SHOULD YOU TAKE SOME OFF THE TABLE?

Is it time for a correction? That is the question that has been on the mind of many investors for some time now. Those who have ridden the wave since the ugly market bottom of March 2009 can afford to be worried as they weathered an uncertain recovery in the market and have generally seen their assets grow quite well. Unfortunately the fires of gloom were hot after the financial crisis with the media fanning the flames of pessimism. Therefore many late arrivers to the market may still be struggling to reestablish their previous portfolio values.

TIME

There are numerous reasons to be concerned about equity values at these levels. Just time alone without a meaningful correction (last 10% correction was in 2011) presses the case for one. Historically the market has pulled back more frequently than in recent periods

> ***According to the Wall Street Journal's Marketwatch, since 1945 there were 27 corrections and 12 bear markets during the 66+ years examined. Taken together, they indicate the market typically has taken a break about every 20 months on average. The average decline during these 27 episodes has been 13.3% and they've taken an average of 71 days to play out (just over three months).***

BREADTH

Another factor signifying some concern is leadership within the markets themselves. Recent market rallies have been driven by the price increase of fewer and fewer companies. Some very popular but overvalued companies with large market capitalizations have carried the indexes. Taken together, Tesla, Netflix and Amazon, while great companies with great products and services, have built market values of over $300 Billion dollars without much, if any earnings between them. The problem with the meteoric rise is there is little in underlying earnings to cushion a fall should the market go into a correction. We call this weak breadth in the market as fewer stocks are supporting the market indices.

ECONOMY

Numerous pundits have chortled over the year that politicians don't worry about government debt because inflation will allow future generations to pay back the debt with much cheaper dollars (or other national currency). Inflation is the battle we have all been taught to fight and worry about for many years. China's investments over the years in physical commodities inflated prices to higher levels but as their growth has cooled so have commodity prices. Slowing in China has affected growth in all economies and sparked worries about deflation. Over the years we have benefitted from "Dis-inflation" with lower prices in a still growing economy. Deflation on the other hand is the lack of growth in prices and economic activity, experienced when overall demand does not meet the market's supply levels. And while consumers and businesses may benefit, some enterprises will suffer in this arena if prices remain too low for too long. Analysts had been expecting a recovery in growth in the second half of the year but that is now less certain as falling prices may be signaling slower economic growth. Hopefully the low cost benefits will kick in and stimulate our consumer driven economy.

SENTIMENT/MOMENTUM

Investors in the market since the financial crisis weathered historical levels of uncertainty and have been rewarded in the recovery. As higher valuations make stocks a bit less attractive momentum factors have come into play where chart readers gauge the strength of stocks not so much by fundamentals but by rate of change in the stock price. Chasing stock prices that are "acting well" relative to the market but devoid of any fundamental backstop can lead an investor into holdings that may not end well when enthusiasm subsides. As discussed in earlier paragraphs these momentum stocks have been carrying the market averages. Normally this type of investment euphoria occurs when investors are giddy with excitement for the market. This is not true today as investors are much less optimistic than in other similar periods. Less investor euphoria may point to available reserves for future market advances.

Corrections can be arbitrary in timing and unpredictable but more likely when stock prices are higher and uncertainty is in the air. So overall there are reasons to be concerned about the market and we have been sitting on reserves (some say for too long) looking for opportunities that a market correction and volatility within weak sectors may provide.

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"It's what you learn after you know it all that counts"
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A fool and his money are soon parted. Investment capital becomes a perishable commodity if not handled properly. Be serious. Pay attention to your financial affairs. Take an active, intensive interest. If you don't, why should anyone else?

There is no free lunch. Risk and return are interrelated. Set reasonable objectives using history as a guide. All returns relate to inflation. Better to be safe than sorry. Never up, never in. Most investors underestimate the stress of a high-risk portfolio on the way down.

Don't put all your eggs in one basket. Diversify. Asset allocation determines the rate of return. Stocks beat bonds over time.

Never overreach for yield. Remember, leverage works both ways. More money has been lost searching for yield than at the point of a gun (Ray DeVoe).

Spend interest, never principal, If at all possible, take out less than comes in. Then a portfolio grows in value and lasts forever. The other way around, it can be diminished quite rapidly.

You cannot eat relative performance. Measure results on a total return, portfolio basis against your own objectives, not someone else's.

Don't be afraid to take a loss. Mistakes are part of the game. The cost price of a security is a matter of historical insignificance, of interest only to the IRS. Averaging down, which is different from dollar cost averaging, means the first decision was a mistake. It is a technique used to avoid admitting a mistake or to recover a loss against the odds. When in doubt, get out. The first loss is not only the best, but is also usually the smallest.

Watch out for fads. Hula hoops and bowling alleys (among others) didn't last. There are no permanent shortages (or oversupplies). Every trend creates its own countervailing force. Expect the unexpected.

Act. Make decisions. No amount of information can remove all uncertainty. Have confidence in your moves. Better to be approximately right than precisely wrong.

Take the long view. Don't panic under short-term transitory developments. Stick to your plan. Prevent emotion from overtaking reason. Market timing generally doesn't work. Recognize the rhythm of events.

Remember the value of common sense. No system works all of the time. History is a guide, not a template.

This is all you really need to know.

TW Advisors does not necessarily agree with the opinions of the outside commentary.