

Market Outlook:

Opportunity wasted

Being *invested* simply isn't enough. We have been warning for weeks that despite the market indices registering sequences of new highs, the valuation expansion in stocks has far outpaced the vast majority of underlying economic data. As a result, one must not only be invested to take advantage of the market's good fortune, but be invested carefully and with acknowledgement that, in every market cycle condition, there are leaders (which must be over-weighted) and laggards (which one tries to under-weight). As this "parallel disconnect" of divergence between fundamentals and valuation widens, we have to be careful about not conflating the two data sets as one, but instead be nimble enough to distinguish amongst the two using prudent methodology and asset allocation.

No one is trying to extinguish your enthusiasm for portfolio performance during the past 6 months. We do want, however, to identify the differences between an all-encompassing bull market and a news-driven hyperbolic response to exaggerated expectations.

What concerns me about unabated euphoria is that profound deterioration of relative strength quotients sometimes is overlooked, later to be manifested into problems that could have been averted.

Here, too, the figures are quite compelling that this is not a market of benevolent generalities, but an incredibly selective rally that favors speculation and euphoria over deferential, but muted, fundamental analysis. The fact that we are limited by upside price resistance points in the bull run should have "*warning sign*" written all over it.

To be sure, it is encouraging (and fun) that the market didn't just go "the other way" after the US election or the Brexit vote. But advancing without regard to mathematical standard deviation and "norms" usually means a commensurate *inverse* response later on. That it hasn't happened is compelling; that it *might* is foreboding.

Another unique characteristic of this rally is that it is happening in the absence of competitive "alternatives" from the bond market. For lack of a better phrase, stocks have been the only game in town for several years. Against this backdrop one would be blind *not* to consider that the market would drive steadily upwards. This does not mean, however, that everyone feels comfortable with this strategy. Let's just say that owning stocks to the exclusion of anything else works at present...until it no longer does!!

Reinforcing what's there

There is, in fact, no clear indication that "judgment day" is imminent. To the contrary, no trends have given any signals that their upside journey is due to expire. But bear in mind that in my world of *parabolic quantitative science* all things down will go up, and all things up eventually will go down. Such is the nature of computing probabilities using quadratic equations and sine waves.

The real roller coaster of the market is usually found in short term emotional volatility in which the news of the day (we call it "*exogenous noise*") diverts one's attention from longer term top-down analysis. This is where sharp divergences over the near term become smoother lines when seen through the prism of *time*. Here again, absent any suitable investment alternatives from other asset classes, the trend lines for stocks become somewhat skewed as to their accuracy about depicting the real underlying economic fundamentals versus everyone's desire simply to be invested, and not to miss all the upside action.

Do not under any circumstances confuse your portfolio good fortune with a never-ending upside trend line or presumptuous strategies of aggression. The fact is that the next correction will become reality at some point, and it makes no sense to throw all one's eggs into a single basket without also remaining diligent about investment discipline and practical portfolio methodology at the same time.

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