THE RIGHT ADVICE AT THE RIGHT TIME DEPEND ON IT

The Peter Dag Portfolio STRATEGY AND MANAGEMENT

Vol. 44 No. 7 George Dagnino, Ph. D. , Editor www.peterdag.com 4-12-2020

Investment trends

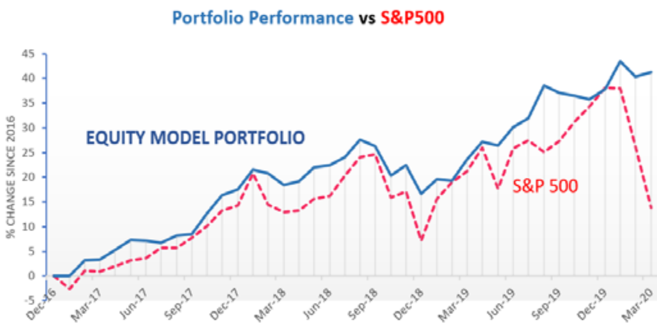


Fig. 1. Our Equity Model Portfolio is outperforming the S&P 500 thanks to the defensive strategy we have adopted since 2018 when the cycle began to turn down. Page 3 shows the performance of the other portfolios.

Fig. 2. Crude oil prices have been declining since 2018 when the business cycle started to decline. Cartels such as OPEC cannot overcome economic forces. They can only adjust to them to minimize losses.

Fig. 3. This graph shows the strength of **the financial sector (ETF: XLF)** relative to the S&P 500. The graph reflects the overall weakness of the financial sector during a business slowdown. The time to buy financial stocks is when the economy strengthens.

Portfolio Strategy

Observations. Long time ago, when I eventually understood the essence of my business, I started reading about Taoism and Zen. It is very difficult to think about an investment strategy when you are bombarded by news raining from everywhere with the markets shaken by emotions. It is important to think and at the same time isolate yourself. Hide your thoughts inside you. Let them wonder in your brain. Eventually they will find the answer you are looking for. It is the intense effort to isolate yourself that eventually translates into a peaceful and a calm assessment of what should be done.

The stock market. The **long-term fundamental** outlook – defensive. We followed a conservative and defensive strategy as soon as the market cycle started to decline in 2018. We invested in sectors doing well in a slower growth environment. They were much different from those that shined during the rising part of the market cycle. Our strategy withstood the horrible happenings of the last two months by aggressively investing in bonds when the consensus was convinced bonds were overbought and yields had only one way to go - up. We will change strategy when our indicators tell us to do so. Until that time, we keep following a defensive strategy with a bias toward raising cash.

Long-term technical model – Bearish.
Near-term technical indicators – Bearish.
Seasonality – Bullish from October to April.
Sentiment – Negative – which is bullish.

Strategy. Will the market follow the 2008 script? Hard to say. The economy is in desperate conditions fueled by hope and enormous liquidity. A defensive portfolio remains the best strategy for the prudent investor.

The US economy. It's a war. A tough one. How will it end? The economy will have to go through several stages before we can feel safe from the virus. It is going to be a process. In the first phase of the war we are facing fear – fatal and financial with the government and the Fed flooding the system with money. The second phase deals with the overlapping health crisis and the record-breaking amount of money having the purpose to save the main economic players. The third phase deals with the issue that we must go back to work and create the wealth that made us a wealthy nation. There is much debate on how and when. The fourth phase is to work on a treatment that will immunize all of us. This is a major effort that will last into 2021. What will the fifth phase look like? Are we going back to the way the economy was before? Or will the impact of this pandemic be such that it will make us more cautious? Business may well decide to have their supply chain in foreign lands is not the safest way to do business – for them and for the nation. How long will it take to change?

All these issues will merge at the same time. Sorting them out will be difficult and slow. And a slow economy will require a defensive investment strategy.

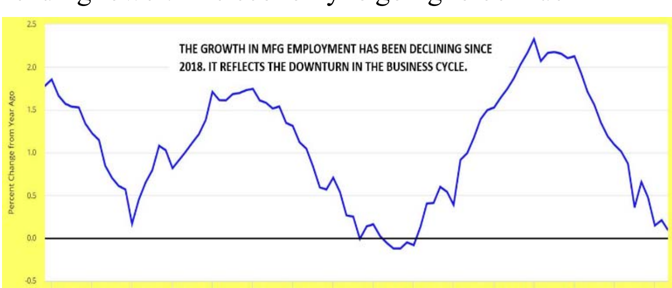
Commodities & Gold. In a collapsing economy our readers should not be surprised to see commodities sinking and gold underperforming bond prices (TLT) since early 2018.

Inflation. The price index of consumer expenditures rose +1.8% y/y. Inflation is not going to be a problem.

Short-term interest rates. Short-term interest rates will respond to the business cycle and the historically incredible injection of liquidity engineered by the Fed.

Bond yields. Declining to 0.0%? It's possible.

Bottom line. As shown in the graph, the business cycle is heading lower. The economy is going to be much



weaker. Since 2018 we have followed a conservative investment approach which resulted in satisfactory returns for our readers. We will continue to follow the same strategy that has made us successful in these turbulent times. We are confident it will provide safe returns with minimum volatility. We will become aggressive when the business cycle stops declining and starts rising, signaling growth ahead.

Global trends. Global output contracted at the fastest pace since 2009 – the year of the Great Recession created by a major financial crisis. The damage caused by the response to the coronavirus pandemic has been immense, as the global economy is being driven to its

knees. In just four short weeks (see above chart) business activity fell to historically low levels.

Global manufacturing continued to contract but the index rose slightly to 47.6. This improvement was mainly due to a stabilization of the China PMI.

The Eurozone manufacturing PMI contracted sharply in March, falling to 44.5. The countries mostly hit by the coronavirus were France, Greece, and Italy with an index value of 43.2, 42.6, and 40.3 respectfully. Only the Netherlands recorded a PMI above 50.0 reflecting no-change in economic activity.

China's manufacturing PMI seemed to stabilize. After deteriorating at the quickest pace on record in February, business conditions faced by manufacturers were stable in March. However, the pandemic continued to impact demand conditions and supply chains, with total new work falling for the second month and delivery times lengthening sharply. It means business is finding with great difficulty the materials needed for production. This is a sign China is still facing a harsh business environment.

The bottom line is the global economy is struggling. Economic resumption is likely to be slow and gradual, unlike at the end of a military war when countries have to rebuild anew destroyed infrastructures and, in some cases, whole cities from nothing.

After a pandemic there is no need to "rebuild cities". What is needed is a slow, grinding effort to make the economic machine work again.

Global equity markets. Underperforming the US market.

Global bond yields. Down as business activity collapses.

The Dollar. The Dollar has the tendency to strengthen when business activity slows down. Foreign money looks for a reliable system like ours.

Dag's Exclusive Model Portfolios

Objective of our portfolios: minimize risk and volatility while achieving attractive returns.

Managed Equity Portfolio. The portfolio keeps performing well - as shown on page 1. The reason for its success and low volatility has been discussed in detail in my books. We remain invested in solid companies with solid performance. Their price movement has been hedged with long-duration Treasury bonds (ETF: TLT). TLT is perfectly balancing the performance of the equities in the portfolio. As we sold the weakest performing stocks, TLT has played a major role in the performance of the portfolio. We are planning to change this strategy when the business cycle shows signs of improving.

Symbol	Description	Shares	Price as of 4/6/2020	Most Recent Value	Change since last purchase	Change since last purchase	Allocation %	Dividend Yield
AWK	AMERICAN WATER WORKS	140.4451	$121.52	$17,066.89	($1,362.65)	-7.39%	4.61%	1.80%
AAPL	APPLE INC	46.6382	$262.47	$12,241.13	$944.94	8.37%	3.31%	1.30%
ATO	ATMOS ENERGY CORP	134.7982	$103.63	$13,969.14	$641.19	4.81%	3.77%	2.40%
BDX	BECTON DICKINSON&CO	0.0000	$237.69	-	-	-	-	1.40%
DHR	DANAHER CORP	45.1255	$141.94	$6,405.11	($368.51)	-5.44%	1.73%	0.50%
MSFT	MICROSOFT CORP	47.2219	$165.27	$7,804.36	$490.77	6.71%	2.11%	1.30%
V	VISA INC CLASS A	69.8839	$169.44	$11,841.13	($712.28)	-5.67%	3.20%	0.80%
TLT	20+ Y TRSRY BND ETF	676.9681	$168.06	$113,771.26	$22,903.39	25.21%	30.72%	1.80%
	Cash & Cash Investments			$187,275.55			50.56%	
	Account Total			**$370,374.57**	**$22,536.85**	**14.04%**		

The above portfolio may not reflect current recommendations or actions. Past performance is no guarantee of future results.

Timing portfolios

ETF Portfolio No. 1. 16.6% in TLT. 83.4% in cash.
ETF Portfolio No. 2. Change. 100% in cash.
Fidelity Mutual Fund Portfolio. Change. 16.6% in FTBFX. 83.4% in cash.
Vanguard Mutual Fund Portfolio. 20% in VUSTX. 80% in cash.
SPY - TLT. 50% in **TLT.** 50% in cash.
SPY- XLU. 100% in cash.
SPY – TLT - XLU. 25% in TLT. 75% in cash.

PORTFOLIOS (Equal weight)	JAN 2008 - MAR 2020 $10,000 BALANCE	$10,000 RETURN	CAGR %	MAX LOSS %	STD DEV %	WORST YEAR %	SINCE 1/2019 CAGR (%)
ETF Portfoliio No. 1 - Timing	$22,711	127.11%	6.9	-7.4	6.9	-3.9	**9.2**
ETF Portfoliio No.2 - Timing	$30,364	203.64%	9.5	-10.9	9.8	-9.9	**3.4**
Fidelity - Timing	$21,843	118.43%	6.6	-7.6	7.6	-7.5	**5.8**
Vanguard Mut. Funds - Timing	$20,964	109.64%	6.2	-7.3	6.7	-4.8	**4.6**
SPY - TLT - Timing (50-50)	$26,506	165.06%	8.3	-8.7	6.8	-5.7	**16.0**
SPY - XLU - Timing (50-50)	$26,473	164.73%	8.3	-8.9	8.4	-8.2	**9.1**
SPY-TLT-XLU -Timing (50-25-25)	$26,762	167.62%	8.4	-7.7	6.5	-5.4	**12.7**
Long-term Technical Model	$28,620	186.20%	9.0	-15.3	9.8	-7.9	**1.6**
S&P 500 - Buy & hold	$22,701	127.01%	6.9	-48.2	15.5	-36.8	**4.6**

The performance parameters of each portfolio are: the compound annual return (CAGR), volatility (STD DEV), the amount gained or lost in the worst year, and the greatest loss suffered by the portfolio (MAX LOSS). CAGR is the rate at which an investment would have grown if it had increased at a steady rate. The performance data in the table have been updated as of the end of **March** and will be updated again at the end of **April.**

Note – The major overwhelming advantage of our timing models is that they considerably reduce the volatility of the portfolios (STD DEV) and the size of the losses (MAX LOSS and WORST YEAR) compared to the buy-and-hold strategy for the S&P 500. They offer an unbiased and quite successful risk management tool.

Relative strength analysis

The table below shows the 30 stocks in the Dow Jones Industrial Average and 30 ETFs. They are ranked by price action and relative strength – near term and long term. The most attractive investments are those displaying rising price and rising strength relative to the S&P 500. **UP** means price and relative strength are rising. **DOWN** means price and relative strength are declining.

DOW JONES 30 STOCKS

	Symbol	Name	S-T TREND	L-T TREND
XXX	AAPL	Apple	UP	UP
	AXP	American Express	DOWN	DOWN
	BA	The Boeing Comp.	DOWN	DOWN
	CAT	Caterpillar	DOWN	DOWN
	CSCO	Cisco	DOWN	DOWN
	CVX	Chevron	DOWN	DOWN
	DIS	Walt Disney	DOWN	DOWN
	DOW	Dow	DOWN	DOWN
	GS	Goldman Sachs	DOWN	DOWN
	HD	Home Depot	DOWN	UP
	IBM	Intl. Business Machine	UP	DOWN
	INTC	Intel	UP	UP
	JNJ	Johnson & Johnson	UP	DOWN
	JPM	JPMorgan	DOWN	UP
	KO	Coca-Cola	DOWN	DOWN
	MCD	McDonald's	DOWN	DOWN
	MMM	3M	DOWN	DOWN
	MRK	Merck	UP	DOWN
XXX	MSFT	Microsoft	UP	UP
	NKE	Nike	DOWN	UP
	PFE	Pfizer	DOWN	DOWN
	PG	Procter & Gamble	UP	UP
	RTX	Raytheon	DOWN	DOWN
	TRV	Travelers	DOWN	DOWN
	UNH	United-Health Group	UP	UP
XXX	V	Visa	UP	UP
	VZ	Verizon	UP	DOWN
	WBA	Walgreens	DOWN	DOWN
	WMT	Wal-Mart	UP	UP
	XOM	Exxon Mobil	DOWN	DOWN

MAJOR ETF SECTORS

Symbol	ETF Name	S-T TREND	L-T TREND	
DBC	Commodity Index	DOWN	DOWN	
EEM	Emerging Markets	DOWN	DOWN	
GLD	Gold	UP	UP	
GXC	China	UP	UP	
IEV	Europe	DOWN	DOWN	
IHE	Pharmaceuticals	UP	DOWN	
IYT	Transportation	DOWN	DOWN	
JNK	High-yield corp bonds	UP	DOWN	
KIE	Insurance	DOWN	DOWN	
KRE	Regional Banking	DOWN	DOWN	
PPA	Aerospace	DOWN	DOWN	
SDY	S&P Dividend	DOWN	DOWN	
SMH	Semiconductors	UP	UP	XXX
SPLV	S&P 500 Low Volatility	DOWN	DOWN	
VEA	Developed Markets ex-US	DOWN	DOWN	
VNQ	REITs	DOWN	DOWN	
VUG	Vanguard growth	UP	UP	
XHB	Homebuilders	DOWN	DOWN	
XLB	Materials	DOWN	DOWN	
XLC	Comunication services	DOWN	UP	
XLE	Energy	DOWN	DOWN	
XLF	Financials	DOWN	DOWN	
XLI	Industrials	DOWN	DOWN	
XLK	Technology	UP	UP	XXX
XLP	Consumer Staples	UP	UP	XXX
XLU	Utilities	UP	UP	XXX
XLV	Health Care	UP	UP	
XLY	Consumer Discretionary	DOWN	DOWN	
XME	Metals & Mining	DOWN	DOWN	
XRT	Retail	DOWN	DOWN	

Investment implications of the above table

1. Price momentum – rising prices are more likely to continue to go up than decline.
2. Relative strength momentum – rising relative strength is likely to continue to increase because it is a function of the degree of success or failure of a company.

This table shows the value of using business cycle trends to set up your investment strategy. It shows the consistent weakness in the Dow stocks and ETFs that have been negatively influenced by the economic slowdown which started in 2918 - industrials, financials, commodities and commodity sensitive companies, and transportation. They should have been avoided and remain unattractive as investment options. The currently attractive stocks and ETFs have been flagged with "**XXX**".

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THE FRAMEWORK OF OUR INVESTMENT STRATEGY

Financial history repeats itself. Why not take advantage of it!

The following information and charts closely reflect the approach to managing portfolios and portfolio risk discussed in Dr. George Dagnino's books *Profiting in Bull or Bear Markets* (McGraw-Hill Education) available also in Mandarin, *Easy Ways to Beat the Market with ETFs* and *Investing Wisely - It is Easier Than You Think.*

THE US BUSINESS CYCLE

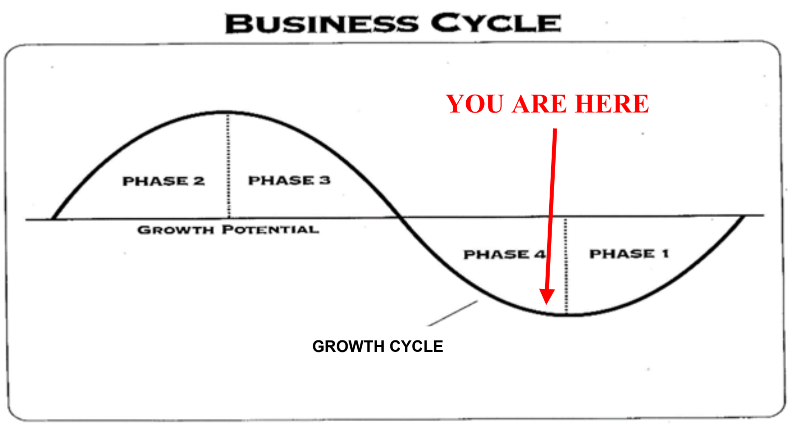


Fig. 4. The business cycle is in Phase 4. In this phase the economy keeps slowing down. Short-term interest rates, bond yields and inflation decline. Housing and auto sectors are weak. Earnings growth declines and credit risk rises. The stock market is more volatile.

1. **Inventories** (see Fig. 5). Pointing to stronger manufacturing.
2. **Income and spending** (see Fig. 6). Good growth.
3. **Durable goods orders** (see Fig. 7). Weak.
4. **Auto sales (**see Fig. 8). Plunging.
5. **Commodities** (see Fig. 9). Weak.
6. **Inflation** (see Fig. 10). Stable.
7. **Interest rates** (see Fig. 11). Yields lower.
8. **The Dollar** (see Fig. 12). Firm.
9. **Stock market - long-term** (see Fig. 13, 14). Cautious and defensive.
10. **Stock market - near-term** (see Fig. 15). Down.
11. **Foreign markets** (see Fig. 16 to Fig. 19). Keep underperforming the US market.

The investment environment – Until the end of February the economy was performing well. In fact, it was poised to start showing visible gains as inventories were finally brought under control – a process that took from 2018 to 2020. Too bad. It is not going to happen. The pandemic has brought the vital and powerful US economy on its knees. Unfortunately, after we conquer this nefarious enemy, the future will likely bring a slow economy. The investment implication is the sectors doing well will be the defensive ones – companies with a steady, predictable sales and income growth – possibly paying a dependable dividend.

Inventories – pointing to growth

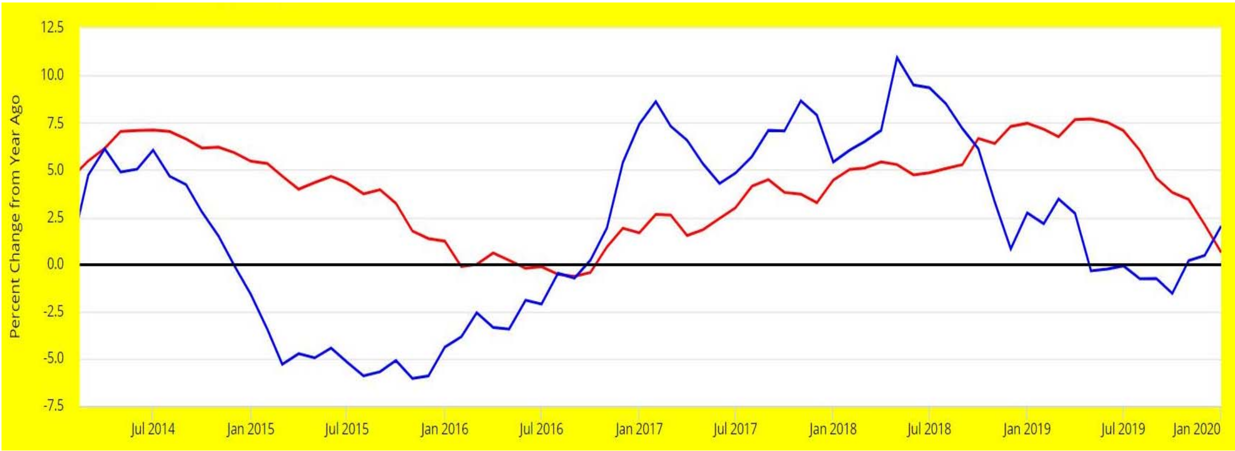


Fig. 5. **Too bad! In January the economy was poised to spring up again following the 2018-2019 slowdown. Instead Covid-19 hit hard. In January inventories (red) were finally under control. Sales (blue) were growing faster than inventories thus forcing business to increase production to replenish inventories. Unfortunately, this rosy scenario is not going to happen because of the economic damage created by the pandemic.**

Income and spending – firm

Fig. 6. **Prior to the pandemic, the economy was strong and on firm foundations. Income (red) was up a solid 4.0% y/y and consumer spending (blue) was expanding at a robust 4.9%. Unfortunately, all this positive economic momentum has been annihilated in just a few days by the invisible, destructive force of Covid-19.**

Durable goods orders - weak

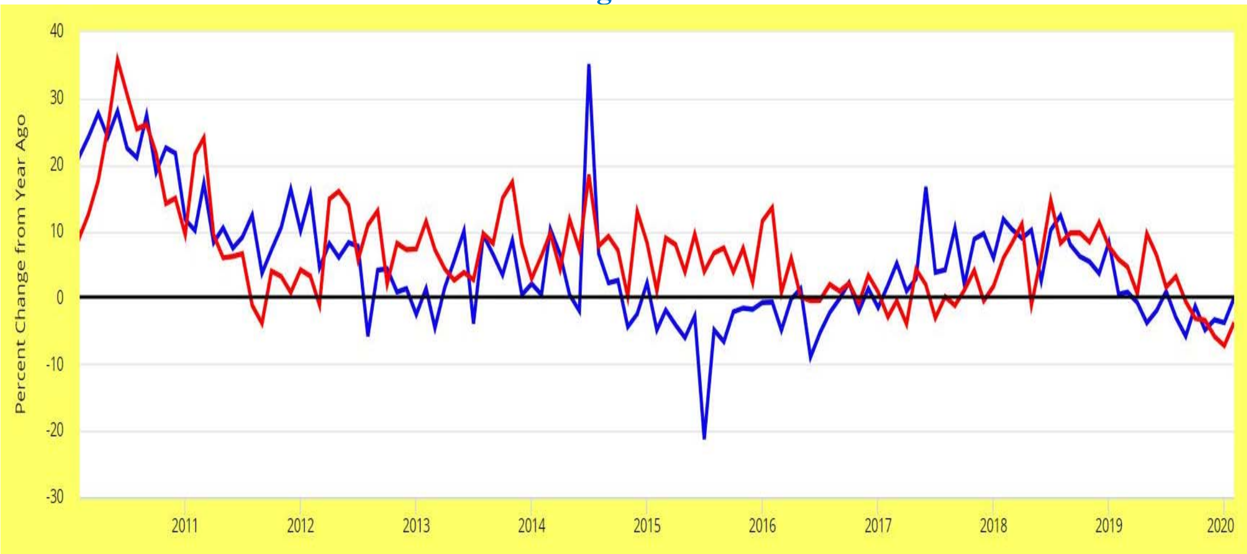


Fig. 7. Growth in durable goods orders (blue) seemed to start improving following the aggressive easing of the Fed. Consumer durable goods (red), however, were still weak: down -3.7% y/y.

Auto sales – plunging

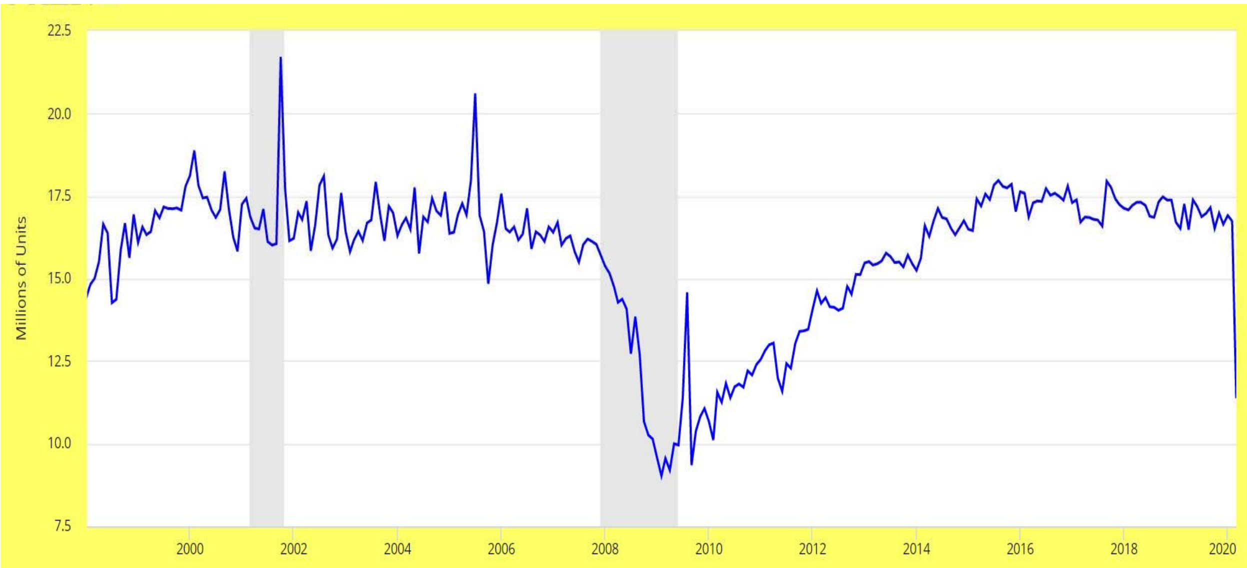


Fig. 8. As of February, the economy was doing great. The sharp plunge in auto sales in March describes the sad and enormous business destruction that took place in just four short weeks. Really incredible!

Commodities – weak

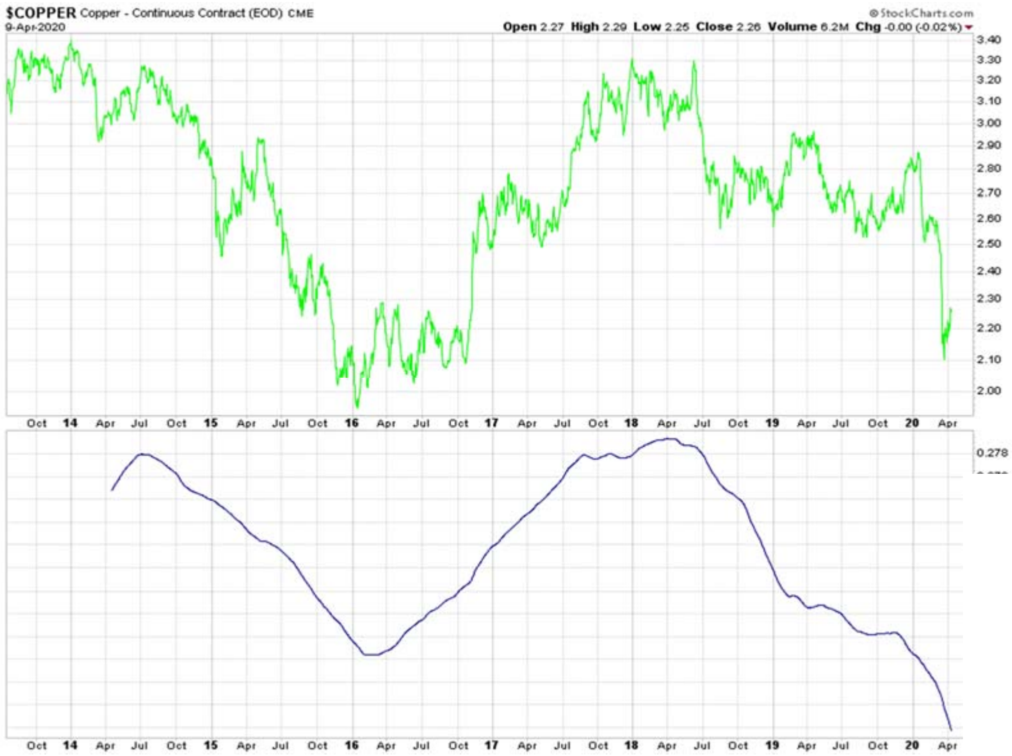


Fig. 9. **The CRB commodity index (green) follows closely our business cycle indicator (bottom line).**

Inflation – stable

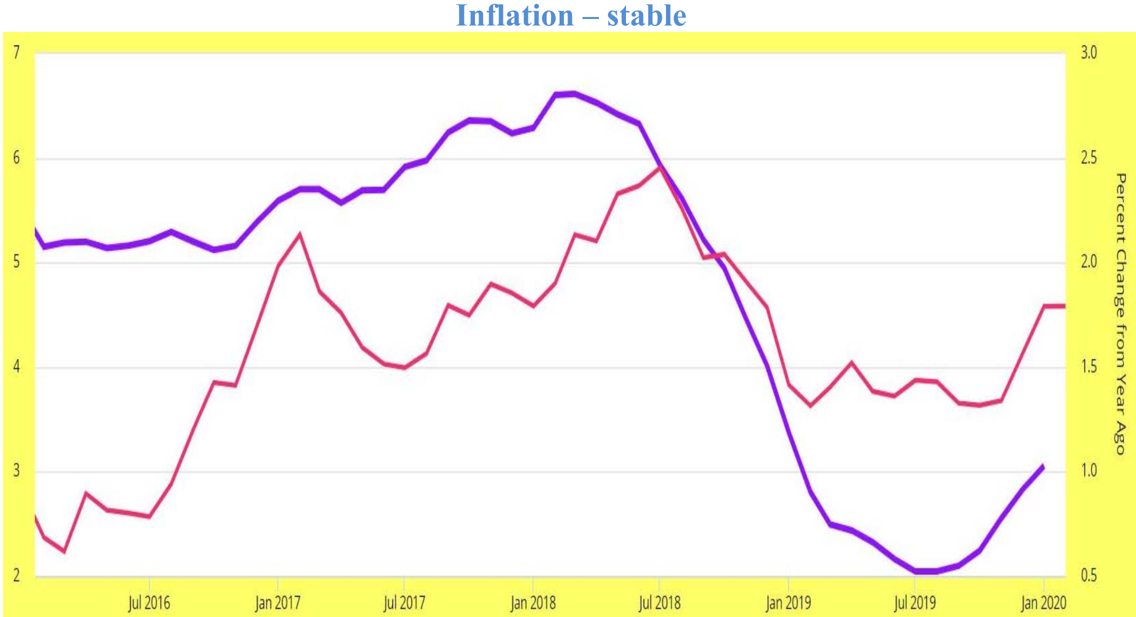
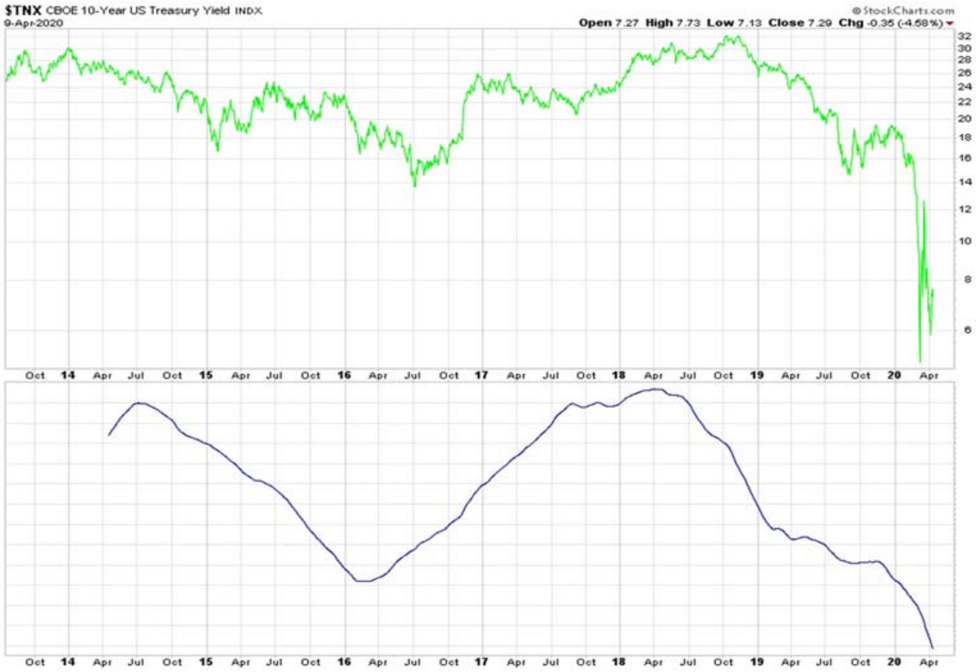


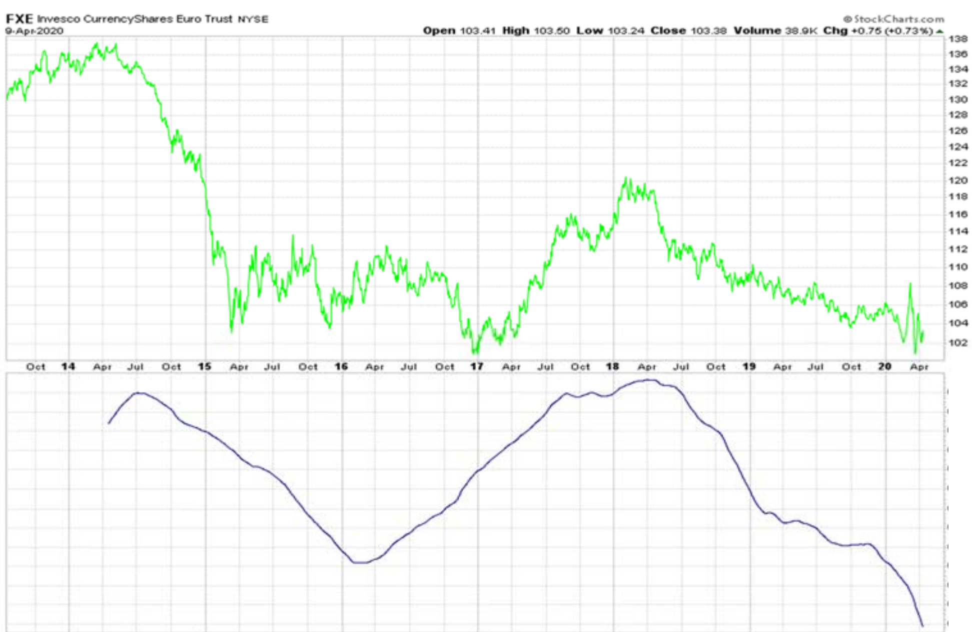
Fig. 10. **The price index of consumer expenditures (red) rose 1.8%. Our leading indicator of inflation (blue) is still pointing to higher inflation.**

Yields – down



<u>Fig. 11</u>. Yields of long-term Treasury bonds (green) decline and bond prices rise when our business cycle indicator (bottom panel) declines.

Euro – weak



<u>Fig. 12.</u> The Euro (green) tends to weaken and the US Dollar to strengthen when our business cycle indicator (bottom panel) declines.

GLOBAL STOCK MARKETS

<u>US long-term outlook: defensive</u>
Liquidity (see Fig. 13). Positive signs.
Spreads (see Fig. 14). Bullish

<u>US near-term technical outlook: down</u>
Volatility (VIX) (see Fig. 15). At bearish levels.

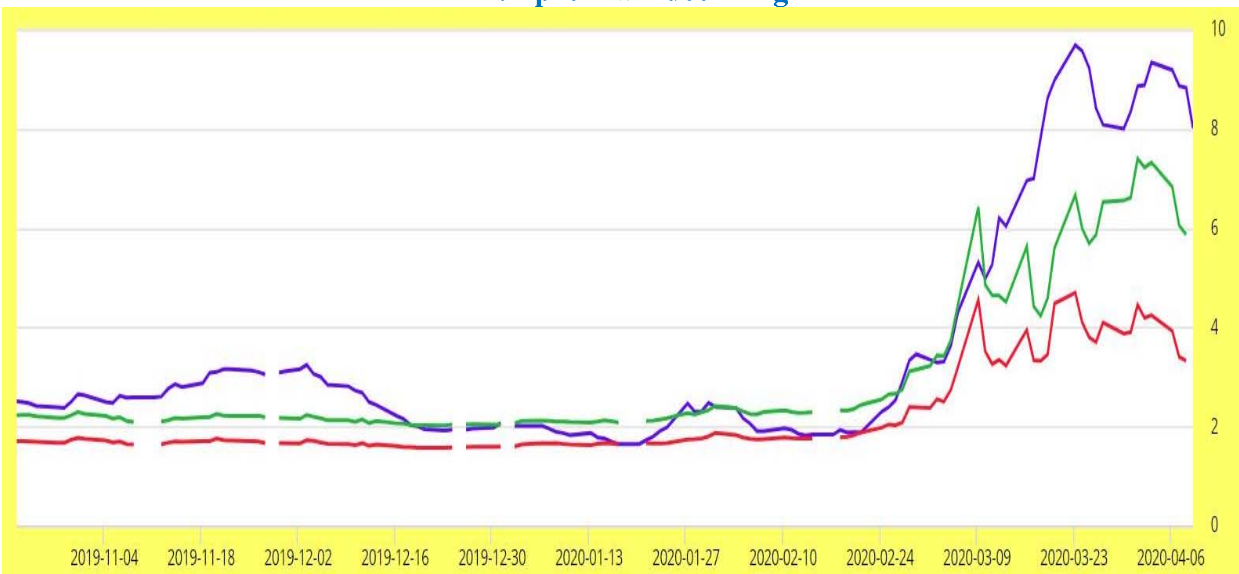
Bottom line. The Fed has set the stage for a strong move up in equity prices – plenty of liquidity followed by visible declines in credit risk. This is what happens before a major market rise. There are two problems to overcome. Our business cycle indicator suggests the economy is still on a down path. The second is our technical indicators are still bearish. But there is no doubt – we are now looking for an important bottom in the market.

<u>Foreign markets (Fig. 16, Fig. 17, Fig. 18, Fig. 19)</u>: They have stalled and keep underperforming the US stock market. Note how the main turning points remain the same among all equity markets. The Chinese market has outperformed the S&P 500 since early February.

Liquidity – rising sharply

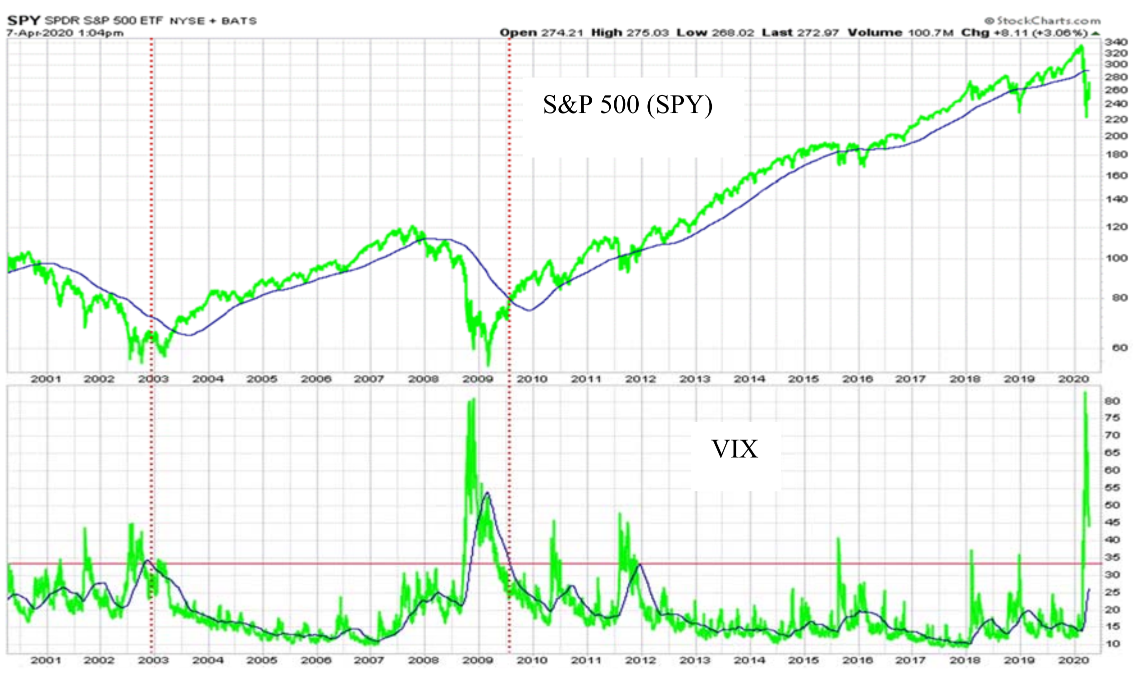
<u>Fig. 13.</u> The Fed started to inject more liquidity after the Fall of 2018 market debacle. The outcome was a sharp rise in equity prices totally unjustified due to the downshifting of the economy in 2019. In early 2020, the Fed did "whatever it takes" (quoting Draghi's famous opine) and liquidity soared even faster as the market plunged 35% in four weeks. There is no doubt the market and the economy have enough liquidity to stage a major move up. The issue facing investors is how rapidly the economy will return to its normalcy.

Risk premia – declining



<u>Fig. 14.</u> Excellent news. The action of the Fed (see Fig. 13) is having its desired effects. Risk premia are declining for bonds of several qualities – from the riskiest to the safest ones (see above graphs). This is good news because the overwhelming majority of long-lasting market gains has been preceded by a visible decline in risk premia.

Near-term momentum - bearish



<u>Fig. 15.</u> The lesson of the last two major bear markets is that volatility (VIX) will have to decline below 35 to signal the beginning of the next major move of the market on the upside (see lower panel). The current level is close to 45.

ALL WORLD MARKET INDEX EX-US (VEU)

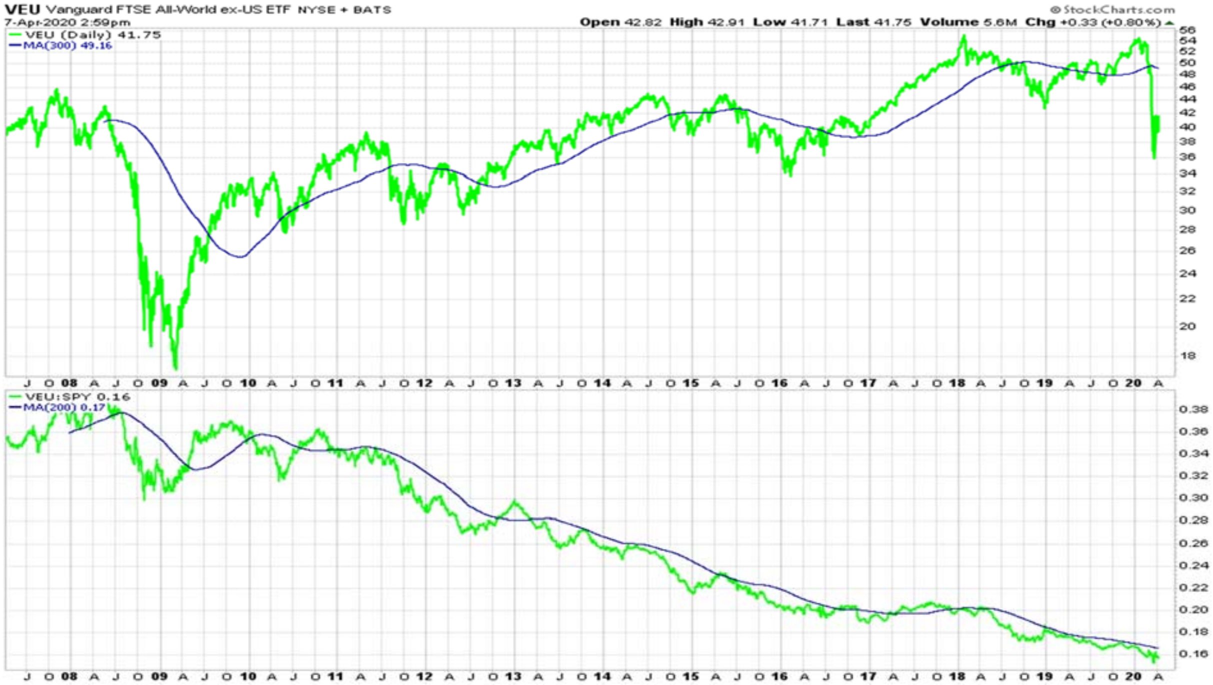


Fig. 16. The "rest of the world" market has stalled and is underperforming the US market. The graphs in the lower panel show the strength of the world market relative to the S&P 500. A declining slope reflects the weakness of VEU relative to SPY. Note how all the equity markets have perfectly synchronized turning points at major tops and bottoms.

EUROPE (IEV)

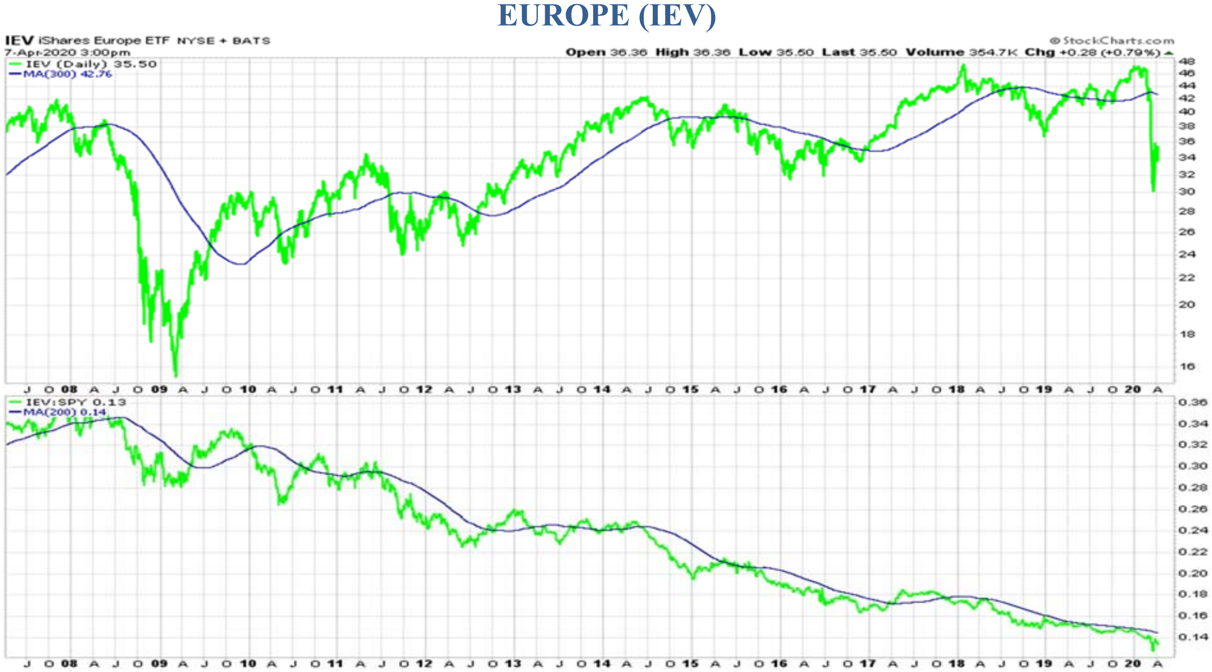


Fig. 17. The European market is underperforming the US market. The graphs in the lower panel show the strength of the European market relative to the S&P 500.

CHINA (GXC)

Fig. 18. The Chinese market rose sharply in the past two months, outperforming the S&P 500. However, it has underperformed the US market since 2018.

EMERGING MARKETS (EEM)

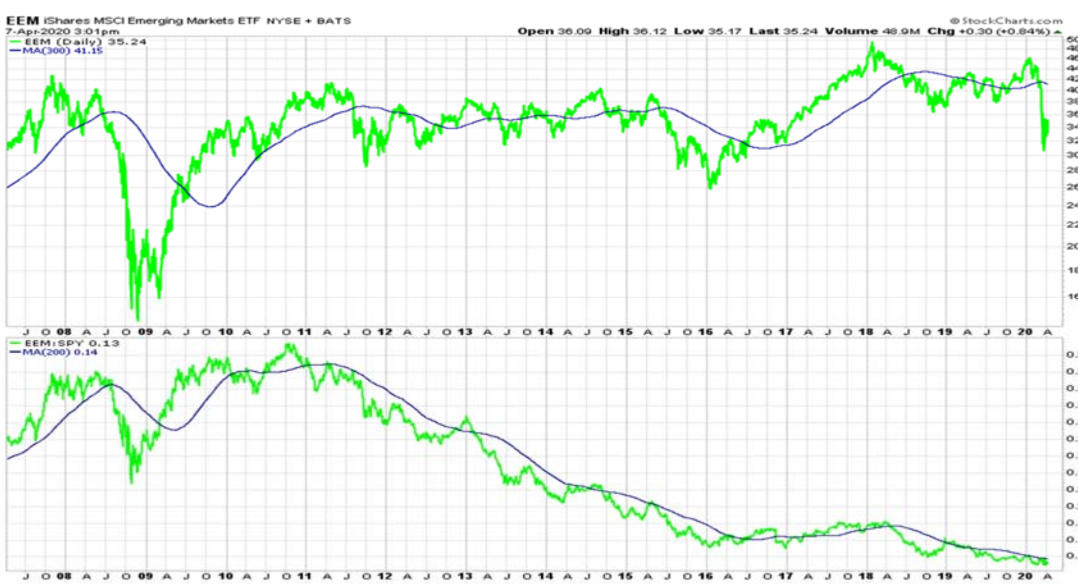


Fig. 19. The emerging markets have stalled and are underperforming the US market. The graphs in the lower panel show the strength of the emerging markets relative to the S&P 500.

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