Opportunities In A Volatile Market

Keith Richards

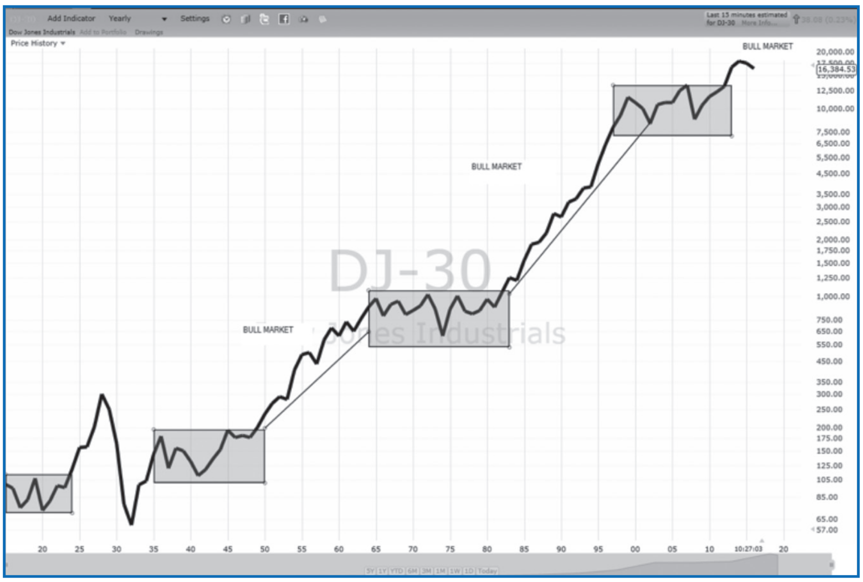
I must admit that the early January correction caught me off guard. At ValueTrend, we held 10% cash, remaining 90% invested coming into the January correction, given our expectation of the traditional "Santa Clause Rally". The setup was good, but then along came China….

We have spoken with very savvy traders and technical analysts who are in the same boat- having been blindsided by the January volatility. However, when one gets blindsided by an unforeseen event, this does not give one permission to stare into the abyss with no trading plan. It is my opinion that bounces should be used as an opportunity to lighten equity positions, and dips can be used as selective buying opportunities.

While the above suggests that I am predicting doom and gloom for the markets, I actually view this market as a range-bound corrective wave within a larger bull market, rather than entering into a bear market. I'd like to suggest there isn't a lot of danger of a major crash this year, beyond rallies and corrections. However, there isn't much hope for a new up leg in the bull market on the S&P500 at this time either. A new leg in the bull market will eventually break out, but it may take several months to happen. Breakouts need a catalyst – in either direction. While a breakdown may occur from the pressures surrounding China, I am not convinced this will be the catalyst to bring on a bear market in North American markets. Meanwhile, I cannot see a positive catalyst to push the markets up from this point either. In other words, there is much more volatility to come, in my opinion, but probably not a crash.

The Good News

It is my opinion that we are still in a secular bull market which should carry us until 2020 or much later. See the 100 year chart of the Dow Industrials (courtesy www.freestockcharts.com) below where I've notated the secular sideways and bull markets. It is clear that the US markets have broken into a secular bull phase. However, it is also clear that US markets are in a corrective wave within that secular bull. That corrective wave started late 2014 and has shown sideways movements since. The bull market, in my opinion, will break out again –but not without a catalyst – as mentioned above.



That catalyst hasn't appeared yet. So we should assume more sideways (big up / swings) patterns until proven otherwise.

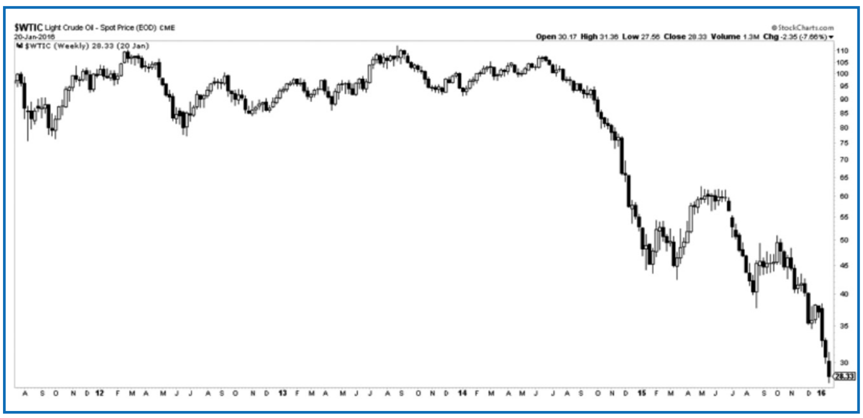
I'm looking at a few opportunistic trades in the current volatility – which are listed below. Please be advised that I may or may not enter into any of these trades. At this point, they are merely ideas on our ValueTrend watch list. We look for specific technical criteria before buying a sector or market. At the time of writing, the securities mentioned below have not yet triggered our "buy" signals, and there are no assurances that our indicators will signal positively on any of them. The list below, therefore, can be viewed as potential opportunities, not outright buys at this point:

The Euro

As the European economies recover from the malaise that has hit them in recent years, I note that the Euro has been stabilizing of late. Given a potentially overbought US dollar, the Euro could benefit as a value play on world currency markets. I'm less interested in European equities than in the Euro itself – although this is not to say that I am avoiding them. At this point, I am reviewing Euro currency ETF's, such as the one shown in the chart below. Note the base on this chart after the Euro's decline in 2014. Should the Euro move up and out of this base, that would suggest a new uptrend may begin.

Oil

Oil tends to have a seasonal bounce from mid-February into the spring. Given its oversold nature, a move out of the current downtrend and into a base would potentially inspire me to execute a trade in this commodity. We need to see that base before becoming too optimistic, but there is a case for an oversold bounce sooner or later. Oil tends to become seasonally attractive in late February and into the spring. Such a trade could be realized through an oil ETF that trades against the commodity, or an energy sector ETF that trades against the energy stocks.



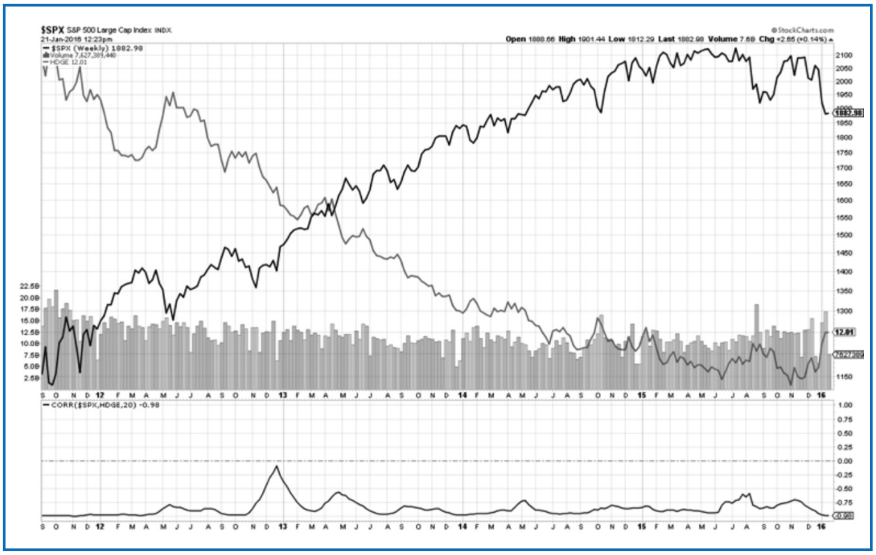
Gold

Gold has returned to acting as a negatively correlated security vs. the stock market. In other words, it zigs when stocks zag. We have noticed a possible basing action on the charts for this much unloved commodity—although at this point it is too early to be overly optimistic on its upside.

In any case, we may execute short termed swing trades (in and out) in gold and gold equities to counter stock market volatility.

Short ETFs

Like gold, a short ETF can trade in a negative direction to stocks. Short ETF's sell short a basket of stocks. My favorite, Ranger Bear ETF (HDGE) shorts about 40 overpriced stocks. It tends to have an almost perfect negative correlation to the S&P500. Thus, like gold, it can help counter stock market volatility if traded on the downswing. The red line is HDGE (note how it went down when the market went up, and how it began moving up when market fell in January). The bottom pane on this chart is a correlation line. The lower that line is, the more perfectly HDGE is offsetting the S&P500. You can see it tends to migrate around -0.90 to -1.0 – meaning it is 90% to 100% perfectly negative in relationship to the stock market. That makes it a very good hedge.



S&P500 Swing Trading

As the US market moves up and down through its current sideways trading range, there will be opportunities to trade in and out of an S&P500 ETF and / or a Dow Jones Industrial Average ETF. I will likely favor a currency hedged version on either of these plays, given our questions regarding continued USD strength.

Keith Richards, Portfolio Manager, can be contacted at krichards@valuetrend.ca.

Keith Richards may hold positions in the securities mentioned. Worldsource Securities Inc., sponsoring investment dealer of Keith Richards and member of the Canadian Investor Protection Fund and of the Investment Industry Regulatory Organization of Canada. The information provided is general in nature and does not represent investment advice. It is subject to change without notice and is based on the perspectives and opinions of Keith Richards only and not necessarily those of Worldsource Securities Inc. It may also contain projections or other "forward-looking statements." There is significant risk that forward looking statements will not prove to be accurate and actual results, performance, or achievements could differ materially from any future results, performance, or achievements that may be expressed or implied by such forward-looking statements and you will not unduly rely on such forward-looking statements. ETFs may have exposure to aggressive investment techniques that include leveraging, which magnify gains and losses and can result in greater volatility in value, and be subject to aggressive investment risk and price volatility risk. ETFs are not guaranteed, their values change frequently, and past performance may not be repeated. Please read the prospectus before investing. Every effort has been made to compile this material from reliable sources; however, no warranty can be made as to its accuracy or completeness. Before acting on any of the above, please consult an appropriate professional regarding your particular circumstances.