“This Fed, massively dominated by academic Keynesians, has demonstrated that the conditions for normalizing rates are far more stringent than many of us had been led to believe from the speeches of the FOMC members themselves. This is a Federal Reserve with hundreds of staff economists who create numerous models to guide their actions. The fact that none of these models have been anywhere close to right for decades should give us pause. Indeed, in her press interview Yellen admitted that the models don’t appear to be working.”

– John Mauldin, *Thoughts From The Front Line*

The great Yogi Berra passed away a few days ago. His famous disjointed sayings, known as Yogisms, have been quoted by many and are fixtures of the American lexicon.

While having a coffee with my daughter yesterday, I asked if she knew about Yogi Berra. She paused, “Do you mean Yogi Bear as in ‘is that a pick-a-nick basket booboo’?” I smiled and said no, Yogi Berra the great NY Yankee. Knowing I was aging myself, we laughed at our generation gap.

Most of his Yogisms are either paradoxical or obviously redundant. Here are just a few of the memorable Yogisms that came from the Hall of Famer:

- “It ain’t over till it’s over.”
- “When you come to a fork in the road … take it.”
- “I didn’t really say everything I said.”
- “I always thought the record would stand until it was broken.”, and
- “It’s déjà vu all over again.”

Janet Yellen backpedaled a little this week stating she expects to raise rates this year. Perhaps it was the unexpected negative message the market sent her way after last week’s surprisingly dovish Fed comments. The Fed is losing credibility. From Greenspan to Bernanke to Yellen, it sure feels to me like “déjà vu all over again”.

I’m in NYC at ETF Trends annual “ETF Boot Camp”. I have many notes and hope to share some of the...
high level highlights with you next week. Much learned!

Today, let’s zero in on recessions and Trade Signals. There are a number of charts but it’s a short read.

Included in this week’s On My Radar:

- Recession Watch – Some Valuable Indicators (Recession is Nearing)
- Trade Signals – HY, S&P and DJIA Support Levels, Sentiment and Trade Signals

Recession Watch

“What scares me, or what worries me, is what the next downturn in the economy looks like, with asset prices where they are and a lesser ability of central banks to ease monetary policy.” – Ray Dalio with Bloomberg’s Tom Keene

There are two charts I favor that look at timing the start of recessions that I share with you today. Why are recessions so important to get in front of? Because the most serious market declines happen during recessions.

Chart 1: Global Recession Probability Model

There have been 10 recessions since 1970. The model, with a current reading above 70 is currently signaling global recession. With a current reading of 79.5, we are in the zone where recessions have happened 86.62% of the time. That is roughly 9 out of the last 10. We should stand alert. Here are the statistics (data 1950 to present):

Model vs. Actual Recession

- Readings above 70. Recession has happened 86.62% of the time. No recession when above 70 happened 13.38% of the time.
- Readings Between 30 and 70. Recession happened 47.73% of the time. No recession 52.27% of the time.
- Readings below 30. Recession happened 13.97% of the time. No recession 86.03% of the time.

Not perfect but I don’t like the odds. Global recession looks highly probable right now.

This from NDR on the model: The model is based on the Amplitude-Adjusted Composite Leading Indicators (CLIs) created by OECD for 35 countries. Each CLI contains a wide range of economic indicators such as money supply, yield curve, building permits, consumer and business sentiment, share prices, and manufacturing production. There are usually five to ten indicators, which vary by type and weight, depending on the country, and are selected based on economic significance, cyclical behavior, and quality.

The NDRG Global Recession Probability Model uses a logistic regression method incorporating both the CLI level and trend data of all 35 countries to predict the likelihood of a global recession. A score
above 70 indicates high recession risks while a score below 30 means low risks.

The CLIs are normally released on the second Friday of each month for two months prior, or about a six-week lag. Meanwhile, the NDRG Global Recession Probability Model is a forward-looking model using a two-month lead in the CLI data. Source NDR.

Not perfect on predicting global recession but pretty darn good. I like to use the global recession model as it relates to my thinking around global equity exposure. Price momentum data is also helpful and to that end we have not been seeing EM or developed market equities showing up on our radar.

Let’s next take a look at the U.S. economy.

Chart 2: U.S. Recession Watch – My favorite U.S. recession forecasting chart: Currently Signaling No Recession

This is a systematic (rules based) process that looks to the stock market as a leading economic indicator. Data is updated monthly. Through the most recent full month-end, 79% of its signals, dating back to 1948, have been correct. My favorite U.S. recession forecasting chart is currently signaling no U.S. recession.

The U.S. model is currently signaling No Recession.

This is something you can track on your own (though I’ll continue to update the monthly results in this piece). Here is how to calculate:

- Signals are generated based on where the S&P 500 index is relative to its five-month smoothed moving average
- Economic Expansion is signaled when the S&P 500 index rises by 4.8% or more above its five-month smoothing
- Economic Contraction is signaled when the S&P 500 index falls by 3.6% or more below its five-month smoothing
- There have been 15 contraction signals generated since 1950 accurately predicting 9 of the 11 recessions. Missed were the 1953/54 and 1960 recessions. There were six false signals. Expansion signals fairly quickly reversed those contraction signals.
- There have been 14 expansion signals generated since 1950 accurately timing the end of 8 of the 11 recessions.
- In summary, the equity market is a very good leading economic indicator.

What you can do is reduce your equity exposure on sell signals. There are also a number of ways you can hedge your downside risk exposure. Remember that it requires a 25% return to overcome a 20% loss and a 100% return to overcome a 50% loss. The largest losses tend to come during times of recession.

It will be interesting to see what the September month-end data looks like. Stay tuned.

Next is data I have shared with you previously. In short, it details the market declines during a
recession. Note that while there is correction during all recessions, the largest declines come when your starting point is an overvalued, expensively priced market.

The following is just a few more data snapshots on recessions (sourced from the various regional Fed banks):

1. Kansas Fed prints -8 (missing expectations of -6), now negative for the seventh month in a row… something not seen outside of a recession.

Source: **Equity Valuations, Recessions and Market Declines**

* If you are not signed up to receive my weekly *On My Radar* e-newsletter, you can subscribe here. ♦

The following is just a few more data snapshots on recessions (sourced from the various regional Fed banks):

1. Kansas Fed prints -8 (missing expectations of -6), now negative for the seventh month in a row… something not seen outside of a recession.
2. Dallas...

3. Richmond...
4. Philly…

5. Chicago…
6. And Empire Fed…
Look – we get recessions. It is always unwelcome but ultimately healthy for the long-term successful growth of an economy. Another recession is in our near future. My best guess is 2016. Much depends on the creativity of the central banks. QE4, which I predict is coming, will kick the can farther down the road. Structural reform? Not without crisis.

The largest equity market declines occur during periods of recession; thus, the above data bears watching.

It looks like a recession storm is nearing.


Our CMG Managed High Yield Bond Program is back in a Sell signal. One of the things I’ve learned over my 20+ years of trading HY is that the HY bond market tends to be a good forward leading indicator for the stock market. I came across this chart from the Leuthold Group earlier this week. It shows the peak in credit and the subsequent peak in the S&P 500 Index (red arrow 2007). The chart on the right shows the peak in credit on June 23, 2014.

![Credit Leads Stocks](image)

When yield spreads (or the difference in the yield that HY bonds yield compared to yields on safer bonds) widen, it represents an increase in the risk environment and a correction in the equity market typically follows. In this regard, the HY bond market is a pretty good leading indicator.

As we have been noting for several months, risk remains high. Overall, the weight of trend evidence remains bearish. Here is a summary of this week’s Trade Signals:
Included in this week’s Trade Signals:

- Cyclical Equity Market Trend: Sell Signal
  1. CMG NDR Large Cap Momentum Index: Sell Signal
  2. 13/34-Week EMA on the S&P 500 Index: Sell Signal
  3. NDR Big Mo: Neutral – Nearing a Sell Signal
- Volume Demand is greater than Volume Supply: Sell signal for Stocks
- Weekly Investor Sentiment Indicator:
  NDR Crowd Sentiment Poll: Extreme Pessimism (short-term **Bullish** for stocks)
  Daily Trading Sentiment Composite: Extreme Pessimism (short-term **Bullish** for stocks)

- Don’t Fight the Tape or the Fed: Indicator Reading = -1 (**Negative for Equities**)
- U.S. Recession Watch – My Favorite U.S. Recession Forecasting Chart: **Signaling No Recession**
- The Zweig Bond Model: **Buy Signal**

Click here for the link to the charts.

**Personal note**

Recession talk is a bit depressing; yet, I believe it all depends on which lens we choose to view it through. There are a vast array of tools that enable you to build truly diversified portfolios. Not all investment risks drive return in the same way. ETFs are one example of a very liquid and diverse tool. Today the plan is to participate and defend. The next recession will bring great opportunity unless your portfolio is overweight equities and ultra-low yielding bonds. Stay tactical and prepared to act when a recession sets the stage for the next great opportunity. Unfortunately, many won’t be in a position to strike.

Separately, I found the below articles to be very exciting from an innovation prospective. I hope you find them as interesting as I did.

- **This Robotic Hand Wired to a Brain Implant Restored a Paralyzed Man’s Sense of Touch**

  **What it is:** DARPA researchers were able to restore near-natural human sensation in a 28-year-old man who was paralyzed for over a decade using robotic prosthetics, brain implants and sophisticated neural technologies. Researchers placed electrode arrays on the paralyzed volunteer’s motor cortex and sensory cortex, tying those arrays to a mechanical hand. In testing, he performed with nearly 100 percent accuracy.

  **Why it’s important:** Traditionally, robotic arms wired to brain implants have enabled paralyzed individuals to act, but without sensory information. DARPA program manager Justin Sanchez says that this innovation “completes the circuit,” enabling “seamless biotechnological restoration of near-natural function.”

- **First Superconducting Graphene Created**
What it is: University of British Columbia physicists have created single-layer superconducting graphene — a world first — by coating the graphene with lithium atoms in ultra-high vacuum conditions. They hope to eventually use this superconducting graphene to produce super-fast transistors, transparent electrodes, semiconductors and sensors.

Why it’s important: As KurzweilAI points out, superconductive graphene wires would have “zero resistance at ultra-low temperatures (at a critical temperature of about 5.9K), so a current flowing through it would generate no heat.” This development enables nanoscale quantum devices and graphene electronics that don’t overheat.

- **Qualcomm’s Quick-Charge Tech Will Get Your Battery Back To Full in Under an Hour**

What it is: Qualcomm has debated Quick Charge 3.0, which can charge a smartphone to 80 percent of its capacity in 35 minutes — which means that it can charge most devices to a full battery in under an hour. The key is Qualcomm’s Intelligent Negotiation for Optimum Voltage, which supports new voltages in 200mV increments and makes the overall charging process more efficient.

Why it’s important: As our lives become increasingly gadget-centric, battery life is everything (ABC = Always Be Charging). When mobile users can charge their dead phones in minutes, they can do more resource-intensive work without battery anxiety. Source: Abundance Insider.

I’m walking away from my friend, Tom Lydon’s, ETF Boot Camp with a wealth of new information—Branding and Messaging, Digital Marketing and Social Media, The Shape of ETFs to Come, Regulatory issues, ETF Strategists and the Rise of the No Transaction Fee Platform and perhaps most importantly, new relationships – Blackrock, Bloomberg, State Street, Powershares, Fidelity, Schwab, TD, NYSE, NASDAQ. I learned a great deal.

I’m also going visit and do some brainstorming with my good friend John Mauldin.

The Morningstar ETF Conference is next week and Dallas follows on October 8 (I’ll be speaking at a Bloomberg sponsored advisor event). I’m also going to visit my good friend John Mauldin.

Here is a toast to the opportunities the next recession will present to us and a toast to being in a strong position to act. I’m working hard on a new white paper titled, The Total Portfolio Solution. It is about combining a number of diverse low-correlating assets and strategies and knowing when to tactically overweight and underweight various exposures. Stay tuned!

* If you are not signed up to receive my weekly **On My Radar** e-newsletter, you can subscribe here. ♦

With kind regards,

Steve

Stephen B. Blumenthal C
hairman & CEO
Stephen Blumenthal founded **CMG Capital Management Group** in 1992 and serves today as its Chairman, CEO and CIO. Steve authors a free weekly e-letter titled, *On My Radar*. The letter is designed to bring clarity on the economy, interest rates, valuations and market trend and what that all means in regards to investment opportunities and portfolio positioning. [Click here](#) to receive his free weekly e-letter.

**Social Media Links:**

CMG is committed to setting a high standard for ETF strategists. And we’re passionate about educating advisors and investors about tactical investing. We launched CMG AdvisorCentral a year ago to share our knowledge of tactical investing and managing a successful advisory practice.

You can sign up for weekly updates to AdvisorCentral [here](#). If you’re looking for the CMG White Paper *Understanding Tactical Investment Strategies* you can find that [here](#).

AdvisorCentral is being updated with new educational resources we look forward to sharing with you. You can always connect with CMG on Twitter at [@askcmg](https://twitter.com/askcmg) and follow our LinkedIn Showcase page devoted to tactical investing.

**A Note on Investment Process:**

From an investment management perspective, I’ve followed, managed and written about trend following and investor sentiment for many years. I find that reviewing various sentiment, trend and other historically valuable rules based indicators each week helps me to stay balanced and disciplined in allocating to the various risk sets that are included within a broadly diversified total portfolio solution.

My objective is to position in line with the equity and fixed income market’s primary trends. I believe risk management is paramount in a long-term investment process. When to hedge, when to become more aggressive, etc.

Trade Signals History: Trade Signals started after a colleague asked me if I could share my thoughts (Trade Signals) with him. A number of years ago, I found that putting pen to paper has really helped me in my investment management process and I hope that this research is of value to you in your investment process.

**Provided are several links to learn more about the use of options:**

For hedging, I favor a collared option approach (writing out of the money covered calls and buying out of the money put options) as a relatively inexpensive way to risk protect your long-term focused equity
portfolio exposure. Also, consider buying deep out of the money put options for risk protection.

Please note the comments at the bottom of this Trade Signals discussing a collared option strategy to hedge equity exposure using investor sentiment extremes is a guide to entry and exit. Go to www.CBOE.com to learn more. Hire an experienced advisor to help you. Never write naked option positions. We do not offer options strategies at CMG.

Several other links:


https://www.trademonster.com/marketing/upcomingWebinarEvents.action?src=TRADA2&PC=TRADA2&gclid=CKna3Puu6rwCFTRo7AodRiQA1w

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