This Is The Only Number That Can "Switch Off" The Bull Market

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The following excerpt explains the rationale for **SURE MONEY**.

> **SURE MONEY** is a new initiative by storied financial author and money manager Michael E. Lewitt. His sole mission is to help individual investors see what's going up and what's going down – from commodities and currencies to individual stocks and bonds – and how to profit.

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SURE MONEY

What's Going Up; What's Going Down; How To Profit Now

This Is The Only Number That Can "Switch Off" The Bull Market

January 17, 2017

By Michael E. Lewitt, SURE MONEY (bio at end)

The stock market has enjoyed quite a run since Election Day. But even before Donald Trump surprised the world and won the U.S. presidency, stocks were on an epic run that began in March 2009 at the depths of the Great Financial Crisis. The most impressive aspect of this bull market is that it defied the worst economic recovery in the last century and survived eight years of Obama administration policies that were hostile to economic growth and markets.

Rather than building on a solid economic foundation, the bull market benefited from zero interest rates, lower corporate tax payments, wage suppression and financial engineering in the form of epic levels of debt-funded M&A, stock buybacks and dividend increases. These factors have little if anything to do with the fundamental financial condition of American corporations. Eight years later, this leaves the markets (which really means the individual companies comprising it) overvalued and over-indebted.

The only important question for investors, however, is not where the market has been but where it is going. The answer to that question lies in whether the serious valuation, growth and debt headwinds facing stocks are more powerful than a set of structural forces that developed over the past two decades that pushed stock prices to extremely high valuation levels today – as high as we have seen in the last one hundred years.

Here is why we're being inexorably sucked into a bull market right now. And here's the only thing that can stop it…

This Bull Market Is Fueled By A Massive Power Imbalance

The most powerful structural force at work is an enormous amount of money pursuing a diminishing number of investment opportunities in U.S. stocks.

There are roughly half as many publicly listed companies trading on US stock exchanges today than 20 years ago. The peak of 7,322 public stocks was reached in 1996; by late 2015 the number dropped to 3,700.

The primary reason for the decline is massive M&A activity that removed many public companies from the mix; lesser reasons include the cumulative effects of private equity firms taking over public companies and a steady slowing of IPO activity. Heavier regulation on public companies such as the Sarbanes-Oxley Act passed in the wake of the Enron scandal, which significantly increased the costs of being a public company, also contributed to more companies

staying private. All of these factors contributed to serious shrinkage in the number of publicly listed companies over the last twenty years.

While the number of listed companies shrunk, thousands of new ETFs sprung up to take their place. But ETFs do not create new investment opportunities; they merely repackage existing ones. As a result, they magnify the shrinkage of available stocks by funneling more money into the limited number available. Stocks included in the most popular and largest ETFs attract more capital than those excluded from such ETFs without regard to their investment fundamentals.

This inflates their values beyond what their fundamentals suggests is justified. This is how you get an overvalued market, which is what we have. But it is also how markets can stay overvalued for long periods of time.

But this is only half of the picture. The other half involves the fact that there is much more money in the world today chasing this diminishing number of investment opportunities.

While the number of stocks dropped in half over the last twenty years, the amount of money available to invest in them exploded as a result of unprecedented efforts by central bankers to revive economic growth. These efforts accelerated after the 2008 financial crisis to the point where the world is now home to more than $200 trillion of non-financial sector debt.

The latest figure provided by the International Monetary Fund is $217 trillion of non-financial debt. Add to that tens of trillions more of global non-financial equity looking for a place to invest and you can see just how enormous the flood of money available to invest in stocks has become. The challenge of earning decent returns on capital is exacerbated by the imposition of historically low interest rates by central banks. With bonds serving as certificates of confiscation that guarantee negative returns for years to come, money is naturally drawn to stocks that at least offer the prospect of positive returns.

Markets are currently celebrating the election of a pro-business Republican to replace an anti-business Democrat in the White House. But while a more economically enlightened policy environment may offer a reasonable basis for buying stocks, the structural factors outlined above that favor money flowing into stocks make an even more powerful case. Even if US stocks struggle with higher interest rates and a strong dollar, the gravitational pull of enormous amounts of capital looking for decent returns into a shrinking pool of stocks may make it much more difficult for a sharp sell-off to occur, certainly one that would last very long before all that money would come back into the market looking for "bargains."

I see only one thing that might stop this strong gravitational pull in the near future.

Stocks Have One Weak Spot – The 10-Year Treasury Yield

Right now, the biggest danger to stocks appears to be higher interest rates. Most observers (at least the ones I respect) put the danger zone at the 10-year Treasury hitting 3%.

I actually think the market could keep going until that yield hits 3.25-3.5% provided higher rates are seen as a sign of better economic growth. The Fed is telling people it plans to raise rates three times in 2017, an aggressive stance to which it is unlikely to stand up. But even 50 basis points (two hikes) would push 10-year yields close to 3% and closer to the day of reckoning.

With American corporations carrying more debt than on the verge of the financial crisis in 2008, higher rates will worry investors. And with total nonfinancial debt in the US hitting $69.4 trillion at the end of the third quarter of 2016 (excluding unfunded entitlements), higher rates will suck hundreds of billions of dollars out of the economy to pay interest (every 1% rise in interest rates costs the economy nearly $700 billion).

The yield on the benchmark 10-year Treasury is already up more than 50 basis points since the election and is almost twice its post-Brexit low last July. The only thing standing in the way of the next upward move is another weakening in the economy, which would also not bode well for stock prices if it materialized.

But until rates hit the danger zone, the structural situation where enormous amounts of money are available to invest in a diminishing number of stocks will remain a strong force supporting the market. That doesn't mean stocks are guaranteed to produce positive returns in 2017, just that the odds of anything worse than a garden variety bear market (down 10%) are limited. Further, all that money chasing the limited number of stocks will likely render any bear market short-lived, especially since investors are trained to "buy dips" since the financial crisis.

Of course, this does not mean a lot of stocks will not still go down – there are many lousy companies trading at unsustainable levels. It remains a stock picker's market on both the long and short side, but the structural forces supporting the market appear pretty potent for the moment.

Last week, markets were pretty quiet with the Dow Jones Industrial Average dropping 78.07 points or -0.4% to 19,885.73 and the S&P 500 dropping 0.1% to 2274.64. The Nasdaq Composite Index gained 1% to a record high 5574.12 as investors continued to buy stocks like Facebook, Inc. (FB), Amazon.com, Inc. (AMZN) and even the ridiculously overpriced and highly unprofitable Tesla Motors, Inc. (TSLA). The yield on the benchmark 10-year Treasury ended the week at 2.398% and the US Dollar Index dropped to 101.19.

With the Friday inauguration, Congress is already taking steps to repeal the disastrous and unaffordable Obamacare law and with a little luck President Trump will wipe a slew of anti-growth regulations off the books within the first 100 days of his presidency. This should provide a positive backdrop for a market that is already benefitting from record levels of bullishness.

For the moment, betting against all of this optimism, especially with the powerful structural forces described above at work, would seem to be unwise. Our overpriced markets will likely see a correction but it may not come until later this year after rates rise further.

BW: Information on the Author is provided on the following page.

ABOUT THE AUTHOR

Michael E. Lewitt

MICHAEL E. LEWITT has managed billions for institutional and high-net-worth clients and created several of the world's top-ranked credit and hedge funds over a 29-year career. He is widely regarded as the No. 1 credit strategist working today.

Michael graduated from Brown University and was a PhD candidate at Yale before earning a JD and LLM in taxation from NYU Law School. He spent 2 years in the tax department of Simpson Thacher & Bartlett.

In 1987, he joined legendary investment banking firm Drexel Burnham Lambert. He served alongside Leon Black in NYC, then Michael Milken in Beverly Hills, working on billions of dollars of M&A and corporate finance transactions until the firm filed for bankruptcy in 1990.

He then co-founded Harch Capital Management (HCM) to manage the Milken family's money, as well as the Drexel Burnham Employee Partnerships, a multi-billion-dollar portfolio of private equity securities that came out of the 1980s LBO boom. Under his leadership, HCM built up a successful money management business. Michael's investment team managed $1.25 billion in CLOs, one of the top-ranked high-yield credit funds (as ranked by Nelson's), and a dedicated short fund. They produced strong risk-adjusted returns for clients like Omega Advisors, Investec Bank, Goldman Sachs, and multi-billion-dollar state pension funds LACERA and TRS. Today, he manages The Third Friday Total Return Fund, L.P., which was awarded "Best U.S. Option Strategies Hedge Fund (Since Inception)" by BarclayHedge in August 2016, and earned the distinction of "2016 Hedge Fund Manager of the Year" for the entire U.S. from *Wealth & Finance International*.

But Mr. Lewitt is perhaps best-known for his written market analysis and predictions. *The New York Times* published his widely read editorial about the pending bailout of AIG in 2008. He was featured alongside Warren Buffett in the *Financial Times* and has contributed to *Forbes*, *Barron's*, *The New Republic*, *El Mundo*, and PBS NewsHour.

Michael's *Credit Strategist* newsletter has gained a large following around the world since 2001. It is read not only by the financial community but also by the media and policy makers. (He was recognized by the *Financial Times* for correctly forecasting the 2001-2 credit market collapse and the 2008 financial crisis.) He is also the author of "The Death of Capital" (Wiley, 2010) and "The Committee to Destroy the World" (Wiley, 2016).

Today, Michael is the editor of *Sure Money* and his elite research service, *Zenith Trading Circle*, where he pinpoints stocks that are about to fall. He also is the Global Credit Strategist at *Money Morning*.