Saut Strategy

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"When Will the Music Stop?"

The actual, private objective of the most skilled investment today is "to beat the gun." As the Americans so well express it, to outwit the crowd and to pass the bad or depreciating halfcrown to the other fellow. For it is, so to speak, a game of Snap, of Old Maid, of Musical Chairs – a pastime in which he is victor who says "snap" neither too soon or too late, who passes the old maid to his neighbor before the game is over, who secures a chair for himself when the music stops.

Or to change the metaphor slightly, professional investment may be likened to those newspaper competitions in which the competitors have to pick out six prettiest faces from a hundred photographs, the prize being awarded to the competitor whose choice most nearly corresponds to the average preferences of the competitors as a whole; so that each competitor has to pick not those faces which he himself finds prettiest, but those which he thinks likeliest to catch the fancy of the other competitors, all of whom are looking at the problem from the same point of view.

We have reached the third degree where we devote our intelligences to anticipating what average opinion expects the average opinion to be. And there are some, I believe, who practice the forth, fifth and higher degrees.

"The General Theory of Employment, Interest, and Money" by John Maynard Keynes (1935)

Last week we received a plethora of emails with the question, "Hey Jeff, when will the music stop?" This question was obviously a response to our early last Wednesday morning's "Trading Flash" that read:

My VERY short-term model just flashed a "trader's sell signal." The downside could be to the October highs (2940 basis the S&P 500). This in no way disturbs the long-term secular bull market.

On Wednesday and Thursday that looked like a pretty good call, but then came Friday's Fling of ~152 Dow Wow points. Later that day we were on CNBC and fully clarified our Trading Flash snippet.

We explained:

The Trading Flash was merely a finesse for very short-term traders and counseled investors to not make much of it because the most downside we could envision was to the early-October highs around the 2940 level basis the S&P 500 (SPX/3022.55). Obviously, at least so far, that "trading call" was not a very good "call" as the SPX is trading towards new all-time highs. Alas, life can only be lived going forward, but only understood in retrospect. However, we have never wavered on our secular bull market theme that should have years left in it.

Last week's late strength is being attributed to rumors of a Chinese trade deal and earnings that appear to be coming in better than expected. To that earnings point, for weeks we have written that earnings were likely going to come in better than most expected. Moreover, we have suggested that more than 65% of reporting companies would beat their estimated earnings. B-I-N-G-O . . . because with some 500 companies reporting Q3:19 bottom-up operating earnings ~73% have reported better than anticipated numbers. Admittedly, the "beat rate" is unlikely to remain this high, it is nonetheless a pretty strong start to Q3 earning's season. As our pals at the astute Bespoke Investment Group note:

There have only been six quarters out of eighty-five earnings seasons over the last ~20 years where the EPS beat rate has been 70% or higher, and we might have a chance to make it seven this quarter.

While the earnings "beat rate" has been above most expectations, the top-line revenue beat-rate is not as strong with only 59% of the companies reporting revenues above expectations. Of interest, however, is what the uber smart Jeff deGraaf (Renaissance Macro Research) said in today's *Barron's* when commenting on Caterpillar (CAT/$139.73):

The stock dropped nearly 4% after the company reported disappointing earnings and guidance on Wednesday, but ultimately ended higher. It's almost exhibit A on price leading data.

Ladies and gents, when stocks ignore bad news that's good news. And that is what happened to a number of stocks last week as the bulls snorted "Caterpillar who?!" Such examples were punctuated by one portfolio manager we spoke with who remains in 60% cash. Indeed, last week was notable for the stock market's ability to shake off several bear attacks. Take Amazon (AMZN/$1761.33), the bears went after AMZN Friday morning to the tune of nearly 100-points, yet the stock closed lower by only some 20-points. The "beat rate" by sectors is worth a look (chart 2). The rally by the SPX since the October 8, 2019 low (2892.68) is now at session 14. As long-time readers of these missives know such upside skeins tend to last 17 – 25 session. Some actually go 25 – 30 sessions, but it is rare to see one go for more than 30 sessions.

Yet it is not only the U.S. equity markets that are acting ebullient for the Stoxx 600 (Europe) has tagged new all-time highs despite the Gloomy Gus predictions of an impending recession (chart 1). Solid earnings, and an appetite for risk assets, set the stage for the upside breakout. And it wasn't just the Stoxx 600 that is breaking out to the upside, but European bank stocks, autos, construction & materials, and European tech stocks are all at new all-time highs. Not to be outdone, Swedish stocks are at new all-time highs and Spain has broken above a multi-year down-trend line. Amazingly, despite the Brexit hoopla, the British Pound has strengthened again the U.S. dollar (chart 3).

Returning to Financial sector, we have been bullish of financial stocks for a long time and suffered from time-to-time for said stance. That said, the KWB Bank Index has finally broken-out to the upside (chart 4). Plainly, this has lifted many of our previous financial stock recommendations include our personal largest holding Raymond James (RJF/$84.48).

Although earnings seemed to be the focus for last week's markets, the economic reports came in softer than expected. The Kanas City Fed's Manufacturing Report and Existing Home Sales disappointed and there is a huge amount of economic data slated for this week. These "softer" reports almost ensure more Fed rate cuts in the future. Again, as often stated in these reports, we think the economy will strengthen going forward and earnings will continue to come in better than most expect. Despite this backdrop the majority of investors remain woefully underinvested because they do not understand what a secular bull market looks like. Folks, secular bull markets tend to last 15 – 20 years. Are there pullbacks? You bet, but 20% drawdowns DO NOT end bull markets like the 1949 – 1966 "bull," or the 1982 – 2000 affair that experienced the 1987 crash (we were in *Barron's* predicting that in September 1987). Yet, "The Crash" did not end the secular bull market, which went on for another 13 years.

The call for this week: The build up of internal energy we thought would have a marginal release to the downside last Wednesday obviously did not appear. This is a tribute to the strength of this secular bull market. Nevertheless, our short-term model remains in cautious mode, but the polarity flip for this week (mid-week) should be on the upside. A few stocks that hit our models on the upside last week are: New York Community Bank (NYCB/$13.48), Canadian Imperial Bank (CM/$85.75), SFL (SFL/$14.77), and Zymeworks (ZYME/$31.07) that continues to trade to new highs. I am on CNBC early this morning, so this report is being submitted at 10:00 p.m. Sunday night with the preopening futures flat (+4.00 points).

<u>Chart 1</u>

Source: Bespoke Investment Group

Chart 2

Source: Bespoke Investment Group

Chart 3

Source: Bespoke Investment Group

Chart 4

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