Aviator Update – November 2020
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Infatuated with Tina

What a month!

We closed out October with another brutal little pullback. Then as the US election unfolded we got a brutal little rally – despite the result being unclear. And then the news that a Covid vaccine is just around the corner…

Here's what that looks like for the S&P500 index:

All-time highs. Against an economic backdrop which is, well… less than all-time highs. But as we already know, the stock market isn't the economy and the economy isn't the stock market.

It gets better. How about US small-caps:

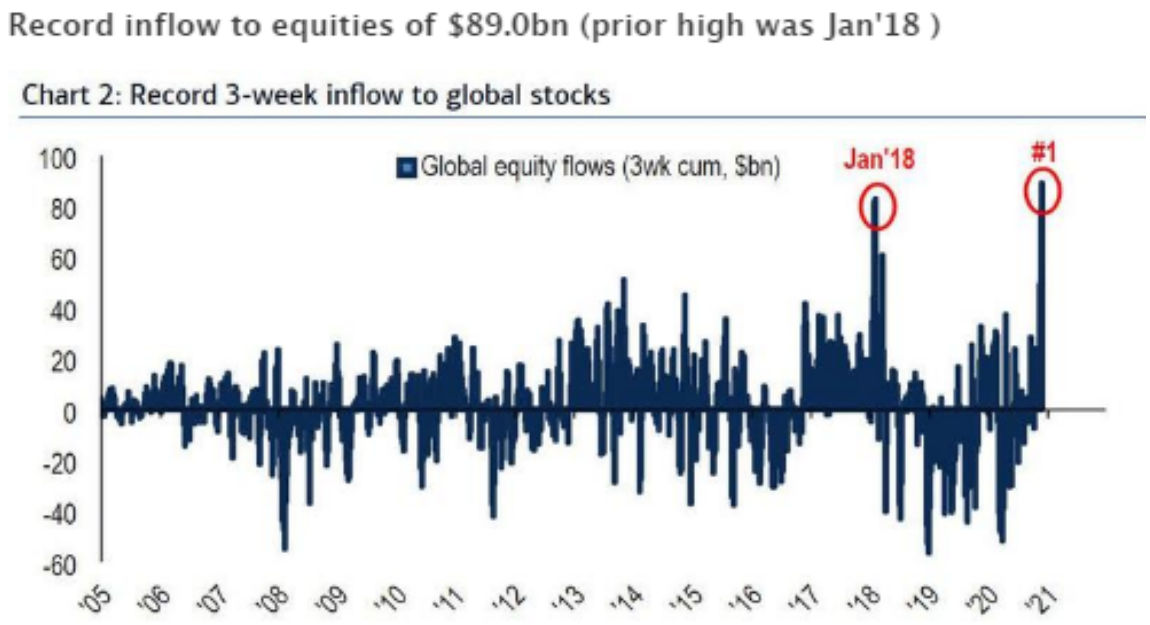
Around 20% in a handful of sessions. The market has practically "crashed higher"!

With respect to the US, the general narrative is that the markets are in a "sweet spot" – Covid will soon be a thing of the past (right?) and with the global economy re-opening, we're set for another sustained period of economic growth. All the while, markets are awash with liquidity as central banks continue to gobble up assets at a frantic pace via their "QE" programs. To top it off, there's still an expectation for more government fiscal stimulus in many nations.

How can we lose?

It wasn't just the USA. With a day or two to go in the month, global markets are poised for their best month ever!

This has been in part fuelled by equity flows that have been the highest ever in the past 3 weeks (chart courtesy of BofA Global Investment Strategy, EPRF Global, via Zerohedge):



Its pleasing to see that the Aussie market has been a beneficiary to this wave of enthusiasm. Here's our ASX200 as at the close on the 25th.

Some individual security charts are spectacular.

Commonwealth Bank:

ANZ – go your good thing!

Rio Tinto.

Qantas – what global pandemic?

From speaking with people, my sense that here in Australia the recent melt-up can be largely attributed to Tina:

“There Is No Alternative”…

Official interest rates here in Australia are now practically zero. Returns on fixed interest products (bonds, term deposits) now reflect this. If you want a decent return (or at least the potential to achieve a decent return), you better look further out the risk asset spectrum.

Former stockbroking colleagues I've spoken to have been taken by surprise by the new investment capital clients that have come to them with the rally. In essence, as the clients see it, with share prices below previous highs and a positive economic outlook, they see shares as a good option at this juncture because, well "TINA".

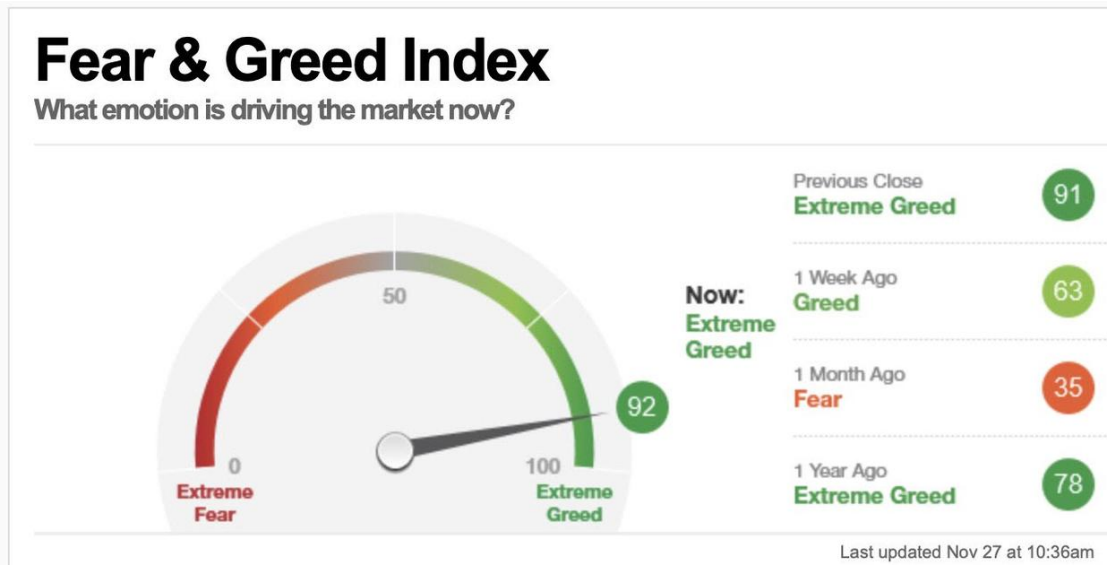
The main issue I feel these Aussie investors have has been demonstrated during this move higher is *global sentiment*. If global markets – particularly US markets – come off the boil, its rather improbable that Australia will escape the same fate despite perhaps being "less exuberant" to date.

The US markets have been over-valued for quite some time although we of course know that valuation is not a useful predictor of shorter-term market direction. Further, the march higher from the March selloff – in the face of a terrible economic backdrop – has been… how do we describe it? "Surprising"?

However, it's only been amidst these most recent moves that things have begun to feel a bit silly.

Indeed, some of the projections are getting silly. I think the most ambitious medium-term target I recall seeing in recent weeks is 6000 for the S&P500. We're seeing silly reasons for further gains such as the good old "cash on the sidelines" fallacy…

There're all sorts of useful sentiment gauges for US markets. The CNN Fear and Greed sentiment indicator is just one of them:



So right now, we have a market characterised by excessively bullish sentiment observable via all sorts of metrics such as Put/Call options ratio at historic lows, margin debt at historic highs, short interest vanquished by relentless gains and a technical backdrop very over-extended…

It needs to be understood that the current speculative features of the US markets are consistent with historical market “tops”. Now, I’m not brave or foolish enough to suggest we are at the top, but the fact that observable market conditions are reflective of prior market tops is inescapable.

If you’re a long-term, disciplined investor, take a moment to reflect on Warren Buffet’s old adage – “be fearful when others are greedy”.

On the flipside, there’s no reason why the market can’t work off its excesses and if investors remain inclined to speculate, further gains are entirely possible. As we have noted on previous occasions, it’s evident that the way in which major investors are approaching today’s markets is a factor. With a proliferation of algorithm and technical based trading systems, momentum begets momentum. More buyers reside at higher and the sellers are lower.

This game of investing doesn’t ever get any easier…