MADISON PARK
CAPITAL ADVISORS

WEEKLY MARKET UPDATE

September 1, 2020

The blowing up of a bubble

Is it a bubble? Is it not a bubble? Regardless of how you want to phrase it, the parabolic move upwards since March for a *handful of stocks* is concerning. I'm not condoning this bubble/not a bubble that is now being blown, but I have to take the world as it is and the decisions that are being made are WAY above my pay grade.

This isn't to say everything is going to come crashing down. What it is saying is that, in our opinion, some of the disconnects have to resolve themselves. This could mean the rest of the market catches up, or it could mean the high flyers do in fact come tumbling back to earth. We're going to explore this a bit here today.

So let's take a look at how what we're seeing now compares with a timeframe many of us remember all too distinctly...the late 90s and early 2000s. That period was interesting ride, to say the least. There are many similarities to the psychology in today's markets. Keep in mind, that Millenials were very young when the Tech bubble formed and unless they studied some history they are likely are unfamiliar with the circumstances at the time. Regardless of your familiarity, let's take a look at the ingredients of inflating a bubble.

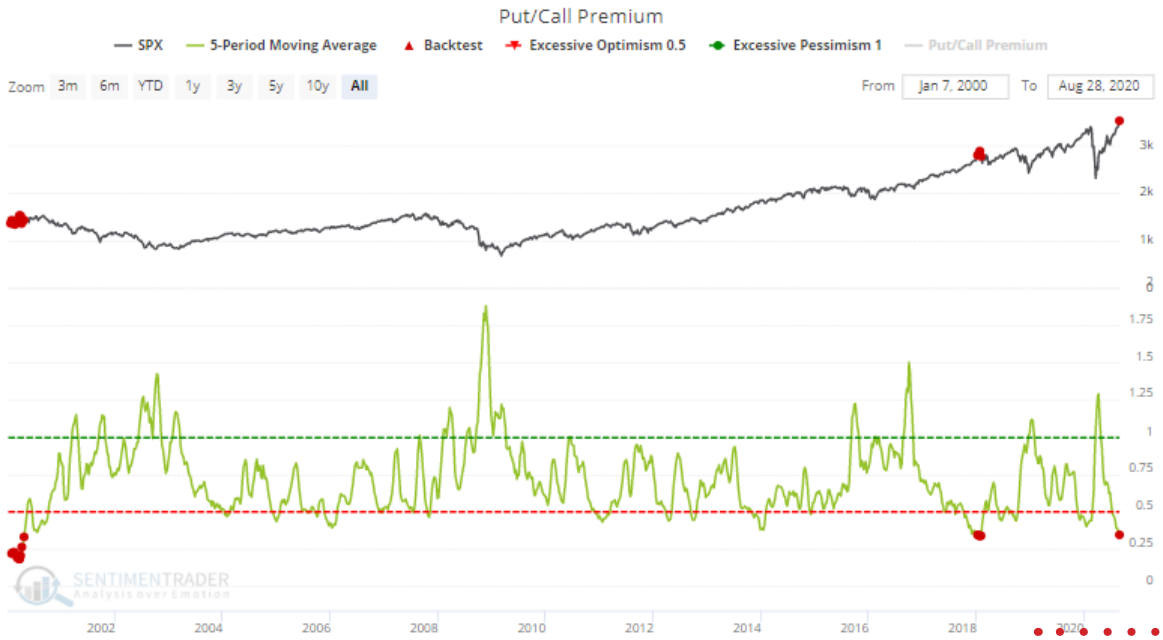
1. Unnecessarily low interest rates (or at least too low for too long)
2. Easy money policy
3. Huge fiscal deficits

These elements are in force today, and they were in force in the late 90s with the notable exception of large deficits. If you remember, we had a budget surplus for the first time since the Kennedy administration. Yes, a federal budget surplus...hard to believe as we stare at today's reality. So we might be able to say the two key ingredients are directly related to the FED, and the Fiscal side of things is icing on the cake.

So we have interest rates at or close to ***ZERO***. The Federal Reserve that said there is "no amount of money" that can't be thrown at this economy. Everybody in government is looking to spend money. The only questions left are, how much and what part(s) of the economy will benefit? This has inflated parts of the markets, while leaving others out in the cold. All growth, all the time now.

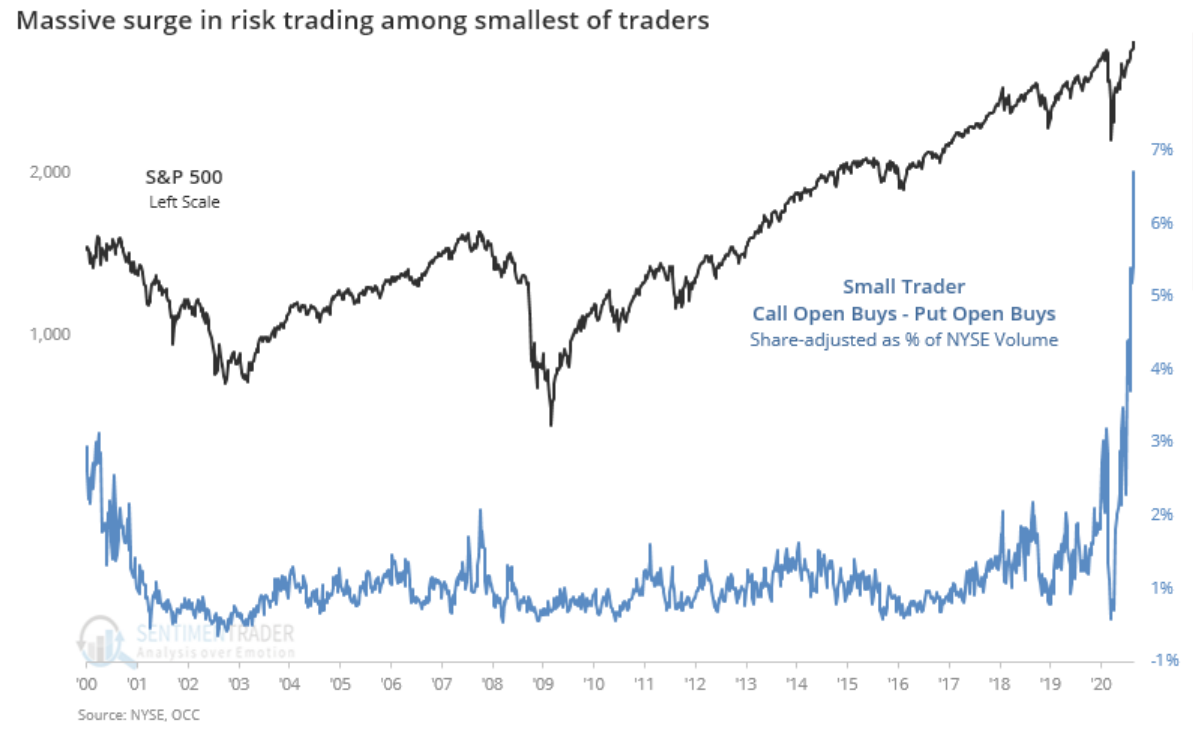
Valuations are not important and stock splits are actually free money (note, sarcasm).

Let's take a look at some charts to see how this "free money" is working its way through the markets. The chart below takes a look at speculative options and, as you can see, it rarely gets to these extremes. In fact, most of the times were clustered around the Dot.Com bubble. If you look out a year, there was not a single instance of positive returns. But Chris, you don't understand, it's different this time.



Trade Date	1 Week Later (%)	2 Weeks Later (%)	1 Month Later (%)	2 Months Later (%)	3 Months Later (%)	6 Months Later (%)	1 Year Later (%)
2000-01-28	4.72%	1.98%	-1.97%	12.30%	5.12%	4.39%	-0.38%
2000-02-04	-2.62%	-5.50%	-1.07%	5.21%	1.97%	1.98%	-5.26%
2000-02-11	-2.96%	-3.88%	0.57%	9.32%	3.28%	6.11%	-5.22%
2000-02-18	-0.95%	4.69%	8.79%	0.78%	5.56%	10.82%	-3.31%
2000-02-25	5.69%	4.63%	14.56%	7.24%	5.52%	12.98%	-6.56%
2000-03-03	-1.00%	3.92%	6.34%	3.07%	-2.21%	7.92%	-11.92%
2000-03-10	4.97%	9.49%	8.69%	2.69%	5.89%	7.13%	-11.59%
2000-03-17	4.30%	2.33%	-7.37%	-2.97%	-0.51%	0.09%	-21.44%
2000-03-24	-1.89%	-0.73%	-6.39%	-7.89%	-4.12%	-5.15%	-25.38%
2000-03-31	1.19%	-9.48%	-3.08%	-8.04%	-3.81%	-4.14%	-22.57%
2000-04-07	-10.54%	-5.70%	-5.52%	-2.58%	-4.07%	-7.08%	-24.07%
2000-04-14	5.40%	7.07%	4.75%	7.40%	9.02%	1.30%	-12.76%
2000-04-24	1.58%	0.19%	-1.60%	2.42%	5.60%	-2.30%	-13.07%
2018-01-12	0.86%	3.11%	-5.98%	0.01%	-6.52%	0.54%	-6.82%
2018-01-19	2.23%	-1.71%	-2.78%	-2.07%	-5.48%	-0.30%	-4.97%
2018-01-26	-3.85%	-8.82%	-4.37%	-9.91%	-7.06%	-1.88%	-7.24%
2018-02-02	-5.16%	-1.08%	-2.57%	-4.39%	-3.34%	2.83%	-2.01%
2020-08-28							

Here's what their options trades look like. Can extremes go higher? Absolutely! Will it eventually end in tears? Yep! The only question left is, when? Your guess is as good as mine – and since we prefer not to simply guess or leave things to chance, we will continue to take measures to manage risk in your portfolios.



Like I said last week, the top 5-10 stocks by market cap have dragged our model to a risk-on allocation, with US Equities now holding the number one spot followed closely by Fixed Income. Money flow models haven't flipped yet, but are very close and would bolster a move higher with more participation. ***That's the trick right now,*** and brings us back to what we mentioned at the start. There are many stocks that haven't participated and if the markets are going to continue to move higher, we must have more stocks participating. If we don't, at some point the top-heavy indexes will likely fall in on themselves.

There is a chance that we could get whipsawed as we move back more heavily into equities. As much as we try to minimize that, it is a possibility. Let's take a look at another longer-term model that compares the S&P 500 (SPX) to the Barclays Aggregate bond index (ticker: AGG). Since 2000, there have only been seven trend changes. This is now the eigth. You can see that it has a very good track record (although the market selloff in March was the outlier). Regardless, you would have done quite well just using this simple signal.

(continued on next page)

S&P 500 Index (SPX)
vs.
iShares US Core Bond ETF (AGG)

Using RS for Asset Class Comparisons

When the RS Chart is on a ***buy signal***, it suggests outperformance from US equities relative to bonds.

Start Date	End Date	Signal	SPX	AGG
11/22/2000	7/31/2003	Sell	-25.11%	23.16%
7/31/2003	7/15/2008	Buy	22.68%	1.84%
7/15/2008	6/5/2009	Sell	-22.62%	-0.69%
6/5/2009	2/11/2016	Buy	94.56%	9.99%
2/11/2016	11/9/2016	Sell	18.27%	-0.15%
11/9/2016	3/16/2020	Buy	10.30%	3.48%
3/16/2020	8/28/2020	Sell	47.02%	3.85%

Buy and hold SPX *(11/22/00 – 8/28/20)*:	+165.28%
Buy and Hold AGG *(11/22/00 – 8/28/20)*:	+47.02%
Switching with RS Signals:	**233.90%**

This example is presented for illustrative purposes only and does not represent a past or present recommendation. Performance of the switching strategy is the result of back-testing. Please see the disclosure slide for important information regarding back testing. The performance numbers above are pure price returns, not inclusive of dividends, fees or all transaction costs. Investors cannot invest directly in an Index, like the S&P 500 Index (SPX), and index performance numbers do not include fees. Past performance is not indicative of future results. Potential for profits is accompanied by possibility of loss.

As always, we welcome your comments and questions. In the meantime, we'll continue to test our assumptions, dig into our research, and lean into our model as we seek to be ever mindful of risk while pursuing long-term returns for your portfolio. Lastly, welcome to September. If you are an educator and/or have kids heading back to the school, we sincerely wish you the very best. Our thoughts and prayers are with you as you navigate these challenging times with grit, determination, joy…and an abundance of flexibility and patience!

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