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OVERNIGHT 11/10/17

Bloomberg --

U.S. stocks climbed to record highs as Wal-Mart Stores Inc. led a rally in consumer shares, and energy producers climbed along with oil prices. The euro strengthened after Catalonia's president stepped back from declaring immediate independence from Spain.

Turkey's lira lost a gain of as much as 1.1 percent amid reports the White House backs its ambassador's decision to suspend visas and news that the country convicted in absentia a U.S. reporter on charges of "terrorist propaganda." The currency tumbled Monday as the diplomatic row with America flared up.

The dollar had weakened against most major currencies as President Donald Trump's feud with Senator Bob Corker clouded the outlook for his much-heralded tax reform. Traders are also waiting for minutes from the Federal Reserve's last meeting, which may provide more details on the path of interest rates and balance sheet tapering. The S&P 500 Index, Dow Jones Industrial Average and Nasdaq Composite Index all set record highs.

"The economy is kind of just chugging along here," said Brian Frank, portfolio manager at Key Biscayne, Florida-based Frank Capital Partners LLC. "It seems like investors just aren't able to put their finger on any risk in front of them."

In the U.K., sterling continued to recover from last week's drop after U.K. Prime Minister Theresa May won public support from Brexit hardliners in her cabinet for outlining contingency plans for leaving the European Union without a deal. The pound was also boosted by a fourth straight month of gains in U.K. like-for-like retail sales, and manufacturing and construction data that beat forecasts.

Gold gained as the greenback weakened, and West Texas oil rose above $50 a barrel before U.S. government data forecast to show crude inventories extended declines for a third week. Japan's Topix index closed at the highest since July 2007 and Korean stocks staged a catch-up rally after a week-long holiday.

What's coming up this week:

- Minutes from the most recent Federal Reserve meeting are due Wednesday.
- API and EIA crude data are delayed to Wednesday and Thursday, respectively, because of Monday's U.S. holiday.
- The International Monetary Fund and World Bank hold their annual fall meetings this week.

- Earnings season begins for major U.S. banks, led by JPMorgan Chase & Co., Citigroup Inc., Bank of America Corp. and Wells Fargo & Co. Also reporting will be BlackRock Inc., Domino's Pizza Inc., Samsung Electronics Co., German container company Gerresheimer AG, U.K. grocery wholesaler Booker Group Plc, and Sky Plc.
- The active Atlantic hurricane season will probably figure prominently in U.S. data on retail sales and consumer prices.

Here are the main moves in markets:

Stocks

- The S&P 500 Index rose 0.2 percent to close at 2,550.66 at 4:02 p.m. in New York, after climbing to a record 2,555.23. The Dow Jones Industrial Average gained 0.3 percent, and touch a high of 22,850.51. The Nasdaq reached a record 6,608.301, and finished the day up 0.1 percent.
- The Stoxx Europe 600 Index was little changed.
- The MSCI All-Country World Index rose 0.4 percent.
- Spain's IBEX Index fell 0.9 percent.
- The MSCI Emerging Market Index rose 1 percent.

Currencies

- The Bloomberg Dollar Spot Index fell 0.3 percent.
- The euro climbed 0.7 percent to $1.1816.
- The Turkish lira dropped 0.1 percent.

Bonds

- Spain's 10-year yield rose two basis points to 1.70 percent.
- Germany's 10-year yield was little changed at 0.44 percent.
- Britain's 10-year yield climbed about one basis points to 1.36 percent.

Commodities

- West Texas Intermediate crude rose $1.36 to $50.94 a barrel.
- Gold futures added 0.4 percent to $1,288.45 an ounce.
- Copper climbed 1 percent to $3.06 a pound.

BOND YIELDS WILL REACT DIFFERENTLY TO WHO SUCCEEDS YELLEN
(Bloomberg) --

If history is any guide, bond traders will be in for a volatile few days if Kevin Warsh is selected as the next leader of the Federal Reserve.

Or, it'll be smooth sailing in the $14.1 trillion Treasuries market if President Donald Trump taps Jerome Powell or Janet Yellen.

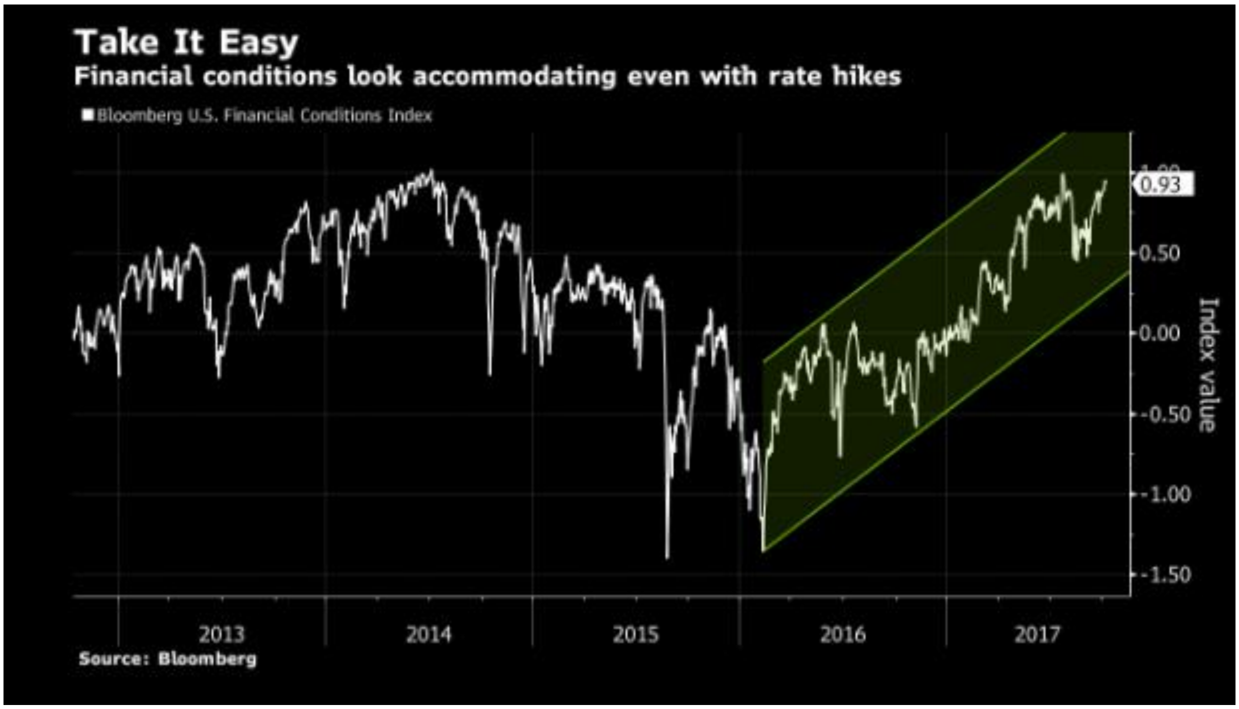
Strategists at Nomura give each scenario 40 percent odds. But while a Powell or Yellen nomination would nudge two-year Treasury yields lower by only two basis points in the following week, Warsh, seen as the front-runner, would spur a 15 basis-point increase, the steepest climb since early March. And the benchmark 10-year yield would jump 10 basis points, pushing it closer to Nomura's 2.6 percent year-end target, from about 2.36 percent now.

"Future moves will be a function of continuity or a major shift," Nomura strategists led by George Goncalves wrote in a report dated Oct. 6. "We view the change in Fed leadership as another critical piece in the puzzle needed for our bearish call to continue, where in many respects we are banking on Warsh to push U.S. rates up."

One key to handicapping market reaction, the strategists say, is looking back at changes in Fed leadership over the past four decades. In the case of Paul Volcker in 1979, he ushered in rapid rate hikes to tame accelerating inflation, with Treasuries not fully pricing in the impending pain.

With Ben S. Bernanke in 2005 and Yellen in 2013, by contrast, there was limited movement in yields in response to their nomination, in part because of the perception of continuity.

Warsh would represent the biggest change in course from the current Fed, according to Nomura. For starters, he'd be less likely to view a declining stock market as a reason to stop tightening policy. That could mean the end of financial conditions remaining near the easiest in decades.



"Warsh could end up being modern-day Volcker when it comes to arresting FCI," Goncalves wrote. They also see the Fed's balance-sheet unwind as more likely to stay in place for longer under Warsh's leadership.

Powell, on the other hand, would be the closest thing to a "Yellen proxy," and 10-year yields would fall only about three basis points in the week after his nomination, the most muted reaction Nomura expects for those on Trump's short-list. The choice might give Trump, who's repeatedly pointed to stock markets setting new records during his term, a sense that he changed something, without dramatically altering the central bank's course, in Nomura's view.

"That he's a Republican with Fed experience would strongly count in his favor," Goncalves wrote. "But, we think a Powell Fed would be viewed as business as usual."

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MUGS GAME

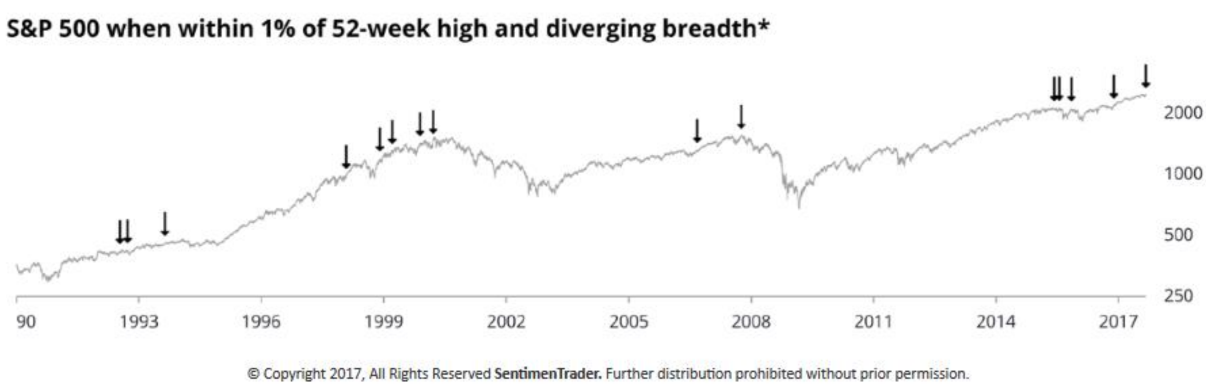
Technical Indicators Flash Long Term Warning Signs

LAMENSDORF MARKET TIMING REPORT

The market continues to exhibit large negative divergences.
This characteristic has historically occurred at times preceding rough periods in the stock market. For instance, the summer of 1987 was plagued by narrow breadth, directly followed by a crash that fall. In the summer of 1998 there were clear warning signs leading into the Thai baht crisis, which triggered an international crash of stocks. A similar situation occurred at the start of 2008, directly before the mortgage crisis. Prudent investors would be foolish to ignore the current warning signs.

The cumulative 21-day advancing/declining volume indicator measures the internal dynamics of the market by monitoring up/down volume. We have highlighted the previous four peaks in order to emphasize the series of lower highs in the up/down volume gauge.

This situation has occurred while the indexes have simultaneously hit higher highs; a classic negative divergence, illustrating that large institutional sponsorship has not been following the indexes.



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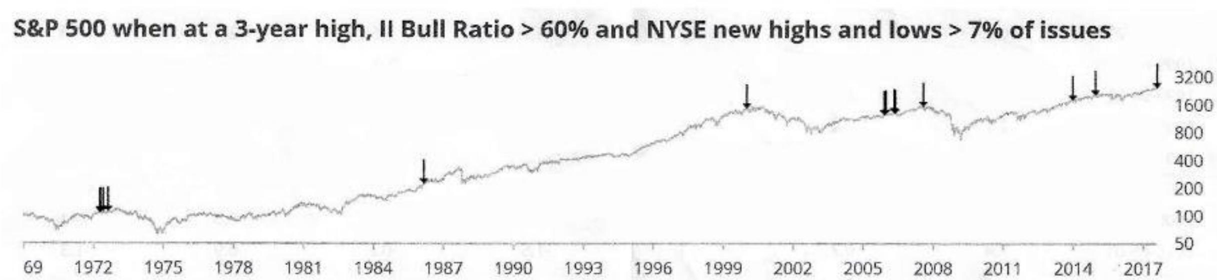
Well-known quant Dr. John Hussman says we are experiencing one of the most dangerous markets in history. He bases his assessment on three simultaneous criteria. Hussman warns of risk when the S&P 500 is at a three year high, the investors-intelligence bulls/bears exceeds 60% and the NYSE new highs and lows are greater than 7% of issues.

This chart identifies such occurrences. Note that in 2000, and then again in 2007-08, substantial corrections followed warning signals. It is notable that the signal was just shy of being triggered a week prior to the 1987 crash. Over the past nine quarters, three sell signals have been triggered.

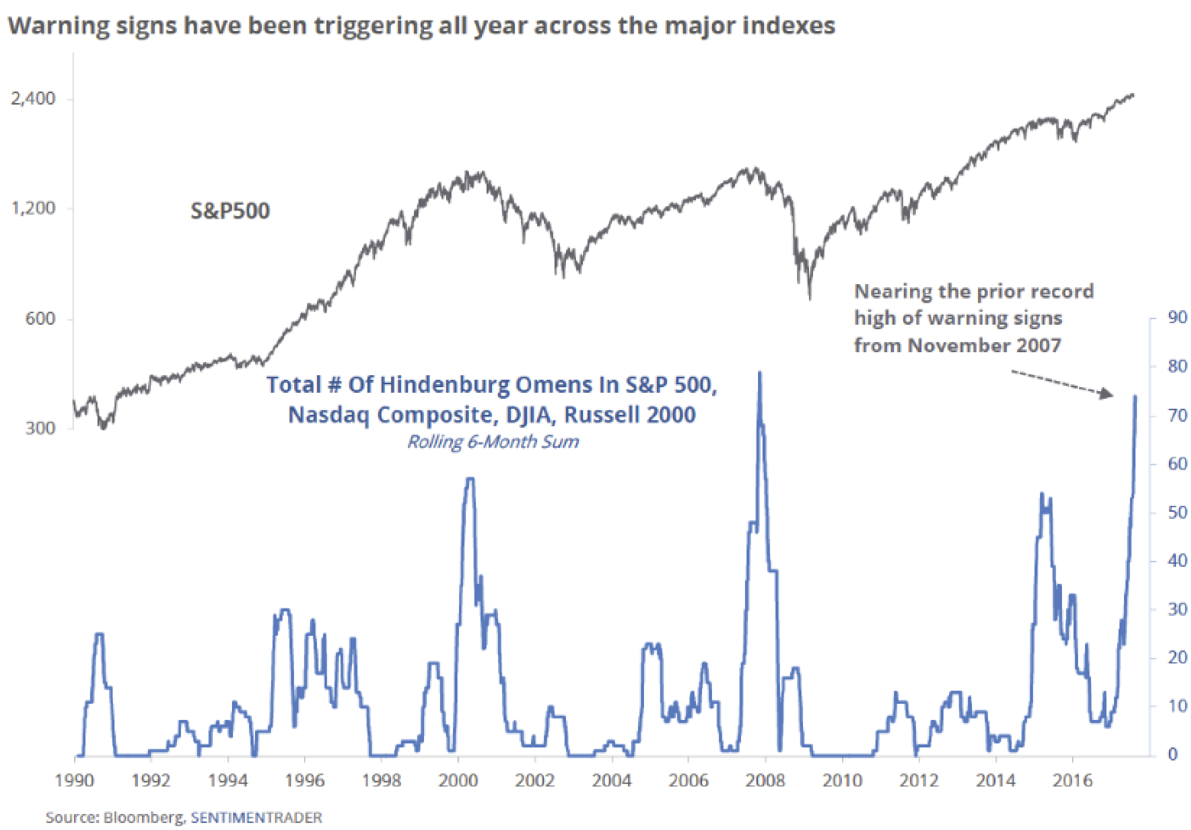


HINDENBURG OMEN

Named after the crash of the German airship in the late 1930s, the Hindenburg omen is a technical indicator developed to predict the potential for a financial market crash. In August, Hindenburg omens occurred five times during a six-day period. A Hindenburg Omen is created when:

- The S&P 500's five-day moving average is higher than it was the day before
- The McClellan Oscillator is below zero
- The 52-week highs are greater than 2.2%
- The 52-week lows are greater than 2.2%

Sentimentrader.com has created a study, going back to 1990, that tracks the occurrence of Hindenburg omens during a six-session period. Arrows on the chart indicate when each omen has been triggered. The S&P has not suffered five signals so tightly clustered since 2007, and prior to that 2000.



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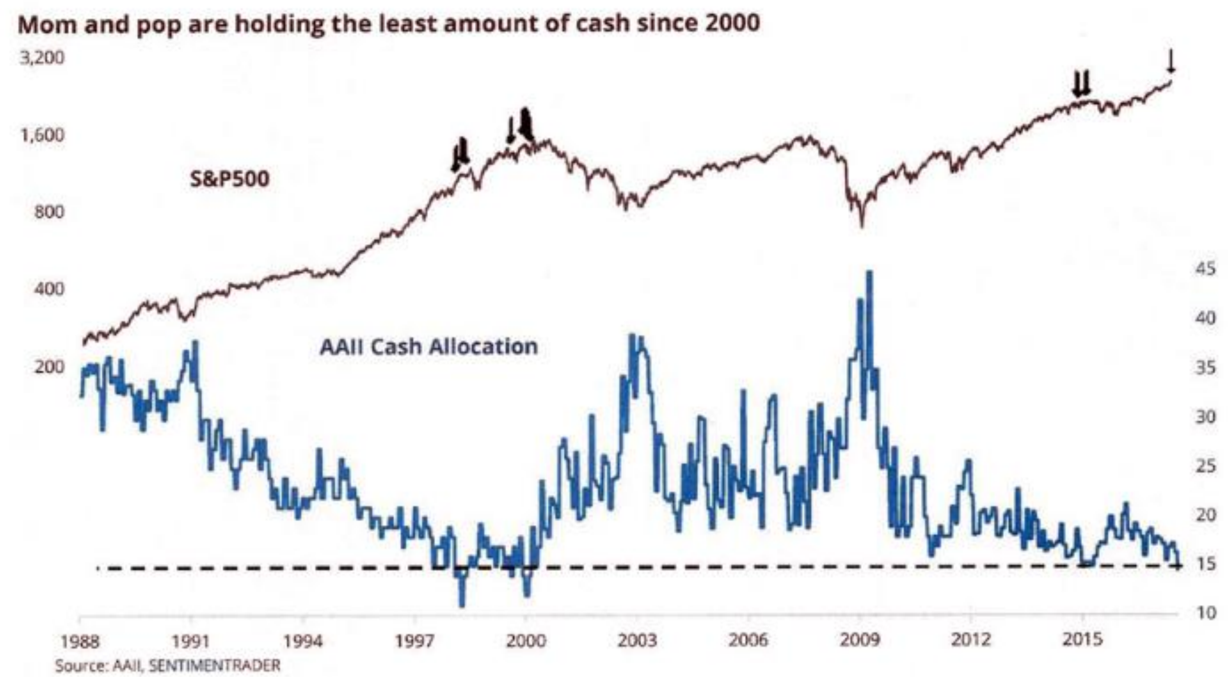
SHARE BUYBACKS FALLING

Corporations have been one of the largest buyers of their own shares throughout the recent bull market.
Over the last year, however, share repurchases have dropped to a four-year low. This sharp drop takes away liquidity and highlights the fact that increasing numbers of publicly-traded companies see
little value in their own company stock.

LOW CASH LEVELS

According to the latest poll by the American Association of Individual Investors, mom-and-pop investors have the lowest cash cushion since 2000, holding only 14.5% of their portfolios in cash.

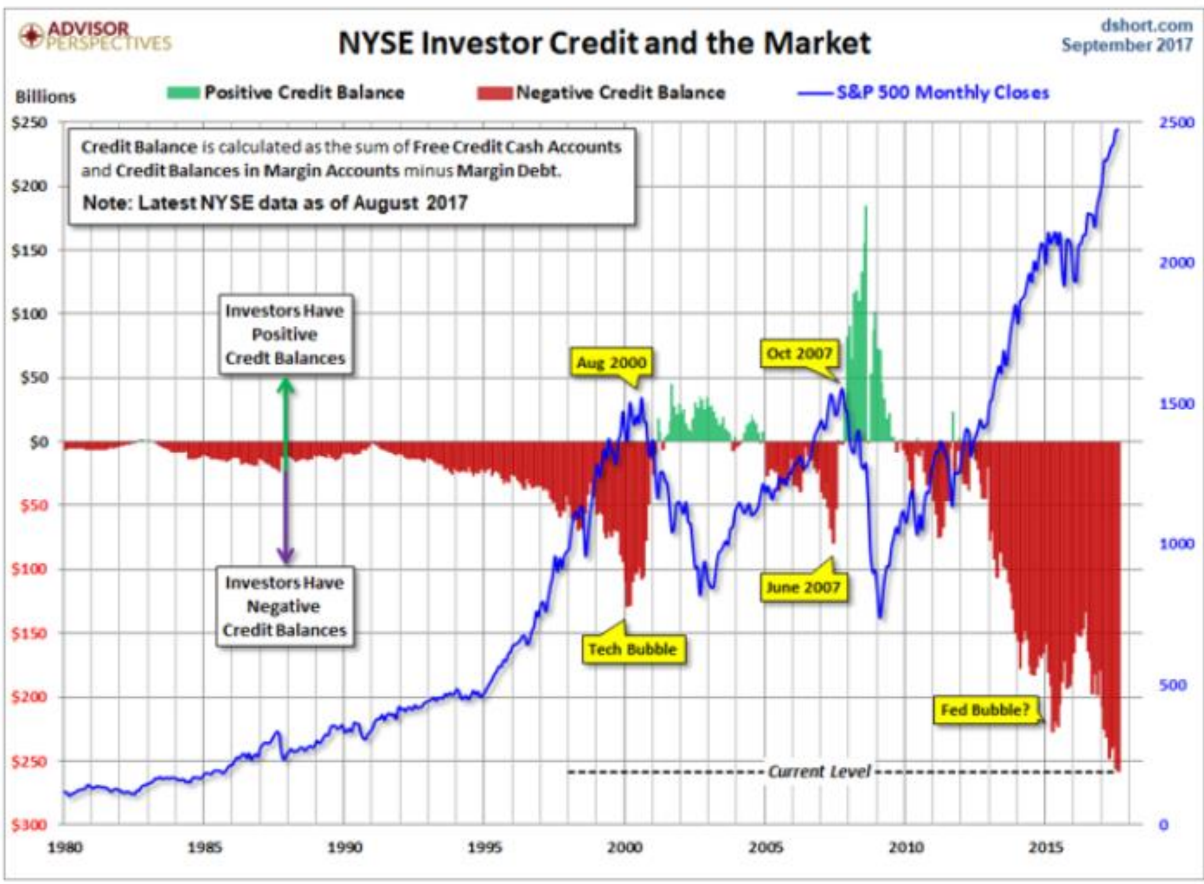
The chart highlights each date, going back to 1987, when investors' cash allocation fell below 15%. Retail investors are traditionally reactive participants. It is interesting to note their horrendous one-
year returns following each signal. At the bottom in 2009, mom-and-pops held the most amount of cash. Sentiment is overly optimistic because they are now fully invested.



MARGIN ACCOUNTS AT HIGHS

The NYSE recently released a worrisome investor credit report, which discloses the sum of the free credit cash accounts and credit balances in margin accounts minus margin debt. The current debit dwarfs the 2000 and 2007 periods, which both preceded bear markets.

The most significant issue with margin is that it creates extremely weak shareholders that can be pushed out of their positions due to margin calls. The current situation sets the stage for a tremendous number of margin calls in the next decline, which could exacerbate selling.



PERFECTION

Investment Master Class

Perfection is an aspiration. It is something to strive for, an ideal so high that its nigh on impossible to achieve. Perfectionists are those that seek flawless outcomes, sublime achievements and impeccable results. And the reality is that if you're seeking **perfection** in Investment, you'll never get there.

The stock market is a **complex system** where an almost infinite number of variables can influence stock prices in any multitude of ways. Information is often ambiguous, participants are often irrational and those variables are in a state of flux. The future is unknown. In this environment you can't possibly expect to know all the information that will impact a company or it's share price. Even the company CEO cannot know everything going on in a company. And even if she could, to profit from it, she would then need to be able to understand how that information will impact market participants.

*"**Complex systems** are full of interdependencies—hard to detect—and nonlinear responses. In such an environment, simple causal associations are misplaced; it is hard to see how things work by looking at single parts. Man-made complex systems tend to develop cascades and runaway chains of reactions that **decrease, even eliminate, predictability** and cause outsized events." **Nassim Nicholas Taleb***

*"The stock market, at least in the short run, responds to **many factors** besides profits and dividends. Inflation and interest rates, the supply of new stock underwritings, the money supply, investor confidence, government actions, and international events are all **factors** that interact with one another in subtle, changing and **unpredictable** ways. What we have, really, is a **complex system** with lags and multiple feedback loops. All such systems share certain characteristics that **hinder predictive accuracy**." **Ralph Wanger***

I remember working with a highly intelligent junior analyst who was always seeking more information about the companies we were analysing. He had come from a corporate finance background where he was used to having an abundance of information to prepare corporate documents and forecasts - company budgets, management accounts, debt schedules, contracts, etc. When it came to the markets and stock ideas, and he was confronted with having much less available information, he became paralyzed by the absence of data and was unable to make recommendations on the basis of probabilities.

And this is a common trend. Yet, accepting that we cannot know everything is an essential psychological mindset for successful investment. One of my favourite books "***The Art of Learning***" by the US Chess Master, **Josh Waitzkin,** highlights the need to be able to operate without **perfection**..

*"We must be prepared for **imperfection**. If we rely on having no nerves, on not being thrown off by a big miss, or on the exact replication of a certain mindset, then when the pressure is high enough, or when the pain is too piercing to ignore, our ideal state will shatter" **Josh Waitzkin***

The current breed of 'Rocket Scientists' created by the Financial Industry want to set standards for Investment that are impossibly high. They want to have a 'clean sheet', an investment record so perfect that the Masters of the Finance Game bow in homage to it. But they're focusing on 'doing things right', rather than 'knowing the right things'; even the **Investment Masters** understand that striving for **perfection** is a futile exercise..

*"**Perfection** doesn't exist in this world. All of my choices involve various **degrees of compromise and tradeoffs**" **Thomas Gayner***

*"Trying to be right **100%** of the time leads to paralysis" **Sam Zell***

*"You can't be **100%** certain but try to look for weaknesses in your thinking" **Walter Schloss***

*"I've never been **100%** certain and I'm never seeking to be stubborn. There are **many possible outcomes**, and there's a large range of profitable outcomes"* **Bruce Berkowitz**

*"Investing is about predicting the future, and the future is **inherently unpredictable**. Therefore the only way you can do better is to assess all the facts and truly know what you know and know what you don't know. That's your probability edge. Nothing is **100%**, but if you always swing when you have an overwhelming better edge, then over time, you will do very well" **Li Lu***

*"I am always searching for the underlying truth, based on **insufficient information**.. it's simply not possible to have a **complete understanding** of anything. We're never truly going to get to the bottom of what's going on inside a company, so we have to make probabilistic inferences" **Guy Spier***

*"One of the things I do very well in investing is, I gather a lot of information but I never know the **whole picture**. I have a lot of inputs but **never everything** and I have to make a decision on incomplete information" **James Dinan***

*"Any time you're investing, pretty much any style of investing, there is no such thing as a **100%** sure bet. You can always have the asteroid come and take everything out – everything is **probabilities**" **Mohnish Pabrai***

*"My conclusions are the result of my reasoning, applied with the benefit of my experience, but I never consider them **100%** likely to be correct, or even 80%. I think they're right, of course, but I always make my recommendations with trepidation"* ***Howard Marks***

Many investors and analysts rely on **financial** and **mental** models to understand and predict how a company operates and how it may perform in the future. But **models** are exactly that, models - they are not reality. Even the best models are **imperfect.**

*"All **models** are wrong, some are useful"* ***George Box***

*"Every scientific law, every scientific principle, every statement of the results of an observation is some kind of a summary which leaves out details, because nothing can be stated **precisely**"* ***Richard Feynman***

*"No **model** captures the richness of human nature. **Models** are supposed to simplify things, which is why even the best models are flawed"* ***Philip Tetlock***

*"All **models** have an inherent limitation on their validity"* ***Ralph Wanger***

*"**Models**, including **financial models**, work only because they **shed certain information** in order to highlight or analyze other information. This is necessarily true. A great physicist once summed up the situation: "To build a perfect **model** of the universe would require all the matter and energy in the universe because the only perfect **model**, the only **model** that sheds no information and made no compromises in order to achieve its object, would be the universe itself." This is the virtue of **models**: They **exclude information** not directly relevant to the question under consideration, allowing us to focus on the significance of particular **variables**. This is also the vice of **models**: If the discarded information proves decisive to the issue being analyzed, the **model** will fail. If the **model** fails in a critical situation, and the people using the **model** cannot recover or even identify the critical lost information, they may not be able to react rationally to events; they may panic"* ***Andy Redleaf***

While **models** can't possibly include all the **variables** that may impact a company, what's important is that they do consider the limited number of critical factors that are key to a company's performance.

*"In my early years, I ended up too much in the weeds. I had to **know everything** about a company and its industry. I've since learned that knowing less is okay as long as you have **identified the one to three things** that will drive the company. We believe **exactness offers little** so we prefer to establish a potential range of outcomes instead. We'd rather be directionally right rather than precisely wrong. "* ***Steven Romick***

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*"I believe that there's **no need to know every detail**, rather there's a need to understand the **three, four or five factors** affecting the company"* **Charles De Vaulx**

*"If you are an investment analyst or investment manager, to be successful and to do well, a couple of things have to happen. Number one, in most businesses, the results are driven by **three or four factors** that control let's say **80 percent** of the outcome and most entrepreneurs are honed in on those **three or four factors**. They understand those factors and they focus on those factors. If the factors you focus on do not match the factors that the guy running the business is focused on, you've not understood the business and there's a problem over there." **Mohnish Pabrai***

*"Every company has 100 things about them you could study and learn. But you have to understand the **differences between data and knowledge**, and between **knowledge and wisdom**. Warren Buffett is remarkable in his ability to cut right through. He sees very clearly the **three or four or five critical factors** that determine whether a company succeeds or fails. It's **not about encyclopedic knowledge**, it's about zeroing in on what truly matters and assessing that. There's no substitute for that in this business." **Howard Marks***

Investment mistakes are usually caused by failures of analysis, not failures of collection. In lieu of time spent collecting all the available information, time is better spent on thinking and the reasoning processes. Is the information collected practically useful? What psychological biases could be at play? Have competitors/customers/suppliers been consulted? Has the idea been tested? What assumptions are being relied upon? Can they be disproved? Can you imagine alternative scenarios? What could have been missed? What don't we know?

*"There are only a few things you have to get right about a company for it to be successful investment. Our view is that if you can get **85% of the way there by answering the big questions**, don't waste your time on the last 15% because the marginal utility isn't worth it" **Steve Morrow***

*"The value of **in-depth fundamental analysis is subject to diminishing marginal returns" Seth Klarman***

By focusing on the things that matter as opposed to seeking every last detail means you're less prone to **over-confidence** and **confirmation bias**.

*"**Information tends to beget information**, as users become addicts. "**Perfect information**", the saying goes, "leads to **perfect decisions**." But **more and more information** gathered in the name of the wrong context leads to worse and worse decisions". **'Ceo's and the CIA: Lessons Learned' Inferential Focus 1998***

*"Investment experts continue to be convinced that their major problems could have been handled if only those extra few necessary facts had been available. They thus tend to **overload themselves with information**, which usually does not improve their decisions but only makes them more **confident** and more **vulnerable to serious errors" Dave Dreman***

*"When forecasters have **too much information**, they often become even **more inaccurate** than when there is too little" **Bennett Goodspeed***

*"Once an experienced analyst has the **minimum information** necessary to make an informed judgement, obtaining **additional information** generally does **not improve the accuracy** of his or her forecasts. Additional **information does**, however, lead the analyst to become more **confident** in the judgement, to the point of **over-confidence**" **Richards Heuer***

Although the ability to collect all the **information** will always remain elusive, investors can still achieve solid returns even if mistakes are made. You don't need a perfect **batting average.**

*"I am a professional mistake maker. **One third** of my trades are probably wrong" **Ray Dalio***

*"If you're terrific in this business, you're right **six out of 10" Peter Lynch***

*"If an investor is right **2 out of 3 times** in the investment decisions they make, they would hit the ball so far out of the park, it would be amazing" **Mohnish Pabrai***

The important thing is **not to dwell on mistakes. Learn from them** and **move on**.
*"To others, being wrong is a source of shame; to me, recognizing my **mistakes** is a source of pride. Once we realize that **imperfect understanding** is the human condition there is no shame in being wrong, only in failing to **correct our mistakes" George Soros***

*"Since actual **perfection and 100% satisfaction** with a position are impossible, we must **learn from results** and **not dwell on past outcomes**, either good or bad. **Moving forward**, even from **large errors**, is required." **Paul Singer***

*"I may try to minimise my errors, but I'm **not one to dwell on them**. It isn't worth it. You have to **put mistakes behind you** and not look back. Tomorrow is another day. Just go on to the next thing and strive to do your best." **Warren Buffet**t*

Remaining open-minded, accepting and learning from mistakes and **adopting a sense of humility** by acknowledging you can't know everything will improve investment results in an environment of impossible perfection.

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*"The humility required for good judgment is not self-doubt—the sense that you are untalented, unintelligent, or unworthy. It is **intellectual humility**. It is a recognition that reality is **profoundly complex**, that **seeing things clearly is a constant struggle**, when it can be done at all, and that human judgment must therefore be **riddled with mistakes.**" **Philip Tetlock***

*"The more you learn, the more you will realize how little you know - and armed with this **humility**, you will never lose sight of the distance that separates self-confidence and self-importance" **Jim Rogers***

Even the Investment Masters make mistakes. It's human nature. And whilst perfectionism is also a fundamental human behaviour, striving for it in Investment is a mistake. We can learn from our mistakes, whereas if we are always seeking that perfect 'batting average', the chances of learning and adapting are minimal indeed. So before you buy your next stock, keep open the possibility you may be wrong ...