

Aug 19-17 Calling Market Tops!!

Good Afternoon To All

I had a wonderful trip to Ireland with my wife Louise (the first time with no kids!!!), and visited several relatives and friends (on Louise's side) and I am now very relaxed and raring to get back at it!!

The title may startle many or even convince you that I over indulged in the Guinness drinking festivities with our regular evening prowling from pub to pub. It is true that I consumed way too much beer but I am now back in the saddle, relaxed and with "minimal media poison" and after reading my 4 favorite investing review reports I am left with a queasy feeling in my gut or a Deja vu of what it was like in 1999 and 2007! Should I listen to my sixth sense??

I am fully aware that trying to call a market top is a fool's errand BUT THE FACTS are that we are now at a point where equity RISK is insanely high and equity REWARD is minimal to nil, and this strong ASYMMETRY encourages me to continue with defense even if the markets climb higher as they often do in the last leg of the cycle.

In fact the asymmetry is so striking I feel that we MUST be close to a market top and the eventual down turn...or that is what my humble and relaxed gut feeling is telling me!?

At these frothy levels I would rather be early and safe on this call and leave some money on the table vs aiming to time the exact top (mid Sept or Oct???) and then trying to bail with the herd through that very narrow gate! My relaxed and well-travelled gut tells me that the next down turn could be well above the average down turn?!

The TSX has hit a rough patch with a negative -0.18% return over the last 6 months and only a slight +0.67% return over the year to date. The S&P 500 has had a better run but it is mainly focused around those very, very expensive FAANG stocks (Facebook, Apple, Amazon, Netflix and Google) and these are simply way too expensive for me to own right now!

So returns are hard to come by these days as even our bonds have taken a hit over (surprised) rising Interest rates in the last 3-4 months, so both broad market equities and bonds have done poorly this year north and south of the border.

Before I go on to our discussion of "Calling Market Tops" I would like to apologize to the recent 5 new clients over their weak returns in the last 3-6 months BUT the silver lining is that these new folks have HUGE dry powder reserves ready to be spent...so please be patient here and with any luck you guys in particular will be rewarded in the near future.

The other apology goes to all clients with our health care TEVA holding—down 40-60% in most accounts!!!! GULP—I need some time to review this and will send a separate note out next week with thoughts on what we should do.

Ok so why the BRAVE-RISKY call about a Market Top (besides my “gut” 6th sense).

Here are some of the reasons:

#1 Market breadth is very weak and weakening with mainly the FAANG stocks supporting the US markets. The small cap and mid cap are all down in 2017. These are not good conditions for the markets to continue higher...FAANG are mostly great companies but NOT great stocks. Way too expensive now and will tumble much more than the market average when the poop eventually hits the fan. These large cap companies are also inflated over the blind buying of passive ETFs which has surged in the last year as agnostic buyers buy blindly! This is a bad investing omen this late in this rich market.

#2 The Valuation On Most Assets Are At Bubble levels—US equities are at the 2nd highest valuation ever on most accounts and approaching 2000 levels—were 2007, 2000 and 1929 good times to be fully invested when similar frothy valuations existed??? Who is chanting “yah good time to invest as we are at the same levels as 1929 or 2007?” or how about “Yah forget about buying low and selling high—that is a myth”.

Only in hind sight will this over valuation penny drop...which will be too late for most and unfortunately this behavior of buying high and staying late is wired into the average investors genome and makes me very nervous as I see markets climb despite very weak wage growth and economic data (e.g. autos and housing). But it is just not equities that are frothy—it’s housing, art, junk bonds etc.

There is way too much liquidity out there globally looking for any investing home and this has pushed valuations to insane levels. But now this is going in reverse as covered in the last correspondence and you do NOT want to fight the Central Banks on this one!

#3 NOBODY is calling for a Recession!!! This is a major déjà vu for me re 1999 and esp. 2007!!! We know the usual recession causes (war, high oil, rapid rate rise, etc.) but often it is the unknown that sends us over and into a recession and there are many, many unknowns right now e.g. the persistent low growth globally only matched by the 1930s, central banks will soon be withdrawing liquidity on a scale never seen before, political dysfunction at levels NEVER seen before etc. (as my side note-Trump will not see 4 years is my expectation, but what happens in the interim is my worry??).

The number and severity of unknowns is extreme and it just seems arrogant and neglectful in my mind to only see the recession odds at 10% when many of these unknowns are so unusual and rare.... and what does happen when we see the next recession with global debt already so high and IR already close to zero???????? I don’t know, but equity markets never do well in recessions and I want to be very close to that exit when the hammer comes down on this very long and rich bull market as history tells us that they **NEVER** end well!

#4 AUG-SEPT-OCT are the 3 scariest months for equity markets and this year we are very much at risk for all the reasons mentioned here and so far August has been very poor...that is why we de-risked last month...just to be safe. Yes I am a “cyclical nut” who loves all these cyclical patterns but history shows us that these patterns do repeat with enough consistency that you need to be aware of them.

#5 The Bitcoin Currency rage to me is the millennials first taste of a greed bubble (we boomers had the dot.com and housing) and this will not end well. If you do not like paper money then BUY gold!!! It is real and can be used to buy anything even to barter with but bitcoin???? For me this is just a sign of the investing mania and greed that is always prevalent after prolonged one way market trends re only going UP FOR 8 years!!! We are wired to see this trend and extrapolate into all sorts of crazy over valued assets such as bitcoin, FAANG, housing, tulips, dot.com etc. etc. and you are an “investing loser” if you are not joining this trend. To me the Bitcoin-Ether craze is another sign of excess herd mentality and a time for caution.

#6 That leads me to Investor Complacency –we see this on several measures but the VIX Fear Gauge is the most obvious –at levels never seen before as there is no fear amongst investors as the equity trend has been only in a steady upward trend for 8 years and every dip is a time to buy!! This brings the HERD in to equities and so who is left to push the markets higher (certainly not the smart money—see #9)...this is typical of a market top!

When we have investor sentiment and consumer confidence near record highs it is always time to look at the other side of the boat!

#7 The Bond Market message continues to be CAUTION as the 10 year remains at 2.2% despite the climbing equity markets and the FED raising rates 3 times since Trump was elected....something is wrong here as it is very unusual for bonds and equities to be going in the same direction and I will bet that the bond market has it correct re slow growth ahead and no inflation...so why are equity valuations so high if there is weak growth ahead??

#8 The Tipping Point for this market or the next recession could be as simple as the FED finally starting to taper its massive balance sheet of \$4.5 TRILLION which is akin to more rate hikes....(but some dumb action or firing by Trump would be a close second cause...)

#9 I also follow Smart guys like Warren Buffet with a whopping war chest of \$100 billion in cash!!!!...or Prim Watsa with a whopping 43% of his investment portfolio in cash-short positions or DRY POWDER!!! and how about Howard Marks in his most recent revered newsletter telling his clients -- “I’m going to issue a warning” about the markets, or GMO’s recent report telling us to AVOID the US marketsyou would be negligent not to listen or follow these really smart and seasoned guys actions here in late summer 2017....they are all shouting sudden death over time is in full play so be ready!

#10 Finally, we usually see a 5% correction every 50 trading days—BUT the last one was 281 days, we usually see a 10% correction every 167 days—BUT the last one was 375 days and since 1928 we have seen a 20% correction (so \$1mill drops to \$800) every 635 trading days and the last one was 2120 days ago! Can you sense the anomaly here...we are in over time for sure!

So this is what asymmetry is all about folks especially when we have mega uncertainties and rich valuations that match 1929, 2000 or 2007 levels!!!! The HERD IS ALL IN and markets are FROTHY because of this participation and where or when it stops is unknown BUT all the signs are there telling me to be cautious with your/my money!!

And I remind readers that since 1930 we have seen a 20%+ correction in the US markets every 5 years DURING TIMES WHEN THERE WAS NO RECESSION!!!! (Ben Carlson) Please reread this...bottom line is we are due even if we do not see a recession!!!

CONCLUSION

It is impossible to call the market top BUT it is also very important for money managers to be cautious (and early) with clients money when we see this much asymmetry in equity risk versus reward.

Additionally, I have learned that it is important to listen to that Sixth Sense especially when it is this sterile AND before it gets poisoned or diluted by the media as it will over the next few weeks as I consume more media chatter.

But of course if the data or macro changes I will reconsider this position but for now very happy to be safe as we wade through Aug-Sept and the ugly October month, and with a relaxed stomach!!

Suggest you have a look at the attachments below as many are well written and support my biased viewpoint.

Have a great weekend!

LIST OF ATTACHMENTS

#1 A Dim Outlook for Trumponomics...suspect it will get even dimmer

#2 A correction is already under way—great read re small and mid-cap, and how FAANG is hiding the real truth!!!

#3 Valuations and the next 7 Year Returns FOR THOSE WHO BUY AT THESE LEVELS—great read!

#4 The famed Ben Carlson and “the Canadian Housing Markets is Bananas”I agree –risky times in housing—rent is best right now folks...

#5 Russel review on Late Cycle lean out i.e. be cautious

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