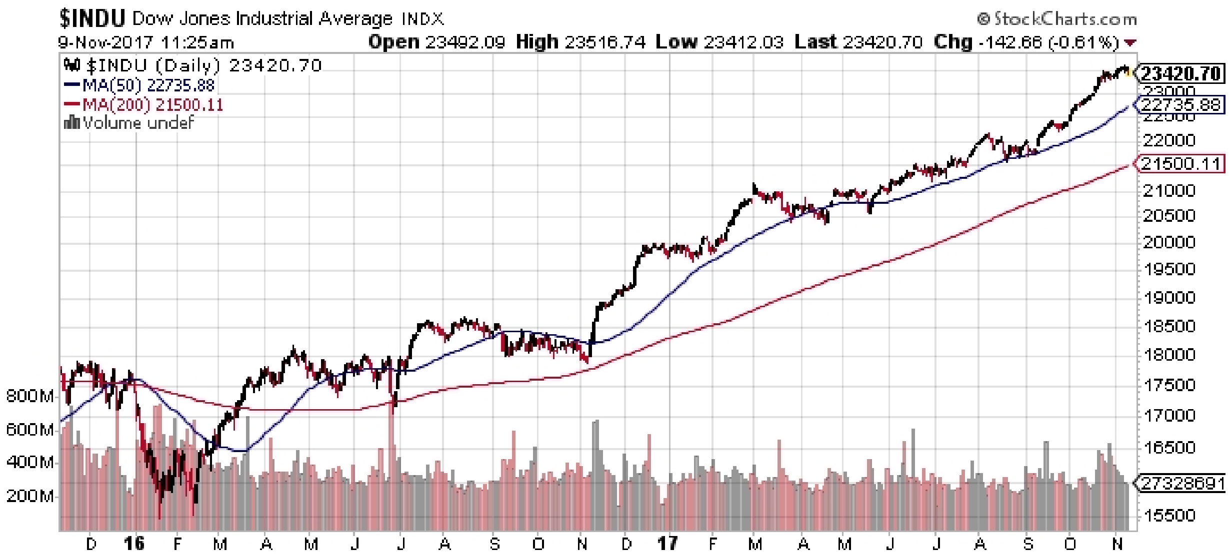
It’s Never Too Early to Protect Your Portfolio

Markets may be hitting all-time highs.

Optimism and confidence in markets may be soaring to unbelievable heights.



But we’ve seen this move before. And as I tell many traders and investors, it’s never too early to start thinking about how to protect your portfolio from potential swings lower.

That’s because if we’re not prepared, all of the gains you see today could be gone tomorrow.

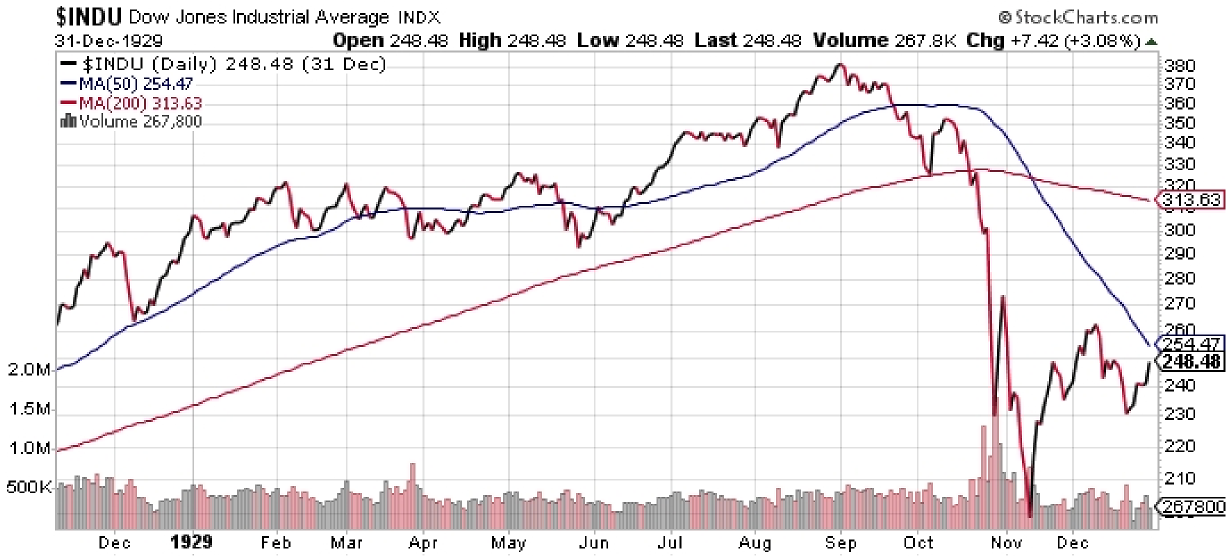
In 1929, we saw similar optimism. Investors were pouring money into stocks on the idea of an improving economy. Unemployment was at historic lows.

Thousands of people were becoming millionaires every day.

Investors were mortgaging their homes just for a piece of the market action.

Stocks quickly became a “sure thing.” Investors couldn’t lose.

Or so they thought. The next thing they knew, the Crash of 1929 hit, and caught many of them off guard. A lot of money was lost.



Unfortunately, many of us don't learn from history because 88 years later, we're doing the same thing, and seeing the same things that preceded the Crash of 1929.

And many of us don't seem to really care. But that'll cost them – again.

Just like 1929, stocks are soaring to new highs. Investors are pouring billions into stocks on an idea of an improving economy. Optimism is exceptionally higher. Unemployment is at historic lows. And up to 1,500 people are becoming millionaires each day.

The other similarity – not many are prepared for a repeat of 1929.

In fact, as many as 75% of Americans are as prepared for an eventual crash as they were in the roaring 20s. Granted, none of us have a crystal ball.

We can't tell you with great certainty exactly when the next crash will happen.

But what we can tell you is, it'll catch many of us off guard – AGAIN.

All as markets have become ridiculously overvalued stretched well beyond fair valuation, just as we've seen with the previous crashes in 1929, 1987, 2000 and 2008.

With History as Our Guide

In 1929, rampant speculation sent the Dow Jones up 300% between 1923 and 1929. Traders and investors believed stocks could only go up. Speculation forced stocks to unbelievable highs with unjustifiable valuation. Then, it all fell apart.

Between 1929 and 1932, the Dow Jones lost 86% of its value.

In 2000, dot-com optimism sent the Dow Jones to nearly 11,000 until unjustifiable valuations and greed sent it back to a low of 7,694.

In 2008, rampant speculation sent the Dow Jones to a high of 14,038 on the heels of a housing boom. Americans were buying homes they couldn't afford. Stocks were exploding on economic optimism and unjustifiable valuations, just like in 1929 and 2000.

Then, it all fell apart.

The Dow Jones would sink to 6,500.

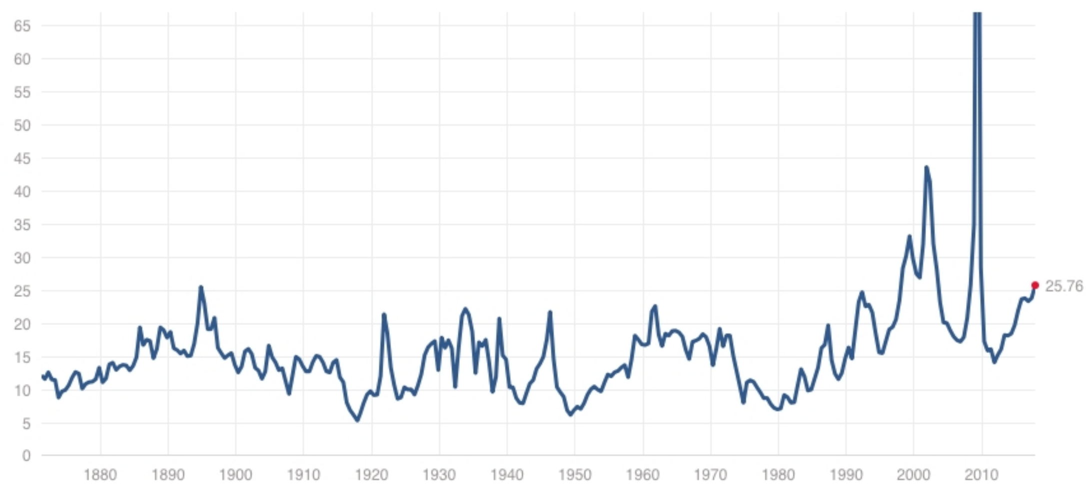
Even today, stocks are soaring on high levels of optimism and unjustifiable valuation.

That could cost us especially those that are not prepared, especially as the likelihood of near-term tax cuts falls by the day.

As I'll remind you, none of us will be able to time the exact date of the next crash. It'll catch many of us off guard, just as we've seen in previous meltdowns.

Stocks are clearly in a bubble

At 25.76, the S&P 500 price to earnings multiple is the highest it's been since 2000 and 2008.



Price to sales ratios now sits at 50-year highs. Price to book ratios are back to 2002 levels. And the stock market cap to GDP is higher than where it was in 2000.

One of the most worrisome signs we're overdue for a correction is the Shiller P/E at 31.50.

Developed by Yale University's Robert Shiller, the ratio helps us determine how much of your portfolio should be invested in stocks, based on the relationship between the price you pay for a stock and the value you get in return.

The S&P forward P/E ratio compares current market prices to average earnings over the last 10 years adjusted for inflation.

And what it has exposed is terrifying, especially in recent months.

The last two times it was this high – or higher – markets crashed not longer after.

In 1929, the ratio sat at 30.

The Dow Jones would crash from an October 1929 high of 352.69 to 198.69. In 2000, the ratio sat at 44.19 at the start of 2000. Not long after, the Dow Jones would slip from 11,638 to 9,731.

Right now, it's back to 31.50.

Even its creator has warned such a high "would definitely be a negative for equities. It would be pretty big. We are at a high valuation. The only time we've had a higher valuation than where we are now was around 1929 and around 2000."

"We could see a major correction," he said. "This is not a forecast. It's a worry."

And while many analysts are still very much bullish with high expectations, they're a bit too bullish. And their expectations are set a bit too high.

At the moment, major banks are forecasting higher highs for the S&P 500. Credit Suisse recently raised its growth estimates to 2,500 from 2,550 and introduced a mid-year 2018 target of 2,600. Goldman Sachs raised its target from 2,300 to 2,400.

The problem with that, of course, is that forecasts are rarely correct and serve very little purpose.

Many respected firms are still very bullish, expecting the market rally to continue.

We have to remember the old saying that bull markets are born in pessimism and end in euphoria, just as we're seeing right now. The bull market just celebrated its eight-year anniversary in March 2017 – quite a sizable, long bull market by most standards.

Never before have we experienced such a rally on ultra-easy money from the global community.

We must be wary that when analysts get far too bullish as they are again now, it happens near market tops, not near market bottoms. The last time analysts were this bullish was 2008. Many called for markets to soar 11%. Instead it fell by more than 40%.

That doesn't mean you should cash out of the markets right now.

It just means you need to be prepared.

Trade Suggestions:

There are four ways to protect our portfolios from potential downside.

No. 1 – Consider moving some of your portfolio into cash

No. 2 – Trade the Potential for Volatility. We can do this by buying to open the VIX March 21, 2018 12 calls for example. We can even buy to open the VIX March 21, 2017 15 calls, which have open interest of 168,762.

No. 3 – We can hedge long positions with a put option on the NASDAQ by buying to open the QQQ February 152 calls for example. Or we can even hedge with the Dow Jones itself by buying to open the DIA March 16, 2018 230 calls as well.

No. 4 – We can even hedge our long positions with ETFs, as well, including the Pro Shares Short S&P 500 ETF (SH), the Pro Shares Ultra Short S&P 500 (SDS) and even the Pro Shares Short Russell 2000 (RWM).

We're not saying the markets could crash tomorrow.

What we are saying is that it's time to protect your money now. Folks in 1929, 1987, 2000 and 2008 sure wish they had.