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Chorus of "This time is different" surfaces at market tops and bottoms

Myopic by nature, how quickly we forget

Keith Richards

Humans are myopic by nature. Market participants move in tandem through waves of cautious optimism, to irrational buying exuberance, to speculation – and then reverse direction into doubt, and ultimately sheer panic selling.

A commonality between the irrational exuberance (topping stage) and the panic (crash) stage are the attitudes of market participants. A common rally call of the crowd at market tops AND bottoms is "This time is different".

Having been through two major crashes (and several large corrections) over my 28 years in the industry (not to mention prior years of investing on a personal basis), I have experienced this "new paradigm" attitude of crowds a few times.

Investors forget the signs leading into a crash. They participate in the madness. Yet in the moment of experiencing a crash, they cry "Never again". Next time, they say, they will be wary of an over-exuberant market. "We won't be fooled again," they cry – right at the market bottom.

But they are fooled again. Because market crashes don't happen close enough to each other to keep the emotional impact of the experience at the forefront of their minds.

Ralph Waldo Emerson asked, "Of what use to make heroic vows of amendment if the same old lawbreaker is to keep them?"

Here's the point of my message: You can't change your habits unless you change the lawbreaker. Will you take note of historic market patterns and/or your own past errors –and learn from them? Or do you believe that this time is different? Are you the same old lawbreaker?

Take a look at the chart below. It's the history of the S&P 500 from 1980, courtesy of the historic chart gallery on stockcharts.com.

I've drawn some channels on the chart to illustrate periods of low volatility and high volatility. The dark channels are normal/high volatility trends. They illustrate that markets climb a wall of worry. There are lots of steps up and down as the market advances.

The lighter trend channels illustrate periods of low volatility. These periods, as you will see in the bullet points below, represent about two to three years of market movement.

They have, in every case, led into a period of correction, consolidation, or crash. Markets do not project upwards and onwards in a straight line forever. The lack of volatility is self-corrected via a period of high volatility. Every time.

Here are the periods of low volatility and rapidly rising markets (illustrated by the light trend channels). Note the corrections, consolidations, and crashes that followed each of them:

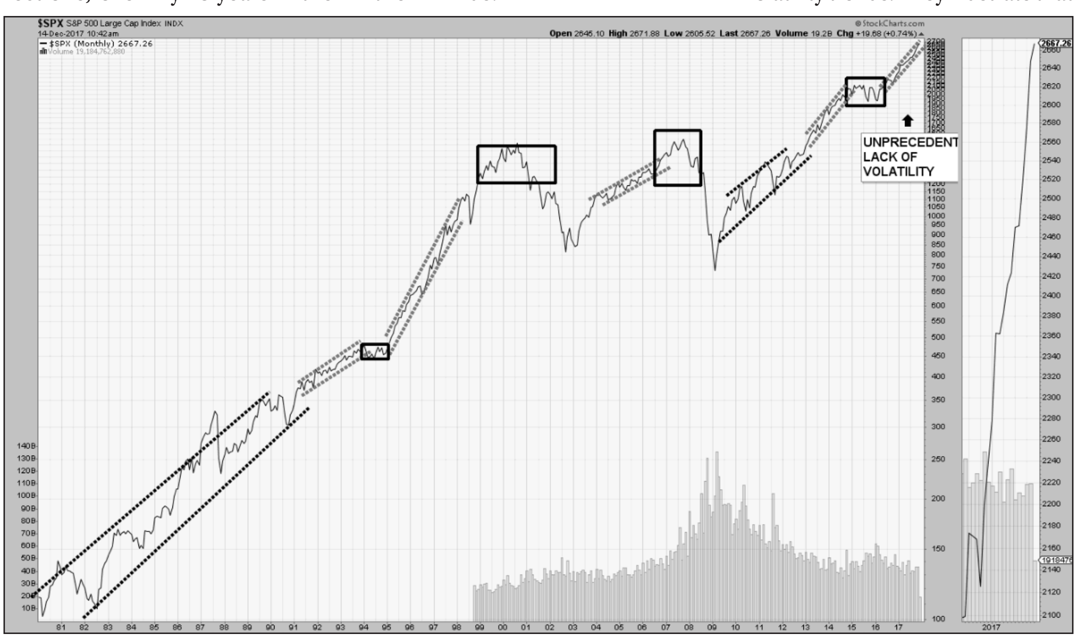
1991 to 1994
1995 to 1998
2004 to 2007
2013 to 2015
2016 to 2018

As you will see by the outright lack of corrections over the past year, we are not only in a period of low volatility, we are in an historic period of almost NO volatility!!!

It is my strong opinion that we will – sooner rather than later – enter into a period of volatility. Markets must self-correct excessiveness. That may mean a choppy consolidation.

It may mean a simple but reasonably deep correction (a drop between 10 per cent and 20 per cent). Or it may mean a crash.

That volatility may begin in January. Or it may begin in June. Or in a year. But it won't begin in five years. That's for sure.



There is a tendency for this year's underperformers to outperform in January – while outperformers often slow down or decline.

Near-termed strategy

At ValueTrend, we are holding stocks, sectors, and markets that are somewhat underappreciated or have pulled back in a trend.

Meanwhile, we are looking for opportunities among what we view as a very likely pullback coming in January.

We are holding a bit less than 20 per cent in cash with an eye on buying stocks on a pullback, should one occur. We have minimal exposure to the market-leading overdone stocks—and greater exposure to what we feel are rotational candidates—below are the prime examples of sectors we own, want to own, or would want to own more of in a correction:

U.S. Banks: Pick your favorite, or consider the **BMO Equal Weight U.S. Banks CAD-Hedged Index ETF** (ZUB-TSX, $30.21) which we hold a position in.

Consumer Staples: Again, pick your favourite consumer staples stock like **Mondelez International Inc.** (MDLZ-NASDAQ, US$43.10), which we hold a position in. Otherwise, you could consider the **SPDR Consumer Staples ETF** (XLP-NYSE/Arca, US$56.78) or the Canadian equivalent offered through BMO, the **BMO Global Consumer Staples CAD-Hedged Index ETF** (STPL-TSX, $20.84).

Energy: As WTI (West Texas Intermediate) crude oil attempts to recover into its next level of overhead technical resistance, we're convinced that Canadian energy stocks such as **Vermilion Energy Inc.** (VET-TSX, $45.60) and **NuVista Energy Ltd.** (NVA-TSX, $7.85) may tag along for the ride. We hold both in our ValueTrend Equity platform.

I hope this helps in positioning your portfolio for the coming year. All the best to my readers, and watch for my upcoming BNN appearance. I'll be on **Market Call Tonight** on Monday, Jan. 8 at 5:30 p.m. If you have questions about the technical analysis of stock trends for individual stocks, be sure to phone in with them during the show.

Call toll-free at 1-855-326-6266 or email your questions ahead of time (please specify they are for Keith) to marketcall@bnn.ca.

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