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Analyst Article March 8, 2017

HUMBLE STUDENT OF THE MARKETS

eResearch Corporation is pleased to feature an article by Cam Hui, CFA who offers investment and trading insights on his website, **HumbleStudentOfTheMarkets.com**

Mr. Hui posts a market comment on the weekend plus one or two articles of interest during the week.

His subscription service includes annual, monthly, or daily pass options, and is focused on building a community of like-minded individuals with a common interest in investing and trading.

Today's article begins on the following page, and is entitled:
Mid-Week Market Update: Sentimental Warning For Bulls And Bears

You can access his website and subscribe to his service at the following link: www.humblestudentofthemarkets.com

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Bob Weir, CFA
Director of Research

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Wednesday, March 8, 2017

Mid-Week Market Update

Sentimental Warning For Bulls And Bears

BW: To enlarge any chart in this report, place the cursor on the chart and <Ctrl-Click>

Recently, there have been numerous data points indicating excessive bullishness from different segments of the market:

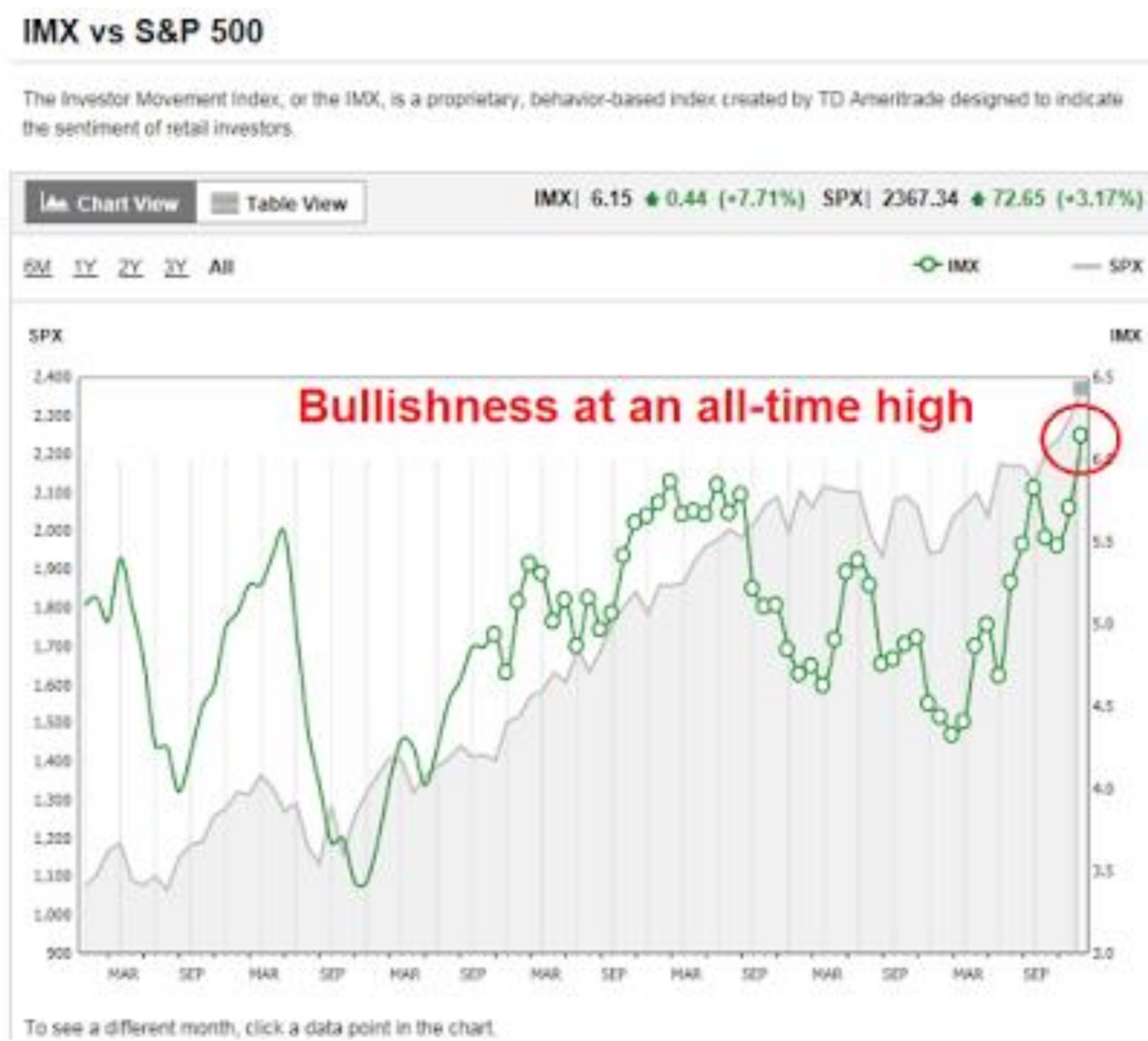
- Retail investors are all-in
- Institutional investor bullish sentiment is off the charts
- Cash is at a two-decade low in global investor portfolios
- RIA sentiment is at bullish extremes
- Hedge funds are in a crowded long in equities

These giddy sentiment readings are comforting to the bear camp (chart via Business Insider) and it will be difficult for stock prices to advance under such conditions. When everyone is bullish, who is left to buy? **(<Ctrl-Click> to enlarge.)**

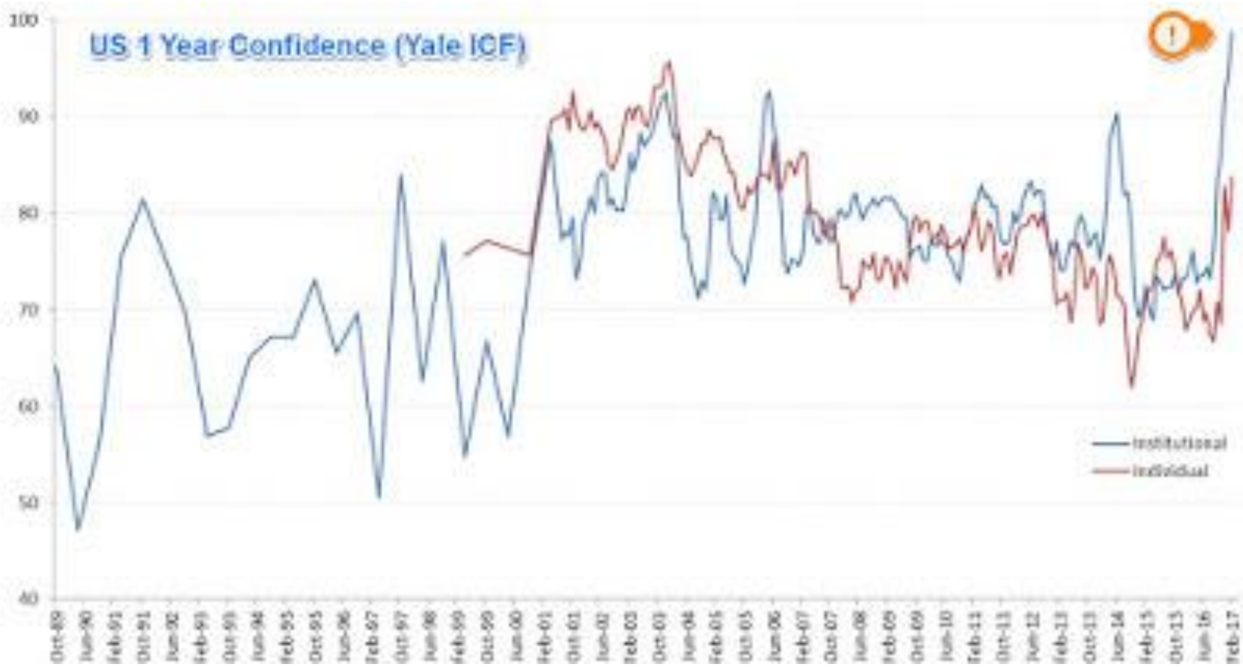
However, I would warn the bears that they should not go overboard and short the market with both hands. In the past, euphoric sentiment has not been a good indicator for pinpointing market tops.

Too Much Bullishness

In the past few days, I have been surprised at the number of reports of excessively bullish sentiment. The latest readings from [TD Ameritrade Investor Movement Index]() shows that retail investor bullishness is at an all-time high (annotations in red are mine).



The Yale School of Management survey of investor confidence, which has been surveying investors for close to two decades, shows that both individual and institutional investor confidence have been surging. In particular, institutional confidence has risen to an all-time high.



Equally worrisome, Ned Davis Research found that cash is at historic lows in global portfolios (via Bloomberg):

> Here is another way of thinking about how far stocks have come in nine years. Relative to balances in money market funds and cash among mutual fund managers, the value of global equities is the highest in almost two decades.
>
> That observation courtesy of Ned Davis Research, which framed the comparison as an indication "cash is underweight" in Planet Earth's asset portfolio. Another way of describing it is that equities have risen so much from the depths of the financial crisis that their value is blotting out everything else to an extent not seen since the dot-com bubble...
>
> In a Ned Davis calculation that treats the global investment portfolio as an amalgamation of stocks, bonds, and cash, the latter now makes up about 17% of investor portfolios, less than half of its allocation in 2009 and close to the lowest since 1980. While bond holdings remained relatively steady over the same period, surging equity values pushed its share to about 60%, well above the long-term average.

> As a sentiment gauge, the study is a distant relation of popular studies of investor and newsletter-writer optimism or even price-earnings ratios. In the options market right now, the CBOE Equity Put/Call Ratio fell to 0.53 last week, tied for the lowest since December 9 and 20% below the measure's one-year average.

In addition, the latest NAAIM survey of RIAs, who manage the funds of individual investors, show sentiment to be at a bullish extreme (annotations in red are mine).

Finally, [Archaea Capital](#) recently observed that the implied equity exposure of hedge funds show a crowded long reading.

If the sentiment of individuals, institutions, RIAs, and hedge funds are all at bullish extremes, who is left to buy?

<continued>

Sentiment An Inexact Top Calling Indicator

I would warn the bears, however, that sentiment models have a spotty track record at calling tops. Consider this chart of AAII sentiment (black) and Rydex cash flow sentiment (green). The blue vertical lines are the buy signals indicating periods of panic, while the red vertical lines show the bullish extremes. As the chart shows, the buy signals work much better than sell signals.

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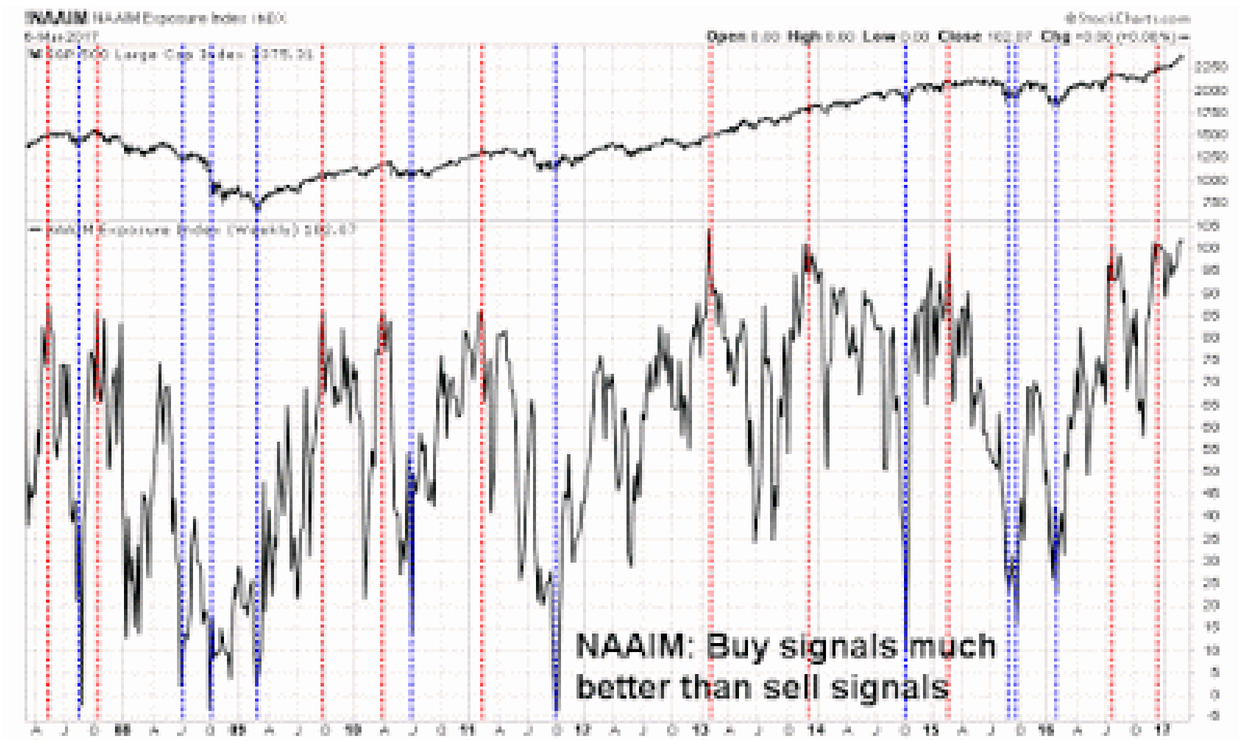
The same story holds for NAAIM sentiment. They are much better at calling bottoms than calling tops.



Caution, Not Panic

Most of these studies have only analyzed one single sentiment indicator in isolation. What happens when all the sentiment indicators show excessively bullish readings?

I have no good answer for that, but I interpret these conditions as the market poises for a correction.

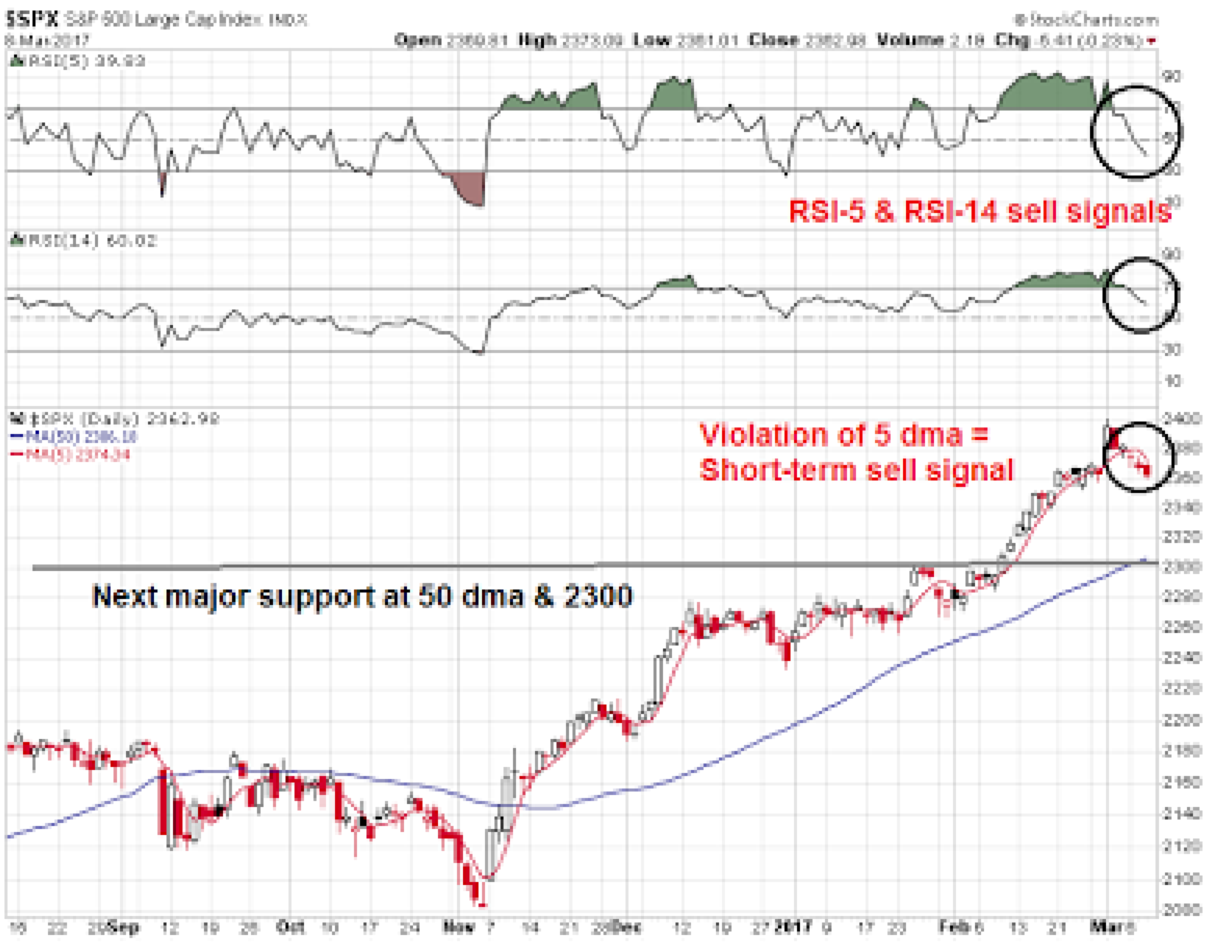
Ed Clissold of Ned Davis Research (see above) stated: "It is a way of showing stocks are pretty stretched, but that is not to say they are going to go down tomorrow. It just means there is not a lot of cash to act as a shock absorber. This measure does tend to mean-revert over time, and we are near the low-end of the range, so this ratio will go back up again."

Art Cashin of UBS recently called for a 5-7% correction on CNBC.

> As major indexes hovered in the red on Tuesday and some stocks were coming off 52-week lows, Art Cashin told CNBC that the market could be setting a stage for a minor correction.

> "It is a mild warning signal, to tell you the truth," Cashin told "Squawk Alley." "When we have seen those kinds of moves before, the market has either stalled or actually pulled back somewhat. Not anything climactic, but you could be setting up for [a] 5 to 7 percent pullback."

In light of the recent technical breaks by the major stock indices, that sounds about right.



Disclosure: Long SPXU, TZA

Regards,

Cam Hui

Humble Student of the Markets, Inc.

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