's programs help the economy once this stock market goes into a real bear market it won't matter and it won't be his fault either.

What this means is that paying attention to news flows and looking for some big story to help you spot the start of the next bear market is not going to help. You have to pay attention to market action.

INVESTORS THROW RECORD MONEY INTO STOCKS

There are signs that all stock small fries are all-in so to speak. For one thing Ameritrade gives monthly reports on the activities of its millions of investors and sums it all up in what it calls the Ameritrade Movement Index. They reported that for the month of February, "The IMX rose to 6.15 in February, increasing above 6.0 for the first time ever and reaching an all-time high. "

Among their top buys, besides ETF's, was NVDA, AMZN, JPM, BAC, and CHK. They also are heavily trading DRYS, which has become a mania for small traders for the past few months.

But what about March? The Ameritradex Movement Index for this month won't come out until April so we won't know until then, but plenty of other sources are showing that stock market small fries are all-in. Warren Buffett has said that the stock market is going to go up forever and that people should just throw their money into ETF's and "passive investments" and so people are making history now doing it!

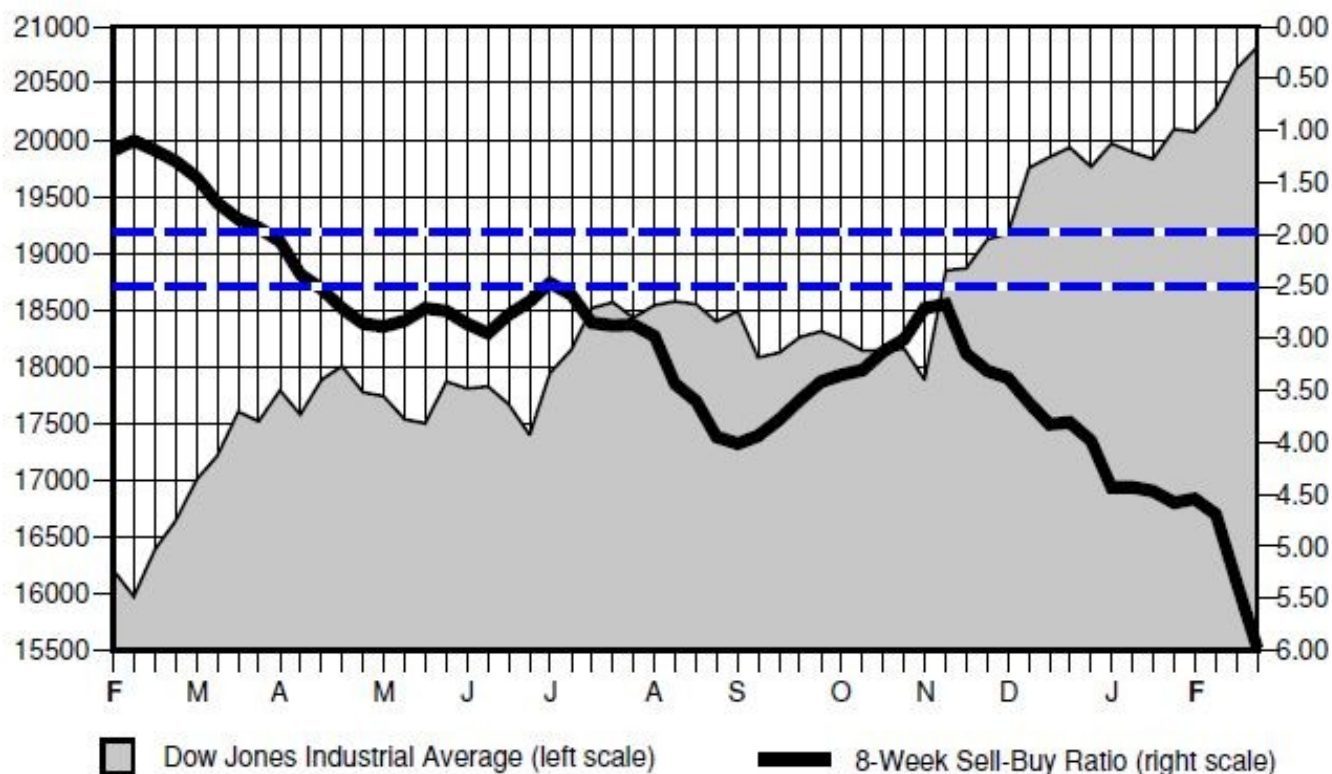
According the Wall Street Journal in an article on Friday, stock market investors put more money into ETF's and mutual funds in the week ending March than in any other week in stock market history with data going back to 2000. Of course as I mentioned last week the day that the DOW rallied 300 points following Trump's speech to Congress brought record buys for XLF and DIA. The bad thing is that despite all of that manic buying the market has actually fallen since that big up day to make it look like a potential exhaustion day.

The WSJ article interviewed a few investors who realize that the stock market is at a high valuation level and could drop one day, but simply feel like they have no choice but to buy more stocks. One man was a doctor in Charlotte who said he cannot make money with bonds and CD's so he must buy stocks.

He boosted his allocation from being 70% in stocks to 80%. He is 69 years old and doesn't seem to realize that a bear market would simply devastate him at that age. He said, ""What do you do? If you take your investment out and stocks go up another 1,000 [points], you're going to be pretty miffed," he said. "I'm slightly concerned that there might be a pullback, but I'm not losing sleep over it."

The biggest risk in his view is simply missing out on further gains. If the market drops he expects to simply hold on and ride any drop out. In comments to the article people were liking to Warren Buffett quotes saying you cannot beat the market and should buy "passive" investments. One person said, "Nobody can time the market or beat the market. Unless you need 70% of your cash in the next couple years, why not just stay in the market and continue investing at a regular cadence. Even if there is a correction for a couple years, the market always goes up.

Of course while the stock market small fry has been piling in the insiders have been cashing out with the insider sell to buy ratio hitting 11:1 in February, which is a level 3X away from the mean. And this is even happening with the DOW 30-stocks as you can see from the above chart coming from a CNBC post.



What the stock market small fries are doing is simply chasing stock market action. The biggest mistake they are making isn't the buying they are doing, but the fact that they are doing so without any real plan of what they will do if things drop on them.

You see this in the quotes and comments. The problem is over and over people end up selling during market drops and crashes when they buy into tops. They think they can ride things out and then the market forces them into selling on bottoms. And the situation is even worse with people who buy on margin and end up completely destroying themselves. Instead of investing with a plan many people are content to gamble it up as if they are in a casino.

I believe in taking money off of the table NOW and have done so my-self. I know that in reality in the long-run money is made buying on dips and corrections and not chasing rallies after they have played out for 12 months. I also know that diversification is key and so is getting more cautious at times of potential major market tops. And the low volatility action of the past few months has all of the earmarks of an exhaustion top being put in place similar to what happens when commodity markets have bull market tops (like was saw in silver in 2011) and even in stock mar-kets like what happened in Japan in 1990. This is an important comparison

to make. I talked about it on page 5 of my PDF report the other week in case you missed it:

http://wallstreetwindow.com/reports/wswreport02262017.pdf

How will we know if a major top is being put in? Well there is no way to know the day the market tops out that it is the top. So that means taking money off the table BEFORE the top or after the top. If you try to do the latter the odds are it will happen when you are losing money. And if you have no plan at all odds are you will do it one a major market crash or bottom at lower prices then you can imagine, which is what is likely to happen to most people stock small fries. And there is a good chance the market already topped!

WHAT THE START OF A BEAR MARKET LOOKS LIKE

The key is to know for sure when the cycle has changed. This stock market bull market has really been driven by stock market buybacks financed by junk bond debt. Those buybacks began to fade away last July, but came back with a vengeance after the Trump election. The thing is though those buybacks can vanish overnight if junk bonds go down in value to cause the cost of financing buybacks to rise.

That happened in the Fall of 2007 and in September of 2000 too. There will be no warning when it happens, but if the JNK ETF, which tracks the value of junk bonds falls fast off of its highs then you will know it is happening.

One thing high yields on corporate bonds will cause is the economy to suddenly stall out when it happens. It isn't Trump's fault that there is a bubble in the junk bond market now thanks to years of zero rates and QE money printing programs enacted by central banks all around the world. They create stock market booms without real economic growth.

Most people don't pay attention to junk bonds though so that will be invisible action to the masses. However, volatility will return. It will start to appear in a few select sectors and even asset classes before it becomes obvious to everyone that it has come back to the stock market.

In short there will be things that fall AHEAD of the stock market. And this is actually happening now. So last week oil closed below $50.00 a barrel and fell over 5% after having traded in a two point $52-54 range since the beginning of the year. Of course the massive giant commercial short position built to a record high in the oil futures market two weeks ago was a big warning flag that a critical breakdown in oil was about to start.

The thing is oil prices seasonally tend to go up and peak in June and July. They are not supposed to fall now! And neither are commodities in general. Agriculture commodities for instance tend to rally from the start of the year into June and July too. That is one reason why I bought them with the DBA ETF a few months ago and sold them a few weeks ago when they did not seem to be acting right.

You can see what is happening with commodities in general by taking a look at the CRB index above. It broke down last week. Now in 2008 commodities actually fell hard starting in August ahead of the October stock market crash. In past "flash crash" style corrections like we saw in August of 2007 and in 2010 and 2011 commodities also actually fell before the market did and made important bottoms on the day of the "flash crash." Gold stocks for example in August 2007 gapped down almost 10% on the day the DOW fell 500 points that month. The gold stocks though made a major bottom on that day and rallied like crazy for the rest of that month and outperformed the stock market for the next 12 months.

I sent an email last week out that also went to my free email list warning about a coming drop in oil. I know oil stocks are very popular with people for the dividends. This email went out to thousands of people and I did not get a single email from reply from one single person worried about oil dropping. I got ONE email from someone telling me that they

thought that it probably wouldn't go up, but it probably wouldn't fall much either so they were just going to hold on.

That is the prevailing mentality you see when a financial market tops out at first. People have seen lots of dips in the past few years that were no big deal and if they sell they fear they will miss out on gains. So they just hold and hope. Then if it crashes on them they get crushed. A simple stop loss order though would save them from that situation.

Ultimately gold and mining stocks will be the best things to own in stock market bear market, because the Fed would eventually respond to falling stock prices by lowering rates again and even printing money! At the same time bonds will be in a bear market along with stocks and money going out of both will end up going into gold. However, I'm not sure what gold and mining stocks are going to do for the next few weeks. They pulled back sharply in February, but the GDX/GLD ratio is starting to firm up.

I'll need to see another week or two of action to see if that is a real bottom or not being put in.

For now I really want to be cautious for the next couple of weeks myself. When you add up all of my accounts right now I am roughly 90% in cash. The model rebalancing portfolio essentially is close to that too as part of it is in the HDGE ETF.

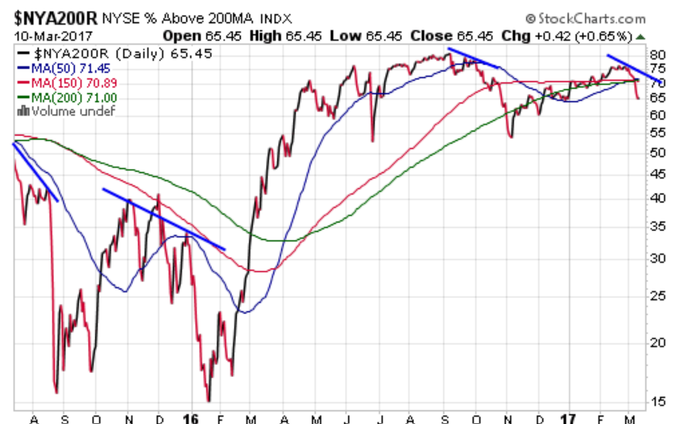
I know few people want to sell or have cash. My suggestion if you do not want to sell is to figure out how much you would be willing to risk losing in a market drop and just put stop loss orders in. If someone is over 70 years old they would be destroyed if the market fell in a real bear market and they refused to sell. Imagine if you were fully invested in mining stocks in 2011 and did not sell. Markets can fall further and for longer than anyone expects and we are in one of the biggest bubbles in world history if you look at the global bond markets and the negative yields they hit last year.

So if oil and other commodities continue to pullback people will ignore it for the most part. If CNBC makes note of it they will probably say well it is because the Fed is going to raise interest rates more in the future and so commodities are falling, but not to worry.

THE MOST IMPORTANT THING TO WATCH FOR NOW

And so the next market pullback is likely to be rationalized and ignored too. Of course seeing the market drop a little from a high does not guarantee that it has topped for good or that a bear market is coming. So how do you know for sure?

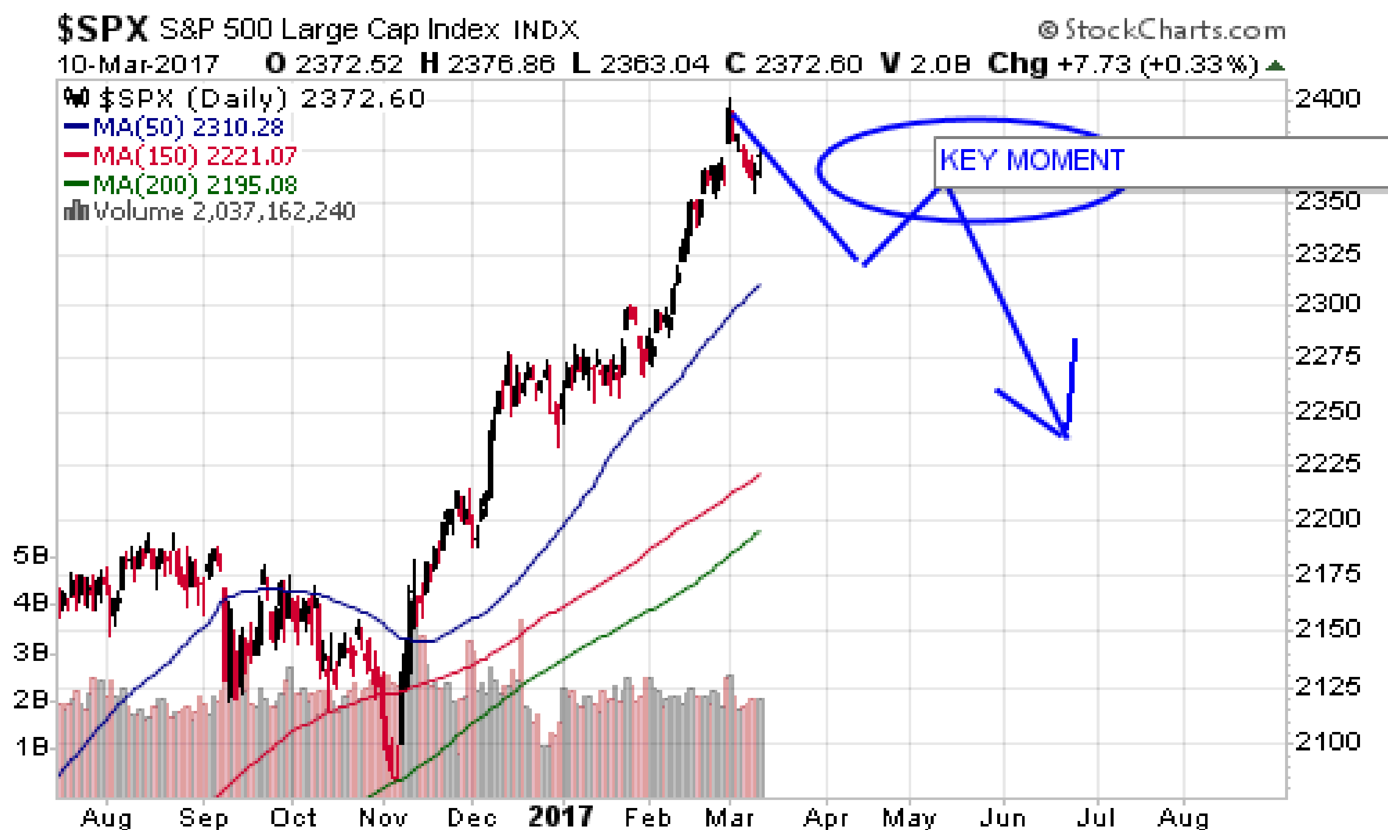
Well it will be the internals of the market that tell us. They are fading a little bit right now. You can see that in the advance/decline, but my favorite indicator is the percentage of stocks above their 200 and 50-day moving averages. When a stage three topping process takes place it is characterized by a deterioration in the internals. That means that stocks in general are trading much worse than the market averages are.



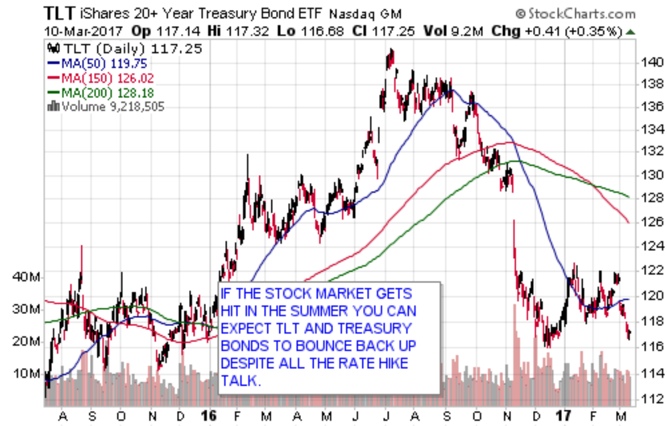
That appears to be starting to happen again. Take a look at the two charts below of the percentage of stocks above their 200-day moving averages on the S&P 500 and the NYSE. The NYSE now only has 65.45% of their stocks above their 200-day moving averages despite the fact that the DOW went 12.4% above it's 200-day moving average the other week, with the Nasdaq getting even more extended from it's 200-day moving average than that, and even more extended then it has at any point in at least the past two decades. The only historical comparison I could find for a stock market index was Japan in 1989 at its top.

The market dipping a little here is no big deal. We could easily see the market averages test their 50-day moving averages in the next few weeks. If they do they would likely bounce during next month's earnings season announcement period.

It is what happens on that next bounce or rally that will tell the story. If that bounce comes with poor internal action that will mean that the stock market is headed for a substantial correction or decline. Such action happened in the summer of 2015 before the August flash crash that hit the market that year. It then happened again at the end of that year ahead of the last market decline in the first two months of 2016. If the internals do this again you will know that the market is getting ready to bust and will be able to do some selling and even bet against the stock market to profit. How things look in 6-8 weeks will be critical. Here are some charts of note for this week:

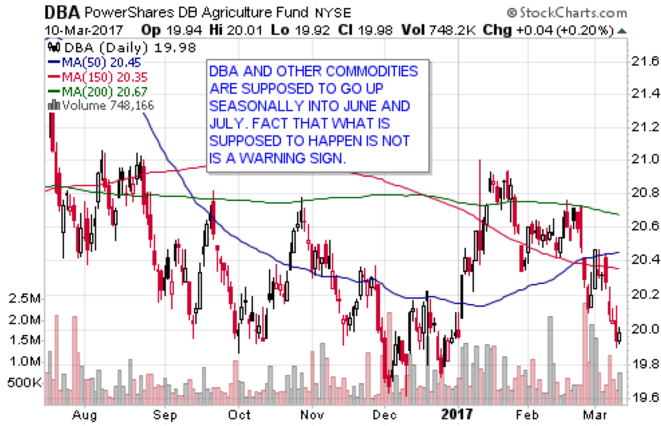


JNK SPDR Barclays High Yield Bond ETF NYSE
©StockCharts.com
10-Mar-2017 Op 36.53 Hi 36.53 Lo 36.25 Cl 36.33 Vol 29.1M Chg +0.00 (+0.00%)
IF JNK MAKES A BREAKDOWN AND GOES BELOW ITS 200-DAY MA THIS SUMMER THAN IT WILL BE SIGN THAT THE BUYBACKS ARE GOING TO END AND THE STOCK MARKET BULL MARKET IS OVER.


TLT iShares 20+ Year Treasury Bond ETF Nasdaq GM
©StockCharts.com
10-Mar-2017 Op 117.14 Hi 117.32 Lo 116.68 Cl 117.25 Vol 9.2M Chg +0.41 (+0.35%)
IF THE STOCK MARKET GETS HIT IN THE SUMMER YOU CAN EXPECT TLT AND TREASURY BONDS TO BOUNCE BACK UP DESPITE ALL THE RATE HIKE TALK.

IWM iShares Russell 2000 ETF NYSE
©StockCharts.com
10-Mar-2017 O 136.29 H 136.31 L 134.84 C 135.96 V 39.5M Chg +0.60 (+0.44%)
DESPITE DOW 21,000 RUSSELL 2000 IS EVEN FOR THE YEAR! IT'S A SIGN OF INTERNAL WEAKNESS IN THE STOCK MARKET.

FB Facebook, Inc. Nasdaq GS
©StockCharts.com
10-Mar-2017 O 138.91 H 139.49 L 138.22 C 138.79 V 16.3M Chg +0.55 (+0.40%)
WE COULD SEE THE NASDAQ 100 GO TO A NEW HIGH OR RALLY IN THE NEXT FEW WEEKS WHILE INTERNALS STINK AND IWM LAGS. THAT IS WHAT HAPPENED IN 2015 IN JULY AHEAD OF THAT AUGUST FLASH CRASH DUMP.


DBA PowerShares DB Agriculture Fund NYSE
©StockCharts.com
10-Mar-2017 Op 19.94 Hi 20.01 Lo 19.92 Cl 19.98 Vol 748.2K Chg +0.04 (+0.20%)
DBA AND OTHER COMMODITIES ARE SUPPOSED TO GO UP SEASONALLY INTO JUNE AND JULY. FACT THAT WHAT IS SUPPOSED TO HAPPEN IS NOT IS A WARNING SIGN.

BBH VanEck Vectors Biotech ETF Nasdaq GM
©StockCharts.com
10-Mar-2017 O 121.48 H 122.36 L 120.77 C 122.28 V 36.4K Chg +1.00 (+0.82%)
BIOTECH STOCKS APPEAR TO BE FLOATING AROUND AGAIN AND IN PROCESS OF MAKING A TOP. I REALLY SEE NO GOOD TRADES TO MAKE THIS WEEK AND THINK IT IS BEST TO BE PATIENT FOR TIME BEING, BUT GREAT THINGS WILL LINE UP SOON.

NVDA NVIDIA Corp. Nasdaq GS
©StockCharts.com
10-Mar-2017 Op 99.61 Hi 100.09 Lo 98.38 Cl 99.12 Vol 12.5M Chg +0.58 (+0.59%)
NVDA IS A TEXT BOOK CASE OF WHAT HAPPENS WITH STOCK MARKET SMALL FRIES. IT BECAME THE "MUST OWN" STOCK AT THE END OF 2016 AND TOP BUY OVER AND OVER ON AMERITRADE AND NOW I DOWN FOR THE YEAR! CRAMER SAID IT WAS A TOP BUY AFTER NEW YEARS, BUT EVEN THAT HAS NOT MATTERED. AND NVDA PEOPLE JUST THROW FITS AT YOU IF YOU SAY THERE ARE NOW BETTER THINGS TO DO WITH THEIR MONEY.

AAPL Apple, Inc. Nasdaq GS
©StockCharts.com
HOWEVER THIS RISE IN APPLE HAS BEEN IMPORTANT TO PEOPLE TOO BECAUSE IT ALSO IS ONE OF THE MOST WIDELY HELD STOCKS.

MODEL REBALANCING ETF PORTFOLIO ALLOCATION

The goal of this portfolio is to have five have core positions with no more than 20% invested in each one that together provide an investment allocation with a low intra-portfolio matrix. This makes it so that when one ETF goes down another can go up overtime. Traditionally people do this with using US stocks and Treasury bonds, but in the long-run a mix of more diversified assets can generate superior investment returns and if one day stocks and T-bills go down together then it will be a necessity.

To make the strategy work one must also rebalance the positions to maintain the fixed allocation percentages. Rebalancing also boosts returns overtime and lowers the overall volatility of the account. To make this work monthly or weekly rebalancing is best.

For more on how this strategy works read my January monthly newsletter from 2015.

http://wallstreetwindow.com/wswmonthly/wswmonthly01012015.pdf

Also see module 7 of my "Bear Market Power Pack" for several videos and academic papers about this market strategy:

http://www.wallstreetwindow.com/powerinvestor/?page_id=1346

Right now my recommended mix of ETF's is the following:

50% - CASH

20% - HDGE: Bear ETF that is short a basket of stocks.

20% - CEF: Central Fund of Canada owns gold and silver bullion.

10% - GDX: Gold Stocks ETF.

This ETF allocation creates a correlation ratio of 0.35 A 50% in TLT and 50% in SPY currently generates a correlation of 0.29.

You can use your own ETF's or funds to play with correlations by going to this website:

http://www.investspy.com/

A correlation of 1.00 would mean that everything in a portfolio is trading together. I have core positions in my trading and investment accounts roughly invested like this model portfolio is with the bulk of my money.

Disclaimer

WallStreetWindow.com is owned by Timingwallstreet, Inc of which Michael Swanson is President and sole shareholder. Both Swanson and employees and associates of Timingwallstreet, Inc. may have a stock trading position in securities which are mentioned on any of the websites or commentaries published by TimingWallStreet or any of its services and may sell or close such positions at any moment and without warning. Under no circumstances should the information received from TimingWallStreet represent a recommendation to buy, sell, or hold any security. TimingWallStreet contains the opinions of Swanson and and other financial writers and commentators. Neither Swanson, nor TimingWallstreet, Inc. provide individual investment advice and will not advise you personally concerning the nature, potential, value, or of any particular stock or investment strategy. To the extent that any of the information contained on any TimingWallStreet publications may be deemed investment advice, such information is impersonal and not tailored to the investment and stock trading needs of any specific person. Past results of TimingWallStreet, Michael Swanson or other financial authors are not necessarily indicative of future performance. TimingWallStreet does not represent the accuracy nor does it warranty the accuracy, completeness or timeliness of the statements published on its web sites, its email alerts, podcats, or other media.

The information provided should therefore be used as a basis for continued, independent research into a security referenced on TimingWallStreet so that the reader forms his or her own opinion regarding any investment in a security published on any TimingWallStreet of media outlets or services. The reader therefore agrees that he or she alone bears complete responsibility for their own stock trading, investment research and decisions. We are not and do not represent ourselves to be a registered investment adviser or advisory firm or company. You should consult a qualified financial advisor or stock broker before making any investment decision and to help you evaluate any information you may receive from TimingWallstreet.

Consequently, the reader understands and agrees that by using any of TimingWallStreet services, either directly or indirectly, TimingWallStreet, Inc. shall not be liable to anyone for any loss, injury or damage resulting from the use of or information attained from TimingWallStreet.