WallStreetWindow Monthly

Stock Market Barometer

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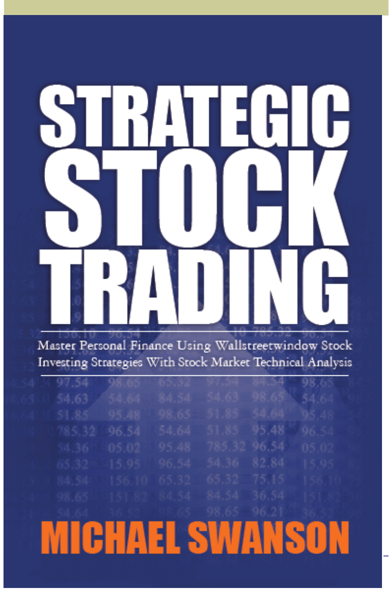
Maxims For A Bear Market - Mike Swanson

Today is day nine of the bear market. I say it is day nine because on 8/20/2015 the S&P 500 and Nadsaq both closed below their 200-day moving averages to complete a stage three top and begin a full blown bear market.

> "Let me give you several bear market maxims that you must use going forward."

A few people are actually making money from this decline. I positioned the Power Investor model rebalancing portfolio back at the end of July to get ahead of the stock market drop and profit from it. I also have given many ideas for stocks to bet against in the Power Investor reports via short selling and the purchase of puts. I sold some options last Monday, but continue to hold my own core short positions. I wish the market would just go up forever to keep everything easy for people so that they did not have to think or work or do anything, but that is not how the real world works and money is made by adjusting and adapting to changes in the big trend of the stock market as long as they occur.



I have been doing everything I can to help you do this. In July I wrote a monthly newsletter explaining why a top in price that would mark highs for the markets for years was about to come and how that top could even mean a peak in valuation for the rest of our lives. If you are new and did not read that report then you must read it to understand what is going on. CNBC is saying the reason the market is dropping is due to China, but this is only a minor factor. The truth is that this was the most obvious coming bear market we may have ever seen and all of the signs that it was going to come were in place by the end of July.

You must read this July report if you have not already done so, because you need to know what preceded this big stock market drop. This drop did not just come out of nowhere:

http://wallstreetwindow.com/wswmonthly/wswmonthly07082015.pdf

Now I also have done hours and hours of videos in the past 60 days with David Skarica to try to grab your attention to what is happening in the stock market. But more importantly I have been issuing some of the most important Power Investor reports ever.

This weekend I wrote a very long report that explained in exacting detail why the bounce in the market that happened last week would fail and how we know that there was no real buying in the broad market at all. Most of the stock market is acting the same way I saw it act in the last two bear markets.

If you are a Power Investor member you should stop reading this monthly report and login to the members area and read my Sunday update, because it is very important and in fact is actually more important than this monthly update, which also goes out to many people who are not Power Investor members. That means that it is less detailed and has zero actionable trading ideas in it.

However, it does have two important things for people in it. The first is I just want to say that in bull markets it is easy for people to make money. You see all you need to do is buy something and believe that it will go up forever you. But in bear markets you can no longer buy and just believe and expect to make money. In fact the longer you do that the more money you are likely to lose. This bear market is only starting and is beginning with a bang. If you did not make changes ahead of this bear drop and have been losing money because of it you can expect to lose more money the longer you just sit there. Oh we saw a bounce last week and may even see the stock market hold up a bit into the next Fed meeting after retesting the recent lows, but it's in big trouble. And it may not even hold up. Or it could go through last week's low and just have a weak bounce and turn down again and do that over and over again for the rest of the year. No matter what it does if you are losing money and continue to sit there doing nothing you can expect to lose even more. In fact I fully expect that most people in the stock market right now are going to wipe themselves out for good by the time this bear market runs its course.

That's why I have been doing everything I can to help people avoid what is happening. The thing is that it now takes real work to make money out of the stock market. You cannot just buy and believe anymore than you have to adapt and adjust. That takes learning how markets work if you do not understand them and using tactics appropriate for the new bear market. That is simply just too much work for most people.

I try to make this information as simple and easy to digest as I can in the Power Investor bear market modules, but for every person that takes action and joins there are hundreds who just sit there. This is not a pitch for the Power Investor Service, because it is closed to new members now and is likely to remain that way for a long time. The point is that most people rather have someone on TV yell at them some picks and buy them against the bear trend in desperation than to believe in themselves and learn and make changes in their accounts when the market calls for it.

There is nothing wrong with that. Not everyone has the inclination to want to do the work necessary to really succeed in the financial markets. What is important now is to accept the reality of this bear market and then decide what you want to do about it. The way I see it you can either take the time and effort to make changes, do nothing and lose money, or just get out of the market for good.

There is nothing wrong with getting out of the stock market for good. Someone who is over 65 years old really does not need to be taking big risks anymore in this market. The game is over. The best thing the average person can do right now is get out of the market, put some money in gold, and just put the rest of the money in the bank for living expenses, because to simply keep it fully invested in the US stock market is a giant mistake now. You have to work and be serious to make money now.

If you want to win in the markets let me give you several bear market maxims that you must now use going forward. The good news about bear markets is that they bring more stock market volatility. That means big swings in the market that can lead to giant opportunities if you understand how to take advantage of them.

In order to navigate a bear market you have to use several principles to guide your investment decisions with. Again you must understand that in a bull market you really do not have to do that to make money or even do much work, because in a bull market you can literally throw money at the stock market and make money. This is why people can buy stocks with no care what the valuation a stock is at and even buy into stocks that are extremely speculative and risky such as penny stocks and still manage to make money if they take profits in time.

In bear markets though the trading patterns that worked in the past no longer tend to work. The stocks that were once big winners now become money traps for people who buy them when they have fake bounces. It takes real work to make money and clear thinking.

Clear thinking is something that few people have when it comes to the stock market. They tend to watch the stock market gyrate big one day and try to draw big conclusions out of it or get so emotionally worked up by sudden swings in the market that they simply are unable to think clearly about what is happening. Desperate trading and investment decisions happen to many people during a bear market as a result.

And the financial media actually does little to help people during bear markets, because most of the so called experts are themselves so fully invested financially in the stock market themselves that they are unable to come to grips with what is happening. In fact the television networks and money managers really have business models that are dependent upon rising stock prices that it is simply difficult for them to be objective about things. What tends to happen as a result is that the financial experts keep calling bottoms all of the way down. It is not that they are lying, but convincing themselves that bottoms are there when they are not.

The problem is that the masses of investors in a bear market want to be convinced that if they just hold and believe that things will be fine. They want to hear that a new bull market is coming, because they do not want to sell. What they actually fear is not selling and losing money. What they really fear is if they sell that the stock market could go up without them and they could see other people make money while they are no longer in the market. For them that would be a total embarrassment that they could not deal with. But they can live with the market falling as long as everyone else they know loses. They become emotional basket cases, so in order to feel some certainty over the market they rationalize this behavior by looking for people who will tell them that the stock market will go up.

The problem is that the experts themselves simply become a part of the stock market herd that is walking off a cliff. To survive and thrive in a bear market then you must separate yourself from the herd by being able to not be caught up in the general Wall Street consensus and get sucked in to bear traps with everyone else. In fact this mental separation from the crowd may be the most important thing you need to do during a bear market. To do that you have to ignore what these people are saying. The only way to do that is if you use a set of trading maxims that you believe in more than in what you see the experts say on TV. Then you can have the confidence to separate yourself from what they say.

The first maxim you must have is that you must accept and respect the bear trend of the stock market. The United States stock market clearly completed a stage three topping process in August of 2015 when the S&P 500 and Nasdaq followed the DOW lower by closing below their 200-day moving averages and then collapsing. This action was preceded by an internal deterioration inside the stock market that has taken place before all other previous bear markets. This internal action made it obvious that some sort of drop was going to occur in the stock market after July 2015 and it did.

The number one maxim you must use to help navigate the bear market is to accept the reality of the bear market and to respect the bear trend. As long as the US stock market averages trade below their 200-day moving averages those moving averages are going to act as resistance and the market will continue lower. All rallies that take place before the stock market completes its stage four bear market will fade and lead to massive losses for those that try to buy into them.

In fact you should write those sentences down and put them next to your computer and read them every time you hear someone tell you to buy stocks. Stock market volatility increases in bear markets. You will see down days in points and percentage for the market averages that may shock you, but you will also see up days that are huge.

Those up days cause people to hope and believe that the stock market is going to begin a new bull market. But they just lead to traps, because they do not change the real underlying bear trend of the market.

This means that you cannot draw big conclusions about the overall stock market based on one day of stock market action. Everything you read and hear about the stock market will attempt to do just that. One day up or down really doesn't mean anything. What does mean something is that the stock market began a bear market in the summer of 2015 and is not going to begin a bull market until that bear market comes to an end. All bear markets are characterized by temporary wonder rallies and constant bottom call attempts by people when they come. You cannot get fooled by such talk. You must not get excited about a few days of action in the stock market, but instead must keep your eyes on the overall trend of the market.

So another maxim for you then should be do not react to one day's worth of stock action in the stock market. And this means do not take your eyes off the first maxim, which is to accept the reality of the bear market and to respect the bear trend.

The truth is as long as the bear market continues if you do not align yourself with bear trend and adapt and adjust to it you will lose money. Therefore the third maxim you need to know is that you must reduce your risk exposure to the US stock market if it is causing you to lose money. What most people do instead when it comes to trading is to try to chase the old winners of the last bull market. They chase the fad stocks when they see temporary rallies.

These stocks do tend to bounce hard during bear market rallies, but it is impossible to get in on them before a rally starts without taking an enormous risk. So what happens is that people who focus on trying to buy these stocks end up buying them after a wonder rally has begun and usually right as it comes to an end.

And they end up trying to do this over and over again as the bear market declines. You see you must learn to use tactics that are appropriate for bear markets, because what worked in the last bull market will no longer work anymore. In fact when new bull markets start the new winners are always different than the stocks that led the last bull market. So you just need to forget about those past fad stocks. You need to forget about stocks like Facebook, Apple, and Google. In 1999 Cisco and Oracle were among the most widely owned and popular stocks. They then led the 2000-2003 bear market down and it took them years to match the performance of the stock market averages once that bear market came to an end. It takes work to look for the new winners and learn new tactics and most people simply do not want to do any real work when it comes to the stock market. What they want to do is gamble it up!

But I am serious about making money and doing the best I can to help you do so too. You must control risk through proper diversification. As for making profits from the US stock market the thing is the best way to make money in a bear market is to actually bet against stocks. You can do this by using exchange traded funds that are designed to go up in value when the stock market drops, by purchasing put options on stocks, and by outright short selling stocks. All of these are things I tend to do in bear markets and give people trading ideas for in my Power Investor Service. Stocks actually tend to go down faster than they go up, so when you make bets that pay off in a bear market the returns can come very quickly.

Now this bear market has actually started out worse than I expected. In no way did I expect the DOW to fall 1,000 points last week on Monday. But it did that. Then we had a bounce dominated by robot buying instead of real buying from investors. I only saw two sectors that appeared to have widespread buying in them. For the rest of them, such as the biotech and semiconductor sector what happened is that the only stocks that got big buying in them were stocks that were a component of an ETF or in one of the market indices. Everything else barely went up. What that means is that the buying was computer driven and not drive by real people. That is not how bear markets end and is not even how corrections within bull markets come to an end either. Nothing like it has happened throughout the entire stock market.

This means that all rallies in the market from now until further notice must be used to reduce your risk exposure to the US stock market if you are heavily invested in it and can be used to bet against the market. I will focus on the latter for Power Investor members do that in my updates. As for going long do not chase temporary US stock market rallies. The way to go long now is to only invest in the few asset classes and sectors that diverge away from the overall bear trend and enter new bull markets of their own. But right now be careful!

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