Disciplined Wealth Management

09/30/2021 Quarterly Newsletter

Discipline is the key to success

With every approach to the stock market, bear in mind that there will always be periods of over-performance and periods of under-performance. Here at Disciplined Wealth Management (DWM), our goal is to concentrate your portfolio in the leading asset classes while avoiding the performance-sapping lagging asset classes; over the long term, our approach strives to provide you with better performance compared to the overall stock market average (the S&P 500) and with less risk. In summary – stay disciplined during times of under-performance; don't become emotional and abandon a proven long-term strategy during a usually short period of under-performance, but stick with it and let the strategy work for you. If someone says they are never wrong, they have just proven themselves otherwise.

General Commentary—

China's Evergrande

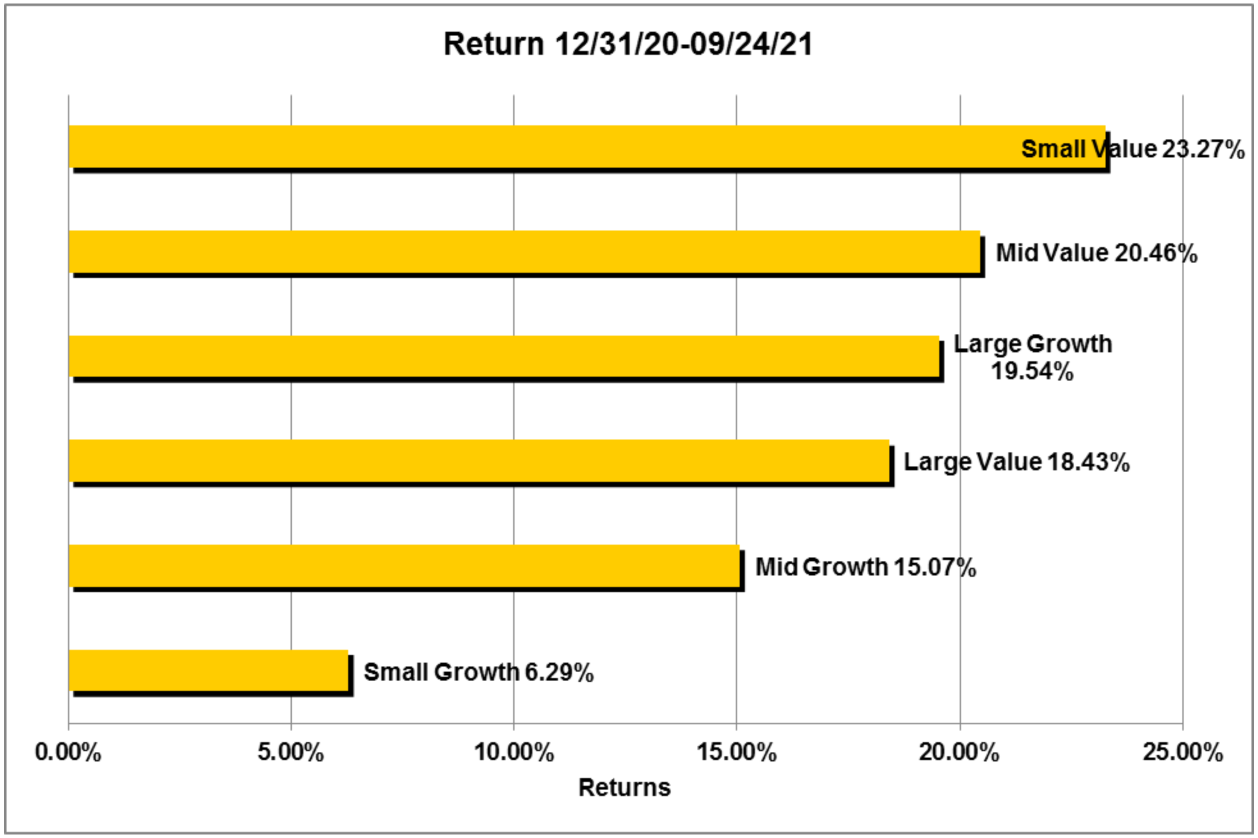
The potential default of Evergrande, China's largest and most indebted property firm, sent markets into a frenzy earlier last week amid concerns of another failure like Lehman Brothers during the financial crisis of 2008. The possible demise of Evergrande puts China's economy, which remains fragile in the face of COVID, at further downside risk. Although we think that a Lehman moment is unlikely, the possible costs of restructuring and the risk of more defaults will add to China's long-term challenges in achieving strong potential growth.

While most of Evergrande's business activity has been in the property market, the company has had its hand in healthcare, electric cars, bottled water, theme parks, and even soccer teams. Several of those ventures were aligned with government goals. Over the years, the conglomerate has used leverage to fuel rapid expansion, accumulating a reported $300 billion in debt, or about 2% of China's 2020 Gross Domestic Product (GDP). This makes the risk of default a great concern.

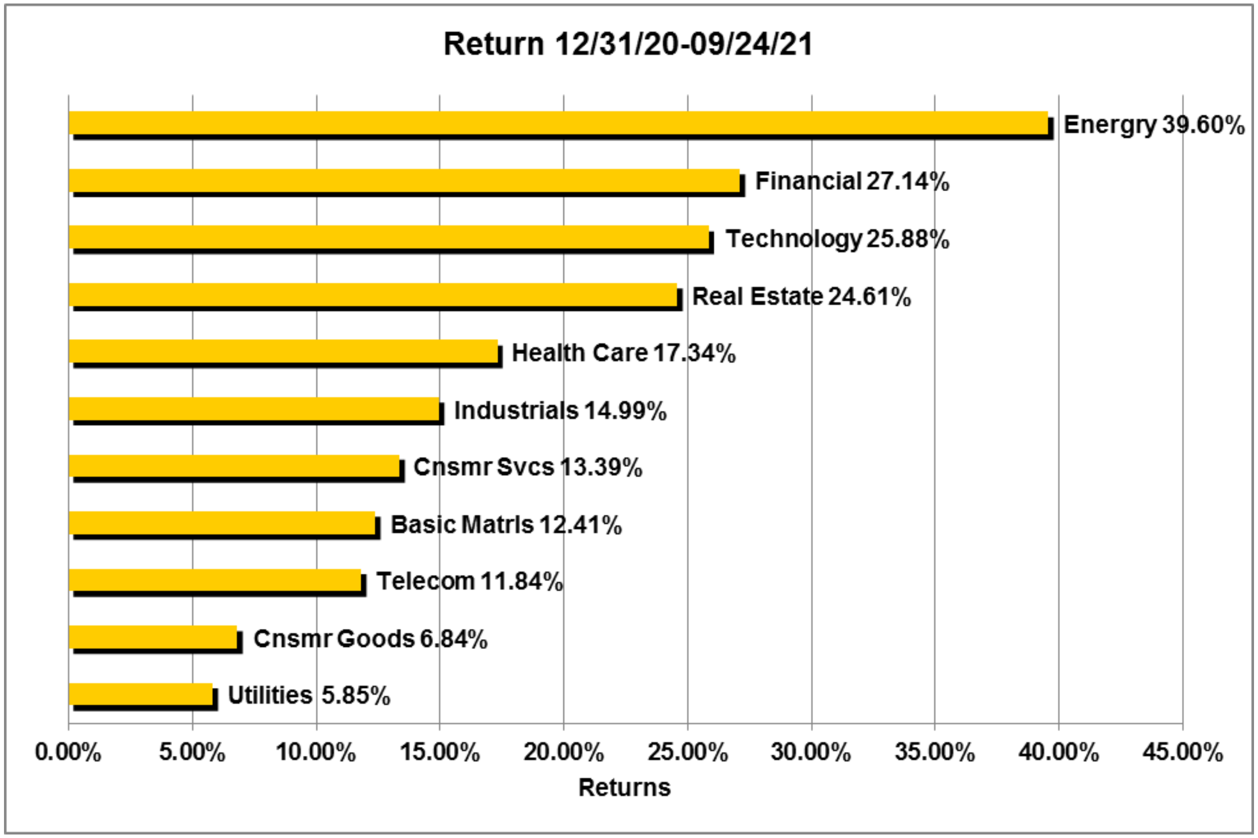
Much of Evergrande's recent demise has been the government's doing. For years, it has been trying to stem growth in the property sector by making the it safer and reducing leverage. Last year's "three red lines policy" restricted debt accumulation in the property sector by capping liability to asset ratios and net debt to equity ratios, which has caused real estate conditions to ease. This creates problems for a highly indebted company that reportedly uses its property holdings as collateral to fund projects and pay off debts.

As we go to press, the overall Market Environment Indicator (MEI) remains bullish and 100% invested. We will continue to monitor this indicator and make the necessary adjustments. For an individual performance review, please call 303-471-5189. Please note that, in the following pages, the performance charts for certain asset classes showing year-to-date returns, are for illustration purposes only and do not reflect our Relative Strength Analysis (RSA) system.

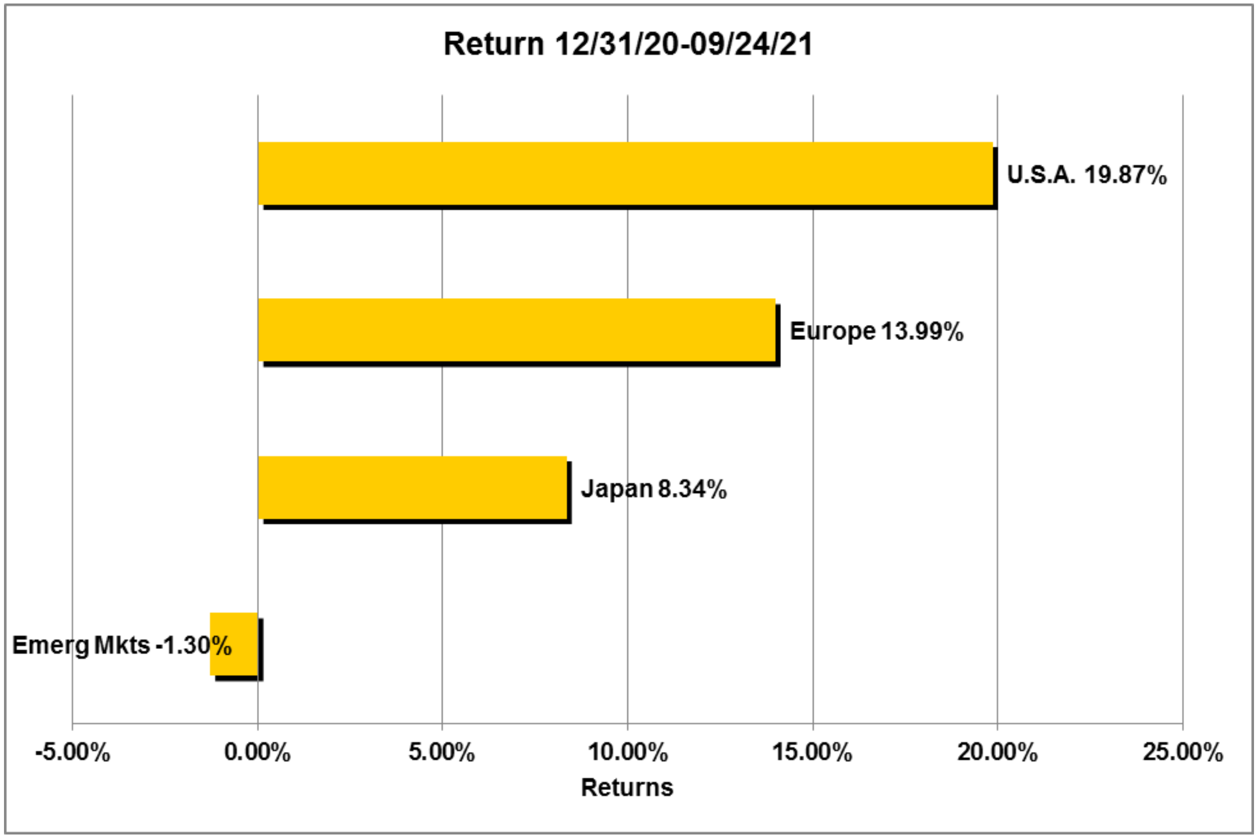
Style Boxes — As of September 24, 2021, Large Growth jumped three spots in my RSA to claim the number one position. Mid Growth also moved up three positions to finish in second place. Mid Value and Large Value both fell one position to finish in third and fourth place in my RSA. Small Value experienced the largest drop, falling four positions to finish in fifth place. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Style Boxes.



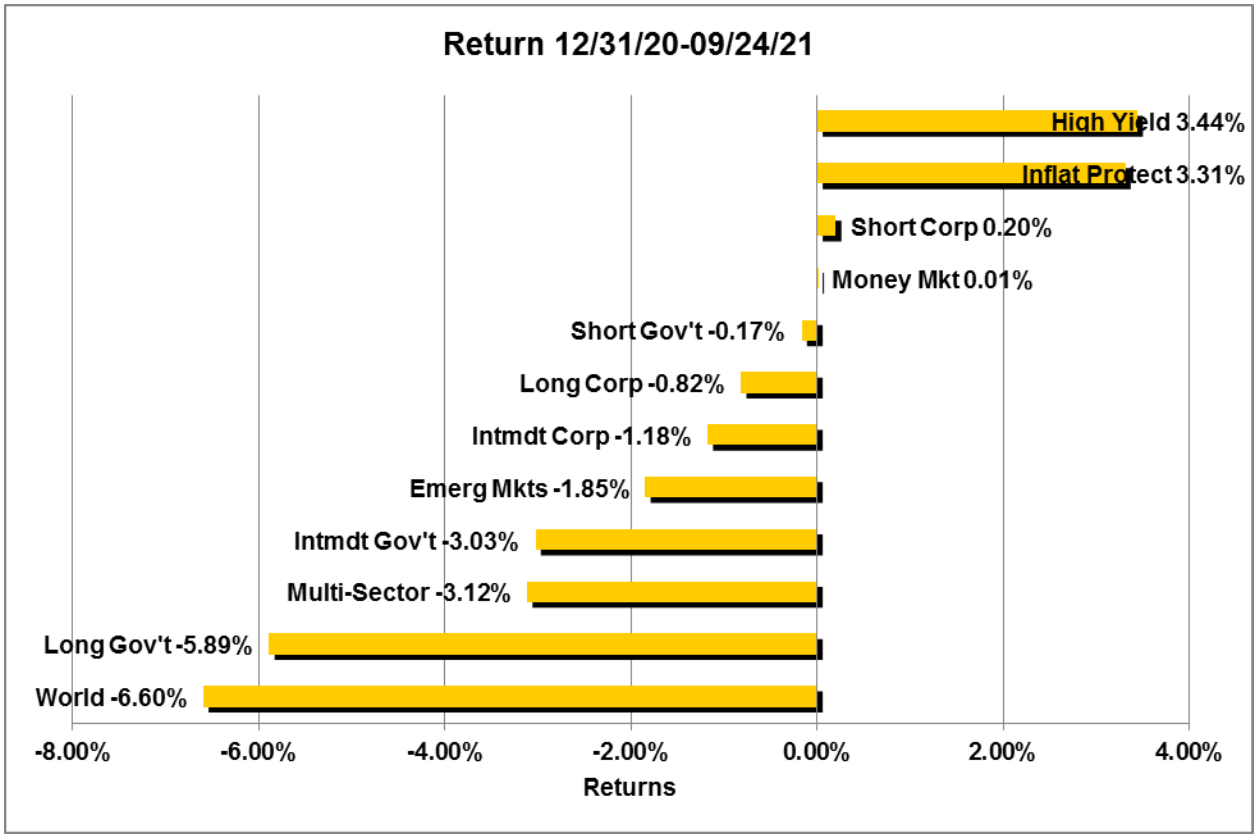
Sectors — As of September 24, 2021, Technology moved up three spots to claim the number one position in my RSA. Health Care experienced the largest move up to claim the third spot. Real Estate moved up one position to finish in second place. Financial Services fell two positions to round out the top four. Basic Materials dropped the most in my RSA, falling six positions to finish in dead last at eleventh place. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Sectors.



Internationals — As of September 24, 2021, not much rotation took place in my RSA surrounding Internationals. The U.S.A. continues its strong hold on the number one position, which comes as no surprise with the widespread availability of vaccines. Europe continues to hold its own at the number two position. Japan and Emerging Markets switched positions finishing in third and fourth place. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Internationals.



Bonds — As of September 24, 2021, Long Gov't experienced the largest jump in my RSA moving up eleven positions from dead last to the number one position. Long Corp came in second place with the largest move up, jumping six positions to finish in third place. Inflation Protection continues its strong hold on the number two position. Emerging Market moved up three positions to round out the top four. Multi-Sector experienced the largest drop in my RSA, falling six positions to finish in dead last at number twelve. As usual, we will continue to rely upon our time-tested RSA to guide our investments in Bonds.



Forecast —

Q4 Gains bigger in Secular Bulls!

Q4 is historically strong, typically the best quarter of the year. On average Q4's performance for the S&P 500 and the Dow Industrials is at least twice the move higher than any other quarter. The Nasdaq Composite appears to march to a different drummer; Q4 is strong but not as big of over-performer on a relative basis.

	Q1	Q2	Q3	Q4
Dow Jones Industrials (1949-June 2020)				
Average	2.0%	1.8%	0.6%	3.9%
Post-Election	-0.1%	1.7%	0.5%	4.2%
S&P 500 (1949-June 2020)				
Average	2.1%	1.9%	0.8%	4.0%
Post-Election	-0.2%	2.2%	0.9%	3.6%
NASDAQ Compostie (1971-June 2020)				
Average	4.1%	3.7%	0.4%	4.2%
Post-Election	-1.2%	6.3%	2.5%	5.0%

Source: Stock Trader's Almanac 2021

In post-election years, the S&P's performance has been slightly weaker than average, while the Dow and NASDAQ have fared better than average.

Historically, weakness in August and September (note weak Q3 performance) has set the stage for good market gains in Q4.

- August has been the weakest month of the year since 1987, for the Dow, S&P and NASDAQ. A trivia point, "Harvesting made August the bests stock market month from 1901-1951", according to the Stock Traders Almanac.
- With a different starting point of 1950, September ranks as the weakest month of the year for all three indices.

Seasonal weakness in Q3, has often set the stage for new uptrends starting in Q4. October is known as the 'bear killer', marking the end of 12 post WWII bear markets. Drilling down and separating Q4's performance between secular bull and bear markets, shows Q4 could be better than history suggest for 2021!

Dates	Secular Bull Q4 % Change	Secular Bear Q4 % Change
12/31/49-11/29/68	5.1%	
11/29/68-8/12/82		1.5%
8/12/82-3/24/00	5.1%	
3/24/00-10/3/11		2.5%
10/3/11-current	4.7%	
Average	5.0%	2.0%
% of positive Q4	85%	63%

Q4 in secular bulls generates an average return of 5.0% for the S&P 500, 25% higher than the norm! And positive Q4's occur 85% of the time.

Secular bulls last for decades with a chart pattern of higher highs and higher lows, consisting of a series of cyclical bull and bear markets. But they are not immune to recessions or financial crises. During the 1949-68 secular bull, the U.S. was handicapped with three recessions. The 1400% secular run from 1982-2000 wasn't derailed by a financial crisis in 1987 nor a recession in 1990. The current secular bull was hit hard with the 2020 pandemic induced recession but regained its feet and charged on to new highs.

By eliminating the Q4's in a recession or financial crisis during the past secular bulls, the average gain moves higher.

Eliminate Q4's in a Recession or Financial Crisis		
Dates	Secular Bull Q4 % Change	Secular Bear Q4 % Change
12/31/49-11/29/68	5.4%	
11/29/68-8/12/82		2.5%
8/12/82-3/24/00	6.7%	
3/24/00-10/3/11		3.2%
10/3/11-current	4.7%	
Average	5.7%	2.8%

With no reason to expect an outlier event like a recession or financial crisis this year, Q4 could produce an even bigger gain, 5.7%. From current levels, that would be +250 points on the S&P 500, taking it to record highs of +4600 by year end.

A current popular topic is 'how overdue the market is for a correction'. The last correction over 5% occurred almost a year ago, 10/12-10/30/20, a drop of 7.5%. Typically, 5%+ corrections occur about every 3 to 3.5 months, and 10%+ corrections happen about once per year. So, the data suggests that in fact the market is overdue, and one could occur at any time.

Looking at the last 6 cyclical bull markets (including the current bull) during secular bulls which represented 18.5 years of rising markets, the data is very different:

Corrections between Low to Peak in Cyclicla Bull Markets, S&P 500 Index							
Cyclical Bull Markets	# greater than 5% less than 10%	# Greater than 10%	Average Correction	Deepest Correction	# of Years with no corrections	Length of Bull Market, Years	Gain of Bull Market
10/11/90-7/17/98	10	1	-6.9%	-10.8%	2	7.8	301.7%
8/3/98-3/24/00	3	2	-8.5%	-12.1%	0	1.6	59.6%
10/3/11-7/20/15	6	0	-7.7%	-9.8%	0	3.8	93.6%
2/11/16-9/20/18	1	1	-7.9%	-10.1%	1	2.6	60.2%
12/29/18-2/19/20	2	0	-6.5%	-6.8%	0	1.2	44.0%
3/23/20-current 9/23/21	4	0	-7.6%	-9.6%	0	1.5	98.9%
Median Average			**7.1%**	**-9.9%**		18.5	

- Corrections over 5% but less than 10% occur only every 8.5 months on average.
- Corrections over 10% but less than 20% (which would signal the end of the bull market), occurred only 3 times. Only half of the cyclical bulls had a 10% correction before they eventually ended, and the other half never had a correction 10% or greater.

In a bull market, corrections are welcomed as they give investors excellent entry points for new money. The problem waiting for a correction is probably a poor strategy during a cyclical bull market within a secular bull. The corrections are elusive and investors stand to miss out on to much of the bull market gains.

Will this be the case? No one knows for sure and only time will tell. DWM, for one, will continue to rely upon its tactical tools to stay in line with the market's fluctuations. Always remember: the key to investment success is to stay disciplined and flexible in an ever-changing market environment. The moment you start to second-guess your decisions is usually when you shouldn't.

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Sources: Style box data = i-Shares Russell Indexes. Source: Investors FastTrack.
Sector data = DJ US Sector Indexes via I-Shares. Source: Investors FastTrack.
International data = i-Shares for Emerging Markets, Europe, Japan, S&P 500 Index for U.S.A. Source: Investors FastTrack.
Bond data = various bond exchange traded funds (ETF). Source: Investors FastTrack.