Executive Summary

November 2018

A bull market is a process. This normally lasts a much longer time than a bear market does because of the nature of human psychology. For example, greed and fear are strong but differing drivers. Greed is a long-lasting emotion and takes time to develop. When a final market top is hit, it is often marked by wild speculative trading. We saw that towards the end of January 2018 and again in September 2018, but to some lesser extent in vastly overvalued stocks this last time.

Bear markets are over sooner than bull markets. Fear is a strong emotion in bear markets and corrections, often marked by a "washout," or capitulation, in which most stocks are sold despite their intrinsic value. We haven't seen such a capitulation point yet despite the volatility of the last two weeks. It may not happen. However, there's still too much complacency among investors with most market dips being bought.

A good portion of market performance over the last few years has resulted from the big name momentum mega-caps that we've often mentioned in previous letters. They are now having the opposite effect to the downside. Just the way they had an outsized performance impact on the major indexes going up, they are now having an outsized effect on indexes going down. A term we often hear in markets is "risk on" or "risk off." Recently it's been "risk off." That could change quickly under the right circumstances. A resolution of the tariffs issue would be one such situation.

If the bull market is truly over, then these aggressive momentum stocks, like Facebook, Amazon, and Netflix, will have seen their best days in price behind them. If history is any guide, they have a long way to go down. In a true bear market , these stocks can easily be expected to go down anywhere from seventy to ninety percent from their recent peaks without real fundamentals changing at all. They'll still continue to be wonderful *long-term* investments. Right now, our assessment is that this no more than another correction. Sometimes corrections turn into real bear markets and we'll let you know if our opinion changes! Even though market index levels are somewhat higher than they were in February, our momentum models are lower and signaling caution.

As an update to our previous letter, momentum has been declining as has price. We may be close to some kind of short-term capitulation in the markets. Another big down day marked by the media and "experts" attributing the decline to some external factors such as tariffs, elections, interest rates, and the like would be such a capitulation.

We're entering what is seasonally the strongest time of the year; stocks usually go up between late October and the beginning of January. The early February decline was marked by prices exceeding the highs in January, but with lower momentum. That was a cautionary signal. The strength of the rally following this most recent decline along with the status of our proprietary momentum models will inform our strategy going forward. The good news right now is that overall market valuations are much more reasonable than they were in February at the bottom.

Again, there are real values in emerging markets and Europe. Emerging markets have held up better than our own indexes over the last two months even though their prices have decreased along with our major domestic markets. These are the areas to look into once we see some actual bottoming. The election tomorrow and a resolution of the tariffs issue should clarify where the markets will be headed for the next few months.

We will continue to update as long as this current volatility is present.

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