USA Financial
Trending Report

3rd Quarter 2017 | Quarterly Commentary from The Formulaic Trending Money Manager

Few Things Are More Dangerous to Investors Than Market Predictions

As Yogi Berra famously stated, "It's tough to make predictions, especially about the future."

But since there are only three ways to invest successfully, far too many investors underestimate the difficulties and therefore (consciously or subconsciously) choose not to heed Yogi Berra's wisdom:

Buy when you should.

Hold when you should.

Sell when you should.

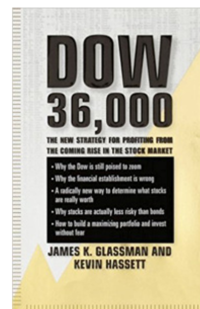
Unfortunately, to make matters worse, many experts are all too happy leading investors astray, spouting off predictions as if they were fact, giving interviews, writing articles and publishing books loaded with poisonous advice and dangerous stock market outlooks. In fact, I saw Jim Rogers was back in the news promising the worst crash of our lifetime and his (he's in his mid-70s). Luckily, Yahoo Finance ran an opposing article on June 13, 2017, titled, "Why Extreme Market Predictions Like Those From Jim Rogers Provide No Value"* along with a list documenting Rogers' chicken-little string of dangerous and inaccurate predictions:

- 2011: 100% Chance of Crisis, Worse Than 2008: Jim Rogers
- 2012: Jim Rogers: It's Going to Get Really "Bad After the Next Election"
- 2013: Jim Rogers Warns: "You Better Run for the Hills!"
- 2014: Jim Rogers – Sell Everything & Run for Your Lives
- 2015: Jim Rogers: "We're Overdue" for a Stock Market Crash
- 2016: $68 TRILLION "BIBLICAL CRASH" Dead Ahead? Jim Rogers Issues DIRE WARNING
- 2017: THE BOTTOM LINE: Legendary Investor Jim Rogers Expects the Worst Crash in Our Lifetime

Jim Rogers seems like a nice-enough fella. He doesn't strike me as a crook trying to lead people astray. But regardless of his intent, that doesn't make his predictions any more accurate.

As if that's not enough, searching for such misleading books on Amazon can be almost comical. Well, only if it wasn't so devastating to think about all the investors' wealth, hard-earned dollars, and retirement dreams that have been squandered following so many compelling predictions that turned out dead wrong.

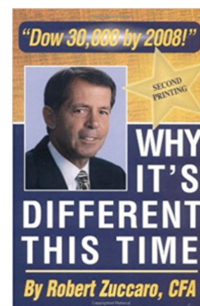
Imagine the financial ramifications from just three classically horrendous predictive books, all written by highly educated and respected authors, who I must imagine completely and wholeheartedly believed they were speaking truth to investors.



DOW 36,000: The New Strategy for Profiting from the Coming Rise in the Stock Market
by James K. Glassman and Kevin Hassett

Prediction = Bull Market
Reality = Bear Market

A very compelling title, yet in reality with hindsight being 20/20, this book could hardly be more wrong. Ironically, its 1999 copyright was just before the tech bubble burst in year 2000. By 2002 the DOW was trading well below 8,000. It wasn't until 2006 that the Dow finally reclaimed its 1999 high watermark. In 2017, the Dow closed above 20,000 for the very first time – still 15,000 below Glassman and Hassett's sky-high prediction 18 years later.

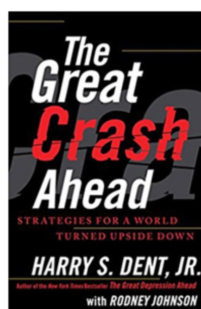


Dow 30,000 by 2008: Why It's Different This Time
by Robert Zuccaro, CFA

Prediction = Bull Market
Reality = Bear Market

Again, a promising title for investors looking forward to 2008, as the book was copyrighted five years earlier in 2003. But as we know, reality can strike deep as the financial crisis of 2008 ultimately sent the Dow plummeting below 8,000 again by early 2009. Not until 2013 did the Dow surpass its 2007 highpoint. Again, it wasn't until 10 years later, in 2017, that the Dow hit 20,000 – still 10,000 below the anti-crisis prediction 14 years later.

* Carlson, Ben, "Why Extreme Market Predictions Like Those From Jim Rogers Provide No Value," June 13, 2017, https://finance.yahoo.com/news/extreme-market-predictions-like-jim-rogers-provide-no-value-144747654.html



The Great Crash Ahead: Strategies for a World Turned Upside Down
by Harry S. Dent with Rodney Johnson

Prediction = Bear Market
Reality = Bull Market

This somewhat spooky title is meant to strike fear, yet is only one in a string of similarly predictive books Dent has written. The introduction for this book (copyright 2011) states straight up, "The crisis is likely to be at its worst by early 2015, or by early 2016 at the latest, and only after stocks crash to between 3,300 and 5,600 on the Dow by the end of 2014, or 2015 at the latest." But in real life the Dow ranged from the 15,000s to 18,000s in 2014 and 2015 – again keeping in mind that the Dow subsequently broke through 20,000 in 2017 – 15,000 above Dent's dire prediction six years later.

So, if even these investment and economic experts can be so very, very wrong – while no doubt believing they were so very, very right – what in the world is the professional financial advisor or astute investor to do? How can one approach the remainder of 2017, and beyond, with any confidence in their individual portfolio selection?

I suggest you push outlooks and predictions aside and concentrate on risk management tools such as formulaic trending to help identify the current environment or status of the market and economy. Use existing data and quantitative reality to assist you in steering your investments, essentially calculating the ongoing odds in favor, or against, equities as we move through time. This way, you can adhere to logical rationale when adjusting your portfolio, based on real time monthly data – rather than rely upon random, often ill-fated, or misguided human emotion.

There is no system, no money manager, no investor, who can gauge the market with 100% accuracy. If anyone ever tells you otherwise, they are lying to you. But there are ways to manage the risk that will always be inherent in the stock market.

Therefore, I believe that risk management should automatically trigger among all three ways to invest successfully. And hopefully, you select a risk management tool with an acceptable degree of accuracy.

Buy when you should.

Hold when you should.

Sell when you should.

Before diving deep into formulaic trending risk management, let me quickly dispel one common misconception where long-term investors automatically think of themselves as buy-and-hold investors. By definition, it is accurate that a buy-and-hold investor must be a long-term investor. However, the opposite is not true. Meaning, by definition, a long-term investor is not required to be a buy-and-hold investor.

For example, I am definitively a long-term investor. But I adamantly refuse to be a buy-and-hold investor.

In other words, I do not wish to limit my options to just "Buy when you should" and then hold indefinitely. I prefer that my options trigger and adjust across all three. Therefore, although I am a long-term investor, I stretch beyond the boundaries of a buy-and-hold investor.

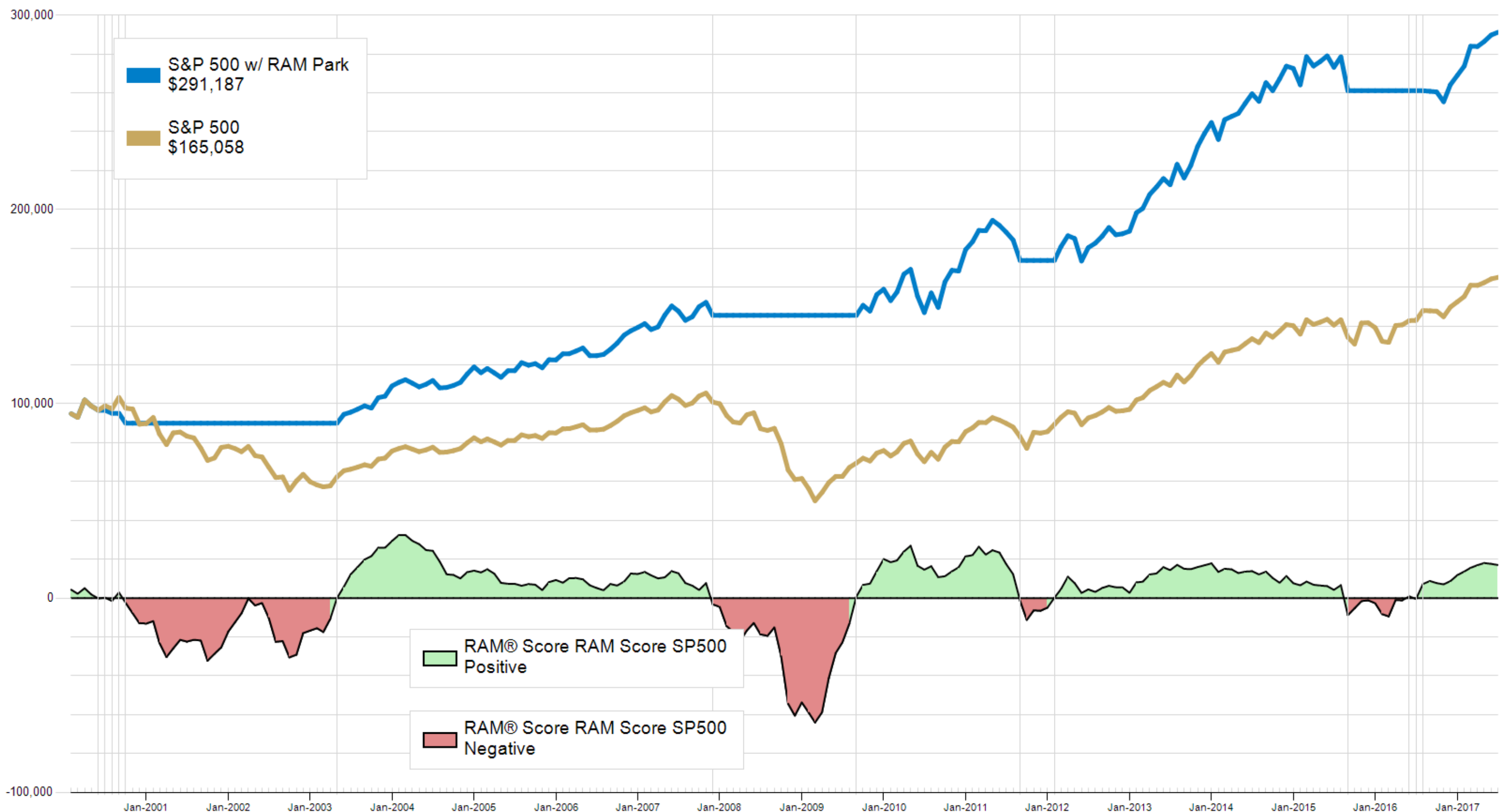
This is an important distinction that many take for granted. You see, even if an investor owns something as simple as a mutual fund, the fund manager is then buying, selling and holding within the fund on behalf of the investors. In the world of risk management, the process is similar, but to reuse a previous example, it simply "stretches beyond the boundaries" of a typical mutual fund. Whereas a mutual fund must be constrained by its category or subcategory, risk-managed accounts may jump across categories depending upon market and economic conditions.

In understanding risk management, especially using formulaic trending, a simple visual aid that is available is our publishing of our patented RAM® Score (**R**ecession and Market **A**llocation **M**anagement) as correlated to various market indices. Each month, as explanation to both advisors and investors, we share the RAM Score correlations for eight primary indexes. This scoring mechanism calculates seven sub-components related specifically to each market index and the economy, then using specific weighting, aggregates them as one so that zero becomes the scoring baseline. Similar to the concept of a "canary in a coalmine," when an index has a positive monthly RAM Score, we believe it indicates the current environment is favorable for such equities (keep mining). If the score is negative, then we believe the environment has become unfavorable and one may wish to exit said equities (stop mining).

Keep in mind, this is not predictive nor is it market timing. It is trending. Meaning, it is specifically an analysis to identify and validate the current situation or state of affairs so that one may recognize the trend at hand and therefore invest accordingly.

As of July 2017, all eight of our primary indexes are reporting a positive RAM Score. This includes the S&P 500, S&P 100, DJIA, NASDAQ-100, NASDAQ Composite, Russell 2000, Russell 3000, and Russell 1000. So, if one were using the RAM Score tool to assist in their risk management within an investment strategy, the current status would indicate that one should (for now) continue to invest in the corresponding equities. However, it is important to understand that this is in no way predictive of the remainder of 2017 or beyond. It is also important to understand that the market may go down when RAM Score is positive and it may go up when RAM Score is negative, but overall, we believe RAM Score may be indicative of the greater trend at hand, and therefore useful in helping to guide investment choices accordingly.

Below is a RAM Score Correlation visual for the S&P 500:



The **RED** valleys indicate when RAM Score is negative.

The **GREEN** mountains indicate when RAM Score is positive.

The **TAN** line indicates the traditional S&P 500 with no correlation to RAM Score.

The **BLUE** line indicates the S&P 500 correlated to RAM Score so that it allocates to cash when RAM Score is negative.

As one studies the graph above, it becomes easy to see that identifying what trend exists at any given point in time can become quite useful and valuable for an advisor or investor.

By redirecting investor focus away from predicting future outlooks for the market and economy and toward clarification of the current trend status that exists today – by default we may then eliminate the emotional toil that trips up so very many investors.

As we are fond of saying, Plan First, Invest Second®.

The real challenge may not be in the selection of an investment, but in the selection of the risk management style you wish to employ. Apply scrutiny to research how certain risk management approaches react under different environmental duress and situations. Scrutinize, locate, and plan accordingly as you infuse the risk management tool into your portfolio management. Then step back

– remaining a long-term investor (but not necessarily a buy-and-hold investor) – and allow the risk management tool to implement, operate, and adjust according to plan on your behalf.

The next time a well-meaning friend presents you a "predictive" financial book, just smile, nod appreciatively, and use it for kindling. Or, better yet, if they are a really good friend, tell them you employ risk management tools so that your emotions don't run amuck and get in the way of your investing.

Thanks & Godspeed as You Invest,

Mike Walters, CEO

IMPORTANT DISCLOSURE: The illustration does not represent any particular Portformula® strategy nor is it intended to recommend any Portformula strategy or the RAM® Score feature. The information simply attempts to illustrate how our firm's RAM Score Allocation Management feature operates. This feature can be applied to many Portformula models at no additional cost.

The line representing the S&P 500 with RAM Score Park applied to it is purely hypothetical and provided to illustrate how RAM Score Park works using a familiar source, i.e., the S&P 500 Index. Indexes such as the S&P 500 are not publicly available investment vehicles and cannot be purchased. As such, RAM Score Park cannot be applied to the index. This illustration is purely hypothetical and cannot be replicated given that no one can invest directly in the index. Additionally, the S&P 500 Index contains far more stocks than a Portformulas model, therefore, the results represented or the additional assets derived as a result of applying RAM Score Park, as illustrated, cannot be carried over to any Portformulas model you might purchase. Many factors, including, but not limited to, the number of stocks in the index compared to those in a limited portfolio, the length of time the portfolios are held, as well as the varying volatility of an index can effect performance results. The hypothetical results illustrated are not indicative of any client's experience. The chart assumes that $100,000 was hypothetically invested in the S&P 500 in January 2000. The resulting performance does not reflect the reinvestment of dividends or other earnings.

RAM Score was not developed until January 2010. Prior to January 2010, clients were utilizing RAM Score's predecessor, RAM. Clients utilizing RAM Park rather than RAM Score Park may have had different results than those reflected. RAM Score movement prior to 2010 is hypothetical and based on retroactive application of RAM Score's indicators to market and economic conditions existing at the time. Portformulas was not managing assets prior to 2007. Back-tested performance should not be considered indicative of Portformulas' skill.

It is important to understand that RAM Score is only a tool designed to assist our firm's management of client accounts. RAM Score does not guarantee any specific results or performance and even with RAM Score on client accounts, it is possible that client accounts will lose value. RAM Score moves assets into or out of the market based on various economic and market indicators. It is possible that the market will move positively while investors are not invested or negatively while an investor is invested, resulting in losses. Any Portformula strategy may under-perform or produce negative results. Past performance is no guarantee of future results. This illustration uses the S&P 500 because it is a well-known index and provides a recognizable frame of reference.

Portformula Investment Strategy - Exclusively from Portformulas
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