MARKET MONITOR

ROYAL ASSET MANAGERS, LLC
AUGUST 2020 VOLUME XV ISSUE 3

Dispersion of Predictions Exemplifies Uncertainty, Permeates the Market, and Plagues Investors

BY: MICHAEL ALEXENKO, CFA

In the aftermath of the 2008 financial crisis it was often said that the bull market that followed was the least-loved or accepted of any previous market rallies. Understandably so, when you had an economy that grew at barely 1.5% for several years while stocks gained on average in excess of 18%. This caused many to doubt the rationality for such lavish returns. And now it's déjà vu all over again as the often quoted Yogi Berra liked to say. The playbook to get our current rally is the same as the one used in 2009, but it's been raised to the 10th power. All the more impressive, or worrisome depending upon how you look at it, is the strength of the rally given the backdrop of social unrest and the risk for more to come with an election on the horizon that may not declare a winner until months after all votes have been cast.

The racial tensions and the political risks that are present today can shake the confidence of the most optimistic investors that believe there's always a brighter future for America. There is probably more market curiosity today than at any other time in recent history and it's being roused by the pandemic. When you have millions of people unemployed and ordered to stay at home, they need something to fill their time, and trading data suggests they've turned to trading the market. This development caused the Shark Tank showman Mark Cuban to begin to opine that the current market is just like the one prior to the dot.com bubble burst. Arguably that was the last time, prior to this Covid-19 rally, that there was so much talk about day trading and the spike in new recruits to the personal trading platforms.
Cuban's forecast seems reasonable and might have some validity if it were backed by real data rather than mere intuition. About the same time that the loquacious Cuban was offering his sage observation, *Business Insider* reported that Barclays looked at the numbers and concluded that, unlike the dot.com bubble that drove winning stock prices, this market rally is not being meaningfully impacted by the jobless twenty-five year olds who might despise Wall Street but can't resist the allure of making some fast money. Barclays' research concluded that the stocks being purchased by the tech savvy day traders were underperforming the market, which means that their trades aren't the ones causing the market to reach new highs. So much for Cuban's idea that this market is ripe for a crash because it's built on novice gamblers using their favorite trading apps.

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A more intellectually based analysis is offered by Jeffrey Gundlach, who runs the largest bond mutual fund and has some prescient calls to his credit. Gundlach's view has an ominous tone to it as well. He believes that Coronavirus will continue to punish our economy and that we can expect "a wave of layoffs" to begin to hit white collar mid-management employees. His believes that stocks are significantly over-valued due to unwise Federal Reserve policy and -at some point- there will be a painful correction. However, Gundlach was also sure that the Covid-19 bear market would break through its March low, which at the present would require the market to lose over 34% of its value. He no longer makes new market lows a theme in his updated commentaries.

On the flip side to the negativity is the idea posited by the former Forbes columnist and billionaire Ken Fischer who directly addresses the concern about the direction of the market after the November 3rd election. Fischer contends that regardless of who wins the election the market is likely to go higher in 2021. That's a bold prediction but he uses historical facts to back his case. Citing years when either a Republican or Democrat candidate wins the presidency that the market generally moves higher in the year following the election, even when a change in party power occurs. There's a lot missing in this superficial conclusion. Take for instance that in 1981 the S&P 500 had a negative 5.33% return, but the remainder of the Reagan presidency was a fantastic success if measured only on the market's performance. It might be

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Synthesize Logical Ideas and Develop Flexible Strategy

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better to evaluate full presidential terms rather than isolating on the first year.

Goldman Sachs, like many large investment banking operations, has opinions that conflict with each other. Most recently, Goldman made the case that the market has gone and will go higher because the market is convinced that a vaccine will be wildly available in the USA late this year. Seems like a plausible argument but then they go on to say that a Biden victory could help the market because international relations will improve with China, because Biden will relax punitive tariffs and loosen trade. But in mid-July, Goldman wrote that a Biden presidency would assure the elimination of the Trump corporate tax cuts which would cause corporate profits to drop by at least 12%, which will be bad for stock returns. So, Goldman offers two diametrically opposed opinions and we are left to choose our favorite one or take both and divide by two.

For more confusion or entertainment, we can add a couple of quick ones to the mix from Bank of America and Morgan Stanley that epitomize the see-saw nature of current market predictions. Bank of America's chief investment strategist says, "I'm so bearish that I'm bullish," and Morgan Stanley's chief equity strategist says, "…expect a 10% correction which will be followed by a resumption of the bull rally." The latter makes some sense but getting the timing right is a tough needle to thread.

Last but not least is Warren Buffet, who's GDP stock valuation model is flashing red. Buffet instructs that when the entire stock market is valued at more than the country's entire GDP, you have an overvalued market. Not since 2000 has the market been this overvalued using this metric, but never have we had our economy be artificially put on hold causing GDP to crash which likely mitigates the usefulness of the Buffett rule.

As we see there is no scarcity of the number of diverse beliefs about what is in store for the market. The best we can do is synthesize the most logical ideas and have a flexible investment strategy in place that allows us to modify risk within reason. If our investment decisions are made based on sensible modifications to an investment strategy then we can more effectively use the information we gather and filter out some of the unhelpful noise.

Market Snapshot: The Bearish and Bullish Case for Stocks

By: Michael Alexenko, CFA

It sure does feel like the market is overvalued. When we have no resolution to the pandemic which is prolonging, if not jeopardizing, a strong recovery then it makes it difficult for companies to make profits-which is the ultimate determining factor of stock prices. Along with a sluggish economy there are some hints of inflation that are exhibited in the price of gold, the drop in the dollar and the rise in the 10 year Treasury bond rate. Even with a 50% surge in the market there's a lack of enthusiasm for adding to risk, because the economic recovery lags far behind where stock valuations are causing a good deal of skepticism about more upside potential.

On the other hand, maybe the market is seeing something that we are unable to at the moment? In general most economic data reports are beating expectations and confidence readings from small businesses are optimistic which is surprising considering that small businesses have been more damaged by Covid-19 than S&P 500 companies. Maybe Goldman Sachs is correct and the market is confident about prospective success with therapeutics and/or vaccines? This along with a huge stockpile of $4.5 trillion in cash sitting on the sidelines could justify another push higher for the market. You can now add this bearish and bullish case to the list above.

Publication courtesy of:

Royal Asset Managers, LLC

1576 N. Fifth Avenue Saint Charles, IL 60174

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