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Winnie The Pooh and The Market

***e*Research Corporation** is pleased to provide an article by Keith Richards of **VALUETREND**.

In this article, Mr. Richards looks at various market indicators from a market sentiment point of view.

The article is reproduced below, beginning on the next page, or you can go directly to it at the following link: ***http://www.valuetrend.ca/winnie-pooh-market/***

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Wednesday, February 15, 2017

Winnie The Pooh and The Market

By: Keith Richards (bio at end)

"Pooh always liked a little something at eleven o'clock in the morning, and he was very glad to see Rabbit getting out the plates and mugs; and when Rabbit said, 'Honey or condensed milk with your bread?' he was so excited that he said, 'Both,' and then, so as not to seem greedy, he added, 'But don't bother about the bread, please." — A. Milne (1882-1956)

Sentiment, as some of you might know, is something of a contrarian indicator—particularly when viewing the sentiment (opinion) of the retail investing public.

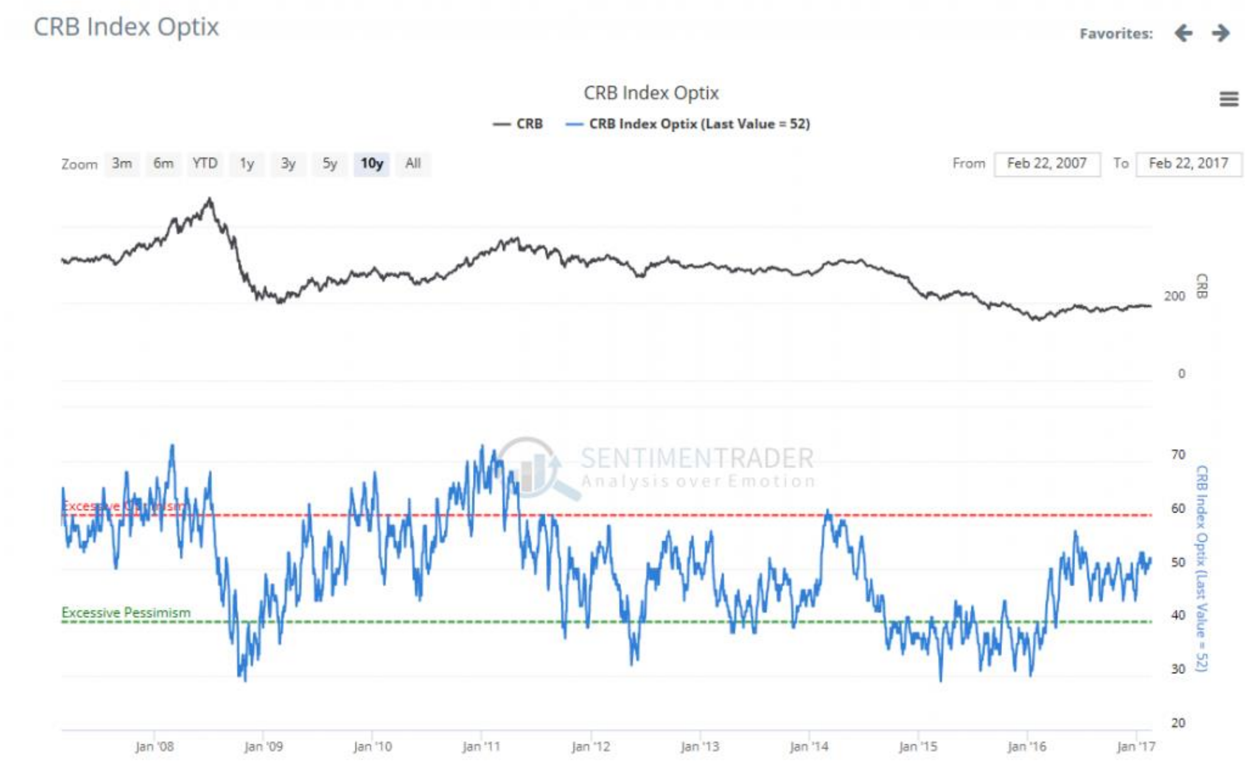
Too many happy retail investors leads to too much ownership of risk assets, which often leads to a market top.

The data behind this theory tends to show reasonable predictability in determining market tops and bottoms on reliable sentiment indicators like the Put/Call ratio, the Smart/Dumb money confidence ratio, VIX, and public opinion/media bias. Essentially, sentiment tends to measure greed and fear.

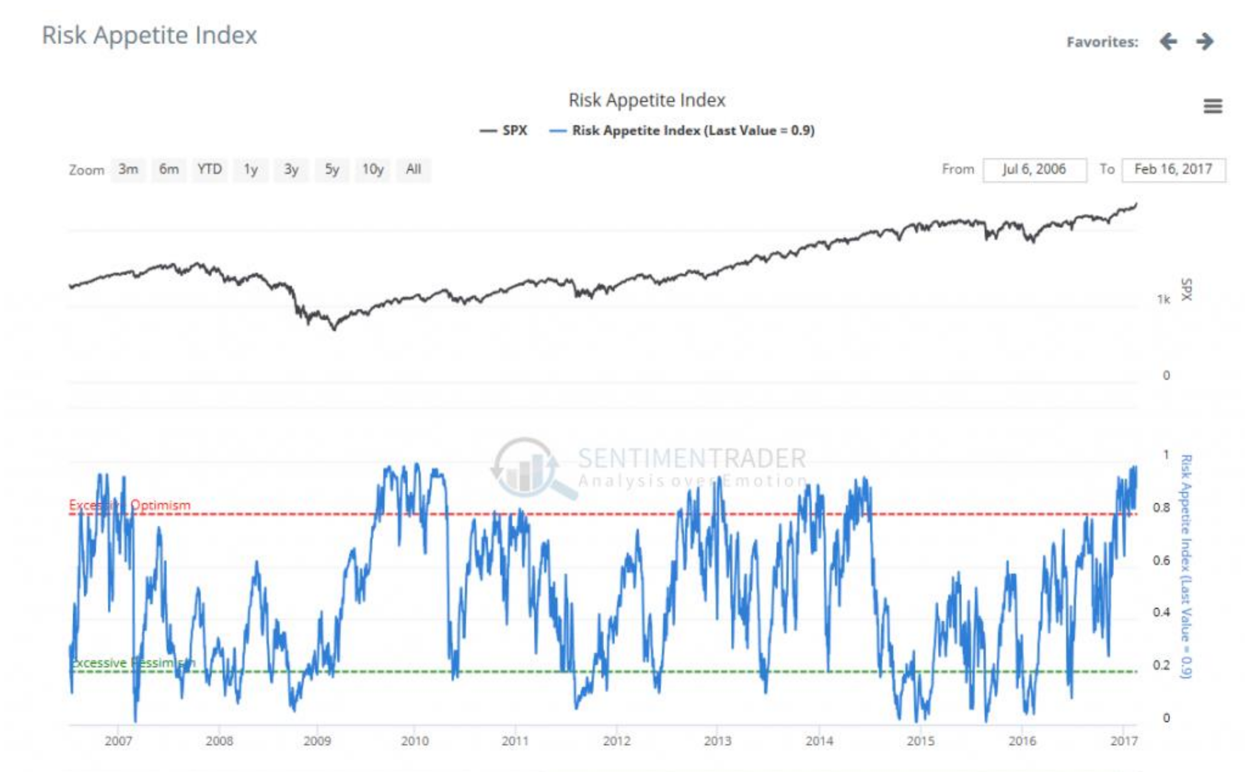
As Winnie the Pooh illustrates in the above quote from Milne's storybooks – nobody likes to admit they are greedy. Investors like to think they are perusing prudent investment strategies when they pile into or out of equities in mass – but their actions speak louder than their words.

There are a few gauges I tend to look at when assessing market sentiment. One of them is the **CRB index** that **sentimentrader** puts together. It is just a compilation of public opinion surveys done by such renowned sources as Ned Davis Research, Market Vane, Bloomberg, Larry Williams, and others. When this indicator reaches extremes, it has been a highly accurate indication of major market tops and bottoms. It is a big, macro indicator – and it tends to move slowly and, right now, it is not indicating an overdone market in either direction. So, from a macro perspective, the CRB is suggesting no major top or bottom is in place right now.

The chart below, courtesy of sentimentrader, shows us that the compilation line of the CRB is midway between extremes. This bodes well for mid-term investors in the market.



A shorter-term indicator created by sentimentrader that I also follow is the **Risk Appetite Index**.

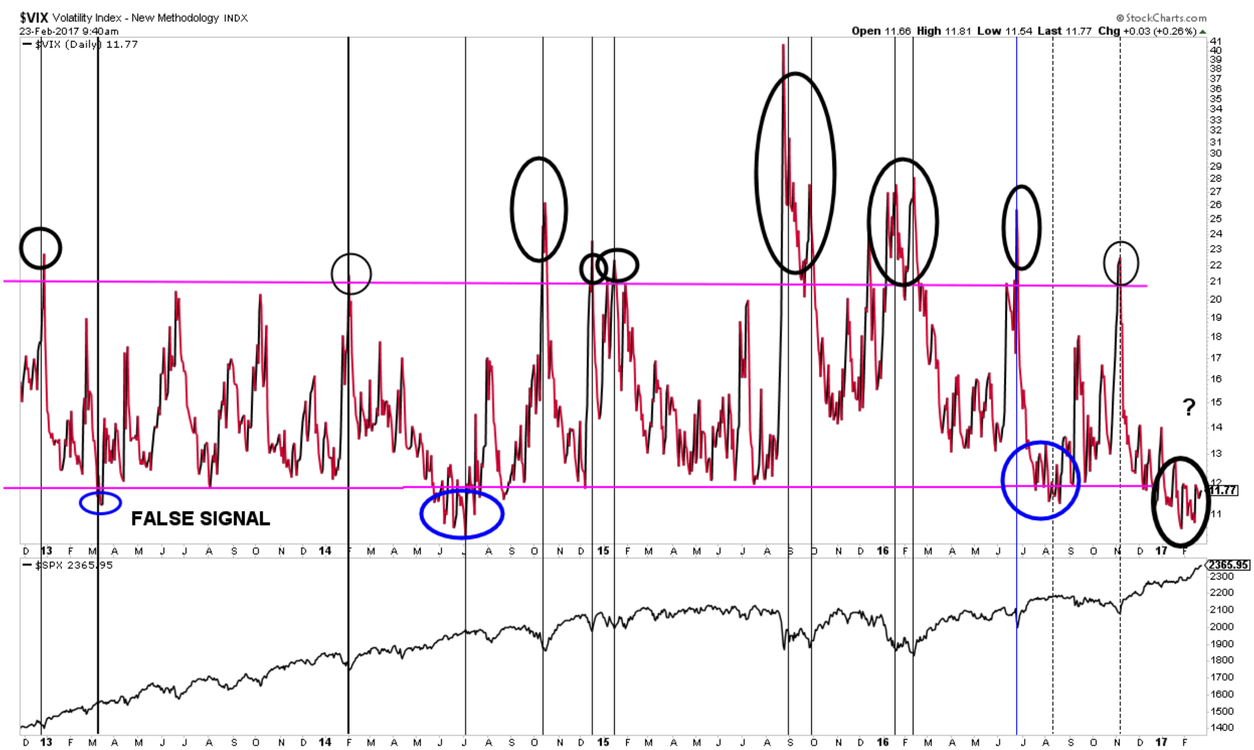


This indicator is a compilation of various research analysts (Citigroup Macro Risk Index, Westpac Risk Aversion Index, and UBS G10 Carry Risk Index Plus). They look at market behavior indicators like credit spreads, equity and foreign exchange volatility, gold prices and sector relative performance (such as between defensive sectors like utilities and economically-sensitive sectors like financials).

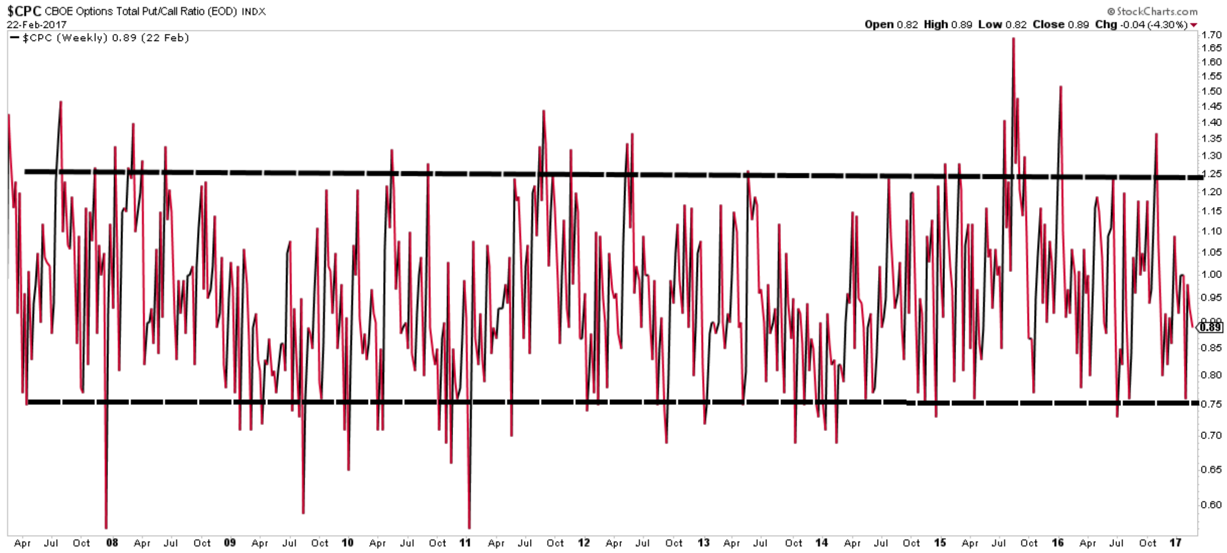
To quote their website: "As the index rises, it means that investors are becoming more and more risk-seeking. An index reading of 1.0 would mean that they are the most risk-seeking possible. As the index falls, investors are becoming more and more risk-averse. An index reading of 0 would mean that everyone has gone into a bunker and stored canned goods for the next apocalypse."

As you will note on the chart below, Pooh is, indeed, becoming very greedy and risk-orientated. As a shorter term indicator than the CRB, that might be something of concern to short- and mid term investors.

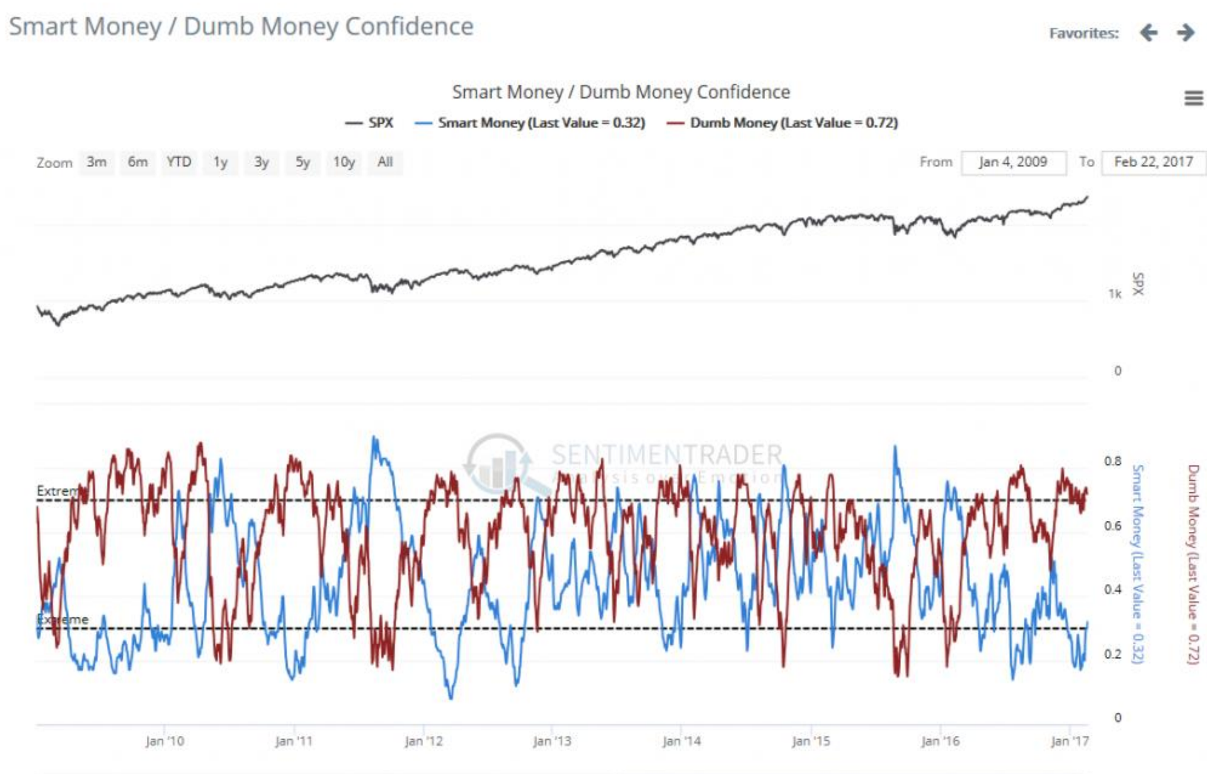
The **VIX** is often used as a near-term indicator for market risk appetite. Below, you can see a puzzling tendency recently for the VIX to remain below my pre-drawn "danger" zone of complacency. Typically, the VIX does not stay this low for such an extended period while markets rise. History does tend to repeat itself eventually, and the low VIX level should be of concern to near-term investors.



The **Put/Call** ratio measures the net trading activity in defensive (puts) options vs. bullish (call) options. Too many puts (compared to trading in calls) means too much pessimism – and vice versa. But only at extremes. I have drawn a line at the ratio of 1.25 puts/1 call as bearish (top line) and 0.75 puts/1 call as bullish (bottom line). Currently, the ratio stands at around 0.9 puts /1 call. This is a neutral rating.



Finally, I will also note that my favorite sentiment indicator, **the Smart/Dumb money** ratio of confidence, remains in bearish territory with a high level of confidence by retail “dumb” money – contrasting a low level of confidence by the more investment savvy “smart” money group. Note the low level of confidence by “smart” money (blue line) vs the high confidence by “dumb” money (red line). Do a search on this blog for greater explanation of whose opinion it is that sentimentrader tracks to formulate these two groups. This too can be a shorter-term market indicator and, as such, suggests some potential for near-term correction.



Conclusion

While some of the indicators suggest caution, some of them suggest no need for worry (specifically the Put/Call ratio, and the CRB public opinion compilation). My two cents worth: there is probably some room for a correction in the near-term, but the balance between these indicators suggests a correction, if any, may not be too extreme.

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See **About The Author** below.

ABOUT THE AUTHOR

ValueTrend Founder and Owner, Keith Richards, has been in the securities industry since 1990. ValueTrend manages over $100 million through a discretionary investment service for high-net-worth clients.

Keith Richards has been in the securities industry since 1990 and is a highly regarded member of the small, exclusive community of Chartered Market Technicians in Canada. Mr. Richard's articles appear regularly in INVESTORS DIGEST, MONEYLETTER, GLOBE AND MAIL, and the TORONTO STAR newspapers.

His appearances on BNN Television have inspired producers to acknowledge him as **"one of [our] most accurate technical analysts."** Mr. Richard's first book, SMARTBOUNCE: 3 ACTION STEPS TO PORTFOLIO RECOVERY, is available in bookstores and directly through his blog page **www.valuetrend.ca/blog/**. His second book, SIDEWAYS: USING THE POWER OF TECHNICAL ANALYSIS TO PROFIT IN UNCERTAIN TIMES was released in late 2011. He has been critical of the commission-based, follow-the-pack approach to investing – where brokers succeed regardless of performance.

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