TWO CORRECTIONS, CHINA, GUNS AND BUBBLES

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Last July we published our August issue titled "Sell Stocks Now," listing 10 reasons for why a significant market downturn was potentially on the horizon. It was not based on a special insight we had, but in the parlance of our national security agencies, we were hearing a lot of chatter. Many highly respected analysts were putting out bearish outlooks based on varied technical and fundamental factors.

It was not exactly a shock as there was something not quite right with the long-term bull market we have experienced since the bottom of the 2008 credit crisis. Many analysts have believed the long-term bull market — one of the strongest on record — was more a product of the Federal Reserve's zero-interest-rate policy than solid economic growth.

It was a good call, but when you put "Sell Stocks Now" on the cover, there is certainly an implication of more than a 10% correction. Well the market, after a solid yet not complete recovery, has corrected again. As of our deadline the August low has not been taken out, but the early January weakness confirms the larger market weakness highlighted in that story. In "Correction 2016: What's next?" (page 10), we look at how the markets have responded when the S&Ps have corrected 10% twice within a six-month period. (Our friends at EidoSearch ran the numbers). The results, perhaps self-evident, show a higher likelihood of extended market weakness when that occurs.

One of the things we have done since rebranding as *Modern Trader* is to have a sharper focus on more narrow sectors. This month we look at the bull market in gun-related stocks and the reasons for it (see "The trader's guide to the firearms sector," page 16).

Garrett Baldwin covers all the bases of this controversial subject. I am old enough to remember when gun control was seriously debated. Back in the 1970s and 80s there were significant measures regarding restricting guns. While a great deal of fear has been raised about the current administration's position, there really has been no serious effort to restrict firearms since the assault weapons ban, passed in the mid-1990s, was allowed to expire.

But each time a tragedy hit and President Obama hinted at taking action, there were armies of lobbyists and right-leaning talk radio personalities scaring those folks who like to be scared that the government would be coming for their guns. The administration has had little luck moving much less controversial legislation so there was not much chance anything major would happen. Yet the mere suggestion of action has helped gun sales. It has become a pretty reliable trade. Even the move in social investing circles to divest from gun manufacturing stocks (see "Activist blowback: Divesting threat," page 26) has mainly served to provide buying opportunities.

Now that the president has decided to take executive action, all the usual suspects said the usual thing and the markets moved accordingly. However, this time there may be a problem. This action is real, if not overly burdensome or impressive. It is something that can be measured and when the end result does not measure up to the worst fears of those opposing any restrictions, the market may move back. In a "buy the rumor sell the fact" fashion, the gun industry may be in a classic bubble. As they say, bull markets need to be fed and this bull market has eaten a lot of empty calories.

Of greater concern to markets and traders is the situation in China. The continued softness in the Chinese economy was a major driver in both last August's selloff and the January weakness in U.S. equities. And falling Chinese demand is arguably a main driver of the weakness in the crude oil market. In "Big bubble in brittle China" (page 37), Christopher McKee shares his most recent analysis of China. McKee, CEO of PRS Group, provides global political risk forecasting (see "Modeling geopolitical risk," page 34).

While 2016 has gotten off to a rocky start, a key question many analysts are asking is whether China is simply experiencing regular growing pains as it moves from an emerging economy to an emerged one and is likely to recover, or if there is a more significant issue with the world's second largest economy? Matt Weller suggests you follow the divergence between China's two currencies in "Why traders should watch the CNH/CNY spread" (page 43).

While guns are a hot issue and may offer trading opportunities, what happens in China will likely drive markets in 2016.

Daniel P. Collins

Daniel P. Collins
Editor-in-Chief, Modern Trader
@moderntradered

Send your comments, criticisms and suggestions to openoutcry@moderntrader.com