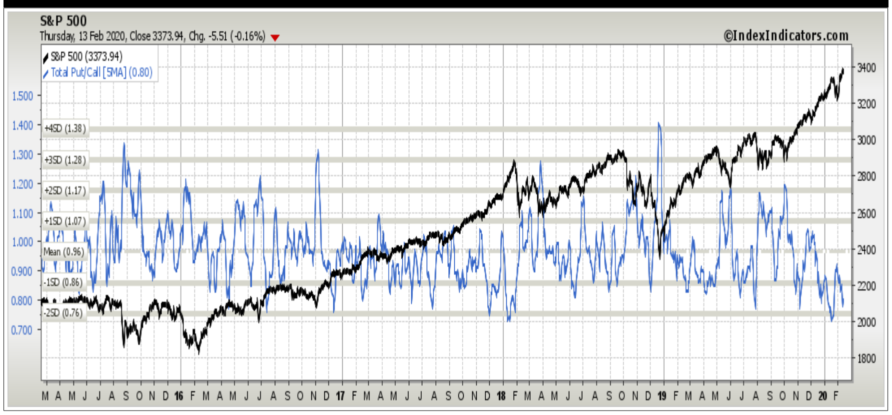
Insider Money
GOLD CASH BONDS STOCK
18th YEAR
Issue No. 142 ▪ Feb 16, 2020 | Monthly | Editor: Stephen Elliott Briese

Stock sentiment extreme by any measure.

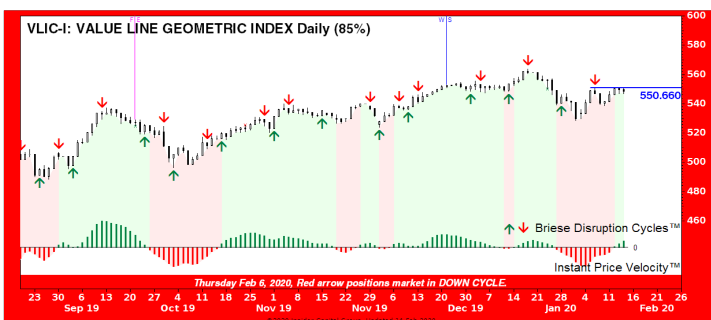


CBOE S&P 500 TOTAL PUT/CALL Ratio: Put buyers (bears) / call buyers (bulls) ratio at extreme only seen at stock market tops.

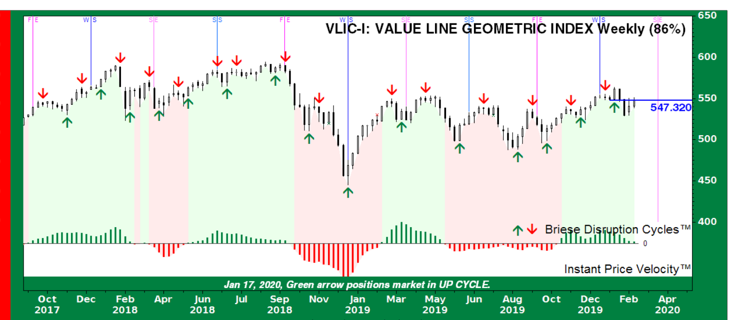
Asset Class	Index	2019 YTD
Gold	Futures	+2.67%
Crude Oil	Futures	-16.20%
Equities	Wilshire 5000	+4.64%
Bonds	T-bond Futures	+3.82%
Euro	Dollars/euro	-3.49%
Real Estate	PHLX Housing	+7.57%
Commodities	Goldman-Sachs	-10.60%
	Average Return	-1.93%

Mutual Fund	Index	2019 YTD
Bear Stock	Rydex Ursa	-4.32%
Bear Bond	Rydex Juno	-6.11%
Bull Bond	iShare IEI	+1.34%
Junk Bond	SPDR JNK	+0.95%

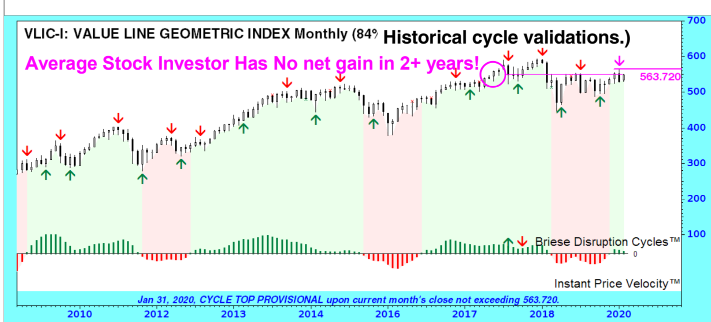
Briese Disruption Cycles™ : Value Line Geometric Index



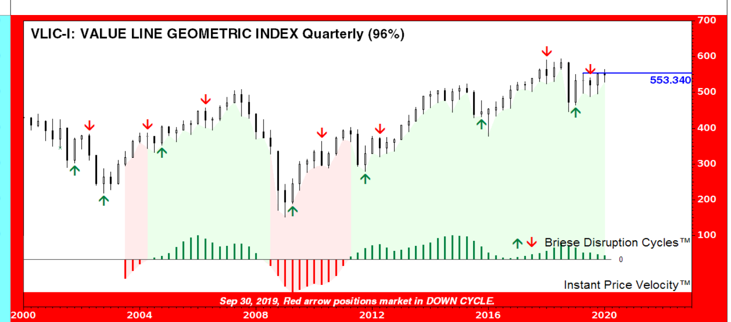
Thursday Feb 6, 2020, Red arrow positions market in DOWN CYCLE.



Jan 17, 2020, Green arrow positions market in UP CYCLE.



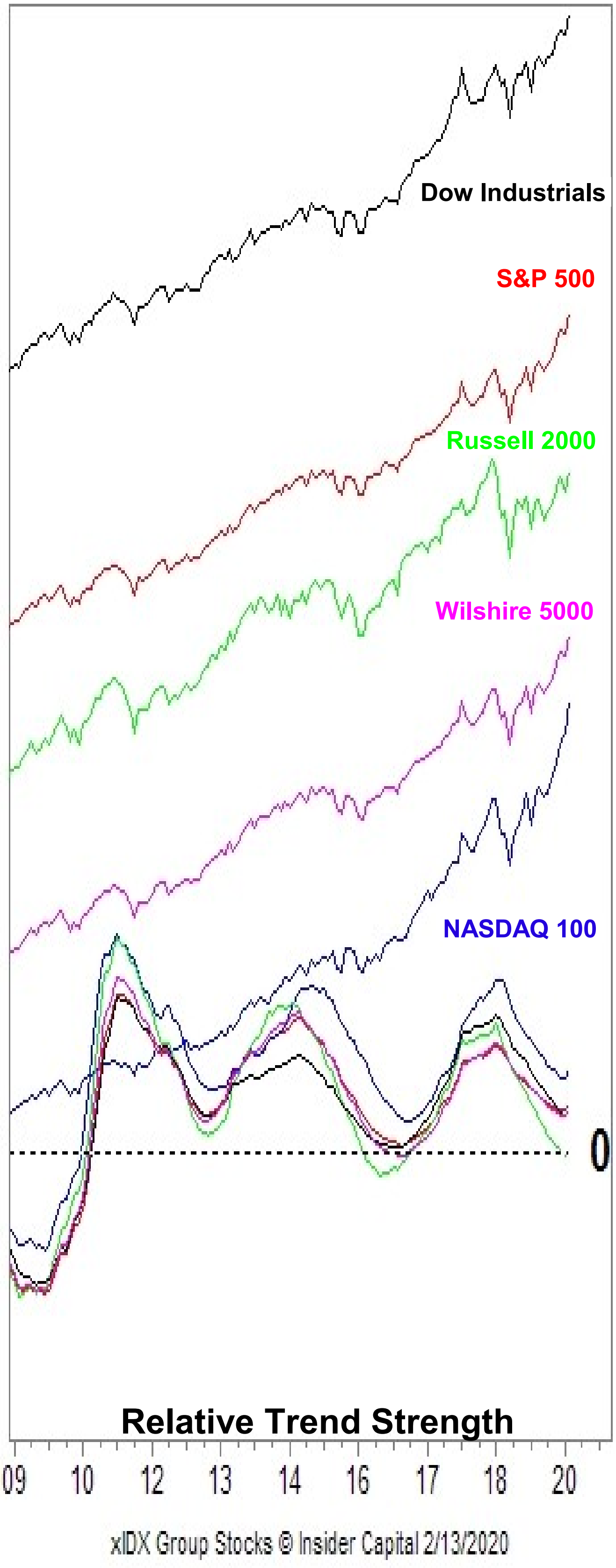
Jan 31, 2020, CYCLE TOP PROVISIONAL upon current month's close not exceeding 563.720.



Sep 30, 2019, Red arrow positions market in DOWN CYCLE.

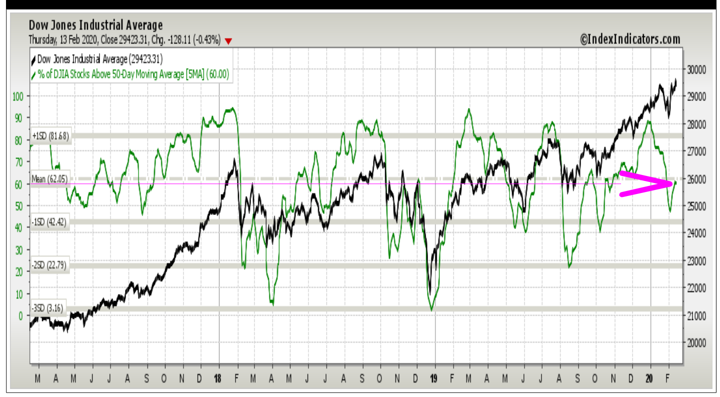
EQUITIES

Stock Indexes Price Monthly



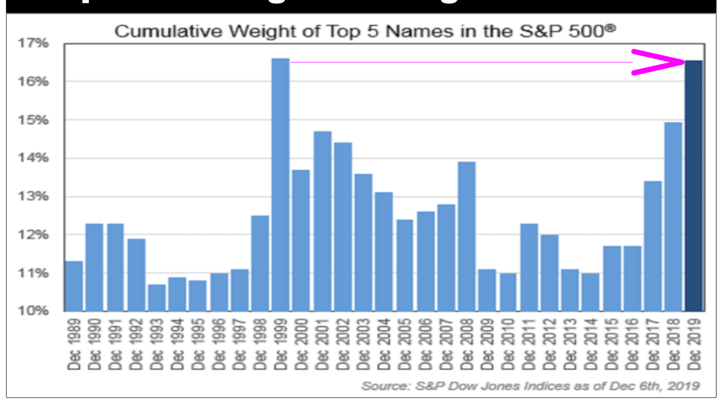
Stock market sentiment indicators have approached or exceeded bearish extremes only seen at 1929 or 2000 market peaks. Following the initial Coronavirus panic, investors have plunged back into a very few big-name issues to push cap-weighted indexes to record highs with historic non-confirmation from the majority of broad-based indexes such as the Russell 2000 (at left) and the Value Line Geometric Index, reflecting average investor portfolio (page 1).

Dow 30 Stocks Above 50-Day Average



The cap-weighted Dow 30 Industrial Index set a new record with just 18 stocks above their 50-day average. The narrowness of this rally is confirmed by the cap-weighted S&P 500:

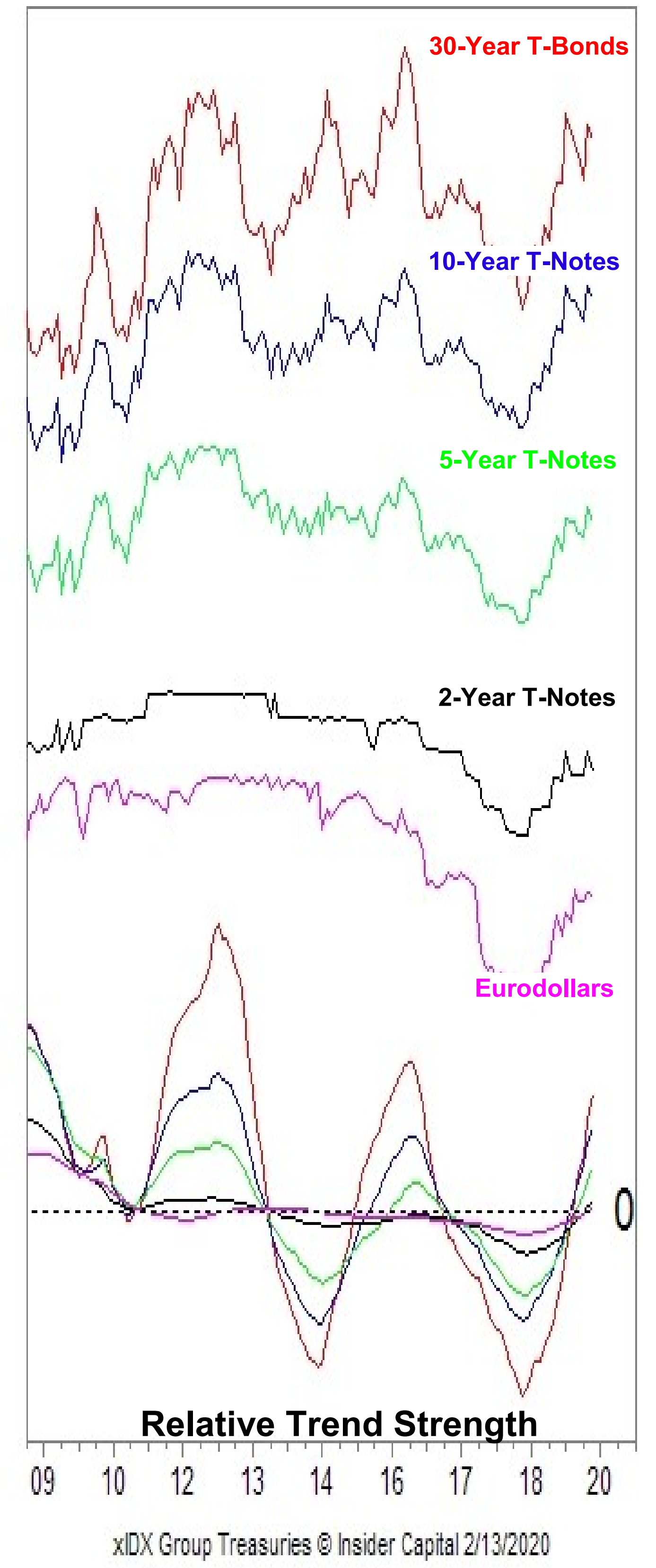
Top 5 S&P Highest Weight Since 2000



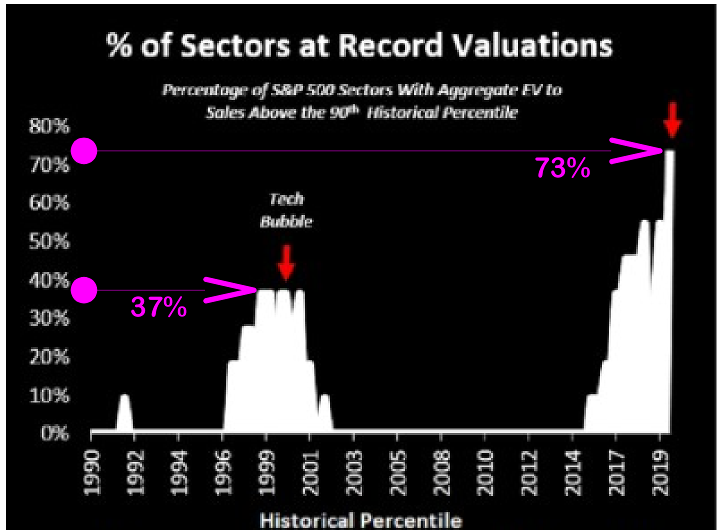
The top 5 stocks alone account for over 16% of the S&P 500 Index, a feat only seen once in stock market history—the 1999 Tech Bubble.

Only this time, it is not just a tech bubble, but the bubble of all bubbles, with 8 out of the 11 S&P economic sectors above the 90th percentile of historic valuations based on price to sales. This is twice the total of the Tech Bubble (table and chart next page).

TREASURY FUTURES MONTHLY



% of Sectors at Record Valuations



Historical Percentile

Sectors	Tech Bubble	Housing Bubble	Today
Consumer Discretionary	76%	44%	99%
Consumer Staples	57%	43%	96%
Utilities	8%	71%	100%
Health Care	75%	29%	55%
Information Technology	100%	63%	98%
Communications Services	95%	78%	99%
Materials	41%	76%	94%
Energy	78%	73%	77%
Industrials	91%	58%	99%
Real Estate	-	-	100%
Financials (Price to Sales)	63%	75%	50%

Source: Bloomberg ©2020 Crescat Capital LLC

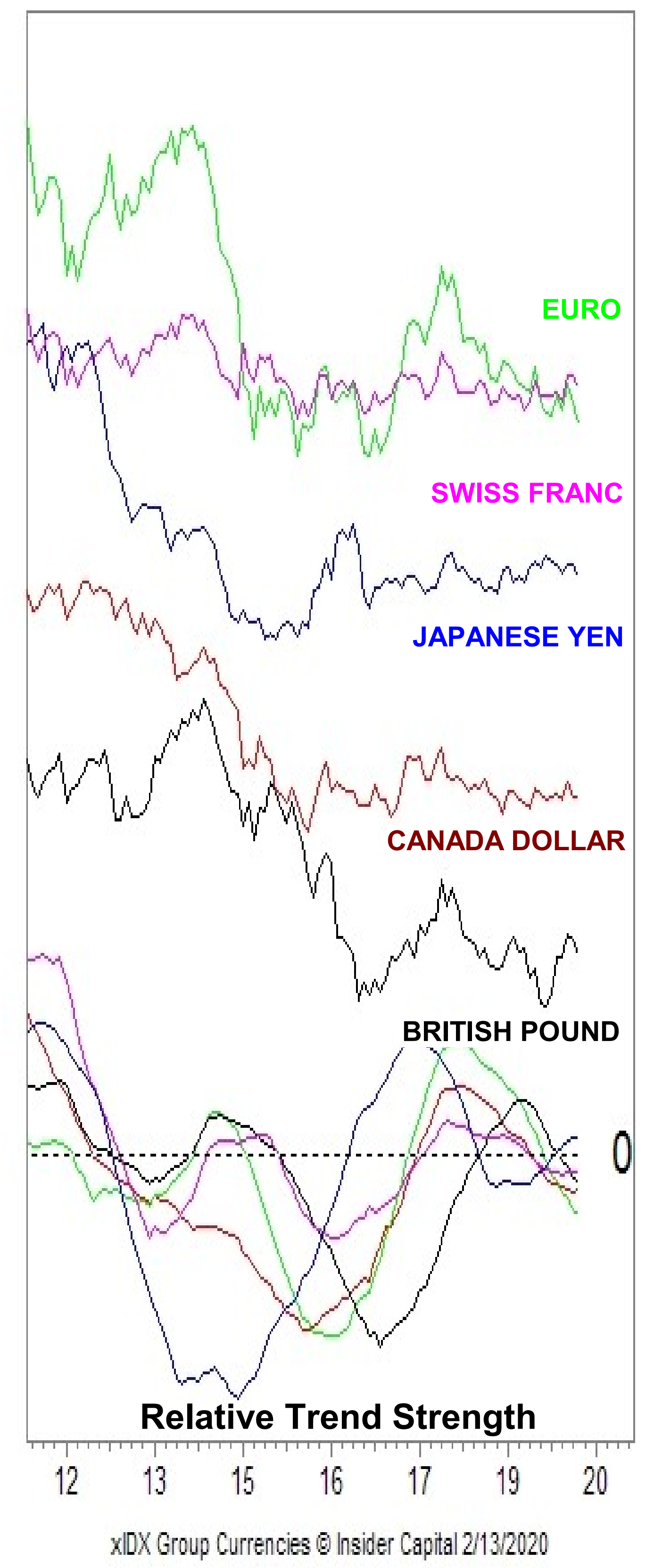
The current market bubble is singularly peculiar. On the one hand, it is historically narrow in the number companies that are participating in the push to record highs—only 60% of stocks are even priced above their 50-day average, with a near-record 16% weighting carried by just 5 issues.

On the other hand, this bubble is broad-based in the sense that only 3 of 11 market sectors are not historically overvalued. During the 1999 Tech Bubble, it was just the opposite as only 3 sectors posted valuations above 90% of their historical range. And during the 2007 Housing Bubble, no sector was above 75%.

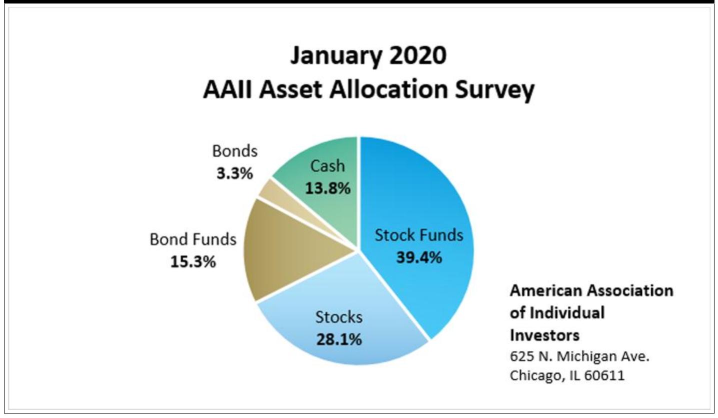
Another area where the current bubble is unusually broad-based is investor mania. The National Association of Active Investment Managers (NAAIM) reports an 86% exposure to US equities by its professional members and the American Association of Individual Investors (AAII) reports 68% equity portfolio exposure among its private investor members (with another 19% allocation to bonds) and holding just 13% cash. With 10-Year T-Notes within 3% of their 2012 record peak, investors are full risk-on, facing massive capital losses when these bubbles burst.

CURRENCIES

CURRENCY FUTURES MONTHLY

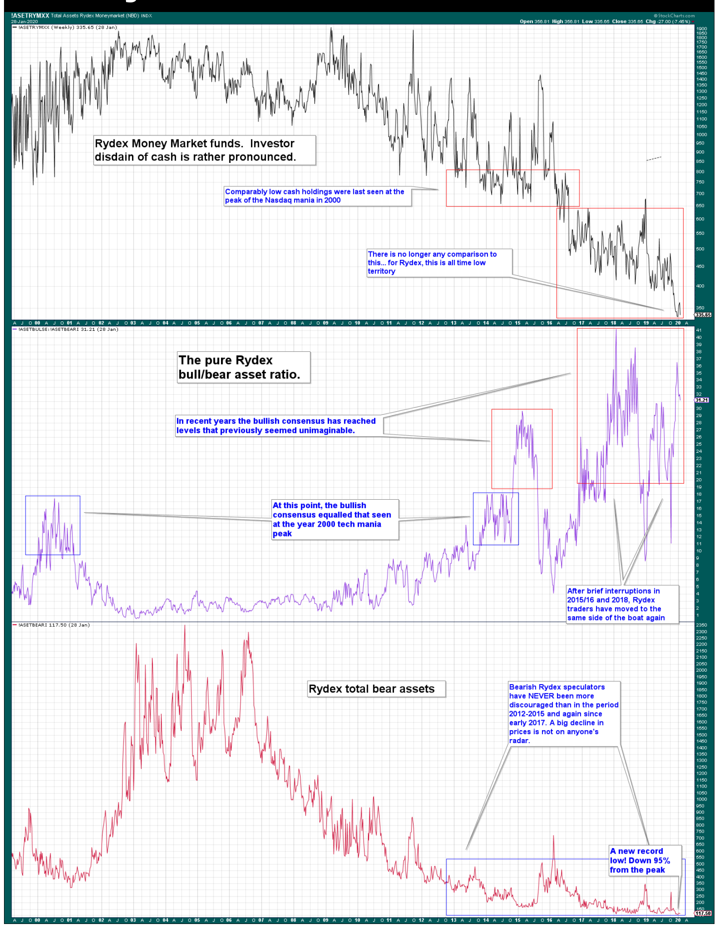


AAII Asset Allocation = RISK-ON



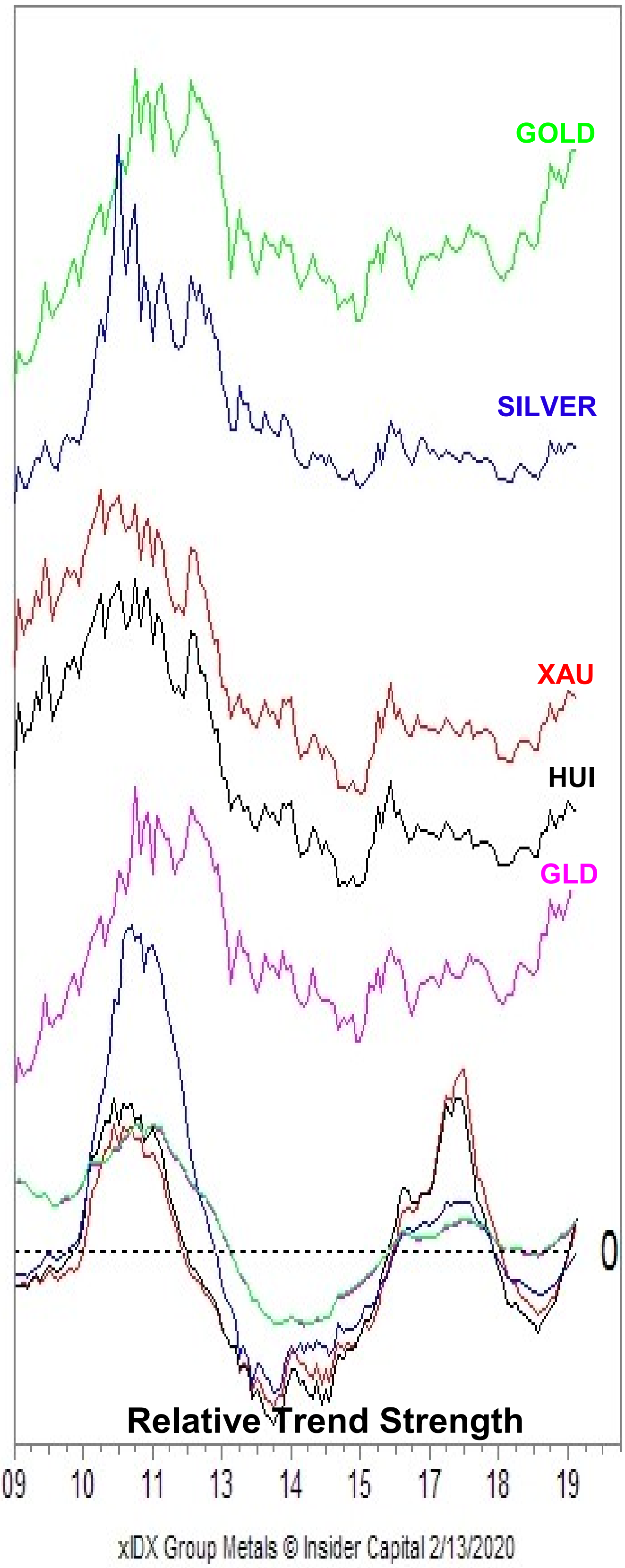
Meanwhile, mutual fund cash allocation dropped to under 3%, a new all-time low. These charts courtesy of Seeking Alpha put mutual fund investor sentiment in startling perspective as both cash and inverse (bear) investments are in record low territory. FINRA NYSE margin debt for December was below the record level of nearly $700b at the 2018 peak, but at almost $600 billion still reflects enormous leverage.

Nary A Bear In The Herd At RYDEX



GOLD & SILVER

PRECIOUS METALS MONTHLY



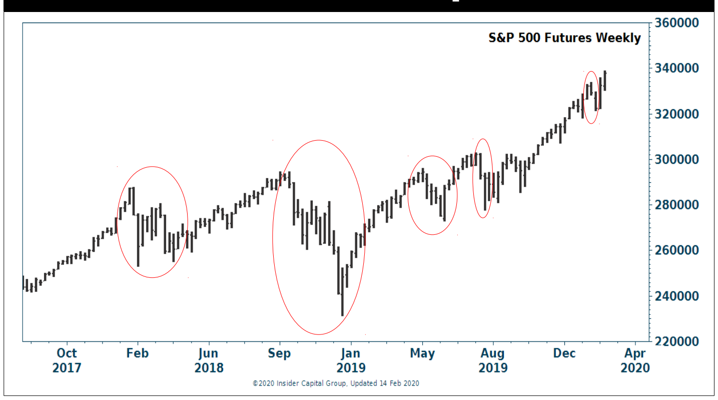
In the first four pages, we have seen striking evidence of a Fed Bubble (with support from Congressional tax cuts) that has driven a narrow range of large-company stocks to record prices while enticing near-universal investor participation. Ironically, the average investor has not seen a net increase in their portfolio balance for more than two years, likely contributing to a near-panic all-in bet by investors who do not want to be left behind. Here is a bubble's life cycle:

- Rising prices (and, in this case, a perceived "Fed Put") make investors overly optimistic.
- Positive feedback makes every dip a buy zone.
- Last potential buyers become stock owners (who now can only sell, not buy).
- Fewer buyers are left to bid up prices. **We are here.**
- Sellers eventually outnumber buyers.
- Prices fall. The more sellers, the further.

There is no secret to what happens when the last buyer has bought. The only questions are: When? How fast the fall? And How far?. Like a rubber band, the more stretched prices are from their norm, the more painful the inevitable reversion.

The market has been at high risk for some time, with only a handful of scares (January – April and September – December 2018, May – June and August 2019, January 2020) to remind us that investing is not risk-free:

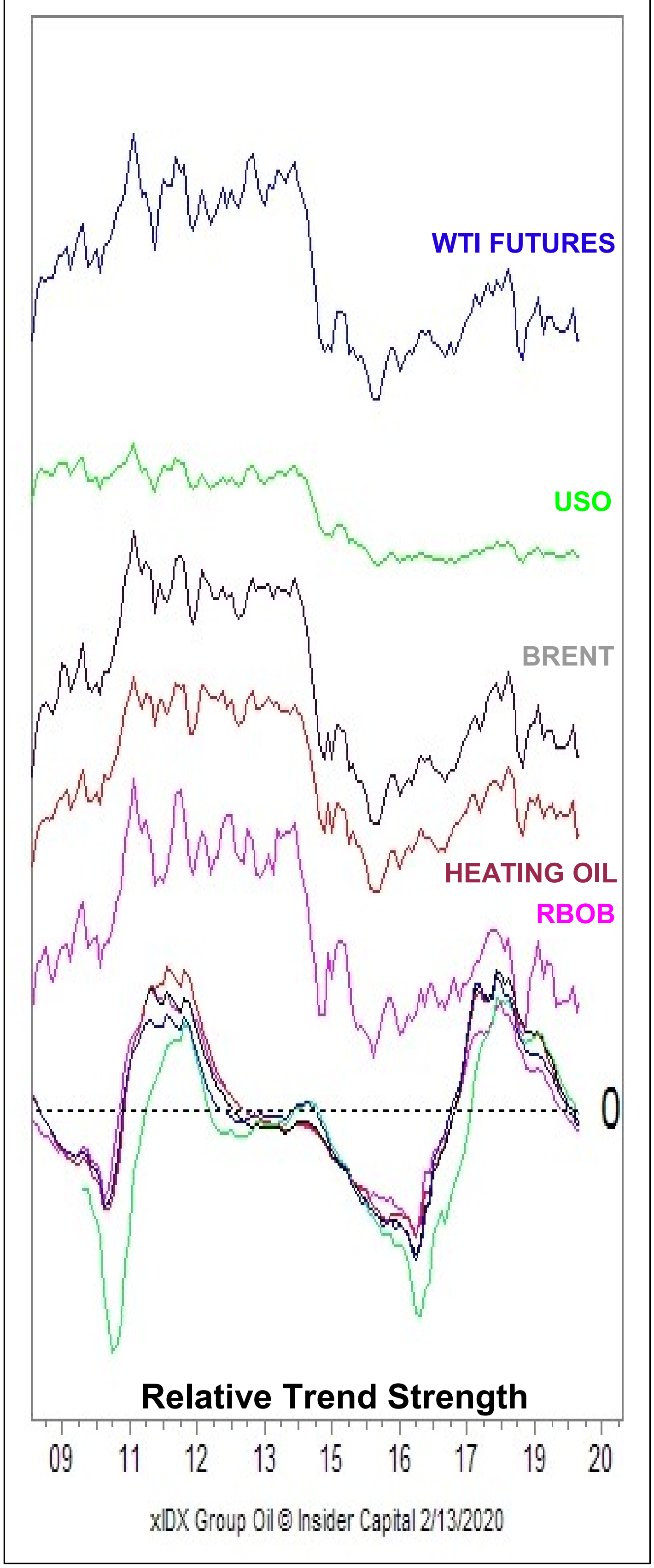
S&P 500 Wake-up Calls



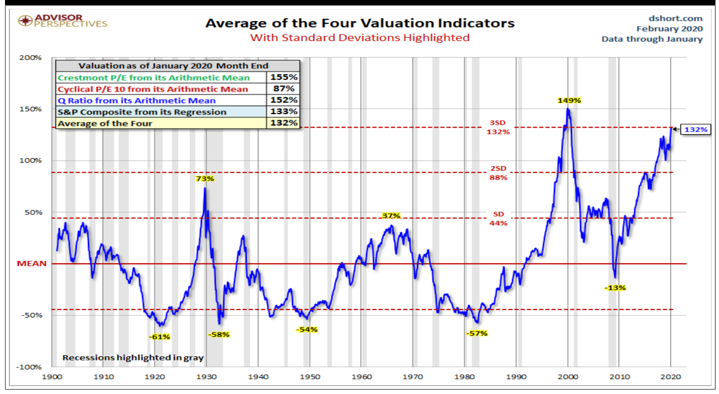
As the 10-year bull market advances, a lottery mentality attracts the last holdouts. Despite knowing the odds of winning a lottery, it is human nature to want to not miss out. *You can't win if you don't play*. Buying stocks at current price/valuation levels, your only chance at bragging rights is to be *the last buyer*.

CRUDE OIL

OIL SECTOR MONTHLY

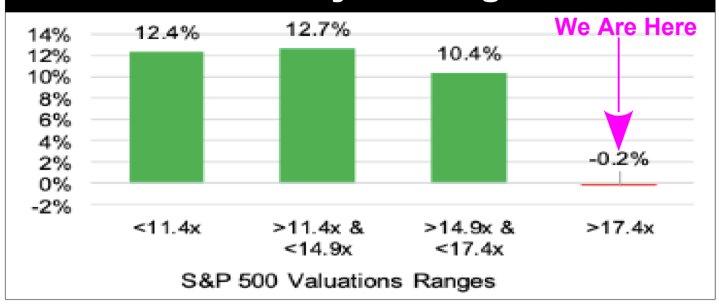


Valuations Have Been Higher...ONCE!



The average of four widely-watched valuation measures has risen to 132% above the long-term average, reaching 3 standard deviations above mean. *The Empirical Rule* in statistics states that 99.7% of the data falls within 3 standard deviations. Current stockholders are betting on the final 0.3%! Here is the return they have to look forward to over the next 1- and 10-year periods (spoiler alert, zero or below):

1-Year Return By Starting Valuation

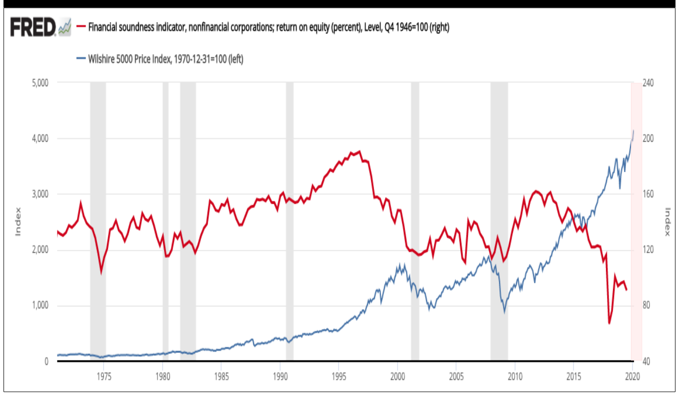


10-Year Return From Starting Date

Investors holding stocks in 1922, 1932, 1949, 1974, and 1982, with mean valuations in the 50% *below* historical mean range, realized total returns approaching 20% annually over the next 10 years.

Those who held stocks in 1929, 1965, or 2000, when valuations were in the range of 100% above average (now at 132%) saw *very* negative returns for the first couple of bubble-busting years and <u>little or negative return for the 10 year period following.</u>

Return On Equity Historic Plunge



Last month we documented the current earnings recession, showing that corporate earning growth went negative in 2019. While that chart should have brought dismay (and instilled some doubt about current analyst's rosy future projections), the above chart adds alarming perspective. The Fed calls this the Financial Soundness Indicator (red line). Downtrends in the earnings/equity ratio have reliably signaled both a bear market and recession. The pink line I have added at right illustrates the consequent imminent recession risk.

Corporate management has used endless Fed largess, liquidity injections, resulting low interest rates, and corporate tax breaks for personal profit from stock price performance incentives. They placated investors by boosting stock prices through unprecedented borrowing to fund corporate buybacks (detailed in last month *IM*), giving short shrift to plant and technology investment that could have averted the record free-fall in return on equity which is the long-term investor's security.

To management's credit, much like the short-sighted Fed and Congressional monetary and fiscal policies, respective, every potential investor has been sucked in, just as homeowners in the last cycle. The result will be just as economically damaging and personally painful—this time impacting a massive retirement generation. Already under threat of Medicare cuts, older workers will face forced early retirement as companies shed workers.

AE Briese Securities Held In 1929

While investors can expect little or no return over the next 10 years, that assumes they will hold on for that period. But this is not the way a mania works. How harmful can your actual stock market returns be? My great-grandfather—who put all of his savings into stocks, corporate bonds, and various other "securities" between 1926 and 1928 realized a <u>negative</u> 100% return in just one year!

I remember my great-grandfather fondly and later inherited his stocks and bond certificates (pictured above), my constant reminder that investing is not risk-free. I started commodity trading in 1973 and watched his son, my grandfather, as he took a large chunk of his savings and invested in dividend stocks in the summer of 1974 when he was 74 years old.

I started my investing career in commodities because silver was just breaking above $4.00 with stocks in a bear market. I will never forget his answer when I asked him how he *knew* when the bear market would end. "*I have no idea, but these companies are willing to pay me 8% a year to wait.*" He only bought one non-dividend-paying stock that I know of—Berkshire-Hathaway. (Unfortunately, I did not inherit that one:)

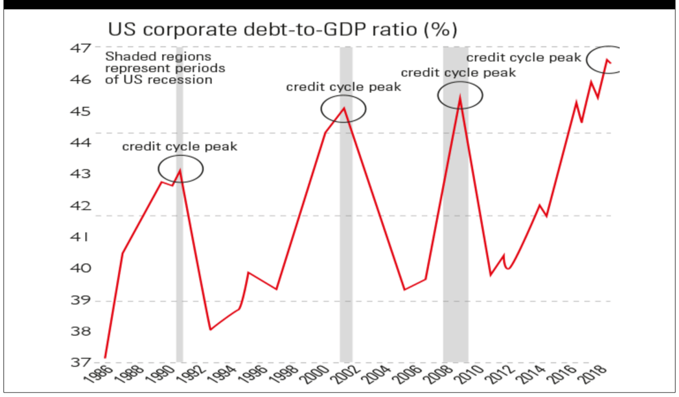
So, my advice passed down from Great-Grandfather to Grandfather to me: Be satisfied with 1.5 to 2% yield on government-insured notes until non-guaranteed dividends offer three to four times this return.

However, there will be some non-dividend-bearing sectors making important early upturns that we will be monitoring. First, where opportunities are <u>not</u>:

BONDS ARE A NO-GO

Treasurys are old-school safe-havens. If you have some, this is a seller's market. Because prices are approaching record highs, and yields move inversely to prices, you can sell now for top-dollar, while giving up a low-yielding asset that has huge downside potential as the business cycle turns down and inflation returns. In addition to capital risk due to falling prices, municipals, corporate (investment grade and junk), and all manner of other non-federally guaranteed issues carry risk of dividend "holidays," reductions, cancellation, and outright default. The COT data shows sell-side investment bankers hedging Treasury inventory in record numbers.

Non-financial Corporate Debt-to-GDP



Total non-financial US corporate debt has ballooned to $7 trillion. And this is not just a domestic problem. Corporate managers have used low rates to borrow funds for 12,000+ US mergers and acquisitions totaling $1.8 trillion-plus stock buybacks approaching another $1 trillion.

The International Monetary Fund (IMF) recently issued a dire warning that years of low-interest rates and easy financing have created mountains of risky corporate debt globally that could pop in a manner similar to the 2008 economic crisis.

The IMF pegs total debt-at-risk (defined as debt owed by companies whose earnings are insufficient to cover interest payments) at $19 trillion, or roughly 40 percent of all global corporate debt, noting some countries at particularly high risk:

"In France and Spain, debt-at-risk is approaching the levels seen during previous crises; while in China, the United Kingdom, and the United States, it exceeds these levels."

While Municipal bonds have, in general, a low default (but not zero) history, investors do face risks. The financial crisis of 2008, which brought with it actual defaults and fear, led to abysmal price performance for lower-rated, high-yielding munis, with many bond mutual funds losing over 20 percent of their value.

CURRENCIES

Last month we pointed out the long-term cycle was in a down phase for the US Dollar Index (see *IM*142 for details on how this index is weighted). For US residents, unless you trade futures or FOREX, there are not many straight forward hedges for your exposure to a declining dollar and resultant cost of living increases. But, I recently added an enormous number of ETFs to **Market Revolutions** (still available free in beta-test form). I noticed one short dollar ETF that made our list of "Currency ETFs". DISCLAIMER: Just making our cycle list is not a recommendation as our only metric is trading volume. Investigating individual securities is beyond the scope of our market letters. If you are not capable of performing your own due diligence, this is not for you. Nevertheless, experienced investors looking for a direct hedge against a dollar decline might wish to investigate this ETF:

UDN: DB US Dollar Index Bearish Fund

Dollar strength has naturally made for a poor recent performance in this inverse ETF, but buying low and selling high is the name of the game. You might wish to monitor Market Revolution charts for an indication that the projected cycle downturn in the dollar (upturn in this inverse ETF) is beginning.

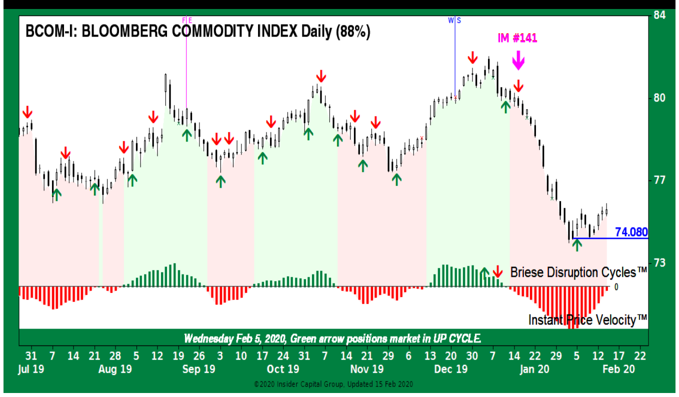
GOLD & SILVER

Nothing has changed in our long-term bearish outlook for precious metals since the last two issues, which covered these in detail. The *Commitments of Traders* (COT) data continues to show a huge speculative long open interest net position in all precious metals. Speculators, betting on 5-10% margin, will be forced to liquidate, plunging prices when a correction set in—sooner than later per our cycle work (*IM* 140).

OIL & OTHER COMMODITIES

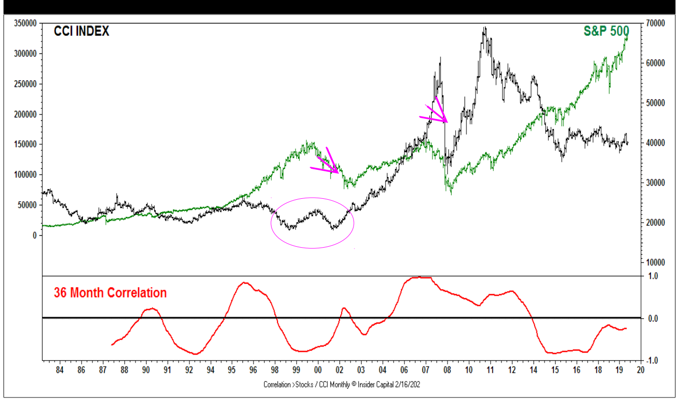
For every time there is a season. For commodity prices, that time may be at hand. Last month we correctly forecasted a "February Break" downturn in commodity prices. (You might call it a "Corona Break" this year, but this is a longstanding seasonal bottoming period for commodities.)

Bloomberg Commodity Index Daily



Market Revolutions signaled a daily cycle downturn as our January **Insider Money** was going to press. That cycle subsequently turned up, but this is a short-term (trading) cycle, not a sign for investors to go all-in commodities yet.

Commodities & Stocks Correlation



Commodity prices tend to decline as demand drops during stock bear markets. However, bear markets are also a drag on production, which typically takes significantly longer to restore compared to post-bear market demand surges. With increasing demand and reduced supply, the commodity sector tends to be among the early top performers following stock bear markets.

CCI Commodity Index 20-Year Cycle

There is a regular 20-year cycle in commodity prices that is in the early stages of its 10-year up phase. Long time readers will recall my March 31, 2008 call for a 50% drop in commodity prices (fulfilled by year-end) which was the subject of a Barron's front-page article. While a massive rebound in oil prices following its collapse to $30 (my forecast, which Barron's thought too implausible to include in the article, but was published online days before the top here), caused a secondary, higher commodity price high. We have now come full circle (or cycle, if you will) and are in the early stages of a 10-year upcycle in commodities.

I have circled the last cycle upturn from 20 years ago on both the above and previous charts. You can see that the 2000 – 2001 market crash produced a double bottom in commodities and that the second commodity price bottom preceded the ultimate bottom in stocks. I would not be surprised to see a similar pattern develop in this cycle. In anticipation of this coming turn, I have added two ETF portfolios to **Market Revolutions**: A "Futures ETFs", which includes individual long/short futures-based issues, and a "Commodity ETFs" that lists various types of broad commodity sector offerings. I expect commodities to be among the first sectors we recommend following the coming stock market crash.

RECOMMENDATIONS

Investors have no rational option but to be 100% in cash at this point in the cycle. Any rush-to-safety will provide at most a very temporary rush to bonds and gold, which are already at speculative price levels and risk. Keep your powder dry for buys of a lifetime to follow the *bubble of bubbles* burst. **[END]**