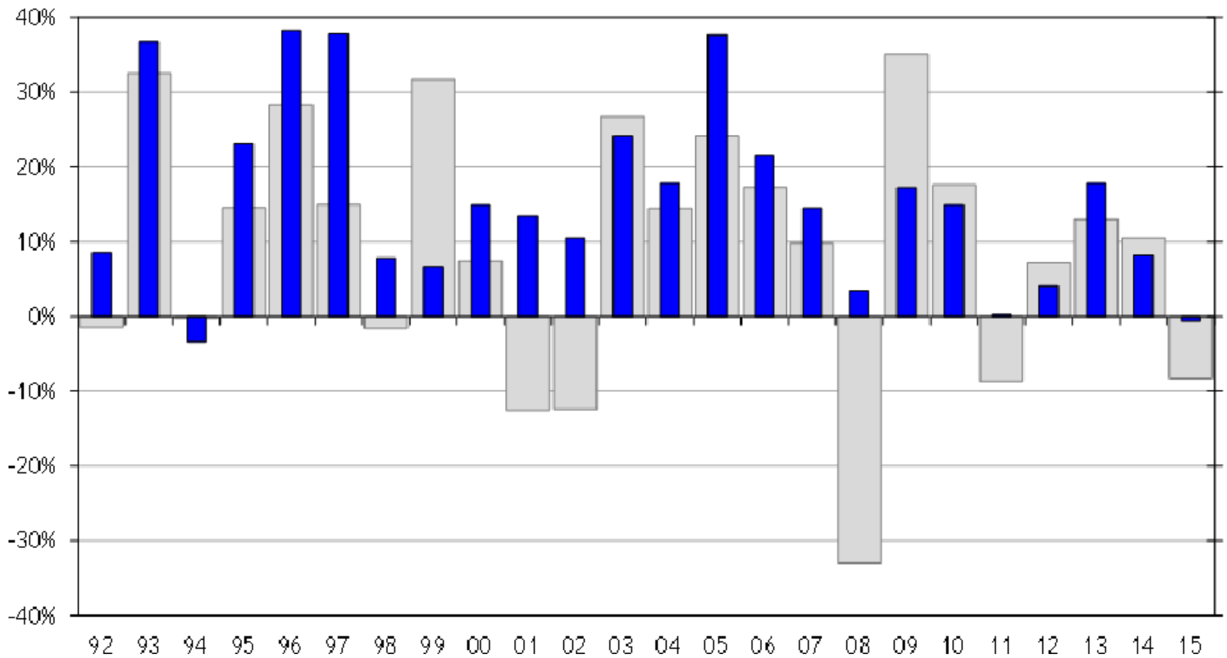
February 20th, 2017

"Won2One" with Nick Foglietta

Tactical Equity Income Model Portfolio Record



Tactical Equity Income Model Present Conditions:

TEAM Model Asset Allocation: 100% stocks
S&P/TSX 60 Closing Value: 15,833
TSX 200 Day Moving Ave: 14,700
% Above/Below 200 Day Moving Ave: **7.71% Above**

Levels for change: 50% stocks - **TSX 15,435** and 100% cash at – **TSX 13,965**

Weekly Quote

“You don’t need a parachute to go skydiving…you need a parachute to go skydiving twice! Allocate assets accordingly.”

<u>The Bubble bubbles on!</u>

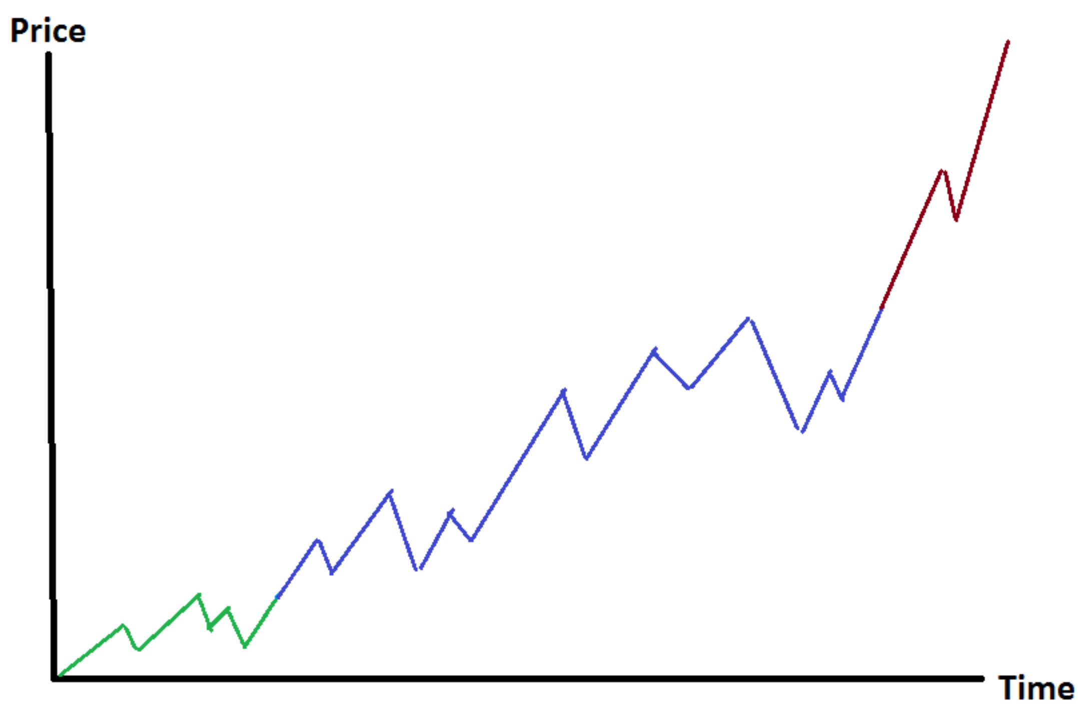
With each week that passes I see more signs of confirmation the BULL market in stocks that began in 2011 is in its final leg upwards. As stated before in these pages, the third leg up is often violent in nature and appears impervious to news. The present move in stocks has that flavor!

One question I was asked this week was how do “bubble” moves in stocks usually end?

Good question…this is the third stock bubble of my career. I have also looked at many other historical bubbles in other asset classes too. <u>There is a usual pattern to the completion that we can watch for</u>.

(An important aside. **The present bubble represents a bubble in EVERYTHING**! Stocks and real estate are the most visual examples…but the real bubble that is going to dictate the end of all these bubbles is the interest rate/bond market bubble. **Therefore, we need to watch the bond markets to take our cue as to when the stock and real estate bubbles will truly be peaking.**)

To begin, I want to create a fictitious chart of the pattern I am looking for in terms of shape and duration:



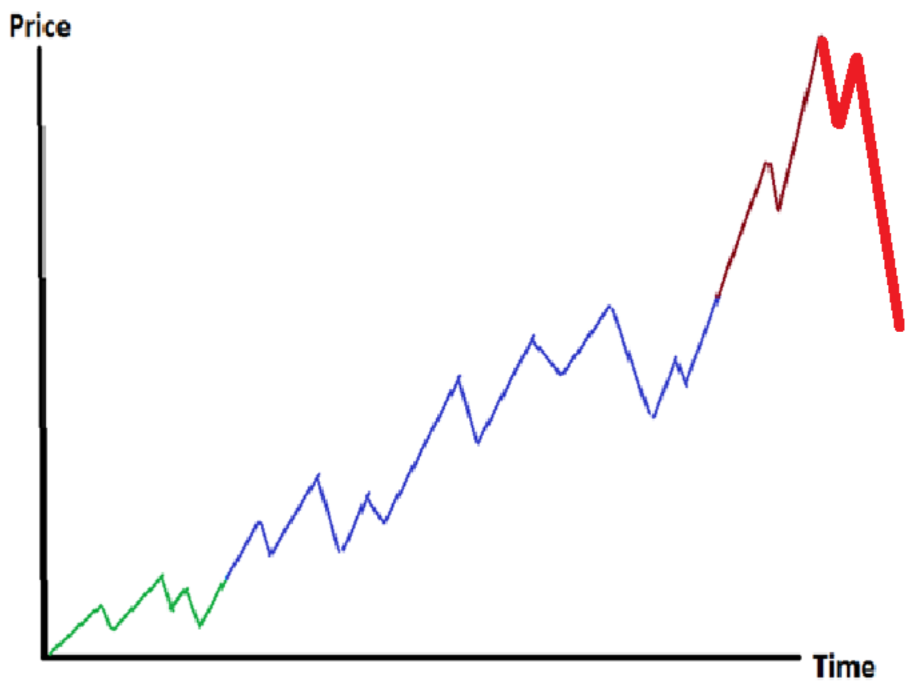
The first section in green represents the “initial” BULL leg in the market. It takes about 35% of the time to complete and is often met with lots of skepticism from the previous BEAR market fears.

The second section in blue represents the “stable” BULL leg in the market. It takes approximately 50% of the time to complete and is always the most comfortable part of a

BULL market. During the second leg there is healthy debate about the BULL market and investors will often increase their overall exposure to the BULL market by adding a greater percentage of their investible assets.

The third section in magenta represents the "bubble" BULL leg in the market. It takes only 10% - 15% of the time to complete and can represent as much as half the total gain that the BULL market makes! During this phase, all doubts are dispelled…investors and speculators and everyone else for that matter are aware of what is happening. The BULL has only small setbacks that rarely last more than a couple of days. "**Overvaluation" does not bring it to its end, "news" does not bring it to its end…only "exhaustion" will stop the relentless move higher.**

And that brings us to what the end will likely look like for the "bubble in everything" bubble!

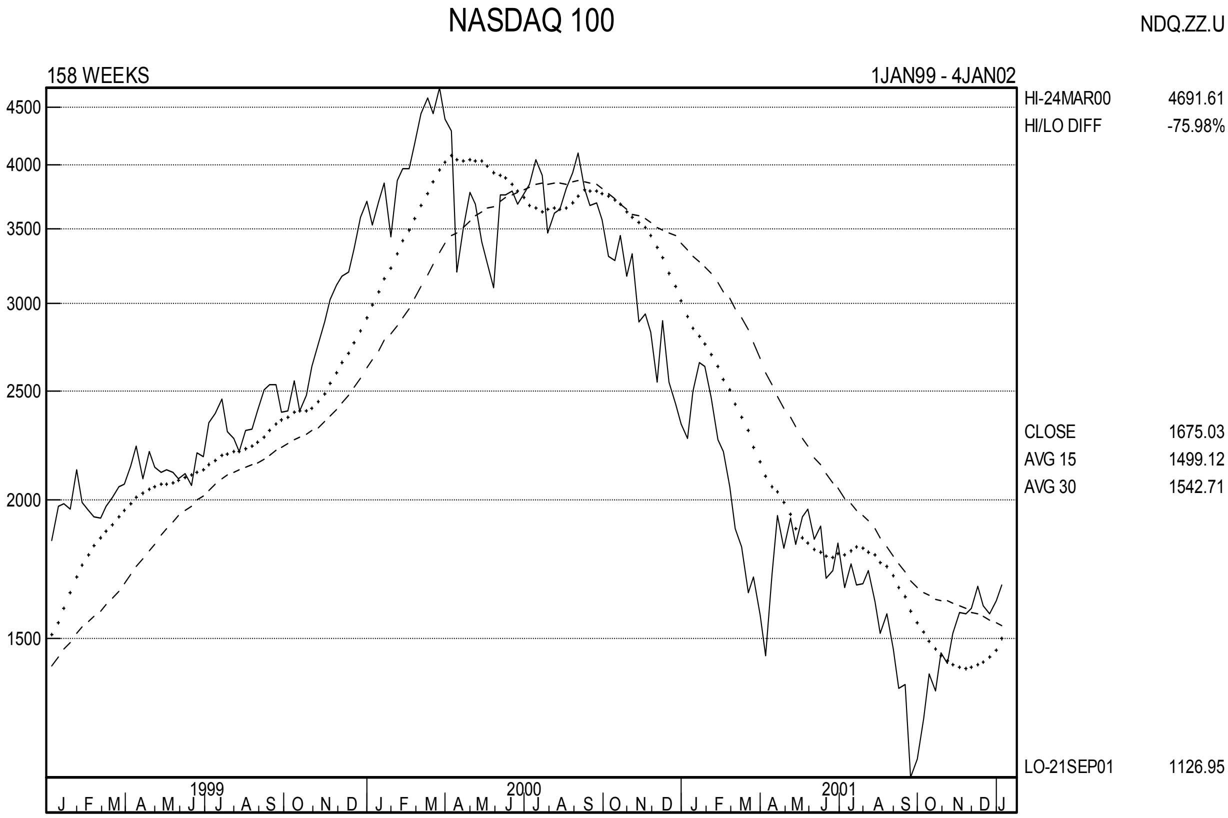


I just recopied the BULL market chart into the weekly and added the thick, red line to show what the typical completion pattern looks like. The first leg of the BEAR market starts with an 8% - 12% decline that is followed up by a recovery that takes the market back to near all-time highs again.

Then, the market begins to break down. All of a sudden, news matters…valuation matters…the constant flow of up days for the market ends and 4 out of 5 days become down days. The other key: The volume of trade on down days starts to become huge vs. the volume on up days.

The key to remember is that it is rare the "bubble" just bursts and goes straight down. Usually there is an "echo bubble" rally…but you have to recognize it as an "echo bubble" and not a continuation of the BULL market.

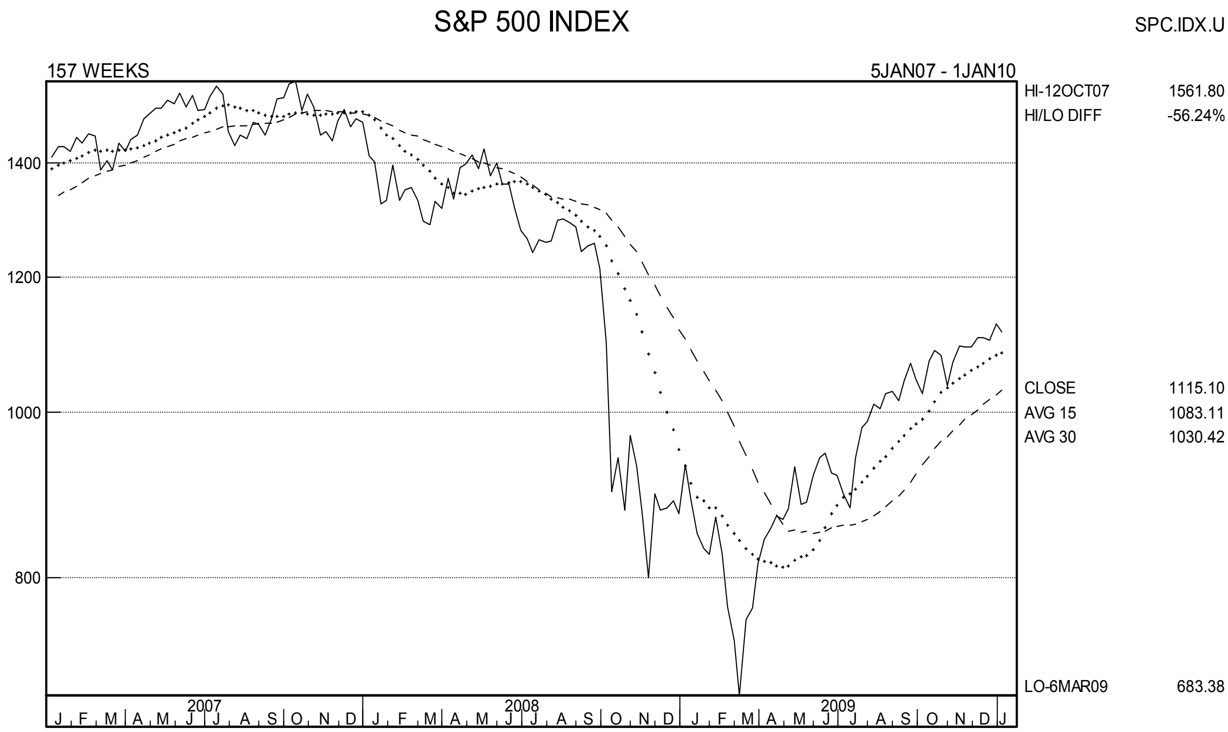
To finish this section, let's look at the real life examples of the peaks of the stock market BULL markets of 1999 – 2001 and the 2007 – 2009:



The NASDAQ 100 was the bubble at the turn of the century. Above you can see the third leg higher that started in October 1999 where the NASDAQ nearly doubled in 8 months!

As the bubble burst, you can see how there was a recovery trade that stretched out the rest of 2000 before, finally, falling over 80% to its terminal low.

The 2007 – 2009 bubble shows a different type of peak. The reason is that the "bubble" in 2007 was not the stock market…it was the mortgage market! The stock market was the second derivative of the bubble…and that is why the peak is not as pronounced. That said, the decline was exactly as expected.



Notice how we don't see the sharp move higher in 2007…the top is more of a rolling top. But if we looked at the U.S. mortgage and housing markets at that same time period, they both would have looked much more like the NASDAQ chart shown earlier.

To conclude, let's go to the "heart of the bubble" of 2017. The chart is of the **PRICE** of the 10 year U.S. Treasury bond. Friends, **the bubble that enables all of the bubbles in 2017 is the bond bubble.** Low interest rates are the heroin all of the asset markets require to be irrational!

The 2009 to 2017 time span represents the era of quantitative easing, central bank manipulation, and the absolute explosion in global debt due to the unprecedented low levels of interest rates. The price of the U.S. 10 year bond made its rapid ascent and now has started to correct. (Thin blue circle in chart above)

If the real estate bubble and stock market bubble are going to make their final long term highs…then the bond bubble that enables all the other bubbles, must conclude it near 40 year BULL market!

Inflation fears grow…they are like kryptonite to the bond markets. The story continues to unfold…

What to Do?

Tactical modeling will adequately control the risk of the bubble bursting in a historically normal manner. The TEAM models are completely comfortable with the present situation.

Stock markets are over-bought and due for a 1%-2% pullback before going higher. In the bubble phase, even one or two percent may be too much of a pullback to expect!

We will continue to watch for signs that the asset "bubble" is completing its run to exhaustion. Stocks have not even completed their up move so there is no reason to get too BEARISH there.

Real estate is showing more "end of bubble" dynamics than stocks. Volumes are drying up…the market is no longer impervious to news. As the Spring busy season comes upon the real estate market, a surge in volume is required to signal the bubble has further to go. We will watch that market with interest.

These truly are interesting times that will be spoken of historically for many years.

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