Risk-O-Meter

All hands on deck warning!

The *Risk-O-Meter* stays on a buy this week, but risks continue to increase for now.

All of the credit market trends we analyze in the *Risk-O-Meter* have flipped to a warning sign. This is one of my favorite areas of the market to look at because historically, credit markets have been better at flagging risk in the markets before the stock market.

Volatility is also flashing warning signs and is in the red zone.

Right on the edge is market breadth. Were this situation worsen in the near term, the *Risk-O-Meter* will hit the "sell" button. We are not there just yet. It might take about a 7% decline from here to flash the sell signal based on current conditions.

Market breadth is critical because one of the defining characteristics of the market advance since the COIVD lows over a year ago has been broad participation from many stocks.

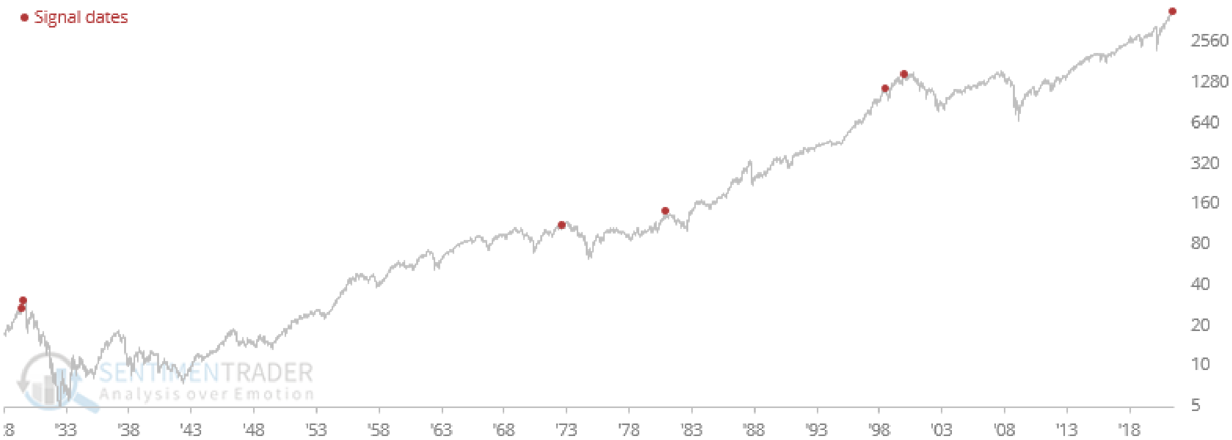
While most stocks have followed the major market trends, there are signs that this massive bullish move may be running out of steam.

The chart below, courtesy of SentimenTrader.com, illustrates what has happened when the S&P 500 continues to make new highs regularly, but many stocks start to trade below their 50-day moving average.

One such signal just occurred for only the seventh time since the 1920s.

The results are sobering.

S&P 500 after 5 days in past 3 weeks with a new high and < 60% of issues > 50-day avg



Signals (7)	1 Week	2 Weeks	1 Month	2 Months	3 Months	6 Months	1 Year
Median	**0.5**	**0.7**	**-3.5**	**-6.6**	**-2.4**	**-3.6**	**-10.0**
% Positive	**57%**	**50%**	**33%**	**17%**	**50%**	**33%**	**17%**
Avg Risk	-0.2	-1.1	-5.4	-9.2	-9.4	-13.6	-18.5
Avg Reward	0.8	1.4	1.4	1.4	3.0	5.6	5.6
% Big Drop	29	33	50	67	67	50	67
% Big Rise	14	33	17	17	17	17	0
Z-Score	0.3	0.2	-2.4	-2.0	-0.7	-1.5	-2.4

© SENTIMENTRADER Numbers are % return after signal; Risk = avg max loss; Reward = avg max gain; Z-Score +/- 2 suggests significance.

As the chart shows, when this rare signal occurs, losses pile up. Over multiple periods from a month to a year, the historical performance is down. The one-year historical performance shows a decline of 10%. What's more, the performance has been positive only 17% of the time.

The average maximum loss is 18.5% compared with an average maximum gain of 5.6%. Poor risk/reward ratios don't get much worse than that.

In fact, in each period, the performance has been positive 50% of the time or less.

It is best not to anticipate sell signals in the *Risk-O-Meter.* Everything could resolve itself too. Last week I noted the market was overdue for a big bounce in smaller stocks.

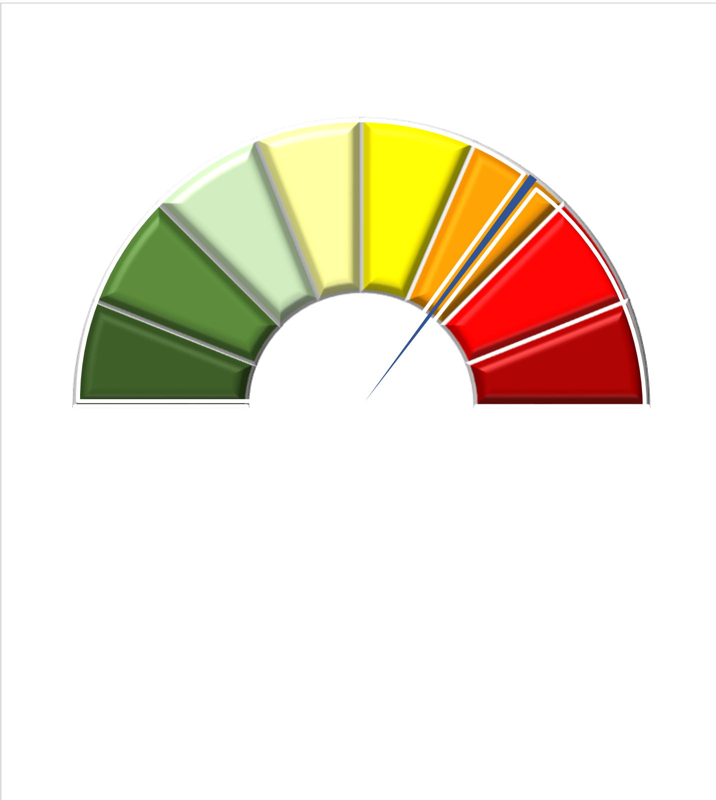
One area that is likely to lag any market downturn is the level of bullishness. The spread between the bulls and the bears is the least predictive indicator we look at over at *Risk-O-Meter* headquarters.

Our analysis shows that most people use it the wrong way. Typically, contrarians bet against heavy bullishness. However, our analysis of the data indicates that those bulls need to aggressively move into the bear camp. As that is happening, there is a lot of selling pressure on the markets.

Of course, those investors (speculators actually) get too bearish, which becomes a signal to buy.

The slight dip in the market recently caused the level of bulls to fall sharply. However, the number of bears didn't budge much. It's still way too low. The current situation leads me to believe that it will be excruciating when the next significant downturn comes because all other indicators will flip first. Then the market sentiment will start to shift. This will accelerate the amount of selling. Selling always overshoots. So, what might be a typical 15% decline in a healthy market could turn into a 40% decline.

For now, we are still on a "buy."



Lastly, Bitcoin is a hot topic, and I wanted to share with you a good article I read on *Advisor Perspectives*. Recently, Nassim Taleb, famous for writing *Black Swan*, has come out negatively on Bitcoin despite being an early supporter of cryptocurrencies.

He lays out his case for why they are worthless. I’m not sure I agree with everything he says, except I do not believe Bitcoin is currency. We agree on that point.

I have condensed the link for you below. If this does not work, type Taleb Bitcoin *Advisor Perspectives* into your favorite search engine, and the article should pop up.

RB.gy/le3rmm

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