2017 Investment Strategy

For many reasons, I did not think the market would be doing as well as it has. Last year I wrote the U.S. economy was fine, it was the rest of the world that is the concern

Unfortunately, global risks have increased:

- Isis and Islamic extremists' and their continued global terrorist attacks
- China: too much debt; bad allocation of capital; lack of transparency; a major shift in economic direction; economy is slowing
- Rising tensions with Iran, North Korea, China, Syria, Iraq and Mexico
- Some of these tensions could lead to military conflicts
- Global nationalism and protectionism. Britain has decided to leave the European Union, EU. France, Netherlands, Germany, and Greece may also vote to leave the EU this year and next. This could be very disruptive to the EU and global economy.
- Growing global nationalism and protectionism could create more tariffs and trade wars
- Global growth has improved lately, but most major economies have sub-par growth.

Many of the listed concerns above could lead to a global recession.

Because we are in the late phase of an economic and market cycle, and because risks of trade and military conflicts are possible, the markets could reverse suddenly and violently. This could happen at any time. Investors need to be vigilant and disciplined.

Most of us we're very surprised about the election results. Most investors are very enthusiastic about the pro-business, pro-growth administration. Because Republicans control the Presidency and both houses, there will probably be tax cuts, infrastructure and military spending, deregulation, and repatriation of corporate profits overseas. All this could be stimulative. We don't know what and when these stimulative laws will be passed and implemented. I will analyze and write about these proposals in an upcoming research reports.

I'm also very concerned about the parabolic moves in the market based on expectations of fiscal stimulus. Looking at an example justifies my concern:

In February 2009 the $831 billion American Recovery and Reinvestment Act of 2009 was passed. There were provisions in the law to make sure that any infrastructure spending must include American companies, workers and materials.

Let's review the chart:

- The passage of the 2009 law and its provisions caused stocks like U.S. Steel, symbol X, to go parabolic.

- The stock moved higher, about 600% when the move ended.

- During the move, there were several violent reversals. Normal behavior when you have parabolic moves. Most parabolic moves are news driven and are speculative. Parabolic trends are hard to sustain. Just as speculators cause the parabolic move up, the speculators are then quick to sell and the gains are lost.

- Eventually the stock lost all of its gains and then some, and finally bottomed in early 2016.

- One of President Trump's major economic proposals is infrastructure spending. X nearly doubled after his election win, without a law being passed.

- The stock lost about 20%, once investors realized passage of a proposal will take time.

- President Trump signed an executive order to advance the approval of the Keystone and Dakota Access Pipelines. He learned that American made steel was not going to be used in the pipelines, so he stipulated that American made steel has to be used. The stock spiked again.

The WSJ recently reported recently that the steel pipes have already been purchased and they won't be using American made steel. The stock is starting to slide again.

The lesson: Parabolic moves are hard to sustain, and can easily reverse.

Because of the probability of economic stimulation, our economy will probably remain positive, but those prospects are in stock prices. Again, I will write about the stimulus proposals. We are learning that some of the proposals are meeting resistance from Democrats and some Republicans, and will take more time to craft the legislation and to get it passed by both the Senate and Congress.

I tend to be a contrarian, and although many investors are very bullish, I believe they are not including some of the head winds and risks investors face. This includes many concerns that the new President has caused (insulting domestic and international friends and foes, gaps between his statements and reality, questions about his and his team's relationship with Russia, the ideology of Steve Bannon his top strategic advisor….).

When things change so should our investment strategy. Admittedly this is one of the trickiest, mature cycles I've invested in.

My new strategy is based on:

- A continued healthy economy with the potential for economic stimulus.
- We are late in an economic cycle.
- Markets and most stocks are overvalued and are parabolic and reflect potential economic stimulus
- Inflation, interest rates and oil prices are rising
- The Fed will probably raise rates several times this year
- Rising geopolitical and global economic risks
- The anticipated stimulus may take more time to be passed and could be less than investors expect. Also, even though there may be stimulus, my research will show that the stimulus may not have the economic results investors believe may happen.

All of the above will make the markets volatile, and we will probably start a new higher trading range once a new resistance is made.

In my last update I provided the chart below:

Here is what I wrote about the chart:

At some point, a new resistance will be made and a new higher trading range will be established. The new higher trading range could be from 21,000 to 18,250. Caveat, it's very difficult to predict the future, especially in regards to where the markets might be, so the above potential trading range is a projection based on what normally happens with these type of price patterns occur.

Also,

When you see parabolic moves, it is normally a sign of speculation. The almost 90 degree trendline will be easy to break causing a sell signal, so these speculators will take profits or sell to minimize losses. These parabolic moves are difficult to sustain.

It's also important to point out that earnings for 2016 were up about 4%, but most markets were up over 10%, and some much more. When the market moves up more than earnings, this normally means that the market borrowed performance from the following year. So, 2016 performance borrowed from 2017. Another reason why we will probably trade in a new higher trading range once a new resistance is found.

Investment Strategy Revised

I wrote about my investment strategy in last year's August Market Outlook, [click here]() to read the outlook. Below is my revised investment strategy:

- What I basically recommended was to focus on stocks that were in bear markets and were undervalued. I continue to recommend this strategy; there's an example below. Remember, a major downturn could happen at any time, similar to the correction at the beginning of last year.

- Also, avoid stocks that have parabolic price action and that are overvalued. Here is another example:

The parabolic moves in the market, Dow 30, are mostly due to expectations of tax cuts, infrastructure spending, and deregulation. The last 300 point move with a gap was due to a widely praised State of the Union Message by the President. We don't know what and when the President's proposals will be enacted. The market has gotten ahead of itself, with many unknowns.

These trends will be very easy to break. Once the trend line is broken, it will create a sell signal and there will normally be a retracement of the move.

- Consider stocks that pay higher dividends like REITS and Business Development Companies aka BDCs (BDCs make middle-market loans and most use leverage to enhance the dividend yield) may be safer now that this economic cycle may last a bit longer. If the economy starts to deteriorate, sell these positions as the downside could be significant.

- As I mentioned above trade or military conflicts could happen at any time, so continue to keep high levels of cash. Current committed investment capital should be short-term oriented this late in the market cycle.

Personally, I've kept some of my dividend stocks and I'm writing options (collecting cash) against them, when they get overbought and overvalued.

I've also been selling puts and collecting premiums, cash that are in bear markets, and are basing, and have above average dividends. Below is an example, Occidental Petroleum, symbol OXY.

OXY is not a recommendation, and is only for **educational purposes only**. Once you invest in a company you must monitor, and then know when to sell. I will not issue updates on the stock, or issue a recommendation to sell.

The stock is down over 40% since its peak in 2010. The stock did rally two times to over $100 in 2011 and 2014. Much of the downside is gone in these type of stocks. When we eventually go into a recession, these type of stocks could have one more leg down, but not like the downside that many stocks that are trading at their highs like the market example above.

The stock found a bottom early last year and has been basing from about $65 to $77. I've been trading the basing, trading range including selling puts or buying at $65, and selling at the $75 to $77 level. Quite simply, trade (buy at support and sell at resistance) these type of stocks until the next decline phase and bear market.

OXY Fundamentals

The stock pays about a 4.5% dividend.

Debt to equity is one of the lowest in the industry, indicating a healthy balance sheet.

Under the right conditions, their reserves should be worth over $100 billion and the market capitalization is less than $50 billion. The $100 billion does not include their significant chemical and marketing and transport businesses.

The stock is oversold, and in a basing pattern. It is also undervalued with valuable energy assets.

If we go into a recession, the stock could have one more leg down, so caution is still needed.

Again, OXY is not a recommendation to buy. The OXY example is for education only.

Because we are very late in the economic and market cycle, it is inevitable we will have a bear market and recession, so investors should have plenty of cash. Personally, I'm in 80% cash.

The reasons for the high levels of cash:

- You make the most amount of money when you invest when stocks are oversold and undervalued. You have poor performance when you invest when stocks go parabolic and when stocks are overvalued.

- When the bear market starts it is swift and nasty. Also, the economic news tends to be negative. It's best to avoid a bear market, especially if you're older, as you don't have time to make up the losses.

- When a low is found in a bear market, when prices start to base, there are plenty of bargains, and you want to have cash to take advantage of the undervalued companies.

Summary

- U.S. economy is doing fine but there are rising global risks

- This economic cycle may last a bit longer due to fiscal stimulus

- Prices are parabolic and stocks, markets are overvalued

- We need to remember because valuations are high and prices are parabolic, a price reversal could be dramatic

- This late in the cycle I suggest: keep short-term, focus on stocks that are basing, pay above average dividends, and are undervalued.

A long-term holding period should be the strategy once we have a bear market, and recession.

- Have a high level of cash to take advantage of an inevitable bear market.

Over the next month I will be issuing research on President Trump's economic agenda including: corporate, personal taxes, repatriation of corporate profits overseas, infrastructure spending, trade, deregulation.