



Market Breaks Support – Updating Sell Targets

I spent the last week in New York doing various media from print to television. The main center of concentration by reporters remained focused on Greece, the Eurozone and when the next hit of Quantitative Easing (QE3) was going to come.

However, what I found interesting is that no one really focused that much on the state of the U.S. economy. There seems to be some disconnected belief that the U.S. can somehow continue to grow despite weakness in the Eurozone and now spreading the China and India.

I remember when I was young that if I would become distracted, from whatever it was I was supposed to be paying attention to, that my father would promptly “whack” me with the Sunday newspaper. *Who needs “Ritalin” when you have the “Sunday Times.”*

Yet this is exactly what I felt on Friday as the economic numbers met with the surprised disbelief of the mainstream media. There were sharp declines, misses, and revisions of the major economic reports from GDP (*revised down to 1.9%*), employment (*on 69k jobs gained and April revised down by roughly 50%*), personal consumption (*only up 0.2% versus expectations of 0.4%*) and ISM Manufacturing (*missed expectations with 5 of 10 components showing contraction*). I could almost feel the “whack” as attention was immediately returned to the domestic economy and the realization that the economy is far weaker than previously reported.

Of course, this is not new information for regular readers of our weekly missives and daily blogs. We have been consistently reiterating that the economy is living on borrowed time and life support for some time now. It appears that the plug may now have been pulled – it will be up to Dr. Bernanke to hit the patient with the defibrillator before it's too late.

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Inside This Issue:

Market Breaks Support Updating Sell Targets

- [S&P 500 Review](#)
- [New Sell Targets](#)
- [2011 All Over Again](#)
- [US Dollar – Too Fast](#)
- [Commodities and Oil Prices](#)
- [Gold](#)
- [Interest Rates – Take Profits](#)
- [Cash Is King](#)

401k Plan Manager

- Revised Sell Signals
- Allocation Reduced
- [Click Here For Current Model Allocation.](#)

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I strongly encourage you to visit the links to the right and join me on [Twitter](#) and [Facebook](#) as I will be updating the economic and market reports during the week to keep you up to date.

After traveling extensively this past week I have many commitments to fulfill with my wife and children who have missed me. Therefore, this week will be a fairly short technical recap of the markets and adjustments to previous sell targets due to the extensive decline last week.

Next week I promise a full analysis of where we stand as we move into the midst of the summer doldrums and what the implications are for the economy and the markets. I appreciate your understanding and patience.

The one positive note, if you can say that, about May was that sharp declines in May are generally followed by a reflexive bounce in June. As I will discuss in this missive we are currently playing out a very similar market pattern as we saw last summer.

With many of the same pressures facing the markets currently from weakening economics, the resurgence of the Greek crisis, a looming potential for a debt ceiling debate and the end of "Operation Twist" - it is not surprising that the markets have run into trouble. The key issue is now what will most likely occur in the months ahead and how we should try to navigate the potential risk of further declines. It will likely be closer to the end of August or mid-September before we see the initiation of the next round of Quantitative Easing.

I did discuss much of this last week during my trip to New York and the links below are the relevant clips to this discussion.

[BNN – U.S. Not Immune From Euro Crisis](#)



[CNBC – Eurozone Slowdown Will Impact U.S.](#)



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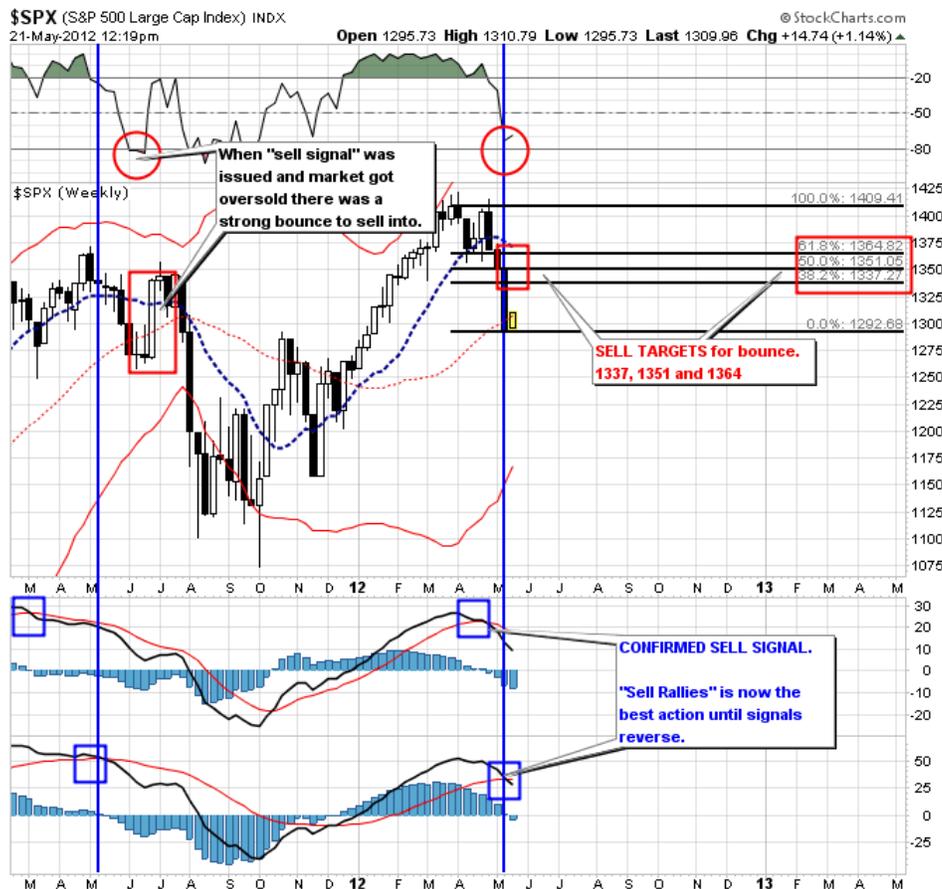


These interviews will get you caught up with my major macro points on the markets and the economy. Obviously, these discussions were before the selloff on Friday that broke both critical support levels that I discussed in these interviews which were 1313 and 1300.

In the next sections I will update the support and resistance levels for the S&P 500 as well as **revise the “sell” targets which are lower now than they were last week.** While the previous targets were not reached, and positions consequently were not liquidated, the markets are now extremely oversold on a weekly basis. The odds are very high that there will be a mild rally in June and should provide an opportunity to raise cash and reduce portfolio risks.

S&P 500 – Analysis and Sell Target Update

On May 21st we penned in [“Sell Signal Confirmed – Initial Targets Set”](#) that “The next chart details the correction process in a little more detail. Last summer after the “confirmed sell signal” was issued the market proceeded to reach “oversold conditions” in a brutal 6 week sell off. The current magnitude of the selloff has likewise gotten the markets to an oversold state which is why, like last summer; we expected a fairly strong countertrend bounce. Currently, using Fibonacci retracement analysis, we can find three potential areas that the bounce could obtain: 1337, 1351, and 1364”



The current correction failed to hold support at the moving average (*thin red dashed line*) and the continued correction has now adjusted those previous sell targets downward as shown in the updated chart below.

As we will discuss in a moment there are many similarities between the current correction and the one that we saw last summer during this same period. The markets are now deeply oversold on a weekly basis, on a confirmed sell signal and have suffered an extended and deep correction. These factors provide the “fuel” for a potential rally.

However, it is important to remember the “psychological” impact of corrections. Many investors are now “trapped” by the current correction and are looking for a rally to “get out.” This is why the current correction is not “the bottom” or the “next buying opportunity” – that opportunity will come, however, currently that is most likely NOT the case.



NEW SELL TARGETS

The new sell targets for the S&P 500 index are now set at 1328, 1343 and 1359. This revised Fibonacci retracement levels are lower than last week and is a function of the continued decline. Most important to understand is that these “sell targets” are general “areas” to begin reducing risk. Do not get hung up on specific numbers.

During a rally in the market, which should occur in the days and weeks ahead, it is important to begin reducing portfolio risk at any point above 1320 on the S&P 500. This doesn't mean sell everything at 1320 – here are some general guidelines to follow:

1320 - Sell positions that are deeply in the red and have been declining with, or more than, the market. *If you can't stand to look at it when you open your statement – sell it.*

1330 - Sell positions that underperformed the rally in the 1st quarter of 2012. It is likely those positions are also pacing the current decline.

1340 – Reduce your best performing positions back to their original portfolio weightings. If you originally put 5% of your portfolio into XYZ company and it is now 8% of your portfolio – reduce it back to 5% and hold the cash.

1350 – Rebalance existing holdings, begin adding fixed income and hold excess cash.

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It's really pretty simple. We believe that managing risk is the key to long term success. Conserve the principal and the rest will take care of itself.

Risk = Loss

Seems like a simple concept – yet most people take way too much risk in their portfolio which is fine as long as the market goes up. The problem comes when it doesn't.

Managed Risk = Returns

By applying varying levels of risk management to a portfolio of assets the potential for large drawdowns of capital is reduced thereby allowing the portfolio to accumulate returns over time.

Total Return Investing

We believe that portfolio should be designed for more than just capital appreciation. There are times when markets do not rise. During those periods we want income from dividends and interest to be supporting the portfolio.

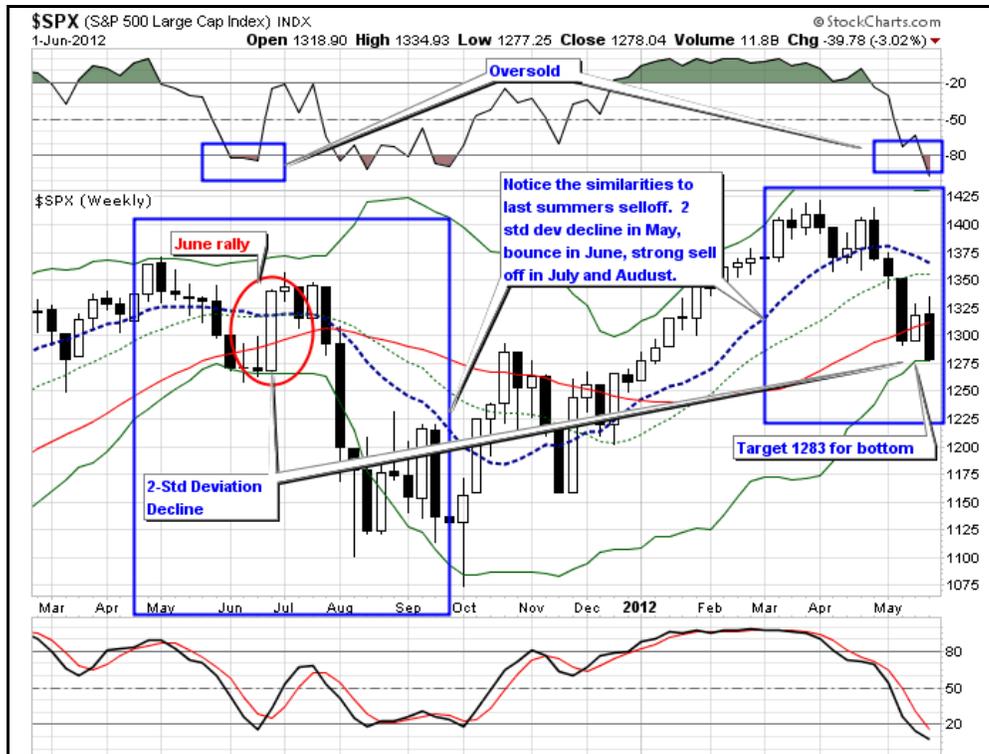
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It is highly doubtful that we will get to 1350 so it is important that you have the majority of the work completed between 1330-1340 on the index.

2011 – ALL OVER AGAIN

As I stated earlier we are currently in the process of replaying the summer of 2011 all over again. Not only are we faced once again by the Greek/Eurozone crisis, a pending debt ceiling debate, the conclusion of a Fed liquidity operation (“*Operation Twist*”) and rising economic weakness – but also the price action of the markets are acting similarly as well. The chart below shows the current market versus last summer.



Starting at the top of the chart you will notice that in both cases the markets reached initial “*weekly oversold*” conditions in May. This is the “*relaxing of the rubber band*” that we often speak of on the radio. When the markets move in one direction, as they did in 1st quarter, the market becomes very overbought, or stretched. In order for the markets to eventually move higher it must correct that overbought or stretched condition by either moving sideways or going lower in price.

The current move lower has quickly corrected that overbought condition. This is actually VERY good news for investors as the market is now in a much better risk/reward position for making investments. However, the timing is not quite right just yet.

In the center of the chart you will see the price of the market between two green lines or bands. These green band lines represent 2-standard deviations of price movement away from the average price of the index over time. Without getting terribly technical a 2-standard deviation move in any direction represents roughly 95% of all possible outcomes.

In other words, once the market has risen or fallen by 2-standard deviations the “rubber band” is pretty well stretched as far as it will go. In June of last year, like now, the market became very stretched to the downside which gave way to a sharp “snap back” rally which quickly reversed the oversold condition. While the media quickly trumpeted that the correction was over - we warned otherwise. The reason was then, as we expect will occur in the next three weeks, that all of our major “sell signals” were in place.

During the rally that will likely occur this month - the media will proclaim that the “bears” have been bested and it is time to jump back into the market. **IT WILL NOT BE.** As stated previously, by the end of June our most critical sell signal will likely be in place signaling more downside risk in the market.

While the market could certainly move lower in the short term, as there is currently no catalyst present to reverse the decline, it is very likely that some event will occur in the next week or two with regards to the Eurozone that will spark a rally in the markets. It will be short lived.

US Dollar – Too Fast Too Furious

Very much like the markets decline which has gotten ahead of itself in the short term – the rally in the dollar has likewise moved too quickly.



The chart above shows the US Dollar index. Currently, the dollar has spiked due to a “flight to safety” as money has flowed out of the Euro looking for a safe place until something resolves itself in the Eurozone. The current spike is very similar to what we saw last year just prior to the implementation of the *Long Term Refinancing Operations* in Europe.

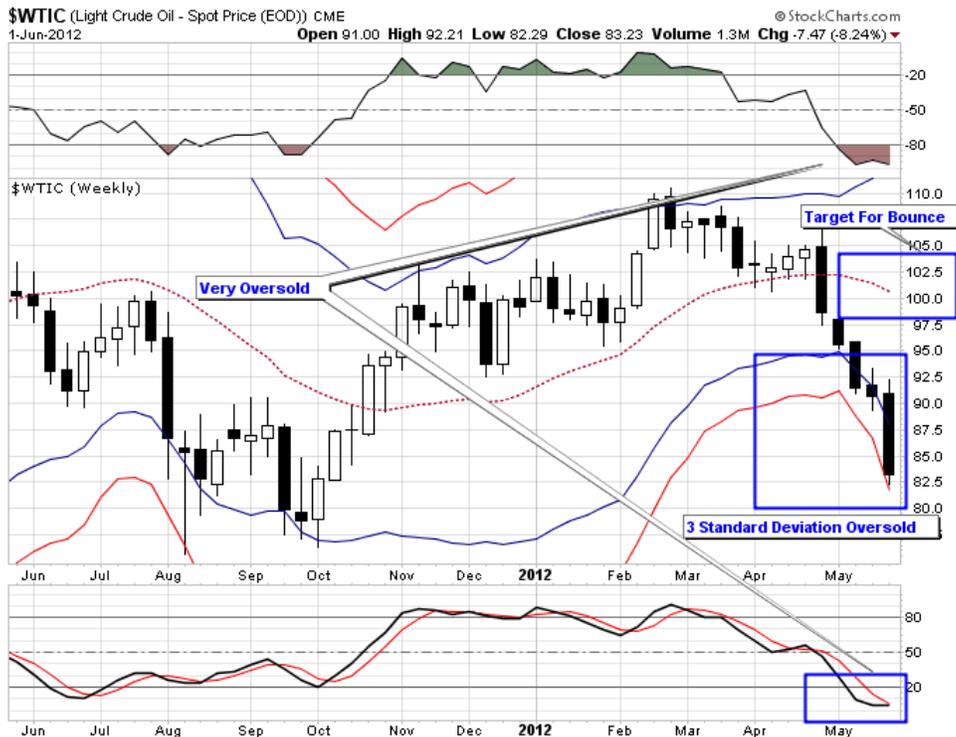
The current 3-standard deviation move, which represents roughly 99% of all possible outcomes, **is unsustainable and will correct**. The correction in the dollar will coincide with a rally in the market and most likely the launching of some new stimulus program to support the Eurozone banks as stated above.

The downside target for the US Dollar is currently between \$79-80. The decline in the dollar will not only coincide with a rally in the stock market but will also impact fixed income and commodities due to asset class rotation.

Commodities/Oil – A Sellable Bounce

The trouncing of commodities, and oil, is not complete. There is more downside to come, however, not before a fairly strong rally in the coming weeks ahead. Like the stock market itself - this will be a rally to reduce commodity and energy related investments into before a secondary decline.

That secondary decline will likely be a very good buying opportunity and will coincide with the launch of a new QE program from the Fed. However, that will likely not be before late summer and we will address that in more detail when the time comes. For now...it is *"risk off"* in energy and commodity related investments.



Oil, as shown above, is much oversold on all measures. A rally to between \$90 and \$100 a barrel is very likely in the short term and will absolutely coincide with a decline in the US Dollar.

If you own a lot of energy related investments in your portfolio I would suggest holding these positions for now and then selling them when oil rises to any level above \$90 a barrel. The decline last summer started in early May, like

today, and bounced downward from \$115 to \$78 a barrel. However, during that more organized decline, oil never got as oversold, as quickly, as it has this past month. Do not be fooled by the rally – it will not last long and will most likely be a good opportunity to reduce energy related positions.

When it comes to the broad commodities complex, as represented by the CRB (Commodity Research Bureau) index it is almost indistinguishable from oil itself. At a 3-standard deviation event we will very likely have a rally in the near future. It should be used to liquidate, reduce and rebalance commodity related positions particularly in the agricultural area.

What about Gold?

Gold – Hated, Unloved and Perfect

Gold has now become the hated asset class – as a contrarian that is a great thing. Last August, as gold reached its 3-standard deviation move to the upside, we stated that the corrective process would take quite some time to complete. (For a complete assessment and review of our analysis read [“Death of the Gold Bull Market”](#))

Gold is in the perfect position to continue to capture money flows as uncertainty in the global market place rises. The issues of the debt ceiling debate, further QE programs, and the Eurozone all continue to driver “*fear*” into individual investors who move money into gold as a “*safe haven*” against the fears of economic collapse.



Importantly, gold has continued to hold its critical support levels at \$1500-1550 an ounce as we have continually maintained. The sharp move on

Friday, as market volatility spiked, was additional confirmation to the strength of these current support levels.

The current downtrend line from the 2011 highs puts the target for the current rally to between \$1650 and \$1700 an ounce. We will reevaluate our holdings once we reach those levels.

Interest Rates – Time To Take Profits In Bond Funds

Interest rates, which are the inverse of bond prices, have moved into an extreme overbought condition.

Our target on the 10-year treasury has been 1% for some time now with a 2% target on the 30-year treasury. As of Friday the 10-year treasury was at 1.46% and the 30-year was at 2.54%.



With the 10-year yield currently at a 3-standard deviation event (are you seeing a pattern here yet?) it is time to take profits in bond funds of all types.

This includes Ginne Mae Funds, Total Return Funds, TIP Funds, Long Term, Short Term, and Intermediate Term – in other words, if it has the word BOND in the name of the fund – it is time to take some profits.

The reversal in interest rates is likely to be short lived and will coincide with the selloff in the US Dollar. A move up in rates to anywhere between 2% and 2.3% will be your next best opportunity to add fixed income back into your portfolio.

Cash Is King Until QE Arrives

It is important to understand that all of the analysis above is SHORT TERM. All markets have reached extremes which MUST BE reversed, therefore, when managing your portfolio and raising cash to reduce investment risk – simply hold the cash in reserve.

The next buying opportunity will come when we start getting more information about the next quantitative easing program from the Fed. It is only a function of time as there are simply no other tools available to support the markets and the banks. Do not be fooled – QE is only about supporting the banking institutions and Wall Street and has no real effect on the economy. In fact, I would argue, that QE is actually very bad for the economy longer term as it creates inflationary pressures that immediately attack the average household in the forms of higher food, energy and utility costs.

The only problem that currently exists is that we do not know WHEN it will arrive, or in what form, which will have various effects on the market and asset classes. **DISCLAIMER:** All of the analysis in this report is based on the assumption that the next QE from the Federal Reserve will arrive between August and September of 2012. **If it arrives earlier than that then the recommendations will immediately change.**

When it comes to technical analysis - we are making an evaluation of what is most likely going to happen in the future based upon the weight of evidence of what has occurred in the past. It is NOT an exact science and must be constantly measured, evaluated and tweaked.

- *You must be prepared to sell investments at a loss.*
- *You must be prepared to be wrong.*
- *You must be willing to take action today that may have a negative result in the future.*

These are all part of the risks of investing in the financial markets. If you cannot comply with these basic rules you have no business investing in the market. However, by limiting losses, taking profits and following some sort of investment discipline that keeps you on the right side of the trade 60-70% of the time – you will be a successful investor over the long term.

Remember – the biggest detriment to your success as an investor are your own emotions. It is always generally better to do exactly the opposite of what you feel. “Buy” when you are scared and “Sell” when you are greedy.

More often than not – you will be right.

See you next week.

Lance Roberts

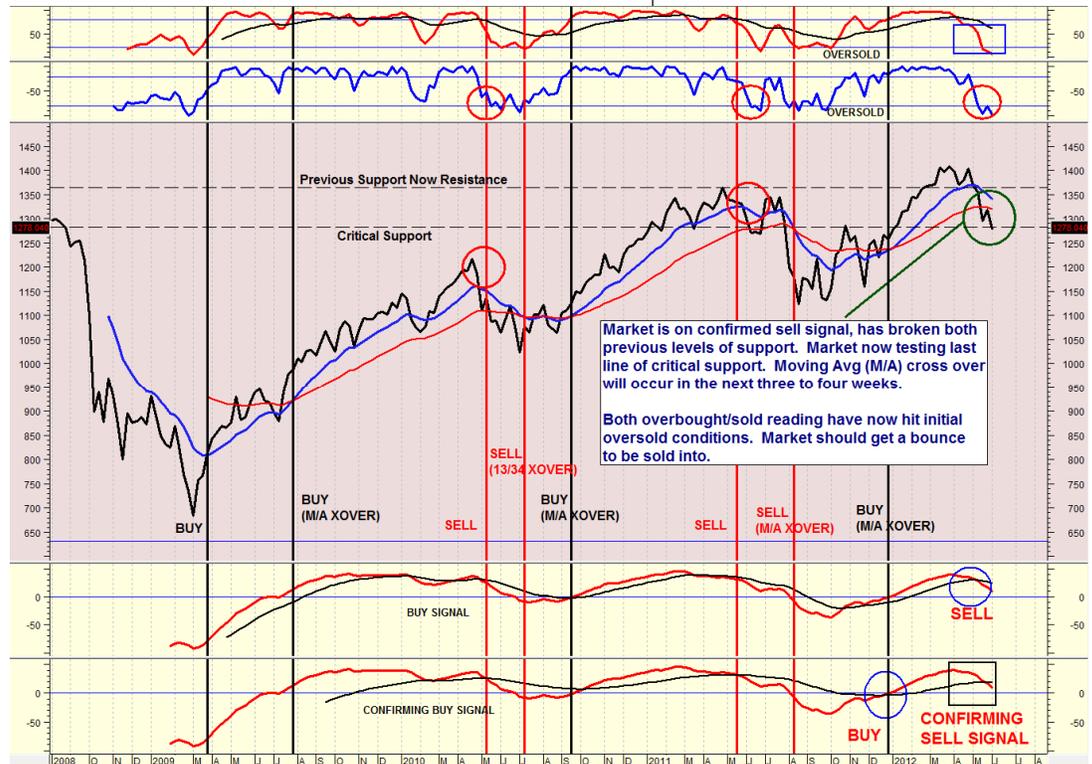
401K Plan Manager

We wrote last week that portfolio risks should be reduced on any rally to the targets set out in the report. While the market attempted a very short term rally last Monday – it simply could not hold onto the gains and fell sharply on Friday.

With the markets grossly oversold on a short term basis – we fully expect a rally to the levels identified in the missive above. At those levels it is important to begin reducing portfolio risk.

As stated start by reducing underperforming and lagging positions. Follow up by resizing the remaining positions back to their original weighting. Finally, hold cash in reserve until the next buying opportunity occurs which should be in August or September.

If you need help after reading the alert; don't hesitate to [contact me](#).



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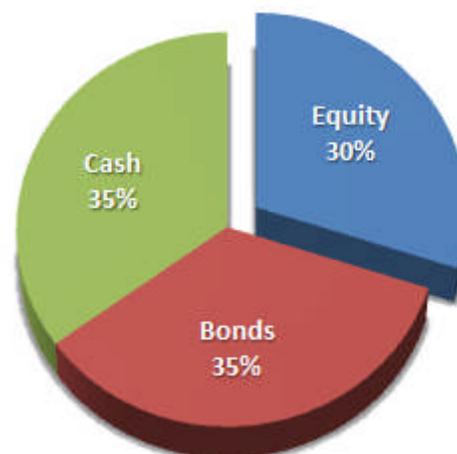
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ALL NEW MONEY (Monthly Contributions)

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Current Allocation Model



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