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STRATEGIES FOR SUCCESSFUL INVESTING

MARKET STRATEGY

Enjoy the music

WATCH THE TREND

Keith Richards

ANY TECHNICAL ANALYST WORTH their salt will tell you that the breakout through the S&P's May 2015 old high (14 month resistance) 2135 is bullish. When the Brexit selloff occurred, we took profits on our hedges and bought a few more stocks on the Monday meltdown following the vote. The recent breakout has justified that move. It added nicely to our portfolio upside in July. We are optimistic and believe that the market will be positive from the fall and on into 2017. However, we continue to retain about 20 per cent cash in our equity platform, in light of a greater than average chance of volatility before winter. Here's why:

Seasonality. Seasonality shows that the greatest period of volatility for markets is from late July through to October. Studies by Yale/Jeffery Hirsch (Stock Traders Almanac, published yearly), and Canadian analysts Don Vialoux (www.timingthe markets) and Brooke Thackray (Thackray's Investors' Guides, published yearly) verify this.

Presidential cycle. The end of a second-term president's run can also add to potential downside. A chart that you can search, seasonal timing website www.equityclock.com, illustrates the standard presidential cycle vs. the second-term presidential cycle. The chart shows us that the potential for loss is greater during the summer in the year of a second-term election. This year could be particularly volatile given the polarity of the candidates.

Sentiment. The CBOE put/call ratio chart shows us that the level of puts vs. calls being traded suggests high optimism by options traders. I've noted that when the put/call ratio gets to about 0.76 (that is, about 0.76 puts traded for every one call), market players are too optimistic and the market is due to correct.

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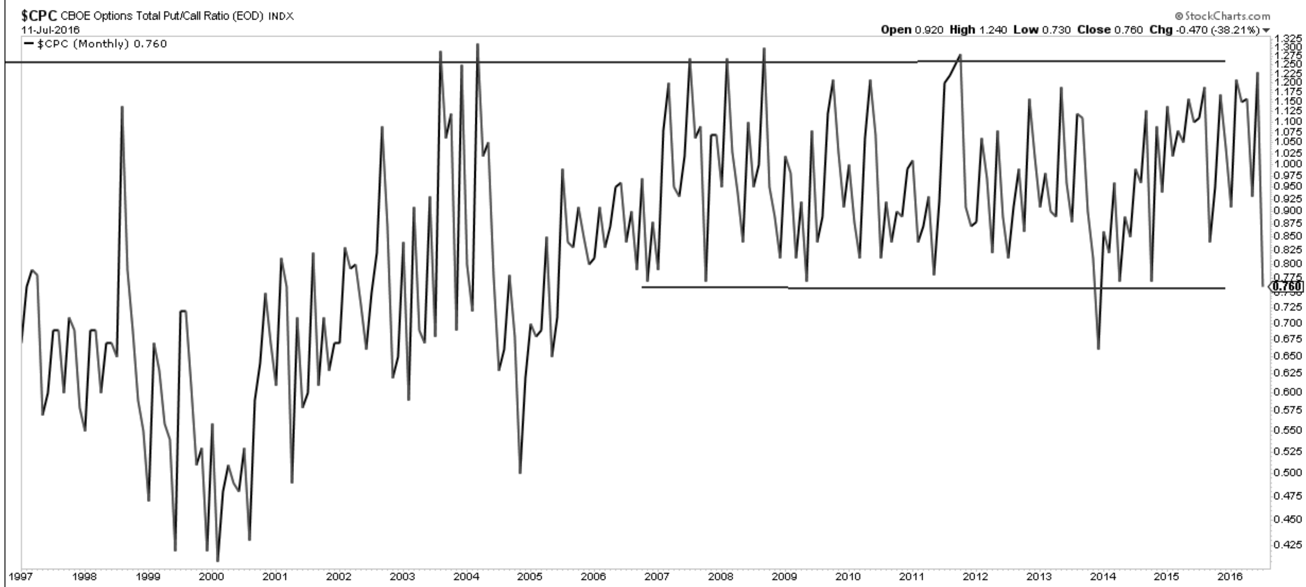
CHART PUTS TO CALL

The NYSE volatility Index (VIX) – another vehicle that tracks the movements of options traders - is approaching a level that my research shows to be "too low." The VIX measures option premiums, which in a way measure the "fear" premium being built into option prices. When the VIX approaches 12, it has shown to be accurate indicator of too much investor complacency – and that typically leads to a selloff.

An interesting phenomenon about the recent rally in markets is that the traditionally "defensive" securities – which are typically sold by market participants in order to reallocate into growth- orientated stocks – are rising along with the growth stocks. In fact, the defensive sectors – namely precious met-



als, treasury bonds, and utilities - have been making new 52-week highs consistently for more than a year. This has driven these sectors into an overbought state.

I use a rule to tell me if a security is overbought and due for a pullback. This rule will serve you well if you are considering either buying into an uptrend, or finessing an exit. And it's easy to use. Here's the rule: If a security is more than 10 per cent over its 200 day Moving Average – it is considered overbought and very likely to experience some sort of pullback.

The defensive sectors noted above (bonds, gold, utilities) are all more than 10 per cent over their 200 day Moving Averages at the time of writing. But that's not the only sign of irrational exuberance (to quote former Fed Chairman Alan Greenspan) about these securities.

CHART GOLD HEDGING

The gold chart shows us that its big picture looks positive – given the positive break in trendline and basing action after that break. So too does sil-

ver's chart. In the near-term, gold and silver may be due for a short-term pullback. Not only are they well over their 200 day Moving Averages, but the seasonal period for a bit of weakness in these metals is approaching. According to Thackray's Investors Guide, it's typically best to buy gold in late July or early August, and silver is best bought between September and late winter.

Adding to the overbought momentum indicators and seasonality tendencies is the discrepancy between "Smart Money" (commercial hedgers/large position traders) and "Dumb Money" (small speculators /retail) on the metal.

The site, www.sentimentrader.com chart (below), shows a condition of exuberance that has not been seen for 23 years. Data going back to 1993, including the 2011 highs on gold, show no comparative for the disproportionate, rampant speculation by small investors. That's a bit disconcerting. Silver too has had a strong movement lately on the back of retail ("dumb") money. Ordinary investors are all over this stuff. Like gold, silver is moving at a pace that probably can't keep going. Don't get me wrong - the charts for both gold and silver look fantastic. But the momentum oscillators are getting overbought, and retail investors are getting excited about these metals like I haven't seen since the oil bubble in 2007 and the tech stock bubble in 2000.

For those of us who were trading during either of those times, you may recall that it went REALLY well for quite a while on either of those sectors, and there was plenty of money to be made! But then.... the music stopped. Thus, my long-term view on bonds, gold and silver is that of playing the trend, and leaving the game before that music stops. That correction may take a while to happen so we might as well enjoy the ride while the music continues to play. ▼

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