Broke

No, this isn't an ESPN 30 for 30 documentary on the sad state of NFL players' bank accounts three years after their careers end. This is about how investors' preoccupation with "repeal and replace" last week led to an unimpressive decline in the S&P 500 and a huge rally in Treasuries and gold.

The greatest trading opportunities come when the public's perception of a market diverges from the most probable direction of that market. This axiom was on full display last week as gurus and media talking heads proclaimed a major "turning point" for markets.

It wasn't a major turning point. But it was an opportunity to use investors' fixation on the event du jour to position yourself in trades that will get you paid when the focus returns to what really matters: U.S. growth, yields and the greenback. When investors turn their attention away from "repeal and replace" and back to the Big 3, you want to be long U.S. equities and short gold and Treasuries.

I'm Short Gurus, Long Process

At the forefront of pundits calling last week's market decline a "turning point" was our favorite guru, Dennis Gartman. I take no great pleasure in undressing Mr. Gartman's investing rationale, but his commentary last week gives us an excellent case study in the dangers of blindly following someone's advice just because they are perceived to be an "expert."

In the aftermath of the S&P's 1.3% decline on Tuesday, Gartman pontificated: "Allow us to be quite blunt here and acknowledge that something "broke" in the markets across the board yesterday… The psychology of the market has taken a very real and very severe beating and we fear, of a sudden, that something more than a mere long-awaited correction has fallen upon our shoulders."

Oh no, Dennis! What did you do?!

"In our own retirement account, yesterday we took very real action to protect ourselves on the downside, for we stepped in early in the session and bought Japanese equities via the Wisdom Tree ETF, DXJ, but within an hour, with the market moving quickly against us, we cast it overboard, taking a small loss in the process. Then as prices continued to deteriorate we actually ventured to the short side of the market, buying bearish derivatives and by 1:00 in the afternoon, doubling those positions and carrying them "home" through the close of trading. This is the first time in a very, very long while we have actually gone short of equities, but it is our intention to become even shorter of them, hoping to sell a bounce that might develop intra-day."

That was Wednesday. Now let's fast forward to Friday morning:

"Regarding positioning… and please do remember that the only money we manage is our own retirement fund and although it is only a few small millions it is still our money and we do indeed value it!... we came into yesterday's session modestly net short of equities. However considering that the passage or non-passage of the health care legislation was a veritable coin toss circumstance we moved to cover those short derivatives positions early in the day and took to the sidelines. We remain there this morning."

It's clear this guy isn't data dependent, process driven or risk conscious. It's more like he's CNBC dependent, tax-loss driven and unconscious.

Let's start with the fact that he "cast" a trading position "overboard" within one hour of taking the position. If your process has you exiting positions within an hour, then it's time to go back to the drawing board, because a process like that will make you broke (unlike the market decline last week).

Now, on to him getting "modestly short of equities" and then covering those positions two days later even though the S&P was essentially unchanged.

Gartman blames the health care legislation for his change of heart, but this is a very common investor mistake. You can't successfully manage money by waking up each day and testing the wind in order to make decisions.

I don't whipsaw on positions within an hour or shift my bias on a market every two days; I rely on being data dependent, process driven and risk conscious. This approach enabled me to see the market's reaction to "repeal and replace" as an opportunity to get long the S&P and short gold and long-dated U.S. Treasuries.

Data Dependent
There is a powerful anchor telling me to be long the S&P and short gold and Treasuries: the current fundamental gravity in the U.S. is bullish for those trades. U.S. growth continues to accelerate, and Fed policy is putting a tailwind behind both the U.S. dollar and U.S. yields.

Despite numerous erroneous headlines and op-eds over the last few months, the growth acceleration that began in Q3 last year continues in Q1 2017. Just last week the latest durable goods growth rate accelerated for the third straight month and is now sitting at the highest rate in three years.

Not only is the data signaling growth, but markets are confirming this fact in real-time.

The year-to-date performance of S&P companies in the top 25% for sales growth outperforms the bottom 25% by 200 basis points. Likewise, companies in the top 25% for earnings growth are trouncing their lower growth counterparts by the same 200 basis point margin.

It's not just growth that is a positive for U.S. equities and a big negative for gold and Treasuries, it's the greenback and yields.

The USD has been weak to start the year, but if it holds the line in the sand at $97, then it's still going to cause issues for gold bulls. Similarly, U.S. 10-year and 30-year yields have bounced around in a trading range for the last four months, but if the 10-year remains above 2.31% and the 30-year above 2.89%, then gold and U.S. treasuries will have little chance of maintaining any upside momentum.

Process Driven

My process is multi-factor, so while economic data and central banking policy are the foundation on which my framework rests, I also evaluate the quantitative and behavioral gravities that impact asset prices.

Quantitatively, I monitor about a dozen independent factors to assess a market's bullish or bearish bias. But let's just keep it simple this week and look at price.

From this perspective, a 1.3% decline in the S&P doesn't "break" anything or deliver a "severe psychological beating" to the market. Sorry Dennis — that kind of thinking may sell newsletters and get you whipsawed for losses, but it's not the basis of a sound investing process.

On the flipside, the two-week, 4% rally in both gold and Treasuries simply provided insightful investors with an opportunity to short these markets, the gravities of which are decidedly bearish at better prices.

Behaviorally, these trades aren't flashing warning signs of being overly consensus.

In the case of U.S. equities, investors are modestly long the S&P, and are actually short U.S. small caps and the NASDAQ. This tells me that people don't fully understand the U.S.'s current fundamental gravity.

People are modestly short gold and Treasuries, but that positioning has been markedly reduced as bears capitulate in light of the latest countertrend rally. I'm happy to step into these trades now because the risk of getting caught in a short squeeze has dramatically reduced as well.

Risk Conscious
One aspect of being risk conscious is not swinging at every pitch that comes along. It means you wait until you get the fat pitch across the middle, and then you swing like Mark McGwire circa 1998.

I'd been waiting patiently for these three markets to trade at prices that offered a reward-to-risk ratio that was heavily skewed in my favor.

I've been bullish on U.S. equities, specifically the S&P, all year, but was waiting for a reasonable pullback before getting involved. Frankly, I'd love to see another 4% downside from here, but last week's minor pullback offered up a long trade with nearly three times as much profit potential as the amount I'm risking.

For gold and Treasuries, I've been bearish all year against the backdrop of accelerating growth, the strong USD and strong yield environment. However, I've traded gold just five times and Treasuries three times in the first three months of the year. You wait and watch, then pounce when the opportunity arises to take a trade with the odds heavily skewed in your favor.

My current short gold trade has three times as much potential profit as risk taken, and the Treasury short is nearly 4-to-1 in my favor.

Bottom Line
Nothing in markets changes in one hour, and only on rare occasions does something significant occur that can change the trajectory of financial markets in 48 hours.

If you find yourself getting whiplash because your bias for markets changes as often as Beyoncé's outfits during a concert, then it's time to re-evaluate your process.

A lot of investors experienced last week's decline and did exactly the wrong thing. Remember, being data dependent, process driven and risk conscious will allow you to spot opportunities in the markets when everyone else is seeing something that is "broke."

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