SectorSurfer Change the Game — Monthly Perspective — ALPHADROID Change the Game

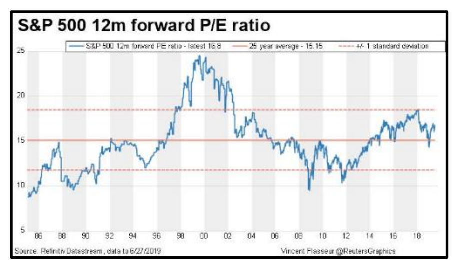
Perspective: Confidently Breaking Through to New Highs

July 8, 2019

S&P500 Index - 6 Months

The Market is Confidently Breaking to the Upside

For the last few months I've said: "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." The S&P500 has now broken through the resistance level of the prior high set in early May indicating it is decidedly heading higher. For now, trade talks that had stumbled with China have resumed, the Mexican Government has agreed to do its best to block migrants at its own southern border, and North Korea may be headed back toward making a deal. Meanwhile, Iran's escalation of its uranium enrichment program and the ever-tightening economic sanctions imposed on Iran is compounding global tensions. Fortunately, Jerome Powell (FED Chairman) recently reaffirmed that he will play his part to keep economic growth strong should it be threatened by any of these problems.



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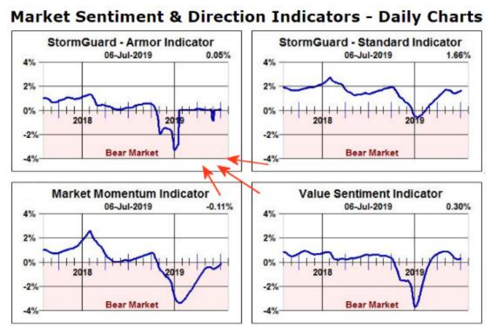
It seems that there's never a shortage of financial experts predicting the imminent demise of the bull market. Such predictions are typically based on past cycles or excess valuation. The Forward P/E Ratio chart (right) throws out both arguments as a basis for an imminent market crash. The 2001 crash began as a valuation bubble that popped and was later exacerbated by the 9/11 attacks that put a chill on everything. The 2008 crash had neither of those problems, but instead had a leveraging problem with collateralized debt obligations (bundled and securitized home loans) that took down Lehman Brothers and nearly cratered the financial industry. None of those things exist today. Instead, we have a quite reasonable market P/E ratio, continuing high

(click to enlarge)

employment growth, record low unemployment, reasonable wage growth for the first time in a decade, and no sign of an inflation uptick. Thus, optimism reigns and the market is willing to continue higher.

StormGuard-Armor's Probation is About to End



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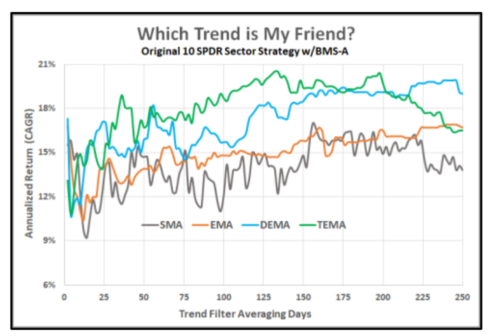
A close examination of the charts of the three underlying components that make up StormGuard-Armor (right) show that all three are now again headed higher. StormGuard-Armor remained on probation for most of the last 5 months (with a value held barely above zero) because the Market Momentum Indicator had been rising steadily but still remained below zero. For a short period, the Market Momentum indicator had lost its positive climb and headed downward (triggering StormGuard) due to heightened China trade tensions. Days later, FED Chairman Powell reaffirmed that "he had the market's back" and sent markets sharply higher. The Market Momentum Indicator quickly headed higher and returned StormGuard-Armor to probation status. It now appears likely that the Market Momentum indicator will move into positive territory this week, marking an end to probation and a solid indication that the large-volume players are finally back.

Which Trend is My Friend?



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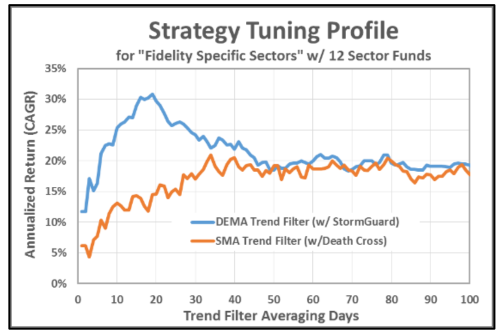
There are lots of momentum indicator algorithms that operate over a wide range of time periods. The chart (right) clearly shows that the performance of an ordinary SPDR sector rotation strategy can vary wildly depending on the filter and chosen time periods. In this chart, the worst performing and most non-uniform of them is the Simple Moving Average (SMA), closely followed by the Exponential Moving Average (EMA). The best performing was the Triple Exponential Moving Average (TEMA) followed by the Double Exponential Moving Average (DEMA). The second chart is for a Fidelity sectors strategy, which responds a bit differently. These filters are explained in my book *"Conquering the Seven Faces of Risk"* and in the AAII seminar video "[Diversification Heresy.]"



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This pair of charts provide the following lessons: (1) The SMA is the favorite momentum filter of academic researchers and industry practitioners — and is the worst performing of these filters. (2) In both charts the return is considerably lower for shorter filtering time periods, indicating that it is better to be right than to be fast. Shorter decision periods result in more instances of whipsaw losses because sharp drops often snap back. (3) The location of the peak response depends on the combination of funds used and thus cannot be set in stone. Furthermore, strategies that have newer funds that start to participate only later in the life of a strategy can cause the strategy's tuning to change. Thus, automatic self-tuning, such as our FWPT provides, is mandatory for best performance of any strategy over time.

Surf Long and Prosper,

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