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IS DOW’S CONCEPT OF CONFIRMATION STILL RELEVANT?

BY CARSON DAHLBERG, CMT

Editor’s note: This research was originally published at Optuma and is reprinted here with permission. Other research into traditional technical tools and more advanced techniques can be found at Optuma’s web site.

ABSTRACT: Charles Dow is often regarded as the father of Western technical analysis, and the influence of his concepts can be seen in modified applications by today’s practitioners. One such concept, and the focus of this paper, is the technical concept of Confirmation, which has its roots in managing returns in a framework which considers risk. In this paper, Confirmation is modeled using modern technical analysis methods, to produce objective signals. When a modern adaptation of a Confirmed Uptrend (CU) model is applied, to the Dow Jones Industrial Average (DJIA) and the Transportation Average (TRAN), to time buying the DJIA, improved metrics of risk and returns over randomly buying DJIA are achieved at consistent intervals within the first year of the signal. This suggests merit to the concept of Confirmation.

Confirmation Concept: Charles Dow was concerned with actively managing returns in the context of risk. Dow understood that stock speculation was, “based on the perception of a stock’s value and the underlying market movements”. To guide investment decisions, Dow focused on defining and identifying trends in consensus value and market movements. Dow defined a longer-term trend through a series of successive price patterns, and posited that trends could do more than identify the current direction. Qualified trends could indicate the future direction as, “signals of danger or encouragement for those that read with care.” Hence, he created industrial and railroad averages to measure trends for his model. “Dow argued that the railroad and the industrial averages had to confirm each other for a signal to be conclusive in judging future trends.” When both averages are trending in the same direction, it indicates that economics and psychology agree - that is a state of Confirmation.

Confirmation You Can Count On?

Dow was motivated by the need to solve real-world problems with investing: knowing when to put capital to work and how to monitor risk, while keeping emotions in check. These problems are just as relevant to the modern investor. Dow’s technical concept of Confirmation provides a framework, to create an objective model, for identifying likely market regimes constructive to investing. It is then possible to make informed investment decisions based on logic.

Confirmation Redefined with Initial Premise
A moving average summarizes the average price over a rolling window of time. Technical analysis makes the assumption that the average price represents the consensus price. Hence, price is trading above consensus indicates an optimistic perception of value, while the opposite indicates pessimism.

Throughout this paper trend will be determined using a 1-year simple moving average (SMA). If the daily closing price is above the SMA, the average is in a defined uptrend and vice versa. The DJIA (blue) and TRAN (orange) are depicted in Figure 1 with their respective 1-year SMAs (both red).

The following pseudo code definitions will be used to examine Dow’s concept of Confirmation.

Defining Trends:

- Uptrend = (Close > 1-Year Moving Average of Close)
- Downtrend = (Close <= 1-Year Moving Average of Close)

Defining States of Confirmation:

- Confirmed Uptrend = (DJIA Uptrend) AND (TRAN Uptrend)
- Unconfirmed Uptrend = (DJIA Uptrend) AND (TRAN Downtrend)
- Confirmed Downtrend = (DJIA Downtrend) AND (TRAN Downtrend)
- Unconfirmed Downtrend = (DJIA Downtrend) AND (TRAN Uptrend)
• Opposite of Confirmed Uptrend = (Unconfirmed Uptrend) OR (Confirmed Downtrend) OR (Unconfirmed Downtrend)

**Defining Confirmed Uptrend**

The concept of a Confirmed Uptrend (CU) is modeled using longer-term SMAs to filter for trend direction, with additional logic used for confirmation. For an uptrend to be confirmed, both the DJIA and the TRAN are required to be in an uptrend. Here is the pseudo code:

```plaintext
//First define uptrends for each average.

DJIA Uptrend = CLOSE > 1-Year Moving Average of DJIA

TRAN Uptrend = CLOSE > 1-Year Moving Average of TRAN

//Logical condition of both averages in uptrend.

If DJIA Uptrend == True AND TRAN Uptrend == True :

Confirmed Uptrend

Else:

Opposite Confirmed Uptrend
```

**Visualizing Confirmed Uptrends**

Over the test period, the DJIA was in CU states 56.6% of the time (11,893 days CU state / 21,020 total days). CU states for DJIA are shaded green in Figure 2 and Figure 3. Visual inspection of Figure 2 suggests CU states are frequently present during persistent uptrends and less frequently during downtrends and high volatility. This is aligned with Dow’s original concept. Figure 3 zooms into more recent decades for the DJIA. Here, it can be seen that CU states can frequently switch on and off. This will be addressed later in the paper.
Absence of Confirmed Uptrends Frequent Downtrends

It is often helpful to visualize opposite states. The Opposite of Confirmed Uptrends (OCU), defined earlier, include all other scenarios when both averages are not trending up. These are shaded red on the chart below of DJIA.
OCU states are observed occurring frequently during many downtrends and secular bear markets. From a risk perspective, this anecdotally demonstrates the potential benefit of applying a confirmation-based model. This also aligns with one of the main drives of Dow’s concept of Confirmation: using objective technical methods to manage risk.

**Absence of Confirmed Uptrends Frequent High Future Expectations of Volatility**

The DJIA chart below, including DJIA Volatility Index (VXD), suggests a relationship between OCU states and implied volatility. Different than historical volatility, implied volatility is designed to reflect investors' consensus view of future (30-day) expected stock market volatility. Periods of elevated implied volatility consistently accompany OCU states.
Measuring future expectations can be viewed as a measure of sentiment. As a CU state persists, investors gain confidence the future consensus is for lower future volatility. As the CU state switches to an OCU state, the future consensus is for higher volatility. Hence, the relationship highlights the behavioral underpinning of Dow’s concept of Confirmation.

Without the benefit of implied volatility data, Dow observed that “There is always a disposition in people’s minds to think the existing conditions will be permanent,” Dow writes, and went on to say: “When the market is down and dull, it is hard to make people believe that this is the prelude to a period of activity and advance. When the prices are up and the country is prosperous, it is always said that while preceding booms have not lasted, there are circumstances connected with this one, which make it unlike its predecessors and give assurance of permanency. The fact pertaining to all conditions is that they will change.”

**Testing Confirmed Uptrends**

Signal Testing

Rather than systematizing the concept of a CU state and testing based on a portfolio equity curve performance approach, this paper will use a signal-based approach. Signal-based testing has the benefit of isolating and measuring the phenomenon for comparison and further analysis. Specific rules for portfolio management can then be data-driven from insights gained from signal analysis.
Test Data

The Dow Jones Industrial Average (INDU) and the Dow Jones Transports Average (TRAN) are used from 4/16/1934 to 7/25/2016, seen in Figure 6. That time span includes 21,020 trading days, covering a myriad of market regimes. Data is from Bloomberg.

![Figure 6: DJIA and TRAN, Semi Logarithmic, 1934-2016](image)

**Step 1 - Benchmark - Randomly Buying DJIA**

The benchmark will be the results of buying DJIA and holding for 1 year, measuring the unmanaged forward returns for each day over this holding period. This is repeated for each day of the time series, treating each day as an individual signal to buy DJIA. The returns from these signals are used to derive the average returns plot (Figure 7) and summary statistics (Figure 8) for comparison to signals from CU states.
Step 2 - Confirmed Uptrend Signal

Figure 9 shows the DJIA with CU states in shaded green regions, representing constructive periods for investment exposure and the application of that information. A testable signal is constructed assuming investment the day after confirming an uptrend in the DJIA - when the state switches from OCU to CU, shown with green arrows.
To observe the opposite, another signal is constructed representing when the uptrend is no longer confirmed, when the state switches from CU to OCU, shown with red arrows. These objective signals allow for exploring the logic codified from assumptions, testing and comparison against the random benchmark, and exploring outcomes of scenarios from different applications of the information from indicators and models.

As discussed earlier, switching states sometimes cluster with high frequency, due to the simplistic SMA model of defining trending. Examples of this in Figure 9 are mid-1996 and late-2000 throughout early-2001. This clustering effect, represents confusion from opposite indications of trend direction occurring so close together. This effect is common enough in trend-following to have made it into the colloquial financial markets lexicon, with terms like “head-fakes” and “whipsaws”.

To reduce the clustering effect (reduce noise) and better measure a switch to a CU state, additional logic is needed. Dow’s Confirmation concept was already concerned with qualifying longer-term uptrends and the additional logic will reflect this objective.

**Step 3 - Confirming Confirmation - Reducing Noise for Confirmed Uptrend Signals**

Adding a wait-and-see logic, introducing a delay, will be defined with the following pseudo code:

```
//added wait-and-see confirmation logic
Window = 5 // in days, which is 1 week
```
If OpposingSignal == True AND TimeSinceSignal <= Window :

Signal == False

Else:

Signal == True

This delay allows additional time for uptrend to develop and to wait for opposing signals. The length of the delay needs to balance lag of measure and loss of opportunity. Since Dow elaborated to, “great swings covering from four to six years” introducing a five-day delay (1 trading week) is reasonable. Optuma Scripting Language for the new CU state signal:

// get DJIA time series
d= GETDATA(CODE=DJI:WI) ;

//1-year moving average
dma = MA(d, BARS=252, CALC=Close) ;

// uptrend
c1= d > dma ;

// get TRAN time series
x=GETDATA(CODE=TRAN:BLMB) ;

//1-year moving average is 252 trading days
tma = MA(x,BARS=252, CALC=Close) ;

// uptrend
c2= x > tma ;

// DJIA Confirmed Uptrend and OCU
InGear = c1 and c2 ;

OutOfRange = InGear == 0 ;
// switching between OCU and Confirmed Uptrend States

s1 = SWITCH(InGear,OutOfGear) CrossesAbove 0.9;

s2 = SWITCH(InGear,OutOfGear) CrossesBelow 0.9;

// 5-day delay

z = OFFSET(s1, OFFSET=5) and (BARTRUE(s2, LOOKBACK=5) <= 0);

z

**Step 4 - Testing Confirmed Uptrend Signals**

CU Signals, using the delayed logic, occurred 132 times during the test period. The median of all CU Signals are plotted in Figure 10. Summary statistics are given at quarterly intervals in Figure 11. Average returns were strong and increased at every interval. Probability of gains were also high at every interval.
Confirmed Uptrend Signal Versus Random Entry

For comparison, summary statistics for the Random Entry Benchmark (R) and the Confirmed Uptrend Signals (CU) are collated in Figure 12.

FIGURE 11
Confirmed Uptrend Signals - Summary Statistics, 1934 - 2016

<table>
<thead>
<tr>
<th></th>
<th>3 Months</th>
<th>6 Months</th>
<th>9 Months</th>
<th>12 Months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Probability of Gain %</td>
<td>68.7</td>
<td>76.9</td>
<td>73.9</td>
<td>73.9</td>
</tr>
<tr>
<td>Probability of Loss %</td>
<td>31.3</td>
<td>23.08</td>
<td>26.1</td>
<td>26.1</td>
</tr>
<tr>
<td>Mean Return %</td>
<td>2.92</td>
<td>4.95</td>
<td>7.05</td>
<td>9.31</td>
</tr>
<tr>
<td>Median Return %</td>
<td>3.36</td>
<td>5.90</td>
<td>8.01</td>
<td>8.97</td>
</tr>
<tr>
<td>80th Percentile Return %</td>
<td>8.56</td>
<td>13.5</td>
<td>17.4</td>
<td>20.6</td>
</tr>
<tr>
<td>20th Percentile Return %</td>
<td>-1.95</td>
<td>-0.73</td>
<td>-2.32</td>
<td>-2.08</td>
</tr>
<tr>
<td>Standard Deviation</td>
<td>6.18</td>
<td>10.3</td>
<td>13.2</td>
<td>15.3</td>
</tr>
</tbody>
</table>

Confirmed Uptrend Signal Versus Random Entry

CU Signals resulted in a lift across all metrics, at all intervals. The one exception was the 80th Percentile (Absolute) Returns at 12 months - adjusting for risk, this too is higher than random. To summarize the lift:

FIGURE 12
Confirmed Uptrend Signals versus Random Entry - Summary Statistics, 1934 - 2016

<table>
<thead>
<tr>
<th></th>
<th>3 Months</th>
<th>6 Months</th>
<th>9 Months</th>
<th>12 Months</th>
</tr>
</thead>
<tbody>
<tr>
<td>R</td>
<td>R</td>
<td>R</td>
<td>R</td>
<td>R</td>
</tr>
<tr>
<td>Probability of Gain %</td>
<td>62.9</td>
<td>66.7</td>
<td>76.9</td>
<td>67.4</td>
</tr>
<tr>
<td>Probability of Loss %</td>
<td>37.1</td>
<td>33.3</td>
<td>23.08</td>
<td>32.7</td>
</tr>
<tr>
<td>Mean Return %</td>
<td>1.87</td>
<td>3.80</td>
<td>4.95</td>
<td>5.78</td>
</tr>
<tr>
<td>Median Return %</td>
<td>2.29</td>
<td>4.07</td>
<td>5.90</td>
<td>6.06</td>
</tr>
<tr>
<td>80th Percentile Return %</td>
<td>7.76</td>
<td>12.6</td>
<td>13.5</td>
<td>16.9</td>
</tr>
<tr>
<td>20th Percentile Return %</td>
<td>-3.61</td>
<td>-4.56</td>
<td>-0.73</td>
<td>-5.07</td>
</tr>
<tr>
<td>80th / 20th Tail Ratio</td>
<td>2.15</td>
<td>2.76</td>
<td>18.5</td>
<td>3.33</td>
</tr>
<tr>
<td>80th - 20th Spread</td>
<td>11.3</td>
<td>10.5</td>
<td>17.1</td>
<td>22.0</td>
</tr>
<tr>
<td>Standard Deviation</td>
<td>7.53</td>
<td>11.0</td>
<td>13.9</td>
<td>16.3</td>
</tr>
</tbody>
</table>
• Higher risk-adjusted returns are observed at every interval.
• Probabilities of gain increased over random.
• Mean and median returns increased over random.
• The tail-ratio (using 80th / 20th percentile returns) as a form of reward to risk ratio, is consistently more than double random.
• The interdecile range, between 80th to 20th percentile, indicates less variability of returns than random.
• Standard deviation, another estimate of risk using volatility, is reduced from random.

For comparison, lift of CU Signals over Random Entry is expressed in absolute terms (A) and as a percentage (%) in Figure 13.

**FIGURE 13**

<table>
<thead>
<tr>
<th></th>
<th>3 Months</th>
<th>6 Months</th>
<th>9 Months</th>
<th>12 Months</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A</td>
<td>%</td>
<td>A</td>
<td>%</td>
</tr>
<tr>
<td>Probability of Gain %</td>
<td>5.8</td>
<td>9.22</td>
<td>10.2</td>
<td>15.3</td>
</tr>
<tr>
<td>Probability of Loss %</td>
<td>-5.8</td>
<td>-15.6</td>
<td>-10.2</td>
<td>-30.3</td>
</tr>
<tr>
<td>Mean Return %</td>
<td>1.05</td>
<td>56.2</td>
<td>1.15</td>
<td>30.3</td>
</tr>
<tr>
<td>Median Return %</td>
<td>1.07</td>
<td>46.7</td>
<td>1.83</td>
<td>45.0</td>
</tr>
<tr>
<td>80th Percentile Return %</td>
<td>0.80</td>
<td>10.3</td>
<td>0.90</td>
<td>7.14</td>
</tr>
<tr>
<td>20th Percentile Return %</td>
<td>1.66</td>
<td>46.0</td>
<td>3.83</td>
<td>84.0</td>
</tr>
<tr>
<td>Standard Deviation</td>
<td>-1.35</td>
<td>-17.9</td>
<td>-0.7</td>
<td>-6.36</td>
</tr>
</tbody>
</table>

Summarizing Figure 13, comparing UC Signals to Random Entry:

• Absolute gains accompanied reductions in standard deviation.
• All metrics describing distribution of returns (mean, median, 80th and 20th percentiles) shifted towards higher returns, and reduced losses.
• Using the 20th percentile returns as a risk measure, losses are reduced by 46, 84, 54 and 65% at 3, 6, 9, and 12 months respectively.
• The spread of returns between CU Signals and Random Entry increased at every quarterly interval, indicating persistence.
Figure 13 paints a picture of the consistency and the magnitude of improvement of UC Signals over Random Entry. These results suggest an advantage to modelling constructive markets using the technical concept of Confirmation - a concept with underpinnings in economics and psychology.

**Summary**

Dow applied his technical concept of Confirmation with the purpose of qualifying favorable market environments for investing. This paper explores the effects of applying a modernized version of Confirmation towards the investment process.

A simple model of Confirmation was extended to define Confirmed Uptrends, which allowed for constructing objective versions of Dow’s “signals of encouragement”. These signals were then used to explore the effects of making informed investment decisions, based on the logic for detecting a newly Confirmed Uptrend.

Buying the DJIA when a Confirmed Uptrend is detected historically results in improved probabilities of gain, improved median and mean returns, and improved risk metrics and risk-adjusted returns when compared to Random Entry Benchmark. This quantitative evidence suggests merit to Dow’s technical concept of Confirmation.

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Presenters

Mathew Verdouw, CMT, CFTe

For over 20 years, Mathew has been building the Technical Analysis software that is Optuma. Programming the models has given Mathew intimate knowledge on the theories of Technical Analysis. Working with CMTs all over the world has provided the practical implementation of how they’re used. Mathew completed his CMT designation in 2013.

Carson Dahlberg, CMT

Starting as an advisor for Morgan Stanley, then a trader at Wachovia, Carson discovered the effectiveness of Technical Analysis in managing opportunities, risk and emotions. Carson has previously taught CMT Prep courses. He serves on the MTA board, and is Chief Market Strategist for Optuma. Carson completed his CMT designation in 2008.

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FIVE TOP CONCERNS FACED BY FINANCIAL ADVISORS IN 2016

BY DAVID WISMER

Editor’s note: This article was originally published by Proactive Advisor Magazine and is reprinted here with permission.

Financial advisors greeted 2016 in a relatively upbeat mood—what are they thinking about now?

Though we still have several important months to go, 2016 has already been a remarkable year on several fronts:

- The worst post–WW II start ever for the U.S. equity markets, followed later by multiple new all-time market highs.
- Geopolitical unrest around the world; increasingly bold and tragic terror-related attacks in both industrialized and emerging-market countries; and, of course, “Brexit.”
- A regulatory environment that has seen significant developments and one that promises to hold further change.
- An unprecedented U.S. presidential election cycle, with undoubtedly many more unexpected twists and turns.

Within this environment, financial advisors have shared their viewpoints directly with Proactive Advisor Magazine and have also responded to numerous surveys conducted by leading financial institutions and the financial media.

What exactly is on advisors’ minds?

Here is a look at five top concerns faced by financial advisors in 2016.

1. Market volatility

Coming into 2016, many analysts, financial institutions, and financial advisors expected heightened volatility—and their prediction was right on target.

While the CBOE Volatility Index (VIX) traded at its lowest levels in over a year toward the end of July (falling below 12), spikes have been common this year, and the VIX has seen almost three months’ worth of cumulative time spent over the important 20 mark.

Managing market volatility has unsurprisingly emerged as the number one advisor concern in several advisor studies conducted in 2016. Advisors attribute volatility to a number of factors: global unrest and headline risk; uncertain global economies and the growth outlook for corporate earnings; an aging bull market; central bank monetary policy announcements and their market, asset class, and currency impacts; U.S. political and regulatory change; and the
structural evolution of markets, including the increased influence of automated trading programs and ETFs. (For unique perspectives on volatility, see our recent articles, “Can managing market volatility really be simple?” and “The volatility cycle.”)

FIGURE 1: TOP FINANCIAL ADVISOR CONCERNS (Q2 2016)

What is top of mind with you among these four choices?

![Figure 1: Top Financial Advisor Concerns (Q2 2016)](image)

**How important has managing market volatility become over the past year?**

- **55%** More important
- **43%** Equally important
- **2%** Less important


2. Portfolio design and management

Closely related to the overall concern about volatility is the #2 concern of financial advisors: the design, allocations, and management of their clients’ portfolios.
Studies identify advisors’ ongoing examination of their clients’ portfolio design and management as a major focal point (see Figure 2). Anecdotally, advisors interviewed by Proactive Advisor Magazine say the market environment of both 2015 and 2016 has created a heightened concern over the proper balance of risk and return for clients. Many of these advisors are increasingly using managed accounts with higher weightings to active, risk-managed strategies. Many advisors are also leaning toward tactically unconstrained strategies.

Two of the most cited important advisor concerns under the broad topic of “portfolio management” are (1) risk management and (2) achieving client portfolio growth at levels sufficient to help clients fund future retirement income needs.

Regarding risk management, one California-based financial advisor recently told us, “I know this bull market will be coming to an end. I just don’t know when. It may be weeks, it may be months, or it may be years, but it will end—not pleasantly, and when we least expect it. I need to make sure clients are well-positioned in risk-managed portfolios to prepare for that eventuality.” This advisor also says she is “not committing any new money to passive strategies” and favors “tactically managed bond strategies” for now.
Many advisors are also seeking solutions to what Mohamed A. El-Erian (then of Pimco) is credited with dubbing “The New Normal.” Former U.S. Treasury Secretary and Obama administration economist Larry Summers (now president emeritus and professor at Harvard University) alternatively calls the overall financial environment “The Age of Secular Stagnation.” Some simply call it “a 2% world.” Others just see it as an economy and investment scenario characterized by low growth, low interest rates, and relatively low returns going forward, compared to most of the post–WW II market and economic history.

While U.S. financial data and indicators generally improved in July, major questions still exist for many financial advisors regarding valuations for equities, the outlook for interest rates and inflation, and where the economy and markets stand from a cyclical perspective.

Though a certain “fatigue” has settled in for the media, financial institutions, and financial advisors on the question of when the Fed will finally start to somewhat normalize interest rates, it is still a critical question for advisors developing client-specific financial and investment plans. A new interest-rate environment creates both opportunity and risk, as Figure 4 indicates.

However, as CNBC noted in December 2015, this is a highly unusual environment:

“But a CNBC analysis of six rate-hike cycles over the last three decades shows that rising rates were often accompanied by falling unemployment, rising stock prices and solid economic growth. ... Examining the results of decades-old monetary policies, though, may have limited value in comparisons with current economic conditions and investment risks. ... The latest rate-hike cycle also follows a period unlike any in the Fed’s 100-year history, when a global financial collapse forced U.S. central bankers to deploy extreme, untested measures—including a move to slash interest rates to zero and hold them there for seven years to revive a badly broken economy and severely damaged credit market.”

And, the normal course of action for the Fed is a series of small, incremental rate hikes or decreases on a fairly regular basis over an extended period. So for this cycle, the current “one and done” or conceivably a “start, stop, start, stop” rate-hike picture—especially given the historically low starting point—may make attempts at historical comparisons meaningless.
3. Changing regulatory environment and the U.S. political landscape

For advisors, the two issues of a changing regulatory environment and this fall’s elections are closely intertwined.
No topic in the advisor-directed media has garnered more space than this year’s adoption of new Department of Labor regulations related to fiduciary obligations. And, without doubt, this year’s presidential campaigns and the November elections have overshadowed all other topics in the general media.

Regarding the Department of Labor regulations, our interviews with advisors dramatically changed tone as the less-onerous-than-feared guidelines were announced and the implementation timetable became clear (Figure 5). Most advisors we have interviewed have also been increasingly adopting a fee-based model for their practices since the credit crisis. They see little real impact of the regulations on their standards of conduct or the philosophical nature of their relationships with clients, though they acknowledge there may be additional administrative and compliance burdens imposed on their practices and their broker-dealer relationship.

Said a very experienced Baltimore advisor, Greg Gann, in a recent Proactive Advisor Magazine article, “Fiduciary responsibility in a world where industry bashing is the norm.” “The bottom line for me is that I have absolutely no issue being held to a high level of accountability in my practice—that is the fundamental premise I have worked from for several decades. I only suggest that this is a shared responsibility, and expectations for client ‘accountability’ should similarly be acknowledged.”

FIGURE 5: DEPARTMENT OF LABOR FIDUCIARY STANDARDS TIMETABLE FOR IMPLEMENTATION

As for presidential politics and the congressional races this November, financial advisors see a great deal of uncertainty surrounding potential policy and regulatory changes. The philosophies of the two parties, and especially the two presidential candidates, could hardly be more far apart on many regulatory, tax, energy, spending, health-care, trade,
workforce, and immigration issues. For example, Ms. Clinton and Mr. Trump have opposing viewpoints on Dodd-Frank regulations and, in general, on the oversight of the financial industry. This election will not only have a profound impact on the operating environment for the financial industry, but also the growth outlook for many specific investment sectors.

4. Practice growth, succession planning, and “The Great Wealth Transfer”

Advisors always consider the growth of their practices, client retention and satisfaction, acquisition of new clients, and their future prospects for increased revenue and profitability to be of great importance. (Proactive Advisor Magazine wholeheartedly agrees and devotes a weekly section to practice marketing “Tips and Tools,” sharing insights from advisors we interview).

Even though 2015 was a difficult year for many equity markets, most advisors approached 2016 optimistically, according to Investment News (see Figure 6).

**FIGURE 6: THREE-QUARTERS OF ADVISORS OPTIMISTIC ABOUT 2016 GROWTH PROSPECTS**

According to Natixis’ 4th Annual Global Survey of Financial Advisors, advisors place the responsibility for achieving growth on their own abilities:

“Lacking the tail wind that bull markets have provided in recent years, three-quarters of advisors say growth will come from acquiring new clients, while seven in ten say it will also hinge on gaining a larger share of assets from current clients. …

“(This) comes at a time of significant change in the advice business. Increased fee pressures, tightening regulations, and growing competition from automated advice platforms, coupled with continued market volatility, all pose challenges to business growth for advisors around the globe. To succeed, many advisors will need to reconsider their value proposition and look at how they add value to client relationships above and beyond asset allocation.”

With estimates of roughly 10,000 Americans reaching retirement age each day (!), it would seem that this should be a golden age in terms of growth prospects for financial advisors. However, retirement also means that many clients are
entering the distribution phase of their lives, and the vast assets brought to retirement by baby boomers, though impressive, will not be on a significant growth trajectory.

**FIGURE 7: NET WEALTH, ALL GENERATIONS ($ BILLION)**

Several closely related issues are facing advisors contemplating the next growth phase for their practices:

- What will be the impact of “The Greatest Wealth Transfer” in history, as boomers pass on assets to younger generations? Study after study shows the retention of clients’ children and grandchildren is a difficult challenge, especially for advisors who have not made the efforts to build a multigenerational practice. (See our recent articles, “The millennial obsession” and “Life happens. Plan for it.”)

- How big a threat is consolidation in the financial-advice industry? And how will the trend toward multi-office practices with significant shared resources affect smaller practices and sole practitioners?

- Will the generations behind boomers truly gravitate toward automated wealth-management platforms?

- With the average age of advisors generally tracking with that of their boomer clients, how can succession planning and injection of younger talent into a practice best be handled? (See our recent article, “Attracting the right successor.”)

5. Global geopolitical uncertainty and risk of systemic shocks

The worry list for advisors on potential shocks to financial markets is long, but the “unknown unknown” is even more concerning.
The market’s fast-and-furious sell-off in response to the Brexit vote in the United Kingdom was just another reminder of how vulnerable financial markets remain to external shocks. Fortunately, as has generally been the case since 2009, markets have rebounded from each and every dip in the U.S. market in relatively short order.

Financial advisors are not only concerned about the length of the current bull market, the state of the U.S. and global economies, interest-rate policy, and valuation levels for equities in general, but they are also worried about the next big unforeseen crisis that will not be overlooked so quickly by markets. Will it come from student-loan debt, from China, from war or terrorism, or from a European nation disrupting the already fragile eurozone? Or somewhere else altogether? Of course, no one knows.

In our discussions with independent financial advisors around the country, the trend is clearly toward the growth of fee-based practices (Figure 8), the use of third-party money managers who provide strategies geared toward risk management, and a healthy mix of both passive and active strategies for clients to provide further diversification and mitigate the risk from market shocks. Many advisors feel most comfortable diversifying client portfolios along numerous dimensions: by time horizons, by asset classes, by strategies, and by using multiple asset managers.

FIGURE 8: GROWTH OF FEE-BASED VS. COMMISSION-BASED ADVISOR COMPENSATION

![Graph showing growth of fee-based vs. commission-based advisor compensation](image-url)
Both retail investors and financial advisors have already faced many surprises in 2016. More volatility this year should not be unexpected, and the advisors interviewed by Proactive Advisor Magazine seem well-prepared to help clients weather any storms, from minor squalls to full-force hurricanes. The two keys to this, repeated many times by different advisors we have interviewed, are (1) fully educating clients on expectations for how their portfolios should perform in a variety of market environments and (2) employing dynamic, risk-managed strategies that can provide a variety of ways to help mitigate risk.

While advisor concerns are significant—both for the dangers of the external environment and the future growth of their practices—successful advisors we have interviewed demonstrate a remarkable optimism and confidence both in their own abilities and that of their partners and outside resources.

David Wismer is editor of Proactive Advisor Magazine. He has deep experience in the communications field and content/editorial development. David has worked across many financial-services categories, including asset management, banking, insurance, financial media, exchange-traded products, and wealth management. To learn more, visit their web site. Subscriptions are available to financial professionals at no charge.
STOCKS ARE BREAKING THE GLASS CEILING: 6 REASONS TO BE BULLISH

BY MARTIN PRING

Editor’s note: This was originally published on August 11, 2016 at PringTurner.com and is reprinted with permission.

At the beginning of 2000, I unsuccessfully submitted a bearish stock market article, *A Turn of the Tide*, to a well-known US financial publisher. At the time, in the middle of a market mania, my contrarian warning was unwelcome. Ironically, it was later carried by a Polish financial magazine—not exactly the wide distribution channel I was hoping for! This incident is being brought up now because the S&P Composite, *when adjusted for inflation*, has made no real progress in the intervening 16-years. That said, it now looks as though bullish forces are conspiring to take prices through the 16-year inflation adjusted glass ceiling to significantly higher levels. Guiding the way higher is our composite stock market indicator the stock “Speedometer”. Before we review that evidence, it makes sense to back up a little in order to evaluate things from a longer-term perspective.

**Valuation- a Wall of Worry**

Chart 1 compares the inflation adjusted S&P Composite to the renowned Shiller P/E, the so-called CAPE (Cyclically Adjusted P/E ratio).

*Chart 1 Inflation Adjusted Stocks versus the Shiller P/E*
High valuations are a problem but only when the trend is negative

At Pring Turner we think of the Shiller P/E as not only a valuation but also a sentiment indicator. High readings indicate confidence, as investors are willing to pay a very high price per each dollar of earnings. Compare that to depressed levels at secular lows, when there is so much fear and pessimism that those same investors demand a much lower price per dollar of earnings (lower P/E) for the huge risks they perceive.

Right now, this indicator is at a high level when compared to historical readings. It’s in what we call the equity “death zone”, as flagged by the pink shaded areas. There is no doubt that the level of this indicator concerns us, but that doesn’t mean a stock price collapse is imminent. In fact, stocks can continue to rise despite the lofty valuations. For example, what was historically extended in 1928 and 1995 became even more stretched by the time the market peaked in 1929 and 2000. The higher you climb on Mount Everest the more dangerous it becomes, but that does not stop determined climbers from taking the risk and pushing through the “death zone” on their way to the summit. In markets, crowd psychology can cause prices to overshoot as market participants become overly confident and expect higher and higher prices. There is no question that the equity prices, by historical measures of very long-term momentum and many valuation yardsticks, are overextended. It is and should be a wall of worry against higher prices. Nevertheless, the vast majority of primary trend indicators (the “tape”) are acting positively.

The Market and the Economy

Over the last century, 3 out of every 4 bear markets occurred during economic recessions. Following business cycle indicators helps us navigate the major ups and downs of the markets. As the economy changes, we make important investment adjustments to better prepare for the road ahead. Bull moves in stocks typically emerge as investors finish discounting recessionary conditions or economic slowdowns. Prices rally as the market senses that a phase of renewed growth is in the air. In this respect, Chart 2 compares the S&P Composite to our Growth Indicator, a composite series constructed from the momentum of several leading economic indicators. The vertical lines flag instances when it reverses to the upside from a position at or below the -12.5% level. Red highlights indicate recessions, the ending of which have been consistently signaled with a bottoming in the Growth Indicator. The signals not connected with recessions mostly developed as the economy was emerging from a growth slowdown, such as in 1962, 1966 and 1984. Each was followed by a very robust equity rally, except for in late 2001. The 2001 reversal correctly forecasted the recovery, but is one of very few instances where the market and the economy were totally decoupled.
When the growth Indicator bottoms expect the economy to improve and for stocks to move higher

The recent rally in the Growth series tells us that business activity will likely do its part, so let’s now turn to some market indicators to see whether they are also ready to oblige.

Long-term Stock Market Indicators

Chart 3 features our Financial Velocity indicator, or rather its 6-month moving average. This series combines the rate-of-change of bonds, stocks and commodities into one series. It triggers buy signals by reversing to the upside from a position at or, more commonly, below the equilibrium level. Examples have been flagged by the vertical lines. Most have been followed by important bull moves in inflation adjusted stocks, but one or two, like 1940 and 1978 have not. These reversals signal that sufficient liquidity is being pumped into the system to power the economy, and therefore the stock market, higher. Note that virtually every recession (red highlights) is associated with a turnaround in the indicator. This velocity series has recently reversed for the 22nd time since 1921. This reversal strongly suggests that a new up leg in the bull market is underway.
When velocity bottoms, stocks usually begin a bull market of some kind

Bond Market Confidence

A strong rally in stocks is often associated with an improvement in bond market confidence. One way that this is telegraphed is from reversals in momentum calculated by the ratio between low quality and high quality bonds (government yields/corporate Baa yields), a so called “credit spread”. This relationship is shown in long-term momentum format in Chart 4. A rising indicator reflects improving confidence amongst bond investors, as they favor higher yielding but more risky Baa corporate bonds over government bonds. The vertical lines tell us that a bottoming in momentum at or below the green “confidence” line indicates that a more positive trend sentiment has begun. In all, there have been eight signals since 1949. In each situation, equities rallied with only the duration and magnitude open to question.
**Chart 4 S&P Composite versus Credit Spread Momentum**

(Source: Martin Pring’s August Intermarket Review – Click Chart to Enlarge)

**Stocks are likely to rise when the momentum of this credit spread bottoms from a low level**

Chart 5 expresses market breadth in the form of the momentum of stocks registering net new 52-week highs on the NYSE. The vertical green lines flag when this price oscillator, following a corrective period (blue arrows), moves above the overstretched green horizontal line. This action suggests the market is severely overbought; however, unlike most overstretched conditions, this is positive because it usually reflects a bull move in its initial stages. The chart shows that each of these six instances has been followed by a worthwhile advance since the 1970’s.
A sharp oscillator correction followed by an overbought reading means higher prices are to come

The sixth and final bullish indicator is our “Stock Speedometer”. The Stock Speedometer is a combination of a wide range of market indicators. Historically higher readings have led to better returns for the average stock; conversely, lower readings have led to poor results. The speedometer is designed to identify the primary environment of the stock market. Similar to your car speedometer, it signals how fast or slow we, as sub advisors, drive our portfolios. As the Speedometer changes, important portfolio adjustments are made in order to better navigate the financial road conditions ahead.

The Stock Speedometer has two crucial areas: a “Safety Zone” and a “Danger Zone”. Since 2000, the NYSE Composite returned +12% per year on average with the speedometer in the positive or Safety Zone. In comparison, it declined -21% per year on average when the speedometer was in the Danger Zone. The latest reading is 90%, which is firmly in bullish territory, thereby indicating an above average exposure to equities.
The current high reading means it is safe to drive portfolios at a faster speed

Conclusion

There is no doubt that the high reading in the Shiller P/E is a cause for concern, a definite wall of worry if you will. Still, history demonstrates that markets can, and often do, overshoot. This does not mean that breaking through the glass ceiling denotes that the sky is the limit. Rather, it tells us to stay the course as long as our Speedometer and other indicators continue to signal safe driving conditions for portfolios. We welcome questions or comments about any of the 6 indicators or inquiries about our sub-advisory services.
Martin Pring founded Pring Research in 1978 by providing research for financial institutions. Since 1984, he has published the Intermarket Review, a monthly global market report that analyzes the world’s principal financial markets. He has written more than 20 books on topics such as asset allocation, market psychology and investing around the business cycle. His widely popular book, “Technical Analysis Explained”, has been translated into 8 languages and for several decades was required reading for the Chartered Market Technician’s (CMT) designation.

Their shared interest in business cycle investing led Martin to join with Joe Turner and co-found Pring Turner Capital Group in 1988. Martin, in collaboration with Dow Jones Indexes, co-developed the Dow Jones Pring U.S. Business Cycle Index in 2012, a unique index based on the firms “Six-Stage” business cycle investment strategy. Currently, Martin is adjunct professor at Golden Gate University in San Francisco teaching the world’s first virtual graduate level course on technical analysis.

Click the following link to download the PDF Glass Ceiling 6 Reasons to Be Bullish.
You may be following the sporting events in Brazil as passionately as you follow market price development. Or perhaps you're not a sports fan, and you're only interested in the stock market?

Either way, there is an exciting question about what effect big international sporting events have on share prices. The country that hosts the Olympic Games draws huge media attention, the domestic mood improves, and big investment projects are carried out. All of this can affect the stock market.

The stock market in Brazil has increased in value

The shares index in Brazil - where the summer Olympic Games were being held - have grown strongly in recent months. Is this a coincidence, or is it linked to the Olympics? To answer this question, let's look at all of the big sporting events for which information is available.

Do international sporting events influence the markets?

Since the Olympics only take place once every four years - ie, relatively rarely - we will also look at the internationally significant football World Cup in our investigation. This allows us to gain greater statistical significance.

Football World Cup tournaments and summer Olympic Games both take place every four years, with two years between each set of events. Since 1960 there have been fourteen summer Olympic games and fourteen Football World Cup tournaments - the current Olympic Games in Brazil have not been included as the investigation also includes the one-year period following each Games.

There have been a total of 28 sporting events, and for 21 of these, daily stock market data is available. For the purpose of standardization, and for the sake of relevance to international investors, the analysis will take place using US dollars. This list shows the countries that have been included in the event study.
A total of 21 countries could be considered for the event study. Source: Seasonax

How do prices develop in the year before and after a sporting event?

In order to investigate the influence of sporting events, we looked at the development of the stock market in the respective countries around the time of the event. This gives us an anchor on which to base our investigation, as these events take place at different times of the year - between the end of May and the beginning of October.

The anchor set was the beginning of the sporting event. The average gains will be calculated in relation to this fixed point in time. This means that we can spot, at a glance, typical price development around large sporting events.

Event study outcomes at a glance.

The following chart, therefore, does not show market development as you are used to seeing it. Instead, it shows the average development of the indices of all of the countries that have been considered. If the average indices increase, the line rises accordingly.

The X axis shows information on how the average share indices rose or fell, in percentages. The Y axis shows the time before and after the beginning of the sporting event.

The beginning of the sporting event is in the middle, with a period of one year shown on either side of the event. Therefore, the chart shows a period of two years. It displays the typical development of all share indices that have been investigated from the relevant countries at around the time at which the events took place.
The average development of 21 national indices one year before and after the beginning of the Olympic Games or World Cup.

As you can see, shares typically increased ahead of sporting events, with the increase beginning some eleven months before the first event in each competition. On average, the increase was at 12.61 per cent. Annualised, the figures stand at 14.85 percent, making them more than double the average MSCI World increase in the same period between 1974 and 2014.

However, on average, prices start to fall again a month before the games begin. The games themselves do not boost share prices.

**Why the Games have an influence.**

What are the reasons for this pattern? The Olympics and World Cup tournaments promote economic development through tourism, consumption, and infrastructural measures, among other things. For example, economists from Deutsche Bank estimated that Germany hosting the World Cup in 2006 contributed to growth by a quarter of one per cent.
In addition, there are the psychological effects. Even the weather, according to one study, influences the stock market - sport has at least as strong an effect on the mood. Furthermore, no other event draws so much international attention. So it can be seen that there actually are effects on the stock market, particularly in the run-up to an event.

The downward trend shortly before, during, and for several months after the Games is most likely a technical correction to the prior increases. As an aside, this happens more strongly around World Cup tournaments than it does around the Olympics.

Overall it’s clear, that the Olympic Games and World Cup do have a significant impact on the stock market which starts 11 months prior to the event, and ends around 1 month ahead.

Dimitri Speck is a professional in the field of pattern recognition and the development of trading systems. He is the founder of SeasonalCharts.de. Speck has published multiple articles in international trade newspapers and is the author of two books. He has been awarded the UCITS Hedge Award for the best performing commodity fund and the €uro Fund Award in the resources category. To learn more, visit www.seasonax.com.
Technical analysis is a great tool to help you develop ideas and be alerted to change in the markets.

We all need to solve real world problems and make decisions in a world of uncertainty and doubt. One tool that offers practical value for investing is technical analysis. Technical analysis is a discipline that uses supply and demand to determine the likely direction of any asset that is freely traded such as stocks, bonds, commodities, currencies, and real estate. I was recently asked how I use technical analysis in my business and as I woke up this morning with this question on my mind. I quickly realized that it is a vast body of knowledge that offers many ways to help people.

Here are a few ways I’ve used it in the past month:

**Timing the Sale of a Concentrated Position**

A client came into my office who is changing jobs. He is a manager with vast experience managing large scale projects for a Fortune 100 company. He owns a significant amount of his former employer’s stock. We discussed his situation and it became clear that it was wise to unload some of his stock. The question was when and at what price? The first thing we did was discuss his time horizon and it became clear that he should sell the stock withing a 6-month time frame. Because stocks are voting machine in the short term and a weighing machine in the long term, there really was less need to analyze the fundamental valuation. We then accessed the key price levels that buyers have stepped-in and sellers unloaded. Technicians call this “support and resistance”. We also accessed the trend of the stock, that is the general bias and tendency of a stock to move either up, down, or sideways in a consolidation. After this analysis, we were able to give him some specific levels to think about selling some of the stock in the very near term, and more later at higher levels and a protective stop order to exit all of the shares if the stock moved against him. The end result is that the client is armed with a plan to exit in a rational way, regardless of the direction of the markets.

**Listening to the Message of the Market**

Buying and selling actions can give you clues about what is happening underneath the hood. This is often called the “message of the market” approach. Technical analysis is very useful for generating investment ideas. It helps you confirm or refute your fundamental hypotheses, to develop ideas for new positions, and to exit in a timely manner. Technical analysis is a great tool to help you keep your head on straight. When we develop a fundamental idea to enter or exit an investment, if the technical indicators of supply and demand do not confirm our beliefs about where the markets are
headed, we reassess our thinking and dig deeper. It gives us pause when the technical indicators don't confirm the fundamentals because market prices contain the collective wisdom of many individuals participating! If there is a difference between the technical facts and our fundamental beliefs about the future, we tend to dig in deeper. This leads us to analyze and sometimes to develop an alternative fundamental hypothesis.

Explaining Market Behavior

We believe that investment management should be done using an evidence-based approach which demands that techniques are tested for the effectiveness. One of the most useful aspects of technical analysis is in developing quantitative strategies to assess and trade markets. We extensively test technical indicators in a statistical and scientific manner to analyze the predictive power and usefulness of implementing our strategies. This comes in handy in both our traditional stock and bonds management as well as our Commodity Trading Advisory (CTA) strategy. We want to see that there is a reasonable basis for technical indicators add value both statistically and logically.
A GRAIN OF SALT – OR IS IT OIL?

Have you ever heard that oil and gold prices are related to the value of the U.S. Dollar? One thing that is always pointed out in the news is that somehow there is a strong relationship between those markets. It seems like these markets evoke an emotional response to a lot of people, so that’s why it’s in the news. Obviously oil prices directly affect our pocket book because we pay for it at the gas pump. Ironically we also protest when oil prices fall because we think the economy is slipping into a recession. So it’s win-win for reporters to come up with stories about these markets to get our juices flowing.

Big moves in the price of gold, oil, and the U.S. Dollar seem to mean different things to different people. But somehow these markets are supposed to magically be related to each other. Is this really true?

If you know about my method of investing, you know that I am an “evidence-based” investor. That is, my philosophy is rooted in both logic AND empirical evidence that can be seen in the data. I grew to love this philosophy many years ago, because I noticed that academic theory about how prices SHOULD respond to fundamental data and other economic relationship, often don’t hold up in the real world. Or more often, the relationships sometimes hold up and other times fall apart.

Are these markets really that strongly related? Let’s look at the data. To answer the questions, my firm ran some statistical analysis on the daily returns of the futures markets underlying oil, gold, and the U.S. dollar index (see chart and correlation matrix below). We looked at the daily returns on a rolling 100 days from 6/18/2002 to 07/28/2016. Here is what the real world has displayed: The blue line is the US dollar versus oil price correlation, the orange is dollar versus gold, and the grey line is oil versus gold.

The first thing you notice is that gold and oil prices are indeed inversely related to the U.S. dollar. But the relationship is less than stable. Although the average correlation of gold versus the U.S. Dollar is -.449, it has a wide range, shifting from positive .306 to negative .858! Second, the relationship of oil prices to the U.S. Dollar is also unstable. The average relationship is negative, albeit less than gold, with an average of -.253 correlations. The range goes from positive to negative as well.
So why do I bring this up? For one simple reason. We naturally want to believe what we hear in the news about how markets move, or more importantly WHY markets move in a certain way. But in reality, the reporters are making generalizations. It goes without saying that you can’t always believe what you hear in the news.

The philosophy of an “evidence-based” investors, is that investment decision should look at the facts, and how valuation and trends are responding RIGHT NOW. We want to invest based on how the real world works, incorporating uncertainty, risk, and looking to profit from opportunities.

Take the news with a tiny grain of salt.
Louis Llanes is an author, speaker, and the founder of Wealthnet Investments, an advisory firm managing assets for individual private clients. Recognized as a top portfolio manager, Louis has advised hundreds of people ranging from wealthy CEO’s to successful entrepreneurs. Prior to founding Wealthnet, Louis was a Senior Portfolio Manager for a major bank and financial analyst. He is credentialed as a Chartered Financial Analyst, Chartered Market Technician and continues to contributes to the knowledge-base of the investment management industry.
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MODERATED BY RHONDA SCHAFFLER
WHY BOND MARKET SECTORS CAN PERFORM VERY DIFFERENTLY

BY PETER MAUTHE

Editor’s note: This article was originally published by Proactive Advisor Magazine and is reprinted here with permission.

In the investment business, we often speak about achieving diversification among asset classes such as stocks, bonds, cash, currencies, commodities, metals, and hard assets. Among individual investors, there is often a lack of understanding about how the component sectors within each asset class perform. Most investors are aware that there are many industry sectors that make up the various stock market averages. However, many investors are not aware of the various bond market sectors and how they perform.

The total-return graph (Figure 1) illustrates longer-term price trends for four important bond market sectors (there are several others): U.S. government bonds, high-yield bonds, municipal bonds, and international bonds. When displayed together they provoke a number of observations.

First, U.S. government bonds have performed the best in recent years. They also represent one of the most volatile of the four bond market sectors illustrated. As the relative strength of government bonds in 2008–9 shows, they can act as a safe haven for investors. Other bond market sectors declined in those years, with investors fearing credit quality downgrades and increased default risk. U.S. government bonds went up, since they theoretically have no credit risk.

FIGURE 1: COMPARISON OF LONGER-TERM PRICE TRENDS FOR FOUR CATEGORIES OF BONDS

Source: Neubig Plan Investments (FP) research, FastTrack data and chart
Another observation is that **high-yield bonds** track equity patterns as much or more than they track interest-rate patterns. There are a number of reasons for this. One of the more important is that the price of high-yield bonds is closely tied to the financial health of the issuing company. So, the better the company and company’s stock does, the higher the valuation of the company’s bonds. Of course, the converse is also true. In 2008, when equities and the economy were declining, high-yield bonds declined sharply along with equities. Then, in 2009, when financial market fears began to lessen, stocks rose, and the high-yield bond sector rose with it. High-yield bonds are, therefore, often used as an indicator for the stock market. If both are trending in the same direction, it is considered confirmation of the trend. When they are going in opposite directions, it is considered a non-confirmation of the trend.

The two remaining bond market sectors present a bit more complexity in understanding the influences on their respective price behavior. **Municipal bonds** have limited liquidity, similar to that of high-yield bonds. One benefit of this for investors is that the lack of liquidity often leads to relatively smooth trends, unlike U.S. government bonds. Municipal bonds are influenced by factors other than just credit rating. Two of the most important factors are interest-rate trends and the federal tax code. Tax code changes, which can include the way municipal-bond interest is taxed, can influence the way investors price municipal bonds.

Figure 1 illustrates **international bonds** denominated in U.S. dollars. This presents an additional factor that comes into play with international bonds. While all bond market sectors have benefited from the long-term decline in interest rates, international bonds have a currency translation issue to take into consideration. For example, international bonds have generally gone sideways since 2014, when the U.S. dollar began to strengthen. The reverse also happens. When the U.S. dollar weakens, it takes more dollars to buy a foreign asset, so the price in dollars for international bonds generally goes up.

Each of these bond market sectors have unique characteristics that investors seek for a purpose. Understanding that all sectors within an asset class are not created equal can help in designing allocations to achieve attractive returns in risk portfolios.

The following figure and table illustrate the returns of the four bond market sectors for 2016 YTD, highlighting how they can perform very differently.
FIGURE 2: ONE-YEAR BOND SECTOR PRICE TRENDS (AUGUST 2015–AUGUST 2016)


<table>
<thead>
<tr>
<th>Bond sectors</th>
<th>One-year returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. government bonds</td>
<td>20.19%</td>
</tr>
<tr>
<td>Municipal bonds</td>
<td>8.63%</td>
</tr>
<tr>
<td>International bonds</td>
<td>6.88%</td>
</tr>
<tr>
<td>High-yield bonds</td>
<td>1.38%</td>
</tr>
</tbody>
</table>

Source: FPI research, FastTrack data

Peter Mauthe is vice president of corporate development at Flexible Plan Investments, Ltd., where he develops new business initiatives and implements corporate and business-level strategies. Mr. Mauthe has been an independent market maker on the Chicago Board Options Exchange; served as president of the American Association of Professional Technical Analysts; and was president, chairman, and director of the National Association of Active Investment Managers (NAAIM).
MTA CHARLOTTE CHAPTER COHOSTS MEETING WITH CFA SOCIETY NC AND CAIA

BY CARSON DAHLBERG, CMT

From left to right, local society leadership: Mathew Verdouw, CMT, CFTe, Carson Dahlberg, CMT, Clint Sorenson, CMT, CFA and Millissa Allen, CAIA.

Mathew and Carson (along with Derek Hernquist) are the Charlotte MTA Chapter Chairs. Clint is the CFA Society NC President and Millissa is CAIA Managing Director of Business Development, Americas.

Involved in the Financial Community

Proudly sponsored by Optuma, the July 20 meeting of the Market Technicians Association Charlotte Chapter proved to be a highly successful event. The night was co-hosted with the CFA Society NC and CAIA, at the sophisticated Ritz-Carlton, in
the heart of vibrant uptown Charlotte, NC. Our esteemed speaker was David Keller, CMT, Managing Director of Research for Fidelity Investments.

**Five Lessons from the Fidelity Chart Room - David Keller, CMT**

David began his talk by highlighting Fidelity’s long history of using technical analysis, giving the attendees a glimpse of the coveted Fidelity chart room. The chart room originated when the founder and portfolio manager drew charts by hand and hung them in his office. These were an important part of his portfolio management process. Interestingly, his first hire was a technical analyst who helped with the construction of these charts.

![Photo courtesy of AllStarCharts.com](image)

The Chart Room evolved into what it is today: a unique resource combining cutting edge data visualization and historical market studies to help portfolio managers and analysts better understand financial market dynamics. If you take a trip to Boston, it will be worth your while to schedule a tour.

David shared his experiences of working at Fidelity, elaborating on their holistic investment approach. He shared the benefits of this approach; each group (fundamental, technical, and quant) add value and unique insights to Fidelity’s Portfolio Managers.

“One of the most rewarding things about working in finance is the opportunity to learn from others.” David Keller, CMT
Keller’s presentation focused on his experiences in the chart room interacting with analysts and portfolio managers. Here are the five lessons David shared:

1. Trends can last way longer than you think.
2. People are irrational, but the markets can be rational.
3. Turning points are tricky, but herding happens.
4. The simplest approach is often the best.
5. The analyst role is changing from provider to curator.

Keller highlighted the behavioral biases investors often struggle with such as anchoring, herding, confirmation bias, and sunk cost. These biases work to create patterns in the market.

Keller’s team utilizes technical analysis to minimize the effects of biases. The team provide idea generation, sell candidates, identify market structure and use data visualization to bring a deeper understanding to quantitative and fundamental data.

Providing relevant examples to bias and effect, Keller revealed that magazine covers often capture extreme bearish sentiment near market bottoms. This example shown left was near the bottom of the last US secular bear market.
Sentiment extremes, along with behavioral biases, make it important to have perspective. Keller’s team helps to provide understanding of when these extremes might be present.

Keller also went on to say that the reasons why something happens in the financial markets usually comes after the event is known — it’s not always evident at the time. Another reason to follow trends in price.

**Innovative Data Visualization**

One example covered of visualization bringing data to life was through the use of Relative Rotation Graphs (RRG), available on Optuma. An example below uses the SPDR Select Sector Fund ETFs. Paths of sector rotation, in an out of leadership, can be seen over 6 months.
More to Come!

All attendees agreed it was a treat to hear from a globally recognized speaker who utilizes technical analysis in one of the most successful global firms. Additionally, this was a great networking opportunity, providing a chance to chat with financial professionals from a myriad of backgrounds - quants, RIAs, traders, strategists, risk and more.

As fantastic as this meeting was, we are already looking forward to the next meeting in Charlotte! We have invited Tom Dorsey of Dorsey Wright & Associates, an innovator and financial services veteran with over 40 years of experience (date to be confirmed).
The Chartered Market Technician ® (CMT) credential is the preeminent, global designation for practitioners of technical analysis. The designation is awarded to those who demonstrate mastery of a core body of knowledge applied in a portfolio management context.