Perspective: FED Remarks Sharply Reverse Market Decline

June 9, 2019

Why StormGuard-Armor Triggered on May 31st

In last month's newsletter, I listed a number of mostly geopolitical problems, but suggested that, "Short of a more serious problem, we may dance with resistance for a while at the all-time high, but the market is otherwise headed higher." During May, China's Communist Party completely rejected parts of the trade deal we thought were in hand and seemed to signal a willingness to wait out the remainder of Trump's term in hopes of a more favorable new president. Furthermore, political tensions spiked as southwest Border Patrol officers dealt with over 143,000 undocumented immigrants in May, leading to threats of border closure or new tariffs on Mexican goods if the country continued to do nothing to abate the problem. Fear that trade war tariffs would reduce economic activity lead to May's moderate market decline.

Meanwhile, StormGuard-Armor had been positive, but on probation for four months. However, at the end of May, the Market Momentum Indicator (fourth chart - institutional volume) turned south. Probation ended, StormGuard-Armor triggered, and their integrated Bear Market Strategies were invoked to seek out a safe harbor. This was the appropriate response, particularly with declining institutional volume.

What Jerome Powell Did to Reverse the Market's Decline

Speaking at a June 4th FED conference in Chicago, Chairman Powell said, "We are closely monitoring the implications of these developments for the U.S. economic outlook and, as always, we will act as appropriate to sustain the expansion."

S&P500 Index - 6 Months

S&P500 Index - 5 Years

Investors interpreted this to mean that the FED will have our backs if the going gets tough with trade negotiations and responded by quickly pushing the markets 2% higher. Clearly, the words "*... we will act as appropriate to sustain the expansion*" is being viewed as a commitment by the FED to actively reduce risk and sustain growth. On Friday, this good news was bolstered by a signed deal with Mexico to stem the flow of migrants and eliminate the threatened tariff increases.

Jerome Powell's remarks are an example of a "punctuated event" that unfortunately cannot be predicted or evaluated in advance. We can only react to the ramifications created by the sum of all previous punctuated events. As investors, Powell's remarks are likely an incredible gift to us that will put a floor under volatility and engender the confidence necessary for producing longer lasting trends – and that is music to our ears! Unfortunately, this gift was delivered to us with terrible timing.

**Why Doesn't StormGuard Always Trigger Faster (or Slower)?**
Whether it is StormGuard-Armor or just sector rotation, the game we must play is illustrated by the Strategy Tuning Profile chart (right) which plots Strategy Return versus the time constant (length) of the trend filter used to measure momentum (trend). The orange line depicts using an SMA (simple moving average) filter while the blue line depicts using a DEMA (double exponential moving average) filter. In both cases, it is quite clear that attempting to trade more quickly results in lower performance. This is because sharp drops often snap back, resulting in whipsaw losses. Of course, waiting too long also has its drawback, which is missing out on the trend's prime time. Striking a balance between avoidance of one kind of loss versus the other kind of loss is the job of the algorithm. Keep in mind that even Merlyn's Sector Nectar strategy loses to the S&P500 on a quarterly basis 27% of the time (see its chart for "Beats"), and every time it is not perfect investor doubt naturally arises. (Sounds a lot like my favorite NFL quarterback.)

(click to enlarge)

Avoiding Whipsaw Losses
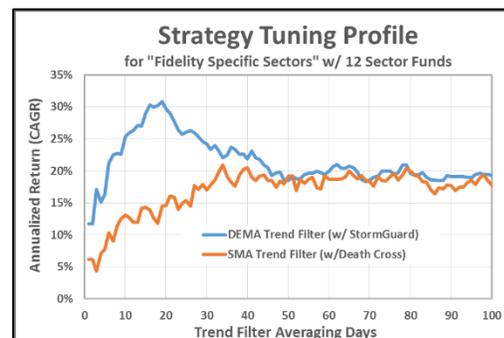
SG-Armor+ Now Fully Implemented In Merlyn.AI Strategies

In review, near the end of December 2018 we implemented the "+" version of StormGuard-Armor that enabled it to break the "month-end only" trading rule under special conditions that require a sufficiently sharp rebound following a market correction. The relative strength of a rebound in proportion to its former drop is an indication of whether the market problem has subsided sufficiently for the market to move forward again. The first test of this feature came with the January 20th early exit signal. Last Friday night, another such signal occurred. Not only was the rebound sharp and significant, but the SG-Momentum Indicator turned upward again for the second day in a row – the institutional investor is definitely emboldened. Finally, as of Saturday, our crown jewel Merlyn.AI Strategies now also have the proper database structure to handle the extra mid-month trade generated by SG-Armor+.

The signals are real. The trades are real.
Powell has enabled the markets to de-risk.

Powell hints Fed will cut rates if needed over trade wars
AP News

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