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Investment Strategy

Two of the Most Important Investing Paragraphs We Have Ever Read

> During major sustained advances in stock prices, which usually occupy from five to seven years of each decade, the investor can complacently hold a list of stocks which are currently unpredictable. He doesn't worry about the top because he knows he is never going to sell at the top. He knows that the chances are overwhelming in favor of the assumption that he will get far better prices by waiting until after the top is passed and a probable reversal in trend can be identified than he will ever get by attempting to anticipate the top, and get out on the nose. In my own experience the largest profits we have ever taken have come from stocks purchased while they were making a new high in a market which was also momentarily expecting the top.
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> As I have already pointed out the absolute price of a stock is unimportant. It is the direction of the price movement that counts. It is always probable, but never certain, that the direction of the price movement will continue. Soon after it reverses is time enough to sell. You should sell when you wish you had sold sooner, never when you think the top has arrived. That way you will never get the very best price—by hindsight your individual transactions will never look daring. But some of your profits will be large; and your losses should be quite small. That is all that is necessary for a satisfactory, enriching investment performance.

Stock Profits Without Forecasting, by Edgar S. Genstein

We have used this quote a number of times over the decades, as these are two of the most important paragraphs we have encountered in more than 47 years of studying markets. DO NOT read them just once. Go off to a quiet spot that invites contemplation and READ THEM SEVERAL TIMES. Then reflect on all of the mistakes you have made in trading and investing. Bells will ring, and curses will be uttered, if you are truly honest with yourself. Our advice is to keep this quote handy, read it over, and study it every time you get ready to make an important buy or sell decision, especially if your emotions reign.

Obviously, we agree with Mr. Genstein's advice, but over the years have added a "twist" to his sage strategy. That twist has been to be a scale-up seller in select stocks that have appreciated when we think we should raise some cash. This does not mean we sell the entire position if we continue to find the fundamentals to be favorable. Scale selling partial positions accomplishes a number of things. We recommended doing some scale-up selling during the entire month of January 2018 when our short/intermediate proprietary models telegraphed that February was the first potential window of downside vulnerability in a long time. The reasons to raise some cash were fairly simple.

Firstly, it allows capital gains to accrue to the portfolio (sometimes long-term capital gains and sometimes not). Secondly, it rebalances said stock positions back toward the original portfolio weighting intended. Thirdly, it tends to give us the “margin of safety” mentioned in Benjamin Graham's book *The Intelligent Investor*. To wit, this strategy allows us to hold some of our original investment positions until we “wish I would have sold them sooner.”

We revisit this topic this morning after spending the past few weeks speaking at several events and seeing institutional accounts. Unsurprisingly, most of the institutions have had a difficult time over the past few months. As one portfolio manager put it, “While we make money in one position we give more than that back in another.” Indeed since the "buying stampede" ended on January 26th it has been a market in which it has been pretty easy to lose money. For example, at the intraday high of January 26th the S&P 500 (SPX/2656.30) traded at 2872.87. It subsequently fell to a “selling climax” low of 2593.07 on February 6th. That low was followed by the anticipated failed “throwback” rally, leading to the undercut low of February 9th (below the 2/6/18 “selling climax low”), which we consider to be THE low until proven wrong; and I committed some of the previously raised cash accordingly.

Meanwhile, many individual stocks have fared far worse. As for individual investors, our presentations to them recently found most frozen like a deer in the headlights of a car buffeted by the recent volatility and the negative “spin” from the media. Verily, as our friend Jason Goepfert, of the invaluable SentimenTrader fame, writes:

"Every day is an emotional swing. For the past 8 days, S&P 500 futures have opened far from where they closed the prior day. That's one of the longest streaks of emotional opening volatility since 1982. Short-term returns were negative after other [such] streaks, but long-term returns were very good" (see chart 1 on page 3).

As our pal Leon Tuey wrote last week:

> One of the biggest challenges for investors is to maintain objectivity and focus on the facts. For most, this is extremely difficult. For one thing, few (including the professionals) understand the market's logic. Consequently, they are influenced by the headlines. For another, those in the investment industry are inflicted with chronic "verbal diarrhea". They never understand why God gave us two ears and one mouth. …Investors are bombarded 24/7 with endless explanations for anything that moves, stocks, bonds, currencies, commodities, political events, etc. At the end, the smoothest talker wins the day and gets headline billings. Not understanding the market's logic, investors turn from one professional gumflapper to another and end up totally confused and bewildered and emotions overtake logic.
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> Market forecasting is neither difficult nor impossible. To know the future, investors must have a deep understanding of the market's economic cause/effect relationships that drive the markets (which was explained in my August 22, 2017 report, "Market Logic – Key to Successful Market Timing" and in my April 1, 2018 report, "A Bear Trap Has Been Set – Bull Market Has Resumed"). Once the market's logic is understood, the future is clear. February's market free-fall has left investors shell-shocked and fearful. Pundits churn out endless reasons for their bearish views. David Rosenberg, a media darling, declared "the bull market is over". Also, the folks at Seeking Alpha gave 10 reasons that the bull market ended.
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> If David Rosenberg is calling for a bear market, he better not hold his breath. As detailed in my April 1 report, "A Bear Trap Has Been Set – Bull Market Has Resumed", there is not a thread of evidence that the bull market is over and a bear market has commenced. As noted, this year's correction was a reaction to the market's grossly overbought condition and too much optimism. The structured VIX products exaggerated the correction which frightened investors worldwide. But available evidence clearly indicated that "the market" bottomed in early February and the early February low was successfully tested recently setting a bear trap. To maintain objectivity and a proper perspective, I urge investors read my reports from the beginning of February to date. The market is behaving exactly as predicted. Yet, pundits are still trembling with fear waiting for "a test of the low", some even feel that a bear market has begun.
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> Bull markets don't die of old age. The grizzly will arrive when the Fed tightens meaningfully. Also, there is a saying that "the elevator doesn't go down until it's fully loaded". What it means is that the market won't go down until investors are fully-invested as market tops are marked by euphoria. That is certainly not the mood of the day as fear reigns. As mentioned in these reports, despite this bull market's power and longevity, investors remain skeptical and wary. Nay, as shown this year, fear is universal and is supported by objective sentiment measures. Recently, the CNN Fear & Greed Index dropped to 4, indicating extreme fear. Also, this week, the AAII sentiment survey reported the Bullish sentiment dropped to 26.1%, a low and bullish reading. Bearish sentiment, on the other hand, rose to 42.8%, the highest level since the week of March 9, 2017. In the week of February 11, 2016, when the correction ended, the Bearish sentiment stood at 48.70%. As shown in the chart (chart 2), when the Bullish sentiment hits 30% or lower, it shows pessimism and often coincides with market bottoms. When it reaches 25% or lower, this indicated excessive pessimism and signals that the market stands at a low-risk, high-reward juncture point. Note in January, bullish sentiment reached 52.60% showing excessive optimism and warned of a market correction. It was bang on the money.
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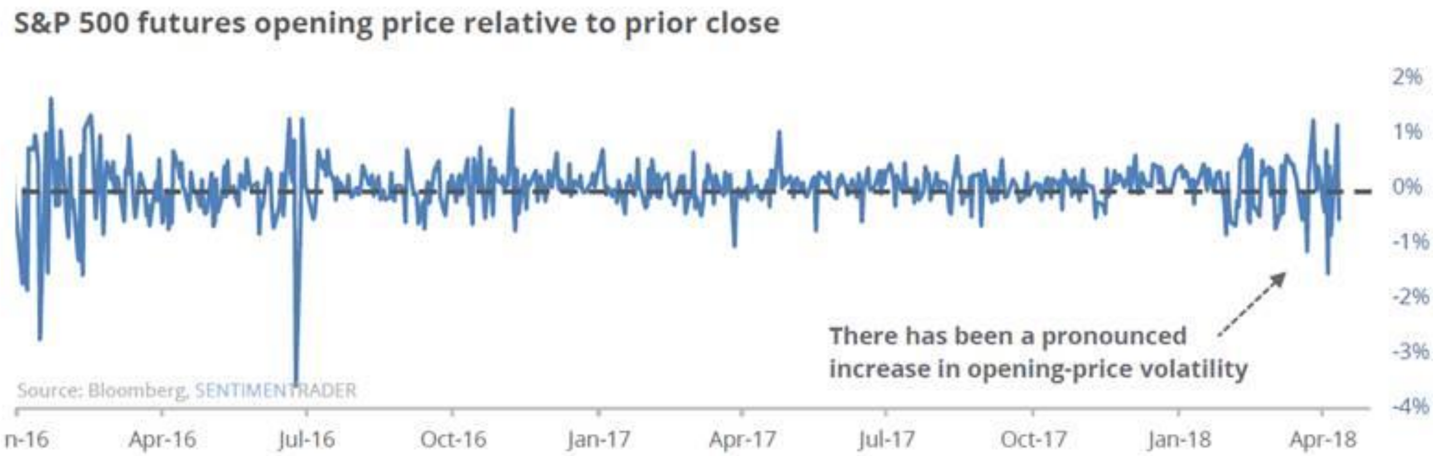
> In conclusion, the market remains in a low-risk, high reward juncture point as it is oversold and sentiment backdrop is ideal as fear is widespread. As mentioned, the market bottomed in early February and the bull market has resumed. There is nothing to fear but fear itself. Long-term, as detailed in my April 1 report, the major market factors remain solidly bullish. The secular bull market remains intact. Until they deteriorate, there is no need to alter my bullish stand.

The call for this week: On a very short-term trading basis Friday's action was, again as Jason Goepfert writes:

"[Friday was a] bearish engulfing [chart pattern]. The price pattern in the S&P does not look promising, according to textbook technical analysis. Friday arguably was a bearish engulfing pattern that suggests weak buying interest and eager sellers. [However] it has not been a successful reason to sell, with stocks rising over the next two weeks essentially every time" (chart 3 on page 4).

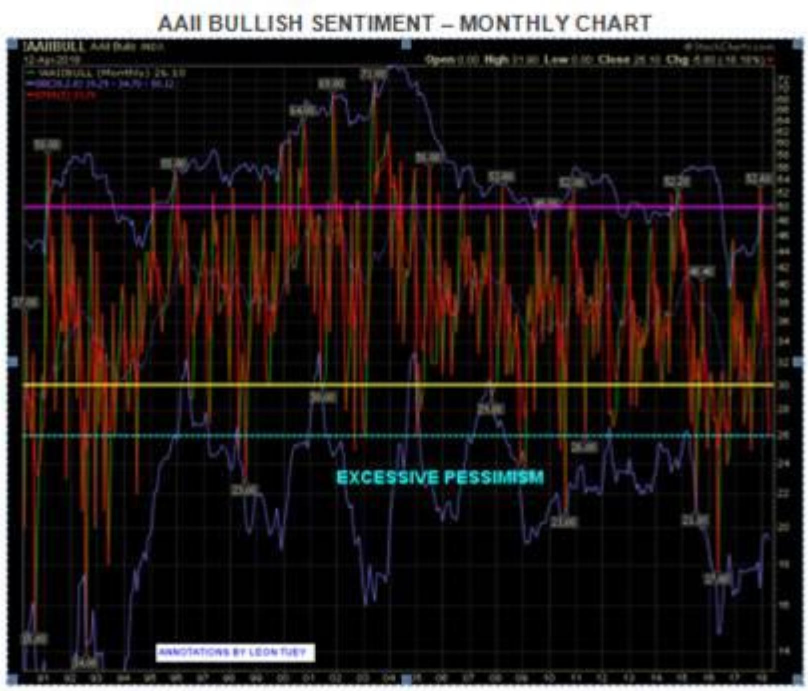
Part of the calculus on striking Syria had to be conveying resolve to North Korea to keep Kim from balking at the scheduled peace talks. We are stunned that every pundit and pseudo expert inveighing against or for the Syrian strike has failed to note this important consideration. There is also a China trade element to the decision to hammer Syria. P.S. - DJT called out Putin and Iran in his Friday night address. Obviously, the attack on Syria was also a message to them. All of this has the preopening S&P 500 futures better by 16 points as we write at 5:33 a.m.

Chart 1



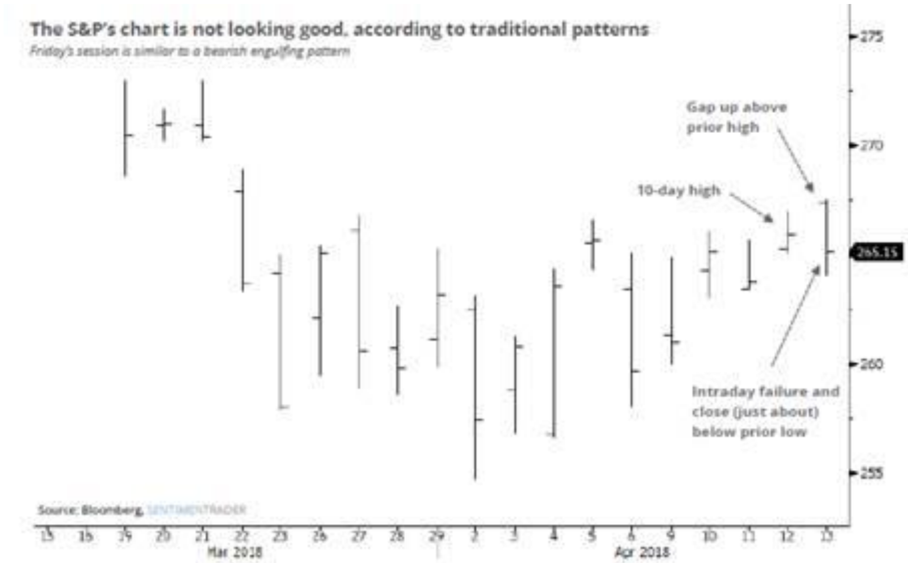
Source: SentimenTrader

Chart 2



Source: StockCharts.com

Chart 3



Source: SentimenTrader

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