THE STOCKMAN letter

HOW TO PROTECT YOUR WEALTH

from the Next Market Crash

By David Stockman

Part I:
The Next Five Years

As daily events remind us, Imperial Washington's grip hasn't been this tenuous in decades. And, clearly, Wall Street is rattled.

Here's another way of addressing the immediate problem: Where are the dip-buyers these days?

It's a big question on the minds of many market participants, observers, critics, and cranks, as the S&P 500 gets up close and personal with the moving averages considered critical by all of them…

The fine folks at Bespoke Investment Group, for example, recently shared this chart:

What appears as a serenely smiling face there is nothing of the kind. Here's the technical explanation:

> *Besides providing a good case for why the stock market should be closed on bond market holidays, yesterday's equity market decline was disheartening from a technical perspective. Last week, bulls were all excited that the S&P 500 traded back above its 200-DMA after a short time below that level. With yesterday's decline, the stint above the 200-*

> *DMA was even shorter. It's also never encouraging to see a major index fail to hold onto its already downward sloping 200-DMA.*

These are signs that monetary central planning's 30-year party is over.

The Mother of All Yield Shocks

In April 2018, the yield on the 10-year U.S. Treasury note topped 3% for the first time since 2014.

The estimable Doug Kass provided context that's as relevant today:

> *Though rates still appear low by historic standards, the sizable climb in debt loads (in both the private and public sectors) and the continued fiscal profligacy will likely exacerbate the impact on the recent rise in yields by providing a governor to economic growth and by stirring a number of other adverse outcomes.*

That means even a relatively small increase in interest rates will have a really big impact on Wall Street… and on Main Street.

Let's talk about some of those "other adverse outcomes" Doug identified.

Because, taken together, they spell the end of the Federal Reserve's Bubble Finance regime.

Nobody seemed to care… until the fall of 2018.

Look, the Donald's first budget was a love letter to Imperial Washington, with $140 billion in new spending.

It also included massive borrowing requirements. The federal deficit was already at $1.2 trillion for 2018. And it's going higher.

At the same time, the Federal Reserve will shed $600 billion from its balance sheet.

The bond pits will be flooded with $1.8 trillion of "homeless" government paper.

That $1.8 trillion includes fiscal 2019 Treasury borrowing of $1.2 trillion.

It also includes $600 billion of bonds the Federal Reserve will be selling from its balance sheet. This is "quantitative tightening," the opposite of "quantitative easing."

Total public debt is roughly $21 trillion. That's an all-time high, as a percentage of gross domestic product. And a rise in interest rates could take debt service to nearly $1 trillion by 2025.

As Doug noted, "Never in the history of modern finance has a near decade-old domestic economic recovery faced this kind of financing hurdle."

Protectionism and the Chinese "debt bomb" also threaten U.S. Treasury markets. The Middle Kingdom could sell down its huge pile of U.S. Treasurys as a retaliatory strike in this still-emerging Trade War.

The European Central Bank is also a source of new U.S. Treasury supply through a "billiard ball" effect. The ECB bought Italian bonds, so Italian investors took that cash and bought higher-yielding U.S. Treasurys.

But the ECB, like the Fed, is turning from QE to QT.

And the U.S. will pay.

But a studied, sturdy indifference kept carrying stock prices ever higher.

Among those many evils of Bubble Finance is what might be called a sort of "Truman Show Effect."

Truman Burbank, played by Jim Carrey, unknowingly lived a fake life on a television set in the 1998 film *The Truman Show*.

Many a Wall Street player – like the naif Truman – has happily prospered inside a bubble.

It's been so long for some that it is their "reality."

They've either forgotten or they never learned the laws of honest markets and sound money.

They have no clue that the system is rotten to the core.

They're unaware that debt-and-speculation-ridden financial markets are accidents waiting to happen...

…And that 4%-plus bond yields are most definitely not priced in.

Meet the New, New Normal

Now, more than ever, we need tools that will help us preserve as much of our wealth as possible from the effects of Bubble Finance.

We need to contemplate the aftermath of the Mother of All Yield Shocks.

The Federal Reserve and fellow-traveling Keynesian central bankers who fueled a massive, global bubble are tomorrow's bond-dumpers, all in the name of "normal."

(Normal, here, means, of course, that our self-interested central bankers are creating "dry powder" so they can ride to the rescue amid the next crisis of their own making.)

Here's what it means, as a matter of global bond market mechanics.

With "quantitative easing," the Fed was "sequestering" bonds on its balance sheet. That, in effect, stimulated demand and held yields down.

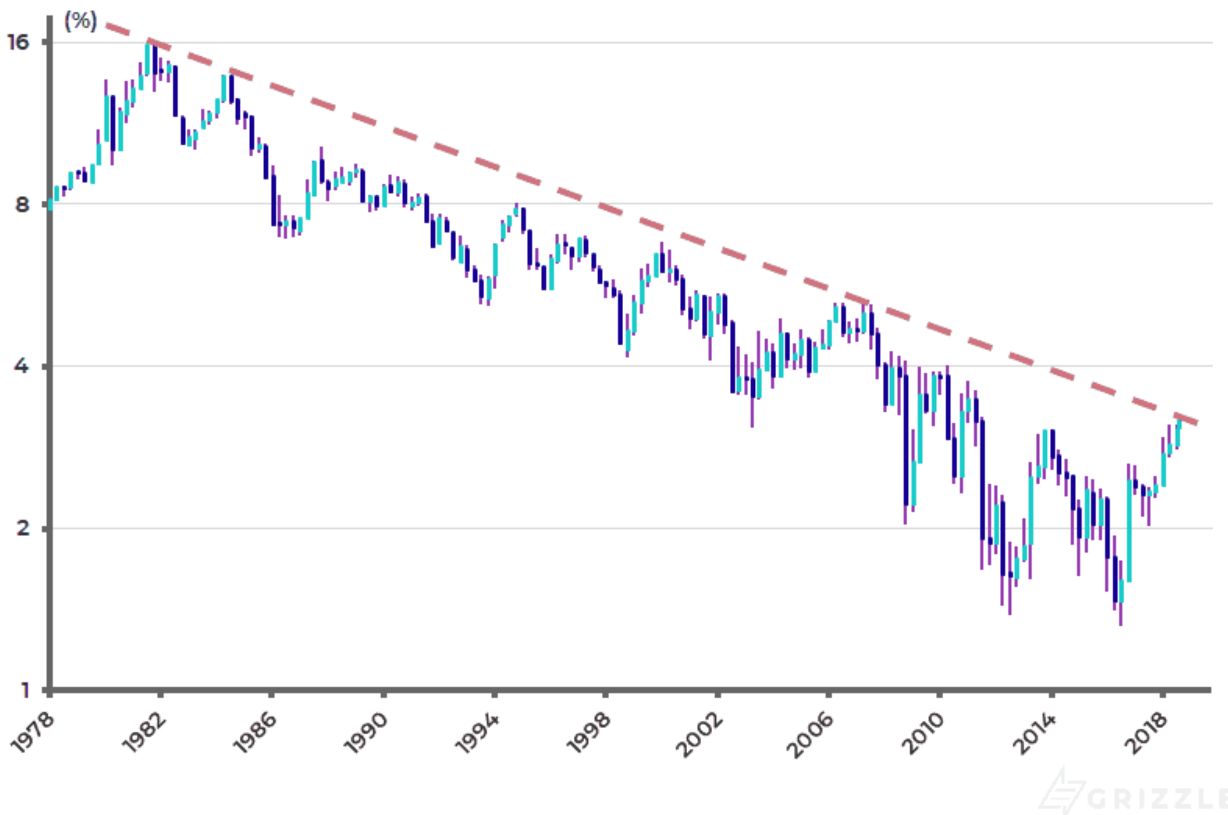
With "quantitative tightening," the Fed is letting those bonds roll off its balance sheet. This, in effect, creates supply.

A lot of other central banks around the world are or will be doing the same thing.

The bottom line is, there's some fresh discovery to be done as far as bond yields and interest rates are concerned.

Experience tells me we're headed much higher than the 3.15% or so we see on the 10-year U.S. Treasury today.

And there's a major line about to be crossed on this march, the 35-year downtrend in place since I was contemplating the desultory math of $200 billion Reagan deficits as far as the eye could see in the face of a 16% read on the 10-year.



Paul Volcker took care of that problem. All he had to do was plunge the U.S. economy into a nasty recession and wring out the 8% or so inflation expectation embedded in that benchmark bond yield.

From there, it was the longest-running bull market in recorded history.

It's about to reverse.

And you've heard virtually nothing about the consequences via Bubblevision.

Well, here it is.

We'll have a non-functioning government over the next two years.

And Imperial Washington's fiscal incontinence will soon embarrass even this doped-up, dumbed-down Wall Street crowd.

You and Your Wealth

Whether you're studying your brains out, looking for a job, planning a family, building a nest egg, saving for retirement, or already focused on just preserving what you have, you're entering a very dangerous time.

It's been hard on Main Street for decades now. Still, the Wall Street economy has hummed along…

And, while it's possible this recovery lasts long enough to get President Trump re-elected in 2020, I don't see it surviving a second term…

When this bubble crashes, anyone who's been following Wall Street's "buy and hold" advice will get crushed.

That little portfolio you've built or restored since the Global Financial Crisis/Great Recession?

Gone.

A good education at a reasonable cost? A new house? A Worry-free retirement?

Pipedreams, all.

The biggest mistake you can make today is to believe this Trumpified bull market can continue ad infinitum.

We're already well past beyond the ad nauseam phase, to be honest.

But, if you need your money for anything within the next five years, it's time to start investing differently.

Following the S&P 500 Index, the Dow Jones Industrial Average, the Nasdaq Composite, or the Russell 2000 Index for the next five years will only keep you strapped down for another 50%-or-so-if-we're-lucky slide.

I have a plan you can put in motion that will help you avoid that trip when the next crash comes.

And you can get started today.

Part II:
It’s Time to Ignore Warren Buffet

Warren Buffett is what Bubblevision refers to as “the greatest investor who ever lived”…

And they always talk about how he got his start in Omaha, Nebraska, and never left.

Actually, the “Oracle” spent a lot of his coming-up years right in Washington D.C. – sure, it was a much smaller town back then. But he was and is the son of Congressman Howard Buffett.

And I think he’s dead wrong to insist that most investors simply put their money into an index fund that tracks the S&P 500 or some other derivative product.

That’s especially so right now.

Look, I’ve been there.

I’ve done “that,” too.

And now I’m here to tell you how it really is inside the Acela Corridor.

“The Acela Corridor” connects Wall Street to Imperial Washington – literally, of course, via rail.

Now, however, we’ve seen the full flower of a decades-in-the-making meeting of minds. This groupthink informs the Warfare State and the Welfare State.

It makes forever war. It enriches few. It feeds on Bubble Finance.

So, how does all this translate on Main Street?

Well, the “too long, didn’t read” version is “it doesn’t.” It doesn’t add up; it doesn’t make sense.

Strategy & Tactics

Every general knows it’s important to allocate resources based on a sound strategy. But informed tactics are just as important when it comes to preserving, protecting, and growing wealth over time.

It's the difference between understanding the map and navigating the terrain – knowing where the shoals are hidden and appreciating the clearest passes when the going gets tough.

Both are important, of course; you have to know how where to have your forces arrayed. But, when bullets start flying, you have to make quick, decisive, win-or-lose moves.

It seems almost instinctive, that ability to "hit the big shot"

But "thinking on your feet" is most often the result of practice, learning from mistakes, and tightening your processes as much as possible…

On the battlefield or the basketball court as well as when it comes to investing, "discipline" wins the day.

Of course, we know "the drill" now: Bubble Finance leads to bigger and bigger busts.

And we're heading for the biggest – the Mother of All Yield Shocks.

But we have a well-designed system to ready us for it.

"Asset allocation" refers to the mix of stocks, bonds, cash, and real assets you have in your portfolio.

"Dynamic" asset allocation is the process of adjusting the weighting of each asset class as markets move through cycles.

That means we'll make adjustments as the facts warrant.

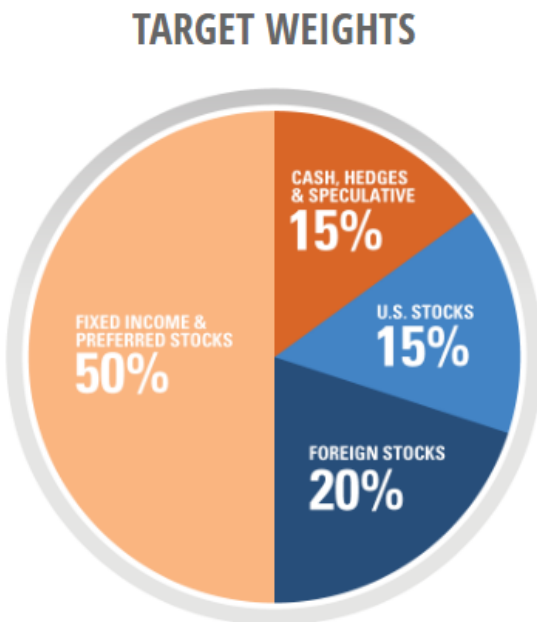
In other words, common sense will guide us.

Each month, I'll assess the changing risk-reward proposition across these asset classes. We'll change relative weightings based on current market conditions.

The goal is for you to construct your own portfolio, one that fits your time horizon and your risk tolerance.

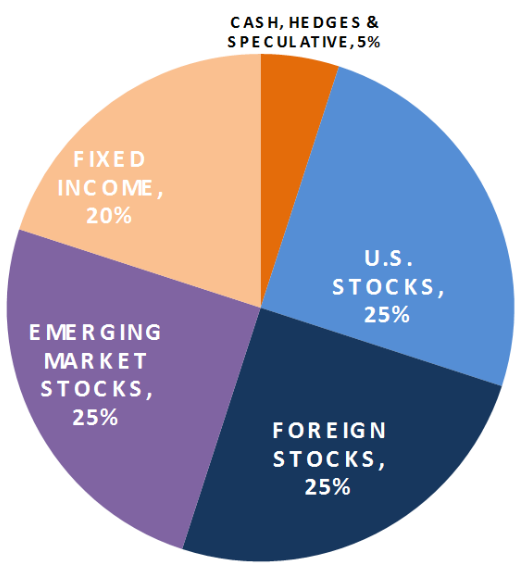
Models

Here's a sample asset allocation model for an overall risk target set at "very conservative":



The portfolio is dominated by fixed income (bonds) and preferred stocks. There's also room for a decent amount of cash. This model cushions volatility.

Here's a hypothetical allocation for an overall risk target set to "very aggressive":



A full 75% of this portfolio is allocated to equities.

The Stockman Model

The Stockman Letter is about the Main Street economy and individual investors.

In the middle of our digital magazine, you'll find "What to Do and When to Do It." It's the central feature of *The Stockman Letter*.

Our strategy includes a strategy of "dynamic asset allocation" with specific asset types and percentages.

It's intended to be flexible – both to change as the facts warrant and to suit your approach to the market.

And we base tactical decisions – a particular exchange-traded fund to buy at a particular time based on a specific catalyst and/or short-term action within the longer-term trend – on the input of multiple highly respected market veterans.

- **A proprietary algorithm that tells you when it's "risk on" and when it's "risk off"… we know a guy who built one…**
- **A forensic accountant who knows how to separate "value" from nonsense, in good markets and bad (it's incredible how much "easy money" has frustrated this stock-picker…)**
- **An options expert who can help us get paid real money, right now, while we wait for otherwise high-quality stocks to shed the stink of Bubble Finance…**
- **A Treasury market hawk – he watches it like one – who'll give us first warning when yields "go critical"…**

"The Stockman Model" is designed to preserve as much of your wealth as possible in the aftermath of The Mother of All Yield Shocks.

Indicators

How will we know when the time is right to take on risk?

Some sort of crisis will be at hand. It won't exactly mirror past crises. And its uniqueness will create uncertainty.

It'll be a very scary time. Fear will proliferate. Most investors will capitulate at their point of maximum pain from market losses.

The point of maximum pain: Right after that is when we'll be buying.

We won't go from "defensive" to "aggressive" all of a sudden. We'll slowly adjust The Stockman Model.

But don't want to ramp up our risk too soon. That's a path to unnecessary losses if the situation deteriorates further.

We don't want to wait too long to initiate riskier positions, or else we'll could miss out on potential gains.

Timing is critical.

We have gauges to rely upon when navigating the financial markets:

- **Equity valuations**
- **Margin debt as a percentage of GDP**
- **BBB credit spreads**

These signals help us make actionable the conclusions we reach based on our review of the macro situation:

- **Geopolitical tensions**
- **Economic growth**
- **Main Street health**

It could be quite a while until leveraged speculation recedes and the U.S. stock market becomes cheap again.

We're not simply waiting around for that to occur, though.

There are opportunities to intelligently take on risk while still being cautious and defensive.

The Stockman Letter is focused on the long term. But we have plans in place for the short term too.

And we will share compelling ideas that capitalize on small but potentially profitable micro-momentum shifts that occur within the larger macro-disaster about to unfold…

Don’t Be Stupid

Financial markets don’t present us with straight-up life-and-death situations.

But our investing decisions do profoundly impact our lives.

So we have to manage our portfolios with patience and discipline.

“The Stockman Model” is, of course, based on the perspective of a well-off guy looking to preserve what he has.

It also reflects my journey from a Midwestern farm to Washington D.C. to Wall Street. I’ve experienced those many cycles of life, and I understand how the rhythms change.

So, “The Stockman Model” also contemplates your own personal adjustments to what Bubble Finance hath wrought…

As we evaluate what’s happening in financial markets and the world’s economies, we’ll discuss the ins and outs of establishing a portfolio model that fits your own situation.

“Safety” is my No. 1 priority right now.

That’s my posture as barrel toward yet another crash. It can and will change… but only as the facts warrant and common sense dictates.

Better Than MAGA

If you need your money for anything in the next five years – your kids, your grandkids, your own retirement – you should absolutely get out of the “Go long the broad stock market!” group-think/doom-loop right now…

But DO NOT stop investing.

I want to be crystal clear. I’m not saying the market is going to crash “today,” “tomorrow,” or even next week. I’m not saying to hide in cash.

And I’m not saying you should start hoarding gold in an underground bunker.

But it is time to be selective about how you invest.

Especially if you need your money for anything important in the next five years.

Why five?

Well, on average, that's how long it takes to get back to even after crashes.

We can do better.

First, we can avoid major wipeouts by incorporating principles of "dynamic asset allocation."

Then, we can take advantage of shorter-term opportunities in the context of larger moves…

That's why I've aligned with Charles Street Research to publish *Deep State Declassified* and *The Stockman Letter*: because of the unique collection of market minds on staff.

And they have the track records to prove the quality of their work.

John Del Vecchio, a forensic accountant who gets what's going on with FANGMAN, has led his *Hidden Profits* readers to an amazing 82% "win rate" as of November 2018, with average annualized gains of 49.5%.

Adam O'Dell's approach basically removes emotional factors from decision-making. His work will help us see major momentum shifts for the broad market as well as identify specific sectors of strength at a given time.

Lance Gaitan's Treasury market "timing" method doesn't really care about direction: He can help us make money on the Mother of All Yield Shocks, when it's coming and when it's going…

And then there's Lee Lowell, an options trader whose approach means we can collect some cash while waiting for big stocks to trade at more rational prices…

It's common for Wall Street to say you can't beat the market.

But these guys do on a regular basis.

That's why I think you can abandon index investing and take control of your money and your future.

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